NPL Resolution Mechanism and Alternative Way-out: Bangladesh Scenario

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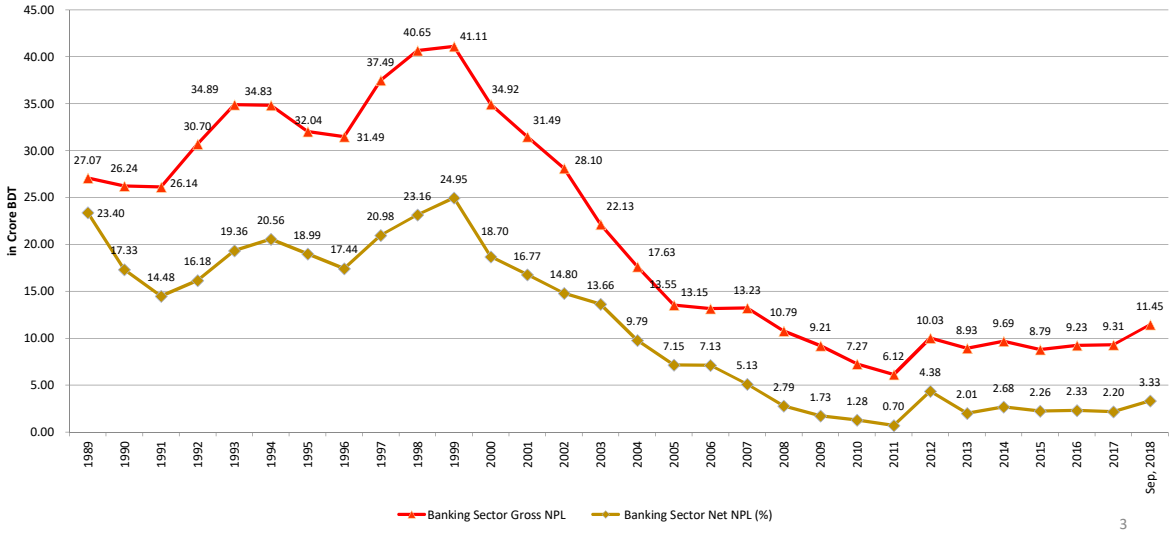
Preamble

- Historically, banking sector remains the main source of funding to the productive sectors in Bangladesh.
- Increasing trend of NPL adversely affect the income and profitability of the banks.
- It has been proven effective that NPL markets and NPL resolution frameworks help –
  - to prevent accumulation of large amount of NPLs,
  - results in positive macro-financial effects,
  - lower the possibility of financial crisis, and
  - also function as a financial safety net.

Gross NPL VS Net NPL (1989-2018)



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NPL Resolution Mechanisms

- Legal framework
- Regulatory framework
- Institutional set-up or operational framework

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NPL Resolution Mechanisms [cont.]

- Legal framework
  - Bank Companies Act, 1991;
  - Financial Institutions Act, 1993;
  - Money Loan Court Act, 2003;
  - Negotiable Instrument Act, 1881; and
  - Public Demand Recovery Act, 1908

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NPL Resolution Mechanisms [cont.]

- Regulatory framework - Guidelines
  - Risk Management Guidelines
  - Risk Based Capital Adequacy
  - Guidelines on Internal Credit Risk Rating (ICRR)

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NPL Resolution Mechanisms [cont.]

- Regulatory framework – Prudential Regulations
  - Loan Classification and Provisioning Policy
  - Loan Rescheduling and Restructuring Policy
  - Write-off Policy

- Bangladesh Bank has also offered incentives, i.e., 10% rebate on interest accrued against the loan accounts of good borrowers encouraging them to keep on repaying regularly.

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NPL Resolution Mechanisms [cont.]

