Towards a Fair and Sustainable Financing System in Bangladesh

Pathways, Challenges and Strategic Interventions

Bangladesh stands at a critical juncture in its political and economic trajectory, marked by aspirations for inclusive development and environmental sustainability amidst an ongoing political transition. As the nation strives to align its growth with global sustainability goals, the role of financial intermediaries, particularly banks and non-banking financial institutions (NBFIs), has become central in promoting green economy initiatives, including renewable energy, sustainable agriculture, and environmentally responsible industries.

However, widespread corruption and mismanagement within the financial sector have undermined the effective allocation of resources, limiting the potential of sustainable finance to drive transformative change.

This policy brief, titled "Towards a Fair and Sustainable Financing System in Bangladesh 2.0: Pathways, Challenges, and Strategic Interventions," explores the current landscape of financial intermediaries and their role in fostering sustainable finance. It identifies gaps in policy implementation, stakeholder awareness, and governance while emphasizing the need for robust oversight, targeted investment strategies, and the

alignment of regulatory frameworks with international best practices.

With an urgent focus on addressing corruption, improving transparency, and leveraging multilateral development bank (MDB) investments, this brief provides actionable recommendations to support a resilient and environmentally sustainable financial ecosystem in Bangladesh. By strategically navigating these challenges, Bangladesh can lay the foundation for a green economy that not only fulfills its development aspirations but also secures environmental and social equity for future generations.

1. Contextualizing Fair and Sustainable Financing in Bangladesh

As Bangladesh transitions through a critical phase of political and economic transformation, the country faces both opportunities and challenges in aligning its growth trajectory with sustainable development goals (SDGs). Recognized as one of the fastest-growing economies globally, Bangladesh has demonstrated remarkable resilience and ambition. However, this growth has come at significant environmental and social costs, including deforestation, carbon emissions, and rising inequality.

Amidst this backdrop, the role of financial intermediaries—banks, non-bank financial institutions (NBFIs), and other entities—has gained renewed focus in driving the agenda of sustainable and inclusive development. These intermediaries hold the potential to bridge the gap between Bangladesh's development aspirations and its sustainability commitments by mobilizing green investments and supporting socially responsible projects.

However, systemic issues such as corruption, governance failures, and non-performing loans (NPLs) have hindered the financial sector's capacity to lead this transition effectively. Furthermore, the financial sector's approach to sustainability has largely been regulatory compliance-driven, with limited proactive investment in green finance. In a country like ours, where limited resources and high population density pose significant challenges, driving national economic growth requires innovative approaches. The need for a fairer, more inclusive, and sustainable financing system is thus critical for Bangladesh to achieve its long-term development goals, particularly in the context of climate resilience and social equity. The International Finance Corporation (IFC), a member of the World Bank Group, recognized Bangladesh as a leader in the adoption of green finance policies, attracting substantial investments from multilateral and bilateral agencies.[1]

[1]Finance News: Latest Financial News, Finance News today in Bangladesh

2. Current State of the Financing System in Bangladesh

2.1. Overview of Financial Intermediaries
Bangladesh's financial sector comprises banks, NBFIs, capital market intermediaries, and insurance providers. Banks dominate the sector, accounting for the majority of financing activities. NBFIs, while smaller in scale, play a crucial role in niche sectors such as housing finance and leasing.

2.2. Green and Sustainable Finance Initiatives
Amidst the challenges faced, the financial sector in Bangladesh is uniquely positioned to lead in environmental stewardship and sustainable investment. The central bank's regulatory attention in sustainable finance may trigger significant advance towards green growth, demonstrating a strong commitment to the principles of People, Planet, and Profit.[2]

