

Large loan restructuring policy: criticisms and answers

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ON January 29, Bangladesh Bank issued a new Large Loan Restructuring Policy (LLRP). Concerns have been expressed in some quarters about the misuse of this policy. There is a fear that this policy will open up the floodgate for loan restructuring that could hurt the earnings of commercial banks, especially state-owned commercial banks. There is also a belief that this policy was adopted under political pressure from influential debtors. How reasonable are these concerns? In this article I explain the rationale for the LLRP and also respond to the concerns that have been expressed about the policy.

The LLRP was adopted as an instrument to facilitate the effective functioning of the market-based Bangladesh economy. In any market economy, private investments are made on the basis of the best available information regarding demand, cost structure, competition, profitability and related variables. Nobody has perfect knowledge or perfect foresight and therefore there is a considerable element of uncertainty, especially about future trends of current variables that were used to make the investment decision. In view of this, profitability of investment tends to fluctuate considerably over time. In particular, world commodity price fluctuations, downtrend in global demand for products and domestic political difficulties can easily derail business incomes and profitability.

In this real world of uncertainty, it is natural to expect that some business could come under substantial stress and face a liquidity crisis. There are plenty of global examples of how business enterprises have come under stress from time to time. In some adverse circumstances an enterprise may need to exit and go out of business. Many countries have sound bankruptcy provisions that allow an orderly exit process with reasonable transaction costs.

But not all distressed companies are candidates for bankruptcy. Many are simply facing a liquidity crisis due to an unanticipated downturn in earnings. With orderly restructuring of business including restructuring of loan repayment facility, these enterprises can manage the downturn and emerge stronger with the restructuring. In recognition of this, many countries have developed loan restructuring policies to help good enterprises that are facing temporary financial distress ride over the crisis. Financial loan restructuring is usually combined with necessary business restructuring to reduce future financial risks, reduce costs and strengthen future earnings potential.

Commercial banks in Bangladesh from time to time restructure individual loans as a normal business decision. These restructuring require Bangladesh Bank clearance as a prudential norm and to avoid collusive behaviour. However, large borrowers with multiple bank loans can face a real challenge in restructuring these multiple loans and the transaction costs of multiple clearances from BB can be high. Importantly,



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The Bangladesh Bank headquarters are pictured at Shapla Chattar at Motijheel in the capital.

there were no clear guidelines for commercial banks to base their restructuring decisions.

The LLRP is aimed at reducing these transaction costs and facilitate an orderly restructuring process for large loans of enterprises that are under temporary financial stress. This is a facility available to all business irrespective of their political affiliation and based only on the merits of the business case. The LLRP was developed with careful scrutiny by the BB board and drew on the good practice examples from Asian countries. Attention was given to ensuring that only a genuine business enterprise with evidence based restructuring proposal duly certified by a pre-qualified accounting firm is eligible. The LLRP requires that individual banks must own and approve the restructuring proposal based on strict business considerations but it also provides prudential limits on the generosity of the restructuring terms. This means a bank, especially a state-owned commercial bank, cannot just decide to forego its earnings based on political pressures.

Against the above context of the origins of the LLRP, let me now answer the concerns highlighted at the beginning of the article. So far, after about four months since the LLRP was announced, not a single restructuring proposal has been approved. Only one case involving Tk 180 crore has been submitted by a reputable private bank to BB for review so far. So, where is the evidence for the opening of the restructuring floodgate?

As explained above, the LLRP is a well designed and technically sound policy that combines the best features of good practice international experience. The entry criteria are tough enough to allow only genuine business enterprise to seek the relief. Collusive behaviour between a politically powerful business

enterprise and the management of a state-owned bank will fail to meet the entry criteria and therefore will not be approved under the LLRP. So, where is the evidence about political pressure leading to the development of LLRP?

Clearly, the concerns about the LLRP are not based on evidence. The apprehensions reflect misinformation and a lack of understanding of the LLRP. This is not uncommon in Bangladesh where populist perceptions and suspicions rather than evidence-based criticisms often tend to share the limelight.

