CPD ANALYSIS

Banking sector needs further reforms

CONTINUED FROM YESTERDAY

THE banking sector in Bangladesh has come under criticism in the recent past due to increased number of financial scams and the rising size of loan default. Undoubtedly, the size of the industry has expanded in terms of total banks and their branches, deposits and credits which in turn have contributed to the economic development of the country. The performance of the banking sector has also improved over the years according to various indications such as capital to risk weighted asset, rate of non-performing loans (NPL) to total loan, expenditure income ratio, return on asset, return on equity, and liquidity. This has been possible due to various reform measures and policy support of the consecutive governments.

Unfortunately, the health check fails to conceal the problems suffered by the sector from time to time. The current situation of large financial frauds and high NPL of banks calls for a close scrutiny of the sector and necessitates taking required measures.

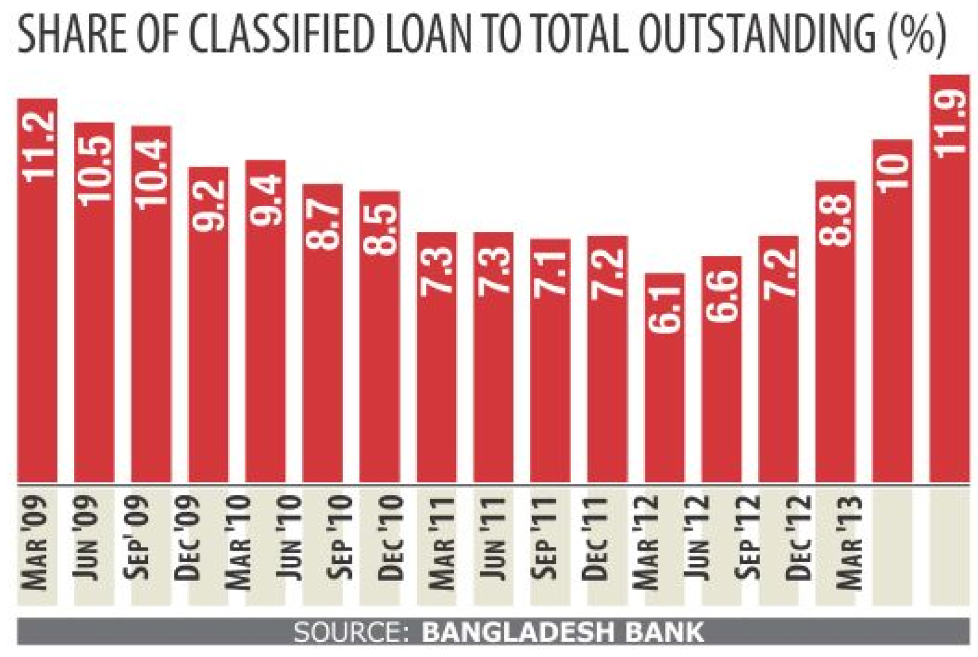
The first reading of the Independent Review of Bangladesh's Development (IRBD) of the Centre for Policy Dialogue prepared in January 2013 presented a detailed analysis of the trend and the governance of the banking sector in the context of the Hall-Mark scam. This section will focus on a selected set of issues relating to some of the emerging concerns.

The soundness indicators of the banking sector performance reveal that since 2009 the overall performance of the sector has been unsatisfactory. Capital to risk weighted assets is on the decline while the percentage share of NPL to total loans is increasing. Similarly, return on asset and return on equity have sharply declined. A disaggregated scenario indicates that NPL in the state owned commercial banks is the highest among all categories of banks in Bangladesh. This is a reflection of the fact that financial malpractices such as Hall-Mark and Bismillah groups which embezzled large amount of money from SCBs have started to tell upon the health of the SCBs.

