Performance, Regulation and Supervision of NBFIs

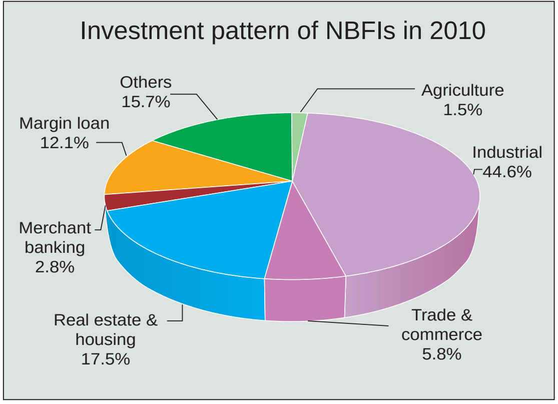
6.1 Non Bank Financial Institutions (NBFIs) in Bangladesh have been playing a significant role in the financial system of the country. This sector has emerged as increasingly important segment of the financial system because of the rapidly rising demand for long term financing and equity type services. NBFIs added differentiation to the bank based financial market of Bangladesh. This sector has turned increasingly into rival of the banking sector in terms of firm size and also offering dynamic services in line with the traditional services. NBFIs in Bangladesh play major role in filling gaps in financial intermediation by providing diversified investment instruments and risk polling services. NBFIs have achieved impressive growth in recent years reflecting the process of financial innovation and holding the promise of deepening financial intermediation in long term financing needs.

Table 6.1 Structure of NBFIs

	2005	2006	2007	2008	2009	2010	2011*
No. of NBFIs	28	29	29	29	29	29	30
Government-owned	1	1	1	1	1	1	2
Joint-venture	7	8	8	8	8	8	8
Private	20	20	20	20	20	20	20
New Branches	5	10	8	8	8	20	50
Total Branches	54	64	72	80	88	108	158

*As on 30 June 2011.
Source: Department of Financial Institutions and Markets

Chart 6.1



Background of NBFIs in Bangladesh

6.2 NBFIs were incorporated in Bangladesh under the then Companies Act, 1913 and were being regulated by the provisions contained in Chapter V of the Bangladesh Bank Order, 1972. Later, to remove the regulatory deficiency and also to define a wide range of activities to be covered by NBFIs, a new statute titled the 'Financial Institution Act, 1993' was enacted in 1993, followed by the 'Financial Institution Regulation, 1994'. NBFIs have been given license and regulated under the Financial Institution Act, 1993. There are 30 NBFIs licensed under this act. As per the Financial Institution Regulation, 1994, at present, minimum paid up capital for NBFIs is Taka 1.0 billion. So far 20 out of 30 NBFIs raised capital through issuing IPO, while three are exempted from the issuance of IPO. Other major sources of funds of NBFIs are Term Deposit, Credit Facility from Banks and other NBFIs, Call Money as well as Bond and Securitisation. NBFIs business line is narrow in comparison with Bank's in Bangladesh. Now a day's NBFIs are working as multi-product financial institutions.

NBFIs Sector Performance

Business Growth

6.3 **Outreach:** Presently, out of 30 NBFIs, two are Government-owned, eight are joint venture and the rest 20 are locally private-owned NBFIs. Meanwhile, the branch network increased to 158 as on 30 June 2011. There is no NBFI incorporated outside Bangladesh. Structure of NBFIs is shown in Table 6.1.

6.4 **Assets:** The asset base increased substantially in 2010. Aggregate industry assets stood at Taka 251.5 billion in 2010 from Taka 193.8 billion in 2009, showing a growth of 29.8 percent. Total asset was Taka 273.4 billion at the end of June 2011 (Table 6.2).

6.5 **Investment:** NBFIs are investing in different sectors of the economy, but their Investments are mostly concentrated in industrial sector. In 2010 NBFIs investment in different sectors are industry (44.6%), real estate (17.5%), margin loan (12.1%), trade and commerce (5.8%), merchant banking 2.8%), agriculture sector (1.5%) and others (15.7%) (Chart 6.1).

