Development of Financial Markets and Financial Stability in Bangladesh

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ABSTRACT

The main objective of this paper is to analyze the financial market development of Bangladesh during 2010-2015. Although having crisis triggered by capital market failure and ailing performance of SCBs, the progress of financial markets during last five to six years, on various counts are noteworthy. Even after taking into consideration of the less than required security measures, the development of payment and settlement system is tremendous and comparable to international standard. The growth of banking market, largest financial market of Bangladesh has been accompanied with well-designed financial stability measures. Finally, it was suggested that the regulatory authorities should continue the coordinated operation of financial watchdogs (BB, BSEC, MRA and IDRA) along with the measures to develop financial market capacity to ensure sustainable development of the financial sector in Bangladesh.

Key Words**:** Money Market, Foreign Exchange Market, Financial Market, NBFI.

INTRODUCTION

The primary aim of financial market development must be to aid economic growth and development. The essential role of financial markets is to mobilize financial resources from ultimate lenders and allocate them in an efficient manner among competing uses (ultimate borrowers) in the economy, thereby contributing to growth both through increased investment and through enhanced efficiency in resource use. It is also widely recognized that the financial sector helps economic development by providing payment services which improves overall efficiency of the economy. The development of financial market is also critical for effective transmission of monetary policy impulses to the rest of the economy. Monetary transmission cannot take place without efficient price discovery specially with respect to interest rates and exchange rates. Deep and liquid financial markets contribute to efficient price discovery in various segments of the financial market. In view of the various roles played by the financial markets, it is important that financial markets are well developed and well integrated.

A number of developments in the recent years such as US financial crisis and subsequent world recession, Euro-zone crisis, several high profile mishaps of well-known institutions, increased complexity of new financial instruments (derivatives) have combined to bring the issue of financial stability in prominence, side by side of financial market development, in the agenda of supervisory authorities and public policy makers. Generally, it is assumed that financial stability exists when the various parts of the financial system such as payment and settlement systems, financial markets and financial intermediaries such as banks and non-banks can operate smoothly and without interruption and with each part resilient to shocks. A stable financial system is able to absorb adverse shocks. The maintenance of financial stability is as important as the financial intermediation (savings investment intermediation) for the economic development of a country.

The major aim of this paper is to trace and analyze the financial market development of Bangladesh during the last few years, 2010-2015. World financial crisis and subsequent world recession started to engulf and knock down one after another big banks and big economies since 2008 – 09. In fact, banks had been at the heart of the global financial crisis and bankers were widely seen as being responsible for the crisis. However, banking system of Bangladesh had been quite resilient during the post crisis period. Bangladesh financial sector remained virtually unruffled by the global crisis mainly because of regulated limited openness of Bangladesh to short term capital flows. Moreover, following financial crisis, Bangladesh Bank has deliberately deviated from the mainstream monetary policy approach of developed economies, rather adopted monetary and financial policies towards supporting inclusive and sustainable growth.

The financial system of Bangladesh is mainly bank dependent. Though at present, a large number of non-banks financial institutions (NBFIs) are operating in the financial sector, yet their proportionate share is not significant. According to Bangladesh Bank statistics, a total of 56 banking financial institutions (BFIs) and 32 NBFIs (licensed by BB) were operating as on June 2015. On the other hand, the role of security market (capital market) is also not significant as compared to BFIs in terms of long-term investment finance. One full-fledged investment bank (ICB), a number of merchant banks, two stock exchanges and a number of other market intermediaries and credit rating agencies are also working in the security market. Money market and foreign exchange market operations are also conducted by the respective stakeholders. Bangladesh Bank and Bangladesh Securities and Exchange Commission are the regulators respectively for BFI and NBFIs; and Security Market institutions. A large number of NGO-MFIs are providing micro-financial services to the poor people mostly in the rural areas. Micro-credit Regulatory Authority (MRA) has been formed by the government in 2006 for regulation, supervision and orderly growth of micro-finance sector. The regulatory oversight of the insurance companies (both general and life) is provided by the Insurance Development and Regulatory Authority (IDRA) established by the government in 2011. It is said that without having appropriate and adequate financial regulators and supervisors, a robust financial superstructure (financial institutions and markets) – necessary for effective savings investment intermediation –

cannot be established. Now Bangladesh has a full range of financial regulators and supervisors (BB, BSEC, IDRA and MRA) for monitoring and shaping the financial structure of the country and it is expected that given necessary independence, they will be able to create a comprehensive and integrated financial system for supporting real sector development of Bangladesh.