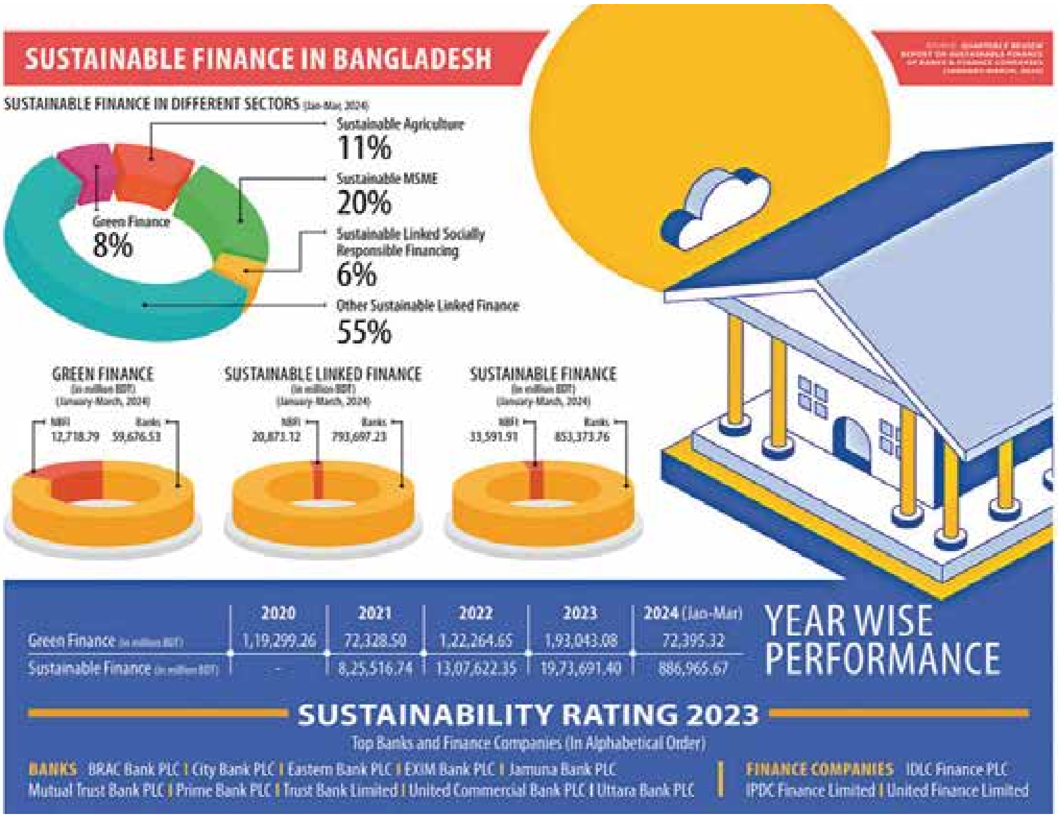
Bangladesh Bank (BB), the country's central bank, has taken several steps to promote sustainable finance. Policies such as the Sustainable Finance Policy (2020) and the Environmental and Social Risk Management Guidelines (2017) set targets for financial institutions to allocate funds to green and sustainable projects. These initiatives mandate that at least 5% of term loans be directed toward green finance, covering renewable energy, green agriculture, and socially responsible financing.

Despite these regulatory measures, the uptake of green finance remains limited. As of 2022, sectors like renewable energy and solid waste management have received minimal investments compared to more traditional projects.

The sustainability ranking for banks seen as a mark of quality and recognition from the central bank, as a result some banks are increasing their commitments to sustainable financing. However, the sustainability ratings for banks and NBFIs, though improving, reveal significant disparities in performance and commitment to expand their capacity to invest in sustainable financing and green financing.

2.3 The status quo of Sustainable Financing
In December 2020, Bangladesh Bank introduced the Sustainable Finance Policy to guide this process and set targets. Consequently, all scheduled banks and NBFIs have now established their own sustainable finance units. Sector-wise, sustainable finance is divided into Sustainable Linked Finance and Green Finance. Sustainable Linked Finance, a broad category, includes Sustainable Agriculture, Sustainable MSME, Sustainable Linked Socially Responsible Finance, and other Sustainable Linked Finance. Green Finance accounts for BDT 72,395.32 million.[3]

[2]Financing Sustainability: Shaping Bangladesh's Economic Future | The Daily Star
[3]Financing Sustainability: Shaping Bangladesh's Economic Future | The Daily Star



