Supervisory Role and Regulating Defaulted Loan: Governance Challenges of Bangladesh Bank and Way Forward

22 September 2020

Executive Summary

(English Version)

Md. Julkarnayeen
Amit Sarkar
Mohammad Rafiqul Hassan

Transparency International Bangladesh (TIB)

Supervisory Role and Regulating Defaulted Loan: Governance Challenges of Bangladesh Bank and Way Forward

Research Adviser

Dr. Iftekharuzzaman, *Executive Director, Transparency International Bangladesh (TIB)*
Professor Dr. Sumaiya Khair, *Adviser - Executive Management, TIB*

Research Team

Mohammad Rafiqul Hassan, *Director - Research and Policy, TIB*
Md. Julkarnayeen, *Deputy Programme Manager - Research & Policy, TIB*
Amit Sarkar, Assistant *Programme Manager - Research & Policy, TIB*

Acknowledgements

We acknowledge contributions of all informants (present and former officials of Bangladesh Bank and commercial banks, Directors of commercial banks, businesspersons, Bank and financial sector experts, Researchers, Economist, Lawyers, Journalists) who have provided their valuable information and opinions to enrich this research. We also express our gratitude to Dr. Iftekharuzzaman, Executive Director, and Professor Dr. Sumaiya Khair, Adviser, Executive Management for reviewing the research report and other colleagues for their assistance in different ways and valuable inputs in the presentation.

22 September 2020

Contact

Transparency International Bangladesh (TIB)
MIDAS Centre (Level 4 & 5)
House # 5, Road # 16 (New), 27 (Old)
Dhanmondi, Dhaka-1209, Bangladesh
Tel: +880 2 9124788-89, 9124792
Fax: +880 2 9124915
E-mail: info@ti-bangladesh.org
Website: www.ti-bangladesh.org

Executive Summary[*]

1. Background, Rationale, Scope and Objective, Method of the Study

Although the commercial banks run their business based on money deposited by the ordinary people, directly or indirectly, the depositors do not have any control over them. On behalf of the depositors, it is the responsibility of the banking sector supervising institutions to ensure the interest of the depositors. The Bangladesh Bank[†], established under the 1972 Presidential Order number 127 and run according to the Bank Company Act, 1991 is supposed to supervise and control the banking sector of Bangladesh as central policymaking and controlling authority. However, particularly during the last one decade, according to various research and media reports, the banking sector of Bangladesh is highly prone to corruption, irregularities, scam, fraud, capital shortfall, high-interest rate, liquidity crisis and high rates of default loan. Over the years, the money deposited by ordinary people has been misappropriated and plundered through willful default loans. Although the default rate has been declining significantly between 2009 and 2011, the default rate has been rising again since 2012. These defaulted loans are not in all cases unintentional and create risks for business crisis. The prevailing situation raises question regarding the effectiveness of the supervising role of Bangladesh Bank.

1.1 Study Rationale: The Seventh Five Year Plan mentions measures for the independence of Bangladesh Bank, increased supervision of state-owned commercial banks, decreasing default loan, end the standard of the regulatory structure. The Perspective Plan 2010-2021 mentions the need for establishing the rule of law and control of corruption, and increasing capacity of public institutions, including the Bangladesh Bank and other regulatory bodies. Besides, the SDG 16.6 is set to develop effective, accountable and transparent institutions at all levels and SDG 16.5 explicitly sets the target to reduce corruption and bribery substantially in all its forms. Although various research reports and articles the corruption and irregularities have been mentioned and discussed, there still exists a gap in terms of in-depth analysis to identify governance challenges in supervision and regulatory role of Bangladesh Bank. Researching to identify governance challenges in important public institutions and sectors is a part regular activity of Transparency International Bangladesh (TIB). The present research was undertaken as part of that continuous effort.

1.2 Study Objectives and scope: The overall objective of this study was to identify the governance challenges of Bangladesh Bank in its regulatory and supervisory role in controlling default loan in the banking sector of Bangladesh. The specific objectives include:

- Review of the laws and policies relevant to supervision and regulation of default loan
- Identify the governance deficits and their reasons in supervision and regulation of default loan, and
- Recommend appropriate measures based on study findings

[*] Summary of the study report titled, "Role of Bangladesh Bank in Controlling Default Loan: Governance Challenges and Way Forward" released on 22 September 2020, Dhaka.

[†] Mentioned alternatively also as 'the Bank' hereafter in rest of this document.