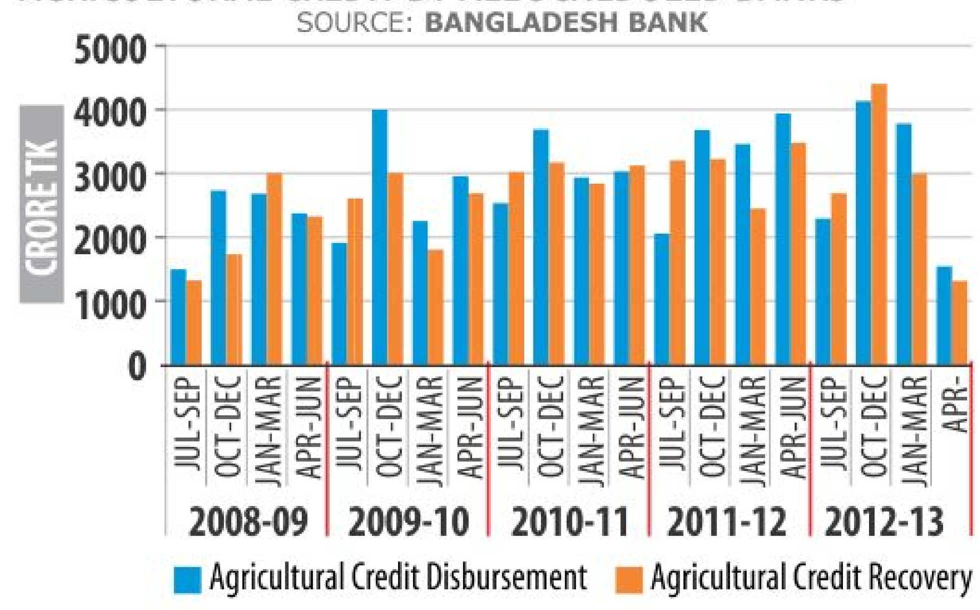
It is apprehended that there could be many more cases of forgeries which may be unearthed in course of time and pose further threats towards the stability of banking sector. Unfortunately, actions against such frauds have been slow.

High NPL pushes the interest rate of banks upwards as they try to make up for their losses from bad loans. Apart from weak monitoring and supervision of loans, the reason for high NPL is also linked to the governance issue. Given the inefficiency of SCBs, there have been propositions to privatise those, except for one which will perform the treasury activities of the government.

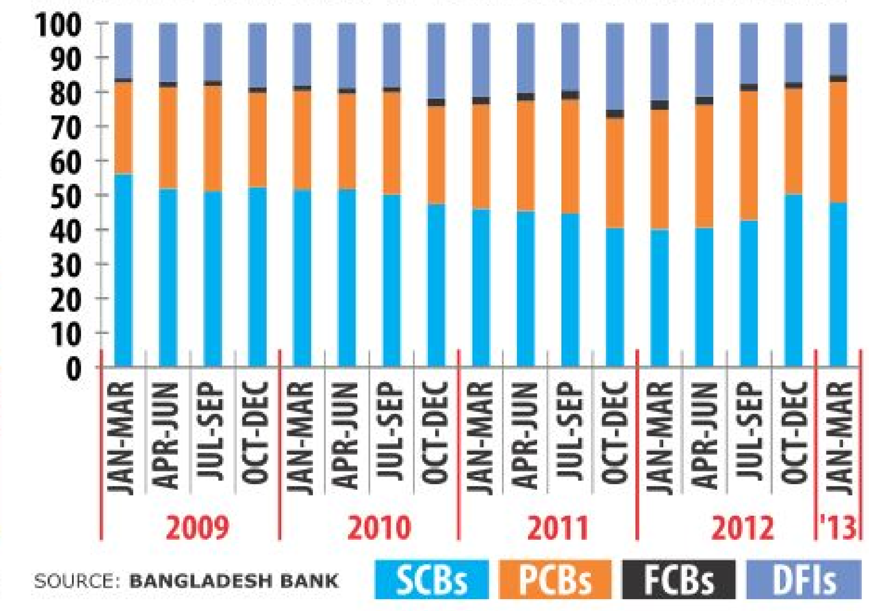
SHARE OF CLASSIFIED LOAN TO TOTAL OUTSTANDING (%)



