

Bridging the Policy Gaps in Addressing Non-Performing Loans in Bangladesh

Dr. AKM Asaduzzaman Patwary^{1*}, Syed Abdullah Al Ahsan², Md. Salehin Surfaraz², Abdullah Al Maruf², Dr. M. Murad Ahmed², Suhel Rana³, Mahamudul Hassan⁴, Kausar Ahmed Majumder⁴, Md. Mahan Mia⁴

¹Secretary General (Acting), DCCI

²Deputy Executive Secretary, R&D and PA Dept., DCCI

³Senior Assistant Executive Secretary, R&D and PA Dept., DCCI

⁴Assistant Executive Secretary, R&D and PA Dept., DCCI

*Corresponding Author

Abstract

The management of non-performing loans (NPLs) has become a major risk to the financial stability of Bangladesh and credit growth, investor confidence, and macroeconomic stability. This paper explores the policy, governance, and regulatory ambiguities that keep the NPLs thriving even after reforms. We used qualitative methodology and a total of 23 in-depth interviews (IDIs) conducted with the six groups of stakeholders, including industry owners/managers, credit authorities, bank board members, auditors, industry associations, and regulatory authorities. The respondents were chosen using non-probability convenience sampling. A case study of a scheduled bank was involved in the study to conceptualize systemic and political aspects of loan defaults. The results indicate that the enforcement and accountability mechanisms have been compromised or misused. In addition, the political interference in the loan disbursement and recovery has promoted willful defaulting behaviors, and institutionalization of governance failures. The structural changes that the respondents highlighted were automation of credit monitoring, legal frameworks, transparent loan classification, and full regulatory autonomy of the central bank. The paper finds that in order to restore financial discipline in the banking sector and ensure the long-term sustainability of the banking sector in Bangladesh, it is necessary to bridge policy and governance gaps by institutional reforms, digital integration and depoliticized regulation.

Keywords: Non-Performing Loans, Policy Gap, Financial Governance, Regulatory Reform

1. Introduction

NPLs impact a lot on the financial market stability and the development of the market in the long run. NPLs can be known as non-performing loans, in which the borrowers do not pay their obligations-both interest and principal within a certain period, usually 90 to 180 days (Farne & Vouldis, 2024). Banks are the major holders of NPLs, which conduct their business as financial intermediaries through the receipt of deposits and the provision of credit. Banks should ideally do business with good borrower or organizations that possess the capacity to repay within the specified timeframe. But failure by borrowers to meet these obligations results in the loan being considered non-performing.

The banking industry in Bangladesh is going through one of the most crucial periods in its history with a historic high increase in NPLs, declining growth of the private-sector credit and an ever-increasing loss of investor trust. Statistics indicate that NPLs have surged beyond Tk. 4.2 lakh crore (Bangladesh Bank, 2025) that is greater than the regional peer figure and directly threatens financial stability. Although the policy rate has been kept at 10% as a goodwill measure to curb inflation without having any effect on the money circulation in the private sector, has gone down to 6.4%, a 22-year low, business opening, and is now headed toward a complex situation that has taken over in all the core productive sectors like CMSMEs.

Systematic failure of governance such as regulatory incompetence to address wilful defaulters, weak risk management structures and culture of political-backed loans have further increased the economic vulnerabilities, which is being exploited by major business conglomerates to empty the banking system with impunity. The failure of the Bangladesh Bank to implement the provisions of the amended Bank Company Act 2023, which permits travel bans, restrictions on purchase of asset, and criminal punishment for wilful defaulters, has resulted with social mistrust and weakened accountability. Although it is commendable that the 14 bank boards are being restructured, and the corrupt directors are being rolled out under the new central bank management, experts caution that without a decisive measure against politically inclined borrowers and enhance transparency, the situation will not turn around.

International studies on emerging markets have shown that the incidence of NPLs is largely driven by a complex interplay of macroeconomic volatility, weak enforcement mechanisms, and insufficient technological infrastructure. Numerous research articles continually highlighted that transformation standards of the financial technologies to optimize credit risk management, allowing bank to track the borrowers in real time and stream, could optimize the procedures of recovering the loans. Nevertheless, such innovations cannot be implemented and scaled in such countries as Bangladesh due to the lack of financial literacy, limited internet access, cultural inertia and resistance to change, which drastically limit the NPL recovery.

The primary aim of this study is to explore the policy gaps to minimize the risk of NPLs in the banking system of Bangladesh by identifying policy-oriented aspects, the efficacy of policy reforms, the effectiveness governance and supervisory structures in eliminating the vulnerability associated with NPLs. To be more precise, this paper discusses the perception of the stakeholders regarding policy reforms, governance, and supervision to minimize the risks of NPLs reduction.

2. Literature Review

NPLs have a substantial importance across the relevant industries, bank managers, loan supervisors, academicians and financial regulatory bodies due to their profound implications for the stability and efficiency of the banking sector. There are several types of factors closely related to loans default and among them seven specific factors have been identified as the most critical. First, high levels of NPLs hinder the credit growth and consequential impact is visible in the real economy, production, consumption and overall economic growth (Ozili, 2025). Ozil's (2025) findings align in the context of Bangladesh and over the years its compounded impact has become evident in the current context of NPLs and the banking sector. Currently, economic growth, private sector credit growth and consumption have declined and that proves the dynamics of NPLs. Quantitatively, the facts are valid with the empirical arguments however, study needs cross verifications through more rigorous investigations using qualitative approaches. Secondly, NPLs are inherently procyclical, and go up in economic downturns and decline during periods of economic expansions (Ari et al., 2020; Alnabulsi et al., 2022) and strongly correspond to the status quo of the NPLs rate in Bangladesh. Thirdly, performance monitoring is a significant factor and may reduce credit risks. The factor needs to be reassessed in terms of the Bangladesh contexts to understand the level of monitoring and its urgency for improvement.

Fourthly, NPLs reflect the level of management and operational practices across the banking sector and any elevated ratios signify weakness in regulatory oversight and supervisory effectiveness. This issue is highly important and the current levels of NPLs strongly reflect the regulatory loopholes. Therefore, these issues need to be re-examined to understand the causes behind the changes in ratio. Fifth, banks with large loan portfolios face a high risk of loan default when macroeconomic instability exists. These unforeseen factors may hinder borrowers' ability to repay (Serrano, 2021). The findings of Serrano (2021) are logical in the case of Bangladesh because sudden changes in exchange rate and interest rate have significant impacts on NPL rate. Sixth, a high volume of loan disbursement contributes to financial instability and erodes banks' capital base and reduce bank profitability. This factor indicates limited relevance in the case of Bangladesh context; however large disbursements have significant impacts on NPLs. Seventh, NPLs highlight the importance of the regulatory issues and are often subject to prescribed single-digit threshold levels for NPL ratio (Kanoujiya et al., 2023). Despite the seven factors analysed, there are a number of other issues e.g., macroeconomic shocks, market volatility, borrower specific circumstances which are beyond control and can directly impact the borrowers' ability to meet their repayment obligations (Bellotti et al., 2021; Foglia, 2022).

The persistence of these challenges remains at the core of debate over the years and call for further study to refine theoretical and regulatory literatures. Increasingly, various study-based loopholes are calling for further in-depth investigations through more dynamics and problem specific approaches to understand the default rate and their co integration with the macroeconomic consequences as well policy-level variations impact. So, current empirical investigations create the perceptions behind the NPLs but further review create the reason more specifically.

Empirical studies have not only focused on the macroeconomic perspective to understand the nature of NPLs but have also identified bank specific several determinants. These commonly

include: loan growth, net interest margin, loan loss provisions, diversifications, of banking activities, operational efficiency, bank size, profitability and interest rate (Ahmed et al., 2021); income diversification (Ciukaj & Kil, 2020; Khan et al., 2020; Ristić & Jemović, 2021); capital adequacy ratio (Kryzanowski et al., 2023; Pancotto et al., 2024) operating cost (Nguyen, 2024) return on equity (Erdas & Ezanoglu, 2022) return on assets (Kjosevski & Petkovski, 2021) liquidity ratio (Msomi, 2022) and bank business model (Farne & Vouldis, 2024). The contributing factors to NPLs are diverse and mostly identified in global context; however, the banking industry in country like Bangladesh has not considered these for comprehensive integration. The questions still arise as to what operational inefficiency remains as loophole to reduce NPLs in Bangladesh banking sector. The study aims to identify the policy-oriented reforms which may capably bring the NPLs under control. Along with these what non-financial determinants emerging from the recent literature also take into consideration. However, corporate governance is most dominant factor (Tarchouna et al., 2022) in NPLs but study will take other factors along with corporate governance.

There is different level of reasons across the continents to contribute NPLs and every single reason have some common types of facts to NPLs. In Europe, interest rate on new loans, bank concentrations, Gross Domestic Product (GDP) growth, debt level, current account balance and real house prices are significant factors to raise the NPLs. In European countries real interest rate are highly integrated with housing prices and any changes in interest rate have significant impacts on the NPLs changes. However, number of factors identified in European context but the factors are not consistent over years. Asian context is bit different from European Union e.g. unemployment rate, real interest rate, external debt to GDP ratios, GDP, sovereign debt, inflation rate, money supply, governance failures, GDP growth, the ratio of liquid assets to total asset. Loan growth, banking sector development, gross loans, and capital adequacy ratio. Among these dominant factors GDP, debt levels and loan growth emerge as the most commonly reported determinants across the Asian region (Ozili, 2025).

