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Covid 19 Impact on Financial Sector of Bangladesh: A Study on Non-Performing Loan

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Abstract: The COVID-19 epidemic has reached a breaking point in terms of health, wealth, and society. The world's economy has fallen to the cruel hold of the coronavirus, which has now spread to every corner of the planet. Covid-19's impact on Bangladesh's banking industry is the topic of this research. A qualitative approach was used to accomplish the study's objectives. According to the study, COVID-19 has a wide variety of economic and financial impacts in Bangladesh. During this time of severe lockdown, the Bangladeshi banking industry is experiencing significant financial losses, an increase in the number of loans that are not being repaid, individual investments, and a decline in operating profitability. The bank workers' capacity to carry out their regular responsibilities is seriously impaired.

Keywords: non-performing loan, loan classification, regulation, Bangladesh financial sector

1. Introduction

COVID-19 impacts the global world in every sector of life, changing societal norms and values, disrupting supply chains, slowing economic and financial activity, increasing market volatility, increasing financial uncertainty, and changing economic actors' mindsets. All of the pandemic's reactions have significant ramifications and unprecedented uncertainties in the global economy and the banking and financial sectors. Households, businesses, and financial markets all across the world are receiving outstanding support from authorities. The government of Bangladesh and Bangladesh Bank subsidized the companies and mobilized the financial sector of Bangladesh. Because of the high interest/profit rate, the cost of conducting business rises, and the industry loses its competitiveness; as a result, lenders may default on loans, disrupting the banking credit system and obstructing the country's economic progress. In this context, Bangladesh Bank issued a circular to all operating commercial banks to boost local and international competitiveness for businesses, industries, and service institutions, create an industry- and business-friendly environment, improve debt/investment repayment ability, and foster economic growth.

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2. Literature Review

Covid-19 has a damaging effect on both the body and the intellect, destroying the global economy and the notion of the global village. Even life science around the world is deteriorating (Mahmud,2020). The financial sector is connected with the economy, and the strength of the banking sector is based not only on the banking sector's strategy but also on the development of the other sectors in the economy of the nation. When it comes to credit returns from customers, uncertainty and skepticism are significant issues for Bangladeshi banks, particularly in light of the fact that the country's financial operations are in disarray (Habib, 2020). Loans that leave banks but do not emerge in their records are known as nonperforming loans, and they are to blame for the decline in monetary liquidity. If a bank has a high percentage of loans that go into default, this reduces bank's capacity to provide loans and puts the investors in danger (Babu, 2020).

According to Mortuza (2020), they were arguing that by the second half of 2020, the majority of banks will be in a precarious position in terms of operating profits. Hasan observed that almost all banks' earnings had gradually increased compared to the previous year. According to Paul, the banking sector is experiencing liquidity and loan recovery issues. According to Kumar, Z. et al. (2020), NPLs are the most pressing concerns and challenges for Bangladesh's banking system. According to M. T. Hossain (2018), administrative softness, lack of brilliant governance, and political will are important causes of bank business being dissatisfied. Kumar noted that the coronavirus disrupts Bangladesh's agro-normal economy's operations. Consequently, the value of agricultural goods is dropping and they are not being sold. Lastly, there were severe losses for farmers. In this case, put the borrower under pressure to return the debt. According to Murtaza (2020), NPLs are the primary cause of a bank's financial deficit.

The lending policies of banks may have a significant impact on non-performing loans. A default decision isn't wholly unreasonable. On the other hand, a defaulter considers a probabilistic assessment of the potential costs and rewards of his action. "Lazy banking" has a negative impact on bank investment portfolios and lending policies (Reddy & Mohan, 2003), (Sinkey, 1991), and (Dash, 2010).

Non-performing loans, often known as NPLs, are regressed on three different sets of characteristics, including credit, bank size-induced risk appetite, and shocks to the macro-economy. The terms of credit variables are significant in panel regression models. The predicted coefficient on changes in credit costs due to a higher interest rate expectation is positive. On the other hand, a longer credit maturity horizon, a healthier credit culture, and favorable macroeconomic and business conditions all contribute to a reduction in NPLs (Ranjan & Dhal, 2003).

Non-performing loans are increasing as a result of a lack of risk management, putting banks' profits at risk. This research suggests that the banking sector can avoid non-performing loans by using procedures recommended by the central bank of the target country (Haneef & Riaz, 2012).

