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RESEARCH ARTICLE

EX-ANTE AND EX-POST METHODS OF NON-PERFORMING LOAN MANAGEMENT:A BANGLADESH PERSPECTIVE

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Abstract

Well-functioning of the banking sector and subsequent economic development of Bangladesh has been significantly constrained by the continuing crisis of the accumulation of Non-Performing Loans (NPLs). The magnitude of accumulation of NPLs largely depends on the strategies adopted by the Government, regulatory authorities and banks for management of the NPLs. A prudent strategic framework offers some effective management tools and methods for management of NPLs. The aim of this paper is to identify the ex-post and ex-ante methods of NPL management practiced in Bangladesh by reviewing the existing literature, central bank circulars, guidelines etc.. This paper will also recommend some other NPL management methods for banking industry of Bangladesh which are practicing in other countries.

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Introduction:-

Banks play the foremost role in the developing economy like Bangladesh for mobilizing savings from the surplus economic unit and providing capital to the investors. Banks' performance has significant impacts on allocation of capital and economic growth. Thus, performance of banks is very much important not only for that specific bank, but also for the entire economy. (Achou and Tenguh 2008). Providing loans and advances to the customers is the banks' prime revenue generating activity. Generally, the loans and advances are the major portion of the banks' asset and their main source of income (Achou and Tenguh 2008).

The term "NPL" is used interchangeably with "bad loans" as described by Basu (2003). Berger and De Young (1997) indicate NPLs as "problem loans". Fofack (2005) termed it as "impaired loans". In the banking industry of Bangladesh the term "Classified Loans" is also used to indicate NPL. Hou (2006) and Bloem and Gorter (2002) mentioned in their studies that, globally acceptable definition of NPL is not yet formulated. Banking systems of different countries define loan classification system with different scopes and contents. Issa (2009) shows that there are variations in definition of NPL among the banking systems of different countries according to their laws and regulations. Bloem and Gorter (2002) show that, banks used both quantitative and qualitative criteria to classify the loans. Usually, number of days is used as a quantitative criterion of loan classification and all the information about the future of the borrower and loans are used as qualitative criteria for classification of loans.

Non-performing Loans (NPLs) are those loans of the banks' from which they are no longer able to receive interest or overdue principal payments. So, NPLs decrease banks' profitability. Increase in NPL also decreases the loanable fund in the financial market. Banks' may have to face capital erosion due to higher level of NPLs. NPLs can affect the balance sheet of banks and due to interconnectedness of banking sector with the overall financial system and the

economy, there may have ripple effects throughout the financial system thereby contributing to financial instability. Thus, exploring the affecting factors of NPLs is a matter of essential importance for the regulatory authorities, banks and governments concerned on financial stability. Determinants of NPL have been analyzed by many researchers and GDP growth rate is found influential on the level of NPL. GDP growth rate is a macroeconomic variable which are not in control of the banking institutions, may have significant causal impact on the non-performing loan.

Impact of NPLs on Banking Growth:

A bank having a high level of NPLs has to incur carrying costs on non-income generating assets that affect not only the profitability but also the capital adequacy of a bank, and in consequence, the bank faces difficulties in augmenting capital resources. A study from IMF (2015) found that countries where the banks have high levels of NPLs credit growth remains slow. Firms those are more dependent on bank finance are likely to be affected more than other firms from the reduced lending capacity of banks. It was also mentioned from IMF (2015) that banks that have high levels of NPLs on their balance sheets, they also have a lower ability for lending to the real economy. This happens through 3 major channels:

Lower profitability:

A high NPL level implies less net operating income for a bank and also reduce profits significantly due to the greater effort that required in order to manage and monitor the large stock of NPLs.

Higher capital requirements:

An increased level of NPL increases the risk weights and as a result higher capital requirements will be needed.

Higher funding cost:

Other Banks and investors have less willingness to lend or lend with higher rate of interest to the banks having higher level of NPLs.

Impact of NPLs on Economy:

As per the ECB annual review high level of 'Non Performing Exposure's or NPEs (i.e. NPLs) create a severe macro prudential problem. First, a large stock of NPLs indicates that households and firms are excessively indebted and impaired, which may decrease consumption and investment, and consequently delay economic recovery. Second, scarce resources in the banking sector, capital, funding, as well as operational capacity, are absorbed by bad assets (NPLs) and cannot be reinvested in new viable investment projects. This, in turn, may elongate the period of subdued economic activity, further aggravating the NPL problem for the banking sector and the economy as a whole'.

NPLs in Bangladesh:

In the context of Bangladesh, well-functioning of the banking sector and subsequent economic development has been significantly constrained by the continuing crisis of the accumulation of NPLs. To ensure transparency and quality of the banks' loan portfolios, determine the actual volume of quality assets and strengthen credit discipline, Bangladesh Bank, in 1989, adopted prudential norms under Financial Sector Reform Program (FSRP) for Loan Classification and Provisioning covering rules, the suspension of interest due, and the making of provisions against potential loan loss.

According to IMF, 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. By bank regulatory definition non-performing loans consist of:

1. Loans that are past due by 90 days or more and still accruing interest, and
2. 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 favour 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. According to Bangladesh Bank "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. The ratio of gross non-performing loan to total outstanding is called the NPL rate.