AGRICULTURAL CREDIT BY ALL SCHEDULED BANKS



CLASSIFIED LOAN AS % OF TOTAL OUTSTANDING LOANS



Within a period of five months, Bangladesh Bank has changed the rules of loan classification and provisioning. On September 23, 2012, the Banking Regulation and Policy Department (BRPD) of the central bank issued a circular with new provisions for loan and rescheduling stating, "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 profitability of repayment are carried at full value on banks' balance sheets" (www.bangladesh-bank.org).

The new BRPD circular no 05 dated May 29, 2013 relaxed the period of rescheduling to six years instead of 4.5 years at present. The time limit for first rescheduling of a classified loan will now be 36 months since the repayment of last instalment instead of present 24 months. Additionally, time limits have been reset at 24 months and 12 months for second and third rescheduling, respectively. Loan provisioning requirement has been reduced to various levels in various sectors. According to the new circular, banks have to make provision of just 1 percent instead of 5 percent for a special mention account (SMA). The provisioning requirement will be 2 percent for housing, professional and investment banks.

While the circular does not explain the reason for such relaxation, officials and the BB told the media that these measures have been taken in view of the rise in classified loans. They also expect to create an additional Tk 500 crore investable funds for banks through these measures. Classified loans have doubled during January to March 2013 compared to the same period in 2012. Both in state banks and private commercial banks, the amount of classified loans doubled during these two compared periods. Though the BB made this move to save the loss making banks and increase the profitability of banks, this is rather a very simplistic way to assess the problems of the sector.

If one looks at the long time trend of the performance of the sector, it is clear that the state banks have consistently been underperformers compared to other players in the sector. Partly, this may be due to various services they have to provide as government owned banks. For example, the state banks have been disbursing higher agricultural credit or providing banking services to the larger section of people with limited income across the country. However, the major reason for high NPL and classified loans lies in its inherent weak mechanism to undertake banking activities by following the existing guidelines of the central bank. Hence, the new announcement is only a window dressing to show an artificial increase of bank profitability.

In FY2012, the BB followed a monetary tightening policy to reduce the inflation rate from double digit to single digit. As a result, inflation rate reduced, but at a cost. This had a negative impact on the credit flow. For example, in July 2011, credit to private and public sectors grew by 24.36 percent and 39.87 percent, respectively. In June 2012, credit to both private and public sectors reduced significantly to 19.72 percent and 25.43 percent, respectively.

Such a decline is apprehended to have an impact on the investment and growth situation of the country. In its monetary policies of FY2013, the central bank focused more on GDP growth through more productive investment and containing inflation. As a result, during the first eight months of FY2013 there has been an increase in money supply. This, however, was not accompanied by increased flow of credit.

The monetary policy statement (MPS) of the BB for the period January-June 2013 set targets at 17.7 percent for the growth of the broad money supply (M2) and 18.5 percent for the growth of the private credit. The early signals of the monetary indicators are, however, not very promising. At the end of February 2013, M2 grew by 18.9 percent as opposed to 18.19 percent in February 2012. In case of credit flows, both public and private sectors suffered sharp decline compared to the last fiscal year.

The growth of credit to the public sector was a mere 8.57 percent in February 2013 compared to 59.92 percent in February 2012. On the other hand, the flow of credit to the private sector experienced a decline from 19.55 percent in February 2012 to 13.96 percent in February 2013.

The decline of credit to the public sector signifies a lower dependence of the government on the banking system and availability of more resources with banks for the private sector. However, the slow growth of credit to the private sector is again a reflection of low appetite of the sector for credit which is mainly related to dampened investment climate of the country due to a lack of infrastructure including power and gas supply and political turmoil.

There have been policy directives by the BB favouring agricultural credit. As a result, commercial banks are mandated to disburse agricultural loans to various sectors including crops, livestock and fisheries.

