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Asset Management Company (AMC): A Way-Out to Solve NPL Problem in Bangladesh

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Foreword

As part of the ongoing dissemination of BIBM research outputs, this document contains the results and findings of the roundtable discussion titled "Asset Management Company (AMC): A Way-Out to Solve NPL Problem in Bangladesh". The study was conducted in 2022 and the paper was presented in a Roundtable Discussion held on 21 June 2022. Bangladesh's financial sector for a long time has been heavily burdened with a high and persistent level of Non-Performing Loans (NPLs). To reduce the level and magnitude of NPL, the Government and Bangladesh Bank have taken various preventive and corrective measures including regulatory, legal and non-judicial measures. As part of the extended effort for enhancing bad loan recovery, the Government has recently planned to form a Public Asset Management Company (PAMC). The paper has examined the probable operational mechanisms and resolution strategies of AMC focusing on PAMC in the perspective of Bangladesh.

This paper has been finalized after incorporating the valuable comments and suggestions of the distinguished panelists, participants of different banks and the academicians joined in this Roundtable Discussion.

It gives me immense pleasure to publish and distribute this roundtable discussion paper to the policymakers, practitioners, academics and common readers. I hope this will be a useful treasure to understand the AMC as a way out to solve the longstanding pervasive problem of NPLs in Bangladesh.

Md. Akhtaruzzaman, Ph.D.
Director General, BIBM

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This study titled "Asset Management Company (AMC): A Way-Out to Solve NPL Problem in Bangladesh" has been completed with immense support from a number of individuals and organizations.

We would like to express our gratitude to the honorable Director General, BIBM, Dr. Md. Akhtaruzzaman for his guidance and solid support in completing this research.

The research team is indebted to the respondents from the recovery division, special asset management department, legal affairs department, and write-off loan division of different banks for providing valuable inputs through online FGD and filling out questionnaires

We are also thankful to Dr. Ashraf Al Mamun, Associate Professor and Director (Research, Development and Consultancy) and all of our faculty colleagues for their opinions and positive suggestions to carry out the research.

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Finally, we would like to extend our appreciation to those who, openly and sincerely provided their support in our research effort.

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Executive Summary

The financial sector of Bangladesh has been heavily burdened with a high and persistent level of Non-Performing Loans (NPLs) for a long period of time. Although the economy experienced a steady long-time decline of NPL from its ever-highest level of 41.1% in 1999 to its current level of 8.53% as of March 2022 (Bangladesh Bank), still it is high against the global standard of tolerance level of 2%-3%. The high percentage of bad loans is causing serious concern for the policymakers because it hampers the ability of banks and FIs to serve the prudent intermediation needs of the communities of a country like Bangladesh. NPL erodes credit supply, creates misallocation of credit, affects the credit cycle, de-motives bankers for lending further and drops market confidence. The increase of NPL in Bangladesh has reached such a degree that it demands a strong breakthrough intervention by the Government, regulator, and banks. Despite the several policy initiatives of Bangladesh Bank to reduce NPLs through restructuring, rescheduling, recovery, one-time exit and write-offs and the banks' efforts in reducing NPL like strengthening recovery units, arranging special recovery programs, and doing negotiation with borrowers, NPL problems are still pervasive in the banking sector of Bangladesh.

As part of the extended effort for enhancing bad loan recovery, the Government has recently planned to establish a Public Asset Management Company (PAMC) to buy distressed loans from banks. AMC is working in various countries with different degree of success. The main objective of this paper is to study the probable operational mechanisms and resolution strategies of AMC by focusing on PAMC[1] characterized by Government involvement at varying degrees.

The paper examines a number of pertinent issues relating to instituting AMC and its effective operation in different countries. The paper utilizes the opinions of the experts through an on-line based Focus Group Discussion (FGD) with 45 participants. Further, the information is collected through a questionnaire sent to the recovery division, special asset management department and write-off loan division of different banks. Opinions and information were also gathered from professional experts and available published sources. The secondary data have

[1] PAMC and AMC have been used interchangeably in many places in the paper.

been collected from different departments of BB like BRPD and DOS as well as from publications namely BB Quarterly, Annual reports of BB. A common accounting and statistical techniques have been applied for analysis.

The suggestions that came out from the analysis of cross-country evidence, responses got from the FGDs, questionnaires and the round table discussion are as follows:

(1) The choice of ownership and number of AMCs depend on factors like the magnitude of the problem, depth of markets, and characteristics of debtors. In Bangladesh, a substantial amount of bad loans has to be transferred to an AMC which entails the requirements of substantial amount of funds along with capability of AMC to penalize powerful and willful defaulters. In this consideration, a government-owned AMC will be a better option for Bangladesh to start with.

(2) Since the AMC is formed for specific, time-bound objectives to address a well-known problem, attempts might be made to commence the operations with regulations, and rules as detailed as possible to minimize the necessity of adding/modifying rules during its tenure. The regulatory responsibility may lie with the MOF and Bangladesh Bank may act as the supervisory authority.

(3) The board and management might be strong and independent enough to keep politics out of AMC's activities, resist pressure from borrowers and prospective purchasers of assets seeking preferential treatment, and run the organization as per written policies for the acquisition, pricing, and disposal of assets acquired. The directors and key management should be appointed from diverse fields such as financial sector regulators, bankers, lawyers, retired defense personnel, real estate specialists, liquidation experts, and people with insights into various industrial sectors.

(4) In the achievement of the goals of AMC, there should have independent internal control and compliance system including an internal audit that will give reasonable assurance relating to compliance of functions according to the approved policies and procedures.

(5) Government, central bank and public banks are usually the main financiers in PAMC. However, this may create an additional burden on the resource-constrained Government and its associated financial organizations. Government-guaranteed

bonds can be issued for collecting funds. Further, the involvement of private banks and financial institutions, and the involvement of the share market in funding PAMC may reduce the pressure on the Government exchequer.

(6) In Bangladesh, a number of private commercial banks are also apprehended in loan default traps apart from SOCBs. The proposed PAMC may keep the options open to buy stressed assets from both SOCBs and PCBs. However, PAMC should fix the criteria for buying toxic assets regarding the sector, amount, quality, and organization so that banks will not suffer from moral hazard problems knowing that they have PAMC options if their loan becomes bad.

(7) Strategies of asset management and disposition might be guided by the goal of maximizing the value of assets considering market conditions as well as the funding cost of the AMC. An online market might be created to dispose of the assets acquired so that anyone from home and abroad desiring to participate can join in the bidding process. Further, state-of-the-art mechanisms used by AMC globally like equity SWAPs, securitization, and tying up with overseas investors to bid for assets are required to be made available in Bangladesh too.

(8) Realistic pricing of assets based on market value, sound accounting norms, loan classification and provisioning standards, and/or discounted present values, is sine-qua-non for the success of AMCs. If the loan is transferred at a higher price, the profitability of AMC will be hampered. In contrast, transferring NPL at a lower price will deprive banks of getting the financial gains that they usually expect.

(9) PAMC should be given special power to acquire, purchase, hold, manage, restructure, rehabilitate, sell, and dispose of NPAs. AMC should have the magisterial power to supersede the Money Loan Court Act, impose restrictions on the mobility of the borrower, and even arrest the borrower. Before issuing a stay order, the court may be required to hear the views of the AMC. Access to information from Bangladesh Bank, NBR, Land Office, DSE, and CSE is also necessary.

List of Abbreviations

ADB	Asian Development Bank
ADR	Alternative Dispute Resolution
AMC	Asset Management Company
APSs	Asset Protection Schemes
ARA	Artha Rin Adalat Ain
BB	Bangladesh Bank
BIAC	Bangladesh International Arbitration Center
BRC	Banking Reform Committee
CAMC	Centralised Asset Management Company
CBRC	China Bank Regulatory Commission
CIRC	The Corporate Industrial Restructuring Corp
CRGS	Credit Risk Grading Scoresheet
DRT	Debts Recovery Tribunals
FGD	Focus Group Discussion
FIs	Financial Institutions
FSC	Financial Supervisory Commission
FSRP	Financial Sector Reform Project
IBRA	Indonesian Bank Restructuring Agency
IRRBB	Interest Rate Risk in the Banking Book
KAMCO	Korean Asset Management Company
MLC	Money Loan Court
MOF	Ministry of Finance
MOFE	Ministry of Finance and Economy
MoU	Memorandum of Understanding
NAMA	National Asset Management Company
NARCL	National Asset Reconstruction Company Ltd
NPAs	Non-performing Assets
NPLs	Non-Performing Loans
PAMC	Public Asset Management Company

PBoC	People’s Bank of China
PSBs	Public Sector Banks
RCC	Resolution and Collection Corporation
RTC	Resolution Trust Corporation
RTI	Right to Information
SCBs	State-Owned Commercial Banks
SRs	Security Receipts
TAMC	Thai Asset Management Company
UKAR	UK Asset Resolution Limited

Asset Management Company: A Way-out to Solve NPL Problems in Bangladesh

1.1 Introduction

The financial sector of Bangladesh has been heavily burdened with a large volume of Non-Performing Loans (NPLs). The Covid pandemic and the current war in Ukraine have added additional agony to the extant situation of NPLs. The spiraled growth of toxic assets has caused serious concern for economists and financial leaders because it impedes the ability of banks and FIs to serve the prudent intermediation needs of the communities of a country like Bangladesh. NPL erodes credit supply, creates misallocation of credit, affects the credit cycle, de-motives bankers for lending further and drops market confidence. As a result, NPLs have emerged as one of the most serious concerns in the path of the economic development of Bangladesh. Alamgir (2015) opines that Bangladesh is caught in a loan default trap which the country must escape in order to realize the political vision of a developed country by 2041. Banerjee et.al (2021) state that the increase in NPL[2] in Bangladesh has reached such a degree that it demands a strong breakthrough intervention by the Government, regulator and banks.