Present Scenario:

In the banking industry of Bangladesh, the ratio of gross non-performing loan to total outstanding is 14.15% for the last Twenty years but a steady average NPL trend of 9.4% has been maintaining during the last five years. The overall trend of NPL rate in Bangladesh from the beginning of this century is shown in the following figure.

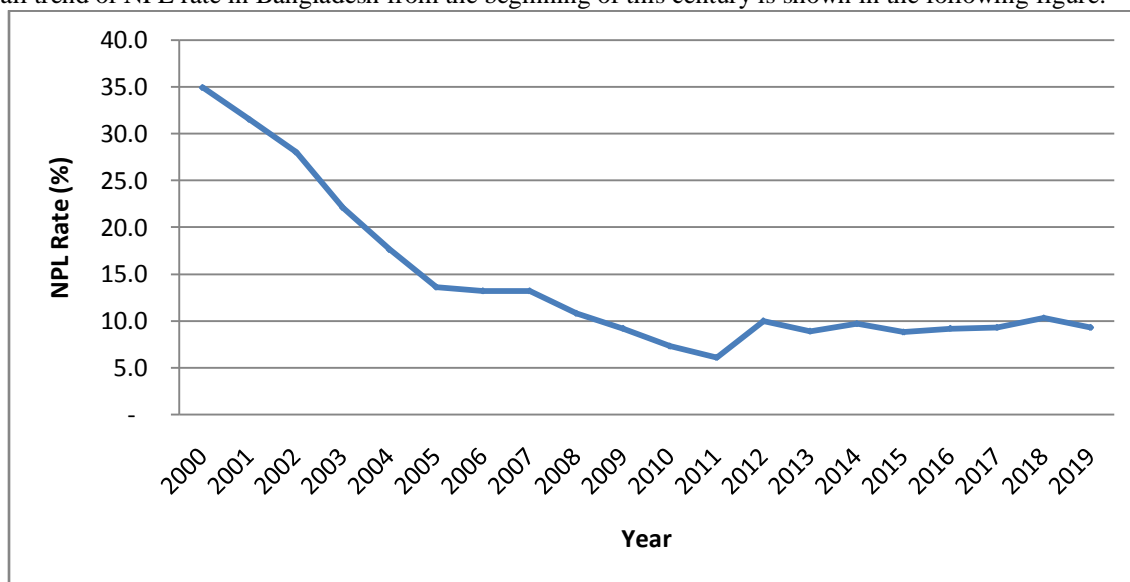


Figure 1:- NPL Rate trend in Bangladesh.

Source: Bangladesh Bank.

Strategies for NPL Management in Bangladesh:

The Government of Bangladesh has adopted several strategies to ensure more effective policy framework for management of NPLs (Dey 2019). Some of them are mentioned below -

National Commission on Money Exchange and Credit

The National Commission on Money Exchange and Credit was formed in 1986, which suggested administrative and judicial measures for solving problem loans of State-owned Commercial Banks (SCBs) and Specialized Banks (SBs) which includes - Setting of recovery targets for SCBs and SBs, Prohibiting defaulters from access to further credit, linking loan recovery measures with the central bank etc.

Financial Sector Reform Project

The Financial Sector Reform Project was started in 1990 to enact different laws and regulations to expedite settlement processes such as, Financial Loan Court Act, 1990 and Bankruptcy Act, 1997. This reform project also took initiatives for fixing collection targets and resolution of legal cases for the 100 largest defaulters and publishing list of 100 largest defaulters in different media.

Banking Reform Committee

In 1996, the Banking Reform Committee was established, which suggested framing a concrete loan recovery policy for SCBs and examined the viability of forming an asset management company (AMC) for settling NPLs. They also suggested for formulating recovery cells and camps in SCBs and Introduction of incentives to bank officials for recovery.

Structural Adjustment Performance Review Initiative

The Structural Adjustment Performance Review Initiative in 2000 concentrated on better loan screening and monitoring standards of individual banks. This initiative also includes Improving central bank's supervision and regulation, Enacting the Money Loan Court Act 2003 and the Bank Company (Amendment) Act 2003 for quick settlement of filed cases, Central bank's instructions to banks to maintain 9% ratio of capital adequacy to risk

weighted assets with core capital at least 4.5%, Making provision to appoint two directors from the depositors in bank board etc.

Credit Risk Grading Manual

The Credit Risk Grading Manual was prepared in 2005 to make the Credit Risk Grading (CRG) system mandatory for analyzing credit risk. This CRG system became mandatory for the Banks from 2006 to prevent fresh NPLs.

Corporatizing SCBs

In 2007, the focus was on corporatizing SCBs, Transfer of regulatory authority of SCBs from the Ministry of Finance to the Bangladesh Bank and increasing the minimum capital adequacy ratio from 9 to 10.

Revision of loan classification and provisioning:

In 2012, measures were adopted for tightening loan classification and establishing provisions that are more in line with international practices. Definition and delinquency periods for fixed term loans were tightened.

Amendment of Bank Companies Act

Key provisions in the Bank Companies Act were amended in 2013 to provide the Bangladesh Bank full regulatory and supervisory control over the SCBs. The amendments include - giving Bangladesh Bank authority to remove the Managing Director of the SCBs; Special diagnostic examination of SCBs by Bangladesh Bank; Signing by SCBs revised MoU with Bangladesh Bank with quantitative targets including reduction of NPLs, limits on the growth of their lending portfolio, and recovery from the largest defaulters etc.