However, the growth of agricultural credit during January-March 2013 is only about 9 percent compared to the same period in 2012. A disaggregated data reveal that since 2009 the share of the crop sector is consistently increasing in total agricultural credit, so is the case with livestock and fisheries. However, the allocation for poverty alleviation activities has mostly been declining. Given the ambition of supporting inclusive growth in the country, efforts towards poverty alleviation programmes demand more attention.

Excess liquidity of the scheduled banks has almost doubled during January 2012 to February 2013. The growth of excess liquidity in the banking system has influenced the money market by bringing down the call money rate significantly, from 19.66 percent in January 2012 to 8.95 percent in February 2013. The call money rate hovered around 10 percent during January 2009 to October 2010, but increased sharply to 33.5 percent in December 2010 because of the adjustment in the CRR and SLR rates by the central bank.

Throughout the FY2011, the excess liquidity in the scheduled banks was more or less stagnant, but started to rise again since January 2012. High excess liquidity is not, however, accompanied by low interest rate, as logic would suggest. In addition to low investment and consumer demand, movements in the stockmarket have also implications for the liquidity situation of the banking sector in Bangladesh. Thus the provision of putting a ceiling on the exposure on stockmarket for banks has also contributed to excess liquidity in banks in the recent period.

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Corbat faces ghost of Weill's deals in Citi's machines

REUTERS, *New York*

WHEN Vikram Pandit was abruptly ousted as Citigroup Inc's chief executive late last year, senior bank employees speculated for weeks about who would follow him out the door.

Chief Operating Officer John Havens had already left with Pandit, and the employees bet the new CEO, Michael Corbat, would push out other Pandit loyalists. High on their list was Don Callahan, who headed operations and technology.

But when Corbat named his new team in January, he kept Callahan, albeit in a reduced role. People familiar with the matter said Callahan survived because he oversees an effort critical to both Corbat and bank regulators - simplifying and standardizing thousands of Citigroup's information technology systems. The process, which ramped up in the aftermath of the financial crisis, will take at least two more years to complete, they said.

Corbat's choice highlights how some 15 years after Sanford "Sandy" Weill merged Travelers Group and Citicorp to create Citigroup, the bank is still trying to integrate all its operations. For example, it still uses different account opening procedures and systems in different countries.

If Callahan gets it right, Citigroup will better track risks and satisfy U.S. regulators who have been pressing it to improve its systems for more than 10 years, and will more efficiently sell products to retail, corporate, and institutional customers. It will help bring down costs and raise revenue, potentially adding $750 million to annual profits starting in 2015 from improvements in consumer banking alone.

The bank spends around $18 billion a year - or about a third of its operating expenses - on operations and technology, including facilities, systems and hardware, making it a major area of concern for the board as well, two sources said. The board is considering hiring a new director with technology expertise to help monitor and assess management's efforts, they said.

Citigroup spokeswoman Shannon Bell said that the bank is simpler than it was before the financial crisis, having sold more than 60 businesses and $800 billion of assets that were not central to its strategy.

"We have worked diligently to integrate and modernize or replace legacy systems while investing in their safety and soundness," Bell said. "The continued integration and consolidation of our technology platforms will improve productivity and client service across the company, improving results for all stakeholders."

Weill, who retired as Citigroup CEO in 2003 and as chairman in 2006, told Reuters he was tireless in integrating companies he acquired.

Over about a dozen years, Weill built Citigroup into the largest U.S. bank, starting with a small consumer lending company in Baltimore and using it as a platform for a series of mergers and acquisitions with companies, including Primerica and Travelers.

REUTERS

Michael L Corbat, chief executive of Citigroup Inc, arrives at the Planalto Palace before a meeting with Brazil's President Dilma Rousseff in Brasilia on April 9, 2013.

"I don't want to sound cocky, but I think I managed it (Citigroup) very well," he said. To Citigroup's critics however, its lingering technology problems are a sign of how the bank is too unwieldy for anyone to run.

