



বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

Bringing Discipline in the Banking Sector: What Should be Done Immediately

Presented by

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1. Introduction

- ❑ 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 that acts as an intermediary between borrowers and savers, thus enabling 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**.

- ❑ 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 faced several serious challenges due to malpractices, scams, corruption and heists.
- ❑ These have affected the sector's overall performance, **reflected through various efficiency and soundness indicators**.
- ❑ Stakeholders have repeatedly expressed concerns regarding the constant deterioration of banking performance and its potential implications for the sector's sustainability.
- ❑ Given that the country's financial sector is **mainly bank-based**, poor health of the banking sector will also impact economic growth. Therefore, fixing the problems is critically important.

- ❑ 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 **previous government did not keep its commitments to safeguard the banking sector** expressed in various policy documents and election manifesto
- ❑ However, the need for a strong banking sector is increasing as the size of the economy is expanding.
- ❑ This presentation discusses what should be done immediately to bring discipline in the banking sector.

2. Governance of the Banking Sector

Conceptual framework of governance in the banking sector of 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

3. Recommendations for Immediate Action

Institutional

- Commercial banks need to be strengthened

Regulatory

- Independence of Bangladesh Bank should be upheld

Legal

- A conducive legal and judicial environment should be created

Data

- Integrity and availability of timely data should be ensured

Commercial banks need to be strengthened

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> • Credit-worthiness has been judged mainly by political worthiness, without routine assessment of the potential risks associated with the borrower 	<ul style="list-style-type: none"> • Loans should be sanctioned based on the Central Bank's "Guidelines on Internal Credit Risk Rating System for Banks"
<ul style="list-style-type: none"> • For e.g. Janata Bank's BDT 10,000 crore loan to AnonTex Group accounted for more than 25% of the state-owned bank's capital base https://archive.dhakatribune.com/business/2018/11/03/bb-inquiry-committee-on-anontex-submits-report 	<ul style="list-style-type: none"> • Single borrower exposure limit for commercial banks should be strictly enforced
<ul style="list-style-type: none"> • On average, only 33% of first-time rescheduled loans, and 30% of third-time rescheduled loans, were recovered during 2011–2014 	<ul style="list-style-type: none"> • Repeated rescheduling and write-offs of NPLs should be stopped permanently
<ul style="list-style-type: none"> • The Hall Mark case of forgery (2012) through inland bills trade involving Sonali Bank Limited (SBL), is a testimony to weak internal control and risk management 	<ul style="list-style-type: none"> • Internal Control and Compliance Departments of commercial banks should be revitalised, and effective internal audits should be ensured
<ul style="list-style-type: none"> • In 2021, as many as 11 banks were unable to meet minimum BASEL III requirements 	<ul style="list-style-type: none"> • The central bank should appoint firm administrators to oversee the operation of troubled banks which cannot comply with BASEL III requirements

Commercial banks need to be strengthened

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> • Several banks are clinically dead but have been kept alive through bailouts 	<ul style="list-style-type: none"> • Banks on the verge of collapse should be allowed to close down
<ul style="list-style-type: none"> • Several previously good banks have experienced a misfortunate decline in their performance after hostile takeovers by crony capitalists 	<ul style="list-style-type: none"> • Banks which are not on the verge of collapse but still performing poorly should have their management and board of directors replaced
<ul style="list-style-type: none"> • The central bank has aimed to merge weak banks with stronger ones to improve financial health, restore confidence and prevent bank failures 	<ul style="list-style-type: none"> • Bank mergers should proceed only after proper auditing of weak banks to determine their real balance sheets.
<ul style="list-style-type: none"> • The MoF influences the appointment of the board of directors of the SCBs 	<ul style="list-style-type: none"> • Appointment of board members of commercial banks should be depoliticised and based only on qualifications and experiences
<ul style="list-style-type: none"> • Board members of weak banks have proven to be individuals of questionable character 	<ul style="list-style-type: none"> • Board members of weak banks should not be allowed to sit on the board of the strong banks after the merger
<ul style="list-style-type: none"> • During 2008-2023, BDT 92,261 crore (equivalent to 12% of the national budget of FY24 or 2% of the GDP of FY23) was embezzled in 24 major banking scams 	<ul style="list-style-type: none"> • All individuals involved with fraudulent activities should be investigated and brought to justice