The present research considered the supervision and regulatory challenges faced by Bangladesh Bank in controlling default loan in the state-owned and private commercial banks in Bangladesh. In doing so, the laws/ policies/ prudential rules and regulations etc., which are relevant to loan management, supervision, and regulation have been reviewed. The activities of the various departments that are most relevant for default loan regulation and control are also brought into the purview of the present study. Such activities include formulation of prudential regulations, offsite and onsite supervision, credit information, joint supervision *etc*. The research also focuses on the role of various stakeholders influencing Bangladesh Bank's supervisory and regulatory function to control default loan. The time reference of supervisory activities considered is up to June 2020 starting from 2010.

1.3 Research method: This is qualitative research. However, some quantitative data has been analysed and used as and where necessary. The data has been collected from both primary and secondary sources. The primary data has been collected from Key Informants (KI) using checklists. Various KIs interviewed for the study includes present and ex-officials of Bangladesh Bank and different commercial banks of the country, directors of banks, experts/ academics/ researchers on the sector, businesspersons, lawyer, journalist *etc*. Sources of secondary information include relevant laws and policy documents, reports and research articles, annual reports, the website of relevant institutions *etc*. The period of data collection and analysis for the present study was January 2019 through June 2020.

1.4 Analytical Framework: The study used following analytical framework (Table-1) consisting of widely known governance indicators developed after a review of available secondary information and relevant existing literature on challenges faced by the central bank in regulating default loan as part of its overall regulatory function in the banking sector of the country.

Table-1: Analytical Framework

Governance Indicators	Sub-indicators/contexts
Independence of the Central Bank	Legal Framework: Institutional independence, Regulating and monitoring autonomy, Ability to take corrective action and impose penalties, Ability to formulate policies and regulations
	External Factors: Formulation of law and banking policy, Formulation board of the Bangladesh bank, Appointment of the governor and deputy governor, Role of government, politicians and business people in decision making, and law enforcement
Supervision Ability	Leadership and decision-making ability, Supervision strategy (offside and onsite supervision), Manpower and Technical capacity
Transparency	Banking report, policy formulation, meeting minutes and voting information, Disclosure of information regarding the appointment process of board members, governors and deputy governors of Bangladesh bank
Accountability	The role of the board of directors, Role of the parliamentary standing committee, Decision-making process, the delegation of responsibilities, participation of various stakeholders

Governance Indicators	Sub-indicators/contexts
Integrity	Types, contexts, causes of irregularities in supervision work, Measures taken against irregularities and corruption, Conflict of interest

2. Study Findings

Significant findings of the present study based on data as collected and analysed according to the analytical framework are as follow.

2.1 The ever-increasing default loan

In 2009 total default loan in the country was BDT224.81 billion, which increased to BDT1162.88 b in September 2019– an enormous increase that amounts to an average default of BDT93.80b annually. As a percentage, from 2009 to 2019, the increase was 417 per cent whereas during the same period the total growth of loan advanced was 312 per cent. The default grew, on a percentile point comparison, 105 points more than the advance. However, according to an IMF estimate in September 2019 the actual amount of total default was even higher – BDT1124.25b. It would increase further to BDT2401.67b if loans that have been repeatedly rescheduled, restructured or have stay order from the court is considered. Finally, the actual amount would stand as even higher – BDT Three trillion, if written off loans, are also considered.

The huge defaulted loan, as mentioned above, constitutes a big challenge for the banking sector of the country. Although it has been said time to time that such loan would be controlled and measures would be taken against the willful defaulters, no effective action has been taken yet in reality. On the contrary, the defaulters have been allowed various considerations to reschedule and restructure their loans repeatedly. Latest, in May 2019 Bangladesh Bank allowed another such opportunity to the defaulters providing them with a chance to reschedule their default loans for ten years paying only two per cent of the total amount. Thus the official figure of the defaulted loan, as of March 2020, came down to BDT925.10 b. However, this reflects little substantial improvement in the current crisis of the continued willful default. Since the regular trend in increasing default loan continued just as in the past and in June 2020, it grew to BDT961.17 b – a 36.07 billion increase.

In addition to various considerations given to the defaulters, the government also has been regularly supporting state-owned commercial banks to come out of the crisis of inadequacy of cash fund due to the vast amount of defaulted loan. Approximately, there, about 50 per cent of the total defaulted loan is from state-owned commercial banks. Available data indicates that during 2012-13 to 2017-18 fiscals, about BDT124.73b have been provided to state-owned banks to help them mitigate their crisis.

The study finds two significant types of governance challenges in supervision and regulatory role of Bangladesh Bank in controlling default loans, bringing stability in the banking sector, and protecting the interests of the depositors. One of them is various external challenges that include limitations of law/policy, political influence and influence created by highly connected business owners. The other is Bangladesh Bank's internal challenges that include limitations in capacity, lack of transparency and accountability, irregularities and corruption in supervisory activities, and more importantly, its weak leadership.