Findings from African reasons are mostly similar with the Asian countries in case of NPLs default rate to change. Along with the current structural facts the findings in Africa strongly included strong regulatory environment, gender considerations and digital financial inclusions are major determinants behind the NPLs. So, in terms of Bangladesh context digital inclusion are considerable facts to verify and study looks to policy matters to take into consideration. In the Middel East and North Africa (MENA) region, NPLs determinants are not different than Africa and Asian regions where differences found in national level of corruptions, global financial crisis, liquidity creation through on balance sheet and off-balance sheet actives along with the factors already mentioned. Ozili (2025) strongly criticised that country level national corruptions are the major causes behind the NPLs in MENA regions. On the other hand, Americas, BRICS, G20, and G7 economies NPLs are closely related to the bank specific issues as well macroeconomics while GDP and GDP growth are the most dominants to change the NPLs (Ozili, 2025). In Bangladesh, Rahman (2022) found that GDP, unemployment, exchange rate, inflation, lending rate, money supply (M2GDP) has a close relationship with NPLs which indicates that macroeconomics factors and their status quo.

Cross-country, country-specific and region-specific findings are vary depending on the nature of the economy, regulatory framework and bank structure, and operational context. Most factors,

e.g. macroeconomics conditions, operational inefficiency, economic growth, and GDP are the common determinants of NPLs. The long-run relationships between NPLs and macroeconomic factors align with growth theory and evidence suggest that NPLs have directly connected with growth dynamics. Theoretical frameworks indicate that macroeconomic stability contribute to a more stable business environment and enhance business performance and vice versa. According to Richards & Smith (2002), to achieve pro-cycle business environment government and governance mechanism are essential. The government deals with bureaucracy, legislation, financial control, regulation and force. This indicate that financial control, regulation, implementation, enforcement lie in hands of the government, and if managed properly, NPLs can be reduced. Empirical evidence suggests that government components are ineffective in implementing to the instrumentation of NPLs control.

Beyond the macroeconomic context it's also partially related to the socio-economic status, unprecedented COVID-19 pandemic effects and so on. Kartika et al. (2022), investigated the influence of corporate governance on NPLs by analysing data from 440 banks in emerging markets, using data sets from 2016 to 2020. They concluded that corporate governance has significant impacts on the NPLs. Governance is a significant issue and it defines actions, methods, and function of governing (Halfani et al., 1994) and taking these factors into consideration, their functionality becomes a key concern in NPLs. Also, Landell (1991) mentioned that good governance means how people are ruled, how the affairs of the state are administered and regulated as well a system of national politics and integration of these with the laws. Two theoretical perceptions indicate that a country like Bangladesh has clear lack of good governance and that has close integration to raise the NPLs. Adusei and Adeleye (2020) cross country study found that credit information sharing among creditors has an impact on NPLs and process of sharing or nor sharing is quite complex. Sharing or Withholding of information is related to the governance and good governance ensure proper management of state affairs and adherence of rules of law.

The majority of studies have adopted a quantitative approach while qualitative studies on NPLs are scarce in the literature. Research uses interviews, questionnaires, or surveys to elicit the opinions of bank managers and credit risk officers on the causes and consequences of NPLs. The response data generated from the interviews, questionnaires or surveys of bank managers and credit risk officers offers new insights that cannot be gained from using secondary data or quantitative methods. Therefore, this research studies undertaken qualitative research when investigating the determinants and consequences of NPLs in terms of policy and technological bridging. Based on the Ozili (2025) findings research has taken initiative to go beyond the quantitative to qualitative in-depth study where non probability convenience sampling helps the reasons behind the NPLs.

Among the policy gaps, the regulatory/supervisory style of the bank regulator/supervisor on bank NPLs need to be assessed. This is crucial because commercial banks will make every effort to minimize NPLs if they understand that the bank regulator/supervisor is adopting a regulatory/supervisory style. The regulatory signals to the banking industry that the bank is in severe distress. There will no guaranteed bailout from central bank. Such regulatory/supervisory inclination or style will incentivize banks to enhance their effort to mitigate NPLs.

2.1 Research Gap

Although a considerable amount of literature exists concerning determinants of NPLs, there could be gaps in policy issues. The majority of the studies are based on the quantitative approach that involves secondary data, whereas there are few qualitative observations of bank managers, credit authorities and regulators. Other unconventional drivers like attitudes of borrowers are understudied yet they can have a significant impact in repayment behavior. In addition, regulatory and supervisory frameworks are recognized, but the role of the supervisory body and credibility on the incentives of banks to manage NPLs has not been adequately addressed. Such gaps underscore the necessity of conducting future studies that also take into consideration qualitative views and supervisory strategies to bring about a more holistic insight about NPLs and future implications on financial stability.

2.2 Theoretical Framework

The prolonged existence of NPLs in the banking sector is a complex issue that is affected by economic, behavioural and institutional factors. Although a lot of empirical research has been able to identify macroeconomic as well as bank-specific factors that cause NPLs, significant gaps still exist in terms of qualitative and policy aspect behind loan default and recovery. Yet, the complex and policy loopholes need to be reconsidered in the context of Bangladesh approach due to the exponential increase in the NPLs of the financial institutions. The policy implementations, legal actions and institutional autonomy that government excessively interferes and creates inefficiency in the regulatory bodies make the NPLs crisis worse, which is highlighted by government theory (Richards & Smith, 2002). In the meantime, Agent Theory (Jensen & Meckling, 1976) stated that such conflicts of interest among stakeholders, driven personal interest, political favor and tolerance can lead to risky lending and loan defaults. Besides these theories, there is the Theory of Governance (Landell, 1991) that describes weak institutional control, absence of transparency and poor accountability mechanisms in bank resulting in ineffective loan monitoring. Regulatory Capture Theory (Stigler, 1971) was considered in this study which serves as an effective prism to examine how institutional weaknesses and supervisory failures can be related to the current problem of dealing with NPLs. This theory argues that even regulatory agencies, instead of to serve the interests of the people, can be captured or in other words influenced by the same industries that they are supposed to be regulating. This seizure may be due to information asymmetry, personal contacts, and or dependence between regulators and financial institutions (Dal Bó, 2006).

Regulatory Capture Theory is useful in the NPLs management context as it can be used to explain how regulatory generosity or biased enforcement can undermine the efficacy of supervisory structure. Close relationship between regulators and the business people of bank to provide information and resource can lead to weak enforcement and supervision on them. This circumstance may induce moral hazard in the banks and prompt them to report less credit risks, have interrelated lending or postpone the classification of the NPLs (Barth et al., 2013). This consequently erodes the plausibility and preventive effect of the regulatory system, thus enabling the continuation of risky lending habits and the accumulation of systemic susceptibility.

Thus, the use of Regulatory Capture Theory enhances the current knowledge of the determinants of NPL by connecting regulatory credibility, institutional incentives and behaviour of borrowers. It highlights the necessity of reforms that would increase regulatory independence, promote transparency and decrease the chances of being captured by political or personal favor. A more holistic approach that incorporates both quantitative determinants and institutional knowledge can therefore result in a more detailed explanation of the development and existence of NPLs, and its consequences to financial stability in the long run.

3. Research Methodology

3.1 Nature of research

This research is explanatory in nature and investigated to understand the multifaceted strategies for reducing NPLs risks in the banking sector of Bangladesh by examining institutional dimension. The study also analysed the effective mechanism to enhance loan performance and reduce default rates through scrutinize the perspectives of the relevant stakeholders. Within the qualitative context, IDIs have immense power to dig out the hidden and unexplained facts which have multiplicative impact on the NPLs to explore. Key Informant Interviews (KIIs) and Focus Group Discussion (FGD), IDIs have extensive power to go beyond the normal perceptions and can help to solve specific problems with detailed explanation. In this study, researchers followed IDIs with relevant subject matter expertise using non probability convenience sampling.

3.2 Research approach

To get sufficient answers in line with the research question of the study, the researchers adopted a qualitative research approach. The research utilized IDIs, along with secondary data review for triangulation to validate the result. The study covered key sectors such as Bank/ Non-Bank, Bangladesh Bank, Industry or Business Owners/Managers, Industry Association Representatives, Bank board members, Independent Auditors/Governance Experts, Borrowers and Industry Experts.

3.3 Sampling technique

To ensure inclusion of stakeholders directly linked to NPLs issues, a non-probability convenience sampling was employed to conduct 23 IDIs using eight unstructured interview schedules. Besides, a Case Study approach was adopted to learn in detail the Bank-Specific Financial and Non-Financial Determinants of NPLs.

3.4 Data collection technique

Six unstructured interview schedules were administered to collect primary data through IDIs from Industry Owners/Manager, Credit Authority, Bank Board Members, Auditors, Industry Association and Regulatory Authority. DCCI R&D team designed the In-depth interview (IDI) schedule. The study took around one month to complete.