Other Strategies

In 2015, several measures were implemented, including placing observers in the board of banks with worsening internal governance, restructuring of large loans, and signing by SCBs of annual performance agreements with the government

In 2019, the government has been devising several reform measures to enforce greater discipline in the financial sector. As part of this, the government reviewed several acts, laws, regulations, and guidelines for amendments, where necessary. These include, among others, the Bangladesh Bank Order, 1972; Bank Company Act, 1991; Bankruptcy Act, 1997; Money Loan Court Act, 2003; and regulations on mergers and acquisitions.

In the meantime, the Bangladesh Bank introduced new guidelines on an internal credit risk rating system for banks effective 1 July 2019 and eased the loan classification and provisioning rules extending the loan repayment period by 3 months effective 30 June 2019.

The government is also planning to set up special audit for banks to investigate anomalies in the sector. Other recommendations by a six-member committee formed in early 2019 comprising of the Ministry of Finance and Bangladesh Bank, included forming of an AMC, creation of secondary market for NPLs, setting up a separate data warehouse for NPLs under the existing facilities of the Credit Information Bureau of the Bangladesh Bank, and a tax rebate facility for traders of the default loans that remain under consideration. The Secured Transaction (Moveable Assets) Act is also under processing, scheduled to be passed by the Parliament in 2020, allowing borrowers to also use their movable assets as collateral with banks.

NPLs Management Methods:

Different managerial tools and techniques are used worldwide to manage NPLs. Exploring the methods is a matter of utmost importance for regulatory authorities, banks and governments concerned on financial stability. Effective Ex-ante and Ex-post methods are essential to handle NPLs when they have incurred and also to prevent loans to turn into NPLs. The general objective of these measures is to have the lowest possible level of NPLs in the balance sheets. In accordance with the strategies taken by Bangladesh Government and regulatory authorities the following NPL management methods are practiced in Bangladesh -

Ex-ante NPL Management Methods

Ex-ante methods are used to as preventive measures to prevent the loans from becoming a non performing loan. Banks has to concentrate on the following to minimize the level of NPLs.

Know Your Customer (KYC):

It is mandatory for the banks in Bangladesh to prepare and update “Know Your Customer” (KYC) profile for all their customers. Sufficient and verified information about the customer must be captured and duly updated with due diligence to avoid information asymmetry. As a part of KYC, visits are made on clients and their places of business/units. The frequency of such visits depends on the nature and needs of relationship. Proper preparation and updating of KYC help banks to monitor the borrower.

Credit Report:

A credit report is a detailed breakdown of an individual's credit history prepared by a credit bureau. Credit bureaus collect financial information about individuals and create credit reports based on that information, and lenders use the reports along with other details to determine loan applicants' creditworthiness. In the United States, there are three major credit reporting bureaus: Equifax, Experian, and TransUnion. Each of these reporting companies collects information about consumers' personal financial details and their bill-paying habits to create a unique credit report; although most of the information is similar, there are often small differences between the three reports. In Bangladesh, report from Credit Information Bureau (CIB) of Bangladesh is taken by the banks to know about the liability status of the borrower. It is mandatory to have a clear CIB report to get a loan from any bank in Bangladesh. Borrowers' having default record in CIB report must not be entertained by the Banks.

The Credit Information Bureau (CIB) of Bangladesh Bank is responsible among others for collection, processing and maintaining an updated database of credit related information supplied by participants, institutions which extend credit i.e. banks (Act.14, 1991), Financial Institutions (Act.27, 1993), HBFC (Presidential Order 7, 1973), ICB (ICB Order 40, 1976). The CIB was set up on 18 August 1992 in the Bangladesh Bank. One of the objectives behind setting up of the CIB was to minimize the extent of default loans by providing the participants with timely reports on credit information based on the enquiry/request about the loan applicants so as to facilitate credit risk analysis by the banks/FIs and decide promptly on the loan applications. The goal of CIB is also to ease problems arising between borrowers and lenders. Formal information exchanges help lenders to identify good borrowers, thus reducing the incidence of adverse selection.

The CIB database contains detailed information on credit granted by participants (banks and financial institutions) to individuals/ institutions/ organizations. The word 'credit information' means any information relating to

1. the amounts and the nature of loans or advances and other credit facilities granted by a banking company to any borrower or class of borrowers;
2. the nature of security taken from any borrower for credit facilities granted to him;
3. the guarantee furnished by a banking company for any of its customers.

If a client is at default, no banks/FI shall extend credit facility under section 27 KAKa and 5 GaGa of Bank Company Act 1991 (Amended). Unless the default loan is adjusted/rescheduled/declassified the borrower in question is eligible for getting a loan/extension of loan.

Credit Rating:

Credit rating is an evaluation of the creditworthiness of a borrower in regular terms or in respect of a specific debt or monetary obligation. It can also be defined as a method that aids the lenders to take their decision about granting credit to the applicants with respect to the applicant's nature (Chen 2003). It consists of a set of decision models and methods to help the bestowers or granters (Bellotti 2009). They can grant customer credit by evaluating the risk of lending to particular users. Credit rating can be ascribed to any organizations – a particular corporation, state or local authority, sovereign management that needs to borrow money. To analyze the credit risk, the common way is to utilize a characterization procedure over comparative features of past clients who are dependable along with who are faulty considering the end goal to discover a connection between the invariant and possible failure. Precise classifier ought to be settled in favor of assort new clients or current clients as trustworthy or faulty (Wang 2005). A company's credit rating plays a very significant foreword to the business itself, its investors, stakeholders, suppliers, and debtors. A company will be assigned a good credit rating, when it is in a good financial position with growth prospects. To see this good credit rating, shareholders will be more confident with their investment and the reliance of the business partners will rise on the company (Hong 2013). Generally, a credit rating agency assesses and evaluates the credit for organizations and governments. These rating agencies are remunerated by the organization that is trying to obtain a credit rating for itself or for its any due case. For individuals, credit ratings are obtained from their credit background provided by credit reporting firms.

