Special Research Work

Field Survey Report

Of

Study on Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral



Bangladesh Bank Head Office Dhaka

29 August 2017

Field Survey Report

of

"Study on Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral"

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Summary or a Short Version of the Field Survey Report

"Study on Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral"

Introduction

The issue "to what extent the loans sanctioned against inadequate collateral affects the nonperforming loans (NPLs) of the country" was extensively discussed in the 25th meeting of the Banking Supervision Committee held on 29th February, 2016 at Bangladesh Bank. In this backdrop, the chairman of the committee, honorable Deputy Governor-2, kindly desired that the Research Department might conduct an in-depth study on this issue and find out effective policy recommendations. Thus the Study on 'Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral' was assigned to conduct by the research department along with officers from other departments of Bangladesh Bank (BB). Accordingly, a study team visited four selected regions namely Dhaka, Chittagong, Khulna and Bogra to get interview directly with the selected 41 banks' 75 branches and their 574 defaulters with a structured questionnaire. Branch managers had also been interviewed with another questionnaire. The report is prepared on the basis of the field responses from both of the defaulted borrowers and concerned branch managers. Direct interview with the defaulters by the regulatory institution like BB is the first ever pioneering attempt to assess the reactions of the defaulters. The report thus reflects the views of the defaulters and branch managers.

Non-Performing Loans are an acute problem of the banks of Bangladesh and more specifically of banks, located in the urban and corporate periphery, dealt with the industrial and big business loans. Credit Risk occurs when a loan becomes non-performing. A Non-performing loan is a loan that is in default or close to being in default. They are non-performing as the loans cease to "perform" or generate income for the bank. On the other hand, Collateral is an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan. Our analysis is based on the observation of link between the defaulters and mortgaged properties with the bank provided by the defaulters which is called collateral. This is the first ever study to examine if there is a long run effect caused by macroeconomic, bank-specific and collateral based determinants.

Arrangement of the Report

The report has been divided into 15 chapters. The **First chapter** deals with the introductory aspects of the study while the **Second chapter** highlights the overall NPL scenario of the country. Currently practiced loan classification, rescheduling and write-off regime in Bangladesh and its constraints have been discussed in **Chapter-3** while single borrower exposure limit and its constraints are highlighted in **Chapter-4**. **Chapter-5** deals with the core issue of collateral: its definition, valuation policies and effectiveness in realization of NPL. **Chapter-6** shows the econometric analysis on link between NPL and collateral. **Chapter-7** highlights the causes on NPL as explained by the defaulted borrowers at field level while **Chapter-8** discusses the

suggested remedial measures by the defaulted borrowers. **Chapter-9** deals with the evidence of the field survey data that inadequate collateral causes credit risk while **Chapter-10** highlights the comments and suggestions provided by the selected branch managers on inadequate collateral and its effect on NPL. **Chapter-11** presents a thorough analysis on the present legal framework related to recovery of NPL, its limitations and suggestions while specific suggestions for effectiveness of collateral policy is discussed in **Chapter-12**. **Chapter-13** elaborated the major findings and main policy implications of the study with special focus on collateral while limitations of the study and concluding remarks are presented at **Chapter-14** and **Chapter-15** respectively.

The study team has identified a number of common causes for creation of NPL in light of separate explanations of the defaulted borrowers and branch managers in all four regions. Again there have been some region-specific causes as explained by them. Common causes of NPL as explained by the defaulted borrowers and branch managers in all four regions are mentioned below:

Causes of NPL from Banks' side:

- 1. Higher interest rate, various other service charges and also some hidden charges increased the size of installments of borrowers that contributed as the leading factor to loan default.
- 2. Banks failed to keep the commitment of delivery of loans to borrowers on stipulated time. Borrowers invested partially in the business/project before getting bank loan relying on banks' commitment and finally they incurred huge loss due to lack of timely finance (long delay in actual disbursement).
- 3. Banks denied extension of the current loan or granting a new loan when the borrowers were defaulted as a result of loss in business. So borrowers couldn't get out from the difficulties, hardly continued the businesses smoothly as they were unable to repay the loans timely.
- 4. Borrowers claimed that upward adjustment of interest rate, imposition of different charges etc. were not clarified to them. On the other hand, borrowers also didn't give due importance to that part as they stayed busy to get the loan, without understanding the loan conditions properly.
- 5. In many cases, bank managers living for long time in the same area, sanctioned loans without adequate collateral and proper analysis of business but depending only on the personal relationship. In many of these cases, documentation was not properly maintained and that's why these types of loans became defaulted.
- 6. Lack of proper monitoring by bank enticed some clients to divert their fund for other activities.
- 7. Nepotism in loan sanctioning procedure in favor of politically exposed persons (PEPs) made the loan vulnerable at the stage of sanction especially when nepotism shown by top level management. Sometimes managers were in the deep pressure to disburse loan to the PEPs. In that case, a loan had been disbursed without proper or adequate credit assessment or sanction

procedure either in terms of the viability of the project or the proper valuation of collateral which ultimately became defaulted.

- 8. In many cases, bank officials were proven to be ignorant about the assessment of the necessity of loans. They were not fully capable to diversify the risk of loan.
- 9. In some cases, greedy bankers were responsible for creating a vulnerable banking sector to some extent by disbursing loan to risky clients.

Causes of NPL from Clients' side:

- 1. There were some willful defaulters who were actually a habitual defaulter. They took loans from banks with mala-fide intention not to pay back the loans. Very often banks failed to properly identify this class of people.
- 2. Some clients were defaulted due to lack of financial literacy. They were small business owners and don't know anything about pros and cons of banking operations at least to run the accounting transactions. They were not to be defaulted if they had financial literacy in a good state.
- 3. One of the root causes for creation of NPL was fund diversion. In this case, management diversified their business and also diversified the fund. Share market investment from business money was a mentionable type of fund diversion. Besides, fund was diverted for treatment purpose, family affairs, repaying loans taken from various sources, house building, and other businesses etc.
- 4. Borrowers, in many cases, couldn't avail conditions for rescheduling as the installment size was too big or rescheduling period was too small for them to execute.
- 5. In many cases, small businessmen faced loss in businesses due to sales on credit. When they failed to recover the money from the debtors in due time (or totally unrecovered), they failed to run businesses and became defaulted.
- 6. In many cases, banks sanctioned and disbursed working capital but borrowers used it for buying fixed asset. Subsequently, interest on loans increased without starting of businesses. It contributed to the business loan became defaulted.

NPL and Collateral Issue

- 1. When the loan was disbursed without collateral, the borrower had fewer obligations to repay it, rather created moral hazard problem.
- 2. Banks or borrowers couldn't sell the collateral property as buyers were not interested to purchase an asset which was under legal procedure or bank's obligation.
- 3. When collateral property was too big, it was difficult to sell it. Again when the land was very near to river or it had no easy access, it was not possible for bank to sell.
- 4. Bank evaluated the value of its collateral after two consecutive years. Most frequently, asset evaluation agency overvalued collateral properties influenced by the clients.

Unhealthy Competition among the Banks' and NBFIs'

- 1. Loan target oriented banking practice created enormous NPLs due to unscrupulous and aggressive banking by the bankers. Bank managers were over burdened by the targets of disbursing loan set by the banks' authorities. This created unhealthy competition among bankers to fulfill the loan targets set for each individual bank staff. Bankers offered huge money and made the client more valuable than actual without considering their eligibility. Client buying or loan buy-out is a common term in the financial market to represent this artificial nature of competitiveness.
- 2. It was seen that Non-bank financial institutions (NBFIs) frequently chose the borrowers of the banks and allured them to come to their FIs for getting loans. This also created unhealthy competition between the banks and NBFIs.

Government Policy and Legal Issues

- 1. Some clients opined that sudden change in government policy has direct implications in their businesses hampering their continuous business flow in the market and make hindrance to the regular cash flow in general.
- 2. Defaulted clients time and again misused their basic right to get 'stay order' from the court and extension of stay order period that prolonged the process of loan recovery. Unfortunately, there is no option exist to prevent the clients from the frequent extension of the stay order.

Other Issues related to NPL

1. In some cases, within the considered time period of loan use, political unrests or natural disasters or any other unfavorable business climate were evident as the main reasons for the borrowers to be defaulted. This brought stagnancy in business activities and slowed down the business process which compelled clients to become irregular in the case of repayments and threw them at the classification basket.

Therefore, it is found from the explanation of defaulted borrowers and branch managers about different root causes of default that quality of loan management and moral hazard gradually playing an important role in creating and pilling up the amount of NPL in the banking system of the country and has been a cause of concern for loan sanctioned with inadequate collateral. In most cases, the enlisted surveyors willfully and with the intention to fulfill the adverse desire of the clients overvalue the collateral. The other main reason for failing to realize collateral in due time is prolongation of judiciary process which seems in many cases as defaulter friendly system.

Based on the above findings, the study team proposes the following suggestions to deal with current NPL problems:

A. BB may like to raise these issues with the banks in Bankers' Meeting--

1. Bank management may exert their best efforts at improving the bank's loan portfolio management. Higher position in the bank may be made conditional upon highly satisfactory performance of managers in branch level.

- 2. Monitoring and supervision of clients should be strengthened and bank management should set regular scheduled on-site visit to prevent diversion of funds, help customers with needful suggestions those are facing some business management problems such as improper records keeping and overtrading that affect their business operations.
- 3. Domestic trade and service sector which is highly financed by the banks, shows highest exposure of bad loan due to lack of proper financial education of clients. Bank has to consider providing financial education to its clients as a measure to minimize risk of default.
- 4. Bank management should organize regular training programs for credit staffs in areas like credit management, risk management and financial analysis. This would sharpen their knowledge and skills to improve the quality for credit appraisal, prevent delayed loan approvals, enable them to recognize the need to comply with credit policy and further enhance monitoring of credit.
- 5. The loan officer has to give good awareness to clients about collateral value to get sufficient loan from the bank.
- 6. To avoid moral hazard problems in selection of right borrowers, it is recommended that loans granted to customers should be well secured in terms of adequacy of collateral provided and also ensures that proper legal documentation is put in place.
- 7. Bank has to use rehabilitation mechanism as primary measure to minimize NPL because it could support both bank and defaulted clients since it is an action of making loan active once again.
- 8. Banks usually deny extending the existing loan or granting of a new loan when the borrowers were in default as a result of loss in business. If bank would address this situation with a positive turn, borrowers could get out from the difficulties, continue their businesses and repay the loans.
- 9. Many corrupt bank officials adheres into bribery and discourage/mislead the clients not to pay back bank loan. BB may instruct the banks to be aware of this issue and ensure implementation of internal control and compliance system at their banks' head offices and branches with due diligence to keep the bank officials (including board member) free from nepotism and availing of undue facilities.
- 10. Banks may be asked to explore new SME clusters or areas of investment. This diversification of loan portfolio may help not to add-on the new loans on the existing NPLs stock.
- 11. Banks should go to the clients with supply-driven policies and mind-set and advise the borrowers the easiest way to revive the loss incurred from businesses. They may also guide the clients for proper market study and business. They may consider, observe and analyze different government policies on various issues and inform the borrowers about the changes.

- 12. The technological obsolescence is a factor that affects repayment abilities of manufacturing firms. The efficiency of manufacturing entity in raising funds impacts the repayment abilities of the firm. The banks should consider the BMRE financing on an extensive basis.
- 13. BB should devise appropriate policy/circular in respect of loan buy-out to prevent the unhealthy competition among the banks and also among the NBFIs in client buying or loan buy-out.
- 14. BB may issue circular regarding this issue by instructing the banks/NBFIs for communicating the clients if there are any changes in the interest rate and service charges as hiding of these information increases the installments of the borrowers.
- 15. BB may issue guideline/circular for absorption of bank loans by the NBFIs so that this sort of practice does not create an adverse situation in the loan market.
- 16. BB may issue circular to the banks/NBFIs to take appropriate measures to educate the clients through 'Financial Literacy Program for the Clients'.
- 17. BB may instruct the banks to strengthen their loan monitoring system.
- 18. BB may instruct the banks to simplify the loan sanctioning procedure and avoid inordinate delay in sanctioning of loan.
- 19. Considering the fraud-forgery and adverse information, BB may again instruct the banks to exchange borrowers' information among them along with getting CIB report from BB to ensure better selection of the borrowers.
- 20. There should be a policy of embargo for the defaulted clients in case of taking loan from more than one bank.

B. BB should devise appropriate policy/circular in respect of-

- 1. **Uniform Valuation Policy**: BB may devise 'Valuation Policy' and issue circular to follow uniform valuation procedures for determining the market value of eligible collateral so that 'Asset Valuation Agency' cannot overvalue the collateral being influenced by the clients.
- 2. **Getting sufficient visible mortgage**: BB may instruct the banks to get sufficient visible mortgage with proper valuation so that in case of default those can be realized and moral hazard problem can be avoided.
- 3. **Realistic payment schedule**: BB may instruct the banks to ensure fixing with borrowers realistic payment schedules on the basis of real cash flows.
- 4. **Politically exposed persons**: BB may instruct the banks/NBFIs not to extend loan to PEPs, and to inform BB about their whereabouts by maintaining list of the PEPs whose business proved as fake and leads the loan to become NPL.

- 5. Separate Loan Classification & Provisioning policy for the Islamic banks: BB may constitute a 'working committee' to prepare separate Loan Classification & Provisioning policy for the Islamic banks.
- 6. **Reporting of rescheduling**: BB may develop reporting format for rescheduling of loans.
- 7. Written off loans: BB may issue a circular regarding inclusion of a separate note to the accounts containing 'amount of cumulative and current year's loan written off'.
- 8. BB may develop a policy limiting the number of banks from whom a single borrower can take loans.
- 9. BB may issue a guideline/policy for debt collection agents.

C. BB may rethink on -

- 1. Existing loan classification and rescheduling system: BB may think whether the existing loan classification and rescheduling system can be customized on the basis of capacity of the borrowers in line with their business strengths as it is a "one size fits all" policy. The policy should take into consideration other countries' practices. There must be appropriate policy regarding qualitative judgment on classification methodology. However, there should be a new policy to ensure that the reversal of interest suspense account (when the loan gets classified) into interest income account (interest collected/accrued when the loan was unclassified) would be effected after realization of NPLs.
- 2. BB can establish a Collateral information data warehouse at its Head Office.
- 3. **BB may raise the issue of 'stay order' to the ministry/government**: Defaulted clients misuse their basic right to get stay order system and go to the court for frequent extension of stay order period that prolongs the recovery period. There is no option to prevent them from it. A condition may be imposed that the defaulted clients may avail the opportunity of getting 'stay order' but after depositing a certain amount (10-15%) of their outstanding loan to the court.
- 4. **BB may raise the issue of NPL with the FBCCI**: A provision may be made that defaulted clients those are members of the chambers of commerce and industries should not be allowed to participate in the chambers election.

D. Government Policy

1. The cyclicality of the business directly influences the repayment capability of the borrowers. Thus, it has an impact on the amount of non-performing assets of the banks. Therefore, government policies especially linked with businesses should be business-friendly.

2. Government policies regarding price of imported goods affects the market and importers' interest. Excessive imports of a product dismantle the market price of that product which indirectly affects the borrower to repay the bank loan.

E. Legal Infrastructure

- 1. BB may instruct the Law Department of the Bank to work on the amendments of Money Loan Court Act, 2003, N.I. Act 1881 and Bankruptcy Act 1997 and take up these issues with the competent authority for discussion and amendments.
- 2. BB needs to assess the process of current Alternative Dispute Resolution (ADR) practices by the court under the MLC Act 2003 and to decide over issuing formal license to ADR institutions especially to deal with the NPLs of the country.

7. Limitations of the Study

However, the limitations of the study were mentionable; it has not covered all of the defaulted clients who have been granted stay order from court and delayed payments year after year. The scope of the study is limited only in 4 selected areas namely Bogura, Khulna, Chittagong and Dhaka regions. The study did not focus on case studies of the defaulted clients which might improve the acceptability of the study. In addition, different methods of research could be used for study of the same topic or other related aspects of the topic.

8. Concluding Remarks

In the light of the findings of this study, we were encouraged to propose some probable policy suggestions for improving the NPL situation of the country. There are huge literatures which show many cross-country experiences that huge NPL leads to insolvency which ultimately may aggravate case of bank failure. However, in BD case, it is envisaged that the SCBs have been incurred huge amount of NPL since long, but they didn't get any episode of failure because of the timely recapitalization of the banks from the budgetary resources. Alongside, the private banks which have experienced NPL at low level also exerted a small impact on average, but no bank failed due to NPL as yet. Another significant factor that played important role to shield the banking sector from failure is the maintenance of adequate level of provisioning (over 70% of their NPLs).

However in regional context, NPL of Bangladesh is much higher than other SAARC countries such as India, Bhutan, Maldives and Sri Lanka except Pakistan. Comparative analysis of NPL of Bangladesh with SAARC countries gives a signal that Bangladesh should be more prudent in making sophisticated and proactive policies for the reduction of NPL in the banking system. Adoption of sound accounting and reporting practices is a must for ensuring a clean banking system. Consistent implementation and compliance to regulatory and accounting requirements contribute to the stability of the banking sector.

BB may also think over creating a separate watchdog for carrying out the loan supervision activities as some other central banks have been managing their supervision activities through separate agencies. To ensure speedy debt recovery, a separate Debt Recovery Tribunal may be

established alongside the money loan courts. BB should consider introduction of uniform accounting framework for the banks. To resolve the NPL problem of the SCBs, government has to make a credible commitment to a once-off bank recapitalization policy and avoid the moral hazard problem of encouraging new bad loans.

Although a secondary source of loan repayment, collateral plays an important role in lending, it can be used to solve multiple economic problems, but it provides little benefit to banks even in good times, because of the difficulty in valuing and realizing collateral. Regarding realization of collateral, one important issue is the execution of collateral. Every bank should maintain data/information on collateral and publish an online registry of collaterals. BB may also establish a *"Data Warehouse for Collateral"* at CIB and share the information with the banks.

External auditors are expected to ensure compliance with both IFRS and regulatory guidance. External auditors may also be required by regulation to report promptly to BB all instances of material misstatement. BB may formulate a uniform valuation policy for the banks. Evaluators may also be taken under direct supervision of BB. Banks may be advised to reduce loan disbursement based on personal undertakings. Credit officer must be skilled enough to understand the psychological behavior of the borrowers. Inspection departments of BB should monitor whether due processes and principles of good lending are strictly adhered to by banks and other financial institutions.

At last, for better management of NPL, BB may like to send a short team on **exposure visit to Sri Lanka and Maldives** to understand the magnitude and determinants of NPL of these countries. BB may also undertake an **elaborate study to understand the after effect of policies** adopted on important issues.

Report of

Study on Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral

Abstract

The Study on Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral was assigned to conduct by the research department along with officers from other departments of Bangladesh Bank (BB). Accordingly, a study team visited four selected regions namely Dhaka, Chittagong, Khulna and Bogra to get interview directly with the selected 41 banks, 75 branches, and 574 defaulters with a structured questionnaire. Branch managers had also been interviewed with another questionnaire. The report is prepared on the basis of the field responses from both of the defaulted borrowers and concerned branch managers. Direct interview with the defaulters by the regulatory institution like BB is the first ever pioneering attempt to assess the reactions of the defaulters. The report thus reflects the views of the defaulters and branch managers.

High ratio or rising tendency of non-performing loans in banking system leads to decrease in the profitability and capital adequacy ratio of the banks. Considered from the point of economics, increase in Non-performing loans (NPLs) negatively affect economic growth by causing to a decrease in loanable funds. Current study concentrates on empirical analysis of non-performing loans of the commercial banks of Bangladesh and investigates the linkage between NPLs and inadequate collateral. NPLs are an acute problem of the banks of Bangladesh and more specifically of banks, located in the urban and corporate periphery, dealt with the industrial and big business loans. Our analysis is based on the observation of link between the defaulters and mortgaged properties with the bank provided by the defaulters which is called collateral. This is the first ever study to examine if there is a long run effect caused by macroeconomic, bank-specific and collateral based determinants. A further novelty has to deal with the unhealthy banking market competition and question of fragmentation of authority especially in case of public utility oriented SCBs.

Quality of loan management and moral hazard (through the loan to deposits effect) play an important role in creating huge amount of NPL in the banking system of the country and has been exerting a stronger effect in respect of loan sanctioned with inadequate collateral. This leads to creation of high level of NPL which necessitates for adoption of appropriate macro-prudential as well as NPL resolution policies in order to invigorate banks and boost growth especially in the much affected and still suffering banks. In most cases, valuation of collateral is done by the enlisted surveyors. They willfully and with the intention to fulfill the adverse desire of the clients overvalue the collateral. A combined effort from banking community to rate these valuation firms' capabilities and subsequently delisting for the entire market would work for change the ill mindset of the valuators/surveyors. The other main reason for failing to realize collateral in due time is prolongation of judiciary process which seems in many cases as defaulter friendly system. Therefore, legal framework of the insolvency regime must be reviewed and necessary amendments should be in place for smooth recovery of the NPLs.

In the light of the findings of this study, we were encouraged to propose some probable policy suggestions for improving the NPL situation of the country. There are huge literature which shows many crosscountry experiences that huge NPL leads to insolvency which ultimately may aggravate case of bank failure. However, in BD case, it is envisaged that the SCBs have been incurred huge amount of NPL since long, but they didn't get any episode of failure because of the timely recapitalization of the banks from the budgetary resources. Alongside, the private banks which have experienced NPL at low level also exerted a small impact on average, but no bank failed due to NPL as yet. Another significant factor that played important role to shield the banking sector from failure is the maintenance of adequate level of provisioning (over 85% of their NPLs).

Chapter-1: Introduction

The prerequisite for the economic development of a country is smooth and efficient flow of saving-investment process. Bangladesh, being a developing country and with an underdeveloped capital market, mainly depends on the intermediary role of commercial banks for mobilizing internal saving and providing capital to the investor. Thus, it matters greatly how well our financial sector is functioning. Looking at the performance of our financial sector for the last decade or so, we observe that our banking sector is heavily burdened with a high percentage of non-performing loans (NPLs). It is obvious that NPL reduce banks' profitability, as banks cannot appropriate interest income from their classified loans. NPL reduce loanable funds by stopping recycling. Banks need to set aside a portion of their income as loan loss reserve to make up bad debt. A bank with a high percentage of NPL suffers from erosion of the capital if there is no provision (assume). All those adverse impact of NPL on banks' financial health such as low profitability and low capital base are clearly reflected in banking sector of Bangladesh.¹

As per the ECB annual review high shares of 'Non Performing Exposure's or NPEs (i.e. NPLs) constitute a serious macro prudential problem and are likely to have far-reaching macroeconomic consequences. First, a large stock of NPEs indicates that households and non-financial firms are excessively indebted and impaired, which may depress consumption and investment, and thus delay economic recovery. Second, scarce resources in the banking sector, capital, funding, as well as operational capacity, are absorbed by legacy assets and cannot be deployed to support new viable investment projects. This, in turn, may lengthen the period of subdued economic activity, further aggravating the NPE problem for the banking sector and the economy as a whole'.²

The theme of "non-performing loans" (NPLs) has attracted more attention in recent decades. Several studies examined bank failures and find that asset quality is an indicator of insolvency (Demirguc-Kunt, 1989; Barr and Siems, 1994). Banks still have a high level of impaired loans before the bankruptcy. Therefore, the large amount of bad loans in the banking system generally results in a bank failure. The NPLs are the main causes of economic stagnation. Each impaired loan in the financial sector increases the possibility of difficulty and unprofitability to lead company.³

Non-performing loans (NPLs) refer to those loans from which banks no longer receive interest and/or installment payments as scheduled. They are known as non-performing because the loan ceases to "perform" or generate income for the bank. Chowdhury et al. (2002) state that the non-

¹ Deep Majumder (2014): Internship Report on Non-performing Loans in Banking Sector of Bangladesh: Causes and Effect, MBA Program, BRAC University.

² European Central Bank: Financial Stability Review, May 2015.

³ Ahlem Selma Messai and Fathi Jouini (2013): Micro and Macro Determinants of Non-performing Loans International Journal of Economics and Financial Issues, Vol. 3, No. 4, 2013, pp.852-860.

performing loan is not a uniclass but rather a multiclass concept, which means that NPLs can be classified into different varieties usually based on the length of overdue of the said loans. NPLs are viewed as a typical byproduct of financial crisis: they are not the main product of the lending function but rather an accidental occurrence of the lending process, one that has enormous potential to deepen the severity and duration of financial crisis and to complicate macroeconomic management (Woo, 2000). This is because NPLs can bring down investors' confidence in the banking system, piling up unproductive economic resources even though depreciations are taken care of, and impeding the resource allocation process.⁴

Definition of Non-performing Loans (NPLs)

A Non-performing loan is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 90 days, but this can depend on the contract terms. According to IMF, definition of NPLs is "A loan is non-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full" (Wikipedia, definition of NPLs). By bank regulatory definition non-performing loans consist of:

- a. Loans that are past due by 90 days or more and still accruing interest, and
- b. Loans which have been placed on nonaccrual (i.e., loans for which interest is no longer accrued and posted to the income statement).

Loan may also be non-performing if it is used in a different way than that for which it has been taken. As per Section 5 (cc) of Bank Company Act 1991, 'defaulting debtor' means any person or institution served with advance, loan granted in favor of him or an institution involving interest or any portion thereof, or any interest which has been overdue for six months in accordance with the definition of Bangladesh Bank. Non-performing loans are also called non-performing assets (NPA), which are loans, classified by a bank or a financial institute, at the instruction of the regulatory authority, on which repayments or interest payments are not being made on scheduled time. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash inflows. Interest cash inflow is excess money over principal, which is called profit.⁵

⁴ Bishnu Pada Banik and Prahallad Chandra Das (2015): Classified Loans and Recovery Performance: A Comparative Study between SOCBs and PCBs in Bangladesh, Jatiya Kabi Kazi Nazrul Islam University, Trishal, Mymensingh, Bangladesh. THE COST AND MANAGEMENT, Vol-43, No-3, May-June 2015.

⁵ Deep Majumder (2014): Internship Report on Non-performing Loans in Banking Sector of Bangladesh: Causes and Effect, MBA Program, BRAC University.

Banks usually treat assets as non-performing, if they are not serviced in scheduled time. If payments are late for a short time, a loan is classified as past due. Once a payment becomes late (usually 30 days), the loan is classified as non-performing. NPL is a sum either of the borrowed money upon which the debtor has not made his/her scheduled payments, which is in default or close to being in default. If the debtor starts making payments against a non-performing loan, it becomes a performing loan.

Types of Classified Loans

A classified loan is the term used for any loan that a bank examiner has deemed to be in danger of defaulting. The borrower does not necessarily need to miss payments order for a bank to label the account in this manner. A borrower can have what the bank calls a classified loan for different reasons. Bangladesh Bank defines classifying system such as Special Mention Account (SMA), Sub-Standard (SS), Doubtful (DF) and Bad and Loss (BL). This is actually the key risk grading system in order to measure the assets' quality. This grading must be used to check assetquality periodically. Downgrading of any facility should be informed in Early Alert Reporting (EAR) for decision-making authorities. The loans are usually classified by the lending bank, whenever the bank has reasons to believe that the borrower would not be able to repay the loan regardless of whether the loan is overdue or not. Loans extended by a bank are classified into the following three categories:

- a. Substandard: Advances which appear substantial degree of risk to bank by reason of unfavorable record or other unsatisfactory characteristics.
- b. Doubtful: Advances the ultimate realization of which are doubtful and in which a substantial loss is probable.
- c. Bad/Loss: Advances which may not be recoverable at all and entire loss is probable.

Definition of Collateral and Relations between Collateral and NPL

Collateral is one of the most widely-used features of debt contracts. An impressive theoretical literature – dating back at least to Stiglitz and Weiss (1981) – motivates collateral as arising from information gaps between borrowers and lenders. While the theoretical models are well-developed, to our knowledge there is no clear empirical evidence that either confirms or refutes the central implication of these models – that a reduction in asymmetric information should reduce the incidence of collateral. The theoretical models explain the use of collateral as a mechanism to reduce equilibrium credit rationing and other problems that arise due to asymmetric information between borrowers and lenders. Most of this literature invokes two particular frictions. The first is ex ante private information regarding project quality held by borrowers that may result in adverse selection problems. The second is ex post risk shifting,

reduced effort, and other moral hazard problems due to costly monitoring or incomplete contracting. 6

Collateral use may play different roles under different circumstances, as evidenced by research where it can be used as a method to mitigate information asymmetries or as a signal of creditworthiness by the borrower. Akerlof (1970), Coco (2000), Booth and Booth (2006) and Berger and Udell (1995) find that collateral can be imposed by the lender to minimize the repercussions of information disparities between the lender and the borrower. Leeth and Scott (1989), Chan and Kanatas (1985), and Spence (1973), however, depict scenarios where borrowers may attempt to self-impose collateral as a signal of their creditworthiness and to obtain more favorable loan terms. The aforementioned studies have looked at links between lender, borrower, and market characteristics and the use of collateral in loan contracts.⁷

Collateral is an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan. Coco (2000)⁸ looks at many other collateral studies and finds that asymmetric information in proposed firm projects as well as between the lender and borrower contributes to the use of this non-price loan term. He finds that collateral is used more by individuals with insufficient established credit histories and acknowledges that not enough has been researched into the impact that long term relationships between lender and borrower might have on collateral requirements. Booth and Booth (2006)⁹ note that most collateral studies focus on the use of collateral for mitigating adverse selection and moral hazard exposures. They analyze a sample of commercial bank loans provided by the Securities and Exchange Commission and the Loan Pricing Corporation, and find that as default risk increases, so does the collateral requirement.

Literature Review and Gap

There are lots of existing literatures in world regarding non-performing loan and the vulnerability of asset to credit risk. Paravisini (2004)¹⁰ showed that when banks face a positive liquidity shock they relax collateral requirements to new borrowers and expand lending to known borrowers with worse histories of repayment performance. Finally, he showed that although low collateral and bad credit histories are good predictors of default on average, loans made during liquidity expansions are not more likely to default. The results are consistent with the suboptimal

⁶ Allen N. Berger, Marco A. Espinosa-Vega, W. Scott Frame and Nathan H. Miller: Why Do Borrowers Pledge Collateral? New Empirical Evidence on the Role of Asymmetric Information.

⁷ Rebecca González and Teófilo Ozuna (2012): Mitigating Information Asymmetries through Collateral Pledges, International Journal of Business, Humanities and Technology, Vol. 2 No. 7; December 2012

⁸ Coco, G. (2000). On the use of collateral, Journal of Economic Surveys, 14, 191-214.

⁹ Booth, J. R. & Booth, L.C. (2006). Loan collateral decisions and corporate borrowing costs, Journal of Money, Credit and Banking, 38, 67-90.

¹⁰ Paravisini, Daniel (2004), "Constrained Banks and Constrained Borrowers: Does Bank Liquidity Affect Loan Growth, Collateral and Default Risk?" MIT, Department of Economics, October 2004.

lending view of financing constraints. Gheorghe (2012)¹¹ presented financial and real sector interaction highlighting that credit growth based on increase of credit demand, of income, of assets prices, of currency availability, the interest rate differential between countries and relaxation of regulatory framework, leaves banks more vulnerable to subsequent downturn in economic activity and asset prices.

Beck, Jakubik and Piloiu (2013)¹² studied the macroeconomic determinants of non- performing loans (NPLs) across 75 countries during the past decade. According to our dynamic panel estimates, the following variables are found to significantly affect NPL ratios: real GDP growth, share prices, the exchange rate, and the lending interest rate. In the case of exchange rates, the direction of the effect depends on the extent of foreign exchange lending to unhedged borrowers which is particularly high in countries with pegged or managed exchange rates. In the case of share prices, the impact is found to be larger in countries which have a large stock market relative to GDP. These results are robust to alternative econometric specifications.

Haneef and et al (2011)¹³ investigated the impact of risk management on non- performing loan and profitability of banking sector of Pakistan with secondary data. The result of this study reveals that there is no proper mechanism for risk management in banking sector of Pakistan. Study also concluded that non-performing loans are increasing due to lack of risk management which threatens the profitability of banks. This study provides suggestion that banking sector can avoid their nonperforming loans by adopting methods suggested by state bank of Pakistan. Philippos Papadopoulos and Xiayan (Jason) Wang (2016)¹⁴ developed a conceptual framework for risk capital calculation for portfolios of non-performing loans. In general banking practice, loans that pass a threshold of delinquency are declared non-performing and are provisioned. Yet there is a residual risk that the provisioning is not sufficient. This risk must be covered by capital buyers. Their framework builds on tools used in portfolio credit risk modeling and provides a structured approach to address the risk prolle that is specific to non-performing loans. Rahman (2011)¹⁵ found that the banks in Bangladesh have started undertaking a number of quantitative and qualitative measures to understand the risks involved in credit or chance of default which may come from the failure of counterparty or obligor (client) to fulfill his/her commitments as per agreed terms and contractual agreement with the bank. Traditionally, a bank gives emphasis on collateral in funding to the clients whereas in the concept of modern banking a bank keenly

¹¹ Gheorghe, Chitan (2012), "The credit and credit risk management during the crisis" Annals of the "Constantine Brancusi" University of Târgu Jiu, Economy Series, Issue 1/2012.

¹² Beck, Roland, Jakubik, Petr and Piloiu, Anamaria (2013), "Non-Performing loans what matters in addition to the economic cycle?" European Central Bank, Working Paper Series no 1515 / February 2013. ¹³ Haneef and et al (2011), "Impact of Risk Management on Non-Performing Loans and Profitability of Banking Sector of

Pakistan" International Journal of Business and Social Science, Vol. 3 No. 7; April 2012.

¹⁴ Papadopoulos, Philippos, Wang, Xiayan (Jason) (2016), Risk Capital for Non-Performing Loans" OPENRISK WHITE PAPER, February 26, 2016. ,€ †

¹⁵ Rahman, Md. Saidur (2011), "Credit Risk Management Practices in Banks: An Appreciation", Journal of Islamic Economics, Banking and Finance, Vol. 7, No. 3, Jul-Sep 2011

feels to measure the business risk over the security risk for ensuring the timely repayment of invested funds.

Majumder (2014)¹⁶ attempted to find cause and effect behind the NPLs in Bangladesh. He explained that, the first reason is entrepreneur's related and Second reason is business related. Effects of NPL are such as Stopping Money Cycling, Earning Reduction, Capital Erosion, Increase in Loan Pricing, Frustration etc. As a result, the values of security are increased and the risks of financial recession also see a rise. Rabeya Sultana Lata (2015)¹⁷ attempted to find out the time series scenario of NPLs, its growth, provisions and relation with banks profitability by using some ratios and a linear regression model of econometric technique. The empirical results represent that NPL as percentage of total loans of SCBs is very high and they holds more than 50 % of total NPLs of the banking industry from FY2006 to FY2013. Moreover, it is one of the major factors of influencing banks profitability and it has statistically significant negative impact on Net Interest Income of SCBs for the study periods.

Rationale of the Study

It is evident from the literature review that there are very few studies examined the relationship between credit risk and collaterals. Our study aims at analyzing the credit risk resulting from increase in non-performing loans (NPLs) due to insufficient amount of collateral. The research question is that whether the inadequate collateral taken by the banks at the time of loan sanction increases NPLs or other factors affecting the NPLs. This is the first ever attempt to investigate the relationship between collaterals and credit risk in Bangladesh based on the primary survey. It is expected that the study will come up with certain specific policy recommendations to lessen the burden of NPL in the country.

