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VOLUME 3

# PAPERS ON LOAN RECOVERY

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Papers on Loan Recovery

VOLUME 3

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## Preface

This is the first volume of six presenting the reports of the Rural Finance Project, Phase I. The Rural Finance Project of the Bangladesh Bank and the United States Agency for International Development was a multi-component undertaking whose objective was to improve the delivery of credit to rural enterprises, both agricultural and non-agricultural, through the formal financial markets as represented by the Krishi Bank (BKB) and the four nationalized commercial banks active in rural areas. These five banks operate some 3,000 branches in rural areas and are engaged in the provision of credit through a large number of specialized programs. The proper delivery of this credit is an essential aspect of the successful development of rural Bangladesh. The RFP set out to improve provision of Rural Credit by increasing the efficiency of rural banking, by increasing deposit mobilization, improving the selection of borrowers, and raising recovery rates. Ultimately the resources devoted to the banking system should earn sufficient to cover the costs and earn an acceptable return on investment. One component of the RFP comprised a technical assistance contract under which Robert R. Nathan Associates, the National Council of Saving Institution and S.F. Ahmed & Co worked under the direction of the Agricultural Credit Department, Bangladesh Bank to provide various inputs into the task of strengthening the rural financial sector. The papers produced during this project are contained in these volumes.

# RURAL LENDING EFFICIENCY IN BANGLADESH

February,1985

by

Timothy J. Smith

# RURAL LENDING EFFICIENCY IN BANGLADESH

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## LIST OF ABBREVIATIONS

| | | |
|---|---|---|
| ACR | - | Agricultural Credit Review |
| BKB | - | Bangladesh Krishi Bank |
| CCB | - | Central Cooperative Bank |
| D/NCB | - | De-Nationalized Commercial Bank |
| MIS | - | Management Information System |
| NCB | - | Nationalized Commercial Bank |
| NP | - | Normal Program |
| SACP | - | Special Agricultural Credit Program |
| UCC | - | Union Credit Committee |

## INTRODUCTION

This report on lending efficiency in rural Bangladesh was prepared during January and February, 1985, by Timothy J. Smith, Senior Development Finance Consultant for the National Council of Savings Institutions (Washington, D.C.), pursuant to a subcontract with Robert R Nathan Associates (Washington, D.C.). A draft of this report was prepared in Dhaka and presented to the Bangladesh Bank and AID for comment, and their comments have been incorporated into this final draft.

The Rural Finance Project aims to enhance the viability of Bangladesh's banking system, mobilize savings above current levels and increase the availability of credit for the rural poor. In this context, Mr. Smith has reviewed the efficiency of rural branch operations, and this report demonstrates how policy and operational decisions at the national level affect rural branches.

Four principal types of finance institutions were investigated: nationalized commercial banks, de-nationalized commercial banks, cooperative banks and the Bangladesh Krishi Bank (the country's principal agricultural lender). Efforts were made to include the Grameen Bank in this study, but Grameen Bank essentially refused to be scrutinized by arbitrarily imposing a very high hourly fee on Mr. Smith for interviewing the bank's staff.

In the course of his fieldwork, Mr. Smith visited a number of rural branches, and regional and district offices. Additionally, he collected data on rural branches from head offices located in Dhaka. The staffs at all the banks visited were forthcoming in providing information, and they seemed candid in reporting both their weaknesses and strengths. While the report's empirical data base is relatively small, most of Mr. Smith's conclusions are supported by other recent studies, including the 1983 Agricultural Credit Review undertaken jointly by the World Bank and Bangladesh Bank, and the Rural Finance Experimental Project.

The report underscores a basic conflict in how the proper role of the banking sector is perceived and translated into lending activities. A commonly-held view among policymakers is that banks need to serve social objectives, primarily by distributing resources to lower income groups without giving priority to loan recovery.

Mr. Smith's report points out that this attitude is counter-productive to developing a viable banking sector, and in the long run can jeopardize the financial well-being of the entire system. Mr. Smith's thesis is that viability must be given priority, and in turn social objectives will be better served by the continued availability of credit which is recovered and relent. Until this conflict between the bank as social programmer versus the bank as finance institution is resolved in favor of the latter, with accordant changes in such areas as interest rates, the possibility of achieving viability in the banking system is remote.

## I. Transaction Costs

A banking system's viability or self-sustainability is a function of its performance in generating sufficient income to cover the costs of providing banking services. A bank's two principal cost areas are:

- The cost of resources, including interest paid on deposits and interest paid on the bank's own borrowings; and,
- Administrative expenses, including costs associated with mobilizing resources, processing loan transactions, monitoring borrowers' performance, and ensuring loan recovery.

Allowances for bad debts or loan losses must also be considered an expense item, and this issue will be discussed in the following section. Other expenses may include capital expenditures, particularly during the start-up or expansion of operations.

The interest earned on loans is a bank's primary source of income, and the spread between the bank's cost of funds and earned interest must be sufficient to cover all other costs if the bank is to sustain its operations without subsidies. Interest rates on deposits and loans are frequently established by factors outside of the bank's immediate control. In the case of Bangladesh, interest rates are set by the Bangladesh Bank and the Ministry of Finance, and the surcharges or fees banks may levy are likewise regulated. In countries where banks are not nationalized, maximum interest rates may be established to prevent usury, but actual deposit and loan rates reflect market conditions in which banks must compete. In either case, the efficiency of a bank in providing services as measured by administrative expenses is important since this is one area in which a bank maintains direct control over its expenses. By reducing administrative costs, private banks can maximize profits and nationalized banks can ensure their long-term viability. In fact, in the case where government controls interest rates - generally to maintain low rates - the need to improve efficiency takes on added importance since the allowable spread between deposit rates and lending rates may be too narrow to provide sufficiently for even moderately high administrative expenses, particularly when inflation rates are high and interest rates are adjusted only occasionally.

In Bangladesh, recent studies have analyzed the national banking system, including the adminstrative costs of the country's three principal rural lenders: nationalized commercial banks (NCBs), the Bangladesh Krishi Bank (BKB) and the cooperative banks.1/ In general, these studies conclude that loan interest rates are too low to cover the cost of funds, administration and bad debts.

This report focuses on the operations of rural bank branches, including the BKB, two nationalized banks (referred to hereafter as "NCB-1" and "NCB-2"), and representative offices of the de-nationalized commercial banks and cooperative banks. The cost of back-up or other services provided to the rural branches by regional, district, zonal, principal or head offices have not been allocated to the rural branches, since an accurate prorating of these expenses to individual branches would be nearly impossible without a lengthy and costly analysis. Also, each branch should be regarded as its own cost center, generating sufficient income to cover direct expenses. Other indirect expenses, such as a head office's administrative costs, need to be covered by the cumulative profits or margins of the branches; thus, a bank's overall viability is dependent on the overall profitability of its branches. If a branch or branches consistently report a loss, due to inefficiency, poor loan recovery or bad market location, corrective action is needed to ensure that individual branches do not jeopardize the viability of the entire system.

Table 1 shows the administrative costs for 15 of the NCB-1's rural branches. Administrative costs include salaries and other overhead, but not depreciation which is not a cash outlay. As a percentage of total outstanding advances (loans), administrative expenses range from 1.3 percent to 11.3 percent, averaging 3.6 percent for all 15 branches. Total expenditures, including interest paid on deposits and the branches' loans from the head office, are shown in Table 2, indicating that total expenditures represent an average of 13.1 percent of total advances. A breakdown by interest payments made to the head office and on deposits appears in Table 3. Overall, interest payments represent 73 percent of total expenditures, and the interest paid to the head office and on deposits represents 42 and 31 percent, respectively, of total expenditures. Borrowings from the head office are necessitated by the fact that the branches' loans far exceed the resources mobilized locally, as shown in Table 4. Since interest paid to the head office is higher than the rate paid on deposits (12.5 percent compared to approximately 8 percent), borrowing from the head office reduces a branch's profit margin.

Generally, for purposes of analyzing a bank's operational efficiency, the costs of adminstration are shown as a percentage of total loans outstanding. In the absence of a time/motion study, a more explicit breakdown for the costs associated with loan transactions is not possible. Table 1 shows that the average administrative costs for the NCB-1's 15 branches is 3.6 percent, a figure which is not excessive but requires further scrutiny 2/. Typical services or tasks normally covered by administrative costs include:

- Mobilizing local resources;
- Servicing deposit accounts;
- Marketing loan programs;
- Processing loan requests;
- Monitoring borrowers' performance; and,
- Recovering loans.

TABLE 1

NCB-1 - Year Ending June 30, 1984
Salaries and Overhead Compared to Advances
(Taka)

| Branch | Total Advances | Total Costs of Administration | Expenditures as % of Advances |
|---|---|---|---|
| A | 4,798,737 | 292,671 | 6.1 |
| B | 2,004,110 | 89,399 | 4.5 |
| C | 6,253,299 | 119,067 | 1.9 |
| D | 2,321,361 | 82,844 | 3.7 |
| E | 8,678,277 | 199,963 | 2.3 |
| F | 10,457,732 | 304,028 | 2.9 |
| G | 6,365,676 | 216,197 | 3.4 |
| H | 7,001,623 | 114,940 | 1.6 |
| I | 10,550,605 | 141,985 | 1.3 |
| J | 2,574,310 | 149,050 | 5.8 |
| K | 1,059,251 | 119,954 | 11.3 |
| L | 3,517,583 | 98,446 | 2.8 |
| M | 6,066,342 | 99,983 | 1.6 |
| N | 3,130,999 | 100,520 | 3.2 |
| O | 11,685,679 | 227,318 | 1.9 |
| Average | -- | -- | 3.6 |

TABLE 2

NCB-2 - Year Ending June 30, 1984
Expenditures Compared to Advances
(Taka)

| Branch | Gross Expenditures | Expenditures % of Advances |
|---|---|---|
| A | 1,068,114 | 22.3 |
| B | 248,240 | 12.4 |
| C | 733,034 | 11.7 |
| D | 262,512 | 11.3 |
| E | 1,262,060 | 14.5 |
| F | 1,186,073 | 11.3 |
| G | 770,831 | 12.1 |
| H | 804,941 | 11.4 |
| I | 1,234,879 | 11.7 |
| J | 350,253 | 13.6 |
| K | 198,318 | 18.7 |
| L | 414,787 | 11.8 |
| M | 577,720 | 9.5 |
| N | 344,098 | 11.0 |
| O | 1,568,974 | 13.4 |
| Average | | 13.1 |

TABLE 3

NCB-1 - Year Ending June 30, 1984
Interest as Percentage of Gross Expenditures
(Percent)

| Branch | Interest Paid to Head Office | Interest Paid on Deposits | Total Interest % of Expenditure |
|---|---|---|---|
| A | 5.0 | 66.8 | 71.8 |
| B | 23.0 | 40.2 | 63.2 |
| C | 61.4 | 22.0 | 83.4 |
| D | 44.4 | 23.1 | 67.5 |
| E | 58.0 | 25.8 | 83.8 |
| F | 26.8 | 46.6 | 73.4 |
| G | 27.3 | 44.2 | 71.5 |
| H | 74.6 | 10.7 | 85.3 |
| I | 75.7 | 12.5 | 88.2 |
| J | 3.0 | 53.9 | 56.9 |
| K | 1.9 | 35.5 | 37.4 |
| L | 58.4 | 16.8 | 75.2 |
| M | 71.6 | 10.8 | 82.4 |
| N | 49.5 | 20.2 | 69.7 |
| O | 49.1 | 36.3 | 85.4 |
| Average | 42.0 | 31.0 | 73.0 |

TABLE 4

NCB-1 - Year Ending June 30, 1984
Advances Compared to Deposits
(Taka)

| Branch | Total Deposits | Total Advances | Advances as % of Deposits |
|---|---|---|---|
| A | 14,150,714 | 4,798,737 | 33.9 |
| B | 1,266,505 | 2,004,110 | 158.2 |
| C | 1,468,818 | 6,253,299 | 425.7 |
| D | 1,019,381 | 2,321,361 | 227.7 |
| E | 6,832,593 | 8,678,277 | 127.0 |
| F | 10,100,511 | 10,457,732 | 103.5 |
| G | 5,527,962 | 6,365,676 | 115.2 |
| H | 2,003,924 | 7,001,623 | 349.4 |
| I | 3,041,550 | 10,550,605 | 346.9 |
| J | 4,337,903 | 2,574,310 | 59.3 |
| K | 1,498,361 | 1,059,251 | 70.7 |
| L | 1,983,131 | 3,517,583 | 177.4 |
| M | 1,701,142 | 6,066,342 | 356.6 |
| N | 1,001,432 | 3,130,999 | 312.7 |
| O | 9,506,823 | 11,685,679 | 122.9 |
| Average | -- | -- | 199.1 |

Other studies[3/], as well as the field investigation and data base for this report, suggest that NCB-1's branches are not adequately carrying out this full range of activities. The extent of borrowings from the head office indicates that local resources are not being effectively mobilized, assuming additional savings are available in rural communities. Under the government's Special Agricultural Credit Program (SACP), which represents a significant portion of these branches' loan portfolios, the marketing of loans, identification of borrowers and even loan disbursements are commonly handled by Union Credit Committees and not the bank's staff. Finally, overall loan recovery is poor, indicating that the branches are not monitoring the use of funds or making necessary efforts to ensure repayment. Satisfactory performance of these activities would increase the branches' administrative expenses, unless overall efficiency improves, and any significant increase in these expenses would make them too costly relative to the size of their operations. In other words, at first glance, these branches' administrative costs do not appear excessive, but their poor performance in carrying out normal banking activities leads to the conclusion that operating inefficiencies exist. Loan recovery policies, paperwork and reporting requirements, and other factors causing these inefficiencies are discussed in subsequent sections of this report.

Given the fact that the efforts of NCB-1's rural branches to monitor and recover outstanding loans are modest at best, a more acccurate portrayal of administrative costs would be the ratio of a branch's annual expenses to its annual loan disbursements. For the NCB-1 branches, a breakdown of loans disbursed in only fiscal year 1984 was not available. However, such data has been provided by the Bangladesh Krishi Bank for 16 rural branches. Table 5 shows total administrative expenses as a percentage of total outstanding advances and total advances made in fiscal year 1984, averaging 1.7 percent and 4.3 percent, respectively. These figures suggest that BKB is operating more efficiently than NCB-1. In addition, recent efforts by BKB to decentralize its operations and improve loan recovery would place the actual transaction or administrative costs somewhere between these two figures, perhaps at about 3 percent which represents their average.

For comparison, information is provided for one branch of the Central Cooperative Bank (CCB), 8 branches of a second nationalized commercial bank (NCB-2), and a branch of one of the recently denationalized commercial banks (D/NCB). While it is difficult to draw definitive conclusions from this small sample, the information illustrates interesting trends relevant to transaction costs as well as the later discussion on interest rates (see Section III).

Table 6 provides information on CCB's rural branch over a two-year period. As this table indicates, administrative expenses represent an average of 2.7 percent of total outstanding advances, but a much higher 12.8 percent when viewed in terms of loans made on an annual basis. However, the branch's staff provides very few services and performs few banking functions. A large portion of savings are mandatory; loan applications are prepared by the cooperatives, submitted to the District Cooperative Office for approval and approved by bank staff on a post facto basis; loans are not monitored, and

TABLE 5

BKB - Total Costs of Administration as a Percent of Total Outstanding Advances and Total Advances Disbursed in FY 1984

(Percent)

| Branch | As % of Total Outstanding Advances | As % of 1984 Advances |
|---|---|---|
| A | 3.6 | 8.0 |
| B | 5.7 | 12.9 |
| C | 1.8 | 3.7 |
| D | 1.1 | 2.7 |
| E | 1.2 | 7.4 |
| F | 0.5 | 1.2 |
| G | 0.7 | 2.2 |
| H | 1.0 | 2.2 |
| I | 1.0 | 3.7 |
| J | 1.3 | 1.5 |
| K | 1.0 | 3.6 |
| L | 2.1 | 5.9 |
| M | 2.2 | 4.6 |
| N | 1.5 | 3.5 |
| O | 1.2 | 2.3 |
| P | 0.8 | 3.1 |
| Average | 1.7 | 4.3 |

sometimes borrowers identified in the application are not the actual recipients of loan proceeds; the current recovery rate is estimated at about 20 percent; and overdue loans dating as far back as 1951 are still on the books. The staff's principal functions appear to be maintaining accounting records and serving as a depository for loan files; thus, any administrative expenses other than the most nominal must be viewed as excessive.

TABLE 6

CCB - Cost of Administration as a Percent of
Total Outstanding Advances and Annual Disbursements
1982/83 and 1983/84
(Taka)

| | 1982/83 | 1983/84 |
|---|---|---|
| Total Outstanding Advances | 5,306,818 | 4,568,918 |
| Total Advances for Year | 2,319,294 | 689,235 |
| Total Administrative Costs | 125,624 | 138,983 |
| Administrative Costs as a % of Outstanding Advances | 2.3% | 3.04% |
| Administrative Costs as a % of Annual Advances | 5.42% | 20.16% |
| Average % of Outstanding Advances | 2.71% | |
| Average % of Annual Advances | 12.80% | |

Table 7 compares NCB-2's administrative costs to outstanding loan advances for 8 rural branches. Compared to NCB-1, NCB-2's transaction costs are much higher, ranging between 5.7 percent and 335.8 percent, with an overall average 64.1 percent. It should be noted that data from these branches were inconsistently reported; thus, some error may exist in these figures. However, even when information from Branches A and H is excluded - assuming this information is in error since these branches have very high percentages of administrative expenses - the overall average is still a high 17.7 percent. Only Branch D reported a net loss in 1984, which seems virtually impossible, and raises questions about how income is reported - an issue discussed in Section IV of this report.

TABLE 7

NCB-2 - Costs of Administration Compared to Outstanding Advances for Year Ending 12/31/84 (Taka)

| Branch | Total Advances | Total Costs | Cost as % of Advances |
|---|---|---|---|
| A | 123,152 | 413,953 | 335.8 |
| B | 3,442,725 | 195,827 | 5.7 |
| C | 610,289 | 129,827 | 21.3 |
| D | 238,952 | 106,372 | 44.5 |
| E | 6,993,707 | 1,019,573 | 14.6 |
| F | 1,080,910 | 133,065 | 12.3 |
| G | 3,242,208 | 251,505 | 7.7 |
| H | 133,398 | 94,922 | 71.2 |
| Average | -- | -- | 64.1 |
| Average Excluding A & H | -- | -- | 17.7 |

Conceivably, the figures for NCB-2's branches are correct, based on similar statistics from one of the de-nationalized commercial banks (D/NCB). Table 8 provides information on one branch's activities for 1983 and 1984, showing the ratio of administrative expenses to outstanding loans to be 160 percent and 121.4 percent, respectively. The difference between outstanding loans for the two years provides a rough estimate of loans disbursed in only 1984, totalling TK 79,765. 1984's administrative costs as a percent of the same year's loan disbursements is an astounding 256 percent. In fact, what this D/NCB branch reports is that it is not making loans unless they are fully secured and the borrowers are well known; in other words, only relatively risk-free loans are considered. Instead, deposit funds are forwarded to the head office, earning 12 percent interest without the risk or expense of making loans. Since current accounts and call savings accounts pay a relatively low rate of interest, through this arrangement the branch makes money - in fact, more money than if it were to make loans. The NCB-2's branches may be operating in the same fashion; thus, Table 7's figures could be entirely correct. This disincentive to extending credit, resulting from the interest rate structure, is discussed in Section III.

TABLE 8

D/NCB - Costs of Administration
Compared to Outstanding Advances
FYs 1983 and 1984
(Taka)

Figures from One Branch

| Year | Total Advances | Total Costs | Costs as a % of Advances |
|---|---|---|---|
| 1983 | 88,534 | 141,610 | 160.0 |
| 1984 | 168,299 | 204,239 | 121.4 |

Change in outstanding advances between 1983 and 1984 : 79,765

1984 Costs of Administration as a Percentage of Change : 256%

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Processing time and decentralization. The efficiency with which loan applications are reviewed, approved or disapproved, and processed is an important aspect in marketing a bank's services. Borrowers who must wait an inordinate amount of time for loan approval will likely take their business to another bank or, in the case of Bangladesh, to local moneylenders. Borrowers tend to save at the same bank from which they receive credit, so to lose a loan customer can result in the loss of deposit funds.

In agricultural lending, timely disbursement of loan funds is especially important, since late disbursements can affect production and diminish the possibility of loan recovery. Lower income, small farmers are not likely to apply for a loan too far in advance, since early receipt of loan funds will simply increase their interest payments and reduce their already narrowprofit margins. Bankers and farmers alike will make their respective lending and production decisions based on ever-changing market conditions, and in turn these decisions frequently must be made relatively close to the start-up of production. For all of these reasons, rural banks must be able to review and process a loan request in a short period of time.

All of the rural branches visited report a relatively quick turn-around on loan approval, once a completed application and supporting documents have been received. Processing time can range between one day to a few weeks, depending on the branch's loan sanctioning authority, the size of the request and the

proximity of the office which must approve the request if it exceeds local authority. However, this time frame pertains only to the processing time once an application is complete, and does not take into account the time spent in preparing the application or meeting a lender's other requirements.

Bank managers report that many borrowers - especially first-time applicants or lower income, illiterate borrowers - are not aware of the requirements to apply for credit. For instance, if a loan is to be secured by land, a borrower may not know that he needs to bring in title papers on which the bank will either enter a lien or hold until the debt is repaid. By some accounts, however, the bank staff itself makes the loan application process unnecessarily difficult by telling an applicant only one requirement at a time, causing the applicant to make several trips to the bank. No particular purpose is served by this process, except to frustrate borrowers to whom the bank does not want to make a loan, or to collect extra fees from the borrower for quicker service.

This particular problem could be alleviated at least in part by posting loan application requirements in the branch office, and making loan applications and explanatory documents readily available at no charge to potential borrowers. These requirements could include the standards or guidelines established by the head office for eligibility and loan amounts, including collateral requirements and evidence of creditworthiness. In addition, establishing guidelines on the maximum amount of time bank staff can take in reviewing loan requests at each stage in the process - and posting these guidelines as well as monitoring staff compliance with them - would mitigate against the possibility of bank staff taking unfair advantage of clients. Finally, by establishing an appeals process for borrowers who feel they have been unfairly treated in their efforts to secure credit - either through an arbitrary denial of credit, imposition of excessive fees or lengthy processing time - would foster conformity and equity in the credit system and prevent unwarranted abuses.

Different procedures have been used for approving agricultural loans under the Special Agricultural Credit Program (SACP) and other loans, such as commercial credits and agricultural loans under the Normal Program (NP). The SACP process, including the role of Union Credit Committees, is discussed later in this section. NCB-1 reports the following basic steps for making non-SACP loans:

1. A borrower must open an interest-free current account at the branch, in the amount of TK 500, and must maintain this account for six months.

2. The borrower must complete a loan application which is processed locally or sent to the appropriate office in the bank's hierarchy.

3. A letter is written to all other banks in the immediate area to ascertain if the borrower has other loans, or if the collateral offered is already encumbered.

Naturally, other steps include a review of the proposed project itself, depending on the request, but through these essential steps a borrower's creditworthiness is determined. This determination appears to be based largely on the client's ability to maintain a minimum cash balance, reflecting the fact that he is not always cash poor and presumably will be able to repay a loan. Even when collateral is offered, a borrower is still required to maintain a current account for six months, which is probably an unnecessary requirement as long as the bank is willing to foreclose on secured property in the event of default. Adequate collateral should enable borrowers to apply for credit without necessitating a waiting period to demonstrate savings capability. Except for this one requirement however, these steps are appropriate for a bank to take in safeguarding against undue risks, and they should not result in excessive transaction costs.

Many bank managers report that borrowers already in default are likely to obtain new credit by applying to another bank. Presumably, NCB-1's efforts to contact other area banks to determine if a borrower has other loans would prevent this from happening, but this process does not always work. The Bangladesh Bank has introduced a "lead bank" system which is intended to coordinate local lending activities, including allocating funds to or setting targets for individual banks under special programs. This system has not developed as envisioned, and its merits will not be discussed here, but it does suggest the possibility of designating a bank as a regional clearinghouse which would maintain information on new borrowers, borrowers in default, and possibly even liens on real property. Naturally, the cost of such a service would need to be covered, which could be handled by charging a fee for each credit report. The availability of such a service potentially could alleviate or reduce the present high rate of overdue and default situations.

The government is encouraging a policy of decentralization in many sectors, including banking, and the BKB appears to have pursued decentralization to a greater extent than most banks. BKB's rural branch managers in general have greater loan sanctioning authority than their counterparts in other banks. For instance, BKB's rural branch managers can approve loans up to TK 25,000, compared to TK 5,000 at NCB-1's rural offices. Loan sanctioning authority at D/NCB's branches at all levelshas been revoked awaiting new guidelines from the head office, and in the interim all loans must be approved at the head office. As previously noted, the CCB's branch manager approves loans only on a post facto basis, with the real loan sanctioning authority vested with the District Cooperative Office.

As a result of BKB's decentralization, loan processing time has been telescoped. Loans which previously took upwards to six months to process

are now processed in 30 days or less. In addition, BKB tends to use field representatives to identify prospective loan applicants, and in some cases borrowers need not appear at the branch office since the field representatives collect application forms, return them to the branch office for review, and arrange for disbursement in the field.

Specialized rural credit programs. The Bangladesh Bank has established over 60 specialized credit programs in the rural sector. These programs are crop-specific (e.g., bananas or jute), activity-specific (e.g., irrigation projects), or client specific (e.g., women). To some extent, this plethora of programs reflects the particular concerns or priorities of the donor agencies which finance them.

Not all programs are offered through all bank branches; as a result, reportedly some borrowers must apply for financing from more than one bank to address their full credit needs. This situation gives rise to a number of problems. From a borrower's perspective, having to apply for a loan from two or three branches is time-consuming, and the banks appear to be unresponsive to his credit needs. Also, if each branch requires the borrower to maintain a minimum balance in a current account, he may be unable to qualify for more than one loan given his limited resources. This lack of one-stop shopping for banking services sometimes causes borrowers to turn to local moneylenders who are more responsive to a borrower's full credit needs, even if at usurious rates. From a lender's perspective, this situation exacerbates the problems of trying to ascertain a borrower's current indebtedness or ensuring that collateral is not already encumbered. Finally, from an efficiency perspective, both borrowers and lenders alike are burdened with additional paperwork.

The extent or ramifications of these problems is difficult to quantify, but common sense dictates that the present number of specialized rural loan programs is excessive, and consideration should be given to their consolidation. In some instances, banks are participating in these programs only because they are obliged to do so by the Bangladesh Bank. However, if interest rates were high enough to provide an incentive for banks to lend in various sectors (see Section III), then many of these specialized programs might prove unnecessary. Only when a sector or class of individuals is clearly underserved by the banking system should special programs be developed; for instance, programs could be justified for the rural landless poor and women, but market conditions should dictate whether credit should be extended for particular crops or economic development activities.

Role of UCC's. Most of the advances which banks approve involve the borrower applying directly to the bank, with the bank staff reviewing and processing requests, including determining a project's feasibility and the borrower's creditworthiness. Under the Special Agricultural Credit Program, however, the bank's role is reduced, and many of these tasks or activities are handled by Union Credit Committees.4/

The UCC generally has between four to six members 5/, including the Union Chairman, a bank representative, two block supervisors of the Bangladesh Agricultural Corporation and two representatives elected at the Union level. The SACP is a special program designed to assist lower income farmers by providing production credit on concessionary terms. Typically, branch managers are not originally from the areas in which they work, but are transferred every two to three years; as such, they are not familiar with villagers, and the role of the UCC is to identify creditworthy applicants for agricultural credit.

The UCC prepares a list of borrowers for the SACP. Banks do not necessarily approve loans for every individual on the list, especially if it is determined that the proposed client is in default or overdue on other loans. However, only individuals appearing on the list are eligible for SACP credits.

This process alleviates a branch's burden of identifying borrowers, and presumably expedites the loan process, but to a large extent it also removes the bank's staff from the lending process for which they are responsible. Since the UCC Chairman and other members are elected representatives, the potential exists for these committees to become politicized, with loans recommended on the basis of favoritism rather than the merits of the request. While a bank representative is always on the UCC, some reports indicate that the banker is intimidated by the Chairman, and thus does not play an effective role in representing the bank's interests. Also, inequities in the system can result when an eligible borrower is not recommended for an SACP loan based on political grounds, and he is unable to apply directly to the bank for SACP credits.

The loan recovery record under the SACP is less favorable than under the Normal Program, suggesting that many of the above-mentioned problems exist. The branch requires a loan application from each approved borrower, but collecting this application is only perfunctory and is not reviewed for purposes of determining creditworthiness. In most cases, the application provides information only on the crop for which credit will be used, and does not provide complete data on a borrower's finances. The UCC which has identified the borrowers plays no active role in loan recovery, and in some cases even knowingly recommends new loans for borrowers who are in default on outstanding loans. As most branch managers report, the UCC simply "disappears" when there are problems with loan recovery.

The only positive role the UCC plays is to identify borrowers and facilitate loan disbursements. These tasks could be better handled by a branch's field representatives who are trained in agricultural finance and are responsible for their own loan portfolios. While this change - eliminating UCCs and shifting responsibility back to the branches - would likely entail an increase in branch staff with a concomitant increase in administrative costs, higher rates of loan recovery would offset these additional expenses. If UCCs continue to operate under the SACP, then

they should be required to assume greater responsibility in loan recovery, however possible. One option in this regard would be to establish targets for loan recovery, and failure on the UCC's part to achieve these targets would automatically eliminate the role of the UCC in the next credit cycle. In order to prevent abuses of the UCC system, borrowers should be permitted to apply for an advance directly to branch offices. If branch managers are unwilling to fairly consider individual requests, due to political pressure or other considerations, then the appeals process suggested earlier in this report would still provide prospective borrowers with access to fair consideration.

Summary of Findings

1. For some banks (in this case, NCB-1), the costs of administration or transaction costs appear reasonable at first glance. However, the branches' apparent poor performance in carrying out normal banking activities, such as mobilizing savings and recovering loans, leads to the conclusion that inefficiencies do exist. Satisfactory performance of these activities would increase the bank's overall transaction costs beyond reasonable levels, unless efficiency improves.

2. BKB appears to have the most efficient rural branch operations, and the CCB appears to be the least efficient. Other banks (in this case, NCB-2 and D/NCB) report very high administrative costs when compared to outstanding loans, which apparently results from a preference to send surplus deposit funds to the head office rather than extend local credit. This preference reflects disincentives created by current interest rates.

3. All banks report a reasonably quick processing time for loan applications once they are submitted along with all required supporting documents. However, borrowers are sometimes unfamiliar with application requirements, and at other times they are subjected to unnecessary delays and even extra fees before their loan requests are considered.

4. Most branches appear to make some effort to ascertain whether a loan applicant already has a loan outstanding, the status of the loan, and if the property offered as collateral is already encumbered. However, many branch managers report that defaulters or poor credit risks still obtain credit, a problem which is exacerbated by UCCs which recommend borrowers who are overdue on other loans.

5. Among all the banks, BKB appears to have decentralized its operation to the greatest extent. As a result loans which previously took 6 months to process can now be handled in 30 days or less. In addition, BKB employs field representatives to identify potential applicants and handle requests, thus facilitating the process for borrowers.

6. The number of specialized rural credit programs is excessive and tends to lead to inefficiencies for both borrowers and lenders alike. Since not all branches administer all programs, borrowers with different credit needs are sometimes required to apply for loans from more than one bank, and this seeming lack of responsiveness on the banks' part to a borrower's credit needs is often the reason why borrowers turn to money-lenders for financing.

7. UCCs are more of an impediment than a help to an efficient credit program. While they facilitate the process of loan disbursements, the borrowers they recommend are not subjected to any real review of creditworthiness and branch staff is one step removed from their legitimate roles as bankers; as a result, loan recovery rates are poor and the UCC plays no role in ensuring loan recovery. Also, the UCC is largely a political body; thus, the potential exists for inequities or abuses, but borrowers who are subjected to unfair treatment have no recourse at present.

Recommendations

1. To facilitate borrowers' understanding of the application process, all loan requirements, including requirements on eligibility, documentation, collateral, processing time and fees, should be posted publicly in each branch. Head offices should establish guidelines in each of these areas, including the maximum time allowed for staff to process loan requests, and compliance with these guidelines should be monitored. Application forms should be provided free of charge, though standard fees at the time of application could be levied. To foster conformity and equity in the credit system, an appeals process should be established, and this process should also be posted in each branch office.

2. When borrowers offer sufficient collateral as security on a loan, they should not be required to open and maintain a current account for six months prior to consideration, a practice now employed by some banks. However, as part of collateral, banks may want to require that a borrower maintain a minimum balance in an account, and this minimum balance should be set by the head office and posted along with other loan requirements.

3. All banks should pursue and implement decentralized policies, thereby granting greater loan sanctioning authority to branch offices which will expedite the processing of loan requests.

4. Consideration should be given to creating area-wide "credit clearinghouses", perhaps in conjunction with the lead bank system, to assist branch banks in their efforts to ascertain whether borrowers have other loans or if the property offered as security is already encumbered.

5. Consideration should be given to consolidating the many specialized rural credit programs, with special programs developed only to address sectors or classes traditionally under-served by the banking system, such as women and the landless rural poor. To ensure that other rural sectors receive adequate financing, the banks should be given incentives to lend to them, such as allowing banks to charge higher interest rates.

6. UCCs should be eliminated from the credit system, and the decisions and responsibilities for making loans should be transferred back to the banks. Concurrently, branches should increase their outreach through field representatives. If the UCCs continue to play a role in rural credit, at the very least borrowers should be able to apply directly to a branch bank for a loan, rather than having all allocation of credit determined by the UCC.

## II. Loan Recovery

Loan recovery is essential to the viability of a banking system. The failure to recover loans erodes an institution's capital base, prevents the expansion of credit services, and eventually threatens the solvency of the institution. Standard banking practice is to establish a bad debt or loan loss rate, and apply this rate to new loans, thereby creating a reserve fund to cover losses. As such, this loan loss rate becomes an operating expense which must be covered by the spread between the cost of funds and interest earnings.

In Bangladesh, where defaults have plagued rural credit and overdues have reached critical levels, allowances have not been made for bad debts. The Bangladesh Bank has prescribed guidelines for classifying loans as "overdue", "stuck-up", etc., but in fact such reporting is not enforced, and the general tendency is never to write-off a loan on the assumption that it will eventually be repaid. As a result, all of the country's banks have loans on the books from pre-liberation days, and despite many years of non-payment these loans continue to be regarded as current insofar as interest income on these loans is accrued and included in the banks' operating statements. One branch of the Central Cooperative Bank reports loans still on the books dating as far back as 1951. The result of these practices, especially the fact that accrued interest on bad debts is reported as income, is to distort the actual financial status of individual banks as well as the banking system as a whole. In addition, the failure to maintain adequate records on loan recovery, including arrearages and defaults, hampers any efforts to establish a reasonable loan loss rate for the purpose of covering such expenses by interest rates.

Agricultural lending is always riskier than many other types of credit activities, since market conditions can experience unforeseen changes and weather can detrimentally affect production. In Bangladesh, the risk factor is even more pronounced, given the general impoverishment of farmers and their lack of resources to secure loans. Even so, the rate of overdue loans is unjustifiably high and results from a combination of factors.

At the branch level, loan recovery problems stem from inadequate appraisals of loan requests, failure to monitor borrowers' activities or use of funds, and lack of will to protect the bank's interest through legal remedies in the event of default. Under the Special Agricultural Credit Program, these problems are exacerbated by the involvement of Union Credit Committees which take no responsibility in loan collections, but by the presence of UCCs in the system, branch employees are largely prevented from performing their role as credit analysts. This arrangement also diminishes the bank staff's responsibility for ensuring loan recovery, since bad SACP loans can always be blamed on the UCC.

While these problems contribute to poor loan recovery at the branch level, even greater responsibility can be attributed to the policy decisions and attitudes formulated at the national level which affect the banking system. Through the promulgation of special programs designed to assist the rural poor, largely through concessionary interest rates, banks have been directed to act as "social programmers" in the redistribution of resources, rather than giving priority to their proper role as viable financial institutions. Banks are required to provide financing under these programs, regardless of their perception of the risk associated with the programs or assessment of their profitability. As an incentive for banks to participate in these programs, the central government has assumed a large share of the risk, but in turn this practice creates a disincentive for pursuing loan recovery. Moreover, the interest rates allowed under these programs are not adequate to cover the cost of funds, administrative expenses and bad debts. In other words, primarily due to mandate are banks participating in these programs, and not due to considerations of profit or viability, and at the same time little motivation exists to bring about loan recovery. Illustrative of this situation is the fact that as soon as one of the former NCBs became de-nationalized, it immediately withdrew almost entirely from agricultural lending, especially under the SACP program.

The conflict between the traditional role of a bank and the bank as social programmer affects the banking system at all levels. While "profits" per se may not seem an appropriate goal under a nationalized system, a respectable profit margin is essential to ensure the system's viability, but in general the country's banks lack a profit orientation. In turn, a lack of self-motivation permeates to the branch staffs, since they perceive their role more as that of carrying out government programs than serving as bankers, and thus they do not assume responsibility for lending decisions since thay have no option but to carry out these programs. Until viability is given priority over social concerns, it is doubtful that this situation can change.

The roles of a bank in furthering social objectives and in serving as a financial intermediary are not necessarily exclusionary. The real issue is which concern is given priority. The availability of credit is important to rural economic development, and to the extent that resources are recycled in the economy, development goals can be better realized. If a bank acts as a one-way conduit for credit, without concern for loan recovery, the impact of its resources is minimized. However, if a bank is concerned with its viability as a finance institution, and thus effectuates loan recovery, those same resources can be re-lent indefinitely. As long as interest rates remain affordable to lower income clients, in the long run the viable bank furthers social objectives more so than the 'social' bank.

Loan losses result in a direct expense for a bank by virtue of the fact that capital is lost. The full ramifications of poor loan recovery, however, extend beyond a simple accounting of losses. Two areas of indirect expenses need to be considered:

1. Opportunity costs. Both overdues and loan losses result in opportunity costs to banks and the banking system. Loan repayments can be recycled into new credits, in turn generating additional income. When loans are overdue, the resulting time lapse means a slower recycling of funds and lower earnings for the bank. Despite a late penalty fee imposed on overdue accounts, this fee is not as high as the interest rate on new loans: 6 percent compared to 16 percent. When overdues actually become loan losses, obviously the opportunity costs are much higher.

2. Subsidies. High overdue rates or loan losses threaten the solvency and viability of a bank. In turn, to safeguard the banking system, central banking authorities - in this case, Bangladesh Bank - find themselves compelled to subsidize the system through such mechanisms as refinance facilities and direct equity injections. These subsidies are costly in a number of ways. First, by propping up non-viable institutions, their financial problems are merely compounded over time, resulting in still higher subsidy requirements. Second, funds provided to the banks for such non-productive purposes as covering loan losses represent an opportunity cost to society as a whole since these funds could have been invested in more productive endeavors. Finally, to the extent that the money supply is expanded to provide these subsidies, inflation rates are pushed higher which again results in a cost to society as a whole.

Measuring Loan Recovery Rates. An increased emphasis appears to have been given to improving loan recovery in the last couple of years, but nevertheless high overdue and default rates persist. Measuring these rates, however, is made difficult by inconsistencies in reporting requirements and formats, as well as a lack of reliable records on overdue loans. As standard practice, many banks simply roll-over loans on their books which may or may not be reported as an extension of new credit or overdrafts, and accrued interest on these loans is reported as income; thus, in many cases overdue loans become designated as recovered.

In 1983, the Agricultural Credit Review (ACR) 6/ reported a deteriorating trend in the recovery rate for agricultural loans, as shown in Table 9:

TABLE 9
ANNUAL RECOVERY OF AGRICULTURAL LOANS

| | |
|---|---|
| FY 1980 | 46% |
| FY 1981 | 42% |
| FY 1982 | 45% |
| Average | 44% |

While recovery performance improved between 1981 and 1982, this improvement was marginal, and the 1982 rate was still lower than two years earlier. The ACR also provided a breakdown for loan recovery rates under the Special Agricultural Credit Program and Normal Program, as shown in Table 10:

TABLE 10
COMPARATIVE RECOVERY PROFILES

| Loans disbursed during | Recovery of loans through June 30, 1982 | |
|---|---|---|
| | SACP | NP |
| FY 1977 | 88% | 91% |
| FY 1978 | 79% | 90% |
| FY 1979 | 71% | 87% |
| FY 1980 | 54% | 75% |
| FY 1981 | 35% | 52% |

Table 10 clearly indicates better loan recovery under the Normal Program compared to the SACP, with first year recovery rates at 52 percent and 35 percent, respectively. Over time, this gap closes, but the risk of loss is still higher under the SACP if overdues of over five years are considered uncollectible.

This trend or situation is supported by data on NCB-2's Rural Credit Program as shown in Table 11. SACP loans accounted for 25.4 percent of all rural credits through November 1984. Of the SACP loans, overdues represented 38.8 percent of outstanding advances, compared to 29.6 percent for all other rural loans.

BKB reports an average overdue rate of 24.8 percent for the last 8 years ending in 1984. Table 12 provides these rates on an annual basis which indicate an improvement in loan recovery through 1982, but a deteriorating situation in later years. However, this data needs to be interpreted with caution, because BKB's loans have been increasingly granted as cash credits or overdrafts. Overdues under this system are commonly extended on a one-year basis, when normally they should have been deemed overdue.[7]

Other data on BKB's rural branch operations suggest that Table 12's figures may reflect a lower than actual overdue rate. Table 13 shows the overdue rates at the same 16 rural branches referred to earlier in this report (see Table 5). Overdue rates range between 11.7 percent and 68.5 percent, averaging 35.6 percent. These figures were provided by BKB's head office, and

they may also be presenting a more favorable situation than in fact exists. On-site data was collected from Branch F which reports a 38 percent average rate of recovery for both SACP and NP programs in January of this year, or a 62 percent overdue rate. However, Table 12 indicates an overdue rate of only 11.7 percent, conceivably because other types of loans have much higher recovery rates thereby offsetting poor performance in agricultural credits.

The reliability of reported recovery rates, though poor in themselves, is brought into further question by information gathered at one of BKB's regional branch offices. The office has reported a 77 percent recovery rate to the head office, but the actual rate is a much lower 54 percent; the difference results from rolling over or refinancing loans on the books. The problems of unreliable data and poor loan recovery are not singular to BKB, but are endemic to all the banks in Bangladesh. BKB has been highlighted in this discussion only because it provided the most information on overdue loans. At NCB-1's head office, information on loan recovery at the branch level was not available, although one of NCB-1's district offices reports a current recovery rate of only 45 percent. Only one bank branch reported a truly favorable recovery rate of 100 percent on recently-disbursed loans - the D/NCB branch which extends no agricultural credit and makes loans only under very secure conditions!

TABLE 11

NCB-2 - Rural Credit Program
from inception through 30/11/84
(Thousands of Taka)

| | | |
|---|---|---|
| Total Loans disbursed: | | |
| | Tk. 311,145 | 100% |
| Of which SACP: | | |
| | Tk. 78,955 | 25.4% |
| All Loans: | | |
| a. | Total outstanding | 165,533 |
| b. | Total overdue | 48,666 |
| c. | Percent overdue (b/a) | 29.6% |
| SACP Loans: | | |
| d. | Total outstanding | 56,566 |
| e. | Total overdue | 21,940 |
| f. | Percent overdue (e/d) | 38.8% |

TABLE 12
BKB - Overdue Loans as a Percent of All Outstanding Advances FYs 1977 - 1984

| Year | Percent Overdue |
|---|---|
| 1977 | 34.0 |
| 1978 | 33.4 |
| 1979 | 28.0 |
| 1980 | 23.3 |
| 1981 | 16.9 |
| 1982 | 18.8 |
| 1983 | 19.6 |
| 1984 | 24.5 |
| Average | 24.8 |

TABLE 13
BKB - Overdue Loans as a Percentage of Total Outstanding Advances for 16 Rural Branches, 1984

| Branch | Percent Overdue |
|---|---|
| A | 40.7 |
| B | 44.4 |
| C | 15.4 |
| D | 14.6 |
| E | 39.0 |
| F | 11.7 |
| G | 25.9 |
| H | 33.8 |
| I | 23.2 |
| J | 68.5 |
| K | 52.0 |
| L | 54.0 |
| M | 37.0 |
| N | 41.5 |
| O | 32.5 |
| P | N/A |
| Average | 35.6 |

An even more negative recovery picture is reflected in data provided by one CCB rural branch as shown in Table 14. CCB reports four principal sources of income: principal repayment on advances, interest due on advances, collection charges (imposed on overdue loans), and interest due on advance money. (This last category is differentiated in CCB's books from other interest due on advances, but why it is represented by a separate line item is not explained.) Recovery from all four sources was only 21.7 percent in 1982/83, falling to 12.6 percent in 1983/84. The rate of recovery of principal alone declined from 26.9 percent to 17.2 percent.

TABLE 14

CCB - Income Earned Compared to Income Due
For 1 Rural Branch, 1982/83 and 1983/84
(Taka)

| | 1982/83 | 1983/84 |
|---|---|---|
| Interest due on advances | 1,690,287 | 1,936,026 |
| Interest earned (realized) | 189,616 | 112,417 |
| Percent earned (realized) | 11.2% | 5.8% |
| Collection charges due | 710,748 | 819,258 |
| Amount collected | 60,447 | 31,029 |
| Percent collected | 8.5% | 3.9% |
| Advances to be repaid | 5,306,818 | 4,568,918 |
| Advances repaid | 1,428,845 | 785,240 |
| Percent repaid | 26.9% | 17.2% |
| Interest due on advance money | 38,440 | 40,564 |
| Interest realized | 100 | - |
| Percent realized | .3% | 0% |
| Total income due | 7,746,293 | 7,364,766 |
| Total income realized | 1,679,108 | 928,686 |
| Percent realized | 21.7% | 12.6% |

A number of factors account for CCB's poor performance. Bank employees do not identify borrowers or approve loans. This authority is delegated to a government agency; thus, this cooperative lending program takes on the characteristics of a social rather than a finance program. The bank staff itself is not trained in banking; rather, the branch manager's training was in cooperative organization at the Bangladesh Academy for Rural Development.

Finally the staff has virtually no contact with individual borrowers, but must rely on the veracity of information provided to the bank by the cooperative societies which apply for loans on behalf of individuals. The staff is aware of several instances in which identified recipients did not actually receive loan proceeds, and where land documentation was bogus. According to this particular branch's staff, these problems are shared by all CCB branches.

Tables 15 and 16 provide a final look at loan recovery rates, in this instance under a specialized salt loan program. The tables show the percent of loans overdue based on the year in which they were disbursed. Table 15 reports information provided by a D/NCB regional office for the various rural branches it services, and Table 16 provides aggregate data for several NCB-2 rural branches. In both cases, most loans are gradually repaid over time, but high overdues occur in the first year or two after disbursement. For loans disbursed by the D/NCB branches in 1982/83, overdues represent 105.4 percent of initial advances, reflecting unpaid interest which has been rolled back into outstanding principal. While some of these salt loans have been made to individuals, most have been made to cooperatives.

The poor track record of the cooperative salt loans, as well as CCB's extremely poor loan recovery record, suggests that cooperative lending in Bangladesh is poorly structured or at least poorly administered. The problem is not with cooperative lending per se, since many successful cooperative credit programs have been implemented throughout developing and developed countries. Rather, the problem appears to be the distance the system puts between the ultimate borrower and lender. In most cases, the loan application shows the cooperative society to be the borrower, but the loan is secured only by the crops or real property of the cooperative members. The society itself does not have any assets with which to secure a loan and the bank's only recourse in the event of non-payment is through the cooperative. In the case of CCB, the staff stated that they thought an agreement was entered into between the cooperative and members, but copies of these agreements were not present in the branch office. The cooperative presents the application to the bank - whether it is CCB, D/NCB or NCB-2 - and the branch staffs must rely on the accuracy of this information, even though case histories demonstrate that it is not always correct. The problems embodied in this system are not dissimilar to SACP's problems where the involvement of UCCs essentially preclude branch staffs from performing their proper roles as credit analysts.

TABLE 15

D/NCB - Salt Advances and percent overdue for selected years (Taka)

| Year | Total advances | Total Overdue | Percent overdue |
|---|---|---|---|
| 1978/79 | 147,000 | 18,468 | 12.6% |
| 1982/83 | 1,347,000 | 1,420,329 | 105.4% |
| 1983/84 | 118,300 | 48,235 | 40.8% |

TABLE 16

NCB-2 - Salt Advances and Percent Overdue FYs 1978/79 - 1983/84 (Taka)

| Year | Total advances | Total Overdue | Percent overdue |
|---|---|---|---|
| 1978/79 | 2,140,200 | 18,809 | .9% |
| 1980/81 | 407,000 | 72,183 | 17.7% |
| 1981/82 | 487,000 | 150,774 | 31.0% |
| 1982/83 | 4,457,400 | 3,781,812 | 84.8% |
| 1983/84 | 5,155,100 | 5,064,849 | 98.3% |

Determining a Loan Loss Rate

As noted earlier, loan losses represent an expense in banking, and this cost needs to be covered by the interest rate spread along with other expenses. Common practice in Bangladesh is to assume that all loans will be repaid eventually, thus making it unnecessary to estab- lish a loan loss factor; but common sense, conventional banking practices and actual recovery performance all point to the need for determining a loss or bad debt percentage.

The data collected during the field investigation for this report is not broad-based enough on its own to fairly measure bad debts; however, in general it supports the Agricultural Credit Review's analysis of an appropriate bad debt factor, and this part of the report will draw upon the ACR study. 8/

Recovery profiles for agricultural loans by program have already been presented in Table 10. Overall recovery profiles for short-term, agricultural credits appear in Table 17. This table indicates the percentage of loans still overdue based on the year of disbursement. Two particular features of this data are relevant to this discussion. First, only 43 percent of all loans are repaid when due; thus, if the same level of financing were to be maintained, additional sources of financing would need to be found to finance the remaining 57 percent. Second, depending on when an overdue is finally considered to be a bad debt, loan loss rates could be a very high 21 percent (if after 3 years overdue loans are written off) or 12 percent (if after 5 years overdue loans are written off). Even at 12 percent, this level of bad debt exceeds what can be covered by a reasonable interest rate spread.

TABLE 17

Overall Recovery Profile for Short-Term Agricultural Advances

| Loans disbursed during | Loan recovery as of 30/6/82 |
|---|---|
| 1976/77 | 88% |
| 1977/78 | 82% |
| 1978/79 | 79% |
| 1979/80 | 64% |
| 1980/81 | 43% |

Without taking into consideration the past accumulation of overdue loans, the ACR calculated a "marginal" bad debt factor for different banking institutions, as follows: 2% for BKB, 6% for NCBs, and 6% for CCB. 9/ This marginal factor would cover only the increase in loans overdue by more than 3 years. The ACR estimated a second loss factor which does take into account past as well as future bad debts, as follow: 4% for BKB, 6% for NCBs, and 6% for CCB. 10/ Only BKB's bad debt percentage has been increased over the marginal rate, which is puzzling given BKB's generally better performance in loan recovery 11/ and suggests one of two possibilities: either a different time frame for writing off overdue loans has been used (5 years instead of 3 years), or the ACR has inaccurately calculated an overall loan loss rate for the NCBs and CCB. When the critical level of overdues for all banks is considered, these rates seem very conservative. Nevertheless, in the following section of this report on interest rates, these marginal rates will be used: 4% for BKB, and 6% for NCBs and CCB. The question of what to do with accumulated loan losses will be considered in Section IV.

Improving Loan Recovery

Improving loan recovery rates among Bangladesh's financial institutions is essential to the banking system's viability, even in the short-term. All feasible remedies or corrective actions should be considered and implemented to enforce loan repayments on schedule. The following list of possible remedial actions is not considered to be all-inclusive, but their adoption or implementation should result in a significant improve- ment in loan recovery.

Clarification of policy vis-a-vis role of banks. At the national or policymaking level, banks have been perceived as playing a role in furthering social objectives, and priority has not been given to their viability. This attitude affects loan recovery. Banks may elect to participate in social programs, such as loan programs designed to assist lower income rural households, but to require banks to commit resources to such programs can be detrimental to their well-being as financial institutions. Until this basic dilemma or conflict is resolved - the bank as social programmer versus the bank as finance institution - loan recovery is likely to remain poor.

Risk and incentives. In keeping with the notion that banks serve social purposes, the Bangladesh Bank has left banks little option but to participate in special loan programs, but at the same time it has assumed a substantial portion of the risk. In turn, banks have little incentive to attempt loan recovery. The branch staffs view their roles as that of putting out the money, but not needing to recover it. If banks are to recover funds under these programs, the risks need to be transferred back to the banks. At the same time, incentives need to be created to encourage the banks to participate in these program. In conventional banking, higher interest rates are charged on riskier loans to cover the greater potential of default. In Bangladesh, however, programs perceived by banks to be riskier, such as SACP, actually have lower rates. If banks were allowed to charge higher interest rates, and at the same time they were at risk in the event of default, sufficient incentive should exist to participate in these special programs and ensure loan recovery.

Staff evaluation. The banks' current accounting practices allow accrued interest on overdue and defaulted loans to be included in year-end operating statements. Also, loans are reported as recovered or current by being rolled over on the books. Based on these two standards of performance - income and recovery rate - employees are awarded year-end bonuses. Until such time that bank employees are evaluated on actual performance, and not on paper entries, there will be a continuing disincentive to improve loan recovery.

Legal action. Branch staffs are reluctant to bring legal action against borrowers, partly as a result of policy emanating from Dhaka. The legal process is regarded as costly and time-consuming. However, until such time that borrowers begin to realize that banks are willing to foreclose on secured property or seek other legal remedies, they will not feel compelled to repay their loans. In this regard, the bottlenecks in the legal system should be identified and remedied, including under-staffing and excessive costs.

Also, consideration should be given to the possibility of bringing action against a group of defaulters rather than individually, such as members of cooperatives, and in this way expedite the process. (This remedy has worked in other situations involving cooperatives. 12/)

Adequate staffing. Rural branches need to have adequate, trained staff. Civil servants who are not trained in finance or bank management are not deemed appropriate staff. Staff capability should exist at the branch level to analyze loan requests, develop customer-bank relationships, monitor use of loan funds and recover loans.

Credit clearinghouses. It has been recommended earlier in this report that "credit clearinghouses" be established on a area-wide basis, perhaps through the lead bank system or another mechanism.. The purpose of this service would be to enable branch managers to ascertain if a prospective borrower has other loans, if he is in default on other loans, or if the property offered as security is already encumbered.

Bank-to-client relationship. Only through a direct bank-to-client relationship can branch staff adequately determine a borrower's ability and willingness to repay a loan, and to effectively seek loan recovery. Under the SACP, the problems the UCCs pose in this regard have already been discussed, and it has been recommended that UCCs be eliminated from the credit system. Cooperative societies appear to play a similarly negative role in bringing about loan recovery. Recognizing that cooperatives serve a useful purpose in social and organizational development, it is not recommended that they be eliminated from rural credit; however, cooperatives should be required to act more responsibly in identifying borrowers and recovering loans. Cooperatives which knowingly falsify information on borrowers or security, or which default on loans, should be ineligible for new loans, and their members should be required to apply directly to the bank. Also, in cases where the cooperative itself is the borrower, unless it can provide sufficient collateral for the loan, the bank should have a direct agreement with individual members enabling the bank to have direct recourse against the borrowers in the event of default.

## III. Interest Rates

Interest rates are key to the viability and efficiency of a banking system. They are a major factor in mobilizing savings, and the spread between the bank's cost of funds (interest paid on deposits and borrowings) and interest earned on loans must be sufficient to cover the bank's expenses if it is to remain solvent. In Bangladesh, interest rates are set by the government in an effort to maintain affordable borrowing rates; however, rates are currently too low for banks to mobilize savings or cover their expenses.

From the savings mobilization perspective, unless banks offer real positive returns on savings, potential savers will be inclined to invest their money elsewhere (e.g., land, equipment, jewelry, etc). The country's current official inflation rate of about 12 to 15 percent is well above the 8 percent rate offered on basic savings accounts; thus, savers experience a real negative return of about -4 to -7 percent. Even savers with sufficient resources to invest in three-year certificates of deposit at 15 percent are barely keeping pace with the official rate of inflation, and unofficially the inflation rate is thought to be closer to 18 percent or even higher.

The inability to mobilize savings detrimentally affects the banking system's financial status. As shown in Table 4, the ratio of the branches' advances to deposits is nearly 200 percent, meaning that only one-third of all loans are made from local deposits. To cover this deficit, the branches borrow from the head office which increases the branches' cost of funds and narrows their interest rate spread. Even though the country's banks report positive net earnings, this income is based largely on accruals and does not represent cash-in-hand. In turn, head offices must resort to borrowing from the Bangladesh Bank, and to the extent that the Bangladesh Bank prints money to cover these transactions, it simply fuels inflation. Even if the Bangladesh Bank has available resources, by putting funds into the system well below the rate of inflation still increases demand and expands the money supply, which again pushes inflation higher. As a result, even a greater demand for credit is generated because it is more economical to borrow when rates are so low, and a vicious cycle develops which is counter-productive for the banking system.

From the lender's perspective, present interest rates on loans are too low to cover their costs. Table 18 shows the blended rate of interest paid on deposits and blended rate of interest earned on loans as of June, 1984, for NCBs and Specialized Banks. (Data for BKB alone is not available; however, BKB is a specialized bank, and these figures will be used for BKB in the following analysis.) As this table shows, NCBs have a positive spread of 5.61 percent and BKB realizes a positive 4.12 percent. These spreads, however, do not take into consideration operating expenses and bad debts.

TABLE 18

Interest spread as of 30/6/84
(Percentages)

| | NCBs | Specialized Banks |
|---|---|---|
| Interest earned on loans | 13.56 | 13.69 |
| Interest paid on deposits | 7.95 | 9.57 |
| Spread | 5.61 | 4.12 |

Assuming that the NCBs' average cost of administration is 5 percent (somewhat lower that the ACR's estimate but higher than the average shown in Table 1; see Section I), and that the loan loss rate is 6 percent, the actual spread on loans becomes a -5.39 percent, as follows:

| | |
|---|---|
| Interest earned | 13.56 |
| Less: | |
| Interest paid | 7.95 |
| Costs of Administration | 5.00 |
| Loan losses | 6.00 |
| Spread | -5.39 |

A similar scenario occurs with the BKB, though the spread is more favorable at only -2.88 percent, assuming BKB's administrative costs are 3 percent (see Section I) and loan losses are 4 percent (see Section II):

| | |
|---|---|
| Interest earned | 13.69 |
| Less: | |
| Interest paid | 9.57 |
| Costs of Administration | 3.00 |
| Loan losses | 4.00 |
| Spread | -2.88 |

In other words, every time these branches extend credit, they are taking a loss. However, since income is reported on an accrual basis and loan losses are not considered, on paper at least they can report modest net earnings. Thus, it is no wonder that the D/NCB discussed in Section I has stopped making all but the most secured loans in order to avoid losses, but prefers to send its surplus funds to the head office. From the D/NCB's perspective, it is more profitable to invest with the head office than to make loans, as the following illustrates.

Assuming the D/NCB's cost of funds is 8 percent, cost of administration is 5 percent, loan losses account for 6 percent, and interest earned on loans and head office deposits are 16 percent and 12 percent, respectively, the following options emerge:

Option #1: Making loans

| | |
|---|---|
| Interest earned | 16 |
| Less: | |
| Interest paid | 8 |
| Cost of administration | 5 |
| Loan losses | 6 |
| Spread | -3% |

Option #2: Investing at head office

| | |
|---|---|
| Interest earned | 12 |
| Less: | |
| Interest paid | 8 |
| Cost of Administration | 5 |
| Loan losses | 0 |
| Spread | -1% |

Under both options, D/NCB takes a loss, but the loss is minimized under Option #2. If the branch could lower its blended rate on deposits to 7 percent, by encouraging savers to open non-interest-bearing current accounts and 6 percent savings accounts, the office would at least break even. To break even under Option #1, deposit rates would need to be lowered to 5 percent. In fact, what this branch is doing is making only risk-free loans at 16 percent, and sending excess deposit funds to the head office where it earns 12 percent, and the blended rate of interest is sufficient to generate a profit since the loan loss rate on new loans is zero.

Table 19 provides a somewhat different perspective on this same issue. This table calculates the interest rates the NCBs would need to charge on loans just to break even, based on a branch's percentage of advances made from local deposits. At 100 percent, the cost of funds is assumed to be 8 percent. As the branch increasingly relies on head office funds at 12.5 percent, the blended cost of funds gradually increases. The combined costs of administration and bad debts remains constant at 11 percent. Table 4 provides information on 15 of NCB-1's rural branches, showing that only one-third of all advances are made from deposits. This current situation is reflected at the bottom of Table 19, showing that these branches would need to earn 22 percent on its loans just to break even without any profit margin. Loans are currently made at 16 percent; thus, these branches on the average take a 6 percentage point loss on each loan.[13]

## TABLE 19

**Calculation of Interest Rate Needed to be Charged by NCBs to Break Even (Percentage)**

| Percent of Advances Made From Deposits | Costs of Funds a/ | Allowances for Bad Debts and Administration b/ | Breakeven Interest Rate |
|---|---|---|---|
| 100 c/ | 8.00 | 11.0 | 19.0 |
| 90 | 8.45 | 11.0 | 19.45 |
| 80 | 8.90 | 11.0 | 19.90 |
| 70 | 9.35 | 11.0 | 20.35 |
| 60 | 9.80 | 11.0 | 20.80 |
| 50 | 10.25 | 11.0 | 21.25 |
| 40 | 10.70 | 11.0 | 21.70 |
| 30 | 11.15 | 11.0 | 22.15 |
| 20 | 11.60. | 11.0 | 22.60 |
| 10 | 12.05 | 11.0 | 23.05 |
| 0 | 12.50 | 11.0 | 23.50 |
| Current situation : d/ | | | |
| 33.4 | 11.00 | 11.00 | 22.00 |

a/ Assumes the balance of advances are made with borrowed funds from the head office on which the branch pays 12.5%.

b/ Assumes 6% for bad debts and 5% for administration.

c/ Assumes no reserve requirements.

d/ Based on average shown in Table 4.

---

The obvious conclusion from this discussion is that current interest rates are inefficient in mobilizing savings or ensuring the viability of the banking system. From the saver's perspective, it is more beneficial to borrow funds than to save; in a sense, a false demand for credit emerges. Branches must ultimately rely on the central bank's support to make loans, which in turn exacerbates inflationary trends and creates additional disincentives to save. From the lender's perspective, extending credit is a losing proposition, and if the D/NCB example is indicative, most banks are making loans only because they are required to do so. In the long run, the very activity from which banks generate income - making loans - will lead to their fiscal insolvency, unless they are heavily subsidized.

Recommendation

The interest rate structure should be rationalized. Interest rates on savings deposits should at least keep pace with inflation. Interest rates on loans should at least enable banks to cover the cost of funds, administrative expenses and loan losses.

4. Balance sheets and operating statements do not conform to standard accounting principles. Information which more appropriately belongs on an operating statement appears on balance sheets, and vice versa.

5. Records are not maintained on the ageing of loans.

6. Separate records are not maintained or poorly maintained on principal and interest payments.

7. Reporting formats are often extremely cumbersome; forms do not fit in a typewriter and are difficult to file.

## General Problem Areas

Below, four more generalized problem areas are discussed.

1. Number of reports. Even a cursory review of branch files shows a plethora of reports, many of which appear unnecessary, and this problem is simply exaggerated as information gets passed through the system. The ACR reports that nearly 300 reports are collected in the banking sector, and this needless duplication of effort requires as much as 60 percent of the branches' staff time.[15/] In rural lending, one reason which accounts for this problem is the number of specialized agricultural programs which have emerged over the years. The current excess of 60 special programs creates inefficiency in a number of ways. As already mentioned, the number of reports required is excessive. In addition, not all banks provide credit under all programs, so borrowers must go to more than one branch to meet their credit needs - unless they simply resort to moneylenders. These problems suggest the need to consolidate these programs, hopefully into only one or two special programs (perhaps a lower income farmers' program and a women's program), with most rural loans made through the Normal Program.

2. Combining accounts. Rural branches are obligated to extend credit under special programs; however, in general, funds provided through these programs are not separately accounted for, but combined with the branches' Normal Program loans. In turn, the success or effectiveness of these programs cannot be determined. Also, due to interest rate policies, the banks are faced with potentially higher losses, part of which the Bangladesh Bank is willing to absorb, but without separate accounting for these programs, these costs cannot be accurately, or at least fully, transferred back to the central bank. As long as banks are obligated to participate in social programs, separate accounts on these programs should be maintained.

3. Recent Bangladesh Bank efforts. Recently, the Bangladesh Bank has introduced six new forms (ACD/L/1 through 6) which are intended to consolidate over 30 existing forms. While recognizing that these forms represent a genuine effort to respond to the ACR and facilitate reporting requirements, they nevertheless embody many of the problems already present in the management information system. The forms are intended to be completed by individual branches and sent to the Bangladesh Bank, circumventing the normal channelling of information from branch to region to head office. The forms themselves

## IV. Management Information System

An effective and appropriate Management Information System is essential to the efficient operations of a banking system - or for any type of financial or administrative system. The MIS must provide consistent and accurate information for purposes of policymaking and planning. If the system is properly designed, it will not be cumbersome or excessively time-consuming, efforts will not be duplicated, and managers/planners at various levels in the system's hierarchy will not receive information irrelevant to their positions or priorities. In banking, a poor information system can lead to liquidity problems, adversely affect the quality of services to customers, and create irreparable harm to the system as a whole.

In Bangladesh, the information system under which the banks currently operate is largely inadequate. Many of the problems which define a bad information system are present, including inconsistencies, inaccuracies and duplication of efforts. The 1983 ACR report highlighted the following problems in the current information system: 14/

1. Information gathering, processing and/or transmitting is not coordinated.

2. Much of the information prepared by branches is redundant and requires needless duplication of effort.

3. Identical reports are often sent to head offices and the Bangladesh Bank.

4. Once introduced, reports are not evaluated for their continuing relevance, and new reports are constantly introduced, which simply increases the burden on the branches.