Bangladesh Bank has recognized eight credit rating agencies which met the eligibility criteria of ECAIs guidelines (BRPD Circular no. 35/2010) of BB. .

1. Credit Rating Agency of Bangladesh (CRAB) Ltd.,
2. Credit Rating Information and Services Limited (CRISL),
3. National Credit Ratings Ltd. (NCRL),
4. Emerging Credit Rating Ltd. (ECRL),
5. ARGUS Credit Rating Services Limited (ACRSL),
6. Alpha Credit Rating Limited (ACRL),
7. WASO Credit Rating Company (BD) Limited and
8. The Bangladesh Rating Agency Limited (BDRAL)

BB has also decided that banks may use the ratings (if available) of the following international credit rating agencies for the purposes of risk weighting their exposure at abroad:

1. Fitch,
2. Moody's, and
3. Standard & Poor. (BRPD Circular No- 01/2014)

Credit Scoring:

Credit scoring is one of the most frequently used methods for assessing credit worthiness of a potential borrower and to evaluate the future risk may posed by providing loan to reduce and prevent the losses due to faulty credit. Credit scoring is used by the granters to determine who are able to grant a loan with credit limits and interest rate. They also practice credit score to determine which clients are likely to fetch the greatest profit and the likelihood that one will become delinquent on an account at some point in the near future. In a credit scoring model, to separate the acceptable and unacceptable credit application, analyst most often utilize their past knowledge with borrower in order to develop a quantitative model. By using this scoring, credit analysts are able to assess the creditworthiness instantly; therefore, the customer services are improved. It is necessary that the banking system is equipped with prudential norms to minimize the problem of credit risk and develop an effective internal credit risk models for the purpose of credit riskmanagement. Bangladesh Bank (BB) introduced the Lending Risk Analysis (LRA) framework in 1993, for all lending exposures of the banks in excess of Bangladesh Taka (BDT) 10 million. The LRA framework, however, made no attempt to introduce a Risk Grading System (RGS) for unclassified loan accounts. As advancement in this area, BB made the Core Risk Management Guidelines (CRMG) mandatory in 2003, introducing the requirement of grading unclassified accounts. In 2005, Bangladesh Bank, (BRPD Circular No.18) advised all scheduled banks to implement Credit Risk Grading (CRG) for their borrowing clients. To cope up with the changing nature of the industry and the economy BB developed an Internal Credit Risk Rating (ICRR) System having 20 different templates for different industries.

Bank can analyze a borrower's repayment ability based on information about a customer's financial condition including their liquidity, cash flow, profitability, debt profile, market indicators, industry and operational background, management capabilities, and other indicators by using Internal Credit Risk Rating System. (Bangladesh Bank BRPD. 16/2018). Proper assessment of credit risk is mainly concerned with managing the quality of credit portfolio before default takes place.

Credit Appraisal:

Appropriate assessment technique of loan applications is one of the most effective solutions to the problem of NPLs. It is necessary to be documented the credit policy to upgrade the quality of credit appraisal in banks. It is necessary that the banking system is equipped with prudential norms to minimize the problem of credit risk. Beside credit scoring, it is required to develop judgmental credit scoring system, which deals with unwritten rules, particular combinations of commercial and qualitative information, ambiguous and missing information. Comparing characteristics of a client with the previous defaulted clients is the overall idea of credit evaluation in judgmental system. Therefore, the application of those clients will typically be rejected. The application will habitually be approved if the client's characteristics are sufficiently similar to those, who have not defaulted. In Bangladesh, each bank has its own credit policy to assess the credit proposal in accordance with the CRM guideline of Bangladesh Bank.

Collateralization:

Collateral is one of the most popular features of debt contracts. 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. Akerlof (1970), Coco (2000), Booth and Booth (2006) and Berger and Udell (1995) found that collateral can be imposed by the lender to minimize the consequences of information asymmetry between the lender and the borrower. Leeth and Scott (1989), Chan and Kanatas (1985), and Spence (1973), show circumstances where borrowers may attempt to self-impose collateral as a gesture of their creditworthiness and to obtain more favourable loan terms.

Property document of the offered collateral property must be scrutinized and verified properly and legal opinion should be taken from legal consultant. Valuation of the property must be done with proper care to avoid overvaluation of property. (Deepak Narang & VS Kaveri 2015)

In the context of Bangladesh, 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 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:

1. 100% of deposit under lien against the loan.
2. 100% of the value of government bond/savings certificate under lien.
3. 100% of the value of guarantee given by Government or Bangladesh Bank.
4. 100% of the market value of gold or gold ornaments pledged with the bank.
5. 50% of the market value of easily marketable commodities kept under control of the bank.
6. Maximum 50% of the market value of land and building mortgaged with the bank.
7. 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.