According to the results of the bit simultaneous equation regression, a greater percentage of non-performing loans brings about a reduction in cost efficiency. In contrast, a reduction in cost efficiency brings about an increase in the percentage of non-performing loans. Results provide further evidence that supports hypothesis put up by Berger and De Young (1992),which states that ineffective management in financial institutions results in poor loan quality, which, in turn, raises the total number of loans that are considered to be

non-performing. (Calice, 2012).
According to the analysis of the other published works, the effect of Covid 19 on non-performing loans in the banking industry is not covered by the most recent data. The main aimis to discuss the current change in total non-performing loan amount of Bangladesh's listed banks. The discussion is based on current data; however, the data are updated on a quarterly basis; for this reason, the suggestion of the analysis may vary as a result of the new data.

3. Problem Formulation

The rise of COVID-19 has put pressure on banks, threatening both their business growth and financial stability. For a long time, the country was on a public holiday, with most economic operations coming to a stop. Deposit growth, credit quality, loan demand, fee income, and otherfactors will all be impacted by the pandemic's economic consequences. In this environment, banks should concentrate their efforts on four critical areas of their operations: i) credit management; (ii) revenue reduction; (iii) customer service; and (iv) business process improvement and product innovation.

4. Research Objectives and Importance

By studying the literature, this research has a few points to be satisfied, which are as follows:

- To summarize the situation with non-performing loans in Bangladesh following COVID-19 Pandemic,
- Impact of the loan classification facility and incentives following COVID-19 Pandemic.

Effectively run the bank and non-bank financial institute throughout the facility provided by Bangladesh Bank during the COVID-19 Pandemic. The influence that non-performing loans have on the amount of money that can be made in the financial industry.

5. Research Methodology

The methodology of this study incorporates a thorough literature review of the financial sector, effects of COVID-19 Pandemic, measurement of a non-performing loan, and standardization of performing loans. The design and development of loan renewal strategies, loan reschedule strategies, and loan restructuring strategies with the requisition of Bangladesh Bank and the Bangladesh Security Exchange Commission for listed companies' Annual data were obtained from Bangladesh Bank's annual report and various annual reports of other commercial banks.

6. Discussion & Analysis

Since the majority of the stimulus packages are structured to provide liquidity support via commercial banks, it is clear that banks will have a substantial role to play in execution of COVID-19 related stimulus packages that have been proclaimed by the government. Sincethe financial industry as a whole was in a helpless situation during the pre-pandemic era, the banks often have a significant obligation to fulfill, which is unquestionably the case. Without a doubt, amid the final decade, the circumstances of the banking segment have been breaking down consistently, which is reflected in significant number of non-performing loans (NPL), acceleration of credit write-offs, major scams, inconsistencies, heists in banks.

i) Excess Liquidity in Banking Sector

During first few months of epidemic, the Bangladesh Central Bank took a number of different steps in an effort to guarantee enough liquidity within financial system and to support operations of financial institutions. It made the announcement that it would buy government bonds and bills from financial institutions;

REPO rates: Reduced REPO rates from 6% to 5.75 percent, effective on March 24, 2020, assisted in lowering them to 5.25 percent, effective April 12, 2020 and the rate was 4.75% as on April 26, 2022.

Cash Reserve Ratio (CRR): Every scheduled bank must maintain a cash balance with Bangladesh Bank. The amount of which must not be less than the percentage of its total demandand time obligations that BB may establish from time to time, and the amount of which shall not exceed that percentage. The cash reserve ratio (CRR) has been updated to 4.0 percent, andthis new ratio will go into effect on April 15, 2020. Since April 15, 2020, the cash reserve ratio(CRR) for all conventional banks has been raised from 85 percent to 87.5 percent. In addition, the investment deposit ratio (IDR) has been raised for Islamic Shariah-based banks whereas Islamic Shariah rules are followed by conventional banks.

According to the data provided by the Bangladesh Bank, the amount of surplus liquidity existing within the banking system has almost increased by a factor of two and a half, going from Tk 1.03 trillion in January 2020 to Tk 2.05 trillion in December 2020. During same time period, the amount of surplus liquidity in state-owned commercial banks (SCBs) has morethan tripled, while the amount of excess liquidity in Islamic banks has more than quadrupled (IBs). In December of 2020, the proportion of the banking sector's total liquid resources that was made up of excess liquid resources was 49 percent.

