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Trade Financing and Loan Against Trust Receipt (LATR) in Banking System of Bangladesh: Policy Implication

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Abstract

The main objectives of the paper are to analyze the extent of loan against trust receipts (LTR) facility given by the commercial banks to their clients (importers/exporters/entrepreneurs) against Letter of Credit (L/C) and to identify the malpractices of LTR facility. The paper uses both secondary and primary data. The primary data have been collected from clients and respective banks manager through a sample survey during 2012-2013. The major finding is that the LTR facility was misused. It was subject to malpractices by both banks and clients. A huge amount of LTR loan was stacked up and converted into term loan. A part of term loan was classified as NPL which is a major concern for the central bank as well as commercial banks.

JEL Classification: F10, F34, G21
Key words: Trade financing, LTR, L/C, NPL and Term loan.

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I. Introduction

Banks play an important role in trade financing in Bangladesh. Banks in Bangladesh disbursed a lion share of credit in trade financing. Data show that about 38 percent of total private sector credit on average went to trade and commerce financing during the five years. Of this , about 15 percent on average is foreign trade financing and rest of domestic trade financing. Historically, trade finance market was considered liquid and well functioning and accordingly did not attract much attention from policymakers (BIS, 2014). In the banking system of Bangladesh, in recent past, the sector has experienced a periods of stress, most notably since 2011. Banking sector experienced a stress in term of liquidity shortage along with increase of term loan , NPL and interest rate during 2011-2013. Malpractices in trade financing was the major causes of stress faced banks during the period. The paper explores the trade financing and uses of loan during the period.

Foreign trade financing is constituted mainly import and export financing in banking system of Bangladesh. Banks support trade financing through a wide range of products that help their customers manage their international payments and associated risks, and provide needed working capital. The term “trade finance” is generally reserved for bank products that are specifically linked to underlying international trade transactions (exports or imports). As such, a working capital loan not specifically tied to trade is generally not included in this definition. Trade finance products typically carry short-term maturities, though trade in capital goods may be supported by longer-term credits. The focus of this report is on short-term trade finance, both because it funds a much larger volume of trade and because of its interactions with bank funding conditions.

BIS (2014) reported that "...0ne of the most common and standardized forms of bank-intermediated trade finance is a *letter of credit (L/C)*. L/Cs reduce payment risk by providing a framework under which a bank makes (or guarantees) the payment to an exporter on behalf of an importer once delivery of goods is confirmed through the presentation of the appropriate documents. For the most part, L/Cs represents off-balance sheet commitments, though they may at times be associated with an extension of credit. This can occur, for example, if an import L/C is structured to allow the importer a period of time (known as “usance”) before repaying the bank for the payment it made on the importer’s behalf"'.

Banks in Bangladesh help to meet working capital needs by providing trade finance loans to exporters and importers. The common loan documentations are loan against import merchandise (LIM), loan against trust receipts (LTR) and pre-shipment credit (PC) which are linked either to an L/C or to other forms of documentation related to the underlying trade transaction.

Trade financing through L/C and LTR increased sharply during 2010-2013 in Bangladesh. Banks prefer LTR loan due to higher earning of revenue and the self liquidating nature (Ali & Howlader, 2005). Proper documentation, market condition and honesty of bankers to select genuine importers and exporters are the crucial factors for recovering trade financing loan. Data on L/C and LTR show that banks disbursed huge loan through LTR during 2009-2013 and these loan stacked up. As a result, amount of NPL increased sharply to BDT 427 billion in 2012 from BDT 226.5 billion in 2011. Banks suffered from liquidity problem, reflecting in call money rate. Call money rate jumped to 15 percent in FY12 from 6.6

percent in FY10 (BB,2014-2015). Banks converted some LTR loan to term loan and term loan also increased during that time. The outstanding LTR loan stood at BDT 320.75 billion in 2015. Of this amount, BTD 20.63 was NPL which is about 4 percent in total NPL (BB,2015a).

Malpractices in trade payment are common in banks of Bangladesh. Habib, Rahman, Alam and Hoque (2012) observe that "... There are trends of creating forced loan rescheduling, and converting non-funded liability into funded liability in Bangladesh". Sometimes issuing bank had to make payment and create forced loan in favor of the importer. Although some malpractices are found in trade financing, import trade is highly dependent on bank financing. Nazia (2015) argues that a well-thought policy measures for import financing can remove problems of trade financing in Bangladesh.