Official Reference of the Study

The 25th meeting of the Banking Supervision Committee held on 29th February, 2016 at Bangladesh Bank chaired by the honorable Deputy Governor-2. The Chairman of the meeting discussed on the topics 'Credit Risk arising in the banks from loans sanctioned against inadequate collateral' and raised the question 'To what extent the loans sanctioned against inadequate collateral affects the non-performing loans (NPLs) of the country?'. In this backdrop, he kindly desired that the Research Department may conduct an in-depth study on this issue and find out effective policy recommendations.¹⁸

¹⁶ Majumder, Deep (2014), Non-performing Loans in Banking Sector of Bangladesh: Causes and Effect", Internship Report, BRAC university.

¹⁷ Lata, Rabeya Sultana (2015), "Non-Performing Loan and Profitability: The Case of State Owned Commercial Banks in Bangladesh", World Review of Business Research, Vol. 5. No. 3. September 2015 Issue. pp. 171 – 182

¹⁸ Reference No.-DBI-1 (Policy)/1001/1/2016-673 dated 31-03-2016.

Objectives of the Study

- a) To review the NPL situation of overall banking system.
- b) To review the collateral taken by the banks against loan.
- c) To review the performance of borrower defaulted due to inadequate collateral to understand the default culture of the country.
- d) To review linkage between inadequate collateral and growth of NPL.
- e) To review the recovery regime of Bangladesh.
- f) To review the existing laws and regulations of insolvency regime of Bangladesh.
- g) To recommend suggestions and future policy directions.

Methodology and Scope of the Study

The study is based on the primary survey which focuses the historical performance of the selected defaulted clients and concerned bank branch managers as per the enclosed questionnaire. Initially, the required data and information had been collected as per the selected variables of same point of time from head office of 56 banks. After selection of bank branches, the study team collected primary data via field survey later from the proclaimed classified clients directly. However, on the basis of the information a detailed TOR including the sample of the survey was prepared. At the second Stage, primary information was collected from four selected regions on the basis of highest NPL record through field survey with formatted questionnaire. Bank branches of different banks had been selected randomly. About 18 bank branches were visited directly in 5 working days in each region and total 75 branches were covered 576 defaulted clients. Data/information was collected through interview in person both of branch manager and clients (Detail of field survey is given at Annexure-I). There were two types of questionnaires; one for the clients and another for the incumbents of the bank branches. After the completion of the field survey and compilation of data in array, this study team applied the crosssectional data analysis due to persistency with the objective of the study exploring about whether the inadequate collaterals affect NPL. The study took the assistance of STATA and E-Views software to investigate the research question.

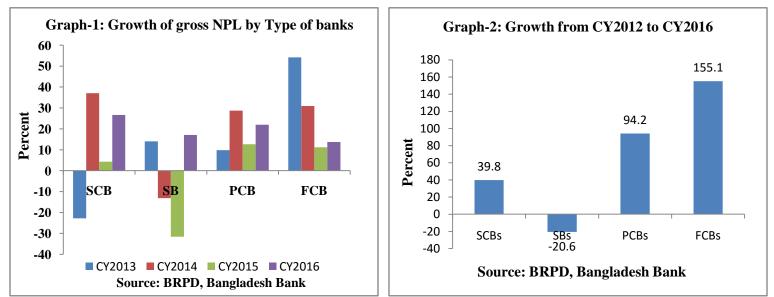
Organization of the Report

The report has been divided into 15 chapters. The **first chapter** deals with the introductory aspects of the study while the **second chapter** highlights the overall NPL scenario of the country. Currently practiced loan classification, rescheduling and write-off regime in Bangladesh and its constraints have been discussed in **chapter-3** while single borrower exposure limit and its constraints are highlighted in **chapter-4**. **Chapter-5** deals with the core issue of collateral: its definition, valuation policies and effectiveness in realization of NPL. **Chapter-6** shows the econometric analysis on link between NPL and collateral. **Chapter-7** highlights the causes on

NPL as explained by the defaulted borrowers at field level while **chapter-8** discusses the suggested remedial measures by the defaulted borrowers. **Chapter-9** deals with the evidence of the field survey data that inadequate collateral causes credit risk while **chapter-10** highlights the comments and suggestions provided by the selected branch managers on inadequate collateral and its effect on NPL. **Chapter-11** presents a thorough analysis on the present legal framework related to recovery NPL, its limitations and suggestions while specific suggestions for effectiveness of collateral policy is discussed in **chapter-12**. **Chapter-13** elaborated the major findings and main policy suggestions of the study with special focus on collateral while limitations of the study and concluding remarks are presented at **chapter-14** and **chapter-15** respectively.

Chapter - 2: Overall NPL Scenario of Bangladesh

The growth rate of total outstanding loan disbursement of the banking sector has shown a plummeted increase of 50.4% during the last five years (during CY2012 to CY2016). It is noted that the data of CY2016 has been taken upto end June. Growth rate has shown a moderate annual increment of 7.8% in CY2016 compared to CY2015. A similar increment has shown in the non-performing loan (NPL) during the last five years. The NPL has also increased by a significant amount of 48.1% during the period. Compared to the outstanding loan disbursement, the NPL has shown a higher growth rate of 23.6% in CY2016. In the banking industry, the ratio of gross non-performing loan to total outstanding has been maintaining a steady average trend of 9.5% during the last five years. The steady trend is also supported by the low standard deviation of 0.6% in the corresponding period. Contrary to the above ratio, the ratio of net non-performing loan to total outstanding (Net NPL ratio¹⁹) maintains a lower trend of 2.8% during the last five years.



Within the banking industry, the foreign commercial banks (FCBs) gained a substantial increment of 155.1% growth of non-performing loan during the last five years. On the other hand, Specialized Banks (SBs) were able to get rid of the NPL, a reduction of 20.7%, during the corresponding years. From the trend analysis, the Private Commercial Banks (PCBs) had a steady increasing trend during the last five years. The NPL of the State Owned Commercial Banks (SCBs) remained with mixed experience; the NPL showed a declining trend for CY2013, however, the NPL had been increasing after CY2014.

Bank-Type-wise NPL:

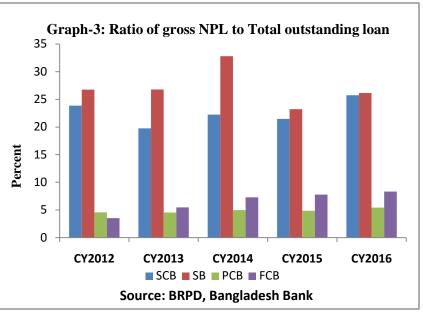
¹⁹ Net NPL ratio = (Gross NPLs - Loan loss Provisions Maintained)/Total Loans Outstanding.

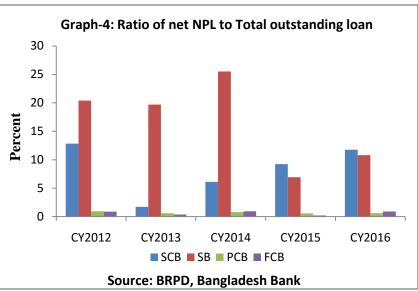
There seems to have a different experience among different types of banks within the banking industry. The SBs had a bad experience for classified loan. The five years average ratio of gross NPLs to total loans was about 27.1% during last five years whereas the larger classified loan of the PCBs gained an impressive experience of containing at lower level of 4.9% during the same period and it was 6.5% for FCBs.

On the contrary, the SCBs had been following an upward trend of dismal experience with SBs. The five years average ratio of gross NPLs to total loans for SCBs was about 22.56% and it was 6.5% for FCBs.

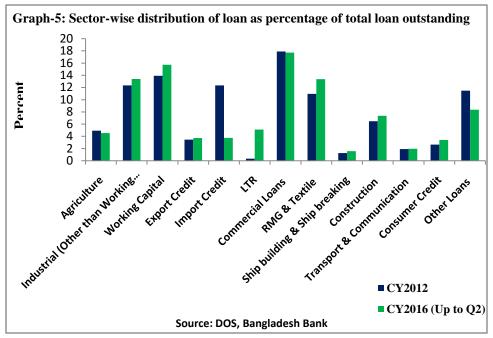
There was a similar trend for the different types of banks if we consider the ratio of net NPLs to total loan. The SBs had the larger average ratio of 16.7%. On the other hand, PCBs and FCBs had the similar but smaller average ratio of 0.7% during the last five

years. The SCBs had an average ratio of 8.3 % for the last five years.

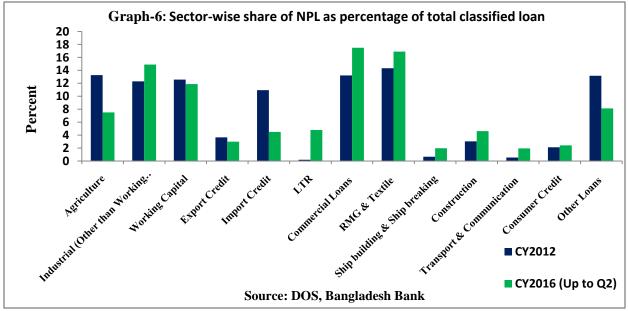




Sector-wise NPL: The sector-wise share of the disbursement loan consists of thirteen sectors with some few sub-sectors. In the five major CY2016. sectors (e.g., commercial loans, working capital, industrial loan, RMG & textile and construction) had availed around 68% of the total loan disbursement. Regarding the sector-wise share of loan, there was large

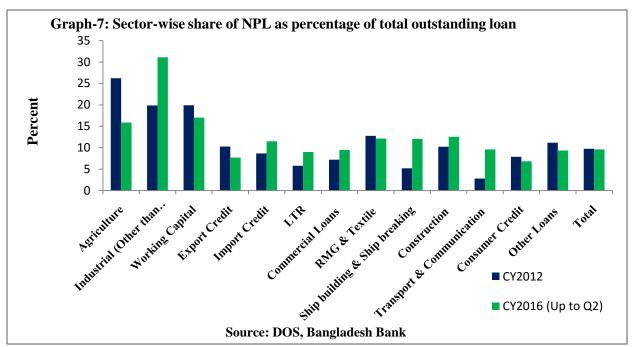


variability in different sectors. Large change in sector-wise share took place in the import credit sector compared to other sectors during the last five years; measured by standard deviation of 3.84. Following a larger variability in import credit sector, a substantial variability also took place in LTR sector which showed 2.92 standard deviation. On the other hand, ship building and ship breaking was maintaining a constant share over last five years with a lower variability (standard deviation of 0.11).



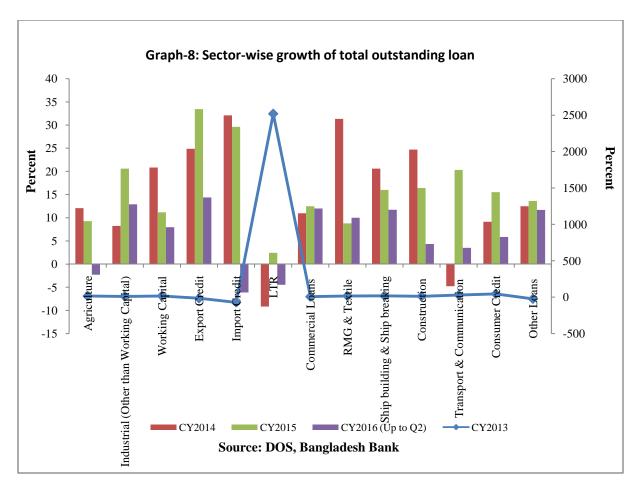
The lion share of the classified loan absorbed by the four major sectors namely commercial loans, RMG & textile, industrial loan and working capital contributed over 60 percent during CY2016. The NPL scenario was relatively better for ship building & ship breaking and transport & communication; share of these two sectors were 1.97% and 1.96% respectively for CY2016.

According to last five years trend, six major sectors like agriculture, import credit, commercial loans, LTR, industrial loan, RMG & textile show a larger variability for classified loans with a standard deviation higher than 1.

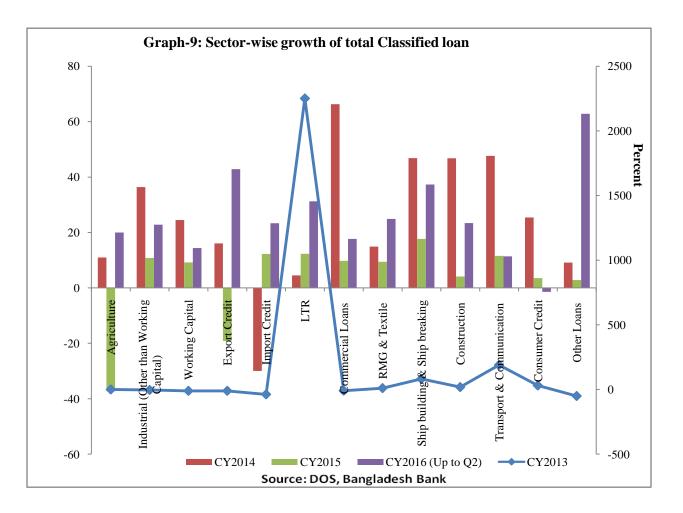


In the banking sector, there is large variability among the sectors. It is evident from the above graph that industrial sector had the largest share of the non-performing loan with 31.1% followed by working capital (17.0%), agriculture (15.9%), construction (12.6%), RMG & textile (12.1%), ship building & ship breaking (12.1%) and import credit (11.5%). On the other hand, a relatively better scenario for classified loan was seen in respect of consumer credit, where only 6.8% loan was transformed as classified in CY2016. Among the thirteen sectors, agriculture, industry and import credit reported larger variability during the last five years. The standard deviations for agriculture, industry and import credit were 5.5, 4.5 and 4.3 respectively.

The sector-wise growth for the total outstanding loan showed that there were some sectors which gained very high growth rate during five years from CY2012 to CY2016. The LTR showed a surprisingly high average growth rate of 2227.6% during CY2012-2016. This was happened due mainly to inappropriate use of the LTR instrument. The growth rate for consumer credit, ship building and ship breaking, RMG and textile, large & medium scale industry recorded at 93.1%, 85.6%, 83.8%, and 79.2% respectively during the last five years. Import credit got a negative growth rate of 54.2%. In line with the import credit, the small and cottage industry showed a relatively slower growth rate of 13.7% during the last five years.

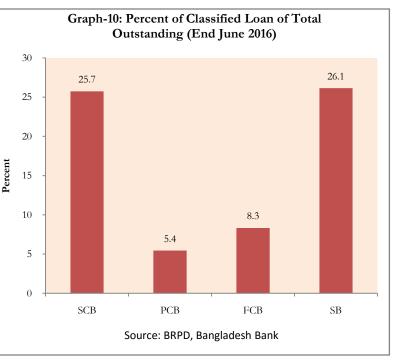


There was a similar feature observed for the classified loans among various sectors on growth rate of NPL. The LTR showed an abnormally high growth rate of 3521.2% during the last five years. Transport and communication sector also registered a higher growth rate of 431.0% followed by ship building and ship breaking (331.9%), housing (202.2%), small and cottage industry (135.5%), and construction (124.3%). Contrary to the positive increment, impressive scenario for reduction in classified loans recorded in the import credit sector (39.1%) and agricultural sector (16.1%) respectively.



Bank-wise scenario of NPL in CY 2016

In the banking industry, the percentage of classified loan to total outstanding stood at 10.1% in June 2016. The percentage was highest for the specialized banks (SBs), 26.1%. On the other hand, the commercial banks private (PCBs) experienced the lowest percentage, which was only 5.4%. The NPL as percentage of outstanding loan of the state owned commercial banks (SCBs) was 25.7% and for the foreign commercial banks (FCBs) 8.3% respectively. Graph-10 shows the percentage of classified loan to total outstanding for the period ended June 2016.

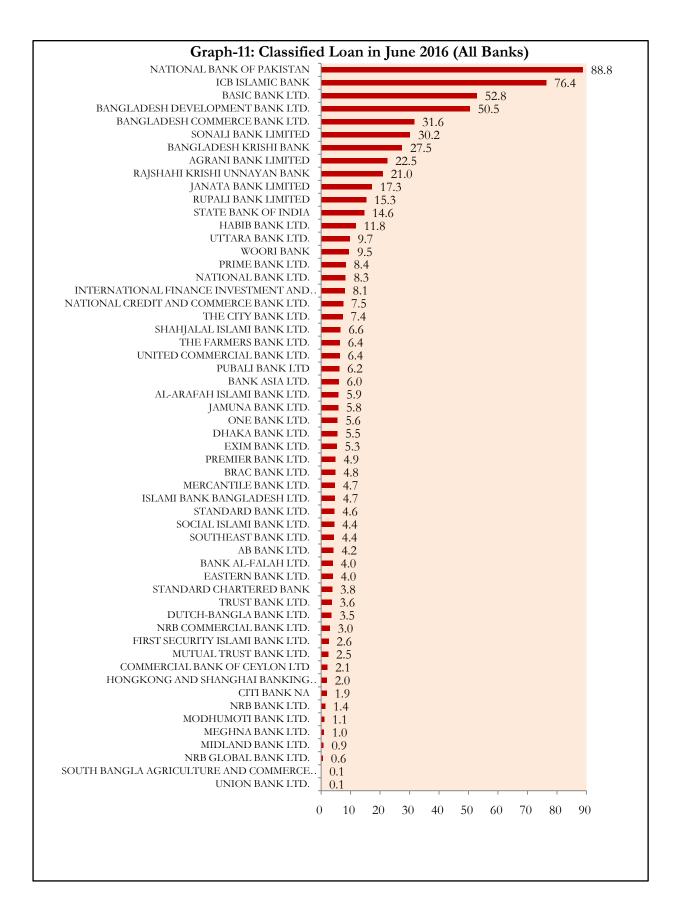


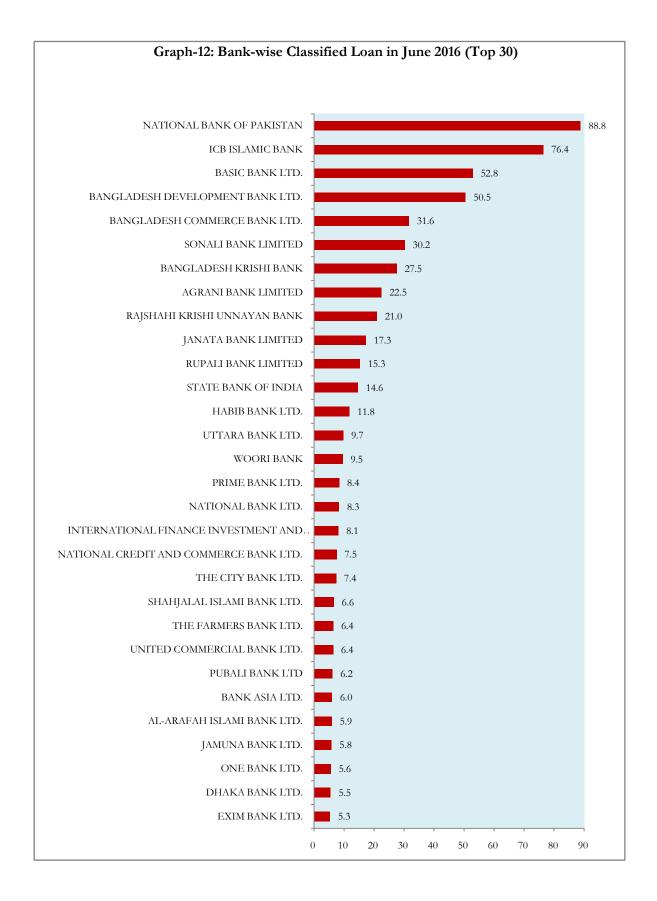
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It is depicted in graph-11 that the percentage of NPL was moderate for all of the FCBs excluding National Bank of Pakistan (NBP) which exhibited the highest percentage of NPL to total outstanding loans during June 2016. NBP's recorded NPL was 88.8% due mainly to long processing time for loan sanction and decision making which was triggered by acute management problems in the bank. State Bank of India and Habib Bank Limited showed 14.6% and 11.8% NPL respectively. On the other hand, City Bank NA showed the lowest percentage of NPL among the FCBs only at 1.93%. Citi Bank NA was very successful in case of loan recovery. There were fewer defaulters in that bank compared to other banks. The reasons behind this lower NPL were due to their techniques applied to select the borrowers like strict adherence to KYC, the proper documentation, quick and independent decision making process, etc. Besides, they follow a proper loan monitoring system both at management and clientele level along with short tenure for the loan. Lack of absence of undue pressure for lending from the top management, and the power delegated to branch managers for outright denial of loan application of the bad borrowers also helped the bank to select the right borrowers. The NPL of the SCBs showed mixed trends in which Basic Bank Limited (52.8%) stood at highest position followed by Bangladesh Development Bank Limited (50.5%); Sonali Bank (30.2%) and all other SCBs experienced more than 15% during June 2016.

As regards the NPL of private commercial banks (PCBs), they had recorded a smallest percentage of NPL among the banking system in June 2016. However, the blink picture of NPL of ICB Islamic Bank Limited aggravated the NPL scenario of the PCBs by recording the highest percentage (76.4%) followed by Bangladesh Commerce Bank Limited (31.6%) during the period. All other PCBs possessed a lower level of NPL; well below 10% and some of them under 5% during the period. The SBs also showed the higher percentage of NPL (26.1%) in June 2016 wherein Bangladesh Krishi Bank recorded 27.5% and Rajshahi Krishi Unnayan Bank 21.0% respectively.

It is delineated from the graph-11 that among the total 57 banks, there were 30 banks with NPL above 5% in June 2016. Within these 30 banks, National Bank of Pakistan occupied the highest position for NPL by 88.8% and EXIM Bank Limited the lowest 5.3% to their total outstanding loans.





Non-performing Loans in the South Asian countries

It is evident from the table-1 that the banking system of Bangladesh is badly impacted by NPL. Likewise, countries of South Asia are also experiencing the same problem of lack of recycling fund due to NPL though it varies across the countries. The position of NPLs in South Asia is given bellow:

the In CY2016, Afghanistan a larger experienced of share nonperforming loans to total loans compared to other countries in The Asia. South percentage of nonperforming loans to total outstanding loans 15.2% was for Afghanistan. On the

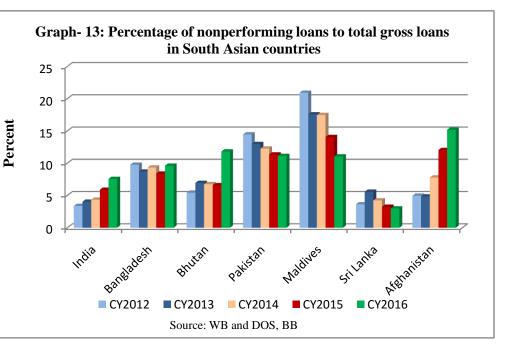
Table-1: Comparative data of non-performing loan of South Asian
countries

Percentage of nonperforming loans to total gross loans					
	CY2012	CY2013	CY2014	CY2015	CY2016
India	3.4	4.0	4.3	5.9	7.6
Bangladesh	9.8	8.7	9.3	8.4	9.6
Bhutan	5.4	7.0	6.8	6.6	11.8
Pakistan	14.5	13.0	12.3	11.4	11.1
Maldives	20.9	17.6	17.5	14.1	11.1
Sri Lanka	3.6	5.6	4.2	3.2	3.0
Afghanistan	5.0	4.9	7.8	12.1	15.2

Source: Data of all countries were collected from World Bank website excepting Bangladesh data. Data for Bangladesh was collected from Dept. of Off-site Supervision, Bangladesh Bank of which CY2016 data corresponds to June 2016.

contrary, Sri Lanka faced the lowest percentage of non-performing loans to total outstanding loans which stood at only 3% during the same period. Regarding the share of non-performing

loans to the total outstanding loans, there was large variability among countries. Pondering five vears standard deviation from CY2012 to CY2016, largest change took place in Afghanistan as well substantial а as variability had been seen in Maldives measured by the standard deviation



of 4.5 and 3.8 respectively. On the other hand, a lowest variability was observed in case of Bangladesh with the standard deviation of 0.6 followed by Sri Lanka (1.0), India (1.7), Pakistan (1.4), and Bhutan (2.5).

It would be good indication to have five years average percent-wise comparison among the countries because standard deviation measures the variability of the percentages only but overlook the level of percentages. In this regard, the economy of Maldives interrupted by 16.2% at five years average ratio of non-performing loans to total outstanding during CY2012 to CY2016 which was the largest percentage of classified loan compared to other South Asian countries. In contrast, Sri Lanka was able to maintain lower level of five years average ratio of NPLs to total outstanding at 3.9% during the same period. The five years average ratio of gross NPLs to total outstanding loans for India was 5.0% which is appreciable. In the case of Bangladesh, the ratio was 9.2%.

Regarding all aspects of the measurements, Sri Lanka was in good position. They maintained both the variability of NPL as well as the level of NPL well below the internationally acceptable limit. The goal of this study is to find out the impact of inadequate collateral on NPL although there are lots of determinants of NPL. It would be good to explore, which determinants are liable for NPL in South Asian countries especially in case of Maldives and Sri Lanka. If any field survey is undertaken in future to understand the magnitude and determinants of NPL in those countries, Bangladesh might be benefited.

Chapter - 3: Loan Classification, Rescheduling and Write-off regime in Bangladesh and its limitations/constraints

Existing Loan Classification and Provisioning of Bangladesh

Money market intermediation mainly depends on the functions of commercial banks. So the well functioning of banks is the most important issue for better loan management of the economy. As loans and advances is the prime asset of a bank, the quality of this asset must be ensured. A proper classification system of loans and advances reflects the asset quality i.e. standard assets/loans and a provisioning system against the classified loans ensures credibility of the financial system that in turn restores trust and confidence of depositors. Loan classification and provisioning system is also essential for regularizing follow-up, monitoring activities and improving the recovery position. As banks can not appropriate interest income from their classified loans, they become Non Performing Assets (NPAs). The actual concept of NPA is that it is an asset which ceases to yield income for the bank and that any income accrued from such asset shall not be treated as income until it is actually realized. Therefore, an asset is to be classified as NPA when there is a threat of loss for the recoverability is in doubt. NPSs/NPLs reduce loan-able funds by stopping recycling. Banks need to set aside a portion of their income as loan loss reserve to make up bad debt. A bank with a high percentage of NPLs suffers from erosion of the capital.

In the context of Bangladesh, well-functioning of the banking sector and ultimately the process of economic development has been seriously constrained by the continuing crisis of the accumulation of classified loans. Here needs supportive and effective regulation to help determination of the financial health and increasing efficiency of the banking sector. At that backdrop, to ensure transparency and quality of the loan portfolios of the banks, determine the actual amount of quality assets and strengthen credit discipline, Bangladesh Bank, in 1989, for the first time adopted prudential norms in Loan Classification and Provisioning covering rules for loan classification, the suspension of interest due, and the making of provisions against potential loan loss under Financial Sector Reform Program (FSRP). The main features of FSRP in the context of banking sector of Bangladesh are: liberalization of interest rate policy, abolition of refinance and introduction of rediscounting scheme, introduction of new system of loan classification and provisioning, capital adequacy requirement, strengthening of Central Bank, improvement in the operation of NCBs (later on changed as Limited Company), computerization of banks, development of human resources, reforms in the legal environment, reforms in foreign exchange regime and development of vibrant capital market.

Due to increasing default risks of loans, the classification and provisioning system has undergone a number of changes from time to time. Comprehensive circulars were issued with major amendments which introduced 'Special Mention Account' to capture early warning signals for accounts showing first signs of weakness and making appropriate provisioning therein. Eventually, to comply with the international best practices and Basel core principle more firmly, previous policies have been revised in 2012 to supervise the banks more intensely. Implementation of the new circular assists in recognizing the actual amount of banks' "expected losses" and "unexpected losses", assuring adequacy in provisioning, calculating and maintaining minimum capital requirement by actual reporting of asset values, certifying appropriately computed income and ensuring skilled and effective credit management, restricting the habitual defaulting by preventing the malpractices in credit management and misuse of rescheduling policy to makeover classified loans.

Loan classification means giving each and every loan case a status like unclassified, SMA, substandard, doubtful and bad or loss through verification of borrowers' repayment performance on a particular date while provisioning means setting aside fund from the profit (profit before provision and taxes) against possible loan loss. This is obviously essential for determining the financial health and efficiency of the banking sector. Loan classification makes two pronged attacks on the activities of banks. First, interests applied on loans are not taken into account because such interests are to be taken into account only on its realization. Second, banks have to make provisions on classified loans as per guidelines by Bangladesh Bank from out of the income earned by them on performing loans.

The existing Master Circular on Loan Classification & Provisioning: BRPD Circular 14 dated September 23, 2012 was issued with a view to complying with the international best practices and Basel core principle. The revised new policy has been issued, kept in mind to revisit the following areas:

- 1. To ensure the actual reporting and asset value
- 2. To align the policy on problem asset management to the international best practices,
- 3. To prevent the reckoning of fabricated profit,
- 4. To be compliant with Basel Core Principle (BCP).
- 5. To bring more transparency in financial and regulatory reporting,
- 6. To avoid overstatement of capital and to ensure capital adequacy of banks in effective manner.

Along with this master circular (BRPD Circular No-14/2012) on Loan Classification & Provisioning, BRPD Circular No-19/2012, BRPD Circular No-05/2013, BRPD Circular No-16/2014 and BRPD Circular No-08/2015 have also been issued to streamline and make effective this issue.

As mentioned in those circulars "Bangladesh Bank has established requirements for general loan loss provisions, in certain percentages, for certain categories of loans that are unclassified or in the Special Mention Account. As the name suggests, general provisions are assigned to take into account the expected losses on pools of loans that are thought to have similar characteristics. The characteristics of each individual loan are not analyzed. Put differently, it is not known or even assumed which loan or loans in the pool are going to result in loan losses; it is simply taken as given that in such large pools, even those currently unclassified, there will undoubtedly be individual loans that in the future will not be repaid. Ideally, the percentages of provision that are applied to each pool are determined based on historical loss experience of similar loan pools. Banks are encouraged to calculate these historical loss experiences on the loan pools for which Bangladesh Bank has indicated general provision percentages, and use these data if they result in higher provisions than are required in this circular. Because general provisions are not formed based on expectations of loss on any individual loan, they are allowed to be included in the calculation of Tier 2 capital, subject to some restrictions. In contrast, specific provisions (established on loans that are classified as Sub-standard, Doubtful or Bad/Loss) are set up on a loan-by-loan basis after careful analysis of each individual loan's probability of repayment. For loans placed into any of these classification categories, weaknesses have been identified that cast doubt on the borrower's ability or intent to make all contractual payments in a timely manner. For this reason, specific provisions are not allowed to be included in the calculation of Tier 2 capital."

The main points of the circular:

- a. It categorizes loans and advances into four types: (a) Continuous Loan (b) Demand Loan (c)
 Fixed Term Loan and (d) Short-term Agricultural & Micro- Credit.
- b. Loans are classified as (a) unclassified (b) Special Mention Account (c) substandard (d) doubtful and (e) bad or loss.
- c. It describes the basis for loan classification: (a) Objective Criteria based on 'Past Due'/'Over Due' period and (b) Qualitative Judgment based on something more that is not covered by Objective Criteria.
- d. It includes application of the interest of Classified Loans.
- e. It sets out rules for maintenance of Provision, Basis for Provision.
- f. It defines Eligible Collateral and the process of determination of its Market Value etc.

For classification and provisioning under the revised procedure banks were instructed to classify the loans as per the following procedure²⁰:

Loans	Duration of overdue	Required Provision (% of outstanding		
		loans)		
Unclassified (UC)	Less than 3 months	1		
Substandard	3 months< 6 months	20		
Doubtful	6 months < 9 months	50		
Bad	9 months or more	100		

	Table-2:	Loan c	lassification	procedure
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²⁰ Bangladesh Bank (2012): BRPD circular no-14, dated September 23, 2012 and BRPD circular no-19, dated December 27, 2012

There is a change in duration of classification for any installment(s) or part installment(s) of a fixed term loan amounting up to Tk. 10.00 lac only:

Table-3: Loan classification procedure (upto Tk. 10.00 lac)

Loans	Duration of overdue	Required Provision (% of outstanding loans)			
Unclassified	Less than 6 months	1			
Substandard	6 months< 9 months	20			
Doubtful	9 months < 1 year	50			
Bad	1 year or more	100			

Current loan classification and provisioning system in Bangladesh shown in a table:

Table-4: Current loan classification and provisioning system

Type of Loan	Period overdue	Status of classification	Rate of provision	
Continuous Loan	a. Less than 02 months	Unclassified	1% (except SME & CF)	
(OD/CC, PC, LIM, LTR etc.). Overdue period will be counted from	b. 02 months or more	SMA	5%	
the day following the date of expiry of such loan.	c. 03 months or more but less than 06 months	Sub-standard	20%	
of such toan.	d. 06 months or more but less than 09 months	Doubtful	50%	
	e. 09 months or more	Bad/Loss	100%	
Demand Loan (Forced LIM, BLC/ PAD, IBP, FBP	a. Less than 02 months	Unclassified	1% (except SME & CF)	
etc.).	b. 02 months or more	SMA	5%	
Overdue period will be counted from the day following the date of expiry	c. 03 months or more but less than 06 months	Sub-standard	20%	
of such loan.	d. 06 months or more but less than 09 months	Doubtful	50%	
	e. 09 months or more	Bad/Loss	100%	
Any installment(s) or part of installment(s) of a Fixed Term	a. Less than 02 months	Unclassified	1% (except SME & CF)	
Loan amounting upto Tk. 10.00 lac	b. 02 months or more	SMA	5%	
Overdue period will be counted from the day following the expiry of the	c. 06 months or more but less than 09 months	Sub-standard	20%	
due date of payment of installment of such loan.	d. 09 months or more but less than 12 months	Doubtful	50%	
	e. 12 months or more	Bad/Loss	100%	
Any installment(s) or part of installment(s) of a Fixed Term	a. Less than 02 months	Unclassified	1% (except SME & CF)	
Loan amounting more than Tk.	b. 02 months or more	SMA	5%	
10.00 lac Overdue period will be counted from	c. 03 months or more but less than 06 months	Sub-standard	20%	
the day following the expiry of the	d. 06 months or more but less	Doubtful	50%	
due date of payment of installment	than 09 months			
of such loan.	e. 09 months or more	Bad/Loss	100%	
Short Term Agri (STAC) & MC/ Housing Finance (HF), Brokerage House (BH), etc. /SME/Consumer Finance (CF)	a. Less than 12 months	Unclassified	2.5% (STAC & MC), 2% (HF, BH, etc.), 0.25% (SME) 5% (CF)	

Overdue period will be counted from			
six (6) months following the expiry	b. After a period of 12 months	Sub-standard	5% (STAC & MC)
of the due date of payment of the	c. After a period of 36 months	Doubtful	5% (STAC & MC)
installment of such loan	d. After a period of 60 months	Bad/Loss	100%

 \checkmark 1% General Provision on the off-balance sheet exposures.