6.6 **Liabilities and Equity:** The aggregate liability of the industry in 2010 increased to Taka 206.8 billion from Taka 164.4 billion in 2009 while equity increased to Taka 44.7 billion in 2010 compared to Taka 29.3 billion in 2009 showing an overall increase of 25.8 percent and 52.6 percent respectively. Total liabilities and equity were Taka 221.7 billion and Taka 51.7 billion respectively at the end of June 2011 (Table 6.2).

6.7 **Deposits:** Total deposits of the NBFIs in 2010 rose to Taka 94.4 billion (45.7 percent of total liabilities) from Taka 80.8 billion (49.2 percent of total liabilities) in 2009 showing an overall increase by 16.8 percent. As on 30 June 2011, total deposit stood at Taka 106.3 billion (48.0 percent of total liabilities) (Table 6.2).

Chart 6.2

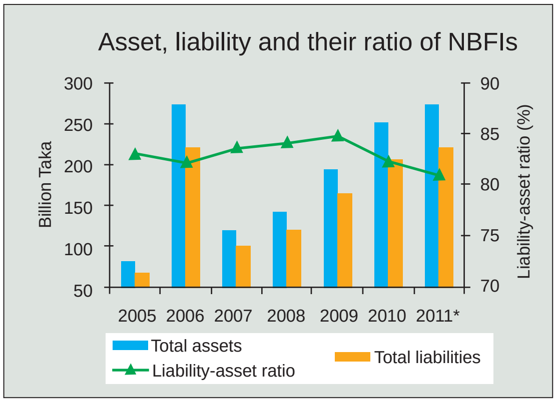


Table 6.2 Assets, liabilities and deposits of NBFIs

(billion Taka)

	2005	2006	2007	2008	2009	2010	2011*
Total Assets	82.3	94.7	120.6	142.4	193.8	251.5	273.4
Total Liabilities	68.4	77.8	100.9	119.8	164.4	206.8	221.7
Liabilities-assets ratio	83.1	82.2	83.7	84.1	84.8	82.2	81.1
Deposit	15.0	20.8	26.8	38.3	80.8	94.4	106.3
Deposit as % of total liabilities	21.9	26.7	26.6	32.0	49.2	45.7	48.0

* As on 30 June 2011.
Source: Department of Financial Institutions and Markets.

Performance and Rating of NBFIs

6.8 Performance of this sector has been evaluated through CAMEL rating which involves analysis and evaluation of the five crucial dimensions of NBFIs' operations. The five indicators used in the rating system are (i) capital Adequacy, (ii) asset quality, (iii) management efficiency, (iv) earnings and (v) liquidity.

Capital Adequacy

6.9 Capital adequacy focuses on the total position of NBFIs' capital and protects the depositors from the potential shocks of losses that a NBFI might incur. It helps absorb major financial risks (credit risk, market risk, interest rate risk, etc.). NBFIs in Bangladesh have been instructed under the Basel Accord for Financial Institutions (BAFI) to maintain Capital

Adequacy Ratio (CAR) of not less than 10.0 percent with at least 5.0 percent in core capital, on test run of Basel Accord in the year 2011. At end December 2010 out of 29 NBFIs, 8 are "1 or Strong", 1 are "2 or Satisfactory", 11 are "3 or Fair" and rest 9 are "5 or Unsatisfactory" in capital adequacy rating in CAMEL rating matrix.

Asset Quality

6.10 The most important indicator intended to identify problems with asset quality in the loan portfolio is the ratio of gross non-performing loans/lease to total loans/lease. In 2010, the ratio for NBFI is 5.9 which is lower than last five years due mainly to proper monitoring and it was highest (7.1) in 2007.

In the total asset composition of all NBFIs concentration of loans, lease and advances is 70.8 percent. At end December 2010, out of 29 NBFIs, 9 are "1 or Strong", 3 are "2 or Satisfactory", 13 are "3 or Fair" and rest 4 are "4 or Marginal" in asset quality rating in CAMEL rating matrix.

Management Efficiency

6.11 Sound management is the most important prerequisite for the strength and growth of any NBFI. The total expenditure to total income, operating expenses to total expenses, earnings and operating expenses per employee, and interest rate spread are generally used to gauge management efficiency. At end December 2010, out of 29 NBFIs, 14 are "2 or Satisfactory" and 15 are "3 or Fair" in Management Capacity rating in CAMEL rating matrix.

