BANK Watch

Quarterly Banking Insights

An Analytical Review of **Governance Failure** and its Ripple Effect on **Commercial Banks** in Bangladesh

APR - JUN 2025

VOL I

ISSUE #1

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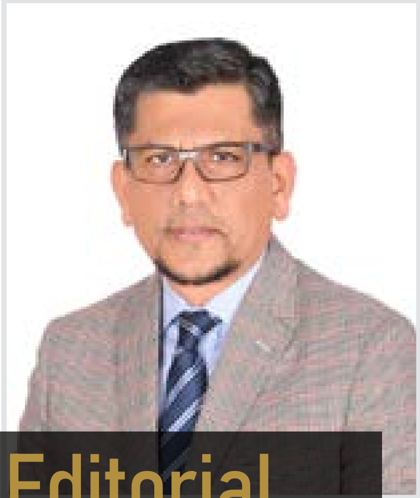

Editorial

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The commercial banking sector of Bangladesh stands at a historic inflection point. Decades of unchecked governance failure have culminated huge burden of default loan, capital adequacy crisis, provisioning shortfall, and eroding depositor confidence. Yet, in crisis lies clarity. With the right supervisory actions, legislative reforms, and institutional accountability, the sector can transition from systemic fragility to fiscal discipline.

In this inaugural issue of **BankWatch**, we bring forward a high-resolution analysis of governance breakdowns across the industry — tracing how compromised decision-making, board interference, and weak internal controls have directly contributed to the current instability. The publication opens with a full-length flagship report titled:

"An Analytical Review of Governance Failure and Its Ripple Effect on Commercial Banks in Bangladesh"

This report draws on real-world case diagnostics, financial data analysis, and policy documentation to provide a structured and actionable critique. It is designed not just to describe the problem — but to clarify the architecture of reform.

We earnestly invite policy institutions, regulatory authorities, banking executives, and research organisations to read, respond, and engage.

Published by
VERSATILE FINANCE & MANAGEMENT ASSOCIATES (VFMA)
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About BankWatch

BankWatch is a quarterly periodical published by Versatile Finance & Management Associates (VFMA), offering data-driven, reform-focused analysis on the financial sector of Bangladesh. Each issue dissects emerging risks, structural breakdowns, and institutional performance trends with a focus on actionable insights for policy, regulation, and governance.

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An Analytical Review of Governance Failure and its Ripple Effect on Commercial Banks in Bangladesh

Executive Summary

This report investigates the deteriorating state of corporate governance in Bangladesh's banking sector, revealing a crisis driven by entrenched board interference, regulatory capture, and systemic negligence. Despite the presence of a regulatory framework and some promising reforms, banking institutions continue to be plagued by insider lending, politically motivated credit decisions, and compromised oversight mechanisms. Non-performing loans (NPLs) have reached unprecedented levels, with over ***Tk. 4.20 lakh crore classified as troubled assets by March 2025***, of which more than 81 percent require full provisioning. This level of asset deterioration directly threatens macro-financial stability and undermines public trust.

The rapid and politically motivated proliferation of banks — 61 as of 2025 — has far outpaced the country's economic fundamentals, contrasting starkly with more consolidated banking systems in regional peers like India, Pakistan, and Malaysia. The crisis is exacerbated by governance failures that include manipulated loan approvals, recruitment scandals, crony vendor arrangements, misuse of corporate social responsibility (CSR) funds, and abuse of director positions for personal enrichment. Prominent cases involving institutions such as Basic Bank, the then Oriental Bank Limited (OBL) (currently ICB Islamic Bank Limited, which is also riddled with various legal issues), National Bank, AB Bank, The Premier Bank, Padma Bank, Southeast Bank, Exim Bank Social Islami Bank, Global Islami Bank, First Security Islami Bank and Union Bank illustrate the extent of regulatory failure, lack of corporate governance and sometimes collusion between bank leadership and politically connected actors.

Bangladesh Bank has introduced significant reforms over the past 12 to 18 months, including the rollout of a risk-based supervision (RBS) framework across all banks, tightened dividend payment regulations for institutions with high NPLs or deferred provisioning, and a roadmap for prompt corrective actions (PCA), including the planned merger of five distressed Islamic banks. These efforts are supported by international partners such as the World Bank and the Asian Development Bank, who are contributing both financial resources and technical guidance to support governance improvements and legal modernization.

Despite these interventions, the persistence of deep-rooted structural weaknesses requires urgent and bold reform. The report recommends enforcing stricter independence requirements for bank boards, reducing family control, improving CEO appointment practices, implementing real-time loan disclosure standards, ending regulatory forbearance, and introducing conditional recapitalization linked to performance. Without meaningful governance reforms and political will to dismantle vested interests, Bangladesh risks deeper financial fragility, eroded investor confidence, and diminished long-term economic resilience.

1. Introduction

1.1. Purpose And Scope Of the Report

Corporate governance has emerged as a cornerstone for ensuring transparency, accountability, and long-term sustainability in the banking sector. In commercial banks, where public trust and financial integrity are paramount, the role of effective governance becomes even more critical. Over the past decades, the global financial landscape has witnessed several banking crises — many rooted in poor governance, insider lending, regulatory arbitrage, and lack of board independence. These challenges are particularly evident in developing economies like Bangladesh, where the maturity of institutional governance remains weak despite a robust regulatory framework.

With nearly 28 years of hands-on experience in the banking industry of Bangladesh, It's been observed how corporate governance practices — or the lack thereof — have directly influenced the operational health, credit quality, stakeholder confidence, and ultimately, the overall performance of banks. While certain institutions have attempted to adopt good governance models, a significant number continue to struggle with issues such as board dominance by sponsor directors, non-compliance with central bank guidelines, misuse of authority, and lack of independence in senior management.

Several emerging issues are currently hindering the sustainable growth of the banking sector. These include rising non-performing loans (NPLs), overexposure to risky borrowers, political interference in credit decisions, weak internal control systems, and a growing disconnect between boardroom policies and operational realities. Additionally, the absence of strong whistleblower mechanisms, accountability frameworks, and ethical leadership has widened the gap between regulatory intent and institutional behavior.

The ongoing transformation of the global banking industry — driven by digitization, ESG (Environmental, Social, and Governance) requirements, and growing stakeholder scrutiny — makes it imperative for Bangladeshi banks to re-examine their governance structure. Without addressing the underlying weaknesses in corporate governance, sustainable growth will remain elusive.

This study aims to critically analyze how corporate governance practices influence bank performance in Bangladesh, identify emerging structural and cultural obstacles, and draw on personal experiences and real-world observations gathered over nearly three decades in the sector. The goal is to offer practical insights and recommendations that can help for reforms and strengthen the governance framework to ensure the long-term resilience and integrity of the banking industry.

1.2. Methodology

The insights presented herein are rooted in a multi-faceted methodological approach. First, the report leverages significant insider experience within the Bangladeshi financial industry, providing a practical and nuanced perspective that often eludes purely academic or external regulatory reviews. This intimate familiarity with operational realities and informal practices offers critical context to the documented failures. Second, the analysis is rigorously supported by documented cases of irregularities, drawing from public records, credible media reports, and official regulatory disclosures. This combination of qualitative, experience-driven understanding and quantitative, evidence-based validation ensures a comprehensive and credible assessment of the challenges. The synthesis of these diverse data points allows for the identification of patterns and causal relationships that underpin the current crisis.

2. The Corporate Governance Framework: What It Should Be

2.1. Definition of Corporate Governance In Banking Context

Corporate governance in the banking context refers to the system of rules, practices, and processes by which a bank is directed and controlled. It encompasses the relationship between a bank's management, its board of directors, shareholders, and other stakeholders, aiming to ensure transparency, accountability, fairness, and responsibility in operations. For financial institutions, robust corporate governance is paramount as they manage public deposits and play a critical role in economic stability. Effective governance mechanisms are designed to protect outside investors from opportunistic behavior by managers or controlling shareholders, thereby securing returns on investment.

2.2. Regulatory Architecture

Act, 1991 (amended up to 2023), which provides foundational provisions for bank operations, including corporate governance aspects. Bangladesh Bank (BB), as the central bank and primary regulator, issues comprehensive guidelines and circulars to ensure good governance. For instance, BRPD Circular No. 02 dated 11 February 2024 specifically addresses the formation and responsibilities of the Board of Directors, emphasizing the need for competent and professionally skilled individuals on the board.