5. Available information is not adequate in terms of accuracy, detail or timeliness.

The field investigation for this report confirmed all of the ACR's findings. In addition, the following specific problems were identified which are commonly shared by most banks:

1. In most cases, banks at the branch, regional or head office levels cannot identify the number of loans made in any one year by the individual branches.

2. Information on branch activity is passed through regional or district offices to the head office, and copies of branch reports are not maintained in the regions despite their supervisory functions.

3. Reports prepared by branch staffs are inconsistent from one year to the next and between branches.

are unnecessarily complicated, with over 60 pages of coding instructions. Once the information is gathered in the proposed format, it is unreadable unless it is aggregated and presented in a different format. Moreover, the information these forms require of the branches is not really appropriate for central bank consideration. The issue is not whether the Bangladesh Bank should or should not have this information, but whether it needs this information to perform as the country's policymaker in banking operations. The Bangladesh Bank's time should not be spent aggregating data from thousands of rural branches; rather, this information should reach the Bank through normal channels.

The nature of these forms highlight another problem briefly mentioned above: the unnecessarily large number of specialized agricultural lending programs. Having separate programs for bananas, coconuts, fertilizers, etc., is an inefficient way to stimulate agricultural production, and certainly inefficient from a management perspective. Market conditions should define the flow of credit to certain crops or agricultural subsectors. Serious consideration should be given to consolidating these special programs into one or two programs targetted to particular income groups. As suggested above, one program might be targetted to women in recognition of their special needs, and another program for lower income farmers or landless peasants, again in recognition of their special needs. Based on the nature of information requested on these forms, it appears that much of the information is being gathered for donor agencies, which in turn suggests that these same agencies have been partly responsible for the proliferation of specialized lending. Typically, donors are interested in the plight of the poor and of women in developing countries; thus, by establishing well-managed programs which address these concerns, donors could be invited to support Bangladesh's own efforts to address lower income needs, rather than having the donors define for the country how it should ameliorate rural conditions. From management and paperwork perspectives, such an approach would certainly be an improvement over the current situation.

4. Instructions to branch staffs. Instructions to the branch staffs on how to complete reports, etc., are provided in two formats: procedural manuals and directives which amend the procedural manuals. The manuals themselves are bound, meaning that any changes to policy guidelines or procedures cannot be inserted into them. Instead, branch managers maintain separate files which are crammed full of directives, and these files are not indexed, meaning that retrieval of new instructions is difficult. New manuals need to be written in a usable format. When new instructions come from the head office, they should indicate which pages in the manual they replace. BKB is apparently in the process of writing new manuals along these lines, and this process should be extended to all banks.

## Reporting Income

Perhaps the single most disturbing aspect of the existing Management Information System is how banks report income. As noted throughout this report, loans are not classified by ageing and are almost never written off as

losses; instead, interest is accrued on all outstanding loans and reported as income in the branches' operating statements. As a result, actual financial performance is greatly distorted. For the banking system's managers, the task becomes almost impossible for determining if a branch is actually cost-efficient or generating net earnings, and in fact, most branches are not profitable given current interest rates and loan recovery performance. Since income is reported on an accrual basis, but expenses on a cash basis, the distortions become compounded.

As an example, the CCB branch highlighted earlier reported net earnings in 1982/83 of TK 13,666. In fact, a review of the branch's books show an actual loss of (TK 214,215), on a cash basis. This CCB branch's problems may overstate the case, given its extremely poor collections record, but the problem is still endemic to the entire banking system. Most of the branches on which data was gathered report year-end net profits, but these profits are largely paper transactions.

Table 20 shows indicators of financial performace for 15 of NCB-1's rural branches. Gross expenditures totalled 97 percent of gross income in 1984 - and remember, this income is largely based on accruals. In other words, on a cash basis, most if not all of these branches actually took a loss. Since these "profits" are reported to the head office, and in turn the head offices aggregate branch data to report the system's year-end status, it is probable that any net earnings reported by banks are simply based on paper transactions and in fact are not real. If this is the case, the implications for the banking system are staggering, and immediate corrective action is needed.

The system itself fosters these practices. If income is reported on an accrual basis, and no consideration need be given to bad debts, then the more loans branch employees make - whether good or bad - benefits them when their performance is reviewed. The practice of rolling over bad debts on the books simply conceals a poor recovery rate, and incomes appear high, so they become eligible for year-end bonuses or promotion.

Recommendations on Reporting Income

To correct these problems, the following steps need to be taken:

1. Clear guidelines on when loans should be written off need to be established, and a loan loss rate determined. This rate should be applied to new advances and these funds should be set aside in a reserve fund to protect the depositors' interests.

2. Loans that are clearly in default at the present time - such as pre-liberation loans - should be written off at this time.

3. Clear guidelines need to be established on how to report income and expenses. If income continues to be reported on an accrual basis, then expenses should also be accrued. Income on overdue loans should not be reported as "realized". A separate line item for "deferred" income might be appropriate, depending on whatever new accounting

TABLE 20

NCB-1 Year Ending June 30, 1984
Indicators of Financial Performance
(Percent)

| Branch | Total Assets (Taka) | Expenditures as as % of Gross Income | Net Income as % of Assets |
|---|---|---|---|
| A | 14,428,793 | 93.3 | .5 |
| B | 2,224,234 | 133.5 | (2.8) |
| C | 6,433,077 | 96.5 | .4 |
| D | 2,593,431 | 104.6 | (.4) |
| E | 12,481,461 | 95.3 | .5 |
| F | 13,911,557 | 89.4 | 1.0 |
| G | 7,202,380 | 94.9 | .6 |
| H | 8,048,531 | 90.1 | 1.1 |
| I | 11,948,707 | 94.2 | .6 |
| J | 4,564,031 | 89.8 | .9 |
| K | 1,599,810 | 117.4 | (1.8) |
| L | 3,698,021 | 81.5 | 2.5 |
| M | 6,312,378 | 83.6 | 1.8 |
| N | 3,215,365 | 99.3 | .1 |
| O | 6,683,792 | 90.0 | 2.6 |
| Average | -- | 96.9 | 5 |

procedures are introduced. In any case, a branch's accounts should reflect a more honest view of its actual operations in terms of income and expenses.

4. Each branch should be considered as its own cost center. A branch which consistently reports a loss on a cash basis, either due to staffing problems, location, recovery problems, etc., should be given target dates by which to improve performance, along with corrective actions to be taken. If the branch is unable to improve its performance, even after all remedial measures have been taken, then it should be closed.

These changes would need to be implemented in conjunction with other recommendations in this report - most notably, rationalizing the interest rate structure so that banks have an opportunity to generate sufficient income to cover expenses.

## Footnotes

1. Among other studies, Government of Bangladesh and the World Bank, Bangladesh Agricultural Credit Review (ACR), Volumes I, II and III, August, 1983. Also, Bangladesh Bank, U.S. Agency for International Development, and Public Administration Service, Rural Finance Experimental Project: Major Evaluation Report, January, 1982.

2. An acceptable level of administrative costs is somewhat context-specific. In developmental or high-risk situations, expenses incurred in loan transactions are typically higher than the costs associated with more conventional banking. A basic criteria for determining an appropriate or supportable level of administrative costs is whether or not interest rates can be raised to cover these costs while maintaining affordable rates.

3. See footnote #1.

4. The SACP is gradually being phased out, and all short-term crop production loans (generally 6-month terms but ranging up to 18 months) will fall under the purview of the UCCs. Only non-agricultural and longer term loans will be handled by branch staffs. As a result, problems already present in the UCC system will be magnified.

5. The actual composition of UCCs may be mandated by law, but in practice, some deviation occurs in the number of members and who they represent.

6. ACR, op. cit., p. 16.

7. Ibid., p. 19.

8. Ibid., Annexes 2 and 3.

9. Ibid., p. 29.

10. Ibid., p. 42.

11. Ibid., p. 20.

Footnotes - continued

12. One instance in which defaulted borrowers have been brought to court as a group has occurred in Maseru, Lesotho. The lender, the Lower Income Cooperative Housing Society (PTY), Ltd. ( a technical services organization), made mortgage loans to the members of the Mohalalitoe Housing Cooperative (MHC). MHC was the actual borrower, on behalf of its members. For years, the members did not repay the loans, and the court system proved to be cumbersome and costly in pursuing individual defaulters. This last year, the country's Registrar of Cooperatives who has legal authority in this case agreed to process the cooperative members as a group.

13. This analysis is intended to be illustrative of the interest rate problem, and not all the nuances of the situation are considered. For instance, it does not take into consideration a branch's reserve requirements which tend to increase its costs of funds since not all funds on deposit are able to be used for loans, causing the branch to borrow even more from the head office.

14. ACR, op. cit., p. 83.

15. Ibid., pp. 83-84.

# MOBILE BANKING FACILITIES (MBF)

## Action Plan for Extending Rural Bank Outreach in Bangladesh

June 1986

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# MOBILE BANKING FACILITIES

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## Executive Summary

In this proposal, mobile banking facilities (MBF) are presented in response to Subtasks A-6 and B-4 of the Bangladesh Bank/USAID Rural Finance Project (RFP) Terms of Reference calling for implementable action plans relating to savings mobilization and loan recovery for rural Bangladesh. MBFs address both issues simultaneously on an integrated basis An MBF is described as a 4-wheel drive Van capable of carrying a banking services staff of four plus driver and armed guard into unbanked and under-banked rural financial markets of Bangladesh; in short, a full-service rural bank branch facility on wheels.

MBF major objectives are (1) to bring depository and credit services to new-to-banking customers (1500 to 2000 out of 4472 Unions have no banks at all) (2) to accelerate collection of existing overdue loans belonging to other branches of the MBF sponsoring bank, (the average rural branch has as much as Tk. 4 million in loans overdue by more than two years) and (3) to render such other banking services as are normally available through branch banking facilities.

The primary sources of MBF income are projected on the basis of its realizing an effective rate of return of 7% on lending out its depository funds, and of receiving a fee equal to one-half of the interest due on collected overdue loans of other branches of the sponsoring bank based in the region served by the MBF. Estimates of MBF income are based on the performance of average rural bank branches as indicated by preliminary results of RFP studies and survey research. However, it is determined that MBF financial viability depends upon its performance being nearly 70% more productive than an average rural branch. Whether this can be achieved depends in the first instance upon whether the market potential actually

exists, and in the second instance, upon whether national banking policy will permit an MBF to operate competitively, aggressively and relatively freely in rural markets beyond a five mile radius of existing fixed location banking facilities. Further intensive pre-implementation empirical baseline surveying is recommended for dealing with the question of market potential. The second issue requires consideration of Bangladesh financial and banking policy makers

Financial analyses of the feasibility of introducing MBFs into rural Bangladesh assess five year forecasts of income and expenditures, cash flow, and balance sheets. The five year period is chosen because that is the expected life of the capital asset (i.e. the Van). These assessments are all promising. Internal rates of return (IRR) are also appraised under two assumptions. If an MBF would be income tax exempt, the IRR would be 20.4% , considerably above fixed term rates. If subject to income tax, IRR would be 12.5%, still better than the bank rate at which MBF capital funding is raised.

All in all, the RFP team recommends that the MBF concept be treated sympathetically and vigorously followed up.

# MOBILE BANKING FACILITIES (MBF)
## A Proposal for Extending the Out-reach of Rural Banks in Bangladesh

1. Introduction and Background:

1.1 The terms of reference of the Rural Finance Project (RFP) called for the development and delivery of two distinct "action plans" for consideration by the Bangladesh Bank (BB). One was to be concerned with improving loan recovery in rural Bangladesh (RFP Task B). A comprehensive loan recovery plan has now been prepared in draft format

1.2 The second action plan was to be concerned with increasing savings deposits and investments in financial assets in rural Bangladesh (RFP Task A). In the latter case many public relations and merchandising schemes came immediately to mind; some primarily concerned with motivating the bankers, others with educating and motivating potential savers and investors. Among those rather conventional direct approaches to savings deposit mobilization, the RFP bank marketing specialists believe that "Contract Savings Schemes" (CSS) would be most appropriate and productive under the conditions of banking (near) illiteracy that prevail among the poorest masses of rural Bangladesh. These and other schemes were reviewed in a working paper presented to BB in the summer of 1985. A "Contract Savings" action plan is being broken out from that general presentation and defined in more practical and operational detail.*

1.3 Among the ideas briefly introduced in the afore mentioned presentation was a Mobile Banking Facility (MBF) Scheme aimed at bringing banking services to the people, especially those people not resident in the market ("command") areas of existing stationary banking facilities. While originally conceived only in the context of facilitating saving mobi-

* See RFP "Contract Savings and Credit Scheme" Volume 5, Final Report, Rural Finance Project

lization, it immediately became apparent that initial capital and operating costs of rendering anything less than full banking services from an adequate vehicular base would not be feasible. To be financially viable (self sustaining) an MBF must be capable of expanding a particular bank's varied customer base within a given market area or territory and/or of servicing some or all of an established customer-base more effectively and profitably than can be done through ordinary stationary bank branch office facilities. Following several field investigations of branch bank operations and extensive interviewing of bank officers and staff, RFP Consultants became convinced there is a role to be played by MBFs in rural Bangladesh and that it is possible it might be accomplished on a self sustaining, if not profitable, basis. The following pages contain a proposed demonstration project by means of which to validate or refute the potentiality of MBFs in Bangladesh.

## 2. Evidence of the need for MBFs

2.1 During fact finding interviews with regional and branch managers an often mentioned constraint to improved market penetration was the limited out-reach capability of typical rural branch banks. Managers and senior officers are "tied to their desks" (willingly or otherwise): motorized personal transport (i.e. cars, cycles, whatever) are felt to be "un-affordable"; and sub-branches ("Krishi Shakhas") are considered useful but still relatively immobilizing of bank "customer services". There was a positive response from all branch managers regarding the need for more effectively bringing bank-ing services to people in the more remote rural areas presently unserved or under-served. One scheme of interest to all was introduction of mobile banking facilities in the form of "putting the bank on wheels" (or a "keel", perhaps) or in some way or other. ("Wings" were not mentioned!)

2.2 The RFP team presented the MBF notion in outline form to ACD/BB and to management of the Sonali Bnak. The conceptual model was based on employment of a mobile extension unit operating out of an existing large rural branch or regional office, preferably the latter in order to fully differentiate an MBF from being seen as just another branch serving its own immediate surrounding "command area" exclusively. Rather, it is hypothesized that the effective market of an MBF will be found to consist of the areas and people within a bank region which that bank's branches are unable to reach and serve efficiently; in other words, the interstitial area between bank branches. Sonali Bank was chosen as a first prospective sponsor due to the fact of it having the greatest number of rural branches (800); also, to the fact of it having pioneered a somewhat similar innovative program successfully in the development of its "Krishi Shakhas"; and finally to the fact that the Managing Director and Deputy Managing Director were supportive of the merits of the MBF concept, in general, and offered assistance of their bank in the further refining of the concept into a working model.

2.3 The RFP team conducted a fact finding field trip to Chittagong and Cox's Bazar (the area was suggested by Sonali Management) in the first week of November. Local Sonali Management kindly provided logistical support and knowledgable guidance. A diary of the tour is presented in Annex 1. The hospitality, cooperation and other contributions of Sonali Bank were invaluable to the team. The team was left in no doubt that <u>if</u> an MBF approach can prove financially viable, legally or politically allowable, and physically do-able anywhere, the Cox's Bazar area provides an extremely appropriate economic environment for it's implementation.

## 3. Objectives

3.1 The marketing strategy of the MBF would be designed to promote

achievement of these objectives:

- To increase investment in financial assets available through the Bank,
- to increase deposits in Savings Accounts,
- to improve loan appraisal and sanctioning practices, thus, improve the quality of loans,
- to increase bank market penetration beyond five mile command area parameters of existing bank branches,
- to improve loan recovery rates and reduce over-due and "stuck-up" loans, and last but not least,
- to increase use of the formal banking system as an alternative to the traditional "money lender" by large, medium and small-scale rural farmers, industrialists and businessmen.

3.2 It is submitted that such objectives can be realized through greatly increasing direct personal contacts between bankers and prospective depositors, investors, borrowers and loanees-in-arrears. Mobile banking facilities should contribute to such ends. To do so, they must be provided with competent officers and assistants. During the course of the proposed experimental project, rigorous monitoring by Sonali Bank and the Bangladesh Bank in order to make necessary adjustments as unforeseen problems arise, will be essential.

4. Some Specifics about the MBF, Itself, and its Deployment

4.1 The pilot project mobile bank facility envisaged at this time would be a four wheel drive motorized vehicle (van, bus or jeep) modified to accomodate a fireproof safe, storage space for supplies and records, a cashier window, and staff of up to five persons plus driver. The presently proposed budget assumes the vehicle to be a self-contained unit within a

reconditioned Van, that the Van would be used exclusively as an MBF, and that it would be garaged nightly at its business base in a Sonali regional office.

4.2 The van would be subject to daily preventive maintenance inspections and weekly and monthly servicing. It would travel to predetermined site(s) each day of each week excepting bank holidays. There would be a removable and portable shamiana extension protruding from the van to protect clients from the elements while socializing or conducting their banking business. Portable benches and collapsible chairs would be provided. The canvass awning, benches and chairs would be transported from site to site and stored in a roof top carrier.

4.3 For security reasons, sponsor identification would not be permitted on the vehicle itself. Signs would be erected at designated operating sites. These signs would include the following: name of the sponsor, days and hours of MBF visits, a statement that this is an experimental project of Bangladesh Bank and Sonali Bank to assist the Government in its objective of making banking services available to all people in the countryside, especially those out of reach of existing bank branch offices.

## 5. MBF Market Characteristics and the Issue of Competition

5.1 The market for an MBF needs still to be defined, and moreover, its perameters will probably need to be officially sanctioned. Meanwhile, from the field visits and preliminary survey data it appears that loanees come from as much as 20 miles from a branch while depositors rarely come from more than five miles away. Branches only four to five miles distance are usually reached on foot. Beyond that distance customers depend upon rickshaws or buses either of which, on the average, necessitate an average expenditure of thirty (30) taka. MBFs should

reduce distances and costs for both depositors and loanees.

5.2 An issue that arises at once is the question of within what range of existing bank office facilities will MBFs be allowed to compete. Ideally, the delimitation should be determined by which institution serves the market most beneficially in economic development terms. It is also very likely that some rural communities can support both MBFs and regular banking facilities. However, the RFP consultants do believe that the "lead bank" system of allocating marketing control and the practice of assigning unions to exclusive servicing by a single bank branch is anathma to the chances of MBFs being successful.

5.3 Once an MBF route has been established along with identification of particular places where the MBF will station itself to do business from day to day, no useful purpose is to be found in limiting who may or may not use the MBF's banking services. A restriction the consultants might find acceptable, if any is required would be to insist that MBF routes and business stations do not encroach upon existing banking offices by less than five miles, but it is felt even this is too extremely conservative and misguided from a modern marketing management oriented point of view.

5.4 So much for competition within Unions where banking facilities already exist. It is expected that beyond such Unions there are many that have never attracted construction or rental of any banking facilities at all. Such areas should be open territory for MBFs to operate without restriction.

5.5 Existing bank statistics reveal that about 3325 rural branches service 4472 unions. That would mean no more than 74% of these unions could have one bank apiece. However, branch banks tend to cluster in areas where they are present. The current situation

is one in which some unions have multiple banks and many others have few or none. It is estimated that about 1500 - 2000 unions may be unbanked. An MBF would not have to consider "command area trespassing" when it functions in an unbanked area.

5.6 Finally, it is wrong to consider competition only negatively. The possibility that MBFs can generate business for the established branches of the parent banking company need also to be recognized. Cooperation between branch bank Field Assistants and MBF staff should prove mutually beneficial. And, of course, more healthy competition between the several banking companies operating in rural Bangladesh can only be in the best interest of economic development and raising the standard of living.

## 6. An Experimental Approach is Proposed

6.1 It is proposed to present an MBF model capable of operating as a full service banking operation, extending all kinds of banking services possible to a thoroughly pre-delimited "command area" or market. It proposes that Soanli Bank collaborate with the RFP in an experimental demonstration or pilot project for testing the feasibility of introducing MBFs into the rural banking sector nationally. The demonstration would be conducted in Sonali Bank's Cox's Bazaar region unless further research indicates conclusively that other areas would be more appropriate.

6.2 The pilot MBF would market it's services (products) aggressively in an effort to show that a new-to-formal-banking customer base of borrowers and depositors can be built-up in unbanked or thinly banked rural areas of Bangladesh. It would also service existing customers located over five miles from any regular rural branches of the parent bank within the

command area of the regional office that provides its base of operations (i.e. Cox's Bazaar in the case of this pilot project).

6.3 For experimental control purposes, the pilot project area would be divided into two parts; an "experimental" part and a "control" part. Savings, new loans, and loan recovery performance would be compared over a period of two or more years to determine the impact of the MBF in the experimental part of the pilot market area as compared with the control part.

7. The Risks Involved

7.1 MBF may seem a conceptually tidy idea, but the risks involved are significant. It faces all the risks usually associated with new business ventures. It is completely unknown how the market will react or even the approximate size or composition of available MBF markets. The sponsor of the program should be cognizant of the problems involved. A single MBF unit may never be able to perform as well as a single rural branch bank. The vehicle's life of 5 years may be shortened due to road conditions that are worse than anticipated. The vehicle may break-down at inconvenient times and locations. There is the problem of security. And there is the fact that an MBF must work hard to gain consumer confidence. There is the additional issue of finding locations for the MBF to park at night when it is impractical to return to base.

7.2 Time and effort must be devoted to educating the market about the MBF concept. Publicity campaigns to create confidence in the minds of the people must be aimed at the local elite. Once the elite acquire confidence in the MBF, the rest of the market will follow. Gradually, as the MBF becomes established it may be able to diversify its products and services such as

by offering various National Savings Schemes including the RFP's proposed Contract Savings and Credit Scheme.

7.3 A careful analysis of the experience of Sonali Bank's Krishi Shakhas would be relevant and useful. In any case, the most thorough possible market research and feasibility analysis ought to be undertaken looking for a strong cash flow propensity with which to meet short term recurrent salary, vehicle operation, and maintenance and replacement expenses. Obtaining a positive return on investment may of necessity be gradual; no overnight profitability is guaranteed. However, it is submitted that a "test marketing" of the MBF concept may prove the most efficient method for appraising its financial viability and sorting out workable features, if any, from unworkable ones.

8. MBF Income Forecast (Table 1, Page 75)

8.1 The financial forecasts developed herein for an MBF are operational ones. Therefore, they differ from the more theoretical "break-even levels (BEL)" and sensitivity analyses previously developed by the RFP team prior to opportunities for more pragmatic assessment of MBF revenue and operating cost potentials.* The picture has considerably brightened. However, the cost forecasts still do not provide for technical assistance should any be required. Nor is there any guarantee that either BB, Sonali Bank or any other bank(s) will be interested in financing or sponsoring even an MBF Pilot Project, much less a national program. It is simply assumed that since the BB called for "action plans" such as the one proposed here, that if BB endorses an action plan, that it must possess or be able to obtain implementation funding.

8.2 In any case, this proposal is set forth as a bankable business proposition; one that an entrepreneur might take to his banker in a sincere quest for financing. From a sponsoring bank's

* See RFP "Comprehensive Savings Mobilization Action Planning report" Dec.15, 1986

point of view, the proposed MBF can be looked upon and operated as a "profit center" under its own independent and separate budget. However, although separately accountable budgetwise, similar to any bank branch, an MBF is not independent of the parent sponsoring bank legally, economically, organizationally, operationally or physically any more than is any branch of any bank.

8.3 This is an important observation because, for example, MBF staff must not be considered to be extra bank staff. They are simply alternative bank staff. The only difference is that MBF staff cover their "command areas" by vehicle whereas bank branch staff cover their "command areas" from fixed location offices. An MBF is a branch of a bank that is "on wheels" rather than in a "fixed-in-place" office facility. The critical difference is in the characteristics of the command area that each facility serves; the one being densely populated with considerable communications infrastructure, while the other is thinly populated with meagre communications infrastructure.

8.4 It is assumed MBFs will operate primarily in unbanked and underbanked communities. This being so, the more "fixed" banking facilities whose establishment can be avoided because of MBF operations, the greater the earnings will it be possible for an MBF to generate for its sponsoring bank.

8.5 Three basic sources of MBF income are envisaged:

(1) Interest Income: Like any bank branch, an MBF will generate deposits which it will lend to borrowers at prevailing rates, "sell" to headquarters, or otherwise reinvest. For the purposes of our forecasts the average interest cost of MBF generated deposits is estimated at 7.9% rounded to 8%. The average gross interest earnings

on these assets assumes most will be loaned out at an average effective rate of return of about 15%. Therefore, a gross interest yield of 7% is assumed.

(2) Loan Collection Fees : It is assumed that an MBF's "command area" will be populated by many borrowers from other branches of its bank who are in arrears on repayment of loans. It is assumed further that because of its mobility, an MBF will be able to collect some overdue and defaulted loans on behalf of the branch banks which advanced the loans. For this service, the collecting MBF is to be credited with a fee or commission equal to one half (50%) of the interest due with the collection; this, to be debited to the lending branch. In the case of disputes the Regional Manager's vote outweighs that of branch or MBF chief officer. However, either of the latter would be able to appeal to an appropriate office at the national headquarters level.

(3) Other Income is estimated at 2% of interest income and loan collection commissions. Included in this category are penalty charges charges for issuing of demand drafts other standard bank charges; investment dividends; fees and commissions for selling N.S.S. certificates, Prize Bonds WEDB, discounting of bills, and so forth.

8.6 The foregoing interest income estimates are based on observation of the average performance of rural bank branches as reflected in annual reports and in preliminary RFP field survey results. For example, the established average Sonali Bank rural branch generates about Tk. 5,120,000 deposits annually*. While an MBF can not be expected to reach this level immediately, it is forecast it will be able to greatly exceed that level in the course of 3 to 5 years.

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* Ibid: Footnote under Para. 8.1

8.7 It has been assumed that MBFs will make possible collection of many badly overdue loans by permitting bankers to meet directly with defaulters in their remote rural villages. Again, preliminary survey results indicate, as do BKB loan ageing data, that a large proportion of loan outstandings are overdue and that a considerable amount of these are more than two years overdue, the age at which interest accruals are authorized to be allocated to suspension accounts. It is proposed that MBFs target their loan collecting efforts on this category of overdue loans belonging to branch banks which, in turn, belong to the same region served by a particular MBF.

8.8 Preliminary RFP research results indicate that (in the case of BKB) for a typical rural region with an average number of 15 rural branches, an estimate of Tk. 2 million in collectable loans that are overdue by 2 or more years is a very conservative estimate.* An even more conservative estimate is that the total interest due on the Tk. 2 million in collectable loans is only 16% or Tk. 320,000.

8.9 Finally, it is submitted that by the fourth year of operation an MBF should be able to collect Tk. 2 million in loans that are over two years old and thereby earn one half of the interest due (Tk. 160,000) as a collection fee starting from only 25% of that amount in the first year of operation.

8.10 As regards income from Service Charges, MBFs will be unique in the matter of bringing banking services to the door-step of depositors as well as borrowers. In the process, it should be in an excellent position to render miscellaneous fee and commission based banking services to remote rural villagers. Our estimate of the value of this at only about 2.5% of total interest income loan is probably overly conservative.

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* An internal BKB report indicates that as of 1984/85 loans overdue by two or more years amounted to over Tk. 4 billion. Spread over 70 BKB regions that means over Tk. 57 million per BKB region, on the average. The MBF collection target is 3.5 percent of the total. It is assumed the branches themselves, will continue their own collection efforts.

8.11 An extremely rapid increase in MBF income is forecast. However, it should be noted that relative command area saturation is expected to be reached in about four years. It is believed this reflects the nature of banking, especially in an economy that is growing very slowly, if at all. Also, should rapid economic expansion occur within a command area, the logical response would be to introduce another MBF rather than expect the first MBF to increase its capacity. No doubt there is a limit to how much business a single MBF can handle efficiently. That limit is probably not much over Tk. 1 million per year in income.

9. MBF Expense Forecast (Table I, page 75)

9.1 Operating and administrative costs of an average Sonali rural bank branch have been estimated at about Tk. 220,000 p.a. based on preliminary RBBUS findings. Operating costs of an MBF are expected to exceed those of an average rural branch considerably; by as much as 68% including interest cost on capital loans. Therefore, our most fundamental assumption is that a mobile banking facility can operate much more efficiently and effectively in a thin or scattered market environment than can a stationary or fixed banking facility. The viability of the MBF depends on the validity of this assumption.

9.2 Initial funding of the MBF is to be provided through capital loans including a term loan in the amount of Tk. 650,000 and a Working Capital loan for Tk. 150,000 (See Cash Flow Forecast in Table 2, page 76).

9.3 The "Fixed asset" capital expense of Tk.650,000 covers

a) The CIF price of a 4-wheel drive van or mini-bus including CDST and Development Tax (Tk.584,000), plus

b) Tk.16,000 to make permanent vehicle modifications (cashier's window and cage, security dividers, roof top rail and awning fixtures, steps, etc., and to purchase folding chairs, tables, cash box, water proof shamiana/ tarp, guard station equipment, storage drawers/shelves for office supplies, special lighting arrangements, officer work station, and so forth.

9.4 The MBF vehicle and equipment salvage value after five years is estimated at 30% (Tk.200,000). The balance (Tk.450,000) is to be written off over the five years in equal annual depreciations.

9.5 The working capital is needed to defray deficit operating expenses, especially salaries, during the first two years after which it is expected that current income will exceed operating expenses.

9.6 Annual income Tax at 60% of net profit is to be paid in beginning of year after the year in which the profit is earned

9.7 MBF Vehicle operating cost estimates are considered reasonable but, of course, this is a very unpredictable area with the chances of accidents and breakdown quite unknown. However, the estimate for tires, batteries and accessory replacements and for fuel should be quite accurate.

9.8 The largest operating cost that is most difficult to assess arises under the "Salaries & Benefits" line. What is the optimal staff for an MBF? Because the effort in going to the customer rather than vice versa is much greater, can the right quality staff be assigned or recruited without some extra incentive being offered? Given the amount of MBF staff

non-productive travel time during working hours - perhaps averaging 2 hours each work day - how will it be possible for MBF officers to handle the same or larger numbers of customers on a daily basis than their counterparts who work only in fixed rural branch bank facilities? Clearly, the chances of MBF's proving viable will depend largely on answers to questions such as these. In estimating salary and benefit requirements, prevailing official standards have been observed. However, it is recognized that an MBF pilot project may demonstrate that present standards may need to be raised in order for an MBF to be successful.

9.9 Assignment to an MBF unit is to be considered a full-time job even though post banking hours (from 11 a.m. on Thursdays and from 1 p.m. on other work days) will be spent travelling back to the regional base office and working in that office until close of the business day.

9.10 The cost of MBF monthly salaries including all benefits applicable to bank employees comes to Tk. 16,116 which amounts Tk. 193,392 annually. The following chart presents the computation of these estimates.

MBF Monthly Salary and Benefits Computation

| Employee category | No. | Basic (Tk.) | Housing (.40xBasic) | Conveyance (Tk.) | Medical (Tk.) | Bonus (3.5xBasic)/12 | Total (Tk.) |
|---|---|---|---|---|---|---|---|
| Officer | 1 | 2,400 | 960 | 20 | 100 | 700 | 4,180 |
| Field Asstt. | 1 | 1,650 | 660 | 20 | 100 | 482 | 2,912 |
| Clerk | 1 | 1,350 | 540 | 20 | 100 | 394 | 2,404 |
| Cashier | 1 | 1,350 | 540 | 20 | 100 | 394 | 2,404 |
| Guard | 1 | 1,000 | 400 | 20 | 100 | 292 | 1,812 |
| Driver | 1 | 1,350 | 540 | 20 | 100 | 394 | 2,404 |
| Total | 6 | 9,100 | 3,640 | 120 | 600 | 2,656 | 16,116 |

9.11 Other Office Expenses: The estimate of Tk. 20,000 annually to cover MBF share of office supplies, postage, utilities steno, messenger and peon services is pure guesswork at this stage. Six employees will make their base of operations at a bank's regional office. Some regional offices will be able to handle this without costly modifications; others will find it more difficult; and some, impossible. It may prove that some large branch banks are in a better position to accommodate MBF operations. However, if a pilot project is mounted with Sonali Bank in Cox's Bazaar, the RFP team believes the regional office could accommodate the project.

9.12 Promotion Expenses: The estimates for promotion espenses are modest in the extreme at only 1.5% of income and 3.1% of operating cost. However, they are much greater than the Bangladesh banking system is used to, and it seemed prudent to be as parsimonious as possible in this area. Actually, it is considered that the routine comings and goings of the MBF vehicle may be its most effective advertising, but there surely will also need to be village level promotional meetings, campaigns to win the support of local elites, radio commercials, and so forth.

## 10. Financial Analysis of MBF Pilot Project

### 10.1 MBF Costs and Sources financing

10.2 The total cost of a motorized MBF has been estimated at Tk. 800,000. It is assumed that the total MBF investment cost will be financed out of borrowed funds. The cost of the project (one MBF) and means of its financing are as follows :

| MBF costs | Tk. |
|---|---|
| - Cost of a vehicle | 584,000 |
| - Cost of equipment | 14,000 |
| - Contingency cost (5%) | 30,000 |
| - Preliminary expenses | 20,000 |
| Total sunk cost | 650,000 |
| Working capital | 150,000 |
| Total cost: | 800,000 |

| Sources of finance | |
|---|---|
| - Term loan at (11.25%) | 650,000 |
| - Working capital loan (at 8% average) | 150,000 |
| Total finance: | 800,000 |

10.3 Financial projections: The length of an MBF financial projection is related to expected duration of operating efficiency of the vehicle. This has been assumed to be five years. Hence the MBF's financial data have been projected for five years. Financial projections include income and expenditure forecasts, cash flow forecasts, and projected balance sheets. The internal rate of return (IRR) has also been computed by discounted cash flow method.

10.4 Income and expenditure forecasts: MBF's income potential, and estimates of important categories of expenses are given in Table 1, page 75 . A summary is presented below:

Summary of income and expenditure forecast

| Income | Year 1 (Tk.) | Year 2 (Tk.) | Year 3 (Tk.) | Year 4 (Tk.) | Year 5 (Tk.) |
|---|---|---|---|---|---|
| - Interest income | 178,500 | 357,000 | 535,500 | 714,000 | 714,000 |
| - Loan collection fees | 40,000 | 80,000 | 120,000 | 160,000 | 160,000 |
| - Other income | 4,400 | 8,700 | 13,100 | 17,500 | 17,500 |
| Total income (A) | 222,900 | 445,700 | 668,600 | 891,500 | 891,500 |
| Operating expenses | 371,000 | 388,400 | 405,900 | 423,300 | 440,800 |
| Operating profit/(loss) (B) | (148,100) | 57,300 | 262,700 | 468,200 | 450,700 |
| Financial expenses | 85,100 | 85,100 | 85,100 | 60,700 | 36,300 |
| Net profit/(loss) (C) | (233,200) | (27,800) | 177,600 | 407,500 | 414,400 |
| Income tax(60%),provision for: | - | - | -* | 194,460 | 248,640 |
| Profit after tax (D) | (233,200) | (27,800) | 177,600 | 213,040 | 165,760 |
| Ratios | - | | | | |
| Gross margin (B ÷ A) | - | 12.9% | 39.3% | 52.5% | 50.5% |
| Net margin (D ÷ A) | - | - | 26.6% | 23.9% | 18.6% |

* There is no provision for tax in 3rd year because years 1 and 2 losses exceed 3rd year surplus. A profit does not occur until Tk.83,400 net operating surplus in the 4th year has been realized.

10.5 Comments on Income and Expenditure Forecast

a. MBF should be in a position to earn operating surpluses from the 2nd year of operation and thereafter. The first year will be devoted to overcoming teething problems and creating a customer-market base. A large deficit is anticipated in that year. Also, as the project is to be 100% debt financed involving a relatively high burden of financial expenses, a net loss of Tk. 27,800 will occur

in the second year inspite of a projected operating surplus of Tk.57,300. The net earning situation will substantially improve from the third year of MBF operation.

b. Standards for comparison of gross and net margin ratios are not available. However, as a wholly self financing profit centre, the ratios for the MBF do appear to be attractive.

c. Over a 5 year period MBF will earn an aggregate net profit of Tk.738,500 (pretax) after absorbing the net losses expected during the first two years. The annual average pretax profit works out to Tk.147,700. This compares favorably with early tabulations of RBBUS Branch level data which indicated average Sonali rural branch profits of Tk.100,000 annually.*

d. Assuming a tax exemption situation for the MBF in line with tax holiday benefits allowed to new industrial ventures, the amount of MBF's profits alone over the 5 years would permit acquisition of a replacement vehicle without recourse to borrowed capital.

e. By the end of the fifth year the pre-tax funds generation would also cover the cost of a new vehicle. This is explained in the projected cash flow section, below.

10.6 Cash flow forecasts: Based on the foregoing investment and profitability estimates cash flow forecasts have been worked out for 5 years and are presented in Table 2, page 76. These are summarized below :

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* Ibid: Para 8.1: Refer to P.78 of the report

Summary of cash flow forecasts

| Year | Beginning cash balance (Tk.) | Cash generation during the year (Tk.) | Cash disbursements during the year (Tk.) | Cash surplus/ deficit during the year (Tk.) | Closing cash balance (Tk.) |
|---|---|---|---|---|---|
| 0 | - | - | - | - | 150,000 |
| 1 | 150,000 | 90,000 | 233,200 | (143,200) | 6,800 |
| 2 | 6,800 | 147,000 | 85,200 | 62,200 | 69,000 |
| 3 | 69,000 | 352,700 | 302,100 | 50,600 | 119,600 |
| 4 | 119,600 | 558,200 | 277,700 | 280,500 | 400,100 |
| 5 | 400,100 | 540,700 | 597,060 | (56,060) | 344,040 |

10.7 The forecasts indicate that MBF will have difficulty in meeting its cash operating costs out of the cash generation in the first year when most of the working capital funds will be used. Afterwards, MBF should have no difficulty covering financial expenses and repaying the term debt. The operating cash deficiency in the terminal year arises because of the large payments on account of term debt, working capital loan, and the payment of taxes relating to the previous year will take place in that year. However the cash build up from preceding years will be adequate to offset the pressure on the cash position and still leave a large cash balance at the end of the 5th year.

10.8 As noted earlier in the income forecast section (Para 10.5.e), the funds accumulation at the end of the 5th year will be as under :

| Tax Status | Ending Cash Balance Tk | + | Salvage Value Tk | + | Taxes Exempted Tk | = | Total Funds Accumulation Tk |
|---|---|---|---|---|---|---|---|
| - Taxes Paid | 344,040 | + | 200,000 | + | - | = | 544,040 |
| - Taxes Exempted | 344,040 | + | 200,000 | + | 194,460 | = | 738,500 |

10.9 By the end of fifth year of its operation, MBF will be able to generate operating funds (after meeting all operational and financial expenses, retirement of debts and payment of taxes) amounting to Tk.344,040 which, plus Tk.200,000 in vehicle salvage value, comes to Tk.544,040. This amount equals 86% of the cost of acquisition of a new vehicle assuming a price of Tk. 630,000. If the tax payment on MBF's earnings is exempted on account of its being a (a) new venture and (b) part of branch net work system of the bank under which tax happens to be a head office obligation, the aggregate funds generation (Tk.738,500) will be adequate not only to buy a new vehicle out of its own funds, but it will also be able to finance 72% of its working capital requirement of Tk.150,000. In other words, an MBF is expected to be virtually self financing by the end of the fifth year of its operation.

11. Projected Balance Sheets: (Table 3, Page 77)

11.1 The estimated asset and liability structures of the MBF during the start-up period and the succeeding five years are presented at Table 3. The facility, even though assumed to be developed out of 100% borrowed funds, has the potential to largely reverse the debt position by the fifth year, and acquire a net equity of Tk. 295,400 by way of retained earnings. The consistent decline in the fixed asset base represents the effect of writing off the vehicle, equipment, and preliminary expenses over the five year period on a straight line method of depreciation.

12. The internal rate of return (IRR): (Table 4 & 5, Page 78 & 79)

12.1 The marginal efficiency of investment in an MBF venture can be calculated on the basis of its IRR. The IRR would equate

cost (or investment outlay of an MBF with the present value of net cash generation over the five years of its projected operation at an appropriate discount rate. This has been worked out and given at Table 4. IRRs for the MBF work out as under:

Tax Exempt : 20.4%
Tax Paid : 12.5%

12.2 The pretax IRR is much higher than the going maximum fixed deposits rate of 15%. Even the post Tax IRR is greater than the cost of the term loan at the bank rate of 11.25%.

13. Conclusion

13.1 The RFP team believes an MBF approach to extending rural banking out-reach is worth persuing, especially if a sponsor such as Sonali Bank is willing to support an experimental pilot project. If such support is available but does not include financing of the MBF capital investment (Tk.800,000), then it is recommended that availability of USAID financing be investigated.

13.2 Quite legitimately, potential sponsors may call for more pre-implementation field research in order to reduce the risk of an abortive start-up. It would certainly be desirable to be able to identify under- and unbanked unions and describe the socio-economic characteristics of their populations and their accessibility by 4 wheel drive vehicle. It is not possible to have too many facts about a test market area. At the same time, a national survey is not called for at this stage. Four or so rural bank regions could be chosen quite purposively as was Cox's Bazaar by Sonali and then subjected to intensive empirical base-line surveying. Even if it is elected to go ahead with implementation in Cox's Bazaar, such further base-line research is strongly recommended by the RFP team.

Table 1

MBF
Income and Expenditure Forecasts

| | | Year 1 (Tk.) | Year 2 (Tk.) | Year 3 (Tk.) | Year 4 (Tk.) | Year 5 (Tk.) |
|---|---|---|---|---|---|---|
| **Income*** | | | | | | |
| a. Interest income | | 178,500 | 357,000 | 535,500 | 714,000 | 714,000 |
| b. Loan collection fees | | 40,000 | 80,000 | 120,000 | 160,000 | 160,000 |
| c. Other income | | 4,400 | 8,700 | 13,100 | 17,500 | 17,500 |
| Total Income (A) | | 222,900 | 445,700 | 668,600 | 891,500 | 891,500 |
| **Operating Costs** | | | | | | |
| - Vehicle operating costs - | | | | | | |
| : Fuel (Diesel) | 28,000 | | | | | |
| : Supplies | 12,000 | | | | | |
| : Repairs & Servicing | 8,000 | | | | | |
| : Insurance | 7,000 | | | | | |
| : Garaging | 3,000 | 58,000 | 63,800 | 69,600 | 75,400 | 81,200 |
| - Administrative expenses - | | | | | | |
| : Salaries & Benefits | 193,000 | | | | | |
| : Office Supplies | 10,000 | | | | | |
| : Postage, shipping, etc. | 5,000 | | | | | |
| : Base office support expenses | 5,000 | 213,000 | 223,600 | 234,300 | 244,900 | 255,600 |
| - Depreciation on vehicle (Tk.650,000 - 200,000) ÷ 5 | | 90,000 | 90,000 | 90,000 | 90,000 | 90,000 |
| - Promotion expenses | | 10,000 | 11,000 | 12,000 | 13,000 | 14,000 |
| Total Operating Cost (B) | | 371,000 | 388,400 | 405,900 | 423,300 | 440,800 |
| - Operating profit/(loss) (C) = (A- B) | | (148,100) | 57,300 | 262,700 | 468,200 | 450,700 |
| **Financial expenses** | | | | | | |
| - Interest on term loan Tk. 650,000 @ 11.25% | | 73,100 | 73,100 | 73,100 | 48,700 | 24,300 |
| - Interest on working capital loan (8% p.a. average) | | 12,000 | 12,000 | 12,000 | 12,000 | 12,000 |
| Total Financial Expenses (D) | | 85,100 | 85,100 | 85,100 | 60,700 | 36,300 |
| - Net profit/(loss) (C- D) | | (233,200) | (27,800) | 177,600 | 407,500 | 414,400 |
| - Income tax provisions | | - | - | - | 194,460 | 248,640 |
| - Profit after tax | | (233,200) | (27,800) | 177,600 | 213,040 | 165,760 |
| | | = = = = | = = = = | = = = = | = = = = | = = = = |

* See text paras 8.5- 8.8

Table 2

MBF
Cash Flow Forecasts

| Particulars | Prestart-up (Tk.) | Year 1 (Tk.) | Year 2 (Tk.) | Year 3 (Tk.) | Year 4 (Tk.) | Year 5 (Tk.) |
|---|---|---|---|---|---|---|
| **Source of funds** | | | | | | |
| Term loan | 650,000 | - | - | - | - | - |
| Operating profit (before interest and taxes | - | - | 57,300 | 262,700 | 468,200 | 450,700 |
| Depreciation & write offs | - | 90,000 | 90,000 | 90,000 | 90,000 | 90,000 |
| Increase in deposits | | 2,550,000 | 2,550,000 | 2550,000 | 2550,000 | - |
| Increase in working capital | 150,000 | - | - | - | - | - |
| Sale of vehicle | - | - | - | - | - | - |
| Total sources (A) | 800,000 | 2,640,000 | 2,697,300 | 2902,700 | 3108,200 | 540,700 |
| **Utilization of fund** | | | | | | |
| Capital expenditure | | | | | | |
| - Vehicle | 584,000 | - | - | - | - | - |
| - Equipments | 16,000 | - | - | - | - | - |
| - 5% contingency on vehicle & equipment | 30,000 | - | - | - | - | - |
| - Preliminary expenses | 20,000 | - | - | - | - | - |
| Increase in loans and investments | - | 2,550,000 | 2,550,000 | 2550,000 | 2550,000 | - |
| Repayment of term loan | - | - | - | 217,000 | 217,000 | 216,000 |
| Repayment of working capital loan | - | - | - | - | - | 150,000 |
| Payment of interest on loans | | 85,100 | 85,100 | 85,100 | 60,700 | 36,300 |
| Payment of taxes | - | - | - | - | - | 194,460 |
| Operating losses | - | - | - | - | - | - |
| Total utilization (B) | 650,000 | 2,783,200 | 2,635,100 | 2852,100 | 2827,700 | 596,760 |
| Cash surplus/(deficit): (A - B) | 150,000 | (143,200) | 62,200 | 50,600 | 280,500 | (56,060) |
| Opening balance | - | 150,000 | 6,800 | 69,000 | 119,600 | 400,100 |
| Closing balance transferred to balance sheet (table 3) | 150,000 | 6,800 | 69,000 | 119,600 | 400,000 | 344,040 |

Table 3

MBF
Projected Balance Sheets *

| | Prestart-up (Tk.) | Year 1 (Tk.) | Year 2 (Tk.) | Year 3 (Tk.) | Year 4 (Tk.) | Year 5 (Tk.) |
|---|---|---|---|---|---|---|
| ASSETS | | | | | | |
| - Cash | 150,000 | 6,800 | 69,000 | 119,600 | 400,100 | 344,040 |
| - Loans and Investments | - | 2,550,000 | 5,100,000 | 7,650,000 | 10,200,000 | 10,200,000 |
| - Vehicle, equipment & preliminary expenses | 650,000 | 560,000 | 470,000 | 380,000 | 290,000 | 200,000 |
| Total | 800,000 | 3,116,800 | 5,639,000 | 8,149,600 | 10,890,100 | 10,744,040 |
| LIABILITIES | | | | | | |
| - Provision for taxation | - | - | - | - | 194,460 | 248,640 |
| - Working capital loan | 150,000 | 150,000 | 150,000 | 150,000 | 150,000 | - |
| - Deposits | - | 2,550,000 | 5,100,000 | 7,650,000 | 10,200,000 | 10,200,000 |
| - Long term loan | 650,000 | 650,000 | 650,000 | 433,000 | 216,000 | - |
| - Accumulated profit/(loss) | - | (233,200) | (261,000) | (83,400) | 129,640 | 295,400 |
| Total | 800,000 | 3,116,800 | 5,639,000 | 8,149,600 | 10,890,100 | 10,744,040 |

* Based on the numbers contained in the income and expenditure forecasts and the cash flow forecasts.

Table 4

## Internal Rate of Return (IRR)

(Income Tax Paid)

| Year | Cost | Benefits | | | Net benefits | Discounted cash flow | |
|---|---|---|---|---|---|---|---|
| | | Earnings after tax but before interest | Depreciation | Total | | Discount factors at 12% | Discounted cash flow |
| 1 | 2 | 3 | 4 | 5 | 6 = 5-2 | 7 | 8 = 6 x 7 |
| | (Tk.) | (Tk.) | (Tk.) | (Tk.) | (Tk.) | | |
| 0 | 800,000 | - | - | - | (800,000) | 1.0000 | (800,000) |
| 1 | - | (148,100) | 90,000 | (58,100) | (58,100) | 0.8929 | (51,877) |
| 2 | - | 57,300 | 90,000 | 147,300 | 147,300 | 0.7972 | 117,428 |
| 3 | - | 262,700 | 90,000 | 352,700 | 352,700 | 0.7118 | 251,052 |
| 4 | - | 273,740 | 90,000 | 363,700 | 363,740 | 0.6355 | 231,157 |
| 5 | - | 202,060 | 90,000 | 292,060 | 292,060 | 0.5674 | 165,715 |
| 6 | - | - | - | - | 200,000 | 0.5066 | 101,320 |
| | | | | | | Total | 14,795 |

IRR = 12.50% (appx.)

Table 5

## Internal Rate of Return (IRR)
(Income Tax Exempt)

| Year | Investment Cost | Benefits | | | Net benefits | Discounted cash flows | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Earnings before interest and taxes | Depreciation | Total | | Discount factors at 20% | Discounted cash flows | Discount factors at 21% | Discounted cash flows |
| 1 | 2 | 3 | 4 | 5 | 6 = 5-2 | 7 | 8 = 6x7 | 9 | 10 = 6x9 |
| | (Tk.) | (Tk.) | (Tk.) | (Tk.) | (Tk.) | | (Tk.) | | (Tk.) |
| 0 | 800,000 | - | - | - | (800,000) | 1.000 | (800,000) | 1.000 | (800,000) |
| 1 | - | (148,100) | 90,000 | (58,100) | (58,100) | 0.833 | (48,397) | 0.826 | (47,991) |
| 2 | - | 57,300 | 90,000 | 147,300 | 147,300 | 0.694 | 102,226 | 0.683 | 100,606 |
| 3 | - | 262,700 | 90,000 | 352,700 | 352,700 | 0.579 | 204,213 | 0.564 | 198,923 |
| 4 | - | 468,200 | 90,000 | 558,200 | 558,200 | 0.482 | 269,052 | 0.467 | 260,679 |
| 5 | - | 450,700 | 90,000 | 540,700 | 540,700 | 0.402 | 217,361 | 0.386 | 208,710 |
| 6 | - | - | - | - | 200,000 | 0.335 | 67,000 | 0.319 | 63,800 |
| | | | | | | | 11,455 | | 15,273 |

IRR = 20.4% (appx)

Memo

To : Dr. Lincoln Armstrong

From : O'Donnell, Molla, Behymer

Re : Mobile Bank Facility - fact finding field trip

Update :

On Saturday November 2, 1985 the team departed by van for Chittagong. At the Chittagong division office of the Sonali Bank we were cordially received by Mr. Mahtabuddin Khondkar, the general manager. He confirmed that he had been informed by the management at the head office to expect the team. He was briefed on the concept and our purpose for visiting his region. He had already advised Mr. Mahbubul Hoque the assistant general manager at Cox's Bazar of our pending arrival. Sunday November 3rd the team departed for Cox's Bazar accompained by Mr. Shawkat from the Chittagong division office. On route visits were made at Chakaria, Dulahazara and Ramu branches of Sonali Bank. Monday, Mr. Hoque accompanied the team to the Taknaf and Ukiya branch offices.

Similiar interviews were made with all the branch managers and data on banking activity was gathered. The model presented was that of a mobile branch facility offering full bank services. It would be stationed at a designated location and could be supported by a motor bike to further extend the command area. The concept was supported by all branch managers, the assistant general manager and the general manager.

The findings of the team were as follows :

* The geographic area as recommended by Sonali Bank was acceptable.
* Deposit growth of the Sonali rural branches was impressive. Teknaf, Ramu, Chakaria, and Dulahazara branches account for about 50% of the total deposits of 85 million (taka) in the Cox's Bazar region.
* A sufficient number of sites without banks exist to locate a mobile facility which would avoid any undue injury to competing banks in the area.
* The economy of the area was diversified - agriculture, fisheries, forestry, wood products, transportation, retail and cottage industries.

Budget

A preliminary budget was prepared including the projected needs for supervision, equipping, supplying, training, staffing and logistical expenses. Certain assumptions on the amount of support from the Sonali Bank and technical supervision were considered in the draft projections.

Conclusions

From our review of the draft budget and relevant Sonali branch bank financial statements we find that the use of major capital equipment in a major savings mobilization or loan recovery program to be financially prohibitive.

Down scaling the project or modifying it to include other activities produced a result so marginal that prudent judgement would recommend against attempting to implement the program without very firm agreement on the revenue assumption and a solid Appreciation of the risks involved by the client.

We have promised to provide a status report to the deputy managing director of the Sonali Bank on Tuesday, November 12th.* The report will be verbal, be full of our gratitude for their assistance in Cox's Bazar but generally negative in other respects.

---

* This was done.

TOUR DIARY OF CONSULTANT TEAM'S VISIT TO SOME BRANCHES OF SONALI BANK CHITTAGONG AND COX'S BAZAR DISTRICTS DURING NOV 2-6, 1985 ON FEASIBILITY STUDY FOR MBF

During the first week of November, 1985 a study team cousisting of Mr. A.J. O'Donnell, Mr. George Behymer and Mr. M.A. Majid Molla visited a few branches of Sonali Bank located in Chittagong and Cox's Bazar Districts to see the possibility of introducing mobile banking facilities for the purpose of improving loan recovery and deposit mobilization in those areas. The tour diary of the Team is given below :

| Date | Time | Itinerary | Work done |
|---|---|---|---|
| 2 Nov.(SA) | 0730 | Left Dhaka | |
| | 1430 | Reached Chittagong | Discussion with G.M. SB, Chittagong regarding purpose of visit. |
| 3 Nov.(SU) | 0800 | Left Chittagong visited SB Branches at Lohagara, Dulhazara, Chakoria and Ramu | Discussion with branch managers regarding problem of loan recovery and deposit mobilization. |
| | 1500 | Reached Cox's Bazar | Discussion with AGM, SB Cox's Bazar Region. |
| 4 Nov.(MON) | 0800 | Left Cox's Bazar with AGM, SB | Visited a Shrimp Farm. |
| | 1100 | Reached Teknaf | Discussion with Branch Manager, SB, Teknaf Branch regarding loan recovery and deposit mobilization problems. |
| | 1500 | Left Teknaf | Visited Ukhiya Branch of Sonali Bank. |
| | 1600 | Reached Ukhiya | Discussed with Branch Manager about loan recovery and deposit problems. |
| | 2000 | Reached Cox's Bazar | |
| 5 Nov.(TU) | 0800 | Left Cox's Bazar | Discussed with AGM, SB Potiya about loan recovery and deposit mobilization problems and prospects of improvement through mobile banking facilities. |
| | 1100 | Reached Potiya, R.O. of Sonali Bank | |

| Date | Time | Itincrary | Work done |
|---|---|---|---|
| 5 (Nov) | 1400 | Reached Chittagong | Visited SB Branches at Raozan and Hathazari and discussed loan recovery problems with the branch managers. |
| | 1530 | Left for Raozan and Hathazari, withone office of SB. | |
| | 20.00 | Returned to Chittagong | |
| 6 Nov.(Wed) | 10.00 | | Discussion with GM Sonali Bank Chittagong G.M BB Chittagong and DGM, BKB Chittagong |
| | 12.30 | Left Chittagong | |
| | 19.30 | Reached Dhaka. | |

Note : During Branch visits, the Branch Managers were asked to answer questions (as per questionnaire prepared by Mr. A.J.O'Donnell) which related to environmental situation within the command area, credit restrictions, problems and prospects of loan recovery, staffing pattern and management problems of the bank branch concerned.

On returning from the tour Mr. George Behymer, had on behalf of the team verbally reported to the Project Manager, on what was observed and then the final report was prepared and submitted. Suggisting an MBF Project on experimental basis.

( M.A. Majid Molla )

# RURAL FINANCE PROJECT: LEGAL ASPECTS

July 1985

by

Samuel A. Sherer

## ACKNOWLEDGEMENTS

This report was completed in consultation with my legal counterpart, Barriseter Nazmul Huda of Chancery Chambers, and with Judge L.R. Taluqder and Advocates Towricur Rahman and Mrs. Dilruba Shahana of his office. It could not have been completed without their help. In addition, the report reflects innumerable discussions with the banking members of the Rural Finance Project, as well as discussions with banking officials of the Bangladesh Bank, the Krishi Bank and the four nationalized commercial banks.

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# RURAL FINANCE PROJECT: LEGAL ASPECTS

## EXECUTIVE SUMMARY

### I. INTRODUCTION

The purpose of this report is to review existing laws and regulations which affect the rural finance system with particular reference to the identification of problems concerned with loan recovery and savings mobilization. Although it makes initial recommendations with regard to changes required to improve that system, a final set of detailed recommendations will be made after the review of lending and deposit practices is completed and when the results of the survey of borrowers and branch managers is available.

The general conclusion is that no major changes of law are required to improve the performance of the Rural Finance System. What is required is more effective implementation of existing provisions and the establishment of more precise regulations and procedures in certain areas, particularly with regard to the credit passbook and the system for identifying and policing overdue loans.

### II. LOAN RECOVERY ISSUES

The major emphasis of the review has been placed upon issues concerned with loan recovery. This is appropriate given the large amount of discussion regarding loan recovery within the government and with the international donor agencies over the past few years and its importance with regard to the viability of the rural banking system. The discussion here is necessarily general in nature as it has been formulated without the benefit of detailed information regarding overdue loans (by type of loan and loan program, size of loan, type of borrower, record of payment and reason for default) that will be collected as a result of the comprehensive survey of borrowers and branch managers. It also has been

formulated before the completion of the comprehensive review of lending terms, conditions and procedures now used for rural credit programs by BKB and the four nationalized commercial banks. Such a review is the necessary first step for the later making of recommendations for the simplification of loan procedures with the goal of providing clearer guidelines for the initial provision of credit and for its later monitoring and supervision. It recognizes the reality that problems of loan recovery can generally be traced back to the process for granting the loan. Such problems are only a symptom pointing to problems regarding the procedures for the granting, sanctioning and policing of loans.

With recognition of the above caveats, the following specific subjects are considered:

1) Certificate Proceeding
2) Loan Security
3) Credit Passbook
4) The Role of the Union Agricultural Credit Committees (UACCS)
5) Group Borrowing/Cooperative Societies
6) System for Identifying and Policing Overdue Loans

A. Certificate Proceeding

Much attention has been paid to the alleged shortcomings of the summary certificate proceeding under the Public Demands Recovery Act, 1913, as amended, which is the basic legal procedure for the recovery of overdue bank amounts. This non-court proceeding was originally developed for the collection of overdue land taxes/revenue by the British colonial authorities and later extended to the recovery of overdue bank loans and to a number of other situations where monies were due to public or semi-public agencies. It is now administered by certificate officers appointed by the Deputy Commissioners. In addition, both BKB and Grameen Bank, among others, are permitted to follow an expedited certificate procedure which eliminates the need to give the debtor a right of appeal

and hearing before a Certificate Officer and substitutes in its place a demand notice by which such debtor is required to deposit the amount due with the Certificate Officer within 30 days or the certificate may be executed immediately. The officers of those institutions are also permitted to be appointed as certificate officer, in the place of civil servants. However, none have yet been so appointed.

The civil officers who were responsible for disposing of certificate cases have not given priority to cases regarding bank loans in the past and thus the cases have not been disposed of promptly, despite the summary nature of the procedure itself. In addition, banks have been reluctant to bring such cases due to the need to pay an ad valorem Stamp Duty of $16^{2}/_{3}$% of the amount due at the time of filing of the certificate case.

In response to these problems, the Cabinet Secretary on November 21, 1984, issued a Circular to All Commissioners and Deputy Commissioners concerning Recovery of Loans Through Certificate Courts [No. CD/DA-I/12/65 /83 (Pt-1)/545 (68)] which requires those officials to assist bank officers in expediting certificate cases as a part of the overall program of loan recovery. In addition, in 1985, the government has decided to extend the expedited certificate procedures to the nationalized commercial banks and also to permit local managers of those banks to serve as certificate officers with the intention that this change would allow expansion in the number of certificate officers without the appointment of more civil servants to serve in the capacity. Though this change has apparently been decided on at the highest levels, no amendment of the Public Demands Recovery Act, 1983, to that effect has been issued to date.

The extending of the expedited certificate procedures to the nationalized banks and the appointment of local bank branch officials as certificate officers may be the only practical short-term solution to improving loan recovery, although these officials will require training to handle these additional duties. It does not require the appointment

of new civil servants and it allows the flexibility of tailoring the number of officers appointed in a given area to the number of overdue loans in that area. Given that these types of proceedings are cut-and-dried; that is, that the only question is whether and how much money is owed which can be determined by written bank records, there should be little opportunity for abuse, although close supervision may be necessary to avoid situations where branch managers might agree not to file a certificate case if given a certain fee.

Such a program may succeed in the short-run. In the long run, it would be better for bankers to be concerned with banking and not be directly involved in the legal process of collection as they are a vested party to such a situation. As noted above, this type of procedure also gives individual bankers a great opportunity to subvert the process as a whole by not issuing certificates for consideration. In addition, the certificate procedure itself is a revenue proceeding whose basic purpose is the collection of overdue land taxes. Banks may not wish to be associated in the collection of their overdue loans with the always unpopular procedure for collecting taxes. If loan recovery improves due to the granting of better loans, then a court procedure, as used in most countries, would both be relatively speedy and provide the proper protection of the rights of the debtor and of the banking system, as a whole.

B. Loan Security

The second legal issue which has been raised regarding loan recovery is of the ability to foreclose or otherwise recover the security given and the minimum amount of security required for agricultural loans. The general conculsion is that the legal procedures for the recovery of all forms of security are sufficiently clear and speedy. However, problems arise because of larger issues connected with the practical ensuing that monies are received when a harvest is collected (where security is the hypothecation of crops) and due to the uncertain state of land records (where the security is land).

In particular, sections 60 and 61 of the Code of Civil Procedure, 1980, as amended, as well as sections 16 and 17 of the Public Demand Recovery Act, 1913, provide efficient procedures for the attachment and sale of crops, while protecting the rights of the farmer. With regard to land, the mortgage by deposit of title deeds procedure under section 58(f) of the Transfer of Property Act, 1982, as amended, provides the right to sell the property which is security without going to court.

However, there remain large problems of proof of land ownership due to out-of-date land records. The credit passbook, if the defects retained below are corrected, can provide an ad hoc solution as long as ownership is not disputed. In the long run, a comprehensive modern land record system should be introduced, district by district.

C. Credit Passbook

The credit passbook system for farmer-borrowers was introduced by ACD Circular No. 21/84, dated October 16, 1984, paragraph 6, although progress in its implementation by the individual banks has been slow to date. BKB branches in two different divisions of the country have been issuing slightly different forms of passbooks. In addition, the Rupali Bank Passbook is different from that issued by BKB. In neither case is there a special numbering system or other security device that would help eliminate the development of phony passbooks. In the meantime, ACD Circular No. 6/85, dated 15 June 1985, "Financing of ITAP 1985", has been issued. Paragraph 4 of that circular indicates that persons will not receive loans under the Intensive T. Aman Program if they do not have, or are unable to get a passbook.

Unfortunately, the present form of passbook is flawed so that its introduction is unlikely to be successful and may even worsen the position of small farmers. The most critical point is that the passbook, alone, cannot fulfill the fundamental purposes of security and identification for which it was originally envisioned. Because of

failure to reach an agreement with the Board of Revenue, the passbook does not contain a legal description of land which is owned or to which the passbook holder has legal rights. It does not contain an extract from the land records which would allow for precise identification of rights. Thus, the bank is not protected with regard to its security and the small farmer does not have a document to show to the bank which does not necessitate another visit to the land records office and the payment of additioal monies for a new copy or certification. In the larger picture, the passbook does not assist the Government of Bangladesh to modernize its land records for use for other purposes. All that the present form of passbook provides is a photograph and a general listing of amount of land owned, mortgaged, leased an/or sharecropped by that individual in that village as attested to by the Union Parishad Chairman or a Ward member. Not even any identification of adjoining owners is provided. One has no way of knowing if several persons in the village are claiming the same land. Liens or other obligations of the passbook holder are not shown, as they would be if backed by a land record.

This type of imprecision also opens the system for abuse by local influentials. This possibility appears to be magnified by the predominant role of the Union Agricultural Credit Committees (UACCs) in deciding who receives passbooks. As presently formulated, the applicants are to submit their applications for passbooks to the UACCs, along with his production plan, a procedure similar to that of the Special Agricultural Credit Program. A small farmer is supposed to be assisted in the preparation of such a production plan by the Block Supervisor from the Department of Agriculture. However, such persons have generally wanted a rather large fee for their services. They have also been often very friendly with the members of the Union Agricultural Credit Committees who might refuse to approve any production plan not developed by a friend with whom they might have a business arrangement. Certification by the UACC would then be required before a passbook would be issued. Thus, the fear that passbooks might be issued to big farmers while creditworthy small farmers might not receive passbooks because they had not been regular borrowers before is well founded. This system for

granting passbooks would seem to retain the detrimental conditions associated with the UACCs from the SACP program. In many ways, it would be worse if the passbooks became a universal requirement for obtaining loans; one that could not be met by many small and landless farmers.

A third point is that each bank in a local area would have its own passbook. Banks in a given area are supposed to communicate with each other, but at present there appear to be large gaps in such communication, and one cannot automatically assume that the situation will improve in the future. The imprecision of the description of security only increases the likelihood that one man or members of the same family will use the same security for several loans. This problem would be lessened if only one passbook were issued by the lead bank in each area which would be used by all of the banks. Such a system would also be more likely to enforce uniformity in type of form used for passbooks.