Bangladesh Bank (BB) has taken several policy initiatives to reduce NPLs through restructuring, rescheduling, recovery, one-time exit and write-offs. Banks are also highly watchful about NPLs and persistently undertaking various measures like strengthening recovery units, arranging special recovery programs, and doing negotiation with borrowers. The Government

[2] Non-Performing Loan (NPL) consists of three categories of loan viz. substandard, doubtful, and bad. A definitional difference is observed between NPL and Default loans. A loan turns out to be default if the length of overdue of a loan is 6 month or more. As per the criteria given by Bangladesh Bank all doubtful and bad loan belong to the default category. But, the case of Substandard (SS) is little bit complicated. Any loan having a length of overdue between 3 to 9 months is treated as substandard. So, not all SS loan will be considered as default loan. For example, a loan having 4-month overdue period will be NPL but not default. On the other, a loan having 7 month overdue period will be NPL as well as default.

has enacted different laws like Money Loan Court, Public Demands Recovery Act, etc. to get rid of this burning problem. However, NPLs problems are still pervasive and all measures fail to stop its upward growth.

To resolve NPLs problems and help restore the health and confidence of the financial sector, the Banking Reform Committee (BRC) established in 1996 suggested examining the viability of forming an Asset Management Company (AMC)[3]. A six-member committee formed in early 2019 comprising of the Ministry of Finance and Bangladesh Bank also prescribed forming of an AMC and other measures like the creation of a secondary market for NPL, setting up a separate data warehouse for NPLs under the existing facilities of the Credit Information Bureau of the Bangladesh Bank, and a tax rebate facility for traders of the default loans for lessening NPLs

Recently, the Government has intended to form a Public Asset Management Company (PAMC) to buy distressed loans from banks. A special law is reportedly being prepared to empower the PAMC to purchase NPLs from banks and afterwards to restructure and sell them to individuals or corporate entities.

The main objective of this paper is to see the operation mechanisms and resolution strategies of AMC by focusing on PAMC[4] characterized by Government involvement at varying degrees.

[3] The term AMC is used here to refer any organizational unit created to manage and recover financial assets from troubled or failed financial institutions. Such entities include asset workout departments or units of banks, bank-owned subsidiaries or affiliated companies, private companies, and Government owned asset management companies. AMC is also called bad bank in many countries.
[4] PAMC and AMC have been used interchangeably in many places in the paper.

1.2. Methodology

A conflicting view about the effectiveness of PAMC has already been noticed in the financial sector of Bangladesh. While a segment of financial experts welcomes PAMC as a panacea for solving all NPL problems, others are skeptical in equal measure. This contradiction indicates that a trade-off is necessary to establish PAMC. This situation motivates researchers to analyze cross-country practices to know the characteristics which have contributed PAMC to be succeeded. To substantiate the cross-country experiences, opinions of the local experts have also been collected by arranging an on-line based Focus Group Discussion (FGD) with 45 participants and sending a questionnaire to the recovery division, special asset management department and write-off loan division of different banks. In addition, opinions and information were gathered from professional experts and available published sources. The secondary data have been collected from different departments of BB like BRPD and DOS as well as from publications like BB Quarterly, Annual Report of BB and Financial Stability Report of BB. Publications of the Asian Development Bank were also considered in this respect. A number of accounting and financial techniques have been applied in analyzing data. A keynote paper was presented in a roundtable. Finally, the study paper has been prepared by incorporating the comments and opinions from the participants of the roundtable discussion.

1.3. Literature Review

The performance of various recovery channels of NPAs including AMC has been studied by a number of researchers. Mesnard *et al.* (2016) examined various kinds of measures to address the issue of non-performing loans which are- transferring NPL to dedicated bad banks, developing a secondary market for NPL, strengthening insolvency frameworks, as well as enhancing supervisory work on loss recognition and troubled assets management and amending tax rules. Under transferring NPL to dedicated bad banks measure[5] there are three other sub-measures of the recovery system namely, system-wide bad banks, state guarantees on asset portfolios ("asset protection schemes") and system-wide state aid-free mechanisms.

As opined by Dey (2018), the performance of various recovery channels of NPAs in the Indian banking system is not satisfactory where improper due diligence, insufficient law to combat defaulters, and externalities of macro-economic variables may be the main cause of weak recovery mechanism process. He analyzed this recovery mechanism of NPAs with its three important wings which are- recovery through Lok Adalat, Debts Recovery Tribunals (DRT) and The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFASEI) and its impact on NPA covering the years from 2003-04 to 2016-17. The Act provides three alternative methods for recovery of non-performing assets, viz; securitization, asset reconstruction and enforcement of security without the intervention of the court.

Considering the time factor, Luvsannyam *et al.* (2021) found that the time required to recover a Non-Performing Loan (NPL) in Mongolia varies, depending on the solving methods. For example, it takes an average of 6.2 years to resolve a court case, while a non-judicial process takes twice as short, 3.4 years. They also considered banking registration software as one of the key factors in differentiating recovery periods of NPL. As there is a deadly mix between market failures and banks' resolutions and recoveries, State-supported schemes are necessary to favour a rapid and smooth recovery of the banking sector. In the case of involving an Asset Management Company (AMC) in recovering process, it should have a clear primary mandate to maximize the recovery values of NPLs on a commercial basis. Moreover, it should be permitted to use any relevant legal tool or

[5] Bad Banks (BBs) were first used in the late 1980s and early 1990s in the United States (Resolution Trust Corporation) and in Sweden (Securum) to resolve problems at banks with persistently high stocks of impaired assets. BBs were also used during the Asian crisis in the late 1990s (Korea, Malaysia, Indonesia), and more recently in Turkey and Nigeria.

devise a strategy to achieve its goals, irrespective of political or vested interests (Navaretti et al. 2017). To strengthen the loan portfolio and initiate more dynamic lending activity in the banking sector, a project called Podgorica Approach[6] aimed at strengthening the financial stability of the system, supporting debtors' recovery, and improving economic growth (Stijepović, 2014). Khan (2000) pointed out that banks and financial institutions could convert part of the NPA debt into equity of the defaulting company as a recovery strategy. Prakash (2011) stated two loan recovery techniques applied in India. For instance, the Bank of India has sought the services of retired staffers to bolster its recovery efforts and the commission payable to outside recovery agents is paid to these ex-staffers.

In Bangladesh, several studies have been conducted to look into the problems of NPL, recovery measures adopted by banks, costs associated with the measures taken, successes thereof, etc. Dey (2018) found that NPL recoveries witnessed significant improvements after 1999, as the NPL ratio steadily decreased to 6.1% in 2011 due to written-off loans and a sharp decline in new bad debt. Aside from stronger regulation, greater legal powers of the banks to recover problem loans through the money loan courts and better screening of new loans by the Credit Information Bureau also contributed. Ahmed (2020) found that the rapid transformation of the banking sector from public-dominated banking to private-led banking has reduced the overall risk of the banking sector by sharply lowering the share of the loan portfolio of public banks. Though this is a positive development that has helped lower the overall NPL ratio for the banking sector as a whole, the total value of NPLs is a considerable source of concern in absolute taka terms.

[6] Podgorica Approach contributed, in particular, to quantitative assessment of the recovery of non-performing loans which could return to the performing status through the restructuring process. A better qualitative understanding of these loans is necessary to act preventively and thus largely reduce migration from performing to non-performing loans.

In an attempt to identify the appropriate approach to using different measures taken by banks for managing NPL, Islam *et al.* (2014) argued that the strategy of addressing the NPL problem must be concerned with how to arrest fresh NPLs as well as recover existing NPLs. Siddique *et al.* (2015) found that it is very vital to apply non-legal measures before disbursing the loan e.g., informing the family members about the issue of availing credit facility from banks, which may ensure a smooth recovery from the very beginning of the loan. They have mentioned some of the out-of-the court-based measures e.g., constant persuasion, Alternative Dispute Resolution (ADR) under Money Loan Court (MLC), yearly action plan for recovery, involving external recovery agents, incentives for recovery, creating social pressure, etc. as effective measures to recover problem loans.

1.4. Organization of the Paper

After introducing the research topic in Section-1 covering methodology, organization of the paper and literature review, Section-2 states the NPL situation and its recovery mechanism in Bangladesh. Section-3 presents major measures undertaken to reduce nonperforming loans in Bangladesh (1986-2022). The concept, evolution, advantage, and challenges of centralized AMC are placed in Section-4. Section-5 describes cross-country experiences. Section-6 reports and analyses the opinion of the respondents. Section-7 puts forward a number of possible policy suggestions, which have been finalized by accommodating the issues raised in the round table discussion.

2. NPL Situation and Its Recovery Mechanism in Bangladesh

2.1 NPL in Bangladesh: Dimension and Trend

High and persistent level of NPL is a perennial problem in the banking sector of Bangladesh. Although the economy experienced a steady long-time decline of NPL from its ever-highest level of 41.1% in 1999 to its current level of 8.53% as of March, 2022 (Bangladesh Bank), still it is high against the global standard of tolerance level of 2%-3%. Table 2.1 presents the bank category-wise NPL movement from 2010 to March 2022. One striking feature is that per cent of NPL is hovering around 9%-10% since 2012 despite various measures adopted by the regulatory body along with the enhanced risk management capacity of the banks. Regulation allowing the banks to keep their NPL at the end of 2019 level for most of the pandemic period might not show the real level of NPL published in recent years. In general, the NPL of state-owned banks (SCBs and SBs) remains at a noticeably higher level than the other group of private owned banks which, however, part of it can be attributed to the higher level of involvement of the SCBs than the PCBs in the priority sector lending such as rural and agricultural financing. The movement in NPL should be interpreted carefully as the amount of NPL is sensitive to the definition of NPL, the volume of rescheduling, writing off, and some other cosmetic arrangement applied for the reduction of NPL. For example, loan rescheduling in our banking industry, unlike the global standard, brings a non-performing loan to the regular category which contributes to lowering the number of bad assets.