Banks must have a separate comprehensive Collateral Policy which must specify the acceptable and unacceptable types of collateral for each type of loan, adequacy of collateral to cover loan outstanding and documentation requirements for various types of collateral etc.

Proper Documentation:

Security Documents are the primary evidence of granting and disbursing the loans. Proper documentation including acceptance of terms and conditions of the sanction letter, charge documents duly signed and executed by competent authority, registration of mortgage and other collateral related documents, insurance etc reduces the risk of credit default. (Deepak Narang & VS Kaveri 2015). In Bangladesh, each bank has its own loan documentation guideline policy in accordance with the laws of Bangladesh.

Early Warning Signals(EWS)

Increasing of the level of NPL significantly depends on the quality of managing credit assessment, risk management by the banks. Banks should have adequate preventive measures, fixing pre sanctioning appraisal responsibility and having an effective post-disbursement supervision. Banks should continuously monitor loans to identify accounts that have potential to become non-performing.

It is important in any early warning system, to be sensitive to signals of credit deterioration. A host of early warning signals are used by different banks for identification of potential NPLs. A series of operational, financial, transactional indicators can be used to identify potential problems in credit exposures at an early stage. These indicators which may trigger early warning system depend not only on default in payment of installment and interest but also other factors such as deterioration in operating and financial performance of the borrower, weakening industry characteristics, regulatory changes, and general economic conditions. Early warning signals can be classified into five broad categories –

Financial warning signals:

Financial warning signals generally derived from the borrowers' balance sheet, income expenditure statement, statement of cash flows, statement of receivables etc. Following common warning signals are captured by some of the banks having relatively developed EWS: Persistent irregularity in the account, Default in repayment obligation, Devolvement of LC/involvement of guarantees, Deterioration in liquidity/working capital position, Substantial increase in long term debts in relation to equity and declining sales.

Operational signals:

Following operational signals are captured by some of the banks: Operating losses/net losses, Rising sales and falling profits, Disproportionate increase in overheads relative to sales, rising level of bad debt losses Operational warning signals, Low activity level in plant, Disorderly diversification/frequent changes in plan, Non-payment of wages/power bills, Loss of critical customer/s, Frequent labor problems, Evidence of aged inventory/large level of inventory.

Banking related signals:

Following are the banking related signals: Declining bank balances/declining operations in the account, Opening of account with other bank, Return of outward bills/dishonored cheques, Sales transactions not routed through the account, frequent requests for loan, frequent delays in submitting stock statements, financial data, etc.

Management related warning signals:

These following signals are related with management: Lack of co-operation from key personnel, Change in management, ownership or key personnel, Desire to take undue risks, Family disputes, Poor financial controls, Fudging of financial statements, Diversion of funds, etc.

Signals relating to external factors:

Signals like Economic recession, Emergence of new competition, Emergence of new technology, Changes in government / regulatory policies, Natural calamities are related to external factors

In Bangladesh, internal credit risk rating of the customers' are reviewed at the end of each quarter and if any signals are found, the loan is flagged as Special Mention Account (SMA) which help banks to look at accounts with potential problems in a focused manner. Loans in the "Special Mention Account (SMA)" are reported to the Credit Information Bureau (CIB) of Bangladesh Bank. (Bangladesh Bank, BRPD.14)

Forbearance:

Forbearance occurs when counterparty is experiencing financial difficulty in meeting its financial commitments; and a bank grants a concession that it would not otherwise consider, whether or not the concession is at the discretion of the bank and/or the counterparty. A concession is at the discretion of the counterparty (debtor) when the initial contract allows the counterparty (debtor) to change the terms of the contract in its own favour (embedded forbearance clauses) due to financial difficulty. Forbearance is synonymous to financial restructuring. (BCBS 2017), The concessions may include:

1. Extending the loan term;
2. Rescheduling the dates of principal or interest payments;
3. Granting new or additional periods of non-payment (grace period);
4. Reducing the interest rate,
5. Forgiving, deferring or postponing principal, interest or relevant fees;
6. Changing an amortizing loan to an interest payment only;
7. Releasing collateral or accepting lower levels of collateralisation;
8. Allowing the conversion of debt to equity of the counterparty;
9. Deferring recovery/collection actions for extended periods of time; and
10. easing of covenants

In the context of Bangladesh, regulatory guideline for forbearance to NPLs is available (BRPD Circular 15 dated September 23, 2012) but for unclassified loans there is no comprehensive regulatory guideline. Banks are practicing forbearance according to their internal policies and practices.

Ex-post NPL Management Methods:

Ex-post methods are used to recover the loan after becoming non-performing loan through different legal and non-legal measures. Banks has to concentrate on the following to minimize the level of NPLs.

