



CPD

Working Paper

128

Financial Sector in Bangladesh
*Recent Trends and Benchmarking
for the Government*

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FINANCIAL SECTOR IN BANGLADESH
Recent Trends and Benchmarking for the Government

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Publisher

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First Published September 2019

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Tk. 80

USD 6

ISSN 2225-8175 (Online)

ISSN 2225-8035 (Print)

Cover design

Avra Bhattacharjee

C42019_5WP128_MPA

Centre for Policy Dialogue (CPD) was established in 1993 as a civil society initiative to promote an ongoing dialogue between the principle partners in the decision-making and implementing process. Over the past 25 years, the Centre has emerged as a globally reputed independent think tank, with local roots and global reach. A key area of CPD's activism is to organise dialogues to address developmental policy issues that are critical to national, regional and global interests, with a view to seeking constructive solutions from major stakeholders. The other key area of CPD's activities is to undertake research programmes on current and strategic issues.

CPD's dialogues are designed to address important policy issues and to seek constructive solutions to these problems. In doing so, CPD involves all important cross-sections of the society, including public representatives, government officials, business leaders, activists of grassroots organisations, academics, development partners and other relevant interest groups. CPD focuses on frontier issues which are critical to the development process of Bangladesh, South Asia and LDCs in the present context, and those that are expected to shape and influence the country's development prospects from the mid-term perspectives. CPD seeks to provide voice to the interests and concerns of the low-income economies in the global development discourse. With a view to influencing policies, CPD deploys both research and dialogue which draw synergy from one another.

CPD's research programmes are both serviced by and intended to serve, as inputs for particular dialogues organised by the Centre throughout the year. Major research themes are: macroeconomic performance analysis; poverty and inequality; agriculture; trade; regional cooperation and global integration; infrastructure; employment, and enterprise development; climate change and environment; development governance; policies and institutions, and the 2030 Agenda for Sustainable Development.

CPD also conducts periodic public perception surveys on policy issues and issues of developmental concerns. With a view to promoting vision and policy awareness amongst the young people of the country, CPD is also implementing a Youth Leadership Programme. As part of its global networking initiatives, CPD hosts the secretariat of the *LDC IV Monitor*—an independent global partnership for monitoring the outcome of the Fourth UN Conference on the LDCs. CPD was also the initial convener and founding host of the *Southern Voice on Post-MDGs*, a network of 50 think tanks from Africa, Asia and Latin America, which seeks to contribute to the ongoing global discourse on the SDGs. CPD was the Secretariat of Southern Voice during January 2013–June 2019. At present, CPD hosts the office of the Chair of the network. At the national level, CPD hosts the Secretariat of the *Citizen's Platform for SDGs, Bangladesh*—a civil society initiative that include more than 100 Partner organisations, founded with an objective to contribute to the delivery of the SDGs and enhance accountability in its implementation process.

Dissemination of information and knowledge on critical developmental issues continues to remain an important component of CPD's activities. Pursuant to this, CPD maintains an active publication programme, both in Bangla and in English. As part of its dissemination programme, CPD has been bringing out CPD Occasional Paper Series on a regular basis. It may be noted in this connection that since November 2011, the Series has been re-introduced as **CPD Working Paper Series**. Research work in progress, background papers of dialogues, investigative reports and results of perception surveys which relate to issues of high public interest are published under this series.

The present paper titled **Financial Sector in Bangladesh: Recent Trends and Benchmarking for the Government** has been prepared by *Professor Shah Md. Ahsan Habib*, Director (Training), Bangladesh Institute of Bank Management (BIBM). He can be reached at: ahsan@bibt.org.bd

This paper was prepared as a background paper for the CPD publication on "State of the Bangladesh Economy and National Elections 2018: Priorities for Electoral Debates." The study was conducted under the *Independent Review of Bangladesh's Development (IRBD)* programme of CPD.

Series Editor: *Dr Fahmida Khatun*, Executive Director, CPD

Financial sector of Bangladesh is a bank-based system that has been facing a number of challenges alongside operational expansions. In spite of some notable development, performances of certain section of banks have not been praiseworthy in terms of efficiency and soundness parameters. In view of the situation, the financial sector needs directions and appropriate measures to offer due support to attain sustainable growth targets of the country. This secondary data-based study has attempted to analyse the underlying issues related to operations and performances of the banking and financial industry to put forward some necessary regulatory and policy initiatives. For consolidation of the industry, the study recommended for: addressing willful default; revitalising internal control and compliance; ensuring uniform regulatory environment; working for product diversification and exit strategy; addressing financial crime and money laundering; promoting cluster development and financing; endorsing technology-driven and inclusive banking; supporting development of capital, bond and insurance market; and above all, improving corporate governance and leadership.

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Acronyms

ADR	Advance–Deposit Ratio
AML	Anti-Money Laundering
APG	Asia-Pacific Group on Money Laundering
BDT	Bangladeshi Taka
BFIU	Bangladesh Financial Intelligence Unit
BIBM	Bangladesh Institute of Bank Management
BO	Beneficiary Owner (account)
BSEC	Bangladesh Securities and Exchange Commission
CAMELS	Capital Adequacy, Assets Quality, Management, Earnings, Liquidity and Market Sensitivity
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CFT	Combating the Financing of Terrorism
CIBIL	Credit Information Bureau (India) Limited
CIPC	Customer Interest Protection Centre
CRAR	Capital-to-Risk (Weighted) Assets Ratio
CSR	Corporate Social Responsibility
EPZ	Export Processing Zone
FATF	Financial Action Task Force
FCB	Foreign Commercial Bank
FICSD	Financial Integrity and Customer Services Department
FSB	Financial Stability Board
GoB	Government of Bangladesh
G-20	Group of Twenty
ICCD	Internal Control and Compliance Department
ICT	Information and Communication Technology
IDRA	Insurance Development and Regulatory Authority
IT	Information Technology
LIM	Loan against Imported Merchandise
LTR	Loan against Trust Receipt
L/C	Letter of Credit
MFI	Microfinance Institution
MFS	Mobile Financial Services
MoF	Ministry of Finance
MPS	Monetary Policy Statement
MRA	Microcredit Regulatory Authority
NBFI	Non-Bank Financial Institution
NIS	National Integrity Strategy
NPL	Non-Performing Loan
NPS	New Payment Systems
PCB	Private Commercial Bank

RBI	Reserve Bank of India
ROA	Return on Assets
ROE	Return on Equity
SCB	State-owned Commercial Bank
SDG	Sustainable Development Goal
SME	Small and Medium Enterprise
SPB	Specialised Bank
SREDA	Sustainable and Renewable Energy Development Authority
TBML	Trade-based Money Laundering
UCPDC	Uniform Customs and Practice for Documentary Credit
UN	United Nations
UPAS	Usance Payable at Sight
VAD	Vigilance and Anti-Fraud Division

1. INTRODUCTION

The financial sector of Bangladesh and the institutional financing activities have expanded over the years in terms of greater number of formal institutions, higher number of financing instruments, and bigger volumes of assets. Financial sector of Bangladesh is a bank-based system that also includes non-bank financial institutions (NBFIs), capital market intermediaries, insurance companies and microfinance institutions (MFIs). However, not all financial intuitions and market components are equally regulated at all levels, and there are also reasonably large informal sector comprising of unregulated lenders, like lending individuals, associations, clubs, and relatives, friends and neighbours.

The key portion of the financial sector of Bangladesh is regulated and supervised by the Bangladesh Bank—the central bank of the country. Unlike in developed economies and sophisticated markets, both long- and short-term financing needs of the country are met by the banking industry. The central bank guides and controls the financing operations and activities of banks and NBFIs that are mainly associated with non-securities financial instruments and markets. Operations and activities linked to securities instruments by banks and NBFIs and capital market are regulated and controlled by the Bangladesh Securities and Exchange Commission (BSEC). Microfinance operations and insurance segments are regulated by two other regulatory agencies—Microcredit Regulatory Authority (MRA) and Insurance Development and Regulatory Authority (IDRA).

Not different from the financial sectors of most developed and developing economies, the banking and financial sector of Bangladesh has been facing a number of serious challenges alongside operational expansions. Performances of certain section of banks have not been praiseworthy in terms of different efficiency and soundness parameters. The sector is stressed with the slander of some financial scams in a few state-owned commercial banks (SCBs) and private commercial banks (PCBs) uncovered in recent years. On the other hand, bond market remained underdeveloped, the capital market could not recover fully from the downfall it has experienced, and the potential of the insurance sector has not been fully explored. In view of the situation, the financial sector needs directions and appropriate measures to offer due support to attain sustainable growth targets of the country.

This paper mainly intends to address the following questions: What regulatory and supervisory changes and developments are required in the country in line with the global standard? Has the structure of the banking industry changed over time? How has the size of the banking sector changed and what have been the trends in growth in terms of major indicators? Have there been changes in the indicators of 'strength and soundness', 'asset quality', 'profitability and efficiency' and 'inclusive, online and development banking'? What measures have been taken to improve governance in the banking industry and what are their outcomes? What are the trends in financial crime including money laundering and terrorist financing issues? What measures have been taken to address these? Have there been any changes in the key banking operational areas? How should the government proceed in terms of addressing the problems in the banking sector? Which should be the priority areas for the government in the banking sector? How has been the performance of the NBFIs? Is performance of the NBFIs comparable with that of the banks? What should be the initiatives to revive capital market of the country? What regulatory measures and oversight mechanisms are needed for a strong insurance sector in Bangladesh?

The study is basically based on secondary information. Some industry experts were consulted in the process of preparing the report. The paper is organised into six sections. Following a background

discussion in the first section, Section 2 is about the structure of the banking and financial sector of the country. Performance, efficiency and soundness issues of mainly banks and NBFIs are discussed in Section 3. Section 4 discourses policy and operational challenges of the banking and financial industry of Bangladesh. Section 5 discusses policy and supervisory measures that have been taken to consolidate banking and financial sector. And finally, Section 6 puts forward some policy recommendations for ensuring a sound banking and financial sector of the country.