The introduction of passbooks also raises the question of what type of program for loan recovery best increases such recoveries while not hurting agricultural production and the condition of small farmers. At present, it is thought to introduce a rigid policy by which no defaulters can receive a passbook and no person without a passbook can receive a loan. However, the rich defaulters will probably find a way to get a passbook issued to someone in their family while the poor farmers are those most likely to be penalized. If this occurs, then the passbook system will be adjudged a failure from its beginning. Thus, some very basic decisions must be made about what is the definition of a "willful defaulter", how different types of loan programs will be treated, and similar matters. At present, there is very little information about what types of loans are not being repaid. The RFP survey of borrowers and branch managers is gathering such information for use in developing a comprehensive loan recovery program. This information will be available in early 1986 and should assist in the development of final policy on passbooks.

Finally, a passbook system is only likely to be successful if its introduction is active in nature, that is, if banks actively seek farmers to whom to give passbooks. Such an active system would have been better introduced as part of a procedure for updating land records and protecting land rights under the National Board of Revenue. It would be hard to get farmers to seek passbocks if they also were not sure that they would immediately get loans. However, a passive system of waiting in bank offices woud ensure that the most sophisticated persons are the most likely to benefit.

D. Role of the Union Agricultural Credit Committees (UACCs)

The Union Agricultural Credit Committees (UACCs) represent an intrusion of general local administration and political concerns into the bank loan making process. Abuses in recommendations of qualified borrowers by UACCs has been one of the major reasons for the low loan recovery rate under the Special Agricultural Credit Program (SACP). If the bank managers alone were responsible for selecting borrowens, this would add to the professionalism of the system. In addition, bankers can be held legally responsible for abuses while the legal penalties to be applied to members of UACCs for such abuses are less clear. Thus, it would be best if bank reviews alone were made with regard to loans.

However, the UACCs do represent an effort to provide a general system of surety, in place of security, so that loans can be given to small and landless farmers. Yet, if this program is to be continued, the members of such committees must take personal responsibility for loans made to persons whom they recommended. This is especially important with regard to the procedures for granting passbooks, as discussed above.

E. Group Borrowing/Cooperative Societies

Group borrowing or group surety is the major alternative to the system of using UACCs to help select qualified lower income borrowers. The best approach is for loans to be made to individuals within a group

with the other members of the group, or one or two of them, signing as personal sureties. Such a system, as now being applied by Grameen Bank and the Swarnivar Program, also lessens the issues of loan security discussed above. However, the heavy costs of administration connected with those programs make it questionable whether they can even be self-financing. In addition, the practice in the Swarnivar Program of requiring only token deposits in relation to the amount of the loan received and of giving loans to more than one member of a group at a time eliminates some of the self-policing incentives that have made such programs successful in other countries.

With regard to cooperatives, the past abuses by managing committees and directors may be limited by the safeguards added in the new cooperative Societies Ordinance, 1984 (Ordinance No. 1 of 1985), if it is effectively implemented. Such effective implementation would require the establishment of uniform banking procedures to be followed by the cooperative banks and policed by the Bangladesh Bank, in addition to the supervision of cooperatives by the Registrar of Cooperatives. It would be preferable if the Apex Cooperative Bank (BSBL) were eliminated and most cooperatives received their funding from the nationalized commercial banks.

## F. System for Identifying and Policing Overdue Loans

The problem of constructing an effective program for loan recovery is exacerbated by the lack of a system for ealy identification of overdue loans--by type and size of loans, type of borrower, location, etc. The development of such a system must be tied to the automatic policing of loans that have been overdue for a reasonably short period (3 months), not to wait, as presently, to classify a loan as substandard only at the end of the Statute of Limitations period of 3 years. to date, the problems in this area have only been identified, but detailed recommendations will be made at the end of the comprehensive survey of lending procedures.

## III. SAVINGS MOBILIZATION

The second major focus of the Rural Finance Project is the improvement of rural savings mobilization. Unlike the area of rural credit/loan recovery, the main problems are not connected with the law or regulation, but rather with marketing and with the provision of better and more secure banking services. The only legal problem raised in the recent BIBM survey for the National Commission on Money, Banking and Credit was that of an heir withdrawing money from the account of a deceased account-holder after his death until there had been a court judgment under the Succession Act, 1925, as amended, that he was indeed the heir. However, any change in this procedure may lead to great abuses. Nominee and custodian/guardian accounts can help to remedy this problem, if the account-holder so wishes.

The only other legal issue is that of confidentiality of the account. The recent introduction of advanced taxation of fixed deposits has seen the issue raised of what information on deposit accounts will be sent to the Bangladesh Bank. Present procedures based on the Negotiable Instruments Act, 1981, as amended, and the common law are good but leave again the possibility of overriding by the Bangladesh Bank. Therefore, the bank should issue a specific circular on this matter. Recommendations on the contents of such a circular, if so desired, can be made in our final report.

## IV. GENERAL PROBLEMS OF ADMINSTRATION AND MANAGEMENT

Finally, there are several issues of general administration and management of the rural credit system that should be considered.

First, the Bangladesh Bank does not now have effective regulation of those financial institutions which are exempt from the provisions of the Banking Companies Ordinance, 1962. They include the Grameen Bank, the Cooperative Bank (BSBL), and the Bangladesh Rural Development Board. The

Bangladesh bank Order, 1972, gives the Bank broad powers to give direction to non-bank financial institutions regarding the conduct of their business (see especially Section 53). It is important that such powers be exercised with regard to procedures for:

1) granting of loans
2) policing of loans
3) audit and inspection
4) accounting procedures

It would be preferable if the provisions of sections 32, 34, 35, 36, 37 (and other of relevance) of the Banking Companies Ordinance, 1962, were extended to such institutions. With regard to Grameen Bank, a notification in the Offical Gazette would be sufficient to make such a change.

Second, the area of rural credit within the Bangladesh Bank is under the jurisdiction of two or more departments, with each department's role defined. Thus, conflicting circulars on matters of lending policy are issued by ACD and the Rural Credit Project Department. The question of refinance is not centralized in one place, but rather split between BCD and ACD. The question of loans to rural industries comes under several departments without apparent coordination. It would be preferable if such questions could be resolved and distinct lines of authority and jurisdiction established for the success of the rural credit system as a whole.

## I. INTRODUCTION

The USAID-funded Rural Finance Project is to give technical assistance to the Agricultural Credit Department of the Bangladesh Bank with regard to the improvement of rural financial markets and the creation of an economically viable rural financial system to provide reliable savings and credit facilities for private farmers and entrepreneurs. Primary emphasis is placed upon savings mobilization measures, a comprehensive plan for improving loan recovery, a review of lending procedures and lending efficiency, a branch rationalization plan, training course development, interest rate rationalization and a financial sector review.

The project is a follow-up to the Rural Finance Experimental Project (1978-1982) which identified and tested eight (8) different credit delivery and savings systems operated by nine (9) rural finance institutions, including the Agricultural Credit Bank (BKB), six nationalized commercial banks, the Apex Cooperative Bank (BSBL) and the Integrated Rural Development Project (IRDP). The systems tested included higher loan interest rates, group lending, area development lending and different types of loan procedures and administration, with an emphasis upon simplification and decentralization. 1/

The project is also a follow-up to the 1983 Joint Bangladesh Agricultural Credit Review by the Government of Bangladesh and the World Bank which identified savings mobilization, loan recovery, interest rate

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1/ See Public Administration Service/S.F. Ahmed & Company, Rural Finance Experimental Project, Terminal Evaluation Report (Dhaka: August 1982) and S.F. Ahmed & Company, Rural Financial Experimental Project, Terminal Evaluation Report (Dhaka: August 1982).

rationalization and simplification of lending procedures as remaining areas of concern for the rural credit system. 2/ It made initial recommendations in these areas which will be used as the starting point for our investigation.

This report is a review of existing laws and regulations in Bangladesh to identify problems and restrictions that would affect the implementation of a viable rural finance system, with special reference to the areas of loan recovery and savings mobilization. Its primary purpose is to clarify a number of issues raised in these previous reports, particularly in the area of loan recovery, and to make initial recommendations regarding legal and administrative charges to improve that system. However, final recommendations will await a comprehensive review of lending and deposit practices which is presently being conducted and the comprehensive survey of borrowers and branch bank managers to be completed in early 1986.

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2/ See IDA - Government of Bangladesh, Bangladesh Agricultural Credit Review (3 Vol.) (Dhaka: August 1981).

## II. BACKGROUND

Since approximately 90% of the population and 55% of the GDP of Bangladesh are in rural areas, a viable system of rural credit is required for the effective development of increased agricultural production and, thus, for the economic development of the country as a whole. For that reason, the rural finance system has received much attention from both the Government and the international donor community since liberation in 1971.

There is a long history to rural finance in Bangladesh, both before and after 1971, which must be considered before making observations and recommendations concerning the present situation. Most of the problems today have been around for a long time. In addition, many types of solutions have been tried, especially since liberation in 1971. In fact, the difficulty with making recommendations in this area is the lack of new things to say. Instead what appears to have been lacking is the reiteration of a consistent policy over time in an area such as loan recovery and the development of an administrative structure within both the banking system and the system of general local administration that would be able to execute such a policy. The turbulence of recent political history and the conflicting demands of the international donor agencies has only exacerbated the situation. The detailed examination of loan and savings procedures and administration to be carried out by the Rural Finance Project is an effort to provide the types of concrete, but incremental, suggestions which can assist the Bangladesh Bank and other relevant government authorities to provide the necessary type of administrative structure and procedures for execution.

It is also important to keep in mind that rural finance is only one part of the overall problem or rural/agricultural development, the development of increased and more efficient agricultural production and more increased employment for inhabitants of rural areas. Thus, an effective system of rural finance must encourage more efficient use of

agricultural land, including the effective consolidation of landholding for production purposes even though not necessarily of landownership, the provision of the fertilizer, seeds, equipment and other inputs required for such production, and also assistance in marketing so that farmers receive a substantial return on their investment of labor and resources so that such efficient production is encouraged. To accomplish these purposes the rural credit system must be closely coordinated with the Department of Agriculture and other ministries concerned with carrying out rural development programs, especially in the fields of agricultural extension, irrigation and rural infrastructure. Any program to strengthen rural credit can only be effective if it also strengthens rural development and administration. In Bangladesh, at present, there appears to be a lack of such effective coordination, especially at levels of government below the national level. In the area of rural credit it is seen in the conflicting signals given by local agricultural officers and political leaders as compared to bank branch managers with regard to timely repayment of loans and difficulties of enforcement of the formal methods of loan recovery, especially certificates, through the relevant local administrative officers. These are reflections of the more universal problems of lack of clarity with regard to lines of authority between agencies and levels of government, and lack of financial and administrative capacity below the national level. The rural finance system reflects these more general problems which cannot be solved by concentrating upon that system alone.

Finally, no efficient rural credit system can work where a vast majority of the population remains illiterate. One must be able to read documents to avoid being cheated. The continued high rate of illiteracy in Bangladesh is probably the single biggest obstacle not only to an efficient credit sy tem, but to economic development as a whole.

A. Prior to 1971

Prior to 1971, there was little emphasis upon either lending or savings mobilization in rural areas by the commercial banks. However,

some efforts had been made from the early 1960s to mobilize rural deposits for ultimate investments in urban enterprises by opening branches at important rural semi-urban centers. Agricultural credit was provided by the Agricultural Development Bank of Pakistan (now BKB) and the Apex Cooperative Bank (now BSBL) which received funds at concessional rates from the State Bank of Pakistan (now the Bangladesh Bank) for on-lending through their branches and intermediaries. In addition, the Government continued the practice started by the British in the 1880s of providing state "Taccavi" loans to farmers, generally in cases of disasters, to permit them to purchase required farming inputs such as seeds and fertilizer. Such loans were often viewed as government assistance and not repaid.

Neither the Agricultural Development Bank nor the Apex Cooperative Bank were oriented to the needs of small or middle-sized farmers. The Development Bank had only 95 branches throughout the country and concentrated its lending to areas where the greatest amount of security could be provided, to large farmers, tea estates and cold storage owners. Even in that situation, its loan recovery rate was not high, generally about 50%.

The situation with regard to the cooperative banking system was even worse. That system had been introduced by the British throughout India in the early 20th century in an effort to eliminate money lending and provide credit at the village level. The system had three tiers - the local cooperative societies (UCMPs) and the Fisherman Cooperative Societies (FCS) at the first level; the 62 Central Cooperative Banks (CCB) and the 16 Land Mortgage Banks (LMB) at the secondary level; and the Apex Cooperative Bank at the third level. The cooperative society legislation and rules placed great power in the hands of the managing committee at all levels. These committees came to be dominated by affluent persons who gave large loans to themselves, their families and supporters which were not repaid. As long ago as 1937, the Reserve Bank of India in its statutory report on agricultural credit had made a series

of recommendations regarding improved lending procedures and the collection of overdue loans by cooperative societies. 3/ However, nothing was done. The Cooperative Societies Law of 1940 (Bengal Act XXI of 1940) and its implementing rules of 1942 did not include specific provisions prohibiting the granting of loans to members of the managemen committee without appropriate safeguards nor the granting of new loans t willful defaulters. Thus, it was difficult to eliminate the practice of such behavior. In the 1950s, the Government tried to halt these abuses by appointing government officials to head the managing committees in many cases. However, those officials were not experienced in banking an the poor record of loan recovery continued. The accumulated outstanding overdues of the provincial Cooperative bank from 1958 to 1971 was Tk. 22C million or one-third of the total amount loaned out over the period. 4/

On a more positive note, the 1960s saw the development of the two-tier cooperative banking system as a result of the Comilla program under the direction of A.H. Khan. The Comilla approach to rural development consisted of four interrelated programs - the development of decentralized administration through the Thana Council and Training and Development Centre, the rural works program (local execution of drainage, embankments, local roads), the Thana Irrigation Program (shallow

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3/ See S.S.M. Desai, Rural Banking in India, pp. 122-124 (Himalaya Publishing House: June, 1979).

4/ See Bangladesh Bank, Agricultural Credit Department, Institutional Delivery System of Agricultural Credit in Bangladesh, P.2 (Dhaka: 1978).

tubewells); and the Cooperative Project. 5/ The cooperative project (later called the Integrated Rural Development Project) was based upon the small farmer mutual credit associations developed in Germany in the 19th century by Freidrich Wilhelm Reiffeisen. The local cooperative societies at the village level were combined together into a Thana Central Cooperative Association (TCCA). In order to avoid some of the previous abuses of managing committees, each such committee was required to hold a general meeting every week. Loans were made based upon joint production plans and the credit was linked with assistance for marketing and closely supervised. For the period 1968-1970 in 20 thanas in Comilla District, there was only a 8.1% default rate on a total loan amount of Tk. 32.95 million. The proportion of own capital (shares and savings deposits) to loans in the 20 thanas was 35%. 6/

However, despite these efforts, the percentage of advances and deposits in rural areas remained very small - about 10% of the deposits and under 59% of the credit

B. Since 1971

Since 1971, there have been a number of major changes in the rural finance system of Bangladesh which have greatly expanded the system of rural credit. Successful efforts have been made to increase the branch network of both the commercial and the specialized agricultural bank in rural areas, to mobilize rural savings, and to eliminate the leakage of rural savings for use as loans to urban areas.

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5/ See A.H. Khan, "The Rural Development Program at Comilla", in The Works of Akhter Hameed Khan, Vol. II, Rural Development Approaches and the Comilla Model (Bangladesh Academy for Rural Development: 1983), pp. 33-86.

6/ A.H. Khan, "A Review of the RWP, TIP and Cooperative Programme in Comilla District", in op. cit., pp. 132-134.

After nationalization in 1972, the six reorganized nationalized commercial banks were instructed to move actively into the field of rural credit. In the first few years they were reluctant to operate in this area, even when given the incentive of a 1.5% interest subsidy for their own rural finance schemes and the availability of refinance at 2% below the Bank rate when borrowing from the Bangladesh Bank. Where they did make loans they were generally to intermediaries like the Comilla (IRDP) cooperatives rather than directly to farmers. After liberation, the former Agricultural Development Bank of Pakistan was reconstituted as the Bangladesh Krishi Bank (BKB). It was the major source of short-term lending to small borrowers. Finally, the cooperative system remained a large, but declining, source of credit. The three-tier system headed by the Apex Cooperative Bank (BSBL) continued to suffer from lack of efficient management, abuses by managing committees of societies, and a huge proportion of overdues. For these reasons, the amount of concessional credit to this system from the Bangladesh Bank was sharply reduced to its present level of about 15% of the rural credit. The Cooperative Societies Ordinance, 1984 (Ord. I of 1985) closed many of the legal loopholes that allowed abuses by officers and managing directors (see Section III.G below), but it is too early to know if the system suffered from the increased politicisation of government programs and their capture by local elites as it expanded to 200 TCCAs and about 23,000 KSS with a total membership of over 700,000 farmers. Its recovery rate which had been over 90% in the late 1960s (see above) dropped to 78.4% in 1973-74, to 57.9% in 1976-77, and below 50% by 1980. In 1982, the IRDP program was reconstituted as the Bangladesh Rural Development Board under the chairmanship of the Minister of Local Government and with representation on its board from the other relevant government agencies, the directors of the Rural Development Academics and members elected by the National Federation of TCCAs. 7/ However, the up-from-the bottom approach of

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7/ Bangladesh Rural Development Board Ordinance, 1982 (Ordinance No. LIII of 1982).

Mr. A.H. Khan seems to have been lost in the process and these cooperatives no longer show the effective savings mobilization and loan recovery that had been evident.

In 1977, the Tk. 100 crore Special Agricultural Credit Program (SACP) was instituted as a means of increasing the rural credit activities of the nationalized commercial banks, who would participate along with BKB. The program had simplified loan procedures and provided crop loans without requiring land as collateral to small farmers with holdings of 3 acres or less. The borrowers were selected with the Union Agricultural Credit Committees (UACCs) headed by the Chairman of the Union Parishad and with a membership consisting of the relevant Ward Chairman and other notables. It received concessional financing from the Bangladesh Bank and a 30% refinancing guarantee. The Tk. 100 crore program was successful in pushing credit to rural areas and in stimulating the rural credit activities of the nationalized commercial banks. However, the pressure to make loans quickly and the political pressures and temptations inherent in having an outside group involved in the selection of borrowers meant that the loan recovery rate for 1977 was only 46%.

Yet the program was a major stimulus to the development of the rural branch banking network and to increased disbursement of credit under the normal rural credit programs. The total number of rural branches of the nationalized commercial banks and the Krishi Bank increased from 414 (of 1,150) total branches in March 1972, to 1,095 (of 2,040) in June 1977, to 3,301 (of 4,836) in December 1984.

During the same period, there was a tremendous expansion, both in agricultural credit and in all credit to rural areas. From December 1975 to December 1984 total advances increased from Tk. 919.4 crore to Tk. 8,214.5 crore, while advances in rural areas increased from Tk. 31.2 crore to Tk. 2,123.2 crore. 8/ Thus, the percentage of advances in

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8/ Bangladesh Bank Bulletin, December 1984, Table XII, pp. 82-85; and Ministry of Finance, Resume of the Activities of the Financial Institutions in Bangladesh, 1984-85 (July 1985), Annexure VI, p. 32.

rural areas increased from 3.4% to 25.8% of total advances. In addition, advances for agricultural purposes 9/ increased from Tk. 87.38 crore in June 1975 to Tk. 2,318.2 crore in June 1984, by 21 times or from 10.7% to 28.2% total advances. 10/

Over the same period, 1975-1984, the expansion of the branch banking system was also a major impetus to the increase in rural bank deposits. Total bank deposits increased from Tk. 1,124.52 lakhs in June 1975 to Tk. 8,910.5 lakhs in December 1984, while rural bank deposits increased from Tk. 106.72 lakhs to Tk. 1,602.5 lakhs. Thus, rural deposits increased from 9.5% of total deposits to 18.0% of total deposits, and by about 15 times during the 10-year period. 11/ From 1977 to 1980 and again from 1984 to the present, higher interest rates have been paid on deposits made to rural branches than in urban branches, during the first period for fixed deposits of up to 2 years and for savings deposits without checking facilities, and since 1984 for savings deposits only. (See Section IV, Savings Mobilization, below.) The first program greatly increased the amount of fixed deposits and proportion of fixed deposits as a percentage of total deposits, but mainly attracted larger depositors. The present program seems to have already had impact but it is too early

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9/ The statistics cover the categories of Agriculture, Hunting, Forestry, and Fishing. Source: Statistics Department, Bangladesh Bank.

10/ Bangladesh Bank Bulletin; December 1984, Table XII, pp. 70-77, and Ministry of Finance, op. cit., Annexure VII, p. 31.

11/ Statistics Department, Bangladesh Bank, as cited in Ministry of Finance, Resume of the Activities of the Financial Institutions in Bangladesh, 1984-85.

to tell conclusively. In any case, the amount of rural deposits in banks, despite a great increase, remains small.

Despite the rapid expansion of rural credit and the large increase in rural deposits, there were not like advances in aiding small farmers and landless farmers who were sharecropping on the land of others. The Land Occupancy Survey, 1977, indicated that the percent of the rural population with no cultivable agricultural land or with not more than 1/2 acre of such land was approximately 50%, and the trends of increased population growth, fragmentation of land holdings through inheritance and reduced need for agricultural labor after the introduction of high-yielding varieties of rice would indicate that the percentage of such persons is now likely to be significantly higher. The Grameen Project, which became the Grameen Bank in 1983, 12/ has used a system of group lending, compulsory deposits and extensive supervision of small production loans successfully. It has a very high recovery rate for loans (about 98-99%) although the fact that it receives its capital through grants from the International Foundation for Agricultural Development (IFAD) and monies from the Bangladesh Bank for its Dhaka area operations leaves some doubts about whether the Bank can be operated in the long run without large subsidies. The Swanirvar approach of group lending at a bank with required minimum deposits also has been successful to some extent in opening up the credit system to lower income groups. The Krishi Shakha small offices of Sonali Bank in rural areas and the Rural Finance Assistant system appear to have had some influence in increasing that outreach in rural areas. Further, the Rural Finance Experimental Project provided some good experience with different types of systems for delivering credit, as well as experimenting with loans with different and higher interest rates. However, each of these

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12/ See Grameen Bank Ordinance, 1983 (Ordinance No. XLVI of 1983).

programs has not yet accumulated much experience. It is not yet clear what approach of this of this kind, or combination of such approaches, is best for Bangladesh. The comprehensive RFP survey should provide some information concerning this matter.

Finally, the system of allocating credit was changed with the annual program or 1984-85. 13/ The new annual lending approach provides credit at a limit as required by an individual farmer rather than under separate production programs. It eliminates the guarantee and other district features of the SACP, as compared to the Normal Credit Programs. It would also require each borrower to have a credit passbook. In addition, 1984-85 has seen a concentrated drive for loan recovery based upon an action plan formulated by ACD and including a directive from the Cabinet Secretary to the Commissioners and Deputy Commissioners for the speedier processing of certificate cases.

This thumbnail sketch of past experience is meant to provide a background for the discussion of specific points below. It indicates that Bangladesh has made a great deal of progress in the past decade in the expansion of its agricultural credit system and in rural deposit mobilization. However, the continued politicisation of the system and increased subsidization that has gone along with this progress has meant that loan recovery, and the viability of the rural credit system, are still not on a sound footing.

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13/ ACD Circular No. 21/84, dated October 16, 1984, "Agricultural Crop Loans - Annual Basis".

# III. LOAN RECOVERY

## A. Introduction

A major emphasis of the Rural Finance Project is a comprehensive review of loan recovery problems with regard to rural credit and the development of an action plan to deal with these problems. The subject of loan recovery has already received a great deal of attention, particularly in the recommendations made in the 1983 Joint Agricultural Credit Review. This attention is appropriately given the importance of loan recovery for the viability of the rural banking system. However, such recommendations have necessarily been general in nature. They have been formulated without the benefit of detailed information regarding overdues by type of loan and loan program, size of loan, type of borrower, record of payment and reason for default; although some of this information for certain programs at certain time periods has already been collected. In addition, a comprehensive review has not been made of the lending terms, conditions and procedures themselves used by the Krishi Bank and the four nationalized commercial banks for the plethora of agricultural and rural credit programs currently operating in Bangladesh. Such a review is the necessary first step for the later making of recommendations for the simplification of loan procedures with the goal of providing clearer guidelines for the initial provision of credit and for its later monitoring and supervision. It recognizes the reality that problems of loan recovery can generally be traced back to the process for granting of the loan. They are only a symptom pointing to problems regarding the procedures for the granting, sanctioning and policing of loans.

The Rural Finance Project is now in the process of making such a comprehensive review of loan procedures, with particular attention to:

1) Policing of loans;
2) required loan documentation;
3) the role of the local union agricultural credit committees; and,

4) the decentralization of authority, especially the sanctioning authority of branch managers.

The comprehensive survey of borrowers and branch managers will collect detailed information regarding overdues of the type mentioned above. The results of the survey should provide the type of data that is required to fashion specific types of loan recovery programs to deal with different types of default situations.

The final recommendations regarding loan recovery will be made at the completion of the project, based upon the results of the comprehensive survey of borrowers and bank managers and upon the detailed review of present procedures for loan recovery. This paper presents initial conclusions based upon a review of current banking laws and regulations, as well as other laws and regulations regarding the determination of overdue loans and related matters. The most important conclusion is that no major changes of the law itself are required with regard to the improvement of loan recovery. Rather, what is required is the more effective implementation of existing procedures and the establishment of more precise regulations and procedures with regard to the identification and policing of overdue loans.

This paper will first discuss recent actions taken by the Government regarding loan recovery. It will then consider a number of specific issues which raise legal and administrative questions that affect the success of any loan recovery program. These issues area:

1. Legal Procedures Regarding Loan Recovery/Certificate Procedures.
2. Loan Security.
3. Credit Passbook.
4. Role of Union Agricultural Credit Committees (UACCs).
5. Group Borrowers/Cooperative Societies.
6. System for Identifying and Policing Overdue Loans.

## B. Recent Government Actions Regarding Loan Recovery

In recent months, the Government of Bangladesh has taken several significant actions to attempt to improve loan recovery, both generally and particularly in the area of rural finance.

### 1. Improved Expediting of Certificate Cases

As discussed in detail below, a November 1984 Circular of the Cabinet Secretary ordered Commissioners and Deputy Commissioners to provide for the quicker disposal of certificate cases regarding bank loans by giving them greater priority and by regularly reviewing this progress, with monthly reports to be sent to the Cabinet Secretary, and copies to the Agricultural Credit Department (ACD) and to the Finance Division, Ministry of Finance. 14/

### 2. 1985 Action Plan for Recovery of Agricultural Loans

In December 1984, the ACD formulated an Action Plan for recovery of agricultural loans to supplement the above circular for the Cabinet Secretary. 15/ That circular letter contained the following elements:

a. Target for Recovery - set at collecting during period January - March 1985, some amount from 80% of loans at each branch that are overdue as of February 1, 1985.

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14/ Circular of the Cabinet Secretary No. CD/DA-I/12(65)/83(Pt-1)/545(68) dated November 21, 1984, "Recovery of Loans Through Certificate Courts".

15/ DC No. ACD(POLY) 911(G)/84-7585, dated December 30, 1984.

b. Rebates - permit rebate to farmers on service charge of 2% if whole amount of the dues is repaid before the final due date for repayment. Similarly, a rebate on penal interest at 2% may be allowed if the overdue amount is repaid by March 31, 1985, or within the quarter of its becoming due.

c. Staff Incentive - to be worked out later in consultation with the bank.

d. List of Defaulters - a list of defaulters may be regularly exchanged once a quarter between bank branches within the Upazila, especially between BKB branches and commercial bank branches. Such a list shall be given tothe Union Parishad and displayed in local huts (weekly markets) and bazaars, with special reference to the names of big farmers and influential groups.

e. Publicity - each bank should consider printing leaflets to be distributed through the branches requesting loanees to repay their loans on time and assuring them of future loans if they make such regular repayments. Other media would also be used, including the beating of drums in the local huts and bazaars.

f. Visits/Tours of Bank Senior Officers - such officers of the banks should visit branches and hold meetings at the Upazila level with local branch officials and local administration officials. Such meetings should cover the importance of repayment and its impact on the total viability of the credit operation.

g. Identification of Crop Loans to Non-Farmers - This abuse should be corrected by the identification of such fake

borrowers with the help of Union Agricultural Assistants/UACC. Such non-farmers should be banned from receiving future loans until these old loans are repaid by them.

3. Submission of Defaulters List for Agricultural Loans

As a following to the Action Plan above, ACD Circular No. 5/85, dated June 15, 1985, "Recovery of Agricultural Loans: Submission of Defaulters List", contained a more stringent series of actions to be initiated by banks, including:

a) Preparation of a list of chronic defaulters, with a separate list for those defaulters who are chairmen of Union Parishads, office-holders or Union Agricultural Credit Committees (UACCs) and KSS cooperative societies, big farmers and defaulters with the largest overdues.

b) Submission of the list of chronic defaulters to the Regional Offices of the Banks for formal submission for action to the relevant Government agencies.

c) Publication of the list of defaulters in local news papers for several days and the display of the list at the branches concerned.

d) Exchange of such lists between local branches.

e) Filing of certificate cases if no repayment is received from such defaulters within 30 days of the publication of the lists.

f) Regular review of the progress of disposal of certificate cases by Regional Offices. Such offices shall

then submit reports for initiating necessary action to the respective District Committees through the Member - Secretary, Lead Bank.

g) Branches shall submit such a list of chronic defaulters to their regional offices on a quarterly basis. The first such report is due on September 30, 1985.

At present, it is too early to see how successful this program will be in comparison to similar programs in the past. However, it is important to keep recent actions in mind when considering the specific issues regarding loan recovery discussed below.

Legal Procedures Regarding Loan Recovery/Certificate Proceedings

The recovery of overdue bank loan amounts is made by way of a summary certificate proceeding under the Public Demands Recovery Act, 1913 (Bengal Act III of 1913), as amended. This non-court proceeding was originally developed for the collection of overdue land taxes/revenue by the British colonial authorities and later extended to a number of situations where monies were due to public or semi-public agencies. The orders and ordinances establishing the Krishi Bank, 16/ the Grameen

16/ Bangladesh Krishi Bank Order, 1973 (PO No. 27 of 1973), as amended, Section 21.

Bank, 17/ the House Building Finance Corporation, 18/ and the industrial development banks 19/ provide specifically for the use of the provisions of the Act for the collection of any arrears. The six commercial banks nationalized under the Bangladesh Banks (Nationalisation) Order, 1972 (PO No. 26 of 1972) have the same authority with regard to the collection of agricultural loans under Schedule I of the Public Demands Recovery Act, as amended by the Public Demands Recovery (Amendment) Ordinance, 1978 (ordinance No. XXV of 1978, Section 3). The cooperative societies, cooperative financing banks and the Apex Cooperative Bank (BSBL) have similar authority under Articles 12A and 12B of Schedule I of the Public Demands Recovery Act, 1913, as amended, and Section 52(3) of the Cooperative Societies Ordinance, 1984 (Ordinance No. I of 1985).

With regard to bank loans, the certificate procedure can only be used when there is no legal question regarding whether the amount demanded is indeed due. If there is any such question, the Certificate Officer is not to consider the matter but is to refer it to the Civil Court. As stated in Section 3(3) of the Act, as amended, the Certificate Officer is either the Deputy Commissioner (in his role as Collector for Revenue) or an officer (civil servant) appointed by the Deputy

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17/ Grameen Bank Ordinance, 1983 (ordinance No. XLVI of 1983), Section 28.

18/ House Building Finance Corporation Order, 1973 (PO No. 7 of 1973), Article 26.

19/ Bangladesh Shilpa Bank Order, 1972 (PO No. 129 of 1972), Section 35; Bangladesh Shilpa Rin-Sangstha Order, 1972 (PO No. 128 of 1972), Section 35.

Commissioner and sanctioned by the Commissioner. In addition, the BKB and Grameen Bank managers have been granted permissive authority to act as certificate officers is so appointed by relevant Deputy Commissioner. 20/ In practice, they have not been so appointed to date for reasons which will be discussed below.

1. Ordinary Certificate Procedure

The ordinary certificate procedure (Annex 1, Table I) requires the submission of a written request for a certificate to the designated certificate officer. At the same time that the request is submitted, the Bank must enclose a fee of $16^{2}/3$% of the amount due. If the certificate officer is satisfied that there is no legal question regarding whether the demand amount is indeed due, he then issues the certificate and serves a notice and copy of the certificate upon the certificate-debtor. In order to protect the rights of the creditor, all transfer of any interest in immoveable property of the debtor in that district after the date of service shall be considered void as against a claim enforceable by the certificate. In addition, the amount due on the basis of the certificate becomes a priority charge as do all subsequent charges on any property of the certificate-debtor. The debtor then has 30 days to file a petition with the certificate officer denying that he owes the amount due. The certificate officer must then hold a hearing, take evidence and determine the liability of the certificate-debtor. At this time, he may set

20/ Bangladesh Krishi Bank Order, 1973 (PO No. 27 of 1973), Section 21(6); Grameen Bank Ordinance, 1983 (Order No. XLVI of 1983), Section 28(3).

aside, modify or vary the certificate. Execution of the certificate may occur after such decision is made but not earlier than 30 days after the date of service of the notice regarding the certificate. The certificate officer has the power to oder the execution of the certificate by attachment and sale of any property, by sale of such property (without prior attachment) or by the arrest of the certificate-debtor and his detention in civil prison for six weeks in all cases and for up to six months when the demand is for an amount exceeding Rs.50 (Section 31) Such arrest and detention can only occur in the case of willful default and refusal to pay, dishonest transfer, concealment or removal of property and likelihood that the debtor would leave the local jurisdiction (Section 29). In practice, such execution requires the assistance of the local Magistrate and police. In addition, the certificate-debtor can file a suit in civil court claiming that the amount claimed is not actually due or had already been paid, that the proper procedures were not followed, or that there was fraud (Sections 35-37).

This general certificate procedure, although it does not require going to a civil court, still takes a great deal of time to carry out in practice. Banks must submit their requests to the local Revenue Officers designated by the collector as certificate officers. Such persons may have several other duties. In addition, the collection of overdue amount for banks is secondary to their primary occupation of the collection of overdue land taxes. They may not want to add to their unpopularity by collecting overdue bank loans as well. Given the opportunity for appeals and hearings, to which no time limit is set, the ordinary period can take a year or more, even in the best circumstances.

## 2. Expedited Certificate Procedure

To combat the problems above, the Bangladesh Krishi Bank Order, 1973 (PO No. 27 or 1973) and the orders establishing the specialized industrial banks 21/ provided for an expedited certificate procedure for the collection of overdue loan amounts (Annex 1, Table 2). 22/ The expedited procedure eliminated the regular notice to the debtor with subsequent right of appeal and a hearing before the certificate officer. In its place, it substituted a demand notice which required the debtor to deposit the amount due with the certificate officer within 30 days of the date of service of that notice. In addition, the procedure eliminated the mandatory 30-day period after service of notice before execution of the certificate. Thus, the certificate can be executive immediately at the end of the 30-day period set by the demand notice.

In practice, the expedited certificate procedure has not yet meant a major improvement in the disposal of certificate cases for BKB. However, the situation may change since the adoption by the Government of a stronger policy to improve the recovery of loans through the certificate process in November 1984, as noted in the previous section.

Circular of the Cabinet Secretary No. CD/DA-I/12(65)/83 (Pt.-1)/545(68), dated 21 November 1984, "Recovery of Loans

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21/ See Bangladesh Shilpa Bank Order, 1972 (PO No. 129 of 1972), Section 35(2); Bangladesh Shilpa Rin Sangstha Order, 1972 (PO No. 128 or 1972), Section 35(2).

22/ This procedure was also granted to Grameen Bank in Grameen Bank Ordinance, 1983, as noted above.

Through Certificate Courts", recognizes the long delays that have occurred with regard to the disposal of certificate cases because of the preoccupation of certificate officers with other matters, particularly with the recovery of land taxes/revenue, the effect of those delays upon compliance with recovery procedures and the significant amount of bank funds blocked from more productive uses by the requirement of the payment of the ad valorem fee (stamp duty) of 16 2/3% of the amount due, along with process fees and other charges, at the time of filing of such cases. The circular goes on to advise the Commissioners and Deputy Commissioners to make the certificate proceedings more effective for the quick disposal of such cases by giving them the same priority as is given for the recovery of land revenues. At the District level, the Deputy Commissioner is to regularly review the progress of the disposal of certificate cases with his District Committee. He is also to see that the Upazila Administration makes the proper efforts in this regard. Compliance reports are to be sent to the Cabinet Secretary with copies to the Agricultural Credit Department (ACD) and to the Finance Division, Ministry of Finance. Subsequently, the Bangladesh Bank, on December 30, 1984, sent its own letter signed by the Governor to all Deputy Commissioners asking that they appoint at least one certificate officer in each Upazila and the government decision to launch a drive from January 1985 with regard to loan recovery [23/] That letter also recognized the problems of abuses regarding the UACCs in the making of loans and requested the opinion of the Deputy Commissioners as to whether loan recovery would be improved if the local

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23/ Bangladesh Bank, D.O. Letter No. ACD(Poly)911/(G)-7514(64), dated December 30, 1984.

Chairman/Members of the Union Parishads were barred from association with agricultural lending in the future if 80% of the loans disbursed as per their lists were not recovered within the due dates.

Also on December 30, 1984, the ACD issued its 1985 Action Plan for Recovery of Agricultural Loans. 24/ Paragraph (viii) of that letter calls attention of the banks to the November 21, 1984 circular of the Secretary, Cabinet Division. Progress of the disposal of certificate cases is to be pursued by bank officers with the Upazila Nirbahi Officers and, as required, with the Deputy Commissioners. It further notes that the Secretary of the District Committee is being advised to send a monthly report on the progress of disposal of certificate cases to the head of ACD. Further, in November 1984, the BKB announced its own program to decentralize the recovery function by putting senior officials at Divisional, Zonal and branch offices and to expand the number of regional officers which would concentrate on better credit operation and performance. A major emphasis would be on the filing and disposal of a greater number of certificate cases. 25/

Finally, in early 1985, the Government decided to extend the expedited certificate procedures that presently apply to BKB and Grameen Bank to the nationalized commercial banks for the

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24/ D.O. No. ACD(Poly)911(G)/84-7585, dated December 30, 1984, "Action Plan for Recovery of Agricultural Loans - 1985" (see Annex 1, Table 6).

25/ See Bangladesh Bank Bulletin December 1984, p. 21.

recovery of agricultural loans and also to permit local managers of those banks to serve as certificate officers. 26/ The use of bank managers as certificate officers would help alleviate the need for a greater number of civil servants to perform this function. The extension of the expedited certificate procedure to the nationalized commercial banks would provide for speedier processing of the vast majority of such cases concerning agricultural loans. The only remaining role for the civil authorities and the courts would be the execution of such certificates although the Deputy Commissioner would still have the power of appointment of such officers and of general supervision over their work.

When implemented this extensive use of bank branch managers and officers to carry out the certificate process might be the only practical short-term solution to putting teeth in the loan recovery process. It avoids confronting directly the present realities regarding restrictions on the hiring of new government employees and the difficulties that continue to be faced by bank officials in getting local certificate officers who are civil authorities to concentrate on helping to collect bank loans at a time when collections of land revenue are decreasing. At the same time, the Deputy Commissioner would retain control over, and responsibility for, the process through his appointment and supervisory powers. It also permits greater flexibility in tailoring the number of officers appointed in a given area to the number of overdue loans in that area. Given the cut-and-dried nature of the proceedings, the only question is whether

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26/ However, as of July 1, 1985, no Public Demands Recovery (Amendment) Ordinance has been issued to this effect.

money is owed, and how much, and the main evidence is written bank records. There should be little opportunity for abuse, although close supervision may be necessary to avoid situations where branch officials agree not to file a certificate if given a certain fee.

The branch officers would require training to handle these additional duties. The RFP Project will make some recommendations later regarding the contents of such a course of series of lectures, as part of its general recommendations regarding bank training.

However, this extensive role for bank branch officers in the certificate procedure is only likely to be effective in the short run. In the long run, it would be better for bankers to be concerned with banking and not be directly involved in the legal process for collection. Not only are they one party in the situation, but this type of summary procedure gives individual bankers a great temptation to subvert the process as a whole by agreeing not to issue certificates for consideration. In addition, the certificate procedure itself is a revenue proceeding whose basic purpose is the collection of overdue land taxes. Banks may not wish to have the procedure for the collection of their overdue loans associated with the always unpopular procedure for collecting taxes.

In the long run, a special court for the collection of such overdues as part of or at the same level as the munsif courts could both be relatively speedy and provide the proper protection both of the rights of the debtor and of the integrity of the banking system as a whole. Such court could be a part-time court, using lawyers or other persons who are not judges but had special training to handle such cases. Such courts could be mobile in nature, moving from one part of the country to the

other as in the old system of holding assises. The use of non-judicial officers would avoid the problems of adding new civil servants that would accompany the expansion of a new court.

## D. Loan Security

Closely connected to the legal procedures for loan recovery itself are the questions of the efficiency of loan security. What type of security is required with regard to what type of loan? How easy is it to foreclose a mortgage on land or to obtain other types of security in case of default?

As with the procedures for loan recovery, the general conclusion is that the legal procedures for the recovery of all forms of security are sufficiently clear and speedy. The only problems arise because of larger problems connected with ensuring monies when a crop is harvested or due to the uncertain state of land records.

### 1. Hypothecation: 27/

The Tk. 100 crore Special Agricultural Credit Program introduced the widespread use of the hypothecation of the crop itself as the major form of security for a crop loan, along with sureties if the borrower was landless and worked the land on a sharecropping or lease basis. The preferable surety was the owner of the land that was leased or sharecropped. A similar form of security is required for the annual crop production

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27/ Hypothecation is a charge created on property or goods for the amount of the debt. It applies only to moveable assets and neither ownership nor protection is passed to the creditor.

loans, including the Intensive Summer Crop Production Program, the Intensive Transplanted Aman Program and the Intensive Rabi Crop Production Program.

In addition, the fisheries loan program requires the hypothecation of the fish produced, as well as the personal surety of local respectable persons if the water body used is not owned by the borrower. 28/ In all such cases, the borrower also signed a D.P. (Demand Promissory) Note in favor of the Bank (see form in Annex 2, Table 4). In similar fashion, deep tubewell loans are secured only by the tubewell itself. 29/ However, loans for shallow tubewells, 30/ spring tubewells, 31/ rental low lift pumps 32/ and irrigation

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28/ See ACD Circular No. 14/83, dated November 30, 1983, "Financing of Fisheries Programme, 1983-84", para. 8.

29/ See ACD Circular No. 11/82, dated August 13, 1982, "DTW Financing-Collateral".

30/ See ACD Circular No. 4/82, dated April 26, 1982, "Marketing of Private Sector's Imported STWs Through Credit".

31/ See ACD Circular No. 1/83, dated January 4, 1983, "Financing of Spring Tubewells".

32/ See ACD Circular No. 15/82, dated October 11, 1982, "Term Financing for Selling of Rental LLPs".

equipment generally 33/ are secured not only by the equipment but also by the mortgage of generally 1/2 acre of land as additional collateral. 34/ The IDA-funded Minor Irrigation Project (IDA Credit No. 1147-BD) which has mainly funded shallow tubewells (STWS) also requires security in the form of hypothecation of the assets created out of the project lending and either the mortgage of land or the signature of personal sureties as additional collateral.

Hypothecation of crops or equipment gets around the problems of providing loans to landless farmers. 35/ However, hypothecation contains risks that are not connected with a land mortgage. Since neither the assets themselves nor any form of ownership deed for the assets is in the hands of the bank, the equitable charge created by the hypothecation can be defeated by the borrower either selling the goods or pledging 36/ the

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33/ See ACD Circular No. 5/81, dated April 25, 1981, "Term Finance for Sale of Irrigation Equipments".

34/ The 1/2 acre requirement applies to spring tubewells and shallow tubewells. There is one acre minimum requirement for low lift pumps.

35/ For security purposes under law, a "landless farmer" is one who owns no land other than homestead land. Homestead land cannot be attached and sold by order of a court as it, along with agricultural tools, cattle and seed grain, are considered required minimum elements for the earning of livelihood under Section 60 of Code of Civil Procedure, 1908 (Act V of 1908), as amended. This definition under the Grameen Bank Ordinance defines a "landless person" as one who owns less than 0.5 acres of cultivable land or land and moveable assets worth not more than the value of one acre of cultivable land in that union.

36/ A pledge is a charge created on property or goods for the amount of a debt in which the moveable assets are delivered into the actual or constructive possession of the lender.

goods to a third party acting in good faith. In addition, a prior hypothecation of the same goods would put the bank in an inferior position, as would persons claiming under rights obtained under the Insolvency Acts.

Thus, banks must have sufficient staff to adequately supervise such loans, particularly to be able to ensure that they receive the amounts due to them when crops are harvested or fish sold. At present, such supervision at many bank branches is inadequate. this has added to the problems of loan recovery. However, this question of efficient administration is the important one. The legal procedures for attachment and sale are quite efficient.

With regard to agricultural produce, Section 16 of the Public Demands Recovery Act, 1913, provides for its attachment by the affixing of the warrant of attachment upon the land where a growing crop is located, and where the crop has been cut or gathered, as well as at the ordinary residence of the certificate debtor or at the place where he carried on his business or is known to have resided last. At the moment of the affixing of the warrant of attachment, the produce is deemed to have passed into the possession of the certificate officer. 37/ Thus, the only problem is acting quickly.

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37/ Section 16 of the Code of Civil Procedure, 1908, however, allows the Government, by a general or special order published in the Official Gazette, to declare that any portion of agricultural produce or class of agricultural produce, as is adjudged to be necessary for the purpose of providing until the next harvest for the due cultivation of the land and for the support of the judgment creditor and his family shall, for all agriculturists or any class of agriculturists, be exempted from liability to attachment or sale in execution of a decree.

With regard to other types of security, Section 17 of the Public Demands Recovery Act, 1913, states that the provisions of the general rules on attachment and sale under Section 60 of the Code of Civil Procedure, 1908 (Ac No. V of 1908) will apply to property to be attached and sold in execution of a certificate. These rules are quite summary in nature, and appear to be efficient in practice.

2. Land Mortgage

Despite the recent emphasis upon hypothecation as a form of security, a land mortgage remains the preferred type of security for bank loans. As noted above, owners of land are generally required to mortgage that land for all types of loans and the requirement of a personal surety with land holding is meant to replace the fact that the borrower himself does not own land or land of sufficient value to serve as security for the loan. The general form for the Mortgage Deed (Annex 2, Table 2) indicates that the main form of land mortgage used by banks in Bangladesh is the so-called mortgage by deposit of title deeds. The title deeds for the property, as well as the mortgage deed itself, are deposited with the bank. The bank is granted the right to sell the property without first going to court, under the provisions of Sections 58(f) of the Transfer of Property Act, 1882, as amended. This is a very summary procedure which can be acted on quickly.

The problems connected with the use of land as security are not those of legal procedure, but are general problems connected with the proof of land ownership due to out-of-date and incomplete land records. Bangladesh inherited the land settlement system first introduced by Lord Cornwallis in 1793 by which revenue records of land ownership were updated every 20 to 30

years. After independence from British rule, the East Bangal State Acquisition and Land Tenancy Act, 1950, eliminated the Zamindars and other middle men who had served as tax farmers and set a maximum level of land holdings at 300 bigha per family. In the wake of these changes, new land settlements were made throughout the country. However, the last 25 years have seen a lack of effective upkeep of the land records system. Both the Muslim and Hindu laws of inheritance provide for inheritance by all sons and daughters, thus, both for the fragmentation of land holdings and for the continual creation of new legal rights to land holdings. The disruptions caused in the wake of the liberation struggle also contribute to the uncertainty regarding land rights. Thus, there are many instances of persons using land as security for which they are only one of many owners, of land being mortgaged more than once, of the obtaining of a title deed for land to which one has no right, and similar types of abuses.

In order to counter some of these difficulties, banks have generally sought from the borrower both a letter of undertaking (halapnama), on stamp paper, that the land being mortgaged is under his possession, and a non-encumbrance certificate from the Land Registrar's Office that such land is free from any encumbrance. However, the obtaining of these documents has been costly and time consuming for the borrower. In the case of the non-encumbrance certificate, some Registrar's offices have refused to issue such certificates because of the lack of knowledge due to the status of the land records. Recently, ACD has asked banks to accept instead only a letter of undertaking without a stamp fee. 38/ In practice, such a letter is enough

38/ See ACD Circular No. 14/83, dated November 30, 1983, "Financing of Fisheries Program, 1983-84", para 8.

if bank officers visit the location and check land records for at least 12 years (the period for adverse possession rights to accrue). However, many times such an investigation is not conducted.

The introduction of the credit passbook was to help alleviate the problem by providing a record of legal security. As discussed below, the present form of passbook does not provide such a precise definition of land rights. What is required in the long run is the amendment of the passbook to achieve this security purpose and the introduction of a modern land records system to provide greater certainty of title. In the short run the present security documents are sufficient if combined with an adequate investigation of the security provided.

## E Credit Passbook

ACD Circular No. 21/84, "Agricultural Crop Loans - Annual Basis", dated October 16, 1984, in its paragraph 6, introduced the passbook system for farmer borrowers to improve the efficiency of lending and loan recovery procedures. The attached Annex II of that circular contains a form for the passbook. (See Annex 3, Table I). Such a passbook system had been considered since 1978 as a means not only of improving loan recovery and assisting in the elimination of the problem of the same security being used for separate loans from separate banks but also of updating land records. Thus, it was first considered that it should be prepared and issued by the Board of Land Revenue so that it could serve as a legal record of land rights. However, agreement could not be reached between the two agencies on the exact nature of the passbook so the Agricultural Credit Department went ahead with the introduction of its own form. That form contains information regarding the general location of land owned, mortgaged, leased or sharecropped by that particular individual, his animals and agricultural implements, the value of his annual production and sales, his annual production plans and previous

sanctioned loans (with loan account numbers), the monthly account of payment of loans, and his record of savings of the bank, as well as a photograph and signature or thumb impression for identification purposes.

The passbooks are to be issued by each bank and internal circulars, attaching the ACD circular, sent by BKB and each of the four nationalized commercial banks to their branches. Passbooks based upon Annex II of the ACD Circular have been prepared by the banks but the progress of introduction at the branch level has been slow. In the meantime, ACD Circular No. 6/85, dated June 15, 1985, "Financing of ITAP 1985", has been issued. Paragraph 4 of that circular indicates that persons will not receive loans under the intensive Transplanted Aman Program if they do not have, or are unable to get, a passbook.

As of July 1, 1985, detailed instructions regarding the issuance of passbooks and safeguards for protecting the security of the passbook system had not yet been issued. However, there are already some differences in the form of passbooks between banks and even within regions of BKB. BKB branches in two different divisions of the country have been issuing slightly different forms of passbook. In addition, the Rupali Bank passbook is different from that issued by BKB. In neither case is there a special numbering system or other security device that would help eliminate the development of phony passbooks.

Unfortunately, the outside pressures to have an operating passbook system by September 30, 1985, have created a situation where its introduction may prove to be a step backward, rather than a step forward.

In the first place, the present form of passbook is flawed so that its introduction is unlikely to be successful and may even worsen the position of small farmers. The most critical point is that the passbook, alone, cannot fulfill the fundamental purposes of security and identification for which it was originally envisioned. Because of

failure to reach an agreement with the Board of Revenue, the passbook does not contain a legal description of land which is owned by or on which the passbook holder has legal rights. It does not contain an extract from the land records which would allow for precise identification of rights. Thus, the Bank is not protected with regard to its security and the small farmer does not have a document to show to the bank which does not necessitate another visit to the land records office and the payment of additional monies for a new copy or certification. In the larger picture, the passbook does not assist the Government of Bangladesh to modernize its land records for use for other purposes. All that the present form of passbook provides is a photograph and a general listing of amount of land owned, mortgaged, leased and/or sharecropped by that individual in that village as attested to by the Union Parishad Chairman or a Ward member. Not even any identification of adjoining owners is provided. One has no way of knowing if several persons in the village are claiming the same land. Liens or other obligations of the passbook holder are not shown, as they would be if backed by a land record.

This type of imprecision also opens the system for abuse by local influentials. This possibility appears to be magnified by the predominant role of the Union Agricultural Credit Committees (UACCs) in deciding who receives passbooks. As presently formulated, the applicants are to submit their applications for passbooks to the UACCs, along with their production plan, a procedure similar to that of the Special Agricultural Credit Program. A small farmer is supposed to be assisted in the preparation of such a production plan by the Block Supervisor from the Department of Agriculture. However, such persons have generally wanted a rather large fee for their services. They also have been often very friendly with the members of the Union Agricultural Credit Committees who might refuse to approve any production plan not developed by a friend with whom they might have a business arrangement. Certification by the UACC would then be required before a passbook would be issued. Thus, the fear that passbooks might be issued to big farmers while creditworthy small farmers might not receive passbooks because they had not

been regular borrowers before is well founded. This system for granting passbooks would seem to retain the detrimental conditions associated with the UACCs from the SACP Program. In many ways it would be worse if the passbook became a universal requirement for obtaining loans, one that could not be met by many small and landless farmers.

A third point is that each bank in a local area would have its own passbook. Banks in a given area are supposed to communicate with each other, but at present there appear to be large gaps in such communication and one cannot automatically assume that the situation will improve in the future. The imprecision of the description of security only increases the likelihood that one man or members of the same family will use the same security for several loans. This problem would be lessened if only one passbook were issued by the lead bank in each area which would be used by all of the banks. Such a system would also be more likely to enforce uniformity in type of form used for passbooks.

The introduction of passbooks also raises the question of what type of program for loan recovery best increases such recoveries while not hurting agricultural production and the condition of small farmers. at present, it is thought to introduce a rigid policy by which no defaulters can receive a passbook and no person without a passbook can receive a loan. However, the rich defaulters will probably find a way to get a passbook issued to someone in their family while the poor farmers are those most likely to be penalized. If this occurs, then the passbook system wil be adjudged a failure from its beginning. Thus, some very basic decisions must be made about what is the definition of a "willful defaulter", how different types of loan programs will be treated, and similar matters. At present, there is very little information about what types of loans are not being repaid. The RFP survey of borrowers and branch managers is gathering such information for use in developing a comprehensive loan recovery program. This information will be available in early 1986 and should assist in the development of final policy on passbooks.

Finally, a passbook system is only likely to be successful if its introduction is active in nature, that is, if banks actively seek farmers to whom to give passbooks. Such an active system would have been better introduced as part of a procedure for updating land records and protecting land rights. It would be hard to get farmers to seek passbooks if they also were not sure that they would immediately get loans. However, a passive system of waiting in bank offices would ensure that the most sophisticated persons are the most likely to benefit. In addition, an active approach would allow for the cross-checking of land rights information that is necessary for the banker in addition to a review of extracts from the land records.

Given the above, it would be preferable to amend the passbook form so as to provide for the copying of the relevant extract from the land records, or the terms of a lease or sharecropping agreement attested by the parties or the passbook itself, with such again attested to, as at present, by the signature of the Union Parishad Chairman or a ward member to identify the person and that the information given with regard to the number of acres of land in each of the categories of ownership - under irrigation and whether irrigation mortgaged, leased and sharecropped - is accurate.

In addition, it would be necessary for the Bangladesh Bank to issue uniform instructions if one passbook was to be prepared by the lead bank in each area and to provide for a security system for such books. The issuance of such instructions, and other as required, are necessary if the integrity of a passbook system is to be preserved.

## F. Role of the Union Agricultural Credit Committees (UACCs)

The Union Agricultural Credit Committees (UACCs) represent an intrusion of general local administration and political concerns into the bank loan-making process. Abuses in recommendations of qualified

borrowers by members of UACCs has been one of the major reasons for the low loan recovery rate under the Special Agricultural Credit Program (SACP). Thus, it would probably be an improvement if all decisions to grant or deny credit were made the responsibility of the bank management alone. This would add to the professionalism of the banking system and avoid its direct involvement with local politics. In addition, there are specific legal provisions for punishing bank officials who give out loans to relatives and friends. Further, one can affect his future promotion and career directly. There are no clear penalities for members of the UACCs who violate the trust of the Government and the bank involved.

However, one cannot avoid consideration of the problems that led to the formation of the UACCs in the first place, especially the problem of the small or landless farmer in showing sufficient security for a loan to be granted. The most obvious alternative to security in the form of land is the guarantee of one or more sureties who hold high and respected positions in the community. The establishment of the UACCs was an attempt to provide such a system on a general basis. However, the members of those committees were not required to guarantee the loans made to the persons whose names they put on their approved lists. thus, they did not suffer when such loans were not paid and had no stake in the SACP program. Often they and their families and supporters were the greatest abusers. A system of committees whose members both made lists and acted as surety for the loans made to these individuals might prove a better system for providing loans to the poor and landless. It also would give local political leaders and influentials a direct stake in loan recovery. However, past experience would not lead one to optimism in this area. The group guarantee approach typified by Grameen Bank, the Swarnirvar Program and the type of reformed cooperative societies program discussed in Section III(G) in which members of the group/society act as surety to the loan would seem to have a better chance of success.

A pilot project using bank reviews of loans alone should indicate if such a process is viable in present-day Bangladesh. As noted in Section

III(E), a decision must be made quickly to avoid the type of problems with the credit passbook system that were faced by the SACP. If such a decision cannot be made, then the members of the UACCs should be made to bear personal responsibility for loans made to persons whom they recommended for passbooks.

G. Group Borrowers/Cooperative Societies

The low level of assets of most potential borrowers in rural Bangladesh means that credit for tubewells, tractors and other types of equipment and storage facilities is best given in a situation where there is a group to act as guarantor or surety for repayments.

Bangladesh has already had much experience with lending to groups, particularly to cooperative societies. As noted previously, much of this experience has not been happy. Cooperatives, even the Comilla Cooperatives, have tended to be controlled by the rural elite who gained control of the society managing committees and granted themselves loans which were never repaid. Despite efforts to stop them, these abuses have continued. As of June 30, 1982, the BSBL (Apex Cooperative Bank) had shared capital and reserves of Tk. 1,167.23 lakhs as compared to bad and doubtful debts of Tk. 3,863.77 lakhs, with overdues of Tk. 43.84 crore (principal) and Tk. 29.54 crore (interest). 39/

The prior legislation for cooperatives, the Cooperative Societies Act, 1940 (Bengal Act XXI of 1940), did not provide sufficient clarity

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39/ Based upon Bangladesh bank estimated cited in Sambhu Nath De, Strengthening and Developing the BSBL Credit System, Final Report (under IDA Credit No. 1147-BD, Technical Assistance for Cooperatives) (Dhaka: June 1984), p. 96.

with regard to the treatment of defaulters. It permitted persons who had defaulted on their loans to continue to serve on the managing committee of that society, and for such persons not to be automatically excluded from receiving new loans until they had repaid the defaulted loan. The new Cooperative Societies Ordinance, 1984, (Ordinance No. 1 of 1985) has a number of stiff provisions which close the legal loopholes with regard to such abuses. (see Annex 4 for list of new provisions added.)

In particular, new Section 19 of the Ordinance provides that no member of a society shall be eligible to be elected as an officer of that society or an affiliated society if he defaulted upon the payment of any loan. In addition, the Government may remove a member or the managing committee, by order in writing, if it is satisfied that he is abusing his position as an officer or otherwise acting in a manner prejudicial to the interest of the society. If a person is so removed, he shall be disqualified for a period of up to 5 years from being a member of officer of that society or of any other cooperative society (new Section 26). In a parallel provision, the Government may disqualify a person for a period of up to 5 years from being a member or officer of a cooperative society if he abused his position or acted prejudicially in that or any other cooperative society (new Section 27). Further, a specific restriction is placed on the maximum amount of loans that can be made to a cooperative bank, based upon the amount of deposits he has in the banks. That maximum is set at 95% of such deposits [Section 39/(3)]. Finally, the definition of misdemeanors under the Ordinance is extended to include the following:

1. continuing as a member of the managing committee of a cooperative society even after being disqualified under this Ordinance [Section 127(c)].

2. not repaying a financing bank any amount recovered from loanee members which that society or person is bound to deposit as repayment with such banks [Section 127(d)].

3. collecting share-money, deposits or other funds for a society and depositing such funds with the society or its financing bank within a reasonable period [Section 127(e)].

4. Wilfully neglecting or refusing to do any act or furnish any information required by the Registrar [Section 127(f)].

Such misdemeanors may be penalized by a fine in an amount set by the Registrar (Section 127).

Thus, the Registrar of Cooperatives now has specific offenses of abuse of the trust of cooperative societies and banks to enforce, and early 1985 has seen a number of such cases brought against managing committees and directors of specific societies.

The reformation of the cooperative system in the long run, however, probably requires a link with the commercial banks and the abolition of the concessional financing (at 2½ 2% below the normal interest rate) to the BSBL by the Bangladesh Bank, even if a scheme can be worked out to repay and/or cancel the debts of the three-tier cooperative system as a whole. The presence of subsidized monies is generally an inducement to capture by those who are sophisticated enough to use the system. That is the worldwide experience regarding many types of cooperatives and it fits the experience of Bangladesh. A better model is the granting of loans to the Comilla (IRDP) cooperatives by the nationalized commercial banks, whose lending practices as scheduled banks are supervised by the Bangladesh bank. Thus, the cooperative banking system would be supervised not only by the Registrar of Cooperatives but also by the standards of the banking system as a whole. Both would need to be effective if abuses are to be avoided in the way that loans to societies are used.

Given the difficulties of eliminating abuses with regard to loans to cooperative societies, other types of group lending appear more

attractive in which loans are given to individuals within the group with the entire group (as individuals) or one or two members of the group acting as personal surety. However, the problem remains as how to keep such lending honest, that is, how to avoid abuses by certain members of the group at the expense of other members and how to enforce the group surety that makes it possible for banks to defend loans to individuals who would not otherwise be considered to have sufficient collateral. The Grameen Bank relies upon requiring compulsory deposits, weekly payments and close supervision, in addition to the surety of one or more other members of the group. However, this type of program has large administrative costs which could generally not be borne by large-scale banking operations. BKB and other banks have begun to give loans to members of Swarnirvar (self-help) groups of 6 persons who have each opened an account with a minimum deposit of Tk. 35 or more. the other members of the group then serve as surety for a loan granted to one member for productive purposes. The local Swarnirvar organization receives a fee of part of the interest paid for generating and supervising the loan. Again, as with Grameen Bank, this system relies upon extraordinary measures which can probably not be built into a banking system in the long run. Further, at the BKB branches that we visited, more than one loan was being given to members of the same group at the same time. Thus, the normal self-policing tendencies of the other members of the group, and the discipline thus imposed, were not allowed to operate. Based upon previous experience with similar types of organizations, it is this additional factor that is required for success. In addition, unlike the Grameen program, the compulsory deposit required for the Swarnirvar program appears to be very small with regard to the size of the loan granted. A deposit by the group as a whole of at least 10% of the loan amount should be required as additional security.

the problems of the group approach as a means to providing loans to poor persons has a long history in Bangladesh but there is no long history of success. Stronger and more precise regulation is required and all organizations involved should be the subject of uniform rules set for the banking system as a whole.

## H. System for Identifying and Policing Overdue Loans

The final area to be considered regarding loan recovery is that of developing an effective system for identifying and policing overdue loans. The problem of constructing an effective program for loan recovery is exacerbated by the lack of a uniform system for identifying overdue loans by type and size of loan, age of loan and part record or repayment along with some form of notation regarding the reason for non-payment (where this is known or can be surmised). Such a system would help to pinpoint the type of program that might be more successful in a certain type of overdues situation.

At present, ACD Circular No. 3/84, dated February 9, 1984, "Classification of Overdue Agricultural Loans", sets out the following three categories:

1. Substandard loans - loans or loan instalments running overdue for periods exceeding 3 years.

2. Doubtful loans - all loans or loan instalments which continue to run overdue without having any repayment during the last 5 years, in spite of the pursuing or recovery and the taking of action through the Certificate Procedure.

3. Bad Debts (Loss) - a loan or portion thereof which is proved beyond doubt to not be recoverable due to:

   (i) death of the loanee or his surety.

   (ii) the passing of a reasonable amount of time after the issuance of a certificate.

   (iii) loss cases.

(iv) the disposal of mortgaged properties by the bank or other competent authority at a value that is less than the amount owned.

(v) the loan having been disbursed to persons who are not traceable.

Final recommendations in this area will be made after the completion of the comprehensive review of loan procedures. Moreover, any adequate policing procedure for loans must include a system in which loans are declared as delinquent after non-payment for a period as short as three months, rather than waiting to declare a loan to be substandard at the end of the statute of limitations period of three years for filing claims for monies due. Such continuous supervision is required if large scale collection is to be achieved.

In addition, one must always keep in consideration the lack of incentive caused by the failure of the Income Tax Act to allow banks to deduct a proper allowance for a bad debt reserve. The formulation of such a proper reserve is a discipline that is closely tied to the effective collection of loans. It would require the more precise definition of terms such as "reasonable amount of time" or the amount of time to be allowed before a person is considered as not traceable in the definition of the "bad debts (loss)" category in ACD Circular No. 3/84.

## IV. SAVINGS MOBILIZATION

### A. Introduction

Aside from consideration of problems arising from the loan process, the Rural Finance Project is also focusing upon the improvement of rural savings mobilization. A number of suggestions have already been made regarding the types of programs to encourage savings in Bangladesh based upon experience in other countries.[40/] The borrower survey to be conducted in the last part of 1985 will also gather information on what types of programs are likely to be successful. In addition, the discussion of group borrowing above (section III (G)) noted the linkage of borrowing with compulsory saving under the loan programs of the Grameen Bank and the Swarnirbar (Self-help).

Rural deposits in the banking system have increased quite rapidly since 1975, both in absolute terms and in terms of percentage of total deposits. As noted in the section on background above (Section II,) rural deposits increased by 15 times to Tk. 1602.5 lakhs during the ten year period to December 1984 while total bank deposits increased by only 8 times. Thus rural deposits increased from 9.5% of total deposits to 18.0% of total deposits. During the same period, as also noted previously, rural credit increased from 3.4% to 25.8% of total advances.

