Regulation, Performance and Supervision of NBFIs

7.1 Non-Bank Financial Institutions (NBFIs), have been playing a crucial role by providing additional financial services that is not usually 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 the customers. NBFIs also play an important role in the capital market as well as in real estate sector of the country. Like the banks, most of the NBFIs have separate subsidiaries to operate merchant banking activities. NBFIs are supervised by Bangladesh Bank under a risk-based supervisory system. NBFIs showed strong performance in terms of growth in assets and deposits during FY18.

7.2 The authority of granting licenses to NBFIs and their control are vested in Bangladesh Bank by the Financial Institutions Act, 1993. As per the Financial Institutions Regulation, 1994 issued by Bangladesh Bank, the minimum paid up capital requirement for establishing a financial institution is BDT 1.0 billion. However, NBFIs' business line is narrow in comparison with banks. NBFIs cannot accept any such deposit as is repayable on demand through cheque, draft, or on order of the depositor. Therefore, they cannot provide operating account facilities like savings and current deposits, cash credits, overdrafts, etc. NBFIs may access public funds, either directly or indirectly through public deposits, commercial papers (CPs), debentures, and bank finance. However, they can only take term deposits with a minimum maturity of 3 months or more. They are not covered under the Deposit Insurance Scheme by the Bangladesh Bank. In addition, they are not allowed to deal in gold and foreign exchange. Nonetheless, they may obtain foreign currency loan from abroad subject to prior approval of the Bangladesh Bank. NBFIs are subject to the prudential guidelines/ limits such as income recognition, asset classification and provisioning norms; capital adequacy norms; single and group borrower exposure limits; prudential limits on capital market exposures; classification and valuation norms for the investment portfolio; CRR/ SLR requirements; accounting and disclosure norms and supervisory reporting requirements issued by Bangladesh Bank.

Table 7.1 Trends in Structure of NBFIs

	2012	2013	2014	2015	2016	2017	2018*
No. of NBFIs	31	31	31	32	33	34	34
Government-owned	2	3	3	3	3	3	3
Joint-venture	8	10	10	10	11	12	12
Private	20	18	18	18	19	19	19
New branches	8	7	20	15	14	30	8
Total branches	168	175	195	210	224	254	262

* As of 30 June 2018.
Source: Department of Financial Institutions and Markets, BB.

7.3 Presently there are 34 NBFIs operating in Bangladesh. Among these, 3 are government owned, 12 are joint ventures with foreign participation, and the rest 19 are locally private owned companies. The branch network of NBFIs increased to 262 as on 30 June 2018. Among the branches, 92 are set up in the district of Dhaka and the rest 170 are located in 34 districts across the country. The ownership structure of the NBFIs and their branch expansion related data are shown in Table 7.1.

Assets

7.4 The asset of NBFIs increased substantially by 17.82 percent to BDT 841.07 billion in December 2017 which was BDT 713.87 billion in December 2016. At the end of June 2018, total assets of NBFIs increased to BDT 870.30 billion (Table 7.2 and Chart 7.1).

Investment

7.5 NBFIs are investing in different sectors of the economy, but their investments are mostly concentrated in industrial sector. Among the total investment made by NBFIs 44.2 percent was in industry sector, 18.18 percent in real estate, 15.87 percent in trade and commerce, 3.81 percent in merchant banking, 2.91 percent in agriculture, 1.95 percent in margin loan and remaining 13.08 percent was in other sector at end of June 2018 (Chart 7.2).

7.6 NBFIs are allowed to invest in the capital market up to 25 percent of their paid up capital and reserve as per section 16 of Financial Institutions Act, 1993. In December 2017, all NBFIs' total investment in capital market was BDT 21.26 billion which was BDT 20.55 billion in December 2016. Investment in capital market accounted for 2.53 percent of the total assets of all NBFIs. As of 30 June 2018, NBFIs total investment in capital market stood at BDT 18.56 billion.

Deposits

7.7 Total deposits of the NBFIs increased to BDT 467.98 billion (64.41 percent of total liabilities) in December 2017 from BDT 382.43 billion (63.05 percent of total liabilities) in December 2016 showing an overall growth of 22.37 percent. At the end of June 2018, total deposit of NBFIs increased to BDT 480.1 billion (Table 7.2 and Chart 7.1).