In this backdrop, the objectives of the paper are given below:

- To analyze the extent of Loan against Trust Receipts (LTR) facility given by the commercial banks to their clients against Letter of Credit (L/C) and to identify the malpractices of LTR facility
- To analyze causes of conversion of LTR to term loan
- To identify whether conversion of LTR to term loan creates any problem in the banking system.
  - Loan diversion
  - Liquidity problem due to stuck up huge amount of LTR among few business group
  - Conversion of non funded liability to funded liability

The reminder of the paper is structured as follows. Following introduction, section II describes the methodology and data. Section III analyses results and findings. Finally, section IV gives conclusion and policy implications.

II. Methodology and Data

A. Data

Both primary and secondary data are used in the paper. Secondary data are collected from Bangladesh Bank's publication, i.e., Annual Report, Scheduled Bank Statistics, and Financial Stability Report. Consolidated data on L/C and LTR are collected from respective banks head office. Some information, views and primary data are collected from manager of banks branch and entrepreneurs/ importers/ clients through interview with structured questionnaire.

B. Sample Survey

A sample domain of banks, branch location and entrepreneur clients was prepared based on number of L/C and LTR loan in respective banks. A study team constituted of officials of Research Department select banks and branches by location through discussion with banks officials. The paper uses data based 18 banks, 64 bank branches and 146 clients/entrepreneurs. The detailed sample distribution is given in Table 1.

Table 1: Sample Survey of Banks, Branches, and Entrepreneurs	
No. Banks	18
No. Branches	64
Dhaka	30
Chittagong	30
Sylhet	4
No. Clients / Entrepreneurs	146
Dhaka	92
Chittagong	34
Sylhet	20

Source: Based on survey data collected from respective banks, 2014

III. Analysis of Results and Findings

Trade financing including export and import financing by type of banks is given in table 2. Private commercial bank including foreign banks allocated major portion of fund in trade financing followed by state own commercial bank. Import financing was dominant over export financing.

Table 2: Share of Trade financing in Private sector Credit by Banks (%)

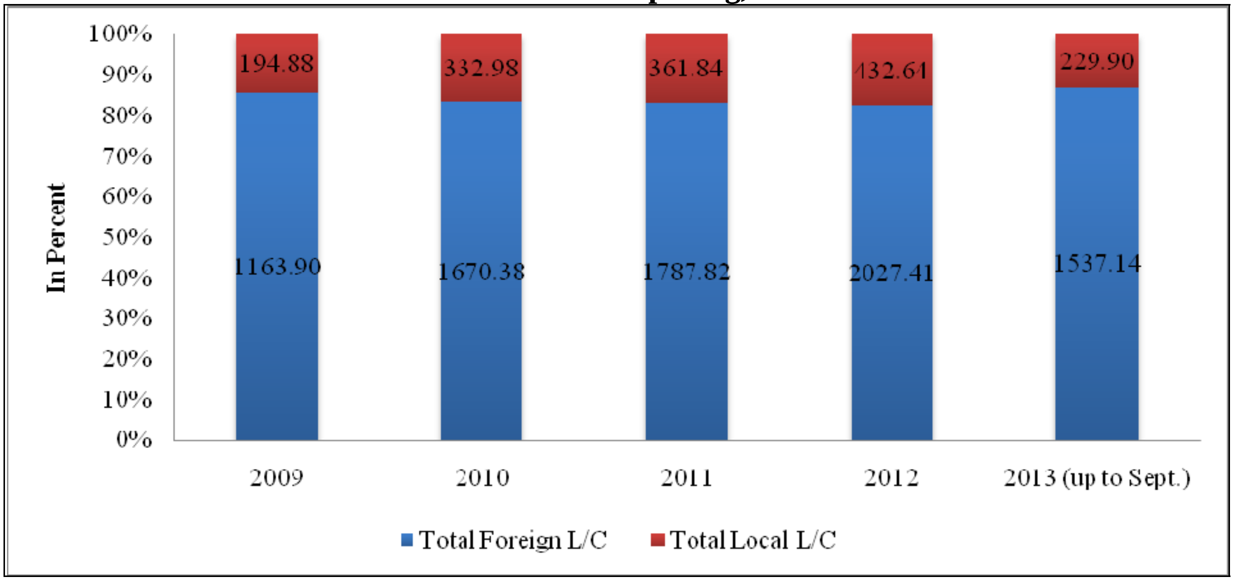
Types of Banks	**Trade financing**	**Imports financing**	**Exports Financing**	**Trade financing**	**Imports financing**	**Exports Financing**
	2009			2015		
All Banks	38.6	13.5	4.41	37.41	10.73	4.81
SOBs	37.26	16.46	7.99	31.05	7.62	6.77
SBs	19.64	2.61	5.68	18.03	9.58	0.97
FCBs	28.91	14.39	2.3	23.94	14.48	1.16
PCBs	41.68	13.59	3.33	40.91	11.44	4.69

