Performance, Regulation and Supervision of NBFIs

7.1 Non Bank Financial Institutions (NBFIs) are playing a crucial role by providing additional financial services that cannot be always provided by the banks. The NBFIs, with more multifaceted products and services have taken their place in the competitive financial market to satisfy the changing demands of customers. NBFIs also play an important role in the capital market as well as in real estate sector of Bangladesh. Like the banks, most of the NBFIs have separate subsidiaries to operate merchant banking activities. NBFIs are supervised by Bangladesh Bank following a risk-based supervisory system.

7.2 NBFIs have been given license and regulated under the Financial Institution Act, 1993. At present, the minimum paid up capital for NBFIs is Taka 1.0 billion as per the Financial Institution Regulation, 1994. NBFIs' business line is narrow in comparison with banks in Bangladesh. NBFIs are allowed to take term deposit for three months from 2 December 2013.

7.3 Presently, out of 32 NBFIs, 3 are Government-owned, 10 are joint venture and the rest 19 are locally private-owned. Meanwhile, the branch network increased to 198 as on 30 June 2015. The Structure of NBFIs is shown in Table 7.1.

Table 7.1 Structure of NBFIs

	2009	2010	2011	2012	2013	2014	2015*
No. of NBFIs	29	29	31	31	31	31	32
Government- owned	1	1	2	3	3	3	3
Joint-venture	8	8	8	10	10	10	10
Private	20	20	20	18	18	18	19
New branches	20	20	53	8	7	7	15
Total branches	88	108	161	169	176	183	198

*As on 30 June 2015.
Source: Department of Financial Institutions and Markets.

A. 1. Assets

7.4 The asset of NBFIs increased substantially by 18.6 percent to Taka 517.6 billion in 2014 from Taka 436.3 billion in 2013. At the end of June 2015, assets of NBFIs increased to Taka 563.8 billion.

A.2. Investment

7.5 NBFIs are investing in different sectors of the economy, but their investments are mostly concentrated in industrial sector. Sector wise composition of NBFIs' investment at the end of June 2015 was as follows: industry 44.9 percent, real estate 17.4 percent, margin loan 3.2 percent, trade and commerce 16.0 percent, merchant banking 4.0 percent, agriculture 1.7 percent and others 12.9 percent (Chart 7.1).

7.6 NBFIs are allowed to invest in the capital market to the extent indicated in the Financial Institution Act, 1993. In 2014, all NBFIs' total investment in capital market was Taka 18.4 billion compared to Taka 10.7 billion in 2013. Investment in capital market accounted for 3.5 percent of the total assets of all NBFIs. At the end of June 2015, NBFIs total investment in capital market stood at Taka 14.8 billion.

A.3. Deposits

7.7 Total deposits of the NBFIs in 2014 rose to Taka 245.7 billion (58.1 percent of total liabilities) from Taka 198.3 billion (56.6 percent of total liabilities) in 2013 showing an overall increase of 23.9 percent. At the end of June 2015, total deposit of NBFIs increased to Taka 271.8 billion.

A. 4. Other Liabilities and Equity

7.8 The aggregate liability of the industry increased to Taka 423.1 billion in 2014 from Taka 350.4 billion in 2013, while equity increased to Taka 94.4 billion from Taka 85.9 billion during the same period showing an overall increase by 20.7 and 9.9 percent respectively. At the end of June 2015, aggregate liability and equity increased to Taka 465.5 and 98.3 billion respectively.

A. 5. Bond and Securitisation Activity

7.9 The bond market in Bangladesh is yet to be modernised. There are few players with a limited number of instruments. NBFIs play a significant role for the development of bond market through issuing zero coupon bonds and asset-backed securitised bonds. By taking NOC from BB, Taka 1.5 billion non-convertible zero coupon bonds were issued by IDLC Finance Limited and Taka 3.0 billion by Lanka Bangla Finance Limited as of June 2015. It can be mentioned here that an NOC has recently been issued from BB to IDLC Finance Limited for "IDLC Infrastructure and SME Zero Coupon Bond" amounting to Taka 5.0 billion.

B. Performance and Rating of NBFIs

7.10 Like banks, the performance of NBFIs is evaluated through the CAMELS rating which involves analysis and evaluation of the six crucial dimensions. The six indicators used in the rating system are capital adequacy, asset quality, management efficiency, earnings, liquidity and sensitivity to market risk.

