Financial inclusivity and the banking sector

From progress to regress

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Financial reforms have been on a reverse gear in Bangladesh. The latest being the announcement to return to a regime of interest rate repression. Following the easing of loan classification and write-off standards and announcing generous rescheduling facility to the defaulters last year, this is yet another attempt to return to a financial regulation regime that we successfully got out of several decades ago.

A STORY OF REFORMS

The financial sector turned around following a series of reform programmes in the 1990s. Legal, policy, and institutional reforms improved the regulatory and governance environment and enhanced the ability of bank owners, management and regulators, and the markets themselves to provide for better governance and regulation. The domination of the banking system by the State-owned Commercial Banks (SCB) declined while Private Commercial Banks (PCB) and Foreign Commercial Banks (FCB) gained market share, increasing competition in the banking industry. The private sector banks have consistently outperformed specialised banks and SCBs in terms of growth in deposits, bank advances and other banking services.

Banks were heavily burdened by high levels of nonperforming loans (NPLs) accumulated over many years due to weak management of the SCBs. Priority lending to loss-making state-owned enterprises, a deficient legal and debt recovery framework, weaknesses in loan screening and supervision, lack of accountability of bank officials, and a weak credit culture undermined good management. The share of NPLs rose steadily from 1972 onwards with the gross NPL ratio to total loans in the banking system peaking at 41.1 percent in 1999. The SCBs and Development Financial Institutions (DFI) recorded the highest NPL ratios. Directed lending programmes led to a massive build-up of poor-quality loans in the 70s and the 80s. Banks were reluctant to write off the long-lasting bad loans mainly due to sub-standard underlying collateral and fear of probable legal complications.

The government adopted several measures, dating back to the 1980s, to ensure better policy framework for managing NPLs. Administrative and judicial measures for solving problem loans of SCBs and DFIs suggested by the National Commission on Money Exchange and Credit, formed in 1986, were heeded to. The Financial Sector Reform Project in 1990 supported enactment of different laws and regulations to expedite settlement processes. A concrete loan recovery policy for SCBs was put in place based on recommendations from the Banking Reform Commission in 1996. The Structural Adjustment Performance Review Initiative in 2000 concentrated on better loan screening and monitoring standards of individual banks while the Credit Risk Grading Manual in 2005 made the Credit Risk Grading system mandatory for analysing credit risk. SCBs were corporatised in 2007 and the minimum capital adequacy ratio was increased from 9 to 10.

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