In addition, since July 1984 savings deposits with checking facility

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40/ George Behymer, Arthur O'Donnell & Mr. Omar Choudhury, Savings Mobilization in Bangladesh A Preliminary Overview Paper 3 in Volume 5 Final Report, Rural Finance Project

made in branches of banks in rural areas[41/] by individuals[42/] have received higher interest than that given on similar deposits in urban areas. In July 1984 the rate for such rural deposits was increased to 9.5% per annum from 8.5 per annum.[43/] This rate was increased to 10.5% per annum from January 1, 1985. Also, from January 1, 1985 a similar different rate was introduced for savings deposits without checking facilities. The interest rates for such deposits in rural areas is now 11.0% per annum as compared to 10.0% per annum in urban areas. Similar differential rates had been in effect from 1977 to 1980 for both savings deposits without checking facilities[44/] and fixed deposits of up to 2 years.[45/] Such rates did stimulate a dramatic increase of such fixed deposits in rural areas, but mostly for large accounts. There are not yet results with regard to the present differential interest rate policy on savings deposits alone.

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41/ "Rural Areas" are defined as anywhere outside of Metropolitan Dhaka, Chittagong and the Municipal Areas of all Divisional and District Headquarters (Present Zillas).

42/ "Individuals" are defined as those who are not firms, companies, corporations and other corporate bodies.

43/ See BCD Circular No. 27/84, dated July 24, 1984, "Interest Rate on Savings Deposits".

44/ From October 1, 1978 to October 15, 1980, new savings accounts without checking facilities in rural areas carried an interest rate of 7.75% per annum, 9.0% per annum in urban areas.

45/ Rates for fixed deposits in rural areas for 3-6 months were 8.5% per annum (as compared to 9.0% in urban areas) for December 15, 1977 to October 15, 1980. Fixed deposits for a period of 6 months - 1 year had an interest of 8.5% per annum (as compared to 9.5% in urban

(Footnote continued to page 1. )

Unlike the area of rural credit, the main problems connected with rural savings mobilization for the formal banking system appear to be with regard to marketing and the providing of better and more secure banking service. More aggressive approaches which tied depositing to preferential treatment in receiving loans and the introduction of a mobile banking system, especially to collect the savings of women, as well as the targeting of different types of contract saving for different areas would seem to be the main points of such a program. Each of these types of programs have been discussed many times before in Bangladesh and have been tried on at least a limited basis. However, as with so many other things, there does not appear to be the incentive and administrative system in place for the sustained effort required nor has the banking system yet been able to overcome problems of integrity as viewed from the local level.

Thus there are no major laws or regulations which should hinder savings mobilization in Bangladesh. However, there are three areas of potential restrictions that merit discussion. They are:

1) restrictions on withdrawal
2) use of account by heirs of account-holder
3) confidentiality of account information

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(Footnote continued from page 145
areas) for the period December 15, 1977 to September 30, 1978 and 9.0% per annum from October 1, 1978 to October 15, 1980. Fixed deposits for a period of 1-2 years had an interest rate of 9.25% (as compared to 8.25 in urban areas) from December 15, 1977 to October 15, 1980.

B. Restrictions on Withdrawal

At present, a depositor can only withdraw up to 25% of his balance with a maximum of Tk. 10,000 per week without notice and a higher amount only with 7 days' notice. However, this does not appear to be a problem in practice. The recent survey by the Bangladesh Institute of Banking Management (BIBM) for the National Commission on Money, Banking and Credit[46/] did not discover that borrowers had significant problems in the making or withdrawing of deposits.

C. Use of Account by Heirs of Account-Holder

However, the BIBM study did mention the problem of heirs withdrawing money from the account of an account-holder after his death until such an heir has gone to court to prove that he is indeed the heir under the Succession Act, 1925), as amended. That procedure can indeed take a considerable time but it is important to safeguard the right of other potential heirs. The BIBM study suggests that some expedited procedure be found by which the account holder may designate an heir with regard to that account at the time that the account is opened. Given the general lack of passage of most property by will in Bangladesh, such a recommendation should be considered. However, such designation will not overcome the general presumptions of both Muslim and Hindu law regarding the passage of property by inheritance. Further, it is possible now to

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46/ BIBM, Summary of Findings of the Surveys on the Appraisal of Customer Services of Scheduled Banks of Bangladesh and Some Recommendations (Draft:June 1985).

set up nominee accounts, joint accounts, custodian/guardian and trustee accounts if one wants money to be under the control of one heir to the exclusion of others. The present system by which bank accounts are transferred on death by either the general wishes of the deceased as expressed in a will or under the relevant laws of inheritance is preferable as a protection to all parties involved.

D. Confidentiality of Account Information

The RFP Report on savings mobilization in Bangladesh noted that its field visits indicated the method of making deposits and withdrawals and the keeping of account records was very public and that branch managers were worried that this lack of confidentiality was keeping some potential customers from opening accounts. In addition, the recent action requiring the deduction of 10% of the interest earned on fixed deposits as a tax has worried depositors about the confidentiality of their accounts. Generally, such confidentiality is protected by common law precedents and by the Negotiable Instruments Act, 1881. However, a specific regulation of the Bangladesh Bank in this area would be welcome along the lines of the recent statement that the names, addresses and account numbers of depositors who had fixed deposits would not be divulged to the head offices of the banks or to any other agencies.

## V. GENERAL PROBLEMS OF ADMINISTRATION AND MANAGEMENT

As a final section, several types of issues with regard to general problems of administration and management of the rural finance system will be mentioned. These issues relate to the efficacy of any such system and reflect more general considerations with regard to administration in Bangladesh.

### A. Policing of Non-Bank Financial Institutions

At present, the Bangladesh Bank does not have effective regulation of those financial institutions which are exempt from the provisions of the Banking Companies Ordinance, 1962 (Ordinance No. LVII of 1962). These institutions include the Grameen Bank,[47/] the cooperative banking network (including the Apex Cooperative Bank (BSBL),[48/] and the Bangladesh Rural Development Board which is responsible for supervising the Comilla cooperative system. The Grameen Bank is under the control of its Board of Directors which consists of 12 persons, including the Chairman and Managing Director, three persons appointed by the Government, four persons appointed by the borrower-shareholders, 2 persons who are appointed by the Government from among the Managing Directors of the Krishi Bank or the commercial banks

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47/ Grameen Bank Ordinance, 1983 (Ordinance No. XLVI of 1983), Section 4(3). However, Section 4(4) of that Ordinance permits the Government, by notification in the Official Gazette, to direct that specific provisions of the Banking Companies Ordinance, 1962, are applicable to Grameen Bank.

48/ The Cooperative Societies Ordinance, 1984 (Ordinance No. I of 1985), Section 3.

nationalized in 1972 and a woman appointed by the government who has experience in working with landless persons.[49/] Thus 3 of the 12 directors are appointed by the Government which is a 60% shareholder of the Bank. These appointments are made by the Minister of Finance. The cooperative banking network is regulated by the Registrar of Coopertives under the Ministry of Local Government, Rural Development and Cooperatives. The Bangladesh Rural Development Board is controlled by a Board of Directors whose Chairman is the Minister of Local Government, Rural Development and Cooperatives and whose other 15 members include the Secretary of the Rural Development and Cooperatives Division of that Ministry, as Vice Chairman, and the heads of the relevant divisions of Agriculture and Forests, and Fisheries and Livestock in the Ministry of Agriculture, the Finance Division in the Ministry of Finance, the Energy Division in the Ministry of Energy and Mineral Resources, the Ministry of Irrigation, Water Development and Flood Control, and the Local Government Division. It further includes the Member of the Planning Commission in charge of rural development; the Chairmen of the Bangladesh Agriculture Development Corporation, one of the two Directors of the Bangladesh Rural Development Academies at Comilla and Bogra; the Registrar of Cooperatives Societies; the Chairman of the Bangladesh Small and Cottage Incustries Corporation, 5 members elected by the National Federation of Thana (now Upazila) Central Cooperative Associations; one member nominated by the Government from the major financial institutions who are financing such Cooperative Associations; one member nominated by the Bangladesh Jatiya Somabaya Union and the Director-General of the Board, who shall serve as its Secretary.[50/] The Cooperative societies systems and the Grameen

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49/ Grameen Bank Ordinance, 1983, Section 9.

50/ Bangladesh Rural Development Board Ordinance, 1982 (Ordinance No. LIII of 1982), Section 5.

Bank are important elements of a viable rural finance system and their successes and deficiencies should be known to the Bangladesh Bank so that it can have effective control over the rural credit system as a whole. It is particularly important that the Central Bank have up to date information regarding amounts and types of deposits, amounts and types of loans made, overdue loans and ages by category, and of costs and profits for operations as reflected at least in annual balance sheets and profit and loss statements. It must have the authority to compel the production of such documents at the appropriate times and based upon uniform forms and procedures. The Bangladesh Bank must also prescribe uniform requirements in accounting and audit and inspection.

At present, Section 53 of the Bangladesh Bank Order, 1972 gives the Bank broad discretion to give directions to non-bank financial institutions regarding the conduct of their business. Section 55 of that Order permits it to inspect the books and accounts of such institutions. Section 52 of the Order permits the Bank to specify what statements should be submitted to it. Cooperative societies are specifically exempted from the aplication of these principles and no changes were made in this situation by the new Cooperative Societies Ordinance, 1984. What is required is that the Registrar of Cooperatives issue an order encompassing the above matters of uniformity and that he receive the reports stated from the secondary bank and the Apex Cooperative Bank (BSBL) and order that a copy simultaneously be sent to the Bangladesh Bank. In the long run, however, the cooperative system should be brought under the provisions of the Banking Companies Ordinance, 1962.

With regard to Grameen Bank, the above cited sections of the Bangladesh Bank Order, 1972 would give sufficient authority to the Bank to impose the needed rules. As an alternative the Government should take advantage of Section 3(4) of the Grameen Bank Ordinance, 1983 and, by notification in the Official Gazette, state that the Grameen Bank is subject to the provisions of the Banking Companies Ordinance, 1962 which give such authority, particularly Sections 32 (half-yearly returns and

power to call for other returns and information), 34 (accounts and balance sheet), 35 (audit), 36 (submission of returns) and 37 (copies of balance sheets and accounts to be sent to registrar). A more complete set of required uniform procedures and forms will be given in the final report.

B. Precise Description of Authority of Relevant Departments of the Bangladesh Bank

A related issue is that of the authority of the different relevant departments of the Bangladesh Bank and of their ability to carry out regulation of the rural finance system.

Under the Bangladesh Bank Order, 1972, the Agricultural Credit Department (ACD) is empowered under Article 68 to:

1. Study all questions of agricultural credit and be available for consultation by the Government, Apex Cooperative Bank, and other banking organizations;

and

2. Coordinate the operations of the Bank in connection with agricultural credit, and the relations of the Bank with the Apex Cooperative Bank and any other organization engaged in the business of agricultural credit.

There is no definition of "agricultural credit" but it has been broadly defined in practice to deal with all kinds of loans that have an impact on increasing agricultural production or furthering agricultural development. The creation of the Rural Credit Project Department in 1981, at the instigation of the World Bank to carry out its Minor Irrigation Project, muddied the lines of authority and has led to the issuance of circulars by both departments on similar matters but with

differing and conflicting terms and conditions. In addition, the Industrial Credit Department gives loans to industries in rural areas. Finally, the Banking Control Department (BCD) plays a general role with regard to setting of standards for activities such as refinance.

For more effective regulation of the rural finance system as a whole, the specific areas of jurisdiction of each of these departments should be more precisely defined and primary responsibility for coordination be given. If BCD is to coordinate all refinance, as under BCD Circular No. 26/84, dated July 22, 1984 "Refinance Program for the Year, 1984-85," then ACD which is responsible for refinance of agricultural credit as per that circular, should keep BCD well informed of any such activities so that there is a complete record at one place, at any one time, of all refinance activities.[51/] If other departments give rural industrial loans, the Industrial Credit Department or ACD, as the case may be, should be informed. "Rural Finance" is more than "Agricultural Credit" alone, and other programs can conflict with, undermine and fail to support agricultural credit programs.

There are more such issues that could be considered but these provide a background for any later discussion of the administration of a rural finance system, as part of the administration of the rural development system as a whole.

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51/ Actually, it should be noted that, in effect, no such refinance activities have been carried out by ACD from that date.

## VI. CONCLUSION

Thus the present laws and regulations in Bangladesh in the area of rural finance are adequate for the implementation of a viable system. It is the administration of these laws and regulations in an effective and consistent manner over time, including a greater degree of precision in execution, that is required. The comprehensive survey of loan procedures being carried out by the Rural Finance Project will permit the pinpointing of more precise recommendations regarding more effective administration by the end of the Project in 1986.

# ANNEXES

1. Certificate Procedure
2. Loan Security
3. Credit Passbook
4. Cooperative Societies

## ANNEX 1

## CERTIFICATE PROCEDURE

| | |
|---|---|
| Table 1 | Standard Certificate Procedure |
| Table 2 | Expedited Certificate Procedure |
| Table 3 | Specific Legal Provisions Authorizing The Use of the Public Demands Recovery Act, 1913, For the Collection of Overdue Bank Loans. |
| Table 4 | Circular of Cabinet Secretary No. CD/DA-I/12(65)/83(Pt-1)/545(68), dated November 21, 1984, "Recovery of Loans Though Certificate Courts" |
| Table 5 | D.O. Letter No. ACD(Poly) 911/6-7514/64), dated December 30, 1984, "Recovery of Agricultural Loans". |
| Table 6 | D.O. No. ACD(POLY)911(6)/84-7585, dated December 30, 1984, "Action Plan For Recovery of Agricultural Loans - 1985" |
| Table 7 | ACD Circular No. 5/85, dated 15 June 1985, "Recovery of Agricultural Loans : Submission of Defaulters List" |

Annex 1
TABLE 1

STANDARD CERTIFICATE PROCEDURE
(Public Demands Recovery Act, 1913)

1. Bank sends Certificate Officer a signed written requisition, along with fee due for plaint for recovery of sum of money due under Court Fees Act, 1870 ($16^{2}/_{3}$ % of amount due), (Section 5),

2. Certificate Officer, if satisfied that demand is recoverable and that recovery by suit not barred by law, signs certificate and files it at his office.. (Section 6),

3. Certificate Officer serves notice and copy of certificate upon certificate-debtor. (Section 7). From time of service, all transfer of interest in immovable property in that district void as against claim enforceable by the certificate and amount due on basis of certificate becomes priority charge as to all subsequent charges on any property of the certificate-debtor. (Section 8).

4. Within 30 days of service of notice, certificate-debtor may file petition denying his liability, in whole or in part. (Section 9).

5. Certificate-Officer holds hearing on the petition takes evidence and determines liability of certificate-debtor. He may set aside, modify or vary certificate, (Section 10). (NO TIME LIMIT SET).

6. Certificate shall not be executed until 30 days after date of service of Section 7 notice, or until Section 9 petition is heard and determined. (Section 13). However, Certificate Officer may attach all or part of movable property of certificate-debtor if he fears that it will be cancelled, removed or disposed of.

7. Certificate-Officer may order execution of a certificate :

   (a) by attachment and sale, or by sale (without previous attachment) of any property, or

   (b) by attachment of any decree or

(c) by arresting certificate-debtor and detaining him in civil prison. (Section 14). (For up to 6 months if certificate-officer feels that debtor is likely to leave limits of his jurisdiction, has dishonestly transferred. canceled or removed any part of his property after the filing of the certificate, the debtor has the means to pay the amount due, or some substantial part thereof, and refuses or neglects to pay (WILLFUL DEFAULTER). (Section 29).

8. Under execution, Certificate-Officer can recover :

(a) interest due from date of signing of certificate to date of realization (higher of $6^{1}/_{4}$ % per annum or as set by law). (Section 16(a) ).

(b) Section 45 costs (those set by Certificate-Officer with regard to the proceeding).

(c) all charges regarding Section 7 service of notice and other services and regarding other proceedings for realizing the demand. (Section 16 (c) ).

9. Suit in Civil Court

(A) Certificate-debtor can file suit in civil court to have certificate cancelled if :

(1) amount stated in certificate was actually paid or discharged before signing of the certificate.

(2) no part of amount stated in the certificate was really due from the certificate-debtor.

(3) proceedings of Deputy Commissioner or Public Officer with regard to finas,damages or costs did not follow provision of relevant law or rules. (Section 35 (1) ).

(B) No certificate shall be modified unless :

(1) Portion of alleged debt was not actually due,

(2) certificate-debtor had not received credit for only portion which he has paid. (Section 35(2) ).

(C) Such suit must be filed within 6 months of :

(1) service of section 7 notice.

(2) date of determination of section 9 petition denying liability (but such notice must have been finally filed).

(3) date of decision of appeal to Deputy Commissioner or Commissioner regarding section 10 order following petition denying liability. (Section 34).

(D) Suit may also be brought in Civil Court to recover possession of immovable property or set aside a sale of such property in execution of a certificate if Section 7 notice not served and debtor sustained substantial injury. Suit can only be filed within 1 year of date of delivery of possession of property to purchaser but not if debtor made appearance at certificate proceeding or applied to certificate Officer under Sections 22 or 23 to set aside the sale. (Section 36).

(E) Otherwise, no suit on certificate issues shall be entertained by a Civil Court except upon the ground of fraud. (Section 31).

Annex 1

TABLE II

EXPEDITED CERTIFICATE PROCEDURE*
(Public Demands Recovery Act, 1913)

1. Bank officer serves as Certificate Officer, signs certificate that demand for amount overdue is recoverable and files it at his office. (Section 6).

2. Certificate issued by Bank Officer is conclusive proof that the amount specified therein is due to the Bank.

3. Demand notice is served on certificate - debtor by registered mail with acknowledgment due requiring the certificate - debtor to deposit the amount due with the certificate - officer within 30 days of the service of such notice. (Section 10A(1)). From the time of that service, all transfer of interest in immoveable property of the debtor in that district shall be void as against the claim enforceable by the certificate and the amount due on the basis of the dertificat becomes a priority charge as to all subsequent charges on any property of the certificate - debtor (Section 8 .

4. If the certificate - debtor does not deposit the amount due within the period of time required, the Certificate - Officer shall proceed to execute the certificate in accordance with the provisions of this Act. (Section 10A(3)).

5. The Certificate - Officer may order execution of a certificate, or send a copy of the certificate for execution by another Certificate - Officer (Sections 11, 12). The certificate may be executed immediately by one of the following means:

   (a) by attachment and sale or by sale (without previous attachment), of any property, or

   (b) by attachment of any decree, or

   (c) by arresting the certificate - debtor and detaining him in civil prison, (Section 14).

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As provided by Section 21 of the Bangladesh Krishi Bank Order, 1973 (P.O. No. 27 of 1973); Section 28 of the Grameen Bank Ordinance, 1983

Annex - 1

TABLE - 3

SPECIFIC LEGAL PROVISIONS AUTHORIZING THE USE OF THE PUBLIC DEMANDS RECOVERY ACT, 1913, FOR THE COLLECTION OF OVERDUE BANK LOANS

I. BANGLADESH KRISHI BANK

(Bangladesh Krishi Bank Order, 1973 (P.O. No. 27 of 1973), as amended, Section 21).

"21. Recovery of Bank Dues Under PDR Act

1. Where any agriculturist who is liable to the Bank under any agreement makes default in repayment or otherwise fails to comply with the terms of his agreement with the Bank, such default or failure not being due to natural calamity, the Bank may, subject to any rules made in this behalf, take over the management of the concern of the agriculturist and sell or realise any property pledged, mortgaged, hypothecated or assigned by the agriculturists to secure his liability to the Bank.

2. All sums due to the Bank shall be recoverable as arrears of land revenue.

3. In the application of the Public Demands Recovery Act, 1913 (Bengal Act III of 1913) for the purpose of the recovery of the dues of the Bank, the provisions of sections 7, 9, 10 and 13 of that Act shall not apply and the certificates issued under section 4 of the said Act shall be conclusive proof that the amount specified therein is due to the Bank.

4. Sums due from a cooperative society, and recoverable under clause (1) may be recovered in accordance with the provisions of law for the time being in force relating to the recovery of such sums due from a cooperative society to the Government.

5. Dues of the Bank may also be recovered by any other legal action without any ad valorem fee for the same.

6. An officer (of the rank of Manager or above) of the Bank may exercise all the powers exercisable by a certificate officer under the Public Demands Recovery Act, 1913 (Bengal Act III of 1913) within his jurisdiction for the purpose of recovery of the dues of the Bank only."

II. GRAMEEN BANK

(Grameen Bank Ordinance, 1983 (Ordinance No. XLVI of 1983), Section 28)).

"28. Recovery of Bank Dues

1. All sums due to the Bank shall be recoverable as arrears of land revenue.

Provided that, no sum shall be so recovered unless fifteen(15) days' notice has first been given by the Bank to the debtor or any other person liable to pay the sum.

Provided further that is no giving notice, the Bank shall inform the debtor or any other person liable to pay the sum that he may pay the dues in such instalments as may be fixed in the notice and that it will proceed as to the entire sum outstanding in case of any default in any instalments.

2. In the application of the Public Demands Recovery Act, 1913 (Ben. Act III of 1913) for the purpose of recovery of the dues of the Bank, the provisions of sections 7, 9, 10 and 13 of that Act shall not apply, and the certificates issued under section 6 of the said Act shall be conclusive proof that the amount specified therein is due to the Bank.

3. An officer of the Bank may exercise all powers exercisable by a certificate Officer under the Public Demands Recovery Act, 1913 (Ben. Act VI of 1913), within his jurisdiction for the purpose of recovery of the dues of the Bank only."

ANNEX 1

III. NATIONALIZED COMMERCIAL BANKS

(Public Demands Recovery (Amendment) Ordinance, 1978 (Ordinance No. XXV of 1978), Section 3)

"3. Amendment of Schedule I of Public Demands Recovery Act, 1913 (Beng. Act III of 1913)

In the said Act, in Schedule I, after Article 14, the following new Article 15 shall be added, namely :

"new Article 15. Any money payable to a new bank constituted under the Bangladesh Banks (Nationalisation) Order, 1972 (P.O. No. 26 of 1972) on account of an agricultural loan."

IV. COOPERATIVE SOCIETIES/COOPERATIVE BANKS

A. Cooperative Societies Ordinance, 1984 (Ordinance No. 1 of 1985), Section 52 (Power to Remit Certain Duties, Fees, Etc.)

"(3) Notwithstanding anything contained in any other law for the time being in force, no court fee shall be payable for filing certificate cases under the Public Demands Recovery Act, 1913 (Ben. Act III of 1913), for execution of awards under sections 88 and 125. (Section 88 involves collection on mortgage on property pledged as collateral security). (Section 125 concerns recovery of overdues from Cooperative Society member or his surety on default)".

B. Public Demands Recovery Act, 1913, as amended, Schedule I, Public Demands

1. "12A. Any sum ordered by a liquidator appointed under section of the Cooperative Societies Ordinance, 1984, to be recovered as a contribution to the assets of a society or as the cost of liquidation".

2. "12B. Any sum due to a land mortgage bank registered under the Cooperative Societies Ordinance, 1984, or any sum due to an assignee of such bank in respect of any principal sum or any interest thereon under a mortgage made to the bank.

V. HOUSE BUILDING FINANCE CORPORATION

(House Building Finance Corporation Order, 1973, (P.O No. 7 of 1973), Articles 26 and 27).

"Article 26.

1. When a borrower or his surety makes default in repayment beyond 24 monthly instalments or otherwise fails to comply with the terms of the agreement or letter of guarantee with the Corporation, the Corporation not withstanding the provisions of any other law may, without the intervention of any Court, sell any property pledged, mortgaged, hypothecated or assigned by the borrower or his surety, to the Corporation by way of security.

2. Any transfer of property made by the Corporation in exercise of its powers under clause (1) shall vest in the transferee all rights in or to the property transferred as if the property had been sold to the transferee by the owner.

3. Al sums due to the Corporation from the borrower or his surety shall be recoverable as arrears of land revenue.

VI. BANGLADESH SHILPA BANK

(Bangladesh Shilpa Bank Order, 1972 (P.O. No. 129 of 1972) as amended, Article 35).

35. Recovery of Dues

1. Without prejudice to the provisions of Articles 33 and 34, all sums due to the Bank shall be recoverable as arrears of land revenue:

Provided that, no sum shall be so recovered unless fifteen (15) days' notice has first been given by the Bank to the debtor or any other person liable to pay the sum that the sum will be so recovered:

Provided further that in so giving notice, the bank sha
inform the debtor or any other person liable to pay the
that he may pay by such instalments as may be fixed in
notice and that upon his so paying every instalment on
before the due date the recovery will be suspended, but
it will otherwise proceed as to the entire sum outstandi
in case of any default in any instalment including the f

2. In the application of the Public Demands Recovery Act, 1
(Ben. Act III of 1913) for the purpose of recovery of th
dues of the bank, the provisions of section 10-A of the
Act shall apply, but the provisions of sections 7, 9, 10
13 thereof shall not apply, and the certificate issued un
section 6 of the said Act shall be conclusive proof that
amount specified therein is due to the Bank.

VI. BANGLADESH SHILPA RIN SANGSTHA

(Bangladesh Shilpa Rin Sangstha Order, 1972 (P.O. No. 128 of 1972).
Section 35).

(exectly same as Section 35 of Bangladesh Shilpa Bank Order, 1972 (P.O.
No. 129 of 1972)).

Annex 1

Table 4

GOVERNMENT OF THE PEOPLE'S REPUBLIC OF BANGLADESH
PRESIDENT'S SECRETARIAT
CABINET DIVISION

No. CD/DA-I/12(65)/83)pt-1)/545(68)
Dated: November 21, 1984

FROM: M.M. Zaman
Cabinet Secretary

TO: (i) All Commissioners.
(ii) All Deputy Commissioners.

RECOVERY OF LOANS THROUGH CERTIFICATE COURTS

1. Flow of agricultural credit has substantially increased since the introduction of the Special Agricultural Credit Program in 1977. Agricultural credit now constitutes about 40% of the total outstanding Bank loans in the private sector of the country. However, the recovery of the agricultural laons is far from satisfactory. The increased volume of overdue agricultural loans, which stood at Tk. 742.00 crore as of 30-6-84, has been causing much concern. Since agricultural loans are disbursed by the banks primarily out of their own resources, built-up through public deposits and secondarily by taking refinance from the Bangladesh Bank, which has to be repaid as due the overdue loans are required to be recovered to enable the banks to recycle the fund and continue to lend as well as to check inflationary pressure on the economy.

2. In order to save the overdue loan cases from being time-barred under the Law of Limitation Act, banks are constrained to file certificate cases in different courts by paying advance ad valorem fees (stamp duty) at a rate of 16.66% together with a process fee and other charges, if any. It has been observed that disposal of the certificate cases takes a long time. As a result, a considerable amount of money spent by the banks on this

account remains blocked until it is recovered with the certificate debts in due course. The delay also tends to

3. It has been brought to notice of the Government that disposal of certificate cases is inordinately delayed due to pre-occupation of the designated certificate officers. It may be appreciated that banks do not take recourse to certificate action in ordinary circumstances. They file certificate cases after exhausting all other possible avenues for recovery from the borrowers who are found recalcitrant to settle their debts. Delay in disposal of certificate cases not only keeps the fund of the banks blocked in the form of outstanding loans and unrealised stamp duties, but it also undermines the effectiveness of this recovery procedure in the eyes of all concerned though it is otherwise considered to be the only legal framework for affecting recovery.

4. With the creation of the Upazila Administration, it is now expected that disposal of cases under the PDR Act will be made more effective, given the proper interest and efforts exerted by the Upazila Administration.

5. He is, therefore, advised to make the certificate courts more effective for quick disposal of the certificate cases filed by the banks by asking them to give as much priority to banks' cases as is given for recovery of land revenue.

6. At the District level, the Deputy Commissioner should review the progress of disposal of certificate cases regularly in the meeting of their District Committees.

7. It is requested that action on the lines outlined above may be taken and a compliance report sent to this Division with copies endorsed to (a) The Finance Division, Ministry of Finance and (b) the Agricultural Credit Department, Bangladesh Bank, Head Office, Dhaka. If he has any suggestions to make the certificate procedure more effective for recovery of bank loans in the context of the present Upazila Administration, they should be made

Annex 1

Table 5

D.O. Letter No. ACD (POLY) 911/G-7514(64)
Dated December 30, 1984

My dear Deputy Commissioner,

RECOVERY OF AGRICULTURAL LOANS

Please refer to Secretary, Cabinet Division's letter dated 21-11-84 addressed to you on the subject of recovery of agricultural loans through the certificate procedure. I am writing this on behalf of the banking sector to seek your co-operation and active support in recovering overdue agricultural loans. This is also in pursuance of Government decision to launch a drive from January, 1985 keeping in mind the recovery of agricultural production/income with the harvesting of Aman and high prices of Jute. I would request you to take as much interest in the recovery of banks' loans as you have been doing in the matter of collection of Government revenue. Bangladesh Bank and the nationalised banks will provide such assistance to you as you may need in this behalf.

From the first-hand information gathered by field visits, it is observed that a considerable portion of the crop loans have been given to non-farmers disbursed as per lists prepared and submitted by the UACCs to the bank branches concerned. The Chairman and other members of the UACCs should, therefore, actively participate in the recovery of loans as they become due. It has been suggested from some quarters that to bring about a sense of responsibility from the local Chairmen/Members it could be stipulated that if 80% of the loans disbursed as per lists prepared by UACCs is not recovered within due dates, the Chairmen/Members of the concerned Union Parishads will not be associated with agricultural lending in the future. We would appreciate your comments on this particular proposal.

In order to save loan cases from being time barred under the law of limitation Act, banks are constrained to file certificate cases in different courts by paying advance ad valorem fees at a rate of 16 2/3% together with

a process fee and other charges, if any. . You will appreciate that banks generally resort to certificate action after exhausting all possible avenues for recovery from the defaulting borrowers who are usually found recalcitrant to settle their debts. It has been observed that disposal of certificate cases is inordinately delayed due to pre-occupation of the certificate officers. As a result, not only a considerable amount of bank money remains blocked up in the form of outstanding loans and unrealised stamp duty, but it also undermines the effectiveness of this recovery procedure in the eyes of all concerned.

Under the circumstances, I will appreciate it very much if you strengthen the certificate courts, if necessary by designating a certificate officer in each Upazila for this purpose and make the courts more effective for quick disposal of the banks' certificate cases by giving it as much priority as is given in the recovery of land revenues.

Yours sincer

(signed)

(M. NURUL ISL

Annex 1

Table 6

D.O. No. ACD (POLY) 911(6)/84-7585 dated December 30, 1984

To Bank General Managers:

ACTION PLAN FOR RECOVERY OF AGRICULTURAL LOANS- 1985

You are aware that overdue of agricultural loans have reached an unsustainable level. Recovery situation has worsened due to floods, droughts which necessitated rescheduling of loan repayment. With the recovery of agricultural production and income, it has been decided by the Government to launch a recovery drive immediately. The following action plan to that end is suggested for your consideration and implementation. You may make such improvement on the action plan as you may consider appropriate:

(i) Target for Recovery:

All banks will fix up a target of collecting, within a period from January to March 1985, 80% of loans which will have become overdue by 1st February, 1985 (including previous overdues) of each branch.

(ii) Rebates:

Farmers may be allowed a rebate on service charge @ 2% if the whole amount of dues is repaid within the final due date of repayment. Similarly, a rebate of penal interest @ 2% may be allowed if the overdue amount is repaid by the 31st March, 1985 or within the quarter of its becoming overdue, whichever is applicable.

(iii) Incentive to Staff:

In order to provide incentive to the bank officials/field assistants, a proposal for introducing monetary benefit for better recovery is being worked out in the Bangladesh Bank which would be finalised in consultation with you.

(iv) List of Defaulters:

Lists of defaulters may be regularly exchanged once a quarter between bank branches within the Upazilla, specially between BKB branches and commercial bank branches in the respective areas. Such a list should also be given to the Union Parishad and be displayed in local hats and bazars. This will create social and psychological pressure specially on big farmers/influential groups who may be defaulting payment of loans wilfully.

(v) Publicity:

Each bank should consider printing leaflets/ handouts and distribute them through the branches requesting the loanees to repay their loans on time and assuring them of future loans at the time of their repayment. Similarly, publicity should also be made through the beating of drums in the local hats and bazars. Publicity through other mass media will be arranged centrally by the Bangladesh Bank separately.

(vi) Visits/Tours of the Senior Officers of the Banks:

Senior officers of the banks should visit the different branches and hold meetings at the Upazilla level for impressing upon the bank/ local administration. They should explain the importance of regular repayment and its impact on the credit operation. Bach branch should be visited by them in connection with the recovery drive as often as is considered necessary.

(vii) Crop Loans to Non-Farmers:

It has been reported that a considerable amount of crop loans have been granted to non-farmers. Banks are advised to identify such fake borrowers with the help of their agricultural assistants/ UACC. All such non-farmers should be debarred from all future lending unless the loans are repaid by them.

(viii) Realisation Through Certificate Cases:

Attention of the banks is drawn to Secretary, Cabinet Division's recent circular on certificate cases (copy enclosed). I am drawing the attention of the Deputy Commissioners to this letter with

the request to take an active interest in both recovery and disposal of certificate cases. The progress of disposal of certificate cases as well as of recovery should be pursued by your officers with Upazila Nirbahi Officers and occasionally with Deputy Commissioners. The Secretary of the District Committee is also being advised to send regularly the progress of disposal of certificate cases to the Chief

Please advise your branches accordingly on priority basis.

Yours sincerely,

(signed)

(M. NURUL ISLAM)

Annex 1

Table 7

ACD CIRCULAR No. 5/85 Dated 15th June, 1985

RECOVERY OF AGRICULTURAL LOANS:
SUBMISSION OF DEFAULTERS LIST

TO: Managing Directors, BKB and
Nationalized Commercial Banks

You are aware that the volume of overdue agricultural loans has already reached an unsustainable level causing inflationary pressure on the economy. Therefore, in order to improve recovery of the loans by causing psychological and social pressure on the recalcitrant defaulters, banks are advised to initiate the following course of action:

1. Bank branches should prepare a list of chronic defaulters, separately of Chairmen (UP) and office bearers of UACC/KSS, big farmers and defaulters with largest overdues;

2. Such list should be submitted to the Regional Offices for taking up with respective Government agencies;

3. Banks would publish the list of such defaulters in local newspapers for a few days and display at the branches concerned;

4. Such lists should also be exchanged between local branches;

5. If no repayment is received from such defaulters within 30 days from publication of the list, certificate cases should be filed;

6. The Regional Offices will regularly review the progress of disposal of certificate cases and submit reports to the respective District Committees through the Member-Secretary, Land Bank for initiating necessary action;

7. Initially, branches should prepare and submit such list to their regional offices by 30th September, 1985. Thereafter, such lists should be submitted on a quarterly basis.

You are, therefore, requested to issue necessary instructions to your branches concerned in this respect under advice to us.

Yours faithful:

(signed)

(Kamal Uddin Ah
GENERAL MANAGE

# ANNEX 2

## LOAN SECURITY

Table 1 Crop Hypothecation Deed

Table 2 Deed of Mortgage

Table 3 Sanction Letter

Table 4 Demand Promissory Note

Table 5 Appraisal Report

Table 6 Loan Application Form

Table 7 Types of Security Required for Different Types of Agricultural Loans

ANNEX 2
TABLE 1

SONALI BANK
CROP HYPOTHECATION DEED
(TRANSLATED FROM BANGLA)

Whereas, Sonali Bank (hereinafter called Bank) has agreed to grant me/us a short/long term loan amounting to Tk. _____ with interest of Tk. 12/- per annum in response to my/our application dated _____ for cultivation of various crops/_____ works, and has demanded mortgage of my/our crops which are standing or will grow, including the crops which are being transported elsewhere or will be transported or which are in my/our custody or in custody of others or will be in custody of others for my/our behalf.

Therefore, I/We agree that :

1) The entire crops present standing or which will be grown or my/our cultivated crops that are/will be in our stock or in the stock of others will be regarded as mortgaged property and shall remain so until the aforesaid loan is paid in full, so that the Bank may in case of necessity sell those crops to collect the loan and its interest due. I/We shall have no objection to such action which will not be require action by a Court.

2) I/We shall not mortgage or transfer the lands mortgaged to Bank, as described in the Schedule, and I/We shall pay the rates and taxes for these lands.

3) The amount of loan will not be used for any unproductive work save and except the purpose for which it has been sanctioned. In default of this provision, I/We am/are bound to repay the whole amount with interest on demand by the bank.

Under the above conditions, the Bank's sanctioned amount of Tk. _____ is being received by me/us and I/We have concluded this Deed of Crop Hypothecation at my/our free will and in clear understanding of its terms.

| Name | Father's name | Address | Signature/Thumb Impression |
|---|---|---|---|
| 1. | | | |
| 2. | | | |
| 3. | | | |

We individually and jointly stand surety for the expenditure of the loan money for the purpose for which the loan has been sanctioned and for the recovery of the loan with interest and cost.

Date _____

1. Signature _____
   Name _____
   Father's name _____
   Full Address:
   Village _____ P.O. _____
   Union _____ District _____

2. Signature _____
   Name _____
   Father's name _____
   Full Address:
   Village _____ P.O. _____
   Union _____ District _____

The aforesaid loan amount of Tk. _____ is paid in our presence.

SIGNATURE OF WITNESSES

1. Signature _____
   Name _____
   Father's name _____
   Full Address: Village _____ P.O. _____
   Union _____ District _____

2. Signature _____
   Name _____
   Father's name _____
   Full Address : Village _____ P.O. _____
   Union _____ District _____

SCHEDULE OF PROPERTY

| Police Station | Mouza(Village) | Khatian No. | Dag No. | Measurement Acre/Percentage | Occupant of the Plot in North |
|---|---|---|---|---|---|
| | | | | | |

ANNEX 2
TABLE 2

L-F-13
No.117457

DEED OF MORTGAGE
(Multiple)
(Translated from Bangla)
Bangladesh Krishi Bank
(Established under President's Order No.27 of 1973)

This Deed of Mortgage is executed by _____ in favour of Bangladesh Krishi Bank, _____ Branch. This Deed of Mortgage is, on _____ 198_ of the Christian era, executed by _____, major son of _____ _____ P.O. _____, Union _____ P.S./Upazilla _____, District _____ for and on behalf of the inhabitants who are called hereinafter mortgagor and includes their heirs, administrators, legal representatives and assigns.

In executing this Deed of Mortgage, we, the Mortgager prayed a loan to Bangladesh Krishi Bank (established under P.O. No. 27 of 1973) hereinafter called Mortgagee, for use in agricultural works or agricultural products or for its upliftment, whereupon the mortgagee agreed to give a loan of a total sum of Tk. _____ under the following conditions :

1. Under the following descriptions and under mutual consent, the mortgagee will pay whole or part of the sum of Tk. _____, which is equivalent sum of the mortgaged property, and may also be paid on additional sum of loan under mutual understanding, and you the mortgagor will repay the sum under the following directions. We, the mortgagors hereby pledge to mortgage the land, structures and property owned by us by way of inheritance or by purchase (fully described in schedule A and B which are regarded as a part of this Deed) and goods, business commodities, furnitures, fittings, credit and good will of the business and the goods/commodities which would be supplied out of the loan amount (which are mentioned in the Sanction Order), and crops that would be cultivated on the lands until we, the mortgagors, pay off the entire loan amount along with interest and other allied expenses. It is further declared that :

A) Property mortgaged for the present loan will also be considered so mortgaged for any additional loan, if granted under the consideration of the mortgagee.

B) This Deed of Mortgage and its terms and conditions is final and the mortgaged property will not be considered free from encumbranches unless duly registered under the Registration Act of 1908.

C) The mortgage property will remain mortgaged to the mortgagee for all additional loan, expenses incurred, payable by the mortgagors and for any balance amount correctly stated by the mortgagee.

D) For sake of security the maximum amount of valuation of the mortgaged property will be Tk. _____. We, the mortgagors do hereby admit, solemnly declare and affirm that we hold absolute ownership of the property and have the authority to mortgage, sell or make all kinds of transfer of such property, which power is not being deprived from us under any law. Save and except as regards the property to be obtained through the loan amount.

2. We, the mortgagors, hereby affirm and confirm that save and except the property to be acquired through loan amount, we are the absolute owner of the property mortgaged under this Deed and the mortgaged property is free from all encumbranches and we have absolute power to transfer, sell or otherwise dispose of the said property.

3. We solemnly affirm and confirm to the mortgagee that we are the permanent owners of the mortgaged property under section 7 of Refugees Act (Land Settlement), which is presently considered in force by the Govt. of Bangladesh. In addition, we further state that if we have an Appeal, Revision or Review pending under Sec. B (read with sub-section 18,19,20) of the Act and if any such Appeal, Revision or Review be filed in future, we shall notify the same to the mortgagee without delay and undertake to refund the entire amount advanced to us as per the desire of the mortgagee. We, the mortgagors, are also binding ourselves to the effect that in case the mortgaged property be considered inadequate for realisation of the loan, the mortgagee will be at liberty to realise the sum by auction sale of any other moveable or innoveable property belonging to us.

4. We, the mortgagor, hereby admit and confirm that the mortgaged property under this Deed is free from all kinds of encumbranc _____ _____ is under mortgage for Tk. _____

5. We, the mortgagors hereby enter into contract that during the period of mortgage, we shall protect the mortgaged property from all kinds of damages, except damage by natural calamities, and shall keep the mortgaged property in good condition and shall not sale, transfer or put or encumbrance or the mortgaged property which is prejudicial to the interest of the mortgagee, either directly or indirectly.

6. We, the mortgagors, hereby bind ourselves with the mortgagee to the effect that we shall maintain, repair, look after properly, and save and except a natural disaster, protect the mortgaged property and shall take all necessary steps in this regard. We shall not sell, transfer or otherwise mortgage this property during the period covered by this Deed so that no damage is done to the mortgaged property directly or indirectly. We, the mortgagors, are hereby entering into contract to the effect that we shall not remove or damage any attached permanent structure or heavy or small machineries, but if for any reason the property is being damaged or caused to be damaged or be unfit to use, in such case we, the mortgagors, will break or remove such property with the written consent of the mortgagee, or if it is being done without the written consent of the mortgagee, we shall with the consent of the mertgagee do so after substituting property of similar valuation as compensation.

7. We, that mortgagors, hereby confirm that we shall be paying all rent, rates, taxes and assessment of the mortgaged property and shall carry out all conditions to use the land and if any damage is done or if there by any weakness or fault due to any claim made by anyone with regard to the mortgaged property or any part of it, in such cases, we shall protect the interest of the mortgagee at all cost.

8. We, the mortgagor, hereby confirm that we shall accept the loan in kind through approved suppliers or person of the mortgagee and shall so accept under written contract as per requirement and in instalment, but the instalment will be fixed and arranged by the mortgagee. It is further agreed that if it is not being possible to pay the cost amount, then this decision of the mortgagee will be regarded as final and for which the mortgagee will not be held responsible for any loss or damage, if any, to the mortgagors.

9. We, the mortgagors, hereby agree that we shall use the loan given or to be given, and also any additional loan granted or to be granted, for the specific purposes and conditions mentioned in the sanctioning order. These purpose and conditions shall be regarded as part of this deed. We shall carry out these purposes under the supervision of a supervisor as per order of the mortgagee.

10. We, the mortgagors entering into contract with the mortgagee that :

a) We shall pay an interest at Tk. _____ per cent on the loan amount, and shall be paying in cash or in kind until entire amount of loan and interest are paid in full.

b) We the mortgagors shall be bound to pay you, the mortgagee, such arrear amount of interest and other incidental charges until it is fully paid up. The balance amount at 30th June of each year will turn into principal for payment with interest.

c) If any instalment remains unpaid, in that case the instalment, its interest, and expenses incurred on servicing notice, etc., all shall be accounted for to be regarded as a principal amount on which we the mortgagors shall have to pay interest as well.

d) As mentioned in the sanction letter and Deed, Principal amount of Tk. _____ is divided into a yearly instalment of Tk. _____ and interest at the agreed rates will be paid in _____ years. Instalment will start from next _____ year on _____ with interest.

e) In case of failure to pay any instalment at the due time the mortgagee shall have the right to get a refund of the entire sum unpaid until that date, and as per decision of the mortgagee the mortgagors shall have to refund the whole amount remaining unpaid.

f) If any instalment is not paid on the due date, then we the mortgagors shall have to pay additional yearly interest on the unpaid instalment which includes the principal sum and its interest until the date of payment. This additional interest is effective from the date of failure to pay the instalment on the fixed date and will be increas every 3 months by 1% upto maximum of 3%, which we the mortgagors are bound to pay.

g) We, the mortgagors, hereby further confirm that if we receive ar further sum of loan from you, the mortgagee, against this Deed of Mortgage, we, the mortgagors, shall remain bound to repay you, the mortgagee, the sum with interest by instalments as stated in the sanctioned letter, and failing to pay any instalment in due date, we shall have to pay additional interest as stated in paragraph 10 (F) of this Deed. The sanctioned letter/letters will be considered as part of such document.

11. We, the mortgagors, further confirm that we will remain liable to pay interest at the rate as mentioned in paragraph 10 of this Deed even if the rate of interest decreases or increases. In addition to this, we further confirm that we shall pay interest at the rate fixed or to be fixed by the Board of Directors of the Mortgagee under Bangladesh Krishi Bank order, 1973 from time to time and any such revised rate of interest will be effective from the date on which the decision was taken by the Board of Directors.

12. As mortgagors, we agree and confirm that the accounts in the books of Mortgagee will be regarded correct unless we can prove it wrong.

13. We, the mortgagors, are entering into a contract with the mortgagee that at the time of receiving the first instalment of the loan or before, we shall insure with an Insurance Company as per written approval of the mortgagee to cover loss, damage, natural and other disaster, pay premiums in due dates and shall take every step to keep such policy in force during the period of mortgage and shall deposit the receipts, insurance policy etc. to the mortgage. Money received under the above Policy, we the Mortgagors, as per decision of the Mortgagee, will use for the loss and damage of the mortgaged property or to repay the Mortgagee's

loan with interest or to pay any other amount payable to the mortgagee, and if any sum is received by us out of the Insurance Policy, we the mortgagors will maintain the same as Trustee of the Mortgagee. If we the Mortgagors do not have insurance to cover the mortgaged property or cannot pay the premium, the Mortgagee will take such Insurance and pay premiums at our cost, and the entire money so spent will be added to the sum of principal loan and will be chargeable against the mortgaged property and we the mortgagors will be bound to repay you, the Mortgagee the next instalment of Principal loan thereon as mentioned in paragraph 10 (A) of this Deed of Mortgage.

14. We, the mortgagors hereby agree and confirm to abide by the rules and conditions described in the Loan Sanctioning Letter.

15. We, the mortgagors, hereby agree and confirm that the balance of the loan amount with interest will be payable in one sum if we fail to pay any instalment of the present loan or any other loan granted afterwards with interest, or disregard any of the conditions laid down in the mortgage deed or if it is proven that we have furnished any wrong or false information in the loan application or in the Affidavit or in any letters written by us addressed to the Mortgagee, and in that case you, the mortgagee, will have the power to realise the balance loan amount with interest after squaring up the other expenditures for such action by selling part or whole of the mortgaged property.

16. We, the Mortgagors hereby confirm that if for any reason the mortgaged property is considered as under the value of the loan amount, in such case the mortgagee as per this Deed, under the Bangladesh Krishi Bank order or under any other law will make a body warrant of us, the mortgagors, or will realise the sum from our other properties.

17. You, the Mortgagee, are at liberty to transfer the power under of this Deed to any person, and on transfer the remaining due sum will be regarded as Principal sum from the date of such transfer and with interest as aforesaid and the transferee will enjoy all the facilities of the terms, conditions, bindings and agreements, and such person will under the power of the Mortgagee, have the right to realise the entire amount from the mortgagors . It is to be noted that in such cases the Krishi Bank Ordinance or any Section under it will not apply and the description in the Transfer Deed will be

enforceable against us, the Mortgagor, and it will be considered as final.

18. We, the mortgagors are entering into contract with the mortgagee that we shall notify the mortgagee the change of our address, if any.

19. Further, we, the mortgagors, are entering into contract with the Mortgagee that any legal or other notice served under Postal Seal to our last given addresses will be regarded as such notices duly served on us.

20. We, the Mortgagors hereby enter into contract with the Mortgagee that original Bangladesh Krishi Bank Order, as cited in this Deed and any other subsequent amendment under it and any further additional Rule, Regulations, Administrative Orders will also be applicable and binding upon us, the mortgagors and all Rules and Regulations and Administrative orders of the above Order will apply on us.

21. We, the mortgagors, are bound to agree to all the conditions contained in this Deed, jointly and individually.

22. We, the mortgagors, hereby confirm and enter into contract with the mortgagee that if any co-sharer files a pre-emption suit in the court than the sum that will be deposited in the court will be regarded as deposited in favour of the Bank and the Mortgagee will be at liberty to withdraw the sum against the loan. We, the mortgagors, further enter into contract with the Mortgagee that we shall inform the mortgagee immediately after receiving any notice of pre-emption suit and shall not withdraw the sum deposited for the pre-emption suit without first squaring up the entire loan payable to Krishi Bank. In default, we the mortgagors will be guilty under the criminal law and also liable for punishment.

## Schedule A

## DESCRIPTION OF MORTGAGED PROPERTY

Total description of Mortgaged property with complete special mark and boundary.

We, the Mortgagors, are pledging the under described landed properties under Mortgage and we, the Mortgagors, hold ownership of these properties which are in our absolute possession. We the mortgagors have one undivided ownership of these properties as per mutual division with the co-sharar and by conciliation or as per the Revenue Board and the area of land in each plot is as shown is in our possession and has been specially shown. Total Area of Mortgaged Land _____ Acre

| Dist. | P.S. Upa-zilla | Sub-Registry Office | Mouza (Village) J.L. No. | Khatian No. (Ledger) | Dag-No. plot | Total Area of plot mort-gaged shown in Col. 5 | Mort-gagors share of plot shown in Col. 7 | Remarks |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |

Schedule B

DESCRIPTION OF MACHINES

| Full description of Machines | Plot on which installed | Owner of the plot | Purchase price of machine | Remarks |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

Be it known that you, the Mortgagee have paid us, the mortgagors as per Sanction Letter No. _____ dated _____ and the said sanction letter will be considered a part of this Deed.

With the above, we the Mortgagors after receiving a total sum of Tk. _____ as mentioned in the Sanction Letter, do hereby sign this Mortgage Deed at our own accord and are of sane mind on this day and year and our heirs hereafter will be bound to abide by these conditions.

Witnesses : Address Date _____

1.
2.

Signature of Mortgagors/Thumb Impression

1. Mr. Father
2. Mr. Father
3. Mr. Father
4. Mr. Father

All of Village _____ P.O. _____
Union _____ P.S./Upazila _____
District _____ have signed this mortgage

Mr. _____ Father _____
of Village _____ P.O. _____
P.S./Upazila _____ District _____
has identified the Mortgagors. The subject matter of this Mortgage Deed has been read out to the Mortgagors and they agreed that this is correct.

| Signature of Identifier/Thumb Impression | Address |
|---|---|
| 1. | |
| 2. | |
| 3. | |
| 4. | |

Annex 2

Table 3

SANCTION LETTER

(TRANSLATED FROM BANGLA)

Bangladesh Krishi Bank
Branch _____

No. _____

To _____
_____
_____

Subject : Sanction of Loan to _____
(Name of Borrower)

Sir,

We are glad to inform you that a loan amounting to Tk. _____ has been sanctioned to you as detailed below as per your application dated _____ for Tk. _____

| Sl. No. | Purpose | Sanction Loan | |
|---|---|---|---|
| | | In kind | Cash |
| | | | |

You are to repay the sanctioned loan amount under yearly instalments as noted hereinunder :

| | Date of repayment | Amount |
|---|---|---|
| 1st Instalment | | |
| 2nd " | | |
| 3rd " | | |
| 4th " | | |
| 5th " | | |

The above loan amount is sanctioned under the following terms and conditions:

1. The cash amount of loan will be paid in instalments. Money under the second and subsequent instalments will be paid only after the Bank is satisfied that the amount of money of the first instalment and subsequent instalments has been used for the purpose for which it is being sanctioned. So, it is imperative that the utilization vouchers duly counter-signed by either the Chairman/Member of the Union Parishad or by an officer of the Department of Agriculture be produced either by the borrower himself or delivered by post. Should such vouchers in respect of expenditure be not deposited or un-utilised money be not refunded within 3 months of if the Bank does not extend additional time for such expenditure, in that case the Bank will not only be empowered to ask for a total refund of the loan at that time but also you will not be entitled to get any loan from the bank in future.

2. Property, described in Schedule 'A', shall remain mortgaged to the Bank as security.

3. The mortgage deed shall have to be completed and a certificate to the effect that the mortgaged properties are free from all encumbranches as per record for the last 12 years to the date of registration of the Mortgage Deed shall be submitted under Affidavit.

4. Properties mortgaged as security to the Bank shall remain mortgaged against the entire amount of loan and interest thereon until the same is fully repaid and any further property gained out of loan amount shall also remain mortgaged to Bank for the purpose.

5. Properties mortgaged, which are insurable, will however be insured with Sadharan Bima Corporation in the joint names of your and the Bank for the loan amount, noted in the Mortgaged Deed, at your expense before the payment of the first installment of the loan, and the properties to be gained out of the loan amount would also be insured likewise immediately after the giving of the same.

6. You will have to pay interest at the rate of _____ percent per annum. Or you will have to pay interest as per a decision of the Board of Directors under the rules of Bangladesh Krishi Bank Order, 1973 at a rate as determined from time to time. Whether the rate is an increase or a decrease and the same will come into effect from the date of taking such decision by the Board of Directors.

7. You shall utilise the loan for the purpose for which it is being accepted by you. Except with special permission, if the loan amount is being spent for any other purpose, then the expenditure will be regarded as misused and the Bank shall realise from you immediately the loan so misused or the entire amount of loan sanctioned.

8. If you fail to repay such amount of misused loan money within the specified time setforth in the notice, you will have to pay additional interest at the rate of 6 percent (per annum).

9. Any official of the Bank, if he so desires, shall have the power to inspect the machineries supplied by the Bank or to see the progress of work at the project site. You shall make no objection whatsoever to such request and shall do your best to abide by all the instructions in this regard.

10. You shall execute a Bond as per approved conditions of the work, and all expenditure incurred in respect of Execution of Deed, Registration Search Certificate and such allied expenses are to be borne by you.

11. If you fail to repay the cash loan amount, payable to the Bank on due date, you shall have to pay an additional interest at the rate of 6% per annum for non-payment of loan amount until it is fully paid up.

12. You shall remain bound to abide by the orders and instructions of the Chairman/Managing Director or Directors of the Administrative Division, and modifications made from time to time in the Bank rules and Registrations in respect of the sanctioning of loans.

13. This sanction of loan is subject to the terms and conditions referred to above and those in Annexure No. 1 & 2 etc. If these above mentioned terms and conditions be considered acceptable to you, then I hereby request you to contact this office during office hours for execution of Mortgage Deed. Failure on your part to contact this office within _____ (Date) this Sanction of Loan amount will lapse and you will not get the loan amount.

Yours faithfully,

(Manager)

Schedule A

| District | Police Station | Mouza | Khatian No. | Plot No. | Area |
|---|---|---|---|---|---|

N.B. (1) You can, if so desire, repay your loan amount by money order or by Draft from any other schedule Bank or through any branch of this Bank.

(2) In all correspondances with the Bank, you must always quote loan Application No. and Date and Account.

Annex 2

ANNEX 2
TABLE 5

L F—5

# APPRAISAL REPORT

( Each page of the report must be signed by the Reporting Officer )

Branch _____ Loan case No. _____

Name of applicant (S) : _____

S/W/O : _____

Village _____ Union _____ P. O. _____

Thana/Upa-Zela _____ District _____

2. Details of Property offered as security :

Total area of acceptable security acres.

| Police Station/ Upa-Zela | Mouza/Vill. | Khatian Nos. | Plot Nos. | Area (in acre) | Remarks regarding title/ownership of Security. |
|---|---|---|---|---|---|
| | | | | | |

Certificate :

a. I visited.....Tahsil Office on..... and examined the records including Register—2 in respect of the property offered as security by Mr./Mrs..... In L. C. No.....I found that the property is (i) recorded in the Applicant's or his father's name - exclusive owner/co-share or (ii) recorded in the name of vendor (in case of purchased property) Prima facie the applicant appears to have heritable and transferable right in the property offered as security.

b. I made spot verification of the properties shown above on.....and found the same in actual and exclusive possession of the applicant (s).

Signature.....

Name in full.....

Designation.....

Annex 2

3. Valuation of Security :

(a) On the basis of sales in the locality as found from registered documents :—

| Year of transfer | Deed No. | Name of registration office | Village | Area | Value | Value per acre |
|---|---|---|---|---|---|---|
| 1 | | | | | | |
| 2 | | | | | | |
| 3 | | | | | | |

Note : ( only last 3 years transactions to be noted )

a) Average value per acre :

b) Total value : Tk._____

(b) On crop basis :

| Name of crop | Yield Per acre | Rate Per maund | Total average value per acre |
|---|---|---|---|
| i).....crop | | | |
| ii).....crop | | | |
| iii) .....crop | | | |
| iv).....crop | | | Total |

Total valuation of the security property on crop basis :— Tk.....

(c) Mean valuation : Per acre.....Total value Tk.....

(d) Valuation assessment :

| Area in acres | Class of Land | Valuation Recommended by | | | | | |
|---|---|---|---|---|---|---|---|
| | | Appl. Staff | | Manager | | Chief Manager | |
| Type of Land | Crops being raised | Rate Per acre | Total | Rate Per acre | Total | Rate Per acre | Total |
| | Head office standard | | | | | | |
| (i) High Land | | | | | | | |
| (ii) Medium Land | | | | | | | |
| (iii) Low Land | | | | | | | |

(e) Remarks of the Appraisal Staff as to the value of lands with reasons thereof :

(f) Please use separate attachment when building/farm machinery has been accepted as security.

**Other Points :** (Answer should be specific)

a) Does/do the applicant (s) or his/their dependants owe money to the Bank or any other Banks/IRDD/Co-operatives ?

b) Is the security property detailed at Page-1 has chance of erosion/likely to be acquired by the Government ?

c) Has the applicant (s) any other source of income ? State briefly.

d) Comments on the credit-worthiness and character of the applicant (s).

e) Total holding (landed property) of the applicant (s).

5. Remarks of the Appraisal Staff regarding the feasibility of the Scheme/Project ( attach separate sheets if needed )

6. Estimate of income expected after use of loan :—

| Present Income | Income expected after use of loan | Increase |
|---|---|---|
| Gross Tk.…… | Gross Tk.…… | Gross Tk.…… |
| Net Tk.…… | Net Tk.…… | Net Tk.…… |
| | ( Please see details at page—5 ) | |

Annex 2

(4)

7. Recommendations of appraisal staff :

| Items No. Amount | Repayment terms |
|---|---|
| 1 | |
| 2 | |
| 3 | |
| 4 | |
| 5 | |
| Total : | |

Signature of Appraisal Staff.....
Name in full.....
Designation.....
Date.....

8. Opinion of the Legal Adviser regarding security :

a) I have examined the case record, title papers of the applicant (s) and certify that :—

i) the security properties detailed in page 1 of the Report, the applicants (s) is/are the sole and exclusive owner (s).

ii) the applicant (s) has/have got heritable and transferable right in land and is otherwise entitled to transfer it to the Bank ;

iii) it is joint property and the applicant (s) has/have fulfilled the conditions for its acceptance as valid security ;

iv) there is no restriction/limitation in the title for its acceptance as valid security.

Signature
Name in full
Date

a. Strike off items not applicable
b. Attach separate sheet, when necessary.

9. Recommendations of LTAC.

.....

10. Recommendations/orders of the Sanctioning Authority.

Date

Signature
Designation

Annex 2

(b)

Crops, Vegetables and Orchards

| Crop etc. | Area under cultivation | | Output per acre | Total output (in maunds) | Price per maund | Total Income |
|---|---|---|---|---|---|---|
| | Irrigated | unirrigated | | | | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| (a) Present Income before utilisation of loan | | | | | | |
| TOTAL | | | | | | |
| (b) Income after utilisation of loan | | | | | | |
| TOTAL | | | | | | |
| (c) Increase :- | | | | | | |
| Net Increase assuming cost of production as 50% of the gross Income :— | | | | | | |

Movement of the case :

(i) Date of application.....

(ii) Date of receipt by Sr. I. O./I. O./Supervisor (Field).....

(iii) Date of investigation.....

(iv) Date of submission of report.....

(v) Signature of reporting officer with date.....

Annex 2

(G)

Reference : Item 5; Page 3

Economics of the Scheme/Project ( additional information.)

ANNEX 2
TABLE 6

B.K.B. L.F.-2

BANGLADESH KRISHI BANK
Established under Bangladesh Krishi Bank Order, 1973
(President Order No. 27 of 1973)

LOAN APPLICATION FORM FOR LOAN OF ABOVE TK. 6000/-
AGAINST PROPERTY MORTGAGED
(TRANSLATED FROM BANGLA)

BRANCH _____
DISTRICT _____

Serial No. _____ Loan Case No. _____

1. Amount of Loan prayed for _____

2. (a) Application Fee _____
(b) Receipt No. of Fees paid _____
(c) Signature of Receiver _____
(d) Date of Receipt of Application _____

3. FULL PARTICULARS OF APPLICANTS:

| Serial No. | Name | Father/ Husband's Name | Profession & Nationality | Age | Permanent Address |
|---|---|---|---|---|---|

4. Purpose of Loan prayed for:

| Serial No. | Particulars of Loan/ Articles/Stuff with short description/Number | Value/ Sanctioned Expenditure | Amount of Loan Prayed for | Remarks |
|---|---|---|---|---|

5. Particulars of plan for utilisation of Loan (Attach separate paper, if needed)

| Serial No. | Short particulars on plan | Project site | Means of communication with direction |
|---|---|---|---|

Village
(Mouza) -
J.L. No. -
Ledger No.
(Khatian) -
Plot No.
(Dag No.) -
Area -

6. Short description of property of the Applicant/Applicants:

| Serial No. | Classification of property | Area | Present Local Valuation | Remarks |
|---|---|---|---|---|
| | a) Agricultural Land<br>b) Non agricultural land<br>c) Homestead<br>d) Project machineries<br>e) Others | | | |

7. Proposed property for Mortgage:

(a)(1) Agricultural Land

| District | P.S./ Upazila | Mouza & J.L. No. | Khatian No./ Ledger No. | Dag No./ Plot No. | Total area of plot (acres) | Area and Boundary of the Mortgaged land | Particulars of Deed of ownership |
|---|---|---|---|---|---|---|---|

(a)(2) Non agricultural land

| District | P.S./ Upazila | Mouza & J.L. No. | Khatian No./ Ledger No. | Dag No./ Plot No. | Total area of plot (acres) | Area and Boundary of the Mortgaged land | Particulars of Deed of ownership |
|---|---|---|---|---|---|---|---|

7. (b)(3) Particulars of building/homestead and other property.

| Serial No. | Description of liability, if any | Whether under own occupation or rented out | Valuation on the basis of rent - monthly yearly | Particulars of Deed of ownership |
|---|---|---|---|---|

8. Financial Loan Liability

| Serial No. | To whom in debted | Amount of Loan | Balance of loan now payable | Remarks |
|---|---|---|---|---|

9. Acknowledgement and Statement of Fidelity

(a) I/We am/are hereby applying for a Loan of Tk. ..... at the existing rate of interest at Tk. ..... per annum. I/We hereby undertake to bind myself/ourselves to the rules under Bangladesh Krishi Bank Order (P.O. No. 27) of 1973, Section 19, Order of the Bank Authority or directions of Chairman/Managing Director as and when any rule is in force, and all the conditions, mentioned in the Deed, to be registered by me/us.

(b) All information given in this loan application is absolutely true to my/own best knowledge with no coercion/persuasion from any quarter, I/We am/are applying for loan solely for the best interest of my/our own production/development programme. All particulars, along with this application, submitted by me/us are wholly true. If in future it is discovered that any such information is false, made up or fictitious, in that case with full knowledge of the penalty of fine and imprisonment under section 29 of the aforesaid Govt. order, I/We am/are hereby on oath deposing that I/We shall be bound to undergo punishment of imprisonment and fine both under the existing law of the land and as per rule 29 of Bangladesh Krishi Bank Order.

(c) I/We am/are agreeing with the mortgagee that if any share-holder or owner of adjacent properties, files any pre-emption suit in the Court of Law for any property mortgaged, the money that would be deposited in the court by such claimants as per valuation of the property claimed shall be payable to the mortgagee and the applicant/applicants (Loan Receiver/ Receivers) or thereafter his/their heirs will have no objection or any such objection will not be accepted by the Court. I/We further state that I/We disclose forthwith to the Bank if I/We receive any such notice of pre-emption suit, and that failing such disclosure I/We shall be regarded as an offender under Criminal Law and will be punished as required.

10. Signature of the application in presence of witnesses and identifiers

(a) After writing this application with all particulars I/We have read by myself/ourselves and/or hearing it read by others, understanding it clearly and with my own will voluntarily withour any instigation from any quarters, annexing hereinunder my/our signature/signatures/thumb impression/thumb impressions.

| Serial No. | Name of Applicant/ Applicants | Signature/thumb Impression | Signature and address of the identifier |
|---|---|---|---|
| | | | |

Place _____
Date _____

Full Name and designation of the Inquiry officer with report

(b) Signature and Address of Witnesses

i. Signature _____
Name _____
Father's name _____
Address _____
Union _____
Post Office _____
P.S./Upazila _____ District _____

ii. Signature _____
Name _____
Father's name _____
Address _____
Union _____
Post Office _____
P.S./Upazila _____ District _____

Annex 2

Table 7

TYPES OF SECURITY REQUIRED FOR DIFFERENT TYPES OF AGRICULTURAL LOANS

(Selected examples)

I. Intensive Summer Crop Production (ISCP) Program (ACD Circular No. 3/83, dated 13 March 1983, "Financing of Intensive Summer Crop Production Programme - 1983", para vii).

1. Owner - Cultivators

Loans to owner - cultivators shall be secured by hypothecation of crops to be produced on the land. The loanee shall execute the farm crop Hypothecation Deed (See Annex 2, Table [illegible]).

2. Share croppers

a. Loans to share croppers will also be secured by hypothecation crops.

b. In addition, one or two personal sureties are required, preferably the owner of the land under cultivation by the share cropper. In the absence of the owner of the land, any other person acceptable to the bank can also be surety. The surety or sureties, and two withesses, shall sign the crop Hypothecation Deed.

3. Group Loans

Group loans may be secured by hypothecation of the crop and by group surety bonds to be executed by the farmers constituting the group.