Limitations and suggestions on the existing Loan Classification & Provisioning System:

- 1. The time frame given for classifying a loan seems to be stringent. The earlier classification regime for SS-DF-BL of 6-9-12/18 months has been shrunk to 3-6-9 months in this circular. Given the macroeconomic situation and considering the average business cycle of the economy, the 3-6-9 months bandwidth for SS-DF-BL does not seem to be well matched. Though it is in line with international practices, which is applicable both for developed and LDCs, but it does not seem to be worthy in the context of the country, even of this region. International best practices are to be adoptable in harmony with the local conditions - like macroeconomic situation, availability of logistic supports, political situation, other policies etc. This time frame differs largely with our neighboring countries, especially with India. In India, a loan becomes NPA when interest and/or principal/installment of principal remain overdue for a period of 90 days; it becomes sub-standard when it remains NPA for a period less than or equal to 12 months and doubtful if it remains in the sub-standard category over 12 months. The loan is Loss Asset when loss is identified by the bank's internal or external auditors or the central bank inspection (RBI inspection) but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value along it may have some salvage or recovery value. So the classification time frame is relaxed in India compared to our country.
- 2. The classification time frame for every loan else the short term agriculture and micro credit loan is same as per the circular, i.e., all loans, indifferent to the size and nature of the loans, are classified as SS/DF/BL after being overdue for 3/6/9 months. This 'one size fits all' policy should not be applicable for all types of loans in any country. All loans must not be classified in the same way. Loans should be categorized according to their size, nature, industry, target group, priority sector etc. There should be a customization window for a loan to be classified considering their basic elements. There could be different classification regime for different type of and different sized industries.
- 3. It is not a positive sign for the country to change such sensitive policy (on loan classification and provisioning) again and again without adequate and proper analysis. It gives pain to the users when the policy is changed instantly after they are set with the former one. So there should be an extensive research work and analysis of after effect before issuing circulars on the important banking and financial issues like loan classification and provisioning.
- 4. As per the circular, loans also could be classified based on qualitative judgment. Points made under this criterion are so subjective that banks are found to be evasive to classify their loans on these given qualitative parameters. Bank can make wrong practice with it.

- 5. The section of 'Accounting of the Interest of Classified Loans' has outlined the accounting treatment of different classified category. It is instructed that if any loan or advance is classified as 'Sub-standard' and 'Doubtful', interest accrued on such loan will be credited to Interest Suspense Account, instead of crediting the same to Income Account. But there is a loophole. It does not precisely instruct about the amount which has already been transferred to income account while it was unclassified as it is mentioned in RBI policy of India. Meaning that, some banks reverse their income account to interest suspense while the account gets classified but some do not.
- 6. Banks are required to maintain General Provision @ 0.25% against all unclassified loans of Small and Medium Enterprise (SME) and @ 1% against all other unclassified loans (other than loans under Consumer Financing, Loans to Brokerage House, Merchant Banks, Stock dealers etc., Special Mention Account as well as SME Financing.) Most of the banks are found to take advantage of the privilege of SME financing provisioning. Banks get the opportunity to define a loan as SME as the SME definition is not much clear to all.
- 7. Items mentioned in the circular as 'Eligible Collateral' in determining base for provision are very small in number. There should be an exhaustive list under 'Eligible Collateral'.
- 8. There is no detailed and elaborated 'Valuation Policy' for determining the market value of 'Eligible Collateral'. The existing policy does not cover many important aspects of the valuation policy that are internationally practiced. Bangladesh Bank may take necessary initiative to formulate a collateral valuation policy.
- 9. Loans are named as Investment in Islamic Financing and their mode of operation differs significantly from the conventional banking. There must be a customized Loan Classification & Provisioning policy for Islamic Banking. Tax treatment on Islamic finance differs significantly and this issue may also be taken into consideration.

Recommendations for streamlining loan classification system

- 1. The classification time frame for loan classification should be determined considering the macroeconomic situation of the country and region, acceptability of such kind of policy, analyzing the neighboring countries' policies on this issue.
- 2. All loans must not be classified in the same way. Loans should be categorized according to their size, nature, industry, target group, priority sector etc. There could be different classification regime for different type and different sized industries. There should be extensive empirical research work on it.
- 3. Banks should be instructed to ensure fixing with borrowers realistic payment schedules on the basis of real cash flows while granting loans and advances instead of tightening the classification time frame. This will facilitate prompt repayment by the borrowers and thus improve the record of recovery.
- 4. An elaborate study must be done to understand the after effect of a policy before issuing circulars on the important issues so that it is not to be changed very soon.

- 5. There should be some precise methods for Qualitative Judgment so that banks cannot willfully avoid classification or intentionally classify the loan which is not required to be classified taking opportunity of absence of concrete policy.
- 6. There should be a clear instruction regarding the reversal of interest income account (interest collected/applied when the loan was unclassified) into interest suspense account (when the loan gets classified). This will deter the mentality of banks to be sure about their income certainty and compel them to be more cautious about the proper loan nursing.
- 7. SME should be clearly defined so that banks cannot take advantage of the privilege of SME financing provisioning and apply it to other fields.
- 8. There should be an exhaustive list under 'Eligible Collateral'.
- 9. There should be an elaborated 'Valuation Policy' for determining the market value of 'Eligible Collateral'.
- 10. There must be a customized Loan Classification & Provisioning policy for Islamic Banking. Tax treatments for investments under different modes of financing should be consistent in line with the Sharia'h.

Loan Rescheduling

Loan Rescheduling Policy first came into existence with the issuance of BCD Circular No 18/1995. Back then rescheduling was applicable for the minimum possible period whereas this minimum possible time had no quantitative definition. The circular was amended several times afterwards. In 2003 through BRPD Circular No-01/2003, it was instructed that no rescheduling for habitual loan defaulters, assessment of overall loan repayment capacity of the applicant was required through reviewing financial statements and on-site inspection and rescheduling was applicable for the minimum possible period. Even then, this minimum possible time had no quantitative definition.

After many years of observation BB found that loans are renewed or extended under unfortunate circumstances that are beyond the control of the borrower and do not signify that the borrower's willingness or ability to repay has deteriorated the loan. Bangladesh Bank is concerned that rescheduling (also known as "prolongation" or "ever greening") may sometimes result in an overstatement of capital, when loans that have a low probability of repayment are carried at full value on banks' balance sheets. Eventually in 2012, Bangladesh Bank considering all these factors, issued BRPD Circular No. 15/2012 in order to communicate its policy stance that rescheduling should be done only in limited circumstances and under restrictions.

The existing circular on Loan Rescheduling: BRPD Circular 15 dated September 23, 2012 was issued with a view to stop ever greening by habitual defaulters, to avoid the routine rescheduling and repeat rescheduling of loans. And, for the first time, a circular was issued which provided specific time frame for rescheduling of different types of classified loan.

Limitations and suggestions on the existing Loan Rescheduling System:

- 1. According to the circular, Loan Rescheduling policy only works for classified loans (SS, DF, and BL) and there is a very narrow rescheduling policy (which is termed as restructuring) for unclassified loans. There should be a comprehensive rescheduling policy (they may be named differently) for unclassified, classified and written-off loans.
- 2. The time frames given for rescheduling different types of classified loans seem to be very rigorous. Given the macroeconomic situation and considering the average business cycle of the economy, the time frame instructed for rescheduling is in any way more than tough for a debtor to comply with. Had he been able to repay as per the schedule, he might not even become classified at the first place/time. The average cash flow cycle of a business in the economy does not match with the repayment schedule most of the time.
- 3. The rescheduling time frames given for different class of classified loan does not justify the macro-economical aspect of the country. In other words, all loans, indifferent to the size and nature of the loans, just by considering the classification category, get the equal time for rescheduling. Like the loan classification policy, this 'one size fits all' policy does not meet the international standard. All loans must not be given the same time for rescheduling just by considering their classification criteria. Loans should be categorized according to their size, nature and type of industry.
- 4. The required down payment prescribed in the policy for different type of classified loan seems to be high.
- 5. Banks seem to be mixing their different types of loans (continuous, demand and term) and converting them to one term loan while rescheduling. This has helped them to conceal the source/genre as well as the real condition of the loans once they get rescheduled. The rescheduling policy must not let banks mingle/mix different types of loans into one term loan.
- 6. There is no rule for restructuring a demand or continuous loan under the policy.
- 7. The restructuring time frame for a term loan is not justified.
- 8. Banks are allowed to take back their provision to income account as soon as the loans are rescheduled. This motivates banks to reschedule as much and as frequently as possible without considering the customers real repayment ability. Banks are prone to exploit the rescheduling policy because this directly affects their profitability. The policy must not let banks take back the provision to the income account as soon a loan is rescheduled. The policy may require actual realization of a rescheduled loan as a condition to inverse the provision to income account or give a proportional realization amount as a condition to make a rescheduled loan unclassified and inverse the provision amount.
- 9. There is no Exit policy prescribed in the circular. In the policy, it has been assumed to be allowed only for *going concern enterprises*. It has nothing for *gone concerns*. For example, What if a debtor dies and his relatives want to repay. Or, what if a business becomes

obsolete (like cassette player) for technology or other reasons and the businessman has no other source of income to repay his debt and he plans to close his business for ever. The time frame instructed in the existing rescheduling policy would not let such concerns to repay since he has no probable cash inflow.

- 10. Bangladesh Bank should have a detailed rescheduling reporting requirement to be filled in by banks at least on quarterly basis. This might help BB understand the real rescheduled loan scenario of the banking industry.
- 11. Asset quality indicators must consider the rescheduled amount since it is almost like a legitimate window dressing.
- 12. If a continuous/demand loan is rescheduled and converted to term loan as per the policy, the converted term loans after rescheduling must have a distinct identification symbol in the Classified Loan Statement [i.e. RSDL-2 (continuous) meaning that the term loan is converted from a continuous loan which has been rescheduled for the 2nd time]. Because, in the existing system, one cannot understand the real loan category of a rescheduled term loan.

Recommendations for customizing the existing Loan Rescheduling System

- 1. There should be a comprehensive rescheduling policy (they may be named differently) for unclassified, classified and written-off loans.
- 2. The repayment schedule must match the average cash flow cycle of a business in the economy; otherwise the loan will be defaulted again and again.
- 3. There should be an assessment procedure beside classification criteria for a loan to be rescheduled. There could be reschedule time frame regime for different type and different sized industries.
- 4. The required down payment policy must be reconsidered as it is seemed high to all the borrowers. Besides amount/percentage of down payment should also be set considering the size and type of loans.
- 5. The rescheduling policy must not let banks mingle/mix different types of loans into one term loan as it conceals the initial identity. There should be an identification symbol that reveals its original type.
- 6. There should be a restructuring policy for demand or continuous loans.
- 7. The time frame for restructuring Term loans also should be realistic.
- 8. There should be included an option in the policy so that bank cannot take back their provision to income account as soon as the loans are rescheduled without delaying for observation of their future performance.
- 9. There should be some way out in the policy for Exit by the gone concerns.
- 10. A reporting requirement should be introduced so that banks have to report regularly to BB to get a bank-wise and overall banking sector-wise rescheduling picture.

11. Policy should be introduced so that unusual/growing rescheduling indicates negative signals for asset quality.

Loan Write-off

Writing off loans is an international practice. The write-off policy was introduced in 2003 by Bangladesh Bank. BRPD Circular No-02/2003 states that banks may, at any time, write off loans classified as bad/loss for which 100% provisions have been kept and cases have been filed in the court of law. The policy requires banks to continue all out efforts for realizing written off loans. Cases must be filed in the court of law before writing off any loan for which no legal action has been initiated earlier.

A separate "Debt Collection Unit" should be set up in the bank for recovery of written off loans. A separate ledger must be maintained for written off loans and in the Annual Report/Balance Sheet of banks there must be a separate "notes to the accounts" containing amount of cumulative and current year's loan written off. In spite of writing off the loans the concerned borrower shall be identified as defaulter as usual. Like other loans and advances, the writing off loans and advances shall be reported to the Credit Information Bureau (CIB) of Bangladesh Bank.

Limitations and suggestions on the existing Loan Write-off System:

- 1. The write-off policy helps banks to conceal the real non-performing loan situation because a written-off loan is taken outside a bank's balance sheet. Though a separate ledger must be maintained for written off loans and in the Annual Report/Balance Sheet of banks there must be a separate "notes to the accounts" containing amount of cumulative and current year's loan written off.
- 2. The policy states that in order to accelerate the settlement of law suits filed against the written off loans or to realize the receivable of written off loans any agency outside the bank can be engaged. But, the debt collection agents are most often seen to complain that the banks do not pay them the agreed commission as per the contract. There should be some elaborated policy regarding debt collection agents.

Chapter - 4: Single Borrower Exposure, its limitations/constraints

Single Borrower Exposure Limit

As stated in the publication 'Supervisory framework for measuring and controlling large exposures' of Bank for International Settlement (BIS) – "banks did not always consistently measure, aggregate and control exposures to single counterparties or to groups of connected counterparties across their books and operations. Throughout history there have been instances of banks failing due to concentrated exposures to individual counterparties. Large exposures regulation has been developed as a tool for limiting the maximum loss a bank could face in the event of a sudden counterparty failure to a level that does not endanger the bank's solvency. The need for banks to measure and limit the size of large exposures in relation to their capital has long been recognized by the Basel Committee on Banking Supervision. In particular, in 1991, the Committee reviewed supervisory practices and issued supervisory guidance on large exposures."

The Committee has concluded that "the existing risk-based capital framework is not sufficient to fully mitigate the micro-prudential risk from exposures that are large compared to a bank's capital resources. That framework needs to be supplemented with simple large exposures framework that protects banks from traumatic losses caused by the sudden default of an individual counterparty or group of connected counterparties. To serve as a backstop to risk-based capital requirements, the large exposures framework should be designed so that the maximum possible loss a bank could incur if a single counterparty or group of connected counterparts were to suddenly fail would not endanger the bank's survival as a going concern."

With a view to ensuring improved risk management through restriction on credit concentration, Bangladesh Bank (BB) has also from time to time advised the scheduled banks in Bangladesh to fix limits on their large credit exposures and their exposures to single and group borrowers as a prudential measure. A master circular was issued in April, 2005 to improve the credit risk management by consolidating all the instructions issued so far and incorporating some amendments to the previous circulars. BB has again amended its policy on single borrower exposure limit in order to comply with the recently incorporated Section-26 (Kha) of the Banking Companies Act (BCA), 1991 (amended upto 2013) and further improve bank's credit risk management and issued BRPD circular no. 02 dated January 16, 2014.

Along with the above-mentioned BRPD Circular No-02 dated January 16 2014 on Single Borrower Exposure Limit, BRPD Circular Letter No-14 dated June 09, 2014 and BRPD Circular Letter No-04 dated May 10, 2016 are also effective on this issue. The circular explained all the issues so the banks and financial institutions would use this as a guideline to define the single borrowers and their exposure limits. The circular -

1. incorporates the definition and interpretation of 'Capital', 'Exposure (Funded, Nonfunded exposure, Large Loan), 'Non-conforming Exposure', 'Person', 'group' of borrowers etc. It specifies that "two or more persons shall be deemed to be a group, if one person has the ability, directly or indirectly, to control the other person(s) or to exercise significant influence over the financial and operating decisions of the other person(s), or if both persons are subject to common control or common significant influence."

- 2. limits the total outstanding financing facilities (both funded and non- funded) to a single person and/or counterparty or a group upto 35 percent of the capital at any point of time. The aggregate outstanding principal amount of funded exposures shall not exceed 15 percent of the capital at any point of time. In case of export financing, the outstanding amount of exposure, both funded and non-funded, at any point of time to a single person and/or counterparty or a group shall not exceed 50 percent of the capital. However, the aggregate outstanding principal amount of funded exposures shall not exceed 15 percent of the capital at any point of time.
- 3. specifies large loan as and necessity for consideration:
 - a. any exposure to a single person/counterparty or a group which is equal to or greater than 10 per cent of the capital.
 - b. sanctioning of large loans amounting to 40 to 56 percent of total loans and advances against their respective net classified loans;
 - c. inclusion of non-funded credit facilities in determining total credit facilities.
- 4. award exemption of 15% ceiling for some cases including public limited companies bearing 50 percent or more public shareholdings, government borrowing and power supplier companies, guarantees of government and AAA rated Multilateral Development Banks (MDBs), loans backed by cash guarantees, interbank money market transactions with a contractual maturity of less than one year. Whatever the 'Exceptions', the ceiling will not exceed 25% of the bank's capital by any means.
- 5. lists prudential norms that the bank has to follow, including:
 - a. collecting loan information on borrowers from BB's Credit Information Bureau (CIB) before sanctioning, renewing or rescheduling loans in order to ensure that credit facilities are not being provided to defaulters;
 - b. assessing credit risk by adopting Credit Risk Grading (CRG) before sanctioning or renewing large loans. If the rating of a CRG turns out to be "Marginal", banks shall not sanction the large loan, but it can consider renewal of an existing large loan taking into account other favourable conditions and factors. However, if the rating of a CRG is "Special Mention Account (SMA)", neither sanction nor renewal of large loans can be considered;
 - c. Judging a borrower's overall debt repayment capacity while sanctioning or renewing a loan by taking into consideration their liabilities with other banks and financial institutions;
 - d. Examining a borrower's cash flow statement, audited balance sheet, income statement and other financial statements to make sure that they have the ability to repay the loan;

- e. Seeking the approval of the Board of Directors while sanctioning, renewing or rescheduling large loans in case of local banks. Such decisions will be taken by the chief executive in case of foreign banks. However, while approving proposals of large loans, among other things, compliance with this circular must be ensured.
- f. when two or more banks collectively provide credit to a borrower under a common loan facility, for example a syndicated loan, the loan limits, as mentioned for the single and group borrowers, apply only to the funds provided by each bank and represent that bank's pro rata share of the total loan;
- 6. stresses with some conditions that if the bank has already exceeded the specified loan amount, it will have to reported to BB and take steps to bring down the loan amount;
- taking proper Risk Management actions following Credit Risk Management Guidelines, Risk Management Guidelines for Banks and all other related policies issued by BB;
- 8. Specifies the period of submission of quarterly large loan statements.

Limitations and suggestions on the existing Single Borrower Exposure Limit

Limitations

- 1. According to the circular, the exposure limit, both funded and non- funded, to a single person and/or counterparty or a group shall not exceed 35 percent of the capital (capital held by banks as per clause (1) of section-13 of the Banking Company Act, 1991 [amended upto 2013]) at any point of time and the aggregate outstanding principal amount of funded exposures shall not exceed 15 percent of the capital at any point of time. The ceiling is exempted for some cases including public limited companies bearing 50 percent or more public shareholdings, government borrowing and power supplier companies, guarantees of government and AAA rated Multilateral Development Banks (MDBs), loans backed by cash guarantees etc. Misinterpreting the 'Exceptions' a large portion of financing from banks went to the power sector maintaining no limit though it is mentioned at the clause (1) of section 26(b) of BCA that the ceiling will not exceed 25% of the bank's capital by any means. Consequently, the circular was also clarified again through a circular letter by BB. Even then sectoral and geographical limit is ignored in the circular. Due to lack of sectoral and geographical limit credits are concentrated to limited sectors and regions. Again, some sectors don't get required fund.
- 2. At present, there are 56 banks for financing the borrowers, groups and sectors. So 'exemption' from the regular direction is unnecessary. At this, one bank is not over burdened with more credit risk and other banks also can finance a good borrower.
- 3. The circular does not restrict a bank for not allowing large loan or single borrower exposure limit if the Single Person/Counterparty or Group has already availed it from another bank. There is no aggregate loan limit for a Single Person/Group that it can avail from multiple banks. It means the same Single Person/Counterparty or Group can avail large loan or single borrower exposure limit from different banks at the same time.

- 4. The definition of group, to some extent, is subjective and there is an opportunity for the banks for misinterpreting it.
- 5. The Foreign banks don't follow Credit Risk Grading (CRG) system at the plea of their better and stringent own policies. But it is not justified from the supervisor's side how strong their policies are.

Suggestions

- 1. Sectoral and geographical exposure limit may be set along with Single Person/Counterparty or Group exposure limit to avoid concentration risk in limited sectors and regions so that all the important sectors get finance and regions are evenly developed.
- 2. 'Exemptions' as given to some cases may be avoided so that one bank is not over burdened with more credit risk and other banks also can finance a good borrower.
- 3. There should be a restriction on from how many banks a Single Person/Counterparty or Group can avail large loan or single borrower exposure limit.
- 4. The definition of 'Group' especially 'economic independence' might be more specific, unambiguous and easy. There should be objectivity. It should be clearly mentioned that whose (the specific relations) loans should be included in the group and their share holding percentage.
- 5. Foreign banks' strong policies (compared to CRG) should be justified by the central bank as they don't follow CRG system.

Chapter - 5: Collateral: its definition, Valuation policies and effectiveness in realization of NPL

Definition of Collateral and Relations between Collateral and NPL

Collateral²¹ is one of the most widely-used features of debt contracts. An impressive theoretical literature – dating back at least to Stiglitz and Weiss (1981) – motivates collateral as arising from information gaps between borrowers and lenders. While the theoretical models are well-developed, to our knowledge there is no clear empirical evidence that either confirms or refutes the central implication of these models – that a reduction in asymmetric information should reduce the incidence of collateral. The theoretical models explain the use of collateral as a mechanism to reduce equilibrium credit rationing and other problems that arise due to asymmetric information between borrowers and lenders. Most of this literature invokes two particular frictions. The first is ex ante private information regarding project quality held by borrowers that may result in adverse selection problems. The second is ex post risk shifting, reduced effort, and other moral hazard problems due to costly monitoring or incomplete contracting.²²

Collateral use may play different roles under different circumstances, as evidenced by research where it can be used as a method to mitigate information asymmetries or as a signal of creditworthiness by the borrower. Akerlof (1970), Coco (2000), Booth and Booth (2006) and Berger and Udell (1995) find that collateral can be imposed by the lender to minimize the repercussions of information disparities between the lender and the borrower. Leeth and Scott (1989), Chan and Kanatas (1985), and Spence (1973), however, depict scenarios where borrowers may attempt to self-impose collateral as a signal of their creditworthiness and to obtain more favorable loan terms. The aforementioned studies have looked at links between lender, borrower, and market characteristics and the use of collateral in loan contracts.²³

Collateral is an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan. Coco (2000)²⁴ looks at many other collateral studies and finds that asymmetric information in proposed firm projects as well as between the lender and borrower contributes to the use of this non-price loan term. He finds that collateral is used more by individuals with insufficient established credit histories and acknowledges that not enough has been researched into the impact that long term relationships between lender and borrower might have on collateral

²¹ A Collateral is an asset/property [be it movable or immovable] pledged by a borrower to secure a loan or other credit.

²² Allen N. Berger, Marco A. Espinosa-Vega, W. Scott Frame and Nathan H. Miller: Why Do Borrowers Pledge Collateral? New Empirical Evidence on the Role of Asymmetric Information.

²³ Rebecca González and Teófilo Ozuna (2012): Mitigating Information Asymmetries through Collateral Pledges, International Journal of Business, Humanities and Technology, Vol. 2 No. 7; December 2012

²⁴ Coco, G. (2000). On the use of collateral, Journal of Economic Surveys, 14, 191-214.

requirements. Booth and Booth (2006)²⁵ note that most collateral studies focus on the use of collateral for mitigating adverse selection and moral hazard exposures. They analyze a sample of commercial bank loans provided by the Securities and Exchange Commission and the Loan Pricing Corporation, and find that as default risk increases, so does the collateral requirement.

The Functions of Collateral²⁶

From the lender's point of view, lender has the right to demand collateral: basically, collateral serves the lenders' following interests:

- a. Protection against risk--collateral must limit a lender's losses by giving the lender a protection against the partial or total loss of resources (in addition to the intrinsic capacity of the financed activity to generate a surplus).
- b. Screening--collateral is also a screening device (next to a number of other screening devices built into a loan contract, for example the interest rate).

The pledge in a collateral arrangement means that the borrower could lose part of his property if he does not pay back; the borrower has an interest in paying back. The hesitation of a borrower to provide collateral could signal to the bank that the borrower is fully aware of the implications of making this pledge, and if he does provide collateral, then he is likely to do everything to avoid the loss of the pledged asset.

In addition to these primary functions, collateral also serves to put the lender into a privileged position vis-à-vis other creditors, should the borrower become insolvent; to obtain this effect, the lender must effectively acquire information on prior claims to the same asset. Another, less frequently observed motive for taking collateral is to reduce transaction costs; this is the case with high-quality collateral, for example financial papers held by the bank, the value of which is stable for the duration of the loan and easier to establish than the inherent creditworthiness. By taking collateral, the bank can save the transaction costs of having to review a loan application.

Collateral as defined by Bangladesh Bank

As per the Master Circular on Loan Classification and Provisioning (BRPD Circular No. 14 date: September 23, 2012) issued by the Banking Regulation & Policy Department of Bangladesh Bank, the eligible collateral²⁷ has been defined as under:

In the definition of 'Eligible Collateral' the following collateral will be included as eligible collateral in determining base for provision:

²⁵ Booth, J. R. & Booth, L.C. (2006). Loan collateral decisions and corporate borrowing costs, Journal of Money, Credit and Banking, 38, 67-90.

²⁶ B. Balkenhol and H. Schütte: Collateral, Collateral Law and Collateral Substitutes (2nd Edition) Working paper No. 26, Employment Sector, Social Finance Programme International Labour Office Geneva ²⁷ Bangladesh Bank (2012): Master Circular on Loan Classification and Provisioning, issued by Banking Regulation & Policy

Department, BRPD Circular No. 14 date: September 23, 2012

- a. 100% of deposit under lien against the loan.
- b. 100% of the value of government bond/savings certificate under lien.
- c. 100% of the value of guarantee given by Government or Bangladesh Bank.
- d. 100% of the market value of gold or gold ornaments pledged with the bank.
- e. 50% of the market value of easily marketable commodities kept under control of the bank.
- f. Maximum 50% of the market value of land and building mortgaged with the bank.
- g. 50% of the average market value for last 06 months or 50% of the face value, whichever is less, of the shares traded in stock exchange.

Determination of Market Value of Eligible Collateral

In determining market value of easily marketable commodities, land and building, banks are advised to follow the instructions mentioned below:

- a. Easily marketable goods will mean pledged, easily encashable/saleable goods that remain under full control of the bank. However, while the concerned bank branch official will conduct periodic inspection to verify as to whether requirements have been met such as the suitability of goods for use, expiry period, appropriateness of documentary evidences, and up to date insurance cover, the same will have to be assessed by the professional assessor from time to time.
- b. For land and building, banks will have to ensure whether title documents are in order and concerned land and building will have to be valued by the professional valuation firm along with completion of proper documentation in favour of the bank. In the absence of a professional valuation firm, a certificate in favour of such valuation will have to be collected from a specialized engineer. Nevertheless, temporary houses including tin-shed structure shall not be shown as building.
- c. In order to facilitate the on-site inspection by Bangladesh Bank's Department of Banking Inspection, banks are also advised to maintain a complete statement of eligible collateral on a separate sheet in the concerned loan file. Information such as a description of eligible collateral, their assessment by a recognized firm, marketability of the commodity, control of the bank, and reasons for considering eligible collateral etc. will have to be included in that sheet.

In terms of the above policies, the banks will conduct their classification- activities on quarterly basis. These activities must include periodic revaluations of collateral, no less frequently than one year for movables and no less frequently than three years for immovables. The classification of each individual loan must be justified in writing and the documentation must contain the signatures of both the persons assigning the classification and the person reviewing it. These written justifications must be maintained in the loan files and be available for viewing by the Bangladesh Bank inspection teams.

Bangladesh Bank Guidelines on Credit Risk Management (CRM) for Banks²⁸

In Chapter 04 of the above guideline (BRPD Circular No. 4 of 08 March, 2016) it is stipulated under the head 'Credit Risk Mitigation' that 'Banks may use different strategies such as collateral and guarantees etc. to mitigate credit risks. Credit Risk Mitigation strategies can be of agreements made between the bank and the borrower, or between the bank and a third party, which lower the credit risk to the bank. The existence of credit risk mitigation is no substitute for proper loan underwriting and loan administration. They are correctly viewed only as secondary sources of loan repayment, never primary sources. Given the often lengthy, arduous, and costly process of realizing the collateral or invoking the guarantee, banks are strongly cautioned against making their loans collateral- or guarantee-dependent. A loan is considered collateral-dependent when repayment is expected to be provided solely by the seizure and sale of the collateral, the continued operation of the collateral, or, sometimes, both together'.

Collateral is defined at Clause No. 4.2 of the guideline as follows:

For proper credit risk management, banks must keep track of which loans are collateralized by which types of collateral. "Concentrations of collateral" are nearly as dangerous as concentrations by type of loan or industry. The following scheme for categorizing loans by collateral type is recommended:

- 1. Commodities/export documents: a) Export documents; b) Commodities: i) Export commodities, ii) Import commodities, iii) Other commodities pledged or hypothecated.
- 2. Shares and securities.
- 3. Machinery/fixed assets (excluding land, building/flat).
- 4. Real estate: a) Residential Real estate, b) Commercial Real estate.
- 5. Financial obligations.
- 6. Guarantee of individuals (personal guarantee).
- 7. Guarantee of institutions (corporate guarantee): a) Guarantee of bank or NBFI; b) Other corporate guarantee.
- 8. Miscellaneous: a) Hypothecation of crops; b) Other.
- 9. Unsecured loans.

i) Type and Amount of Collateral Required

It is imperative that the bank, when extending credit, demand the type and amount of collateral as stated in its credit risk management policy. The loan-to-value ratio must be low enough to

²⁸ Bangladesh Bank (2016): Guidelines on Credit Risk Management (CRM) for Banks, BRPD Circular No. 4 of 08 March, 2016, Chapter 04 of the above guideline).

absorb declines in the value of the collateral that may occur with a small, though not insignificant probability.

The most valuable collateral is cash and easily en-cashable financial collateral stipulated in Risk Based Capital Adequacy Guidelines (in line with Basel III). Other collateral in order of its quality and marketability would be marketable securities, real estate and a personal guarantee. The order of collateral mentioned is the same as the operating cycle of the company. The farther away from cash, the more tenuous the value becomes. Real estate, taken as collateral, is less liquid and marketable in the short run but is controllable and dependable in value.

ii) Initial and Ongoing Valuation of Collateral

Collateral is only as good as the lender's ability to locate, identify, and legally claim the collateral and eventually sell the collateral for enough to recover the principal, interest, plus all liquidation costs. When collateral is taken as security, consideration must be given to the dependability of the value, its marketability, the liquidity and the ability of the bank to control the collateral when in the possession of the debtor and when the bank must liquidate.

Cash flow is the primary source of repayment and the collateral taken should be valued on a liquidation basis. The bank is unlikely to be more successful with the collateral than the borrower has been. Determining value of collateral at the time of the inception of the loan is essential. Continuous updated valuations are needed, depending on the length of the loan, particularly if the loan becomes a problem loan. The techniques of valuing include the cost, or replacement value, market, income as a going concern or liquidation, and the liquidation value. It is essential that the bank uses outside appraisers or companies familiar with auctions and liquidation experience. If a borrower gets into trouble, the good collateral will be the first to be used by the borrower to satisfy other debtors or suppliers. The bank should consider the costs to liquidate, which includes foreclosure, holding the collateral for sale, and the costs of selling.

To reiterate, banks need to reassess the value of collateral on a periodic basis. Appropriate inspection should be conducted to verify the existence and valuation of the collateral. The frequency of such valuation is very subjective and depends upon the nature of the collateral. For instance, credits granted against shares need revaluation on almost a daily basis, whereas if there is mortgage of a residential property the revaluation may not be needed as frequently.

Third-party Guarantee and Credit Risk

The bank must understand that the credit risk on a loan is not eliminated by the existence of a third-party guarantee. The bank merely substitutes the credit risk of the guarantor for that of its own client. With regard to guarantees, banks should evaluate the level of coverage being

provided in relation to the credit-quality and legal capacity of the guarantor. Additional creditenhancing steps are the following:

- a. The corporate guarantee must be supported by a Memorandum of Association (MoA) and Articles of Association (AoA) of the company giving the corporate guarantee. Additionally, the corporate guarantee to be approved in the board meeting of the corporate guarantor.
- b. The guarantor company must be rated in any of the investment grade categories by at least one ECAI.
- c. The balance sheet of the third party giving a corporate guarantee is to be analyzed. Net worth, total assets, profitability, existing credit lines, and security arrangements of the company giving the corporate guarantee to be analyzed to ensure that the company is not exposed to financial obligation beyond its capability.
- d. Once the financial stability of the corporate guarantor has deteriorated in terms of the above, the bank shall ask for remedial measures from the borrower (replacement/new collateral).
- e. Reciprocal guarantee arrangements between two banks will be disregarded. For example, if Bank A guarantees loans made by Bank B to certain client(s), and Bank B guarantees loans made by Bank A to certain client(s), only the difference between the two guaranteed amounts will be considered as a credit enhancement for the purposes of determining the overall level of credit risk at the bank whose borrowers benefited from the higher amount.

Chapter-6: Link between NPL and Collateral

Model Specification:

The significance of the non-performing loan (NPL) to the overall stability of the banking industry has been obtaining much interest among the financial experts in recent years. In this regard, using the bank-wise data collected from all scheduled banks' head offices and secondary data collected from the Department of Off-site Supervision of Bangladesh Bank, the study team set the following model with a view to understand the linkage between NPL and outstanding loan against inadequate collateral. To estimate the model, the study team has used the E-Views software package. The model is set as under.

 $LNPL_{i} = \beta_{0} + \beta_{1} LOIC_{i} + \beta_{2} LOLC_{i} + \beta_{3} WLR_{i} + \beta_{4} ME_{i} + \beta_{5} LIE_{i} + \mu_{i}$ Where, LNPL = Log of non-performing loan LOIC = Log of outstanding loan against inadequate collateral LOLC = Log of outstanding loan against letter of credit WLR = Weighted average lending rate ME = Management efficiency LIE = Log of interest expenses μ = Stochastic error term

In this model specification, it is expected that LOIC, LOLC, WLR and LIE are positively associated with the LNPL and ME is negatively associated with the LNPL.

The estimated equation is given below.

 $LNPL = 4.66 + 0.45 \ LOIC + 0.19 \ LOLC - 0.62 \ WLR - 0.01 \ ME + 0.55 \ LIE \\ p-value: (0.0145) \ (0.0961) \ (0.3692) \ (0.0000) \ (0.3237) \ (0.1875) \\ R-squared = 0.61 \\ Adj. \ R-squared = 0.57 \\ DW \ stat = 1.98 \\ Prob \ (F-statistic) = 0.0000 \\ \end{array}$

From above mentioned coefficient explanation of the estimated equation, it is observed that if the outstanding loan against inadequate collateral (LOIC) increases by the amount of 1 percent then non-performing loan (NPL) on an average increases by 0.45 percent. It is clear that this coefficient is statistically significant at 10 percent level. In the case of the outstanding loan against letter of credit (LOLC), non-performing loan on an average increases by 0.19 percent

when LOLC increases by the amount of 1 percent. It is also clear that the coefficient of the outstanding loan against letter of credit (LOLC) is statistically insignificant at 10 percent level.

Whereas the weighted average lending rate (WLR) increases by 1 unit then non-performing loan on an average decreases by 62 (0.62*100) percent and WLR statistically significant at 1 percent level. The estimated equation showed negative relationship between WLR and NPL which was expected positive relationship before estimating the equation. This is happened due to various reasons. The study team has used the cross sectional data for one year (end December, 2015) that may affect the result. The observed relationship from our field survey experiences, higher lending rate might cause to increase NPL. Borrowers are not very cautious about the interest rates. When they observe the increasing trend of installments, they become worried about their repayment. In this case, interest burden compels them to become defaulter.