2. STRUCTURE OF BANKING AND FINANCING INDUSTRY: CHANGES AND DEVELOPMENTS

Licensed under the Bank Companies Act, 1991, banks of Bangladesh are guided and supervised by the Bangladesh Bank. Empowered by the provision 13 (2) of the Banking Companies Act, 1991, in consultation with the government, Bangladesh Bank in 2008, re-fixed the minimum paid-up capital and reserve fund of banking companies at BDT 400 crore, of which the paid-up capital must not be less than BDT 200 crore. As for the major changes in terms of governance framework of the banks, the 2017 amendment of the act included: number of board members from one family (four, in place of two); and their tenures (three years for consecutive three terms, in place of two).

NBFIs, in Bangladesh, are licensed under the Financial Institutions Act 1993, and the minimum paid-up capital for NBFIs is BDT 100 crore, as per the Financial Institution Regulation 1994. Certain provisions of the key acts like Companies Act 1994 and Bangladesh Securities and Exchange Commission Act 1993 have implications for NBFIs and banks. Though, Bangladesh Bank is the regulatory and supervisory authority of both banks and NBFIs, the Ministry of Finance (MoF) of the government exercises notable control over government-owned banks and NBFIs.

The financial sector of Bangladesh took a changed shape mainly since the mid-1980s, in terms of the number of institutions, branches, rural–urban distribution, and volume of assets and advances. In the banking sector, new private sector banks started operation, and the number of specialised banks (SPBs) reduced through merging or changing operational strategies. During 2013–2018, a total of 10 new commercial banks started operation. Government-controlled commercial banks (SCBs) were in operation as limited companies that were corporatised in 2007. Over the last 10 years, the number of bank branches increased by over 67 per cent, mainly because of notable growth in the branch expansion by the PCBs, which was close to 250 per cent. PCBs as a group has become even more dominant in the banking market, with around two-third of the market share in terms of total assets and total advances in 2018 (Table 1). As of February 2018, the country had 57 banks, of which more than half were PCBs, and of those, eight were Islamic banks. In addition, 16 banks were offering Islamic banking services, using 19 Islamic banking branches and 25 Islamic banking windows (Bangladesh Bank, 2018b).

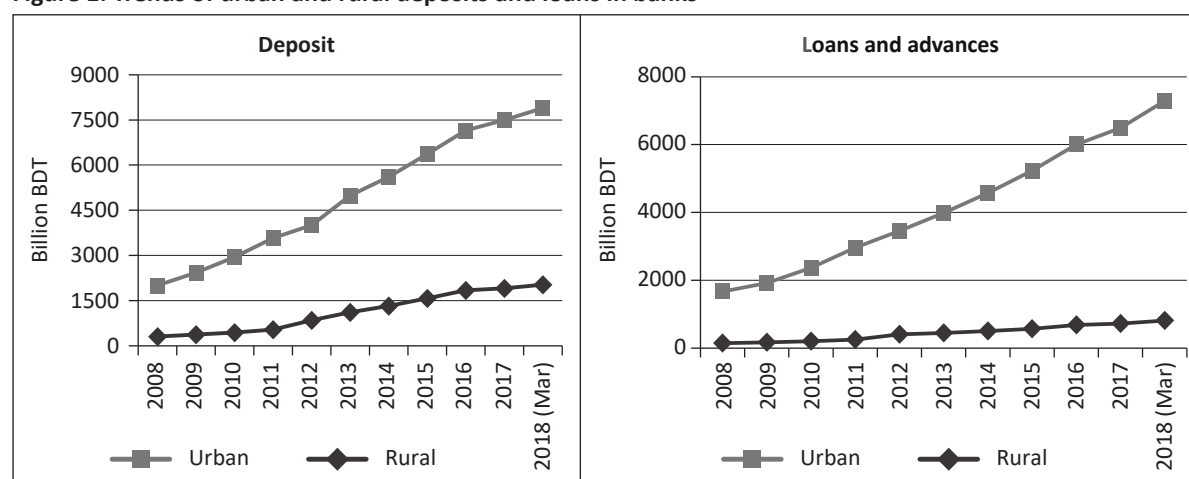
In the liability side, banks depend almost completely on deposits. According to Bangladesh Bank (n.d.), as of end-September 2018, total volume of bank deposits reached at BDT 9,771 billion, of which over 89 per cent was time deposits, and around 20 per cent were collected from rural areas. Trends in connection with deposit compositions remained more or less consistent over the years, however, proportion of rural deposits increased remarkably over the last 10 years, by 7 per cent (from 13 per cent). Bank credit touched BDT 8,910 billion in September 2018, of which around 98 per cent was outstanding in the private sector. Unfortunately, only 10 per cent of the total outstanding credit was in the rural areas, which had been more or less consistent over last 10 years. Credit and deposit trends show increased gap between urban and rural areas during 2008–2018 (Figure 1).

Table 1: Comparing broad structure of the banking industry: 2008 and 2018

Bank Type	Year	Number	Total branch	Urban–rural branch ratio	Total assets (%)	Total advances (%)
SCB	2008	4	3383	37:63	29.27	33.38
	2018	6	3721	37:63	28.87	26.80
PCB	2008	30	1928	72:28	56.37	53.85
	2018	40	4766	58:42	67.07	66.30
FCB	2008	9	53	100:0	8.57	7.10
	2018	9	69	100:0	4.62	4.16
SPB	2008	4	1359	11:89	5.79	5.67
	2018	2	1407	8:92	2.43	2.74
Total	2008	48	6723	42:58	100.00	100.00
	2018	57	9963	44:56	100.00	100.00

Source: Ministry of Finance (MoF) and Bangladesh Bank.

Note: FCB: Foreign commercial bank.

Figure 1: Trends of urban and rural deposits and loans in banks

Source: Ministry of Finance (MoF).

Of the other financial institutions, the number of NBFIs was 34 (increased from 29 in 2008), with their 257 branches spread all over the country, as of February 2018 (Table 2). Though the growth rates of deposits and advances of NBFIs were relatively higher than that of the banks during the last 10 years, NBFIs remained an insignificant portion of the financial institutions of the country. In 2008, NBFIs' total volume of outstanding advances was around 3 per cent of the total advances of the financial

Table 2: Comparing broad structure of the NBFi sector: 2008 and 2018

NBFi Type	2008	2018
Government	1	3
Joint venture	8	12
Private	20	19
Total	29	34
Total branches	80	257
Total assets (crore BDT)	75530	14240
Total deposits (crore BDT)	64570	11980

Source: Ministry of Finance (MoF) and Bangladesh Bank.

institutions that increased to around 7 per cent in the first quarter of 2018. In spite of remarkable growth, NBFIs as a whole remained insignificant, as compared to that of the banking industry. Not very different from banks, NBFIs' liability side has mainly been composed of term deposits.

Though the advances and deposits figures were not very significant during the last 10 years as compared to that of the banking industry, the benefits of the MFIs had been availed by a significant number of low-income rural people. As of June 2017, total number of borrowers reached close to 25 million, and the market had clearly been dominated by only three MFIs.

Insurance industry comprised 78 (32 life and 46 non-life) companies. Insurance industry remained underdeveloped with very limited coverage, in spite of the growth in the volume of assets, gross premium, number of policies and number of claims, in recent years.

Capital market as a whole, expanded with the increase in number of listed securities, beneficiary owner (BO) accounts and market capitalisation; however, capital market indicators displayed inconsistent trends during the last 10 years (MoF, 2018).

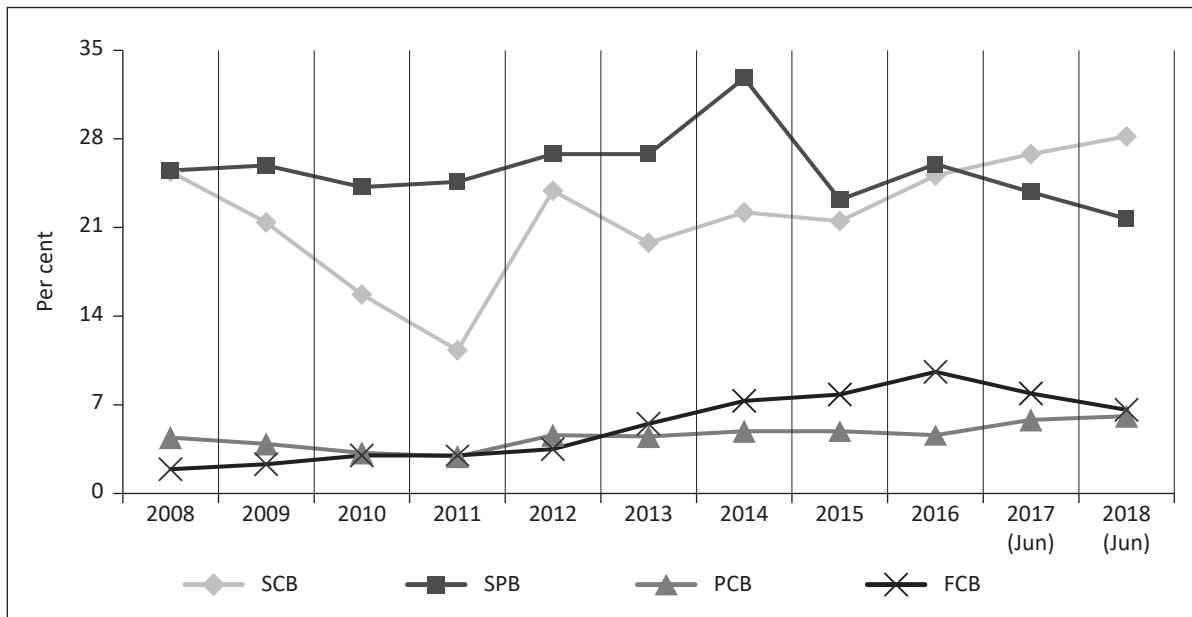
3. PERFORMANCE, EFFICIENCY AND SOUNDNESS OF THE BANKING AND FINANCIAL INDUSTRY OF BANGLADESH

There are some widely accepted indicators to assess performance, efficiency and soundness of the banking and financial industry in any country. In the context of Bangladesh, a commonly accepted approach has been to compare performances of the broad bank groups on the basis of some key indicators, though their regulatory, operational and competitive environment are clearly different. These indicators are generally associated with asset quality, capital adequacy, earnings, management soundness, liquidity, online banking service and developmental banking.