3.5 Analytical Technique

The qualitative data that were gathered in the study was systematically analysed through thematic and content analysis method. Themes of recurrent ideas, attitudes and behaviour patterns were identified and grouped together through thematic analysis to manifest the underlying themes with regard to repayment behaviour. Content analysis also allowed exploring narratives and textual information to understand the frequency and the importance of a particular response. Special emphasis was laid on the interpretation of the behavioural predispositions and cultural standards according to which people decide on how they pursue a loan repayment. This method of analysis allowed gaining a better understanding of the social and contextual issues that affected the repayment practices in the community under study.

4. Results

This section presents the findings related to the overall objective of the study, which aims to investigate the multifaceted strategies for reducing NPL risks. The data collection timeline for this research was from September 15, 2025, to September 27, 2025. A total of 23 IDIs were conducted among Industry Owners/Managers (7), Credit Authority (6), Bank Board Members (3), Auditors (1), Industry Association (3), and Regulatory Authority (3). Besides, to validate the information gathered from the IDIs, a detailed case study was also conducted with a bank official.

4.1 Stakeholder perceptions

4.1.1 Industry Owners/Manager

The study focused understanding the loan repayment and interest rate effects on the NPLs from the industry owner/manager's points of view. The respondents emphasized that it is not a matter of the cost of borrowing, but the problem is associated with the systems of borrowing loans and repaying them in Bangladesh. The respondents stated that in most cases, borrowers experience significant challenges whenever there are delays in loan repayments despite the situations that may be beyond their control. Representatives of the industry also clarified that in the time of the COVID-19 pandemic, a significant number of Small and Medium Enterprises (SMEs) could not make payments because the crisis has never been experienced before. Even in this extraordinary case, banks were not willing to give the required flexibility which forced some businesses to sell off its assets to pay off the dues. New credit facilities that were supported by collateral were also not granted in various instances and this made these borrowers to be considered as defaulters (Raihan et al., 2020).

Even though stimulus packages facilities were officially announced for SMEs, most entrepreneurs complained that they had trouble accessing them. As a matter of fact, small enterprises were not favored by the banks as they seemed to focus on giving more credit to the big borrowers most of whom were already at the brink of bankruptcy or loan classification. The main problem, therefore, is not just high interest rates but the existence of discriminatory and in a few cases, politically biased practices of granting loans and repayment (World Bank, 2024). The recent

rise in the interest rate has had a negative impact on the cash flow of the business and it has increased the general cost of operations and added more financial strain. Moreover, the new recovery measures adopted by banks are limiting the repayment of the SMEs and thus raising the chances of default (BRPD¹ Circular No. 15, 2024). The representatives of the business proposed that in case terms of loans were more lenient, i.e. by allowing longer periods to repay them, or by installments payments according to real income streams, the repayment would be easier. They also stressed that there was a need to have a reduction in interest rates to facilitate business sustainability.

Although disruptions in the supply chain, market variability and poor macroeconomic conditions were recognized, the respondents highlighted some other barriers e.g., internal operational challenge was also mentioned as the significant challenge by the business owners. SMEs are high-risk borrowers and the banks focused on quick recovery efforts instead of providing flexibility. On the other hand, large, and politically linked borrowers were enjoying the better treatment as well as they were being re-financed even after massive defaults. Respondents emphasised that these types of double standards are the direct cause of NPLs in the banking sector. In addition, inefficiency and corruption among bank officials were also reported as the major challenges. Besides, the respondents also complained that there is no industry friendly roadmap in the policies like Industry policy, SME Policy for the CMSMEs.

The interaction between most of the industry owners and the bank officials during repayment delays were usually unpleasant as reported. Borrowers were in a number of cases given notices in harsh terms or pressured which led to a lot of mental disturbance. Nevertheless, some banks were recognized to have more customer-friendly practices, which allowed the clients to reschedule repayments in a free and friendly way. Entrepreneurs positively saw these approaches.

The study finds that there were significant discrepancies in evaluating loans in dissimilar industries (Hassan et al., 2024), (TIB, 2020). According to the respondents, the evaluation processes tend to be too formal and in other instances, they have been used discriminatively. As an example, some companies were in desperate need of financing and their Letters of Credits (LCs) were valid, but they could not get the required funds in time. However, on the other hand, where companies had large deposits, the banks are seen to be more receptive and eager to loan out money implying favoritism (Hassan et al., 2024), (TIB, 2020).

Most of the respondents when questioned on whether the assessment of loans across industries was fairly done indicated that, it was not fair. They observed that banks are inclined to prefer those enterprises that have greater current debts or better financial impact. SMEs have more rigorous loan approval conditions and take longer to process than their larger counterparts, which tend to be approved faster and under better conditions. This balance, the respondents found, remains disadvantageous to the advancement and competitiveness of the smaller sector.

¹ Banking Regulation and Policy Department (BRPD), a department within Bangladesh Bank responsible for creating and enforcing prudential regulations for the banking sector in Bangladesh.

Table 1: Summary of Findings from the Industry Owners and Managers

Key Findings	Gaps Identified	Insights from Interviews
Loan repayment challenges due to the banks' rigid system and lack of required flexibility.	The borrowing and repayment system is inflexible, not just Interest-related.	Delayed payment occurs due to disruption in the regular cash flow, e.g., COVID-19, political unrest, etc.
Most SMEs faced difficulties accessing financing packages.	Lack of transparent and equitable loan allocation for SMEs	Recent interest rate hike has little impact on NPL; rather, the lending system is faulty.
New recovery measures adopted by banks, like seizing collateral, are limiting the repayment of the SMEs and thus raising the chances of default.	No flexible repayment system or real income-based installment system.	Installments tied to real income streams would make repayment easier and reduce default risk.
Double standards and corruption among bank officials fuel NPLs.	Weak governance and oversight in loan process.	SMEs perceived unfair evaluation and favoritism in loan approval.
SMEs are high-risk borrowers, and the banks focus on quick recovery efforts instead of flexibility.	No customer-friendly rescheduling system.	Large and politically linked borrowers enjoy preferential treatment and refinancing even after massive defaults.
Inefficiency and corruption among bank officials.	Inconsistent and discriminatory loan appraisal.	SMEs' loans take longer to process and are subjected to stricter conditions compared to large borrowers.

(Source: Authors' findings, 2025)

4.1.2 Credit Authority

The study focused on bridging the policy gap to address NPLs within the context of both banking and non-banking sectors in Bangladesh. To explore the various facets of NPLs, the study engaged with the credit and compliance divisions of Bank to understand their specific policy-oriented issues in both perspectives. The bank representatives were highly experienced in credit and compliance, and each representative with more than fifteen years of professional experience. They willingly shared their experiences, insights, and perspectives revealing several important facts related to policy development and implementation strategies.

The study examined six different sections to understand the diffusion and contagion effects of NPLs. This section focused on the policy specific credit and compliance factors to influence NPLs and its dynamic norms across the industry. Several issues, e.g., including political, system integration or broadly management they were mentioned (Hossain, 2025). Among these, according to a senior representative of one of the major commercial banks, the latest Master Circular on the subject Loan Classification and Provisioning BRPD Circular No. 15, 2024 resulted in a massive increase in the officially reported amount of NPLs in Bangladesh. Nevertheless, the official

explained that this increase is not a sign that the behavior of borrowers has worsened or that the number of loan defaults in fact has risen. This is actually a product of the restriction of loan classification criteria which are intended to reflect the actual status of the non-performing exposures in the banking system. The officials pointed out that the regulatory reform will make the domestic prudential framework of Bangladesh compliant with global best practices, especially the standards of Basel III ² and IFRS 9³.

The most significant change to be enacted by the circular as the official claims is the shortening of the overdue period which initiates the classification of loans. However, all sorts of loans will be treated as non-performing once they are overdue by three months, which is a drastic change in terms of loan management compared to the previous regime that gave the bank a grace period of nine months before the loan is classified as non-performing. Loans that were Non-performing with a period greater than three months could be placed under forbearance of another six months. The new regulation does not have this flexibility and this means that risk recognition is more immediate and realistic (Islam, 2024). As a result, a large amount of loan classified as Special Mention Accounts (SMA) or even unclassified will be put on the official NPL portfolio. The official said the change will improve transparency and accuracy in the description of the real credit risk profile of the banking industry.

The circular also requires the incremental adoption of the Expected Credit Loss (ECL) methodology as necessitated in the IFRS 9, and full adoption is expected by 2027 (BRPD Circular No. 15, 2024). According to the official, the shift of the historical model of incurred losses to a prospective, risk-sensitive one is a paradigm shift in the assessment of credit risk. In this system, the banks will be expected to identify the anticipated losses before they happen and not after a default event has taken place. As the official pointed out that this change will require increased provisioning and strong internal risk management capacity. Moreover, it will also strengthen the credit management system and will increase the resilience of the financial sector.

What is more, the circular sets more rigid provisioning requirements. This new provisioning rates have been standardized to 20 % on Substandard loans, 50 % on Doubtful loans, and 100 % on Bad/Loss loans, and SMA currently have to have a general provision of 5 % (BRPD Circular No. 15, 2024). In addition to this, the general provisioning rate has been raised in the case of CMSME sector to 1 % as opposed to 0.75 % previously. According to the official, these new standards of provisioning will make banks have more capital buffers against possible credit risks. These, together with the expedited schedule of classification, guarantee that the balance sheets of banks also have a more realistic representation of their actual financial position and the risk of their balance sheets.