Table 2.1: Dimension and Trend of Bank Group-wise NPL (2010-2022)

Bank Group	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022 (March)**
SCBs	15.7	11.3	23.9	19.8	22.23	21.46	25.1	26.5	30.0	23.9	22.7	19.28	20.01
SBs	24.2	24.6	26.8	26.8	32.81	23.24	26	23.4	19.5	15.1	15.9	12.02	12.01
PCBS	3.2	2.9	4.6	4.5	4.98	4.85	4.58	4.87	5.5	5.8	5.9	5.31	5.84
FCBs	3	3	3.5	5.5	7.3	7.77	9.56	7.04	6.5	5.7	5.5	4.29	4.53
Total	7.3	6.1	10.0	8.9	9.69	8.79	9.23	9.31	10.3	9.3	9.2	7.93	8.53

Sources: Bangladesh Bank. 1. Annual Reports 2. Bangladesh Bank Quarterly

2.2 NPL in Bangladesh: Number of Banks by Percent of NPL and Share of NPL in Top 3, 5, and 10 Banks

The distribution of NPL among the banks is widely varied as shown in Table 2.2. About 65% banks lies below less than 5% NPL category while 15% banks go into more than 20% NPL category. Four banks are in dire situation with having more than 50% of loan in NPL category. The concentration of NPL among few banks is still significant as top 3, 5, and 10 banks' NPL constitute 35.89%, 44.3%, and 63.1% respectively (Table-2.3) even after concentration is being reduced gradually. So, a high standard deviation in the percentage of NPL both among and within the same category of banks suggests that the problem is not predominantly a systemic one.

Table 2.2: Number of Banks by Percentage of NPL (31 December 2020)

Percentage of NPL	Number of Banks
Less than 2%	11
2% to <3%	11
3% to <5%	16
5% to <10%	6
10% to <15%	5
15% to <20%	1
20% to <25%	2
25% to <50%	3
50% & Above	4
Total	59

Source: Researchers Compilation from data of BRPD, BB

Table 2.3: Share of NPL in Top 3, 5, and 10 Banks (% of Total NPL)

Year	Top 3 Banks	Top 5 banks	Top 10 banks
2010	52.33	63.10	76.39
2011	50.66	60.95	72.8
2012	50.51	62.72	73.21
2013	44.28	54.50	67.4

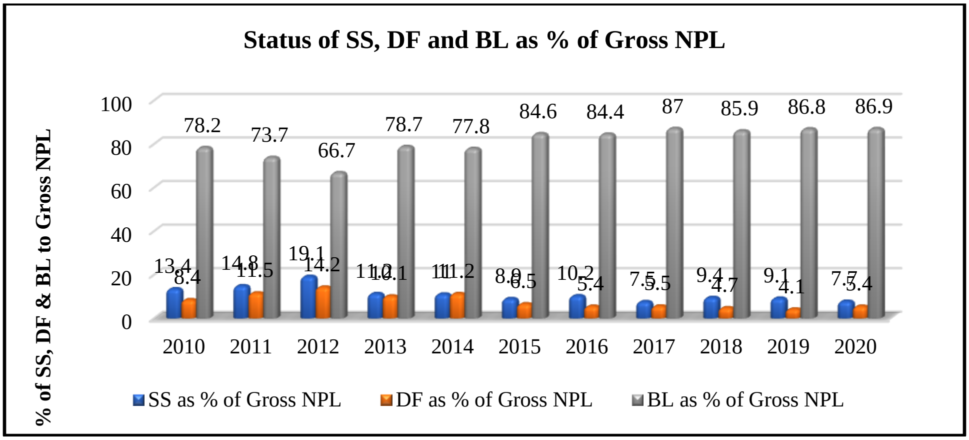
Year	Top 3 Banks	Top 5 banks	Top 10 banks
2014	39.69	53.60	67.4
2015	36.43	49.90	63.5
2016	37.53	51.80	65.9
2017	36.59	49.20	65.5
2018	40.38	50.90	66
2019	34.81	45.80	63.3
2020	35.89	44.30	63.1

Source: Financial Stability Reports and BRPD, BB

2.3 NPL in Bangladesh: Status of SS, DF, and Bad Loan

One more alarming aspect in the banking industry is the high concentration of NPL in the 'bad 'category as shown in Figure-2.1. As a bad loan is not likely to be paid back from the business, having 85% in that category for a long period of time poses a great threat to the bank management for recovery of such a high amount of bad loan, especially in an environment with weak enforcement status of legal recovery.

Figure 2.1: Dimension and Trend of NPL: Status of SS, DF and BL as % of NPL



Source: Bangladesh Bank. Financial Stability Reports.

2.4 NPL Recovery: Regulatory Measures

Prevention of NPL and its recovery measures have been dealt with by the Bangladesh Bank with a number of regulatory guidelines, policies and enhanced supervisory functions since the beginning of the problem in the 90's with active engagement on the part of the commercial banks through using better NPL resolving tools and ensuring compliance with the laid down rules and procedures. NPL recovery measures at the operational level/functional level mainly are of two types- regulatory/non-legal and legal measures through filing suits in the debt recovery-related courts.[7] Regulatory measures mainly include loan rescheduling; persuasion and/or creating pressure through relatives, guarantors, business associates; negotiation with the borrower either by the bank or third party like BIAC; ADR under Artha Rin Adalat Ain,2003; interest waiver; external recovery agents; debt-equity swap; motivating recovery staffs through objective key performance indicators; corporate restructuring; selling a bad asset to an asset management company, and write off. In the context of the banking sector of Bangladesh, other than negotiation with the borrower, the most widely used regulatory measures are loan rescheduling and write-offs. Legal measures for loan recovery or debt recovery-related Acts mainly include Artha Rin Adalat Ain 2003, Public Demands Recovery Act, 1913, and The Bankruptcy Act,1997 of which the ARA Act is the most suitable and relevant one for the banks to fall upon as legal measures for recovery.

2.4.1 Rescheduling of Loans

Rescheduling of loans, ideally, should be used in a conservative way to ensure the recovery of NPL in a situation where there arises an unavoidable estimation gap between the predicted business outcome and the actual business performance of the borrower. But, Banerjee et al. (2021) in a study on the banking sector of Bangladesh found that about 99% of total requested

[7] All the attempts or measures taken by bank to recover non-performing loan other than settlement through the verdict of the court may be termed as regulatory/outside the court settlement process/ non-legal measures for loan recovery.

cases have been accepted for loan rescheduling during 2016-2020. The percentage of more than first-time rescheduling in total rescheduled cases was in between 30% and 40% during 2016-2020, which gives the evidence of liberal use of rescheduling in our banking sector. Chowdhury et al. (2017) found evidence of allowing rescheduling facility to one every out of five loans in a year during their study period. As a defaulted loan becomes regular after it is rescheduled, unlike the international best practice, it is probable that some incentives on the part of the bank management will be created in favour of rescheduling in order to reduce the NPL amount. These distortions in incentives of the bank coupled with the natural preference of the borrower to get a rescheduling facility result in too many cases of rescheduling. The trend of loan rescheduling in the banking industry is seen in the following table. The trend is upward except for the year 2020 due to permission given to the banks to keep maintaining their loan classification status at the pre-Covid period.

Table 2.4: Trend of Loan Rescheduling

Year	Rescheduled Amount (in Billion Tk.)	Rescheduled Loan to Outstanding Loan
2016	154.2	8.0
2017	191.2	7.1
2018	232.1	7.5
2019	527.7	11.2
2020	134.7	11.8

Source: Bangladesh bank. Financial Stability Report.

2.4.2 Write-off of Loan

The write-off is another NPL recovery tool that was introduced in 2003 by the regulatory authority.[8] The amount of written-off loans stood at Tk.568.45 billion till December 2020 which equals 3.1 per cent of the banking sector's on-balance sheet assets at the end-December 2020. However, write off has not yet appeared as an effective recovery measure

[8] Giving the responsibility of recovery a long-lasting bad loan to a dedicated unit after it is removed from the bank's book backed by 100% provision and a legal suit is known as write off that ideally improves the recovery prospect of a distressed loan.

in our banking system, as only 22% (Tk. 126.9 billion) of total written-offs have been recovered by the banks till December 2020 (Financial Stability Report, BB).

Banerjee et al. (2021) studied the effectiveness of NPL recovery measures by taking a sample of 30 commercial banks, which found 70% share of large loans in total written-off loans during 2015-2020. Written off by the PCBs was the highest (51%), followed by SCBs (46%). The percentage of the number of written-off loans remaining unsettled for 5 years or more was as high as 73 per cent, giving evidence of the time-consuming nature of recovery after the loan is written off. Also, the ratio of the recovered amount to write-off decreases with the increase in the size of the loan, which points to the difficulty in dealing with large loans in our banking industry. The effectiveness of write-off as a recovery measure is not observed as the recovered amount to write-off amount remained below 10%, except for the PCBs in 2010 and 2017. The performance of PCBs was markedly higher than the SOCBs in getting write-off loans recovered.

2.4.3 Negotiation & Mediation

In general, the outside court settlement process that includes negotiation, and mediation both before and after filing the suit and ADR under ARA Act, 2003 did not prove as strong NPL recovery measures, at least for a large loan in our industry. Engaging third parties like Bangladesh International Arbitration Center (BIAC) by the banks in the negotiation process with the borrowers is rarely practiced in our banking industry.[9] BIAC has so far signed a Memorandum of Understanding (MoU) with 10 scheduled banks for referring cases, out of which only four banks so far have referred cases for mediation to BIAC (Banerjee et al., 2021).

[9] Bangladesh International Arbitration Center (BIAC), the country's first and only government-licensed institution for Alternative Dispute Resolution (ADR)/ OCS, was established in 2004 with assistance from three business Chambers-- International Chamber of Commerce, Bangladesh, Dhaka Chamber of Commerce and Industry and Metropolitan Chamber of Commerce and Industry, Dhaka.