Ratios of non-performing loans (NPLs) are the central indicators to assess asset quality of banks. According to Bangladesh Bank's published data, the ratio of NPL to total loan was 10.8 per cent in 2008, which was reported to be 10.4 per cent as of June 2018. The journey of the bank groups on this indicator was challenging for most banks. Detecting scams and strengthening prudential norms (tightening loan classification norms and provisioning requirements in end-2013) caused deterioration in the NPL figures for banks in several instances. Particularly for the SCBs, performance as a whole deteriorated (Figure 2). About 47 per cent of the NPLs were concentrated in five banks as of end-June 2018 (Bangladesh Bank, 2018c). Moreover, published data indicate growing tendency of failing to comply with loan-loss provisioning requirements by the banking industry, mainly because of the performance of SCBs.

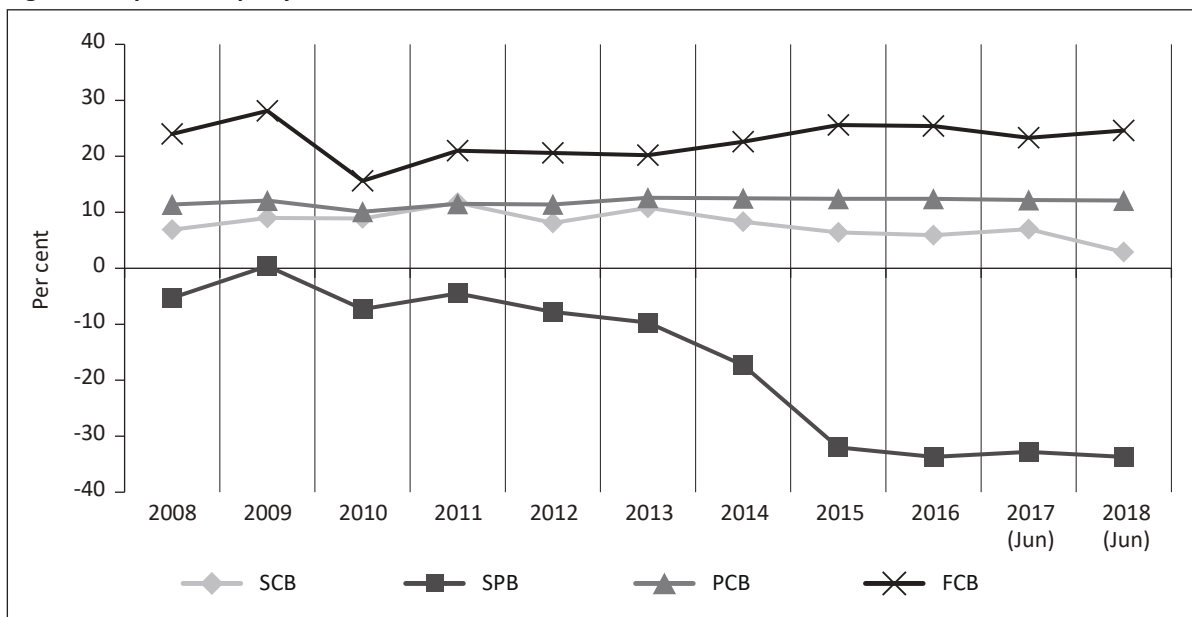
Capital adequacy ratio (CAR), the proportion of a bank's risk-weighted assets, indicates the ability of a bank to absorb shocks of losses that a bank might face. As a whole, foreign commercial banks (FCBs) and PCBs had been comfortable with the maintenance of capital adequacy requirement over 2008–2018 (Figure 3), though enforcement of Basel II (in January 2009) and Basel III (since March 2015) requirements brought stringent criteria for calculating CAR. In 2008, banks' CAR was 10.1 per cent, which increased to 11.5 per cent in 2013, and went down to 10.1 per cent in June 2018. SCBs and SPBs had always been in trouble in maintaining capital adequacy requirements.

Figure 2: Ratio of NPL to total loans of bank groups



Source: Bangladesh Bank Annual Report (various issues).

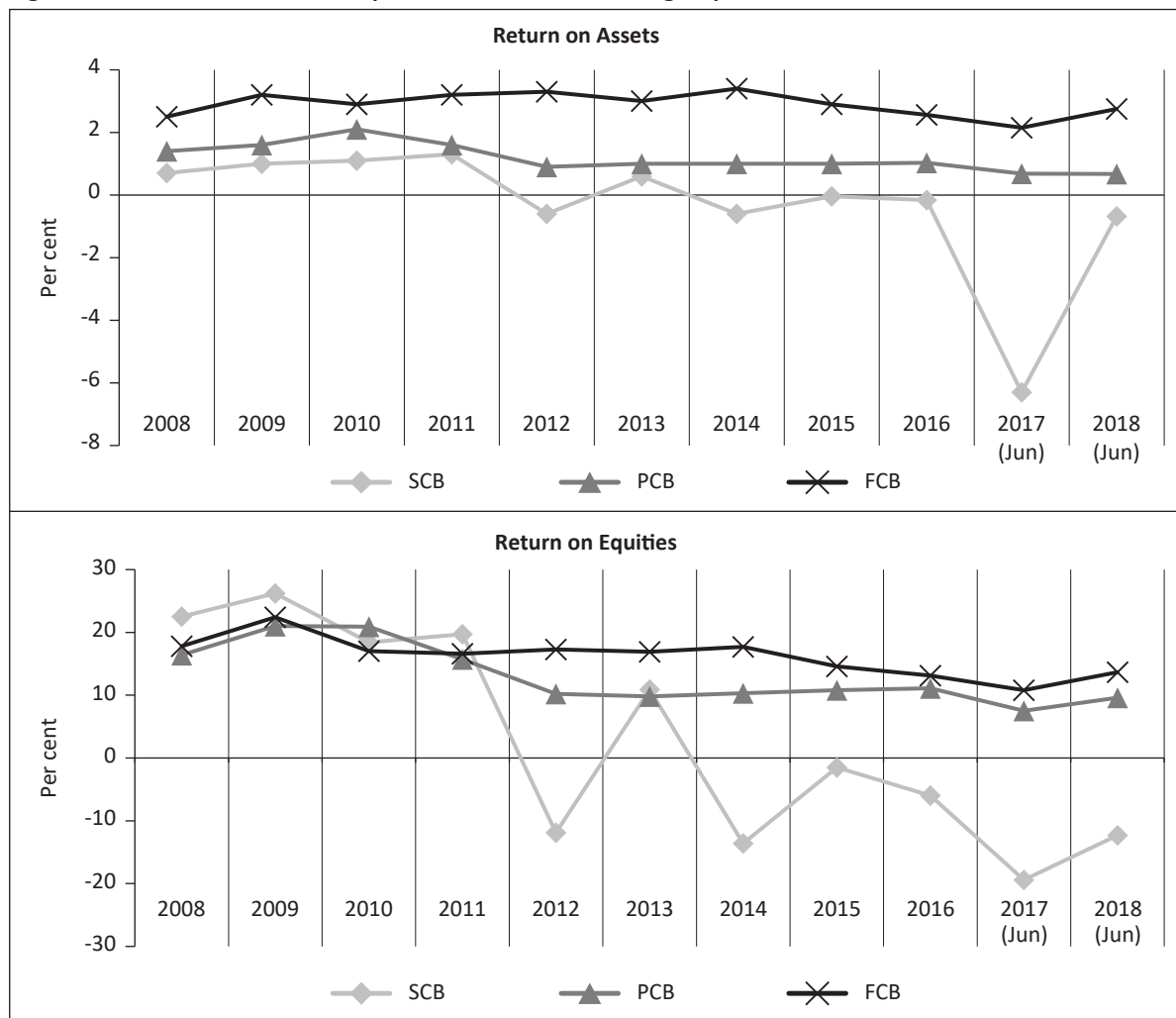
Figure 3: Capital adequacy status of banks



Source: Bangladesh Bank Annual Report (various issues).