PAYMENT AND SETTLEMENT SYSTEM

The payment and settlement system constitutes the backbone of the financial sector and enables conclusion and settlement of financial contract. These are the means through which funds are transferred among financial institutions, business and persons and also important for effective implementation of the central bank's monetary policy. Owing to its intrinsic convenience, cash is the most dominant and popular form of medium of transaction in Bangladesh. The domestic cheque system is the second most important medium for national payments. The volume and value of cheques have grown steadily over the years. Apart from non-cash payments like cheques and drafts etc. card-based payments which include credit-card, debit card, ATM transactions, POS etc. are gaining popularity. Prior to 2010, payment and settlement system in Bangladesh was not at par with the international best practices. Most of the payment products were traditional and the numbers of modern technology driven products were not widespread. In order to enhance the efficiency of payment and transaction system and also to raise it at par international standard, Bangladesh Bank has taken several initiatives since 2010.

Bangladesh Bank has started automated clearing system known as BACH (Bangladesh Automated Clearing House) from October, 2010. BACH has two components: Automated Cheque Processing System (ACPS) and Electronic Fund Transfer (EFT). For the smooth operation of ACPS and EFT, a state – of – the art Data Centre (DC) and a Disaster Recovery Site (DRS) have been established. Mobile financial services (MFS) is another electronic platform, where mobile operators network have been used as delivery channels for extending financial services to the unbanked (also banked) population. BB Annual Report 2014-15 states that by this time BB has permitted 28 banks for MFS and the registered customers for MFS are around 29 million. Also, as a part of financial inclusion and offering limited banking services to both rural and urban unbanked people, BB has also initiated Agent Banking. In the meantime, BB has issued directives for the banks for starting E-commerce activities. In addition, new end-user centric and real time payment systems such as National Payment Switch (NPS) and Real Time Gross Settlement (RTGS) have been introduced.

Automated cheque processing, electronic fund transfer and mobile financial services have already proved their potential by offering fast, secure and cost-effective financial services. Specially, paperless EFT transactions are gaining increasing popularity among the corporate bodies, stock exchange members and industry alliances.

Besides, the introduction of mobile financial services, m-commerce and e-commerce are significantly changing the financial services landscape of the country. When fully implemented, the RTGS and NPS will increase end-user centric electronic payments and broaden the landscape for financial transactions in the country. The migration of Bangladesh from traditional payment system to modern IT based payment system should not be oblivious about cyber security. In fact, recent reserve fund heist of BB and ATM hacking of some PCBs have brought the issue of cyber security in forefront. A number of studies by BIBM over the last few years have proved that the security issue has been ignored by the banks in Bangladesh making banking information and critical infrastructures vulnerable to cyber-attacks. In order to address the security issue, along with taking appropriate cyber security measures on the part of service providers (Central Bank and Commercial Banks), raising awareness of the end-users of the modern payment system is also a must.

MONEY MARKET

Bangladesh Bank has always been according prime attention to the development of the money market as it is the key link in the transmission mechanism of monetary policy to financial market and finally to the real economy. With the deregulation of administered interest rate and adoption of indirect market based instruments of monetary policy, Bangladesh Bank has been steadily approaching towards developing an efficient, stable and liquid money market by creating a favorable policy environment and introducing new instruments. The major participants in the money market are the banking financial institutions (BFIs), development financial institutions (DFIs) and non-banking financial institutions (NBFIs) of the country. Bangladesh Bank, as the leader of the money market, has been guiding and controlling the institutions of the market. The distinct components of the money market in Bangladesh are: a) Inter-Bank Market; b) Call Money Market; c) Repo and Special Repo Market; d) Reverse Repo Market; c) BB Bill Market and f) Government Security Market.