Earnings and Profitability

6.12 Earnings and profitability of an NBFI reflects its efficiency in managing resources and its long term sustainability. These indicators determine the capacity to absorb probable losses by building an adequate capital base, finance its expansion and pay adequate dividends to its shareholders. Among various measures of earning and profitability, the best and widely used indicator is return on assets (ROA), which is supplemented by return on equity (ROE) and net interest margin (NIM). ROA, ROE and NIM of all the NBFIs in December 2010 were 4.3, 24.4 and 4.4 percent respectively. In December, 2010 weighted average deposit and lending rate of the NBFIs are 9.6 and 13.1 percent respectively. As of December 2010, out of 29 NBFIs, 3 are "1 or Strong", 25 are "2 or Satisfactory" and 1 is "3 or Fair" in earning ability rating in CAMEL rating matrix.

Liquidity

6.13 NBFIs are allowed to mobilise term deposit only. At present term liabilities are subject to a statutory liquidity requirement (SLR) of 5 percent inclusive of average 2.5

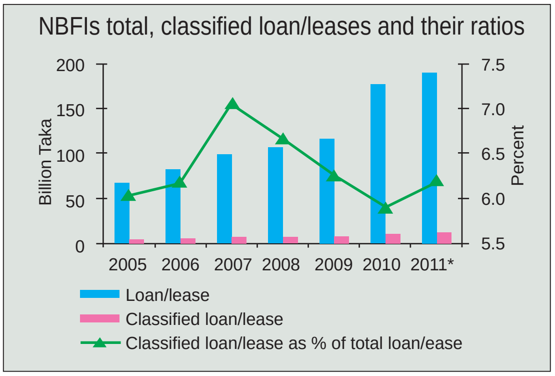
Table 6.3 Total loan/lease and classified loan/leases

(billion Taka)

	2005	2006	2007	2008	2009	2010	2011*
Loan/Lease	67.9	82.6	99.1	106.4	116.7	178.1	190.4
Classified Loan/Lease	4.1	5.1	7.0	7.1	7.3	10.5	11.8
Classified Loan/ Lease as % of total loan/lease	6.0	6.2	7.1	6.7	6.3	5.9	6.2

* As on 30 June 2011.
Source: Department of Financial Institutions and Markets.

Chart 6.3



percent (at least 2 percent in each day) cash reserve ratio (CRR) on bi-weekly basis. SLR for the NBFIs operating without taking term deposit is 2.5 percent. The Infrastructure Development Company Limited (IDCOL) established by the Government of Bangladesh is exempted from maintaining the SLR. At end December 2010, out of 29 NBFIs, 3 are "1 or Strong", 6 are "2 or Satisfactory" and 20 is "3 or Fair" in liquidity position rating in CAMEL rating matrix.

Composite CAMEL Rating

6.14 As of December 2010 out of 29 NBFIs the composite CAMEL rating (C=capital adequacy, A=asset quality, M=management capacity, E=earning ability and L=liquidity position) of 14 NBFIs is "2 or Satisfactory" and the rest of the 15 NBFIs rating is "3 or Fair". On the other hand, in December 2009, out of 29 NBFIs, the composite CAMEL rating of 17 NBFIs was "2 or Satisfactory", 9 was "3 or Fair" and rest 3 was "4 or Marginal" NBFIs. The CAMEL rating of the entire industry is improving compared to the previous year.

Investment in Shares by NBFIs

6.15 NBFIs are allowed to invest in the capital market to the extent as indicated in the Financial Institutions Act, 1993. At end December 2010, all NBFIs share in total investment was Taka 16.9 billion, compared to Taka 13.6 billion in December 2009. Investment in share comprises 6.7 percent of total Asset of all NBFIs.

Bond and Securitisation

6.16 Bond market in Bangladesh is at its earlier stage. There are very few players operating in this market with limited number of instruments. NBFIs play a significant role for the development of bond market through issuing Zero Coupon Bond and Asset-backed Securitised Bond. By taking NOC from Department of Financial Institutions and Markets (DFIM), Taka 8.5 billion and Taka 1.7 billion Zero Coupon Bond and Asset-backed Securitised Bond have been issued respectively by all the NBFIs as of December 2010.