2.2 External Influence on Regulatory and Supervisory Function of Bangladesh Bank

For effective supervision and regulation, a strong and independent regulatory/supervisory body is needed. The study observes three types of external influences that undermine the independence of Bangladesh bank as supervisor of the financial sector of the country. These are –

1. **Limitations and Deficits in the Existing Law and Policy Structure:** There are some limitations and deficits in the existing legal/policy structure that undermine the independence of Bangladesh Bank, directly or indirectly, and creates risk and opportunity for political / business influence;
2. **Political Influence:** This includes changing existing legal /regulatory provisions favourably, creating opportunities/risks for unhindered access and exerting control over the banking sector, influencing the management and operation of Bangladesh Bank, introducing dual control over the banking sector by creating a separate Financial Institution Division, and creating obstacles in the way of implementing the decisions taken by Bangladesh Bank;
3. **Influence Exerted by the Highly Connected Business owners**: Creating control/influence over the banking sector by business syndicate/specific group, influencing policy /law/banking rules and regulations, influence to change decisions taken by Bangladesh Bank, disregard rules and regulations, relevant procedures and orders/recommendations made by Bangladesh Bank, and creation of syndicate to influence the loan disbursement and regulation process.

2.2.1 Independence of the Central Bank: Limitations of Legal Structure

Principal legal instruments based on which Bangladesh Bank, the Central Bank of Bangladesh, operates includes the Bangladesh Bank Order 1972, the Bank Company Act, 1991, the Money Loan Court Act, 2003, the Bankruptcy Act, 1997, the Bangladesh Banks (Nationalization) Order, 1972, *etc*. Moreover, Bangladesh Bank formulates/revise various prudential regulations time to time under which the Bank sector. These include, among others, policies and guidelines on Capital adequacy, Loan classification and provisioning, Single borrower limit, Loan rescheduling and restructuring, Write off, Corporate governance in bank management, Appointments of Directors *etc*.

However, there exists some limitations /gaps in the existing relevant legal framework/structure that affects the independence of Bangladesh Bank, weakens its supervisory and regulatory functions, and increases opportunities and risks for intervention and influence by the vested interest. All these gaps and anomalies facilitate the creation of a "family-based oligarchy" and its domination in the sector. Thus, syndication emerges in collusion of this "family-based oligarchy" with other influential actors capturing control over the sector and contribute to increasing defaulted loan.

The following table (Table-2 on next page) presents a summary of various limitations**,** gaps, and challenges in relevant existing policies, laws, rules and regulations.

Table-2: Limitations, Gaps, Challenges in Existing Policies/Laws/Rules/Regulations Relevant to Banking Sector Supervision and Controlling Defaulted Loan

<table>
<tr><th>Subject</th><th>Section of the relevant law</th><th>Limitations / Practical Challenges / Outcomes</th></tr>
<tr><td colspan="3">Bangladesh Bank Order 1972</td></tr>
<tr><td rowspan="2">Appointment and removal of Governor and Deputy Governor</td><td>The appointment of the governor and deputy governors has been said to be subject to fulfilment of the conditions laid down by the government [10(3)(4)]</td><td rowspan="4">▪ In all four cases, there is a deficit in following internationally recognised and exemplary practices
▪ Lack of transparency due to lack of clarity in the process, person/institution responsible for recruitment and removal
▪ Political consideration by the Ministry of Finance on appointing the Governor, Deputy Governor and member of the Board of Directors
▪ Eligibility Conditions change from person to person
▪ These issues pose a risk to the independence of Bangladesh Bank</td></tr>
<tr><td>The government may remove him if he fails to meet the eligibility criteria mentioned in the law, fails to perform his duties, breaches the trust entrusted or engages in activities contrary to the interests of Bangladesh Bank [15(1)]</td></tr>
<tr><td rowspan="2">Formation and dissolution of the board</td><td>Governor, a Deputy Governor, three government officials nominated by the government and four others (according to the government who have experience and skills related to banking, business, industry, commerce, agriculture) [9(3)]</td></tr>
<tr><td>If it appears to the government that Bangladesh Bank has failed to fulfil any of the responsibilities prescribed by law, the government has the power to dismiss the entire board of directors by publishing a gazette [77(1)]</td></tr>
<tr><td>Institutional Capacity</td><td>The general supervision and management of all matters relating to the activities of Bangladesh Bank shall be vested in a Board of Directors [9(2)]</td><td>Due to legal constraints on the structure of the board and the process of its formation, it has limited the independent exercise of this power.</td></tr>
<tr><td colspan="3">Bank Company Act 1991</td></tr>
<tr><td>Supervision power of Bangladesh Bank</td><td>While Bangladesh Bank has the power to remove the chairman, director or chief executive of any bank to prevent it from engaging in harmful activities against the interests of banks or depositors [46(1)], this power does not apply to state-owned banks [46 (6)]</td><td>This restriction of state-owned bank supervision undermines the absolute independence of Bangladesh Bank in controlling the banking sector, which conflicts with the Basel Principles.</td></tr>
</table>