2.5. NPL Recovery: Legal Measures

2.5.1 Legal Measures: Amount Claimed, Settled, and Recovered under MLC, PDR, and BA (Tk.in crore)

Enforcement status of existing debt recovery related Acts in the backdrop of limited use of outside court settlement process is vital for relieving the banks from the accumulated default loan. However, recovery of default loans through legal measures is usually expensive, time-consuming and unpleasant (Siddique et. al., 2015). The amount claimed, settled, and recovered up to December 2020 under Artha Rin Adalat Ain (ARA) 2003, Public Demands Recovery (PDR) Act,1913, and Bankruptcy Act (BA),1997 indicate that the legal recovery mainly depends on The ARA Ain with a share of 97.48%, 93.59%, 91.96% in total claimed, settled, and recovered amount respectively (Table-2.5).

Table 2.5: Amount Claimed, Settled, and Recovered under MLC, PDR, and BA* (Tk. in Crore)

Act name	Amount Claimed	Amount Settled	Amount Recovered
MLC	190673.34 (97.48)	56908.63 (93.59)	18896.51 (91.96)
PDR	2205.54 (1.13)	1687.99 (2.78)	1239.28 (6.03)
BA	2732.99 (1.40)	2209.05 (3.63)	413.81 (2.01)
Total	195611.87 (100.00)	60805.67 (100.00)	20549.60 (100.00)

Source: Bangladesh Bank. and Banerjee et al. (2021).
Note: *Figure in parenthesis represents share in total

2.5.2 Legal Measures: Rate of Settlement under the Artha Rin Adalat Ain (ARA), 2003 and Recovery thereof

The percentage of settled cases as well as amount and recovery amount in the banking industry under ARA during the period 2015 – 2020 is given in Table-2.6. The percentage of settled cases remained similar at around 67% during the period. The rate of settlement amount remained at a low level i.e. below 30% with a slight variation across the years under consideration. What ultimately matters to assess the strength of the legal measures is the percentage of the recovered amount, which is shown in the last column of the table. After witnessing around 50% recovery out of the settled amount in the first three reported years, the recovery rate noticeably declined in 2020 with a rate of 33.21%. So, as a whole, the enforcement status of the ARA, which the bank relies on for legal recovery does not still yield an expeditious recovery process.

Table 2.6: Rate of Settlement under the Artha Rin Adalat Ain (ARA), 2003 and Recovery Thereof

Year	% of Settled Cases (Of case filed)	% of Settled Amount (Of Claimed amount)	% of Recovered Amount (Of Settled Amount)
2015	67.69	29.89	50.25
2016	66.20	28.03	49.19
2017	66.11	25.86	49.52
2018	65.86	25.32	45.22
2019	66.26	27.10	38.87
2020	67.32	29.85	33.21

Source: Bangladesh Bank and Banerjee et al (2021).

Maintaining a tolerance level of NPL depends on preventing a loan from becoming NPL and recovery of accumulated NPL. The limitations in the banks' internal capacity to recover bad assets and the weaknesses in the enforcement status of debt recovery-related Acts are observed by different researchers, policymakers and practitioners. They support the importance of instituting an Asset Management Company backed by the law that may improve the NPL recovery position in a focused way within a reasonable period of time and allow the banks to contribute more to the economy by giving more attention to the new loans rather than struggling with the age-old distressed loan.

3. Major Measures Undertaken to Reduce Non-Performing Loans in Bangladesh (1986-2022)

Undertaking measures to reduce NPL and reforming the financial sector in Bangladesh may be traced back to the formation of the Money, Banking and Credit Commission in the mid-1980s. The report of this commission suggested administrative and legal measures for solving NPL problems which later on motivated the Government and BB to undertake two notable initiatives in the 1990s like Financial Sector Reform Project (FSRP) in 1990 and the Banking Reform Committee (BRC) in 1996 for bringing discipline in the lending culture of Bangladesh. Enactment of different laws and regulations, concrete loan recovery policy of State-Owned Commercial Banks (SCBs) and proposal for setting up an Asset Management Company (AMC) were the notable outcomes of aforesaid measures (Table-3.1). Afterwards, the review initiative on the Structural Adjustment Performance in 2000, introducing the Credit Risk Grading Scoresheet (CRGS) manual in 2005 and corporatizing SCBs were the major initiatives undertaken in the 2000s for setting up new loan screening and monitoring standards and ensuring accountability in banks. In the 2010s, significant initiatives like introducing new loan classification and provisioning rules in the line with international standards, placing observers on the board of banks with worsening internal governance, restructuring large loans, and introducing the Internal Credit Risk Rating System (ICRRs)were undertaken by BB. Afterwards, to address the business slowdown caused by COVID-19 and Ukraine war, and ensure the collection of instalments within the given time, steps like the relaxation of loan classification policy, flexibility in fixing instalments, adoption of a guideline on Interest Rate Risk in the Banking Book (IRRBB), etc. have been initiated by BB.

Table 3.1: Major Measures Undertaken to Reduce Non-Performing Loans in Bangladesh: 1986-2020

1986	1990	1996	2000	2003
National Commission on Money, banking and Credit: • Setting of recovery targets for SCBs and DFIs. • Prohibiting defaulters from access to further credit. • Linking loan recovery measures with the central bank.	Financial Sector Reform Project: • Enacting new laws, regulations, and instruments (such as, Financial Loan Court Act, 1990 and Bankruptcy Act, 1997). • Fixing collection targets and resolution of legal cases for the 100 largest defaulters. • Publishing list of 100 largest defaulters in different media.	Banking Reform Committee: • Formulating recovery cells and camps in SCBs. • Introduction of incentives to bank officials for recovery.	Structural Adjustment Performance Review Initiative: • Improving the central bank's supervision and regulation. • Central bank's instructions to banks to maintain 9% ratio of capital adequacy to risk-weighted assets, with core capital at least 4.5%. • Making provision to appoint two directors from the depositors in the bank board.	• Enacting the Money Loan Court Act 2003 and the Bank Company (Amendment) Act 2003 for quick settlement of filed cases.
2005	**2007**	**2012**	**2013**	**2014**
Credit Risk Grading (CRG) Manual: • Making CRG system mandatory from 2006 to prevent fresh NPLs.	• Corporatizing SCBs. • Transfer of regulatory authority of SCBs from the Ministry of Finance to the Bangladesh Bank. • Raising the minimum capital adequacy ratio from 9 to 10.	Revision of loan classification and provisioning: • Tightening loan classification to bring it more in line with international practices. • Tightening of definition and	• Amending the Bank Company Act, giving Bangladesh Bank authority to remove the Managing Director of the SCBs. • Special diagnostic examination of SCBs by Bangladesh Bank.	• Automation of bank branches by end-2016 in financial reporting.

1986	1990	1996	2000	2003
		delinquency periods for fixed-term loans.	• Signing by SCBs revised MoU with Bangladesh Bank with quantitative targets, including reduction of NPLs, limits on the growth of their lending portfolio, and recovery from the largest defaulters.	
2015	**2019**	**2020**	**2021 -2022**	
• Placing observers in the board of banks with worsening internal governance. • Restructuring of large loans above Tk. 5 billion. • Signing by SCBs annual performance agreement with the Ministry of Finance to reinforce good practices.	• Launching Internal Credit Risk Rating System (ICRRS) effective 1 July 2019. • Forming 'Special Monetary Cell' headed by Deputy Managing Director (DMD) in all scheduled banks to monitor classified loans amounting Tk. 100 crore and above. • Easing loan classification and provisioning rules effective on30 June 2019	• Relaxation of loan classification policy to address business slowdown caused by the coronavirus pandemic. • Discussion on Asset Management Company for NPL problems.	• Flexibility in fixing instalment • Adoption of Guideline on Interest Rate Risk in the Banking Book (IRRBB)	

Source: Managing Non-Performing Loan in Bangladesh, Asian Development Bank (ADB) Briefs, No 116, November 2019/ Bangladesh Bank Circular/ BIBM publications.

4. NPL Resolution and Asset Management Company: Concept, Development, Advantage and Challenges

4.1 NPL Resolution & Asset Management Company

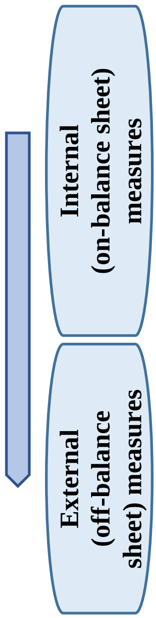
4.1.1 NPL Resolution Approaches: On-balance Sheet and Off-balance Sheet

The solutions available to banks dealing with NPLs are quite broad. It ranges from on-balance sheet measures such as the establishment of internal workout units by the originating bank to off-balance sheet[10] measures such as the disposal of assets through direct sales to investors (Figure-4.1).

Approaches to NPL resolution placed in the above figure allow a more comprehensive yet country-specific approach to dealing with NPL problems including Asset Protection Schemes (APSs), securitization, and the creation of Asset Management Companies (AMCs). However, the characteristics of a country's economic and banking structure, the type of bad assets, fiscal space for use of the public fund, and legal & judicial environments help select the optimal option of NPL resolution which is likely to differ among countries.

[10] In an on-balance sheet measures, bad assets are placed in a separate internal unit of banks. This step raises bank's transparency and showcases the commitment to clean its balance sheet. The off-balance sheet measures, on the other hand, can take the form of a special-purpose entity structure, where bad assets are offloaded, securitised, and sold to different investors.