According to data provided by the Bangladesh Bank, the total amount of excess reserves heldby all banks increased from Tk 67.40 billion, which is equivalent to 2.15 percent of total liquid assets, in January 2020 to Tk 447.80 billion, which is equivalent to 10.81 percent of total liquidassets, in December 2020. Excess reserves are expensive for banks to retain since they represent uninvested funds.

During the same period, banks, on the other hand, increased their holdings of unrestricted authorized securities. These securities are completely risk-free assets since theyare either issued or guaranteed by the government. Banks are able to produce returns when they hold surplus liquidity in the form of general authorized securities. This is due to the fact that such securities are earning assets. According to the data provided by the Bangladesh Bank, the total value of general approved securities held by all banks increased from Tk 2.11 trillion in January 2020, representing 67.15 percent of total liquid assets, to Tk 2.80 trillion in December 2020, representing 67.69 percent of total liquid assets. This represents a significantincrease. Commercial banks choose to keep their excess liquidity in the form of risk-free authorized securities rather than funds available for lending. This is evidence that the banks believe yields on risk-free authorized securities offer better value than the risk-adjusted returns on interest-bearing loans that carry the possibility of default. This indicates that commercial banks are reluctant to lend money because they believe that the economic activity willnot begin anytime soon and that there is a significant chance of default on any loans they makeas a result.

Excess liquidity, on the other hand, can indicate that loan demand is low, which is likely giventhat real economy is still reeling from effects of the COVID-19 shock. The falling advance-deposit ratio indicates that economic activity is still slowing. Other economic indicators, like proxy gauges of investment, reflect this as well.

ii) Non-Performing Loans

A loan is a kind of financial obligation taken on by a person or business. A quantity of money is advanced to the borrower by the lender, which is often a business, financial organization, orthe government. After providing loan, it can be categorized as unclassified loan and classified loan. Unclassified modes are standard (STD) and special mention account (SMA). On the otherhand, classified modes are sub-standard (SS), doubtful (DF) and bad/loss (BL). This classified mode is very risky for lender which loan is known as non-performing loan.

Both traditional banks and alternative financial companies face competition from non-performing loans. Non-performing loans, often known as NPLs, are loans from which investing banks and non-bank financial institutions (NBFIs) do not collect interest or recover principal as planned or rescheduled for the loan. It has been a regular source of worrisome and earth-shaking news in the Bangladeshi media that non-performing loans (NPLs) are on the increase in Bangladeshi banks and NBFIs. The percentage of Bangladesh's nonperforming loans (NPLs) was 8.9 percent in September 2020, which was a decrease from the 9.2 percent recordedin the previous quarter. The standard percentage for loans that are considered to be non-performing is 2%, according to those with expertise in finance. Banks and NBFIs can now reschedule loans to extend their loan payment schedules. As a result, the NPL ratio has fallen,while banks and NBFIs forecast that it will climb after the rescheduling periods expire.

In the post-COVID-19 period, central bank's decision to offer loan defaulters access to two of most important liquidity support packages may have contributed to an increase in NPLs.Due to central bank's year-long prohibition on loan categorization in 2020, it was impossible to identify the true state of NPLs in banking sector in 2020. As of September 2020, NPL ratio was at 8.9%. This may not represent true picture of central bank'sloan classification moratorium. The performance of weak and poorly controlled banks may deteriorate as a result of the more inefficient rules imposed by COVID-19. It is impossible to determinethe exact health of individual banks in the country because the Ministry of Finance's FinancialInstitutions Division (FID) has stopped publishing data on banks for several years.

Due to the fact that significant companies have already received the bulk of the liquidity assistance associated with COVID-19, willful defaulters may choose to take advantage of this opportunity to default once again. Commercial banks are required to use their own discretion in order to determine whether or not potential loan applicants have been "affected" by COVID-19. This is due to the fact that the central bank has not established any transparent, quantitative, or objective criteria for defining the term "affected." The commercial banks have been permitted by the central bank to offer loans for the import of life-saving medications, medical kits, equipment, and other critical medical supplies related to the coronavirus. These loans do not require a guarantee of repayment, and in some instances, the tariffs will be waived entirely. It is unknown how much illegal financial outflows may be inadvertently boosted as a result of the lack of a repayment guarantee and an import tax, both of which can be used to facilitate import over-invoicing and trade-based financial fraud.