II. Fisheries Program

(ACD Circular No. 14/83, dated November 30, 1983, "Financing of Fisheries Programme, 1983-84," para 8).

1. D.P. (Demand Promissory) Note

Borrowers will draw and sign D.P. Note in favor of the Bank. The D.P. Note delivery letters should be signed by both the borrower and the guarantor.

2. Hypothecation Deed

Each borrower will execute a simple "Hypothecation Deed" hypothecating the fish to be produced in the tank/pond/derelict water body in favour of the bank.

3. Mortgage of Water Body (if owned)

a. An owner of a water body shall mortgage that water body as collateral valued at the local market price of adjoining land.

b. Such mortgage shall be by method of deposit of title deed through a memorandum of deposit with a clouse for sale by the bank, if required, without intervention of the court under Transfer of Property (Amendment) Act, 1929. 1/

c. If the loanee fails to produce a valid ownership title in respect of the water body, the loan may be sanctioned and disbursed against the deposit of a title deed in respect of other immovable property of the intending loanee.

d. The value of the mortgaged property should not, however, be related to the quantum of the loan. That shall be determined strictly on the basis of the established credit norms, related to its productive potentiality.

4. Personal Surety (If Water Body Not Oned, But Leased)

a. Lessor - borrowers, in addition to drawing and signing a D.P. note and executing a Hypothecation Deed in favor of the Bank, shall also produce a personal surety from local respectable persons, such as Union Parishad Chairman or Members, Doctors and Teachers, who have adequate and sufficient immovable properties.

b. For joint ventures between the Government and Private parties for fish culture the D.P. note, the Hypothecation Deed and the surety, as in (a) above, shall be required.

5. Joint Owners Must Produce A Consent Letter For Applicant

a. Existing practice requires all joint owners of ponds/tanks to apply for the loan jointly or to authorize the applicant to deal with the bank on their behalf by a duly executed power of attorney.

---

1/ ACD Circular No. 14/83 incorrectly states that this is the Transfer of Property (Amendment) Act, 1929. See Section 58(f) of the Transfer of Property Act, 1882 (Act No. IV of 1882), as amended, which permits such mortgage by deposit of title deeds for land wherever situated as long as the mortgage deed itself is executed in Dhaka, Chittagong or Narayangonj.

b. To speed up the process, the banks may henceforth disburse loans to prospective loanees if such applicants can produce a cansent letter from the joint owners stating that they have no objection to the applicant receiving such a loan.

5. Letter of Under taking By Applicant That Land Being Mortgaged Is Under His Possession And Free From Any Encumbrance

a. Under existing procedure, loanees are required to give an under taking on stamp paper that the land being mortgaged is under his possession. In addition, he must furnish a non-encumbrance certificate letter from the Land Registrar's Office that such land is free from any encumbrance.

b. From now on, all banks will accept such a letter of under taking without a stamp fee and will not insist on the production of a non-encumbrance certificate.

III. Land Mortgage Loan

(ACD Circular No. 14/84, dated 27 August 1984, "Land Mortgage Loan To Flood Affected Farmers"

A. Eligibility (para 2)

1. Farmers who possess up to 5 standard bighas of agricultural land, excluding homestead land, and who may make a distress sale of that land. The farmers, after mortgaging the land with the bank, will continue to possess and cultivate that land during the tenure of the mortgage.

2. Small farmers who have already mortgaged their land to private lenders (and thus do not have un encumbered land) are eligible also for such loans in order to redeem that mortgage.

3. No loan will be given against the mortgage of only homestead land.

B. Security (para 10)

1. The loan will be secured by a land mortgage.

2. The mortgage deed will be registered by the branches themselves without the payment of a registration fee or stamp duty according to the procedure set forth in ACD Circular No. 11/80, dated 25 November 1980, and Circular Letter No. ACD 933/365(b), dated 10 February 1981.

3. The title deeds and latest Dakhila will be required to be deposited with the Bank.

4. A copy of the deeds so registered, along with a copy of the letter sanctioning the loan will be sent to the Registrar/ Sub-registrar having local, jurisdiction of the land mortgaged for recording.

   In addition, banks, without any longer insisting on production of a non-encumbrance certificate from the Registrar, will obtain a "Halapnama" (under taking) from the borrower that the land given as mortgage is absolutely under his legal ownership and possession and that the same is free from any encumbrance and that for any misstatement of facts he will be held liable under law.

5. In addition to the mortgage, the borrower will furnish an agreement and demand promissory note in favour of the Bank.

6. Farmers who mortgage their land under this program will continue to be eligible for a crop hypothecation loan (except for a Rabi Crop loan under IRCP - ACD Circular No. 24/84, dated November 6, 1984, "Land Mortgage Loan").

IV. Irrigation Equipment

A. Shallow Tubewells (STWs)

(ACD Circular No. 4/82, dated 26 April 1982, "Marketing of Private Sector's Imported STWs Through Credit")

1. Loan is secured by hypothecation of STW and by mortgage of ½ acre of land as collateral.

2. A group surety bond will be obtained where the loan is sanctioned to a group of farmers or to cooperatives.

3. Loan should be sanctioned on basis of a letter of undertaking to be obtained on non-judicial stamp papers of Tk. 3.00 in the form already prescribed. If necessary the form of the letter of undertaking shall be modified to incorporate particulars of the title deeds.

B. Deep Tubewells (DTWs)

(ACD Circular No. 11/82, dated 13 August 1982, "DTW Financing-Collateral").

1. Such loans shall be provided without a mortgage as collateral.

2. The DTW itself will be hypothecated to the Bank which shall satisfy itself about the technical feasibility and viability of the project, keeping in mind the command area of the DTW, before sanctioning the loan.

C. Rental Lowlift Pumps (LLPs)

(ACD Circular No. 15/82, dated 11 October 1982, "Term Financing For Selling of Rental LLPs")

1. The loan shall be secured by the hypothecation of the pump itself, The mortgage of one acre of land may also be taken as collateral.

2. For group loans, a group surety bond with joint and several liability for the members of the group shall be obtained, in addition to the hypothecation of the pump and the mortgage of land.

D. Spring Tubewells

(ACD Circular No. 1/83, dated 4 January 1983, "Financing of Spring Tubewells")

1. Hypothecation of tubewell itself and mortgage of ½ acre of land as collateral security.

2. Group surety bond also required if loan is sanctioned to a group of farmers or to a cooperative.

3. Loanees required to give undertaking on plain paper, without stamp fee, stating that land being mortgaged is under his possession and that the same is free from any encumbrance.

# ANNEX 3

## CREDIT PASSBOOK

Table 1. ACD Circular No. 21/84, dated 16 October 1984, "Agricultural Crop Loans- Annual Basis" (including Annexure II- Credit Passbook form)

Table 2. BKB Credit Passbook Form

Table 3. Rupali Bank Credit Passbook Form

Table 4. ACD Circular No. 6/85, dated 15 June 1985, "Financing of ITAP 1985".

Annex 3

Table 1

ACD CIRCULAR NO. 21/84 Dated 16 October, 1984

TO: The Managing Directors, BKB and
Nationalized Commercial Banks

Dear Sir,

AGRICULTURAL CROP LOANS- ANNUAL BASIS

It has been observed that under the existing system of sanctioning loans on a crop to crop basis, disbursement of loans to farmers could not be made in time on the ground of non-receipt of instructions by the branches from their Head Offices and/or time taken for processing application of each crop or delayed receipt of the recommended list of farmers from the UACC at the beginning of each crop season. Late disbursement has been cited as one of the reasons for diversion of agricultural loans to other uses which frustrates the purpose of the crop loans. To overcome this problem, it has now been decided to assess the requirement of S.T. crop loan of a farmer on an annual basis rather than on a crop to crop basis and to introduce for this purpose an Annual Lending Programme. Under this system, the quantum of credit required by a farmer for cultivating various types of crops during a year will be determined and sanctioned at a time. The following criteria are prescribed for the purpose:

1. Credit requirement of the farmer will be assessed on the basis of an annual production plan covering all crops at the beginning of each year. The banks will adopt October- September as the agriculture year for this purpose. The farmer will have to submit the existing loan application form to UACC incorporating his annual production plan. The list of eligible farmers will be prepared as usual by the UACC which will also assess and indicate the specific crops and acreage to be cultivated by the listed farmers during the year. These will be incorporated in prescribed form/production plan (enclosed). Such a list for the current year will be prepared and submitted by the UACCs to the concerned bank branches within a month of receiving this circular. In the future, however, such lists are to be submitted by the end of June for the following year (October- September) so that bank branches will have time to determine the fund needed by them and make necessary arrangements for it with their Head Officers.

2. Banks will sanction annual loans at a time according to the prevailing credit norms covering all the crops as per the production plan. Disbursement for different crops must, however, be made within the period mentioned in the crop loan calendar (Annexure- I). Efforts should be made to disburse the loans at the beginning of the disbursement period.

3. Normally, the loanees will repay the loan taken for a particular crop after harvest and marketing of the crops as per the prescribed normal due date of the crop in question. (Column 4, Annexure- I). Banks will make vigorous efforts to recover the dues after each harvesting period. Loanees failing to repay the loan, even as per final repayment date mentioned in column 5, will not be debarred from getting loans for the subsequent crops during the same year for which sanction has already been accorded.

4. In keeping with the change over to annual crop loan programme, it has been decided not to apply penal rate of interest before the expiry of the final date fixed for repayment of the loan for each crop as shown under column 5 of the Annexure- I, thus automatically providing for a grace period before the application of the penal rate of interest. So, henceforth, loans will be treated as overdue after the expiry of the respective final repayment dates as indicated under column 5 of the Annexure- I.

5. Loanees, who intentionally do not repay the loans within the prescribed final repayment dates even after normal production and also those who avail fresh loans after the rescheduling of their past due loans but ultimately do not repay the same within the rescheduled due dates, may be treated as chronic defaulters and be made ineligible for fresh loans, subject to the concession given in paragraph 3 above.

6. For better operation of the annual lending system, banks will introduce a credit pass book, the format of which is attached. (Annexure- II). Banks will issue pass books to the farmers as and when the books are available and full particulars are received from UACC. The pass book will remain with the farmers/borrowers who will produce it at every transaction.

7. All documentation of the loans covering the whole year will be finalised on an annual basis (before the beginning of the first crop season of the year), instead of obtaining the same on a piece-meal basis at the time of each disbursement.

8. For recovery of loans, sanctioned (and disbursed) as per recommendation of the UACC/UZACC, the UACC/UZACC will be made equally involved and responsible along with the bank branches concerned. Normal recovery procedure under the PDR Act may also be followed.

9. The bank branch will continue to extend agricultural credit to their existing good borrowers depending on banker-customer relationship even though the list of borrowers may not be received or the names concerned are not included in that recommended list of the UACC.

10. The bank will not extend agricultural credit to any chronic defaulter, as defined above, even though his name may be included in the recommended list of the UACC. In such cases, the branches will send to the UACC a list of names of chronic defaulters giving the related particulars.

11. In unions where BKB disburses crop loans side by side with any designated commercial bank, the UACC will prepare two separate lists for the two banks and it should be ensured by UACC that duplication is avoided; that means that the same farmers' names are not included in both the lists. Members of Co-operatives who are eligible for a crop loan under the BRDB/BSBL programme should also be excluded from their lists.

You are, therefore, requested to issue necessary directives to your branches concerned in order to introduce the system forthwith

A copy of your circular issued to the branches in this respect may please be endorsed to us for our record.

Yours faithfully,

(signed)

(Kamal Uddin Ahmed)
CHIEF OFFICER

Annex 3

## ANNUAL PRODUCTION PLAN

1. Name of Farmer:

2. Father's name :

3. Address:

Mouza _____ Village _____ Union Council _____

Upazila _____ District _____

A. Particulars of land for crop budgeting

| Topography (Land type | | | | Land title (acreage) | | | Remarks |
|---|---|---|---|---|---|---|---|
| Highland | Medium high land | Low land | Total | Area of land owned | Area of land share-cropped | Total Area | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |

B. Crop-wise production Planning

| Sl. No. | Name of crop | Proposed cropping acreage | Credit Recommendation | | | | | | | | Remarks |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | In kind | | | In cash | | | | | |
| | | | Seed (Tk.) | Fertilizer (Tk.) | Total (Tk.) | Pesticides (Tk.) | Irrigation (Tk.) | Labour Cost (Tk.) | Total | Total (Tk.) | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| 1. Aus: Local | | | | | | | | | | | |
| HYV | | | | | | | | | | | |
| Total | | | | | | | | | | | |
| 2. T.Aman: Local | | | | | | | | | | | |
| HYV | | | | | | | | | | | |
| Total | | | | | | | | | | | |
| 3. B.Aman | | | | | | | | | | | |
| 4. Boro: Local | | | | | | | | | | | |
| HYV | | | | | | | | | | | |
| Total | | | | | | | | | | | |
| 5. Wheat | | | | | | | | | | | |
| 6. Potato | | | | | | | | | | | |
| 7. Mustard(HYV) | | | | | | | | | | | |
| 8. Groundnut: | | | | | | | | | | | |
| Kharif | | | | | | | | | | | |
| Rabi | | | | | | | | | | | |
| 9. Jute | | | | | | | | | | | |
| 10. Sugarcane | | | | | | | | | | | |
| 11. Vegetable | | | | | | | | | | | |
| 12. Fruit Plantation: | | | | | | | | | | | |
| -Mango | | | | | | | | | | | |
| -Banana | | | | | | | | | | | |
| -Pineapple | | | | | | | | | | | |
| Total cropped | | | | | | | | | | | |

Figures to be incorporated from approved credit ceiling

Name of Block _____

Name of Union Council _____

Name of Upazila _____

Signature of Block Supervisor _____

Block Supervisor's Full name _____

ANNEXURE-I

CROP LOAN CALENDAR

| Crops | Production season: Loan giving period | Production season: Harvesting period | Normal due date for recovery of loans | Final repayment date after which penal interest will be applied. |
|---|---|---|---|---|
| 1. T. Aman: | | | | |
| (a) Local | June 15 - Sept.15 | Nov. 1-Dec. 31 | End Feb. | End March. |
| (b) HYV | June 15 - Sept.15 | Nov. 1-Dec. 31 | End Feb. | End. March |
| 2. Boro: | | | | |
| (a) Local | Oct. 15 - Jan. 31 | April 15-June 30 | End July | End Sept. |
| (b) HYV | Nov. 15 - March 15 | May 1 - June 30 | End July | End Sept. |
| 3. Wheat | Nov. 1 - Dec. 15 | Feb. 15-April 30 | End May | End June. |
| 4. Potato | Sept. 15 - Nov. 30 | Jan. 1 - April 15 | End May | End Sept. |
| 5. Sweet Potato | Sept. 15 - Dec.15 | Feb. 15-April 15 | End May | End Sept. |
| 6. Mustard | Oct. 1 - Nov. 30 | Jan. 15-March 31 | End May | End June. |
| 7. Ground Nut: | | | | |
| (a) Kharif | April 15 - June 30 | Sept. 15-Nov. 30 | End Dec. | End March |
| (b) Rabi | Oct. 15 - Dec. 31 | April 1 - May 31 | End July | End Sept. |
| 8. Sugarcane | Oct. 1 - April 30 | Nov. 1 - Feb.28 | End March (Next year) | End March (Next year) |
| 9. Aus: | | | | |
| (a) Local | March 1 - June 15 | July 1 - Aug 31 | End Sept. | End Dec. |
| (b) HYV: | Feb. 15 - May 31 | July 1 - Aug.31 | End Sept. | End Dec. |
| 10. B. Aman | March 1 - May 15 | Nov. 1 - Dec.31 | End Feb. | End March |
| 11. Jute | March 1 - April 15 | June 15 - Sept. 15 | End Oct. | End Dec. |

ANNEXURE- II

CREDIT PASSBOOK (FORM)

(Translated from Bangla)

_____ Bank

_____ Branch

_____
(Farmer's Name)

_____
(Address)

_____

_____

_____

_____

_____ (Pass Book No.)

_____ (Savings Account No.)

## GENERAL INFORMATION

_____ (Pass Book)

_____ (Date of Issue of Pass Book)

_____

PHOTOGRAPH

_____

_____
Identifier's Signature
(UP Chairman/ Ward Member)

1. _____ (Name)
2. _____ (Father's Name)
3. _____ (Village)
4. _____ (Post Office)
5. _____ (Upazila)
6. _____ (Main Source of Income)
7. _____ (Other Sources of Income)
8. Information Relating to Land:
   a) Land owned _____ acre _____ decimal
   (i) Irrigated _____ acre _____ decimal
   (ii) Unirrigated _____ acre _____ decimal
   b) Land In Leased _____ acre _____ decimal
   c) Land Out Leased _____ acred _____ decimal
   d) Sharecropped Land _____ acre _____ decimal
9. Information Relating to Properties:
   a) Dwelling House _____
   b) Farm House _____
   c) Fish Farm _____
   d) Trees and Plants (edible fruits) _____
   Value of Annual Production: _____
   Annual Sale Proceeds: _____
   e) Other Trees _____
10. Animal Husbandry
   a) Ox/Bullock/Cow/Calf/Buffalo- No. _____
   b) Goat/Sheep- No. _____
   c) Cock/Hen, Duck- No. _____
   d) _____
   e) _____

11. Agricultural Implements

a) _____
b) _____
c) _____
d) _____
e) _____
f) _____

Annex 3

## PARTICULARS OF ANNUAL PRODUCTION PLAN, LOANS OUTSTANDING AND SANCTIONED

1. Production Plan

_____
_____
_____
_____
_____

2. Applicant's Signature/ Thumb Impression _____

3. Amount of Previous Unpaid Loans _____

4. Purposewise Allocation of Loans Sanctioned:

a) _____ Tk. _____
b) _____ Tk. _____
c) _____ Tk. _____
d) _____ Tk. _____
e) _____ Tk. _____
f) _____ Tk. _____
g) _____ Tk. _____
h) _____ Tk. _____
i) _____ Tk. _____
j) _____ Tk. _____

_____
Total Tk.

Account No. _____

PARTICULARS OF LOAN PAYMENTS AND REPAYMENTS

| Date | Loan Ledger Folio No. | Voucher No. | Amount Received | Amount Repaid | | | | Balance Outstanding | | | | Signature of Authorised Officer |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Principal | Interest | Service Charge | Total | Principal | Interest | Service Charge | Total | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| | | | | | | | | | | | | |
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SAVINGS

| Date | Ledger Folio No. | Voucher No. | Amount Deposited | Amount Withdrawn | Balance | Interest Paid | Total Savings | Signature of Authorised Officer |
|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | | | | | | | | |
| | | | | | | | | |
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| | | | | | | | | |

Annex 3

Table 2

BANGLADESH KRISHI BANK CREDIT PASS BOOK FORM
(Translated from Bangla)

BANGLADESH KRISHI BANK

_____ Branch

CREDIT PASS BOOK

Name of Borrower _____

Address _____

_____

_____

Pass Book No. _____

Savings Account No. _____

_____
Branch Bank Manager

## GENERAL INFORMATION

Pass Book No. _____

Date of Issue of Pass Book _____

PHOTOGRAPH

_____

Farmer's Signature/ Thumb Impression

_____

Identifier's Signature (UP Chairman/ Ward Member)

1. Name _____
2. Father's/Husband's Name _____
3. Village _____
4. Post Office _____
5. Upazila _____
6. District _____
7. Principal Source of Income _____
8. Other Sources of Income _____
9. Information Relating to Land:
   - a) Land owned _____ acre _____ decimal
     - (i) Irrigated _____ acre _____ decimal
     - (ii) Unirrigated _____ acre _____ decimal
   - b) Land In Leased _____ acre _____ decimal
   - c) Land Out Leased _____ acre _____ decimal
   - d) Sharecropped Land _____ acre _____ decimal
10. Information Relating to Properties:
    - a) Dwelling House _____
    - b) Farm House _____
    - c) Fish Farm _____
    - d) Trees and Plants (edible fruits _____

      Value of Annual Production: _____

      Annual Sales Proceeds: _____
    - e) Other Trees _____
11. Animal Husbandry
    - a) Ox/Bullock/Cow/Calf/Buffalo- No. _____
    - b) Goat/Sheep- No. _____
    - c) Cock/Hen/Duck- No. _____
    - d) _____
    - e) _____
    - f) _____

12. Agricultural Implements

a) _____ b) _____

c) _____ d) _____

e) _____

Annex 3

PARTICULARS OF ANNUAL PRODUCTION PLAN AND CREDITS SANCTIONED

1. Production Plan:

_____
_____
_____
_____

2. Applicant's Signature/ Thumb Impression _____

3. Amount of Previous Loans Outstanding _____

4. Purposewise Allocation of Loans Sanctioned:

a) _____
b) _____
c) _____
d) _____
e) _____
f) _____
g) _____
h) _____
i) _____
j) _____

Loan Account No. _____

(THIS PAGE THEN REPEATED TWICE MORE)

PARTICULARS OF ANNUAL PRODUCTION PLAN AND CREDITS SANCTIONED

1. Production Plan:

_____
_____
_____
_____

2. Applicant's Signature/ Thumb Impression _____

3. Amount of Previous Loans Outstanding _____

4. Purposewise Allocation of Loans Sanctioned:

a) _____
b) _____
c) _____
d) _____
e) _____
f) _____
g) _____
h) _____
i) _____
j) _____

Loan Account No. _____

PARTICULARS OF PAYMENT AND REPAYMENT OF LOANS

Name _____ Loan Account No. _____

| Date | Loan Ledger Folio No. | Receipt/ Voucher No. | Amount Received | Amount Repaid | | | | Balance Outstanding/Due | | | | Signature of Authorised Officer |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Principal | Interest | Service Charge | Total | Principal | Interest | Service Charge | Total | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| | | | Tk. P. | Tk. P. | Tk. P. | Tk. P. | Tk. P. | Tk. P. | Tk. P. | Tk. P. | Tk. P. | |
| | | | | | | | | | | | | |
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(THERE IS A SECOND SIMINAR PAGE)

SAVINGS

Name _____ Savings Account No. _____

| Date | Ledger Folio No. | Receipt/ Voucher No. | Deposit | Withdrawal | Balance | Interest Paid | Total Savings | Signature of Authorised Officer |
|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | | | Tk. P. | Tk. P. | Tk. P. | Tk. P. | Tk. P. | |
| | | | | | | | | |
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Annex 3

Table 3

RUPALI BANK CREDIT PASS BOOK FORM
(Translated from Bangla)

RUPALI BANK

_____ Branch

AGRICULTURAL CREDIT PASS BOOK

_____

PHOTOGRAPH OF BORROWER

_____

Name of Pass Book Holder _____

Pass Book No. _____

Date of Issue of Pass Book _____

Savings Account No. _____

_____
Borrower's Signature/ Thumb Impression

_____
Identifier's Signature (UP. Chairman/ Ward Member)

_____
Signature of Agricultural Credit Assistant

_____
Signature of Branch Manager

## GENERAL INFORMATION

1. Name _____

2. Father's/Husband's Name _____ _____

3. Village _____

4. Post Office _____

5. Upazila/Police Station _____

6. District _____

7. Principal Source of Income _____

8. Other Sources of Income _____

9. Information Relating to Land:

| | Area Acres | Area Decimals | Location/ Mouza | Khatian No. |
|---|---|---|---|---|
| a) Land owned | | | | |
| (i) Irrigated | | | | |
| (ii) Unirrigated | | | | |
| b) Sharecropped | | | | |
| c) Leased In | | | | |
| d) Leased Out | | | | |

10. Information Relating to Properties:

a) Dwelling House _____

b) Farm House _____

c) Water Body/Pond Suitable for Fish Cultivation (and Approximate Annual Income Therefrom) _____

d) Fruit Trees _____

Approximate Annual Production Value: _____

Actual Sales Proceeds: _____

e) Other Trees _____

11. Animal Husbandry

a) Ox/Bullock/Cow/Calf/ Buffalo- No. _____ b) Goat/Sheep- No. _____

c) Cock/Hen/Duck- No. _____

12. Agricultural Implements

a) _____ b) _____

c) _____ d) _____

e) _____

PARTICULARS OF ANNUAL PRODUCTION PLAN AND CREDITS SANCTIONED

1. Production Plan: (Agricultural Year- October 198__ to September 198__)

| Sl. No. | Crop | Area Under Culti-vation | Purpose of Loan | | | | | | Method of Payment | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Seed | Ferti-lizer | Pesti-cide | Irrig-ation | Labour Charge | Other | Cash | In Kind | Total |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | Total | | | | | | | | | | |

2. Applicant's Signature/ Thumb Impression _____

Signature of Person Who Prepared the Plan _____

3. Previous Outstanding Loans (Tk):

a) Overdue Amount (Tk) _____

b) Amount Not Overdue (Tk) _____

TOTAL (Tk) _____

4. Purposewise Allocation of Loans Sanctioned:

a) _____

b) _____

c) _____

d) _____

e) _____

Loan Account No. _____

(THREE IDENTICAL PAGES THEN FOLLOW)

PARTICULARS OF PAYMENT AND REPAYMENT OF CROP LOANS

Name of Crop _____ Loan Account No. _____

| Date | Loan Ledger Folio No. | Loan Account No. | Amount Received | | | Amount Repaid | | | | Amount of Overdues | | | | Amount of Total Outstanding Loans | | | | Signature of Auth. Officer |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | In Cash | In Kind | Total | Principal | Interest | Service Charge | Total | Principal | Int. | S. Chge | Total | Prin. | Int. | S. Cg. | Total | |
| | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | |
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(FOLLOWED BY TWO SIMILAR PAGES)

PARTICULARS OF BORROWER'S SAVINGS ACCOUNT

| Date | Ledger Folio No. | Amount Deposited | Amount Withdrawn | Balance | Interest Paid | Total | Signature by Authorised Officer |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| | | | | | | | |
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(FOLLOWED BY TWO IDENTICAL PAGES AND BY A CROP CALENDAR WHICH HAS NOT BEEN REPRODUCED (BUT SEE ANNEXURE- I IN ANNEX 3, TABLE 1 (at page 211 ,Annex 3)).

Annex 3

Table 4

ACD CIRCULAR NO. 6/85 Dated 15 June, 1985

TO: The Managing Directors, BKB and Nationalized Commercial Banks

Dear Sir,

FTAP 1985- FINANCING OF

The season for production of Transplanted Aman is about to set in. The credit norm for financing the crop for this season has been prescribed at Tk. 2148 and Tk. 1025 for HYV and Local Variety respectively as detailed in the Annexure.

In financing the programme, banks will follow the following guidelines:

1. Minimum of one-half bigha (16.5 decimals) and maximum of 6 bighas per borrower should be financed under the programme.

2. The credit component for fertilizer will be disbursed in kind while the rest may be given in cash. Credit for meeting irrigation cost will be provided only when and where required.

3. In the old district areas of Patuakhali, Khulna and in the fringe land of Kaptai lake in Rangamati District, credit for fertilizer component may be left at the option of the farmer because of the varied natural soil condition of the area.

*4. Banks will issue credit pass books along with sanctioning/ disbursement of the credit under the programme if by this time it has not been issued to the loanees. If necessary, banks themselves will get a simple production plan of the prospective loanees prepared in case the same is not made available in time by the Block Supervisor of the Department of Agriculture Extension.

5. Credit will be disbursed by the branches of NCBs and BKB exclusively in the areas allotted to them.

6. Unions originally allocated to Pubali Bank, Ltd., will be financed by the branches to whom the unions will be re-allocated by the respective District Committees.

7. All other procedure, terms and conditions relating to sanction, disbursement and recovery of the loans, as contained in our ACD Circular No. 21/84, dated the 16th October, 1984, will remain unchanged.

You are, therefore, requested to issue necessary instruction to your branches concerned in this respect under advice to us.

Yours faithfully,

(signed)

(Kamal Uddin Ahmed)
GENERAL MANAGER

ANNEXURE-

## CREDIT NORM FOR ITAP 1985

Quantity
Value

| Name of the crops | Fertilizer (in maunds) Urea | T S P | M. P. | Total | Cost of seeds | Irrigation cost | Cost of pesticides | Cost of labour | Per acre cost of production | Credit per acre Kind | Cash | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| T. Aman | | | | | | | | | | | | |
| HYV | 1-20-0 Tk. 261.30 | 0-35-0 Tk. 144.18 | 0-25-0 Tk. 80.91 | 3-0-0 Tk. 486.39 | 0-12-0 Tk. 75/- | Tk. 250.00 | Tk. 110.00 | Tk. 1227/- | Tk. 2148.39 | Tk. 486.39 | Tk. 1662.00 | Tk. 2148.39 |
| LV | 1-0-0 Tk. 174.20 | 0-35-0 Tk. 144.18 | 0-20-0 Tk. 64.72 | 2-15-0 Tk. 383.10 | 0-12-0 Tk. 75/- | Tk. 30.90 | Tk. 100.00 | Tk. 436.00 | Tk. 1025.00 | Tk. 383.10 | Tk. 641.90 | Tk. 1025.00 |

| Maximum per borrower for 2 acres | Minimum per borrower for half standard bigha |
|---|---|
| 14 | 15 |
| Tk. 4296.78 | Tk. 355.00 |
| Tk. 2050.00 | Tk. 169.00 |

**Per maund price of fertilizer**

| | |
|---|---|
| UREA | Tk. 174.20 |
| T.S.P. | Tk. 164.80 |
| M. P. | Tk. 129.44 |

Annex 3

/N.H./

## Annex 4

## COOPERATIVE SOCIETIES

Table 1 Changes Made By Co-operative Societies Ordinance, 1984 (Ordinance No. 1 of 1985)

Annex 4

Table 1

## CHANGES MADE BY CO-OPERATIVE SOCIETIES ORDINANCE, 1984

(Ordinance No. 1 of 1985)

I. CHAPTER II. REGISTRATION (Sections 6-13)

1. Societies Which May Be Registered (Section 8)

   a. Government may now prescribe qualifications for membership of any class of co-operative societies.

   b. Registrar, after a hearing, may remove from membership any person who is not so qualified to be a member (Section 8(2)).

2. Registration (Section 10)

   a. No society shall be registered unless its bye-laws provide for representation to different groups of members of the society, as may be prescribed. (Section 10(3)).

   b. Registrar shall register or not register society within 90 days of date of submission of application. (PREVIOUSLY NO TIME LIMIT). (Section 10(4)).

   c. Registrar shall communicate any order of refusal to register, with reasons therefore, to applicant within 30 days. (Section 10(5)).

3. Amendment of Bye-Laws of a Co-operative Society (Section 12)

   - Registrar shall register or not register amendments of bye-laws within 30 days (PREVIOUSLY NO TIME LIMIT). (Section 12(2)).

4. Power of Financing Bank or Registrar to Direct Amendment of Bye-Laws (Section 13)

   - Registrar who thinks amendment of society bye-laws is necessary or desirable may direct that society to held a special general meeting for that purpose within 45 days, failing which he shall register the amendment.

## II. CHAPTER III. STATUS AND MANAGEMENT OF CO-OPERATIVE SOCIETIES (Section 14-28)

### 1. General Meetings (Section 16)

a. All general meetings of a society shall be called by the managing committee as prescribed. (Section 16(1)).

b. Annual audit report shall be considered at annual general meeting or at special general meeting called within 90 days of date of its receipt.(Section 16(5)).

### 2. Managing Committee (Section 18)

a. Members of the managing committee shall be elected by direct election in a prescribed manner. (Section 18(2)).

b. The term of the managing committee shall be 2 years (Section 18(3)).

c. Functions of Managing Committee shall be performed by persons appointed by Registerar if committee not reconstituted before end of its term. (Section 18(4)).

d. Registrar by special order in writing will call special general meeting of society to elect managing committee members (Section 18(5)).

### 3. Disqualification For Being Elected As A Member of the Managing Committee (Section 19)

a. No member of a society shall be eligible to be elected as an officer of that society or an affiliated society if he has defaulted on payment of any loan or of any goods taken on credit (Section 19(1)).

b. No person who has been a member of a managing committee for a consecutive terms shall again be eligible for election as on officer of such society until the lapse of two years. (Section 19(2)).

### 4. Dissolution and Reconstitution of Managing Committee and Disqualification of Its Members (Section 22)

- Where Government, after enquiry, is satisfied that a society is :

a. suffering from insolvency, of

b. that its managing committee is mismanaging the affairs or acting prejudicially to the interest of the Society.

by order in writing dissolve the managing committee of the society, after giving that commitee an opportunity to show cause against the order. (Section 22(4)).

5. Removal of Members of the Managing Committee (Section 26)

a. Government may remove a member of the managing committee, by order in writing, if it is satisfied that he is abusing his position as an officer or otherwise acting in a manner prejudicial to the interest of the society. He shall have an opportunity to show cause against the order.

b. Such person who is removed shall be disqualified, as in the order, for a period of up to 5 years from being a member or officer of that society or any other cooperative society.

6. Disqualification of A Person From Being A Member of The Managing Committee, etc. (Section 27)

a. Government may disqualify person for up to 5 years from being a member or an officer of that cooperative society or any other cooperative society. Such person shall have the opportunity to show cause against such order.

b. Such disqualification shall be for abusing his position as an officer of the society or otherwise acting in manner prejudicial to the interest of the society.

7. Power of Government and Registrar to Nominate Members (Section 28)

a. For a national cooperative society, Government shall nominate one-third of members of managing committee where it has subscribed over 50% of the loans and advances of the society are given or guaranteed by the Government.

b. For other societies, under the some circumstances, the Registrar shall nominate one-third of the members of the managing committee.

III. CHAPTER IV. DUTIES AND OBLIGATIONS OF CO-OPERATIVE SOCIETIES (Sections 29-41)

1. Restriction on Lending (Section 39)

- A Cooperative bank may accept deposits from any person or cooperative society, whether or not such person or society is a member of the bank and make loans to such person or society up to 95% of the deposit made. (Section 39(3)).

IV. CHAPTER V. PRIVILEGES OF COOPERATIVE SOCIETIES (Sections 42-53)

1. Power To Remit Certain Duties, Fees, Etc. (Section 52)

- No court fee payable for filing certificate cases under Public Demands Recovery Act, 1913 for execution of awards under :

  a. Section 88 (award treated as final mortgage decree for property pledged as collateral security)

  b. Section 125 (award directing payment of loan due by defaulting member).

V. CHAPTER VII. PROPERTY AND FUNDS OF COOPERATIVE SOCIETIES (Sections 54-59)

1. Reserve and Other Funds (Section 55)

a. Of net profits annually of a cooperative society, not less than 15% shall be carried to reserve fund (or such high proportion as prescribed for such society or class of societies) (WAS 25%). (Section 55(2)).

b. Bad Debt Fund and Agricultural Credit Stabilization Fund

(i) Every financing bank shall keep such with regard to profit, of any, derived from such transactions. (Section 55(5)).

(ii) For bad debt fund - not less than 10% of annual net profits (or such higher proportion as set for that financing bank or class of financing banks). (Section 55(6)).

(iii) For agricultural credit stabilization fund - not less than 10% of annual net profits (or such higher proportion as set). (Section 55(6)). Except as prescribed, no part of this Fund shall be used in the business of a financing bank (Section 55(7)).

c. Inventory loss fund for trading or manufacturing activity

(i) Such a fund shall be maintained if a society has any profit from such transactions. (Section 55(8)).

(ii) Each year carry to such fund not less than 10% of profits (or such higher proportion as prescribed for such society or class of societies) (Section 55(9)).

VI. CHAPTER VII. PRIVILEGES, LIABILITIES AND OBLIGATIONS OF MEMBERS OF COOPERATIVE SOCIETIES (Section 60-75)

1. Liability of Members (Section 65)

- Where any share of a society is purchased by another cooperative society or the Government, upon the winding up of the society, the liability in respect of such share is limited to the amount paid in respect of the share.

2. Liability of Past Member and of Estate of Deceased Member (section 66)

- Where a society is directed to be wound up under section 90 within the said period of 2 years, the liability will continue until the proceedings for winding up the society are completed by the liquidator

VII. CHAPTER VIII. AUDIT, INSPECTION AND INQUIRY (Sections 76-85)

1. Rectification of Defeats (Section 80)

- amended to make managing committee, not the cooperative society as a body, responsible to explain defects and irregularities noted in the audit report, and report to the Registrar what action has been taken.

VIII. CHAPTER IX. SETTLEMENT OF DISPUTS (Sections 86-89)

1. Dispute to be Referred to Registrar (Section 86)

- includes those of any person having transactions with the concerned cooperative society (Section 86(c)).

2. Settlement of Disputes (Section 87)

a. All disputes shall be settled within 3 months of the date of their receipt by the Registrar. (Section 87(3)).

b. Three months further time can be allowed by Registrar, based upon a report from the officer concerned. (Section 87(4)).

IX. CHAPTER X. WINDING UP AND DISSOLUTION OF COOPERATIVE SOCIETIES (Sections 90-95)

1. Appointment of a Liquidator (Section 91)

- new provision that it is not necessary to appoint a liquidator to wind up a cooperative society which has not commenced working, or has share capital or members' deposits not exceeding T. 500.

X. CHAPTER XI. SPECIAL PROVISIONS FOR COOPERATIVE LAND MORTGAGE BANKS, CENTRAL SOCIETIES AND NATIONAL SOCIETIES (Sections 96-121)

1. Priority of Mortgage Over Claims Arising Under Land Improvement Loans Act, 1883 (Act XIX of 1883) (Section 99)

- new section stating that mortgage executed in favour cooperative land mortgage bank shall have priority over any claim on that land after the date of execution of that mortgage (Section 99(2)).

2. Power To Distrain (Section 100)

- New provision that value of the property to be distrained and sold shall not be more than aggregate of sum due to cooperative land mortgage bank, central society or primary society, and the costs of the distraint and sale.

3. Delivery of Property to Purchaser (Section 110)

- Registrar replaces Court to order delivery of possession of property to purchaser where a certificate issued after a sale of defaulted mortgaged property.

## XI. CHAPTER XII. ENFORCEMENT OF OBLIGATIONS AND RECOVERY OF SUMS DUE (Sections 122-131)

### 1. Charge and Surcharge (Section 126)

- Statute of limitations for prosecuting by Registrar of past or present officer of society for stated intentional or negligent offenses extended from 4 to 10 years from date of audit, inspection or report concerning that matter. (Section 126(1)).

### 2. Penalty For Certain Misdemeanors (Section 127)

- List of misdemeanors extended by adding the following :

  a. continuing as a member of managing committee of cooperative society even after bing disqualified under this Ordinance. (Section 127(c))

  b. not repaying financing bank any amount recovered from loanee members which the society or person is bound to deposit as repayment with such bank (Section 127(d)).

  c. collecting share-money, deposits or other funds for a society and not depositing same with society or its financing bank within a reasonable period. (Section 127 (e)).

  d. wilful neglecting or refusing to do any act or furnish any information required by the Registrar (Section 127 (f)).

### 3. Recovery of Dues By Distraining Crop (Section 130)

a. Where a debt or outstanding demand is due to a society from a member or past member or non-member, then the society may apply to the Registrar in the prescribed manner to recover that debt or outstanding demand by distraining and selling any crop or other produce in his possession and belonging to him (Section 130(1)).

b. The Registrar, where he is satisfied that the debt or outstanding demand is due, shall distrain the crop or produce and sell the same in the manner prescribed. (Section 130(2)).

c. Out of the sale proceeds, the Registrar shall pay the society the amount due to it, after deducting the cost of distrain and sale. The remaining balance, if any, shall go to the defaulter. (Section 130(3)).

XII. CHAPTER XIII. JURISDICTION AND APPEAL (Sections 132-134)

1. Appeal (Section 134)

a. Limitation Act, 1908. Its provisions will not apply to appeals under this Section. (Section 134(3)).

b. Appeals shall be disposed of within 3 months of the date of presentation. (Section 134(4)).

c. Parties who disagree with the appeals decision may make application to the District Judge within 30 days. The decision of the District Judge shall be final. (Section 134(5)).

XIII. CHAPTER XIV. OFFENCES, PENALTIES AND PROCEDURES (Sections 135-138)

1. Presumption Raised By Entry in Register of Members (Section 137)

- Where such register is not available, the detailed list of members with shares enclosed with the audit report shall be treated as prime facie evidence of membership as of the date the balance sheet is drawn up. (Section 137(2)).

# AN ACTION PLAN TO IMPROVE LOAN REPAYMENT IN BANGLADESH

July 1986

by

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# AN ACTION PLAN TO IMPROVE LOAN REPAYMENT IN BANGLADESH

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# S E C T I O N - I

## INTRODUCTION

## THE NATURE OF LOAN REPAYMENT IN BANGLADESH

THE NATURE OF A DIFFICULT PROBLEM

It is very clear from research done during the Rural Finance Project, previous research done by countless others, discussions with local central bankers and discussions with various commercial bankers and donor agencies, that loan repayment is a problem in Bangladesh.

The unfortunate circumstance in all human endeavor is that knowing you have a problem or even knowing what specifically the problem is does not solve the problem. An analogy one might draw is as follows: A man discovers that his house is on fire. He runs out of the house yelling, "Fire, fire". His neighbors come running and stand outside the house with the man and agree with him that his house certainly is on fire. The house burns to the ground. After the event they analyze the situation and come to various types of conclusions. They could or should make their houses out of fireproof material. They should keep water or sand around the area to put the flames out should a fire start. Some people should be assigned in the village to watch and see if a fire breaks out to warn others and summon help. They argue for a great deal of time over what should be done but in the end no one is made responsible for implementing a plan and no one is made responsible for further consideration on the matter. The result is that the problem is reasonably well understood. Fire hurts the individual and community. Some environmental and some specific tactical measures would help. Continued monitoring of the potentially dangerous situation would help prevent further mishap. However, since no one has been given the authority and responsibility to improve the situation, nothing is done to actually prevent a further fire or mitigate its potential impact and the process is repeated the next time a fire burns down a house.

The loan recovery problem in Bangladesh has the nature of the problem of the fire in the village house. Everyone knows credit is necessary to develop an economy. Everyone knows the failure to repay a loan injures a bank's financial health and takes capital from the banking system. Everyone knows loans should be repaid. Everyone writes in the newspapers how terrible the situation is and how bad those people are who do not repay. The result is that the problem is reasonably well understood. However, no one is made responsible for implementing a plan and no one is made responsible for further consideration on the matter. The process is repeated the next time someone considers the loan repayment problem.

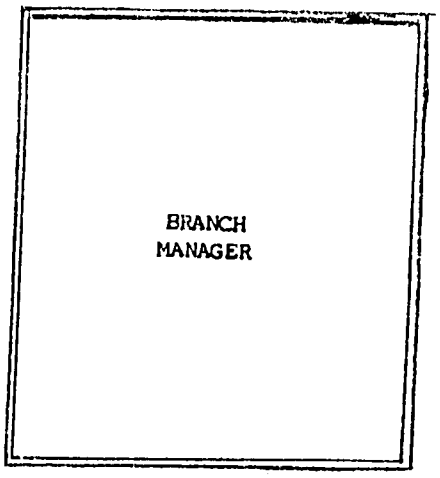
The challenge in RFP Subhask B4.1 is to make the recommendations that will change the environment surrounding and nurturing the loan repayment problem, and establish the line of authority and responsibility through which programs to recover loans can be implemented.

It would be a mistake to start the action plan discussion at the tectical plan level. For an action plan to be successful it must be implemented in an environment that is conducive. If the environment is not prepared properly for the tactical action plan, the action plan will run the risk of being rendered ineffective by elements that are outside the mechanical implementation issues such as training, manpower, effort and monitoring. It is important that the tactical action plan succeed or fail according to its own merits and not because some other consideration did not allow it to succeed. To this end, the discussion of Specific Action Plan Measures to Improve Loan Repayment begins with the consideration of what will be required to change the loan repayment environment.

The following visual illustration of the loan repayment environment establishes the current situation. For this program to be a success, one must create a far more formidable environment for a borrower to consider befire he defaults on a loan.

The analysis of the issue must begin with an analysis of the real nature of loan repavment in order to develop an Action Plan which will impact the topic permanently. The analysis can procede with some assumptions and the topic can be developed from the results of this analysis.

C U R R E N T  L O A N
R E P A Y M E N T  E N V I R O N M E N T




DEFAULTING BORROWERS SEE
ONLY ONE LITTLE MAN
TRYING TO COLLECT
A LOAN

IF THE DEFAULTER CAN AVOID OR DETER HIM, THE
DEFAULTER CAN AVOID REPAYING HIS LOAN

ASSUMPTIONS ON BANKING IN BANGLADESH

Whenever one reviews a banking problem that involves many issues such as large transaction volumes, large sums of money, vast numbers of people over large areas and complicated technical topics, such as in Bangladesh, one must search for a focus which will clarify the substantive issues and simplify the analysis of those issues. One method is to list potential issues as a series of declarative statements and to then try and determine which of these might be the cause of the problem under review and which of these might only be symptomatic of the problem. Clearly, some issues could be both.

From extensive conversations with the Managing Directors and General Managers in the Nationalized Commercials Banks (NCBs) and the Bangladesh Krishi Bank (BKB), plus discussions with Bangladesh Bank and National Planning Commission officials, and the interviews with hundreds of rural branch and regional bank managers, the following statements appear relevant to the topic of loan repayment in the rural areas of Bangladesh. It is assumed that it is always possible to expand or contract the list. The statements are not necessarily in any order of priority.

Bank loan repayments in Bangladesh are influenced by -

a) The Government of Bangladesh's (GOB) willingness to have loans collected by the banks.

b) GOB's desire to aid citizens who have been the victims of natural disasters.

c) GOB's desire to be popular with large or important sectors of the population such as rich farmers or rural industrialists, or the entire population of farmers in the country.

d) The nature of penalties for loan default that are available under the legal system.

e) Legal ramifications which will impact accounting or other banking technical practice either positively or negatively.

f) The length of time it takes the legal system to process cases involving loan repayment default.

g) The effectiveness of legal enforcement of court cases won by a bank who has been the victim of a loan default.

h) The lending policy of a given bank or banks. Who they lend to, how much they lend, what collateral is required and how potential borrowers are selected for evaluation are all issues in this topic.

i) The desire of a given bank or the GOB to make credit available to support a given activity in the economy.

j) The ability of bank accounting and MIS to provide meaningful information for decision making.

k) The willingness and ability of head office officials to develop, implement and monitor loan repayment programs.

l) The willingness and ability of bank middle management and branch management to implement loan repayment programs and file requested reports on the programs.

m) The effectiveness of programs that are implemented by the banks.

n) The willingness and ability of bankers and the GOB to understand the loan repayment program and the commitment necessary over a number of years to make it work in an acceptable fashion.

Needless to say, many more statements could be made on this topic. No statements are made here concerning the borrower or what he thinks or wants to do. It is a time honored banking approach to lend to individuals who have an acceptable level of risk to the bank. It is also well known that the banking and legal system must make willful loan default an unattractive option for a borrower. If it is an attractive option, borrowers will default. Only the government, the legal system and the banks, taken as a whole, can make loan default an attractive or unattractive option for a borrower or a class

of borrowers. The borrowers cannot control the environment unless they are financially very large or the government, legal system and banks allow them to control the environment through inaction or inability.

ANALYSIS OF ASSUMPTIONS ON BANKING IN BANGLADESH

If the assumption that bank loan repayments in Bangladesh are influenced to a greater or lesser degree by the 14(a-n) statements previously made is correct, the analysis of the nature of these statements will provide an indication of the types of actions required to improve loan recovery.

If the types of actions necessary to improve loan recovery become clear, it should be reasonably straightforward to study the current situation of these activities and from the results of that study develop specific strategies to met national banking objectives.

The first interesting observation on the 14(a-n) statements is that although this is the Rural Finance Project and a major emphasis is on rural bank branch management, the majority of the statements concerning topics that influence loan repayment have nothing to do with rural branch operations and are entirely beyond their ability to influence. Depending on how broadly one draws some of the statements which were intended to be of a general nature, only statements j, l, m and n are really impacted by bank branch performance at all and in some cases branch performance is only part of the issue.

The second interesting observation on the 14(a-n) statements is that there is nothing inherently rural about them from a general perspective. This makes some sense as a government's, legal system's or bank's desire to have loans repaid should be all inclusive and have no artificial boundries such as an urban-rural distinction influencing it. Governments try to encourage activity in given economic areas by granting concessionary credit which could have an urban versus rural context but all banks want their loans repaid. This is a simple matter of financial survival.

The third interesting observation is that the major issues influencing loan repayment appear to have either a government policy nature or a bank head office management nature to them. If wealthy farmers are not to be bothered about repaying loans or no effort is made to amend laws which hinder bank loan repayment activities in the courts, these are government decisions. If bank accounting does not reasonably represent the value of assets or banks do not lobby government strongly to change laws and legal procedures which hinder loan repayment activities, these are bank management decisions. It must always be remembered that to do nothing is to take an action and it matters not at all that the decision was actively or passively taken.

## DO THE ASSUMPTIONS REPRESENT TOPICS THAT ARE SYMPTOMS OR CAUSES OF THE LOAN REPAYMENT PROBLEM IN BANGLADESH?

If it is possible from experience or research to focus on the loan recovery/repayment problem in such a way that the program that is prepared by the Rural Finance Project impacts the causes rather than the symptoms of the loan repayment problem, a more efficient loan repayment program can be implemented.

The 14(a-n) statements made previously involve one or more of the following groups involved in obtaining repayment of rural loans :

1) Government management of banking, and management of rural programs.

2) The laws and legal process in Bangladesh as they impact the loan repayment process.

3) Bank head office management who are responsible for the creation, implementation and monitoring of loan policy and loan repayment programs.

4) Bank district/regional/branch management who are responsible for the physical implementation of loan policy, loan repayment and loan reporting programs.

On the following pages is a table which displays the 14(a-n) statements and the four groups involved with them and the analysis of the impact each group has on the statement or is influenced by the subject matter of the statement.

The goal of an analysis of this type is to focus on the priority areas which influence or could influence loan repayment and find ways to research the topics. From the results of this examination it should be possible to create a precise research plan to focus on loan repayment actions that will incorporate the key causal elements in government bank management, the legal system, bank head office/senior management and district/regional/branch bank management.

Within the cells of the matrix formed by the 14(a-n) statements and the 4 defined groups in Table 1 are estimates one can make from discussions with local senior bankers, and RFP consultants' observations of banking in Bangladesh of the impact each group and statement have on the subject of loan repayment. The point of this evaluation is to focus the research in appropriate directions and subsequent research will demonstrate the proper weighting of these topics.

Within the cells of Table 1 are the following codes :

**Cause** - This means that the statement made and the group involved have a significant impact on the topic of loan repayment and require serious study to evaluate the positive or negative aspects of the impact in Bangladesh.

**Symptom**- This means that the statement made and the group involved reflect an aspect of the tipic of loan recovery but are not directly a cause of loans not being repaid Study is important but of lesser overall impact.

**Yes/No** - These mean that the statement made and group involved are (Yes) or are not (NO) influenced by the statement in their consideration of loan repayment issues. This is more an indication of attitude or environment, rather than a specific result or action.

ANALYSIS OF TABLE 1

Government Management and Loan Repayment

For the purpose of this analysis the word "government" means any level or type of government from the national level such as actions by the President or Ministry of Finance to actions taken by the Bangladesh Bank or any other local type of government in the country.

From discussions with local bankers it is clear that actions of government are highly influential when considering the tipic of loan repaymgnt. This makes sense. Government in any country is charged with maintaining law and order. This law and order does not simply fall in the area of dealing with criminal matters or matters of national defense, it includes maintaining law and order in civil matters also.

Bank loan policy and practice is influenced by the enforceability of the loan contract under civil law. If government takes actions over a period of time that actively support the importance of the civil contract, the enforceability of the law will be strengthened. If government takes actions over a period of time that seem to undermine the importance of the civil contract, the enforceability of the contract under law will be weakened.

Governments will take policy or strategic actions that seem to make political sense and, hopefully, are in the national interest. It should never be assumed that members of government know how to implement banking strategies. Bankers, hopefully, know how to implement banking strategies in response to government directives acting in the national interest.

This has extreme relevance. The government actions set the commercial and legal environment that the bankers have to work in and react to. If one expects bankers to be efficient in the execution of national policy, it is only logical that the bankers determine, organization by organization, how they can accomplish what is requested of them. This requires a direct and continuing dialog

between the senior bankers and the senior government officials concerned with financial matters. It would seem that the proper role for each would be for the government to speak to matters of national policy and for the bankers to comment on the policy to influence the final result and to determine the appropriate implementation plan to achieve the goals of the national policy.

The role and influence of government is so great on the topic of loan repayment, that it is necessary to develop a unique long term strategy for the use of that power in conjunction with the development of a long term tactical plan within the banks to improve loan repayment in Bangladesh.

The Law and Legal Process

In the analysis of the topic of loan repayment, there are two fundamental questions which must be answered. Does the legal system allow for the prosecution of bank borrowers who default on their loan? If yes, does the legal procedure aid or hinder banks in the enforcement of their loan contracts with borrowers? Does the legal process act as a deterrent to loan default ?

From research done during the Rural Finance Project[1/] it is clear that there is a legal basis to bring suit for defaulting on the repayment of a loan from a bank.

The second issue is a bit more complicated. If the legal process to collect a loan is expensive, difficult, excessively time consuming or otherwise very burdensome, it will act as a disincentive to the bankers to use. Another way to analyze this is from the borrower's perspective. If use of the legal system to collect loans that have defaulted has disincentives associated with it, this is an incentive for a borrower to default as one of the usual business hazards for contract violation has been effectively removed. The environment that supports contract law is rendered ineffective.

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1/ Sherer, Samuel A., Legal Aspects of Rural Banking Problems Paper 3 in this volume, page 85

It is straightforward to see that the legal system is influenced by government desire to enforce certain laws or expedite certain procedures. From the RFP Survey data it will be quite important to analyze the importance to the rural branch bankers ofusing the legal process in the collection of defaulting loans.

Bank Head Office Management

What is most clearly heard from senior bankers in Bangladesh is that bank head office management is dictated by government policy and pronouncements, and that bank head office management is also responsible for the implementation of programs to implement government policy.

Since district/regional and branch bank officers must follow the head office directives which implement government policy, the question must be asked as to what role the head office managers play in the formulation of the strategy and tactics which will dictate the actions of branch managers ?

This is a vitally important issue. A simple example will highlight the topic. The government writes to the banks and says it wants everyone to try hard and work to have 80% of the overdue loans paid in the next three months. Saying that this is possible, a branch officer would immediately ask how should he go about doing what everyone wants? Even if he is willing, he will not know how to go about it. The head office management has to be responsible for the tactics to achieve the goals for the banking system. If the goal is reasonable, but the timing or some other aspect is not possible, it is their obligation to listen to reasoned arguments. If government generated programs are impractical or inadequate, attempting to implement them will only frustrate the branch managers and reinforce the idea among the defaulting borrowers that the banking system is powerless to collect loans and the government is powerless to enforce contract law.

If the example given is considered simple or farf tched, oneshould review the banking circular ACTION PLAN FOR RECOVERY OF AGRICULTURAL LOANS - 1985,2/ as generated by the Agricultural Credit Department No. ACD(POLY)911(G)/84-7579-85. The program is not much more involved than the example cited.

Involvement of each of the banks is necessary in the formulation of loan repayment policy with the Bangladesh Bank and other appropriate parts of government. It is also clear that some thought has to be given to a significant, long term program to collect loans in a routine manner utilizing all aspects of the enforcement environment, the government, legal system and head office structure, through the rural branch banking network.

Management of Bank Branches

Rural bank branches in Bangladesh reflect they way they are managed and the environment in which they exist.

An individual branch bank can do very little, if anything, to influence the policy directives and programs to implement that it receives from head office. In fact, it could be argued that the only real influence a given branch could have on the practice imposed on it is in defiance. It could refuse to implement a given program or file a given report. This defiance could be active or passive. A branch manager could actively refuse to file a report or implement a program as a protest and at risk to his career. Passive defiance could take the form of inability to carry out an assignment or file a report, or not even knowing it should be filed or implemented. In either case something does not get accomplished and this negative type of result is virtually the only type of impact available to the branch manager on the system he is a part of.

It could be argued that the branch manager could impact the system positively by making suggestions on deposit mobilization or innovating in loan repayment Realistically, when one is in a branch one is in a branch one is in the earlier part of one's career. This is not the time when an officer has his opinions respected by senior managers in a bank. If one is very senior and still working in a branch, one probably has not had a very good career and who would want to listen in that case? Bank branches are the places where bank policies and programs are implemented, not created.

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2/ Annex one, Agricultural Credit Department, Bangladesh Bank.

Since branches are most useful in the implementation of programs and most sensitive to environmental conditions, what types of programs are branches most effective in implementing ?

Branch managers have limited time and limited ability to receive detailed training for most programs. The programs must be simple, straightforward and build upon experience the branch officer has had in the past or has previously been trained to do. Fortunately, there are few new techniques in branch banking so building on previous knowledge or experience is usually possible.

What stops programs from being effectively implemented in the branch network? If a branch manager thinks that a program is not going to be effective or he does not know how to implement a program, the quantity of daily work will be the reason given for lack of success. This will be evidenced by a request for more staff, or a protest concerning the number of reports to be filed every day or the number of loans being processed or the number of customers coming to visit, etc. No branch manager wants to say he does not know how to implement the program or that he thinks the program has no chance for success so why should be try ?

What can be done to improve the odds that a loan repayment program can be implemented and successful through the rural branch network? They key issue in the successful implementation of branch programs is the removal of as many environmental obstacles as is possible. If government programs are impractical, let the banks create the programs to meet national policy needs. If it takes many years to process cases through the courts, rewrite the laws and procedures to help the banks. If enforcement of judgements when the banks win a loan repayment case is the problem, create a method to enforce them. If the branches have too much paperwork, find a way to reduce it and put people to work on loan repayment issues. It is necessary to make the environment attractive for loan collection and unattractive for loan default. This type of environment plus a simple and routine loan repayment collection process for the branch bankers will improve loan recovery.

TABLE 1

INFLUENCE OF ASSUMPTIONS AND GROUPS ON LOAN REPAYMENT

| STATEMENT | G GOB | LEGAL | BANK H.O. | BANK BRANCHES |
|---|---|---|---|---|
| a) GOB'S DESIRE TO COLLECT LOANS | CAUSE | YES | YES | YES |
| b) GOB'S DESIRE TO AID CITIZENS | CAUSE | YES | YES | YES |
| c) GOB'S DESIRE TO BE POPULAR | CAUSE | YES | YES | YES |
| d) NATURE OF LEGAL PENALTIES | CAUSE | CAUSE | SYMPTOM | SYMPTOM |
| e) LEGAL ISSUES FOR ACCOUNTING AND BANK PRACTICE | NO | CAUSE | SYMPTOM | SYMPTOM |
| f) TIME IT TAKES THE LEGAL SYSTEM TO WORK | CAUSE | CAUSE | SYMPTOM | SYMPTOM |
| g) EFFECTIVENESS OF LEGAL ENFORCEMENT | CAUSE | CAUSE | CAUSE | SYMPTOM |
| h) BANK LENDING POLICY | CAUSE | NO | CAUSE | SYMPTOM |
| i) BANK OR GOB LENDING POLICY FOR GIVEN AREA | CAUSE | NO | SYMPTOM | SYMPTOM |
| j) ACCOUNTING AND MIS CAPABILITY IN BANKS | SYMPTOM | NO | SYMPTOM | SYMPTOM |
| k) BANK H.O. ABILITY TO IMPLEMENT REPAYMENT PROGRAMS | NO | NO | CAUSE | SYMPTOM |
| l) ABILITY OF BANK MIDDLE AND BRANCH MANAGEMENT TO IMPLEMENT REPAYMENT PROGRAMS | NO | NO | CAUSE | CAUSE |
| m) EFFECTIVENESS OF BANK PROGRAMS TO IMPROVE LOAN REPAYMENT | NO | NO | CAUSE | SYMPTOM |
| n) GOB AND BANK SENIOR OFFICER LONG TERM COMMITMENT TO IMPROVE LOAN REPAYMENT | CAUSE | NO | CAUSE | SYMPTOM |

## WHAT MUST BE STUDIED TO IMPROVE LOAN RECOVERY?

It would appear logical to evaluate any potential modifications to the banking system in Bangladesh as a series of changes to the managerial approaches involving loan recovery. Since it has already been established that government and bank head office management are the active developers of the environment and strategy surrounding loan repayment, some aspects of that management must be studied. Since it has been established that the legal system and the branch banks are the tools of the government and the bank head office managers, technical issues that hinder their usefulness as tools to achieve loan repayment must be studied. As in Table 1, all 4 groups must be reviewed individually.

### Government Management and Loan Repayment

In order to obtain the clearest possible picture of government philosophy and managerial approach to the topic of loan repayment, research will focus on the technical and pronouncement circulars issued by the Bangladesh Bank, with emphasis on the Agricultural Credit Department, to determine their content, style, clarity and appropriateness in improving loan repayment. This research acknowledges the importance of government directives in establishing both the tone and the technical approach to loan recovery for the Nationalized Commercial Banks.

Research of this type is found in Annex Notes, AN1, AN2, AN16 and in ongoing research.

### Bank Head Office Management

This research must focus on the management techniques used by each bank to accomplish the national goal of improved loan repayments Emphasis must be placed on the head office management structure, internal programs developed for loan recovery and the importance of loan repayments to the liquidity structure of each bank. The goal of this research would be to clarify the emphasis each bank places on loan repayment and to make arguments for improvement of managerial approach as appropriate.

Research of this type is found in Annex Notes, AN5, AN6, AN8, AN9, AN10, AN11, AN12, AN13, AN14, AN15 and in ongoing research.

The Law and Legal Process

As the legal system is a tool that the banks use to force the payment of defaulting loans, a study must be done on the technical aids and impediments to recovery that the ordinary branch officer faces as he tries to routinely use this method of collection to the benefit of his bank and national policy. Emphasis must be placed on costs, length of proceedings, effectiveness of collection after winning a case and the impact of laws on bank accounting and lending practice.

Research of this type has been conducted by Dr. Samuel Sherer, the RFP Legal Advisor and in Annex Notes, AN3, AN7 and in ongoing research.

Management of Bank Branches

As the branches are also a tool to utilize to achieve improved loan repayment, research must focus on removing obstacles for the branch officer and providing him with programs that are clear and goals that can be attained as a routine part of his daily activities. Developing programs that can be integrated into his daily activity is essential for long term success of the program. It is no longer acceptable to send circulars to banks which tell them to "do better" on loan recovery or ask for success in a few months time. Before any new programs go to the branches, a careful development process must determine a method where success is a reasonable expectation.

Research of this type is found in Annex Notes, AN4, AN8, AN10 and in ongoing research.

## DRAFT ACTION PLAN TO IMPROVE LOAN RECOVERY

From the analysis and discussion of the various assumptions developed concerning loan repayment, it is possible to develop an outline for a loan repayment program which would include all the aspects discussed and would accommodate most of the environmental considerations and managerial obstacles that currently impede the progress of loan repayment efforts.

This program can be viewed as a managerial implementation through a series of Actions. Each Action builds upon the former until the managerial structure and environment is modified to allow greater success in loan repayment to be a routine occurence.

The Actions can be generally described at this point and a flow chart follows to provide a visual presentation of the draft action plan.

### ACTION I : DEVELOPMENT

From the varied analyses performed by rural Finance Project members, detailed programs, reforms, modifications and management approaches to legal, regulatory and accounting issues can be developed. The result should be the creation of an integrated program to impact the political, legal and managerial considerations that influence loan repayment.

### ACTION II : MARKETING

Before any involved program can be implemented successfully, it is necessary to obtain the agreement of the individuals who whould have the responsibility to implement the program or who influence implementation in some fashion. An effort should be made to involve any and all influential groups to support and sponsor the recommended program including but not limited to the Bangladesh Bank, Ministry of Finance, CMLA representatives, bank senior managements, USAID and any others deemed important.

ACTION III : ENVIRONMENTAL

Whenever one has to change a managerial circumstance which has become part of the routine of business life, it is not enough to announce a program. One must demonstrate to the business community that the existing rules of the game have changed. Only through changing the existing conditions can a lasting impact be made on an unsatisfactory business circumstance. If laws are changed both bankers and businessmen must consider what impact this will have on daily business. If regulations are changed for the banker, he must consider his new duties and responsibilities under the new regulations and modify his behavior accordingly.

The goal of this Action is to change the environment sufficiently to modify the behavior of selected groups of borrowers to generate significant improvements in loan repayment. If this phase implements legal and regulatory changes which will allow the modification of borrower and banker behavior, the environment will have been prepared for influence by managerial programs to collect loans.

ACTION IV : MANAGERIAL

To successfully and efficiently implement a business program in any organization requires that an appropriate level of manager be assigned to implement the details of the program and report to more senior levels the results of the program. In the case of a loan repayment program of national importance it would seem that a very senior officer should be responsible for the implementation in each bank and be given wide ranging authority within the bank to assure effective and efficient mobilization of internal resources for each phase of the program. If program modifications or added emphasis was required, a senior officer could accomplish this with a minimum of delay and could settle any internal managerial disputes as quickly as possible.

Establishing this position and role also changes the environment within the bank itself. It announces that the former business conditions no longer exist and it indicates a new level of commitment to achieve a desired goal.

ACTION V : TRAINING

It is not enough to have introduced new laws and regulations. It is not enough to establish a new senior management role. It is not enough to publish a program for loan repayment.

It is necessary to inform the middle level managers of each bank concerning the new laws and regulations, and the new senior management role, and the new programs for loan recovery in as influential and dramatic a way as is possible. As many regional, district, division and branch officers should receive classroom training on these changes as possible. Training officers should be assigned to travel to different regions to present the changes in environment at the regional management level in office meetings and large branch meetings. Regional managers must discuss these changes with their officers and branch managers. It is necessary that as close to 100% of the officers in the banking system understand that the loan repayment environment has changed at that the marketplace must understand the changes.

ACTION VI : IMPLEMENTATION

When the laws and regulations have been modified or new ones created and implemented, it is time to start the loan recovery program. Any and all managerial techniques must be utilized to motivate all levels of the banking network to implement the program as a whole. This would present a unified front to the borrowers and would provide more positive reinforcement to the idea that circumstances concerning loan repayment have changed and that the need to repay is inevitable.

ACTION VII : MONITOR

Reporting on this program will have two natures. The first will be to insure that the program is implemented in each branch of the banking network. The second will be to quantify the impact a given program is having in a given area on loan repayment. Both types of reporting are straightforward and are, perhaps, the easiest aspect of this action plan to implement.