Legal Measures:

The magnitude of accumulation of NPLs largely depends of the legal measures taken for recovery of the NPLs. A strong and effective legal framework increases the possibility of recovery of NPLs. A number of acts related to recovery of loans enacted in Bangladesh, on the basis of which banks takes legal measures against the defaulted borrowers to recover the NPLs. (Siddique 2015)

Money Loan Court Act, 2003:

Before 1990 banks had to file cases in Sub-judge Courts, commercial courts, assistant judge courts and Certificate cases under the Public Demands Recovery Act 1913 since there was no special law related to recovery of loans. As a part of legal framework reform under the Financial Sector Reform Programme in early 90's, Financial Loan Court Act 1990 was enacted but this law was not effective enough to recover the defaulted loans substantially. To get rid of the crisis of increasing trend of NPLs, Special Court was established under the Money Loan Court Act, 2003. According to this act, banks are empowered to sale the mortgaged property to adjust the defaulted loan outstanding before filing suit in the court. Banks required publishing sale notice in a widely circulated national Bengali daily newspaper and in a local daily newspaper. This law allows the borrower to settle the case through mediation. Appeal and revision against judgment or decree is discouraged in this law. If the borrower deposited 50% of decreed amount in cash, appeal shall be admitted for action and if 75% of decreed amount deposited, revision application will be accepted. If the judgment debtor, detained in civil prison repays 25% of outstanding loans in cash and executes a bond to effect that the borrower shall repay the rest amount within the next 90 days, civil imprisonment is relaxable upto 6 months. Some major amendments were made in the Money Loan Court Act, 2003 on March 2010. The amendments include deleting of the phrase "Power of Attorney" which empowers the banks to sell the mortgaged property to adjust the defaulted loan without having Power of Attorney from the borrower. Another major change was, the decree holder shall get possession of the property automatically after six years on written application to the court by the decree holder. The fear of losing property and honour the default borrowers tend to communicate with banks for settlement of suits. (Siddique 2015)

The Public Demand Recovery Act, 1913:

The Public Demand Recovery Act, 1913 was published on 22nd May 1913. Under this act, a certificate obtained is deemed to be the decree of a Civil Court and the execution proceeding may be started against the debtor immediately. Certificates are executed by the certificate officer or any other authorized officer. The legal process involved in this act is expeditious, effective and less expensive compared to a civil suit.

The Bankruptcy Act, 1997:

The Bankruptcy Act 1997 was enacted with a view to expediting the recovery of NPLs from defaulted borrowers through declaring them bankrupts. It was expected that this act would be able to introduce corporate restructuring that go beyond liquidation like the bankruptcy act of the developed countries.

Other Legal Actions:

Several other legal measures are applicable in some cases, such as filling criminal cases under 406/420 BPC, for committing breach of trust, unauthorized sale of mortgaged property, migration to other places without repaying loans, providing fake documents etc. Suit may be filed under Civil Procedure Code on the strength of only the documents i.e Demand Promisory Note, Bill of Exchange, Cheque etc, where there is a prima-facie evidence of the defendant's liability.

Non-Legal Measures:

Recovery of NPLs through adopting legal measures is very expensive, time consuming and complex process, so it is always preferable to settle the cases amicably instead of initiating litigation process. Banks adopt some non-legal measures to recover the NPLs and also to reduce the level of NPL in their balance sheets. The major effective non-legal measures which are practiced in Bangladesh are described below –

Communication with the defaulted Borrower:

One of the most important approaches of loan recovery is keeping continuous communication with the borrower. Arranging meetings with the borrower, calling the borrower frequently, issuing letters and visiting the business center or residence of the borrower are the effective forms of communication with the defaulted borrowers. Bank may conduct formal or informal visit to the borrowers by officials of different management level depending on the level of complexity.

Persuasion:

Bank should persuade the defaulted borrower to repay the loan giving him counseling on negative aspects of loan default from ethical, social and legal point of view, offering interest waiver, loan rescheduling etc. for timely settlement of the loan. If the communication made through meeting, telephone call, letter, visit etc failed, bank may give a final notice asking for full adjustment mentioning that if the borrower fails to repay the loan within the given

time, bank will go for legal action. Besides all these persuasion, bank may create pressure on the borrower through the guarantor of the loan and other social pressure for amicable settlement of the defaulted loan.

Motivating Collection Officials

Bank should give motivation to their loan collection or recovery officials through proper training, workshops, incentives, appreciations etc. In this way Collection official will become more confident and their negotiation skill will increase in this way, which will help the bank to recover the NPLs.

Conducting Recovery Campaign

Recovery campaign are formal meetings arranged by the bank where the borrowers, local representatives and reputed persons, government officials, In-charge of local police are invited and high officials of the Bank's Head Office are present there. These sorts of campaigns are conducted with an aim to recover NPLs by persuading the borrower and creating a social pressure on them and also by offering incentives.

Appointment of Recovery Agent

In most bank branches, employees remain busy in their regular business operations and hardly could spare time to perform loan recovery activities. The responsibility of loan recovery can be given to different external recovery agencies. A loan case may be transferred to a Recovery agent when the loan remains due for long time and the borrower do not repay even after repeated persuasion, the collateral is not sufficient of defective, the borrower is untraceable or unwilling to pay the loan.

Loan Rescheduling

Loan rescheduling is a standard practice to deal with NPLs. Bangladesh Bank issues various circulars time to time regarding Rescheduling of NPL to guide the Banks. Bangladesh Bank recognizes that insome cases, a legitimate banking practice may allow for the renewal of a continuous loan or line of credit. Occasionally, even a term loan is 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. However, Bangladesh Bank is concerned that rescheduling (also known as "prolongation" or "evergreening") 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. Bangladesh Bank is hereby issuing this circular in order to communicate its policy stance that rescheduling should be done only in limited circumstances and underrestrictions.