Subject	Section of the relevant law	Limitations / Practical Challenges / Outcomes
Ability to take corrective action and impose penalties	The government has the power to acquire, temporarily suspend, merge or restructure a bank that has repeatedly failed to comply with the Central Bank's directives or is causing loss to the depositor [58, 77]	Bangladesh Bank's independence has been curtailed as the government has the power to acquire, temporary close or suspend banks that violate the rules and regulations.

2.2.1.1. Lack of Compliance with Basel Principle

The laws and policies relevant to supervision also do not fully comply with international standard, e.g., one set by the Basel Principle. The Basel Committee on Banking Supervision constituted in 1974 to formulate principles and rules aiming at reducing assets in risk and strengthening the financial sector. However, the existing law and policy for banking sector supervision in Bangladesh do not fully comply with the Core Principles for Effective Banking Supervision (Principle 1 and 2) that focuses on powers, responsibilities, and functions of supervisors. There also exists some challenges at the implementation level, even if there is provision compliant to Basel Principle.

The following table summarises the deficits and some practical challenges.

Table-3: Basel Core Principles for Effective Banking Supervision vs Relevant Laws of Bangladesh

Basel Principle	Relevant laws of Bangladesh	
	The presence of policy	Deficiencies/ Practical Challenges
Determining the responsibilities and objectives of the supervisory authority (establishing a healthy and secure banking system)	Partial	Absence of primary purpose of bank supervision
Determining the independence, accountability and management structure of the supervisory body	Partial	There is scope for government intervention in the law
Clarification on the process of appointment and removal of Chief Executive and Board members	×	Absence of transparent and straightforward process in law
Power to impose penalties by the supervisory body	Partial	No mandate to liquidation/ merging of banks and removal of directors of state-owned banks

Basel Principle	Relevant laws of Bangladesh	
	The presence of policy	Deficiencies/ Practical Challenges
Provide access to any bank to ensure compliance with the rules and regulations	√	Political interference even if, there is power
Provide the ability to set and revise Prudential standards	√	Although there is power, the practice of policy capture exists

2.2.1.2 Absence of Specific Laws Relevant for Regulating Defaulted Loan

The existing law defines defaulted loan and when a borrower should be considered as a defaulting borrower. However, there is no legal definition of Willful Default or Willful Defaulter or what would be the punitive measure against such a borrower. Therefore, the Willful borrowers cannot be brought into book and cannot be exempted from various concessions (or even incentives in some cases) allowed by the bank in general. Despite being willful borrowers, they enjoy the benefits of such packages, which are targeted to genuine cases that are unwilling in trouble due to market condition or other.

The current provision for Single Borrower Limit seems inadequate in the sense that although it fixes a ceiling of borrowing from a particular bank by a single borrower or group but it does not provide any guideline as to how much that specific individual or group would be allowed to borrow from the sector as a whole from various banks.

2.2.2 Policy Capture by the Business

Powerful stake in the banking sector influence changes relevant laws and policies and exert a strong influence in the formulation of regulations by Bangladesh Bank as well as on its independent functioning in various ways. It creates a big challenge for the Bank in its supervisory/regulatory role and increases opportunities for loan default.

2.2.2 Policy Capture by the Business

Powerful stake in the banking sector influence changes relevant laws and policies and exert strong influence on formulation of regulations by Bangladesh Bank as well as on its independent functioning in various ways. This creates a big challenge for the Bank in its supervisory/regulatory role and increases opportunities for loan default. For an example, following amendment in the Bank Company Act 1991 created opportunities for family-based control and domination over the sector and thus risk for increasing defaulted loan:

- Increasing provision of maximum number of members in the Board of Directors from the same family from 2 to 4 (in addition to that, there exists scope for appointing near relatives of the same family as Director that also help strengthening the grip of a particular family further on a commercial bank)
- Successive appointment of the same Director for three tenures instead of two tenures (each tenure is for three years)

Despite criticism from various quarters, the government also recently amended the Bangladesh bank Order 1972 to increase age limit of the sitting Governor only for the sake of his continuation in the position. The following table (Table-4) provides a summary of prudential regulations in favor of loan defaulters.