## ACTION PLAN TO IMPROVE LOAN RECOVERY

### FLOW CHART

| | | |
|---|---|---|
| ACTION I : | RURAL FINANCE PROJECT DEVELOPS A PROGRAM | - DEVELOPMENT |
| ACTION II : | DISCUSS AND OBTAIN APPROVAL AND COOPERATION OF BB, GOVT. AGENCIES, BANKS AND USAID | - MARKETING |
| ACTION III : | INTRODUCE NEW<br>- LAWS<br>- REGULATIONS<br>- CIRCULARS | - ENVIRONMENTAL |
| ACTION IV : | ESTABLISH THE SENIOR MANAGEMENT ROLE IN EACH BANK THAT WILL IMPLEMENT THE RECOVERY PROGRAM | - MANAGERIAL |
| ACTION V : | MIDDLE MANAGEMENT MUST BE TAUGHT THE MEANING OF THE NEW LAWS, REGULATIONS, CIRCULARS AND THE IMPACT ON THE LOAN RECOVERY PROGRAM | - TRAINING |
| ACTION VI : | BRANCHES BEGIN THE LOAN RECOVERY PROGRAM | - IMPLEMENTATION |
| ACTION VII : | BRANCHES REPORT ON PROGRESS OF THE PROGRAM | - MONITOR |

## SECTION - 1

## SUMMARY AND COMMENTS

This section has been prepared in an effort to establish the nature of the problem of loan repayment. Hopefully, with a better appreciation of the problem it will be more likely that a specific program or series of programs can be developed to significantly impact and improve rural repayment rates in Bangladesh.

If the draft action plan approach stated in this paper is reasonable, the next step would be to utilize RFP research and observations to create a program which can be marketed to the relevant parties in Action II.

At this point the program can only be a draft subject to possible changes after analysis of data from the project survey and changes in the environment in Bangladesh. However, the program must impact the groups indicated and, I believe, go through the phases previously described. To that end a significant amount of the loan repayment program should be able to be developed in anticipation of statistical support. The analysis of specific data may change the emphasis on a tactical approach but is unlikely to alter the strategic view as presented in this paper.

# S E C T I O N - II

## PHASE ONE

## POLITICAL
## AND
## LEGAL ACTIONS

THE POLITICAL ENVIRONMENT

In any government it is difficult to determine where decisions are made and who actually has the ability to influence ideas and the ultimate action on those ideas. In this regard the government in Bangladesh is like many others. In the newspapers, television and radio there have been countless references to the poor state of loan repayment and how the government thinks this is unsatisfactory and must change. This is an inadequate response to the problem.

The political environment must change in an important fashion. It must stop speaking in generalities and be prepared to take some specific actions. The government must appoint a man or a committee to improve loan repayment in Bangladesh. They or he are not to be appointed to study the problem. They are to be appointed to improve loan repayment. These men will have to be broad and flexible thinkers as the topics are complex. They would need to have courage as the decisions are difficult. They will need to have their positions for a few years as implementation of broad programs cannot be accomplished overnight. They must be able to withstand criticism, as many influential people are likely to be critical of their actions. They must be leaders, for many people in the government, legal system and banks will need to be guided, taught, motivated, inspired and sometimes threatened to implement difficult loan repayment programs. They must be diplomats as many people will be upset at the change in environment which previously allowed loan default to go on indefinitely at little personal cost. They must be able to persevere if success is to be achieved.

If the political system can find such men and the government is willing to support their recommendations and programs, the RFP can provide some substantive programs to recommend. If the government is unwilling to appoint and support a group of men with the authority and responsibility to improve

loan repayment, loan repayment will not be improved in a substantial fashion.

In this paper the new committee will be called the National Committee to Improve Loan Repayment (NCILR).

THE NCILR : WHERE DOES IT FIT ?

One of the major questions that would have to be answered in order to make this aspect of the action plan a success is, "Where does the NCILR fit in the government organization ?"

In Bangladesh, the Ministry of Finance is responsible for banking activities and planning to the government and people. As conceived in this action plan, the NCILR would be an action arm of the Ministry of Finance which would concern itself with the operational issues of implementing programs of national importance in the banking system. In this case the National Committee is concerned with the national program to improve loan repayment. Their focus is not the conceptual issue, everyone wants to collect loans, it is the practical, activity oriented job of actually accomplishing the task within the banking system.

Since the NCILR tasks are so important to the well being of the nation, the NCILR would require all the authority of the Ministry of Finance to initiate legal and regulatory change through the governmental system with the ability to overrule and circumvent individuals and areas who would obstruct the actions the NCILR perceive as necessary to accomplish at a given time.

The NCILR, more than any other government entity, will need the ability to initiate and implement their recommendations and programs quickly. The must be able to avoid the pitfalls of typical governmental delay and politicing.

If the NCILR is allowed to act quickly, this will be another powerful demonstration that the political will of the government is behind the program to collect overdue bank loans and will take all reasonable and determined legal action to assist the banks in this activity. This will be another signal to the borrowers that loan repayment is unavoidable under the law and that the law will be enforced to the benefit of the banks.

NCILR-POLITICAL ELITE REPAYMENT PROGRAM

As the NCILR receives its mandate from the highest levels of national government, it seems most appropriate that one of its earliest programs should demonstrate the leadership the senior members of government are showing towards the solution of the loan repayment problem.

The first program, which should be announced with the start of the NCILR, is the Elected Official Program. Any elected official or an official's family member who has an overdue loan must pay it off or make it completely current within 90 days of the ruling going into effect. Statements must be made by government officials concerning their indebtedness. A false statement is a criminal offense. Failure to make a statement, or to make their credit position cufrent within 90 days is a resignation from government service.

The second program to be announced should be the Government Candidate Program. Any individual who wishes to run for any level of elected office must have all his credit be current or paid completely. Overdue credit would disqualify any candidate from appearing on a public ballot.

These programs are straight forward demonstrations of political will. They impact the political system's individuals before any people in the country are approached with pressure to pay overdue credit.

This type of demonstration by the government should give the NCILR the type of start and emphasis that it requires.

Assuming that the government would be willing to support important changes, the next two environmental areas in which the NCILR should implement change is in the areas of law/legal process and bank management.

WHAT IS THE PHILOSOPHY OF A LOAN REPAYMENT PROGRAM ?

In order to maintain the respect of one's peers or the respect of the bank's clients, both large and small, a loan repayment program which puts significant pressure on borrowers to repay and, as a result may threaten their financial or personal situation,must be perceived to be just.

Justice is an interesting issue to introduce in an action plan discussion but is basic to this topic. If one uses the collection method only against the small farmer, it could be argued that they are being "controlled" or "kept poor" by the tactic. If one tries to collect from the weaver but not the industrialist or the merchant, the claim of favoritism will soon follow. If one tries to collect from a man who has been financially destroyed by a devastating calamity such as a flood, you will be considered both cruel and stupid.

What must be made abundantly clear at the beginning and repeated often, is that the system is enforcing civil contract law. If a fellow who has taken a loan, has resources to pay and has not repayed, the system must be difficult for him. However, if the individual allows himself to become dependent on credit availability, repays his loans and asks for another, the system must be prepared to provide him with one. This is just and it rewards "right" behavior.

Justice in the context of loan repayment must mean that "right" or "expected" behavior is always rewarded or treated better by all aspects of the system than "wrong" behavior such as defaulting on a loan from the banking system.

The NCILR will have to face the challenge of considering modifications to law and legal procedure while maintaining or creating the impression, feeling and fact among all concerned that the ultimate goal of these actions is to develop a more just handling of the nation's resources and credit for the ultimate benefit of all the people in Bangladesh.

With that consideration, the NCILR study of the legal environment would begin.

## THE LEGAL ENVIRONMENT

In studying the topic of law as it relates to loan repayment, a banker only has two thoughts. First, does the law allow me to bring a loan defaulter to court for non-payment of his debt ? If the answer is yes, does the court provide an efficient methodology for me to collect my loan if I win the case? If the banker is able to answer, "Yes," to both questions, all he has to do is compare the benefit on collecting his loan versus the administrative costs of bringing the case to court to decide on his course of action.

The first challenge for the NCILR is to assure that the legal process works as an effective loan repayment tool for the bankers to use. Their improvements to the legal system should have several different aspects: Priority for default cases, Shortened Time-frames for Default Cases, Enhanced Collection and Enforcement Procedures are major headings for topics containing a large number of issues.

### Give Priority to Default Cases

The point of this issue is that the courts must have the settlement of loan repayment cases as a priority activity to perform. The Certificate Courts were originally created to aid in the collection of tax revenues in rural areas. This is still their priority function. Loan repayment cases must have enhanced priority through the addition of legal staff or through the reassigning of tasks among existing staff.

Expedited procedures to assist the banks have been implemented in some areas of the country and should be expanded to accomodate as many cases as possible. As many Upazilas, as possible, should receive court coverage to ease the burden of bankers having to travel significant distances to press a case of loan default.

A better result might be possible from the establishment of autonomous commercial courts throughout the country. This would end the problem of default cases not being processed in an expeditious fashion. However, it is acknowledged that the financial resources and manpower may not be available to create a new type of court across the country. This option would have to be reconsidered if the certificate courts prove to be inadequate to process the cases generated by the loan repayment action plan.

Shorten Timeframes for Default Cases

Bankers have continually described the certificate case process as being lengthy. When a defaulter is brought to court anywhere in the World he usually asks the magistrate for additional time to try to repay. Under current law in Bangladesh that timeframe can be expressed in years. Clearly the borrower should be allowed some time to "reorganize" but that time should be expressed in months (6 months?) rather than years. If the magistrate thinks that the borrower is not making a legitimate attempt to arrange his finances to repay, the magistrate must be prepared to rule for the bank immediately. The legal procedings timeframe must work in favour of the banker, not to the benefit of the defaulter. Default case timeframes must be shortened.

Collection and Enforcement Procedures must be Enhanced

It appears from discussions with branch bank personnel in Bangladesh that winning a case is not enough. The object is to win and to collect enough to compensate for the loan and the related expenses. As the current procedure is contained within the tax collection process, the loan collection process has to compete for resources in the attempt to finalize a case. If an officer of the court has the legal paperwork instructing him to serve papers and seize assets to collect back taxes in some cases and defaulted loans in other cases, the tax cases will receive priority on many occasions. This creates another obstacle to loan collection and another delay for the banker.

When a certificate is being issued by a bank officer, such as in the case of BKB, it is often difficult to have even the initial procedures enforced by the local authorities.18/ A bank officer, even in his own estimate according to preliminary RBBUS results, is not always a very important individual in rural life. The legal system must require that local authorities respond to the certificate procedures and act when branch bank managers initiate the process.

All of these types of problems suggest that it might be necessary that the bankers have an independent arm of the courts to aid in the collection of defaulted loans. Thus, no conflicts of priority would arise and the process could procede with as much efficiency as possible considering the circumstances. This is subject to the same manpower and financial constraints and ultimate considerations as the previous recommendations.

18/ CMLA's Secretariat letter No.7011/11/Civil-1 dated 25 February 1986.

Summary of Legal Recommendations

It is not enough to have a legal system which allows defaulting debtors to be brought to court. The legal process must act as a deterrent to loan default. The borrower in loan default court must feel the burden of his debt and the inevitability that it must be repaid. Anything less than this will encourage rather than discourage loan default.

The NCILR must give the bankers the most effective tool that it is possible for the NCILR to develop. The NCILR must also review the costs of bringing a case to court from the bankers perspective. Currently, the bankers must pay an Ad Valorem fee of up to 16-2/3% of the defaulted debt for bringing a case to court plus other charges (possibly but not madatorily reimbursed when a case is won and collected from the debtor). This type of fee and expense structure gives a significant incentive to the banker not to bring large cases to court. The fee compounds opportunity losses felt by the bank by having its resources demobilized. The fee structure has to be fixed at a given amount so that there is no disincentive to bringing large cases, or the fee should be collected at the completion of the case from the loser of the case by the court. This puts the cost where it belongs and gives the court an incentive to hear cases as quickly as possible, plus it would inspire quicker collection by the authorities against the defaulting borrower.

The Ultimate Legal Consideration: Courage

The NCILR will need courage to issue its most important order. That order will be to the banks to bring their oldest and largest defaulters to court. The large defaulters will certainly have political influence and will be using it to their fullest extent. Ultimately, for the loan repayment program to succeed, the largest, most influential borrower must discover that repayment by court action is inevitable and political influence is of no avail. As the statistics provided by Bangladesh Bank indicated at the end of June 1985,[4/] the average certificate case was less than Taka 2,000. The use of the legal system exclusively against the little defaulting borrower must change. This change will cause pain to the large borrower who will make every effort to avoid repayment. The ultimate success of the NCILR will be in their ability to make the privileged few pay back their loans which can be used by the banking system as the example for the small borrower that he must repay also.

4/ Annex 7, Position of certificate cases per Bangladesh Bank.

THE NCILR LOAN REPAYMENT ACT

The NCILR must draft and put into effect a law which requires that bank officers take specific actions to collect large, overdue bank loans.

The nature of the law would be that bank capital, which is the source of the funds which are being lent, is a precious national resource which must be conserved and protected if the nation is to grow. Those who receive significant amounts of these funds have a special obligation to the nation to repay them according to contractual terms in order that they may be used to help other citizens of the country in their development efforts.

If a loan is for a significant amount, Taka 10,000 or more, and is overdue for 30 days or more, the branch manager is required, under penalty of dismissal, to present the borrower with a form notice which demands payment of the loan within 30 days of the notice date(Draft notice format follows).

If the borrower pays within 30 days, he will become eligible for new credit in 90 days, assuming he meets the normal credit standards at that time.

If he does not pay, legal notice is served on him within thirty days of the final notice period and the conclusion for the borrower will be to repay or have assets seized for auction and repayment. The borrower will never be eligible for credit again.

Specific exemptions from this program will be granted for specific classes of borrower. Actual flood victims might have their loans forgiven, as an example. No individual exemptions will be granted.

Under the law the bank officer has the option of carrying out the law's provisions or being dismissed from his position. The provisions of the law can not be modified by the individual bank manager. This creates a situation where borrower and banker alike know that the collection program must be implemented and can not be corrupted by bribe or influence. Loan collection becomes unavoidable and the branch manager is easier to deal with than the legal system is.

NOTICE OF DEFAULT

Date : _____

Loan Number: _____

To :

Address:

Dear Sir or Madam:

By Law Number_____ I am required to inform you under the Large Borrower Default Provision, that your loan with us for Taka _____ taken on _____, due on _____ is now more than 90 days overdue

The law also requires that I inform you that payment in full, or payment to make your overdue loan current, must be made in this office within 30 days from the date of this notice.

If this bank does not receive payment by this time you will be denied the privilege to borrow in the future under the law, and the case will be taken to court as required by law. As of _____

| | | |
|---|---|---|
| Your balance is as follows: | Principal | : |
| Rate : | Interest | : |
| Rate: | Penal Interest | : |
| Rate: | Service charges: | |

Respectfully:

Manager :

Bank :

Address :

CC: Regional Office

CC: Recovery Department

The largest and oldest loan borrowers are to be the first notified and inmacted by the program. The small borrowers should sense a feeling of justice that the largest, most flagrant defaulters are made to repay first under this new law.

By implementing this law against the rich and powerful who have casually ignored the law and their obligations in the past, a powerful signal should be sent to the entire country that the times have changed and banking obligations must be met as a routine matter.

# S E C T I O N - III

## PHASE TWO

## BANK MANAGERIAL ACTIONS

THE BANK MANAGEMENT ENVIRONMENT

It is not enough to make the political and legal system more responsible and more effective concerning loan repayment. Senior bank officers must feel that they have the authority and the responsibility to improve loan repayment at their banks as well.

The desire to collect loans that are due must permeate through every layer of a bank organization. The attitude to accomplish any corporate task radiates from the top down. This is true in Bangladesh as it is in other countries.

The problem in Bangladesh, however, is that the most senior bank managers are appointed by the GOB and, as such, are subject to frequent rotatice at Government whim. This places the banking system at a tremendous managerial disadvantage compared to banking systems in other countries. From studies done during the RFP, since 1980 the managing directors in Banks in Bangladesh hold their positions less than two years and the general managers hold their positions less than four years.[5/] This might be acceptable if they were junior personnel or only had a caretaker's role. As the senior managers of an industry vital to the nation's health and well being, this policy seems determined to generate inaction and confusion on a regular basis at an organizational level where leadership and confidence are primary requisites to accomplish corporate and national objectives.

If one assumes that the senior bankers are the most brilliant of men and the most experienced of bankers, they would still require some time to become familiar with the activities of their organizations and the capabil'ties of the managers that report to them. There is nothing unusual in this and it could be expected to take a year for an individual manager, perhaps longer. It is always useful to remember that a bank such as Sonali has a similar amount of

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5/ Annex 6, Tenure of Senior Bank Managers.

branches to control and direct as the Bank of America has in California or Indosuez has worldwide. The size of the transactions may be different but the organizational problems of management and control are the same if not greater.

The frequent rotation policy rarely allows a managing director the opportunity of implementing any significant programs which he might have discovered were necessary during his first year's learning process. If he does manage to start them the likelihood is that he will not be able to stay to evaluate and modify them as necessary. It is hard to imagine that a new senior manager would have the same perspective concerning a given type of program to solve a perceived problem as the previous manager had. The rotation policy offers yet another serious problem to the banking system. It would tend to make the senior bankers passive and inclined to try to solve the problems of today rather than plan and implement to generate the growth and prosperity needed for tomorrow. The most intelligent and dynamic of men would be hard pressed to develop long range plans for a job he might not have and an organization he might not be a part of next month. Thus it is possible that internal problems can be well known but nothing might be done about them for years, if at all.

It may be beyond the scope of the NCILR to attempt to make major revisions in the general civil service rotation policy but they should be allowed to make selective changes to improve bank management.

Establish the Authority and Responsibility for Loan Repayment

The most useful way to ensure that a topic receives the attention one thinks it is due is to place a manager in charge of that activity. This has the advantage of establishing very clearly who is responsible for a task. The risk that one runs in in placing someone in charge of a given activity is to assure that the responsibility is not the only consideration he receives. The manager must receive the authority to impact the activity also. Following from this, the greater the responsibility and authority are, the longer the time to study, implement and monitor/modify programs must be made available to the manager. The most effective programs are those where the creator is allowed to implement, monitor and modify his own work. When an individual has his own work and reputation at stake, he makes every effort possible to see it a success.

The NCILR should create a new position at the banks reporting to the managing director. The title of this position should be something unusual and distinctive such as the Executive Director for Bank National Programs (EDBNP). The first national program this manager should be concerned with would be the improvement of the loan repayment status of the bank Unlike the other bank officer positions, this is a relatively permanent job The EDBNP should have his position for a minimum of five years, which experience suggests is long enough to impact most major corporate activities. He should be accountable only to the managing director and the NCILR. In cases of conflict between the managing director and the EDBNP the NCILR would settle the issue. The EDBNP would be responsible and have full authority to make any organizational changes and implement any program which in his view would enhance the collection of loans. His authority on this matter, subject to review by the managing director and the NCILR would be absolute in his bank. He should be removed only if his progress in the position dissatisfies both the managing director and the NCILR This is as close to a permanent bank officer position as this banking system would have. Today the EDBNP's problem is loan repayment. Tomorrow, the concern could be training or accounting or MIS or computerization. The possible topics to concern this manager are endless.

WHAT IS THE EDBNP ROLE IN THE GOVERNMENT AND THE BANKS ?

In the western management sense of the term, the EDBNP is a "functional manager".

A functional manager is one who is responsible to see that a goal is met or an objective is satisfied or a given plan is implemented. A branch manager is responsible for making loans, obtaining deposits, answering questions on a wide variety of banking and financial topics, seeing that dozens of reports are sent to various departments and organizations, making sure accounting is done, collecting loans, acting as secretary to the UACCs, signing checks, authorizing disbursements, answering correspondence and countless other varied tasks. An accounting manager is responsible for having

vouchers posted in a given timeframe, seeing reports are done, checking a variety of controls to see if authority or limits have been violated in the daily activity of others and reporting to senior managers if violations appear to have occurred. These are traditional manager role types.

A functional manager has a different role. The EDBNP would not be in charge of a branch but would be responsible for the branch's implementation of the repayment programs, He's not in charge of the recovery department but he is responsible for seeing that it is properly staffed, develops programs and implements them with proper monitoring methods. He does not manage accounting but is responsible for the appropriateness of accounting for loan repayments under the various programs. He has the authority and responsibility to implement change throughout his organization to improve the "function" he is responsible for. In this case, he is responsible for improving loan repayment in his bank.

At the government level, he is the agent of the NCILR, the line manager who is responsible for the operational design and implementation of the programs of national importance. He is the bank employee who is responsible for implementing specific national programs without the ability to make the excuse that he was not in charge of a key area, or he did not receive cooperation or he changed jobs too soon to implement a program. He has the authority and responsibility to succeed.

The relationship between the Managing Director and the EDBNP is a sensitive and crucial one. The Managing Director is in charge of the bank on a daily basis with accountability to Bangladesh Bank, the Ministry of Finance and his board. The EDBNP is responsible to the NCILR at the Ministry of Finance. In effect, they have the same boss. The EDBNP will tell the Managing Director what he thinks should be done to improve loan repayment. The Managing Director will add his input and his staff's input. Hopefully, all will agree on the internal plan of action to be ordered by the Managing Director and supervised by the EDBNP. In case of

dispute, the NCILR will settle the matter with the EDBNP's approach receiving priority consideration. The NCILR decision would be final.

A key to the success of this Action Plan will be in the EDBNP's ability to work with his Managing Director.

PROGRESS AND COMMENTS ON ENVIRONMENTAL ISSUES

At this point, what would the RFP recommendations have achieved ? First, the government would have committed to the concept of collecting the loans that are made by the banking system. Second, the government would have demonstrated that commitment by the creation of the NCILR to implement positive change to improve loan repayment and paying the loans political individuals had that were overdue. Third, the NCILR would make changes to the legal system to make it a more effective tool for the bankers to use to force loan repayment from reluctant debtors. Fourth, the NCILR would establish a senior manager position in each bank which is responsible for the implementation of programs involving national issues. Improving loan repayments would be the first national issue assignment and the EDBNP would have wide ranging authority to go with his level of responsibility.

Program success at this time would mean that the responsibility and authority for improving loan repayment had been clearly established at all levels of government and management. The RFP has a number of specific measures for the EDBNP in each bank to implement to improve loan repayment. Consistant with the action plan to this point, they also will establish appropriate levels of responsibility and authority to accomplish program tasks.

EDBNP BANK ORGANIZATION PLAN TO IMPROVE LOAN RECOVERY

Before the EDBNP can set about making and implementing plans to improve loan recovery, it will be necessary for him to establish his department/division for this task in the bank. RFP research has shown that the different banks in Bangladesh are each organized in a unique fashion concerning the topic of loan repayment.[6] Most of the banks have a Rural Credit Department and most have a Recovery Department which is at least concerned with maintaining some type of MIS on the repayment topic. The size and organization of the Recovery Departments vary greatly from bank to bank. One issue that seems common to these Recovery Departments is that they do not engage in extensive program development in the area of improving loan repayment. The banks and their recovery departments seem to take a passive role and allow Bangladesh Bank to dictate the types of programs they implement. This will now have to change. With the creation of the EDBNP role, the men in the Recovery Departments become responsible for improving loan repayment in their respective banks. The Recovery Department would now be responsible for MIS on the topic, program development, program implementation and modification. Ultimately, they will be the keepers of program discipline for both defaulting borrowers and reluctant bankers alike. The Recovery Department will oversee the progress of court cases with emphasis on the largest, most politically sensitive cases. The Recovery Department will also have the responsibility of monitoring branch and regional manager performance in implementing the various programs which will be designed and presented to them. Failure to implement the programs under Recovery Department guidelines will cost a manager his position with the bank.

The Organization of the Recovery Department

Each EDBNP will have his own opinion and view of what will be necessary in terms of staffing his Recovery Department. This will be influenced by the size of the bank, the level of individual the EDBNP believes he requires and the amount of effort required to implement the programs the Recovery Department will design. The major tasks the Department will have are as follows:

a) Current Situation Evaluation and Monitoring
b) Program Design and Implementation
c) Legal Support
d) Training

6/ Annex 12, Recovery department emphasis in bank organization charts.

Each of the major tasks are an essential component of the repayment effort and the staff for each task will have to have enough flexibility to support other tasks in the Recovery Department when the need arises. The role of each major task is as follows:

Current Situation Evaluation and Monitoring

The key element in the proper management of the loan repayment programs is the availability of accurate data related to the topic which is presented in a timely fashion. If the information is not accurate, quality judgements can not be made from it. If the information is not timely, opportunities to improve a program may be delayed or the passing of a legal deadline may allow a loss to occur that could have become a repayment through legal action.

The monitoring must be timely and accurate. the evaluation of the MIS must be an ongoing and dynamic process. Only through constant evaluation can programs be improved and individuals who are implementing programs be motivated. If an individual knows that his performance is being reviewed, he knows he must try to perform.

If financial incentives are to be part of the program to inspire speedy initial implementation and/or to promote adherence to a series of new procedures which are to become part of the loan repayment routine, the monitoring aspect will become even more important. The decision on whether or not an individual performed acceptably in order to receive a financial reward related to loan repayment would be made on the basis of the standards established by the Recovery Department and the performance indicated in the MIS related to loan repayment.

The BDBNP must be concerned with his MIS as one of his earliest issues as both the bank's performance and his, will be judged most critically on the basis of the information it provides.

Program Design and Implementation

The topic of loan repayment in Bangladesh has many common elements regardless of the bank involved. Many of these elements relate to the environmental issues already discussed. Many operational problems such as branch rotation difficulties, different experience levels among branch personnel, isolation of some branches and personnel problems are common to all the banks in the system and add to management problems.

With all of these common problems will be a series of problems unique to each bank. The EDBNP and his staff will have to sort out the common and unique difficulties related to loan repayment with the bank personnel involved and create a series of programs that utilize the strengths of their organization as effectively as possible to meet the organizational objectives.

With the design of programs comes the always difficult task of implementation. The implementation of anything new with a large group of people always contains an amount of organizational risk, The risk of confusion is always present. The risk of error is always present. The risk that managers refuse to implement a program is always present. The challenge of implementation is largely met in the design phase where all conceivable objections, difficulties and problems have to be anticipated and answered before the program is ever released to the branches. It is understood that something unexpected usually occurs somewhere but quality planning reduces the impact of this type of occurence.

This risk of implementation is very great. If a Recovery Department program is implemented poorly, the critics will certainly use it against the NCILR and the EDBNP concept. This type of criticism could be fatal to the loan repayment program in the early stages.After the program generates some significant success, as it surely will, the program will never again be so vulnerable to critical comment.

The RFP will have some useful programs for the Recovery Department and the EDBNP to consider in its early days. The programs are described later in this report.

Legal Support

It goes without saying that a cornerstone of this entire thrust to improve loan repayment can be found in the changes suggested in this report for the legal system. Whatever changes are implemented will require that the Recovery Department be familiar with all the prior and new nuances of the law as it relates to loan repayment. This will have several aspects. One aspect is that managers will have questions concerning the law and loan repayment. Someone will have to answer them. Another aspect is that some large cases will be brought in the early days of the program that the bank must win at all costs and effort. These cases can not be left to the bank's general barristers, no matter how qualified they are. The bank needs legal specialists on this topic at this and all other times.

To lose a large, politically significant case in the early stages would seriously undermine the collection effort when what is most needed are important court decisions in the banks' favor to inform the country that the times have changed regarding loan repayment in the rural and all other areas.

Training (Internal Marketing)

The whole NCILR and EDBNP concept will take some time for the bankers, as well as the marketplace, to understand. In order to enhance understanding and speed the acceptance and understanding within the bank, some training materials and programs will need to be developed. These programs need not be unique to this particular topic but could be included in the regular programs offered by the bank's training institute and by the Bangladesh Institute of Bank Management, as appropriate. Written programs, and classroom programs to be given on a regional basis could be developed at minimal cost as part of the course development programs at the bank training institutes.

A series of quality written and verbal management presentation products could be viewed by senior bank management as some insurance against confusion related to the loan repayment programs. Ultimately, a new generation of bankers will "grow up" with the new approach, Until then, an ongoing training effort will be required to insure understanding and to convince reluctant or skeptical bankers that a permanent change has occurred.

RECOVERY DEPARTMENT SUMMARY AND COMMENTS

When the great effort to establish the EDNP position is accomplished, many people, some skeptical and some curious, will be carefully watching to see how he performs in each bank. It is essential that the Recovery Department be adequately staffed with the right type of people, intelligent, aggressive and brave. Every organization has them but it may take some effort to find them. This is the time to make that effort.

Everything this department does in the early stages will be watched as if under a microscope. They can not afford a big error. This is the moment when the government and the banks should commit excessive resources to a task rather than the normal inclination of bank managements everywhere to try to do with less. This is a new concept and a different approach to the problem of loan repayment. If the initial programs result in failure or perceived failure, the NCILR and EDBNP may not be given a second chance. Reasonable success must be achieved with the first attempt. Nothing else will be acceptable.

RECOVERY DEPARTMENT PROGRAM DESIGN

In order to design a banking program to accomplish a given task, one must determine the customer or borrower or market segment that one is trying to impact. After one makes that determination, the evaluation of all subsequent programs that are designed can be made on the basis of how they achieve the goal of impacting the target market. For the topic of loan repayment, one must choose what loan or borrower characteristic that one wants to use to initiate the program's activities or to be used as a guideline for the implementers to use.

Loan repayment has a number of characteristics which could be used to guide the program design:

a) Age of loan

b) Size of loan

c) Type of program the loan was dispersed under

d) Location of borrower.

e) Major lending programs of the bank.

f) Other characteristics

The key to the loan repayment problem program design is in matching the capacity of a branch to implement a program against the need to collect a significant volume of loans.

Obviously, one of the key aspects of a loan repayment program is to collect some definition of old or overdue loans and to insure existing loans which are current be paid when due. We also know that rural loans and programs which lend in the rural areas are important considerations, and that it is always valuable to collect large loans that are due or overdue.

When this topic is sorted out it would appear that the essential distinction can be made in the rural, or any area, by age and size of loan due or overdue. Since the largest financial impact would come from the collection of a large loan, and pursuing only a few large borrowers might have a greater financial impact than a large number of small borrowers being pursued, a program which has an emphasis on collecting large loans rather than small has a significant initial appeal. It may be possible to develop some figures from bank statistics which might allow us to consider what a large borrower program might entail. This will be developed subsequently within the Action Plan Benefit Vs. Expense Section.

# S E C T I O N - IV

## PHASE THREE

## LARGE BORROWER COLLECTION ACTIVITIES

EDNP PLAN 1-RECOVER FROM LARGE BORROWERS

Throughout the Rural Finance Project it has been an assumption, which has not been contradicted to this point, that large borrowers have as poor, if not worse, a repayment record in Bangladesh as small borrowers. Saying that this is true and remains true in the final analysis, it is necessary to develop a tactical action plan program to collect from these borrowers. It would be a recommendation to the EDBNP to attempt to collect from the large borrowers as a priority activity.

Advantages of Collecting from Large Borrowers

a) Large borrowers tend to be a small subset in the total set of borrowers. As such, collection programs can be more tightly focused, more quickly implemented and have a stronger financial impact in a short period of time.

b) Since they are large financially, the program should show a superior return per administrative expense required.

c) Success in collecting from this group will have powerful advertising benefit with the rest of the borrowers in the country. If large borrowers are forced to repay, the government and banks are serious about this topic. Then the smaller borrowers will be positively influenced on the loan repayment topic.

Disadvantages of Collecting from Large Borrowers

a) Large borrowers will use their political influence to attempt to avoid repayment. This may result in coercion of bankers by bribe or intimidation, threats of force at the national level or other drastic negative action.

b) It is very possible that this program may develop to be more of an urban program than a rural program. Even if a large rural loan is overdue, it is possible that the borrower resides in an urban area. The thought that loan repayment is not an exclusively rural topic has been developed earlier and may well manifest itself in this action plan.

EDBNP INSTRUCTIONS TO THE BANK'S BRANCHES

a) The first instruction that the branches must receive is the guidance that the bank is emphasizing the collection of overdue large loans by the implementation of a program which is being promoted by banks across the country.

b) The program is of national importance as the health of the banking industry is at stake and only they, the branch personnel, can carry out the necessary tasks.

c) There will be (could be) an incentive bonus scheme for early implementation of the plan but failure to implement within the required period will result in disciplinary action against the branch manager, with refusal or inability to implement resulting in dismissal from bank service.

d) The branch bankers must make it clear to the borrowers that they are following a national program, established under law, which the borrower can not avoid, and if the borrowers do not make full payment within 30 days of their receiving program notice, legal action will begin which will force them to pay. If a borrower does not pay when he has the resources to pay, and a court finds him guilty of failing to repay and makes him pay or has assets seized to effect payment, that borrower will not qualify for a loan again.

e) If an overdue borrower pays his full loan and interest before the legal proceedings are initiated, he will be eligible for consideration of a new loan 90 days after repayment, provided the normal credit criteria are met for the new loan. This time delay is to avoid loan rollovers which do not truly represent payment, simply book adjustment of a loan.

f) If must be very clear to both the banker and borrower that this process is inevitable. The banker must implement the program or lose his job and the next banker will implement the program. The borrower must repay voluntarily and apply at a later time for more funds or be taken to court, forced to pay or lose possessions, and never be allowed to borrow again. No alternatives are possible.

g) The major premise of loan collection efforts worldwide is to make the borrower feel that it is a preferred action to repay the lender rather than have to suffer the consequences of facing the lender and the lender's agents when the loan is not repaid. A moneylender will apply physical force and intimidation to obtain repayment. A bank uses the legal system and eliminating the opportunity for future credit as its weapon to motivate large borrowers to repay. In both cases, some type of pressure has to be available to the lendor to ensure repayment from his borrower.

HOW DOES THE BRANCH SELECT THE PROGRAM BORROWERS ?

All the branches must select the overdue borrowers for participation in the program in a similar fashion or risk the criticism that the program shows favoritism to a certain borrower or group of borrowers. In order to avoid that type of criticism, each branch will be required to prepare the following type of table which will provide guidance as to who and when the program is applied.

LOAN STATUS MATRIX

| | Overdue | 1Yr. + | 6 - 12M | 3 - 6M | 3 M | 2 M | Month | Current |
|---|---|---|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| A | 50,001 | | | | | | | |
| B | 50,000 to 20,001 | | | | | | | |
| C | 20,000 to 10,000 | | | | | | | |
| D | All Other | | | | | | | |

The emphasis will be placed on the oldest and largest loans first and will progress towards smaller and more recent loans over time.

For branches of some size, only overdue loans of Taka 10,000 or more will be included in the program. For smaller branches or branches without high volume of large loans (which should be most of the rural branches) the top 10% of their overdue loans, by size and age, qualify for the program. In this fashion, all of the branches should be participating to some degree. All loans over Taka 10,000 or the top 10% of the overdues by age and size, whichever number is larger, will be the total loans chosen at this time.

The program will start with cell A1 which is the oldest and largest loans and work down the oldest column first as far as C1 for all the oldest overdues and then the program would work across starting at A2 through A4, then B2 through B4 and C2 through C4. In this fashion all the oldest and largest loans would receive the priority emphasis.

WHAT LOANS/BORROWERS WOULD NOT BE INCLUDED ?

This is a very sensitive area which will require some significant attention by the NCILR in the early days of their program development. It would appear that the following types of situations would have to be segregated and treated as special cases:

a) Pre-liberation loans granted to individuals no longer in Bangladesh.[7/]

b) Loans to individuals who have subsequently died.

c) Loans that have been forgiven or deferred by political decree.

d) Other specific cases, not currently determined.

This topic is a serious problem area. Every defaulter with an ounce of political influence will claim that his loan should be given special consideration. It is going to take great judgement and political courage for the NCILR to limit the number of loan types which will receive special attention.

One of the interesting financial ramifications of RFP research is that there is not much financial room in the banks' capital bases for writing-off loans. Therefore, it is not a primary consideration to limit the age or type of loan we want to collect. If the borrower is in Bangladesh and has a past due loan of sufficient size, we want the money back with interest, in this program, now.

This approach has at least one major advantage. It will avoid charges that we have descriminated against those who paid their loans years ago by writing-off the defaulters loans at this time. Some write-offs may be unavoidable, however, as legal statatory time limits for successful pursuit of legal remedies might have passed.

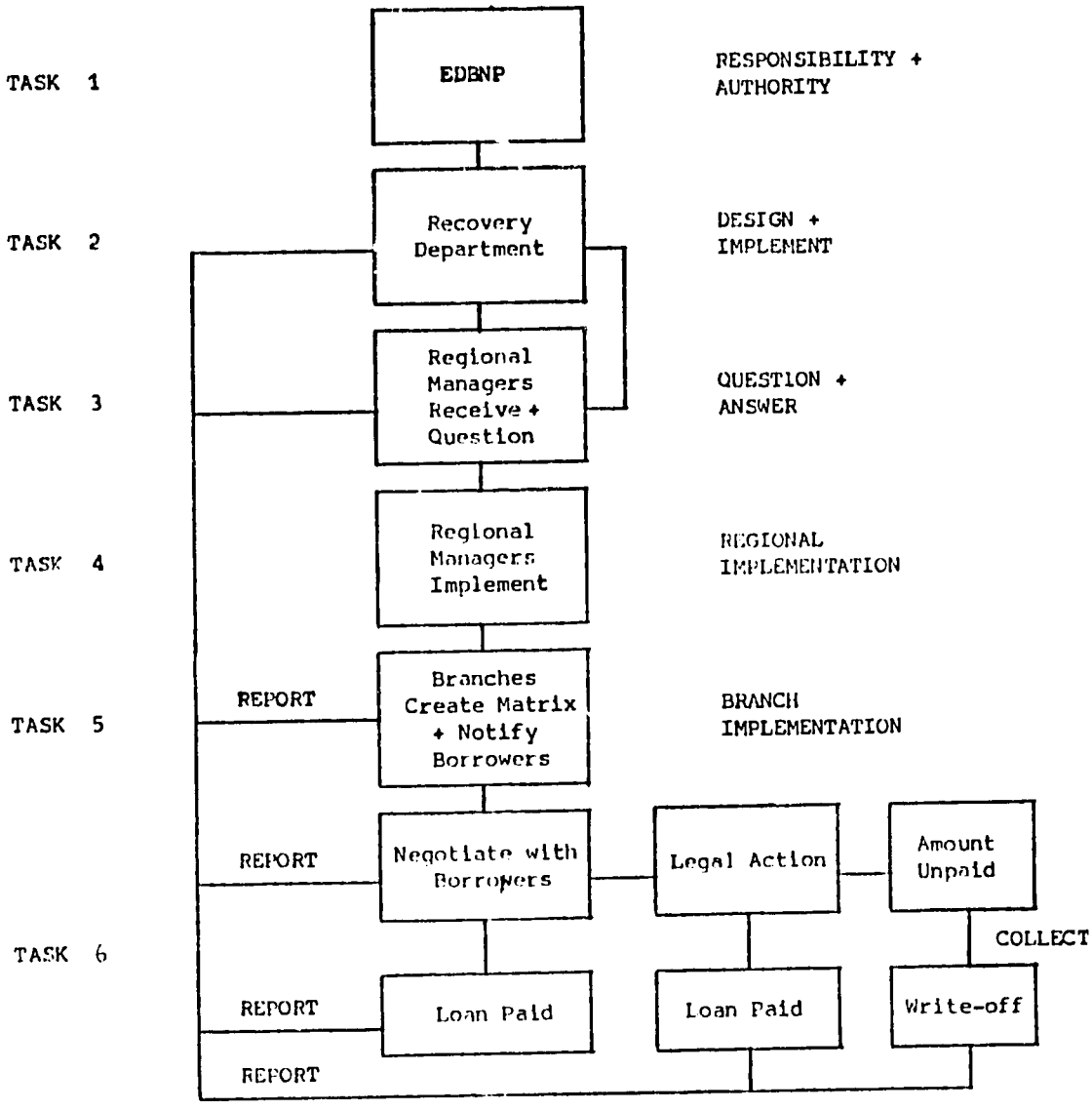
Death and loss of legal remedy are probably the only causes of automatic loan write-off that this program will have. Even with those two it may be possible to attach an estate or pressure the defaulted borrower who is beyond the time limit for legal action with the denial of future credit privileges. The program can not give up easily.

SUMMARY OF LARGE BORROWER PROGRAM

The following flow chart illustrates the six major tasks that are fundamental to the "Large Borrower Action Plan" and provides a concise view of the plan's elements.

LARGE BORROWER ACTION PLAN

FLOW CHART



TASK ONE: RESPONSIBILITY & AUTHORITY

Once the EDBNP's responsibility and authority to improve loan repayment in a given bank is established, it is up to him to demonstrate that he has the leadership and management ability to perform his duties.

After he forms his Recovery Department, he will have to work closely with them to design a number of repayment programs which seem most appropriate for his institution.

The EDBNP must provide the organizational strength and will to perform a difficult task. In times of difficulty, the entire repayment effort will depend on his ability to motivate and inspire his team to determined and sometimes courageous actions.

TASK TWO: DESIGN & IMPLEMENT

The Recovery Department will have the tasks of both designing the operational details of the repayment plans and seeing that the implementation of these plans is possible. Many good ideas in business have foundered because they were too complex or too confusing or too impractical to be useful. The Recovery Department must avoid this type of difficulty and provide the line bankers with plans that can be understood, acted on and reported on in a straightforward manner. The bankers' skill, experience and resourcefulness should be demonstrated in their dealings with the overdue borrowers, not in trying to understand and implement the repayment program.

The Recovery Department will have to implement the programs in stages. First, the programs have to be marketed and understood by local senior management. Later, the program can be presented to the branches for ultimate implementation.

TASK THREE: PRESENT TO REGIONAL MANAGERS

It is assumed that the initial information concerning the law changes and the initial presentation of the program to collect large loans will be met with a certain amount of indifference and resistance from the Regional Managers. Change is always difficult for people to accept and loan repayment problems have been discussed frequently through the years.

The first obstacle to be overcome in the implementation phase is to motivate the Regional Managers to understand that a new era is upon them. Overdue loans can not be tolerated or accepted as a part of everyday business anymore. Educational memoes, and telephone calls to the Recovery Department marketing (training) staff to answer questions with an occasional visit by them, should help the program get started.

In the case where a particular senior manager seems reluctant, a call from the EDBNP should provide the necessary inspiration.

When the Regional Managers seem reasonably secure in the elements of the program, it is time for the branch implementation.

TASK FOUR: REGIONAL IMPLEMENTATION

This is an important step. The Regional office must be prepared for this program and the problems that will surround it. Large borrowers will certainly call and visit to complain about the program or to negotiate avoidance. Branch managers will certainly have questions or fears that will have to be put to rest.

The staff at the Regional Office will have to be prepared for this role and be prepared to provide the MIS which will be required to monitor the program in the Recovery Department at head office.

Most of all, the Regional Office must be prepared to make the effort to guarantee that the program activities are being implemented in the branches. Even treatment of all overdue large borrowers will lessen one type of criticism that the program will receive. It will be difficult for the bank to argue that it is treating all large, overdue borrowers equally when one branch in a region is fully into the program and one has not even started to implement the program.

A quality Regional implementation program will ease the difficulties of implementation in the branches to the overall benefit of the program. This point can not be over emphasized.

TASK FIVE: BRANCH IMPLEMENTATION

If the the Recovery Department at head office and the Regional Office have done a good job, the branches will have an adequate understanding of the program before the implementation begins.

The initial key tasks will be the identification of the overdue loans under our classification matrix and the notification of the overdue large borrowers formally that the time for them to finally make payment has come and can not be avoided.

Since there will be some fear and reluctance among some branch staffs and individuals, these tasks must be as simple as possible The classification is not too complex and the branches will be provided with the form letter described elsewhere which only needs to be filled in. If the branch only has a few overdue loans (1,10,100?) these tasks should not be lengthy and one of the programs desired impacts, speed, will have been achieved.

TASK SIX: COLLECT THE LARGE OVERDUE LOANS

At this point in the program, only one of three things will occur:

a) The borrower will pay.

b) The borrower will refuse to pay.

c) The borrower will negotiate for some other terms of payment.

If the borrower pays we will all be very happy and a problem will be solved. If they don't pay the banker takes them to court per law with some dire consequences for the borrower. These consequences make the banker more attractive to deal with rather than avoid.

The last point is the topic of whether to negotiate with the borrower or not. If one chooses to negotiate with a defaulting borrower, strict rules should apply. Rules such as the following would be appropriate :

The bank will not go to court if the borrower immediately does the following:

a) Payshallpinterest due on the loan.

b) If the loan has a series of payments and a payment or payments are overdue, the payments must be made current immediately.

c) If the loan had one final repayment date which has been missed, the borrower must pay 50% of the original principal balance in addition to the entire amount of interest outstanding.

d) The borrower must pledge additional collateral equivalent to 100% of the final expected interest and principal payment.

e) A new repayment date will be negotiated which will not exceed 50% of the original term and the interest will continue to accrue at the original rate plus service charges and penal interest.

The key to the negotiated terms is that they must be tough. Borrowers must feel it is to their advantage to repay under the original terms.

The negotiated terms must also be standard. The banker must not be allowed to be intimidated by a borrower. If the banker has no control over the program or the negotiated terms, he can not be bullied by the borrower in the normal course of events.

If the terms are not standard, the program will be criticized by borrowers claiming that some other large borrower received a better deal. The program can not be undermined if the terms are standard for all defaulting borrowers.

# S E C T I O N V

## PHASE FOUR

## SMALL BORROWER

## COLLECTION

## ACTIVITIES.

EDENPPLAN P- GENERAL RURAL LOAN RECOVERY ACTION PLAN.

The key issue that has been developed in this paper is that loan repayment in Bangladesh will only improve when the environment that supports loan default is changed to make default an unattractive option for a borrower. A major action plan has been developed to change the environment and to impose repayment discipline on the small number of borrowers who have a significant proportion of credit in the mation and in the rural areas

If we succeed in changing the repayment environment for the better and implement a program to force repayment from the largest borrowers, the next issue to be faced is how to obtain repayment from the large number of small borrowers.

Small borrower Repayment Action Plan.

It could be argued that a highly successful action plan to collect small rural loans has already been implemented in the countryside of Bangladesh and has been in effect for many years.Unfortunately, this highly effective method of collecting loans from small, often unsecured, rural borrowers has not been implemented by the banking system, and it is time that it was considered as part of the banks' routine activities.

Moneylenders in the informal sector of an economy have been collecting loans successfully, without recourse to courts or incentives for repayment, as long as the need for credit has existed. A moneylender tells a borrower only two things:

a) The terms of repayment.

b) What happens to the borrower if he does not repay.

The terms of repayment are always onerous (this is a characteristic of this type of lending worldwide) and the failure to repay usually carries some type of personal threat to the individual, his family or his property. When an individual fails to repay, the moneylender often informs him that he is sorry that something unfortunate will happen to the borrower but that is necessary to prevent other borrowers

from thinking that they too can decide not to repay for whatever reason. Moneylenders the world over rarely enforce their own "contracts." Usually some agents are hired who will be present at the appropriate time to collect a payment or to inform the moneylender of default. These agents are usually charged with the task of imposing the designated "discipline" on a defaulting borrower. The general system is reliable, for the borrower in that credit is available generally, and efficient for the lender in that it is always a better alternative to repay rather than default.

WHAT CAN BE LEARNED FROM MONEYLENDER MANAGEMENT ?

Clearly, no formal credit authority can enforce its contracts with the brutality that can characterize moneylenders' methods. However, some of the attitudes and psychological approaches that moneylenders use are appropriate as management techniques for the formal banking system.

A moneylender always makes his presence felt, either in person or in the form of his agents. This technique has a number of benefits:

a) The agents are always available to inform a borrower that a payment is due. In this regard they act like a monthly credit card billing or a mortgage coupon book might in a Western credit system.

b) The agents know who needs money and why. They are a ready source of reliable information for the moneylender.

c) The agents are well known, so the joining of borrower and lender is made more efficient.

d) The agents are a constant and visible reminder that loans must be repaid and that there are serious consequences for failing to repay, whatever the reason.

e) The agents know when the borrower has money available to repay and press him for repayment at that time. This minimizes the likelihood that the borrower will consume the cash before he considers making his loan repayment.

f) The agents can be found at places where the borrower or potential borrower will have money, such as at a produce or livestock sale, or will need money, such as at a market. This follows the time honored retail business concept that 90% of a successful retail business comes from being in the proper location.

g) The terms that were agreed upon, must be enforced at all times. The moneylender relaxes his repayment enforcement for a perceived benefit to himself, not the borrower, and his agents understand this concept.

THE BANKING SYSTEM AND THE MONEYLENDER REPAYMENT CONCEPTS

It is clear from the prior discussion that the key to repayment of moneylenders' loans is in the certainty and unpleasantness of enforcement and by the continuing attention given to borrowers and potential borrowers by the agents of the moneylender.

In the action plan to collect loans from large bank borrowers, an attempt was made to create the environment where large loan collection will be a certainty and failure to repay will, at least, be unpleasant for the defaulting borrower in the legal sense.

If this type of program is successful, it may be possible, with proper advertising of the results, to impress small borrowers as well as large that loan repayment is inevitable. If this impression can be combined with a program of close supervision by bank field assistants and bank officers, a similar (although always less threatening) version of the moneylenders repayment management technique might be created by the banks in the rural areas.

The small borrowers in Bangladesh constitute a universe of literally millions of individuals scattered all over the country. In their annual report for the financial year 1983-84, BKB listed the making of loans under Taka 10,000 to over 1 million borrowers in a single year ! Clearly, the borrowers from previous years and from other banks makes this universe vast.

The conclusion that one can draw from this is that it is most likely to be impractical to try to develop an action plan for this universe of borrowers that would rely exclusively or heavily on administrative procedures such as legal remedies through the courts. The administrative cost would be a large percentage of the loan repayment and it is unlikely that most small borrowers have enough assets to make seizing them an effective tactic. Needless to say, the government, Bangladesh Bank and the Rural Finance Project do not want to seize the land of the small farmer as a result of his failing to pay a loan.

Managerially, only a couple of types of actions can be taken to improve loan repayment in these circumstances.

Raise Credit Standards

Every banker collects information concerning a borrower before he makes a loan and estimates his ability and likelihood to repay the loan. A banker can improve his loan repayment record by making those standards more difficult to meet. This has the effect of improving loan repayment rates before the loan is ever made. Characteristics of good and bad borrowers will be studied from the data collected in the RFP RBBUS survey material and will be part of the evaluation in the loan sanctioning section of the RFP final report.

Bankers Need Routine and Disciplined Loan Supervision Methods

Loan supervision means different things to different people. To some, loan supervision means that accurate bookkeeping records are kept and periodic reports are generated from those records.

To some, loan supervision means lending to a target group under a specific program with time limits and disbursement levels to meet.

To some, loan supervision means the relationship between bank and borrower after a loan is made and before the loan is repaid.

It is this relationship, after a loan is made and before it is repaid, that is the focus of the Small Borrower Repayment Action Plan.

Small Borrower Repayment Action Plan

Each regional and branch manager must make a map of every hat, roadside market, bazar, location of special events and their timetables in his area. The regional manager must require that each of his branches send an officer and the branch's field assistants to their hats when held, roadside markets as they occur and bazars at appropriate times on a regular schedule to meet their borrowers when the borrowers are likely to have money. They will confront the borrower in front of friends and strangers to make payment trying to put as much psychological and personal pressure on him as is possible. The discipline of the program is found in the concept that all the hats, bazars, roadside markets and special events are covered by the bankers. The rural people need and want to come to these places to do business, shop and socialize. Meeting the banker must become an inevitability for them.

The goal of this type of action plan, aside from collecting loans, is to make the program as inexpensive as possible for the banks.

Since over 80% of all borrowers are in the rural areas and their numbers are in the millions, it is impractical to design a national small borrower action plan which depends on the bankers travelling to visit each small borrower. The bank transportation resources are limited and the borrowers are too dispersed to make a very active program cost effective.

The goal of the program is to take the personnel resources the banks have and will have, and use them as effectively as possible. For example, a bank region may discover that it does not have enough field assistants and bank officers to cover all the hats, markets, bazars, and events held in the region at this time. They should study where their greatest number of borrowers are and where the largest and closest hats, markets and bazars are to these borrowers and use their available staff to cover these opportunity areas. As the bank staff of field assistants and officers increase, the number of hats, bazars, markets and special events which can be covered increase also.

This type of program is unlikely to produce the best possible mathematical result, as some borrowers will still not be supervised on a regular basis, but it is likely to produce the best result that is possible under the circumstances at the least possible increase in incremental administrative expense.

SMALL BORROWER ACTION PLAN COMMENTS

1. It is recommended that this Action Plan be implemented after the Large Borrower Action Plan for 2 reasons.

   a) The Large Borrower Action Plan is of greater importance and the banks should place all their emphasis on it first.

   b) The small borrowers are always the target of collection and legal enforcement. This program should use the success of the Large Borrower Action Plan as a psychological tool to demonstrate that times have changed concerning loan repayment.[8]

2. No unique budget has been developed for this plan as it reallocates existing resources but does not demand additional resources.

3. Monitoring of this program will be done through the same reporting function performed for the Large Borrower Program in a format similar to ACD(L)1-6.

4. The program is simple in concept and should not be too difficult to implement by individual banks and regions of the banks.

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8/ Annex 7, RFP File notes, position of certificate cases per Bangladesh Bank.

# S E C T I O N - VI

## LARGE BORROWER

## ACTION PLAN

## BUDGET

## CONSIDERATIONS

## AND

## BENEFIT

## ANALYSES

## THE ACTION PLAN FOR LOAN REPAYMENT: A BUSINESS CASE

Any business venture, such as the Action Plan for Loan Repayment, must be seen to be cost effective before serious thought can be given to implementation. In order to evaluate the cost effectiveness of the plan, a comparison of benefits versus cost needs to be made utilizing the best bank financial figures that can be obtained. To this end, some financial information has been gathered from the 1983-1984 Annual Report of the Bangladesh Krishi Bank (BKB). These should be most relevant for Rural Finance Project purposes as the past, current and future involvement of BKB in rural financing, and some urban based financing, is assured.

## BKB FINANCIAL INFORMATION FROM 1983-1984 ANNUAL REPORT

The following financial information is useful in evaluating the importance and appropriateness of the stated Action Plan for Loan Repayment.

| | | |
|---|---|---|
| Year end Loans outstanding | : | Taka 12,534,000,000 |
| Year end Loans overdue | : | Taka 3,082,000,000 |
| Percentage of overdue/outstanding | : | 24.6% |
| Loans not overdue | : | Taka 9,452,000,000 |
| Ratio of not overdue/overdue | : | 3.1 : 1 |
| Rural branches | : | 812 |
| Urban branches | : | 88 |
| Regional offices | : | 64 |

Percentage of BKB's 1984 Disbursements -

| | | Number | % | Amount | % |
|---|---|---|---|---|---|
| Loans over Taka 10,000 | : | 49,190 | 4% | 2,613,630,000 | 44% |
| Loans to Taka 10,000 | : | 1,139,176 | 96% | 3,310,634,000 | 56% |
| | | 1,188,366 | 100 | 5,924,264,000 | 100 |

In the 31 December 1985, RFP File Note on this topic,[9/] it was determined that in the last three financial years BKB loans over 10,000 Taka constituted over 50% (50.54%) of the credit outstanding while being concentrated in the hands of relatively few borrowers (4.76%), 115,336 of 2,421,972 in all.

9/ Annex 8, BKB loan distribution by size, 1981-82 through 1983-84.

If one uses the recent 44% of loan disbursements being large (over Taka 10,000) and estimates that this is the current and future trend of loan disbursements, and assume that the percentage of large and small borrowers who are overdue are approximately the same, some interesting budget benefit analysis can be done.

BKB LOAN REPAYMENT PROGRAM BENEFITS

Before the benefits can be estimated, some calculations must be made.

The amount of overdue loans which qualify for the large borrowers program must equal the total amount of overdue loans x 44%. This would be :

Taka 3,082,000,000 x 44% = 1,356,080,000 Taka large loans overdue. Of this amount, Taka 1,356,080,000, some estimates must be made such as the following:

A) What percentage of this amount would never be collected without this program ?

B) What percentage of this amount would be collected earlier with this program than would occur without this program (Assume one year) ?

C) What percentage of this amount would not be collected or collected earlier by this program (The program impacts the ultimate result not at all) ?

It could be argued that the benefit of item A, is the entire principal amount in the year collected and some interest income benefit subsequently.

In item B, the benefit is obtained as an interest benefit achieved by bringing the money to useful purposes again

Item C provides no measureable benefit.

THE BENEFIT SCENARIOS

Let us assume that the large borrower program is implemented in the country over a two year period. BKB Net Interest Income as a percentage of earnings assets and Interest Income as a percentage of earning assets have been calculated as 3.6% and 9.1% respectively.

SCENARIO I

Item A) 1% would never be collected without this program

Item B) 10% would be collected 1 year earlier as a result

Item C) 89% would not be impacted

(Taka)

| | Principal Benefit | | Interest Benefit | | Total |
|---|---|---|---|---|---|
| | Year 1 | Year 2 | Year 1 | Year 2 | |
| Item A | 5,085,300 | 6,780,400 | 192,818 | 308,508 | 12,367,026 |
| Item B | - | - | 762,795 | 1,220,472 | 1,983,267 |
| Item C | - | - | - | - | - |
| Total | 5,085,300 | 6,780,400 | 955,613 | 1,528,980 | 14,350,293 |

It is assumed in all Scenarios that 50% of the large borrowers will force the program to go to court. For purposes of these analyses it is assumed that collection occurs 6 months after court proceedings are initiated.

On Item A, loans that are collected only as a result of this program, the benefit is assumed to be the total principal recovered, and interest on that principal which is calculated at the average rate of interest income/earning assets for BKB for the average principal collected during the year.

On Item B, the interest benefit is conservatively calcualted at the not 1 interest income/earning assets for BKB for the average principal collected.

EXAMPLE CALCULATIONS FOR SCENARIO I

YEAR 1 ITEM A: Taka 1,356,080,000 x 1% = 13,560,800 Taka loans to be processed over 2 years or 6,780,400 each year for this category.

50% go to court : Taka 6,780,400 x .5 = 3,390,200

50% do not : = 3,390,200

Those loans that go to court in the second half of the first year, will be collected in the second year.

The principal benefit in year 1 is all principal from borrowers who did not go to court and 50% of those who did go. The additional 50% of borrowers who went to court would have their principal collected next year.

ITEM A: PRINCIPAL = Taka 3,390,200 + .5 (3,390,200)
= Taka 5,085,300

ITEM A: INTEREST = Taka 3,390,200 ÷ 2 x 9.1%
Non court = Taka 154,254
Court = Taka 3,390,200 ÷ 2 (Half the principal this year)
÷ 4 (Only received in the second half of the year)
x 9.1% = 38,564

Item A: Principal Interest = 5,085,300 Taka + 192,818 Taka
= Taka 5,278,118

YEAR 2 ITEM A:

PRINCIPAL:

| | | |
|---|---|---|
| Non court | = Taka 6,780,400 x .5 = | 3,390,200 |
| Court | = Taka 3,390,200 x .5 = | 1,695,100 |
| Previous year | = Taka 3,390,200 x .5 = | 1,695,100 |
| Total Principal = | Taka | 6,780,400 |

INTEREST = Taka 6,780,400 x 9.1% ÷ 2
= Taka 308,508

Item A Principal + Interest = Taka 6,780,400 + 308,508
= Taka 7,088,908

YEAR 1 ITEM B:

Principal = Taka 1,356,080,000 x 10% ÷ 2 years
= Taka 135,608,000 ÷ 2 = 67,804,000

Court = Taka 67,804,000 x .5 = 33,902,000
Non-court = Taka 67,804,000 x .5 = 33,902,000

INTEREST:

Non-court = Taka 33,902,000 ÷ 2 x 3.6% = Taka 610,236
Court = Taka 33,902,000 ÷ 2 ÷ 4 x 3.6% = Taka 152,559

Total Interest = Taka 762,795 Year 1 Item B

YEAR 2 ITEM B:

PRINCIPAL:

Non-court = Taka 67,804,000 x .5 = 33,902,000
Court = Taka 33,902,000 x .5 = 16,951,000
Previous year = Taka 33,902,000 x .5 = 16,951,000

Total Principal = Taka 67,804,000

INTEREST = Taka 67,804,000 ÷ 2 x 3.6%
= Taka 1,220,472

It is assumed that principal that has been recovered which would have been lost should be treated as capital and earns at a full 9.1% p.a. while loans collected earlier are treated as a normal resource and earn at the Net Interest Income rate of 3.6% p.a.

SCENARIO II

ITEM A: 3% would never be collected without this program
ITEM B: 10% would be collected 1 year earlier as a result.

The benefit table is as follows:

(Taka)

| | Principal Benefit | | Interest Benefit | | Total |
|---|---|---|---|---|---|
| | Year 1 | Year 2 | Year 1 | Year 2 | |
| Item A | 15,255,900 | 20,341,200 | 578,454 | 925,524 | 37,101,078 |
| Item B | - | - | 762,795 | 1,220,472 | 1,983,267 |
| Total | 15,255,900 | 20,341,200 | 1,341,249 | 2,145,996 | 39,084,345 |

SCENARIO III

Item A : 5% would never be collected without this program

Item B : 20% would be collected 1 year earlier as a result

(Taka)

| | Principal Benefit | | Interest Benefit | | Total |
|---|---|---|---|---|---|
| | Year 1 | Year 2 | Year 1 | Year 2 | |
| Item A | 25,426,500 | 33,902,000 | 964,090 | 1,542,540 | 61,835,130 |
| Item B | - | - | 1,525,590 | 2,440,944 | 3,966,534 |
| Total | 25,426,500 | 33,902,000 | 2,489,680 | 3,983,484 | 65,801,664 |

SCENARIO IV

Item A : 10% would never be collected without this program

Item B : 20% would be collected 1 year earlier as a result.

(Taka)

| | Principal Benefit | | Interest Benefit | | Total |
|---|---|---|---|---|---|
| | Year 1 | Year 2 | Year 1 | Year 2 | |
| Item A | 50,853,000 | 67,804,000 | 1,928,180 | 3,085,080 | 123,670,260 |
| Item B | - | - | 1,525,590 | 2,440,944 | 3,966,534 |
| Total | 50,853,000 | 67,804,000 | 3,453,770 | 5,526,024 | 127,636,794 |

COMMENTS ON THE ACTION PLAN BENEFIT SCENARIOS

The fundamental questions to be asked in this type of analysis are two:

1) Can we assume that this program will collect some loans that otherwise will never have been repaid ?

AND

2) Is it reasonable to calculate a benefit for collecting a loan earlier ?

It is assumed that the answer is, "Yes", to both questions. However, the cost effectiveness of the program does not depend on the answer to question 2.

The answer to question 1 has to be affirmative. If it was believed that all the loans are collected eventually, RFP subtask 4.1 would probably not exist. The real issue is to determine what level of total overdue loans should be budgeted as collectable for benefit Scenario estimation. The "right" answer to this question is not known.

However, it is known that over 3,000,000,000 Taka of loans were overdue to BKB at the end of the 1984 financial year. If it is assumed (as found from research) that 44% of these are large loans and, at most, 10% will be considered as collected that never would have been collected otherwise, only 4.4% of the overdue loans were claimed as the maximum benefit for this collection Action Plan. It is difficult to estimate more conservatively than this level of important success.

At the most expansive analysis (Scenario IV) only 30% of the 44% (13.2%) of the overdue BKB loans were considered successfully collected by this program with the rest being collected or not but essentially being unaffected by the program at all. Some might consider this unacceptable or trivial success. It is conservative. Even at this level the benefits are massive compared to the expenses that have to be expended to obtain them.

Question 2 should deserve an affirmative answer also. Based on the liquidity problems the banks in Bangladesh have had, collecting funds earlier would reduce the levels of refinance the babks require. This is worth something to the banks. However, as a review of the Benefit/Expense summary charts demonstrate, Item B is not material to the success or failure of the Action Plan. It seems reasonable, however, to assign some interest benefit to this type of Action Plan result.

ACTION PLAN EXPENSE BUDGET

If we assume the NCILR consists of five men at the level of bank Managing Directors, annual expense estimates can be made for them and an imaginary staff.

| Function | Number | Salary + Benefits | Total |
|---|---|---|---|
| NCILR member | 5 | Taka 200,000 | 1,000,000 |

Assuming a large staff to support them:

| Function | Number | Salary + Benefits | (Taka) Total |
|---|---|---|---|
| Bank Officer level | 5 | Taka 60,000 | 300,000 |
| Clerks | 10 | Taka 36,000 | 360,000 |
| Typists | 5 | Taka 30,000 | 150,000 |
| Drivers | 5 | Taka 30,000 | 150,000 |
| MLSS | 5 | Taka 24,000 | 120,000 |
| | 35 | Total Salaries + Benefits | 2,080,000 |

Five Automobiles for the NCILR members @ 360,000 Taka each, assuming 50% resale value after 3 years:

| | |
|---|---|
| Annual Auto Expense | 300,000 |
| Auto Maintanance + Fuel | 390,000 |
| Insurance | 25,000 |
| Total Auto | 715,000 |

Assuming they will publish a great deal:

| | |
|---|---|
| Stationary | 300,000 |

Assuming they must rent 2,000 Sq. ft. of office space:

| | |
|---|---|
| Rent | 240,000 |
| Tele, Elec., Water | 200,000 |

Assuming 50% resale value after 3 years :

| | |
|---|---|
| Furniture + Fixtures | 200,000 |
| Office Equipment | 250,000 |
| Maintenance | 100,000 |
| Implementation | 100,000 |
| Theft Insurance | 7,000 |
| Office Utilities | 50,000 |
| Total Expense | 4,242,000 |
| 20% Contingency | 848,400 |
| | 5,090,400 |

Other expenses:

Assume that only the EDBNP themselves, their cars and drivers add expense to a given bank:

| Function | Number | Salary + Benefits | (Taka) Total |
|---|---|---|---|
| EDBNP | 5 | Taka 200,00 | 1,000,000 |
| Automobile + Other | 5 | - | 715,000 |
| Drivers | 5 | 30,000 | 150,000 |
| | | | 1,865,000 |

Total NCILR + EDBNP Expense : Taka 6,955,400
For Analysis Purposes : Taka 7,000,000/year

ACTION PLAN EXPENSE BUDGET COMMENTS

An effort has been made to estimate the NCILR expenses and the unique expenses of the EDBNPs in each bank.