Chart 7.1 Investment pattern of NBFIs as of 31 June 2015

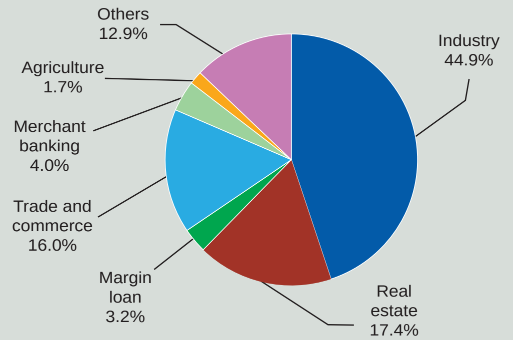
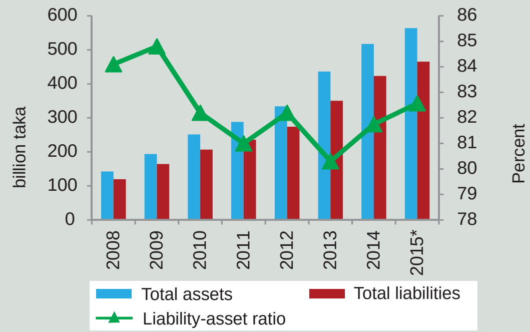


Chart 7.2 Assets, liabilities and their ratios of NBFIs



*As on 30 June 2015.

Table 7.2 Assets, liabilities and deposits of NBFIs

(billion Taka)

	2009	2010	2011	2012	2013	2014	2015*
Total assets	193.8	251.5	288.4	333.9	436.3	517.6	563.8
Total liabilities	164.4	206.8	235.7	274.3	350.4	423.1	465.5
Liabilities-assets ratio	84.8	82.2	81.7	82.2	80.3	81.7	82.6
Total deposit	80.8	94.4	112.6	145.4	198.3	245.7	271.8
Deposit as % of total liabilities	49.2	45.7	47.8	53.0	56.6	58.1	58.4

*As on 30 June 2015.
Source: Department of Financial Institutions and Markets, BB.

B. 1. Capital Adequacy

7.11 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 related to credit, market, interest rate, etc. NBFIs in Bangladesh have been instructed under the Basel Accord to maintain capital adequacy ratio (CAR) of not less than 10.0 percent with at least 5.0 percent in core capital. At the end of June 2015, out of 32 NBFIs, one NBFI is yet to come under this operation, two were evaluated as "1 or Strong", 18 were "2 or Satisfactory", 10 were "3 or Fair" and the remaining one was "4 or Marginal" in the capital adequacy component of the CAMELS rating.

B. 2. Asset Quality

7.12 The most important indicator intends to identify problems with asset quality in the loan portfolio is the ratio of gross non-performing loan/lease to total loan/lease. At the end of June 2015, the NPL for NBFIs was 7.7 percent. In the total asset composition of all NBFIs, the concentration of loans, lease and advances was 72.6 percent. At the end of June 2015, out of 32 NBFIs, seven were evaluated as "2 or Satisfactory", 14 were "3 or Fair" and 10 were "4 or Marginal" in the asset quality component of the CAMELS rating (The remaining one NBFI is yet to come under this operation).

B. 3. Management Efficiency

7.13 Sound management is the most important prerequisite for the 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 the end of June 2015, out of 32 NBFIs, two were evaluated as "1 or Strong", 18 were "2 or Satisfactory", eight were "3 or Fair" and three were "4 or Marginal" in the management capacity component of the CAMELS rating (The remaining one NBFI is yet to come under this operation).

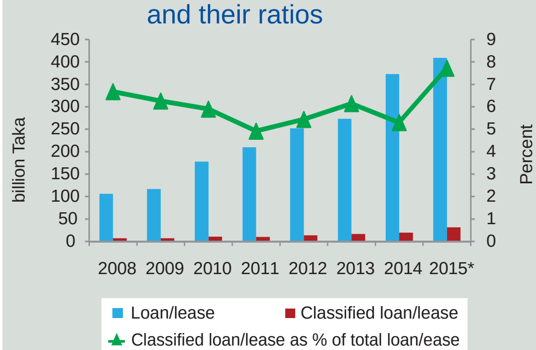
Table 7.3 Total loan/lease and classified loan/leases

(billion Taka)

	2009	2010	2011	2012	2013	2014	2015*
Loan/lease	116.7	178.1	209.7	252.1	273.6	372.8	409.2
Classified loan/lease	7.3	10.5	10.3	13.7	16.8	19.7	31.6
Classified loan/ lease as % of total	6.3	5.9	4.9	5.4	6.1	5.3	7.7

*As on 30 June 2015.
Source: Department of Financial Institutions and Markets, BB.