Table-4: Example of Policy Capture: Amendment of Prudential Regulations in Favor of Defaulters

Policies	***Changes***	***Observations and results***
Loan rescheduling and one time exit	Reschedule for ten years with 2% down payment of the defaulted loan	More comfortable conditions for willful defaulters than regular borrowers; Encourage regular borrowers to default
Loan write-off	Resetting bad loan write-off period to three years from the five years; the provision of 100% security reserves has been relaxed	Defaulted loan artificially is shown less, Encouraging defaulted loans, Reduce the bank efforts in collection of the write-off loans
Loan classification	Increase in time by three months to repay classified loans instead of following internationally accepted standards	Defaulted loan artificially is shown less, Losing the objectivity of banking reports at the international level, Risk of adverse effect in case of foreign transaction or LC bill

It is also observed that the government has been repeatedly changing some regulations to salvage the commercial banks from liquidity crisis like increasing Advance Deposit Ratio (ADR), decreasing Cash Reserve Ratio (CRR) and Repo rates.

2.2.3 Establishing Control over the Banking Sector through Political Influence

It is also observed that political influence has been used to disregard decisions given by Bangladesh Bank on various functional matters and ignore prudential rules and regulation flagrantly. There are also examples of obtaining approval for new banks in a same way despite the fact that opinion of the experts on the sector was that new banks were not actually required for the economy. Political influence was allegedly used to buy shares of commercial banks violating rules of maximum limits and, at least in one such case, making Bangladesh Bank officials stay late evening to complete formalities for transfer etc. To reinforce grip on a bank by certain families, it is reported that there are example of appointing even six members from the same family, whereas the highest legal limit is only up to four. Besides, individuals who are not qualified enough to become Director of a commercial bank are appointed considering family interest. Existence of Directors with defaulted loan in commercial banks, which is violation of rule, is also reported. Though the members of the Board of Directors are supposed to be appointed through the Annual General Meeting (AGM), it is reported that in many cases the approval by the AGM is merely decorative while the membership remains predetermined. It is also observed that, in case of private commercial banks, there is example of even appointing an individual with allegations of corruption as Chief Executive through use of political influence ignoring Bangladesh Bank's advice.

In case of the State-owned Commercial Banks (SCBs), it is alleged that political influence is also used to control its management and functionalities. Experts opine that creation of a separate Division under the Ministry of Finance to supervise the SCBs was motivated. This undermines the role of Bangladesh Bank as an independent supervisor of the banking sector of the country and creates a dual control over it. The Directors of SCBs are often appointed under political consideration. In many instances, individuals appointed in such positions are linked with the interest of large business groups. This increases risks and opportunities for defaulted loan. In case SCBs, there also exist examples of ignoring advice of Bangladesh and appointing individual having allegations of irregularities/corruption as CEO.

2.2.4 Syndicated Influence in Default Loan

It is reported that a kind of syndicate has been developed in the banking sector where politically connected and influential persons, a section of the business, and bankers are working in connivance with each to exert control over the sector. They are securing large loans from the banks, becoming willful default, continuing to take advantage of repeated rescheduling/restructuring loans, and obtaining bank stay orders and avoiding legal consequences etc. It is reported that up to 30 September, 2019 the Directors of various Banks have obtained loan amounting to about BDT716.16billions from each other's bank, which is equivalent to about 11.21 per cent of total loan advanced in the sector during the same period! Besides these Directors have also taken loans amounting to BDT6.14 b from their own banks. These loans are in their own names; there are also allegations that they have taken more loans in the name of their other family members in disguise. When default loan matters are taken to the court, it is reported that weak reports are submitted in connivance with the bank officials and thus the verdict is won in favor of the defaulters.

2.2.5 Influence on the Central Bank

There are allegations of creating pressures on Bangladesh Bank when it tries to take measures against irregularities and corruption. Telephone calls from highly influential political positions like ministers are made to create such pressure. Higher officials, having good relation, are contacted from outside to intimidate or discourage in taking measures. It is also alleged that the observers appointed in banks in bad shape cannot play or do not play their desired role.

Scope for political influencing and influence created by the vested interest in the business upon the supervisory and regulatory function of Bangladesh Bank is indispensably related to the process of appointment, removal, and selection of the member of the Board of Directors, the Governor, and Deputy Governors. It is reported that a new Governor was appointed within two hours of resignation of the earlier Governor.

It is alleged that the individuals appointed in above positions are usually chosen considering their potential to taking a more lenient stance against the vested interest. Recent developments at operational level indicates that this allegation is not baseless. As mentioned above, for completing formalities related to transfer of a commercial bank, the officials of Bangladesh bank waited late evening at office, which epitomizes the level of influence exerted upon the management and functionalities of the Bank. It won't be an exaggeration, told key informants of this study, if one says that the banking sector regulatory policies are now formulated in the lobbies of five star hotels in Dhaka.