"These institutions are too big and complex to manage effectively," said Gary Stern, former president of the Federal Reserve Bank of Minneapolis and co-author of "Too Big to Fail: The Hazards of Bank Bailouts," a 2004 book policymakers often cited during the financial crisis.

"It is a daunting challenge to effectively integrate systems," Stern added.

The technology issues have had a real impact on the bank's business, current and former executives said. As markets cratered during the financial crisis, for example, it took days for the bank to gather data about risks from different trading desks, according to a person involved in the quest to figure out the bank's exposure to particular securities, derivatives and counterparties.

"We were flying blind," said another former executive.

These problems also affected day-to-day operations of the bank. In 2005, for example, a customer service representative at a Citibank branch needed to know how to operate 89 different systems to sell every product the bank offered. At one point, the bank employed 30 people whose sole job was to help branch staff reset passwords to these systems, a former official at the bank said.

Corporate clients complained that they felt like they were being called on by hundreds of Citigroup sales people, each of whom was oblivious to the efforts of their colleagues, one of the former bank officials said.

The systems problems that Citigroup faces are, in varying degrees, issues for every major U.S. bank, most of which also arose through acquisitions. JPMorgan Chase & Co, for example, says it spends more than $8 billion a year on systems and technology, but generated some $6 billion of trading losses last year from the "London whale" scandal that were in part due to flawed valuation systems.

"A lot of these banks have grown through mergers, so they have a Noah's ark of platforms: they have two of everything and they have to all come together," said Ray August, a senior executive at CSC, which helps banks rationalize their systems.

Citigroup's problems may be worse than many of its rivals, say executives who have worked there and at other major banks.

Islamic banks can help fund Asia's infrastructure needs

AFP, *Singapore*

ISLAMIC banks can help finance Asia's burgeoning infrastructure investment needs while continuing to adhere to fundamental Sharia tenets, executives said Tuesday.

Islamic banks, which emerged relatively unscathed from the global economic crisis in 2008, saw total assets top $1.6 trillion (1.22 trillion euros) in 2012, a 20.4 percent rise from 2011.

Asian nations hold 13 percent of global Islamic banking assets, the highest outside of the Middle East, speakers said at the World Islamic Banking Conference in Singapore.

"Within Asia and the Middle East, there is a huge amount of infrastructure building to cater to the needs of growing populations in some countries and mass urbanisation in others," Mohammad Y. Al-Hashel, governor of the Central Bank of Kuwait, said in a keynote speech.

"Since Islamic finance dictates that lending should be backed by tangible real assets, it has the potential to offer the much needed funding for infrastructure building," he said.

The Asian Development Bank in 2012 estimated that fast-growing Asia needs to invest a total of $8.0 trillion to fund national infrastructure needs such as rail networks, airports, power networks and water treatment plants in the current decade to 2020.

Ranjit Ajit Singh, chairman of the Securities Commission of Malaysia, said the region's "staggering and substantial" infrastructure capital needs could be a key driver for Islamic finance to gain a foothold in more Asian economies.

"These substantial amounts provide tremendous potential in my view for financing and capital raising through the issuance of sukuk (Islamic bonds) as many infrastructure assets are inherently Sharia-compliant," he said.

Singh added that the growing affluence of middle-class Asian consumers could also spur an increased demand for Sharia-compliant investments and savings products, especially within Southeast Asia, which has a substantial Muslim population.

"The opportunity for Islamic investments to meet this prospectively strong demand should not be underestimated," he said.

Officials also reiterated the need for Islamic banks to avoid the excesses of their mainstream counterparts that led to the global economic crisis, and to invest in "socially responsible" industries.

Apart from barring investments in "haram" or banned sectors such as gambling and alcohol, Islamic finance does not allow the payment of interest, which is seen as a form of gambling.

Risks are shared between the bank and depositor so there is an incentive to ensure any deal is sound.

Al-Hashel cautioned against the creation of financial products that were against the "true essence of Islamic banking".