Strong return on assets (ROA), return on equity (ROE) and reducing expenditure–income ratio are expected in case of banks that are operated commercially. However, in case of Bangladesh, the performances of the commercial banks (FCBs, PCBs and SCBs) have, in fact, deteriorated, in terms of ROA and ROE. As of June 2018, ROA and ROE of the banking industry stood 0.3 per cent and 5.3 per cent, respectively. However, performances of FCBs and PCBs were much better as compared to that of SCBs during 2008–2017 (Figure 4). Over the past few years, government provided support to recapitalise banks which has been criticised, as it has been seen by some as the government diverting taxpayers’ money away from much-needed investments. In recent time, government’s Finance

Figure 4: Returns on assets and equities of commercial bank groups



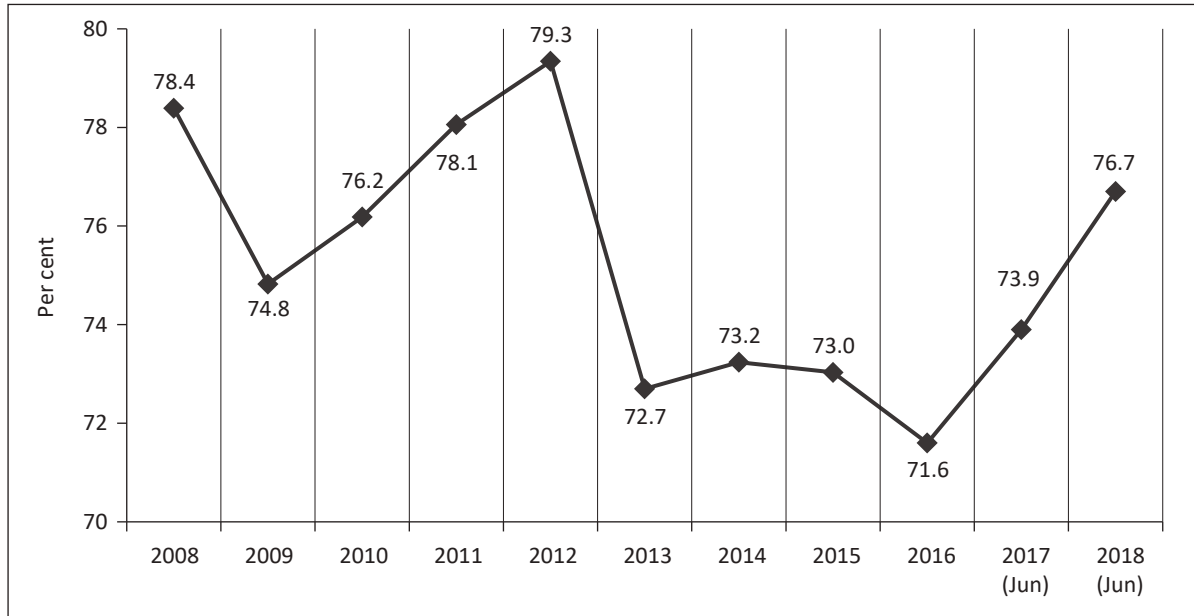
Source: Bangladesh Bank Annual Report (various issues).

Division and Bangladesh Bank have shown dissatisfaction on the capital shortfall and performance of the state-controlled banks.

Expenditure–income ratio for banks, an efficiency parameter, deteriorated over the years, and was around 79, mainly because of the high ratios of SPBs and SCBs, as of June 2018. Practically, the expenditure–income ratios for most FCBs and PCBs improved following 2013. In response to the Bangladesh Bank’s continuous efforts, deposit–lending gap—another indicator of efficiency and management soundness—had been showing positive trend. The weighted average gap of deposit and lending rates improved, and came down to 4.14 in June 2017 (Bangladesh Bank, 2018a). A fluctuating advance–deposit ratio (ADR) indicates inefficiency in liquidity management by some of the banks (Figure 5). During the last few years, the banking industry faced more than two unusual incidences of both liquidity surpluses and liquidity shortages that required policy interventions.

Improvements in the processes of banking operation were visible in key functional areas (credit operation, trade services operation, internal control and compliance, information technology (IT), human resources operation and treasury operation) as captured in the annual review studies of the Bangladesh Institute of Bank Management (BIBM) (since 2012). In a number of banks, the processes

Figure 5: Advance–deposit ratio of banks

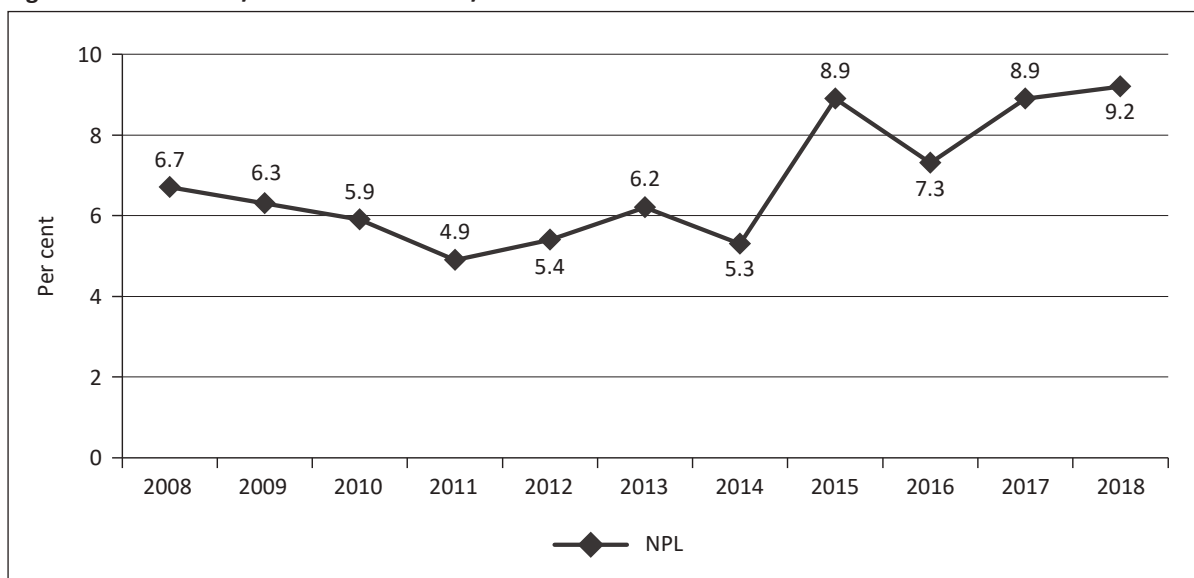


Source: Bangladesh Bank Annual Report (various issues).

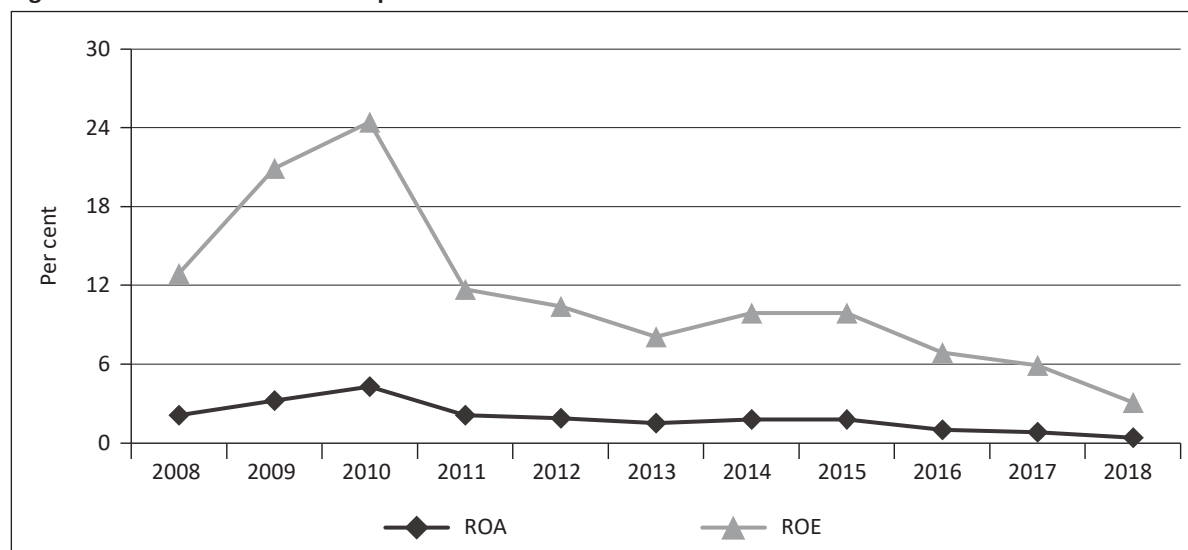
were centralised and digitised, and many others are preparing. Use of technology and digitalisation brought greater efficiency and cost effectiveness in several areas of banking operation. Capacity development received great emphasis in the banking industry of the country in recent years.

In regard to the performance of 34 NBFIs, CAMELS (capital adequacy, assets quality, management, earnings, liquidity and market sensitivity) rating of Bangladesh Bank indicates one NBFIs as good performer, and 17 as satisfactory, and others below that level (Bangladesh Bank, 2018a). As a whole, volume of NPL was showing increasing trend, and was close to 9.2 per cent as of June 2018 (Figure 6), which was slightly lower than the average of banks. Both ROA and ROE for NBFIs were positive, but declining (Figure 7). Profits of the NBFIs mainly came from interest incomes. NBFIs’ revenue

Figure 6: Ratio of NPL/leases to total loans/leases of NBFIs



Source: Bangladesh Bank Annual Report (various issues).

Figure 7: Returns on assets and equities of NBFIs

Source: Bangladesh Bank Annual Report (various issues).

comprised of over 90 per cent of the interest income, as compared to around 70 per cent for the banking industry as of June 2018. Profit after tax for NBFIs has been relatively better as a whole, as compared to that of the banking industry. However, increasing trend of the cost of fund of NBFIs has been concerning in recent months (around 9.3 per cent, following April 2018).

In spite of several challenges, capital market activities expanded in response to several consolidation measures. At end-March 2018, the market capitalisation stood close to BDT 3,920 billion, which is 7.4 per cent lower than what was recorded at end-December 2017. A downward trend was observed in market capitalisation since November 2017. Establishment of IDRA in 2011 brought major changes in the consolidation process of the insurance sector of the country, which is dominated by three market players, and is yet to create due foundation to contribute effectively. MFIs were brought under formal regulatory set up in the last 10 years. The number of members and borrowers increased consistently over 2008–2018. As of June 2018, 696 MFIs were offering microfinance services with over 17 thousand branches. In recent times, a good number of MFIs were engaged in banks' credit disbursements, mainly in agriculture and green finance sectors, as linkage arrangements.

Bonds, though have worldwide popularity as a deposit instrument, have a marginal impact in the securities market of Bangladesh due to trading only a few listed bonds in the exchanges. Currently bond market in Bangladesh plays a very insignificant role in the economy. Neither the policymakers nor the corporations have shown any substantial interest in bonds. The available government debt instruments are the treasury bills and treasury bonds. Banks and financial institutions are the main buyers of treasury bonds. Treasury bills and bonds are short- and long-term obligations issued by Bangladesh Bank on behalf of the Government of Bangladesh (GoB). In the absence of a vibrant bond market, there was growing demand for investment in government securities in a scenario of relatively lower interest rates in banks. Foreign exchange market transactions in the country include basically spot dealings. Uses of derivatives in the financial market remained extremely limited, though certain transactions are allowed.