2.3 Bangladesh Bank's internal challenges in its supervisory/regulatory role to control defaulted loans

The study finds several internal governance challenges that affect the supervisory and regulatory role of Bangladesh bank to control defaulted loans as follow.

2.3.1 Lack of Strong Leadership: Although the revised Bangladesh Bank Order 1972 (Amendment 2003) ensures full independence in decision-making by the governor in operational matters[‡], Bangladesh Bank seldom takes any strong position against the irregularities and corruption existing in the sector. On the contrary, particularly during recent years, the Bank has been formulating/revising prudential regulations in a way that rather facilitates the continuation of willful default and promoting grip of a syndicate over the sector. According to relevant experts, there are examples of ignoring political pressure in decision making by the heads of central banks in many countries. Even in Bangladesh, in earlier periods, previous governors set instances of ignoring political pressure and upholding sectoral interest. However, the situation has just reversed during recent years. Some even consider that Bangladesh Bank has now assumed role of an "order bearer". Given a recent incident where it is reported that the Bank officials had been wait the late evening to provide approval for changes in a private bank, this allegation may not be an exaggeration.

2.3.2 Various other capacity constraints: The Bank also suffers from various other capacity constraints that weaken its role as supervisor and regulator of the defaulted loan. This also widens the opportunity and risks available for abuse and irregular, corrupt practices affecting the volume of defaulted loan and its timely mitigation. This include shortage of human resources in departments relevant to onsite and offsite supervisions, inadequate time available for inspection, decreasing delegation of authority to the inspection teams, reduced number of inspection visits, difficulties/inability in identifying misinformation/anomalies sent by various banks for offsite supervision, etc.

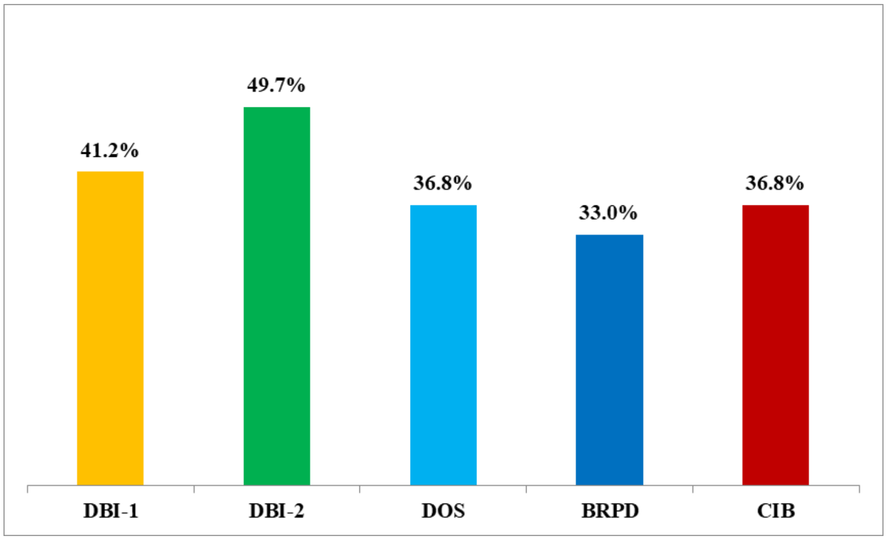
It was found that in Banking Inspection Department 1 and 2 (DBI-1 and DBI-2) responsible for onsite supervision, there exist vacant positions at first-class officer level (about 41.2 and 49.7 per cent respectively). In other relevant departments,[§] there also exist significant vacancy at officer's level, which ranges from 33 to 37 per cent (see Graph-1 below).

It is reported that earlier the inspection teams enjoyed greater autonomy in spot decision-making when anomalies/irregularities were found. Presently such authorities have been restricted. It is also reported that the teams now need to take permission from higher authority before each of inspection visits, which earlier they did not.

[‡] Bangladesh Bank Order 1972 (Amendment 2003), https://www.bb.org.bd/aboutus/regulationguideline/lawsnacts.php, as accessed on 20 September, 2020.

[§] Like Department of Offsite Supervision (DOS), Banking Regulation and Policy Department (BPRD), and Credit Information Bureau.

Graph-1: Vacant First Class Officer Posts in Different Departments



It provides that the total number of bank inspection by Bangladesh bank have a declined trend during recent years. In contrast, the number of branches of commercial banks has been increasing consistently during the same period (Table-5).