Figure 4.1: Elements of a Comprehensive Approach to NPL Resolution



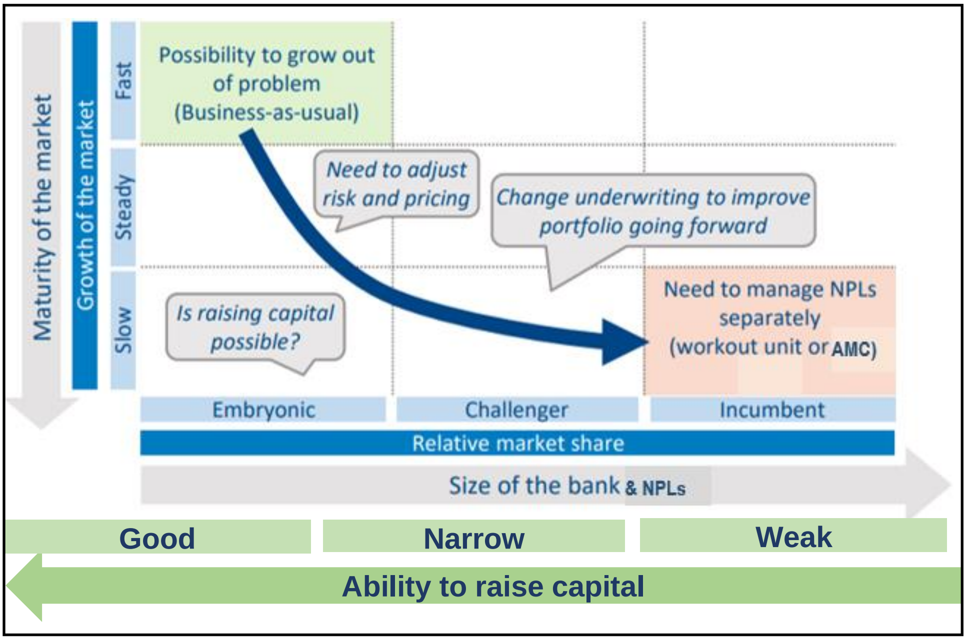
Internal Workout/ Restructuring Unit	Bank introduces various restructuring options for high-risk assets to prevent defaults. The bank can also try to accelerate recovery by actively “managing down” the assets themselves. It can, for example, forfeit closeouts, offer discounts, or terminate contracts if, say, covenants have been broken.
Asset Protection Scheme	Risk-sharing agreement to limit further losses, state-backed entities offer insurance on loss on NPLs to restart the bank’s credit provision.
Securitization & Synthetic Securitisation	Banks, SPVs or AMCs pool & tranche loans and sell securitized products in dedicated markets. Co-investment structures where the state co-invests with NPL investors are particularly effective in the context of securitisation.
Centralised Asset Management Company	A legally, operationally, and financially separated entity into which NPLs are offloaded.
NPL Trading Platforms	It may act as a central hub for NPL sales by being a central repository for NPL data from participating banks. Investors able to build their own NPL portions from multiple banks.
Direct Sale	The asset is sold directly to investors, provided there are sufficiently liquid dedicated markets.

Source: Fell et al. (2017)

4.1.2 NPL Strategic Assessment Matrix

The NPL strategic assessment matrix guides decision-making for the NPL resolution. A number of aspects are the prerequisites for setting appropriate options. These are 1) Size of the problem: the NPLs as a percentage of the bank’s total balance sheet; 2) Market share: the bank’s share in the banking market (embryonic, challenger, incumbent); 3) Ability to raise capital: capability of bank to raise capital from existing or new shareholders to fund growth (good, narrow, weak); 4) Maturity, growth & dynamics of the market: the expectation of the growth of the bank’s balance sheet in the years to come. Consolidation and sophistication of the market (slow, steady, or fast).

Figure 4.2: NPL Strategic Assessment Matrix



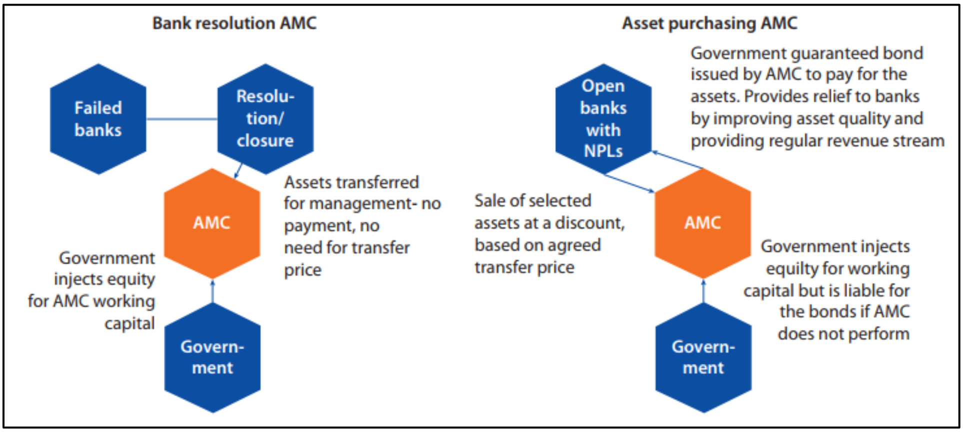
Source: De Backer (2021)

As per the above figure, considering an environment where the banking market is consolidated and growing fast, the banks might be better served by their standard procedures for dealing with NPLs instead of setting up a working unit or AMC. On the other end of the spectrum, when the bank in terms of market share is incumbent with a large-sized NPL relative to its portfolio and its ability to raise capital is weak, the maximum risk transfer is required. Further, if the bank is working in an environment where the banking market is fragmented, and the growth of the market is slow then the bank banks should create an AMC.

4.1.3 Centralised AMC: Types

AMC is a public, private, or joint public/private entity (also referred to as a bad bank) which manages non-performing assets removed from the financial system with the goal of maximizing the recovery value of these assets, thereby reducing the cost of recapitalization (WB, May 2018). In the process, the bank divides its assets into two categories. The illiquid and risky securities go into a bad pile along with other troubled assets such as nonperforming loans. What is left are the good assets that represent the ongoing core business of the bank. In the formation of centralised AMCs, two broad approaches have been used. 1) as a bank resolution entity (to restructure the debt, sell, and liquidate failed banks), or 2) as an asset purchasing entity (purchasing NPLs from open banks in exchange for securities and the outright sale of the loan/underlying asset).

Figure 4.3: Public AMC: Types



Source: Cerruti, C and Neyens, R (2016)

In the first approach, the stressed assets of the banks are transferred for management. The AMC is selected to restructure or liquidate insolvent or failed banks entirely or partly. It does not select or purchase assets. Hence, AMC does not engage in any kind of financial transaction or purchase. In the second approach, however, the AMC is involved in purchasing stressed assets from banks that are still in operation. These assets must meet specific quality as defined by the legislation or the AMC. A financial transaction takes place between the selling bank and the AMC. Generally, the AMC issues government-guaranteed bonds to pay for the purchase. In both cases, the value of the stressed assets needs to be settled by a prior evaluation of the assets by the supervisor, or by the AMC through a transparent, market-based, due diligence process by an experienced and independent third party.

4.2 Centralised AMCs in Different Countries: Name and Establishment Years

Although loan restructuring, harnessing and reforming insolvency and resolution frameworks have been tried and tested over a period to deal with the overhang of non-performing assets (NPAs), the centralised Asset Management Company was established globally in different times and remains one of the more popular concepts, especially while dealing with system-wide stressed assets (Table-4.1).

Table 4.1: CAMCs and Their Dates of Establishment

Country	Name of Centralized Asset Management Company	Establishment Date
Korea	Korean Asset Management Company (KAMCO)	1962
USA	Resolution Trust Corporation (RTC)	1989
Sweden	Securum	1992
Indonesia	Indonesian Bank Restructuring Agency (IBRA)	1998
Malaysia	Danaharta	1998
China	Orient, Great Wall, Cinda, Huarong Asset Management	1999
Japan	Resolution and Collection Corporation (RCC)	1999
Thailand	Thai Asset Management Company (TAMC)	2001
Ireland	National Asset Management Company (NAMA)	2009
Germany	FMS Wert management	2010
UK	UK Asset Resolution Limited (UKAR)	2010
Spain	SAREB	2012
Pakistan*	The Corporate Industrial Restructuring Corp (CIRC)	2000
India	National Asset Reconstruction Company Ltd (NARCL)	2022

Source: Herwadkar, Snehal S. et al. (2022)
Notes: * After establishing in 2000, Pakistan AMC (CIRC) closed its activities in 2006 by handing over its half-done job to the National Bank of Pakistan.

4.3 Centralized Asset Management Company: Advantages

The global experiences suggest that a centralized asset management company has several systemic benefits in reducing NPLs. Further, it enables and complements the existing mechanism of bad asset resolutions (Table-4.2.)

Table 4.2: Centralized Asset Management Company: Advantages

Advantages	Description
Overcomes asymmetric information and reduces market failures.	Asymmetric information between buyers and sellers prevents markets work efficiently. For a sale to take place, buyers and sellers need to agree on a price. In the markets for distressed assets, usually, sellers have more inside information than buyers about the quality and probability of recovery of the assets which they may not transfer to buyers. The lack of transparency about the quality and real value of assets results in uneven bargaining power between buyers and sellers. This situation leads to a large gap between the market price and the real value of the assets. AMC through its impartial and accurate asset evaluations and clear communication reduces asymmetric information and boosts market confidence.
Bridges inter-temporal pricing gaps	When the liquidity in the markets is drying up, the risk premia required by the investors is high because of high-risk aversion. In this situation, market prices for NPLs and the underlying collateral are temporarily low-down and gaps emerged between the initial transfer price and the market price. But, with of the expectation that NPL sale prices may recover once economic conditions improve, AMCs may tend to postpone their disposal of bad assets at a low price. In this way, AMCs bring a bridge for the inter-temporal pricing gaps. The bridging is achieved because AMCs sell the NPLs to the market after a long gestation period to maximize their recovery value.
Makes NPLs attractive to the investors	The quality and value of NPL portfolios are hard to assess from the outside. The benefit of setting up an AMC is that it splits the bank's assets and liabilities. The separation of the NPL portfolio into an AMC makes the bank attractive to investors by aligning its risk/return profile with investors' preferences.
Speeds up the NPL resolution	AMC consolidates the creditor position and enhances the bargaining power of the creditors in dealing with debtors. Moreover, AMC can more easily acquire the specialized expertise required to pool of NPLs both of which help speed up the NPL resolution.