Policy and regulatory support have brought notable changes in the banking and financial industry of Bangladesh in terms of technology adoption, product development and service delivery. Alongside

improving operational banking and processes, technology-driven products and service delivery started contributing in the financial inclusion of the country. Mobile banking has now become the most popular medium for monetary transactions in Bangladesh, because of its ease and speed. This concept of mobile financial services (MFS) has brought under its fold a huge unbanked segment of the population, especially in rural Bangladesh, within a span of seven years, since its launching in 2011. As a matter of fact, GoB has laid the foundation of an enabling environment for the new payment services with an actionable ICT (information and communication technology) Policy 2009, Right to Information Act 2009 and ICT Act 2009. As of end-2017, Bangladesh Bank has issued 19 licenses to commercial banks for providing MFS. Among these, 18 have launched their products, though all are not equally active. In most cases, banks are engaged in money transfer and remittance services. Banks are also providing e-wallet services. Regarding MFS market development, whereas the proportion of MFS accountholders in the population was only 3 per cent in 2014, it rose to around 38 per cent by the end of 2017, which was in fact, higher than the South Asian average of 33 per cent. Agent banking is a relatively new, but remarkable venture in the banking industry of Bangladesh. Within just one-and-a-half years of its inception, agent banking has been able to attract a huge number of clients, forcing most commercial banks to take up this alternative form of financial service, in addition to branch-based banking. The central bank issued an agent banking guideline in 2013, the first bank started full-fledged agent operation in 2016, and by the end of March 2018, the number of agent banking accounts stood at close to 15 lakh, having deposits of over BDT 1,634 crore, according to the latest estimate of Bangladesh Bank.

Financial inclusion drives of the Bangladesh Bank brought remarkable improvements in several socioeconomic fronts, for example, notable changes have taken place in terms of higher access to finance, and increased geographical penetrations of the financial services. All banks and NBFIs have created governance framework with relevant policies and sustainable finance units to support development activities. A good number of banks and NBFIs came up with special packages and products for micro and small enterprises, sharecroppers and women entrepreneurs. Though at slower pace, green and environmental financing started getting momentum in semi-urban and rural areas. Bangladesh Bank has been supporting the endeavours of banks and NBFIs through a number of refinance schemes. In response to the Bangladesh Bank's initiative, the expenditure of corporate social responsibility (CSR) activities increased by many folds. A recent BIBM study (Siddique et al., 2018b) has shown that, developmental banking activities of the banking industry was significantly linked to some of the Sustainable Development Goals (SDGs), especially that were relating to inclusive growth, gender equality and sustainable development.

4. POLICY AND OPERATIONAL CHALLENGES OF BANKING AND FINANCIAL SECTOR IN BANGLADESH

Financial crime and willful default

Alike most other global economies, crimes associated with financial sector have grown up massively. A survey by Habib et al. (2017e) identified that about 65 per cent banks of Bangladesh faced one or more of financial crime incidents in their banks during the period 2014 to 2017. The survey pointed out that general banking, credit and IT were the three most vulnerable areas from the point of view of financial crime. Of the different types of financial crimes, loan processing, deposit and cheque-related frauds were very commonly experienced. Nature of loan-related frauds include creating loan in the name of non-existent borrowers, fund diversion, collateral valuation, directed lending, fake title deed, etc. The data on willful defaults in the context of banks are not generally maintained and reported,

and are not recognised as financial crimes. These are about some big borrowers that are mainly engaged in committing such crimes and misappropriation of banks' and public money. SCBs are the most affected bank groups struggling to address the issue. In the context of developing countries, lack of adequate regulations and/or weak enforcement of laws are causing moral hazards. In recent time, Reserve Bank of India (RBI) framed rules defining willful default, and asked banks to declare borrower as 'willful defaulter' and to initiate action against such accounts under laws to auction residential or commercial properties to recover loans. Also, the Indian Parliamentary Standing Committee on Ministry of Finance in its report presented in February 2016, recommended that, as a measure of public accountability, each bank must make names of 'willful defaulters' public, and the relevant laws and regulations should be amended (Lele, 2016). As per the RBI circular, being a willful defaulter, the individual or company is under certain penal measures: banks and institutions are required to submit the list of suit-filed accounts of willful defaulters at the end of every quarter to the Credit Information Bureau (India) Limited (CIBIL); banks have to report the names of current directors, as well as directors who were associated with the company at the time the account was classified as defaulter; a willful defaulter is not to be offered with lending facility from any bank or institution; not to be permitted to float any new business for a period of five years from the date of being declared a willful defaulter; and banks and institutions have been given the right to change the management of the willfully defaulting company (Lele, 2016). It is well-circulated news that, recently China came down heavily on loan defaulters, and the Chinese government barred loan defaulters from buying plane tickets, travelling by high-speed trains, prohibited for loans and credit cards, restrictions on staying at luxury hotels and enrolling their children at expensive schools (The Financial Express, 2017).

Challenges of corporate governance and network leadership

Shareholders take entrepreneurial risks, and deserve the right and authority to decide on the policy and strategic issues of a business entity; however, is it really possible to relate this concept entirely with banking industry? It is true that a commercial bank is set up as an entrepreneurship activity. However, when a bank is established, it becomes part and parcel of an economy, and all of its depositors become the actual major risk-takers. As crucial government machinery, the central bank regulates and supervises banks, mainly to protect the interest of the depositors and to restrict banks from taking excessive risks. Management of a bank practically performs the role of agents in the process of running the banks. The shareholders and the minority risk-takers have the scope to play role in the banks' board, and thus protect their interests. In such an ownership and governance structure, depositors are the true risk-takers, and the central bank represents them. Practically, for sound and secured operation of a bank, a body of decision-makers comprising board and top management (termed as network leadership) has a crucial role to play. They must cooperate, and at the same time, they must maintain a logical distance between them. It is obvious that, bank management, employees and board members must show their due accountability towards the depositors in the process of taking any decisions and guiding or running the banks (Habib et al., 2018b).

In the context of Bangladesh, the role of network leadership raised question marks in a number of instances. There is no doubt that the banking industry has notable cases of transformation and innovation, led by some network leaderships of banks; and there are many cases and instances of sound leadership, and governance practices and behaviour in the country (Habib et al., 2018b). Unfortunately, these excellent cases and ventures are overshadowed by some frustrating cases of unethical corporate leaderships. In several financial scams unearthed in recent years, it was identified that a few banks disbursed loans to the non-existent companies, without proper documents—

patronised by the leadership network. In some cases, board of directors of the bank approved the loans even before the branch sent the proposal to the bank head office. And in some cases, banks' top managements were aware about all these activities, but they did not take any action (Habib et al., 2017e).

Board-based approach in the banking industry, following the bank failure in the most recent crisis, might draw lessons in this connection. Regulators and investors are now demanding more from the board members in terms of accountability, engagement and expertise. Skills and competencies required by boards are changing, and members/directors are now expected to acquire their own understanding in the areas of financial risk, technology and human capital, and not depend on the expertise of others (Earnest and Young, 2015).

Money laundering and the associated challenges

Money laundering has become one of the most critical concerns for the banking industry around the globe, and of the different types, trade-based money laundering (TBML) is the most common, which can be practiced through the misrepresentation of the price, quantity or quality of imports or exports involving: over- and under-invoicing, multiple invoicing, over- and under-shipments, falsely described goods and services, etc. In response to this, increasing compliance requirement has been pulling the overall costs of offering trade services in all global economies. According to the ICC survey (2017), over 68 per cent global banks identified 'compliance and regulatory requirements' as area of significant concerns and costs.

Among the four basic techniques of TBML, over- and under-invoicing of goods and services and falsely described goods and services are common in Bangladesh. Though the main motive behind the TBML is to hide the proceeds of crime, but in some cases, gaining government subsidies and/or evading tax/duty instigate perpetrator to engage in money laundering. To hide or profitably use the proceeds of crime through illicit outflows of funds from Bangladesh, the criminals use overpricing in import of low-duty items like capital machineries, raw materials and spare parts, and underpricing of export. For gaining government benefit like cash incentives and subsidies, there are also tendencies of overpricing of exported items (Habib et al., 2018c).

Newly developed payment systems and virtual currencies, popularly known as New Payment Systems (NPS), has become another area of money laundering concerns in recent years. The growing use of NPS and an increased awareness of associated money laundering and terrorist financing risks have resulted in the detection of a number of money laundering cases during 2006–2010 (FATF, 2010). At the March 2018 meeting of the Group of Twenty (G-20), Finance Ministers committed to pursue global implementation of the FATF's guidelines on NPS, including for virtual currencies (European Parliament, 2018). In Bangladesh, it became particularly visible during certain incidences of the abuse of MFS during 2016–2017, in connection with remittance transfer. Several cases were compiled based on the information collected from the field in Habib et al. (2017a), which captured the nature and extent of informal remittance channelling and abuse of MFS platforms. In some cases, people were not even aware, whether these were legal. Several agents were found engaged in informal money transfer activities (Habib et al., 2018d).

Price verification for financial crime control purposes is another difficult challenge. In Bangladesh, the obligation of ensuring the prices of importable items are 'competitive', and the price of exportable

item are 'fair' lays with banks; hence, they have to find out an effective mechanism to implement the obligation. It is really a difficult task. Although customs offer a list of minimum prices for selected items for tradable, the problem remained (Habib et al., 2019). Banks and financial institutions generally are not in a position to make meaningful determinations about the legitimacy of unit pricing due to the lack of relevant business information, such as the terms of business transactions, volume discounting, or the specific quality of the goods involved (Monetary Authority of Singapore, 2018).

