Implementation of Basel Accords in Bangladesh

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To our parents

Preface

Despite very significant discussions in the literature on the effectiveness of Basel Accords for enhancing the resilience of internationally active banks, less has been done to investigate the universal applicability of Basel Accords to local banks particularly in developing countries. As a matter of facts, Bangladesh, one of the least developed countries has introduced the Basel-type 'capital to risk-weighted assets based approach' for assessing the capital adequacy of banks, having abandoned the 'capital to liabilities approach' in 1996 and formally introduced the Basel Accords II and III in 2009 and 2015, respectively. The chief objective of the introduction of the Basel Accords in Bangladesh was to bring its financial stability and make its bank capital more shock absorbent. However, during our investigated period of 2009–2018, the banking industry has accumulated huge non-performing loans which eroded its profitability. This adverse effect was the motivation of writing this book, partly because the first author was in the financial instability in Bangladesh as a bank staff.

The book has nine chapters which can be categorized into three tracts. First tract (chapter 2 and 3) deals with the historical and theoretical issues on Basel Accords, banking theories and academic debate on banking regulations. The second tract (chapter 4 to chapter 7) offers a comprehensive discussion on the Bangladeshi regulations on external credit assessment institutions (ECAIs), subordinated debt and cases on bank distress in Bangladesh. The third tract (Chapter 8 and 9) offers a set of pragmatic way out to the decision makers to build a resilience capital regulation and reaping the potential benefits from implementation of Basel Accords in Bangladesh, summary of the entire study and future research issues.

This book challenges the conventional explanations of Bangladeshi financial instability and suggests a different set of failures that affected the Bangladeshi banking system. In this book, we analyze a funding and liability structure of Bangladeshi banks; to maintain the minimum capital adequacy ratio, Bangladeshi private commercial banks were forced to tap into subordinated debts (sub-debt) as Tier 2 capital on the one hand, and the bulk of public money was injected constantly to recapitalize the state-owned commercial banks on the other hand. This practice in funding in this decade (2009–2018) undermined the banking resilience and increased the systemic risk of the financial system. In fact, Bangladeshi banks were not able to build sustainable retained earnings due partly to the loan loss provisioning and the payout pressure of cash dividends to their equity holders. We shed an analytical light on the ill-by-product of Basel Accords such that the banks tend to increase sub-debt as Tier 2 capital just to maintain the minimum capital to risk-weighted assets ratio (CRAR). In this book, we also analyze that the naïve and excess reliance on ECAIs' credit rating in the process of adopting the Basel-type capital adequacy amounted to a risky strategy for the Bangladeshi banking industry. As an endorsement for our discussions, we raise several cases of bank distresses for understanding the Bangladeshi banking sector malaise from the Basel Accord perspective. We believe that this book will contribute to further discussions on the possible ill-by-product of the internationally standardized Accords which do not necessarily have the universal applicability.

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A K M Kamrul Hasan received his Ph.D. (Focusing on Banking and Financial Institutions) from Ritsumeikan Asia Pacific University, Beppu, Oita, Japan. His research interest includes banking regulations, financial stability, venture capital, corporate governance, etc.

Yasushi Suzuki is a Professor of Finance at Ritsumeikan Asia Pacific University, Japan. His research interest focuses on theories of banking, Islamic finance, public finance, institutional political economy,philosophy of economics, etc.

Abbreviations

ALCO	Asset and liability management committee
BB	Bangladesh bank
BDT	Bangladesh taka
BIS	Bank for international settlements
BSEC	Bangladesh securities and exchange commission
CRAR	Capital to risk-weighted assets ratio
CRAs	Credit rating agencies
CRC	Credit rating company
ECAIs	External credit assessment institutions
IRB	Internal ratings-based approach for credit risk
NPL	Non-performing loans
ROA	Return on assets
ROE	Return on equity
RWA	Risk-weighted assets
SA	Standardised approach for credit risk
Sub-debt	Subordinated debt
USD	United States Dollar

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