It will probably be noted that the 10 senior men have quite extensive budgets. They all have cars and drivers and their staffs are paid well. The expenses of creating and maintaining senior level managers are not minimized. This has been done for several reasons.

a) The large borrower program must have the resources it needs.

b) It demonstrates the importance of these functions.

c) It demonstrates the power of this Action Plan as virtually no imaginable expense keeps the program from being cost effective.

It will also probably be noted that the budget of the EDBNP only includes him, his driver and a car in each bank. The assumption here is that all the required staff, talent and resources for the large borrower Action Plan are contained in each bank at the present time. The issue is in the improvement of the management of the topic and the EDBNP will provide this management.

LARGE BORROWER
ACTION PLAN
BENEFIT VS EXPENSE
ANALYSES.

INTRODUCTION

The following pages contain a series of charts which summarize the potential benefits and deficits for the various Scenarios described under the Large Borrower Action Plan.

It is assumed that the NCILR would be in operation for a year before the Large Borrower Action Plan would be implemented. Also, it is assumed that the EDBNP would only take his position in a given bank during the middle of the preliminary year. No collections related to his function would be made until the program is established and his recovery function is established in each bank.

After the preliminary activities are completed, the collection program begins. Each collection program scenario has an interest benefit and a principal benefit which has been calculated previously and is now summarized in the scenario charts.

It is presumed that the program costs are generously stated and that they can be treated as fixed for the three program years illustrated.

It is assumed that legal expenses will not be a notable component of program expense. In house bank counsel would be used to bring cases to court. Case fees paid to the courts would be reimbursed by the losing borrower. Such a small percentage of borrowers are being handled by this method that the banks should be able to produce a legal success rate near if not exactly, 100%. If all this is true, and it should be legal costs should not be a notable consideration in this analysis.

(Taka)

| SCENARIO 1 | PRELIMINARY ACTIVITIES FOR A YEAR. | YEAR 1 | YEAR 2 | THREE YEAR RESULT VS BKB. |
|---|---|---|---|---|
| BENEFITS. | | | | |
| A | - | 5,278,118 | 7,088,908 | 12,367,026 |
| B | - | 762,795 | 1,220,472 | 1,983,267 |
| TOTAL | - | 6,040,913 | 8,309,380 | 14,350,293 |
| EXPENSES. | | | | |
| NCILR | 5,090,400 | 5,090,400 | 5,090,400 | 15,271,200 |
| EDBNP | 933,000* | 1,865,000 | 1,865,000 | 4,663,000 |
| TOTAL. | 6,023,400 | 6,955,400 | 6,955,400 | 19,934,200 |
| NET BENEFIT (LOSS) | (6,023,400) | ( 914,487) | 1,353,980 | (5,583,907) |
| CUMULATIVE | (6,023,400) | (6,937,887) | (5,583,907 ) | (5,583,907 ) |

6 Months only.

(Taka)

| SCENARIO II | PRELIMINARY ACTIVITIES FOR A YEAR. | YEAR 1 | YEAR 2 | THREE YEAR RESULT VS BKB. |
|---|---|---|---|---|
| BENEFITS. | | | | |
| A | - | 15,834,354 | 21,266,724 | 37,101,078 |
| B | - | 762,795 | 1,220,472 | 1,983,267 |
| TOTAL | - | 16,597,149 | 22,487,196 | 39,084,345 |
| EXPENSES. | | | | |
| NCILR | 5,090,400 | 5,090,400 | 5,090,400 | 15,271,200 |
| EDENP | 933,000 | 1,865,000 | 1,865,000 | 4,663,000 |
| TOTAL | 6,023,400 | 6,955,400 | 6,955,400 | 19,934,200 |
| NET BENEFIT (LOSS) | (6,023,400 ) | 9,641,749 | 15,531,796 | 19.150,145 |
| CUMULATIVE | ( 6,023,400 ) | 3,618,349 | 19,150,145 | 19,150,145 |

6 Months only.

(Taka)

| SCENARIO III | PRELIMINARY ACTIVITIES FOR A YEAR | YEAR 1 | YEAR 2 | THREE YEAR RESULT VS BKB. |
|---|---|---|---|---|
| BENEFITS. | | | | |
| A | - | 26,390,590 | 35,444,540 | 61,835,130 |
| B | - | 1,525,590 | 2,440,944 | 3,966,534 |
| TOTAL. | - | 27,916,180 | 37,885,484 | 65,801,664 |
| EXPENSES. | | | | |
| NCILR | 5,090,400 | 5,090,400 | 5,090,400 | 15,271,200 |
| EDBNF | 933,000 | 1,865,000 | 1,865,000 | 4,663,000 |
| TOTAL | 6,023,400 | 6,955,400 | 6,955,400 | 19,934,200 |
| NET BENEFIT (LOSS) | (6,023,400) | 20,960,780 | 30,930,084 | 45,867,464 |
| CUMULATIVE | (6,023,400) | 14,937,380 | 45,867,464 | 45,867,464 |

• 6 Months only.

(Taka)

| SCENARIO IV | PRELIMINARY ACTIVITIES FOR A YEAR. | YEAR 1 | YEAR 2 | THREE YEAR RESULT VS. BKB. |
|---|---|---|---|---|
| BENEFITS. | | | | |
| A | - | 52,781,180 | 70,889,080 | 123,670,260 |
| B | - | 1,525,590 | 2,440,944 | 3,966,534 |
| TOTAL | - | 54,306,770 | 73,330,024 | 127,636,794 |
| EXPENSES. | | | | |
| NCILR | 5,090,400 | 5,090,400 | 5,090,400 | 15,271,200 |
| EDBNE | 933,000* | 1,865,000 | 1,865,000 | 4,663,000 |
| TOTAL | 6,023,400 | 6,955,400 | 6,955,400 | 19,934,200 |
| NET BENEFIT ( LOSS) | (6,023,400) | 47,351,370 | 66,374,624 | 107,702,594 |
| CUMULATIVE | (6,023,400) | 41,327,970 | 107,702,594 | 107,702,594 |

* 6 Months only.

LARGE BORROWER BENEFIT VS. EXPENSE BUDGET COMMENTS

Like all business cases, the Large Borrower Action Plan has budget and benefit strengths and weaknesses.

The major potential weaknesses are that the expenses for the NCILR and EDBNP's are somehow under estimated or that significant expenses related to bringing cases to court are unavoidable regardless of changes in law and legal proceedings.

The power of this Action Plan is not in its ability to finely define the potential expense. It could be that expenses will be greater than planned.

The power of this plan is found in its strengths. The entire cost of the plan for all 5 banks has been estimated and stated. However, only BKB's outstanding overdues have been the basis for the benefit calculations.

If the collection figures for Agrani, Janata, Rupali and Sonali were added, it would make a compelling argument even more difficult to refute. The Scenario estimates for success are such a small percentage of overall overdues, it is difficult to develop an expense Scenario for failure since no other expense estimates are involved. If one tripled expenses, the less (although still) conservative Scenarios still show a significant benefit versus BKB figures.

The mathematical benefits and conservative approach to their development are difficult to deny.

# SECTION VII

## BANK INCENTIVES TO IMPLEMENT THE LOAN REPAYMENT PROGRAMS.

SHOULD FINANCIAL INCENTIVES FOR INDIVIDUALS BE PART OF THE LOAN REPAYMENT PROGRAM ?

To answer this question, two topics must be considered. The first question concerns the overall cost of incentives to the banking system and the second question would be the consideration of how these incentives would inspire "right" rather than inappropriate behavior.

POTENTIAL INCENTIVE COST.

At the end of the 1984 bank financial year, the five banks under review showed total branches, employee salaries plus benefits and net profit before taxes and transfers as follows :

| | branches. | Salaries & benefits. | Profit. |
|---|---|---|---|
| AGRANI | 789 | 208,570,472 | 170,919,314 |
| JANATA | 838 | 264,412,306 | 230,998,642 |
| RUPALI | 483 | 142,467,527 | 115,691,665 |
| SONALI | 1,233 | 373,097,798 | 552,305,778 |
| BKB | 900 | 167,501,666 | 169,500,000 |
| TOTAL | 4,243 | 1,156,049,769 | 1,239,414,399 |

If one took the 4,243 branches (URBAN AND RURAL) and estimated incentive levels to reward Managers and branch staff for program implementation and/ or collection success, this cost should be compared with recent profit and salary & benefit levels for the banks to see what the overall percentage impact would be.

| | TAKA | | |
|---|---|---|---|
| INCENTIVE/BRANCH | 1,000 | 5,000 | 10,000 |
| TOTAL INCENTIVE | 4,243,000 | 21,215,000 | 42,430,000 |
| % OF NET PROFIT | 0.34% | 1.71% | 3.42% |
| % OF SALARIES & BENEFITS | 0.37% | 1.84% | 3.67% |
| % OF LARGE BORROWER PROGRAM EXPENSES-3 YRS. | 21.3% | 106.4% | 212.9% |
| % OF LARGE BORROWER AVG. PROGRAM EXPENSE-1 YR. | 63.9% | 319.3% | 638.6% |

If one also compared the incentive costs with the large borrower program cost estimates, it can be seen that the additional expense impacts the action plan program far-more than the banks overall expense or profitabilitysituation.

Since the large borrower action plan has huge potential benefits, the cost of virtually any incentive program has little impact on the action plandecision process.

POTENTIAL INCENTIVE BENEFIT.

Since the cost of an incentive program to assist this large borrower/ small borrower action plan is negligible, the real benefit evaluation comes in the speculation of how this type of incentive would help the program.

This need not be a crucial decision. If the program has been properly prepared by the Government and presented by the banks, an incentive program should not be necessary to achieve success.

However, if the GOB wants to offer a potential benefit to the bankers to offset the negative ramifications of failing to implement the program, virtually any reasonable incentive level will work financially.

The choice belongs to the Government of Bangladesh.

# S E C T I O N VIII

## ACTION PLAN
## SUMMARY

## ACTION PLAN SUMMARY

The loan repayment Action Plan is a complicated series of activities which is summarized as follows under the headings of Environmental Considertions and Tactical Actions :

## ENVIRONMENTAL CONSIDERATIONS

### PHASE ONE: POLITICAL AND LEGAL ACTIONS

a) The Government of Bangladesh (GOB) announces that all loans must be repaid as a priority national issue.

b) The GOB makes law that all GOB officials or candidates for government positions must repay or make current overdue loans or lose government position or right to be candidate for a position.

c) The GOB will create the National Committee to Improve Loan Repayment (NCILR) which will have the mandate to study and implement recommendations to improve loan recovery. The NCILR will have all authority necessary to authorize and implement necessary changes.

d) The NCILR will study and implement changes to the legal system which will give priority to loan repayment cases, speed the process of evaluating a borrower's ability to repay or reorganize to repay, and strengthen the collection process initiated by court order to make the legal system a more useful tool for bank officers to use to obtain repayment.

e) The NCILR will draft and implement law to make it a requirement that bank officers take all large defaulters to court after loans of Taka 10,000 or more fall overdue more than 30 days and they fail to rectify the situation after formal notice by the bank. The bank officer will have no discretion in this matter to avoid problems of his being compromised by the borrower.

PHASE TWO : BANK MANAGERIAL ACTIONS

a) The NCILR will create a new bank senior manager position called The Executive Director for Bank National Programs (EDBNP).

b) An EDBNP position would be created in each bank for the purpose of improving a single national issue for the banking system. Loan repayment is the first national issue to be managed in this fashion. The position is permanent in that it has a personal duration of at least 5 years and the EDBNP reports to the bank's Managing Director and the NCILR jointly In cases of dispute between the Managing Director and the EDBNP on any issue, the NCILR will make the final decision.

c) The EDBNP in each bank will reorganize the loan recovery department to make it a more effective tool to utilize in the repayment of loans. The department must have the ability to design and implement programs, direct the creation of training materials, understand and support bank legal activities concerning loan recovery and monitor and evaluate the current and future loan repayment circumstances of the bank.

TACTICAL ACTIONS

PHASE THREE : LARGE BORROWER COLLECTION ACTIVITIES

a) The EDBNP and his loan recovery department must prepare their regional and branch managers to collect loans under the new rules.

b) The EDBNP must train and motivate the regional managers to understand the importance of the program and the power of the new laws.

c) After the regional managers understand, the branch implementation would begin. The branch managers would use a classification matrix to identify the oldest and largest borrowers under the new law. They would notify these overdue borrowers as prescribed by law and collect as much as possible. Negotiation with the overdue borrowers to extend the loan for additional time

and the conditions involved would be prescribed under the law.

d) Borrowers who fail to repay after formal notice is made will be brought to court and made to pay or to forfeit personal assets. Borrowers who are brought to court will be denied future credit.

e) Exceptions to this program will be made rarely and only under the guidelines established by the NCILR.

PHASE FOUR: SMALL BORROWER COLLECTION ACTIVITIES

a) The small borrower program would be implemented after the large borrower program had been implemented and had some success.

b) The program would depend on improved supervision of small borrowers as somewhat already contemplated under the field assistant program that has been implemented to a limited degree at the present.

c) This program would use the success of the large borrower program as a psychological tool and will emphasize the importance of field assistants and bank officers being in the right places, hats, bazars, etc., at the right time, after a harvest or a produce sale, to ease the collection of outstanding loans before they become seriously overdue.

d) This program builds on the existing field assistant program and existing plans to increase their strength. The small borrower collection program is inherently rural in nature, but the large borrower collection program is not necessarily rural in nature.

e) Loan collection emphasis must be based on justice and equality of action and, as such, cannot be based on purely rural versus urban grounds.

OTHER COMMENTS

It is presumed that these programs are extremely cost effective and analysis is attempted to demonstrate this fact.

The programs attempt to use existing staff whenever possible. The EDBNP positions require only five good men for implementation. The banks already have collection departments, training and legal staff. The only thing required of these individuals is some leadership to change their emphasis.

In the large borrower program the court costs would be paid by the loser of the case which will be the borrower. The small borrower program depends on success of the large borrower program and the use of staff that have already been considered as necessary and will be available to the banks over time.

The programs described should be taken as a whole. If the environmental conditions are not modified in some fashion similar to what is described in this plan, it is not likely that the large and small borrower programs will have any significant effect and under current conditions, the large borrower program might be quite expensive as well as ineffective.

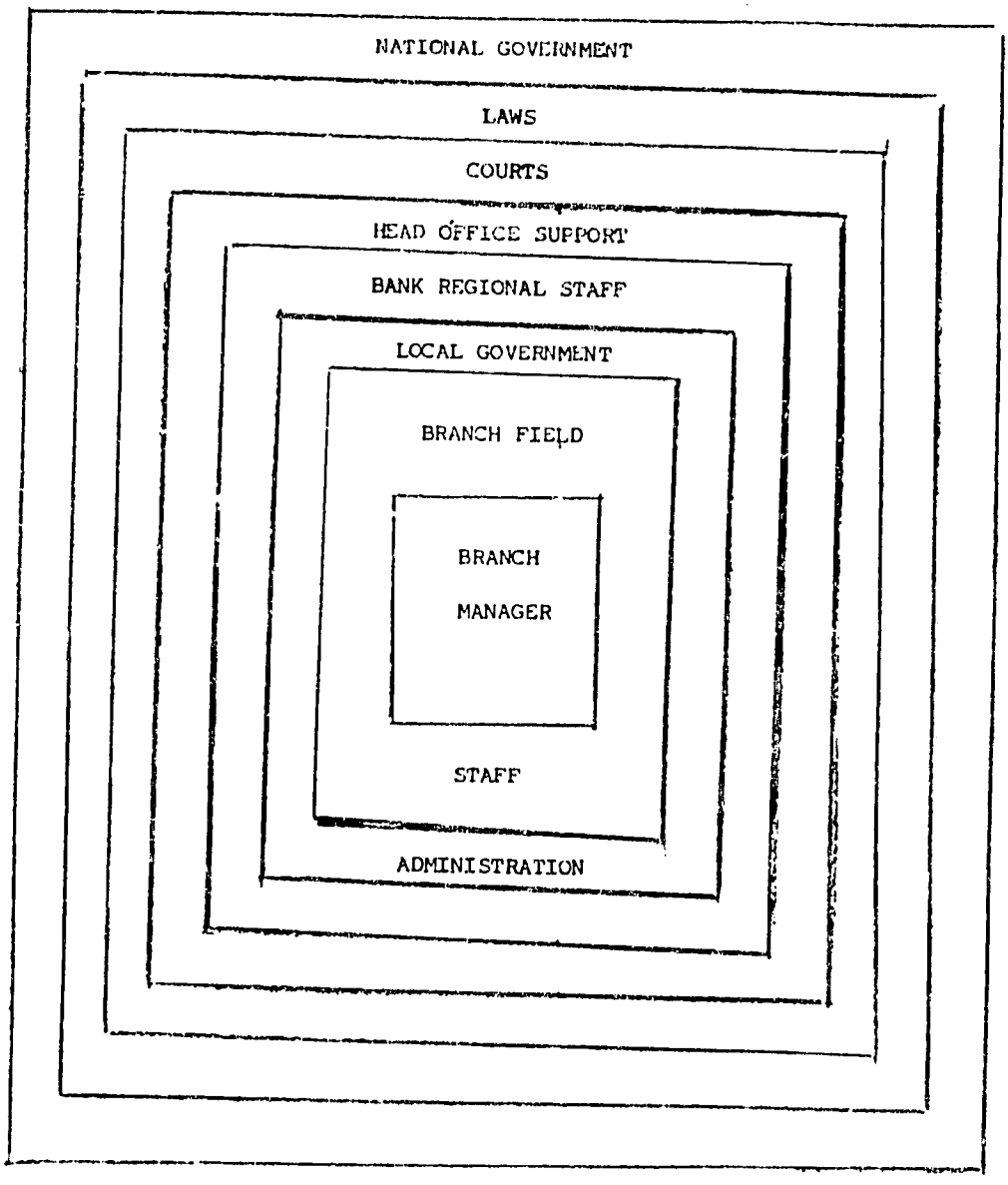
CONCLUSION

This loan repayment Action Plan makes an effort to change the environment which allows poor loan repayment to exist easily.

The change in environment involves aspects of National Government, local government, law and legal process and bank management to make a defaulting borrower (as the following chart depicts) feel and believe that the financial, legal, social and political structure opposes his defaulting on a loan.

Each aspect is a vital component in the equation for collecting loans. Without success in modifying the environment in each area, the ultimate goal of collecting significant amounts of credit are unlikely to be achieved.

THE NEEDED LOAN REPAYMENT
ENVIRONMENT




DEFAULTING BORROWERS MUST SEE THE ENTIRE FINANCIAL, LEGAL, SOCIAL AND POLITICAL STRUCTURE OF THE NATION OPPOSED TO THEIR ATTEMPT TO FAIL TO REPAY THEIR LOAN

# S E C T I O N IX

## ANNEXURES

## RURAL FINANCE PROJECT

## FILE NOTES.

The Following Rural Finance Project file notes were researched and support the topics,comments, and concepts in this action plan and are annexed to this report :


| | | |
|---|---|---|
| An 1 | Action plan for recovery of agricultural loans-1985 D O No. ACD(poly)911(G)/84-7579-85 | 340 |
| An 2 | Agricultural loans- application of service charges and refinance Matrix, ACD circular letter No.ACD(poly) 2/83 of 29 September 83. | 344 |
| An 3 | Legal issues and loan repayment. | 352 |
| An 4 | Bank loan portfolio components | 354 |
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| An 7 | Position of certificate cases per Bangladesh Bank | 372 |
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| An 9 | Definitions of loan portfolio condition | 383 |
| An 10 | Bank income statement items and allocations vs.earning assets. | 386 |
| An 11 | Limits of loan write-offs. | 391 |
| An 12 | Recovery department emphasis in Bank organization charts. | 393 |
| An 13 | Liquidity of the five Banks in Bangladesh review-a composite view | 397 |
| An 14 | Loan loss reserves in Banks in Bangladesh | 418 |
| An 15 | Loan loss reserves in Banks in Bangladesh # 2 | 425 |
| An 16 | Bangladesh Bank rules for classification of problem loans and related interest- BCD circular No. 17 of April 23,1975. | 427 |
| An 17 | Pre-liberation loans from RBBUS-BM2 results | 435 |
| An 18 | CMLA's Secretariat letter No.7011/11/Civil-1 dated 25 February 1986. | 437 |

Date : Dhaka 24 September 1985

ANNEX # 1

Re : ACTION PLAN FOR RECOVERY OF AGRICULTURAL LOANS-1985
D.O. NO. ACD(POLY)911(G)/84-7579-85

I have reviewed the attached instruction from the Agricultural Credit Department to the Managing Directors of the Nationalized Commercial Banks and BKB with the following comments :

1) A target of obtaining 80% of all or some unspecified segment of overdue loans is unrealistic within a 3 month period. The banks are not staffed to launch this type of massive short term campaign and were not given enough notice to effectively implement the campaign even if they were properly staffed.

2) The entire thrust of this campaign is that farmers will be so pleased with obtaining an interest rebate and be free of possible legal involvement that they will repay enough loans to reach 80% recovery of all overdues.

Unfortunately, this program does not take into consideration why the loans are overdue. If an individual has taken a loan with no intention to repay, why should making it less expensive change his original intent? If an individual's crop or project has failed, how can this program help him repay? The only group this program should impress is the group who could repay from normal activities but for some reason have chosen not to. It is a speculation, but I wonder if this group would repay with acceptable timeliness if they were guaranteed that additional credit would be made available to them when they next applied. If that speculation is true, this program is a waste of money. What must be true is that this program undermines the credit system. If you do not repay, eventually the government will reward you for trying to undermine the banking system.

3) Incentives to bank staffs to inspire better performance is acceptable within limits. I would give the incentives to the Rural Finance Assistants who will lose their jobs if they do not recover a significant percentage of the loans that have been assigned to them. For the greater risk there should be greater reward.

4) Creating and distributing lists of defaulters is a useful idea but one should not expect that showing them in the hats and bazars will influence powerful borrowers very much. It could well act as advertising for just how powerful and above the law they are. Little borrowers who are defaulters may be frightened into finding ways to repay.

5+6) Various publicity campaigns are useful and visits by senior bank officers are useful when combined with the phases of long term projects to keep momentum going and staffs and the public aware of the program. This program is too short term oriented to make great use of leaflets and senior management participation.

7) It is a strong idea to utilize the Rural Finance Assistants to verify that loans have been made to bona fide borrowers. The results should be made available to bank management and the audit department directly to confirm if the branch manager was involved in any fraud. It is questionable how useful the UACC members should be in this process as they probably suggested this "borrower" originally.

8) It is a strong long term objective to utilize and make the court system work to the banks' advantage. For a 3 month campaign, I do not know if court procedures will be of much use.

ANALYSIS OF THE PROGRAM

1) The government is making an attempt to collect loans and this is a positive sign.

2) The problem of loan repayment is a long term, complicated one and short term solutions are unlikely to generate the desired results. Some loans will be collected and that will satisfy some members of the government and banking community.

3) Rebates undermine the banking system. Why should branch personnel struggle to collect loans when the government will ultimately reward defaulters with rebates? Why should a borrower repay on time when he might not obtain a new loan and the government will provide financial incentives to repay if you go past due?

4) Large defaulters who flaunt the banking and legal system must feel the result of their actions through strong legal and criminal procedures. If the risk of going to jail for a long period or having their assets seized and sold is greater than the reward of not repaying, they will repay. We should not delude ourselves that it is any other way and think that there are many alternatives to strong civil and criminal procedures.

5) The topic of loan recover is a long term management problem. The banking system must be able to recover loans, pursue legal remedies and process exceptional loan loss circumstances (such as loan forgiveness for a natural disaster) routinely. Periodic, than a temporary positive financial impact but run the risk, as in this program, of generating impressions among the public that it to their benefit to delay repayment of loans to the banking system.

D.O. NO. ACD(POLY)911(G)/84-7579-85 Dated December 30, 1984.

My dear Managing Director,

ACTION PLAN FOR RECOVERY OF
AGRICULTURAL LOANS - 1985

You are aware that overdue of agricultural loans have reached an unsustainable level. Recovery situation has worsened due to floods, droughts which necessitated rescheduling of loan repayment. With the recovery of agricultural production and income, it has been decided by the Government to launch recovery drive immediately. The following action plan to that end is suggested for your consideration and implementation. You may make such improvement on the action plan as you may consider appropriate :-

i. Target for recovery:

All banks will fix up a target of collecting, within a period from January to March, 1985, 80% of loans which will have become overdue by 1st February, 1985(including previous overdues) of each branch.

ii. Rebates:

Farmers may be allowed a rebate on service charge @ 2% if the whole amount of dues is repaid within the final due date of repayment. Similarly, a rebate on penal interest @ 2% may be allowed if overdue amount is repaid within 31st March, 1985 or within the quarter of its becomin overdue, whichever applicable.

ii. Incentive to Staff:

In order to provide incentive to the bank officials/field assistants, a proposal for introducing monetary benefit for better recovery is being worked out in Bangladesh Bank which would be finalised in consultation with you.

iv. List of Defaulters:

List of defaulters may be regularly exchanged once a quarter between bank branches within the Upazila specially between BKB branches and commercial bank branches of the respective areas. Such a list should also be given to the Union Parishad and be displayed in local hats and bazars. This will create social and psychological pressure specially on big farmer /influential groups may be defaulting payment of loans wilfully.

v. Publicity:

Each bank should consider printing leaflets/handouts and distribute them through the branches requesting the loanees to repay their loans in time and assuring them of future loans at the time of their requirement. Similarly, publicity could be made through beating of drums in the local hats and bazars. Suitable publicity through other mass media will be arranged centrally by Bangladesh Bank separately.

vi. Visits/tours of the senior officers of the banks:

Senior officers of the banks should visit the different branches and hold meetings at Upazila level for impressing upon the bank/local administration. They should explain the importance of regular repayment and its impact on the credit operation. Each branch should be visited by them in connection with the recovery drive as often as is considered necessary.

vii. Crop loans to non-farmers:

It has been reported that a considerable amount of crop loans has been granted to non-farmers. Banks are advised to identify such fake borrowers with the help of Union Agricultural Assistants/UACC. All such non-farmers should be debarred from all future lending unless the loans are repaid by them.

viii. Realisation through certificate cases:

Attention of the banks is drawn to Secretary, Cabinet Division's recent circular on certificate cases (copy enclosed). I am drawing the attention of the Deputy Commissioners to this letter with request to take active interest in both recovery and disposal of certificate cases. The progress of disposal of certificate cases as well as of recovery should be pursued by your officers with Upazila Nirbahi Officer and occasionally with Deputy Commissioners. The Secretary of the District Committee is also being advised to send regularly the progress of disposal of certificate cases to the Chief Officer, Agricultural Credit Department, Bangladesh Bank, Head Office, Dhaka each month.

Please advise your branches accordingly on priority basis.

Yours sincerely,

( M. NURUL ISLAM )

Dr. A. Rahim,
Managing Director,
Bangladesh Krishi Bank,
Head Office,
8/1, Motijheel Commercial Area,
Dhaka.

Date : Dhaka 6 October 1985

ANNEX # 2

Re : AGRICULTURAL LOANS - APPLICATION OF SERVICE CHARGES AND REFINANCE MATRIX, ACD CIRCULAR LETTER NO. ACD(POLY)2/83 of 29 September 83

This circular issued by the Bangladesh Bank's Agricultural Credit Department in 1983, tries to impact several different problems confronting the banking system in three large paragraphs. As in the previous circulars I have commented on, the circular prose will be given first, followed by comments and a brief analysis will be made at the end of the memo.

Quote
During the last two years, volume of agricultural credit has increased to a great extent without showing corresponding improvement in the recovery of loans. As a result large amount of loans disbursed by the credit institutions remain overdue at field level and the fund is not available to the credit agencies for recycling, causing strain on the resource position. One of the main reasons for poor recovery performance is the lack of effective supervision of the loan operation by the credit agencies. With a view to enabling the credit institutions to meet the rising cost of loan operation, it has been decided to apply service charge at 4% over the normal interest rate of 12% on short-term loans and at 3% over the normal interest rate of 13% on term loans.
Unquote.

COMMENT

This paragraph touches upon a number of topics and issues.

1) Loan repayment rates are not improving.

2) Lack of improvement in loan repayment rates is causing liquidity problems for the banks in Bangladesh.

3) The loan repayment rates are not improving because you cannot manage your banking business.

4) Since you cannot manage your bank, we will raise the cost of credit.

Quote
In order to discourage holding up of the loans by the borrowers after the same become due and to induce them to make timely repayment, it has been decided to enhance the existing penal interest from one percent per quarter with a maximum of 3% to a flat rate of 6% to be charged on the overdues applicable from the day following the due date of repayment.
Unquote.

COMMENT

1) This regulatory change of penalty interest has as an underlying assumption that the size of rate being changed in the strongest motivating factor for influencing an overdue borrower to repay. There is no consideration of the reason why a borrower has not repaid his loan or of other possible remedies or concerns.

Quote
The lending institutions have increasingly become dependent on refinance from the Central Bank for funding their programme on agricultural credit. The basic reasons for such dependence are the lack of availability of resources and lack of incentive to apply own resources to lending in the agricultural sector. With a view to encouraging the lending institutions to finance an increasing proportion of their need for funds from their own resources, it has been decided to apply variable interest rates of refinance as per the undernoted matrix:
Unquote.

COMMENT

The matrix can be found in the attached memo and has not been reproduced for this analysis.

1) The banks are having liquidity problems with the amount of agricultural credit they are being asked to disburse.

2) The banks think the risk/reward ratio for agricultural credit is inappropriate for the volume of credit the government would like to see disbursed.

3) This refinance matrix will motivate the banks to use their own resources to fund agricultural credit.

ANALYSIS OF THE CIRCULAR

This is an example of a piece of banking regulation that tries to do too much within a few pages to differing groups of recipients.

1) It severely criticizes bank management.

2) It acknowledges that current lending levels creates a liquidity problem for the banks.

3) It implies that increasing penalty rates on loans will improve loan repayment, therefore, liquidity problems will improve.

4) The circular ends with a baffling type of theoretical argument. If the banks are having liquidity problems and do not like the risk/reward ratio for agricultural lending, they will do more agricultural lending from their own resources if we make refinance more expensive or more complicated.

This circular has quite a number of theoretical and practical deficiencies.

1) It cites loan repayment rates as insufficient and offers no substantive program for solving that problem.

2) The topics concern refinance which is a head office treasury issue and, service charges and penalty interest which is an issue for the bank branch networks. The two topics are complicated and not really for the same audience within the banks.

3) It whows a limited appreciation for bank liquidity, loan repayment, lending motivation of bank management and the use of a funding mechanism to motivate bank activity.

Since the banks feel compelled to try to lend in the agricultural sector in the volumes the government desires, they will be forced to utilize refinance facilities to fund their activities unless they can significantly improve deposit and loan repayment growth rates, and improve their internal capital growth.

If government is unwilling or unable to understand how significant and determinant their role is in improving the circumstances of the nation's banks in areas such as loan repayment, there will be no solution to these problems.

Telegram
'BANGLABANK'

BANGLADESH BANK
HEAD OFFICE
POST BOX NO. 325
DHAKA

Agricultural
Credit Department

ACD CIRCULAR LETTER NO. ACD(POLY)2/83- Dated September 29, 1983.

The Managing Director,
Bangladesh Krishi Bank/
Sonali/Agrani/Janata/Rupali/
Pubali/Uttara Bank,
Head Office,
Dhaka

Dear Sir,

AGRICULTURAL LOANS - APPLICATION OF SERVICE CHARGES AND REFINANCE MATRIX

During the last two years, volume of agricultural credit has increased to a great extent without showing corresponding improvement in the recovery of loans. As a result large amount of loans disbursed by the credit institutions remain overdue at field level and the fund is not available to the credit agencies for recycling, causing strain on their resource position. One of the main reasons for poor recovery performance is the lack of effective supervision of the loan operation by the credit agencies. With a view to enabling the credit institutions to meet the rising cost of loan operation, it has been decided to apply service charge at 4% over the normal interest rate of 12% on short-term loans and at 3% over the normal interest rate of 13% on term loans.

2. In order to discourage holding up of the loans by the borrowers after the same become due and to induce them to make timely repayment, it has been decided to enhance the existing penal interest from one percent per quarter with a maximum of 3% to a flat rate of 6% to be charged on the overdues applicable from the day following the due date of repayment.

3. The lending institutions have increasingly become dependent on refinance from the Central Bank for fuhding their programme on agricultural credit. The basic reasons for such dependence are the lack of availability of resources and lack of incentive to apply own resources to lending in the agricultural sector. With a view to encouraging the lending institutions

(Contd....P/2)

to finance an increasing proportion of their need for funds from their own resources, it has been decided to apply variable interest rates of refinance as per the undernoted matrix :-

| Refinance Rate (in percent) | Refinance Scale in Percentage of Disbursement | | |
|---|---|---|---|
| | Commercial Banks | B.K.B. | B.S.B.L. |
| 6.0 | - | - | 30 to below 50 |
| 7.0 | - | - | 50 to below 70 |
| 7.5 | 30 to below 50 | 30 to below 50 | - |
| 8.0 | - | - | 70 to below 80 |
| 8.5 | 50 to below 60 | 50 to below 80 | 80 to below 90 |
| 9.0 | - | - | 90 to below 100 |
| 9.5 | 60 to below 80 | 80 to below 95 | - |
| 10.5 | 80 to 100 | 95 to 100 | 100 |

However, the refinance against the financing of irrigation equipments will be admissible to the extent of 90% at an interest of 8.5%.

This supersedes all previous instructions in this regard and will come into effect from 1st October, 1983.

You are requested to issue necessary instructions to your branches accordingly under advice to us.

Yours faithfully,

S/d

(Kamaluddin Ahmed)
Chief Officer

Endt.No. ACD(POLY)2/83- of date

Copy forwarded for information and necessary action to :-

1. The Secretary, Ministry of Agriculture, Agriculture & Forests Division, Govt. of the People's Republic of Bangladesh, Dhaka
2. The Secretary, Finance Division, Ministry of Finance & Planning Govt. of the People's Republic of Bangladesh, Dhaka
3. The Secretary, Rural Development & Cooperatives Division, Ministry of Local Government, Govt. of the People's Republic of Bangladesh, Dhaka
4. The P.S.O. to the CMLA, CMLA's Secretariat, Old Sangshad Bhaban, Dhaka

(Contd....P/3)

5. The P.S. to the Minister for Agriculture.

6. The P.S. to the Minister for Finance & Planning.

7. The Manager, Bangladesh Bank, Khulna/Chittagong/Bogra/Rajshahi/Sylhet.

8. The Chief Officer, Banking Control Deptt., Bangladesh Bank, Head Office, Dhaka.

9. The Inspection Division, Agricultural Credit Deptt., Bangladesh Bank, Head Office, Dhaka.

10. The Chief Officer, Department of Banking Inspection, Bangladesh Bank, Head Office, Dhaka.

11. The Special Cell, Agricultural Credit Deptt., Bangladesh Bank, Head Office, Dhaka.

12. The P.S. to the Governor, Bangladesh Bank, Head Office, Dhaka.

13. The A.S.O. to the Deputy Governor(II), Bangladesh Bank, Head Office, Dhaka.

14. The Director, Rural Credit Project Deptt., Bangladesh Bank, Head Office, Dhaka.

15. All Sections of ACD, Bangladesh Bank, Head Office, Dhaka.

( M. A. Rahman )
Deputy Chief Officer

TELEGRAM
'BANGLABANK'

BANGLADESH BANK
HEAD OFFICE
POST BOX NO. 325
DHAKA

AGRICULTURAL CREDIT
DEPARTMENT

CIRCULAR LETTER NO. ACD(POLY)2/85-1258(7) Dated the 30th March, 1985.

The Managing Director,
Sonali/Janata/Agrani/Rupali/
Pubali Bank Ltd./
Bangladesh Krishi Bank,
Head Office,
Dhaka.

The General Manager,
Bangladesh Samabaya Bank Ltd.,
9/D, Motijheel Commercial Area,
Dhaka.

Dear Sir,

RATE OF INTEREST ON REFINANCES AGAINST AGRICULTURAL CREDIT

Please refer to our Circular letter Nos. ACD(POLY)2/83 dated the 29th September, 1983 on the above subject.

Consequent upon enhancement of the Bank Rate from 10.5% to 11% effective from Ist January, 1985, it has since been decided to refix the rate of interest at the last slab of the refinance matrix at 11% in place of 10.5%. This rate will also be applicable on all outstanding refinance availed under the said slab.

The new rate will come into force with effect from the Ist April, 1985.

Yours faithfully,

( Kamal Uddin Ahmed )
GENERAL MANAGER.

ENDT. No. ACD(POLY)~~917~~2/85-1265(110) of date.

1. The Principal Staff Officer to the CMLA, CMLA's Secretariat, Old Sangshad Bhaban, Dhaka.

2. The Zonal Martial Law Administrator, Zone-A, Dhaka/Zone-B, Bogra/Zone-C, Chittagong/Zone-D, Comilla/Zone-E, Jessore.

3. The P.S. to the Minister for Agriculture, Government of the People's Republic of Bangladesh, Dhaka.

4. The P.S. to the Principal Finance Secretary, Government of the People's Republic of Bangladesh, Dhaka.

5. The Secretary, Finance Division, Ministry of Finance Government of the People's Republic of Bangladesh, Dhaka.

6. The Secretary, Agriculture and Forests Division, Ministry of Agriculture, Government of the People's Republic of Bangladesh, Dhaka.

7. The Secretary, Rural Development & Co-operative Division, Ministry of L.G., R.D. & Co-operatives, Government of the People's Republic of Bangladesh, Dhaka.

8. The Director-General, Department of Agricultural Extension, Khamar Bari, Farm Gate, Dhaka.

9. The Director-General, Bangladesh Rural Development Board, 24-25, Dilkusha Commercial Area, Dhaka.

10. The Joint Secretary(Investment) Finance Division, Ministry of Finance, Government of the People's Republic of Bangladesh, Dhaka.

11. All Member-Secretary, District Committee.

12. The General Manager,Bangladesh Bank,Dhaka/Chittagong/Khulna/Rajshahi/ Bogra/Sylhet.

13. The General Manager, Banking Control Department/Department of Banking Inspection/Agricultural Credit Inspection Department, Bangladesh Bank, Head Office, Dhaka.

14. The General Manager, Rural Credit Project Department/Department of Research, Bangladesh Bank, Head Office, Dhaka.

15. The Deputy Director, (Co-ordinator for Agricultural Credit),Bangladesh Bank, Chittagong/Khulna/Rajshahi/Bogra/Sylhet.

16. The Private Secretary to the Governor, Bangladesh Bank, Head Office,Dhaka.

17. The A.S.O. to the Deputy Governor-I,Bangladesh Bank,Head Office,Dhaka.

18. The P.S. to the Executive Director-I,Bangladesh Bank,Head Office,Dhaka.

19. The Chief, World Bank Resident Mission in Bangladesh, 222, New Eskaton Road, Dhaka.

20 All Sections of ACD, Bangladesh Bank, Head Office, Dhaka.

( Mir Abdur Rahim )
DEPUTY DIRECTOR
Phone:- 235000/622.

N.H.

Date : Dhaka 13 October 1985

ANNEX # 3

Re : Legal issues and Loan Repayment

From my study of issues concerning the topic of loan repayment, there are some aspects of a legal nature that require further legal study and possible generation of a new law or modification of an existing law or legal procedure.

The topics are as follows :

Loan write-off versus Legal Remedies

One of the big accounting and MIS topics for the loan repayment aspect of this project is the purging of loan past due loans from a given branch's loan portfolio. This is an important element in evaluating branch profitability and the size of provisions for loan loss. It appears from discussions with bank personnel the writing-off a loan on the banks' books will lose the bank the right to bring suit for non-payment. This issue creates large problems in trying to determine the quality of the loan portfolio and confuses rate of return and other types of analysis. If a law obstructs reasonable loan write-offs, we should consider a modification of the law as a project recommendation.

Certificate Cases Deferred For Years

It appears that when a bank brings suit for non-payment, the defaulting borrower can ask the court to defer the case while the borrower "attempts" to find the resources to repay. It appears that the period deferred can be up to three years. If this is so, it seems to reflect the timing and realities of another age. Even in poor circumstances the legal process can move somewhat more quickly these days. The borrower should be allowed a reasonable amount of time to try to repay but three years seems like a long time and makes one aspect of loan default seem somewhat attractive. The process should be reviewed and if found to be excessive, should be modified as a project recommendation.

Collection of Certificate Cases

It appears from discussions with branch personnel that winning a certificate cases is not enough. The object is to win and collect enough to compensate for the loan. As the procedure is a part of the tax collection process, it is easy to give it less priority than an attempt to collect taxes. If this is the case, the banks need an independent arm of the courts to aid in the collection of defaulted loans. If this makes legal sense, it should be a project recommendation.

Expedited Procedures

There have been some efforts made to expedite legal procedures for the business sector. These efforts should be reviewed and either

a recommendation should be made for expansion of the activities of this court throughout the country in support of banking activities to collect loans or the recommendation should be considered to modify the expedited procedure to assist banks to the degree possible in collecting loans.

SUMMARY

Much has already been written concerning the legal process and how it establishes an important part of the environment that influences loan repayment. The comments made in this note are not necessarily unique and may have already been commented on by others but are worth repeating due to their importance for the loan repayment issue.

An important element in changing the current loan repayment situation is in changing the current legal environment which appears to make loan default an attractive alternative while loan collection is difficult, time consuming and expensive (a bank posts a bond of 16.67% of the claimed amount with the court when suit is brought). The legal process should not be an obstacle to justice in this matter.

Positive change in the legal environment would be a strong signal to the borrowers that the banks and government are serious about collecting defaulted loans. Strong legal efforts followed by strong management of collection efforts will improve the repayment circumstance in Bangladesh.

Date: Dhaka 27 October 1985

ANNEX # 4

Ref. : Bank Loan Portfolio Components

Under the RFP terms of reference subtasks B4.1 and B4.2 specific measures are to be recommended and technical assistance offered to improve loan recovery. One way to prepare for this activity is to consider the mix and status of loans that comprise a rural bank branch portfolio and develop methods and technical assistance projects related to the nature of each component.

From my branch visits and extensive reading on lending programs, it appears that the following loan situations can be found in the portfolio and others, probably, that I have not discovered may be found also:

The loan portfolios consist of:

1. Current loans - Acceptable earning assets using any reasonable definition of current.

2. Pre-liberation loans - Some loans are still on branch bank books from Pakistan days. They may or may not be accruing interest to income or interest suspence accounts. They may or may not be increasing the branch outstanding loan balance.

3. Disaster Disrupted loans - Loans made for crop production or a variety of projects can be influenced by weather or a variety of natural disasters. Some loans are still on the branch bank books where the underlying project or crop was destroyed and the possibility of repayment from that productive activity no longer exists.

Contd....P/2

| | | |
|---|---|---|
| 4. | Willful Default Loans | A borrower took a loan, had no intention of repaying, has assets which would be adequate to repay but the loan remains overdue. |
| 5. | Absent Borrower Loans - | A loan was made to a borrower who has either disappeared or died. The loan is still overdue on the books of the bank. |
| 6. | Fraudulent Loans - | A loan was made to a borrower who lied about his identity or who was being coerced to obtain the loan by an influential individual. The loan goes overdue and is still on the books of the bank |
| 7. | Government Influenced Loans | Loans were made and remain on the books where government pronouncement has deferred or waived principal and/or interest payments temporarily or permanently. |
| 8. | Failed Project Loans | A project was proposed to the bank for funding, a loan was made but the project failed and the loan was not repaid although it is still on the books. |
| 9. | Bank Crime Loans - | A loan or series of loans are made by a branch manager to fictional borrowers. Clearly, no repayment is likely or, perhaps, intended and the loans remain on the branch bank's books. |

In each of the above mentioned circumstances, a different repayment treatment is likely to be necessary to recover or collect loan principal and interest in a satisfactory manner.

It is a reasonable banking goal to avoid having a large number of reasons for loan default, but once having them a bank must be prepared to deal with each unique loan failure situation as it occurs and with routine procedures.

As the RFP survey results clarify and weight the types of loan default in Bangladesh, specific measures can be developed to manage each problem type to improve loan repayment.

Date : Dhaka 24 November 1985

ANNEX # 5

Re : Bank Profitability in Bangladesh

Attached are a series of tables on profitability which have been compiled from the annual reports of the respective banks.

This analysis has been done to evaluate the magnitude and allocation of bank profits in Bangladesh in order to support or refute strategies to improve loan recovery that might incorporate selected write off procedures for certain old or otherwise uncollectable loans in an immediate time frame. This creates a baseline for that analysis.

MAGNITUDE OF BANK PROFITS

In Table 16 the total profits reported by the banks for the 3 years under review came to Taka 2,510 million. The most profitable bank, by far, was Sonali with total profits for the 3 years of Taka 1,218 million which was 49% of the total. Janata and BKB came in a very distant second and third with profits of Taka 425 and 375 millions respectively.

MAGNITUDE OF BANK CAPITAL AND RESERVES

In Table 18 the total average capital + reserves reported by the banks for the 3 years under review was Taka 908 million. The capital position for BKB was greater than the other banks combined for all three reporting periods.

RETURN ON CAPITAL BEFORE AND AFTER ALLOCATIONS

Bank profits are subject to Bangladesh corporate income taxes, and mandatory profit transfers to government under section 25 of Bangladesh Banks (Nationalisation) Order of 1972.

Contd....P/2

When the profits of Table 16 are compared to the average capital of Table 18, a calculation for the pre-tax and pre-allocation return on capital can be made. The results of this calculation are shown in Table 19.

The results of this calculation can only be classified as astounding. For Agrani, Janata, Rupali and Sonali, the lowest pre-tax and allocation return on capital was 56% and the highest was 379% ! BKB's results were more modest. Their results were (only !) in the 20-28% range. The weighted calculation for the profitability to capital ratio was an extremely high 92%.

Table 17 shows the next amazing development. The government, through taxation and mandatory transfers, takes 83% of the available profits made by the banks. This leaves the banks with after tax and transfer profits of 16% of capital when reviewing the results of operations over three years.

Of the Taka 1,215 million previously indicated for Sonali Bank profits for the 3 years, 965 million Taka were paid to the government. Sonali paid 46% of bank profits paid to the government. The four banks paid a total of 87% of their profits to the government.

BANK PROFIT AND CAPITAL GROWTH

During the three years under review bank profits grew from Taka 515 million to 1,074 million or 109%.

In the same period bank capital grew from Taka 724 million to 1,063 million for a growth rate of 47%.

BKB's profit grew 85% while its capital grew 59%. The four banks profit grew 114% while their capital grew 33%.

ANALYSIS AND COMMENTS

1. It is hard to imagine any bank in the world having a return on capital of 379% before taxes. An average for the system of 92% would have to place grave doubts concerning the rules which dictate profitability levels.

Contd. .P/3

2. In Table 21, the average loans for the banks over the period was Taka 40,358 million with the average capital being Taka 908 million. The capital to average loan ratio would be 2.25%. In most banking systems, the capital to total assets ( of which loans are merely one component) ratio begins to be considered adequate at 5%. It is acknowledged that these banks are government entities, but they still seem severely under capitalized.

3. It is clear from this analysis that the government thinks that it is appropriate and necessary to strip these banks of a significant percentage of their stated profits. This need and fact will need to be taken into account in any recovery program which might require strict accounting standards for loan classification and loan income classification.

# DETAILS CONCERNING THE TABLES IN THIS REPORT

## SOURCE OF DATA

All financial data has been compiled using the published annual reports for the Bangladesh Krishi Bank (BKB) for 30 June 84, 83 and 82, and for 31 December 83, 82 and 81 for the Agrani, Janata, Rupali and Sonali Banks. These are the official end of year public statements for these organizations.

## STATEMENT OF DATA

All financial data are stated in Taka Millions except where percentages are indicated, and parenthesis indicate decline rather than growth.

## COLUMN AND ROW HEADINGS

Column 1 is financial year 81-82 for BKB and 1981 for the others.
Column 2 is financial year 82-83 for BKB and 1982 for the others.
Column 3 is financial year 83-84 for BKB and 1983 for the others.
Column T is the summation of columns 1, 2 and 3.
Column AVG is the average of columns 1, 2 and 3.

Row A contains Agrani Bank Statistics.
Row J contains Janata Bank Statistics.
Row R contains Rupali Bank Statistics.
Row S contains Sonali Bank Statistics.
Row ST contains sub total Bank Statistics.
Row BKB contains Bangladesh Krishi Bank Statistics.
Row T contains the summation of all bank statistics for a given year.

TABLE HEADINGS

NET PROFIT (LOSS)

Consists of interest income minus interest expense plus all other income minus other expenses before taxes or other allocations.

GOVERNMENT ALLOCATIONS

Consists of taxes paid to the government plus mandatory transfers made under various nationalisation orders.

CAPITAL AND RESERVES

Consists of paid in equity of a bank plus reserves which have been specifically allocated to the capital account for capital growth as some type of retained earnings. This category will often be referred to simply as "capital".

TOTAL ADVANCES

Consists of all loans urban and rural, Agricultural and non-agricultural, outstanding on the books of a bank at the end of a particular period.

(An 5 Contd.)

GOVERNMENT TRANSFERS
AND TAXES PAID

TABLE 15

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 66 | 86 | 111 | 263 |
| J | 60 | 157 | 166 | 383 |
| R | 58 | 64 | 80 | 202 |
| S | 215 | 376 | 374 | 965 |
| ST | 399 | 683 | 731 | 1813 |
| BKB | 67 | 88 | 110 | 265 |
| T | 466 | 771 | 841 | 2078 |

(An 5 Contd.)

NET PROFIT BEFORE
GOVERNMENT ALLOCATIONS

TABLE 16

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 68 | 89 | 119 | 276 |
| J | 61 | 171 | 193 | 425 |
| R | 62 | 67 | 87 | 216 |
| S | 232 | 481 | 505 | 1218 |
| ST | 423 | 808 | 904 | 2135 |
| BKB | 92 | 113 | 170 | 375 |
| T | 515 | 921 | 1074 | 2510 |

(An 5 Contd.)

PERCENT OF TAXES AND GOVERNMENT
TRANSFERS TO NET PROFIT

TABLE 17

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 97 | 97 | 93 | 95 |
| J | 98 | 92 | 86 | 90 |
| R | 94 | 96 | 92 | 94 |
| S | 93 | 78 | 74 | 79 |
| ST | 94 | 85 | 81 | 85 |
| BKB | 73 | 78 | 65 | 71 |
| T | 90 | 84 | 78 | 83 |

(An 5 Contd.)

TOTAL CAPITAL + RESERVES

TABLE 18

| | 1 | 2 | 3 | AVG |
|---|---|---|---|---|
| A | 67 | 68 | 72 | 69 |
| J | 109 | 115 | 122 | 115 |
| R | 66 | 69 | 75 | 70 |
| S | 100 | 127 | 187 | 138 |
| ST | 342 | 379 | 456 | 392 |
| BKB | 382 | 558 | 607 | 516 |
| T | 724 | 937 | 1063 | 908 |

(An 5 Contd.)

PERCENTAGE OF NET PROFIT BEFORE GOVERNMENT ALLOCATIONS, COMPARED TO CAPITAL RESERVES

TABLE 19

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 101 % | 131 % | 165 % | 133 % |
| J | 56 % | 149 % | 158 % | 123 % |
| R | 94 % | 97 % | 116 % | 103 % |
| S | 232 % | 379 % | 270 % | 294 % |
| ST | 124 % | 213 % | 198 % | 181 % |
| BKB | 24 % | 20 % | 28 % | 24 % |
| T | 71 % | 98 % | 101 % | 92 % |

(An 5 Contd.)

PERCENTAGE OF NET PROFIT AFTER GOVERNMENT ALLOCATIONS COMPARED TO CAPITAL + RESERVES

TABLE 20

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 3 % | 4 % | 11 % | 6 % |
| J | 1 % | 12 % | 22 % | 12 % |
| R | 6 % | 4 % | 9 % | 7 % |
| S | 17 % | 83 % | 70 % | 61 % |
| ST | 7 % | 33 % | 38 % | 27 % |
| BKB | 7 % | 4 % | 10 % | 7 % |
| T | 7 % | 16 % | 22 % | 16 % |

(An 5 Contd.)

TOTAL ADVANCES

TABLE 21

| | 1 | 2 | 3 | AVG | T |
|---|---|---|---|---|---|
| A | 362 | 4273 | 6237 | 4710 | 14131 |
| J | 8148 | 10968 | 11637 | 10251 | 30753 |
| R | 3067 | 3267 | 3975 | 3436 | 10309 |
| S | 9997 | 14734 | 16144 | 13625 | 40875 |
| ST | 24833 | 33242 | 37993 | 32023 | 96068 |
| BKB | 4973 | 7881 | 12153 | 8336 | 25007 |
| T | 29806 | 41123 | 50146 | 40358 | 121075 |

Date : Dhaka 23 December 1985

ANNEX # C

Re : Tenure of Senior Bank Managers

In order to develop RFP Subtask B4.1, an action plan to improve loan repayment, it is necessary to appreciate the role of the Senior Managements in the guidance of the 5 banks (BKB, Sonali, Janata, Agrani, Rupali) contained in our study.

Since the banking system in Bangladesh is directly managed by the Ministry of Finance and the Central Bank using regulations, circulars and a variety of directives to dictate the banks' activities, it is relevant to attempt to ascertain the Senior Managers' role in the system. It is through the Managing Directors to their banks that any action plan will have to be implemented after approval by government authority, with the General Managers responsible for daily compliance.

The first issue that one might review is the tenure of their assignment. Bank officers are subject to rotation policies such as other civil servants in the government. The issue is whether this policy extends to the highest managers. The following table reflects the information on Managing Director tenure as provided by each bank covering the 14 years (168 months) since liberation to the end of 1985.

| Bank | Number of Managing Director | | Months in office | Approx. years in office | Longest individual tenure |
|---|---|---|---|---|---|
| | Total | New since 1980 | | | |
| Agrani | 3 | 2 | 164 | 4.6 | 10 Yrs. |
| Janata | 6 | 3 | 168 * | 2.3 | 4 Yrs. |
| Rupali | 7 | 4 | 165 | 2.0 | 5 Yrs. |
| Sonali | 8 | 4 | 166 | 1.7 | 6+ Yrs. |
| BKB | 6 | 2 | 168 * | 2.3 | 5 Yrs |
| | 30 | 15 | Approximate | 2.5 | |

If the tenures of the longest serving Managing Directors are eliminated for each bank, the average tenure is 1.6 years.

If one calculates the average tenure for the Managing Director since 1980 (Eliminating the last years of men who started before 1980), counting those who only began and served since that time, the average tenure is 1.3 years.

It could be argued that the role of General Manager is far more important to the daily operation of a bank than the Managing Director is. The tenure of the General Managers for the 4 banks (BKB failed to give tenure information. BKB had 17 General Managers in the 14 years) is contained in the following table.

GENERAL MANAGERS

| Bank | TOTAL | | NEW SINCE 1980 | | CURRENT | |
|---|---|---|---|---|---|---|
| | Number | Average years | Number | Average years | Number | Average years |
| Agrani | 8 | 2.8 | 7 | 2.2 | 5 | 2.5 |
| Janata | 11 | 3.2 | 8 | 2.1 | 5 | 2.4 |
| Rupali | 8 | 2.6 | 5 | 1.2 | 2 | 1.4 |
| Sonali | 20 | 2.3 | 14 | 1.6 | 7 | 1.1 |
| Total | 47 | 2.7 | 34 | 1.8 | 19 | 1.8 |

The results found in the General Manager data correspond to the results found when reviewing the Managing Director information.

Of the 47 men who have been General Managers, 72% (34) have been placed in the position since 1980. The average tenure since 1980 has been 1.8 years which is just slightly better (longer) then the Managing Directors' 1.3 years.

This is a significant change from earlier expectations. Managing Directors hired before 1980 had a tenure of 3.3 years and the General Managers had a tenure of 5.1 years.

ANALYSIS AND CONCLUSIONS

1) It is safe to say, by world standards, these Managing Directors and General Managers do not hold their positions for long considering their level of responsibility and accountability.

2) From the results of this study, the question must be asked "what are the responsibilities and accountabilities of a Managing Director or a General Manager?". This question must have a practical answer, not a theoretical or organizational manual answer. Are they profit seeking, entre preneurial businessmen or civil service caretakers? Are they part of the problems of the banking system or part of the solution to the system's problems ?.

3) Until someone can demonstrate otherwise, I must regard this situation as part of the problems of the banking system. This should not be interpreted as an automatic criticism of the individuals who hold these positions, it is a criticism of their tenure only.

4) The conclusion that this tenure situation is a problem is a practical one. It is hard to imagine a Managing Director (who has a bank that may have more branches than Bank of America has in California) becoming familiar with the Ministeries of Finance, Agriculture and others, Bangladesh Bank, his board and the capabilities of his Senior Managers (who also are changing), appreciate his current business situation, plan for the future, negotiate approval for his plans with his board and the relevant parts of government, implement the plans, monitor and modify the plans, all within 2 years. It is also impractical to imagine that business plans started by one Managing Director could be immediately grasped by the next, accepted as appropriate and implemented and monitored without pause. Everyone has a learning phase to go through in a new position, regardless of how brilliant or experienced a banker he might be.

5) There is no reason to believe the situation is more simple or clear for a General Manager. He has the same problems of learning to appreciate his function, assess his staff and plan to have things done. He also has frequent changes in Managing Directors to influence or stop his planning or projects, and the typical intra organizational rivalries to contend with which will impact his effectiveness.

6) The only conclusion regarding this managerial situation one can reach isthat it is a problem which must be accounted for and overcome in any action plan the RFP develops. The conservative approach will be to treat the Senior Managers as caretakers and to build programs that will minimize the impact of the current tenure situation, or require extended tenure, as necessary, for the relevant senior Manager(s) involved in the action plan.

Date : Dhaka 24 December 1985

ANNEX # 7

Re : Position of Certificate Cases per Bangladesh Bank

As part of RFP Subtask B4.1, Prepare an Action Plan to Improve Loan Recovery, it seems reasonable to consider that some part of the action plan could involve the use of the legal system to force or pressure repayment from some borrowers.

This paper intends to examine the current certificate case position per figures supplied by the Bangladesh Bank. The Public Demands Recovery Act of 1913 as amended in 1973 is the body of law which is relevant for the legal enforcement of the loan contract by a bank against a defaulting crop borrower who has adequate assets to repay but who has failed to repay. The following table depicts the status of cases filed against agriculturalists (the term used in the law) by bank and the amounts involved.

STATEMENT SHOWING POSITION OF CERTIFICATE CASES
OF DIFFERENT BANKS AS OF JUNE 30, 1985

(Taka in million)

| Bank | Total Cases Filed | | Cases Completed | | Cases Pending | |
|---|---|---|---|---|---|---|
| | Number | Amount | Number | Amount | Number | Amount |
| Bangladesh Krishi Bank | 114,880 | 236.71 | 12,354 (11%) | 23.77 (10%) | 102,526 (89%) | 212.94 (90%) |
| Sonali Bank | 33,963 | 61.10 | 12,469 (37%) | 29.2 (48%) | 21,494 (63%) | 31.9 (52%) |
| Agrani Bank | 34,289 | 62.86 | 14,543 (42%) | 29.29 (47%) | 19,746 (58%) | 33.57 (53%) |
| Janata Bank | 50,743 | 92.29 | 15,800 (31%) | 27.14 (29%) | 34,943 (69%) | 65.15 (71%) |
| Rupali Bank | 27,439 | 51.32 | 7,618 (28%) | 12.60 (25%) | 19,821 (72%) | 38.72 (75%) |
| Total | 261,314 | 504.26 | 62,784 (24.0%) | 122.00 (24.2%) | 198,530 (76.0%) | 382.28 (75.8%) |
| Average Case | Tk. 1,930 | | Tk. 1,943 | | Tk. 1,926 | |

CERTIFICATE CASE TABLE: ANALYSIS & COMMENTS

1) The first fact from the table that is noteworthy is that the average case is rather small, at Taka 1,926 for the average pending case and Taka 1,943 for a completed case.

2) If one made an assumption that 10% of the pending cases were for Taka 10,000 (there is no evidence that suggests this is the case), the average pending case for the remaining 90% would fall to Taka 1,028.

3) By almost any standard, it would seem that the average certificate case is rather small for a court procedure to be utilized. At the end of 1984, there were 3,735 bank branches in the rural areas of Bangladesh. If one divides the total branches into the pending cases, it averages to slightly less than 54 cases per rural branch. It is hard to imagine that some other procedure other than a court procedure couldn't be utilized to collect this number of relatively small loans, whatever the usual problems are.

4) The implied issue in this analysis is that there are very few large agricultural loans in these statistics. If we believe that large farmers pay before the decision to go to court is made, the numbers are fine and only the administrative issue of collecting these small loans is relevant. If we believe that large farmers do not pay very well and should be reflected in these statistics, a number of problems develop. If the large court cases are reflected here, the vast majority of these cases are truly tiny. If the cases are not reflected here because the large defaulting borrowers are not being brought to court, the law is being used against the small, and a major misuse of the justice system has developed.

5) If we assume that the vast majority or all of the pending certificate cases were filed from 1980 to 1985, approximately 6 years, the average number of cases filed per year would be about 33,085 per year or about 9 per branch per year using the present number of rural branches or about 10 for the average number of rural branches in the 1980-1984 period. It is difficult to see why 10 small, problem loans couldn't be treated as exceptional cases each year rather than using a court procedure.

6) It is easy to understand why BKB has the largest number of cases over the period, as they are the agricultural lending leaders. It is odd, however, to note that they are much poorer at having their proportionate share of cases settled by the court procedure than the other banks. One might think that they should be the best, having the most experience, best trained personnel, their officers can act as certificate officers in place of a magistrate if none is available, and the importance of agricultural lending in their activities. Unless one can argue that BKB's agricultural lending is somehow different from the agricultural lending the other banks do, it does not make sense and does not speak well for BKB procedures that their performance is so poor.

7) It would appear from the implications of the analysis in this paper, that the legal system is either used inappropriately to collect a large number of very small loans and a small number of large loans, or it is used as a collection method only against small and politically weak individuals and virtually not at all against large, powerful borrowers in the rural areas. Unfortunately, in either case the system seems to be misused and requires modification of approach before the courts can be used as an appropriate bank tool in the collection of defaulted loans.

Date : Dhaka 31 December 1985

ANNEX # 8

Re : BKB Loan Distribution by size, 1981-82 through 1983-84

In order to develop an action plan to recover overdue Rural loans, as required in RFP subtask B4.1, it is necessary to develop a view of the borrower population as to number of borrowers and the size of the loans they hold.

The Bangladesh Krishi Bank (BKB) makes this information available in its annual reports. This information for the last three years for which statements are available is summarized in the attached tables which indicates the number of borrowers who have received loans during the period under review. The following analysis makes a first attempt to focus attention on the topic of rural loan distribution. It is understood that BKB statistics will not necessarily reflect the exact loan distribution pattern of all the banks in the rural areas, but the importance of BKB in rural finance is underniable and is a reasonable starting point for this type of consideration.

ANALYSIS AND COMMENTS

The tables on the following pages contain two types of analysis. The first shows the distribution of BKB loans in each of three years. The second shows two composite views of the 3 period figures under review.

1) In all the years under review, a very small number of borrowers have obtained a disproportionate amount of the credit that BKB has disbursed.

2) This percentage of large borrowers declined over the period from 7.63% in 81/82 to 4.14% of total borrowers in 83/84.

3) Their percentage of total loan volume declined from 71.82% in 81/82 to 44.12% of total loan volume in 83/84.

4) The number of total borrowers increased dramatically in the period from 379,063 in 81/82 to 1,188,366 in 83/84. This was an increase of 213 5%

5) The large borrower population receiving loans grew from 28,894 in 81/82 to 49,190 in 83/84. This was a growth of 70.2%.

6) The small borrower population grew from 350,169 in 81/82 to 1,139,176 in 83/84. This was a growth of 225.3%.

7) In the composite analysis for the three years it becomes clear that BKB has two classes of borrower, one having loans less than TAKA 10,000 and another having loans in excess of TAKA 10,000. Although the credit volume is virtually even between the two classes, those who have loans of less than TAKA 10,000 constitute over 95% of all BKB borrowers while those having loans greater than TAKA 10,000 constitute less than 5% of all BKB borrowers in the period.

8) If we find from the RBBUS borrower research that the rural borrowers split as disproportionately as the historical BKB figures suggest, some interesting and important considerations must be made.

9) If the loan recovery problem is the same (or worse) for the large borrowers, and the administrative cost of a legal action is the same for virtually all borrowers (Advalorem fees are proportional and reimbursed when the

case is won), a better return on administrative cost will be obtained by bringing larger (rather than the current practice of bringing smaller) defaulters to court since the average large loan is TAKA 55,401.

10) Since the small borrowers are such a large percentage of all borrowers (over 95%), when they default and if they are brought to court as a routine procedure, the administrative costs would be huge. With rewards of this type of action being the collection of loans that average TAKA 2,711, it does not seem like a court procedure is appropriate to use.

11) If administrative cost for bringing a case to court are the same for large and small cases, it is 20.4 times more productive to bring the large borrowers rather than the small (TAKA 55,401 ÷ TAKA 2,711) to court.

12) It is vital from the RBBUS borrower research to determine if large borrower repayment is poor in the rural areas. If it is, a very clear RFP recommendation will be to use the legal process against large defaulters, rather than small, as a routine procedure. Needless to say, the courts must work efficiently and enforce their decisions decisively to make this approach successful.

13) From this analysis it would seem that a tactic other than recourse to the legal system will be necessary to manage the large numbers of defaulting small borrowers. Perhaps a routine close administrative approach, similar to the Grameen Bank model, may be a more appropriate method of improving rural loan repayment in the future. More analysis and consideration is required.