For listed banks, the Bangladesh Securities and Exchange Commission (BSEC) also exercises oversight through its Corporate Governance Code. The BSEC's code, which has seen revisions in 2012, 2018, and ad hoc changes up to 2024, sets mandatory compliance conditions for listed companies, including banks, to enhance corporate governance in the interest of investors and the capital market. The BSEC's 2018 code, for example, increased board independence requirements and introduced new sub-committees like the Nomination and Remuneration Committee (NRC).

The Board of Directors holds central responsibility in the governance framework, tasked with establishing policies for risk management, internal controls, internal audit, and compliance, and ensuring their implementation. They are expected to determine objectives, chalk out strategies, and monitor financial performance, including income, expenditure, liquidity, and non-performing assets.

2.3. Role of Board, Independent Directors, Audit Committee, Risk Management Committee

The effectiveness of corporate governance hinges on the proper functioning and independence of key organs:

- **Board of Directors:** The board is the apex body responsible for strategic direction, oversight of management, and ensuring operational integrity, ethical standards, transparency, and accountability. The *Bank Company Act, 1991* (amended up to 2023), supported by BRPD Circular No. 02 (2024), specifically outlines the board's responsibilities in establishing policies for risk management, internal controls, and internal audit. The chairman and directors are explicitly prohibited from interfering in administrative or operational affairs, including recruitment and disciplinary measures, and must avoid involvement in day-to-day management activities (BRPD 02/2024, sec. 10).
- **Independent Directors:** These directors are crucial, especially in markets with highly concentrated ownership like Bangladesh, to provide assurance to minority shareholders

that their rights are protected. BSEC regulations stipulate that at least one-fifth of the total directors should be independent non-executive directors, with criteria for independence covering shareholding, family relationships, executive history, and other pecuniary ties. Under the updated rules from Bangladesh Bank (BRPD Circular No. 02, 2024), banks must now have at least three independent directors if the board has a full complement of 20 directors, or at least two independents if smaller (BRPD 02/2024, sec. 2 (গ)). Directors must pass stringent fit-and-proper tests, including financial probity checks and disclosure of beneficial ownership, to ensure professionalism and integrity.

- **Audit Committee (AC):** Formed by the Board, the AC assists in discharging oversight responsibilities related to financial reporting, internal control, and internal audit. It evaluates management's compliance culture, reviews financial statements, monitors internal audit independence, and assesses external auditor performance. According to BRPD Circular No. 02 (2024), the Audit Committee must comprise a maximum of seven members, including at least one independent director with expertise in accounting or finance. The chairperson must be an independent director, and the committee is required to meet at least quarterly (BRPD 02/2024, sec. 11.2).

- **Risk Management Committee (RMC):** This committee is responsible for formulating and implementing strategies for risk assessment and control, monitoring risk management policies, and regularly reviewing lending limits and other critical risk parameters. Its role is to ensure adequate organizational structure for risk management and compliance with risk-related guidelines. Bangladesh Bank guidelines (BRPD Circular No. 02, 2024) emphasize the board's responsibility to frame comprehensive risk management policies and to monitor compliance through quarterly risk assessments. The RMC, similar to the Audit Committee, should have a maximum of seven members, ensuring oversight of credit, market, liquidity, operational, IT, and reputational risks (BRPD 02/2024, sec. 11.3).

2.4. Basel Principles for Effective Banking Supervision (Cross-reference Global Norms)

The Basel Committee on Banking Supervision (BCBS) sets de facto minimum standards for sound prudential regulation and supervision globally. The revised Core Principles for effective banking supervision were endorsed in April 2024, reflecting post-global financial crisis lessons and structural changes in the banking industry. These principles are universally applicable and are used by the IMF and World Bank to evaluate countries' banking supervisory systems.

Bangladesh Bank has adopted the Basel III framework, issuing guidelines on Risk Based Capital Adequacy (RBCA) in line with Basel III, with full implementation targeted for January 2019 (though challenges persist). Basel III aims to strengthen banking system stability by applying stringent standards for capital adequacy, liquidity, and leverage, and by promoting better risk management practices. While primarily focused on financial performance and stability, Basel III also has significant implications for corporate governance by requiring increased transparency and disclosure, and by discouraging risky behavior through higher capital requirements. The framework's three pillars — minimum capital requirements, supervisory review process, and market discipline — collectively aim to enhance resilience and ensure that banks have adequate capital to absorb shocks. Bangladesh Bank's revised foreign exchange risk management guidelines also align with Basel Core Principles.

Challenges in implementing Basel III in Bangladesh include the need for significant capital augmentation, particularly for state-owned banks, difficulties in data collection and formulation for new liquidity standards, and the imperative to improve analytical capabilities for risk management and stress testing. Despite these challenges, the adoption of Basel III is seen as crucial for enhancing the financial performance and stability of the banking sector, promoting better risk management, and contributing to overall macro-financial stability.

3. Bangladesh's Banking Sector: Rising NPLs, Overbanking, and Corporate Governance Crisis

The year 2025 marks a critical juncture for Bangladesh's banking sector and its broader economy. The nation is grappling with substantial macroeconomic hurdles, including persistent inflationary pressures, the imperative to stabilize the exchange rate, and the urgent need to rebuild dwindling foreign exchange reserves. In this precarious economic environment, corporate governance failures in the banking sector exacerbate existing fragilities, contributing significantly to a dampening of public trust in the financial system.

According to the ***Bangladesh Bureau of Statistics (BBS)***, the Gross Domestic Product (GDP) of Bangladesh stood at **USD 462 billion (approximately Tk. 55 lakh crore)** in the first nine months of FY 2024–25, ranking it as the **35th largest economy** in the world. Despite this moderate economic size, Bangladesh has an **excessively high number of banks — 61 in total.** This figure is significantly disproportionate when compared with peer economies and regional neighbors. For instance:

- **India:** With a projected GDP of approximately \$3.97 trillion in 2025 — nearly nine times larger than Bangladesh's — and a population estimated at over 1.45 billion (more than eight times Bangladesh's projected 176 million), India's commercial banking landscape is more consolidated. While it has a broader array of financial institutions (including regional rural banks and cooperative banks), its core commercial banking sector comprises 12 Public Sector Banks and 21 Private Sector Banks, totaling 33 major commercial banks. This demonstrates a significantly lower density of core commercial banks relative to its economic and demographic scale.

- **Pakistan:** A regional neighbor with a comparable economic structure, Pakistan's banking sector includes around 25-30 major commercial banks and specialized institutions.

- **Malaysia:** A more developed economy in the region, Malaysia maintains a highly consolidated banking sector with 8 domestic commercial banks and 10 domestic Islamic banks (totaling 18 domestic commercial and Islamic banks), in addition to foreign banks and investment banks. This structure is significantly more concentrated than Bangladesh's.

This abnormal proliferation of banks raises serious concerns. In 2010, Bangladesh had **38 banks**, but since then, **14 more banks have been approved.**

The reasons are now increasingly evident: **political considerations, vested business interests, and regulatory capture** have driven the expansion, not genuine market demand.

3.1. Alarming Rise in Non-Performing Loans (NPLs)

The Bangladeshi banking sector is currently facing a severe crisis. Non-performing loans (NPLs) frequently exceed 30%, with some banks reporting NPLs as high as 60%, a stark contrast to the global norm of below 10%. In the first quarter of 2025 alone, NPLs surged by a staggering Tk. 74,570 crore, pushing the total classified loans to over Tk. 4.20 lakh crore (24.13%). This means that nearly one in every four-taka lent by banks is now classified as troubled, with Tk. 3.42 lakh crore (81.38%) categorized as “bad loans” requiring 100% provisioning. This severely limits banks’ capacity to extend fresh credit for vital working capital or project financing, thereby acting as a drag on overall economic activity.

Breakdown of NPLs

State-Owned Banks

During the March quarter, the NPLs at state-owned banks surged to Tk. 146,406.88 crore, representing a staggering 45.79% of their total disbursed loans, according to Bangladesh Bank data.