Another explanation can be given to support the observed result of WLR. When huge liquidity exists in the market though the size of the economy remains same but the number of banks becomes large, banks try to lend more with low interest rate to maintain the level of expected profit. In this case, banks overlook the credit risks and go for aggressive lending to fulfill loan target that causes NPL. However, it is observed from this estimation that the relationship between WLR and NPL is negative.

Management efficiency (ME) is a variable included in this equation to explore how does ME affects NPL. In this regard, the Management efficiency (ME) increases by 1 Unit then nonperforming loan (NPL) on an average decreases by 1 (0.01*100) percent with statistically insignificant at 10 percent level of significance. R-squared is 0.61 in this model, which indicates that the non-performing loan is explained by 61 percent (approx.) from the chosen variables. In the stated model, the probability of F-statistic is 0.000, which shows the appropriateness of the overall significance of this equation as well as the chosen variables. In the diagnostic test, heteroskedasticity test is more important for cross-sectional data analysis. Breusch-Pagan-Godfrey heteroskedasticity test shows p-value of Obs*R-squared is 0.0903, which does not reject the null hypothesis (there is no heteroskedasticity) at the 5 percent level of significance. Thus, there is no heteroskedasticity problem in the independent variables.

In conclusion, the summary of the analysis is that the model justifies the outstanding loan against inadequate collateral is significant to raise the NPL. However, the result of the model would be more robust, if panel data is used to estimate the model.

Chapter-7: Causes of NPL as explained by the Defaulted Borrowers at Field Level (Region-wise)

Causes of NPL as explained by the Defaulted Borrowers in Khulna Region

Study team started the field survey from Khulna region. The field survey was enthusiastic for us because of the extensive and cordial participation of the defaulted clients at each bank. This type of face to face interview from the regulator's side was the first ever attempt in the country. The most interesting fact unveiled that defaulted clients got inspiration to repay the defaulted loans from the interaction with the study team. The field survey experiences achieved from Khulna region are given below:

- 1. Most of the defaulted borrowers argued that the causes behind the NPL were loss in their business due to political unrest in 2013 and 2014.
- 2. Natural calamity is an important cause for the agricultural loans to be NPL.
- 3. Lack of fulfillment of bank commitment was another factor of NPL because sometimes bank did not provide the entire committed amount to the borrowers within the stipulated time, especially in case of working capital.
- 4. Family mishaps like death of borrower, sickness of borrower, lack of efficient heirs from the family members etc. were also causes for creation of NPL.
- 5. Most of the borrowers were allured to enter the shrimp business without having proper knowledge about it and thus became defaulters.
- 6. The booming situation of share market in 2010 attracted the borrowers to invest their bank loans to the share market that had caused heavy bearing while share market collapsed.
- 7. Shrimp business collapsed because of unanticipated virus attack. Again, dishonesty of the businessmen also caused loosing of shrimp market abroad. Lack of professionalism is another cause of failure of the business. That's why shrimp business failed and NPL increased.
- 8. Bank made payment against export bills creating loan but importer didn't receive any goods against those bills. That's why the borrowers became defaulters.
- 9. Unhealthy competition among banks was one of the negative experiences gathered from this region. Target oriented banking drive created NPLs. 57 banks and 31 financial institutions working in the small economy. Bank managers were over burdened by the loan targets fixed by their higher authorities. Promotion and development of their careers depended on fulfillment of the targets. That's why market became more unhealthy and competitive, bankers offered huge money, and made the client overburdened with huge amount of loan. Client buying or loan buy-out is a common term in the financial market. All those things aggravated NPL situation in Khulna region.
- 10. It was explored that the percentage of willful defaulter is high enough in this region. It was interesting to learn that some defaulters had created an association to protect themselves from legal action there!

11. Some of the defaulted clients confessed that they had diverted their fund for more gain from buying land at cheap rates, and investing in Easy Bike etc. But due to excessive fall of land price and saturation level of Easy Bike sale, they experienced huge losses. Consequently NPL increased.

Causes of NPL as explained by the Defaulted Borrowers in Chittagong Region

It was evident from the figures that the proportion of willful defaulters is also not less in this region compared to other regions of the country.

- 1. Excessive import of a product lowered the price of that product which indirectly affected the repayment of bank loans.
- 2. Defaulted clients admitted that the possibility of quick earning from share market induced them to invest there without having enough experience.
- 3. Shrimp industry became a broken industry due to excessive competition, vulnerability of global market price of shrimp and dishonesty emerged in the shrimp business by some unscrupulous businessmen which caused NPLs.
- 4. Without having enough experiences and feasibility study, some defaulted clients diverted their fund to another business that caused NPLs.
- 5. Lack of adequate financial literacy of the clients created scope for the bankers to impose higher interest rate and excessive service charges. This situation led the clients to be defaulted because of huge amount of installment.
- 6. Some businesses stopped their activities due to family mishaps.
- 7. Agility and punctuality is the key to business success. Lack of awareness of some clients made them defaulter.
- 8. When duty on import of tubes decreased according to govt. policy, local tube producers lost the competition as their production cost was higher compared to imported (Chinese) tubes.
- 9. Poultry firms and poultry feed mills faced a mentionable business failure due to bird flue. That's why those clients failed to repay.
- 10. A borrower claimed that his bank had applied interest to CC account at the end of every month but other banks applied at the end of quarter.
- 11. As a consequence of virus attack, EU & Singapore banned importing shrimp from Bangladesh.
- 12. Borrowers opined that due to unhealthy competition in the local market, they couldn't do profit. Businessmen sometimes sell goods in lower price to make the competitors out of market.
- 13. Irresponsible and dishonest foreign importers denied to accept the shipped goods with the intention to get goods at lower prices from the seller and in some cases, they returned the exported goods and the exporter (borrower) bore losses. Thus NPL was created.

- 14. When a borrower had sister concern accounts maintained in the same bank, defaulting of one concern led the bank immediately stop opening of export LC for other concerns.
- 15. The goods obtained from ship breaking were normally sold in the international market. The price fall of those goods in international market made the ship breakers incur loss as the ship breaking cost was higher compared to international price of related goods.
- 16. Local market in Chittagong (commodity market) was dominated by some syndicates. They imposed severe entry barrier for new entrepreneurs. That's why the new entrepreneurs experienced huge costs to enter into the market and experienced huge loss.
- 17. Some clients hold high priced D/Os (delivery orders) for making profits out of transferred price but eventually did not get the buyers and the products. Collapse of D/O market in Khatunganj had a crucial bearing on the D/O holders.
- 18. Seizure of imported fertilizer and filing case against client by the joint forces during emergency period of 2007-08 had impacted on creation of NPL. Due to seizure of the goods, quality of the fertilizer deteriorated and filing of suit also disrupted the business operation. Moreover, due to absconding of the CEOs of the businesses for the above reasons, they could not run the business profitably.
- 19. Banning of imported FMP fertilizer by the government in the year 2003 had badly affected the price in the market. So, Government embargo on the import and marketing of fertilizer led the borrowers to be defaulted.
- 20. The borrower became frustrated from the loss in business and now unable to repay the loan. Other family members were unwilling for taking the burden of that loan.
- 21. Borrower willfully absconded and escaped away from the country to avoid the repayment of classified loans.
- 22. Some defaulters complained that the cause of being defaulted was the increased project costs due to delayed disbursement of loan by the banks.
- 23. CIB report submitted to the bank was proved as a fake report when the client became defaulted.
- 24. Expansion of the previous business and entry to new business without considering the market demand caused NPL.
- 25. When the original borrower defaulted, the family members formed new company and ran the business with fresh bank loan. Then, the previous loan remained unattended.
- 26. In Cox'sbazar, the hotel managers could not run their business as tourist didn't visit in a usual manner because of political instability. Besides, the real estate sector in Cox'sbazar did not flourish because of the govt. policy. The loan granted to the developers had been stuck up.
- 27. For imposition of excess interest rate on bank loans, ship breaking and ship building industry couldn't compete with their international counter-part.
- 28. Most of the defaulted borrowers argued that the causes behind the growing NPL were loss in their business because of political unrest in 2013 and 2014 and domestic market price fall of importable commodity's.

29. Fund diversion to construction of building, hotel and market was another cause of NPL in this region.

Causes of NPL as explained by the Defaulted Borrowers in Bogra Region

- Technological advancement was a reason that compelled the borrowers in Bogra region to be defaulted. The study team faced this type of experiences from Naogaon district of Bogra region. Conventional Rice Mills couldn't fight with technologically advanced large scale Auto Rice Mills.
- 2. Reduction of import duty on rice (that gives incentive to import more to ensure huge supply of rice in the market stabilizing price of rice) by government brought disaster for rice producers according to their statement.
- 3. Regular accounts became defaulted as one account of the borrower among several accounts in the same bank got defaulted as per Money Loan Court Act.
- 4. Higher interest rate reduced profit of borrowers business and gradual low profit resulted at default. Excessive hidden interest rate increased the cost of loan. Bank should inform the clients about the change they made in the interest rate.
- 5. In this region, some clients were defaulted due to lack of financial literacy. They were small business owner and didn't know anything about banking operations especially how to run the banking transactions.
- 6. Businessmen of this region became defaulter due to the political unrest in 2014.
- 7. Defaulted borrower claimed that they gave money to the manager without deposit slip when the manager visited him for recovery purpose and it was observed finally that money was not credited into the borrower's account.
- 8. Sometimes bankers themselves were involved in the businesses and maintained accounts in others' name. Thus they made others in danger and the loan became defaulted.
- 9. When the borrower of the business died, his family members informed that they didn't know anything about loan. In these cases, businesses got closed and loan amount remained unpaid if no collateral was kept. Again, though collateral was kept, the successors didn't want to sell the property.
- 10. As a consequence of under-capacity production and lower price of paddy, demand of agrobased light machineries decreased and consequently, the light engineering industry became looser.
- 11. Due to political unrest, some borrowers went to jail for 2/3 years and the loan became classified. Politically involved businessmen could not run their business properly, some didn't get the money back from other business partners timely and properly, as a result, there was loss in business and they could not repay the loan timely.
- 12. Business loss was incurred because of damaged imported food products (like, onion, ginger, garlic, dry chili, rice, wheat etc.) due to delay in port clearing.

- 13. The defaulted clients used the loan to build houses, higher study in abroad for their children etc. that led to grow NPL.
- 14. Switch to another business without experiences became a mentionable reason behind the defaulting loans.
- 15. Pressure of the high bank officials for granting loans to new entrepreneurs due to excess liquidity in the banks led to creation of NPL.
- 16. Concentration of loans among few borrowers was one of the root causes for creation of NPL.
- 17. Massive loss in poultry farm due to natural disaster is the another factor of NPL in this region.
- 18. Trade business like Rice Mill and Poultry Farm were badly affected by political unrest in 2013 and 2014. As a result, the borrowers became defaulted.

Causes of NPL as explained by the Defaulted Borrowers in Dhaka Region

- 1. Accidental disaster like fire in factory building was an unavoidable reason for defaulting loans.
- 2. Claim of speed money by the dishonest bankers for passing of loan application/extension of time for previous loans for BMRE or other purposes caused prolonged NPL.
- 3. Some defaulters became defaulted due to the diversion of fund to another business and purposes.
- 4. Non-cooperation of Rajuk in handing over the plots/lands in time compelled some clients to become defaulters.
- 5. Borrower could not be able to install individual Effluent Treatment Plant (ETP) which led the foreign buyer not to buy his product as per previous order. This type of non compliant RMG industries incurred loss and became defaulter.
- 6. Rise of fuel price while it was falling in the international market, increased the production cost that forced the product out of market due to high price and compelled the producer to be defaulted.
- 7. Unrest in the garments sector such as sudden catching fire, workers unrest and demonstration destroyed RMG sector and widened the classified amount of loans.
- 8. Due to political unrest in 2013-14, some borrowers became classified. Businessmen could not run their business properly, some didn't get the money back from other business partners timely and properly, as a result, there was loss in business and they could not repay the loan timely.
- 9. Rise of construction materials price affected the respective industries and increased classified loans.
- 10. The borrower became aggressive to expand his business volume compared to bank financing. As a result, it created enormous accounts receivables and lack of working capital to finance operations led him to default.

- 11. Businessmen expended a large amount out of their loan for hiring and decorating their showroom. This huge expenses and maintenance costs deterred the borrowers from making profit out of their initial business and got defaulted.
- 12. Due to govt. policy regarding connection of gas and electricity, developers could not sell their projects (flat/plot) in due time and thus failed to repay bank loans.
- 13. Garments stock lot was one of the reasons for defaulting borrowers that had been repeatedly mentioned by garments exporters.
- 14. Home loans got classified because the default borrowers could not maintained their usual cash-flow which they used to earn while the loans were sanctioned. The earning mismatch had caused many of the home loan borrowers to default.
- 15. Some shop owners who owned shops in different shopping complex/malls in the city said that the shopping complexes were not attracting the buyers for good business due to their location.
- 16. Borrowers of various industries could not run the project timely due to capital inadequacy and delayed sanctioned of loan.
- 17. Banks were not willing for any negotiation after filing suits.
- 18. Increased competition among the local producers and importers due to non-protection policy for the local producers played an important role for lowering the market prices which led to loss in business of the domestic producers.
- 19. Management problems in the banks especially delay in sanctioning loan badly affected the clients to take timely decision for their business and that's why clients became defaulters.
- 20. Higher interest rate in case of exporting vegetables (CC loan) and the time period to repay the loan (45 days) created problem for storing and marketing. Therefore, the time limit of repayment of vegetable loan might be increased at 90 days as they exporters demanded.
- 21. Loan disbursement target fulfillment pressure from the top of the management of the banks to the officers led to unhealthy competition in the loan market.

Common Causes of NPL as explained by the Defaulted Borrowers in all four regions

- 1. Higher interest rate, other service charges and hidden charges increased the installments of borrowers that led to default.
- 2. Defaulted clients misused their basic right to get 'stay order' and extension of stay order period that prolonged the recovery period. Unfortunately, there is no option still to prevent the clients from the frequent extension of the stay order.
- 3. It was seen that Non-bank financial institutions (NBFIs) frequently chose the borrowers of the banks and allured them to come to their FIs for getting loans. This created unhealthy competition between the banks and NBFIs.
- 4. Technological advancement was a reason that compelled the clients to be defaulted.

- 5. The intelligence of the bankers was not up to the mark. They didn't have good management quality as well as good networking to recover the loans. They were totally ignorant about the assessment of the necessity of loans. They were not capable to diversify the risk of loan.
- 6. Fulfillment of loan target oriented banking created enormous NPLs due to unscrupulous and aggressive banking by the bankers. Bank managers were over burdened by the targets uploaded by the higher authorities of their respective banks. That's why market became more competitive; bankers offered huge money and made the client more valuable than actual. Client buying or loan buy-out is a common term in the financial market. All those things caused NPLs.
- 7. Bank evaluated the value of its collateral after two consecutive years. Asset evaluation agency over valued collateral properties influenced by the clients.
- 8. Politically exposed persons (PEPs) had the tendency to be defaulted. Sometimes managers were in the deep pressure to disburse loan to the PEPs which ultimately became defaulted.
- 9. Within the considered time period, political unrest was the main reason for the borrowers to be defaulted. This brought stagnancy in business activities and slowed down the business cycle which compelled clients to become irregular in the case of repayments and threw them at the classification basket. On the other hand, Business performance was very sensitive to govt. decisions. Some govt. decisions also brought disaster for the borrowers and increased NPL.
- 10. Some greedy bankers were responsible for creating a vulnerable banking sector to some extent by disbursing loan to risky clients.
- 11. Some clients were defaulted due to lack of financial literacy. They were small business owners and don't know anything about pros and cons of banking operations at least to run the accounting transactions. They were not to be defaulted if they had financial literacy in a good state.
- 12. Lack of business experience of the clients/directors is one of the crucial causes of business loss. New generation (successors of the businessmen) couldn't take proper decision in the fields of business expansion, starting of new business for new products due to lack of experience. They were short of experience for business in local market even though they were educated from abroad. Besides, internal conflict among them also caused business loss.
- 13. One of the root causes for creation of NPL was fund diversion. In this case, management diversified their business and also diversified the fund. Share market investment from business money was a mentionable type of fund diversion. Besides, fund was diverted for treatment purpose, family affairs, repaying loans taken from various sources, house building, and other businesses etc.
- 14. Large businesses suffered from absence of good corporate governance and culture. So sometimes there occurred wrong decision which was not need-based or prudent for business survival.
- 15. Banks failed to keep the commitment though previously assured borrowers to give loans on stipulated time. Borrowers invested in the business/project relying on banks' commitment

and finally they lost due to lack of timely finance. In this case, borrowers incurred the loss in business only due to inordinate delay in sanctioning of the loan.

- 16. Most of the borrowers claimed that interest rate was very high. They couldn't repay the full amount in time due to compound interest accounting framework.
- 17. Banks or borrowers couldn't sell the collateral property as buyers were not interested to purchase an asset which was under legal procedure or bank's obligation.
- 18. When collateral property was too big, it was difficult to sell it. Again when the land was very near to river or it had no easy access, it was not possible for bank to sell.
- 19. When the business partnership broke or one partner withdrew him from the business, the remaining partner couldn't continue the business in maximum cases due to lack of experience and got loss.
- 20. Banks denied extension of the current loan or granting a new loan when the borrowers were defaulted as a result of loss in business. So borrowers couldn't get out from the difficulties, continue the businesses and repay the loans.
- 21. Borrowers, in many cases, couldn't avail conditions for rescheduling as the installment size was too big or rescheduling period was too small for them to execute.
- 22. When the loan was disbursed without collateral, the borrower had fewer obligations to repay it, rather created moral hazard problem for banks.
- 23. In many cases, small businessmen faced loss in businesses due to sales on credit. When they failed to recover the money from the debtors in due time (or totally unrecovered), they failed to run businesses and became defaulted.
- 24. Bankers didn't explain clearly the requirement and terms & conditions for getting the loans to the borrowers. Borrowers claimed that interest rate appreciation, imposition of different charges etc. were not clarified to them. On the other hand, borrowers also didn't give importance to that part as they stayed busy to get the loan, not to understand the loan conditions properly.
- 25. In many cases, bank managers living for long time in the same area, sanctioned loans without adequate collateral and proper analysis of business but depending only on the personal relationship. In most of these cases, documentation was not properly maintained and that's why these types of loans became defaulted.
- 26. In many cases, banks sanctioned and disbursed working capital but borrowers used it for buying fixed asset. Subsequently, interest on loans increased without starting of businesses. That's why the business loan became defaulted.
- 27. Businessmen associated with different political doctrine were absconded themselves due to political harassment and their business suffered loss.
- 28. Clients wanted some of their collateral to be free so that they could sell their collaterals at market value but not in an auction. Because, auctions offered much less value than the market value. For that reason, the clients couldn't settle their loans with the banks.
- 29. Lack of proper monitoring by bank enticed some clients to divert their fund for other activities.

- 30. Some clients said that sudden change in govt. policy hampered their continuous business flow in the market due to dumping and that's why the regular cash flow of their business became stagnant.
- 31. Loan sanction procedure of some banks had some flaws, like they didn't verify legal documents of a mortgage property. It happened for their lack of sincerity and knowledge. Even they failed to do proper valuation of the mortgaged property for lacking of proper mechanism.
- 32. In many cases, the study team found that there were unhealthy competitions among the banks for offering more loan facilities to the customers without considering their eligibility. Especially, it happened in many loan take-over cases.
- 33. There were some willful defaulters who were actually a habitual defaulter. They took loans from banks with mala-fide intention not to pay back the loans. Very often banks failed to properly identify this class of people.
- 34. Nepotism in loan sanctioning procedure made the loan vulnerable at the stage of sanction especially when nepotism shown by top level management. In that case, a loan had been disbursed without proper sanction procedure.
- 35. Loan monitoring system was not enough strong in the banking industry. Very often, bank thought that it was their only duty to disburse the loan properly.
- 36. When a bank fixed a loan target for any of its officer or for branch manager that drove him to disburse risky loan or disburse loan violating the set loan sanctioning procedure. That's why the risky loan created in the banks by the bankers which ultimately became defaulted.
- 37. When a loan was disbursed without sufficient mortgage from the very beginning, the customer felt an immunity that he was free from legal obligation of paying back the loan and this type of notion led to default.

Chapter-8: Remedial Measures suggested by the Defaulted Borrowers at Field Level (Region-wise)

Remedial Measures suggested by the Defaulted Borrowers in Khulna region

- 1. Proper monitoring of business should get priority by the business enterprises and they should develop the second line of command to conduct the business in case of mishap.
- 2. Proper and timely support from bank in case of loan sanction/renewal/extension is needed to run the business successfully.
- 3. Interest waiver is also needed in case of genuine default.
- 4. Bank should come up with the pragmatic policy of time extension/rescheduling/easy installment schedule to assist the defaulted borrowers.

Remedial Measures suggested by the Defaulted Borrowers in Chittagong region

- 1. Interest waiver is needed in case of genuine default.
- 2. Bank should come up with the pragmatic policy of time extension/rescheduling/easy installment schedule to assist the defaulted borrowers.
- 3. Bank should devise interest rate policy to help the businesses of the country. They might reduce loan interest rate at single digit level.
- 4. Government policy should facilitate and protect the local producers so that production increases and new producers get incentives to initiate new concerns.
- 5. Down payment for rescheduling purpose might be at tolerable level so that defaulters can come out from NPL.

Remedial Measures suggested by the Defaulted Borrowers in Bogra region

- 1. Interest waiver is needed in case of genuine default.
- 2. Bank should come up with the pragmatic policy of time extension/rescheduling/easy installment schedule to assist the defaulted borrowers.
- 3. Govt. policy on rice import should be reviewed in favour of the local rice traders/mills.
- 4. The producers of agro-light engineering cluster demands interest rate of single digit to encourage this cluster in Bogra region.
- 5. Some borrowers of agro-light engineering cluster suggested for creating a special credit fund for this cluster.
- 6. The husking/rice mill owners demanded that they should get priority for supplying rice to the govt. procurement. They also felt that the big auto rice mills should treat them as sub-contractor to supply rice to them as backward linkage producers.

Remedial Measures suggested by the Defaulted Borrowers in Dhaka region

- 1. The defaulted borrowers demanded rescheduling of their loans with low down payment.
- 2. Some of the defaulters claimed rescheduling of their loans without down payment for their survival.
- 3. Interest waiver is needed in case of genuine default.
- 4. Bank should come up with the pragmatic policy of time extension/rescheduling/easy installment schedule to assist the defaulted borrowers.
- 5. If the sick industries get special incentives, they can run their businesses again and consequentially make profit and repay the overdue loans.
- 6. To check NPL, good corporate governance in the banks is to be ensured.
- 7. Bank should monitor businesses with a pragmatic plan to stop overtrading.
- 8. Banks should provide sufficient fund to the borrowers so that they can run their businesses properly.

Common Remedial Measures suggested by the Defaulted Borrowers in all four regions

- 1. Bank should scrutinize mortgage property and its valuation properly. If the mortgage value of property is assessed wrongly by third party valuator, the bank should include a clause of compensation in the contract with the third party valuator.
- 2. Sufficient mortgage should be ensured by the banks to avoid moral hazard problem.
- 3. Bank should give proper emphasize on qualitative judgment rather than quantity base judgment in case of loan disbursement.
- 4. Banks should strengthen their loan monitoring system.
- 5. Bank should implement internal control and compliance system with due diligence to keep the bank officials (including board member) free from nepotism and morally upright.
- 6. All banks should interchange clients' overall information among them for better selection of the borrowers.
- 7. BB can introduce market-based policy for loan take over by the banks and NBFIs.
- 8. BB can establish a Collateral information data warehouse like CIB at its head office to help the banks to check the credibility and valuation of the collateral given to the bank.
- 9. Govt. should have capacity to assess the demand and supply of a product in the case of imports. Excessive imports of a product dismantle the market price of that product which indirectly affects the borrowers to repay the bank loans.
- 10. Banks should assess correctly the management efficiency of the business concern. They should justify whether the management is capable enough to deal with the business.
- 11. Banks must have in place a proper loan monitoring system to look into whether the fund is properly used or not.
- 12. Banks have to be confirmed that good corporate governance and culture prevails in the borrowers' institutions, especially in case of large corporate borrowers.
- 13. Banks have to be careful enough to select the real entrepreneurs.

- 14. Banks should take financing decision for stimulating local industries/entrepreneurs to facilitate the even development of the country.
- 15. When the collateral asset is too big to sell to a single party and property value is much higher than loan outstanding amount, there should be the opportunity of releasing partial collateral so that it can be sold, thus loan can be repaid and business can be restarted.
- 16. Government policies regarding price of imported goods must be issued and implemented considering the importers' interest as they import goods as per policy of govt. and sometimes as per instruction of govt.
- 17. Interest rate should be lowered at single digit.
- 18. Banks can collect information about the business history of large borrowers from the Chamber and thus select good borrowers.
- 19. Defaulted members of the chambers of industries should not be allowed to participate in the chamber election.
- 20. Banks should monitor the loan regularly and closely after disbursement so that they can get early warning if the businesses are going worse and they can give suggestion to the borrowers.
- 21. Banks should support/facilitate the real borrowers by extending the loan amount or giving new loans when they are in problem so that they can get rid of difficulties and do businesses and repay the loans.
- 22. Bankers should clearly explain every terms & conditions to the customer and customer must know them before taking the loans.
- 23. Banks should give advice to the borrowers and find out for them the easiest way to revive the businesses so that the good borrowers repay the loan and get back to the businesses.
- 24. The borrower who is maintaining business with more than one bank and if this client becomes defaulter with any bank, then the banks involved with this particular client may take decision not to disburse further loan to that client until the settlement of the dues. Therefore, there should be a policy of embargo for the defaulted clients in case of taking loan from more than one bank.
- 25. Banks may play advisory role for the clients to guide them for proper market study and business. Banks may also consider, observe and analyze govt. policies on various issues and inform the borrowers about the changes.
- 26. Bank should have planned to educate the borrowers about banking norms and procedures regarding loan. For this, bank may implement financial literacy programs for the borrowers.
- 27. In the businesses, especially in proprietorship businesses, second line of management should be maintained from the family. As a result, it will be easier for banks to recover the money from the successors as they are trained of the business and loans. Otherwise it may be difficult for banks to recover loan amount as businesses get closed and none knows about the businesses and loans.
- 28. When the borrower has more than one concern, the usage of banks' finance becomes overlapping and it is not possible to identify how much bank finance is used in one particular

concern. Thus, the accounting system of the concerns may be maintained separately determining loss in a particular concern.

Chapter-9: Evidence from field survey data (Cliental Level) that inadequate collateral causes credit risk

Coverage of the field survey

The duration of survey period was 23rd October 2016 to 08th December 2016. The study team visited 75 bank branches of 41 banks spread over four regions of the country on the basis of severity of nonperforming loans (NPLs) of the branches. The regions were Bogra, Chittagong,

Table-5: Coverage of the field survey										
	(in numbers)									
Regions No. of bank branches No. of defaulted borrowers										
		interviewed								
Bogra	19	136								
Chittagong	19	132								
Dhaka	19	155								
Khulna	18	151								
Total	75	574								
Courses Field current data										

Source: Field survey data

Dhaka, and Khulna. The team interviewed 574 defaulted borrowers of the respective banks. Table-5 shows detail coverage about the survey.

Table-6: Regional distribution of borrowers by purpose of loan											
Personal Loan		Business Loan		Agriculture Loan		Industrial Loan		Others		Total	
Region	No. Borrower	Percent	No. Borrower	Percent	No. Borrower	Percent	No. Borrower	Percent	No. Borrower	Percent	No. Borrower
Bogra	11	22.45	107	24.83	16	42.11	2	4.44	0	0	136
Chittagong	13	26.53	96	22.27	5	13.16	15	33.33	3	27.27	132
Dhaka	19	38.78	107	24.83	1	2.63	26	57.78	2	18.18	155
Khulna	6	12.24	121	28.07	16	42.11	2	4.44	6	54.55	151
Total	49	8.54	431	75.08	38	6.62	45	7.84	11	1.92	574

Source: Field survey data

Regional distribution of borrowers by purpose of loan

It is observed from Table-6 regarding regional distribution of loan by purpose, 49 defaulted borrowers or 8.54% of 574 defaulted borrowers took personal loans and 38.78% of that 49 defaulted borrowers were from Dhaka region, the highest in compare to the four regions. On the other hand, Khulna occupied lowest position in respect of personal loan.

Business loan got the top position in the distribution. 431 defaulted borrowers or 75.08% of 574 defaulted borrowers fell in the category. The study team observed a very interesting aspect that in Khulna region, personal loan was the lowest but business loan occupied the highest position

among the four regions. 28.07% of 431 defaulted borrowers took loan for business purpose in Khulna region whereas Chittagong occupied the lowest position.

Defaulted borrowers of Khulna and Bogra regions showed an upward tendency in taking agricultural loan compared to other two regions. 38 defaulted borrowers or 6.62% of total 574 defaulted borrowers took agricultural loan. Among them, 42.11% of 38 defaulted borrowers of each of Khulna and Bogra regions availed agricultural loan. It was expected that the share of agricultural loan took by the defaulted borrowers would be minimum in Dhaka region, only 2.63% of total agricultural loan of all four regions.

The analysis became interesting in respect of industrial loans. 45 defaulted borrowers or 7.84% of 574 defaulted borrowers took industrial loans. The highest number of borrowers of Dhaka region took this type of loan which was 57.78% of 45 defaulted borrowers and the second

highest among the four regions was Chittagong region with 33.33% of 45 defaulted borrowers.

It is evident from Chart-1 that 75.08% defaulted borrowers preferred business loan which recorded the highest position compared to other purposes of loan taken by the defaulted clients, and was followed by 8.54%, 7.84%, 6.62% and 1.92% for the purpose of personal loan, industrial loan, agricultural loan and others purposes respectively.

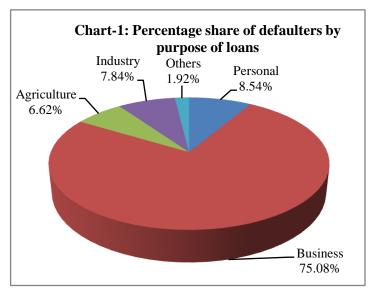


Table-7: Collateral position against loan amount of the defaulted clients										
					Loan amount		Loan amount does			
			Does not keep		coverage by		not coverage by			
Region	Keep collateral		collateral		collateral		collateral		Inadequate collateral	
	No.		No.		No.		No.		No.	
	Borrower	Percent	Borrower	Percent	Borrower	Percent	Borrower	Percent	Borrower	Percent
Bogra	117	24.74	19	18.81	101	28.13	16	14.04	35	16.28
Chittagong	95	20.08	37	36.63	63	17.55	32	28.07	69	32.09
Dhaka	137	28.96	18	17.82	88	24.51	49	42.98	67	31.16
Khulna	124	26.22	27	26.73	107	29.81	17	14.91	44	20.47
Total	473	82.40	101	17.60	359	62.54	114	19.86	215	37.46

Source: Field survey data

Region-wise Collateral position against loan amount of the defaulted clients

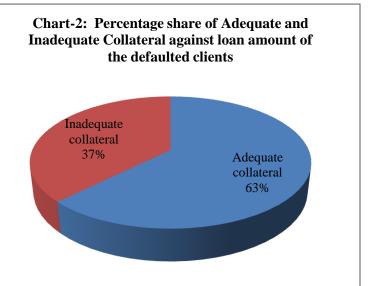
Table-7 illustrates that region-wise collateral status of the banks in details. Banks kept collateral from 473 borrowers out of 574 defaulted borrowers. 28.96% of 473 defaulted borrowers gave collateral in Dhaka region which was the highest among the four regions of the country and the lowest was Chittagong region (20.08%) in this regard. Out of 574 defaulted borrowers, the loan amount of 359 borrowers was covered by their collateral value (Adequate Collateral) whereas the loan amount of 215 borrowers was not covered by their collateral value (Inadequate Collateral).

Percentage share of Adequate and Inadequate Collateral against loan amount of the defaulted clients

Banks got adequate collateral from 29.81% of 359 defaulted borrowers of Khulna region which was the highest among the regions and the lowest was in Chittagong region which was 17.55%

of the total defaulted borrowers. On the other hand, banks kept inadequate collateral from 32.09% of 215 defaulted borrowers of Chittagong region which was the highest among the regions, and Bogra region was the lowest (16.28%). It is clear that banks in Chittagong region were not very cautious and inclined to take adequate collateral against their disbursed loan amount.

In Chart-2, it is seen that the share of adequate collateral was 63% and share of inadequate collateral was 37% that was



kept from the 574 defaulted borrowers of the four regions.

	Table-8: Reasons behind the irregular payment of the defaulted Borrowers								
Region	Loss in business		Family mishaps		Fund diversion		Others		Total
	No. Borrower	Percent	No. Borrower	Percent	No. Borrower	Percent	No. Borrower	Percent	No. Borrower
Bogra	96	22.86	17	30.36	10	23.26	13	23.64	136
Chittagong	98	23.33	7	12.5	15	34.88	12	21.82	132
Dhaka	120	28.57	17	30.36	5	11.63	13	23.64	155
Khulna	106	25.24	15	26.79	13	30.23	17	30.91	151
Total	420	73.17	56	9.76	43	7.49	55	9.58	574

Source: Field survey data

Reasons behind the irregular payment of the defaulted Borrowers

Reasons behind the irregular payment of the defaulted borrowers can be analyzed from the information given in Table-8. In Chart-3, 73.17% of 574 defaulted clients showed business loss as the reason of their being defaulted, 9.76% defaulted clients explained the reason as family mishaps, 7.49% confessed the reason of their being defaulted as fund diversion and 9.58% explained other reasons. Table-8 delineates that defaulted borrowers of Dhaka region were affected by business loss severely. The defaulters of Bogra and Dhaka regions

were compelled to be the defaulter compared to other two regions by their family mishaps. Fund diversion in severe case was Chittagong region and Khulna region was very close to Chittagong region in this respect.

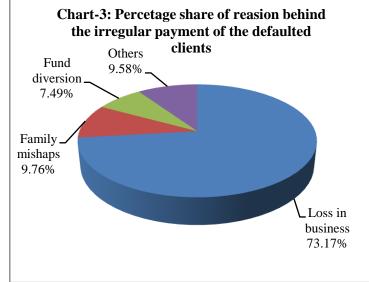


Table-9: Types of Actions taken by the banks for recovery of NPL					
Туре	No. Borrower	Percent			
Court injunction	23	4.01			
Rigidity on asset	35	6.1			
No case filed	142	24.74			
Notice issued	116	20.21			
Case filed	258	44.95			
Sources Field survey date					

Source: Field survey data

Types of Actions taken by the banks for recovery of NPL

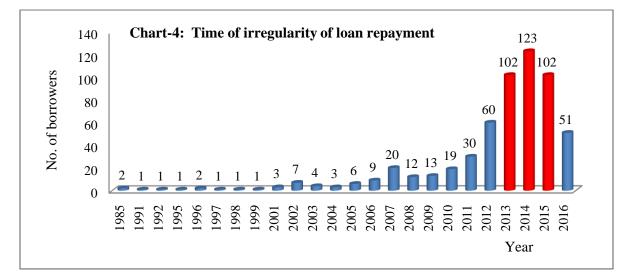
The causes behind the rigidity on recovery of the loan amount have been explained in Table-9 which depicts that cases had been filed for 44.95% out of 574 defaulters, followed by 24.74%, 20.21%, 6.1% and 4.01% of defaulted clients in the category of 'no case filed', 'notice issued', 'rigidity on asset' and 'court injunction' respectively.