Chart 7.3 NBFIs total, classified loan/lease and their ratios



* As on 30 June 2015.

B. 4. Earnings and Profitability

7.14 Earnings and profitability of an NBFI reflects its efficiency in managing resources and its long term sustainability. Among various measures of earnings and profitability, the best and widely used indicator is the return on assets. (ROA) which is supplemented by return on equity (ROE). ROA and ROE of all the NBFIs in June 2015 were 1.3 and 7.6 respectively. At the end of June 2015, out of 32 NBFIs, two were evaluated as "1 or

Strong", 17 were "2 or Satisfactory", 11 were "3 or Fair" and one was "4 or Marginal" in the earnings and profitability component of the CAMELS rating (The remaining one NBFI is yet to come under this operation).

B.5. Liquidity

7.15 NBFIs are allowed to mobilise term deposit only. At present, term liabilities are subject to a statutory liquidity requirement (SLR) of 5.0 percent inclusive of average 2.5 percent (at least 2.0 percent in each day) cash reserve ratio (CRR) on bi-weekly basis. The 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 the end of June 2015, out of 32 NBFIs, 20 were evaluated as "2 or Satisfactory", nine were "3 or Fair" and two were "4 or Marginal" in the liquidity position component of the CAMELS rating (The remaining one NBFI is yet to come under this operation).

B. 6. Sensitivity to Market Risk

7.16 The sensitivity to market risk reflects the degree to which changes in interest rates or equity prices can adversely affect an NBFI's asset-liability position, earnings and capital. When evaluating this sensitivity component, consideration should be given to management's ability to identify, measure, and control market risk via the implementation of effective core risk management system. Vulnerability of the NBFI in a stressed situation from either an interest rate or equity price shock (or both) should be taken under consideration to evaluate sensitivity. For many NBFIs, the primary source of market risk arises from non-trading positions and their sensitivity to changes in interest rates. At the end of June 2015, out of 32 NBFIs, six were evaluated as "2 or Satisfactory", 18 were "3 or Fair" and seven were "4 or Marginal" in the sensitivity to market risk component of the CAMELS rating (The remaining one NBFI is yet to come under this operation).

Table 7.4 Profitability of NBFIs

(percent)

	2008	2009	2010	2011	2012	2013	2014	2015*
Return on equity (ROE)	12.9	20.9	24.4	11.7	10.4	7.5	9.9	7.6
Return on asset (ROA)	2.1	3.2	4.3	2.1	1.9	1.5	1.8	1.3

*As on 30 June, 2015 (Annualised).
Source: Department of Financial Institutions and Markets, BB.

B. 7. Composite CAMELS Rating

7.17 As of June 2015, out of 32 NBFIs, the composite CAMELS rating one was evaluated "1 or Strong", 14 were "2 or Satisfactory", 15 were "3 or Fair" and one was "4 or Marginal" (The remaining one NBFI is yet to come under this operation).

C. Legal Reform and Prudential Regulations

7.18 As part of the ongoing efforts to strengthen the NBFIs through the adoption of policies aimed at both improving the financial strength as well as bringing about greater transparency in their operations, some legal and regulatory policy measures continued in FY15.

C. 1. Capital Adequacy and Progress of BASEL Accord Implementation in NBFIs

7.19 Basel-II has been implemented in the NBFIs since 1 January 2012. Prudential guidelines on capital adequacy and market discipline (CAMD) has been issued to promote international best practices and to make the capital of NBFIs more risk-based as well as more shock resilient. NBFIs have to follow the guidelines as statutory compliance. In this regard, a high-level Steering Committee (SC) headed by a Deputy Governor of BB comprising NBFIs' Chief Executive Officers has been formed for working on policy decisions. Furthermore, a Working Group (WG) headed by an Executive Director of BB has been assisting 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.