	2020	2021	2022	2023	2024 (Jan-Mar)
Green Finance (in million BDT)	1,19,299.26	72,328.50	1,22,264.65	1,93,043.08	72,395.32
Sustainable Finance (in million BDT)	-	8,25,516.74	13,07,622.35	19,73,691.40	886,965.67

2.4. MDB-Backed Investments

Multilateral development banks (MDBs) such as the International Finance Corporation (IFC) and the Asian Development Bank (ADB) have been instrumental in financing sustainable projects in Bangladesh. MDB investments have supported initiatives in renewable energy, ready-made garments (RMG), and infrastructure development. However, the potential of MDB-backed financing remains underutilized due to systemic inefficiencies and governance challenges.

3. Analysis of Existing Financing Systems and Their Impact

3.1. Exacerbation of Inequality

The financial sector's current practices have contributed to widening inequalities. Access to finance remains skewed in favor of large corporations and urban areas, leaving marginalized groups and rural enterprises underserved. There is little to no attention to address the need to financial awareness, literacy or education by the Financial institution among the underserved mass. The financial sector largely remains risk averse and incognizant to the sustainable financing needs of the Women-led businesses, small and medium enterprises (SMEs), rural entrepreneurs, and environmentally conscious startups for example.

3.2. Limited Environmental Impact

Bangladesh, a country already combating with the adverse impacts of climate change, should commit to the the pressing need to choose more environmentally responsible financial practices.The focus on regulatory compliance rather than transformative investments has limited the environmental impact of green finance. Many financial institutions prioritize short-term gains, such as refinancing existing loans, over funding innovative or high-impact green projects.

3.3. Governance Failures

Corruption and governance lapses within the financial sector have eroded trust and efficiency. High NPL rates, particularly among state-owned banks, highlight systemic weaknesses in credit risk management. This mismanagement undermines efforts to attract foreign and MDB investments, which rely on robust governance frameworks.

3.4. Misaligned Standards

Discrepancies between local and international sustainable finance taxonomies create barriers to MDB engagement. Without alignment, financial institutions face additional complexities in reporting and compliance, reducing their attractiveness as investment partners.

4. Key Challenges and Bottlenecks

i. **Policy and Regulatory Gaps:** Climate change is not yet a core theme in Bangladesh Bank's Sustainable Finance Policy, limiting the scope for targeted climate-related investments.

ii. **Transparency Deficit:** Sustainability ratings and reporting methodologies lack transparency, undermining accountability and stakeholder trust. Bangladesh Bank offers a sustainability rating of top banks and NBFIs, but the methodology for this rating is not disclosed, and the data is not available for independent agencies to validate.

iii. **Low Awareness:** Many financial sector employees are unaware of the potential of green finance, leading to missed opportunities for innovation and impact. There is limited knowledge of green financing principles and their potential benefits among lenders and borrowers. The borrowers face challenges in accessing green finance due to higher interest rates and more stringent eligibility criteria. Fis perceive the green projects/products as riskier compared to the usual businesses, primarily due to their unfamiliarity with the associated technologies and potential regulatory uncertainties and absence of impact monitoring and management system in place.

iv. **Inadequate Targets:** The 5% green finance target is insufficient to achieve Bangladesh's long-term sustainability goals, such as transitioning to 50% sustainable finance by 2041.

v. **Capacity Constraints:** Financial institutions often lack the technical expertise and systems needed to assess and implement sustainable finance initiatives effectively.

5. Pathways for a Fairer and More Sustainable Financing System

Enhancing Governance and Oversight

- Strengthen regulatory frameworks to enforce compliance with sustainability mandates.
- Improve governance structures within banks and NBFIs to reduce NPL rates and enhance financial stability.

Promoting Financial Inclusivity

- Expand access to finance for underserved groups, including SMEs, women entrepreneurs, and rural enterprises.
- Develop targeted financing products for priority sectors such as renewable energy, sustainable agriculture, and socially responsible businesses.