Corporate ethics and insider frauds

In February 2015, the Financial Stability Board (FSB) published a letter to the G20 Finance Ministers and Central Bank Governors highlighting that, "the scale of misconduct in some financial institutions has risen to a level that has the potential to create systemic risks" (FSB, 2015, 5). Again, two years after, in March 2017, the FSB reaffirmed in a letter to the same audience that, "numerous instances of misconduct in the financial industry in recent years have damaged confidence in financial institutions and undermined trust in markets. The implications of misconduct can be far-reaching, limiting the potential of finance to serve real economies and to foster global economic growth" (FSB, 2017, 4). A study by Habib et al. (2017b) identified different forms of unethical behaviour that occurs in different degrees in banks and NBFIs of the country, such as engagement in false or deceptive marketing services, taking bribe from customers, getting involved with external criminal groups, etc.; and identified 'lack of corporate ethics' as one of the prime causes. Though banks/NBFIs are generally having a set of Code of Conduct, as claimed, these are not clearly communicated to their employees. Banks and financial institutions generally do not have proper reporting procedure on possible misconduct of their employees (Habib et al., 2017b). Occurrence of unethical behaviour adversely affects work environments in banks; traditional internal controls hardly prevent unethical behaviour, and top leadership has a role to play here. Role models facilitate the acquisition of ethical behaviour, and ethical leadership encourages similar conduct among subordinates (Brown and Trevino, 2014).

Challenges in trade services by banks and foreign currency borrowings

There are evidences that, in Bangladesh, a good number of trade transactions started on wrong footings, i.e. false or locally prepared pro forma invoices. Though locally Bangladesh has a Contract Act, it is not suitable for international trade transactions or may not be accepted by the counterparts. Though 89 global countries have ratified the United Nations (UN) Vienna Convention as the regulatory guideline, Bangladesh is yet to do that (Habib et al., 2018c).

In response to the de-risking measures by the multinational banks, correspondent banking relationship remained a critical factor for trade facilitation for last few years that are affecting trade services and trade transactions of the country. Most local banks of Bangladesh faced correspondent relationship cut during last few years (Habib et al., 2017f). However, compliance risks and sanction issues remained critical challenges for banks.

Credit risk and default loan scenario in trade services in Bangladesh is not different from the NPL scenario in the country, as a whole. In several instances, banks had to create forced loan against imported merchandise (LIM) and loan against trust receipt (LTR) due to the non-compliance of the importers. Non-compliance on the part of exporters resulted in NPL in some cases, where there are evidences of unholy collusion between traders. In regard to handle fraudulent activities in letters of credit (L/Cs) which is the most widely used method in the country, there should be applicable

supportive local laws/set of rules. Since there is no specific law for governing the cases under documentary credit, there are frequent interventions of court refraining banks to honour obligation on the plea of quality and/or quantity claim (Habib et al., 2018c).

Banking sector and the economy have experienced sudden growth of short-term foreign currency borrowing in recent years. The existing macro picture of short-term foreign currency borrowing by the private sector is not alarming by any indicator. However, given the global experiences with short-term financing, a close monitoring and effective management of short-term debt (in particular, of that intermediated by domestic banks) are essential to avoid any future difficulty. Sudden growth of private sector credit is clearly visible following the year 2013; and there are adequate evidences that point towards sudden growth of banking sector's foreign currency liabilities, following the initiation of buyers' credit or UPAS (usance payable at sight) activities in the country (Habib et al., 2017d).

Weak internal controls and ineffective internal audits in banks and NBFIs

The Internal Control and Compliance Department (ICCD) of banks and NBFIs is expected to add value through its independent observations on different activities performed by other units. However, generally it is considered as one of the least effective departments or units in most banks. Practically, the scams unearthed by regulators or other stakeholders were supposed to be identified by the banks' own ICCDs. Sometimes employees consider their posting at the ICCD as a punishment rather than a reward.

The regulation requires a bank to be audited by the external auditors. In the most recent review on banks' internal control and compliance, Siddique et al. (2018a) examined the contents of the audit reports of different banks, and found almost identical comments about the internal audit, internal control and risk management system, regardless of the financial condition of the banks. It was surprising that the banks that suffered huge losses in the last few years due to large-scale corruption, were in fact, reported as banks having adequate internal control system.

Cross-cutting challenges of the banks/NBFIs of Bangladesh

Uniform regulatory environment is critical for the effective and competitive environment in the banking industry of Bangladesh. SCBs do not seem to be operated under the same regulatory and supervisory environment as that of PCBs and FCBs of the country. It seems unfair to compare SCBs and other broad bank groups, when SCBs cannot always operate commercially and have differential regulatory treatment. Moreover, a competitive interest rate structure in banks, NBFIs, and private and government bond markets is a pre-condition for developing a better financial market which is missing in the country.

It is well-known that, bank management and executives perform banking activities as the agents, and the principal agent is one of the key operational and governance challenge in the banking industry. Nature of banker–customer relationship is different in Bangladesh, where clients of SCBs and most PCBs transact with bankers, and not with the banks. Such type of relationship offer less incentive to follow due credit risk management process (Habib et al., 2018b).

In spite of improvements and portfolio diversification efforts in the banking industry, large and medium enterprise are the major beneficiaries of banks credit in the country. Considering all bank

data for 2017, over 32 per cent of the total loans outstanding was found in the category of BDT 200 million and above, and highest rate of growth of bank credit was observed in the same category; and over 85 per cent of the total credit was disbursed in Dhaka and Chattogram in 2017 (Banerjee et al., 2018).

A good number of banks have entered into the banking market of the country in recent years and there are preparations for more. With the increase in the number of market participants, greater competition should come in, and efficiency should be enhanced. However, for that matter, banks must work on product diversification and market expansion to the unexplored areas. There should also be exit strategy of the banks. Operating with the same client base is causing unfair competition in some instances in the banking industry of Bangladesh.

Ensuring capacity of the employees of banks and NBFIs is a critical challenge. In spite of certain efforts, employees of top management and board members of banks and NBFIs could not be brought under effective capacity and knowledge enhancement programmes on leadership and governance issues. Clients need to understand their obligations and rights as part of the banking and financial system.

NBFIs remained small, and sometimes market-distorting

Volume of services of NBFIs is very limited to offer due support to the economy for long-term investment. In recent times, tendencies of offering very high deposit rates by some NBFIs were clearly unreasonable on their part. It seems unsustainable and irrational to collect such high-cost deposits, considering the interest rate structures in lending operations and investment returns. NBFIs gained considerable popularity both in developed and developing countries to facilitate long-term investment and financing, which is often a challenge to the banking sector; the growth of NBFIs widens the range of products available for individuals and institutions with resources to invest. However, in spite of growth, the market share and extent of operations of NBFIs of Bangladesh remained far from the requirements.

The current green financing market has distorting components that are working as disincentive for some market participants, especially banks. Some NBFIs have relatively better access to the concessional and donor funds for lending on. Being in the same market and financing areas, it is not possible for the banks to compete with the NBFIs counterparts, as it is commonly known that banks' cost of funds is more expensive.

Inadequate agri-financing and access of women to the financial sector

In spite of some regulatory initiatives, financing to the agriculture sector did not get due push. Though, some deposit products brought positive changes in terms of improving financial inclusion amongst farmers and sharecroppers, effective credit products by the formal sector banks or NBFIs are absent. Though warehouse receipts system by itself, or as part of commodity exchange arrangement, contributed significantly in ensuring financing to the agricultural sector in several developing and neighbouring countries, Bangladesh could hardly reach near those levels. Microinsurance has also been very successful in several instances.

In spite of some great efforts to promote women entrepreneurship and financial access of women, gender gap between men and women widened in terms of access to the financial services. According to the Global Findex 2017, 65 per cent Bangladeshi men had accounts, while the figure for women

was only 36 per cent. The study added that the gap was one of the largest in the world (World Bank, 2018).

Overdependence on banks and underdeveloped nature of markets

Bangladesh economy has clear overdependence on banking industry that has been playing the role of both short-, medium- and long-term financing needs. In spite of expansion and regulatory efforts for consolidation, it seems that capital market is to move a long way to win the due trusts of the investors necessary for developing a sound secondary market in the country. Institutional investors are crucial and important for capital market development; however, capital market cannot be developed only by the support of the banking industry under regulatory pressure. Underdeveloped bond market in the country is an obstacle for the banks' financial operations, as it means heavy dependence on common depositors for funds. Promoting new ventures has remained a critical challenge for the economy, as banks do not support such ventures. In Bangladesh, so far 11 companies have got the necessary license as alternative investment fund under the BSEC (Alternative Investment) Rules, 2015; almost all of these companies are relatively new and only starting the business (Habib et al., 2018a). Appropriate regulatory and policy supports are the need of the time for promoting venture capital and related funds in the country. Insurance is yet to find place as trustworthy institutions for managing risks for socioeconomic purposes. According to a recent report (The Daily Star, 2018), some 33 per cent life insurance claims in Bangladesh remain unsettled, which indicates to the weak financial health and lack of governance. Practically, insurance companies are generally investing in fixed assets and having low average return. Some MFIs are facing challenges in gathering funds in a situation of diminishing donor funds. In addition to that, credit overlapping, capacity development, disaster recovery arrangements and deposit insurance—have remained critical challenges for most MFIs.

5. REGULATORY AND SUPERVISORY INITIATIVES FOR THE CONSOLIDATION OF THE BANKING AND FINANCIAL SECTOR

Regulatory changes have been installed in several areas of banking and financial sector, either to align these with the global standards, or to address internal needs and requirements. Bangladesh Bank issued guidelines on five core risk areas (updated in recent years) covering—credit risk, foreign exchange risk, internal control and compliance risk, IT risk and asset-liability management risks. There are also several special guidelines of Bangladesh Bank on integrated risk management and prudential issues both for banks and NBFIs. To cope with the international best practices and to make the bank's capital more risk-sensitive, as well as more shock-resilient, Guidelines on Risk Based Capital Adequacy for Banks (in line with Basel II) was introduced from 2009; and another updated version has been issued in 2014 (in line with Basel III). In 2015, Bangladesh Bank gave banks a roadmap to implement the Basel III framework from January 2016, under which, their capital-to-risk (weighted) assets ratio or CRAR will rise to 12.5 per cent by 2019. A number of acts were legislated and amended in recent years to address money laundering and terrorist financing challenges to match with the global standards, such as amendments of Money Laundering Prevention Act in 2009, 2012 and 2015; enactment of Anti-terrorism Act 2009 and amendment of the same in 2013; and, enactment of The Public Demands Recovery Act 1913. Regarding capital market, some recent rules and amendments were associated with market formation and clearing and settlement (BSEC Rules 2017), merchant banking, provisioning requirements, and public issues (BSEC Rules 2015). Formation of IDRA in 2011 under IDRA Act 2010 was the most remarkable initiative of the recent time in the insurance sector of the country.