C. 2. Corporate Governance in NBFIs

7.20 BB has taken some policy measures in order to put in place good corporate governance in NBFIs. BB has specified clearly the authority responsibility and functions of the Board of Directors, Executive Committees, Audit Committees, Management and Chief Executive Officer of NBFIs. In addition, BB has defined duties, responsibilities and organogram of the audit committee and arrangement of the meeting. The number of Directors in the Board is ranged from 9 to 11. The 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.

C. 3. Asset Classification and Provisioning

7.21 NBFIs are required to maintain provision for expected losses on loans, advances, leases, investments on an aging analysis. Aging analysis of overdue loan/ lease classifies them to standards, special mention accounts, sub-standards, doubtful and bad/losses, requiring the NBFIs to keep 1, 5, 20, 50 and 100 percent provision respectively. At the end of June 2015, the total outstanding of loan/lease was Taka 409.2 billion of which NPL was Taka 31.6 billion (7.7 percent).

C. 4. Loan Rescheduling Policy

7.22 Rescheduling of loan/lease is allowed under the policy of receipt of down payment. The minimum receipt of a down payment for reschedule is 15, 30 and 50 percent of overdue or 10, 20, 30 percent of outstanding, whichever is lower for 1st, 2nd and thereafter instances of restructuring respectively.

C. 5. Core Risk Management

7.23 Guidelines on five core risk areas, namely, credit risk management, internal control and compliance, asset-liability management, prevention of money laundering and terrorist financing and information and communication technology (ICT) security have been issued for NBFIs. NBFIs have customised their guidelines in monitoring and minimising these risks in the light of the guideline provided by Bangladesh Bank.

C. 6. Stress Testing

7.24 NBFIs have been conducting stress testing on quarterly basis since 2010. A new financial position indicator, insolvency ratio (IR), artificial intelligence to auto-generate recommended action plan, rating scale of 1 to 5, zonal positioning (Green, Yellow & Red) through weighted average resilience-weighted insolvency ratio (WAR-WIR) matrix have been included in the revised guideline for NBFIs. As per the new guideline, NBFIs carry out stress testing on quarterly basis i.e. at the end of March, June, September and December. As of June 2015, out of 31 NBFIs four were in Green Zone, 13 were in Yellow Zone and the other 14 were in the Red Zone.

D. Consumer Protection Regulations

D. 1. Schedule of Charges

7.25 BB has rationalised the charges of some services to ensure the interest of depositors/investors/customers and advised all NBFIs to display the complete schedule of charges in suitable places in their branches and head offices so that the current and potential clients can easily see them. They are also instructed to post the same information in their websites. BB monitors this issue and NBFIs are required to submit semi-annual statements in this regard. No charge/commission like commitment fee, supervision fee and cheque dishonour fee can be charged.

D. 2. Guidelines on Products and Services of Financial Institutions in Bangladesh

7.26 Along with the banks, the financial institutions with their customised products and services have emerged as the competitive financial intermediaries to meet the growing and changing demands of customers. The 'Guidelines on Products and Services of Financial Institutions in Bangladesh" has outlined the different characteristics of existing and new products. These guidelines protect clients' interest as well as provide greater flexibility to financial institutions to cope up with changing environment. This also helps promotion of sound risk management system and brings discipline in launching new products and services.

E. Cost of Funds Index for NBFIs

7.27 NBFIs are regularly submitting their monthly statements of base rate and cost of funds to BB as per guideline published in 2013. On the basis of these statements, BB prepares an aggregate cost of funds index, uploads that in the BB website and updates it in its website on a monthly basis. It can be mentioned that base rate is the minimum interest rate below which it is not viable for an NBFI to lend in the market. As there was no specific guideline before December 2013, the NBFIs calculated the interest rate in different ways from their own perspective. Some NBFIs provided loan using floating interest rate. In that case, they imposed the rate based on the deviation among their own cost of funds. As a result, their efficiency or inefficiency to manage the liquidity directly affected the clients. The cost of funds index is used as an acceptable reference rate. The base rate system facilitates the interest rate determining process and ensures more transparency and accountability in the NBFIs. It is used in different countries including India, Nepal and Bhutan. In Bangladesh, for the first time, this base rate system for NBFIs has been initiated to introduce cost of fund index in the system.