ANALYSIS BY YEAR
DISTRIBUTION OF BKB LOANS BY SIZE
(TAKA IN THOUSANDS)

1981 - 1982

| SIZE OF LOANS | BORROWERS | % | AMOUNT | % |
|---|---|---|---|---|
| Up to 3,000 | 279,950 | 73.85 | 451,438 | 16.66 |
| Over 3,000 to 10,00 | 70,219 | 18.52 | 312,327 | 12.52 |
| Over 10,000 | 28,894 | 7.63 | 1,946,641 | 71.82 |
| | 379,063 | 100 | 2,710,406 | 100 |

1982 - 1983

| SIZE OF LOANS | BORROWERS | % | AMOUNT | % |
|---|---|---|---|---|
| Up to 3,000 | 562,045 | 65.77 | 1,134,458 | 28.30 |
| Over 3,000 to 10,000 | 255,246 | 29.87 | 1,044,196 | 26.05 |
| Over 10,000 | 37,252 | 4.36 | 1,829,455 | 45.65 |
| | 854,543 | 100 | 4,008,109 | 100 |

1983 - 1984

| SIZE OF LOANS | BORROWERS | % | AMOUNT | % |
|---|---|---|---|---|
| Up to 3,000 | 696,973 | 58.65 | 1,301,601 | 21.97 |
| Over 3,000 to 10,000 | 442,203 | 37.21 | 2,009,033 | 33.91 |
| Over 10,000 | 49,190 | 4.14 | 2,613,630 | 44.12 |
| | 1,188,366 | 100 | 5,924,264 | 100 |

COMPOSITE DISTRIBUTION
OF BKB LOANS BY SIZE
(TAKA IN THOUSANDS)

1981/82-1983/84

TABLE - A

| SIZE OF LOANS | BORROWERS | % | AMOUNT | % |
|---|---|---|---|---|
| Up to 3,000 | 1,538,968 | 63.54 | 2,887,497 | 22.84 |
| Over 3,000 to 10,000 | 767,668 | 31.70 | 3,365,556 | 26.62 |
| Over 10,000 | 115,336 | 4.76 | 6,389,726 | 50.54 |
| | 2,421,972 | 100 | 12,642,779 | 100 |

TABLE - B

| SIZE OF LOANS | BORROWERS | % | AMOUNT | % |
|---|---|---|---|---|
| Up to 10,000 | 2,306,636 | 95.24 | 6,253,053 | 49.46 |
| Over 10,000 | 115,336 | 4.76 | 6,389,726 | 50.54 |
| | 2,421,972 | 100 | 12,642,779 | 100 |

ANNEXURE-III

DISTRIBUTION OF LOANS ACCORDING TO SIZE OF HOLDING OF BORROWERS FOR THE YEAR 1983-84.

(Amount in Thousand)

| | Size of Borrowers' holding | No. of loanees | Percentage | Amount | Percentage |
|---|---|---|---|---|---|
| 1. | Landless | | | | |
| | a) Individuals | 106419 | 8.96 | 498062 | 8.41 |
| | b) Corporate bodies | 25583 | 2.15 | 98530 | 1.66 |
| 2. | Less than 1.0 acre | 263164 | 22.15 | 1327642 | 22.41 |
| 3. | 1.0 acre to less than 2.5 acre | 544074 | 45.79 | 1732305 | 29.24 |
| 4. | 2.5 acre to less than 7.5 acre | 212266 | 17.86 | 1190907 | 20.10 |
| 5. | 7.5 acre to less than 12.5 acre | 31923 | 2.69 | 355422 | 6.00 |
| 6. | 12.5 acre to less than 33 acre | 4287 | 0.25 | 412721 | 6.97 |
| 7. | 33 acre and over | 650 | 0.05 | 308675 | 5.21 |
| | Total : | 1188366 | 100.00 | 5924264 | 100.00 |

ANNEXURE-IV

DISTRIBUTION OF LOANS ACCORDING TO SIZE OF LOANS FOR THE YEAR 1983-84.

(Amount in Thousand)

| | Size of loans | No. of loanees | Percentage | Amount | Percentage |
|---|---|---|---|---|---|
| 1. | Upto Tk. 1,000 | 165977 | 13.97 | 146008 | 2.46 |
| 2. | Over Tk. 1,000 to 3,000 | 530996 | 44.68 | 1155593 | 19.51 |
| 3. | Over Tk. 3,000 to 10,000 | 442203 | 37.21 | 2009033 | 33.91 |
| 4. | Over Tk. 10,000 to 20,000 | 19413 | 1.63 | 275303 | 4.65 |
| 5. | Over Tk. 20,000 to 50,000 | 26338 | 2.22 | 785264 | 13.25 |
| 6. | Over Tk. 50,000 to 100,000 | 1842 | 0.16 | 138034 | 2.33 |
| 7. | Over Tk. 100,000 to 300,000 | 572 | 0.05 | 87983 | 1.49 |
| 8. | Over Tk. 300,000 | 1025 | 0.08 | 1327046 | 22.40 |
| | Total : | 1188366 | 100.00 | 5924264 | 100.00 |

ANNEXURE-V

TERMS-WISE DISTRIBUTION OF LOANS FOR THE YEAR 1983-84.

| | Terms | No. of loanees | Percentage | Amount | Percentage |
|---|---|---|---|---|---|
| 1. | Short term | 906521 | 76.28 | 3715923 | 62.72 |
| 2. | Medium term | 254884 | 21.45 | 1268613 | 21.42 |
| 3. | Long term | 26961 | 2.27 | 939728 | 15.86 |
| | Total : | 1188366 | 100.00 | 5924264 | 100.00 |

## DISTRIBUTION OF LOANS ACCORDING TO SIZE OF LOANS

## 1982-83 (ALL CASES)

Annexure - 7

(Taka in Thousand)

| Size of loans | Short Term | | Medium Term | | Long Term | | Total | |
|---|---|---|---|---|---|---|---|---|
| | No. | Amount | No. | Amount | No. | Amount | No. | Amount |
| 1. Upto Tk. 1,000 | 138451 | 157953 | 12481 | 11403 | 52 | 160 | 150984 | 169516 |
| 2. Over Tk. 1,000 to 3,000 | 336137 | 827200 | 74746 | 136976 | 178 | 766 | 411061 | 964942 |
| 3. Over Tk. 3,000 to 10,000 | 176389 | 758928 | 78511 | 277080 | 526 | 8188 | 255246 | 1044196 |
| 4. Over Tk. 10,000 to 20,000 | 1894 | 34897 | 6011 | 55805 | 3223 | 64632 | 11128 | 155334 |
| 5. Over Tk. 20,000 to 50,000 | 489 | 18870 | 6693 | 96241 | 17724 | 524608 | 24906 | 639719 |
| 6. Over Tk.50,000 to 100,000 | 212 | 19905 | 228 | 12127 | 184 | 8752 | 624 | 40784 |
| 7. Over Tk.100,000 to 300,000 | 141 | 75223 | 72 | 8265 | 38 | 8900 | 251 | 92388 |
| 8. Over Tk. 300,000 | 243 | 692004 | 11 | 5551 | 89 | 203675 | 343 | 901230 |
| TOTAL : | 653956 | 2584980 | 178753 | 603448 | 22014 | 819681 | 854723 | 4008109 |

(An 8 Contd.)

## DETAILS OF LOANING UNDER SPECIAL AGRICULTURAL CREDIT PROGRAMME(SACP)

1981-82

### TABLE 5

### DISTRIBUTION OF LOANS ACCORDING TO SIZE AND TERM: 1981-82

| As to size of loan | Short Term | | Medium Term | | Long Term | | Total | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | No | Amount | No | Amount | No | Amount | No | % | Amount | % |
| Upto Tk. 1000 | 71508 | 748.88 | 13385 | 168.76 | - | 2.56 | 84893 | 22.40 | 920.20 | 3.40 |
| Over Tk. 1000 to 3000 | 120678 | 1971.90 | 74344 | 1621.53 | 35 | .75 | 195057 | 51.46 | 3594.18 | 13.26 |
| Over Tk. 3000 to 10000 | 13744 | 605.42 | 55807 | 2217.67 | 668 | 300.18 | 70219 | 18.52 | 3123.27 | 11.52 |
| Over Tk. 10000 to 20000 | 600 | 93.66 | 5314 | 628.24 | 9142 | 904.84 | 15056 | 3.97 | 1626.74 | 6.00 |
| Over Tk. 20000 to 50000 | 350 | 346.06 | 2671 | 645.19 | 9582 | 1781.27 | 12603 | 3.32 | 2772.52 | 10.23 |
| Over Tk. 50000 | 471 | 12897.34 | 530 | 560.11 | 234 | 1609.70 | 1235 | .33 | 15067.15 | 55.50 |
| Total | 207351 | 16663.26 | 152051 | 5841.50 | 19661 | 4599.30 | 379063 | 100.00 | 27104.06 | 100.00 |

Date : Dhaka 5 January 1986

## ANNEX # 9

Re : Definitions of Loan Portfolio Condition

OUTSTANDING LOANS

Outstanding loans are the loans that can be found in the accounting records of a bank at any given time. The outstanding loan balance will always contain principal amounts which have not yet been repaid and will also contain various interest amounts which have been capitalized (added to the original loan balance like principal) according to local accounting practice. The outstanding loan balance will often contain three different general categories of loan condition :

1) Loans Outstanding but Not Due for Repayment

2) Loans Outstanding and Due for Repayment during a given period.

3) Loans Outstanding and Overdue for Repayment.
   A loan becomes overdue when the time period in which it was expected to be repaid has been exceeded.

Loan repayments have two general components, principal and interest in banking systems where interim interest calculations are not placed in a distinct account, the combination of principal and interest will simply be subtracted from the loans outstanding balance when the loan repayment is made. Whatever remains after the repayment is the new loans outstanding balance.

CLASSIFYING LOAN REPAYMENT

The quality of loan repayment performance is characterized by the quantity (%) which can be collected before the end of the Due period and the ultimate profitability of the collection activity will be characterized by the quantity of overdue loans collected. Overdue loans not collected within a given period are usually candidates for write-off and are usually losses to the bank involved.

It is possible to evaluate loan repayment performance by treating the items of Loan Outstanding and Loan Repayment as a series of numbers related to the general categories indicated in the first paragraph.

| | | | | | | |
|---|---|---|---|---|---|---|
| Loans Outstanding (LO) Start of Period | = | Loans Not Due (LND) | + | Loans Due (LD) | + | Loans Overdue (LOD) |
| Loan Repayments(LR) impact the various categories | = | (RND) | + | (RD) | + | (ROD) |

If the Loan Repayment equation is subtracted from the Loans outstanding at the start of the period equation (LO-LR), element by element, the new status of loans outstanding is expressed by general category :

Loans Outstanding at
End of Period (LOE) = LO - LR

Loans Not Due at
End of Period (LNDE) = LND - RND

Loans Due at
End of Period (LDE) = LD - RD

Loans Overdue at
End of Period (LODE) = LOD - ROD

Therefore, at the end of a repayment period :

LOE = LNDE + LDE + LODE

MEASUREMENTS OF LOAN REPAYMENT

The first number from the calculations these equations provide which must be considered is the Loans Overdue at End of Period, LODE. This measure is the largest amount that one will have to evaluate in terms of potential write off. LODE is best compared as a percentage of Loans Outstanding to estimate what the size of potential loan reserves will need to be and as a percentage of bank profitability to estimate the time it will take to rebuild the capital loss.

The next measure of interest (assuming pre-payments are not of great interest) would be the repayment rate for loans that are due and overdue :

Repayment Rate (D + OD) = (RD + ROD) / (LD + LOD)

Overall Loan Repayment (LRO) would include all elements :

LRO = LR / LO

A measure of current performance would use the elements only related to the loans Due in this period and Repaid in this period.

Current Repayment Performance (CRP) = RD / LD

MEASURES OF LOAN PORTFOLIO CONDITION

The primary measure of loan portfolio condition might be found the ratio between the non-overdue component of Loans Outstanding to the overdue component :

Loan Portfolio Condition (LPC ) = (LND + LD) (LOD)

The higher the ratio, the better for the loan portfolio.

A second measure of portfolio condition places emphasis on the Due and Overdue elements of Loans Outstanding:

Loan Portfolio Condition(LPC2) = (LD + LOD) / (LO)

This percentage focuses on the emphasis a given bank must place on loan collection during a given period. The higher the percentage, the greater collection efforts must be as a percentage of total loan supervision efforts.

OTHER MEASURES

In some reference material, the ratio of loan repayment to loans disbursed in a given period is presented as a measure of loan repayment. This is a valuable calculation as a bank liquidity measure but it a difficult calculation for loan repayment as the disbursement rate is a related but not directly related issue. Loan repayment needs comparisons by years and in percentage comparison with the original amounts disbursed to be informative.

OTHER ISSUES

Another topic which is related and is always the subject of analytical debate is the concept of what is "Due for Repayment" There are generally two guidelines for this discussion. The first guideline is usually the standard accounting treatment for a given banking system which drives the classification and aging methods. The second guideline, often used in the absence of the first, is market place practice or traditional practice. In the absence of accounting treatment which is standardized, market practice is usually driven by the limits and considerations of the legal system. From the observations we have made of the regulatory environment and legal procedures, it is clear that the period in which a loan could be considered as Due but not Overdue can be quite liberally interpreted. This topic requires more study as the RBBUS survey material becomes available for computer analysis.

Date: Dhaka 13 January 1986

ANNEX # 10

Re : Bank Income Statement Items and Allocations Vs. Earning Assets

The attached table consists of an extract from an extensive analysis of published bank financial statements from 1981 through 1984.

The percentages in the table consist of weighted averages of 4 years of income statement items compared against the banks' corresponding earning assets for the respective period.

The banks' earning assets consisted of the following categories:

a) Money at call

b) Investments

c) Advances

d) Bills Discounted

These categories contain all the financial assets which would generate the interest related income of the banks under review. It is not possible to analyze the income precisely by earning asset type. The interest income component in an annual report's income statement does not typically differentiate the source of the interest.

The point of this type of analysis is the determination of the percentage magnitude of various components of income or expense against a standard for each bank. A relevant and typical standard is the value of earning assets. This measure is particularly useful as it demonstrates the magnitude of various incomes and expenses versus a standard which helps focus one's thinking for purposes of evaluating various strategies for topics such as bad debt reserve possibilities.

ANALYSIS

Also included in this report is a table which shows the components of earning assets as a percentage of total earning assets. This table will allow for some appreciation of the relative influence each component has on the overall rates.

INTEREST INCOME

The first impression one has when one looks at this measure is that the average rates appear low. The bank rate has been 11% over the period and one would expect lending rates to be in excess of that. The conclusion that one can draw from this (and studylater) is that the rates on some credit and the 26.9% of non-advance earning assets must be rather low. Another consideration is that interest income is reduced to create loan loss reserves which are not explicitly stated in taka terms. This certainly has an impact on the calculation.

INTEREST EXPENSE

This figure is relatively low also. If one assumes an even distribution of current, savings and fixed deposits, the rate would be in the 7+% range. However, in the analysis, 42% of the deposits were current, 22% savings and 36% fixed as a percentage of total deposits which pulls the average rate into the range calculated in this report.

For BKB with its relatively small and slow growing deposit base, the low cost of funds must be related to concessionary refinance and donor monies made available through the years. With refinance being nearly double BKB's deposit base any given year, if the current blended refinance rate of 8.5% was applied, the average cost of funds should be well in excess of 5.5%.

OTHER INCOME

Other Income normally represents fee and commission income generated from providing a financial service (e.g. issuing a letter of credit or selling an official check) rather than extending credit which generates interest income.

Rupali Bank has extremely high Other Income as a percentage of earning assets which is generated by fees from their foreign exchange business in support of import/export financing for clients. Rupali places significant emphasis on this service for building income as it has difficulty obtaining inexpensive money (Interest expense and net interest income percentages are the worst) BKB, on the other hand, shows very little emphasis on providing financial services other than credit as its very low percentage of Other Income to earning assets demonstrates.

OTHER EXPENSE

All the banks showed these expenses in the 2-3% range except for Rupali Bank. This was consistant with previous analysis as Rupali Bank's foreign exchange and import/export business would generate brokerage costs and bank commissions which would increase this category.

NET PROFITABILITY

Sonali Bank leads the way as a result of a very low interest expense position. Clearly, they are the recipient of a great deal of commercial current account funds and inexpensive government account money when acting as agent for Bangladesh Bank.

Despite having the highest interest income percentage, Janata also had the highest cost of funds and was not able to make up the difference with other income, thus they had the worst profitability by this measure.

COMMENTS

1) Another clue that hidden reserves are maintained as bad debt provisions are shown in the interest income percentages that are surely lower than one would expect with a bank rate at 11%.

2) The investment portfolios contain various types of government securities, equity of joint stock companies, prize bonds, debentures and some Pakistan related securities. In the absence of additional analysis, it is difficult to imagine that this type of portfolio generates significant revenues for the banks. There is not significant comment on these portfolios in the annual reports.

3) BKB refinance has to have been historically inexpensive to make their cost of funds only 5.5% of earning assets over the period. Donor money must have been inexpensive also. The annual reports do not clarify these points.

(AA 10 Contd.)

INCOME STATEMENT PERCENTAGE COMPARISONS
VERSUS INDIVIDUAL NCB AND BKB EARNING
ASSETS 1981 - 1984

| | | AGRANI | JANATA | RUPALI | SONALI | NCB AVG * | BKB |
|---|---|---|---|---|---|---|---|
| 1 | INTEREST INCOME | 8.81% | 9/25% | 8.53% | 8.20% | 8.64% | 9.1% |
| 2 | INTEREST EXPENSE | 6.25% | 6.91% | 6.87% | 5.06% | 6.00% | 5.5% |
| 3 | NET INTEREST INCOME | 2.56% | 2.34% | 1.66% | 3.14% | 2.64% | 3.6% |
| 4 | OTHER INCOME | 1.76% | 1.53% | 3.16% | 0.99% | 1.52% | 0.3% |
| 5 | OTHER EXPENSE | 2.99% | 2.77% | 3.31% | 2.10% | 2.58% | 2.4% |
| 6 | NET PROFIT BEFORE TAXES AND TRANSFERS | 1.33% | 1.10% | 1.51% | 2.03% | 1.58% | 1.5% |
| 7 | TAXES | 1.07% | 0.82% | 1.16% | 1.25% | 1.08% | 0.97% |
| 8 | RESERVES(RETAINED IN CAPITAL) | 0.07% | 0.11% | 0.10% | 0.35% | 0.20% | 0.35% |
| 9 | PROVIDENT + OTHER FUNDS | - | 0.01% | 0.01% | 0.03% | 0.03% | 0.09% |
| 10 | TRANSFER TO GOVERNMENT | 0.19% | 0.16% | 0.24% | 0.40% | 0.27% | 0.13% |

* Weighted

Source : Computed from individual Bank Annual Report financial statements for 1981, 1982, 1983, 1984.

(An 10 Contd.)

EARNING ASSET CATEGORIES VERSUS TOTAL EARNING ASSETS

| | AGRANI | JANATA | RUPALI | SONALI | NCB AVG | BKB |
|---|---|---|---|---|---|---|
| MONEY AT CALL | 1.3 | 4.2 | 0.6 | 5.1 | 3.7 | - |
| ADVANCES | 71.0 | 75.9 | 75.6 | 71.4 | 73.1 | 96.1 |
| BILLS DISCOUNTED | 4.5 | 5.2 | 2.7 | 6.6 | 5.4 | 0.2 |
| INVESTMENTS | 23.2 | 14.7 | 21.1 | 16.9 | 17.8 | 3.7 |
| TOTAL | 100% | 100% | 100% | 100% | 100% | 100% |

Source : Individual Bank Annual Reports 1981 - 1984.

Date : Dhaka 19 January 1986

ANNEX # 11

Re : Limits of Loan Write-offs

Much discussion has occurred before and during the RFP concerning what levels of loan loss reserves the banks should maintain. To that end it is useful to clarify what limits appear to be possible.

| | | Agrani | Janata | Rupali | Sonali | BKB |
|---|---|---|---|---|---|---|
| 1 | Average earning assets (000 000) | 8,449 | 14,861 | 5,431 | 21,734 | 7,439 |
| 2 | Average capital (000 000) | 72 | 120 | 72 | 165 | 481 |
| 3 | Average profits before taxes + transfers (000 000) | 112 | 164 | 82 | 443 | 113 |
| 4 | Capital/E.A. | 0.85% | 0.81% | 1.33% | 0.76% | 6.47% |
| 5 | Profits/E.A. | 1.33% | 1.10% | 1.51% | 2.04% | 1.52% |
| 6 | Total 4 + 5 | 2.18% | 1.91% | 2.84% | 2.80% | 7.99% |

Source : Individual Bank Annual Report Financial Statements 1981 through 1984.

If one did the same calculation with the advance category only, the table would look like this :

| | | Agrani | Janata | Rupali | Sonali | BKB |
|---|---|---|---|---|---|---|
| 1 | Average advances (000 000) | 5,998 | 11,284 | 4,105 | 15,525 | 7,148 |
| 2 | Average capital (000 000) | 72 | 120 | 72 | 165 | 481 |
| 3 | Average profits before Taxes + transfers (000 000) | 112 | 164 | 82 | 443 | 113 |
| 4 | Capital/Adv. | 1.20% | 1.06% | 1.75% | 1.06% | 6.73% |
| 5 | Profits/Adv. | 1.87% | 1.45% | 2.00% | 2.85% | 1.58% |
| 6 | Total 4 + 5 | 3.07% | 2.51% | 3.75% | 3.91% | 8.31% |

Source : Same

Analysis and comments

1) What these tables demonstrate is that there is not a lot of financial room for strategies that focus on establishing elaborate loan loss reserves or the actual writing off of significant numbers of loans.

2) From previous analysis on loan loss reserves, let's imagine that each bank is implicitly reserving 1% each year for losses (a fairly typical world percentage for large banks which is somewhatt on the high side of average). If the banks were to have no profits at all, the total reserves might look like 3.85% of advances for Sonali and on the low side, 2.45% for Janata.

3) When reserves hit 4.91% (1$3.91) for Sonali and 3.51% (1$251) for Janata, they would have no profits and no capital at all. They would effectively cease to be operating organizations.

4) The alterative to any type of write-off strategy seem to be one of the following :

   A) Limit loan reserves or write-offs to very small percentages.

   B) Increase the capital base of each bank to be able to sustain write-offs as necessary.

   C) Create a write-off "sinking fund" which is amortized against profits over a number of years. This could be an appropriate technique, for example, to handle the issue of uncollectable pre-liberation loans.

5) There are no recommendations to be made concerning this topic at this time but it is important to know and appreciate the constraints in any loan reserve or write-off strategy.

Date: Dhaka 27 January 1986

ANNEX # 12

Re : Recovery Department emphasis in Bank organization charts

The official organization charts, as approved by the Brigadier Enamul Huq Khan, martial law committée in January, 1984, have been reviewed for the five banks.in our study.

The point of this presentation is to understand the position and emphasis the recovery departments have in each organization as expressed in an official document. This hopefully, provides some limited insight as to the importance of the function in the organizational thinking.

As the following table indicates, there are three different approaches used to represent the loan repayment areas in the banks.

Analysis and comments

1) Janata Bank does not have the recovery function listed explicitly in its organization chart at all. Experience with Janata finds the rural recovery statistics maintained internally within the rural credit department.

2) Sonali Bank used a decentralized approach to loan recovery by splitling the country into four areas or "circles". This is controlled out of the head office in Dhaka.

SUMMERY OF LISTED LOAN RECOVERY DEPARTMENTS

| | Agrani | Janata | Rupali | Sonali | BKB |
|---|---|---|---|---|---|
| Recovery Dept : | | | | | |
| - No | - | ✓ | - | - | - |
| - Yes | ✓ | - | ✓ | ✓ | ✓ |
| Central Control | ✓ | - | ✓ | - | ✓ |
| Decentralized Control | - | - | - | ✓ | - |
| Leader | Dy Gen Mgr | N/A | Below GM | Dy.GM. | Dy.Gen Mgr |
| Total Personel | 41 | N/A | N/A | 91 | 12 |
| Org.Chart Finalized | 9/1/84 | 18/1/84 | N/A | 7/1/84 | 31/1/84 |

3) BKB, Agrani and Rupali list their loan recovery departments as centralized in their head offices in Dhaka.

4) When explicitly indicated(3 cases), the loan recovery areas are managed by a Deputy General Manager.

5) Sonali's decentralized approach utilizes 91 staff members while Agrani and BKB's centralized approaches utilize 41 and 12 staff respectively. Agrani's approach has the recovery and general credit function combined, so it is difficult to differentiate staff and specific function.

6) Discussion with Sonali Bank rural branch personnel indicated that Sonali Bank head office or regional staff do not assist in actual loan repayment or collection activities. Therefore, it could be assumed that they are used in some type of monitoring or control functions or

possibly collection program design.

7) Agrani and BKB have far fewer staff than Sonali has assigned to this topic, so it might be reasonable to assume that they too do not use their recovery department staffs for field collection or field support work.

8) Organization charts go out of date quickly and these were formalized in January 1984 so some caution in analysis is prudent. From discussions with the banks, the emphasis and locations of the departments do not seem to have changed significantly in the last 2 years.

Conclusions

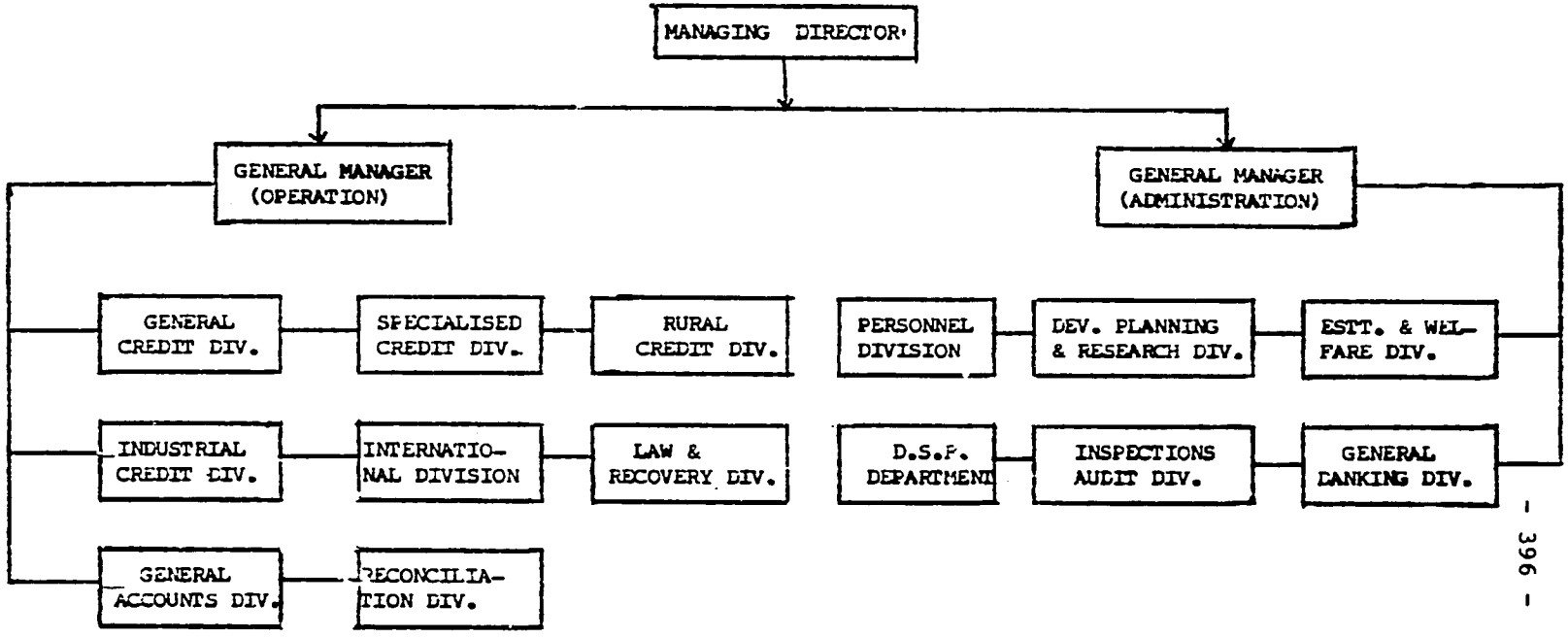
1) The department is managed by a Deputy General Manager, which is a senior position, but does not tend to be a decision making or policy setting position. Policy is normally set at the Ministry level and relayed through the banks' Managing Directors and General Managers.

2) The staffs are inadequate for extensive field work so they must be involved in control and monitoring and, perhaps, some program design.

3) Without extensive field work or a senior management leader, the recovery department staff might be considered to be in a passive role for a topic that requires continuing and active involvement to improve a serious condition.

(An 12 Contd.)

ORGANOGRAM OF RUPALI BANK




Abbreviation

DSR - DEADSTOCK, STATIONERY RECORDS

DIV - DIVISION

Date: Dhaka 25 November 1985

ANNEX # 13

Re : Liquidity of the five Banks in Bangladesh under review - A composite view.

In my review of the annual reports of Agrani, Janata, Rupali, Sonali and BKB, it came to my attention that there was no "Funds statement" included in the banks annual financial statements. A bank's"Funds statement" depicts the increases (or decreases) in various asset or liability categories from one year to the next. This is an important analysis. A bank balance sheet is only a snapshot in time. An analysis of line item growth gives a sense of movement an indication of where the bank is going and how it is getting there.

The funds statement has two components. The first is an analysis of how funds are used from period to period and the second examines the sources of funds that the bank or banks apply in banking activities.

Table 1 and Table 2 provide a composite view of the five banks.

Tables 3 to 8 examine asset growth in each bank.

Tables 9 to 14 examine liability growth in each bank.

COMPOSITE USES OF FUNDS-TABLE 1

It comes as no surprise that the major use of funds in the last three years comes to support loan growth. Net loan growth constituted 73% of the need for funds in the three years which is a total of Taka 25,347 of 34,638 million required.

Loan and investment growth utilized the vast majority of new funds mobilized at 93% of the total.

USES OF FUNDS BY BANK (TABLES 3-8)

Net Loan Growth - In the 3 year period, BKB required 8,523 of 25,347 million Taka required while Sonali's net growth was 7,736 million Taka. Sonali and BKB had 64% of the systems loan growth. (TABLE 3)

Investment Growth - Sonali Bank contributed 46% of the growth in this category, needing 3,204 of 6.930 million Taka in the period. (TABLE 4)

Bills Discounted - In 1983 Sonali Bank reduced its port_folio by 1,231 million Taka. These funds appear to have been redirected to the investment portfolio. (TABLE 5)

Cash and Bank Balances - For some reason Janata Bank maintained cash balances nearly twice as high as Sonali Bank, despite being significantly smaller. Janata's cash growth was 42% of the total in the period. (TABLE 6)

COMPOSITE SOURCES OF FUNDS-TABLE 2

In the period under review deposit growth provided 75% of the need for funds. Refinance provided 16% of the remaining need.

With all the growth in this analysis, capital growth provided a disappointing 1% of the cash need over the period.

SOURCES OF FUNDS BY BANK (TABLES 9-14)

Deposit Growth - Deposits grew by 26,148 million Taka. BKB mobilized 9% of the total deposits. Even little Rupali Bank was able to mobilize 2,698 million Taka, 10% of the total, in the period. (TABLE 9)

Capital Growth - Government taxation and allocations destroyed any possibility for capital growth. Only BKB was allowed any real advance by 247 million Taka which was 67% of the total capital growth. (TABLE 10)

**Refinance** - Only Janata and BKB increased their refinance positions in the period. BKB utilized 5,123 million Taka in the period which was 92% of the refinance growth. Sonali made a major effort to reduce its refinance position by 4,114 million Taka in 1983. (TABLE 11)

Other Borrowings - Janata Bank decreased its other borrowings by 2,135 million Taka in the period while increasing refinance by 2,219 million Taka. this may have been a profit maximizing strategy. (TABLE 13)

ANALYSIS AND COMMENTS

1. Many comments are made in Bangladesh concerning the need for more deposits in the banks. In the three years under review the deposits exceeded the loan growth by 801 million Taka.

2. If one examined the funds statement in isolation, one might get the impression that the central bank refinance program is funding the liquidity reserves in the bank investment portfolios. I am not sure that this is not true.

3. It is hard to imagine BKB, with its huge branch net work, being the worst bank in the mobilization of deposits. It isn't expected that they be the best at this task since their branches are in the country and BKB doesn't have the large commercial accounts of some of the other banks. Rupali, however, is only two thirds BKB's size by some measures.

4. It is unclear why Janata needs more cash then the other banks. Perhaps it is a problem. Perhaps there is some issue the figures do not reveal.

5. It is disconcerting to see an average capital position for the banks at a level of about 2% of outstanding loans. It is also confusing to watch the government tax away most of the 2,510 million Taka profit before taxes and then fund refinance growth of 5,568 million Taka over the period.

## WHAT IS BANK LIQUIDITY ?

The concept of bank liquidity refers to a bank or banks' ability to make available the funds necessary to meet deposit or withdrawals or to meet investment or loan growth requirements.

Bank and banking systems meet their liquidity needs in a variety of ways depending on the need, size and sophistication of the given bank or system. Short and long term liquidity needs are often met in different ways.

### LONG TERM LIQUIDITY NEEDS

Over a long period of time funds are required to increase the loan portfolio and other earning assets a bank has. Banks normally depend on deposit growth, and capital growth through profitability and stock sales to fund this type of liquidity need. In sophisticated markets long term debt or other issues can be sold to raise additional funds for long term growth.

### SHORT TERM LIQUIDITY NEEDS

In the short term a bank has to meet deposit withdrawals, commitments to disburse loans and repayments of bank debts. These needs are met with vault cash in the simplest case of typical customer withdrawals. Most banking systems require some type of reserves be maintained at the Central Bank. Money supply control issues aside, these are additional funds available to meet customer requirements in unusual demand situations. Most banks require, by management approach or by government regulation, that some part of their earning assets be kept in negotiable obligations which can be liquidated to provide cash at fairly short notice. An alternative funding approach might be to borrow funds for short or long periods from other banks in the banking system.

These long and short term methods account for the vast majority of bank liquidity requirements.

EXCEPTIONAL CIRCUMSTANCES

In the unfortunate circumstance that a bank cannot meet its funding needs by the methods described, most banking systems have a lending facility such as the discount window in the Federal Reserve Bank in the U.S.,to help banks through periods of difficulty in meeting their funding requirements. The refinance facilities of Bangladesh Bank have some aspects of this nature. Refinance in Bangladesh is also thought of as concessionary credit support for program lending the Central Bank would like to encourage.

# DETAILS CONCERNING THE TABLES IN THIS REPORT

## SOURCE OF DATA

All financial data has been compiled using the published annual reports for the Bangladesh Krishi Bank (BKB) for 30 June 84, 83 and 82, and for 31 December 83, 82 and 81 for the Agrani, Janata, Rupali and Sonali Banks. These are the official end of year public statements for these organizations.

## STATEMENT OF DATA

All financial data are stated in Taka Millions except where percentages are indicated, and parenthesis indicate decline rather than growth.

## COLUMN AND ROW HEADINGS

Column 1 is financial year 81-82 for BKB and 1981 for the others.

Column 2 is financial year 82-83 for BKB and 1982 for the others.

Column 3 is financial year 83-84 for BKB and 1983 for the others.

Column T is the summation of columns 1, 2 and 3.

Column AVG is the average of columns 1, 2 and 3.

Row A contains Agrani Bank Statistics.

Row J contains Janata Bank Statistics.

Row R contains Rupali Bank Statistics.

Row S contains Sonali Bank Statistics.

Row ST contains sub total bank statistics.

Row BKB contains Bangladesh Krishi Bank Statistics.

Row T contains the summation of all bank statistics for a given year.

Row LD refers to Loan Disbursements in a given year.

Row AIR refers to Accrued Interest Receivable (but not yet collected) in a given year.

Row LR refers to loan principal and interest collected in a given year.

TABLE HEADINGS

NET PROFIT (LOSS)

Consists of interest income minus interest expense plus all other income minus other expenses before taxes or other allocations.

GOVERNMENT ALLOCATIONS

Consists of taxes paid to the government plus mandatory transfers made under various nationalisation orders.

CAPITAL AND RESERVES

Consists of paid in equity of a bank plus reserves which have been specifically allocated to the capital account for capital growth as some type of retained earnings. This category will often be referred to simply as "capital."

TOTAL ADVANCES

Consists of all loans urban and rural, Agricultural and non-agricultural, outstanding on the books of a bank at the end of a particular period.

USES OF FUNDS

It is a measure of the change in bank assets from one time period to the next. The measure is in currency units and the emphasis and importance is found in the size of the need to fund earning assets.

SOURCES OF FUNDS

It is a measure of the change in bank liabilities and capital from one time period to the next. The measure is in currency units and the importance is in the type of liability that funds the earning assets.

(An 13 Contd.)

COMPOSITE
USES OF FUNDS

TABLE 1

| | 1 | 2 | 3 | T | % |
|---|---|---|---|---|---|
| NET LOAN GROWTH | 4820 | 11179 | 9348 | 25347 | 73.2 |
| INVESTMENT GROWTH | 242 | 2283 | 4405 | 6930 | 20.0 |
| BILLS DISCOUNTED | 603 | 196 | (1197) | (398) | (1.2) |
| CASH + BANK BALANCES | 172 | 913 | 642 | 1727 | 5.0 |
| PREMISES | 33 | 20 | 43 | 96 | 0.3 |
| OTHER ASSETS | 503 | 104 | 329 | 936 | 2.7 |
| TOTAL USES | 6373 | 14695 | 13570 | 34638 | 100 |

(An 13 Contd.)

COMPOSITE
SOURCES OF FUNDS

TABLE 2

| | 1 | 2 | 3 | T | % |
|---|---|---|---|---|---|
| DEPOSIT GROWTH | 3891 | 8015 | 14242 | 26148 | 75.5 |
| CAPITAL GROWTH | 27 | 218 | 126 | 371 | 1.1 |
| REFINANCE | 845 | 6300 | (1577) | 5568 | 16.1 |
| OTHER BORROWINGS | 202 | (575) | (134) | (507) | (1.6) |
| BILLS PAYABLE | (4) | 123 | (95) | 24 | 0.1 |
| OTHER LIABILITIES | 1412 | 614 | 1008 | 3034 | 8.8 |
| TOTAL SOURCES | 6373 | 14695 | 13570 | 34638 | 100 |

(An 13 Contd.)

USES OF FUNDS

TABLE 3

NET LOAN GROWTH

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 374 | 652 | 1964 | 2990 |
| J | 1112 | 2676 | 994 | 4782 |
| R | 408 | 200 | 708 | 1316 |
| S | 1589 | 4737 | 1410 | 7736 |
| ST | 3483 | 8265 | 5076 | 16824 |
| BKB LD | 2710 | 4008 | 5924 | 12642 |
| AIR | 597 | 928 | 1428 | 2953 |
| LR | -1970 | -2022 | -3080 | -7072 |
| BKB | 1337 | 2914 | 4272 | 8523 |
| T | 4820 | 11179 | 9348 | 25347 |

(An 13 Contd.)

USES OF FUNDS

TABLE 4

INVESTMENT GROWTH

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 439 | 87 | 1250 | 1776 |
| J | 135 | (56) | 866 | 945 |
| R | 123 | 206 | 609 | 938 |
| S | (684) | 1892 | 1996 | 3204 |
| ST | 13 | 2129 | 4721 | 6863 |
| BKB | 229 | 154 | (316) | 67 |
| T | 242 | 2283 | 4405 | 6930 |

(An 13 Contd.)

USES OF FUNDS

TABLE 5

BILLS DISCOUNTED

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | (43) | 32 | 24 | 13 |
| J | - | - | - | - |
| R | 7 | (75) | 10 | (58) |
| S | 639 | 239 | (1231) | (353) |
| ST | 603 | 196 | (1197) | (398) |
| BKB | - | - | - | - |
| T | 603 | 196 | (1197) | (398) |

(An 13 Contd.)

USES OF FUNDS

TABLE 6

CASH + BANK BALANCES

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 65 | 280 | (53) | 292 |
| J | 203 | 161 | 359 | 723 |
| R | 22 | 35 | 186 | 243 |
| S | (77) | 336 | 105 | 364 |
| ST | 213 | 812 | 597 | 1622 |
| BKB | (41) | 101 | 45 | 105 |
| T | 172 | 913 | 642 | 1727 |

(An 13 Contd.)

USES OF FUNDS

TABLE 7

PREMISES

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 3 | (2) | 1 | 2 |
| J | 6 | (4) | (4) | (2) |
| R | - | 14 | 10 | 24 |
| S | 16 | (3) | 7 | 20 |
| ST | 25 | 5 | 14 | 44 |
| BKB | 8 | 15 | 29 | 52 |
| T | 33 | 20 | 43 | 96 |

(An 13 Contd.)

USES OF FUNDS

TABLE 8

OTHER ASSETS

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | (71) | 26 | 147 | 102 |
| J | 39 | 277 | 84 | 400 |
| R | (25) | (20) | 53 | 8 |
| S | 450 | (141) | (18) | 291 |
| ST | 393 | 142 | 266 | 801 |
| BKB | 110 | (38) | 63 | 135 |
| T | 503 | 104 | 329 | 936 |

(An 13 Contd.)

SOURCES OF FUNDS

TABLE 9

DEPOSIT GROWTH

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 1019 | 1352 | 3200 | 5571 |
| J | 971 | 1248 | 3764 | 5983 |
| R | 398 | 561 | 1739 | 2698 |
| S | 960 | 4034 | 4537 | 9531 |
| ST | 3348 | 7195 | 13240 | 23783 |
| BKB | 543 | 820 | 1002 | 2365 |
| T | 3891 | 8015 | 14242 | 26148 |

(An 13 Contd.)

SOURCES OF FUNDS

TABLE 10

CAPITAL GROWTH

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | - | 1 | 4 | 5 |
| J | 2 | 6 | 7 | 15 |
| R | 3 | 3 | 6 | 12 |
| S | 5 | 27 | 60 | 92 |
| ST | 10 | 37 | 77 | 124 |
| BKB | 17 | 181 | 49 | 247 |
| T | 27 | 218 | 126 | 371 |

(An 13 Contd.)

SOURCES OF FUNDS

TABLE 11

REFINANCE GROWTH

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | (365) | - | (5) | (370) |
| J | 223 | 1701 | 295 | 2219 |
| R | (73) | (109) | (319) | (501) |
| S | 303 | 2908 | (4114) | (903) |
| ST | 88 | 4500 | (4143) | 445 |
| BKB | 757 | 1800 | 2566 | 5123 |
| T | 845 | 6300 | (1577) | 5568 |

(An 13 Contd.)

SOURCES OF FUNDS

TABLE 12

BILLS PAYABLE

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | (22) | (12) | 10 | (24) |
| J | - | - | - | - |
| R | (2) | 18 | (4) | 12 |
| S | - | - | - | - |
| ST | (24) | 6 | 6 | (12) |
| BKB | 20 | 117 | (101) | 36 |
| T | (4) | 123 | (95) | 24 |

(An 13 Contd.)

SOURCES OF FUNDS

TABLE 13

OTHER BORROWINGS

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 111 | (292) | 70 | (111) |
| J | 92 | (309) | (1918) | (2135) |
| R | 155 | (160) | 26 | 21 |
| S | (223) | 68 | 1369 | 1214 |
| ST | 135 | (693) | (453) | (1011) |
| BKB | 67 | 118 | 319 | 504 |
| T | 202 | (575) | (134) | (507) |

(An 13 Contd.)

SOURCES OF FUNDS

TABLE 14

OTHER LIABILITIES

| | 1 | 2 | 3 | T |
|---|---|---|---|---|
| A | 24 | 26 | 54 | 104 |
| J | 207 | 408 | 151 | 766 |
| R | 54 | 47 | 128 | 229 |
| S | 888 | 23 | 417 | 1328 |
| ST | 1173 | 504 | 750 | 2427 |
| BKB | 239 | 110 | 258 | 607 |
| T | 1412 | 614 | 1008 | 3034 |

Date : Dhaka September 15,1985

ANNEX # 14

Re : Loan Loss Reserves in Banks in Bangladesh

A review of 1983 annual reports for Sonali, Janata, Agrani and Rupali banks and the 1983-84 annual report for BKB explicitly indicates that general loss reserves and capital account reserves are created by each bank.

Additions to the reserves are shown as appropriations from profit on the balance sheet each year. The reserves sections within the capital account portion of the balance sheets show accumulations from year to year. The "Other Liabilities" section of the balance sheets show reserve accumulations for losses from year to year.

A case can be made that these banks are also accumulating hidden reserves. Sonali, Janata, Agrani and Rupali have all listed taxes paid at year end in excess of the 60% tax rate on stated profit. No reasons are indicated in the notes to the statements for additional taxes having been paid.

If hidden reserves are being created, it is possible to estimate them. Assume that the taxes paid by each bank is the correct amount at a rate of 60%. Using the amount paid at 60%, one can calculate the profit necessary to generate the taxes paid. Subtracting the "stated profit" from our "calculated profit" gives us an estimate of hidden reserve.

It is interesting to note that the additicn of the calculated hidden reserves to the stated reserves when taken as a percentage of the average loan portfolio for each bank yields generally similar results, ranging from approximately 0.5 to 0.9 of a per cent of the average loan portfolios; BKB being the lowest at 0.46 of a per cent.

Note also the calculated ratios for annually accumulated reserves to the average loan portfolios (Page 7). The range was from approximately 1% to 2.3%. BKB had the largest standing reserve ratio at 2.3%. Agrani and Rupali had the smallest at 1.08 and 1.81%.

There seems to be a logic in BKB allocating only 0.46% in 83/84 as it has a large standing reserve. Agrani and Rupali allocated more from 1983 as they had comparatively smaller standing reserves taken as a percentage of their average loan portfolios. Janata's calculation is flawed as it does not explicitly list accumulated reserves in its "Other Liabilities" section.

It is not possible at this time to comment on the adequacy of these reserves. At the end of the RFP Rural Bank And Bank User Survey (RBBUS) a great deal more will be known about the age of the loan portfolios and the reasons for loans being past due. A large bank in the West will accumulate loan loss reserves up to about 1% per year and will keep it at levels somewhat higher than that depending on their loan loss experience. Special additional reserves are often established in unusual situations. Latin American debt problems are a recent example for banks in the U.S. When information is available from the RBBUS it should be possible to make estimates of appropriate reserve levels and timetables for establishing them.

In the following pages are demonstrated the methods used in calculating estimated hidden reserves and the ratios for contributions for stated years as well as ratios for standing reserves.

There have been only limited opportunities to discuss the subject of this note with senior members of the respective banks, and at times the bank officials seemed reluctant to discuss the matter in detail. The analysis in this Note has been developed primarily from a review of the annual reports of each bank, and from the author's experience with the subject.

| | | SONALI | JANATA |
|---|---|---|---|
| LOANS | 1983 | 16,144,333 | 11,636,542 |
| (000) | 1982 | 14,734,445 | 10,967,821 |
| | AVG. | 15,439,389 | 11,302,181 |
| TAXES PAID IN 83 | | 305,561 | 146,148 |
| ÷ by 60% RATE | | | |
| ESTIMATED PROFIT | | 509,268 | 243,580 |
| STATED PROFIT | | 509,513 | 192,718 |
| HIDDEN RESERVE | | 4,855 | 50,862 |
| STATED CAPITAL and GENERAL RESERVE & RURAL CREDIT FUND | | 110,000 | 25,255 |
| TOTAL RESERVES | | 114,855 | 76,117 |
| HIDDEN & STATED RESERVES ÷ AVG. LOAN PORTFOLIO | | 0.74% | 0.67% |

These calculations estimate contributions to reserves as a percentage of average loan portfolios at the end of the 1983 reporting year for each bank.

| | | AGRANI | RUPALI |
|---|---|---|---|
| LOANS | 1983 | 6,623,611 | 4,101,553 |
| (000) | 1982 | 4,635,517 | 3,382,723 |
| | AVG. | 5,629,564 | 3,742,138 |
| TAXES PAID IN 83 | | 94,860 | 67,227 |
| ÷ 60% RATE | | | |
| ESTIMATED PROFIT | | 158,100 | 112,045 |
| STATED PROFIT | | 118,760 | 86,616 |
| HIDDEN RESERVE | | 39,340 | 25,429 |
| STATED CAPITAL & GENERAL RESERVE & RURAL CREDIT FUND | | 7,800 | 6,500 |
| TOTAL RESERVES | | 47,140 | 31,929 |
| HIDDEN & STATED RESERVES ÷ AVG. LOAN PORTFOLIO | | 0.84% | 0.85% |

BKB

| | | | |
|---|---|---|---|
| LOANS | 1983/84 | 12,153,186 | |
| (000) | 1982/83 | 7,881,137 | |
| | AVG. | 10,017,161 | |
| TAXES PAID IN 83/4 | | 100,000 | |
| ÷ 60% RATE | | | |
| ESTIMATED PROFIT | | 166,666 | |
| STATED PROFIT | | 169,500 | |
| HIDDEN RESERVE | | (2,834) | Tax Dispute |
| STATED CAPITAL & GENERAL RESERVE & RURAL CREDIT FUND | | 48,500 | |
| TOTAL RESERVES | | 45,666 or 48,500 | eliminating the tax dispute. |
| HIDDEN & STATED RESERVES ÷ AVG. LOAN PORTFOLIO | | 0.46% or .48% | |

Date : Dhaka 17 September 1985

ANNEX # 15

Re : Loan Loss Reserves in Banks in Bangladesh # 2

I have reviewed the annual reports for BKB, Sonali, Janata, Agrani and Rupali bank for at least the last three years and as much as the last six years. The most current annual report is the 1983 year for the NCB's and the 1983-84 year for BKB.

The point of this analysis was to determine if the banks were utilizing their stated reserves to write-off loan losses or if they were simply accumulating the reserves for future use as appropriate.

I have determined from this review that the banks are accumulating their stated reserves and have not utilized them to write-off loan losses in any year I have reviewed.

It is difficult to present a concise visual analysis of this topic from the statements as the banks appear to change accounting approaches when they change accountants. However, I have attached a time line analysis of Agrani Bank taken from their last six annual reports. Their accounting has been consistant and their results are consistant with the impression I have received from my review of all the banks.

The analysis consists of a matrix created by the annual transfers to three different reserve categories. The categories are the following: Rural Credit Fund, Unforeseen Loss and Capital Reserves. Each category has two numbers. The top number indicates the amount transferred to this category in a given year and the number below in brackets indicates the accumulation for this category from year to year. The addition does not indicate any subtractions for writing-off loans.

It is possible, if this bank is creating "hidden reserves", (part of the previous paper's consideration of the reserve topic) that loan write-offs are coming from that "reserve". This is complete conjecture on my part but it would be an explanation if the bank is writing-off loans. If no loans are being written-off and no "hidden reserves" are being utilized, it appears that stated reserves are allocated and accumulated but have not been utilized.

If the banks lose their legal remedy against defaulting borrowers by writing-off the debt, this would be a strong disincentive to utilize the reserves that are being accumulated. The accumulation of reserves I have observed in the annual reports is consistant with this disincentive.

Date : Dhaka 17 September 1985

ANNEX # 16

Re: Bangladesh Bank Rules for Classification of Problem Loans and Related Interest-BCD Circular No. 17 of April 23, 1975

The attached Circular establishes the rules for classifying problem loans and related interest in the financial statements of the scheduled banks in Bangladesh. This memo states the various rules as presented in the Circular and then attempts to annotate or comment on the rule as appropriate.

ADVANCES CLASSIFIED AS 'SUBSTANDARD'

If any stuck up advance classified by Bangladesh Bank Inspectors as 'Sub-standard' continues to remain stuck up without any repayment of interest or principal for 2 years or more after the date of inspection, interest accrued on such accounts from the 3rd accounting year and onward after inspection should be booked through 'Interest Suspense Account' till the account is regularised. No provision need however, be made against such stuck up advances in the bank's Annual Accounts.

ADVANCES CLASSIFIED AS 'SUBSTANDARD' : COMMENTS

1) It appears that only Bangladesh Bank's Inspectors can classify loans.

2) The classification period is not related to the loan term but to when the loan has been reviewed by the Inspectors. It would seem that if there is no inspection during a year, there are no classifications that year in a given branch under this rule.

3) The title of the circular is the "APPLICATION OF INTEREST ON CLASSIFIED LOANS & ADVANCES & MAKING PROVISIONS THEREFOR", however, the circular appears to provide guidance on the correct stating of both principal and interest. The title of the circular might suggest to some that only the classification of interest is involved.

ADVANCES CLASSIFIED AS 'DOUBTFUL'

Provision need not be made by banks in their annual accounts for advances classified by Bangladesh Bank Inspectors as 'Doubtful' during the first 2 years after such classification. However, if the advances continue to remain un-recovered during the 3rd accounting year after classification, provision should be made in the Annual Accounts of the banks against such advances as under -

a) Private Sector Advances-- 50% of the classified amount at the end of the 3rd Accounting Year.

b) Public Sector Advances-- i) 25% of the classified amount at the end of the 3rd Accounting Year.

b) Public Sector Advances-- ii) Further 25% at the end of the 4th Accounting year, to raise the accumulated provision to 50%.

Interest accrued but not realised on such advances should, however, be credited to the 'Interest Suspense Account' right from the day of classification till actual realisation thereof.

ADVANCES CLASSIFIED AS 'DOUBTFUL' : COMMENTS

1) The interest is already being placed in a suspence account so this rule mainly applies to principal.

2) There is no definition of "provision" in this rule. It would appear that a provision is a reserve against a potential bad debt and not an instruction to treat the loan as uncollectable and, therefore, to write it off.

3) This rule does not indicate at what level of a banking organization it applies to. I interpret this rule as applying to the head office when it prepares the annual accounts which means the head office needs current information on loan classification from its branches. I interpret in this fashion as I do not recall seeing a loan provision in any rural branch I have visited.

ADVANCES CLASSIFIED AS 'LOSS'

This rule was modified by a circular on 11 October 76 and it is the modified version that is reviewed here.

Provisions for advances classified by Bangladesh Bank Inspectors as 'Loss' should be made to the extent specified below and at the time of Annual Closing of Accounts immediately following the expiry of the period spelled out in each undernoted case :-

a) In case the advances remain un-recovered during the first year after classification.
Private Sector: 30% of the classified amount.
Public Sector : 20% of the classified amount.

b) In case the advances continue to remain un-recovered during the 2nd year after classification.
Private Sector: Further 35% of the classified amount.
Public Sector : Further 20% of the classified amount.

c) In case the advances continue to remain un-recovered during the 3rd year after classification.
Private Sector: Further 35% of the classified amount to raise the cumulative provision to 100%.
Public Sector: Further 20% of the classified amount.
Public Sector: 4th year after classification, further 20%.
Public Sector: 5th year after classification, remaining 20% of the classified amount to raise the cumulative provision to 100%.

Interest accrued but not realised on such advances should, however, be credited to the 'Interest Suspence Account' right fron the date of classification till the advances including interest are either recovered or written off.

ADVANCES CLASSIFIED AS 'LOSS': COMMENTS

1) It is interesting to note that as much as 3 to 5 years after classification in the 'Loss' category the rule does not instruct the bank to write off the loan and it does not make any reference to using the legal system to assist in collection.

2) At no point in this circular is the term 'stuck-up loan' defined. Clearly, a loan has to reach its original maturity date of the date of some installment before it can be considered to be some type of problem. If the loan matured after two years with no repayment having been made and the inspectors do not make the classification until a year later, it would appear that the loan might not be fully reserved for until as many as 5 to 8 years after the original loan was made. At this point the loan still is not written off and this rule makes no comment as to the necessity of utilizing the courts although it is conceded that the banks have their own policies on this matter.

3) It would appear that this section of the rule uses percentages to indicate amounts to be reserved for a loan that is immediately placed in the 'Loss' category or it divides up the remaining amount that has not been reserved for when the loan was in the 'Doubtful' category. The intent is clear but the mechanics are not.

4) It is not clear if the process is to move loans from substandard, to doubtful to loss over a period of time or if the category is simply chosen by the inspectors at the time they look at it. There is probably common practice governing this matter but the rule does not make it clear.

ANALYSIS OF BCD CIRCULAR NO. 17

1) It is a positive sign that rules exist concerning reserving for possible loan loss.

2) There rule is not as clearly written as it might be. If no changes in this issue come about as a result of this project, we should at least re-write this circular to make it a little clearer.

3) The lack of instruction requiring loans to be written off is another powerful suggestion that doing so may lose the bank its legal remedy against the borrower.

4) In my opinion the exagerated timeframes in this rule reflect the realities of another age. Business and banking dealings happen a little more quickly these days and I have some confidence that these rules could be accelerated somewhat.

5) The analysis that the RFP will do on the branch bank financial statements combined with the loan portfolio information gathered should provide us with some insight as to the modifications that may be appropriate for this rule. This Circular and the practice it generates is an important part of the management environment around loan recovery in the head offices and the rural branches. A quality revision of this rule would be a strong sign that the attitude around loan repayment was changing and was serious.

BANGLADESH BANK
HEAD OFFICE
P.O.BOX NO.325
DHAKA

BANKING CONTROL
DEPARTMENT

BCD CIRCULAR NO.17

OCTOBER 11,1976

ALL SCHEDULED BANKS IN
BANGLADESH

Dear Sir,

APPLICATION OF INTEREST ON CLASSIFIED LOANS AND ADVANCES AND MAKING PROVISIONS THEREFOR.

Please refer to sub-para 1(iii) of our BCD Circular N.17 dated the 23rd April 1975 on the captioned subject.

2. It has since been decided that the existing instructions regarding provisions for advances classified as loss appearing in sub-para 1.(iii) of the above Circular under the heading "Advances Classified as Loss should be substituted by the following:-

(iii) ADVANCES CLASSIFIED AS LOSS:

Provisions for advances classified by Bangladesh Bank Inspectors as 'Loss' should be made to the extent specified below and at the time of Annual Closing of Accounts immediately following the expiry of the period spelled out in each undernoted case:-

| | Private sector | Public sector |
|---|---|---|
| a) In case the advances remain un-recovered during the first year after classification. | 30% of the classified amount | 20% of the classified amount |
| b) In case the advances continue to remain un-recovered during the 2nd year after classification. | Further 5% of the classified amount | Further 20% of the classified amount. |
| c) In case the advances continue to remain un-recovered during the 3rd year after classification. | Further 35% of the classified amount to raise the cumulative provision to 100% | -do- |
| d) In case the advances continue to remain un-recovered during the 4th year after classification | | -do- |
| e) In case the advances continue to remain un-recovered even at the end of the 5th year after classification. | | Remaining 20% of the classified amount to raise the cumulative provision to 100% |

Interest accrued but not realised on such advances should, should, however, be credited in the 'Interest Suspense Account' right from the date fo classification till the advances including interest are either recovered or written off.

Banks are requested to make necessary changes in the said BCD circular & ensure proper complinner to the revised instructions in this regard.

Please Acknowledge receipt.

Yours faithfully,

Sd/-

( B.B. DEBNATH )
ADDITIONAL CHIEF OFFICER

BANGLADESH BANK
BANKING CONTROL DEPARTMENT
HEAD OFFICE : DHAKA

BCD CIRCULAR NO.17 APRIL 23,1975

ALL SCHEDULED BANKS IN BANGLADESH.

Dear Sir,

APPLICATION OF INTEREST ON CLASSIFIED LOANS & ADVANCES & MAKING PROVISIONS THEREFOR:

In supersession of all previous instructions issued on the subject, the following revised procedure is prescribed with regard to application of interest on classified advances and making provisions therefor in the Annual Accounts of the banks effective from the accounting year 1985.

(i) Advances classified as 'Substandard'

If any stuck up advance classified by Bangladesh Bank Inspectors as 'Sub-standard' continues to remain stuck up without any repayment of interest or Principal for two years or more after the date of inspections, interest accrued on such accounts from the 3rd accounting year and onward after inspection should be booked through Interest Suspense Account' till the account is regularised. No provision need however, be made against such stuck up advances in the bank's Annual Accounts.

(ii) Advances classified as 'Doubtful'

Provision need not be made by banks in their annual accounts for advances classified by Bangladesh Bank Inspectors as 'Doubtful' during the first two years after such classification. However, if the advances continue to remain unrecovered during the third Accounting Year after classification, provision should be made in the Annual Accounts of the banks against such advances as under:

(a) Private Sector Advances -- 50% of the classified amount at the end of the Third Accounting Year.

(b) Public Sector Advances -- (i) 25% of the classified amount at the end of the Third Accounting year.

(ii) Further 25% at the end of the Fourth Accounting year, raised the accumulated provision to 50%.

Interest accrued but not realised on such advances should however, be credited to the 'Interest Suspense Account' right from the date of classification till actual realisation thereof.

(iii) Advances classified as 'Loss'

Provisions for advances classified by Bangladesh Bank Inspectors as 'Loss', should be made to the extent specified below and at the time of Annual Closing of Accounts immediately following the expiry of the period spelled out in each under-noted case:

| | Private Sector | Public Sector |
|---|---|---|
| (a) In case the advances remain unrecovered during the first year after classification. | 30% of the classified amount | 20% of the classified amount |
| (b) In case the advances continue to remain un-recovered during the 2nd year after classification. | 50% " | 30% " |
| (c) In case the advances continue to remain un-recovered during the 3rd year after classification. | 100% " | 50% " |
| (d) In case the advances continue to remain un-recovered even after 5 years of classification. | | 100% " |

Interest accrued but not realised on such advances should, however, be credited to the 'Interest Suspense Account' right from the date of classification till the advances including interest are either recovered or written off.

(iv) Apart from the above interest accrued/charged on loans and advances, recovery of which is considered bad or doubtful by the bank itself should also be credited to 'Interest Suspense Account' pending actual realisation of the same.

(v) While preparing Annual Balance sheet and profit and loss Account, the total amount of interest in respect of all branches of the bank, which was earlier credited to 'Interest Suspense Account' should be deducted from the total outstanding loans and advances and the resultant balance only should be show under 'Loan and Advances' portfolio in the balance sheet.

(vi) Similarly, while reporting the figures of loans and advance to the Bangladesh Bank in various returns, the bank should dedect the amount of outstanding balance in 'Interest Suspense Account' from the total loans and advances.

2. For the purpose of item Nos (i), (ii) and (iii) of paragraph 1 The latest Inspections Report prepared by Bangladesh Bank, should be taken as the basis for determining the position of advances.

Receipt of this Circular may please be acknowledged.

Yours faithfully,

Sd/-

( S.A. KABIR )
CHIEF OFFICER

Date: Dhaka 18 June 1986

ANNEX # 17

Re : Pre-Liberation Loans from RABUS-BM 2 Results

Do you have Preliberation Loans?

| | Agrani | BKB | Janata | Rupali | Sonali | Total |
|---|---|---|---|---|---|---|
| Yes | 2 | 24 | 1 | Ø | Ø | 27 |
| No | 20 | 1 | 15 | 7 | 30 | 73 |
| Total Branches | 22 | 25 | 16 | 7 | 30 | 100 |
| How Many ? | 4 | 2,524 | 3 | Ø | Ø | 2,531 |
| Loan value outstanding (Tk000) | 7 | 4,580 | 6 | Ø | Ø | 4,593 |
| Number of branches with recoveries in 84-85 | 1 | 19 | Ø | Ø | Ø | 20 |

Comments and Analysis

(1) Pre-liberation loans are a BKB phenomena with 99.7% of them located in their branches.

(2) BKB would have approximately 105 loans/branch from pre-liberation times.

(3) Assuming 890 rural branches at the end of 1985, there would be a system approximation of 89,712 pre-liberation loans.

(4) Average loan value would be Tk. 1,815.

(5) Total pre-liberation loan outstandings for BKB would be approximately Tk. 162,827,280.

(6) Pre-liberation loans of taka 163 MM VS BKB financials - 1983/84

| 1983-84 | Taka (000000) | Percentage |
|---|---|---|
| Total Capital | 610 | 26.7% |
| Paid-in-Capital | 376 | 43.4% |
| Total Loans | 12,134 | 1.3% |
| Total Refinance | 7,377 | 2.2% |
| Total Interest Income | 1,127 | 14.5% |
| Net Income | 170 | 95.9% |
| Loans Overdue | 3,083 | 5.3% |

(7) The small average loan size suggests they were crop loans.

(8) The survey suggests there are over 105 of these loans in each of 96% of BKB's rural branches. They are an administrative and funding burden. At the average agricultural refinance rate of 8.5% p.a., these loans would cost BKB taka 13,840,519 to fund each year. This is over 8% of BKB's net income in 1984 and over 1% of total interest income.

(9) The loans are a small percentage of BKB refinance (2%) and a large percentage of total capital (27%).

(10) As the loans are small, a majority of the borrowers were small farmers who probably returned to Pakistan, died or who relocated as a result of or after the liberation conflict.

Recommendation

(1) BKB should write off all pre-liberation loans.

(2) The Government should allow BKB to reduce its refinance obligation by an equal amount due to the political and social nature of theproblem.

(3) This activity should be taken with a minimum of fanfare and whatever collection activities are possible should continue to be taken.

Annex # 18

(Translated from Bengali)

Urgent
CMLA'S SECRETARIAT
OLD SANGSHAD BHABAN
TEJGAON, DHAKA

25 FEBRUARY 1986

7011/11/Civil-1

See Distribution

Re: Certificate cases for realization of agricultural loans and withdrawal of warrants for arrest

In the context of instituting certificate cases in various parts of the country by the BKB, police have issued warrants for arresting defaulting farmers of agricultural loans. A proposal relating to realization of agricultural loans is under consideration of the highest level of the government. Under the circumstances, no decision on certificate cases and no arrest warrant are to be executed upto 30 June 1986. In those cases where the cases have been finalized and arrest warrants have been issued, verdict on such cases and execution of arrest warrants will stay in abeyance till 30 June 1986.

Sulzer Rahman
Lt. Col.
for Principal Staff Officer

Distribution:

Action:

- Managing Director, Bangladesh Krishi Bank, Head Office, Dhaka.
- Managing Directors, Sonali Bank, Rupali Bank, Agrani Bank and Janata Bank.
- All District Commissioners
- All Police Superintendants

Information

- Governor, Bangladesh Bank
- Secretary, Cabinet Division
- Secretary, Finance Division
- Inspector General of Police
- All Upazila Chairman
- Private Secretary to the Finance Advisor

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RFP Note: According to a subsequent directive from the CMLA's Secretariat No. 7056/9/Civil-3 dated 16 March 1986 only the borrowers of crop loans were brought under the purview of the directive dated 25 February 1986. The directive was not applicable to the loanees in respect of agricultural projects sanctioned by BKB and various commercial banks.