To conclude, the bank official emphasized that Master Circular is not the cause of new loan defaults but it eradicates regulatory forbearance and advocates a more rule based and transparent

² Basel III is an international set of banking regulations developed by the Basel Committee on Banking Supervision in response to the 2007-2008 financial crisis to strengthen the banking system. Its core goals are to improve banks' ability to withstand economic and financial shocks by increasing their capital requirements and to improve risk management and transparency through enhanced liquidity, leverage, and disclosure rules.

³ IFRS 9 is an international accounting standard that sets the rules for the classification, measurement, impairment, and hedge accounting of financial instruments.

reporting regime. The increase in the reported NPL ratio shown to project should therefore be viewed as a realignment of its regulation and not a change in the quality of the loans. The measures included in the circular of creating stricter standards of classification and provisioning will increase the stability of the banking system in Bangladesh, instill confidence among investors and bring the regulatory regime of the country nearer to international practices in credit risk management.

On the other note, a top executive of a major commercial bank in the country claims that NPL crisis in Bangladesh is a complex problem that cannot be blamed only on regulatory circulars like BRPD Circular No. 15. The issue is very structural, institutional and macroeconomic backward that has been maturing with time (BRPD Circular No. 15, 2024). The official pointed out that the crisis is actually a failure of governance, as well as operational flaws within the banking ecosystem which are exacerbated by poor economic factors.

According to the official, the most prominent factor that is leading to the present situation of NPLs is the inadequacy of corporate governance, and the all-encompassing impact of political meddling and interfering in the banking activities. According to him, lending in a corrupt manner, especially the lending of the connected-party, nepotism and the lending decisions based on political considerations is the worst thing that has destroyed the integrity of the sector. Karim et al. (2025) also find the similar findings in their study. Banks often lend money to persons who are associated with the bank directors or politically powerful persons without due diligence. When such loans default, then political favors and influence are employed to hinder recovery efforts or regulation actions. This has been termed as willful default and it has become an industry wide phenomenon. He also noted that lack of a robust accountability system has become a culture of defaulting loans without any form of legal or social repercussion, which has encouraged the culture of repeat delinquency among borrowers.

Another issue that was highlighted by the official is weak supervision. Political pressure, fragile institutions, and lack of autonomy in their operations tend to make Bangladesh Bank and other regulatory bodies not capable of imposing compliance. The enforcement measures are, in most cases, delayed or watered down and this undermines the integrity of the supervisory structure and allows influential defaulters to remain non-compliant. Such lapses in governance have rendered a condition in which the abuse of the banking resources is condoned and continued.

When talking about bank specific operational shortfalls, the official noted that most of the banks are plagued by a poor credit evaluation procedure and ineffective post-disbursement surveillance measures. Loans are granted in many instances without thorough risk assessment and due evaluation of the feasibility of the projects (Karim et al., 2025). Once the funds are given, it is not commonly followed up to see how the money is being used and when the organization realizes that something is amiss, it is usually too late to change as the situation turns into default. The problem is worsened by inefficient management particularly in state owned commercial banks and failure to make sound decisions and poor internal controls. He also noted that there is also a moral hazard issue where some bank owners and managers indulge in lending on risky or unwise terms and believe that any losses they incur will be ultimately borne by the government or depositors.

On the macroeconomic level, the official noted that increased economic instability on a broader level has also led to the increase in NPLs. Sluggish economies, stagnation in sectors and reduction in GDP growth have damaged the ability of the borrowers to earn incomes and pay their

loans punctually. The inflationary pressure and fluctuating exchange rate have not only hiked the cost of production especially to those sectors which rely on imports, but have also ensured that financial pressure among corporate clients is compounded (World Bank, 2024). He also added that the high interest rates have greatly contributed to the cost of servicing a loan and many borrowers cannot afford to make regular repayments. Such circumstances, in their turn, increase the %age of non-performing assets in the banking sector.

On a final note, the official once again echoed that the NPL crisis is not such just a regulatory failure but an expression of institutional under-strengths, politicization, and lack of proper risk management (Hassan et al., 2024; TIB, 2020; Banerjee, 2025). The issue will not go away despite the new circulars or reforms without the renewed corporate integrity, independence of regulatory bodies, and credit discipline among banks. He requested a concerted strategy that encompassed tightening of the belt, open management practices and better management of the macroeconomic system to protect the long-term stability of the financial system.

Table 2: Summary of Findings from the credit authority

Key Findings	Gaps Identified	Insights from Interviews
Strict Loan Classification and Provisioning	Overly strict criteria, shorter overdue periods, and insufficient assessment of borrower capacity.	Regulatory tightening without understanding borrowers' repayment capacity contributes significantly to NPL risk.
Governance failure and operational flaws within the banking ecosystem are exacerbated by poor economic factors.	Weak governance and operational inefficiencies in the banking system.	Weak governance and operational flaws, combined with adverse economic conditions, hinder borrowers' ability to repay loans.
Inadequacy of corporate governance and political interference in the banking activities	Political interference in the banking activities.	Weak corporate governance and political interference contribute to rising NPL.
High provisioning requirements can sometimes erode banks' capital base.	Higher capital buffer requirements strain bank resources.	Excessive provisioning erodes banks' capital base and increases financial risk.
Weak credit evaluation and inefficient post-disbursement monitoring.	Inadequate analysis of borrowers' capacity and market conditions.	Undermining the loan quality band increased the risk of NPL.
Moral hazard issue and managers extend loans on risky or unwise terms.	Lack of check & balances in the loan approval process.	Compromising asset quality escalates default risk due to managerial discretion without accountability.
Economic instability on a broader level also led to an increase in NPLs.	Absence of a flexible loan repayment schedule during economic shocks.	Economic downturns reduce borrowers' repayment capacity.

(Source: Authors' findings, 2025)

4.1.3 Bank Board Members

The majority of the respondents agreed that they combine both Integrated Software and Paper-based checklist to incorporate corporate governance in the process of loan approval and monitoring in bank. The respondents indicated that they can have access to the integrated system to check the profile of the borrower but physical verification is still in place. Systems inform them on the history of repayments of their clients, yet cannot inform them of whether a factory machine is not in use. It is the reason why managers are compelled to look before they can sign. The digital tools that are available in public banks are not fully dependable as in the case of the private banks.

Even when a borrower has a clean Credit Information Bureau (CIB) report, there are usually underlying financial weaknesses concealed in the form of misleading borrowing and classification of loans. This discrepancy is depicted by three common patterns. First is the practice of loan shuffling or debt rolling which gives a false impression of repayment on time because outstanding debts are being repaid by new short-term loans that are meant to signal a cash flow crisis even though the CIB record is perfect. Second, the problem of business-use loans being misclassified as personal loans would conceal the actual risk of business operations, as the supposedly low-risk personal credit would be directly at risk as a result of defaults in business operations. Third, off-balance sheet or informal loans of the CIB have no sense of shadow liabilities since the lenders are private or other parties (Chowdhury, 2025).

These practices point to a severe shortcoming of CIB-based tests: an unblemished credit history can be misleading about the soundness of the borrower. Field checks and total financial review are thus the complementary needs to the credit bureau data to determine actual credit risk.

This study found that, in spite of increased efficiency in loan processing software, the human judgment in credit assessment is important. An example is a loan case in agro-industrial loan in Rangpur, the system data indicated that there was low risk, but a visit to the field revealed that the factory of the borrower did not have the equipment needed to start a likely default. This example indicates that the software decisions are restricted to the quality of the input, data, whereas realities unknown to paper work are revealed through the experiences of the managers and shop floor inspections. Finally, technology may help, but even good lending requires human checks and balances.

The Risk Management Committee (RMC) is in the middle of loan approval and its role is not only to analyze each borrower but to oversee the issue in a wider scope. The RMC has stringent scrutiny of sectoral exposures, exposes the entire portfolio of credits to stress tests conducted in unfavorable economic conditions, and sees to it that due diligence is always punished in all lending decisions. In essence, they spearhead the management in setting and defining risk assessment structures. One tangible outcome of them was their vote in 2023 to impose restrictions on the exposure to single borrowers at 10% below the ceiling of Bangladesh bank. This initiative is the very reason behind the reduction of high-risk credit concentrations in the bank.

The work of the RMC has been complemented by the Audit Committee that has played an important role in lending discipline. It has raised the issue of the continuity of re-scheduling of high defaulters severally enough. The committee made a decisive move in 2023 and was able to

put a halt to the long-standing trend of evergreening loans. This activity that includes taking more loans to clear other ones had earlier enabled the bank to overstate its NPL level artificially. After these interventions, the bank has been making an aggressive recovery campaign in 2024. The campaign was able to recover a considerable amount of Tk. 12,728.90 million of classified loans using special tribunal to recover the largest defaulters. This goes to show that strong surveillance and timely tribunal actions were effective in making them reclaim over Tk. 12.7 billion despite the fact the NPL ratio of the bank remained at a high of 41.60 % in the same year (Bhuiyan, 2024).

These recovery efforts are however confronted with a consistent and aggravating challenge in the legal system that adds to the continuous NPL problem. Upon default of a borrower, the bank usually tends to proceed to collect the debt by auctioning off the assets that the borrower has mortgaged. The borrower will usually appeal to the court, and get a stay order of the auction in a typical legal gambit. Such a legal injunction essentially puts a complete stop to all the recovery system of the bank and the borrower is not obliged to pay a single penny; the bank cannot sell the collateral either. This time-consuming and frozen legal procedure will see the loan that was defaulted listed and never recovered, and day after day the NPL figures of the bank are soaring.