Advantages	Description
Provides economies of scale	The creation of a single organization to collect scattered NPLs from various banks may lower setup and management costs due to economies of scale.

Source: Desk Study

4.4 Centralized Asset Management Company: Challenges

A Centralized Asset Management Company faces a number of challenges worldwide including moral hazard, cost to the Government exchequer, pricing of the NPLs, etc. (Table-4.3) in its establishment and operation. It is expected that utmost care will be taken to address the following challenges in designing and structuring the proposed PAMC in Bangladesh.

Table 4.3: Centralized Asset Management Company: Challenges

Challenges	Description
Could generate moral hazard	AMCs can generate moral hazard in the lending behaviour of banks. A moral hazard problem can happen when banks can able to transfer their NPLs to the AMCs at little cost or if an AMC buys banks' NPLs at deliberately inflated prices providing an incentive for banks to continue with the same behaviour. This kind of situation creates pressure on fiscal budgets and leads to the bad loans problem.
First-mover disadvantages	If participation in the AMC is left entirely to the discretion of banks, then it may result in inaction by the participating banks due to first-mover disadvantages[11]. In the beginning, if the AMC is not strong enough to attract enough investors, then secondary markets will be affected by the first-mover disadvantage that may result in inaction by the participating banks. There may also be a cherry-picking of NPLs, with participating banks trying to offload their lowest-quality NPLs to the AMC.
AMC can be a complex operation	Creating an AMC can be a complex operation requiring significant investments and special skills. Moreover, an AMC requires a

[11] The first-mover disadvantage refers to a disadvantage or challenge faced by an institution that first introduces a product or service to the market. However, the first-mover disadvantage enables an institution to establish strong recognition and product/service loyalty before other entrants to the market.

Challenges	Description
	separate legal entity and operational organization, which can be extremely complex, especially regarding impaired asset valuation.
A poorly designed AMC may increase the risks to the country	Losses incurred by an AMC fall inevitably on the resource-constrained government, and ultimately, on the taxpayers and adversely affect the value of residual NPLs remaining in banks. This, in turn, would increase the contingent liability of the country.

Source: Desk Study

5. Issues Relating to AMC: Cross-Country Evidence

5.1 Funding of Asset Management Company (AMC)

Government, central bank and public banks are the main financiers in PAMC. In addition, public offering of shares and debt securities as well as private banks are also utilized to get funds in AMC. In case of China, AMC is funded by Govt, public banks and financial institutions. In India, public sector banks and financial institutions, and private banks have contributed to the equity of AMC (Table-5.1) whereas the Federal Government funded the total amount of equity of AMC in Pakistan. East Asian Countries also follow the same footprints, the exception is that issuance of Govt guaranteed bonds has also played important role in funding AMC. For example, the Korean Asset Management Company (KAMCO) issues government-guaranteed bonds for collecting funds and generates about one-fourth of its paid-up capital from other financial institutions.

Table 5.1: Funding of Asset Management Company (AMC)

India and Pakistan	East Asian Countries	China
I. Capitalizing through equity contributions from banks/ financial institutions (FIs). Holding 51 per cent stake by Public sector banks and state-owned financial institutions and the rest is with the private sector lenders. II. Raising debt as and when required.	I. Funded by Government directly. II. Through the issuance of government guaranteed bonds. III. Contributions of financial institutions in equity of AMC	I. Equity injection by the Ministry of Finance (MOF). II. AMC Bond. III. Special Loans from the People's Bank of China (PBoC) IV. Commercial Borrowings from other financial institutions.

Source: Content Analysis.

5.2 Acquisition of Bad Assets

A wide variation is observed in the acquisition of bad assets across countries (Table 5.2). Indian AMC is going to buy all types of stressed assets except fraud loans[12] from all banks, however, it will concentrate more on the recovery of assets of Public Sector Banks. Pakistan AMC was established to buy bad assets of around 100 industries from six Public Sector Banks. Among East Asian countries, in Thailand, AMC buys impaired assets from both Govt. and private banks and financial institutions, however transferring qualifying assets is obligatory for the Govt. banks but optional for the private banks. AMC in this region is mandated to buy a part of the bad loans with a minimum amount instead of buying the total amount of the impaired loans from banks/FIs. Danharta in Malaysia buys 80 per cent of the total NPLs of a bank/FI with a minimum amount of MYR 5 million whereas, in South Korea, half of the bad loans of a bank/FI are bought by the AMC whereas the remaining half of the loans are required to be collected by the respective banks /FIs. China follows geographical restrictions in buying NPLs, the local/provincial AMCs can acquire NPLs originating only from the same areas.

Table 5.2: Acquisition of Bad Assets

India and Pakistan	East Asian Countries	China
I. Acquiring aggregate bad loans from all Banks, mostly Public Sector Banks (PSBs).	I. Acquiring toxic assets from Govt. as well as private owned banks and financial intuitions. II. Obligation or optional in shifting NPLs. III. Transferring a part of bad loans of banks / financial Institutions.	I. Geographically restrictions on acquisitions of NPLs. II. Taking over diverse assets ranging from manufacturing to the farm sector.

[12] Banks operating in India reported fraud of Rs 4.92 trillion as on March 31, 2021, which represents nearly 4.5% of the total bank credit, showed Reserve Bank of India (RBI) data, which was sought under the Right to Information (RTI) Act by Saurabh Pandhare. The data showed that 90 banks and financial institutions reported a total of 45,613 cases of loan fraud till March 31, 2021(Business Standard, March 31, 2021).

India and Pakistan	East Asian Countries	China
II. Loans classified as fraud cannot be sold to NARCL.	IV. Setting a minimum amount of NPLs for handing over. IV. Acquiring NPLs originated from all sectors or particular sectors V. Analyzing to know the quality of the toxic loans and conducting due diligence on loans before purchasing any loan.	III. Extending the vast majority of the NPLs by the state-owned commercial banks to SOEs.

Source: Content Analysis.

5.3 Pricing of Acquired Loan

Pricing of acquired loans is crucial for making this initiative successful. If a loan is transferred at a higher price, the profitability of AMC will be hampered. In contrast, transferring NPL at a lower price will deprive banks of getting the financial gains that they usually expect. Usually, factors like the nature and quality of assets, the book value of assets, the market value of the collateral and the probability of recovery are considered in the setting transfer price of the loan. Both China and India follow almost the same pricing principle. However, AMC in India is not paying the entire amount of NPL to banks like in China, rather it pays 15 per cent cash upfront and provides government-guaranteed security for the remaining amount. In Pakistan, an independent evaluator appointed by the board of CIRC fixed the price of transferred loans. East Asian countries follow techniques like percentage of collateral, discounting at large, net tangible assets, and discounted cash flow in fixing transfer prices (Table 5.3). They also adjust pricing criteria depending on the market conditions over time.

Table 5.3: Pricing of Acquired Loan

India and Pakistan	East Asian Countries	China
1. NPLs are being acquired through a 15 per cent upfront payment in cash to the lenders and 85 per cent	1. Paying a fixed percentage of the collateral value (In KAMCO, 45% of the collateral value).	Acquiring NPLs at a flat rate of book value indicate the explicit approval of the Chinese Govt. for financing NPL acquisition.

India and Pakistan	East Asian Countries	China
government-guaranteed security receipts (SRs), a tradable security. 2. Independent evaluator appointed by the board fixed the price of NPLs.	2. Buying unsecured loans at a large discount (80% or more of face value). 3. Acquisition of assets at the negotiated price on an arm's length basis applying either the 'net tangible asset' or the discounted cash flow.	

Source: Content Analysis.

5.4 Legal Environment

The existing legal system in most of the countries where AMCs were established is found insufficient to operate and achieve the goal of AMC. Thus, a strong and adequate legal framework has been placed in action in all countries to overcome the probable hurdles an AMC may face before its establishment (Table-5.4).

Table 5.4: Legal Environment

India and Pakistan	East Asian Countries	China
1. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 provides the legal basis for the setting up of ARCs in India. 2. Overhauling the rules governing Asset Reconstruction Companies (ARC) to enhance the availability of bad loans for transactions and bring in a wider set of investors to the market for distressed assets. III. CIRC in Pakistan can exercise power and function to acquire, purchase, hold, manage, restructure, rehabilitate, sell and dispose of NPAs.	**Korea:** Pending legislation would permit KAMCO to appoint a Special Administrator to manage a borrower's business or assets or both. **Indonesia**: AMU can foreclose on a loan without going through the court and it can buy/sell a loan without debtor approval. **Thailand:** AMC is exempted from notifying debtors of transfers of claims required by law. It is also exempted from certain fees and taxes. **Malaysia: (i)** Statutory vesting permits to step into the shoes of the selling institution, with the same rights and priority as a creditor. (ii) Can appoint a Special Administrator to take over a distressed company.	Since the establishment of four AMCs, Chinese authorities have issued a series of notices, guidance, judicial interpretation or changes of laws. The special regulations concerning AMCs, along with other laws or rules, formed the legal framework for the secondary NPL market.

Source: Content Analysis.

5.5 Disposal of Assets

Techniques for the disposal of assets are noticed as tailor-made to suit the nature of classified assets being dealt with. In East Asian Countries, a battery of techniques is being used. AMC is usually selling corporate loans to local and international investors as well as third parties/serving agents either directly or through the court (Table-5.5). AMC may give efforts to collect loans from the bank's borrowers through the negotiation process too. In this case, the AMC manages the collateral asset and equity in the debtor's company. Asset securitization is also popularly utilized in the disposal of acquired viable assets. In addition to the aforesaid techniques, China follows two more techniques like debt-equity SWAPs and leasing out the underlying assets.