Nevertheless, while there is a genuine business case for LLRP, the BB board is also mindful that excessive loan concentration generally poses risks for the overall health of the banking sector. It has instructed the BB management to strengthen the monitoring of loan concentration for all large borrowers with a view to ensuring that all prudential norms are applied for these borrowers and to find ways to reduce such concentration. Although individual bank specific single borrower limit is in place and duly monitored, a system is needed where the full banking exposure of both an individual enterprise and a group of enterprises belonging to a single owner are monitored and prudential norms applied to both. Too large to fail borrower syndrome is not a healthy development for a sound banking sector. Accordingly, BB needs to take steps to avoid unhealthy loan concentration at both the individual bank level and for the banking sector as a whole at both the individual enterprise level and at the level of group holdings of a single owner.

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Microcredit's Grameen rate of interest

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IT is often said that the financing charges, in the form of interest, as applicable to microcredit operations, including that levied by Grameen Bank in Bangladesh and elsewhere, are high compared to the prevailing interest rate in the conventional market. At the same time, overall experience gained suggests that microcredit business continues to be popular and there is strong public demand for additional coverage.

It needs to be recognised, however, that the financing charge in the form of interest seems to have unique but divergent response and operational outcome from the two distinctly different markets. In the conventional market in Bangladesh, until recently, prevailing rate of interest was in the range of 12-14 percent; in some countries it was in single digit. While the rate applicable to a microcredit borrower, in Bangladesh, Grameen Bank had deliberately kept it low, allowing its rate of interest charges at about 20 percent, for early removal of poverty. At the other end of the spectrum, Banco Compartamos in Mexico charged as high as 70 percent, arguing in favour of capital formation and early wider coverage.

Almost in all other countries, microcredit charges are alleged to be relatively high with a common 'outcry' of 'high interest' impeding poverty reduction. But everywhere, recovery rate has been high. Grameen Bank experienced 99 percent recovery. Even in strife-torn Afghanistan, Brac has had a successful microcredit operations experiencing relatively high rate of recovery.

In view of high rate of return in microcredit operations, lenders in Bangladesh, India and Mexico have been charging relatively 'very high interest' rate. Entertaining this perception of 'high interest' and for protecting the poor, Bangladesh Bank has capped the rate of interest applicable to microcredit operation at 27 percent. The Economist (November 20, 2012), seemed to have questioned the wisdom of such a move, suggesting that such a step may "deter new entrants (lenders) and reduce competition". In other words, it apparently argued that an unrestricted rise of interest could be justified if the relevant (mc) market would bear it, even though the clients were poor, seeking redress from poverty.

The experience of micro-lending at the so-called 'high interest' but experiencing, at the same time, a high recovery rate, and in view of the Economist's recent observations, effectively supporting an undeterred move towards a higher rate, lend one to ask if interest in the conventional market and the one for micro-lending are in fact

two different products, in terms of cost consequence and operational outcome. Answers to these may help establish the fact that financing charge, called interest, applicable to microcredit operations is essentially a variant of conventional market interest, a distinctly different product, hence, logically, should be called differently. By way of name giving, it may be called "Grameen rate of interest" - 'gi', thereby help defining it more accurately, with the world already familiar with 'Grameen'.

The apparent main difference between the two markets seems to be in conditions laid for lending. In conventional market the borrower's main conditions are provision for collateral and penalty on default. In reality, recovery rate is frequently sluggish. Whereas, in microcredit market, there is no collateral and the recovery rate, universally, is very high.

However, the real difference, one is likely to argue, is in the respective outcome, in terms of returns to investment, in project performance, one under conventional market conditions and the other under microcredit operations. Commercial lending rate normally reflects the prevailing discount rate -- a proxy for the opportunity cost of the capital -- which also reflects the minimum expected rate of return for the entrepreneur. Whereas in the conventional market a rate of return in the order of 20-30 percent is acceptable, given the prevailing interest rate; in case of a microcredit operation frequently it exceeds 100 percent, raison d'être for its popularity and its high rate of recovery. No wonder that the outcry of 'high interest' in a microcredit operation is not from the borrowers themselves.