The inter-bank markets in Bangladesh operate in a limited scale in the form of inter-bank deposits and inter-bank borrowing and has virtually no interest rate fixing mechanism. Usually, scheduled commercial banks lend to each other when they are in need of temporary funds. Sometimes, banks also keep a part of their mobilized resources in other banks as deposit and borrow as and when needed against the lien of those deposits. The call money market is the most sensitive part of the money market in Bangladesh, in which a good number of BFIs and NBFIs actively participate on a regular basis, in order to wipe out the temporary mismatch in their assets and liabilities. Since there is no brokerage house or intermediary organization in the call money market of Bangladesh, the transactions in this market usually take place on the basis of bilateral negotiations among the BFIs and NBFIs. Sometimes, call money market rates witness a lot of fluctuations. There are a number of reasons for such fluctuations:

overall liquidity shortage, excessive credit growth, seasonal factors, foreign exchange management, reserve requirement etc. However, in the recent years, because of regulations and monitoring of the market, and liquidity management through repo and reverse repo operations of Bangladesh Bank, the call money market rate has become quite stable.

Repo and Reverse Repo as indirect monetary policy tools were introduced for day to day liquidity management in response to temporary and unexpected disturbance in the supply of and demand for money. The repo injects required money in the system and provides banks with necessary funds to maintain their liquidity. While repo injects money in the system, the reverse repo takes it away from the system. That is the reverse repo mops up excess liquidity of the banks/ money market. Both repo and reverse repo transactions are conducted for overnight and seven days through auction held on all working days. Subsequently, Bangladesh Bank has also allowed inter-bank repo transactions, whereby liquidity shortage of a bank may be met up through repo operation with the banks those have excess liquidity. For inter-bank repo there is no tenor limit.

Prior to adoption of repo and reverse repo transaction various maturities of government treasury bills were the main instruments used for monetary management in Bangladesh. However, in FY 2007, the system of automatic monetization of government deficit through creation of ad hoc treasury bills and using treasury bills for mopping up excess liquidity from the market has been discontinued. Instead, it has been decided that the government treasury bills/bonds will be exclusively used for government debt management. This induced Bangladesh Bank to re-introduce 30 – day and 91 – day Bangladesh Bank bills in October – 2006 to mop up excess liquidity linked to large inflow of remittances and export earning from the market. In terms of government securities markets segment, market based system of auction have been introduced for both treasury bills and bonds since 2007. Since FY2011, BB has started providing Liquidity Support Facility (LSF) to Primary Dealer (PD) banks against the holding of treasury bills and bonds and Special Repo (Repo facility after 12 noon), in addition to normal Repo Facility, to keep market liquidity at a desired level. Above discussion shows that money market in Bangladesh is basically used for monetary policy purpose of maintaining desired level of market liquidity. Corporate use of money market is totally absent and that is why, products like commercial paper, banker’s acceptance etc. are not seen and traded.

CAPITAL MARKET

The capital (security) market is equity dominated; the bond (debt) part is not that significant. Even in terms of raising long-term industrial funds, the contribution of equity security market is also insignificant as compared to that of long-term bank lending. According to BB Annual Report, 2014-15, the amount of industrial term loans disbursed by banks and non-bank financial institutions stood at Taka 597.8 billion, many fold higher than the amount of Taka 7.3 billion raised by new capital issues through private placements and public offerings in the equity capital market in FY2015. This indicates the overwhelming preference of bank finance in industrial investment financing. In a recent survey, it is observed that the high cost of IPO, time consuming and cumbersome process, fear of losing control of the companies (by the sponsors), price disincentives (for issuers) are important among other reasons for discouraging the issues to go for IPO. One of the important requirements of developing a corporate bond market is the development of an active government bond market by constructing a benchmark yield curve. The government bonds are traded in the primary market through auctions. Trading of existing government bonds is not very active in the secondary market.