Source: Scheduled Banks Statistics, Bangladesh Bank, October-December, 2009 and 2015.

Importer / entrepreneurs opened both foreign and local L/C for industrial raw material, industrial goods, essential item and other item in different banks. Consolidated data on L/C collected from 40 commercial bank show that outstanding foreign L/C increased to BTD 1537.14 billion in 2013(up to September) from BTD 1163.90 in 2009 . Trend in L/C opening is given in Chart 1 which shows that about 85 percent (on average) L/C is foreign.

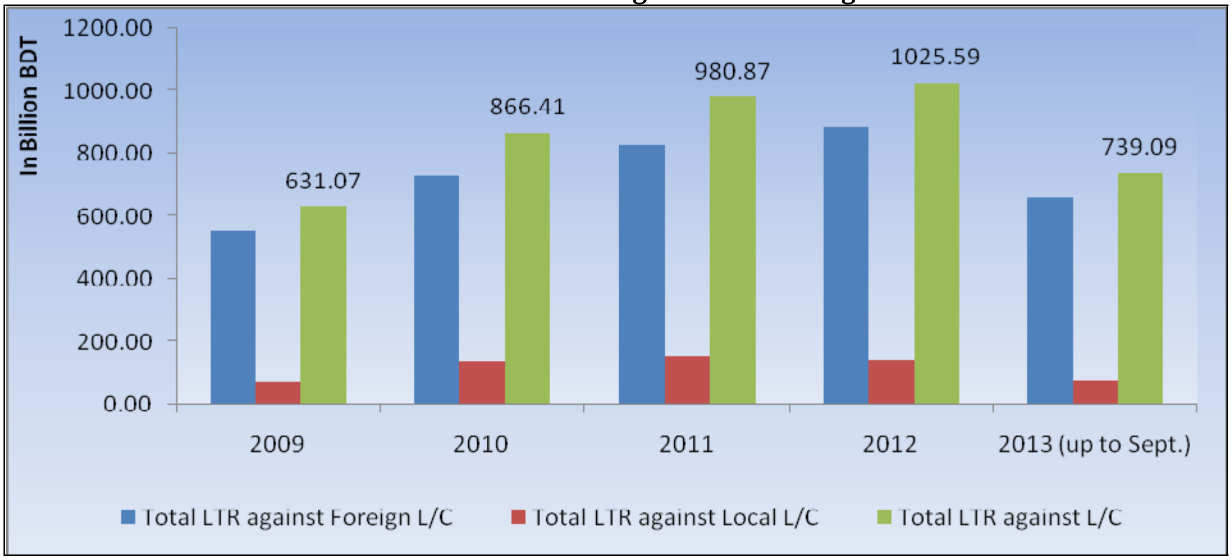
Against this L/C amount banks disbursed huge amount of loan to importers /entrepreneurs. The outstanding amount of LTR loan sharply increased to BDT 1025 .59 billion in 2012 from BDT 631.07 billion in 2009 (Chart 2).

Chart 1: Trends in L/C Opening, in Billion BRD



Source: Based on survey data collected from respective banks, 2014

Chart 2: Trend in LTR loan against L/C during 2009-2013.