Table 5.5: Disposal of Assets

India	East Asian Countries	China
I. Initiating to bring in a wider set of investors to the market for distressed assets. II.AMC is tying up with outside investors to bid for assets.	I. Selling corporate loans through open auctions to local and international investors. II. Selling commercial loans to selected third parties /servicing agents. III. Offering flexibility to borrowers to settle debts by providing a 100% discount on interest and a 25% discount on principal. IV. Issuing asset-backed securities to investors. V. Selling underlying assets through court or directly by AMC. VI. Entering joint venture partnerships with foreign investors in managing and disposing of assets. VII. Following two approaches - loan management (loan restructuring and disposal of loans) and asset management (managing collateral real estate and equity in the debtor's company)	I. Debt collection, portfolio sales, auctions, joint ventures, debt–equity SWAPs, and leasing out the underlying assets.

Source: Content Analysis.

5.6 Oversight and Supervision Authority

Supervising AMC in a pragmatic manner is a prerequisite for reaping the best benefits from AMC. This is also necessary for confirming the businesses of AMC in a transparent and professional manner in line with international best practices. The extant supervision authority of AMC is not uniform in all countries. In China, MOF, CBRC and CSRC are collectively supervising the activities of AMCs. In Malaysia, an oversight committee for Danaharta comprising three members representing the Ministry of Finance, BNM and the Securities Commission was established to approve appointments and terminations of special administrators and independent advisors including their recommendations. However, India is going to follow the subcontinent style i.e. supervision by RBI in oversighting the function of NARCL.

Table 5.6: Oversight and Supervision Authority

India and Pakistan	East Asian Countries	China
NARCL in India is expected to be regulated by RBI. CIRC in Pakistan was regulated and supervised by the State Bank of Pakistan.	Korea Asset Management Company (Kamco): Financial Supervisory Commission (FSC) supervises KAMCO. FSC consisting of KAMCO's CEO as well as officials from the FSC, MOFE, KDB, and outside professional organizations is working closely with the Ministry of Finance and Economy (MOFE). Malaysia Asset Management Corporation (Danaharta): An oversight committee of three members representing the Ministry of Finance, Bank of Negara Malaysia (BNM) and Securities Commission supervises Danaharta.	Ministry of Finance (MoF), China China Bank Regulatory Commission (CBRC)[13] China Securities Regulatory Commission are responsible for supervision.

Source: Content Analysis

[13] From April 2003 onward, the four AMCs of China have been regulated by CBRC which were regulated by PBoC before that date.

5.7 Tail-off AMC/ Bad Bank

In the context of the lifetime of AMC, two views are prevailing. One view is in favour of a clearly defined realistic lifetime for the AMC. This view is dominated by moral Hazard concerns. On the other hand, the second view is that AMC is part of a toolkit for solving bad loans and does not have any sunset days. Korean and Chinese AMCs possess the latter view whereas Malaysia and Thailand own the former view.

Table 5.7: Tail Off AMC/Bad Bank

India and Pakistan	East Asian Countries	China
1. India proposed for 5 years. 2. Pakistan established in 2002 for 6 years.	1. Korean AMC does not have any winding down days. 2. Danaharta, Malaysian AMC, was set up with a finite timeline (wound down in 2005) 3. The Thai Asset Management Company (TAMC)was established in 2001 for 12 years.	Established for 10 Years.

Source: Content Analysis.

6.0 Elements of AMC: Focus Group Discussion (FGD) and Questionnaire Responses

6.1 Operational Goals for AMCs

An AMC must have clearly defined goals and a governance structure to operate effectively. Experience shows that AMCs having clearly defined goals, a sunset clause, and a commercial focus, including governance, transparency, and disclosure requirements are more likely to be successful. The AMC to be formed in Bangladesh can have, *inter alia*, the following priorities: one, disposing of the assets acquired against the bad asset as quickly as possible to avoid further deterioration in value and minimize the carrying cost; and two, corporate workouts and restructuring the nonperforming loans [borrowers] to make them marketable.

6.2 Structure of AMCs

6.2.1 Regulatory and Supervisory Structure

An AMC must have a clearly defined regulatory and supervisory structure for achieving the core objectives and ensuring accountability and transparency. Since the AMC is formed for specific, time-bound objectives to address a well-known problem, attempts might be made to commence the operations with regulations, and rules as detailed as possible to minimize the necessity of adding/modifying rules during its working life (Table-6.1).

Table 6.1: Regulatory and Supervisory Structure

Questions asked	Responses
What should be the regulatory and Supervisory structure of an AMC?	• The regulatory responsibility may lie with the MOF. Because of the nature of the mandate, supervisory requirements are mostly to be made on an off-site basis through reporting requirements. • Bangladesh Bank may act as supervisory authority in this regard.

Source: FGD and Questionnaire

6.2.2 Ownership and Number of AMCs

In terms of ownership, AMCs can be either public or private or even jointly owned. This is mostly depending on the amount and types of Bad loans and clout of the defaulters, etc. The choice of a number of AMCs depends on several factors, including types of assets, the magnitude of the problem, the depth of markets, and the characteristics of debtors. When the types of impaired assets in different banks differ substantially, there may be some rationale to group assets by type centrally and transfer them to AMCs specializing in the management of a particular type of assets (Table-6.2).

Table 6.2: Ownership and Number of AMCs

Questions asked	Responses
What should be the ownership pattern of AMC?	• As a substantial amount of bad loans of banks in Bangladesh has to be transferred to an AMC over a short period, it is often difficult to find a private investor willing to own such an AMC without asking for significant government guarantees. So, a government-owned AMC will possibly be better in Bangladesh. • The government can bear the loss if any otherwise, it can be benefitted from any profit made by an AMC, especially in the case of uprising price movements of the assets acquired. • Moreover, the government has the state apparatus to manoeuvre the powerful willful defaulters.
What should be the number of AMCs in Bangladesh?	• There should be only one state-owned AMC at the beginning. In Bangladesh, there is a lack of depth in markets for bad loans as well as collateral security mortgaged against bad loans. Thus, there may be a stronger rationale for a centralized approach in the disposition of such assets to ensure uniformity and avoid any abuse of the special power. • However, based on experience, some private AMCs may be allowed either as subsidiaries of banks or independent organisations in the future.

Source: FGD and Questionnaire

6.2.3 Special Powers of AMC

The government may ensure that appropriate laws are in place for the AMC to operate efficiently. It should create a framework for debt workouts (Table-6.3).

Table 6.3: Special Powers of AMCs

Question Asked	Responses
Which special powers should be given to an AMC to be formed in Bangladesh?	• Considering the limitations of the existing legal recovery system, the AMC should be given special power in having the full rights on the bad loans and the collaterals like that of the lending banks. AMC may be given the power to realise the bad loans by capturing and selling the security against the loans and other property of the borrower without going to the court.

Which reforms in the existing laws, regulations and enforcement are needed to ensure the smooth functioning of the AMC?	• AMC should have the magisterial power to supersede the Money Loan Court Act, impose restrictions on the mobility of the borrower and even arrest the borrower. AMC can have a Special Enforcement Unit equipped with trained members of law enforcement agencies. Before issuing a stay order, the court might be required to hear the views of the AMC. • AMC might be allowed to get relevant information from Bangladesh Bank, NBR, Land Office, DSE, and CSE.

Source: FGD and Questionnaire

6.2.4 Sunset Clause/ Limited Life of AMC

Two views are prevailing over the lifetime of the AMC. One is in favour of a clearly defined time, the other believes that AMC is a part of the financial crisis toolkit (Table-6.4).

Table 6.4: Sunset Clause/ Limited Life of AMC

Questions Asked	Responses
Do AMCs need to have a Sunset Clause?	• To ensure speedy disposal of the assets acquired and to avoid moral hazard, the AMC should be formed for a certain period (sunset clause). • The period of AMC may be fixed based on the conservative calculation of the probable time required to recover a complicated large bad loan considering the existing legal environment for loan recovery.

Source: FGD and Questionnaire

6.3 Governance of AMCs

Good governance is critical for an AMC because the very nature of the asset management process invites political interference. An AMC should be governed according to the principles of corporate governance (Table-6.5).

Table 6.5: Governance of AMCs

Questions Asked	Responses
How to ensure good governance?	• AMC must have written policies regarding the acquisition, pricing, and disposal of assets acquired. • Directors should be sufficiently independent to assist the AMC in resisting pressure from borrowers and prospective purchasers of assets seeking preferential treatment. • The majority of the board of directors might be Independent Directors. • The board might have a clearly defined mandate and it might be responsible for assuring that the AMC carries out its mission and meets performance goals. • There should have independent internal control and compliance system including an internal audit that will give reasonable assurance relating to compliance of functions according to the approved policies and procedures and achievement of the goals of AMC. • The directors and key management people should be appointed from diverse fields such as financial sector regulators, bankers, lawyers, retired defense personnel, real estate specialists, liquidation experts, and people with insights into various industrial sectors. • AMC should have narrowly focused objectives, functions, and well-defined operational procedures as far as possible. • AMCs should have budgetary independence by meeting operating expenses from their income. • They must report to their competent authority to ensure accountability and transparency. • AMC should be insulated from political interference in the disposition and restructuring of assets. • AMC must be audited regularly to assure that its financial statements are accurate.

Source: FGD and Questionnaire

6.4 Operational Issues

The selection of assets to be purchased, pricing of assets, funding, and strategies for asset realisation are critical for the success of AMC (Table-6.6).

6.4.1 Selection of Banks and Assets

Table 6.6: Selection of Banks and Assets

Questions Asked	Responses
What should be the criteria for the selection of banks and Bad loans to be purchased?	• The AMC should be formed to buy NPAs from all banks. • Banks having a higher level of bad loan as compared to the total loans as determined by the AMC will be its priority. • Buying large Bad loans shall be the priority of AMC • AMC shall buy Written-off loans at a deep discount or based on profit and loss sharing with the transferring banks. • AMC can act as a recovery agent on a PL sharing basis.

Source: FGD and Questionnaire

6.4.2 Pricing of Assets to be Purchased

Realistic pricing of assets based on market price, sound accounting norms, loan classification and provisioning standards, and/or discounted present values, is sine-qua-non to the success of AMCs. The rigorous recognition of loan losses is the first and most important element of an effective strategy for dealing with problem assets, as it creates the right incentives for banks to restructure their loans and foreclose on the collateral (Table-6.7).