Table 6.4 Profitability of NBFIs

	2005	2006	2007	2008	2009	2010
Return on equity-ROE	14.2	12.4	13.8	12.9	20.9	24.4
Return on asset-ROA	2.4	2.2	2.3	2.1	3.2	4.3

Source : Department of Financial Institutions and Markets.

Legal Reform and Prudential Regulations

6.17 As part of the ongoing efforts to strengthen the NBFIs through the adoption of policies aimed at both improving the financial strength of NBFIs as well as bringing about greater transparency in their operations, several policy and regulatory measures were introduced and published in the name of 'Prudential Regulations' during FY10.

Corporate Governance in NBFIs

6.18 Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a company is directed, administered or controlled. Authority, responsibility and functions of the Board of Directors, Committees, Management, and Chief Executive Officer of NBFIs are clearly stated in different circulars issued from time to time by BB. Number of Directors in the Board is 9-11. Board sets and approves the vision/mission, Annual Strategic Planning, Key Performance Indicators, Core Risk Management Guidelines etc. Chief Executive Officer is responsible to conduct day to day functions and materialisation of the Strategic Business Plan.

Asset Classification and Provisioning

6.19 NBFIs are required to maintain provision on probable loss of loan, advance, lease, investments on an aging analysis. Aging analysis of overdue loan/lease classes them to Standards, Special Mention Accounts, Sub-standards, Doubtful and Bad/Losses requiring to keep 1, 5, 20, 50 and 100 percent provision respectively.

Loan Rescheduling Policy

6.20 Rescheduling of Loan/lease is under the policy of receipt of down payment. Least receipt of down payment for reschedule is the lower of 15, 30 and 50 percent of overdue or 10, 20, 30 percent of outstanding for 1st, 2nd and then after respectively.

Schedule of Charges

6.21 BB has issued directives on caps of different charges, likewise, loan/lease transfer fee, early settlement fee, supervision fee etc. to ensure rationalisation of the schedule of charges. BB monitors this issue and NBFIs are required to submit semi-annual statement in this regard.

Core Risk Management

6.22 Guidelines on four Core Risk Areas, namely, Credit Risk Management, Internal Control and Compliance, Asset Liability Management and Information and Communication Technology Management on NBFIs have been issued. NBFIs have developed their customised guidelines on these risk areas keeping the stated guidelines as minimum requirements.

Environmental Risk Management (ERM)

6.23 The concept of Environmental Governance is now a very important phenomenon. Bangladesh Bank has issued a Guideline on ERM to streamline solutions for managing the environmental risks in the financial sector. ERM is made for all sort of financing.

Progress of BASEL Accord Implementation in NBFIs

6.24 Basel Accord will be implemented in the NBFIs from January 2012. Now, NBFIs are undergoing a test run period of one year starting from 1 January 2011. BB has already issued a draft guideline namely Basel Accord for Financial Institutions (BAFI) to cope up with the international best practices and to make the capital of FIs more risks sensitive as well as more shock resilient. With a view to ensuring implementation of BAFI in a non-disruptive manner, BB issued a roadmap in August 2010. As a part of consultative approach in this regard, a high-level Steering Committee (SC) headed by a Deputy Governor of BB was formed comprising NBFIs' Chief Executive Officers for working on the policy decisions. Furthermore, there is a Working Group (WG) headed by an Executive Director of BB to assist the SC in decision-making. Basel Implementation Cell (BIC) under DFIM has been formed to assist and carry out the instructions of SC and WG on Basel Accord implementation. BB has completed one-to-one meeting with all FIs as stipulated in the roadmap which will ultimately facilitate to issue the final BAFI guideline within 31 December 2011.

Stress Testing

6.25 In order to further strengthen the country's financial system, Bangladesh Bank (BB) has issued a stress testing framework for NBFIs to manage risks proactively. The guideline focuses on "Simple Sensitivity and Scenario Analysis".

On-site Supervision of NBFIs

6.26 BB is entrusted with the responsibility to regulate and supervise the NBFIs operating in the country. Department of Banking Inspection-2 (DBI-2) of BB conducts the comprehensive and special inspection on NBFIs. DBI-2 conducted a total number of 76 comprehensive inspections during FY11 including 24 Head Offices and 52 branches of NBFIs. Under the special inspection programme, a total number of eight inspections were carried out during FY11.