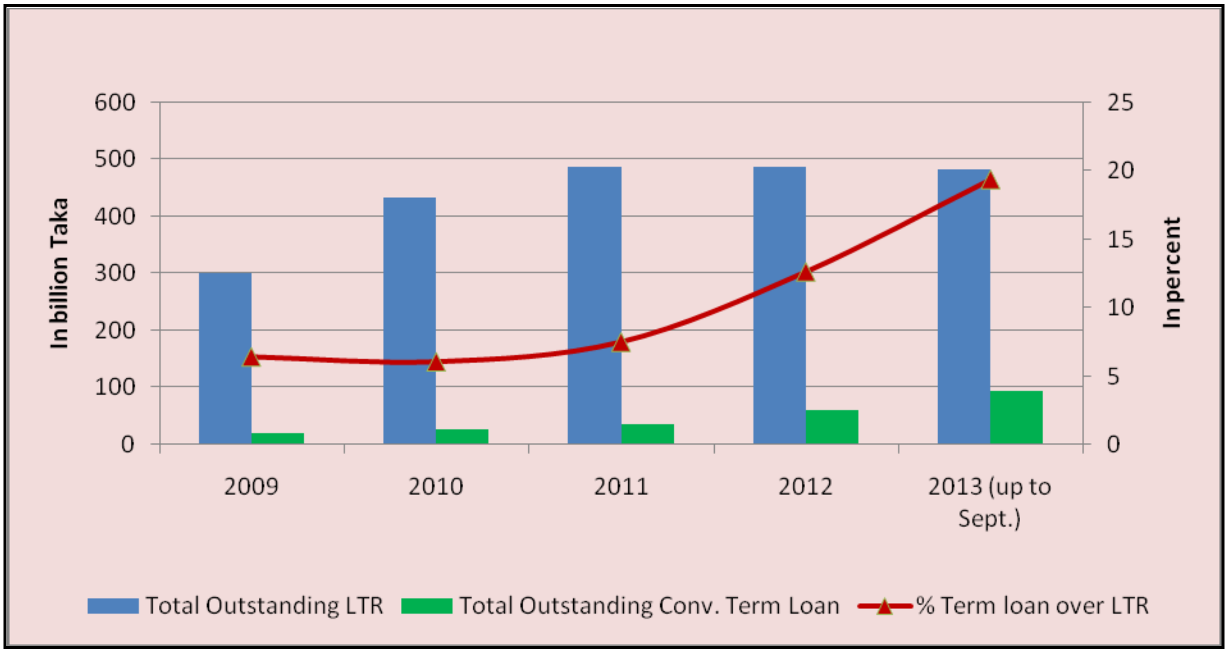
Source: Based on survey data collected from respective banks, 2014

Many clients/ entrepreneurs/ importers did not settle their LTR loan against L/C generally within 90 days. Banks gave an opportunity to convert LTR loan to term loan. As a result, off-balance sheet asset of banks decreased but balance sheet asset increased. Total LTR stood at Tk. 483.12 billion at the end of September 2013 which is 32.82 percent of outstanding Trade financing of FY13 Chart 3).

At the end of September 2013, outstanding term loan stood at Tk. 93.52 billion which about 19.36 % of outstanding LTR. This outstanding term loan is about 11.76 percent of total outstanding term loan of the banking system.

The possibility of recovering this term loan is apparently very low due to lack of adequate mortgage/security, absence of goods in the banks go-down and the fluctuation of prices of unsold goods. In many cases, importers / clients divert the fund to purchase land, to invest in stock market, to establish new industries / business etc.