Senior bankers, on the other hand, claim that a large number of borrowers took advantage of the BB's loan repayment relaxation policy during the period. For loans or investments issued in the CMSME sector in accordance with BRPD Circular Letter No. 51, the relevant loan or investment may be represented as unclassified if at least 15% of the due amounts from January 21 to December 21 of all other categories of loans or investments are realized by the last working day of December 2021. According to authorities, the remaining 85% of outstanding credits from January to December 31 of previous calendar year will be paid within one year of loan term expiring. With effect from April 1, 2020, all unclassified loans and investments, except credit cards, will have a maximum lending rate of 9%, according to BRPD circular no-03/2020 (Bangladesh Bank. 2021).

Listed bank of Bangladesh has to prepare quarterly financial statement and an audited financial statement based on the year closing date. Loan or Investment is the major parts of financial statement based on which company keeps provision according to BRPD circular of Bangladesh Bank which impact on profit or loss of the company. During covid-19 Bangladesh government provide incentive facilities and repayment facilities regarding loan or investments and had the option to extend the payment period which actually makes the tendency to nonpayment of the loan and makes the loan into non-performing loan. Due to covid-19 company could not keep the actual provision against loan according to Bangladesh bank circular. After the classified facility banks have the possibility of a major increase in provision amount which drastically impact the comprehensive income statement of the company.

Bank Name	**Loan/Investment Amount As on 31 December, 2021**
AB Bank Limited	289,832,803,054
Bank Asia Limited	234,243,717,970
Brac Bank Limited	318,954,425,006
The City Bank Limited	282,994,757,476
Dhaka Bank Limited	212,291,159,510
Dutch Bangla Bank Limited	299,139,586,778
Eastern Bank Limited	234,038,851,242
Exim Bank Limited	412,855,417,129
First Security Islami Bank Limited	453,021,615,078
Global Islami Bank Limited	105,782,681,421
IFIC Bank Limited	286,490,180,371
Islami Bank Bangladesh Limited	1,137,670,855,057
Jamuna Bank Limited	161,248,555,524
Mercantile Bank Limited	250,571,388,181
Mutual Trust Bank Limited	219,396,487,169
National Bank Limited	440,584,412,775
NRB Commercial Bank Limited	103,313,244,407
ONE Bank Limited	220,873,878,073
Premier Bank Limited	227,012,420,281
Prime Bank Limited	221,701,136,687
Pubali Bank Limited	349,626,391,590
South Bangla Agriculture and Commerce Bank Limited	63,711,064,030
Shahjalal Islami Bank Limited	198,607,299,997
Social Islami Bank Limited	297,611,586,727
Standard Bank Limited	157,499,496,248

Trust Bank Limited	235,811,252,517
United Commercial Bank Limited	375.926,324,265
Union Bank Limited	188,105,717,264
Uttara Bank Limited	145,619,159,365

Table: Loan an Investment position of listed bank as on 31 December 2021

The researcher comes to the conclusion that the COVID-19 epidemic considerably impedes Bangladesh's economic advancement based on the conversations that took place in focus groups, the observations that were made, and the assessment of specific financial data from banks. The central bank of Bangladesh is the most crucial driving force behind the country's economic activities. It is very important to make payments on time for any loan payments or installments completed during this downtime period. As a direct consequence of this, financial institutions such as banks are in a dangerous situation, and the number of NPLs continues to rise. As a result of the annual growth in NPLs, banks face a greater risk of defaulting on their loan obligations. Every bank in Bangladesh has already put this decision into effect after it was recently decided by the government of Bangladesh to reduce the interest rate on loans to a single digit. Borrowers will gain from this measure, but banks will see a significant decrease in their revenues. The COVID-19 outbreak is now wreaking havoc on the population of Bangladesh. During this period, their primary objectives are to keep themselves safe and to resume living their lives as fast as they can. If people want to keep themselves safe, they cannot pursue their business endeavors with the intention of generating a substantial profit from such endeavors. Saving allows for investment, which income is a necessary prerequisite for saving. Individuals' savings are dwindling as a result ofthe last word.