Private Commercial Banks

NPLs at private banks reached Tk. 264,195.43 crore, accounting for 20.16% of their total disbursed loans, according to data as of March 31, 2025.

For perspective, when the current government assumed office in 2009, the total NPLs in the banking sector were approximately **Tk. 22,481 crore.** The staggering increase over the past 15 years — nearly **a tenfold rise** — highlights the **deep-rooted structural and governance issues** in the sector.

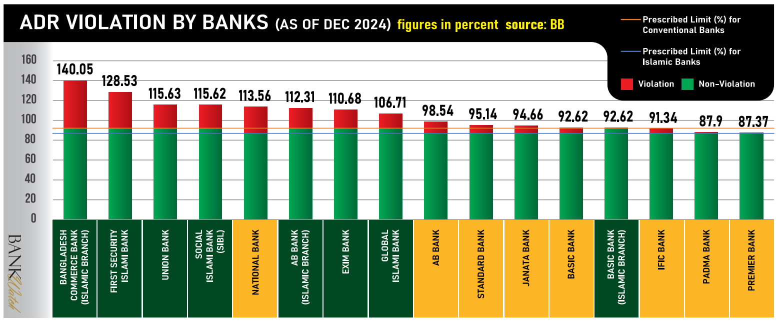

Fig. 1: Advance-to-Deposit Ratio (ADR) by Banks (Dec 2024)

The Advance-to-Deposit Ratio (ADR) data as of December 2024 paints a dire picture of systemic over-leverage. Several banks — particularly Bangladesh Commerce Bank (Islamic Branch), First Security Islami Bank, Union Bank, and Social Islami Bank — have ADRs far exceeding the regulatory ceilings set by Bangladesh Bank (87% for Islamic banks and 92% for conventional banks).

Chronic breaches of prudential norms point to board-level failures in credit governance and internal control, often enabled by lax regulatory enforcement and political patronage.

The distribution of bad loans further reinforces the governance crisis. As of late 2024, Janata Bank, Islami Bank, and Agrani Bank collectively account for over 35% of all classified loans in the sector. The dominance of state-owned and Shariah-based banks in this segment suggests deep-rooted issues in credit appraisal, political interference, and failure of independent board oversight.

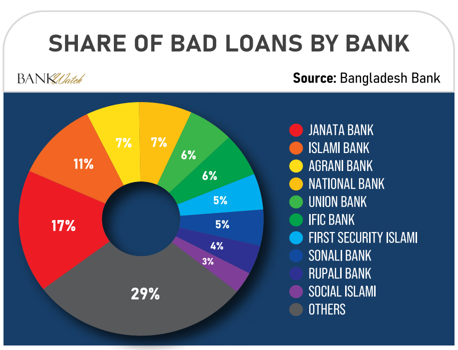

Fig. 2: Bank-wise Share of Bad Loans (Dec 2024)

The capital shortfall crisis exposes the sector's worsening financial health. As of December 2024, 20 banks reported a combined shortfall of Tk. 1.71 lakh crore. Janata Bank alone accounts for nearly a third of the deficit. The plunge in capital-to-risk-weighted-asset ratio (CRAR) from 11.64% in Dec 2023 to just 3.08% in Dec 2024 is symptomatic of unrecognized losses and massive NPL accumulation, exacerbated by weak provisioning and poor internal controls.

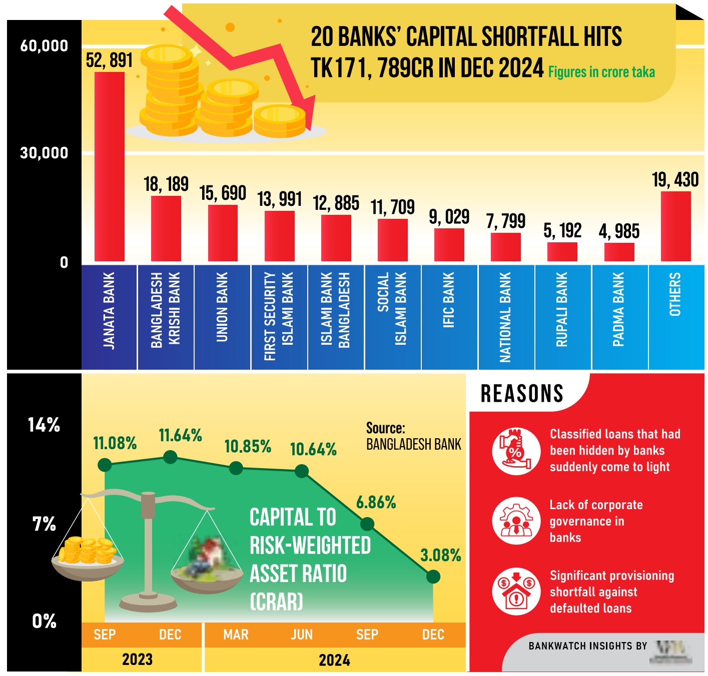

Fig. 3: Capital Shortfall of 20 Banks (Dec 2024)

A bank's classified loan portfolio is a direct proxy for failed governance. As of end-2024, Janata Bank (Tk. 70,845 crore) and Islami Bank (Tk. 47,618 crore) topped the list, indicating an overwhelming concentration of credit risk in a few institutions. These figures reveal the erosion of due diligence and the persistence of insider lending and client capture — core symptoms of governance failure.

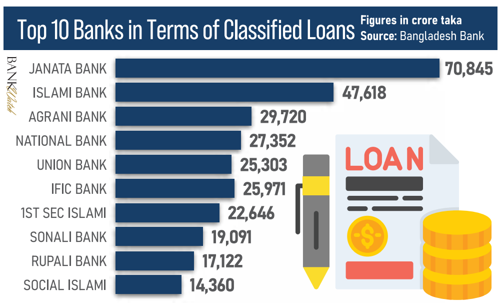

Fig. 4: Top 10 Banks by Classified Loans (Dec 2024)

The steep rise in provisioning shortfall — from Tk. 1.09 lakh crore in Dec 2024 to Tk. 1.77 lakh crore by March 2025 — confirms regulatory findings that many banks had been underreporting risk and provisioning inadequately. This sudden surge followed Bangladesh Bank's stricter classification rules. Governance breakdowns — including manipulated board oversight and politicized credit approvals — are primary drivers of the provisioning gap.

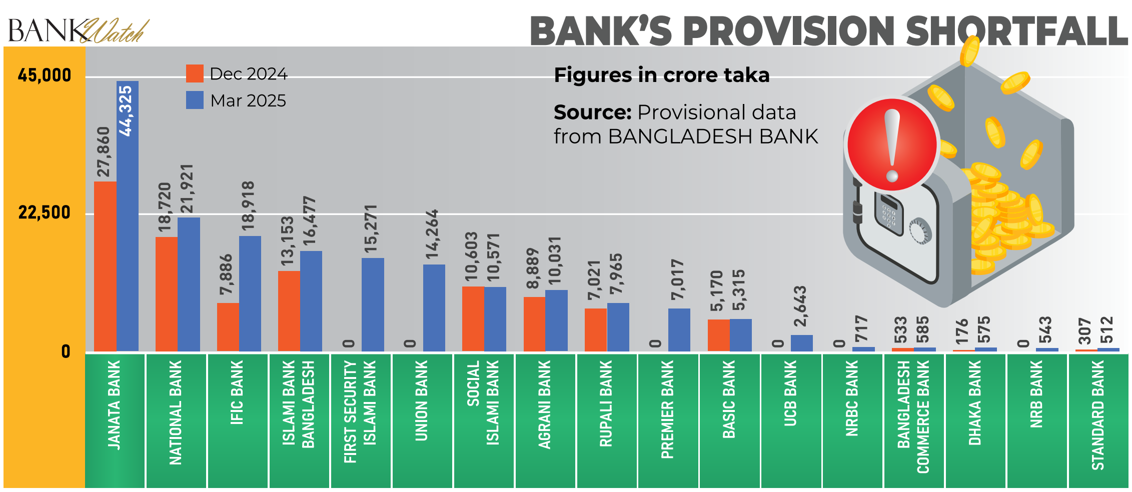

Fig. 5: Banks' Provisioning Shortfall (Dec 2024 vs Mar 2025)

Despite a marginal recovery in 2024, profitability indicators such as Return on Equity (ROE) and Return on Assets (ROA) remain structurally weak across the banking sector, underscoring the long-term impact of governance failures. According to Bangladesh Bank's *Q3 2024 Financial Stability Assessment Report*, average ROE declined to 8.1% — down from 10.3% in the same period of the previous year — while ROA dropped to 0.4% from 0.5%. These declines are closely tied to poor asset quality, elevated levels of non-performing loans (NPLs), and weak internal controls — symptoms of broader corporate governance breakdowns. Board-level interference, politically influenced lending decisions, and lack of enforcement of risk management frameworks have compounded credit risk and eroded earnings capacity. In particular, state-owned and poorly governed banks have had to set aside large volumes of loan loss provisions, significantly depressing their net profits and further distorting sector-wide ROA/ROE metrics. The ongoing profitability deterioration reflects not merely operational inefficiencies, but a systemic failure in governance and regulatory accountability, which continues to weaken the banking system's resilience.

