



Regulatory Relaxation in Loan Classification: Making Best Use of It

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Bangladesh Bank has recently issued a circular where by notable change has been brought about in the loan classification regime. It has huge impact on the banking industry in one hand and private sector on the other.

A six-month period have been provided for a term loan and installment thereof to be called as overdue or past due, among others. Such overdue loan will take another three months to be classified as Sub-Standard which will remain so for another six months before it can be classified as a doubtful one and so on.

Facilitating the existing business environment and aligning with the economic cycle were cited to be the purpose of issuing the new set of instructions. The earlier provisioning regime, however, was stricter compared to the same in some of the other neighboring countries, BB defends.

Private sector in our country is heavily dependent on bank borrowings, even for longer-term projects which should ideally be financed from stock market, should there be a vibrant, transparent and a well-functioning one in place. Unfortunately, such a market is absent here and the entrepreneurs are forced to be inclined towards bank loan for their projects- irrespective of the project tenure.

Some of the entrepreneurs seemed to have jumped upon projects without much of thought or having a business case or a meaningful business plan for that matter. In a handful of cases, however, success have been seen but many others met failure too. This has

led some of the organizations to be collapsed even. There have been cases of miserable failure in debt servicing- what is popularly termed as bank default. A statistics of default loan indicate that total default loan in our country has gone up to over BDT 1,330 billion by now which is around 12% of total loan outstanding. Such rate of Non-Performing Loan is one of the highest in the region.

Greed of banks for excess profit by charging high interest, and interest on overdue loan putting exorbitant and undue pressure on corporates have also created much difficulties. High cost of deposit and a moderate spread requirement, however, are often cited to be the reasons for a higher landing rate than warranted. Government initiative for a single digit rate of interest can be a very effective measure to solve the problem. Banks also do not seemed to behave very ethically in most of the cases when it comes to responding to a reduction of interest rate. They are often quite prompt and smart in elevating the lending rate but reluctant to reduce it when warranted. On many occasions, it requires repeated persuasion by the borrowers to finally get the rate reduced, which is again very unfortunate.

Coming back to the recent change, some industry experts have been criticizing the move and feared worse situation in the industry in the long run. Some claimed that the move will downgrade the country's banking industry in the international setting.

Direct benefits for businesses, so to say, private sector and how they should react to the changes:

To my mind, the corporates shall definitely get a big relaxation in terms of their financial management. The extra cushion will reduce their financial pressure for at least a quarter, which is quite significant. This is a golden opportunity for them to reorganize their businesses by regularizing dues against their operating costs, meeting other short-term obligations and making a fresh start. Good corporates should avail the opportunity to become regular in bank repayment too. Then only they would be best utilizing the regulatory favour.

Direct benefits to banks:

Due to relaxation in classification of loans, there will be substantially low provisioning leading to a

rosy balance sheet. Stakeholders will get a wrong impression of profitability and the state of affairs of the banks. This is also likely to have a direct impact on the share price of the scrips in the stock market due to the profit hike backed by regulations.

Caution:

If, however, the corporates further continue to expand their footings in an unplanned manner or under pressure of the entrepreneurs for lack of foresight and unwarranted greed perhaps, the situation will be further distressful- not only for the organization but also for the banking industry and economy as a whole. Therefore, banks should also come forward with an advisory and supportive role to make the regulatory change meaningful.

Vigilant oversight:

Stricter regulations are helpful for protecting the industry interest in the long run. The regulatory relaxation should not be abused in any manner. Rather, corporates in distress should avail the opportunity to redress and overcome their internal issues and come up with a good repayment behavior for a healthy bank-client relationship. Therefore, banks should have a careful and vigilant oversight on how the corporates are playing with the regulatory relaxation.

The classification ease, again, should be time bound, meaning this should not be a very long-term approach on part of the regulators and policy makers. Otherwise, the crisis may never end and a total collapse may overtake the industry. It would be pertinent to cite here the example of margin loan call and forced selling in capital market. The country has had a worse experience in prolonging the regulatory relaxation which caused a greater financial loss of investors, stock brokers and merchant banks. Ultimately the market experienced a greater suffering for a short term comfort. Ultimately it is the market force and economic reality that should decide the rules of the game.

Accountants and auditors, as they have industry insight, professionalism and farsightedness, can help corporates taking the right steps to make best use of the regulatory relaxation provided by the Bangladesh Bank. Thus, they can contribute in disciplining the financial industry and help economy to move in the right direction. 