Table-5: Bank's Branch Visit by Bangladesh Bank

Fiscal Year	No. of Branches	Total No. Visited Branches by Bangladesh Bank
2014-15	7651	2490
2015-16	7971	2783
2016-17	8242	2413
2017-18	8629	1917

Moreover, due to a shortage in manpower, the inspections are done, in many cases, within 3-4 days based on a 10 per cent sample activity of a branch. Whereas for an in-depth, fuller assessment at least 10-15 days of investigation is required. Shortage of workforce also slowdown analysis of data received through offsite reporting. The process of identification of irregularities and corruption is also delayed and taking prompt and appropriate measures are challenged due to shortage of manpower. Existing bureaucratic complicacies also delays the process of report preparation, finalisation, and taking actions accordingly. For example, a significant incident of violating single borrower's limit, although it occurred during 2007 -2014, was only identified in 2017.

2.3.3 Irregularities and Corruption in Banking Supervision to Control Defaulted Loan

Various types of irregularities and corruption that have implication on the volume of **the defaulted loan** (particularly willful default) and its ever-increasing trend have been identified. This includes lack of implementation of recommendations, lack of written documentation of anomalies/irregularities, not taking into cognisance a report (shelfing), weak or manipulated reporting, negligence in duty, conflict of interest etc.

Sometimes part of the higher authority is found negligent in implementing recommendations made by the inspection teams in their reports. It is also alleged that sometimes they, due to their excellent relations with a few influential business groups, drop significant findings of the investigation/inspection report on irregularity and corruption during the process of finalising a report. Some of the reports made by juniors, it is alleged, never "see the light of the day and lost in the black hole". A part of higher officials, it is alleged, refrain from taking measures as per recommendations of the investigation report with the expectation of employment in contractual higher positions in public or private sector after their retirement with the help of influentials. It is observed that some of the high officials join in higher positions immediately after their retirement in the institutions they were responsible for supervision. This creates "revolving door" situation and exists as a potential conflict interest during their service period in Bangladesh Bank. Strict measures are not taken against irregularities and corruption due to the warm relation of higher authorities with higher-level banking officials.

Moreover, sometimes gross anomalies or irregularities, incurred by the commercial banks, are not even documented in the form of a written report. Given the politically influential position of so-called "bank owners", the relevant officers only warn verbally and urge for corrections. This is often done in the name of "greater interest in the stability of the financial sector". A part of the officials responsible for inspection and reporting submit a weak report or hide relevant information in return for various benefits they receive from the commercial banks during the inspection. Juniors, sometimes, comply with "unofficial advises" of seniors, in consideration of avoiding adverse scoring in annual appraisal. Getting a higher score is very crucial for their future promotion.

2.3.4 Accountability and transparency in regulatory/supervisory function: Three most important factors ensuring Bangladesh Bank's accountability are 1) Role of the Board of Directors, 2) Role of the Parliamentary Committees, and 3) Openness of the Bank to ordinary citizens. The study observes deficiencies in all the three types of mechanisms for ensuring accountability of the Bank.

The role of the Board of Directors is limited to formal approval of administrative and budgetary decisions like approval for a new department in the Bank or approval of the annual budget. The periodic reports, interim reports meeting minutes *etc*., are also routinely raised in the Board meeting for formal approval. According to knowledgeable sources, essential matters like approval for new banks, changes in prudential regulations, *etc.*, are also routinely raised and approved. The Board's role in these matters is rather decorative. As the number of the Board member nominated by the government, directly and indirectly, is higher, the risk for influencing Board's decision and shaping its role under the political influence remains higher as well.

The Bangladesh Bank Order (1972) makes provision for the Bank's accountability through the Parliamentary Standing Committee (PSC). The Bank must submit reports to the Standing Committee on the Ministry of Finance. However, it is alleged that a large number of the members of the Parliament and ministers are also involved in the banking sector business, and thus a potential conflict of interest exists. It is observed that in the relevant PSCs, during the 9th to 11th Parliament, one or more than one members had interest related to the commercial banks. This specific accountability mechanism, therefore, never worked as effective as desired. The Public Accounts Committee advised the Office of the Comptroller General (OCAG) to conduct a special audit into the financial activities of Bangladesh Bank. This occurred only 3-4 days after Bangladesh Bank decided to appoint an observer for a fourth-generation bank because of various allegations of irregularities. The PAC chair was also the chairperson of this Bank. Many do not consider this as a mere coincidence. In another instance, a Committee report prepared on a big scam of a private bank was excluded from the agenda.

Deficits in transparency is another important factor contributing to ineffective accountability. True it is that the Bank publishes many reports periodically where the overall situation of the banking sector and the Bank's activity are reflected. However, there exists a deficiency in sharing information like the actual process of important policy decisions, the explanations/rationale behind taking such significant decisions, the possible impact of such policy decisions on the Bank's functionality and other existing policies, meeting minutes, and information on voting by the members of the Board *etc*. For this, the common people, particularly the depositors, are not fully aware of how the Bank's decisions have been benefiting the vested interest and going against their own.