Table 6.7: Pricing of Assets to be Purchased

Questions Asked	Response
How to determine the price of transferred loans?	• The participatory bank will transfer default loans to AMC at an agreed price. • In the absence of an agreed price, the participatory banks will have to realise the BL within a stipulated time given by the AMC, otherwise, the bad loans shall be transferred to the AMC at the agreed price.

Questions Asked	Response
	• To ensure a fair price, besides the AMC, other PCBs having bad loans lower than a benchmark set by the AMC will be allowed to participate in the bidding process of Bad loans.

Source: FGD and Questionnaire

6.4.3 Funding of AMCs

AMCs must be sufficiently funded to perform their intended functions. To achieve transparency, the operating budget of the AMCs should be separated from its funding for asset takeover (Table-6.8).

Table 6.8: Funding of AMCs

Questions Asked	Responses
How much should be the fund size? How should AMC be funded?	• The size of the fund will be determined in line with the goal of AMC to purchase the bad loans. • Initially, one-third of the total required fund can be given as capital, which will be continued during the entire life of AMC. • Government bonds should also be issued. • Development partners can also be requested to fund AMCs in the form of equity and/or debt.

Source: FGD and Questionnaire

6.4.4 Asset Management and Disposition

Strategies of asset management and disposition should primarily be a commercial decision and be guided by the goal of maximizing the value of assets considering market conditions as well as the funding cost of the AMCs (Table-6.9).

Table 6.9: Asset Management and Disposition

Questions Asked	Responses
How to ensure quick and fair disposition of assets acquired?	• An online market should be created to dispose of the assets acquired. • There shall have transparent online bidding (auction sale) process to ensure that anyone desiring to participate can join in the bidding. • In selling assets, AMC may give preference to the buyers such as not-for-profit organisations that help achieve various social goals like offering education, health, and old home facilities.

Source: FGD and Questionnaire

7. Policy Suggestions

A number of issues generated from the analysis of cross-country evidence and responses got from the FGDs and questionnaire survey and finally from the roundtable discussion have been summarized below with a view to putting forward as policy suggestions for the authority.

7.1 Ownership and Number of AMCs

AMCs can be either public or private or even jointly owned. The choice of ownership and number of AMCs depends on several factors like the magnitude of the problem, depth of markets, and characteristics of debtors. When the types of impaired assets in different banks differ substantially, there may be some rationale to group assets by type centrally and transfer them to AMCs specializing in the management of a particular type of assets. Further, as in Bangladesh, a substantial amount of bad loans has to be transferred to an AMC and a sufficient amount of funds will be needed along with the capacity to penalize powerful and willful defaulters. In this consideration, a government-owned AMC would possibly be a better option for Bangladesh to start with.

7.2 Regulatory and Supervisory Structure

Since the AMC is formed for specific, time-bound objectives to address a well-known problem, attempts might be made to commence the operations with regulations, and rules as detailed as possible to minimize the necessity of adding/modifying rules during its tenure. The regulatory responsibility may lie with the MOF and Bangladesh Bank to act as the supervisory authority.

7.3 Governance of AMCs

The nature of the public AMC invites political interference which may be higher in Bangladesh. The board and management should be strong and independent enough to keep politics out of AMC's activities, resist pressure from borrowers and prospective purchasers of assets seeking preferential treatment, and run the organization as per written policies for the acquisition, pricing, and disposal of assets acquired. The directors and key management should be appointed from diverse fields such as financial sector regulators, bankers, lawyers, retired defense personnel, real estate specialists, liquidation experts, and people with insights into various industrial sectors.

7.4 Strong Internal Control and Compliance

In the achievement of the goals of AMC, there should have independent internal control and compliance system including an internal audit that will give reasonable assurance relating to compliance of functions according to the approved policies and procedures.

7.5 Funding of AMC

Government, central bank and public banks are usually the main financiers in PAMC. However, this may create an additional burden on the resource-constrained Government and its associated financial organizations. Government-guaranteed bonds can be issued for collecting funds. Further, the involvement of private banks and financial institutions, and the involvement of the share market in funding PAMC may reduce the pressure on the Government exchequer.

7.6 Acquisition of Bad Assets

PAMC is usually established to buy stressed assets from public sector banks. Buying bad loans from private banks is not also unusual. In Bangladesh, a number of private commercial banks are also seized in loan default traps apart from SOCBs. The proposed PAMC may keep the options open to buy stressed assets from both SOCBs and PCBs. However, PAMC should fix the criteria for buying toxic assets regarding the sector, amount, quality, and organization so that banks will not suffer from moral hazard problems knowing that they have PAMC options if their loan becomes bad.

7.7 Asset Management and Disposition

Strategies of asset management and disposition should be guided by the goal of maximizing the value of assets considering market conditions as well as the funding cost of the AMCs. An online market should be created to dispose of the assets acquired so that anyone from home and abroad desiring to participate can join in the bidding process. Further, state-of-the-art mechanisms used by AMCs globally like equity SWAPs, securitization, and tying up with overseas investors to bid for assets are required to be made available in Bangladesh too.

7.8 Pricing of Stressed Assets

The rigorous recognition of loan losses is the first and most important element of an effective strategy for dealing with the pricing of toxic assets, as it creates the right incentives for banks to restructure their loans and foreclose on the collateral. Realistic pricing of assets based on market price, sound accounting norms, loan classification and provisioning standards, and/or discounted present values is sine-qua-non to the success of AMCs. If the loan is transferred at a higher price, the profitability of AMC will be hampered. In contrast, transferring NPL at a lower price will deprive banks of getting the financial gains that they usually expect.

7.9 Sunset Clause

Considering the existing legal environment for loan recovery in the country, two views are prevailing about the lifetime of the AMC. One is in favour of a clearly defined time, the other believes that AMC is required to be continued as an integral part of the financial sector. To ensure speedy disposal of the assets acquired, the AMC might be formed for a certain period. The period of AMC may be fixed based on the conservative calculation of the probable time required to recover a complicated large bad loan.

7.10 Legal Powers of AMC

PAMC should be given special power to acquire, purchase, hold, manage, restructure, rehabilitate, sell, and dispose of NPAs. AMC should have the magisterial power to supersede the Money Loan Court Act, impose restrictions on the mobility of the borrower, and even arrest the borrower. Before issuing a stay order, the court may require to hear the views of the AMC. Getting access to information from Bangladesh Bank, NBR, Land Office, DSE, and CSE is also necessary in this respect.

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Appendix-1: Online Focus Group Discussion on "Asset Management Company: A Way-out to Solve NPL Problems in Bangladesh"

List of Nominated Participant(s) from Banks

#	Name and Designation	Bank Name
1.	Mohammad Shahriar Siddiqui, Additional Director	Bangladesh Bank
2.	মোঃ শফিউল আলম, ডেপুটি জেনারেল ম্যানেজার	Sonali Bank Ltd.
3.	Mohammad Golam Morshed, Assistant General Manager	Bangladesh Development Bank Ltd.
4.	Md. Fida Hasan, Deputy General Manager	BASIC Bank Ltd.
5.	জনাব মোঃ মোসাদ্দেক হোসেন, উপ-মহাব্যবস্থাপক	Rajshahi Krishi Unnayan Bank
6.	জনাব মোঃ জাকির হোসেন, উপ-মহাব্যবস্থাপক	Rajshahi Krishi Unnayan Bank
7.	Md. Anisur Rahman, Deputy General Manager	Pubali Bank Ltd.
8.	A. K. M. Kamal Uddin, SEVP	AB Bank Limited
9.	Md. Sohel Faisal, SVP & Divisional Head	National Bank Limited
10.	Md. Farid Uddin, Senior Vice President	Islami Bank Bangladesh Ltd.
11.	Syed Rezaul Karim Chowdhury, SVP	ONE Bank Ltd.
12.	Mohammad Kamruzzaman, Vice President	NCC Bank Ltd.
13.	Brig Gen Kamrul Islam (Retd.), SEVP & Head of Recovery & Monitoring	Trust Bank Ltd.
14.	Md. Abu Zafar Shamsuddin, EVP	Social Islami Bank Ltd.
15.	Muhammed Mizanul Kabir, SVP & Head	Southeast Bank Ltd
16.	Khondker Ishtiaque Hassan Mahdi, VP	Standard Bank Limited
17.	Md. Tariqul Islam, EVP & Head of SAM	EXIM Bank Limited
18.	Sheikh Moyeen Uddin, A.D.M.D & Head	Mutual Trust Bank Ltd.
19.	Mohammad Shariful Islam, Unit Head	Bank Asia Ltd.
20.	Jakir Hossain, FVP	South Bangla Agricultur and Commerce Bank Ltd.
21.	Mohammad Eqramul Islam, AVP	NRBC Bank
22.	Md. Abdullah, Sr. Executive Vice President & Head of Legal Affairs & Recovery	
23.	Syed Mahbubul Haq, SEVP, Head of Special Asset Management Division	Union Bank Ltd
24.	Md. Azadur Rahman, EVP & Head	NRB Bank Ltd.
25.	Sarafat Ullah, Vice President	BRAC Bank Ltd
26.	Shah Ibnul, Head of Corporate SAM	Shahjalal Islami Bank Ltd.
27.	Tariqul Islam, Executive Vice President & Head	Padma Bank Ltd
28.	Feroze Alam, SEVP & Head-RAMD & LAW	State Bank of India
29.	Joyanta Sarkar, FAVP	Habib Bank Ltd
30.	Md. Alamgir Hossen, Manager – Structured Credits	Commercial Bank of Ceylon PLC
31.	Md. Fozlul Hoque, Relationship Associate – Corporate Banking	
32.	Tahsina Rahman, Senior Manager & Head	

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We believe that the book will not only empower the professionals with a better understanding of finance but will also broaden their capabilities and help them contribute more to the country's economic prospects.

Our best wishes to BIBM.

Selim R.F. Hussain
Managing Director & CEO
BRAC Bank Limited

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