According to the respondents, some loans in the past failed due to political influence and weak due diligence. To prevent such occurrences, banks now require dual legal vetting of collateral and independent valuation reports. However, valuation anomalies still exist, as some assets are found to be significantly overvalued. For example, a property of a company worth no more than Tk. 1 crore might be reported as Tk. 10 crore, inflating the borrower's financial position and misleading the credit committee (Anti-Corruption Commission, 2025). Respondents noted that independent valuers often escape accountability because they are not required to provide a traceable verification number such as a Document Verification Code (DVC) number used by chartered accountants in audit report. To address this, they emphasized the need for an automated system that assigns a unique identification number to every valuation report. Furthermore, if any credit authority later proves that a valuation was intentionally overestimated or underestimated, the responsible valuer should be held legally accountable and subject to disciplinary action. It was also observed that in earlier times, branch managers were hesitant to reject loan proposals from influential individuals. The introduction of dual legal assessments and independent valuations, however, has given officers stronger grounds to reject unviable or politically motivated loan proposals with greater confidence.

In this respect, the respondents believe that the profitability comes when the loans are well serviced and held in good health. They stated that they would concentrate more on SMEs and remittance-backed retail loans as this is an area with a superior repayment discipline as opposed to reliant on high-risk corporate loans. They said that they survive on a constant government business and secure investments. They further stated that it is not about risky corporate borrowing in order to make profits but smart use of capital and liquidity. They also described that they deal with risks through diversification. Although the returns of industrial loans are higher, they have more risks hence balance it by targeting CMSME and export backed sectors who are more likely to make reliable repayments.

The respondents indicated that there is need to have a *centralized credit scoring system* that would be shared by all banks. They also insisted on the need to have tougher bankruptcy

legislation. In their opinion, NPLs are not going to be reduced until banks will be able to sell collateral in a short period of time. They also said that banks ought to have independent professional directors in place of having the government appointees as the only ones. Besides this, they also pointed out that more cases of loans recovery should be expedited in court. The absence of these changes meant to them that NPLs would not reduce. Moreover, the respondents further indicated that the collateral auctions ought to be implemented at a faster rate. They advised that there should be an enhancement of digital monitoring to be in a position to monitor loans. Finally, they understood the need to have a work culture where the loan officers are encouraged to give good quality loans and not huge loans.

Table 3: Summary of Findings of Bank Board Members

Key Findings	Gaps Identified	Insights from Interviews
Both an Integrated Software and a Paper-based checklist to incorporate corporate governance in the process of loan approval and monitoring is important.	Banks rely too heavily on digital processes without complementary physical checks.	Physical inspection can reveal issues that are not comprehended by software.
Hidden weaknesses may exist despite having a clean CIB.	CIB data is incomplete and may not capture off-book loans.	Loan shuffling and misclassification distort true borrower risk, making NPLs harder to predict.
Overvaluation of collateral and lack of accountability for valuation experts.	Misleading collateral assessment and valuation due to a lack of independent verification.	Independent or third-party valuations provide accurate and true information, preventing inflated collateral claims
Need for a centralised credit scoring platform	Absence of a unified credit scoring system or platform.	A centralised system can track borrowers' credit history and improve risk assessment.
Dual legal assessments and independent valuations help reject risky, politically motivated loans.	Absence of mandatory dual legal assessments and independent valuations in place.	Implementing dual assessment can significantly reduce sanctioning of risky or politically motivated loans.

(Source: Authors' findings, 2025)

4.1.4 Auditors

According to the respondents, the existing governance system in banks is still mostly manual. Paper files are *physically moved around*, which causes delays and opens the door for manipulation. They further expressed the view that board-level committees do exist, but they often fail to act effectively. As an example, in 2024, a major company's loan kept getting rescheduled. Even though it was flagged, the Risk Committee approved it because the company was considered strategically important. An example of such dilemma in the view of strategic importance prevailing over risk considerations can be seen in a large organization that has a substantial presence in the pharmaceutical industry in Bangladesh (Daily Sun, 2025). In the event that such a company failed

to repay their loan. In this regard, the short-term and harsh effect on the supply of medicine in the country would be a significant strategic issue. Since the production of medicines is critical, the loss of a large industry would not be easily substituted in the short run. As such, to ensure the medicine supply smoothly that strategically important company can be provided support to maintain the business, stabilizing the market and ensuring current prices of medicine to serve the common good.

On the other hand, one well-known bank recruited the *independent experts* to assess the value of collateral in 2021. As a result, fewer properties were overestimated as loan security. This smart move helped the bank avoid major losses later on.

They explained that with a high default rate of NPL at 41.60%, it's challenging to maintain profitability. Profit should come from performing assets, not by artificially cleaning books. In order to reduce NPLs, respondents suggested making the loan approval process fully *digital to avoid delays and manipulation*. For setting aside funds to cover risky loans, they emphasized strengthening the rules. They also highlighted the necessity of holding managers accountable for approving bad loans by linking their performance to the quality of loans they sanction.

Table 4: Summary of Findings of Auditors

Key Findings	Gaps Identified	Insights from Interviews
Existing bank governance is largely manual, with paper files circulating physically.	Relying on paper-based process increases delays and allows manipulation.	Manual assessment can lead to delays and potential manipulation of loan approvals.
Board committees often prioritize strategic interest over risk; as a result, NPL increased.	Biased decision-making and absence of a collective decision-making process.	Concentrated power in boards sometimes bypassed proper risk assessment.
A fully digital loan process prevents delays and reduces manualization, and increases transparency.	Absence of a digital loan process system with an integrated monitoring system.	Loan sanction can be done digitally, which reduces time and borrowers' excessive paperwork.
Need to reduce NPLs and improve loan governance	Absence of a fully digitalised loan approval and monitoring system	Fully digital loan processing to eliminate delays and manipulation, strengthening provisioning rules and holding managers accountable.

(Source: Authors' findings, 2025)

4.1.5 Industry Association

According to the respondents, the prevalence of NPLs among the RMG industry members is moderate. The representative from RMG sector opined that the NPLs ratio from RMG sector is similar to other sectors and this sector alone is not responsible for the present situation. Regarding the trends in loan repayment patterns across different business sizes, the respondents stated that NPLs are currently rising and are expected to increase further for classified loans (Quarterly

Financial Stability Assessment Report, 2025). In the previous term, the government did not disclose the data on classified loan properly. But now, because of Bangladesh Bank's stricter rules, that hidden data is coming to light, so older NPLs are finally being seen.

The respondents believed that NPLs are rising because of decision making capacity by Bangladesh Bank and unethical buying practices in the global market. They felt these factors are making the situation worse instead of improving it. They also mentioned that businessmen should not be blamed for delaying bank instalments. Many businesses suffered heavy losses, after the COVID-19 pandemic, which made it difficult for them to repay loans on time. Consequently, several factories have already shut down, and more closures are expected if banks do not offer better support.

According to the respondents, the businessmen from knitwear sector usually took smaller loans, less than 100 crores, while those in spinning and textile (backward linkage industries) borrowed much larger amounts, ranging from 200 to 1000 crores. Therefore, they suggested that the latter group might carry more responsibility for the rising NPLs. They added that despite introducing several policies, there has been no visible improvement in reducing NPL level. Finally, they pointed out that while SME loan borrowers generally pay their instalments on time, they still face difficulties with the monthly payment system, which needs to be addressed.

Most respondents felt that banks' lending rules do not match the real situation in the country (Raiser, 2024). They believed that the criteria used by banks are often unrealistic and don't reflect the actual challenges faced by businesses. They pointed out that Bangladesh is still a developing country, so banking policies from developed nations may not work here yet. According to them, advanced systems like *automated notification and quick legal actions should be introduced* slowly and step by step. Respondents warned that applying strict foreign-style banking practices too suddenly could increase pressure on borrowers and lead to a rise in NPLs. They stated that while some of Bangladesh Bank's current policies were seen as practical, most were considered out of touch with the realities of the local economy.

They explained that there are two types of loan defaulters: those who intentionally avoid repayment (willful defaulters) and those who default because of tough circumstances (involuntary defaulters) (The Daily Star, 2024). Most businessmen fall into the second group, as they didn't get a supportive business environment but banks are not taking this into account. The respondents stated that Bangladesh Bank needs to create its own banking policies based on the country's current situation. According to them the industries are struggling due to ongoing gas and electricity deficiencies, and the government has not yet been able to fix these problems. Consequently, many factories are operating at only 40% of their full capacity, which has made it tough for businesses to produce goods and repay loans on time. They realised that banks should take these challenges into account when designing loan policies. According to them, policies must reflect the real conditions borrowers are facing, or else NPLs will continue to rise.

The respondents also mentioned that simply using automated financial monitoring tools has not helped reduce NPL risks. They explained that NPLs depend on two key factors: the overall business environment and the borrower's intention to repay. In cases where borrowers deliberately avoid repayment, strong legal action is needed. They believed that NPL data should be made public

and transparent. Although some corrections are now being made, they stressed the importance of taking timely action based on current circumstances.