Following the share market crash in 2010 and subsequent submission of Probe Committee report, GOB has reconstituted the BSEC and started implementing the measures recommended by the Probe Committee, albeit late and selectively. Side by side, the reconstituted BSEC has also formulated a 10 year plan for reforms and development of the capital market. In the meantime, both DSE and CSE have been demutualized. Surveillance system has been modernized. Omnibus account operation has been stopped. Rules for book building and margin loan and guidelines for corporate governance have been reformed. A Special Tribunal for quick disposal of security market related cases has been formed in 2014 and BSEC has been given more independence for regulating the security market. For the benefit and protection of small investors, a special scheme has also been introduced. It is expected that these measures would help to eradicate not only the basic drawbacks of capital market but also to stabilize and deepening the market in the long-run. However, the results so far achieved are not very encouraging. It may be observed that by and large, the GOB is trying to address the security market problems through “market-based” measures, but these are not sufficient. Rather policy makers should give equal attention to the structural, operational and management related matters concerning the capital market of Bangladesh if the confidence of investors is to be restored and the capital market stability is to be ensured.

FOREIGN EXCHANGE MARKET

The regulatory framework governing the foreign exchange market and the operational freedom available to market participants is, to a large extent, influenced by the exchange rate regime followed by an economy. The foreign exchange market of Bangladesh has witnessed a lot of changes since early 1990s following the phased transition from a pegged exchanged rate regime to a market determined exchange rate regime in 2003. In the meantime, Bangladesh has adopted current account convertibility and accepted article VIII status of IMF and also made substantial liberalization of capital account transactions specifically for nonresidents. Until 2003, Bangladesh followed an exchange rate policy of occasionally adjusting the rate with an eye on maintaining an export competitiveness, mainly with reference to the trend of real effective exchange rate (REER) index based on a trade weighted basket of currencies of major trade partner countries, acted as a sort of benchmark for the banks to set their own rates. Bangladesh Bank floated its exchange rate for Taka with effect from May 31, 2003. Under this arrangement, banks and authorized dealers are free to set their own rates of foreign exchange against Bangladesh Taka for their inter-bank and customer transactions. Now, the exchange rate is being determined in the market on the basis of market demand and supply forces of the respective currencies. However, to avoid any unusual volatility in the exchange rate, Bangladesh Bank occasionally engages itself to intervene in the market through purchase and sale of U.S. dollars as and when it deems necessary to maintain stability in the foreign exchange market. The exchange rates of Bangladesh Taka against major international currencies remained stable during the floating regime. However, in the recent years, because of surplus in current Account Balance, Taka is gradually appreciated and in order to maintain high export growth, BB has been always purchasing dollars. High remittance growth and regular purchase of dollar by BB have been increasing the volume of foreign exchange reserve of Bangladesh.

Gradual changes in the exchange rate regimes could not bring substantial changes in market structure of foreign exchange market. The market in Bangladesh is still predominantly an onshore spot market, that too mostly in dollars. The U. S. dollar also plays the role of a vehicle currency in cross currency transactions in Bangladesh. The forward market is very limited because of lack of awareness regarding the benefit of forward market on the part of business people (customers). The currency swaps are permitted only against approved underlying commercial transactions. Unlike developed foreign exchange market where the coexistence of auction and dealer markets is the norm, Bangladesh foreign exchange market is dealer based and the ADs net open position is limited up to 12.5% of their capital. The volume of inter-bank foreign exchange market is not only much lower than customer level transactions, but also declining in the recent years. The inter-bank foreign exchange transactions stood (which includes spot, forward and swap) at U.S. $ 19.5 billion in financial year 2015 as compared to U.S. $ 17.2billion in financial year 2014. However, this contrasts with the large volume of inter-bank trading in developed markets relative to customer level transaction. This small size of the inter-bank market suggests a limited scope for price discovery in the foreign exchange market of Bangladesh. Finally, the foreign exchange reserve of Bangladesh reached around US $ 25 billion as on June -2015.