Table-10: Frequency distribution of assistances desired by the defaulted borrowers from banks					
Туре	No. Borrower	Percent			
Interest redemption	279	48.61			
Time extension	123	21.43			
New loan	49	8.54			
Reschedule	69	12.02			
No assistance	20	3.48			
Others	34	5.92			

Source: Field survey data

Frequency distribution of assistances desired by the defaulted borrowers from banks

Teble-10 delineates that defaulted borrowers wanted some assistances from their respective banks. 48.61% of 574 defaulted borrowers expressed their desire to get rebate from interest, around 21% defaulted borrowers desired to get time extension facility, around 12% defaulted borrowers desired to get rescheduling of their loans and around 8% defaulted borrowers desired to get new loans.



History of irregularity of loan repayment from 1985 to 2016

Chart-4 delineates the history of irregularity of loan repayment from 1985 to 2016. The study team observed that there were several reasons behind the irregularity of repayments from the borrowers end. Despite the reasons of irregularity, out of 574 defaulted borrowers, 123 defaulted borrowers became irregular in 2014 which was the highest number compared to the other years. The years 2013 and 2015 got the second highest position jointly by the same number of defaulted borrowers (102) who confessed these years as their years of irregularity. These three consecutive years made sense and exhibited a very rational and plausible feature regarding the reason of becoming irregular client of a bank. These three years were the year of political unrest which was the cause of diminishing business confidence, hindrances of supplying business good, invoking international trade stagnancy. That's why the ultimate effect went on business environment and incurred business loss. Borrowers were severely affected by political unrest which compelled them to abscond from their business and made them defaulters.

The study team surveyed the four regions to explore the impact of inadequate collateral on credit risk and tried to find out the answer of the question whether the inadequate collateral had caused credit risk. Considering this objective of the survey, the outstanding amount of loan against adequate collateral and inadequate collateral shown in Table-11 gives a vivid picture and proof of the concerned question.

Table-11: Outstanding amount of loan against collateral						
	Outstanding amount	of loan against	Outstanding amount of loan against			
Region	adequate col	lateral	inadequate collateral			
	No. Borrower	Mean	No. Borrower	Mean		
Bogra	101	38.02	35	22.96		
Chittagong	63	56.60	69	178.71		
Dhaka	88	382.87	67	404.80		
Khulna	107	18.36	44	17.09		
Total	359	119.95	215	190.74		

Source: Field survey data

Outstanding amount of loan against both adequate and inadequate collateral in four regions

It is not mandatory to keep collateral against disbursing any amount of loan though keeping adequate collateral helps to get rid of credit risk. Whether or not to keep collateral from the borrowers depends entirely on banks' attitude which may vary from region to region due to different business environments, efficiency of bank management and client behavior. Out of 574 defaulted clients, banks kept adequate collateral from 359 clients and kept inadequate collateral from 215 clients (inadequate collateral is defined by sum of collateral those does not cover the loan amount and personal guarantee). Average outstanding amount of loan which was disbursed against inadequate collateral in Chittagong and Dhaka regions was higher than average outstanding amount of loan was disbursed against adequate collateral. It is clearly observed that out of 574 defaulted clients, average outstanding amount of loan disbursed for 215 defaulted clients against inadequate collateral was BDT 190.74 million, which was higher than BDT 119.95 million, average outstanding amount of loan for 359 defaulted clients, against adequate collateral was the evidence that the inadequate collateral inflated credit risk.

Chapter-10: Comments and Suggestions provided by the Selected Branch Managers on Inadequate Collateral and its effect on NPL

a. Inadequate collateral is one of the major reasons for loan to become classified

The branch managers generally opined that if there was adequate collateral, it was easier to recover the loan; but inadequate collateral was one of the major reasons, not the foremost one. Rather intention of the borrower was the foremost reason of a loan to become classified. There were other major reasons for classified loans such as customer's capacity and/or intention to pay; because intentional client might take advantage regarding this but in addition, client selection & lack of monitoring/supervising the investment were also big reasons for investment to become classified. Mortgage of own residence-property as collateral security is prestigious to the borrower. If a borrower mortgaged less important properties or value of collateral became inadequate, there was an indication of becoming willful defaulter.

In some part inadequate collateral was one of the reasons for loan becoming classified. Overall land was devaluated for the last few years in this area. So in few cases it might discourage customer to pay loan. The diversion of fund and loss of business were the major reasons for loans to become classified. Borrower incurred losses in the business for consecutive 03 years due to government policy for huge amount of rice importing from INDIA and the price of imported rice was lower compared to our locally produced rice. Due to that policy rice millers of our country were badly affected. Rather intention of the borrower was the foremost reason for a loan to become classified.

It was expressed by some managers that inadequate collateral was very important issue especially in case of consumer loan. In SCBs, before making lending decision they properly assessed the business requirement and cash flow considering all the internal/external factors and performance of the enterprise was closely monitored after lending. Though adequate collateral brought significant comfort to recover money in distressed situation, but if lending was made upon proper assessment of business cash flow and business performance was properly monitored by the bank, inadequate collateral could not be the major reasons for loans to become bad unless client diverted fund or some unforeseen adverse events impacted client's business badly.

Business Loss was the main reason for loans being classified. In some cases loan became bad/classified due to inadequate collateral security. Inadequate collateral was one of the reasons for loans becoming classified. But it differed from case to case. It was one of the reasons, but there were other major reasons for classified loans such as customer's capacity and/or intention to pay. Collateral could not be the only aspect bankers took into account while financing to a borrower. But in fall back situation it worked to realize bank's money. However, the business cash flow was the main source of repayment by the client which was ignored in Bangladesh

market due to non-reliable financials produced by the clients and authenticated by practicing Chartered Accountants (CA). Since the CA firms were not accountable in true sense, they were very casual in certifying audited financials except few reputed firms. So law must be formulated by the Government to bring CA firms under accountability framework.

Adequate collateral security helped the Branch to recover the non-performing loans by ways of selling the mortgage property. But the collateral taken as security purpose was itself subject to natural depreciation. So, when the borrowers did not pay the loan regularly (the value of collateral decreased with passage of time naturally like machinery, building and other wasting assets), collateral might become inadequate against the piled up loan amount, (although at the time of sanction the collateral was adequate). Despite the increase in the value of collateral, sometimes the borrowers did not pay the loan in due time and the loan was turned to be bad/classified. In that case proper valuation of collateral could not save loan from becoming non-performing. In some cases, they found that the borrower mortgaged inadequate collateral and was reluctant to repay the loan and tried to avoid/delay repayment by doing re-scheduling, restructuring and seeking injunction through writ-petition.

b. Regarding collateral free loan for the Politically Exposed Persons (PEPs)

The managers opined that it was not easier to get collateral free loan from bank for anybody else and as per general banking practice it was not easier to get collateral free loan for the locally influential people. They always tried to avoid proposals initiated/supported by the PEPs (Politically Exposed Persons) or locally influential people. It depended on how strictly the bank management followed the policy issued by their Head Office and other regulatory bodies. Loan sanction decision totally depended on Credit Risk policy of the Bank. Some managers expressed that they had standard set of credit assessment and collateral acceptance criteria laid down in their internal policy documents. Every loan had to qualify through these criteria and there was no scope of external influence in the credit assessment process.

Some observed that loan sanction depended on Client's credibility, his business performance, his net worth, past repayment behavior and commitment. Collateral free loan was designed mainly to promote small entrepreneurs, who had not sufficient collateral to get bank loan, but had potential to grow. In that case, by providing some data/documents, the entrepreneurs were allowed the loan. Therefore, in principle, locally influential people had no scope to get such loan without meeting the pre-selected criteria. Some opined that locally influential persons might have the higher probability to get collateral free loans easily compared to ordinary people from local private banks. However, in foreign banks it was difficult to get collateral free finance for the politically exposed persons.

c. Enhancement of collateral securities/revaluation in case of extension of loan

The managers' responded that generally they enhanced collateral securities/revalued in case of extension of loan. Proper evaluation of credit proposal and credit risk profile of the customer must take place before enhancement of loan. Bank, if necessary, revalued collateral securities every after two years or while new construction made over the landed property on case to case basis. Bank also enhanced the collateral securities in case of extension of loan in the form of taking additional collateral security subject to requirement of additional fund for the business, client's credibility, his business requirement, personal net worth, business performance, past repayment behavior and commitment. Revaluation was considered only after 3 to 4 years later from the previous valuation with consideration of radical appreciation of market price, credit proposal and credit risk profile of the customer.

Some banks told that they enhanced the collateral security and revalued the collateral in case when the proposal limit crossed 90% of the distressed/forced sale value of the present collateral & added collateral. They usually revalued collateral securities after three years interval by another surveyor in case of immovable properties/assets and after one year for movable assets. Moreover, they usually sought for additional collateral to secure bank's exposure in case of extension of loans. Some other banks expressed that need-based revaluation of collateral was occurred due to subsequent addition in the borrower's assets through equity investment. Some banks replied that they enhanced collateral securities/revalued in case of extension of funded investment which must be 100% and non-funded investment sometimes got relaxation like 50% to 70% coverage.

d. On physical visits of the projects/businesses to monitor proper usage of the loan

As regards physically monitoring of the projects of the clients, it was found that different banks follow different type of inspection policies. Some banks told that their Regional Managers (RMs) visited the factory/warehouse of the customer at least once a year. In addition, stock inspection was conducted by an independent 3rd party annually. Besides, divisional head and senior management also visited customer office regularly generally at least once in three months. Some banks said that they always gave priority to visit each business physically at least once in a month to ensure the proper usage of fund. The frequency of visit increased when the loan was on the way of becoming classified. Some banks said that they physically visited their client's outlet, go-down, collateral and residence at any time when needed/or fortnightly to monitor proper usage of the loan and collected the monthly stock report to get verified by the bank officials.

Some banks physically visited client's offices, go-down premises frequently and observed their business trend after disbursement of the loan whether they purchase their inventory or diverted the fund to unproductive sector and guided the clients to utilize the fund in their actual purpose. In addition, stock inspection was conducted by an independent 3rd party annually. Some other

banks observed that physical visit of the client's office, showroom and factories/projects was usually done on a quarterly basis. However, depending on approval condition and nature of transaction, inspection frequency might get accelerated to ensure the fund utilization especially at the time of limit enhancement. Some banks told that they visited their investment projects as per the risk grading of the borrower, minimum twice in a year. Some other banks told that they physically visited the client's outlet, go-down, collateral and residence after disbursement of the loan to monitor the proper usage of the loan on monthly/quarterly/half yearly on case to case basis as per their banks' credit norms. Some banks told that weekly asset monitoring review was done by their branch credit officials.

Some banks narrated that they maintained client-wise visiting schedule and through office order monitoring officer visited the establishment of the client on monthly basis and obtain monthly stock report and check their daily/monthly business turnover, receivable and payable and matching of the existing stock with liability. In some cases, they visited the customers more than once in a month. In some cases branch incumbent and investment team also visited frequently the business establishments twice in a week/month.

e. Valuation of collateral and valuation policy

Third party property surveyors or valuation companies enlisted with the Bank conducted valuation of collateral properties. Based on approved conditions property valuation were conducted and revaluated in every three years as per guidance of CRM. Some of the banks said that they had credit policy covering valuation formalities details on that. According to the policy an enlisted independent surveyor assessed the collateral security value. In addition, another valuation was conducted by the Branch credit committee constituted by branch incumbent, manager operations, credit/investment in charge and dealing officer of the branch simultaneously for the same security. These two valuations were considered for sanction of a loan. Some banks told that bank enlisted surveyor firms for conducting the valuation of the collateral at first. Thereafter, branch officials along with the manager conducted another valuation and checked the genuineness of the surveyor's valuation.

Some banks observed that valuation was conducted by the Bank enlisted valuator. Bank had a valuation policy where it was clearly mentioned that branch would conduct a separate valuation by the branch official and match it with the valuation of the enlisted valuator. If the value differed more than 10%, the bank could accept the third party valuation. Some other banks expressed that they had a valuation policy, where any amount of collateral security bank had to be evaluated by bank-enlisted survey companies. Primarily they submitted the report after physical verification based on the market information. If there was variation in valuation above 10% between the branch and survey company then it was reviewed further by another survey company and the average value was considered. Nevertheless, in case of Tk. 10.00 crore and above, collateral value was assessed by two nominated survey companies.

Some other banks told that their bank's head office, branch and Survey Company conducted the valuation of the collateral separately according to head office valuation policy considering the present market value, forced sale value, mouza rate fixed by the sub registered office per year. The enlisted professional surveyor company conducted the valuation of the collateral independently; head office official visited the location of collateral and assessed the value of the property internally. Branch officials conducted their collateral valuation as per credit policy manual. Then the bank took decision on the basis of three reports prepared by head office officials, bank branch officials and professional surveyors with approval from competent authority. Some banks expressed the same procedure. They said that in case of collateral valuation, bank enlisted surveyor, head office investment related executives for collateral valuation, branch manager, operation manager, investment in-charge of branch and others investment related officers conducted the valuation of the collateral. In some bank, third party valuators/surveyors conducted valuation of collateral after having enlistment with the bank. After that, the branch manager independently certified that the valuation of the property was aligned with the current market price as surveyed by the enlisted valuator after conducting physical visit of the property.

Regarding the collateral valuation policy, some banks told that they had collateral valuation policy approved by the board where it was clearly mentioned that branch would conduct a separate valuation by the branch officials and match it with the valuation of the enlisted valuator. If the value differed more than 10%, the bank would not accept it. Some other banks told that they had no prescribed specific valuation policy excepting some clauses inserted in the CRM circular. These banks basically depended on the assessment of their branch level credit officers, the government quoted price of land on Mouza basis, and the report of the surveyors engaged by the client.

f. State of training of the branch managers' regarding credit risk mitigation or collateral valuation

Branch managers generally replied that they had the training regarding credit risk mitigation and collateral valuation and credit officials of the branch had general understanding on product parameters, credit risk and collateral valuation at branch level. However, detail credit risk assessment, collateral valuation and security documentation (e.g. Mortgage) were conducted by relevant department Credit Risk Management Unit, Credit Operation Unit etc. The credit officials completed credit management training at their banks' training institutes covering all sort of credit risk mitigation technique as well as valuation procedure of collateral securities. Some of the managers told that their head office conducted several training regarding credit risk mitigation on every year like credit risk management, credit analysis and handling of proper documentation and legal issues related to loans etc. Some managers expressed that they did not get formal training on collateral valuation but got training on overall credit risk analysis and

mitigation techniques, recovery, financial statement analysis, financial risk assessment, industry & business risk assessment, accounting for credit professionals and debt management issues.

Some bank told that they had training regarding credit risk mitigation or collateral valuation and relevant circulars regarding credit risk mitigation or collateral valuation. Head office executives and trainers of various famous financial institutions conducted training on credit risk mitigation. Their training institute conducted training regarding credit risk mitigation or collateral valuation. Some stated that their banks' had no formal training institute of their own, but their head office usually sent staffs to Bangladesh Institute of Bank Management (BIBM) for training on Credit Risk Mitigation/Management and collateral valuation.

g. State of training of credit officers regarding credit risk mitigation or collateral valuation

A large number of banks replied that their credit officers had adequate training regarding credit risk and collateral risk management. Collateral valuation was conducted by enlisted professional valuation companies. The banks' training institutes offered different types of training programs for their credit officers regarding credit risk mitigation and valuation of the collateral despite of having third-party valuation company for valuation. Though the credit officers had no formal training on collateral valuation; however, they had training on overall credit risk analysis and mitigation techniques, recovery and debt management issues. Some banks told that their credit officers' didn't have training on collateral valuation but they had adequate training regarding credit risk and collateral risk management.

Some of the banks' training institutes had been conducting various 'on the job training programs' for their credit officers like Credit Lending Principals (CLPS), Retail Credit Risk Course, Credit Skill Assessment (CSA), Commercial Lending for Small Business Certification (CLSB), Corporate Credit Curriculum (CCC), Credit Underwriting Training etc. These courses were designed to build up the skill on financial statement analysis, financial risk assessment, industry & business risk assessment, management risk assessment, accounting for credit professionals, mitigating credit risk etc.

h. Problems faced by the branch managers on realization of collaterals

Generally, realizing collaterals was a lengthy process. Sometimes, the interested purchasers showed less interest regarding collateral properties and they offered low price. As a result, the borrowers did not cooperate whole heartedly to the process. Sometimes, the borrowers got stay order against realizing process. Almost all branch managers told that non-cooperation from the defaulted clients played a major role for creating hindrances in realizing collateral assets. Inordinate delay in completing the process of liquidation and procrastination in legal procedure, impossibility for marketability of collateral and unsuccessful auction attempted due to absence of acceptable bidders whether deterred by client or not, lacks of active cooperation and support from law enforcement agencies for property repossession and finally issuance of stay order

(availed upon writ petition in the high court) against auction sale of mortgaged properties affected adversely the process of realization of collateral.

Definitely, the collateral realization should be achieved through the legal procedures. When a bank got possession under sec-33(5) of Artha Rin Adalat Ain 2003, it could take real possession due to lack of sufficient manpower for that. Once the possession of collateral handed over to the bank by the honorable court under sec-33(7), it became difficult for acquisition. Because, during the acquisition of the collateral, the main problem was that buyer (public) didn't feel interested to purchase the land that was owned by the bank through legal process. People thought they would be in trouble if they purchased mortgaged land from the bank and engaged in clash with the defaulter clients. That's why collateral acquisition and realization was very difficult for the bank. In most of the cases, bank didn't get proper value of the property as people didn't get interest on buying this kind of mortgaged securities at market price out of fear that taking possession of the property would become very difficult. So, threats and pressures from the socially influential defaulted borrowers and politically exposed persons created hindrance in the sale process of the mortgaged property. Secondly, people who intended to buy mortgaged securities from bank, had tendency to buy the security with a very much lower price. So in most cases it was not possible for the bank to sell the collateral securities at actual price.

Some banks told that banks had to face problems when possession of the collateral were needed to be taken over from the mortgagor at the time of sale of the mortgaged property either in auction or in private negotiation. In most of the cases clients didn't help the bank in completing the realizing process of collaterals. Again, non-cooperation of the proprietor/ mortgagors/ guarantors also created hindrance in realization of collateral. Moreover, collateral securities remained under possession of the clients which created possession related problem while realizing collaterals. Lack of proper and timely support from law enforcement agencies for property repossession also created havoc. However, the banks had to face stint problem in realizing collaterals due to time petition for stay order against court cases by the client as per Money Loan Court Act 2003 and NI Act 1881. Accordingly, extension of the validity of the stay order again and again led to wasting of time and creating uncertainty in realization of collaterals.

Some bank managers stated that lengthy legal process, poor response of buyers and hassle created by the defaulted clients to sell the mortgaged property, local influence of the borrower, inappropriate documentation status, lack of clear identification of area and location of the collateralized low land, legal time barrier and stay order were the major problems for timely realization of collaterals. Moreover, non-mutation of the property, non-availability of up-to-date rent receipts (DCR), sub-standard location of the land, mismatch of valuation between bank's surveyor and borrowers' declaration, title deeds of collateral not in the name of the borrower, lack of documentation knowledge of the borrowers about the offered collateral, dispute in the chain of land documents, lands under the same Dag/Plot mortgaged to different banks, lack of

proper demarcation of the land, lack of the possession on the collateral by the borrower, unwillingness of the borrower to fix bank's signboard on the mortgaged property etc. caused delay in realization of collateral. Some bank managers reiterated the problems in another way and told that when a bank published the auction notice in the paper to sell the immoveable property, the defaulted clients usually arranged stay order from the honorable High Court, which created a long term complexity. Moreover, when bank took step to realize collateral they were harassed by the defaulted client. Fake documents sometimes led the banks in awkward situation. On the other hand, bank faced sharp devaluation of property while realizing collaterals since the valuators were not accountable for their overvaluation conducted at the time of pre-disbursement valuation.

i. Suggestions by the branch managers regarding collateral acquisition and realization

The branch managers opined that the legal and auction process of realization of collateral should be completed in a very faster way with the active cooperation and support from the law enforcing agencies. Besides, there should be a provision of law under which Asset Management Companies might provide guarantee to the bank for loan provided to the borrowers and bank might transfer the collaterals to them in case of failure of the borrowers to repay the loan. Court might order for one stop solution in taking the possession within a very short time. Besides these steps, managers suggested some issues that might be addressed by the concerned agencies to facilitate the timely realization of collateral:

- 1. Acquisition of collateral means getting ownership and realization means getting sale proceeds; therefore collateral acquisition and realization process should be simplified.
- 2. Adequate support from law enforcement agencies should be ensured to take repossession of collateral.
- 3. According to Artharin Adalat Ain, Sec. 12(3), Banker can publish Auction Notice in Newspapers to sell out the collateral to liquidate bank dues and can execute sell deed of collateral; but in many way bankers have to face some legal complication; ultimately Sec. 12(3) is not very much helpful toward acquisition and realization; In this context Sec. 12(3) of Artharin Adalat Ain should be modified/amended in such a way that facilitates Banker in case of acquisition and liquidation of bank dues without undue delay.
- 4. Although Artharin Adalat Ain facilitates bankers to acquisition of collateral toward realization of bank dues; but in practice verdict of Artharin Adalat is the outcome of long time consuming judicial process. In this situation Banker should be empowered allowing for acquisition of collateral directly for realization of bank dues without court's intervention; which will ultimately improve NPL situation.
- 5. Creation of marketplace where collateral security will be traded to ensure stability of the value of collateral.
- 6. Stay order should not be allowed abruptly to delay the process of realization while the bank is empowered to take possession and liquidate the collateral.

- 7. Creating a social and legal culture among the borrowers to permit the bank to take possession and realization of collateral.
- 8. Special court may be established for realization of collateral.
- 9. Direct selling authority may be given to Bank without following the auction procedure as per RIPA.
- 10. As the acquisition and realization is a legal procedure, knowledge regarding this should be clear to dealing officers also. For this, at least one employee having legal educational background like LLB/MLB degree or sound knowledge of laws & regulations of the country may be posted at the big branches of the banks. On the other hand, bank may employ experienced lawyer to conduct suit files of the branch. Branch may also be allowed to appoint local additional experienced lawyer to deal with the existing suits.
- 11. Issuance of direct body warrant of the defaulted clients and guarantors may work as an effective tool for acquiring and realizing collateral.
- 12. Litigation process may be made quick and easier for the money suit/cases.
- 13. In case of acquisition of collateral securities the borrower creates willful hindrance by himself or by any third party. In those situations, the defaulted borrowers most often try to waste time and they file a Miss Claim/ Stay Order against bank. In those cases if there is any law that a certain percentage of the outstanding liability must be deposited in the Higher Court (i.e., 20% to 30% of the outstanding), then the acquisition procedure will be smooth enough. The Government needs to give proper protection to the bank to keep the collateral under banks' control.
- 14. Quick support from Law Enforcement Agencies is required for timely support to execute the court order for realization of collateral.
- 15. Putting auction signboard on collateral or publishing selling advertisement in local newspaper should be ensured by the court.
- 16. Collateral acquisition and realization is sometime becomes complicated due to the local influence. So, local government leaders (UP Chairman/MPs) may be linked with the collateral realization process. If it is possible to tag the court in disposal system with giving a time bar then it may make the system feasible.
- 17. In case of bail under NI Act 1881, client must provide minimum down payment before obtaining bail.
- 18. In order to get fruitful result as well as to get verdict within short time, government should pay special attention in court process. It may establish special tribunal at least for the large defaulted loans.
- 19. There may be a provision to sell the mortgaged property without recoursing to auction procedure.
- 20. Emphasis should be given on implementation of court decrees by the local administration.
- 21. Scope should be made to get co-operation from law enforcing agency on call of the bank, when possession of the collateral are needed to be taken over from the mortgagor without intervention of any court and similar scope also should be made at the time of retaining possession by the bank so long required and also at time of delivery of possession to the purchaser from bank.
- 22. Legal Procedure need to be accelerated because it takes long time to come to a decision.
- 23. Stay order should not be allowed in the cases when power of the bank is valid to take possession and liquidate.
- 24. Creating a social and legal culture among the borrowers to permit the bank to take possession and realization.
- 25. Proper identification regarding ownership of land should be made.
- 26. Auction process should be made hassle free.
- 27. Law enforcement agencies should be more bank-friendly for the greater national interest.

- 28. There should be a robust process or specific guideline based on which Bank shall be able to take possession of the collateral with the help of local law enforcing agencies as and when required. If bank is not in possession of the collateral it becomes very difficult for the bank to attract the potential buyers even if the auction notices are being published in the top ranked national daily news papers
- 29. Bangladesh Bank may formulate standard easy procedure for realization of collateral within a very short period.
- 30. Digitalization of land record office of the country regarding record keeping of mortgaged land should get prime importance.
- 31. Establishment of separate Bench at Judge Court for dealing with the cases of Bank and Financial Institutions in order to quick disposal of the same is urgently needed.
- 32. Special Bench of the Supreme Court of Bangladesh to be introduced to deal with only for Banking related matters; so that no one can easily obtain stay order for restraining the Auction procedure.
- 33. Artha Rin Ain 2003 may be made more effective and updated.
- 34. Timely and proper implementation of Artha Rin Adalat Ain-2003 is needed.
- 35. Banks may be given the sole authority to sell the mortgaged property without intervention of the court.
- 36. After sell of the mortgaged property by auction, court should not accept further appeal from the mortgagor.
- 37. Collateral value should be reported in the client's CIB report.
- 38. There may be an arbitration council or banking ombudsman with legal empowerment to work as third party whose work will be to realize defaulted clients' collateral to adjust bank classified investment similarly as the role played by the bank enlisted surveyor.
- 39. Bank should have its own policy regarding collateral acquisition & realization.
- 40. Creation of a marketplace to ensure easy marketability of collateral security.
- 41. Collateral acquisition and realization is a big challenge in case of default by the borrowers. There should be a quick disposal process of collateral so that the public money can be recovered. In practical situation, bankers found it difficult since there is syndicate who are dominating the land sale market. Therefore, to verify the genuineness of the property at concerned registrar office, digitization is needed in the preservation of the information on nature of the land (whether enemy or vested property, waqf property etc.) transfer of ownership of land, leasing of land and mortgage details and mapping. This will help the banks to authenticate the chain of documents, easy demarcation and title deed of ownership.

j. Suggestions of the branch managers for amendment of Money Loan Court Act 2003, Negotiable Instruments Act 1881, Transfer of Property Act 1882 and Bankruptcy Act 1897

As regards the necessary amendments to the above mentioned acts/laws, the banks felt that at present amendment of Money Loan Court Act, 2003 and N. I. Act 1881 is must because some borrower were intentionally diverting fund as such the loan became classified. Amendments may be carried out by establishing a separate Money Loan Court Adalat in every district for reducing time of judgment, giving permission to attach other property of the client easily and criminal case under N. I. Act 1881 should be non bailable crime. Other managers observed that stay order from high court is a big issue and proceedings of Money Loan Court hinders for this. Legal

bureaucracy should be reduced and a timeline should be set to close the legal case. A mere stay order to delay the process should not stop legal proceedings and verdict to take possession. There should be presence of adequate judges who will deal those cases only so that all the relevant matters can be resolved quickly. Few clauses may be incorporated in Money Loan Court Act 2003 and N.I Act 1881 so that the client must have to provide minimum down payment before obtaining bail and stay order from high court.

Other suggestions made by the branch managers are as follows:

- 1. Banks are worried about the writ petition by the defaulted borrower at High Court and stay order against the auction under section-12(3) as well as under section-33 of Money Loan Court Act 2003 which kills lot of time, sometimes its fall into time barrier under section-28(4). They suggested to add a clause to deposit at least 20-30% of outstanding loan amount as down payment through the court at the time of filing writ petition and writ will be automatically vacate after the given time period of the High Court.
- 2. As per Money Loan Court Act, 2003, Bank has to publish Auction Notice in the reputedly public print media which becomes costly and time consuming for the bank. Moreover total settlement process is very lengthy so total litigation process has to be faster. Body warrant of the applicant and Guarantor may be effective tools for realizing collateral.
- 3. In case of every suit, there should be a time frame regarding disposal of the suit.
- 4. Quick disposal of legal steps by the Honorable Court is highly demanded by the banks.
- 5. As per present Money Loan Court Act, 2003 highest physical punishment is only 06 months imprisonment. It seems inadequate. A hundred crore loan default client should get 10 years or more sentence for physical punishment.
- 6. N. I. Act 1881: Bank should allow filing a suit with security cheque. And it should include in Loan Sanction Advice that "client will submit an undated security cheque at the time of availing the loan. And if client defaults Bank has the right to file suit with this security cheque." Besides Bank should be allowed filing a suit with lower amount than cheque value. For example if a client got loan for Tk. 50.00 lac subsequently cheque also taken for Tk. 50.00 lac. But at the time of classification client's liability may be for Tk. 20.00 lac. So in that case bank should allow filing a suit for Tk. 20.00 lac with Tk. 50.00 lac cheque.
- 7. A separate bench in Supreme Court may also be formed to look after MLC cases so that by pursuing writ at higher courts the defaulters cannot avail fresh financing from other banks and the cases may also be disposed quickly that will eventually enhance the efficiency of the special money loan court in high courts. Also a minimum deposit of certain amount out of total borrowed fund shall be prerequisite for submission of writ plea at Supreme Court since they diverted the public money in other way.
- 8. Formation of special bench in the honorable high court division of Supreme Court for bank related writ petition.
- 9. Provision for mandatory deposit in the court at the time of appearance of the defaulted clients to be made which to be handed over to the bank, so that realization process can be in motion.
- 10. Legal bureaucracy should be reduced and a timeline should be set to close the legal case.
- 11. Suggestion to amend N.I. Act 1881: Section 134 of NI Act 1881 may be amended. Bailment of the accused should be within a time frame. In this regard appeal process to make some extent easier i.e. in

case of appeal 1st payment may be 25% in lieu of 50% & rest 75% may be in 3-installments within a short interval. This will encourage the defaulted clients to pay the bank's dues. The century old NI Act-1881 should be amended. In case of bail prayer by the defaulted borrowers' physical appearance should not be enough he must have to deposit 10% of claimed amount by the bank so that public money can be recovered and they should not have the right to go to higher court for Writ petition unless the lower court provide its verdict

- 12. Suggestion to amend Bankruptcy Act: A very important structural reform in the bankruptcy act is necessary which will ensure time-bound settlement of insolvency resolution process and ease the process of doing business. The bankruptcy law will strengthen hands of bankers to recover outstanding debts by setting a fixed deadline for parties to pay or face liquidation.
- 13. The provision of selling collateral security after final verdict (as per Artharin Adalat-2003) may be amended to facilitate the sale of the security at any stage during the suit for adjustment of the loan.
- 14. A special tribunal may be formed to settle the classified loan.
- 15. The Money Loan Court Act-2003 may be amended with the provision that a borrower when filed a writ petition to the honorable High Court against Money Loan Court Act 2003, he must have to deposit minimum 20% of his outstanding loan in the court as down payment (unlike in the case of rescheduling of a loan) and then writ may be accepted. Section 28 (4): limitation for filing a new execution suit after filing of first Execution suit should be increased. Section 35: Warrant should be as effective as criminal case and a specific format of form should be introduced for warrant as like criminal case. Sections 22, 28(3), 34, 37 of Artha Rin Adalat Ain -2003 may be amended. Time frame of the trial should not be of directive nature, it should be mandatory i.e. time frame to settle the suit should be fixed. Mediation process also should be monitored closely by the authority to close the process within the time frame. The clients are using to take mediation process to kill time and take various dilatory tactics which should be closely monitored.
- 16. Valuation farm should be taken under explanation of Bangladesh Bank.
- 17. Legal bureaucracy should be reduced and a timeline should be set to close the legal case, a mere stay order to delay the process should not stop legal proceedings and verdict to take possession of the mortgaged property.
- 18. Auction process should be simplified for quick disposal of the mortgaged property.

k. Steps taken by the branch managers to reduce classified loan

The branch managers expressed that they had involved all the Officers in the loan monitoring and supervision process and their performances in this regard are being monitored periodically. They had introduced the policy for appreciation and rewarded the performing Officers. Besides, they were knocking every customer, arranged meetings with them regularly and were arranging interest waiver for the deserving borrowers subject to approval of the competent management. Apart from that all sorts of legal activities also was underway to protect the interest of public money. HSBC has dedicated Collection Management Unit for retail portfolio for early detection and management of delinquent loans to prevent growth of NPL. The bank tracked the portfolio and delinquency movements through regular MI reports. Various collection tool e.g. telecollection, SMS text reminders, collection letters, physical visits, face to face customer meeting/settlement plans etc were utilized to reduce NPL. Moreover, legal actions were also initiated by the bank for collection and recovery from NPL loans.

Some managers told that they started regular monitoring and follow-up before and after the loan disbursement and initiated pragmatic recovery drive. Proper valuation of collateral and risk assessment for covering credit risk, contact with applicant to ensure proper use of the fund and review the business condition of the clients, call up letter and legal notice to customer after disbursement, to file case in case of cheque dishonor, auction publication, case filed against applicant and guarantors, persuasion, settlement and negotiation etc. measures had been undertaken by the banks. Some other managers expressed that they had initiated some activities to reduce their classified loans. The adopted measures were: persuasion and pressure over phone, regular contact with the defaulted client to deposit money in their loan account, issuance of reminder letter, trying to find suitable buyer of the collateral securities and trying to make settlement by selling the securities, meeting with the spouse, parents, relatives, neighbours of the defaulted borrowers and make social and politically influential persons' pressure to the borrower about settlement of the liability, arranging meeting with the borrower in presence of third party like President of Chamber & Commerce, serving legal notice, filling suit under N.I. Act & Money Loan Court Act, auction sale of mortgaged property under Section 12(3) of Artha Rin Adalat Ain-2003 etc.

Some branch managers disclosed that they had created *Special Asset Management Division* (SAMD) at their head office for close monitoring of NPLs and officers from SAMD frequently visited the branches for reducing the NPL. They closely monitored the loan, regularly visited the business center. Branch officials were continuously communicating with the borrowers to adjust their liability and offering some interest waiver if they could adjust the entire liability at a time. Apart from these activities, bank officials also monitored clients' account transactions whether sale proceeds were properly deposited in clients' over draft accounts, regular visits of clients' show room/business premises, sudden visit of the mortgaged place and property, stocks and collateral security, matching with clients fund withdrawal with client's sales reflection, stocks, and receivables. When any deviation was found, officials discussed with the client. Some mangers told that they had fixed the recovery targets and distributed the targets among the officers. Some steps had also been taken through rescheduling and compromising settlement with the borrower and also filing of suits/cases against the borrower. Discussion was also held on regularly through branch task force meeting to contact with the clients and officials were assigned with the particular NPL clients by office order to keep close persuasion with them.