Time limit for rescheduling ContinuousLoan:

The loan account in which transactions may be made within certain limit and have a date for full adjustment will be treated as Continuous Loan:

Frequency	Classified as Sub-standard	Classified as Doubtful	Classified as Bad/Loss
First Rescheduling	Maximum 18 months from the date ofrescheduling	Maximum 12 months from the date ofrescheduling	Maximum 12 months from the date ofrescheduling
Second Rescheduling	Maximum 12 months from thedate of rescheduling	Maximum 09 months from the date of rescheduling	Maximum 09 months from the date of rescheduling
Third Rescheduling	Maximum 06 months from the date of rescheduling	Maximum 06 months from the date ofrescheduling	Maximum 06 months from the date ofrescheduling

Conditions:

During the rescheduled period all required principal and interest payments must be made. Rescheduled amount should be repaid in monthly installments. If the amount of defaulted installments is equal to the amount of 3(monthly) installments, the loan will be classified as Bad/Loss.

Time limit for rescheduling Demand Loan:

The loan which becomes repayable on demand by the bank is treated as Demand Loan. If any contingent or any other liabilities are turned to forced loan (i.e. without any prior approval as regular loan) those too will be treated as Demand Loans

Frequency	Classified as Sub-standard	Classified as Doubtful	Classified as Bad/Loss
First Rescheduling	Maximum 12 months from the date of rescheduling	Maximum 09 months from the date of rescheduling	Maximum 09 months from the date of rescheduling
Second Rescheduling	Maximum 09 months from the date of rescheduling	Maximum 06 months from the date of rescheduling	Maximum 06 months from the date of rescheduling
Third Rescheduling	Maximum 06 months from the date of rescheduling	Maximum 06 months from the date of rescheduling	Maximum 06 months from the date of rescheduling

Conditions:

During the rescheduled period all required principal and interest payments must be made. Rescheduled amount should be repaid in monthly installments. If the amount of defaulted installments is equal to the amount of 3(monthly) installments, the loan will be classified as Bad/Loss.

Time limit for rescheduling Fixed Term Loan:

The loan which is repayable within a specified time period under a prescribed repayment schedule is treated as Term Loan.

Frequency	Classified as Sub-standard	Classified as Doubtful	Classified as Bad/Loss
First Rescheduling	Maximum 36 months from the date of rescheduling	Maximum 24 months from the date of Rescheduling	Maximum 24 months from the date of rescheduling
Second Rescheduling	Maximum 24 months from the date of rescheduling	Maximum 18 months from the date of rescheduling	Maximum 18 months from the date of rescheduling
Third Rescheduling	Maximum 12 months from the date of rescheduling	Maximum 12 months from the date of rescheduling	Maximum 0 months from the date of rescheduling

Conditions:

During the rescheduled period all required principal and interest payments must be made. Rescheduled amount should be repaid in monthly/quarterly installments. If the amount of defaulted installments is equal to the amount of 6 monthly or 2 quarterly installments, the loan will be classified as Bad/Loss.

Time limit for rescheduling for Short-term Agricultural and Micro-Credit

First Rescheduling	Repayment time limit for rescheduling should not exceed 02 years from the date of rescheduling.
Second Rescheduling	Maximum 01 year from the date of rescheduling.
Third Rescheduling	Maximum 06 months from the date of rescheduling.

If the loan becomes default after third rescheduling, the borrower will be treated as a habitual loan defaulter and the bank shall not consider for further loan rescheduling.

Approval of loan rescheduling cannot be made below the level at which it was originally sanctioned. A detailed appraisal report including implications of such loan rescheduling on the income and other areas of the bank must be placed to the approving authority at the time of placing the rescheduling proposal.

Conditions for Rescheduling

The borrowers whose credit facility has been rescheduled will get new loan facility subject to fulfillment of the following conditions:-

The defaulting borrower who has availed interest waiver must settle at least 15% of the compromise amount

(excluding the down payment on rescheduling as per present guidelines) to avail any further credit facility from any Bank.

In case of borrowing from other Banks, the same rule will be applicable, i.e. the borrower will have to settle at least 15% of compromise amount (excluding the down payment on rescheduling as per present guidelines), then, will be allowed to take regular facility from other Banks subject to the submission of NOC (No Objection Certificate) from the rescheduling bank.

If there is any Principal waiver, no fresh facility will be allowed till the full settlement of compromise amount.

Export borrowers may be granted further credit facility (after being identified as not a willful defaulter), if required, subject to settle at least 7.5% of the compromise amount (excluding the down payment on rescheduling as per present guidelines) being paid.

Prior approval of Bangladesh Bank shall have to be obtained if the loan is related to the director/ ex-directors of a Bank Company.

If any such issue is already there (such fresh facility has already been allowed after allowing waiver), the same will not fall under purview of this circular.

Waiver of Interest:

In those cases where full recovery of loans seems impossible due to business failure, death or disability of the borrower or any other genuine ground examined by the bank prudently and judiciously, banks may waive certain amount of interest to recover the remaining outstanding.

Loan Write-off:

Loan Write-off is an international practice for separating NPLs from bank's balance sheet. The write-off policy was introduced in Bangladesh by incorporating loans written off section 28 ka in the Bank Company Act-1991 in 2001 and subsequent issuance of BRPD Circular No-02/2003 states that banks may 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.