In view of all these, she (frequently a woman in Bangladesh) cannot said to be operating in a conventional market. Also it can be argued that Grameen Bank's financing charge, although called interest, is not the market rate of interest in form, structure or in its financial consequence. Then, is not her payment of 'interest' a misnomer for some other form of financing charge, such as 'grameen interest', in her real world ('grameen market'). The two markets are distinctly different in the scale of their undertakings, source of customer response, and the rate of profitability. In any case, the interest charge she is liable to pay is of a distinctively different kind -- it's another variant. It could more meaningfully be called "Grameen rate of interest" (gi), thus allowing potentially a fresh thought, perhaps introducing a new concept, in the area of microcredit operation, globally.

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REUTERS

A worker prepares to demonstrate how to dry unhusked rice using a solar panel, a process called Solar Dryer Bubble 25, at a company which manufactures solar dryers and storage facilities for a variety of grains in Subic Bay, Zambales city, north of Manila on Friday. The Philippines' National Food Authority has invited Vietnam, Thailand and Cambodia to a June 5 tender for the supply of 250,000 tonnes of rice, a spokesman for the state grains procurement agency said. The country is seeking offers from the governments of its three neighbours for the supply of the 25-percent broken variety of rice to boost its buffer stocks ahead of the lean harvest season that begins in July.

Google unveils Android Pay in fresh challenge to Apple

AFP, San Francisco

GOOGLE on Thursday unveiled its pay-with-a-phone system for Android devices, ramping up its challenge to Apple in mobile payments.

Android Pay, unveiled at the Google developers conference in San Francisco, brings together mobile carriers, payment networks, banks and retailers to allow smartphone users to use their handsets instead of payment cards.

Google engineering vice president Dave Burke said Android Pay would work in more than 700,000 US retail outlets that accept contactless payments.

"We are at the start of an exciting journey, we are working closely with payment networks, banks and developers," he said.

Similar to the Apple Pay system unveiled last year, Android Pay will allow consumers to store credit card information on their handsets along with loyalty cards and other data.

For extra security, Android Pay will generate a one-time "token" or virtual account number so the actual credit card data is not revealed in a transaction.

"Users can simply and safely use their Android phone to pay in stores where you see an Android Pay logo," Burke said. "We are focused on simplicity, security and choice."

Google said in February it was teaming up with the mobile phone payment firm Softcard to ramp up its efforts in the emerging sector. This will allow Google Wallet to become a pre-installed "tap to pay" app on Android smartphones.

No date was announced for the roll-out of Android Pay but the Google statement said it would be "available on Google Play for download soon."

Apple's iOS and Android rule the global smartphone market, and the companies are eager to be at the potentially profitable heart of shopping or other financial transactions as consumers go increasingly mobile.

Google announced that enhancements being built into a new "Android M" version of the mobile operating system include support for fingerprint-checking, which would match



AFP

An attendee at Google's annual developers conference checks out cardboard virtual reality head gear next to a camera that the internet titan is developing to capture immersive 360-degree videos, in San Francisco, California on Thursday.

the feature built into Apple's latest iPhones and iPads for security.

"The things they announced today are good, but the 'M' doesn't stand for 'Major,'" Current Analysis research director Avi Greengart told AFP at the gathering.

"Some of the improvements are Google playing catchup in payments and fingerprint recognition."

Apple Pay also works with Apple Watch, essentially allowing users to pay with the waves of a wrist. The Android team gave no indication if their new Pay feature will extend to smartwatches.

Google did show off a slew of upgrades for Android-powered smartwatches, such as gesture controls and being able to distinguish between actions such as push ups and golf club swings.

"We love watches," Android Wear director

David Singleton said during an on-stage presentation.

"They have always been this incredible mix of beauty and technology."

He said Google is partnering with an array of hardware makers to add to the current line-up of seven different kinds of Android smartwatches.

There are more than 4,000 applications tailored for Android-powered smartwatches. The Apple Watch is fueling the emerging smartwatch market and is expected to be the top seller in the segment for next few years, according to a market research report released early in May.

Fun, functional or hip applications made by the kinds of software wizards packed into the Google developers conference here are seen as vital to the popularity of smartwatches and smartphones.