BANKING MARKET

Banking market is the mainstay of the financial market in Bangladesh. Though, a number of non-banking financial institutions have been licensed during the last one and a half decade, yet the banking sector occupies the lion share of the financial market. At present, the banking sector of Bangladesh is comprised of 56 banks. Out of 56 banks, there are 4 SCBs, 4 DFIs, 39 PCBs and 9FCBs. The banking system of Bangladesh has evolved through a continuous process of reforms since 1982. Because of these reform measures, there have been substantial structural changes in the banking sector, which has also been maintained after 2010. The absolute number of branches increased from 7658 in 2010 to 9131 in June - 2015, around 4% average annual growth. In 2010, the proportionate shares of SCBs and PCBs were 44% and 37% respectively in total branches. However, over the five year period (2010-2015), both deposits and credits experienced more than 100% growth. Till 2003, the proportionate shares of SCBs in total deposits and credits were higher than the respective shares of PCBs. From 2004, the shares of PCBs surpassed those of SCBs, which have not only been maintained, but also widened in favor of PCBs during 2010-2015. By June-2015, the share of PCBs in terms of total deposits and credits stood at around 64% and 63% respectively, whereas those of SCBs reached 28% in case of both deposits and credits.

The indicators such as non-performing loan (NPL) ratio, return on equity (ROE) etc. are reflective of operational performance of banks. The ratios of NPL to total loans was 7.3% in 2010, then experienced “see-saw” over the subsequent years and finally reached 9.7% in June-2015. All bank groups (SCBs, DFIs, PCBs and FCBs) experienced the upward movements in NPL ratio during 2010-2015. However, NPL of SCB was around 22% in June-2015. Political turmoil of the country, loan scams specially in the SCBs, excessive finance to some large business groups, implementation of stricter new loan classification rules, were mainly responsible for the uprising of NPL. In addition, poor appraisal and inadequate follow-up and supervision of the loans disbursed by the SCBs (and DFIs) in the past eventually resulted in their large NPLs. The latest BIBM credit review for 2015 shows that NPL ratio dropped to 6.22% in the last quarter of 2015, mainly because of restructuring of large loans. During 2015, private sector credit growth was around 14% and average lending rate also fell from 12.84% to 11.27%. In regard to ROE, it was 21% in 2010, then declined remarkably in the subsequent years and finally dropped to only 6.6% in 2015. The large and steep fall in ROE of SCBs and DFI was mainly responsible for downward movement of ROE of all banks in during 2010-2015. In fact, ROE of both SCBs and DFIs were almost negative during the period. However, ROE of PCBs was around 21% in 2010, and finally declined to around 10% in 2015. It may be observed that not only the proportionate share of SCBs in branch network, mobilization of deposit and deployment of fund declined but also their (SCBs) operational performances in terms of NPL ratio and ROE went down significantly.

One of the important reasons of better performance of PCBs is the imposition of effective supervision of central bank on them (PCBs). It is a fact that the intensity and quality of banking supervision has been improving continuously since 1990s. The establishment of credit information bureau (CIB), introduction of off-site supervision (CAMELS rating), prevention of insider lending, identification of big defaulters for legal action, disqualification of PCBs directors etc. were instrumental in initiating the process of bringing financial discipline in the banking system during 1990s. These were supplemented by some other effective steps of the central bank taken since 2001 such as formulation of large loan policy, adoption of single borrower exposure level, rationalization of loss incurring branches, introduction of core risk management modules, enactment of new Money Loan Court Act-2003, adoption of different corporate governance measures etc. Since 2009, both the on-site and off-site supervision of Bangladesh Bank have been strengthened and upgraded along with an intensive capacity development program for BB officials. In regard to on-site supervision, risk based inspection has been installed and financial integrity and customer service department have been established. In respect of off-site monitoring, stress-testing, financial projection, quick review, reviewing minutes (of Bank Boards and their committees) etc. have been added to existing CAMELS rating exercise. All these measures have ultimately reflected in the better performances of PCBs and overall banking system. On the other hand, the deteriorating conditions of SCBs over the years should be a matter of concern for the policy makers. It is true that SCBs have failed, but SCBs must succeed. Because, without the turnaround of SCBs, neither the overall efficiency nor the sustainable development of the Bangladesh banking system can be ensured. For this purpose, along with the strict application of internal corporate governance of SCBs, ensuring effective supervision of SCBs by the Bangladesh Bank is a must.