3.2. Regulatory Forbearance for Defaulters: Excessive Flexibilities and Their Consequences

Bangladesh Bank's regulatory forbearance policies have significantly undermined banking discipline by consistently favoring defaulters over prudent banking practices. In September 2022, Bangladesh Bank allowed banks to reschedule loans without prior central bank approval, removing regulatory oversight and enabling Tk. 7,900 crore in bad loans to be rescheduled in just the first quarter of 2023.

These excessive flexibilities have created systematic moral hazard where borrowers, particularly those with political connections, expect regulatory accommodation rather than adhering to repayment obligations. The result has been normalized expectations of regulatory relief and erosion of credit discipline across the banking sector.

3.3. Unjustified Recapitalization: Rewarding Inefficiency in State-Owned Banks

A critical aspect exacerbating the crisis in Bangladesh's banking sector is the government's continued recapitalization of inefficient state-owned banks (SoBs), despite persistent governance and performance failures. Between FY 2009–10 and FY 2023–24, the government injected over Tk. 25,000 crore into SoBs, including Sonali, Janata, Agrani, and BASIC Bank, to offset capital shortfalls. In FY 2023–24 alone, Tk. 1,000 crore was allocated from the national budget for state-owned-bank recapitalization. This practice, rather than resolving structural inefficiencies, has institutionalized moral hazard by enabling delinquent lending practices and shielding politically connected defaulters from accountability.

Experts, including the Centre for Policy Dialogue (CPD), have raised alarms over the fiscal consequences and ineffectiveness of such recapitalization efforts. They argue that these injections lack performance-linked conditions and transparency, leading to the cyclical erosion of bank capital. Many of the recapitalized institutions, particularly BASIC Bank and Janata Bank, have been at the center of massive loan scams and mismanagement scandals, indicating systemic governance failure. The International Monetary Fund (IMF), as part of its $4.7 billion support program for Bangladesh, has urged the government to halt unconditional recapitalizations and adopt stricter governance reforms.

This approach raises serious questions of fiscal responsibility and governance ethics. Public funds — largely sourced from taxpayers — are used to patch over bank losses resulting from insider lending, political patronage, and lack of credit discipline. Without accompanying reforms in board independence, loan classification, and credit risk management, recapitalization acts merely as a bailout mechanism that delays — but does not prevent — financial collapse. It has become a recurrent cost of policy inaction.

Overall, the erosion of confidence, coupled with the escalating non-performing loan crisis, poses a direct threat to macro-financial stability and risks undermining Bangladesh's international reputation, potentially impacting foreign investment and credit ratings. Without decisive action to address these governance deficits, the cost of inaction could manifest as systemic collapse, with far-reaching implications for national economic development and social stability.

4. Irregularities Triggered by Weak Corporate Governance

The pervasive corporate governance failures in Bangladeshi banks are not isolated incidents but rather systemic irregularities that undermine the integrity and stability of the financial system. This section outlines a typology of these failures, illustrating each with real-case scenarios, their systemic impact, and relevant regulatory violations.

4.1. Credit Approval Compromise: A Root Cause of Default Loan Crisis

One of the most critical and damaging violations of banking norms in Bangladesh is the compromise in credit approval processes due to insider interference, particularly from members of the Board of Directors and politically influenced individuals. Despite having clearly defined regulatory guidelines issued by Bangladesh Bank — including credit risk management frameworks, due diligence protocols, and board-level approval policies — these are often bypassed or deliberately weakened under internal pressure.

Research and sectoral data indicate that nearly 75% of total default loans in the banking sector can be attributed to credit disbursed through insider influence, often in violation of standard underwriting procedures. In many cases:

- Borrowers with questionable financial strength or political backing are granted large loans.
- Proper risk assessments, CIB reports, and project feasibility studies are ignored or manipulated.
- Loan decisions are made not on the basis of creditworthiness, but due to personal relationships or vested interests.

Analysis of existing public records the history of malpractice in credit approval that rocked not just the banks that are affected but also the country's foreign reserves as most of this capital has been siphoned off to another countries.

- The Beximco Group case revealed a significant gap between the market values of collateral and the amount of loans taken (Tk. 40,000 crore from nine banks, with Tk. 23,285 crore from Janata Bank alone), indicating inflated collateral values. Some banks disbursed loans without proper assessment or audits since 2011.
- Union Bank was found by Bangladesh Bank to have lent a large portion of its total disbursal to some 300 companies that existed only on paper, often lacking even trade licenses.

These were “anonymous loans” that were not classified as defaulted despite non-realization.

- The S Alam Group case involved the group borrowing over 80% of Islami Bank’s total loans (Tk. 155,659 crore), leading to a sharp rise in bad loans across multiple banks under its influence, indicating insider lending and connected party exposure.
- The Hallmark-Sonali Bank Loan Scam (2010-2012) involved over Tk. 35 billion (approx. $454 million) lent based on falsified documents, with Hallmark Group receiving the majority. This was a conspiracy between borrowers and senior bank officials.
- These practices lead to a surge in Non-Performing Loans (NPLs), eroding bank capital, undermining profitability, and creating a fiscal burden. They also reduce investor confidence and impede resource allocation. The total NPLs reached Tk. 4.20 trillion by March 2025, representing 24.13% of total outstanding loans, a 130.57% increase from March 2024.

During my about three decades of Banking services, I worked in six different banks and found that reasons behind a large portion of total NPL was interference of Chairman or some influential directors. It has been observed that in certain commercial banks, some members of the Board of Directors, including the Chairman, do not have any other legitimate business or professional engagement. As a result, they appear to rely solely on the financial benefits, allowances, or commissions — often obtained through unethical means — particularly by influencing or approving loan disbursements for personal gain. This dependency on irregular earnings not only compromises the integrity of the credit approval process but also severely undermines corporate governance and the long-term stability of the bank.

4.2. Irregularities in Branch and Head Office Rental Agreements

Concerns regarding irregularities in branch and head office rental agreements have been raised, leading to formal interventions. In many cases, directors of PCBs have been found to exert undue influence to lease out their own commercial or residential properties to the bank at inflated rental rates, bypassing standard procurement and location feasibility protocols. These decisions are often driven by personal financial gain rather than institutional necessity.

What makes this practice more damaging is that, in several instances, the location of the property is operationally unsuitable for establishing a bank branch. Despite clear concerns regarding accessibility, customer flow, or security, branches are set up under board pressure. As such the branch fails to meet its business targets due to poor location, leading to operational inefficiency and recurring losses that burden the bank’s income statement

In 2019, a human rights group, Human Rights and Peace for Bangladesh (HRPB), served a legal notice seeking an inquiry into banking sector irregularities, including those related to premises rent. In response to such concerns, Bangladesh Bank issued new guidelines in January 2023 for opening and shifting bank branches and sub-branches. These guidelines now require banks to obtain prior permission from the central bank for entering into rental agreements and to inform the central bank annually by November. The circular also established specific criteria and conditions for space rent, lease, closure, and renewal of branch lease agreements. The sequence of these events, where a legal notice highlighted irregularities in 2019, followed by the central bank’s comprehensive guidelines in 2023, suggests a reactive regulatory approach. This indicates that issues related to premises rent persisted for a considerable period before formal, comprehensive guidelines were put in place, underscoring a delay in regulatory response to known problems.