Chart 3: Trend in Outstanding LTR and Term loan during 2009-2013

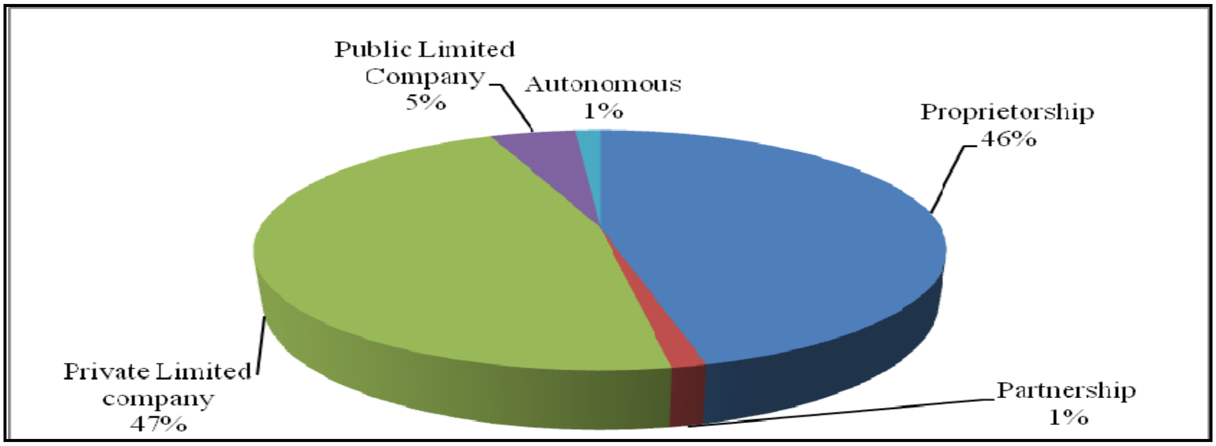


Source: Based on survey data collected from respective banks, 2014

The survey data show that ownership of respondent who opened L/C and took loan against L/C is private limited company (47 percent), proprietorship (46 percent), and rest of public limited company, autonomous and partnership. Some of these borrowers are very influential due to close link with political party and top management of banks (Chart 4).

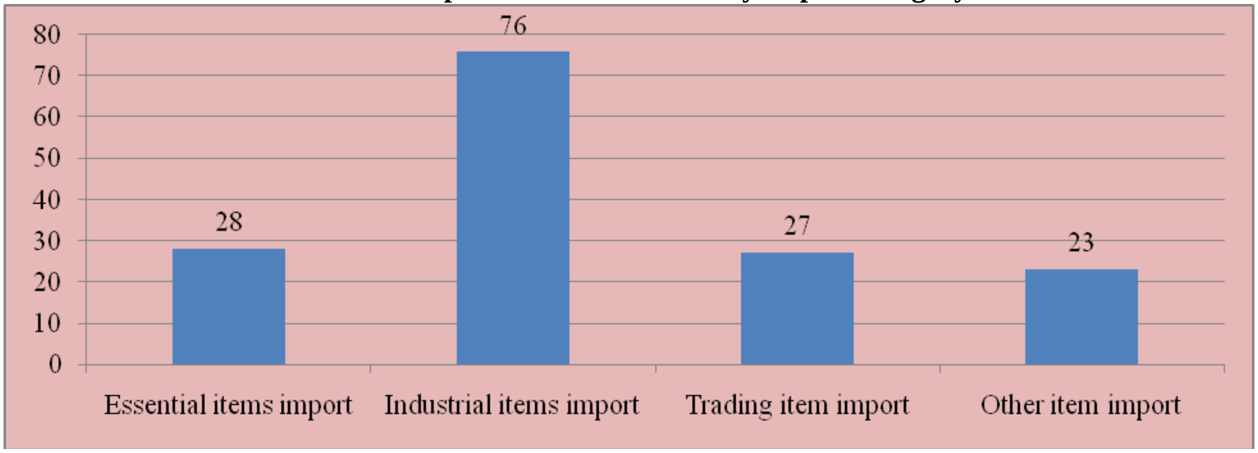
As a importers, about 76 respondents are industrial commodity importers, 28 respondents are essential item importers and rest of are trading and other item importers (chart 4). The survey team collects information and discuss with those importers to find out the causes of conversion of LTR to term loan instead of paying back loan. The causes/reasons as per respondents are given in Chart 5. The results show about 48.1 percent of respondent opined that price fluctuation of commodities in both international and domestic is main reason for LTR loan default. Some importers about 16.3 percent respondent holds their imported goods for a long time for higher profit and not pay back loan. The LTR loan defaulters of importers due to exchange rate fluctuation and fund diversion are 8.7 percent and 4.8 percent respectively. The rest of importers (about 22 percent) did not specify the reason of not paying LTR loan.