Respondents recommended that all banks should offer SME loans to new entrepreneurs, as they are not responsible for the existing NPL problem. They highlighted some scheduled banks approved collateral-free loans of up to Tk. 5 crore at single digit interest for members of an Association. These loans are easy for members to access. They further suggested that borrowers in this sector should be allowed to repay instalments every six months, similar to the Cash Credit Loan system. They believed that this *flexible repayment option would encourage more businessmen* in the sector to apply for SME loans.

A recent initiative taken Bangladesh Bank's initiative was appreciated by the respondents, where borrowers are allowed to reschedule their loans by paying only 2% upfront, along with a grace period of up to two years (Bangladesh Bank, BRPD Circular No.07, 2025). They considered this a helpful step for struggling businesses. However, they suggested that the two-year grace period should be extended based on the actual repayment ability of the businessmen but have to align with bank policy too. They felt that a more flexible timeline would better support borrowers facing financial challenges. The respondents also emphasized the need to remove political influence from banking decisions. They believed that *interference from board members within banks should be reduced*, and that recommendations from the Central Bank should not be allowed to affect loan approvals or rescheduling decisions (Bangladesh Bank, 2021). Regarding the collateral-free SME loan, they noted that the documentation process is smooth and borrowers can access to the loan easily. However, they recommended that the instalment payment period should be extended to make repayment more manageable for these entrepreneurs.

Table 5: Summary of Findings of industry association

Key Findings	Gaps Identified	Insights from Interviews
Banks do not offer better support to businesses.	Polices do not account for business constraints.	Many factories suffer during economic shocks.
Banks' lending rules are often unrealistic and do not match the country's real economic and social situation.	Banks' lending criteria fail to reflect actual economic challenges.	Banks' lending rules don't reflect developing countries' economic challenges.
Most businessmen fall into the involuntary defaulters.	Monthly installments do not align with cash flow patterns	Six-month installment or grace periods are preferred to manage repayments effectively.
Interference from board members and influence from Central Bank recommendations affect loan approval.	Absence of a conflict-of-interest policy and robust governance system.	Such interference often leads to high NPL and undermines fair lending practices.

(Source: Authors' findings, 2025)

4.1.6 Regulatory Authority

The respondents shared that the challenges in the banking sector are complex and come from many directions. They mentioned that loan classification rules are often made more flexible, and the actual number of defaults is not clearly shown. In many cases, borrowers with *political connections are given special treatment*, which weakens the system of monitoring and reduces accountability (Banerjee, 2025). They also pointed out that the *attitude of borrowers* adds to the problem. Many borrowers think that defaulting on loans is something they can negotiate, rather than a serious issue. Because loans are often rescheduled without any real consequences, the habit of repaying on time has become less important. This, according to the respondents, has made the overall loan discipline much weaker (Modak, 2025).

The respondents thought that numerous macroeconomic forces are aggravating the situation. They said that the problem is being worsened by slow GDP growth, increasing inflation, fluctuating currency rates, and strain in various business sectors. They noted as well that there are *still significant restrictions on the independence and capacity of Bangladesh Bank*. Banks are grappling with the lack of talented officers, ineffective application of risk analysis applications, and ineffective loan borrower tracking systems notably in knowing who will pay and who will not. Indeed, the respondents indicated that NPLs have emerged to be a major challenge to the economy of the country. The banks are losing their capacity to lend to other parties, particularly the SMEs as they are compelled to hold back more money to cater to these risky loans. The greatest sufferers are SMEs since banks have become more careful with issuing loans.

The respondents stated that even though Basel-III standards have been adopted, there are still major gaps in banking regulations. They said that banks and non-bank financial institutions continue to have weak capital reserves, and enforcement of rules is not being done properly. They also pointed out that *a lack of transparency* is making the situation worse. According to them, there are no strong policies in place to *monitor borrowers* who take loans from multiple banks. In addition, they mentioned that there are limited research and *not enough reliable data* available to support better decision-making in the financial sector.

The respondents indicated that the problem of NPLs in Bangladesh has escalated to a very high level particularly in the banking sector. They believe that the *poor administration, laxity in following laws and the mindset of borrowers* are exacerbating the situation. They further noted how political interference, inadequate control and irresponsible lending methods have gradually eroded confidence in the financial system. They state that such issues are now posing greater threats to the economic development of the country, future investments, and the stability of the country in general.

The respondents said that *effective and reliable reforms* are necessary to solve the NPL crisis. They wanted the Bangladesh Bank to be *granted complete independence*, not interfered with politically, with the strict adherence to loan classification and provisioning rules. They also focused on the importance of enhancing accountability of borrowers. This, according to them, would be achieved by making legal adjustments, blacklisting individuals who default repeatedly and conducting awareness campaigns that will motivate them to repay loans on time.

In addition, the respondents mentioned that more effective monitoring and research is very much needed. They proposed to have a *centralized credit registry that is connected to unique IDs* and obligatory interbank checks. This would aid in real time tracking of borrowers. They also suggested further research based on the requirements of the policy, such as stress tests of particular sectors, and early warning reports to enable banks to prepare against risks. Moreover, they recommended that an Asset Management Company should be established promptly in order to assist in lowering NPL ratios. They thought that the credit guarantee programmes would help reduce the chances of loan default and legal recovery procedures should be simplified and expedited to lessen the burden on banks. Lastly, they also proposed that the names of *loan defaulters should be published publicly* so as to deter voluntary non-payment as well as enforced non-payment to enhance overall loan discipline.

Table 6: Summary of Findings of Regulatory Authority

Key Findings	Gaps Identified	Insights from Interviews
Many borrowers think that defaulting on loans is something they can negotiate, as a result habit of repaying on time has become less important.	Lack of enforcement and accountability, as well as political influences.	Borrowers with influential connections receive leniency, making late repayment a recurring habit for some borrowers.
Ineffective application of risk analysis and loan borrower tracking systems.	Weak risk analysis and a borrower's tracking system.	Borrowers exploit weak risk analysis and intentionally conceal information.
Limited research and <i>not enough reliable data</i> available to support better decision-making in the financial sector.	Absence of a centralized interbank credit registry system	Difficulty in tracking borrowers across multiple banks leads to poor lending decisions.
Absence of a credit guarantee mechanism and asset management support	No dedicated institution to manage bad assets or mitigate default risk.	Establishing AMC and a credit guarantee programme can reduce NPL ratios.
Weak borrowers' accountability and culture of impunity	No public disclosure or penalty for repeat offenders.	Publishing defaulters' names and enforcing penalties to top defaulters could improve repayment behaviors.

(Source: Authors' findings, 2025)

5. Case Study

The case study relies on the thoughts and experiences of one of the top officials of a scheduled bank in Bangladesh. The insights indicate that the emergence of NPLs and their maintenance have been affected by financial and non-financial aspects especially political interference. The official believes that the increase in NPLs in Bangladesh cannot be explained only by the weaknesses in the banking rules or policies. Rather their roots lie much deeper, such as:

- **Inadequate due diligence in selection of the borrowers:** The income, business viability and management capabilities of borrowers are not properly evaluated.

- **Fraudulent documents:** Sometimes fraudulent or falsified documents are accepted, particularly where the borrowers are well-connected.
- **Collateral complication:** Properties have been overvalued or mortgaged with more than one bank and it is hectic to recover property.
- **Group based lending risks:** It did not consolidate loans among various businesses in the same ownership that they could assess their risks leading to unsustainable debts.
- **Weak enforcement environment:** The time-consuming court proceedings do not allow banks to liquidate collateral and retrieve capital.

Also, politically powerful borrowers were usually able to borrow at lax conditions. This kind of favoritism destroyed banking discipline and encouraged impunity culture. The official emphasized that non-financial factors like corporate governance and quality of management were not the main factors behind the growth of NPLs in Banks, especially Islamic and State-owned banks. Rather, it had been decided by political factors. The previous government was targeting Islamic banks with a wider campaign of political suppression.

- **Propaganda and delegitimization:** *The state supported propaganda falsely alleged that the Islamic banks funded terrorist groups, this brought down their credibility.*
- **Politically related forced takeover:** *In 2017, a series of Islamic banks were virtually given away to strong business conglomerates. The banks were used by these actors to direct money towards personal gain, increasing the pace of NPLs growth.*

In this atmosphere, boards and internal bank officials had no power to make decisions and were left helpless to contain politically inclined lending. Therefore, the accusation of NPL growth as a result of poor governance or management was viewed as being misleading because the issue was systematic political manipulation and not internal incompetence.

In the past, the Islamic banks used Shariah-compliant risk assessment models, which focused on Borrower creditworthiness and project viability. But, these structures were compromised by politics. Loans were granted under duress particularly in the situations that risk assessment processes identified risks. Following the removal of the authoritarian regime, risk management was once again of importance with improvement being greater verification of customers, improved collateral re-valuation, cross-checking to avoid two or more mortgages, aggregated analysis of group lending and powerful legal and recovery teams.

5.1 Policy Change and Direct Effect on NPL Ratio

The largest policy-related change in NPL ratios was in or about 2017, when the government organized a takeover of Islamic banks by politically affiliated entities. The policies that were implemented by this regime compelled banks to grant loans on political grounds and before long they were NPLs as a result of embezzlement and misappropriation of funds. The collapse of the government led the government to tighten its regulatory control over the banking sector; its depositors once again gained confidence and the Islamic banks once more adopted prudent lending. As a result, there were more deposits and the NPL burden decreased over a period of time.