4.3. Asset Misappropriation via Renovation, Procurement

In the banking sector, this study identified a crucial problem: the general trend of over-invoicing and fund diversion through fraudulent trade practices. This occurs through 'shadow exports' and 'phantom shipments,' where inflated payments are wired abroad under the guise of legitimate trade payments, or invoices are created for non-existent transactions.

For example, in 2021, five founder directors of Southeast Bank Limited accused the bank's former Chairman Alamgir Kabir of siphoning off money through over-invoicing when the bank set up 185 cash recycling machines (CRM) at its various branches, with another 300 machines in the process of being imported.

In another similar case involving NRBC Bank, Lanta Fortuna Properties, a subsidiary of a company linked to the bank's chairman, Tamal Parvez, bagged interior design work for the bank on multiple occasions, including an Tk. 87 lakh contract in June 2019, suggesting crony vendor involvement.

It was observed that one of the directors of a reputed PCB were paid Tk. 10 million per year in the name of an IT firm as yearly service charge for maintenance of Bank's website and it was too higher than prevailing market rate.

4.4. HR Recruitment Interference

The integrity of human resource management, particularly recruitment, has been severely compromised in the country's banking sector, resulting in numerous wide-scale scandals. During my long Bank career, I observed in some banks, some officials had submitted forced educational certificates at the time of joining although it was identified after five to six years from the date of joining. Most of them were relatives of some influential members of board of directors.

A commercial audit report exposed gross anomalies in Basic Bank's recruitment processes in 2012-2013. A staggering 731 officials were hired without following any bank or government rules, public notices, or examinations. Many of these appointees lacked the necessary educational qualifications or were over the age limit. A significant number, 242 individuals, were from the former chairman's constituency, Bagerhat, clearly indicating rampant political influence and nepotism in hiring. The audit further noted that approximately 700 of the bank's 2,249 employees were deemed incompetent and unproductive yet continued to draw salaries.

Union Bank and First Security Islami Bank (FSIB) both took decisive action against a total of 456 officials for their involvement in recruitment irregularities and their role in granting loans to S Alam Group under false names. Union Bank dismissed 262 officials, while FSIB removed 194, including branch managers. Union Bank was even reported to have hired junior officers without conducting any tests.

The extensive evidence of recruitment irregularities clearly demonstrates that hiring decisions are frequently driven by political connections, nepotism, or outright fraud. The consequence is a significant proportion of incompetent staff, directly leading to institutional capacity degradation. When critical positions are filled by unqualified individuals, it severely impacts operational efficiency, risk management, and the overall integrity of banking services.

4.5. Loan Recovery Challenges and Interference

The ability of Bangladeshi banks to recover defaulted loans is severely hampered by political interference, regulatory loopholes, and judicial delays, contributing significantly to the NPL crisis. Bangladesh Bank has historically struggled to effectively contain defaulted loans due to significant pressure from political forces, illegal interference by powerful business syndicates, and weak leadership.

Banks have been found to provide "unbridled loan restructuring facilities" and "rescheduling benefits" with low down payments (e.g., 1-2% instead of prescribed rate) and extended tenures (e.g., 10 years), often for large business groups with political backing. This includes the 2015 case where 11 large business groups, including Beximco, restructured Tk. 15,000 crore in bad loans.

A study by Transparency International Bangladesh (TIB) critically observed that "bank owners, regulators and the government – these three parties jointly create the scope for depositors' money to be looted".

This indicates a systemic "capture" of the banking and regulatory apparatus, rather than merely individual acts of political interference. The central bank's attempts to take decisive action against delinquent borrowers have frequently been rendered futile due to persistent political pressure during last 16 years (2009-2024).

4.6. Interest Waivers and Write-offs

A serious governance concern in the banking sector of Bangladesh is the unethical exercise of authority by the Board of Directors in granting interest waivers and writing off loans, even in cases where borrowers have the clear financial capacity to repay. These actions are often taken in violation of Bangladesh Bank's prudential guidelines and without adhering to the bank's internal risk assessment framework.

In many instances, this is done in connivance with willful defaulters, where the Board puts undue pressure on the bank's senior management to:

- Withdraw ongoing legal proceedings or litigation initiated to recover defaulted loans.
- Approve interest waivers or complete loan write-offs on fabricated grounds such as hardship or business loss, despite the borrower's visible solvency or ongoing business operations.

According to news reports, Southeast Bank had allegedly illegally provided interest waiver facilities worth Tk. 54 crore to Lub-Rref Bangladesh Limited, a company owned by a close relative of its former chairman, according to a letter signed by five of its founder directors.

In 2022, banks waived Tk. 5,064 crore in loan interest, a significant increase from previous years, with former central bank governors noting that these benefits primarily went to 'large borrowers, who are mostly willful defaulters'. This practice, regardless of its original intent, effectively rewarded delinquency and fostered a 'moral hazard,' where borrowers had little incentive to repay their loans, knowing that lenient terms or waivers could be obtained.

4.7. Appointment of Managing Director and Members of Senior Management

The effectiveness of board oversight in Bangladeshi banks is severely compromised by pervasive influence from business groups and political affiliations, leading to institutionalized conflicts of interest and a lack of genuine independence. In some cases, this is particularly evident in the appointment of Managing Directors (MDs) and Additional Managing Directors (AMDs) based on political influence or Yes-Man rather than professional acumen / merit, resulting in regulatory rubber-stamping under pressure.

Despite regulatory protections, the practical reality undermines CEO independence. According to Bangladesh Bank Circular, "Decision of Bangladesh Bank regarding appointment of CEO will be treated as final and such appointed CEO cannot be dismissed, released and removed from his office without prior approval from Bangladesh Bank." However, in practice, most of the CEOs remain preoccupied with satisfying chairmen or directors, often violating standard policies and regulatory guidelines to protect their positions or secure contract extensions and renewals.

It is observed that most of the members of Senior Management of serious crisis -ridden banks did not have sound professional knowledge /expertise to run those banks. The Board of Directors appointed those Yes-Man type Managing Directors & CEOs who were most obedient to serve their purpose rather than protecting interest of the Bank.

4.8. Lack of Independence and Competency Among Independent Directors

Despite regulatory requirements for independent directors, their effectiveness is often nominal. Independent directors are frequently appointed based on their loyalty and close relationships with the chairman and other directors, rather than on their professional competencies. Consequently, they are often unable to play a genuinely independent oversight role. Challenges persist in implementing policies related to independent directors, particularly due to the prevailing "family orientation" within the banking sector and issues with policy coordination.

The regulatory framework establishes clear expectations for independent directors' responsibilities. According to Bangladesh Bank Guidelines, "Independent directors must inform the Bangladesh Bank of any violation of provisions in the *Bank Company Act, 1991* or that of any other rules by the board of directors. If opinions of independent directors are not taken seriously or contradictions are found in the bank's operations, they must inform the Bangladesh Bank's Department of Off-Site Supervision and Banking Regulation and Policy Department in writing." However, in practice, independent directors rarely fulfill these reporting obligations.

This disconnects between regulatory intent and operational reality demonstrates that the practice of appointing "independent directors" based on loyalty and personal relationships rather than professional qualifications and true independence creates a "façade" of good governance. While formal structures of corporate governance might be in place, their practical effectiveness is severely compromised, resulting in the appearance of oversight without the actual substance of independent, critical scrutiny. Regulatory efforts must therefore move beyond merely ensuring compliance with formal requirements for board composition, focusing instead on the actual independence, competence, and effectiveness of board members.

Legislative changes have further exacerbated these governance challenges. Amendments to the *Bank Company Act* in 2023 extended the tenure of directors from nine to 12 consecutive years and increased the number of family members allowed on a board from two to four. Later the 2023 amendments have reduced it to 3. However small they seem, these changes have demonstrably impaired operating governance in banks, as the influence of business groups, family members, or politicians on the board consistently and adversely affects decision-making. It is widely observed that 'dummy directors, chairman, and managing directors' often serve as proxies for influential sponsor shareholders, preventing them from acting independently.

Consequently, the board, which should serve as an independent oversight body, effectively becomes a mechanism for self-enrichment and political patronage. This indicates that the problem is not merely about individual instances of corruption but a deeply embedded structural flaw where the very governance framework is designed or manipulated to facilitate illicit financial gains. Genuine corporate governance structure cannot be established without dismantling these institutionalized conflicts.