- Institutional set-up or operational framework
  - Banking Regulation & Policy Department (BRPD)
  - Department of Off-site Supervision
  - Department of Bank Inspection (DBI)
  - Financial Integrity and Customer Services Department (FICSD)
  - Credit Information Bureau (CIB)
  - Enterprise Data Warehouse (EDW)
  - Integrated Supervision System (ISS)

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Financial Reform Initiatives

- Bangladesh Government has previously undertaken several projects to develop and reform the financial landscape of Bangladesh. Some major initiatives were –
  - Financial Sector Reform Project (FSRP)
  - Central Bank Strengthening Project (CBSP)
  - Financial Sector Support Project – FSSP
- Despite all these concerted efforts to reform, rehabilitate and develop the financial landscape of Bangladesh, NPL remained the bottleneck for the banking industry. NPL is gradually increasing in Bangladesh in recent years.
- An establishment of a Public Asset Management Company (PAMC) as an alternative NPL resolution mechanism has been proved to be effective in many countries around the world.

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NPL Resolution Mechanisms (recent updates)

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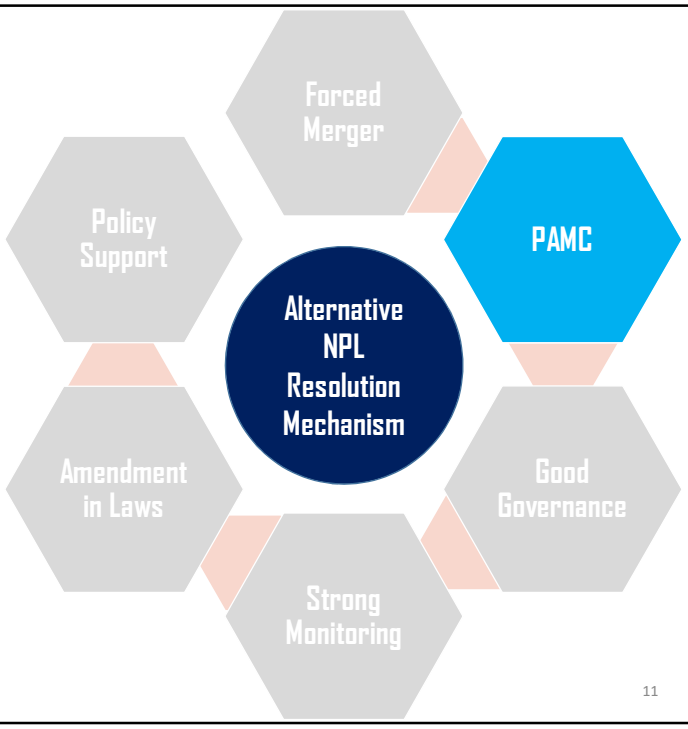
Alternative NPL Resolution Mechanism: Public Asset Management Company [PAMC]



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Policy Response – PAMC

- Government is keen to establish a Public Asset Management Company in order to resolve the Non-Performing Loan (NPL) scenario.
- A feasibility study of establishing a Public Asset Management Company has already been conducted by the Bangladesh Bank.
- In this regard, a Joint Committee comprised of officials from the Financial Institutions Division (FID) of the Ministry of Finance (MoF) and Bangladesh Bank (BB) has been actively working to undertake a holistic approach in order to establish a Public Asset Management Company namely Bangladesh Asset Management Company (BAMCO) as an alternative 'NPL Resolution Mechanism'.

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Policy Response – PAMC [cont.]

- The members of the Joint Committee have attended the '5th International Public Asset Management Company Forum (IPAF) Summit and International Conference' held on 25-27 September 2019 being invited by the ADB.
- Series of meetings were held between the ADB and the Joint Committee where the ADB was requested –
  - to provide necessary technical assistance;
  - to organize a national level seminar for experience sharing;
  - to help obtaining an **Associate Membership** of International Public Asset Management Company Forum (IPAF);
  - to help obtaining **General Membership** of IPAF by establishing a Public Asset Management Company in Bangladesh.

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Policy Response – PAMC [cont.]