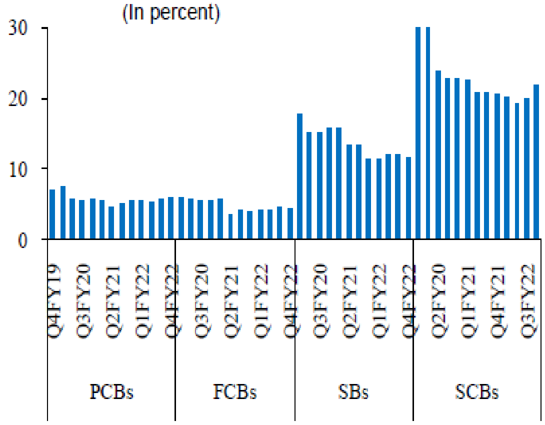
Quarters	Items	SCBs	SBs	PCBs	FCBs	All Banks
Q4FY21	Total classified loan	438.4	36.9	491.9	24.9	992.1
	Required provision	302.9	23.3	364.7	18.6	709.5
	Provision maintained	195.6	23.1	411.1	23.9	653.7
	Excess(+)/ shortfall(-)	-107.3	-0.2	46.4	5.3	-55.8
Q1FY22	Total classified loan	440.2	37.0	507.4	26.9	1011.5
	Required provision	303.1	23.3	377.3	19.7	723.5
	Provision maintained	199.4	23.1	413.2	25.8	661.4
	Excess(+)/ shortfall(-)	-103.8	-0.2	35.9	6.1	-62.0
Q2FY22	Total classified loan	449.8	39.9	515.2	27.9	1032.74
	Required provision	370.3	23.3	390.8	22.2	806.54
	Provision maintained	199.7	23.6	414.4	28.8	666.47
	Excess(+)/ shortfall(-)	-170.6	0.3	23.5	6.6	-140.07
Q3FY22	Total classified loan	487.4	40.2	578.0	28.8	1134.41
	Required provision	365.0	23.3	439.8	22.5	850.68
	Provision maintained	204.0	23.7	447.8	27.8	703.22
	Excess(+)/ shortfall(-)	-161.0	0.3	8.0	5.2	-147.46
Q4FY22	Total classified loan	554.3	41.9	626.8	29.6	1252.58
	Required provision	315.3	23.9	499.4	24.1	862.68
	Provision maintained	209.1	24.5	468.3	28.7	730.48
	Excess(+)/ shortfall(-)	-106.2	0.6	-31.1	4.5	-132.20

Table: Comparison of Classified Loans and Maintained Provisions (In Billion BDT)

The overall banking sector had a mixed performance in Q4FY22, as evidenced by an increase in ratio of non-performing loans (NPLs) to total loans. The percentage of gross nonperforming loans to total loans reduced in Q2FY22 from Q1FY22, with Private Commercial Banks (PCBs) and State-owned Commercial Banks (SCBs) playing a major role. However, as compared to 2020, the ratio of gross nonperforming loans to total loans increased in 2021. In Q4FY22 compared to Q3FY22, the proportion of gross nonperforming loans to total loans increased, with state-owned commercial banks (SCBs) and private commercial banks(PCBs) being the main drivers.

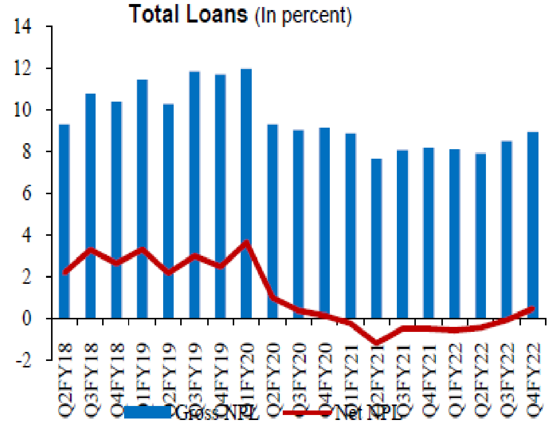
At the end of Q4FY22, ratio of gross non-performing loans to total loans increased slightly from 8.53% at the end of Q3FY22 and 8.18% at the end of Q4FY21, mostly due to withdrawal of a lenient loan categorization policy and weaker loan repayment. At the end of Q4FY22, gross NPLs ratio in SCBs and PCBs increased to 21.93 and 6.01%, respectively, from 20.01 and 5.84%, at the end of Q3FY22. However, the FCB NPLs ratio only slightly improved from the previous quarter's 4.53% to 4.40% at the end of Q4FY22. The weaker provision maintained against classified loans caused the ratio of net NPLs to total loans to rise from -0.07% at the end of Q3FY22 to 0.49% at the end of Q4FY22. In Q4FY22 compared to Q3FY22, the ratio of gross nonperforming loans to total loans increased, with state-owned commercial banks (SCBs) and private commercial banks(PCBs) being the main drivers (Bangladesh Bank. 2022).