Harmonizing Standards

- Align Bangladesh's sustainable finance taxonomy with international frameworks to attract MDB investments.
- Advocate for the harmonization of the sustainability taxonomy of the Bangladesh Bank with MDB standards. This entails the explicit inclusion of climate change as a crucial thematic element. This alignment would promote uniformity in sustainable finance practices and streamline reporting and compliance procedures for financial institutions.
- Advise for transparent timelines and practices to ensure the successful integration of the Task Force on Climate-related Financial Disclosures (TCFD) policy into the financial sector, while closely monitoring its implementation. Simplify reporting and compliance processes to reduce administrative burdens on financial institutions.

Building Institutional Capacity

- Conduct training programs for financial sector employees to enhance their understanding of green finance opportunities.
- The bank's central IT system integrates the the recording and reporting of green loans.
- Targeted promotion for green and climate

adaptive products and projects to increase awareness.Collaborate with academic and research institutions to develop expertise in sustainable finance.

Fostering Innovation

- Encourage the development of innovative financial products, such as green bonds and sustainability-linked loans.
- Leverage digital technologies to streamline green finance processes and improve accessibility.

Strengthening Civil Society Engagement

- Institutionalize mechanisms for civil society input in policymaking and regulatory oversight.
- Foster partnerships between financial institutions and civil society organizations to amplify the impact of sustainable finance initiatives.

6. Key Policy Recommendations

Policy Reforms

1. Incorporate Climate Change: Update the Sustainable Finance Policy to integrate climate change as a central theme, supported by clear targets for climate finance.
2. Enhance Transparency: Publish detailed methodologies for sustainability ratings and allow for third-party validation.
3. Set Higher Targets: Gradually increase green finance targets, with specific allocations for high-impact sectors such as renewable energy and green agriculture.
4. SME policy: Incorporate green businesses under the national SME policy and promote their opportunities for flexible green financing.

Capacity Building

4. Raise Awareness: Implement nationwide awareness campaigns and training programs on sustainable finance for financial sector employees.
5. Develop Technical Expertise: Establish dedicated units within financial institutions to focus on sustainable finance and green governance.

International Collaboration

6. Leverage MDB Engagement: Advocate for increased MDB investments and establish partnerships to align local practices with international standards.
7. Align Taxonomies: Harmonize local sustainable finance standards with global benchmarks to simplify compliance and attract foreign investments.

Civil Society and Stakeholder Engagement

8. Strengthen Feedback Mechanisms: Institutionalize platforms for civil society input in financial policymaking.
9. Promote Accountability: Advocate for transparent reporting practices and independent monitoring of financial institutions' sustainability performance.

7. Conclusion: Moving Forward

Bangladesh is at a historic turning point, marked by the Interim Government's bold and sweeping reform initiatives targeting state agencies and the financial sector. The establishment of the White Paper Committee and the Task Force on Economic Reforms reflects a commitment to addressing long-standing systemic challenges such as corruption, inefficiency, and the lack of transparency. These reforms present a unique opportunity to align the country's financial sector with global standards of governance, accountability, and sustainability.

Within this transformative context, advancing a fair and sustainable financing ecosystem is both timely and essential. By integrating sustainable finance into the broader reform agenda, the Interim Government can address critical gaps in the financial sector while driving progress toward environmental resilience and social equity. This includes fostering green investments, modernizing governance frameworks, and enhancing the capacity of financial institutions to meet the demands of a rapidly evolving global economy.

The ongoing reforms also provide a platform to institutionalize civil society engagement and amplify the role of multilateral development banks (MDBs) in supporting Bangladesh's sustainability goals. By prioritizing transparency, capacity building, and inclusivity in financial policymaking, the government can position the financial sector as a catalyst for long-term economic and environmental stability.

As Bangladesh undertakes this ambitious reform journey, integrating sustainable finance into the broader restructuring process will not only strengthen the financial sector but also ensure that the country's development trajectory is equitable, resilient, and aligned with global sustainability standards. The time to act is now, leveraging the momentum of reform to build a financial system that supports a prosperous and sustainable future for all.

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