- A '**Draft Act**' regarding the formation and operation of the BAMCO has already been prepared incorporating relevant stakeholders' opinion.
- The '**Draft Act**' has already been uploaded in the website of Financial Institutions Division of the Ministry of Finance.

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Possible Benefits – PAMC

- NPL removed from Bank's Balance sheet→ Relaxed provision requirements;
- Risk-weighted asset will decrease → diminished capital requirement;
- Force banks to recognize losses → restore confidence in the financial system;
- Economies of scale and bargaining power → more efficient asset sale and recovery process;
- Back to basic business → Improve asset quality, liquidity and provide income to banks;
- Reduced cost of crisis → no need for recapitalization
- Allow banks to focus on financial intermediation rather than asset recovery.

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PAMCs in Different Countries

FIRST GENERATION PAMCs	SECOND GENERATION PAMCs	THIRD GENERATION PAMCs
1. Resolution Trust Corporation (RTC), **US** – 1989 2. Securum, **Sweden** – 1993	**1. Korea** Asset Management Corporation (KAMCO) – 1997 **2. Indonesian** Bank Restructuring Authority (IBRA) – 1998 3. Danaharta of **Malaysia** – 1998 4. Savings Deposit Insurance Fund (SDIF) of **Turkey** – 1999 5. Sukhumvit Asset Management Co., Ltd (SAM) of **Thailand** – 2000	1. National Asset Management Agency (NAMA) of **Ireland** – 2009 2. Asset Management Corporation of Nigeria (AMCON) of **Nigeria** – 2010 3. Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (SAREB) of **Spain** – 2012 **4. Vietnam** Asset Management Company (VAMC) – 2013 **5. Zimbabwe** Asset Management Corporation (Private) Limited (ZAMCO) of Zimbabwe – 2014

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Proposed framework - PAMC

Legal basis	:	Special Act.
Legal status	:	PAMC shall be a separate body-corporate.
Key mandates	:	Purchase, manage, rapid disposal and restructuring of NPLs.
Internal governance	:	Board of Directors, Executive Committee and Audit committee.
External supervision	:	Financial Institutions Division, Ministry of Finance.
Transparency	:	Periodic Audit and Market Disclosure.
Capital	:	BDT 5,000 crore.

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Major challenges

- Banks have **advantage over investors** regarding the quality of NPLs and also collaterals which may lead to an outcome where only **low-quality assets** may be traded in the market.
- **Investors with limited information** may use a much **higher discount rate** in evaluating the value of NPLs, creating wide bid-ask spreads.
- Legal procedures needed to enforce debt and collateral may take long time and also high cost which eventually may increase the **cost of debt recovery**.

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Major challenges [cont.]

- **Inefficiency** in debt and collateral enforcement **may require long time and high cost** in resolving NPLs.
- Loans are **concentrated on specific sectors** may make it **difficult** to recover NPLs through disposal of collaterals.
- Lack of a **secondary NPL market** for NPL disposal.

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National Strategies – Proposed

- Introduce and strengthen prudential regulations to prevent NPLs
- Strengthen incentives of banks to resolve NPLs
- Conduct legal and judicial reforms for efficient collateral and debt enforcement
- Remove tax, accounting and other impediments to NPL resolution
- Establish Public Asset Management Company for NPL resolution
- Develop secondary markets for distressed assets
- Take measures to address information asymmetry about NPLs
- Prepare measures for out-of-court corporate restructuring

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Conclusion

- PAMC is a new policy agenda for the financial sector of Bangladesh.
- Policy reforms for NPL resolution are distinctively aimed at managing the stock of NPL and the future flow.
- The growing stock of NPL suggests that the stock problem cannot be resolved unless the flow problem is addressed which can be resolved by existing NPL resolution mechanism.
- PAMC has been proven to be instrumental over other solutions especially in the resolution of already piled up NPL stock.
- By limiting the flow to a tolerable level and resolving the stock of NPL, Banks can go back to their basic focus which is offering cost-effective credit flow in the financial sector.

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Thank you

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