Regarding nondisclosure of information, it is alleged that Bangladesh Bank often raises the issue of "risk for the financial sector" as a plea. It becomes difficult to analyse conclusively the exact scenario prevailing in the financial sector. Often, the disclosure is partial—for example, a list of 300 top default borrowers. However, the data is by the name of the business enterprises/firms; hence, it does not explicitly provide information on how many of them are owned by the same individual or group. The name of individual owners who have repeatedly restructured or rescheduled their default loans is not mentioned as well. During the present research, an unprecedented lack of cooperation in providing information was experienced. The authority of Bangladesh Bank did not respond to formal requests for information and interview. Later, when an application was made according to RTI, the authority responded – neither to the first RTI application nor to the appeal made to the highest authority of the Bank. Then the researchers had to make an appeal to the Information Commission, and only then partial information was available from the Bank.

There also exists a lack of transparency in the appointment process of the Governor, Deputy Governors, and the members of the Board. There exists no detailed guideline on the appointment process in these positions as well. .

3. Overall Observation

Although various policy documents of the government mention need for controlling defaulted loan and promoting good governance in the banking sector and the regulatory institution, these are not implemented due to lack of political will**.** Under the influence of a syndicated effort by a limited group of people in the business, laws and policies have been changed and opportunities have been created for controlling the banking sector in their favor. On the other hand, lack of strong leadership, deficiencies in supervisory capacity, legal limitations/deficits, deficits in accountability and transparency, and irregularities and corruption in its supervisory function etc., have turned Bangladesh Bank as if a de facto agent of that vested interest. Whatever opportunity the existing law provides to uphold independence of Bangladesh Bank, remains unused due to lack of strong leadership. Bangladesh bank is thus relegating form its role of an independent supervisor/regulator. This is reinforcing the trend in irregularities and corruption, and flagrant violation of whatever laws, policies, prudential regulations exist to control and regulate the banking sector and defaulted loan by various actors, particularly the commercial banks and the its large willful borrowers. The commercial banks, particularly the state-owned banks have been suffering from capital inadequacy and the government needs to subsidize them year after year with the tax money of ordinary people. The existing situation that favors willful borrowing in effect, also affecting the business spirit of good borrower's and working as a disincentive for them. The huge amount of money that are being siphoned off from commercial banks in the name of business are being spent non-productively or allegedly being laundered to foreign countries. Unabated increase in willful defaulted loan has been affecting the desired role of banking sector and risk of drawing the economy on the verge of a big, catastrophic disaster has been increasing eve year.

4. Recommendations

Following recommendations are made based on the study findings:

1. To bring in desired reform in the banking sector an independent Banking Reform Commission should be formed constituting of experts and specialists in the sector reputed for their expertise and having no conflict of interest; based on recommendation of that Commission, short, medium, and longer term changes will have to be implemented that would bring discipline in the sector and eliminate willful default;
2. Amend section 46 and 47 creating full opportunity for Bangladesh to exert its independent control over the banking sector;
3. Specific policy will have to be formulated on recruitment and removal process for the position of the members of the Board of Directors, the Governor, the Deputy Governors where formation, roles, responsibilities, and qualification of Selection Committee members for the above positions would also be delineated clearly;
4. Number of official representatives members in the Board of Directors of Bangladesh Bank will have to be reduced and that of private members will have to be increased; the private members should be selected from the experts on the banking sector and on good governance;
5. All clauses that go against interest of depositors and facilitate creation of family-based control by some business group and their grip over the banking sector will have to be abolished/reformed (e.g. reducing once again the number of members in the Board of Directors of a bank from one family; reducing successive tenure of the same member for three terms, reducing total number of members of the Board etc.,);
6. A panel will have to be developed for appointing Directors in commercial banks through a selection committee; individual who are involved in party politics will have to be

excluded from such panel; approval of bank loans for the members of the Board will have to be made directly by Bangladesh Bank;

7. Current provision of exemption of keeping provisioning money against loans with court stay order will have to be canceled;
8. List of individual business owners/firms who remain perpetual defaulters even after repeated restricting and rescheduling will have to be made public
9. Number and duration of bank inspection will have to be increased, vacancies in various departments directly related to supervision (both online and offline) will have to be filled in immediately; the inspection reports will have to be completed /finalized on time; the inspection team will have to be re-delegated the authority they enjoyed earlier
10. Those responsible for various types of irregularities in bank inspection, report preparation, and implementing recommendations in such report will have to be identified and punished.

========