The branch managers also told that they had the programs of rescheduling/restructuring of the loan, waiver of interest to accommodate their loan repayment, ensuring of proper usage of the loan to avoid fund diversion by the borrower to reduce the NPL burden at their branches. They also tried to negotiate with the clients to regularize the classified loans where appropriate and withdrew court cases only after accounts were settled in full. Some banks' had their own

recovery taskforce; they stimulated the large and medium sized NPL borrowers from time to time from head office. Some banks followed policy to create family and social impediment through various actions including pressures by the peers and reach to an amicable settlement outside the court duly protecting interest of the Bank. A mixed approach was adopted by some of the banks to reduce NPL, by pursuing all legal procedures with the defaulted borrowers and also communicating one to one for amicable settlement as part of Alternate Dispute Resolution (ADR). They had succeeded to reduce NPL. Keeping constant touch with the defaulted borrowers, physical visit to customer places and listening their grievances and motivating them to pay off bank's liabilities through moral suasion were proved to be effective tools for recovering banks' dues.

Different banks had undertaken different steps on the basis of social customs and practices to reduce Non-Performing Loan through quick disposal of pending cases, consultation with market leader/association, execution of multiple suits against the same client at different times, Rescheduling, Restructuring, Interest Waiver with 'One time Exit Plan'. Some managers meticulously followed the recovery guideline of the Bank as well as the circulars from Bangladesh Bank. They tried to assess the reason(s) for classification, if their business found running with little pace then they advised them to reschedule with down payment so that he could adjust the loan on installment basis. Moreover, bank communicated with guarantors also to motivate the clients. In some cases bank followed very lenient view. If the borrower failed in business due to economic recession, unrest situation of the country, technology up-gradation, loss in business for new law impose by the Govt., sudden price fall nationally or internationally, in that case bank might further finance in his business if the client was real businessman and confident to recover his loss. But if he was willful defaulter or his management was incapable, then there was no alternative to sell his security or immediate suit file.

Chapter-11: Present Legal Framework related to Recovery of NPL and its Limitations

A few amendments in the Artha Rin Adalat Ain-2003 (Money Loan Court Act 2003) is urgently needed for making the Law more effective to facilitate the recovery process of the bank. The suggested amendments are given below:

Suggestions for Amendments of Artha Rin Adalat Ain-2003

a. Section 4 (5) of the Artha Rin Adalat Ain-2003 should be properly ensured because very often the Judge who has been appointed on such appointment try others civil case that causes delay of rendering his original duty.

[Section 4 (5): 'The Government shall appoint Judges for the Artha Rin Adalat on consultation with the Supreme Court amongst the Joint District Judges. The Judge who has been appointed on such appointment shall not any others civil of criminal case except the cases relating to money lending'.]

b. Section 12(8) of the Artha Rin Adalat Ain-2003 should not be interfered by any court

['Section 12(8): Notwithstanding anything contained in any other law for the time being force mortgaged immovable or movable property sold under the authority of lien, pledge hypothecation on under this section, the sale of that property shall create lawful interest by the purchaser. The purchase by the purchaser shall not be raised in question: Provided that the mortgagor-debtor shall be able to prefer compensation against the financial institutions if the financial institution does any illegal or procedural irregularly in the field of sale proceedings'.]

c. Section 22 of the Artha Rin Adalat Ain-2003 should not be abused for delaying purpose. Any intentional delay by any party under the veil of arbitration should be punishable offence and Ain should be amended accordingly.

['Section 22-Proceedings of arbitration shall become into end within 60(sixty) days of initiating attempt from the order passing date in order to settle the dispute through arbitration, unless the written prayer bearing requests of the parties or the Court itself mentioning the reasons extend that time limit for further 30(thirty)days: Provided that, within ten days of order of arbitration under sub-section (1)the parties shall bring into Courts concern in writing whether they have agreed to make attempt to settle the dispute through arbitration who is engaged as arbitrator: Provided further, if the parties fail to inform the Court in according to the aforesaid condition the order for arbitration under sub-section(1) shall be cancelled and the hearing and proceedings of the case shall be performed immediately in such a way as if no order were passed for arbitration'.]

d. Section 28 of the Artha Rin Adalat Ain-2003: Time limit to file suit for execution under this section should be relaxed.

['In spite of anything contained in the Limitation Act, 1908 and The Code of Civil Procedure, 1908, if the decree holder demands to execute the decree or order through the Court, he shall file a suit to the Court, he shall file a suit to the Court on application within maximum 1(one) year of gaining decree or order subject to the procedure of section 29. When the suit is filed after expiring of 180(one hundred and eighty) days disregarding the procedure(1) to award of decree or order, any suit submitted for execution shall be barred by limitation and then this Court shall reject the case outright not taking for execution. When second or any other subsequent cases filed for execution after one year of rejection or disposed up the same suit shall be barred by limitation: and summarily be rejected without taking under consideration. Where any new suit for execution is submitted after 6(six) years' expiry of first execution suit, the same shall be barred by limitation: and in this respect the Court directly dismiss that suit barred by limitation without taking it for action'.]

e. Section -33 (7) of the Artha Rin Adalat Ain-2003 should be amended to the effect that In this case court will assess a value of the property and Financial Institutions will be entitled to file a separate suit against the borrowers for realization of rest of the money.

['Section -33(7) In spite of anything contained in the provisions of sub-section(4) & (5), if the decree holder submits a written prayer stating to desire to gain property as its owner, the Court shall not make any deviation of the provisions of the sub-section (1), (2), (2A),(2B), (2C) & (3) and it shall abstain from following proceedings of sub-section (4) & (5), then been declared of vesting the title of the property prayed by the decree documents of title, the Court shall send a copy thereof in the concerned of title, the Court shall send a copy thereof in the concerned of title, the Court shall send a copy thereof in the concerned local office for the purpose of the sub-registrar for registration. (7A) if it is required to have the possession of the property by the court under sub-section (5) or (7), the court may put the possession of the property by the written order from the decree holder. (7B) The Court may require to have re-affirmation before handing over the possession of the property to the decree holder under sub-section (7A) that whether there had been mortgaged against the particular loan of the decree by the actual owner'.]

f. Section 34(1) of the Artha Rin Adalat Ain-2003 may be amended to ensure Rigorous imprisonment of 5 years in lieu of 6 month civil jail.

['Section -34(1) On consideration the submitted prayer by the decree holder subject to the provisions of sub-section (12), the Artha Rin Adalat is empowered enough to recover of the decreed money, the said Court shall send in the civil jail to the Judgment debtor to the extent of 6 (six) months'.]

g. Section (36) of the Artha Rin Adalat Ain-2003 should be amended and insert the clause that "Every Financial Institution should make bound by circular of BB to give information to other Financial Institution about defaulters assets on their demand".

['Section 36: Recovery of the decreed money from the third party : If the decree holder informs to the Court in written prayer that the decree debtor will get money to any person, in this respect the Court after hearing the person if deems it proper shall pass a written order to that third person in order to realize equal amount of decreed money, after recovering of the money the Court issue a receipt on that behalf and by such receipt that person shall be lawfully relived the debtor for that lending amount. In spite of anything contained in any law the time being in force, under sub-section (1) if the defendant/debtor is supposed to get any money from any post office, financial intuitions or insurer the Court being satisfied after hearing, from those institutions in order to fulfill realizing the amount through attachment; and in such case, the Court shall not have submit any pass book deposit receipt, policy paper, any other document entry, endorsement or such any other instrument concern thereof. If the debtor does not carry out the orders by the Court under sub-section (1) and (2) and does not give equivalent amount of money, and the same Court belong deemed as magistrate of the first class and related powers shall recover the money as fine'.]

h. Section (41) of the Artha Rin Adalat Ain-2003 should be amended considering the provision that 'Deposit of 50% decreed money should be relaxed and it can be 25% to 30%. Because when Defaulters go for writ petition in lieu of appeal he makes his argument on the 50% payment as a bar. But when defaulters get stay order form courts it totally hamper the lower courts activities. Especially big defaulters take the chance of this 50% payment bar''. Moreover, ''Every time limitation of court under sec-10, 15, 16, 17, 19, and 22 and in other sections should be mandatory for court because Justice delayed Justice denied.

[Section (41)—'Special provisions in respect of filing appeal and disposal : As a proof of party admission of the claim of the plaintiff the appellant shall deposit equivalent figure of 50% of the decreed money in cash to the decree holder financial institution and if does not admit the plaintiff's claims shall deposit money to the Court as security and the evidence of such deposit is not submitted to the Court having the memo of application or appeal in this case any appeal shall not be accepted for consideration under sub-Section (1). In spite of anything contained in sub –section (2) by depositing 10% money in cash or as deposit as per provision under section 19(3) in the mean time, in case of filing appeal the said 10% money shall be got minus from the above 50% fifty percent money'.]

Suggestions for Amendments of N.I. Act-1881

Section-138 of Negotiable Instrument Act (N.I. Act), 1881 may be amended including this provision that "Jail under this section will be bail able after payment of 25% of loan amount and with a bond of make rest of the payment with in 1 year. Any case filed under this act court shall not dismiss the case for over demand court should continue the case for rest of the money".

[Section-138 (1)] Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provision of this Act, be punished with imprisonment for a term which may extend to one year, or with fine which may extend to [thrice] the amount of the cheque, or with both: (3) Notwithstanding anything contained in subsection (1) and (2), the holder of the cheque shall retain his right to establish his claim through civil Court if whole or any part of the value of the cheque remains unrealized. Provided that nothing contained in this section shall apply unless- (a) the cheque has been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier; (b) the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer of the cheque, within [thirty days] of the receipt of information by him from the bank regarding the return of the cheque as unpaid, and (c) the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within [thirty days] of the receipt of the said notice. (1A) The notice required to be served under clause (b) of sub-section (1) shall be served in the following manner- (a) by delivering it to the person on whom it is to be served; (b) by sending it by registered post with acknowledgement due to that person at his usual or last known place of abode or business in Bangladesh; or (c) by publication in a daily Bangla national newspaper having wide circulation.] (2) Where any fine is realized under sub-section (1), any amount upto the face value of the cheque as far as is covered by the fine realized shall be paid to the holder. (3) Notwithstanding anything contained in sub-section (1) and (2), the holder of the cheque shall retain his right to establish his claim through civil Court if whole or any part of the value of the cheque remains unrealized.]

Suggestions for Amendments of Bank Company Act-1991

Section-45 of Bank Company Act 1991 may be amended as "BB can make circular under sec-45 to inspect case files of commercial banks by official having legal knowledge that the concerned bank is taking appropriate steps or not for conduct the case properly. [Section-45 Power of the Bangladesh Bank to give directions.- (1) Where the Bangladesh Bank is satisfied that- a) in the public interest, or b) to provide for the improvement of the monetary policy or banking policy, or c) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or d) to secure the proper management of any banking company, it is necessary to issue directions to banking companies generally or to any banking company in particular, it may issue such direction as it deems fit; and the banking company concerned shall be bound to comply with such direction. (2) The Bangladesh Bank may, on representation made to it or on its own motion, cancel or modify any direction issued under subsection (1); and such cancellation or modification may be subject to any condition.]

Section-46 (6) of Bank Company Act 1991 should be repealed because this sub section give impunity to directors of government owned banks from BBs action.

[Section-46 (6): Power of the Bangladesh Bank to remove a director etc. of a banking company.-(1) Where the Bangladesh Bank is satisfied that it is necessary to remove a chairman or director or principal executive officer, by whatever name he be called, of a banking company in order to prevent its affairs being conducted in a manner prejudicial to the interests of the banking company or its depositors or to secure in the public interest the proper management of the banking company, it may, after committing its reasons to writing, issue direction that such chairman, director or principal executive officer be removed from his office. (2) Before issuing a direction under subsection (1), the person affected shall be given reasonable opportunity to make a representation: Provided that, notwithstanding anything contained in subsection (2), where the Bangladesh Bank is of the opinion that a delay arising from giving such opportunity will be prejudicial to the public interest or to the interest of the banking company or its depositors, it may at any time, when or after giving the abovementioned opportunity or while deciding on a representation made under that subsection, give, by a direction in written form, order that- a) the said chairman or director or principal executive officer shall, from the date on which the direction in writing comes into effect, cease to act as chairman, director or principal officer or cease to take any part in the management of the company in any manner, directly or indirectly; and b) whoever is temporarily appointed for this purpose by the Bangladesh Bank shall act as chairman or, as the case may be, director or principal executive officer. (3) Where a chairman or director or principal executive officer of a banking company has been removed under subsection (1), he shall not be reinstated as chairman or, as the case may be, director or principal executive officer, and he shall not, for the term of the direction which shall not exceed three years, be connected with or take part in any manner, directly or indirectly, in the management of that banking company or any other banking company. (4) Chairmen, directors or principal executive officers appointed under subsection (2) shall- a) subject to the conditions determined in their letter of appointment, occupy that position for the period, not exceeding one year, determined by the Bangladesh Bank and in dependence of the Bangladesh Bank being satisfied or not; and b) not be responsible, financially or otherwise, for anything carried out in

accomplishment of the duties of their offices. (5) No person removed under subsection (1) may claim any compensation on account of thus having been removed. (6) Nothing contained in this section shall apply to any chairman, director or principal executive officer, by whatever name he be called, chosen or appointed by the Government.]

Section 49 of Bank Company Act 1991 should be strengthened by empowering BB that BB can make circular with due rigidity under Section-45 and 49 to control loan taking tendency of directors of a bank from other banks.

[Section 49: Further powers and functions of the Bangladesh Bank. (1) The Bangladesh Bank may- a) caution or prohibit banking companies generally or any banking company in particular against entering into any particular transaction or class of transactions) require banking companies generally or any banking company in particular to refrain from taking such action as it may specify in relation to any matter relating to the business of such banking company or companies, or to take such action in relation thereto as the Bangladesh Bank thinks fit. c) on a request from the banking companies concerned and subject to the provisions of section 76 assist as intermediary or otherwise, in proposals for the amalgamation of such banking companies. d) during the course, or after the completion, of any inspection under section 44, by order in writing and on such conditions as may be specified therein-i) require the banking company to call a meeting of its directors for the purpose of considering any matter relating to or arising out of the affairs of the banking company, or require any officer of the banking company to discuss any such matter with an officer of the Bangladesh Bank; ii) depute one of its officers to watch the proceedings at any meeting of the Board of Directors of the banking company or of any committee or of any other body constituted by it and require the banking company to give an opportunity to that officer to be heard at such meetings, and require that officer to send a report of the proceeding at such meetings to the Bangladesh Bank; iii) require the banking company to send to any officer specified by the Bangladesh Bank all notices of, and other communications relating to, any meeting of the Board of Directors of the banking company or of any committee or of any other body constituted by it; iv) appoint one of its officers to observe the manner in which the affairs of the banking company or of any of its branches are being conducted; v) within the prescribed time, require the banking company to make, within such time as the Bangladesh Bank may specify in the order, such changes in its management as the Bangladesh Bank may consider necessary in consequence of the state of affairs disclosed during or after the inspection. (2) The Bangladesh Bank shall make an annual report to the Government on its activities to provide for the progress and development of the banking business in the country, including in such report its suggestions for the strengthening of the banking business throughout *the country.]*

Suggestions for application of Anti Money Laundering Act 2012

Defaulters who divert their fund, or willfully default loan can be proceed under this act for commit money laundering.

["money laundering" means – (i) knowingly moving, converting, or transferring proceeds of crime or property involved in an offence for the following purposes:- concealing or disguising the illicit nature, source, location, ownership or control of the proceeds of crime; or assisting any person involved in the commission of the predicate offence to evade the legal consequences of such offence; (ii) smuggling money or property earned through legal or illegal means to a foreign country; (iii) knowingly transferring or remitting the proceeds of crime to a foreign country or remitting or bringing them into Bangladesh from a foreign country with the intention of hiding or disguising its illegal source; or (iv) concluding or attempting to conclude financial transactions in such a manner so as to reporting requirement under this Act may be avoided; (v) converting a predicate offence; (vi) acquiring, possessing or using any property, knowing that such property is the proceeds of a predicate offence; (vii) performing such activities so as to the illegal source of the proceeds of crime may be concealed or disguised; (viii) participating in, associating with, conspiring, attempting, abetting, instigate or counsel to commit any offences mentioned above;]

Suggestions for Amendment of Registration Act -1908

Registration Act-1908 may be amended as under:

Any searching report related to property transfer, mortgage, baina-nama deed shall be signed by sub-register himself, concerned sub-register should make liable in person for providing any false searching report. Because very often a property wrongfully mortgaged to bank creates realizing problems. It is possible to protect it by ensuring genuine searching report.

Suggestions for giving License to ADR Institutions

The term "alternative dispute resolution" or "ADR" is often used to describe a wide variety of dispute resolution mechanisms that are short of, or alternative to, full-scale court processes. The term can refer to everything from facilitated settlement negotiations in which disputants are encouraged to negotiate directly with each other prior to some other legal process, to arbitration systems or mini trials that look and feel very much like a courtroom process. Negotiation systems create a structure to encourage and facilitate direct negotiation between parties to a dispute, without the intervention of a third party. Mediation and conciliation systems are very similar in that they interject a third party between the disputants, either to mediate a specific dispute or to reconcile their relationship. Mediators and conciliators may simply facilitate communication, or may help direct and structure a settlement, but they do not have the authority

to decide or rule on a settlement. Arbitration systems authorize a third party to decide how a dispute should be resolved.²⁹

Alternative dispute resolution by way of mediation, arbitration or conciliation is not a panacea of all evils. It is not a substitute for formal adjudication of disputes by the courts. It is an alternative route to a speedier and less expensive mode of settlement of disputes. It is not a compulsory method of settlement, as trial of a case is, but a voluntary and willing way out of the impasse. India, Pakistan and Bangladesh, by amending their respective Codes of Civil Procedure, have been obliged by circumstances to give ADR the recognition it deserves, namely, a place in the formal judicial system itself.³⁰

In the Money Loan Court Act., 2003 the mechanism of ADR selected is a Settlement Conference to be presided over by the trial Judge and to be held in camera. The Court Fees paid by the parties will be refunded if the Settlement Conference results in a compromise decree. The Conference and its proceedings are confidential. If the Conference is not successful the case will be tried by another Judge of co-equal jurisdiction, provided the Settlement Conference Judge has not been transferred in the meanwhile. Sections 21-25 of Money Loan Court Act. 2003 deals with the issue of ADR. If both parties agreed to direct mediation under certain conditions then court may use Section 21 for settlement conference and Section 22 for direct mediation. These two alternate dispute solution processes seems too much depended upon Bank and most probability of fair output does not exist. To avoid this problem, ADR institutions may be given license as a formal negotiation body to deal with the legal matters between bank and borrowers. ADR institutions may act as Dispute Clearinghouse to exert a significant impact on reducing court backlogs.

However, the major conditions for success of the ADR institutions are: ADR program can be designed to run at lower cost, disputes are screened so that only those that can be resolved using simple procedures go to ADR, Adequate political support for institutionalizing non-court fora for solving disputes, adequate pool of qualified neutrals is willing to work, Laws/ rules can be written to support ADR fora and procedures without "judicializing" them, ADR users maintain right of appeal to formal system, Safeguards against coercion are adequate, ADR procedures can be designed to substantially reduce need for advocates, Adequate pool of ADR staff available to provide individual counseling, and ADR procedures designed to maintain parties' confidentiality.

BB may allow License to ADR Institutions to resume their activities in the country

 ²⁹ USAID: Alternative dispute resolution practitioners guide, CMG's Advisory Group of ADR and conflict management experts includes Professors Frank Sander and David Smith of Harvard Law School; Robert Ricigliano, CMG Executive Director; Diana Chigas, CMG Regional Director; and Antonia Handler Chayes, CMG Senior Advisor.
 ³⁰ Justice Mustafa Kamal (2004): Former Chief Justice of Bangladesh. "Judicial Settlement and Mediation in Bangladesh" Paper

³⁰ Justice Mustafa Kamal (2004): Former Chief Justice of Bangladesh. "*Judicial Settlement and Mediation in Bangladesh*" Paper read at the Third Working Session of The Conference on Alternative Dispute Resolutions held under the joint auspices of the International Centre for Alternative Dispute Resolutions, New Delhi and Bombay High Court in Bombay on 20th and 21st November, 2004 then published in HRPB magazine.

Need for Banking Ombudsman in Bangladesh

Many countries of the world have banking ombudsman to delivering alternate dispute resolution services. In the modern world, an ombudsman was first established in 1809 in Sweden. The word "ombudsman" is of Swedish origin and means "representative or agent" of the people. In 1919, more than a century after Sweden appointed an ombudsman, another Scandinavian country, Finland, adopted the Swedish model for the redressal of public grievances against agencies of state. The next country to follow was Denmark -this happened more recently in 1955. The first country outside Europe to establish such an office was New Zealand. This was in 1962 and generated tremendous global interest inspiring many countries, in search of good governance to launch such schemes. Today, over 100 countries have such a platform in place. In 1995, the European Union established the first European Ombudsman under the Maastricht Treaty.

We could benefit from innovations that have taken place in investigation techniques used by other ADR players. The Financial Ombudsman Service was set up by law as an independent public body. Their job is to resolve individual disputes between consumers and businesses – fairly, reasonably, quickly and informally. What matters most to them and their customers is fairness. Where things aren't fair, they can use their power to put them right. Ombudsman or similar schemes have contributed to an improved and more efficient banking system. The schemes have invariably had a very positive influence on the system where banks have become increasingly conscious of their responsibilities as service providers and of the need to satisfy and meet customer demands professionally and efficiently.

Banking Ombudsman in India

Reserve Bank of India places a great deal of importance on customer service in the banks and towards this end, it has formulated the Banking Ombudsman Scheme (BO Scheme) in 2006 which provides for a free and easily accessible alternate complaints redress mechanism for bank customers. Indeed, a reliable and robust redress mechanism is a core component of an effective customer protection framework. Such mechanism should ensure that disputes between customers and financial service provider are dealt with fairly and expeditiously.³¹ Over the years, RBI instituted BO Scheme has gained wide acceptance among bank customers for being an independent, transparent, cost-effective and expeditious grievance redressal framework. The Scheme has benefitted common bank customers, who quite often do not have means to approach other forum such as Courts, Tribunals etc.

Vision and Goals of the Banking Ombudsman Offices of India stipulated that their vision is to act as a visible and credible dispute resolution agency for common persons utilizing banking services. Their goals are to ensure redress of grievances of users of banking services in an inexpensive, expeditious and fair manner that provides impetus to improve customer services

³¹ RBI (2014): The Banking Ombudsman Scheme 2006 - Annual Report 2013-14

in the banking sector on a continuous basis, to provide policy feedback/suggestions to Reserve Bank of India towards framing appropriate and timely guidelines for banks to improve the level of customer service and to strengthen their internal grievance redress systems, to facilitate quick and fair (non-discriminatory) redress of grievances through use of IT systems, comprehensive and easily accessible database and enhanced capabilities of staff through capacity building.

Banking Ombudsman in New Zealand

New Zealand's Ombudsmen Act 1975³² states the function of Ombudsman as: (1) it shall be a function of the Ombudsmen to investigate any decision or recommendation made, or any act done or omitted, whether before or after the passing of this Act, relating to a matter of administration and affecting any person or body of persons in his or its personal capacity, in or by any of the Departments or organizations named or specified, to investigate either on a complaint made to an Ombudsman by any person or of his own motion; and where a complaint is made he may investigate any decision, recommendation, act, or omission to which the foregoing provisions of this section relate, notwithstanding that the complaint may not appear to relate to that decision, recommendation, act, or omission, to investigate—Any decision, recommendation, act, or omission of any Act or regulation, a right of appeal or objection, or a right to apply for a review, available to the complainant, on the merits of the case, to any Court, or to any tribunal constituted by or under any enactment, whether or not that right of appeal or objection or application has been exercised in the particular case, and whether or not any time prescribed for the exercise of that right has expired.

Banking Ombudsman in Malaysia

Bank Negara Malaysia announced Financial Ombudsman Scheme 2015³³. The Regulations, which were published in the Gazette on 11 September 2015, provide for the approval, oversight and obligations of a Financial Ombudsman Scheme (FOS) in Malaysia. The Regulations pave the way for the establishment of a FOS as part of Bank Negara Malaysia's efforts to enhance financial dispute resolution arrangements for consumers and to strengthen consumer protection. The FOS is required to affirm a two-stage dispute resolution process comprising mediation and adjudication which provides ample opportunity for disputing parties to review the relevant facts, issues and disagreements in an attempt to reach an amicable agreement. Where an agreement cannot be reached, a decision by the ombudsman must be supported by his reasoning for the decision and is binding on the financial service provider (FSP) if accepted by the complainant. The board of the FOS is required to put in place procedures to accept referrals from FSPs for the sole purpose of its internal review to continuously improve the effectiveness of the

³² New Zealand's Ombudsmen Act 1975

³³ Bank Negara Malaysia (2015): Financial Ombudsman Scheme 2015.

FOS. Such information will also be available for the Bank's and independent party reviews of the FOS's operations. However, it will not affect the finality of decisions made by the ombudsman which is critical to ensure the effectiveness of the FOS as an alternative dispute resolution mechanism.

Banking Ombudsman in Pakistan

According to Federal Ombudsmen Institutional Reforms Act, 2013, The Banking Mohtasib shall have the power and responsibility ---- (a) to entertain complaints from customers, borrowers, banks or from any concerned body or organization; (b) to facilitate the amicable resolution of complaints after giving hearings to the complainant and the concerned Bank; (c) To receive evidence on affidavit; (d) To issue commission for the examination of witnesses; and (e) in the event that complaints cannot be resolved by consent, to give finding which shall be acted upon in the manner set out herein.

The banking ombudsman is a quasi-judicial authority and has power to summon both the parties--bank and customer, to facilitate resolution of complaint through mediation. BB may actively consider introducing banking ombudsman scheme in Bangladesh

Chapter-12: Specific Suggestions for Effectiveness of Collateral Policy

Defined by the Small Business Administration, a United States government agency, collateral is "an additional form of security which can be used to assure a lender that you have a second source of loan repayment." The definition itself expresses that collateral secures a loan. If the borrower defaults on a loan secured with collateral, the lender/bank can seize the collateral and sell it to repay the debt. Most commonly, collateral is real property, but it can also be represented by borrower's business's inventory, cash savings or deposits, and equipment etc.

Collateral is effective in realization of defaulted loan as

- a. Collateral can be used to offset the loan to any borrower failing to pay the principal and interest under the terms of a loan obligation.
- b. The borrower does not want to lose the pledged collateral due to non-payment of the loan.
- c. Banks generally view secured loans as low risk investments and therefore charge significantly lower interest rates on such loans.

Though collateral does not guarantee the repayment of loan by the borrower; it ensures the bank that in case default by the borrower, bank can get the money back by selling the collateral. So it plays an important role in recovering the defaulted loans. Collaterals like financial obligations like deposits, government bond, savings certificate, government/BB guarantee, etc. are the most ensured collateral that can easily off-set the defaulted loans if proper documentation is accomplished. Again sometimes primary collaterals, the purchases/commodities against which loans provided, are more convenient for banks to realize the bad loans.

As mentioned earlier that collateral does not guarantee the repayment of loan, default risks of loans are increasing day by day and it has already made the banking sector sick. There are so many cases that banks can't recover the loans in spite of sufficient collateral maintained against them. In most cases small borrowers have some concerns for their collateral assets and try to repay their loans to save their properties; they also have genuine causes that hinder their regular payment. But the willful borrowers have hardly genuine causes. They keep collateral against the loans but they express their concerns for the collateral through managing 'stay order' from the court against classification of their loans, against decreeing for selling the collateral securities, through rescheduling/restructuring the loans.

On the other hand, collateral management (taking right type of collateral which is easily liquidable, justification of genuine ownership, position of collateral, valuation, lien marking/registration, documentation etc.) is a very important issue. In some cases collateral is inadequate, valuation is inaccurate, again collateral is too big to sell, position of collateral is not suitable enough to the purchaser etc. The eligible collateral has been defined under the Master

Circular on Loan Classification and Provisioning (BRPD Circular No. 14 date: September 23, 2012) issued by the Banking Regulation & Policy Department of Bangladesh Bank. Collateral is also discussed in the core risk guidelines: Credit Risk Management (CRM) for Banks. But they don't contain a detailed valuation policy. There should be an extensive Collateral Policy including an exhaustive list of eligible collateral, Collateral Valuation Policy so that taking collateral becomes effective in recovering non-performing loans.

There are some recommendations that may make collateral effective in realization nonperforming loans:

- 1. Collateral Policy: There must be a separate comprehensive Collateral Policy which will contain the types of collateral acceptable and unacceptable for each loan type, adequacy of collateral to cover the outstanding balance of the loan, documentation requirements for various types of collateral etc.
- 2. Eligible Collateral: There should be an exhaustive list under 'Eligible Collateral' which are easily encashable, marketable and maintainable.
- 3. Valuation Policy: There should be an elaborated Valuation Policy for determining the market value of 'Eligible Collateral'. Valuations of residential and commercial properties should be carried out by an independent professional valuation company. Valuation will take into account all relevant factors affecting the salability of such assets including the difficulties in obtaining their possession, their location, condition and the prevailing economic conditions in the relevant sector, business or industry. Valuation method including the assumptions made, the calculations/ formulae/bases used in the determination of the values i.e. the forced sales value (FSV) shall be mentioned in the report.
- 4. Frequency of valuation: The valuation policy should clearly describe how frequently collateral valuations will be performed. Typically, the frequency of valuations depends on the size of the exposure, the type of collateral, the location, and the established controls over the collateral.
- 5. Controlling over Valuation Company: There should be a controlling authority over the functions of the valuation company to monitor their valuation methodology since it is seen that Valuation Company shows high market value of the security than its present value.
- 6. Ongoing monitoring: Collateral valuation is required at origination and should be repeated on an ongoing basis to ensure that the assets maintain their value. Appropriately trained staff must be available to perform ongoing collateral monitoring.
- 7. Justifying the Genuineness of Collateral: Collateral security whether it is good or bad depends on the genuineness of that security. Fake security adds no value to the bank. So, the bank should ascertain the genuineness of that security.
- 8. Registered mortgage: Collateral mortgage will be duly registered with the appropriate local and/or national authorities before a loan is disbursed.

- 9. Ratio of Loan to Collateral Value: The loan to collateral value should not be so high. In case of large amount of security, it may be impossible for bank to recover the loan by selling out the collateral.
- 10. Within the controlling area of Bank branch: The collateral security should be preferred under the supervision area of the bank branch.
- 11. Collateral Insurance: Collateral is usually structured on a case-by-case basis. All collateral (including any residence involved), especially that which the Borrower relies on to generate cash flow, should be insured along with any other collateral a guarantor might provide separately from business collateral.
- 12. Effectiveness of Collateral law: There should have collateral law in the sense that it constitutes a coherent body of dispositions; collateral law is rather a collection of dispositions in different legal compartments in private law and in penal law. There should be legal support for banks so that the defaulter can't again and again take the opportunity of stay order to prevent the selling of collateral properties against non-performing loans.

Chapter-13: Major Findings and Main Policy Suggestions of the Study with special focus on Collateral

NPLs are an acute problem of the banks of Bangladesh and more specifically for banks located in the urban and corporate periphery dealing with the industrial and big business loans. Our analysis was based on the observation of link between the defaulters and mortgaged properties with the bank provided by them which is called collateral. This is the first ever study to examine if there is a long run effect caused by macroeconomic, bank-specific and collateral based determinants. A further novelty has to do with the unhealthy banking market competition and fragmentation of authority question especially in case of public utility oriented SCBs.

Quality of loan management and moral hazard (through the loan to deposits effect) play an important role in creating huge amount of NPL in the banking system of the country and has been exerting a stronger effect in respect of loan sanctioned with inadequate collateral. This leads to creation of high level of NPL which necessitates for adoption of appropriate macroprudential as well as NPL resolution policies in order to invigorate banks and boost growth especially in the much affected and still suffering banks. In most cases, valuation of collateral was done by the enlisted surveyors. They willfully and with the intention to fulfill the adverse desire of the clients overvalue the collateral. A combined effort from banking community to rate these valuation firms' capabilities and subsequently delisting for the entire market would work for change the ill mindset of the valuators/surveyors.

The other main reason for failing to realize collateral in due time is prolongation of judiciary process which seems in many cases as defaulter friendly system. Therefore, legal framework of the insolvency regime must be revisited and necessary amendments should be in place for smooth recovery of the NPLs.

A number of **policy options** are proposed in the subsequent paragraphs about how to deal with current NPL problems:

- 1. Bank management may exert their best efforts at improving the bank's loan portfolio management. Therefore it is recommended that this effort to avoid NPL should be strengthened more and more. Higher position in the bank may be made conditional in favour of the excellent branch managers.
- 2. Regarding the sectors with high non-performing loan, it is identified that domestic trade and service sector which is highly financed by the banks, shows highest bad loan due to market problem and lack of proper financial education. Therefore it is recommended that bank has to consider providing financial education to its clients as a measure to minimize risk of default.
- 3. Regarding factors which cause non-performing loan from the borrower's side, fund diversion stands as one of the formidable reason. Therefore, it is recommended that monitoring and supervision of clients should be strengthened and bank management should set regular schedule on site visit; this would prevent diversion of funds into business ventures other than

the agreed purposes, help loan officers assist customers who are facing some business management problems such as improper records keeping, and overtrading that affect their business operations.

- 4. Regarding cause for non-performing loan from bank side, the main causes as revealed by the finding were poor credit appraisal, ineffective monitoring, delayed loan approval and under financing. Therefore, it is recommended that bank management should organize regular training programs for credit staff in areas like credit management, risk management and financial analysis. This would sharpen the knowledge and skills of credit officers so as to improve on the quality of credit appraisal, prevent delayed loan approvals, enable credit officers appreciate the need to comply with credit policy and further enhance monitoring of credit.
- 5. To avoid under financing, the loan officer has to give good awareness to clients about collateral value to get sufficient loan from the bank.
- 6. To ensure effective monitoring, it is recommended that bank management should ensure that credit offices of the branch should be adequately resourced in terms of staff, vehicles and other logistics, to support monitoring activities. It enables the bank assess borrowers' current financial conditions, ensure the adequacy of collaterals, ensure that loans are in compliance with the terms and conditions of the facility, and identify potential problem loans for action to be taken.
- 7. To avoid moral hazard problems in selection of right borrowers, it is recommended that loans granted to customers should be well secured in terms of adequacy of collateral provided and also ensures that proper legal documentation is put in place. This would reduce losses arising out from problem loans and minimize effects of such loans in the form of bad debt provisions, on financial performance of bank.
- 8. Regarding measures taken to manage and minimize burden of nonperforming loan, it is recommended that bank has to use rehabilitation mechanism as primary measure because it could support both bank and defaulted clients since it is an action of making loan active once again.
- 9. The cyclicality of the business directly influences the repayment capability of the borrowers. Thus, it has an impact on the amount of non–performing assets of the banks. Therefore, government policies especially linked with businesses should be business-friendly.
- 10. The technological obsolescence is a factor that affects repayment abilities of manufacturing firms. The efficiency of manufacturing entity in raising funds impacts the repayment abilities of the firm. The banks should consider the BMRE financing on an extensive basis.

BB may like to raise this issue with the banks in Bankers' Meeting

11. Existing unhealthy competition among the banks for loan buy-out through offering more money and easy conditions created an opportunity for the borrowers to divert the bank loan and ultimately increasing the NPL of the system. This is happening in the bank loan market

because of the target oriented banking drive. Bank managers are over burdened by the loan targets fixed by their higher authorities. Promotion and development of their careers also depend on fulfillment of the targets. That's why market became more unhealthy and competitive, bankers offer huge money, and makes the client more valuable and overburdened with huge amount of loan. Client buying or loan buy-out especially by the new generation banks aggravates NPL situation. BB should devise appropriate policy/circular in respect of loan buy-out. It is suggested that in case of transfer of loan ownership in favour of new bank/NBFI. Conditions may be imposed that in line that loan may be increased only by 10-15% after adjusting all dues of immediate past bank.