Monetary Policy Statement (MPS) is a half-yearly declaration of the Bangladesh Bank on the way to forecast and plan the following six months on the money supply, exchange rate interest rate and accommodation on targetted price levels by the fiscal authority. It commonly offers forward-looking market signals and initiatives on several financial market indicators, in line with the broad economic goals. Introducing 'strategic plan' was a notable policy development at the Bangladesh Bank, for—coordinating monetary policy measures, strengthening supervision and regulation, and optimisation of human capital. In 2009, Bangladesh Bank published the first strategic paper for 2010–2014; and in September 2014, the Bangladesh Bank Governor declared the second strategic plan for the period 2015–2019. Practically, major supervisory and prudential norms were redesigned in recent years, mainly to ensure greater soundness and strengths of the banking and financial sector, in accordance with the changed global standards. Especially, experiences of the most recent global financial crisis (sparked during 2007–08) resulted in notable initiatives by the global standard-setting bodies to rectify supervisory and prudential measures. Incorporation of technology in supervision and service facilitation can easily be observed in the approach of the central bank. Several initiatives have also been undertaken for smooth and secured e-banking operations by the banks and financial market participants.

There were efforts to address the critical challenges of corporate governance issues that include periodic review of stability of the individual banks, as well as the whole banking system, stress testing, monitoring of large borrowers, fraud-forgeries and strengthening internal control and compliance through self-assessment of anti-fraud internal controls, among others. For improving corporate governance in the banking sector, Bangladesh Bank published guidelines for 'fit and proper' test for appointment of chief executive officers of PCBs, specifying the constitution of audit committee of the board, enhanced disclosure requirements, etc. In continuation of the above reforms, the roles and functions of the board and management have been redefined and clarified with a view to specifying the powers of the management and restricting the intervention of directors in day-to-day management of the bank. BSEC also has circulars for the stock exchange listed companies in Bangladesh, to enhance corporate governance in the interest of investors and the capital market.

Remarkable initiatives have been undertaken by the Bangladesh Financial Intelligence Unit (BFIU) to prevent money laundering through banks. Alongside enactment of relevant laws and regulations, Bangladesh became the founder member of the Asia-Pacific Group on Money Laundering (APG); and Bangladesh Bank installed UN-accredited software to combat suspected financial transactions to fulfill the promises made to the Financial Action Task Force (FATF). Banks have already started to respond to the Bangladesh Bank's initiatives by complying with stringent customer due diligence (CDD) requirements. BFIU issued a master circular in 2017 to be complied by the bank, where commercial banks were asked to take measures before introducing new technology-based payment services. Banks are directed to identify relevant risks, risk-tolerance level and readiness to handle the risks associated with new technology-based payment services before launching any product. BFIU has also asked banks to follow certain steps in appointing agents, and monitoring their activities in mobile and agent banking ventures (Habib et al., 2018d). As measures to develop awareness on money laundering, BFIU organises programmes for banks, NBFIs, insurance companies, MFIs and other stakeholders.

The Vigilance and Anti-fraud Division (VAD) under the Financial Integrity and Customer Services Department (FICSD) of Bangladesh Bank has been established to keep keen eyes on the banking sector of Bangladesh to prevent and minimise corruption and fraud-forgeries through conducting

special inspections. In 2015-16, special inspections conducted by the VAD unearthed a number of fraudulent transactions and malpractices in banks, which prevented those to become worse. According to Bangladesh Bank (2017) data, during 2015-16, highest number of inspections (19) was conducted in the Farmers Bank Limited.

Bangladesh Bank has established Corporate Memory in electronic form to store all detected fraudulent activities of the financial sector. Bangladesh Bank also installed a 'Whistle Blower Protection' mechanism. If anyone has the knowledge that some illegal activity is going on, or misappropriation of public fund or a fraud is happening, and decide to inform the appropriate authority, then s/he can get protection as per the regulation Public-interest Information Disclosure Act (Provide Protection), 2011. Moreover, to ensure customers' rights and protection, a Customer Interest Protection Centre (CIPC) was established in the head office and branch offices of Bangladesh Bank in March 2012. Recently a new unit, named the FICSD, has been opened for dealing with the complaints of the customers and clients of banks and financial institutions more quickly and easily. In 2017, Code of Conduct for Banks and NBFIs has been introduced by the Bangladesh Bank to implement National Integrity Strategy (NIS) in the financial sector of Bangladesh.

6. POLICY RECOMMENDATIONS: WAY FORWARD FOR THE GOVERNMENT

To maintain the existing domestic production and the ongoing high growth, it is very important to have a sound and stable banking sector, considering the extensive extent of dependence of the real sector of the economy on the banking sector of the country. In view of this, the present paper recommends the following measures that will need policymakers' due attention:

Multiple pressure elements for addressing willful default

There is no doubt that addressing willful default culture is the most challenging task associated with the banking industry of Bangladesh today. It is indeed essential now, to draw line between loan default for genuine reasons and the willful defaults. The provision of loan classification norms of the country does not make distinction between willful and other forms of defaults; and there is no requirement to report to the central bank about willful defaulters. Thus, loan classification norms should be redesigned to identify and make reporting arrangement for willful defaulters following specific definition. Willful defaulters should automatically come under penal actions on the ground of the misappropriation of the public money. There are provisions for undertaking legal actions against the bank defaulters by banks under Money Loan Court Act 2003, alongside some other lenders' recourse-related laws. Though the act discourages writ in favour of the defaulters, there are many instances of availing undue protection through writ petition. Willful defaulters must not be allowed to avail any such protection under law. Specialised Money Loan Courts are operating in all districts; however, there are very limited instances of penalising big defaulters within the indicative time limit of 120 days. Rather, cases under the act take years to resolve. Generally, legal process for recovering loan is perceived as complex and lengthy. As such, huge amount of defaulted loans are waiting for recovery in the legal process. The existing legal proceedings are hardly punitive for defaulters, and thus, discouraging for the banks. Cases against willful defaulters must be settled within a stipulated time period. Enforcement of the existing act with a given time period might bring remarkable outcome. Moreover, banks should be given right to change management in a defaulted company. In addition, willful defaulters should be hassled with measures for public and social humiliation to recover money, in line with Chinese examples. At the bank-level, centralised loan processing might help developing

right kind of bank–customer relationship for better risk management. Banks must create adequate incentive to create due pressure and non-legal measures before going for legal actions against a willful defaulter. It is crucial now to undertake social awareness programmes by the government, central bank, banks and NBFIs on the issue.

Support services and rescheduling for genuine non-performers

Genuine defaulters must not be treated in the same manner and under same regulations as the willful defaulters. There must be prescribed criteria and definitions, determined and circulated by the regulatory and supervisory authority, so that clients who have genuine grounds for their non-performance, receive due support in repairing their businesses. Changed business and economic environment, and disasters of different types should be amongst the genuine causes. Opportunities for rescheduling of loans should be awarded only to the genuine non-performances. To support defaulters with genuine reasons, banks and NBFIs may come up with additional financing and management support, in line with the venture or alternative investment fund arrangements.

Improving corporate governance and leadership in banks and NBFIs

Corporate governance practices and leadership in banks, as a whole, has become a matter of concerns of all the banking industries all over the world, mainly following the most recent global financial crisis. To address the challenge, regulators in developed systems strengthened engagement, accountability and appointment criteria for the board members. The changing regulatory requirements indicate towards increase in responsibilities, accountabilities and expertise of the banks' board members. Keeping the gap or line intact in between board and top management, it is crucial that board members take part in serious strategic decision-making process of the management. In Bangladesh, many board members need capacity in terms of required knowledge and information on banking and financial risks, operational issues, cyber securities, financial crimes, etc. In line with the global development, board members should be complied with certain qualification criteria for capacity development (at least requirements for attending especially designed modules on banking and financing issues) before sitting in the board. It is important that board members and top leadership should deliver under a clearly disclosed long-term strategic goals and reasonable profit targets. In addition, board members must be assigned with certain accountabilities at individual levels, tagged with the performance of the banks.

Revitalising ICCD for better governance in banks and NBFIs

ICCD of banks and NBFIs must be given a new shape under the network leadership of banks to ensure true reflection of good corporate governance. Though internal control and compliance in a bank is supposed to prevent loss of resources due to errors and frauds, it could hardly identify the major financial crimes associated with the banking sector of the country, and thus, dubbed as ineffective. In fact, ineffectiveness of the credit-related internal controls and internal audit function of banks became a cause of concern in view of the unearthed banking scams in recent years. External audit is supposed to play an important role in identifying different accounting-related errors and frauds; however, external audits have been less effective in preventing and detecting accounting and other frauds and financial crimes in banks. Uninterrupted and independent operation of internal control is very effective in identifying banking crimes, where network leadership has a great role to play.

Uniform regulatory framework for competitive and fair banking

A fair and competitive environment improves efficiency in the financial market and optimises service quality and overall outcome. SCBs of Bangladesh do not have the required regulatory and governance environment to operate commercially and compete with other market players. These banks were supported with capital injection using taxpayers' money by the government in a number of instances. However, it must be mentioned here that SCBs are engaged in many non-profit-making activities, assigned by the government, at the public interests. Moreover, in quite a number of cases, SCBs offer services to the government free-of-charges. There is no harm in performing these tasks or jobs as assigned by the government. However, all these services must be priced to understand the true financial status of SCBs and actual levels of financial losses and recapitalisation need. It is unfair to compare performances of SCBs with that of PCBs and FCBs being in such a dissimilar regulatory and governance environment. At the same time, corporate government and leadership practices in SCBs need even more attention for streamlining sound commercial banking practices in the country.