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> • Bangladesh Bank does not take independent decisions on its operations and monetary policy formulation and implementation 	<ul style="list-style-type: none"> • The autonomy of the central bank should be upheld in line with the Bangladesh Bank Amendment Bill 2003
<ul style="list-style-type: none"> • BDT 157.05 billion was spent in recapitalising banks during the period FY2009-FY2017 	<ul style="list-style-type: none"> • Recapitalisation of poorly governed commercial banks with public money should be stopped
<ul style="list-style-type: none"> • In 2006, Bangladesh Bank dissolved Oriental Bank's board of directors and auctioned majority of the shares 	<ul style="list-style-type: none"> • An exit policy for troubled banks should be formulated by protecting depositors' money in those banks
<ul style="list-style-type: none"> • In 2013, the government approved licenses for nine new private commercial banks to politically powerful owners, including a former mayor 	<ul style="list-style-type: none"> • No more licenses for new banks should be given on political grounds without pragmatic assessment of the need for the economy
<ul style="list-style-type: none"> • In 2017, a single corporation gained control over 7 private commercial banks in Bangladesh 	<ul style="list-style-type: none"> • A single individual or group of individuals should not be allowed to obtain majority ownership of more than one commercial bank
<ul style="list-style-type: none"> • From 2007 to 2014, illicit financial outflows from Bangladesh ranged between USD 47 billion to USD 67 billion, according to the Global Financial Integrity (GFI) Report 2005-2014 	<ul style="list-style-type: none"> • The Bangladesh Financial Intelligence Unit should be strengthened to prevent illicit financial outflows and stop previously laundered money from entering the country to destabilise the new interim government or create anarchy

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> • The mandate of the Financial Institutions Division (FID) is directly contradictory to Bangladesh Bank Order, 1972 (P.O. No. 127 1972) since it allows FID to exercise its authority to oversee Bangladesh Bank's governance 	<ul style="list-style-type: none"> • The Financial Institutions Division (FID) of the Ministry of Finance (MoF) should be closed immediately, and all current and former officials of FID should be investigated for any wrongdoing.
<ul style="list-style-type: none"> • During the last 15 years, governors of Bangladesh Bank helped the vested interest groups either by ignoring the existing rules or changing the laws to favour them 	<ul style="list-style-type: none"> • These instances should be investigated and concerned governors should be made accountable.
<ul style="list-style-type: none"> • In 2016, BDT 679.6 crores was lost in a heist from the treasury account of Bangladesh Bank with New York's US Federal Reserve Bank by international cyber hackers 	<ul style="list-style-type: none"> • The Criminal Investigation Department (CID) is probing the case; CID has taken 79 dates to submit the report (as of July 2024) and the new date for submission is 4th September 2024 https://shorturl.at/Tqm9J • Once completed, the investigation report should be published. If needed, another independent investigation should be conducted.
<p>“No person shall hold office as Governor or Deputy Governor who is a member of the Legislature or a Local Government or who is employed in any capacity in the public service of Bangladesh”</p>	<ul style="list-style-type: none"> • In line with Bangladesh Bank (Amendment) Act, 2003, the new governor and any new deputy governors should not be any current or former government official