4.9. Misuse of Corporate Social Responsibility (CSR) Funds for Sponsor Interests

While Corporate Social Responsibility (CSR) initiatives are intended for social good, concerns have been explicitly raised regarding the proper allocation of CSR budgets, emphasizing the need for these funds to be "free of insider interests" and for robust monitoring of their end-use. Bangladesh Bank has issued structured guidelines for CSR fund allocation and utilization since 2014. However, persistent concerns about "insider interests" suggest that these guidelines may not always be effective in preventing the misuse or diversion of funds for the benefit of sponsors or connected parties. This indicates a broader pattern of exploiting any available financial channel for illicit gain and points to a potential regulatory blind spot if these funds are not rigorously monitored and audited. The scope of financial irregularities extends beyond core lending activities to other areas of bank operations, requiring comprehensive regulatory oversight that encompasses all financial activities, including CSR expenditures and subsidiary operations.

4.10. Irregularities in Connection with Bank's Subsidiaries

Corporate governance concerns extend beyond core banking operations to encompass subsidiaries and related-party transactions, which often serve as conduits for illicit activities.

4.10.1. Fraudulent Activities in Brokerage and Securities Company

The capital market, often linked to banking entities through subsidiaries, has become a significant site of irregularities that pose systemic risks to the broader financial sector. In 2022, The Bangladesh Securities and Exchange Commission (BSEC) has filed litigation against Premier Bank Chairman HBM Iqbal and five other individuals as well as two institutions over allegation of opening 26,000 fictitious beneficiary owners (BO) accounts to grab Premier Bank primary shares illegally.

The case initially filed in 2005 by BSEC went inactive somehow and the regulator filed a fresh case in Dhaka's Chief Metropolitan Magistrate Court in September 2024 based on its previous investigation report.

These fraudulent activities manifest through several key risk areas that undermine market integrity and investor protection:

- **Market Manipulation Risks** present significant threats to capital market stability by violating established regulations, eroding investor confidence, and creating artificial losses that distort market mechanisms and pricing efficiency.
- **Conflict of Interest in Investment Decisions** occurs when fiduciary duties are breached and investor funds are misused, creating situations where the interests of financial institutions or their subsidiaries are prioritized over those of their clients and the market at large.
- **Imposed Appointments and Staff Interference** compromise operational integrity by reducing efficiency and leading to regulatory violations, as external pressures influence personnel decisions and operational processes that should remain independent and professional.
- **Unauthorized Use of Funds or Margin Accounts** creates substantial financial risks by increasing the probability of defaults while simultaneously causing reputational

damage that can have long-lasting effects on institutional credibility and market standing.

- **Dividend or Capital Withdrawal Pressure** weakens the fundamental financial foundation of institutions by depleting capital reserves and hampering expansion capabilities, ultimately limiting their ability to serve clients effectively and maintain market competitiveness.
- **Disregard for Compliance and Regulatory Obligations** results in a cascade of negative consequences, including financial penalties, reputational damage, and increased regulatory scrutiny that can severely constrain business operations and market participation.

These interconnected risks highlight the critical need for robust oversight mechanisms and stringent compliance frameworks within brokerage and securities subsidiaries to protect both individual investors and the stability of the broader financial system.

4.10.2. Undisclosed Related-Party Transactions

Undisclosed related-party transactions are a significant factor that reduces the operational efficiency of banks. These transactions, when not transparently reported, can facilitate self-dealing, fraud, and the siphoning of funds, often by insiders connected to powerful business groups or political figures. The World Bank's proposed financial sector reforms specifically include measures to require banks to disclose ultimate beneficial owners and to limit related-party lending, directly addressing this issue. The lack of transparency in related-party transactions is a fundamental enabler of fraud, as it allows insiders to grant undue favors, manipulate financial statements, or extract resources for personal gain without detection. Transparency in related-party transactions and clear identification of beneficial ownership are foundational to establishing good corporate governance and are crucial for restoring market integrity and investor confidence.

5. Consequences of Lack of Corporate Governance in the Banking Sector

5.1. Negative Rating from International Rating Agencies

International rating agencies have identified governance failures as the fundamental driver of Bangladesh's banking crisis. S&P Global Ratings' 2025 midyear outlook warns that the banking sector will remain under pressure through 2026 due to "deep-rooted structural problems" stemming from "weak lending standards and foreclosure laws." Critically, S&P explicitly identifies "governance issues at several state-owned and Islamic banks" as a key factor undermining industry stability.

Moody's Investors Service has consistently highlighted "weak corporate governance and risk management practices" as systemic risks, emphasizing that political interference in lending decisions and inadequate board oversight threaten long-term financial stability. Similarly, Fitch Ratings has identified weak internal controls, insufficient risk management frameworks, and political influence on commercial banking decisions as critical weaknesses constraining the sector's creditworthiness.

5.2. Withdrawal or Reduction of Credit Limits by Foreign Correspondent Banks

- Correspondent banking relationships rely heavily on trust, transparency, and regulatory compliance.
- Banks in countries with reputational or compliance risks (e.g., AML/CFT failures, insider-driven decisions, fraud) are seen as high-risk partners.

Implications:

- Foreign banks reduce or suspend credit lines to Bangladeshi banks.
- This leads to:
    - Slower trade finance (L/C processing)
    - Reduced access to foreign currency liquidity
    - Difficulty in settling international payments

5.3. Impaired Access to Global Financial Infrastructure

- Global platforms (SWIFT, foreign clearinghouses) may impose enhanced due diligence or restrict access if bank practices appear non-compliant.
- High compliance risk = High cost and low efficiency.

5.4. Reduced Foreign Investor Confidence

- Foreign investors (bondholders, shareholders, DFIs) monitor governance indices and board effectiveness.
- Poor governance signals higher fraud risk, misreporting, or regulatory capture, reducing FDI and external borrowing appetite.
- Frequent irregularities (e.g., director interference, poor audit controls, insider lending) contribute to sovereign and bank-level rating downgrades, raising the cost of borrowing from abroad.

5.5. Domestic Manifestations of Governance Failure

Eroding Depositors Trust

High-profile loan scams, insider lending, and politically influenced credit approvals have driven depositors to withdraw and hoard cash, fearing banking failures or fund insecurity. Currency held outside the banking system surged from Tk. 2.49 lakh crore in October 2023 to Tk. 2.96 lakh crore in March 2025 — a clear symptom of eroding public trust in the formal financial system.

Declining Private Sector Credit Growth

This unprecedented cash exodus has triggered a liquidity crisis that forces banks to rely on high-cost borrowing and central bank support, pushing up call money rates and harming productive lending. Poor governance has led to loan disbursement based on influence rather than merit, with over 75% of large loan defaults attributed to board interference and political connections. This creates a vicious cycle where viable projects are crowded out by politically connected but financially unviable ones. Private sector credit growth remained below target at 6.95% against 9.8% in May 2025, indicating the sector's inability to support economic growth effectively.

Undermine Monetary Policy Effectiveness

The systemic impact extends beyond banking to undermine monetary policy effectiveness, as central bank tools become ineffective when large portions of currency remain outside the formal system. This weakens inflation control, exchange rate stability, and interest rate transmission while deterring foreign investment and pushing up the country risk premium. The governance crisis has also distorted capital markets through subsidiary institutions and reversed financial inclusion efforts, marginalizing low-income populations and jeopardizing Bangladesh's broader economic development objectives.

5.6. Regulatory Forbearance: Institutionalizing Moral Hazard and Default Culture

The extensive use of regulatory forbearance has fundamentally altered borrower behavior, making strategic defaults rational economic decisions for borrowers who calculate that forbearance is more likely than enforcement. This has created systemic vulnerabilities where genuine financial distress becomes indistinguishable from willful default.

Market discipline has been systematically undermined, leading to distorted risk pricing where banks lose incentives for proper risk assessment. The consequences include depositor confidence erosion, reduced foreign correspondent bank exposure, and ultimately fiscal costs as state-owned banks require repeated capital injections funded by taxpayers.