BB should devise appropriate policy/circular in respect of loan buy-out. I

12. Hiding of the information of imposing high interest rate and other service charges on loan account increases the installments of the borrowers. Bank does not inform the clients about the change in the interest rate and other service charges.

BB may issue circular regarding this issue by instructing the banks/NBFIs for communicating the clients if there are any changes in the interest rate and service charges.

13. Defaulted clients misuse their basic right to get stay order system and go to the court for further extension of stay order period that prolongs the recovery period. Unfortunately, there is no option to prevent the clients from the frequent extension of the stay order.

BB may raise this issue to the ministry/government that defaulted clients may avail this opportunity but after depositing 10-15% of their outstanding loan to the court.

14. It is seen that Non-bank financial institutions (NBFIs) frequently allure the borrowers of the banks to come to their NBFIs for availing increased limit of loans. This has created an unhealthy competition between the banks and NBFIs.

BB may issue guideline/circular for loan absorption of banks by the NBFIs so that this sort of practice does not create an adverse situation in the loan market.

15. Bank evaluates the value of its collateral after 2 consecutive years. The value of collateral depends on the economic situation. When banks observe the declining trend of the collateral value, they try to adjust the loan or strongly focus on that specific loan for recovery. Asset evaluation agency may over value the collateral influenced by the clients. In many cases banks also accept the valuation of agency imprudently which makes realization of collateral difficult when bank gets court verdict.

BB may devise 'Valuation Policy' and issue circular to follow uniform valuation procedures for determining the market value of eligible collateral.

16. Politically exposed persons (PEPs) have the tendency to get loan from banks/NBFIs by any means and loan certainly become default. Sometimes bank/NBFI managers are in the deep pressure from the board members or from the top management of the bank to disburse loan to the PEPs which ultimately become default.

BB may instruct the banks/NBFIs not to extend loan to PEPs, inform BB about their whereabouts by maintaining list of the PEPs whose business proved as fake and leads the loan to become NPL.

17. Political unrest/hartal/fighting between the rivals is one of the main reasons for clients to be defaulted. This brings stagnancy in business activities and slows down the business cycle which compelled clients become irregular in the case of repayments and throws them at the classified basket.

Government may take all-out measures to maintain law and order situation businessfriendly.

18. Some clients were defaulted due to lack of financial literacy. They were small business owners and don't know anything about pros and cons of banking operations at least to understand the loan conditions and legal actions in case of default. This creates unnecessary gap between the bank and clients. It is assumed that they were not to be defaulted if they have minimum financial literacy in a good state.

BB may issue circular to the banks/NBFIs to take appropriate measures to educate the clients through 'Financial Literacy Program for the Clients'.

19. One of the root causes for creation of NPL is fund diversion for different purposes. Clients diversify their business at their own judgment and also diversify the fund for new entity. Land purchases at cheap rates for sale in future at higher price or investment in the share market for short term windfall gains are the areas of fund diversion. Besides, fund is diverted for treatment purpose, family affairs, repaying loans taken from various sources, house building, and other businesses etc. This is happening because of the lack of active monitoring of loan by the banks.

BB may think over the issue and may instruct the banks to strengthen their loan monitoring system and report to BB.

20. Large businesses suffer from absence of good corporate governance and culture which affects the timely repayment of loan.

SEC and Chamber of Commerce and Industries may be asked to guide the large businesses to practice good corporate governance and culture in their businesses.

21. It is evident from the field study that banks fail to keep their commitment to provide with the loan within the stipulated time. Borrowers initially invest in the proposed business/project relying on the banks' commitment and finally if don't get timely disbursement their business/project affected and leads to default. In this type of cases, borrowers incur huge loss in business and get disappointed due to inordinate delay in sanctioning of the loan.

BB may instruct the banks to simplify the loan sanctioning procedure and avoid inordinate delay in sanctioning of loan.

22. It is identified in the field survey that banks deny extending the current loan or granting of a new loan when the borrowers were in default as a result of loss in business. If bank would address this situation with a positive turn, borrowers could get out from the difficulties, continue their businesses and repay the loans.

BB may draw attention of the banks to this issue at Bankers' Meeting.

23. A large number of borrowers raised question about the BB policy of loan classification and rescheduling. They told the survey team that in many cases, due to "one size fits all" policy of loan classification and rescheduling, they can't avail reschedule conditions as the installment size is too big for them to comply with or rescheduling period is too small for them to execute. In this situation,

BB may think whether the existing loan classification and rescheduling system can be customized on the basis of capacity of the borrowers in line with their business strengths.

24. When a loan is disbursed by bank without having sufficient mortgage, from the very beginning the customer feel an immunity that he is free from legal obligation for pay back the loan and this type of notion leads to fund diversion and loan default. To avoid this type of moral hazard problem

BB may instruct the banks to get sufficient visible mortgage with proper valuation so that in case of default those can be realized.

25. It is noted that many corrupt bank officials adheres into bribery and discourage/mislead the clients not to pay back bank loan. BB may take up this issue and discuss at the "Bankers Meeting". BB may also instruct the banks to ensure implementation of internal control and compliance system at their banks head office and branches with due diligence to keep the bank officials (including board member) free from nepotism and availing of undue facilities.

BB may take up this issue and discuss at the "Bankers Meeting".

26. Selection of right borrowers or real entrepreneurs is the prime issue of all banks. To facilitate this process, banks should interchange clients' overall information among them. But this exchange of information has been closed after introduction of CIB reporting system.

But considering the fraud and forgery and adverse information, BB may again instruct the banks to exchange borrowers' information among them to ensure better selection of the borrowers.

27. BB can establish a Collateral information data warehouse like CIB at its head office to help the banks to check the credibility and valuation of the collateral given to the bank. There should be an exhaustive list under 'Eligible Collateral'.

BB can establish a Collateral information data warehouse at its Head Office.

28. Government should have the capacity to assess the exact demand and supply of a product in the case of imports since government policies regarding price of imported goods affects the market and importers' interest. Excessive imports of a product dismantle the market price of that product which indirectly affects the borrower to repay the bank loan.

BB may take up this issue for discussion at the appropriate government forum.

29. Banks should take financing decision to stimulate local industries/entrepreneurs to facilitate the even development of the country. In this respect, banks may be asked to explore new SME clusters or areas of investment.

Banks may be asked to explore new SME clusters or areas of investment.

30. To check rising trend of NPL, a provision may be made that defaulter clients those are members of the chambers of commerce and industries should not be allowed to participate in the chambers election.

BB may raise this issue with the Chambers and Commerce and Industries apex body FBCCI.

31. Banks should play the role of advisers to the clients. Banks should go to the clients with supply-driven policies and mind-set and suggests/advise the borrowers the easiest way to revive the loss businesses so that the good borrowers repay the loan and get back to the business again. Banks may also play advisory role for the clients to guide them for proper market study and business. Banks may also consider, observe and analyze different government policies on various issues and inform the borrowers about the changes.

BB may highlight this issue at Bankers Meeting.

32. The borrower who is maintaining business with more than one bank managing different sister concerns and if this client becomes defaulter with any one bank, then hiding the information client avails loan from other banks for other sister concerns. To check this sort of risky practices, the banks involved with this particular client may exchange information from each other and take decision not to disburse further loan to that client until the settlement of the dues. Therefore, there should be a policy of embargo for the defaulted clients in case of taking loan from more than one bank.

BB may raise this issue at the bankers meeting and issue directives for the banks.

33. In the businesses, especially in proprietorship businesses, second line of management should be maintained from the family. As a result, it will be easier for banks to recover the money from the successors as they are trained of the business and loans. Otherwise it may be difficult for banks to recover loan amount as businesses get closed and none knows about the businesses and loans.

This issue may also be taken up at the Bankers Meeting and banks may be advised to make knowledge sharing program/financial literacy programs for the successors of businesses.

34. When the borrower has more than one concern, the usage of banks' finance becomes overlapping and it is not possible to identify how much bank finance is used in one particular concern. Thus, the accounting system of the concerns may be maintained separately determining loss in a particular concern.

BB may advise the banks to maintain proper information.

35. The classification time frame for loan classification should be determined considering the macroeconomic situation of the country and region, acceptability of such kind of policy,

analyzing the neighboring countries' policies on this issue. All loans must not be classified in the same way. Loans should be categorized according to their size, nature, industry, target group, priority sector etc. There could be different classification regime for different type and different sized industries. There should be extensive empirical research work on it.

BB might initiate an extensive research study to develop a robust loan classification system taking into consideration of other country's best practices.

36. There should be some precise methods for qualitative judgment so that banks cannot willfully avoid classification or intentionally classify the loan which is not required to be classified taking opportunity of absence of concrete policy.

BB may devise appropriate policy regarding qualitative judgment on classification methodology

37. Banks should be instructed to ensure fixing with borrowers realistic payment schedules on the basis of real cash flows while granting loans and advances instead of tightening the classification time frame. This will facilitate prompt repayment by the borrowers and thus improve the record of recovery.

BB may instruct the banks to ensure fixing with borrowers realistic payment schedules on the basis of real cash flows

38. There should be a clear instruction regarding the reversal of interest income account (interest collected/applied when the loan was unclassified) into interest suspense account (when the loan gets classified). This will deter the mentality of banks to be sure about their income certainty and compel them to be more cautious about the proper loan nursing.

BB may issue directive/circular addressing this issue.

- 39. SME should be clearly defined so that banks cannot take advantage of the privilege of SME financing provisioning and apply it to other fields.
- **40.** There must be a customized Loan Classification & Provisioning policy for Islamic Banking system since there investment modalities are quite different from the conventional banking system.

BB may constitute a 'working committee' to prepare separate Loan Classification & Provisioning policy for the Islamic banks.

- 41. There should be a comprehensive rescheduling policy (they may be termed differently) for unclassified, classified and written-off loans. The repayment schedule must match the average cash flow cycle of a business in the economy; otherwise the loan will be defaulted again and again. There should be an assessment procedure beside classification criteria for a loan to be rescheduled. There could be reschedule time frame regime for different type and different sized industries.
- **42.** The required down payment policy must be reconsidered as it is seemed high to all the borrowers. Besides amount/percentage of down payment should also be set considering the size and type of loans. The rescheduling policy must not let banks mingle/mix different types of loans into one term loan as it conceals the initial identity. There should be an identification symbol that reveals its original type.

BB may think to revise the rescheduling policy and instruct the banks accordingly.

43. There should be a restructuring policy for demand or continuous loans. The time frame for restructuring Term loans also should be realistic. There should be included an option in the policy so that bank cannot take back their provision to income account as soon as the loans are rescheduled without delaying for observation of their future performance. There should be some way out in the policy for Exit by the gone concerns.

BB may issue a prudent circular considering the implications of restructuring policy for the large defaulted borrowers.

- 44. Policy should be introduced so that unusual/growing rescheduling indicates negative signals for asset quality and BB can initiate some measures to check the problem.
- 45. A reporting requirement should be introduced so that banks have to report regularly to BB to get a bank-wise and overall banking sector rescheduling picture.

BB may develop reporting format for rescheduling of loans.

46. The present write-off policy helps banks to conceal the real non-performing loan situation because a written-off loan is taken outside the bank's balance sheet. Though a separate ledger must be maintained for written off loans and in the Annual Report/Balance Sheet of banks there must be a separate "notes to the accounts" containing amount of cumulative and current year's loan written off.

BB may issue a circular regarding for inclusion a separate note to the accounts'' containing amount of cumulative and current year's loan written off.

47. It was informed that one client (organization) had business with 32 different banks and this client became defaulter in all of these banks after completing taking loans from all of the 32 banks. This type of culture had created a systemic problem in the banking sector because a lot of money had been concentrated in few hands and remained away from recycling of the money in the economy.

BB may develop a policy limiting the number of banks from whom a single borrower can take loans.

48. The policy states that in order to accelerate the settlement of law suits filed against the written off loans or to realize the receivable of written off loans any agency outside the bank can be engaged. But, the debt collection agents are most often seen to complain that the banks do not pay them the agreed commission as per the contract. There should be some elaborated policy regarding debt collection agents.

BB may issue a guideline/policy for debt collection agents.

49. As regards the judicious fixation of single borrower exposure limit, present sector-wise and geographical exposure limit may be set along with Single Person/Counterparty or Group exposure limit to avoid concentration risk in limited sectors and regions so that all the important sectors get finance and regions are evenly developed.

BB may like to prepare a new circular/guideline regarding single borrower exposure limit.

50. There should be a restriction on from how many banks a Single Person/Counterparty or Group can avail large loan or single borrower exposure limit. The definition of 'Group' especially 'economic independence' might be more specific, unambiguous and easy. There should be objectivity. It should be clearly mentioned that whose (the specific relations) loans should be included in the group and their share holding percentage.

BB may discuss this issue at Bankers' Meeting

- 51. 'Exemptions' as given to some cases may be avoided so that one bank is not over burdened with more credit risk and other banks also can finance a good borrower.
- 52. Foreign banks' strong policies (compared to CRG) should be justified by the central bank as they don't follow CRG system.

BB may discuss this issue at Bankers' Meeting

53. Interbank money market exposures may be included as they might be considered as another source of concentration risk that might potentially endanger banks' survival.

BB may issue directives regarding the inter-bank market exposure limit of the bank.

- 54. As regards the legal infrastructure for insolvency regime of the country, it is observed that many amendments are required to streamline the loan management process. To ensure quick removal of the NPLs, implementation of the laws on time is necessary. There are a lot of suggestions to amend the especially the *Money Loan Court Act, 2003, N.I. Act 1881 and Bankruptcy Act 1997*. Sections 22, 28(3), 34, 37 of Artha Rin Adalat Ain -2003 may be amended. Time frame of the trial should not be of directive nature, it should be mandatory i.e. time frame to settle the suit should be fixed. Mediation process also should be monitored closely by the authority to close the process within the time frame. The clients are using to take mediation process to kill time and take various dilatory tactics which should be closely monitored. The Money Loan Court Act-2003 may be amended with the provision that a borrower when filed a writ petition to the honorable High Court against Money Loan Court Act 2003, he must have to deposit minimum 20% of his outstanding loan in the court as down payment (unlike in the case of rescheduling of a loan) and then writ may be accepted.
- 55. Section 28 (4): limitation for filing a new execution suit after filing of first Execution suit should be increased. Section 35: Warrant should be as effective as criminal case and a specific format of form should be introduced for warrant as like criminal case. Section 134 of NI Act 1881 may also be amended. Bailment of the accused should be within a time frame. In this regard appeal process to make some extent easier i.e. in case of appeal 1st payment may be 25% in lieu of 50% & rest 75% may be in 3-installments within a short interval. This will encourage the defaulter clients to pay the bank's dues. A very important structural reform in the bankruptcy act is necessary which will ensure time-bound settlement of insolvency resolution process and ease the process. Thus the bankruptcy law will strengthen hands of bankers to recover outstanding debts by setting a fixed deadline for parties to pay or face liquidation. Specifically following amendments are necessary in different laws:

Section-45 of Bank Company Act 1991 may be amended as "BB can make circular under sec-45 to inspect case files of commercial banks by official having legal knowledge that the concerned bank is taking appropriate steps or not for conduct the case properly. Section-46 (6) of Bank Company Act 1991 should be repealed because this sub section give impunity to directors of government owned banks from BBs action. Section 49 of Bank Company Act 1991 should be strengthened by empowering BB that BB can make circular with due rigidity under Section-45 and 49 to control loan taking tendency of directors of a bank from other banks. Defaulters who divert their fund, or willfully default loan can be proceed under this act for commit money laundering. Registration Act-1908 may be amended as under: Any searching report related to property transfer, mortgage, baina-nama deed shall be signed by sub-register himself, concerned sub-register should make liable in person for providing any false searching report. Because very often a property wrongfully mortgaged to bank creates realizing problems. It is possible to protect it by ensuring genuine searching report.

BB may instruct the Law Department of the Bank to work on the proposed amendments and take up these issues with the competent authority for discussion and amendments.

56. In the Money Loan Court Act., 2003 the mechanism of ADR (Alternative Dispute Resolution) selected is a Settlement Conference to be presided over by the trial Judge and to be held in camera. The Court Fees paid by the parties will be refunded if the Settlement Conference results in a compromise decree. The Conference and its proceedings are confidential. If the Conference is not successful the case will be tried by another Judge of coequal jurisdiction, provided the Settlement Conference Judge has not been transferred in the meanwhile. Sections 21-25 deals with the ADR. If both parties agreed to direct mediation under certain conditions then court may use Section 21 for settlement conference and Section 22 for direct mediation. These two alternate dispute solution processes seems too much depended upon Bank and most probability of fair output does not exist. To avoid this problem, ADR institutions may be given license as a formal negotiation body to deal with the legal matters between bank and borrowers. ADR institutions may act as Dispute Clearinghouse to exert a significant impact on reducing court backlogs. However, the major conditions for success of the ADR institutions are: ADR program can be designed to run at lower cost, disputes are screened so that only those that can be resolved using simple procedures go to ADR, Adequate political support for institutionalizing non-court fora for solving disputes, adequate pool of qualified neutrals is willing to work, Laws/ rules can be written to support ADR fora and procedures without "judicializing" them, ADR users maintain right of appeal to formal system, Safeguards against coercion are adequate, ADR procedures can be designed to substantially reduce need for advocates, Adequate pool of ADR staff available to provide individual counseling, and ADR procedures designed to maintain parties' confidentiality.

BB needs to assess the process of current Alternative Dispute Resolution (ADR) practices by the court under the MLC Act 2003 and to decide over issuing formal license to ADR institutions especially to deal with the NPLs of the country.

57. We could benefit from innovations that have taken place in investigation techniques used by other ADR players. The Financial Ombudsman Service was set up by law as an independent public body. Their job is to resolve individual disputes between consumers and businesses – fairly, reasonably, quickly and informally. What matters most to them and their customers is fairness. Where things aren't fair, they can use their power to put them right. Ombudsman or similar schemes have contributed to an improved and more efficient banking system. The schemes have invariably had a very positive influence on the system where banks have

become increasingly conscious of their responsibilities as service providers and of the need to satisfy and meet customer demands professionally and efficiently.

BB may consider establishing "Banking Ombudsman" in the country to function as a quasi-judicial authority and has power to summon both the parties--bank and customer, to facilitate resolution of complaint through mediation.

58. South Asian countries' experience of NPL envisaged that among them Sri Lanka had been able to keep NPL at below 5% level (well below the internationally acceptable level) whereas it was at double digit level in case of Maldives. It would be good step to explore, which determinants are liable for NPL in South Asian countries especially in case of Sri Lanka and Maldives. If any exposure visit is undertaken in future to understand the magnitude and determinants of NPL in those countries, Bangladesh might be benefited.

BB may like to send a short team on exposure visit to Sri Lanka and Maldives to understand the magnitude and determinants of NPL of these countries.

59. Finally, the study team likes to propose that an elaborate study must be done to understand the after effect of a policy before issuing circulars on the important issues so that it is not to be required to amend/change within a very short period of implementation.

BB may undertake an elaborate study to understand the after effect of policies adopted on important issues till date.

The foregoing findings including policy suggestions show that NPL eroded the financial gains of the bank and created enormous problems in the system which badly affected the financial performance of the country. In view of the important role the bank plays in the economic development of the country, it is very essential for all stakeholders, especially regulator and bank management to adopt practical measures to minimize the NPL problem in the bank with keeping collateral visible, realizable and correctly valued.

Chapter-14: Limitations of the Study

We have selected 41 banks' 75 NPL burdened branches covering 574 defaulted clients which reflected an insignificant amount of total population (defaulted borrowers). However, after scrutinizing of data/information supplied by all banks, heavily burdened NPL branches had been selected for field survey. The study team conducted this primary survey through direct inspection of the concerned bank branches and interviewed with 574 defaulted clients directly as a sample data for the study. The sample was however, not well enough to represent the whole spectrum of the problem.

The limitations of the study were mentionable, it has not covered all of the defaulted clients who have been granted stay order from court and delayed payments year after year. Any interested researcher may conduct further study having wider sample and questionnaire with time series data. The scope of the study is limited only in 4 selected areas namely Bogura, Khulna, Chittagong and Dhaka regions. The study did not focus on case studies of the defaulted clients which might improve the acceptability of the study.

Using the bank-wise data collected from all scheduled banks' head offices and secondary data collected from the Department of Off-site Supervision of Bangladesh Bank, which was cross sectional data for one year (end December, 2015) that may vary the linkage between NPL and outstanding loan against inadequate collateral. In this regard, the further study may use the panel data in this area.

In addition, different methods of research could be used for study of the same topic or other related aspects of the topic. Specifically, a future study might research into the NPL problems in different banks with emphasis on Trade and service, Building and construction and agriculture which are key sectors of the banks' lending activities.

Chapter-15: Concluding Remarks

High ratio or rising tendency of non-performing loans in banking system leads to decrease in the profitability and capital adequacy ratio of the banks. Considered from the point of economics, increased in Non-performing loans negatively affects economic growth by causing to a decrease in loanable funds. Non-performing loan can enhance the insolvency of banks leading to bank failure. Current study concentrates on empirical analysis of the nonperforming loans of the 41 selected commercial banks' 75 branches of Bangladesh and investigates the response of NPLs to macroeconomic and bank specific factors.

The high level of NPLs requires banks to raise provision for loan loss that decreases the bank's revenue and reduces the funds for new lending. NPL of Bangladesh is much higher than other SAARC countries such as India, Bhutan, Maldives and Sri Lanka except Pakistan. Comparative analysis of NPL of Bangladesh with SAARC countries gives a signal that Bangladesh should be more prudent in making sophisticated and proactive policies for the reduction of NPL in the banking system. Adoption of sound accounting and reporting practices is a must for ensuring a clean banking system. Consistent implementation and compliance to regulatory and accounting requirements contribute to the stability of the banking sector. BB may think over creating a separate watchdog for carrying out the loan supervision activities as some other central banks have been managing their supervision activities through separate agencies.

To ensure speedy debt recovery, a separate Debt Recovery Tribunal may be established alongside the money loan courts. Banks have expressed their dissatisfaction with the money loan court system that was instituted to ensure speedy recovery. The number of claims in litigation is quite large and changes should be made urgently in money loan court act. Unless the system is overhauled, the rate of pendency at the money loan court will rise unrestrained. Such a state of affairs will seriously put the banking system in doldrums. A study on China³⁴ revealed that increasing financial fragility was attributable mainly to the evolving triangular relations among the fiscal system, the state-owned enterprises (SOEs) and the state-owned banks (SCBs). To reduce financial risks and build a strong banking system, the Chinese government has introduced a set of reform measures including adopting a new accounting system, improving financial supervision and regulation, recapitalizing the SCBs, and establishing four asset management companies (AMCs) for dealing with the bad loans. We may also think for devising AMC policy and allow them to work in resolving existing NPLs or in preventing the creation of new NPLs. Relationships between the parent banks and the AMCs may be defined to deal with the problem

³⁴ John Bartel and Yiping Huang, Dealing with the Bad Loans of the Chinese Banks, Discussion Paper Series Discussion Paper No. 13, APEC Study Center, Columbia University, July 2000.

enterprises with their NPLs. The establishment of AMCs in China provides the potential for putting in place a solid foundation upon which a strong reformed banking system has been built.

One of the reasons identified for dynamic evolution of the stock of NPLs in the country consists of both gradual recognition and continued soft lending to loss-making clients, i.e., making new bad loans. The former is related to unrevealed information due to an unwillingness to disclose the true nature of client loans by the banks because of internal incentives within the bank and to uncertainty about the ability of a client to repay a loan because of the overall economic environment in which the client operates. BB should consider introduction of uniform accounting framework for the banks. To resolve the NPL problem of the SCBs, government has to make a credible commitment to a once-off bank recapitalization policy and avoid the moral hazard problem of encouraging new bad loans. SCBs must be granted independence in decisionmaking from both the government and their bad clients. Independent bank governance may deal with bad loans efficiently. Alongside, AMCs should also be created and allowed to develop financial institutions that provide competition for the commercial business of the big four SCBs and SBs. We know that undercapitalized commercial banks did not promote effective competition; rather it led to systemic instability. Therefore, more foreign bank penetration may play an effective role to encouraging such competition. The government should broaden the possibilities for privatization of the SCBs. The thin capital markets of the country need to be deepened and broadened to facilitate the eventual disposal of assets by the AMCs.

Although a secondary source of loan repayment, collateral plays an important role in lending, it can be used to solve multiple economic problems, but it provides little benefit to banks even in good times, because of the difficulty in valuing and realizing collateral. Regarding realization of collateral, one important issue is the execution of collateral. This process was very lengthy and problematic. Even collateral in the form of residential mortgages can also poses considerable risks, which depends on real estate market developments and the effectiveness of the legal and judicial system. Banks must be properly regulated to force them to do their 'know your customer' (KYC) due diligence properly, so that if they cannot identify the ultimate beneficial owner of the funds, they must not accept the customer as a client. Every bank should maintain data/information on collateral and publish an online registry of collaterals. Such transparency of publishing collateral information should become a mandatory criterion for banks. BB may also establish a ''Data Warehouse for Collateral'' at CIB and share the information with the banks.

Banks may be required to maintain the politically exposed persons (PEPs) database on which the banks rely to carry out their customer due diligence. Banks should be required by regulation to respond to requests for information from other banks on collateral of the clients seeking loans from new banks/NBFIs. BB may require detailed credit policies and procedures and adherence thereof by the banks, periodic financial statements duly endorsed by board and senior management to ensure that those are true reflections of the financial positions of the banks. Failure to correctly disclose financial information should constitute an offence and the concerned bank may be penalized. For effective method of identifying and monitoring collateral, separate

agency may be created for reviewing the collateral regularly. Role of Loans Review Committees of the banks should play a more central role in oversight of credit performance. They should report directly and timely to the Board. MIS of the banks should be robust that effectively supports the credit risk management process.

External auditors are expected to ensure compliance with both IFRS and regulatory guidance. They should ensure appropriateness of loan classification and provisioning framework, correct and consistent treatment of collateral and valuation practices consistent with IFRS. External auditors may also be required by regulation to report promptly to BB all instances of material misstatement. Banks may be instructed to diversify their portfolio of loan with proper inspection to reduce the burden of non-performing loan. Proper valuation of the collateral is essential to avoid the risk of the willful defaulters. BB may formulate a uniform valuation policy for the banks. Evaluators may also be taken under direct supervision of BB. Banks may be advised to reduce loan disbursement based on personal undertakings. Banks can introduce incentive programs to encourage the employees in the recovery section to bring down the non-performing loans. Credit officer must be skilled enough to understand the psychological behavior of the borrowers. Inspection departments of BB should monitor whether due processes and principles of good lending are strictly adhered to by banks and other financial institutions.

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Terms of Reference (TOR) of the Study on Credit Risk arising in the Banks from Loans Sanctioned against Inadequate Collateral

Introduction

Smooth and efficient flow of saving-investment process is a prerequisite for the economic development of a country. Bangladesh, being a developing country and with an underdeveloped capital market, mainly depends on the intermediary role of commercial banks for mobilizing internal saving and providing capital to the investor. Thus, it matters greatly how well our financial sector is functioning. Looking at the performance of our financial sector for the last decade or so, we observe that our banking sector is heavily burdened with a high percentage of non-performing loans (NPLs). It is obvious that NPL reduce banks' profitability, as banks cannot appropriate interest income from their classified loans. NPL reduce loanable funds by stopping recycling. Banks need to set aside a portion of their income as loan loss reserve to make up bad debt. A bank with a high percentage of NPL suffers from erosion of the capital if there is no provision (assume). All those adverse impact of NPL on banks' financial health such as low profitability and low capital base are clearly reflected in banking sector of Bangladesh.³⁵

As per the ECB annual review 'high shares of Non Performing Exposures or NPEs (i.e. NPLs) constitute a serious macro prudential problem and are likely to have far-reaching macroeconomic consequences. First, a large stock of NPEs indicates that households and non-financial firms are excessively indebted and impaired, which may depress consumption and investment, and thus delay economic recovery. Second, scarce resources in the banking sector, capital, funding, as well as operational capacity, are absorbed by legacy assets and cannot be deployed to support new viable investment projects. This, in turn, may lengthen the period of subdued economic activity, further aggravating the NPE problem for the banking sector and the economy as a whole'.³⁶ The theme of "non-performing loans" (NPLs) has attracted more attention in recent decades. Several studies examined bank failures and find that asset quality is an indicator of insolvency (Demirguc-Kunt, 1989; Barr and Siems, 1994). Banks still have a high level of impaired loans before the bankruptcy. Therefore, the large amount of bad loans in the banking system generally results in a bank failure. The NPLs are the main causes of economic stagnation. Each impaired loan in the financial sector increases the possibility of difficulty and unprofitability to lead company.³⁷

Non-performing loans (NPLs) refer to those loans from which banks no longer receive interest and/or installment payments as scheduled. They are known as non-performing because the loan ceases to "perform" or generate income for the bank. Chowdhury et al. (2002) state that the non-performing loan is not a uniclass but rather a multiclass concept, which means that NPLs can be classified into different varieties usually based on the length of overdue of the said loans. NPLs are viewed as a typical byproduct of financial crisis: they are not the main product of the lending function but rather an accidental occurrence of the lending process, one that has enormous potential to deepen the severity and duration of financial crisis and to complicate macroeconomic management (Woo, 2000). This is because NPLs can bring down investors' confidence in the banking system, piling up unproductive economic resources even though depreciations are taken care of, and impeding the resource allocation process.³⁸

³⁵ Deep Majumder (2014): Internship Report on Non-performing Loans in Banking Sector of Bangladesh: Causes and Effect, MBA Program, BRAC University.

³⁶ European Central Bank: Financial Stability Review, May 2015.

³⁷ Ahlem Selma Messai and Fathi Jouini (2013): Micro and Macro Determinants of Non-performing Loans International Journal of Economics and Financial Issues, Vol. 3, No. 4, 2013, pp.852-860.

³⁸ Bishnu Pada Banik and Prahallad Chandra Das (2015): Classified Loans and Recovery Performance: A Comparative Study between SOCBs and PCBs in Bangladesh, Jatiya Kabi Kazi Nazrul Islam University, Trishal, Mymensingh, Bangladesh. THE COST AND MANAGEMENT, Vol-43, No-3, May-June 2015.

Definition of Non-performing Loans (NPLs)

A Non-performing loan is a loan that is in default or close to being in default. Many loans become nonperforming after being in default for 90 days, but this can depend on the contract terms. According to IMF, definition of NPLs is "A loan is non-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full" (Wikipedia, definition of NPLs). By bank regulatory definition non-performing loans consist of:

- a) Loans that are past due by 90 days or more and still accruing interest, and
- b) Loans which have been placed on nonaccrual (i.e., loans for which interest is no longer accrued and posted to the income statement).

Loan may also be non- performing if it is used in a different way than that for which it has been taken. As per Section 5 (cc) of Bank Company Act 1991, 'defaulting debtor' means any person or institution served with advance, loan granted in favor of him or an institution involving interest or any portion thereof, or any interest which has been overdue for six months in accordance with the definition of Bangladesh Bank. Non-performing loans are also called non-performing assets (NPA), which are loans, classified by a bank or a financial institute, at the instruction of the regulatory authority, on which repayments or interest payments are not being made on scheduled time. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash inflows. Interest cash inflow is excess money over principal, which is called profit.³⁹ Banks usually treat assets as non-performing, if they are not serviced in scheduled time. If payments are late for a short time, a loan is classified as past due. Once a payment becomes late (usually 60 days), the loan is classified as non-performing. NPL is a sum either of the borrowed money upon which the debtor has not made his/her scheduled payments, which is in default or close to being in default. Once a loan is non-performing, the odds that it will be repaid in full are considered to be substantially lower. If the debtor starts making payments against a non-performing loan, it becomes a performing loan.

Types of Classified Loans

A classified loan is the term used for any loan that a bank examiner has deemed to be in danger of defaulting. The borrower does not necessarily need to miss payments order for a bank to label the account in this manner. A borrower can have what the bank calls a classified loan for different reasons. This is simply a precaution that financial institutions take to prepare for a possible loss and to prevent any further risk. Bangladesh Bank defines classifying system such as Special Mention Account (SMA), Sub-Standard (SS), Doubtful (DF) and Bad and Loss (BL). This is actually the key risk grading system in order to measure the assets' quality. This grading must be used to check asset-quality periodically. Downgrading of any facility should be informed in Early Alert Reporting (EAR) for decision-making authorities. The loans are usually classified by the lending bank, whenever the bank has reasons to believe that the borrower would not be able to repay the loan regardless of whether the loan is overdue or not. Loans extended by a bank are classified into the following three categories.

a) Substandard: Advances which appear substantial degree of risk to bank by reason of unfavorable record or other unsatisfactory characteristics.

³⁹ Deep Majumder (2014): Internship Report on Non-performing Loans in Banking Sector of Bangladesh: Causes and Effect, MBA Program, BRAC University.

- b) Doubtful: Advances the ultimate realization of which is doubtful and in which a substantial loss is probable.
- c) Bad/Loss: Advances which may not be recoverable at all and entire loss is probable.

Definition of Collateral and Relations between Collateral and NPL

Collateral is one of the most widely-used features of debt contracts. An impressive theoretical literature – dating back at least to Stiglitz and Weiss (1981) – motivates collateral as arising from information gaps between borrowers and lenders. While the theoretical models are well-developed, to our knowledge there is no clear empirical evidence that either confirms or refutes the central implication of these models – that a reduction in asymmetric information should reduce the incidence of collateral. The theoretical models explain the use of collateral as a mechanism to reduce equilibrium credit rationing and other problems that arise due to asymmetric information between borrowers and lenders. Most of this literature invokes two particular frictions. The first is ex ante private information regarding project quality held by borrowers that may result in adverse selection problems. The second is ex post risk shifting, reduced effort, and other moral hazard problems due to costly monitoring or incomplete contracting.⁴⁰

Collateral use may play different roles under different circumstances, as evidenced by research where it can be used as a method to mitigate information asymmetries or as a signal of creditworthiness by the borrower. Akerlof (1970), Coco (2000), Booth and Booth (2006) and Berger and Udell (1995) find that collateral can be imposed by the lender to minimize the repercussions of information disparities between the lender and the borrower. Leeth and Scott (1989), Chan and Kanatas (1985), and Spence (1973), however, depict scenarios where borrowers may attempt to self-impose collateral as a signal of their creditworthiness and to obtain more favorable loan terms. The aforementioned studies have looked at links between lender, borrower, and market characteristics and the use of collateral in loan contracts.⁴¹

Collateral is an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan. Coco (2000)⁴² looks at many other collateral studies and finds that asymmetric information in proposed firm projects as well as between the lender and borrower contributes to the use of this non-price loan term. He finds that collateral is used more by individuals with insufficient established credit histories and acknowledges that not enough has been researched into the impact that long term relationships between lender and borrower might have on collateral requirements. Booth and Booth (2006)⁴³ note that most collateral studies focus on the use of collateral for mitigating adverse selection and moral hazard exposures. They analyze a sample of commercial bank loans provided by the Securities and Exchange Commission and the Loan Pricing Corporation, and find that as default risk increases, so does the collateral requirement.