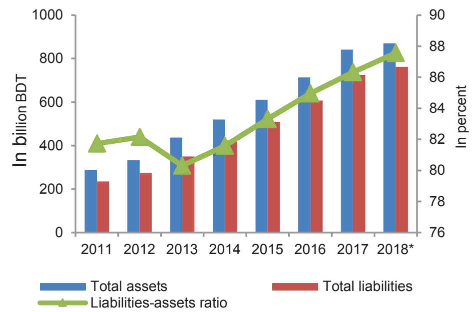
Table 7.2 Trends in Assets, Liabilities and Deposits of NBFIs

(billion BDT)

	2012	2013	2014	2015	2016	2017	2018*
Total assets	333.9	436.3	520.1	611.0	713.9	841.07	870.30
Total liabilities	274.3	350.4	424.2	509.0	606.46	725.95	762.04
Liabilities-assets ratio	82.2	80.3	81.5	83.3	84.95	86.36	87.56
Total deposit	145.4	198.3	238.5	318.1	382.43	467.98	480.10
Deposit as % of total liabilities	53.0	56.6	56.2	62.5	63.1	64.41	63.00

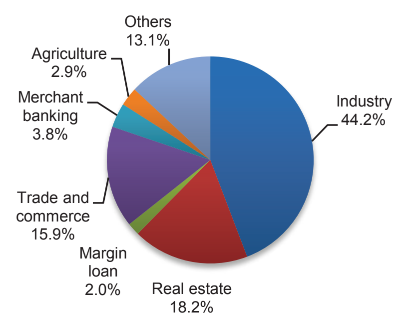
* As of 30 June 2018.
Source: Department of Financial Institutions and Markets, BB.

Chart 7.1 Trends in Assets, Liabilities and their Ratios of NBFIs



* As of 30 June 2018.
Source: Department of Financial Institutions and Markets, BB.

Chart 7.2 Investment Pattern of NBFIs (as of 30 June 2018)



Source: Department of Financial Institutions and Markets, BB.

Other Liabilities and Equity

7.8 Total liability of the industry increased to BDT 725.95 billion in December 2017 from BDT 606.46 billion in December 2016 while equity increased to BDT 115.12 billion compared with BDT 107.44 billion during the same period showing an overall increase in liability by 19.7 percent and equity by 7.15 percent. At the end of June 2018, total liability and equity increased to BDT 762.04 billion and BDT 108.26 billion respectively.

Bond and Securitisation Activity

7.9 NBFIs play a significant role for the development of bond market through issuing different types of Bonds. By taking NOC from the Department of Financial Institutions and Markets (DFIM) of BB, six instruments have been floated in the market up to June, 2018.

Performance and Rating of NBFIs

7.10 Like banks, the performance of NBFIs is also 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.

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 FI might incur. It helps absorb major financial risks related to credit, market, interest rate, etc. NBFIs in Bangladesh have been instructed under the Basel III Accord to maintain Capital Adequacy Ratio (CAR) of not less than 10.0 percent with at least 5.0 percent in core capital.

Asset Quality

7.12 This indicator intends to identify problems with asset quality in the loan portfolio. This is the ratio of gross non-performing loan/ lease to total loan/lease. At the end of June 2018, the NPL for NBFIs was 9.22 percent. In the total asset composition of all NBFIs, the concentration of loans, lease and advances was 74.34 percent. The trends of the ratio of gross non-performing loan/lease to total loan/ lease is presented in Table 7.3 and Chart 7.3.

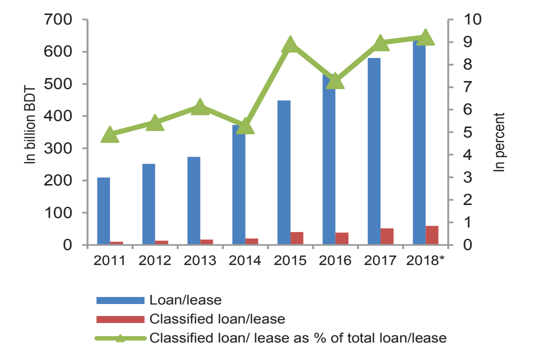
Table 7.3 Trends in Total Loan/Lease and Classified Loan/Lease

(In billion BDT)

	2012	2013	2014	2015	2016	2017	2018
Loan/lease	252.1	273.6	372.8	448.5	530.7	580.4	641.9
Classified loan/lease	13.7	16.8	19.7	40.0	38.7	52.1	59.2
Classified loan/ lease as % of total	5.4	6.1	5.3	8.92	7.29	8.97	9.22

* As of 30 June 2018.
Source: Department of Financial Institutions and Markets, BB.