Product diversification of new entrants and market exit strategy

Regarding new entrants in the banking sector, growing number of market players in the financial market should ensure greater competition, efficiency and innovation. The higher number should ensure greater financial inclusion in a country like Bangladesh, where still a section of people remains out of the scope of banking services. For obtaining true benefits in the area of financial inclusion, the new banks should be allowed under an incentive framework to diversify their services to some unexplored areas and sectors. The banking market needs exit strategy alongside provisions for fresh entrants. In this connection, merger and acquisition options should be enforced for ensuring competitive commercial banking environment in the banking arena. Bangladesh Bank issued a comprehensive guideline on this in 2007 that covers voluntary approach of merger and acquisition in the financial sector, and accordingly some sections are adapted in the Bank Company Amendment Act. Probably a separate act and the guideline may collectively contribute in undertaking due initiatives by some market players. The roles of network leaderships are particularly critical for the success of merger and acquisition in banking and financial sector.

Addressing money laundering through greater coordination

Incidences of TBML are a growing concern for policymakers and central banks throughout the globe. Though the available sets of anti-money laundering (AML) rules in Bangladesh are in line with globally accepted standards, many of the things are evolving. Compliance is already the greatest concern for the banks, and banks should be ready for the cost implications of such developments. However, compliance of AML rules should be a collective concern. It is not easy for banks to ensure competitive and fair prices of tradable. Although customs authority offered a list of minimum prices for selected items, the problem remains. The country needs greater coordination amongst different stakeholders to address the pricing issues and country-risks for competitiveness and regulatory compliance. Collective efforts from Bangladesh Bank, BFIU and customs authority are the pre-requisite for greater enforcement of AML rules in trading. In regard to the use of trade payment methods, greater use of L/C offers better protection, monitoring and control of the regulatory authority. At this moment, use of L/C in Bangladesh is not only connected with credibility, but also to ensure right kind of regulatory control to address financial crime like TBML. BFIU needs even greater coordination with all law-enforcing agencies.

Ratifying UN Vienna Convention and protection of traders and banks

In most cases, the contract or purchase/sale agreements in international trade are not legally enforceable for ensuring optimum protection. For sound purchase/sale agreement, it is essential to have coverage of a recognised regulatory framework. Alongside ratifying UN Vienna Convention on Contract of Sale by the government, there should be clear instructions on the other non-ratifying countries in regard to the guiding framework for all international trade transactions for better protection of the traders and bankers. In regard to handle fraudulent activities in L/Cs, time has come to have separate L/C law for the country alongside universally accepted sets of rules, i.e. Uniform Customs and Practice for Documentary Credit (UCPDC). Moreover, considering the unique nature of trade transactions and growing complexity, a separate bench in the court may be needed to ensure effective use of regulatory machinery. In response to the expansion of the use of UPAS, banking activities in export processing zones (EPZs) and other financing issues in offshore banking, the country needs a regulatory guideline immediately. Considering the requirements of specialised efficiency and market credibility, stringent criteria should be followed to allow offshore banking units in the country.

Cluster development and promoting SME financing

Inadequate financing has been considered as a critical bottleneck for small and medium enterprises (SMEs). There are global evidences that SME clusters are useful in handling the asymmetric information and other related problems effectively and make differences in ensuring efficiency in SME financing (Habib et al., 2015). As financing approach, other than a few exceptions, banks/NBFIs in Bangladesh do not make distinction between financing to the individual SME entrepreneurs and to the SMEs within a cluster. Generally banks and NBFIs do not follow cluster approach to finance SMEs. In the area of agriculture and green financing, a few instances to the renewable energy sector are really encouraging. The development of collaborative and sustainable clusters may be a way to stimulate innovations, manage resources efficiently, and can help environmental and social challenges. A generic SME strategy would not work for sustainable cluster development; the identification of clusters based only on geographical proximity do not offer true picture of cluster identification. The country requires an in-depth analysis of the relevant information on the developmental levels of small manufacturing clusters of the country. This would be true background for undertaking effective cluster development strategies and ultimately using cluster approach in SME financing.

Promoting technology-driven services and agent banking

Mobile banking and technology-driven products and services by the banks and NBFIs brought remarkable transformation in the financial inclusion statuses and strategies. To be competitive and to address future challenges, a bank/NBFI cannot keep itself away from the upcoming technology and innovation. Particularly, the newly added banking channel—agent banking—might prove to be effective in terms of efficient and cost-effective service delivery mechanism by banks both at urban and rural settings. It might be of great support to deepen the country's financial inclusion efforts by ensuring higher deposit inclusion and offering access to other financial services amongst low-income rural population. The issue of agent is one of the most critical and difficult aspects of the regulation of mobile and agent banking. Selecting and monitoring right agents are critical for effectiveness, and for ensuring protection against abuse of the platforms by the money launders. It is essential to enforce comprehensive and appropriate AML/CFT (combating the financing of terrorism) regulatory

framework in relation to evaluate and monitor agents engaged with mobile and agent banking channels. For ensuring transparency and quality of financial inclusion drives, data and drives should be segregated into: payment inclusion, deposit inclusion and credit access.

Promoting developmental banking to support the SDGs

Development banking activities in the banking and financial sector of Bangladesh have been basically regulator-driven. However, banks and NBFIs have responded tremendously to the central bank's efforts, and there are visible outcome in certain areas: special deposit services for underprivileged and underserved people, green financing, financial literacy and philanthropic activities. Some linkage programmes of banks and MFIs are working in the areas of agriculture and green financing. Roles of a few NBFIs in renewable energy financing are inspiring and replicable (Habib et al., 2017c). However, for sound market development and business, it is crucial to have undistorted and competitive market structure. For ensuring wider participation of banks and NBFIs, all market-distorting factors must be handled with care. In this existing scenario of green financing, right market segmentation could handle market distortion by some NBFIs. In offering financing to the low-income people, the existing documentation process of different banks/NBFIs and intermediaries are not same. Especially, banks follow relatively stringent documentation criteria in the process of loan disbursement. For banks, it is important to make the process less cumbersome to attract customers and create demand for green finance. Currently, most CSR funds of banks/NBFIs are used for philanthropic purposes. CSR funds of banks may be used to offer subsidy to the sustainable finance and to bring CSR funds within the core banking activities. Bangladesh Bank may encourage banks/NBFIs in this regard. Appropriate use of Climate Risk Fund considering risk premium might be an upcoming agenda. The government agency—Sustainable and Renewable Energy Development Authority (SREDA)—has been playing great role in supporting renewable energy financing through coordinating different stakeholders. Greater coordination amongst government agencies, Bangladesh Bank, banks and NBFIs might contribute even more on the way to attain the SDGs.

Promoting agricultural financing and reducing gender gap

There are huge potentials of designing and offering credit and insurance products targetting agricultural sector of the country, when significant portion of population still directly depends on agriculture sector. To ensure sustainable financial inclusion and adequate financing flows to the agriculture sector, introducing warehouse receipt system is must, and is only the initial step. There should be initiative and advocacy for setting up of regulatory authority for warehouse receipt systems and a commodity exchange arrangement for agricultural marketing in the country. There are already some scattered and piecemeal initiatives to support agricultural commodity markets in Bangladesh. Now it requires establishing a national-level agricultural commodity exchange arrangement; setting up of government warehouses or licensing of private warehouses; local-level service points with the existing telecentre networks; and designing an effective warehouse receipt system. An integrated approach of all these initiatives may bring up a sophisticated commodity market in the country for effective agricultural financing. Bangladesh Bank and IDRA might collaborate in offering targetted insurance products for agriculture, micro and small enterprises. Women depositors and entrepreneurs should receive more and special impetus to reduce gender gap.

Promotion of capital market, bond market, insurance companies and MFIs for a sound and balanced financial system

Financial system of Bangladesh needs desperate efforts to reduce overdependence on the banking sector. Developments of other segments are also relevant for the sustainable banking operation in the country. Due to the underdeveloped nature of bond and capital market, banks and NBFIs rely only on a few deposit products. Practically, overdependence on only deposits is a critical weakness of the liability portfolios of both banks and NBFIs of the country. Government needs to support financial market in maintaining a market-oriented competitive interest rate structure for the development of bond market. For promoting innovative entrepreneurships, venture capital financing and funds need policy and regulatory patronisation. Interconnections and interdependence amongst sound market participants of a financial market are indeed considered as strength; however, this is not always the case in the country. Banking sector has roles to play to promote all other segments, however, not at the cost of depositors' risks. And, capital market has to be taken to the level to attract banks and other institutional investors. Banks and NBFIs may have effective collaborative approach with MFIs for credit linkage in certain areas; and there might be bank-insurance products targetting the big unexplored insurance market of the country. Insurance activities need more rigorous regulatory supervisions and controls to create trusts amongst common people. Governments and regulators need to deliver more on financial literacy associated with capital market and insurance services.

Addressing capacity development and awareness of the key stakeholders

Addressing capacity and awareness development of the key stakeholders needs further impetus. With the growing compliance requirements, processes, technologies and financial crimes, employees of banks and NBFIs need regular training and capacity development programmes. There is no doubt that situation has improved remarkably, and both banks and NBFIs are now allocating relatively higher resources and efforts for capacity development by undertaking on-the-job and off-the-job training programmes. However, gaps remain—which is especially visible in the government-controlled banks. Banks and NBFIs should contribute in the awareness development of their clients as part of regulatory requirements under CSR. Top managements and board members of banks and NBFIs must be brought under effective capacity and knowledge enhancement programmes on leadership and governance issues.

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