The Functions of Collateral⁴⁴

From the lender's point of view, lender has the right to demand collateral: basically, collateral serves the lenders' following interests:

⁴⁰ Allen N. Berger, Marco A. Espinosa-Vega, W. Scott Frame and Nathan H. Miller: Why Do Borrowers Pledge Collateral? New Empirical Evidence on the Role of Asymmetric Information.

⁴¹ Rebecca González and Teófilo Ozuna (2012): Mitigating Information Asymmetries through Collateral Pledges, International Journal of Business, Humanities and Technology, Vol. 2 No. 7; December 2012

⁴² Coco, G. (2000). On the use of collateral, Journal of Economic Surveys, 14, 191-214.

⁴³ Booth, J. R. & Booth, L.C. (2006). Loan collateral decisions and corporate borrowing costs, Journal of Money, Credit and Banking, 38, 67-90.

⁴⁴ B. Balkenhol and H. Schütte: Collateral, Collateral Law and Collateral Substitutes (2nd Edition) Working paper No. 26, Employment Sector, Social Finance Programme International Labour Office Geneva.

- a) Protection against risk--collateral must limit a lender's losses by giving the lender a protection against the partial or total loss of resources (in addition to the intrinsic capacity of the financed activity to generate a surplus).
- b) Screening--collateral is also a screening device (next to a number of other screening devices built into a loan contract, for example the interest rate).

The pledge in a collateral arrangement means that the borrower could lose part of his property if he does not pay back; the borrower has an interest in paying back. The hesitation of a borrower to provide collateral could signal to the bank that the borrower is fully aware of the implications of making this pledge, and if he does provide collateral, then he is likely to do everything to avoid the loss of the pledged asset. In addition to these primary functions, collateral also serves to put the lender into a privileged position vis-à-vis other creditors, should the borrower become insolvent; to obtain this effect, the lender must effectively acquire information on prior claims to the same asset. Another, less frequently observed motive for taking collateral is to reduce transaction costs; this is the case with high-quality collateral, for example financial papers held by the bank, the value of which is stable for the duration of the loan and easier to establish than the inherent creditworthiness. By taking collateral, the bank can save the transaction costs of having to review a loan application.

Collateral as defined by Bangladesh Bank

As per the Master Circular on Loan Classification and Provisioning (BRPD Circular No. 14 date: September 23, 2012) issued by the Banking Regulation & Policy Department of Bangladesh Bank, the **eligible collateral**⁴⁵ has been defined as under:

In the definition of 'Eligible Collateral' the following collateral will be included as eligible collateral in determining base for provision:

- a) 100% of deposit under lien against the loan.
- b) 100% of the value of government bond/savings certificate under lien.
- c) 100% of the value of guarantee given by Government or Bangladesh Bank .
- d) 100% of the market value of gold or gold ornaments pledged with the bank.
- e) 50% of the market value of easily marketable commodities kept under control of the bank.
- f) Maximum 50% of the market value of land and building mortgaged with the bank.
- g) 50% of the average market value for last 06 months or 50% of the face value, whichever is less, of the shares traded in stock exchange.

Determination of Market Value of Eligible Collateral

In determining market value of easily marketable commodities, land and building, banks are advised to follow the instructions mentioned below:

a. Easily marketable goods will mean pledged, easily encashable/saleable goods that remain under full control of the bank. However, while the concerned bank branch official will conduct periodic inspection to verify as to whether requirements have been met such as the suitability of goods for use, expiry period, appropriateness of documentary evidences, and up

⁴⁵ Bangladesh Bank (2012): Master Circular on Loan Classification and Provisioning, issued by Banking Regulation & Policy Department, BRPD Circular No. 14 date: September 23, 2012

to date insurance cover, the same will have to be assessed by the professional assessor from time to time.

- b. For land and building, banks will have to ensure whether title documents are in order and concerned land and building will have to be valued by the professional valuation firm along with completion of proper documentation in favour of the bank. In the absence of a professional valuation firm, a certificate in favour of such valuation will have to be collected from a specialized engineer. Nevertheless, temporary houses including tin-shed structure shall not be shown as building.
- c. In order to facilitate the on-site inspection by Bangladesh Bank's Department of Banking Inspection, banks are also advised to maintain a complete statement of eligible collateral on a separate sheet in the concerned loan file. Information such as a description of eligible collateral, their assessment by a recognized firm, marketability of the commodity, control of the bank, and reasons for considering eligible collateral etc. will have to be included in that sheet.

In terms of the above policies, the banks will conduct their classification- activities on quarterly basis. These activities must include periodic revaluations of collateral, no less frequently than one year for movables and no less frequently than three years for immovables. The classification of each individual loan must be justified in writing and the documentation must contain the signatures of both the persons assigning the classification and the person reviewing it. These written justifications must be maintained in the loan files and be available for viewing by the Bangladesh Bank inspection teams.

Bangladesh Bank Guidelines on Credit Risk Management (CRM) for Banks⁴⁶

In Chapter 04 of the above guideline (BRPD Circular No. 4 of 08 March, 2016) it is stipulated under the head 'Credit Risk Mitigation' that 'Banks may use different strategies such as collateral and guarantees etc. to mitigate credit risks. Credit Risk Mitigation strategies can be of agreements made between the bank and the borrower, or between the bank and a third party, which lower the credit risk to the bank. The existence of credit risk mitigation is no substitute for proper loan underwriting and loan administration. They are correctly viewed only as secondary sources of loan repayment, never primary sources. Given the often lengthy, arduous, and costly process of realizing the collateral or invoking the guarantee, banks are strongly cautioned against making their loans collateral- or guarantee-dependent. A loan is considered collateral-dependent when repayment is expected to be provided solely by the seizure and sale of the collateral, the continued operation of the collateral, or, sometimes, both together.

Collateral is defined at Clause No. 4.2 of the guideline as follows:

For proper credit risk management, banks must keep track of which loans are collateralized by which types of collateral. "Concentrations of collateral" are nearly as dangerous as concentrations by type of loan or industry. The following scheme for categorizing loans by collateral type is recommended:

- a) Commodities/export documents: a) Export documents; b) Commodities: i) Export commodities, ii) Import commodities, iii) Other commodities pledged or hypothecated.
- b) Shares and securities.

⁴⁶ Bangladesh Bank (2016): Guidelines on Credit Risk Management (CRM) for Banks, BRPD Circular No. 4 of 08 March, 2016, Chapter 04 of the above guideline).

- c) Machinery/fixed assets (excluding land, building/flat).
- d) Real estate: a) Residential Real estate, b) Commercial Real estate.
- e) Financial obligations.
- f) Guarantee of individuals (personal guarantee).
- g) Guarantee of institutions (corporate guarantee): a) Guarantee of bank or NBFI; b) Other corporate guarantee.
- h) Miscellaneous: a) Hypothecation of crops; b) Other.
- i) Unsecured loans.

i) Type and Amount of Collateral Required

It is imperative that the bank, when extending credit, demand the type and amount of collateral as stated in its credit risk management policy. The loan-to-value ratio must be low enough to absorb declines in the value of the collateral that may occur with a small, though not insignificant probability. The most valuable collateral is cash and easily en-cashable financial collateral stipulated in Risk Based Capital Adequacy Guidelines (in line with Basel III). Other collateral in order of its quality and marketability would be marketable securities, real estate and a personal guarantee. The order of collateral mentioned is the same as the operating cycle of the company. The farther away from cash, the more tenuous the value becomes. Real estate, taken as collateral, is less liquid and marketable in the short run but is controllable and dependable in value.

ii) Initial and Ongoing Valuation of Collateral

Collateral is only as good as the lender's ability to locate, identify, and legally claim the collateral and eventually sell the collateral for enough to recover the principal, interest, plus all liquidation costs. When collateral is taken as security, consideration must be given to the dependability of the value, its marketability, the liquidity and the ability of the bank to control the collateral when in the possession of the debtor and when the bank must liquidate. Cash flow is the primary source of repayment and the collateral taken should be valued on a liquidation basis. The bank is unlikely to be more successful with the collateral than the borrower has been. Determining value of collateral at the time of the inception of the loan is essential. Continuous updated valuations are needed, depending on the length of the loan, particularly if the loan becomes a problem loan. The techniques of valuing include the cost, or replacement value, market, income as a going concern or liquidation, and the liquidation value. It is essential that the bank uses outside appraisers or companies familiar with auctions and liquidation experience. If a borrower gets into trouble, the good collateral will be the first to be used by the borrower to satisfy other debtors or suppliers. The bank should consider the costs to liquidate, which includes foreclosure, holding the collateral for sale, and the costs of selling.

To reiterate, banks need to reassess the value of collateral on a periodic basis. Appropriate inspection should be conducted to verify the existence and valuation of the collateral. The frequency of such valuation is very subjective and depends upon the nature of the collateral. For instance, credits granted against shares need revaluation on almost a daily basis, whereas if there is mortgage of a residential property the revaluation may not be needed as frequently.

Third-party Guarantee and Credit Risk

The bank must understand that the credit risk on a loan is not eliminated by the existence of a third-party guarantee. The bank merely substitutes the credit risk of the guarantor for that of its own client. With regard to guarantees, banks should evaluate the level of coverage being provided in relation to the credit-quality and legal capacity of the guarantor. Additional credit-enhancing steps are the following:

- a) The corporate guarantee must be supported by a Memorandum of Association (MoA) and Articles of Association (AoA) of the company giving the corporate guarantee. Additionally, the corporate guarantee to be approved in the board meeting of the corporate guarantor.
- b) The guarantor company must be rated in any of the investment grade categories by at least one ECAI.
- c) The balance sheet of the third party giving a corporate guarantee is to be analyzed. Net worth, total assets, profitability, existing credit lines, and security arrangements of the company giving the corporate guarantee to be analyzed to ensure that the company is not exposed to financial obligation beyond its capability.
- d) Once the financial stability of the corporate guarantor has deteriorated in terms of the above, the bank shall ask for remedial measures from the borrower (replacement/new collateral).
- e) Reciprocal guarantee arrangements between two banks will be disregarded. For example, if Bank A guarantees loans made by Bank B to certain client(s), and Bank B guarantees loans made by Bank A to certain client(s), only the difference between the two guaranteed amounts will be considered as a credit enhancement for the purposes of determining the overall level of credit risk at the bank whose borrowers benefited from the higher amount.

Overall NPL Scenario of the Country⁴⁷

In the case of Bangladesh, the gross non-performing loan (NPL) ratio (i.e. gross non-performing loans as percentage of total loans outstanding) in the banking sector declined to 8.8 percent in Calendar Year 2015 (CY15) from 9.7 percent in CY14. Though, in monetary terms, gross NPLs increased by 2.4 percent over the years, faster growth in the total loan portfolio (14.8 percent), accompanied by the restructuring facility granted by BB and increased amount of rescheduled loans during the same period caused the gross NPL ratio to decline. The gross NPL ratio of all groups of banks except FCBs went down between end-December 2014 and end-December 2015. FCBs experienced a slight increase of 0.5 percentage points in gross NPL ratio during this period. Consequently, FCBs recorded a higher NPL ratio than that of the PCBs for the third consecutive year. The SDBs demonstrated a better performance during the review period. The gross NPL ratio of these banks dropped to 23.2 percent in CY15 from 32.8 percent in CY14. The gross NPL ratio of SCBs also recorded a decline of 0.9 percentage points in CY15 and stood at 21.5 percent. The gross NPL in monetary amount increased from BDT 501.6 billion in CY14 to BDT 513.7 billion in CY15. The quarterly analysis shows that the gross NPL amount in the last quarter of each year since 2011 was lower than the preceding quarters except for the year 2012, in which each quarter recorded a higher NPL amount than the previous one. This trend indicates that the banking industry reschedules and/or restructures a portion of their stressed loans at the end of each year, which inflates banks' profitability and reduces provision requirements.

The net non-performing loan (NPL) ratio in CY15 remained the same as it was in CY14 despite having a lower gross NPL ratio in CY15. This is due to a relatively higher provision shortfall experienced by the banking industry during this period. The overall net NPL ratio of the industry went down to 4.2 percent from a gross NPL ratio of 8.8 percent after accounting for the loan-loss provisions maintained. The lower the net NPL ratio of the banks the more resilient they are thought to be to withstand stability threats. In this regard, PCBs holding the largest share of the industry in asset size maintained a net NPL ratio much below the industry average. It is observed that SDBs had a lower net NPL ratio than that of SCBs, despite having a higher gross NPL ratio. FCBs, usually, maintain relatively higher provisions against gross NPLs compared with other categories of banks. Due to this fact, they had the lowest net NPL ratio in CY15 despite having higher gross NPL ratio than that of PCBs.

In monetary terms, the gross NPLs increased by BDT 12.2 billion in CY15. This increase required banks to maintain cumulative provisions amounting to BDT 308.9 billion as of end-December 2015, against

⁴⁷ Bangladesh Bank (2015): Financial Stability Report, 2015.

which banks actually maintained provisions amounting to BDT 266.1 billion. The maintained provision in CY15 is around BDT 15.6 billion lower than that of CY14 leading to a sharp rise in provision shortfall from BDT 8 billion in CY14 to BDT 42.8 billion in CY15. As of end-December 2015, banks maintained 86.1 percent of required provisions compared with 97.3 percent as of end-December 2014. During the same period, the ratio of the maintained provisions to gross NPLs went down from 56.2 percent to 51.8 percent. The decline in the maintained provision amount along with the decline in the provisions to gross NPL ratio may signal an early warning of deteriorating resilience of banks, especially in the presence of bad/loss loans of 84.6 percent of gross NPLs. The decline in NPLs to total loans ratio in recent years till 2011 can be attributed to some progress in recovery of long outstanding loans and partly to write-off of loans as 'bad' or 'loss'. But it went again in 2012 and 2014 due to new loan classification policy and some scam in the banking industry. The SCBs and DFIs continued to have high level of NPLs due mainly to poor appraisal, inadequate follow-up and supervision of the loans disbursed. Furthermore, these banks were reluctant to write-off the historically accumulated bad loans because of poor quality of underlying collaterals. The collateral adequacy affects the performances/quality of loans to a great extends. This study aims at analyzing the present situation of NPLs in the banking industry and the cause and effect of an increase in NPLs. The study will include an analytical analysis on credit risks and policy recommendations regarding credit risk management in Bangladesh.

Literature Review and Gap

There are lots of existing literatures in world regarding non-performing loan and the vulnerability of asset to credit risk. Paravisini (2004)⁴⁸ showed that when banks face a positive liquidity shock they relax collateral requirements to new borrowers and expand lending to known borrowers with worse histories of repayment performance. Finally, he showed that although low collateral and bad credit histories are good predictors of default on average, loans made during liquidity expansions are not more likely to default. The results are consistent with the suboptimal lending view of financing constraints. Gheorghe (2012)⁴⁹ presented financial and real sector interaction highlighting that credit growth based on increase of credit demand, of income, of assets prices, of currency availability, the interest rate differential between countries and relaxation of regulatory framework, leaves banks more vulnerable to subsequent downturn in economic activity and asset prices.

Beck, Jakubik and Piloiu (2013)⁵⁰ studied the macroeconomic determinants of non- performing loans (NPLs) across 75 countries during the past decade. According to our dynamic panel estimates, the following variables are found to significantly affect NPL ratios: real GDP growth, share prices, the exchange rate, and the lending interest rate. In the case of exchange rates, the direction of the effect depends on the extent of foreign exchange lending to unhedged borrowers which is particularly high in countries with pegged or managed exchange rates. In the case of share prices, the impact is found to be larger in countries which have a large stock market relative to GDP. These results are robust to alternative econometric specifications.

Haneef and et al (2011)⁵¹ investigated the impact of risk management on non- performing loan and profitability of banking sector of Pakistan with secondary data. The result of this study reveals that there

⁴⁸ Paravisini, Daniel (2004), "Constrained Banks and Constrained Borrowers: Does Bank Liquidity Affect Loan Growth, Collateral and Default Risk?" MIT, Department of Economics, October 2004.

⁴⁹ Gheorghe, Chitan (2012), "The credit and credit risk management during the crisis" Annals of the "Constantine Brancusi" University of Târgu Jiu, Economy Series, Issue 1/2012.

⁵⁰ Beck, Roland, Jakubik, Petr and Piloiu, Anamaria (2013), "Non-Performing loans what matters in addition to the economic cycle?" European Central Bank, Working Paper Series no 1515 / February 2013.

⁵¹ Haneef and et al (2011), "Impact of Risk Management on Non-Performing Loans and Profitability of Banking Sector of Pakistan" International Journal of Business and Social Science, Vol. 3 No. 7; April 2012.

is no proper mechanism for risk management in banking sector of Pakistan. Study also concluded that non-performing loans are increasing due to lack of risk management which threatens the profitability of banks. This study provides suggestion that banking sector can avoid their nonperforming loans by adopting methods suggested by state bank of Pakistan. Philippos Papadopoulos and Xiayan (Jason) Wang (2016)⁵² developed a conceptual framework for risk capital calculation for portfolios of non-performing loans. In general banking practice, loans that pass a threshold of delinquency are declared non-performing and are provisioned. Yet there is a residual risk that the provisioning is not sufficient. This risk must be covered by capital buyers. Their framework builds on tools used in portfolio credit risk modeling and provides a structured approach to address the risk pro1le that is speci1c to non-performing loans. Rahman (2011)⁵³ found that the banks in Bangladesh have started undertaking a number of quantitative and qualitative measures to understand the risks involved in credit or chance of default which may come from the failure of counterparty or obligor (client) to fulfill his/her commitments as per agreed terms and contractual agreement with the bank. Traditionally, a bank gives emphasis on collateral in funding to the clients whereas in the concept of modern banking a bank keenly feels to measure the business risk over the security risk for ensuring the timely repayment of invested funds.

Majumder (2014)⁵⁴ attempted to find cause and effect behind the NPLs in Bangladesh. He explained that, the first reason is entrepreneur's related and Second reason is business related. Effects of NPL are such as Stopping Money Cycling, Earning Reduction, Capital Erosion, Increase in Loan Pricing, Frustration etc. As a result, the values of security are increased and the risks of financial recession also see a rise. Rabeya Sultana Lata (2015)⁵⁵ attempted to find out the time series scenario of NPLs, its growth, provisions and relation with banks profitability by using some ratios and a linear regression model of econometric technique. The empirical results represent that NPL as percentage of total loans of SCBs is very high and they holds more than 50 % of total NPLs of the banking industry from FY2006 to FY2013. Moreover, it is one of the major factors of influencing banks profitability and it has statistically significant negative impact on Net Interest Income of SCBs for the study periods.

Rationale of the Study

It is evident from the literature survey that there are very few studies examined the relationship between credit risk and collaterals. Our study aims at analyzing the credit risk resulting from increase in non-performing loans (NPLs) due to insufficient amount of collateral. The research question is that whether the inadequate collateral taken by the banks at the time of loan sanction increases NPLs or other factors affecting the NPLs. This is the first attempt to investigate the relationship between collaterals and credit risk in Bangladesh based on the primary survey. It is expected that the study will come up with certain specific policy recommendations to lessen the burden of NPL in the country.

⁵² Papadopoulos, Philippos, Wang, Xiayan (Jason) (2016), Risk Capital for Non-Performing Loans" OPENRISK WHITE PAPER, February 26, 2016. , € †

⁵³ Rahman, Md. Saidur (2011), "Credit Risk Management Practices in Banks: An Appreciation", Journal of Islamic Economics, Banking and Finance, Vol. 7, No. 3, Jul– Sep 2011

⁵⁴ Majumder, Deep (2014), Non-performing Loans in Banking Sector of Bangladesh: Causes and Effect", Internship Report, BRAC university.

⁵⁵ Lata, Rabeya Sultana (2015), "Non-Performing Loan and Profitability: The Case of State Owned Commercial Banks in Bangladesh", World Review of Business Research, Vol. 5. No. 3. September 2015 Issue. pp. 171 – 182

Official Reference of the Study

The 25th meeting of the Banking Supervision Committee held on 29th February, 2016 at Bangladesh Bank chaired by the honorable Deputy Governor-2.The Chairman of the meeting discussed on the topics 'Credit Risk arising in the banks from loans sanctioned against inadequate collateral' and raised the question 'To what extent the loans sanctioned against inadequate collateral affects the non-performing loans (NPLs) of the country?'. In this backdrop he kindly desired that the Research Department may to conduct an in-depth study on this issue and find out effective policy recommendations.⁵⁶

Objectives of the Study

- h) To review the NPL situation of overall banking system.
- i) To review the collateral taken by the banks against loan.
- j) To review the performance of borrower defaulted due to inadequate collateral to understand the default culture of the country.
- k) To review linkage between inadequate collateral and growth of NPL.
- 1) To review the recovery regime of Bangladesh.
- m) To review the existing laws and regulations of insolvency regime of Bangladesh.
- n) To recommend suggestions and future policy directions.

Methodology and Scope of the Study

The study is based on the primary survey which will focus the historical performance of the selected defaulted clients and concerned bank branch managers as per the enclosed questionnaire. Initially, the required data and information have been collected as per the selected variables of same point of time from head office of 56 banks and the study team will collect primary data via field survey later from the proclaimed classified clients directly. However, on the basis of the information a detailed TOR including the sample of the survey has been prepared. At the second Stage, primary information will be collected from four selected regions/Divisions/Districts with highest NPL record through direct field survey with formatted questionnaire. Bank branches of different banks have been selected randomly. About 18 bank branches will be directly visited in 5 working days in each region and total 72 branches will cover 576 defaulted clients. Data/information will be collected through interview in person both of branch manager and clients (Detail of field survey is given at Annexure-I). There will be two types of questionnaires; one for the clients and another for the incumbents of the bank branches. After the completion of the field survey and compilation of data in array, this study team may apply the cross-sectional data analysis due to persistency with the objective of the study to explore about whether the inadequate collaterals affect NPL. To do this analysis, this study will apply STATA or E-Views software.

Limitation of the Study

After scrutinizing of the data/information supplied by the banks, 72 branches of 41 banks have been selected for field survey which will cover 576 defaulted clients. Team will conduct this primary survey through direct inspection of the concerned bank branches and take direct interview from 576 defaulted clients as a sample data for the study. The sample is well enough to represent the study and draw policy implications for the central bank. The limitation of the study is that it is not covering all of the defaulted clients who have been granted stay order from the court and delayed the payments year after year. Any interested researcher may conduct further study having the wider sample and questionnaire with time series data. The scope of the study is limited only in 4 selected areas namely Bogura, Khulna, Chittagong

⁵⁶ Reference No.-DBI-1 (Policy)/1001/1/2016-673 dated 31-03-2016.

and Dhaka regions. Study will try to focus some case studies of the defaulted clients which may highlight the background causes and consequences of those clients.

Study Team

The study team has been constituted of the following officials of different departments of Bangladesh Bank⁵⁷.

Sl.	Name	Designation	Department	Responsibility
1	Mr. Md. Abdul Awwal Sarker	GM	RD	Chief Coordinator
2	Mr. Md. Golam Moula	DGM	RD	Member
3	Ms. Jebunnessa Karima	JD	DOS	Member
4	Md. Nazimul Arif Sarker	JD	RD	Member
5	Md. Mokhlesur Rahman	JD	RD	Member- Secretary
6	Ms. Ayasha Akter	JD	RD	Member
7	Mr. Md. Moshiur Rahman	DD	LD	Member
8	Mr. Mir Iftekhar Hossain	DD	BRPD	Member
9	Mr. Mohammad Ali	DD	DBI-4	Member
10	Mr. Md. Faruk Hosen	AD	DBI-1	Member

The study will be conducted under direct supervision and guidance of Md. Abdul Awwal Sarker, General Manager, Research Department, Bangladesh Bank as Chief Coordinator to the Study.

Assigned Work to be completed	Timeline		
	From	То	
Submission of draft TOR for Approval	04-10-2016		
Contact with the selected banks' head			
office, regional offices and Bangladesh			
Bank offices. Preparation of	9-10-2016 to 20-10-2016		
questionnaire sets for bank branch			
incumbents and borrowers			
The Field Survey Period ⁵⁸	23-10-2016	08-12-2016	
Data compilation, tabulation and analysis	11-12-2016	31-12-2016	
Preparation of draft report	01-01-2017	31-01-2017	
Submission of the draft report	28-02-2017		
Presentation of the findings in an In-	Mid-March, 2017		
house seminar			

⁵⁷ Note: Members of the above stated study team may be replaced in case of any unanticipated emergency situation.

⁵⁸ Detailed plan of field survey is given at Annexure-I.

Arrangement of Expenditure

- a) Officials of the study team will be entitled to TA/DA and other existing allowances according to existing rules and regulation of Bangladesh Bank for conducting field survey during 23 October 2016 to 08 December 2016.
- b) Officials of the study team have already completed eleven (11) meetings to discuss the issues in detail and completed the background work of the study and prepared the TOR of the study. Therefore, team members will be entitled to meeting honorarium as per the Administrative Circular No. 30 dated 04 October, 2012 of Human Resources Department-2.
- c) Dead Stock Section of Expenditure Management Department-1 will provide necessary papers, stationary materials and other logistics required to conduct the study as per the list⁵⁹ enclosed at Annexure-II.

⁵⁹ List of stationary materials is enclosed at Annexure-II.

Bangladesh Bank Survey on Credit Risk arising due to Loan against Inadequate Collateral

Questionnaire for Defaulted Clients¹

Name of the Bank: Name of the Branch: Date: Information of the Client Name: Address: 1. What is your loan amount (in million)? a. Principal amount b. Outstanding amount 2. a. Purpose of loan? personal/business/agriculture/industry/others b. Type of loan: Micro/Small/Medium/Large c. When did you start your business/agricultural farm/industry (year)? ------3. When did you avail bank loan first time for your business (year)? ------4. From when your payment became irregular (year)? ------5. What were the reasons behind your irregular repayment (tentative amount)? loss in business/family mishaps/fund diversion/use in other purpose 6. Do you have insurance policy to cover any mishaps? Yes/No 7. a. Did you keep collateral against your loan? Yes/No b. If yes, then what type of collateral did you keep? -----c. What was the value of the collateral (in million)? ------8. a. Does the collateral value cover the loan amount? Yes/No b. If yes, then why bank could not use it recover the full loan? Court injunction/rigidity on asset/no case filed/notice has been issued/case filed c. If no, then what was the shortfall amount (in million)? ------9. a. Do you expect any assistance from Bank to repay your loan? Yes/No b. What sort of assistance do you need? Interest redemption/time extension/new loan/reschedule/others. 10. What kind of loan do you prefer? With collateral/without collateral 11. a. Have you used your total loan for the described purpose? Yes/No b. If no, then where did you use the amount? -----c. If the fund diverted into other business, do you have any experience to run that new business?

¹ The information will be used for research purpose of Bangladesh Bank. No individual name or information will be published.

Bangladesh Bank Survey on Credit Risk arising due to Loan against Inadequate Collateral Ouestionnaire for Branch Incumbent²

Introduction of Branch

Name of the Bank: Name of the Branch: Branch Incumbent's Name and Designation: Contact Details: **Mobile:**

E-mail:

- 1. What is the outstanding loan amount of your branch as on 31 December 2015?
- 2. Please provide the NPL status of your Branch in the following format (in Million Taka):

	SS			DF		BL			Provisioning	
Year	Loan Amount	Collateral amount	Collateral free loan amount	Loan Amount	Collateral amount	Collateral free loan amount	Loan Amount	Collateral amount	Collateral free loan amount	Amount
2011										
2012										
2013										
2014										
2015										

3. Please tick the main reasons behind NPL in your Branch

- a. Collateral does not cover the loan
- b. Collateral is overvalued
- c. Collateral is itself fake
- d. Diversion of Fund by the Clients
- e. Loss in Business
- f. Lack of efficiency of Clients or Management/Family Mishaps
- g. Stay Order issued
- h. Loans considered after saturation level
- i. Pressure from the Top Management of the Bank
- j. Lack of proper identification of location of mortgaged property
- k. High Loan Pricing by the Bank
- 1. Over-financing due to unhealthy competition among the banks for loan buy-out
- m. Other reasons (Please mention the reason. If necessary, use separate sheet)
- 4. Do you think inadequate collateral is one of the major reasons for loans to become bad/classified?
- 5. Is it easier to get collateral free loan for the locally influential people?
- 6. Do you enhance collateral securities/revalue in case of extension of loan?
- 7. How often do you visit physically to monitor the proper usage of the loan?
- 8. Who conducts the valuation of the collateral? Do you have any valuation policy?
- 9. Do you have any training regarding credit risk mitigation or collateral valuation?
- 10. Do your credit officers have any training regarding credit risk mitigation or collateral valuation?
- 11. What kind of problems do you face while realizing collaterals?
- 12. What are your suggestions regarding collateral acquisition and realization?
- 13. Do you have any suggestion to amend the Money Loan Court Act, 2003, N. I. Act 1881, Transfer of Property Act, 1882 and Bankruptcy Act 1897?
- 14. What steps have you taken to reduce NPL in your Branch?
- 15. What are the measures should be taken to reduce classified loan?

²The information will be used for research purpose of Bangladesh Bank. No individual name or information will be published.

Appendix-1

	Appendix-1: Sector	-wise Non-pe	erforming Lo	ans Distribut	tions (CY201	.6)
Sl	Name of the sectors	Total loans	Gross NPL	Gross NPL	Share of	Share of
No.		outstanding		ratio	loans to a	NPL to a
					particular	particular
					sector	sector
					(percent)	(percent)
1	Agriculture	29958.61	4760.63	15.89	4.54	7.51
2	Industrial (Other than	88264.93	9442.56	31.10	13.38	14.89
	Working Capital)					
	(a) Large & Medium Scale	82353.49	8191.98	9.95	12.49	12.92
	Ind.					
	(b) Small & Cottage Ind.	5911.44	1250.58	21.16	0.90	1.97
3	Working Capital	103655	7535.09	17.03	15.72	11.88
	(a) Large & Medium Scale	88196.75	5945.27	6.74	13.37	9.38
	Ind.					
	(b) Small & Cottage Ind.	15458.25	1589.82	10.28	2.34	2.51
4	Export Credit	24540.64	1891.64	7.71	3.72	2.98
5	Import Credit	24782.79	2851.81	11.51	3.76	4.50
6	LTR	33754.32	3032.41	8.98	5.12	4.78
7	Commercial Loans	116934.36	11085.72	9.48	17.73	17.48
8	RMG & Textile	88237.74	10708.13	12.14	13.38	16.89
9	Ship building & Ship	10330.37	1246.88	12.07	1.57	1.97
	breaking					
10	Construction	48651.59	2921.1	12.55	7.38	4.61
	(a) Housing	31504.14	1686.49	5.35	4.78	2.66
	(b) Other than Housing	17147.45	1234.61	7.20	2.60	1.95
11	Transport & Communication	12926.53	1243.07	9.62	1.96	1.96
12	Consumer Credit	22393.3	1533.68	6.85	3.40	2.42
13	Other Loans	55109.27	5154.15	9.35	8.36	8.13
	Total	659539.45	63406.87	9.61	100.00	100.00

Appendix-2

Classified Loan as on 30-June-16

(Taka in Crore)

FI Cluster	Bank Name	Total Outstanding	Total classified Loan (SS, DF, BL)	% of Classified Loan on Total Outstanding
	AGRANI BANK LIMITED	22217.51	4992.13	22.47
	BANGLADESH DEVELOPMENT BANK LTD.	1500.46	757.14	50.46
SCB	BASIC BANK LTD.	12781.90	6752.63	52.83
	JANATA BANK LIMITED	34068.19	5891.08	17.29
	RUPALI BANK LIMITED	15421.60	2360.99	15.31
	SONALI BANK LIMITED	30847.02	9322.90	30.22
Sub-Total		116836.67	30076.86	25.74
	AB BANK LTD.	20586.11	869.23	4.22
	AL-ARAFAH ISLAMI BANK LTD.	18260.52	1078.83	5.91
	BANGLADESH COMMERCE BANK LTD.	1619.07	511.62	31.60
	BANK ASIA LTD.	14998.75	900.70	6.01
	BRAC BANK LTD.	13009.49	629.08	4.84
	DHAKA BANK LTD.	12791.15	706.25	5.52
	DUTCH-BANGLA BANK LTD.	15238.27	539.30	3.54
	EASTERN BANK LTD.	12249.31	488.47	3.99
	EXIM BANK LTD.	20356.81	1086.45	5.34
	FIRST SECURITY ISLAMI BANK LTD.	20795.37	533.85	2.57
РСВ	ICB ISLAMIC BANK	926.14	707.45	76.39
100	IFIC BANK LTD	12590.31	1014.16	8.06
	ISLAMI BANK BANGLADESH LTD.	55641.69	2604.15	4.68
	JAMUNA BANK LTD.	9156.24	534.22	5.83
	MEGHNA BANK LTD.	1735.62	17.43	1.00
	MERCANTILE BANK LTD.	12889.09	605.23	4.70
	MIDLAND BANK LTD.	1641.58	13.99	0.85
	MODHUMOTI BANK LTD.	1353.26	14.77	1.09
	MUTUAL TRUST BANK LTD.	10280.10	251.43	2.45
	NATIONAL BANK LTD.	18939.19	1579.91	8.34
	NATIONAL CREDIT AND COMMERCE BANK LTD.	11298.10	850.11	7.52

	NRB BANK LTD.	1291.24	18.36	1.42
	NRB COMMERCIAL BANK LTD.	2784.99	82.40	2.96
	NRB GLOBAL BANK LTD.	2701.88	17.05	0.63
	ONE BANK LTD.	11582.25	645.58	5.57
	PREMIER BANK LTD.	10278.17	505.99	4.92
	PRIME BANK LTD.	14032.78	1173.50	8.36
	PUBALI BANK LTD	18084.78	1114.80	6.16
	SHAHJALAL ISLAMI BANK LTD.	10272.94	677.77	6.60
	SOCIAL ISLAMI BANK LTD.	14784.81	656.19	4.44
	SOUTH BANGLA AGRICULTURE AND COMMERCE BANK LTD.	2561.65	2.30	0.09
	SOUTHEAST BANK LTD.	17625.22	771.92	4.38
	STANDARD BANK LTD.	9406.31	427.95	4.55
	THE CITY BANK LTD.	14059.97	1036.54	7.37
	THE FARMERS BANK LTD.	3488.40	223.28	6.40
	TRUST BANK LTD.	12915.48	467.41	3.62
	UNION BANK LTD.	5938.50	2.71	0.05
	UNITED COMMERCIAL BANK LTD.	19590.45	1244.93	6.35
	UTTARA BANK LTD.	7294.22	709.80	9.73
Sub-Total		465050.22	25315.13	5.44
	BANK AL-FALAH LTD.	719.14	28.71	3.99
	CITI BANK NA	1141.44	22.02	1.93
	COMMERCIAL BANK OF CEYLON LTD	1611.68	34.38	2.13
	HABIB BANK LTD.	421.82	49.63	11.77
FCB	HONGKONG AND SHANGHAI BANKING CORPORATION	7400.60	144.93	1.96
	NATIONAL BANK OF PAKISTAN	1502.41	1333.66	88.77
	STANDARD CHARTERED BANK	12498.06	471.90	3.78
	STATE BANK OF INDIA	303.07	44.31	14.62
	WOORI BANK	282.87	26.98	9.54
Sub-Total		25881.09	2156.53	8.33
	BANGLADESH KRISHI BANK	17595.37	4841.30	27.51
CD			075 46	20.95
SB	RAJSHAHI KRISHI UNNAYAN BANK	4655.90	975.46	20.95
SB Sub-Total		4655.90 22251.27	5816.76	26.14