5.7. Fiscal Drain and Risk Perpetuation through Recapitalization

The repeated recapitalization of state-owned banks without correcting governance failures has created a long-term fiscal drag. According to the Asian Development Bank (ADB), this practice reduces fiscal space for vital public investments, such as education, healthcare, and infrastructure. In its 2024 assessment, the ADB noted that recapitalization transfers effectively represent implicit fiscal costs to the government that do not appear directly in the national budget but have a significant impact on public finances.

This chronic use of taxpayer money to absorb private sector default risks has also damaged the perception of policy credibility. The 2023 World Bank report highlighted that recapitalizations lacking clear performance benchmarks and strict conditionalities tend to weaken borrower accountability, leading to repeated loan defaults, especially among politically connected companies. This is further compounded by weak judicial mechanisms for loan recovery and opaque related-party transactions within SoBs, making enforcement difficult and costly.

Moreover, recapitalization inflates sovereign debt and weakens Bangladesh's credit profile. Rating agencies such as Moody's and Fitch have flagged contingent liabilities from SoBs as off-balance-sheet risks that may impair debt sustainability. When public money is repeatedly used to shore up insolvent banks without structural reforms, it creates an environment where failure is subsidized, risk pricing is distorted, and discipline is eroded. This undermines confidence not just in individual banks, but in the financial governance regime of the country.

6. Regulatory Action: Bangladesh Bank in the Last 12–18 Months

6.1. Implementation of Risk-Based Supervision (RBS) Policy

Bangladesh Bank is undertaking a comprehensive restructuring of its regulatory framework through the implementation of a Risk-Based Supervision (RBS) policy across all scheduled banks. The full rollout to all 61 scheduled banks is scheduled to begin in July 2025, with complete implementation anticipated by January 2026. This initiative represents a fundamental strategic shift in Bangladesh Bank's supervisory approach, transitioning from a traditional, reactive, compliance-based model toward a proactive, risk-focused, and data-driven framework.

6.2. Tightened Dividend Payment Rules for Banks with Provisioning Deferrals or High NPLs

In March 2025, Bangladesh Bank significantly tightened rules on dividend payments to enforce greater financial discipline. Banks that have obtained provisioning deferrals from BB are now explicitly prohibited from issuing dividends. Beginning in 2026, this restriction will extend to all banks whose non-performing loans (NPLs) exceed 10% of their total loan portfolios.

By restricting dividend payouts, Bangladesh Bank is compelling banks to retain earnings, thereby strengthening their capital base and forcing them to confront and provision for asset quality issues. This sends a strong regulatory signal about the seriousness of improving asset quality and capital adequacy, even at the cost of short-term shareholder pain. The policy creates direct pressure on bank management and boards to clean up their balance sheets, potentially leading to more accurate financial reporting and a more robust, resilient banking system.

6.3. Policy on NPL Resolution Roadmap and Prompt Corrective Action (PCA) Plans

Bangladesh Bank announced a comprehensive NPL resolution roadmap in February 2024, including a Prompt Corrective Action (PCA) plan that specifically involves merging weak banks with stronger, more stable institutions. Before consolidation, thorough Asset Quality Reviews (AQR) must be undertaken, followed by key actions including improving governance of state-owned commercial banks, establishing robust legal frameworks for bank resolutions, and ensuring compliance with international standards for NPL recognition and provisioning in accordance with IFRS 9.

As part of this strategic approach, Bangladesh Bank has announced plans to merge five distressed Islamic banks — Social Islami Bank, Global Islami Bank, First Security Islami Bank, Union Bank, and EXIM Bank — into a single entity.

6.3.1. Strategic Significance

This NPL resolution roadmap and PCA plan represent critical recognition by Bangladesh Bank that some institutions are "clinically dead" and pose significant systemic risk to the entire financial sector. Mergers, when executed transparently and based on thorough Asset Quality Reviews, can consolidate weak institutions, reduce overall systemic risk by preventing contagion, and potentially improve governance by integrating stronger management and operational practices into troubled entities.

This represents a decisive move to clean up the sector rather than perpetually bailing out individual failing banks. However, successful implementation will require immense political will to overcome resistance from powerful vested interests associated with weak banks, transparent valuation of assets and liabilities during the merger process, and careful management of consolidation to avoid further destabilization or loss of depositor confidence. The human resource implications and potential job losses also require careful consideration.

6.4. Strengthening the Legal Framework for Bank Resolutions

International partners are actively supporting Bangladesh's efforts to bolster its financial sector. The World Bank is providing $500 million in financing to improve transparency, public sector accountability, and financial sector stability. A key component of this support involves providing Bangladesh Bank with a complete range of resolution powers to effectively address banking sector vulnerabilities, backed by necessary legislative changes.

Similarly, the Asian Development Bank (ADB) has approved a $500 million policy-based loan specifically to stabilize and reform the banking sector by strengthening regulatory supervision, corporate governance, asset quality, and stability. The World Bank's broader support also encompasses reforms for domestic revenue mobilization, financial sector stability, data production, and public investment.

The involvement of international financial institutions provides crucial technical assistance and financial leverage, enabling Bangladesh Bank to implement difficult structural reforms, particularly in developing and exercising resolution powers. This external pressure can help overcome domestic resistance to necessary, albeit painful, changes.

6.5. Enhanced Transparency and Accountability Measures

Beyond specific regulatory tools, Bangladesh Bank and the government are pursuing broader measures to enhance transparency and accountability. This includes aligning financial reporting with international standards and increasing overall transparency.

World Bank-Supported Reforms

Proposed financial sector reforms supported by the World Bank will require banks to:

- Disclose ultimate beneficial owners
- Limit related-party lending
- Report non-performing loans in alignment with international best practices

The World Bank is also supporting efforts to strengthen public sector performance through increased transparency, accountability, and efficiency via the Strengthening Institutions for Transparency and Accountability (SITA) Project. This project aims to improve data transparency, domestic revenue mobilization, and public investment management.

7. Recommendations for Banking Sector Reform

Bangladesh's banking sector is at a critical juncture. Overbanking, regulatory failure, and poor corporate governance have culminated in a massive surge in NPLs, threatening financial stability. Some regulatory initiatives like Risk Based Supervision, *Banking Resolution Ordinance, 2025* and implementing ECL based Loan Classification & Provisioning under IFRS 9 have already been undertaken by Bangladesh Bank (BB) to promote corporate governance and sound banking practices in line with international best practices. In line with aforementioned measures taken by Bangladesh Bank, as a practicing Banker, I would recommend followings for establishing a more resilient Banking Sector in Bangladesh.

7.1. As Regards Composition of Board of Directors

Balanced Board Structure

- Implement mandatory 50:50 composition between sponsor and independent directors to ensure balanced decision-making and prevent domination by any single interest group.
- Mandate appointment of Chairman from independent directors with demonstrated background in accounting, finance, audit, or banking.
- Appointment of independent Directors by Bangladesh Bank rather than chosen by Banks themselves.
- Incorporate required provisions to address boardroom malpractices and ensure ethical decision-making.

- Introduce stringent penalties for regulatory violations and governance failures.
- Establish clear accountability mechanisms for board members and senior management.
- Set maximum age limit of 70-75 years for all board members to bring fresh perspectives and modern expertise.

7.2. As Regards Amendment of *Bank Company Act* and Other Regulations

Legislative Framework Strengthening

- Amend the Bank Company Act to reduce family member representation on boards which would enhance transparency and accountability while preventing concentration of control within family groups
- Limit tenure of each director to prevent entrenchment and ensure regular infusion of new ideas and perspectives.