A conducive legal and judicial environment should be created

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> According to Bangladesh Bank's roadmap for reducing NPL released to the media in February 2024, 72,543 cases were pending in the Money Loan Court, with an outstanding amount of BDT 1,78,277 crore 	<ul style="list-style-type: none"> 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
<ul style="list-style-type: none"> Main restriction of Bankruptcy Act is that it only covers individuals rather than corporations or cross-border bankruptcy. Hence, large defaulters are largely out of its reach. 	<ul style="list-style-type: none"> The Bankruptcy Act should be amended to include corporate bankruptcy and cross-border bankruptcy following the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency
<ul style="list-style-type: none"> The existence of loopholes in the system results in money loan lawsuits brought by banks being unresolved in the lower courts for extended periods of time 	<ul style="list-style-type: none"> Efforts should be made to recover NPLs through out-of-court procedures such as Alternate Dispute Resolution (ADR)
<ul style="list-style-type: none"> In 2018, the Bank Company (Amendment) Bill increased the number of family members to be appointed to the boards of directors in private banks from two to four. In 2023, this was reduced to three, but the tenure of directors was increased to 12 years 	<ul style="list-style-type: none"> The Banking Company Act should be amended so that there is only one member from one family on the board of directors, and the tenure of each director should be limited to 3 years, with each director being allowed to serve a maximum of two terms in their entire lifetime

A conducive legal and judicial environment should be created

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> • BRPD Circular No. 07 dated 03/04/24: Companies of business groups will be eligible for new loans until the parent company is classified as wilful defaulter 	<ul style="list-style-type: none"> • If one company in a group of industries defaults on loan repayment, companies in the same group of industries should not be allowed to take new loans
<ul style="list-style-type: none"> • The total volume of NPL has increased from BDT 22,481 crore in 2009 to BDT 1,82,295 March 2024 	<ul style="list-style-type: none"> • Bank accounts of wilful defaulters and their immediate family members should be immediately frozen. Their own and their immediate family members' assets should be liquidated, and their businesses should be nationalised temporarily
<ul style="list-style-type: none"> • Between 2014 and 2016, an amount of about BDT 236 crore was laundered using AB Bank's offshore banking service https://www.newagebd.net/article/122440/ab-bank-siphons-tk-236cr-more 	<ul style="list-style-type: none"> • Information on wilful defaulters should be shared with Visa, Mastercard, American Express, and the Society for Worldwide Interbank Financial Telecommunications (SWIFT) network so that their transactions in other countries are blocked by these companies
<ul style="list-style-type: none"> • S Alam Group took out about BDT 30,000 crore in loan from Islami Bank Bangladesh Ltd in 2022 https://www.newagebd.net/article/187895/yes-another-loan-scam-yet-another-central-bank-failure 	<ul style="list-style-type: none"> • The list of wilful defaulters should be disclosed publicly so that they may be put on a media trial

Problem	Recommendation for immediate action
<ul style="list-style-type: none"> • Bank-wise data on capital adequacy, asset quality, management efficiency, earnings, and liquidity have not been published after 2018 	<ul style="list-style-type: none"> • Reports and data on individual banks and financial institutions should be published regularly and made publicly available.
<ul style="list-style-type: none"> • Several weak and poorly governed banks have repeatedly failed to publish their mandatory disclosures under BASEL III 	<ul style="list-style-type: none"> • All commercial banks should be obliged to make their mandatory disclosures under BASEL III in a timely fashion
<ul style="list-style-type: none"> • According to the IMF, loans should be classified as NPLs if: i) payments of principal and interest are past due by 90 days or more, ii) interest payments equal to 90 days interest or more have been capitalized, refinanced, or rolled over, and/or iii) sufficient evidence exists to classify a loan as non-performing even in the absence of a 90 day past due payment 	<ul style="list-style-type: none"> • Loans should be classified according to international standards, such as those outlined by the International Monetary Fund's Financial Soundness Indicators guide
<ul style="list-style-type: none"> • Between 2009 and 2013, an amount of BDT 4,500 crores was embezzled from BASIC Bank through fake companies and dubious accounts https://www.thedailystar.net/news/scam-hits-basic-bank 	<ul style="list-style-type: none"> • 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

4. 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 of the former government.
- ❑ Sporadic measures were not successful since the nature and depth of the problem require **comprehensive due diligence and structural reforms**.
- ❑ Reforms **must be backed by political will** as there will be resistance from the vested interest groups.
- ❑ A goal-specific, time-bound, transparent, unbiased, inclusive and independent **Banking Commission should be formed** to bring transparency to the prevailing situation, identify the root causes of the manifest problems, and suggest credible measures for improving the situation sustainably.

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