Alternative Dispute Resolution:

The term "Alternative Dispute Resolution" (ADR) refers to the facilitated settlement negotiations where disputants are encouraged to negotiate directly with each other prior to going for some other legal process. Such negotiation systems create a structure to facilitate direct negotiation between parties to any dispute, without any intervention of a third party. (USAID: Alternative dispute resolution practitioners guide). In ADR method disputes are expected to be resolved by way of mediation, arbitration or conciliation. It is not a compulsory method of dispute resolution, but a voluntary and willing way out process. ADR is not a substitute for formal settlement by the courts; rather it is an alternative route to a speedier and less expensive mode of settlement of disputes. (Justice Mustafa Kamal, 2004).

In the context of Bangladesh, there is provision for ADR under the Money Loan Court Act., 2003, where a Settlement Conference is held presided over by the trial Judge. In case of successful settlement of dispute in the conference, the Court Fees paid by the parties will be refunded. Otherwise the case will be tried by another Judge of co-equal jurisdiction. There is no separate institution for ADR in Bangladesh.

Recommendations and conclusion:

Despite adopting several strategies and executing different methods, Bangladesh needs to explore the international best practices in NPL management and the resolution techniques implemented in other countries in Asia and the Pacific, and Europe. The management of NPLs should be multipronged, for both prevention and resolution. Some key measures are mentioned below:

Corporate governance:

Corporate governance should be strengthened and careful due diligence followed in lending decisions by banks. Efforts are needed to ensure that loans are made only on commercial considerations, devoid of administrative or

political influences. Similarly, effective measures are needed to ensure that sincere efforts are made at recovering loans.

Professional Board of Directors for SCBs:

Boards of directors of SCBs should be composed of competent professionals, instead of those appointed on political considerations alone. SCB management should allow full operational freedom in conducting banks' daily operations. Both the boards and management must be accountable to the central bank. The central bank should be allowed authority to ensure that individuals sitting on PCB boards possess operational knowledge of banking and finance. Changes in laws will be needed to provide required legal mandates.

Data Warehouse of Collateral Properties:

Fair pricing of collaterals through competent accounting firms with global best practices is necessary. A data warehouse for collaterals also needs to be set up to bar borrowers from taking loans from several banks by way of using the same properties as collateral.

Asset Management Companies (AMC):

During last few decades, creation of an institution by public authorities, which will be responsible for dealing with NPLs is the most common method to deal with the problem of non-performing loans (Campbell 2007). Asset Management Companies (AMC) are such organizations administered by the government having legal powers essential for the resolution of NPLs. It is the most widespread and accepted method in many countries is that the individual banks sell their NPLs to an AMC. The main advantages for choosing this method are the following (Woo, 2000):

Enhancement of credit discipline:

Through executing this method, a clear separation of bad loans from the financial institutions are made which lead to a more effective and objective resolution of NPLs

Division of labour:

By separating NPLs from the affected bank managers are able to concentrate more on regular banking restructuring and new lending, while AMCs managers focus on the recovery of NPLs.

John Bartel and Yiping Huang (2000) studied on China and revealed that, 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 for dealing with the bad loans. Bangladesh still do not adopt this method of establishing AMCs to manage NPLs.

Banking Ombudsman:

Over 100 countries of the world including India, Pakistan, Malaysia, and New Zealand have banking ombudsman to delivering alternate dispute resolution services. Ombudsman was first established in 1809 in Sweden. The word "ombudsman" is of Swedish origin and means "representative or agent" of the people. In Bangladesh, still there is no such platform.

New Zealand's Ombudsmen Act 1975 states the function of Ombudsman as: 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 in respect of which there is, under the provisions 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.

Asset Protection Scheme:

Asset protection scheme is an alternative measure to cover the losses that have to do with a specific asset portfolio, through an insurance mechanism, to cover the losses until we have favourable market conditions again. Spain, Austria and Germany executed these measures successfully. Bangladesh still does not have such scheme to cover loan losses.

Asset protection scheme is probable option that partially achieves separation of NPLs from the balance sheet. Under this scheme certain assets are 'ring-fenced' within the bank's balance sheet and guaranteed by the government. This measure has been employed in various crisis situations in Europe, and secures institutions against further value. Effectiveness of this mechanism depends on the sovereignty of credit rating and how well it would withstand contingent liabilities from the guarantee. (Lehmann 2017)

Debt for Equity Swap:

In a debt/equity swap process part of the outstanding debt of the borrower is converted into shares and the lender becomes a co-owner of the company. This process deleverages the balance sheet of the troubled company (thereby making the company appear stronger financially to prospective customers/suppliers and investors) and at the same time improves the cash flow by reducing the debt service requirements. This dual effect on both the balance sheet and the cash flow can help to avoid over-indebtedness and illiquidity and can therefore avoid the need for the directors of the troubled company to file for insolvency. For the lender, such a swap can help to ensure the success of the restructuring, and can be particularly helpful if there are concerns about other restructuring routes. (Sinhar 2009)

Securitization:

In a securitization, the cash flows from a number of NPLs are pooled to create a security with senior, mezzanine and subordinate tranches. Each tranche has a different risk-reward profile. The advantage of securitization is that there is some diversification of risk away from a single credit name, and with the use of tranches, investors can choose the risk-reward combination that best reflects their preferences. Moreover, securitization converts NPLs to marketable securities, which could be of interest to a larger set of buyers, including foreign institutional buyers. (Baudino and Yun 2017). Xu (2005) mentioned securitization allows for the design of securities with returns and maturity dates and therefore could appeal to investors ready to take on a wide range of risks.

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