Chart 4: Ownership of distribution of 146 entrepreneurs'/ respondents



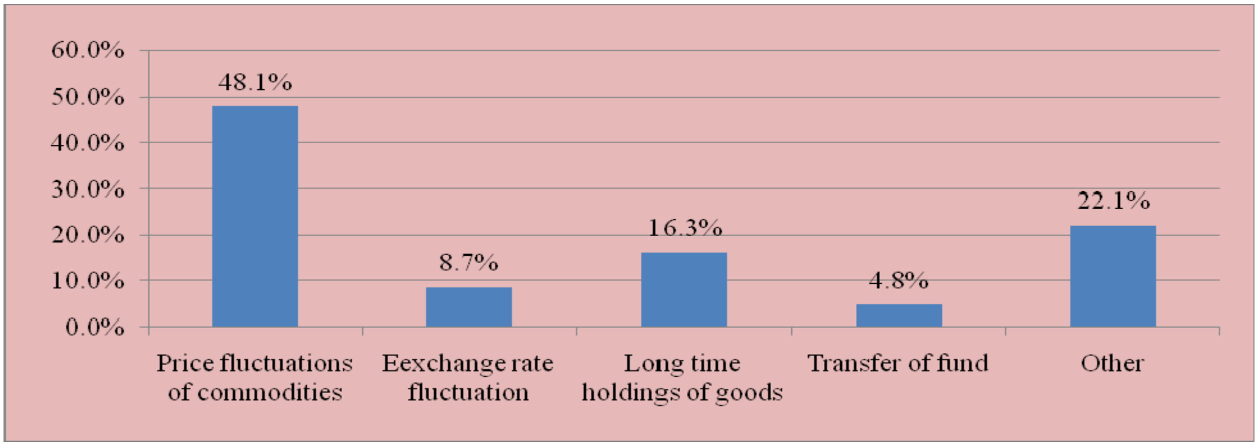
Source: Based on survey data collected from respective banks, 2014

Chart 4: Respondents Distribution by Import category



Source: Based on survey data collected from respective banks, 2014

Chart 5: Causes of conversion LTR to Term Loan, %



Source: Based on survey data collected from respective banks, 2014

IV. Analysis of Major Findings

The paper uses both primary and secondary data/info formation regarding trade financing especially LTR loan, its usages and malpractices in the banking system during 2009-2013. The paper highlights some major findings based on survey data, information collection from branch managers of respective banks, and selected importers/ entrepreneurs. The findings are as follows:

- Total LTR stood at Tk. 483.12 billion at the end of September 2013 which is 32.82 percent of outstanding Trade financing of FY13.
- At the end of September 2013, outstanding term loan stood at Tk. 93.52 billion which about 19.36 % of outstanding LTR.
- This outstanding term loan is about 11.76 percent of total outstanding term loan of the banking system.
- The possibility of recovering this term loan is apparently very low due to lack of adequate mortgage/security, absence of goods in the banks go-down and the fluctuation of prices of unsold goods.
- In many cases, importers / clients divert the fund to purchase land, to invest in stock market, to establish new industries/business etc.
- It is observed that interest rate and L/C commission charge are much higher (Interest rate: 13-22 % per annum and Commission: 0.25 -0.50 % per quarter).
- One kind of evil competition has been observed among different banks branches in case of LC opening and providing LTR facilities against large groups in order to meet their profit target at branch level.
- Sometimes bank branches often open L/C and provide LTR facility as instructed by banks head office which creates a problem for branch manager to assess the clients. As a result, those LTRs are not adjusted and at a stage those LTR converted to term loan.
- It has been observed clearly that same borrower/ group is availing LTR facility from different banks due to Single Borrower Exposure Limit. But the banks have no information on loan amount from other bank, as a result borrower/ importers are repaying loan to one bank by taking loan from another bank.
- The survey team observes that the large importers (mostly defaulters) are taking stay order from the court. As a results, they get clean CIB report for eligible for further trade financing. This is a great obstacle for recovering outstanding LTR and term loan in banking sector.

V. Conclusion and policy implication

Trade financing specially export and import financing by banks is very important for real economic activities in Bangladesh. The importers/ entrepreneurs avail of trade financing through L/C and LTR due to meet short term financing need . Banks disbursed huge amount in trade finance during 2009-2013 for higher revenue income. The paper reviewed the malpractices of LTR loan of banks which is very important for policy maker of both Bangladesh bank and commercial banks. Because, a bulk of amount of LTR loan was converted into term loan and a major portion of term loan turned into NLP.

Although the LTR loan was not policy concern in Bangladesh for a long time, it has been raising a major concern in the banking system since 2011. The non funded liability of banks has been converted into funded liability through LTR loan. Besides, the risk of LTR which is originated by the borrower was also shifted to Banks. Banks should take proper steps to minimize malpractices of trade financing.

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