Chart VI.1: Ratio of Gross NPLs to Total Loans
(In percent)



Source: Bangladesh Bank

Chart VI.2: Ratio of Gross NPLs and Net NPL to Total Loans (In percent)



Source: Bangladesh Bank

In the shadow of recent financial troubles, Bangladesh's banking system's classified-loan buildups increased by over 16 percent, or Tk 145.40 billion, in previous calendar year. Despite the central bank's policy support of rescheduling non-performing loan repayments, write-offs, and other measures, the economy continues to deteriorate.

As of the 30th of June, the amount of non-performing loans (NPLs) had climbed to Tk 1252.58 billion, up from Tk 992.1 billion a year earlier, as shown by the most recent figures that were provided by the central bank. If the amount of write-offs is factored in, the total amount of classified loans will increase even more.

In 2003, Bangladesh Bank (BB) issued guidelines for writing off categorized loans, with the goal of improving loan recovery and making bank financial statements more transparent and accountable. It is common practice to write off loans all around the world. However, the ability of a bank to write off its bad loans will be a factor. Before making any final decisions, bank management must confirm that the amount to be written off is provisioned100 percent.

According to a BB report, the quantity of categorized loans increased marginally in fourth quarter (Q4) of 2021 over previous quarter due to a greater volume of total outstanding loans in banking sector. However, in explaining recent trend of classified loans, NPLs have fallen in percentage terms throughout the time under consideration. According to statistics provided by BB, the amount of categorized loans increased by 2.0 percent, or Tk 21.23 billion, from Tk 1011.50 billion on September 30 to Tk 1032.74 billion on December 31. This represents an increase from the previous three-month low of Tk 1011.50 billion.

Officials from the BB assert that debt recovery and rescheduling have helped to maintain an "acceptable level" of non-performing loans in the fourth quarter of 2021. However, because the BB's policy of loan repayment relaxation has already been phased out, analysts and bankers believe that the number of NPLs would climb even higher in the current calendar year's first quarter (Q1). This is due to the fact that the BB's policy relaxation on loan repayments was implemented in the past.

Meanwhile, total default loans with six state-owned commercial banks (SoCBs) increased to Tk 554.3 billion in Q4FY22, up from Tk 487.4 billion the previous quarter. In the third quarter of 2021, the sum was Tk 440.16 billion. On the other hand, as of June 30, total amount of NPLs with the 42 private commercial banks had increased to Tk 626.8 billion, up from Tk 491.9 billion on the same day in 2021. In the third quarter of 2021, it was Tk 507.43 billion. Total amount of categorized loans held by nine foreign commercial banks (FCBs) increased to Tk 29.6 billion in Q4FY22, up from Tk 20.38 billion the previous quarter. On September 30 of previous year, it was Tk 26.92 billion.

7. Conclusion and Recommendations

Loan default is a common occurrence in every financial system, since some borrowers will intentionally or unintentionally fail to return their loans on time. However, the issue arises when numerous large borrowers become regular defaulters and attempt to escape payments to banks by using their ties with influential quarters. Many large borrowers were defaulting on their debts, and banks' lending capacity were reducing, denying credit to those who truly deserved it. Those who sanctioned the faulty loans should be held to the same level of accountability. Any inquiry into financial crime that is stored in a drawer opens the door to fresh crimes. Autonomy develops through time and must be earned. It would be impossible to completely remove political influence from the central bank since it must interact with lawmakers. Although some folks in positions of power may deny it, the country's banking sector is in serious difficulties as a result of the massive NPLs that have been reducing the banks' profitability. Several recommendations have been made based on current trends and associated concerns in order to enable the financial sector must contribute more favorably to the nation's recovery from the pandemic (The Financial Express. 2022). These are discussed below.

i. To deal with any potential asset quality declines, banks will need to strengthen their capital bases.

ii. The government should work to reduce economic uncertainty and financial stress.

iii. To sustain liquidity in the case of Covid-19, the BB should immediately focus on thefinancial system and its environment.
iv. Both the money and capital markets must be properly operated.
v. After the lockdown is lifted, a facility to grant loans should be established to keep all small and medium-sized businesses on track.
vi. The government should strengthen the economy in order to avert future crises.
vii. To ease the strain on the country's banking industry, the central bank's capabilities should be strengthened, and the bankruptcy legislation should be reviewed.
viii. According to the proposal, all state-owned banks should be merged into one organization and administered by the central bank, which could drastically reduce current default loans.

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