This case demonstrates that the main factor that caused NPL growth in the Islamic banks was not weak internal government but political interference. It is a fact that even the well-managed banks can be turned into vulnerable ones due to systematic abuse of financial institutions. The reforms that have followed after the crisis like increased verification, assessment of lending by groups and tougher legal recovery measures are essential in restoring sanity.

6. Discussion

According to findings, major concern is borrowing system. Meanwhile, discriminations in loan distributions are the pushing factors in NPLs as well industry specific operational challenges and double standards in loans disbursement remain causes behind the loan defaults. Alongside, the study revealed that bank officials' behaviour and assessment system remain heterogeneous to the business specific loan distribution while contributions to the economy almost same. Similarly, Ahmed et al. (2021) mentioned that interest rate is the factor to contribute to NPLs rising while study results indicate that loan distributions are not considerable issue rather than concern about the loan processes. This issue raises two perceptions either borrowers not getting access to the loans or borrowers do not care about loans rate because they can make good profit even the define rate. In terms of operational challenges, it aligns with Ahmed et al. (2021) findings but double standards in loan distributions are the unique points to raise in NPLs changes.

Credit authority findings revealed that policy specific BRPD Circular No. 15, absence of credit scoring, lack of experience in businesses and corporate governance are the major concerns behind changes in NPLs rate. Corporate governance and business experience is aligned with the Tarchouna et al. (2022) findings. There are numerous risk management processes available yet the lack of interest in risk diversification is an inherent reason for defaults and example are visible across the industries in NPLs rising. These findings strongly support the results of study results while absence or not undertaking instruments means NPLs may rise (Ciukaj & Kil, 2020; Khan et al., 2020; Ristić & Jemović, 2021).

In terms of bank board members integrated system and paper checks are available and there has access to verify the personal data. The findings aligned with Ozili (2025) digital inclusion perceptions in NPLs reduction and study support that system based digital integration may reduce NPLs. In addition, real facts need to verify in person as well need to improve judgement to the loans with real facts checks. They also exposed that dual loans processing and stringent monitoring helped them to take control over loan defaults. Study further revealed that engagement of independent professional director in bank board member and digital monitoring can acts as significant factors to change loans defaults. Independent auditors' findings exposed that auditing files still in paper based and manipulative. In addition, emphasized that independent valuations and digital transformation can reduce time and falsifications.

Industry association representatives revealed that the decision-making capacity by Bangladesh Bank and unethical buying practices in the global market are the major causes behind changes in NPLs. Meanwhile, they mentioned that SMEs loan borrowers pay their instalment in time but they face difficulties which need to be addressed. Automation and prompt legal actions may help reduce defaults, while foreign styles practices could increase pressure and lead to rise in NPLs. However, Ozili (2025) mentioned in this study that the policy issues while instalment process is a unique

contribution to this study. Respondents suggested incorporation of the flexible repayment option would encourage more businesses in the sector to apply for SME loans and discourage the board member interfere in the loan process.

Regulatory authorities' opinions reflected a reaffirmation of political connections which weaken the monitoring and accountability of the loans. In addition, borrower behaviour and the lack operational independence hinder the efficiency of the central bank's capacity to cope with defaults. The authorities also emphasized the lack of transparency and the policy gaps existing in multiple loans monitoring, along with the absence of reliable data. They believe that poor administration, lenient enforcement of laws and borrower's attitude. A centralized credit registry linked to unique IDs should be established, and mandatory interbank checks and public disclosure loan defaulters should be implemented to reduce NPLs.

7. Conclusion and Recommendation

NPLs are a significant issue in countries like Bangladesh, affecting the financial sector through governance, economic, and system weaknesses. The study covers diverse multi-party perceptions to understand the core and fundamental causes behind the extent of literature. The approach of this study is distinctive and relies on subjective expertise to identify the major flaws that still remain to raise NPLs. The study covers six key stakeholders' groups, e.g., industry owner/manager; credit authority or compliance; bank board's members, regulatory body, auditors and industry associations to provide contextual insights. The IDIs engaged experts from each group to address the issues and contribute unique findings to the literature.

The research findings align with existing literature with a few divergent views and exceptions such as decision-making capacity of the central bank, procedural inefficiencies that need to be resolved. The study also found that double standards in loan distribution and behavioral distortions in loan repayment make it difficult for borrowers to access finance. From the perspectives of credit authorities, the loan classification policy is a significant cause behind the changes NPLs while introduction of credit scoring can mitigate the unexpected manipulation.

In terms of digitalisation, industry associations and independent auditors revealed that paperless valuations, system automation, and time variant Bangladesh Bank policy may reduce NPLs. In addition, the study found that flexible installment options for SMEs loans, prompt legal actions, unbiased loan processing can significantly lower NPLs rate. Regarding regulatory issues, the study identified operational independence particularly for the central bank, as fundamental. Furthermore, establishing a centralized credit registry, connections with IDs and publicly disclosing willful defaulters could help bring NPLs under control.

The findings also highlighted the need for feasible reform roadmap. Bangladesh Bank can enforce uniform loan classification, strengthen supervision, introduce a centralized credit scoring framework, and improve data disclosure practices. Over the long term, structural reform such as accelerating loan recovery through specialized tribunals, ensuring full autonomy of Bangladesh Bank and appointing independent professional directors can help reduce NPLs to a great extent. In this regard, a coordinated efforts among the Bangladesh Bank, The Ministry of Finance, commercial banks and NBFIs is needed. Moreover, digital transparency, good governance,

accountability and depoliticizations of financial decision are essential to restoring discipline and stability in the banking sector.

Reference

- Adusei, M., & Adeleye, N. (2020). Credit information sharing and non-performing loans: The moderating role of creditor rights protection. *International Journal of Finance & Economics*, 27(4), 4756–4769. <https://doi.org/10.1002/ijfe.2398>
- Ahmed, S., Majeed, M. E., Thalassinou, E., & Thalassinou, Y. (2021). The impact of bank specific and macro-economic factors on non-performing loans in the banking sector: Evidence from an emerging economy. *Journal of Risk and Financial Management*, 14(5), 217. <https://doi.org/10.3390/jrfm14050217>
- Alnabulsi, K., Kozarević, E., & Hakimi, A. (2022). Assessing the determinants of non-performing loans under financial crisis and health crisis: Evidence from the MENA banks. *Cogent Economics & Finance*, 10(1), 2124665. <https://doi.org/10.1080/23322039.2022.2124665>
- Alnabulsi, K., Kozarević, E., & Hakimi, A. (2023a). Non-performing loans and net interest margin in the MENA region: Linear and non-linear analyses. *International Journal of Financial Studies*, 11(2), 64. <https://doi.org/10.3390/ijfs11020064>
- Ari, A., Chen, S., & Ratnovski, L. (2020). COVID-19 and non-performing loans: Lessons from past crises. <https://doi.org/10.2139/ssrn.3632272>
- Ari, A., Chen, S., & Ratnovski, L. (2021). The dynamics of non-performing loans during banking crises: A new database with post-COVID-19 implications. *Journal of Banking & Finance*, 133, 106140. <https://doi.org/10.1016/j.jbankfin.2021.106140>
- Banerjee, A. (2025, July 31). Reform or ruin: Bangladesh ‘one crisis away’ from financial meltdown, experts warn. *Sunday Guardian Live*. Retrieved from <https://sundayguardianlive.com/news/reform-or-ruin-bangladesh-one-crisis-away-from-financial-meltdown-experts-warn-136692/>
- Bangladesh Bank. (2024, November 27). *Master Circular: Loan Classification and Provisioning (BRPD Circular No. 15)*. Retrieved from <https://www.bb.org.bd/mediaroom/circulars/brpd/nov272024brpd15e.pdf>
- Bangladesh Bank. (2025). *Bangladesh Bank Quarterly (January–March 2025)*. Retrieved from <https://www.bb.org.bd/en/index.php/publication/publicn/2/7>
- Bangladesh Bank. (2025). *Monetary Policy Statement (2025)*. Retrieved from <https://www.bb.org.bd/en/index.php>
- Banking Regulation & Policy Department. (2024, November 27). *Master Circular: Loan Classification and Provisioning (BRPD Circular No. 15)*. Retrieved from <https://www.bb.org.bd/mediaroom/circulars/brpd/nov272024brpd15e.pdf>
- Barth, J. R., Caprio, G., & Levine, R. (2013). Bank regulation and supervision in 180 countries from 1999 to 2011. *Journal of Financial Economic Policy*, 5(2), 111–219. <https://doi.org/10.1108/17576381311329661>