Financial stability and risk management practices are among the issues that came into limelight following the global financial crisis which started in 2007-08. As stated earlier, financial stability exists when the various parts of the financial system such as payments and settlement systems, financial markets and financial intermediaries such as banks can operate smoothly and without interruption and with each part resilient to shocks. Maintaining adequate amount of capital is an integral part of the process of risk management in banks as capital is regarded as the shock absorber. Accordingly, the international community (Basel Committee) adopted risk based capital adequacy standard for banks, popularly known as Basel-I, in 1988. However, to address the deficiencies of Basel-I framework, Basel-II framework was developed in the late 1990s which sought to harness into the supervisory process best practices in risk management in banking and market discipline. The drawbacks of Basel-II approach became clear during the financial crises in 2007-08, when many banks found that they did not have the financial strength to withstand the losses on investment that proved to be much riskier than the model suggested. Again, the Basel Committee (Basel-III) reforms address these weakness through both micro prudential (raising the quality of capital, improved coverage of the risks, higher level of common equity and global liquidity standard) and macro prudential (leverage ratio, reduction of pro-cyclicality and additional capital for systematically important banks) measures to be adopted by the banks starting from 2013. Clearly, micro and macro prudential reforms are closely related, as greater resilience at the individual bank level reduces the risks of system wide risks.

Banks operating in Bangladesh started maintaining capital since 1996 in line with Basel-I framework. Subsequently, in order to make banks' capital requirement more risk sensitive, Bangladesh Bank has asked all banks to follow Basel-II framework since January -2009. In terms of migration to Basel-II from previous Basel-I in Bangladesh, the conscious decision of Bangladesh Bank has been to begin with the simpler approaches available under Basel-II framework. Though according to Basel-II frameworks, banks which are internationally exposed, are required to have minimum capital at the level of 8% of RWA, but as per BB guideline, banks (in Bangladesh) are required to maintain capital adequacy ratio (CAR) of not less than 10% with at least 5% in core capital since July-2011. By the end of 2010, actual capital of all banks stood at 9.3% of RWA and subsequently increased to 10.3% by June-2015. By the end of June-2015, the Capital Adequacy Ratio (CAR) of SCBs, DFIs, PCBs and FCBs were 4.9%, -18.1%, 11.8% and 24.1% respectively. The very unsatisfactory level of capital on the part of SCBs and DFIs is attributed to their high NPL for which GOB has provided huge amount of fund to improve their capital. For all bank groups, one can observe high concentration of core/T-1 capital. This is really very good, as we know that Basel-III sets extreme importance on core capital, which might have an added advantage for the banking sector of Bangladesh, while implementing the road-map of Basel-III by Bangladesh Bank.

However, there are other risk management issues as well. Prior to adoption of Basel-II, Bangladesh Bank introduced and implemented a number of risk management programs for the banks which included asset-liability management, credit risk management, foreign exchange risk management, internal control & compliance, money laundering prevention and IT security. Bangladesh Bank has also issued Stress Testing, Environmental Risk Management (ERM) and overall Risk Management guidelines very recently in order to ensure banking practices in a formal and structured manner in line with global norms. With a view to ensuring good corporate governance in the bank management in Bangladesh, Bangladesh Bank issued detailed guidelines covering the specific demarcation of responsibilities and authorities among the Board of Directors, its Chairman, Chief Executive Officer (CEO) and Adviser to the private bank in respect of its overall financial, operational and administrative policy making and executive affairs including overall business activities, internal control, human resources management etc. In line with international best practices, BB has also created one Financial Stability Department, which produces financial stability reports. To improve the understanding of overall bank liquidity and solvency, the department is also implementing one financial projection module (FPM) and trying to identify domestic Systematically Important Banks (SIB) and capital buffers. Moreover, for better risk management practices, each bank has been advised to form firstly an Independent Risk Management Unit (RMU) and subsequently to convert the RMU to Risk Management Division (RMD) with a Chief Risk Officer (at least at the level of DMD). Banks have also been instructed to prepare a Risk Management Paper (RMP), which would ultimately be submitted to BB via regular monthly meeting of RMD, to facilitate BB to evaluate the risk management practices of banks and to recommend the banks to improve their risk conditions. Finally, it can be said that though the impact of financial crises (both Asian and U.S) was not strongly felt by the banking sector of Bangladesh, yet there has been remarkable progress in terms of adoption of best practices and regulations in the banking sector. Financial stability as an explicit policy issue has been addressed and the relevant risks associated with financial stability are being continuously monitored by Bangladesh Bank as part of its supervisory responsibility and implementation of the Basel framework. Because of this groundwork, we expect that Bangladesh will not be far behind for complying the time–schedule of Basel-III, which is planned to finish its journey in 2019.