Bankruptcy Law Modernization

- Comprehensively reform the Bankruptcy Act, 1997, which in its current form is underutilized, outdated, and not aligned with global best practices like India's Insolvency and Bankruptcy Code (IBC) or the US Chapter 11 model
- Shift focus from liquidation-only approach to include rehabilitation of viable borrowers, preventing job loss and asset decay.
- Establish time-bound resolution processes to ensure efficient handling of distressed assets

Judicial Capacity Enhancement

- Significantly increase the number of judges handling Money Loan Court Act, 2003 and Bankruptcy Act, 1997 cases to ensure speedy disposal of loan default cases
- Implement systems to reduce case backlogs and improve judicial efficiency in financial dispute resolution

International Standards Compliance

- Mandate loan classification according to international standards to ensure transparency and comparability with global practices
- Align provisioning requirements and asset quality assessment with internationally recognized norms

Reinstating Group-Based Loan Classification Provision

To ensure credit discipline and prevent willful default culture, it is essential to reinstate the previous provision under Section 27KaKa of the *Bank Company Act, 1991* (as updated in 2023), which mandated that:

> *"If any business enterprise within a corporate group default on its loan obligations, then all other entities under the same business group shall also be classified accordingly."*

This group-based loan classification approach serves as an effective regulatory mechanism to hold interconnected companies accountable and discourage the misuse of inter-company linkages for avoiding classification or restructuring norms. The removal of this provision has led to fragmented risk assessments and encouraged loan diversion and strategic defaults across group entities.

Therefore, reintroducing this provision is crucial for restoring financial discipline, improving transparency in group exposures, and strengthening the overall risk management framework within the banking sector.

7.3. Legal Provisions for Independence of Central Bank

Currently, the Central Bank operates as a "body corporate" under the Bangladesh Bank Order 1972 and is meant to be autonomous. However, political interference, as was evident during the Awami League regime, seriously undermined its autonomy, leading to cascading effects on the broader economy from hyperinflation to near collapse of the banking sector.

Strengthening Central Bank Autonomy

- Amend the Bangladesh Bank Order to grant the Central Bank greater autonomy in monetary policy formulation and implementation
- Establish clear legal boundaries between monetary policy decisions and political interference
- Implement governance structures that protect central bank decision-making independence, as recommended by the IMF
- Ensure strong political will and commitment from leadership to respect and maintain central bank independence, which depends on the mindset and integrity of those in power. Currently, it is expected that banks can no longer leverage political protection to operate as freely with impunity as they did under the previous regime.

7.4. Introducing More Robust Risk Management Policy to Combat Upcoming Challenges Comprehensive Risk Framework Implementation

- Develop and implement robust risk management policies addressing credit, operational, market, and liquidity risks
- Establish real-time monitoring systems for early identification of potential threats
- Strengthen supervisory capabilities through enhanced technology and human resources
- Implement stress testing and scenario analysis for all banks to assess resilience under adverse conditions

7.5. As Regards Frequent Changes of Policy / Guidelines

Frequent policy changes by Bangladesh Bank — especially over the past few years — have had mixed but increasingly disruptive impacts on the banking sector. While some policy shifts aim to address macroeconomic challenges, their lack of consistency, predictability, and strategic alignment is causing serious concerns for banks, investors, and borrowers.

Policy Consistency and Predictability

- Address the disruptive impact of frequent policy changes that require internal adjustments, system updates, staff training, and documentation, which slows service delivery and increases operational costs

- Implement a more predictable, transparent, and consultation-based policy framework including:
    - Strategic consistency in monetary and regulatory policies
    - Stakeholder engagement before major policy shifts
    - Gradual phasing-in of reforms with clear roadmaps
- Promote financial system resilience, restore investor confidence, and help banks align with long-term economic goals through stable policy environment

7.6. Updating and Strict Enforcement of Loan Classification & Provisioning Rules

Enhanced Regulatory Compliance

- Ensure rigorous enforcement of loan classification standards to align with international standard and to prevent window dressing and manipulation of financial statements
- Implement automated monitoring systems for real-time compliance assessment
- Establish severe penalties for non-compliance and misrepresentation of asset quality
- Strengthen supervisory oversight to detect and prevent regulatory violations

7.7. Review of Single Borrower Exposure Limit / Capping Maximum Group Credit Limit

For reducing systemic risk by avoiding overexposure to large borrowers it needs to set a maximum threshold for total loan exposure a corporate borrower can access from the banking sector. Any capital requirements beyond this limit must be raised through the capital market, such as IPOs, bonds, or private placements.

If implemented with proper regulatory and market support, this policy can significantly reduce default loan culture, promote financial discipline, and develop a resilient financial system in Bangladesh.

7.8. Formulate Policy by Bangladesh Bank on Inter-Bank Transfer of MD/AMD/DMDs

Executive Leadership Governance Implementing a policy for inter-bank transfer of Managing Directors (MD), Additional Managing Directors (AMDs), and Deputy Managing Directors (DMDs) in private commercial banks can enhance corporate governance by preventing undue influence, favoritism, and regulatory capture.

Expected Benefits

- Reduces power monopolies and entrenched relationships that can lead to governance failures
- Encourages fresh leadership perspectives and innovative approaches
- Promotes independent and ethical decision-making free from historical relationships
- Enhances transparency and enables objective performance evaluation
- Helps detect and correct irregularities through fresh oversight

Implementation Process

- Set maximum tenure limits (e.g., 5 years) with mandatory cooling-off periods between positions
- Establish a transfer mechanism managed by Bangladesh Bank to ensure systematic

rotation

- Enforce fit and proper criteria before each transfer to maintain leadership quality
- Protect whistleblowers and encourage transparency in reporting governance violations
- Provide incentives for transparent succession planning and knowledge transfer

If enforced properly, such a policy can significantly strengthen corporate governance, reduce unethical practices, and restore public confidence in the banking sector of Bangladesh.

7.9. Improved Coordination Between Bangladesh Bank (BB) and BSEC to Strengthen Financial Governance

The banking and capital markets in Bangladesh are closely interconnected. Banks finance listed companies and invest in the capital market, while corporates raise funds from both sources. Weak supervision in either sector creates systemic vulnerabilities. Global best practices (Basel, IOSCO) call for integrated supervision to ensure transparency and financial stability.

More Coordination Between Bangladesh Bank (BB) and BSEC to Strengthen Financial Governance is needed in the following areas:

- Create a Financial Stability Council with BB, BSEC, and Finance Ministry to monitor total exposure
- Apply the same governance standard across banks and capital market institutions
- Evaluate systemic impact of corporate failure through cross-sector stress testing
- Standardize disclosures for all regulated entities
- Establish joint action on fraud, insider trading, and regulatory breaches

Lack of coordination between BB and BSEC allows regulatory arbitrage, increases systemic risk, and contributes to declining confidence from foreign rating agencies and correspondent banks. Strengthening coordination and moving toward unified supervision will align Bangladesh with global best practices and restore investor and institutional trust.

7.10. Eliminating Regulatory Forbearance and Restoring Credit Discipline

Strict Enforcement of International Standards

Implement the 90-day loan classification rule without exceptions and eliminate all discretionary forbearance measures. Establish automated classification systems and adopt IFRS 9 Expected Credit Loss model to align with international best practices.

Reformed Restructuring Framework

Limit borrowers to maximum one restructuring opportunity with substantial down payments (10-15% of outstanding amount) and require independent financial viability assessments. Replace regulatory discretion with objective financial criteria and establish automatic conversion to legal recovery for failed restructuring cases.

7.11. Ending Unconditional Recapitalization and Enabling Responsible Restructuring

In light of the deepening fiscal and financial risks stemming from unaccountable recapitalization practices, urgent reforms are needed. First, the government must cease unconditional capital injections into state-owned banks. Any future recapitalization must be strictly tied to performance metrics, including reductions in NPL ratios, improved risk management, and

independent governance audits. The Ministry of Finance and Bangladesh Bank should jointly enforce Recapitalization Conditionality Frameworks (RCF), modeled on international standards, that link funds to verifiable improvements.

Second, a Bank Resolution Corporation may be established under the *Banking Resolution Ordinance, 2025* to handle distressed SoBs without systemic contagion. This entity can help execute structured wind-downs, mergers, or asset sales in cases where banks are no longer viable, thereby minimizing public fiscal exposure. Parallel to this, existing boards of weak SoBs must be reconstituted with vetted independent directors and professionals selected through a centralized panel approved by Bangladesh Bank, not political appointment.

Lastly, the government should explore the partial privatization of non-performing SoBs, especially where recurring capital shortfalls suggest structural unviability. Lessons from India's reform of IDBI Bank and global cases show that targeted privatization, paired with tight regulatory oversight, can significantly improve governance, reduce contingent liabilities, and restore market confidence. Without such decisive restructuring, the banking sector risks becoming a permanent fiscal liability and a bottleneck to Bangladesh's economic growth trajectory.

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