- BBC News Bangla (2024, July 4). *How banks forgive interest of big businessmen*. *BBC News Bangla*. Retrieved from <https://www.bbc.com/bengali/articles/c6p2qw8yyq1o>
- Bellotti, A., Brigo, D., Gambetti, P., & Vrins, F. (2021). Forecasting recovery rates on non-performing loans with machine learning. *International Journal of Forecasting*, 37(1), 428–444. <https://doi.org/10.1016/j.ijforecast.2020.06.009>
- Bhuiyan, K. (2024, November 17). Bangladesh non-performing loans have increased to EUR 22.6 bln, revealing the true picture. *Stein & Partners*. <https://www.steinandpartners.com/finance-investment/bangladesh-non-performing-loans-have-increased-to-eur-226-bln-revealing-the-true-picture/>
- BSS. (2025, October 20). ACC charge sheet against 26 people including Atiur-Barakat. *BSS News*. <https://www.bssnews.net/bangla/national/245899>
- Byron, R. K., & Jahid, A. M. (2024, July 30). Politically-motivated lending causing bad loans to spiral: WB. *The Daily Star*. <https://www.thedailystar.net/business/news/politically-motivated-lending-causing-bad-loans-spiral-wb-3665071>
- Chowdhury, M. (2025, January 29). 5 state-owned banks are giving false reports about big defaulters. *The Daily Jugantor*. Retrieved from <https://www.jugantor.com/economics/910011>
- Ciukaj, R., & Kil, K. (2020). Determinants of the non-performing loan ratio in the European Union banking sectors with a high level of impaired loans. *Economics and Business Review*, 6(1), 22–45. <https://doi.org/10.18559/eb.2020.1.2>
- Daily Sun. (2025, August 18). After Beximco, now Nassa Group to get govt support to keep factories running. *Daily Sun*. <https://www.daily-sun.com/post/820637>
- Dal Bó, E. (2006). Regulatory capture: A review. *Oxford Review of Economic Policy*, 22(2), 203–225. <https://doi.org/10.1093/oxrep/grj013>
- Erdas, M. L., & Ezanoglu, Z. (2022). How do bank-specific factors impact non-performing loans: Evidence from G20 countries. *Journal of Central Banking Theory and Practice*, 11(2), 97–122. <https://doi.org/10.2478/jcbtp-2022-0015>
- Farnè, M., & Vouldis, A. (2024). Do retail-oriented banks have less non-performing loans? *The Journal of Economic Asymmetries*, 29, e00358. <https://doi.org/10.1016/j.jeca.2024.e00358>
- Foglia, M. (2022). Non-performing loans and macroeconomic factors: The Italian case. *Risks*, 10(1), 21. <https://doi.org/10.3390/risks10010021>
- Government of the People's Republic of Bangladesh. (2023). *Bank Company Act, 2023 [Act No. 14 of 2023]*. Ministry of Law, Justice and Parliamentary Affairs. <http://bdlaws.minlaw.gov.bd/act-1430.html>
- Halfani, M., McCarney, P., & Rodriguez, A. (1994). *Towards an understanding of governance: The emergence of an idea and its implications for urban research in developing countries*. Centre for Urban and Community Studies, University of Toronto.
- Hassan, M. M., Bidisha, S. H., Mahmood, T. I., & Raihan, S. (2024). Political economy of private bank governance in Bangladesh. In S. Raihan, F. Bourguignon, & U. Salam (Eds.), *Six challenging institutional areas* (pp. 95–130). Cambridge University Press. <https://www.cambridge.org/core/books/is-the-bangladesh-paradox-sustainable/political->

economy-of-private-bank-governance-in-bangladesh/1B368072B7ED88A77C59F4AFEEC83CEE#chapter

- Hossain, M. Z. (2025, January 12). Banking sector on the edge of a cliff: Time is now to tackle this anarchy. *ICAB Publication*. <https://www.icab.org.bd/publication/news/4/1575/>
- Islam, M. S. (2024, December 3). Implications of the master circular: Loan classification and provisioning. *The Bangladesh Today*. <https://thebangladeshtoday.com/?p=26144>
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360. [https://doi.org/10.1016/0304-405X\(76\)90026-X](https://doi.org/10.1016/0304-405X(76)90026-X)
- Kanoujiya, J., Bhimavarapu, V. M., & Rastogi, S. (2023). Banks in India: A balancing act between profitability, regulation and NPA. *Vision*, 27(5), 650–660. <https://doi.org/10.1177/09722629211034417>
- Karim, A. W., Siddiqui, N., Mohaimen, F. J., & Lipa, S. A. (2025). *Playing with fire- Governance or the lack of it in politically captured banks in Bangladesh*. Paper presented at the 10th Annual Banking Conference (ABC), Bangladesh Institute of Bank Management, Dhaka, Bangladesh. <https://www.researchgate.net/publication/395451183>
- Kartika, I., Sulistyowati, S., Septiawan, B., & Indriastuti, M. (2022). Corporate governance and non-performing loans: The mediating role of financial performance. *Cogent Business & Management*, 9(1), 2126123. <https://doi.org/10.1080/23311975.2022.2126123>
- Khan, M. A., Siddique, A., & Sarwar, Z. (2020). Determinants of non-performing loans in the banking sector in developing state. *Asian Journal of Accounting Research*, 5(1), 135–145. <https://doi.org/10.1108/AJAR-10-2019-0080>
- Kjosevski, J., & Petkovski, M. (2021). Macroeconomic and bank-specific determinants of non-performing loans: The case of Baltic States. *Empirica*, 48(4), 1009–1028. <https://doi.org/10.1007/s10663-020-09491-5>
- Kryzanowski, L., Liu, J., & Zhang, J. (2023). Effect of COVID-19 on non-performing loans in China. *Finance Research Letters*, 52, 103372. <https://doi.org/10.1016/j.frl.2022.103372>
- Landell, M. P. (1991). Governance and external factors. In *Proceedings of the World Bank Annual Conference on Development Economics* (pp. 303–309). World Bank.
- Modak, T. (2025, August 12). Loan rescheduling facility for 300 firms draws mixed reactions from bankers, economists. *The Business Standard*. <https://www.tbsnews.net/economy/banking/loan-rescheduling-facility-300-firms-draws-mixed-reactions-bankers-economists>
- Msomi, T. S. (2022). Factors affecting non-performing loans in commercial banks of selected West African countries. *Banks and Bank Systems*, 17(1), 1. [http://dx.doi.org/10.21511/bbs.17\(1\).2022.01](http://dx.doi.org/10.21511/bbs.17(1).2022.01)
- Nguyen, P. D. (2024). Non-performing loans and bank profitability: Evidence from Vietnam. *Macroeconomics and Finance in Emerging Market Economies*, 1–21. <https://doi.org/10.1080/17520843.2024.2318927>
- Ozili, P. K. (2025). *Bank non-performing loans research around the world (June 10, 2025)*. SSRN. <http://dx.doi.org/10.2139/ssrn.5288979>

- Pancotto, L., Ap Gwilym, O., & Williams, J. (2024). The evolution and determinants of the non-performing loan burden in Italian banking. *Pacific-Basin Finance Journal*, 102306. <https://doi.org/10.1016/j.pacfin.2024.102306>
- Rahman, A. (2022). The macroeconomic determinants of non-performing loans in Bangladesh: An empirical analysis. *International Journal of Applied Research in Business and Management*, 3(2), 81–99. <https://doi.org/10.51137/ijarbm.2022.3.2.6>
- Raihan, S., Uddin, M., Ahmed, M. T., Jonaed, & Khan, F. B. (2020). *COVID-19 and business confidence in Bangladesh: Results from the firm-level survey in July 2020*. SANEM Publications. <https://sanemnet.org/wp-content/uploads/2021/12/COVID-19-and-Business-Confidence-in-Bangladesh.pdf>
- Richards, D., & Smith, M. (2002). *Governance and public policy in the United Kingdom* (1st ed.). Oxford University Press.
- Ristić, K., & Jemović, M. (2021). Analysis of non-performing loans' determinants in the banking sector of the Republic of Serbia. *Economic Themes*, 59(1), 133–151. <https://doi.org/10.2478/ethemes-2021-0008>
- Serrano, A. S. (2021). The impact of non-performing loans on bank lending in Europe: An empirical analysis. *The North American Journal of Economics and Finance*, 55, 101312. <https://doi.org/10.1016/j.najef.2020.101312>
- Stigler, G. J. (1971). The theory of economic regulation. *The Bell Journal of Economics and Management Science*, 2(1), 3–21. <https://doi.org/10.2307/3003160>
- Tarchouna, A., Jarraya, B., & Bouri, A. (2022). Do board characteristics and ownership structure matter for bank non-performing loans? Empirical evidence from US commercial banks. *Journal of Management and Governance*, 26(2), 479–518. <https://doi.org/10.1007/s10997-020-09558-2>
- The Business Standard. (2021, June 26). Export stimulus loan repayment deadline may be extended again. *The Business Standard*. Retrieved from <https://www.tbsnews.net/economy/banking/export-stimulus-loan-repayment-deadline-may-be-extended-again-266530>
- The Financial Express. (2025, August 12). Governance breakdowns, political interference behind record NPL, says BIBM study. *The Financial Express*. Retrieved from <https://thefinancialexpress.com.bd/economy/bangladesh/governance-breakdowns-political-interference-behind-record-npl>
- TIB. (2020). *Central Bank non-functional: Puts banking sector on edge Default loan, political influence, and business groups intervention blight Bangladesh Bank*. Ti-Bangladesh.org. Retrieved from <https://www.ti-bangladesh.org/articles/story/6330>
- World Bank. (2024, April 5). *Strong financial sector, fiscal and monetary policy reforms will be critical to sustain Bangladesh's growth momentum*. Retrieved from <https://www.worldbank.org/en/news/feature/2024/04/05/strong-financial-sector-fiscal-and-monetary-policy-reforms-will-be-critical-to-sustain-bangladesh-s-growth-momentum>