Financial Inclusion or Inclusive Banking policy of Bangladesh Bank has been viewed as an important landmark in the central banking history of Bangladesh. This strategy has been vigorously pursued by Bangladesh Bank following the inception of world financial crisis in 2008. According to Bangladesh Bank official document: “financial Inclusion is a high policy priority in Bangladesh, for faster and more inclusive growth”. One estimate shows that about 25 percent of adult population is still financially excluded. Choudhury (2011) has observed, a substantial proportion of the households, especially in rural areas, is still outside the coverage of the formal banking system and is therefore, unable to access mainstream financial products such as bank accounts and low cost loans. In spite of the existence of 58 percent of total bank branches in rural area, the shares of rural bank branches in total deposits and advances were 19 percent and 10 percent respectively as of June 2015 which indicates a very low exposure of rural people to the formal banking system.

BB has taken strong initiatives in the last few years to widen the coverage of banking services, especially by including the disadvantaged section of the society in the formal financial system. Along with moral suasion, a number of policy measures covering opening of bank branches, deposit and credit products, some of which are very innovative for our banking system, have been taken in this regard. These include: changing of branch opening rules from 5:1 to 1:1 (for opening 1 urban branch, 1 rural branch is to be opened), availability of highest quality banking services to farmers by allowing them to open banks account with minimum initial deposit (Tk. 10 only); issuing branch licenses to all SME/Agriculture service centers; easy and effective access to banking services for physically incapable people, hard core poor, unemployed youth, freedom fighters etc.); relaxing conditions of loan repayment and providing fresh facilities to natural calamity affected farmers; mandatory participation in agriculture/rural credit for all banks including PCBs and FCBs; provision of agriculture credit to sharecroppers; formulation and implementation of Agriculture and SME Credit Policies and targets; putting emphasis on financing women entrepreneurs; arranging refinancing schemes for banks; developing ICT solutions (mobile banking, smart card etc.) for inclusive banking; encouraging creative partnership between banks and MFIs; Agent Banking, policy guidelines for Green Banking and introduction of financial inclusion oriented CSR, School banking, arranging cross country banking road show etc.

The policies and measures which have been undertaken so far in Bangladesh in the context of inclusive banking are of course essential and in the right directions and have already started creating positive impacts. For example, by this time, government owned commercial and specialized banks have so far opened more than 1 crore 10 Taka farmers' accounts. It is obvious that opening of these accounts will help our government to migrate from paper based payments of state benefits (which is really very time-consuming and sometimes inhuman on the part of beneficiaries) to direct payment into accounts. Ultimately, these accounts are expected to play a key role in stimulating demand for other financial products. In the context of Bangladesh, it is expected that these farmers account can facilitate a transaction to higher level of financial transition, which in turn can lead to greater financial inclusion. Moreover, BB has undertaken one refinancing scheme of Tk. 200 crore for financing Tk. 10 account holders at easy terms with a view to make rural economy vibrant through keeping Tk. 10 accounts active. Likewise, volume of SME financing (as a tool of financial inclusion) by the banks has increased manifolds. Now, SME loans constitute around 30% of total loans and advances. A lot of entrepreneurs are getting substantial amount of SME loans and every bank has got SME dedicated and women dedicated SME desk. One Bangladesh Bank study shows that SME loans have a number of positive impacts on Bangladesh economy in terms of employment creation, improvement of living standards, women empowerment, contribution to GDP etc. For coordinating and reinforcing the financial inclusion efforts, BB has converted the Agricultural Credit Department into Agricultural Credit and Financial Inclusion Department and created two new departments namely, SME and special Programs Department and Green Banking and CSR department. Finally, all these financial inclusion efforts have direct and indirect effects on the promotion of financial stability of the country. Through promoting a diversified deposit and loan portfolio (directly) and thereby ensuring greater income equality (indirectly), financial inclusion activities are contributing towards achieving financial stability of the country.

NBFIs MARKET

Non-banking financial institutions (NBFIs) comprise a wide variety of financial institutions, which do not accept any deposits payable on demand by cheques, drafts, or orders drawn by the depositors. In terms of contribution toward economic development of a country, NBFIs (like BFIs) do the same through financial intermediation. Bangladesh Bank is the regulator for the NBFIs, which are licensed within the framework of Financial Institutions Act-1993. At present, there are 32 NBFIs, of which 3 are government owned, 19 are privately owned local companies and the rest 10 are joint ventures. Though the market is very small as compared to banking market, yet the market (NBFIs) is expanding rapidly. There were 108 branches of NBFIs in 2010, but by June 2015, the number of branches increased to 198. Their total assets and liabilities were around Tk. 252 billion and Tk. 207 billion respectively in 2010 and subsequently reached Tk. 564 billion and Tk. 466 billion respectively in June-2015. NBFIs in Bangladesh are mainly concentrated on leasing followed by term lending, housing finance, merchant banking, equity financing, venture capital financing etc. Loans and leased assets constitute around 73 percent of total assets of NBFIs. In terms of liability, most of the NBFIs have raised capital through issuing IPOs. Other major sources of funds of NBFIs are term deposits, credit facilities from banks and other NBFIs, call money market, as well as bonds and securitizations. The NBFIs' business line is narrow in comparison with banks in Bangladesh, but they are offering some products to a greater extent than banks. NBFIs are working as multi-product financial institutions.

Total classified loan of all NBFIs stood at Tk. 31.6 billion in June 2015 against their total outstanding loan of Tk. 409 billion showing a classified loan to total outstanding loan ratio of around 7.7 percent. The ROE shows significant variation across NBFIs. In June 2015, the average ROE was 7.6%. Several NBFIs were observed to have ROEs lower than the industry average. However, ROE of NBFIs was 11.7% and 10.4% in 2011. Like Banks, the asset quality of NBFIs deteriorated because of political turmoil and application of strict loan classification rules. Moreover, fall in ROE also indicates requirements on the part of NBFIs to access both low cost funding and ensure better portfolio management for improving their (NBFIs) performances. However, Bangladesh Bank has been pursuing policies and initiating measures to ensure healthy and efficient expansion of NBFIs. Bangladesh Bank has instructed to raise the capital of NBFIs to 10% of RWA, with at least 5% in core capital. In order to reduce their excessive dependence on call money market and avoid asset liability mismatch, Bangladesh Bank has suggested them (NBFIs) to utilize other alternative long-term sources such as credit line, asset securitization, commercial paper etc. Against the backdrop of the global financial crisis, NBFIs have been asked to be cautious in their financial management. Bangladesh Bank has instructed the NBFIs to rationalize investment portfolio, realize default loans, comply Anti Money Laundering Ordinance and adopt corporate governance measures. In order to bring the NBFIs under an effective risk management system, Bangladesh Bank has provided guidelines to develop structures and undertake measures to improve their (NBFIs) institutional risk management system in core risk areas (credit, ALM, ICC and ICT). Bangladesh Bank has also introduced a risk based audit system for the NBFIs. Since the NBFIs serve as important complements to the banking sector in meeting the financing needs that are well suited to the banks, the development of NBFIs is crucial to ensuring a sound financial system in the country.

FINAL WORDS

In spite of failure to reactivate the capital market and lackluster performance of SCBs, the progress of financial markets during last five to six years, on various counts are noteworthy. Even after taking into consideration of the less than required security measures, the development of payment and settlement system is tremendous and comparable to international standard. The growth of banking market, largest financial market of Bangladesh has been accompanied with well-designed financial stability measures. The landmark financial inclusion strategy is not only going to supplement financial stability but also to contribute inclusive growth of Bangladesh. Finally, the coordinated operation of all sorts of financial watchdogs (BB, BSEC, MRA and IDRA) along with the measures for their capacity development is likely to contribute into continuous and sustainable development of the financial sector of Bangladesh.

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