Chart 7.3 Trends in NBFIs' Total, Classified Loan/Lease and their Ratios



*As of 30 June 2018.
Source: Department of Financial Institutions and Markets, BB.

Management Efficiency

7.13 Sound management is the most important prerequisite for the growth of any FI. 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 understand management efficiency.

Earnings and Profitability

7.14 Earnings and profitability of an FI 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 2018 were 0.32 and 2.50 respectively (Table 7.4).

Liquidity

7.15 NBFIs are allowed to mobilize 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.

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 FI's asset-liability position, earnings and capital. When evaluating this sensitivity component, consideration is given to management's ability to identify, measure, and control market risk via the implementation of effective Core Risk Management System. Vulnerability of the FI in a stressed situation emanated 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.

Composite CAMELS Rating

7.17 At the end of December 2017, out of 34 NBFIs, in the composite CAMELS rating no FI got evaluation as "1 or Strong", 8 were evaluated as "2 or Satisfactory", 20 were "3 or Fair", 3 were "4 or Marginal" and 2 were "5 or Unsatisfactory". The remaining one FI is yet to come under this rating.

Table 7.4 Trends in Profitability of NBFIs

(percent)

	2012	2013	2014	2015	2016	2017	2018*
Return on equity (ROE)	10.4	7.5	9.9	9.9	6.9	8.3	2.5
Return on asset (ROA)	1.9	1.5	1.8	1.8	1	1.14	0.32

* As of 30 June 2018.
Source: Department of Financial Institutions and Markets, BB.

Legal Reform and Prudential Regulations

7.18 As part of the ongoing efforts, in FY18, some legal and regularity policy measures have been taken to improve the financial strength of NBFIs and to ensure the transparency in their operation.

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.

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 clearly specified the authority, responsibility and functions of the Board of Directors, Executive Committee, Audit Committee, Management and Chief Executive Officer of NBFIs. The number of Directors in the Board ranges from 9 to 11. The Board sets and approves the vision/ mission, annual strategic business plan, key performance indicators, core risk management guidelines, etc. Chief Executive Officer is responsible to conduct day to day functions and materialization of the strategic business plan.

Asset Classification and Provisioning

7.21 NBFIs are required to maintain provision for expected losses on loans, advances, leases, investments considering 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 provision by 1 percent, 5 percent, 20 percent, 50 percent and 100 percent respectively. At the end of June 2018, the total outstanding loan/ lease of NBFIs stood at BDT 641.9 billion of which NPL was BDT 59.2 billion which is 9.22 percent of total loan/ lease (Table 7.3). At the end of June 2018, the amount of provisioning was BDT 4.18 billion.

Loan Rescheduling Policy

7.22 For the purpose of rescheduling of loans/ leases NBFIs must receive down payments from clients. NBFIs will take minimum of 15 percent, 30 percent, 50 percent of overdue amount or 10 percent, 20 percent, 30 percent of outstanding amount, whichever is lower, as down payment in cash for first time, second time and third time rescheduling respectively.

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. Besides these, with a view to address and manage all the risks in a more prudent and organized way the 'Integrated Risk Management Guidelines for Financial Institutions' have also been issued to adopt improved policies and procedures in line with internationally best practices for their risk management framework. The Guidelines encompass all the probable risks that include credit risk, market risk, liquidity risk, operational risk, compliance risk, strategic risk, reputational risk, environmental risk, and money laundering risk.

Consumer Protection Regulations

Schedule of Charges

7.24 BB has rationalized 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 clients can easily notice them. They are also advised to publish the same information in their websites. BB monitors these issues and NBFIs are required to submit semi-annual statements in these regard. No charge/ commission like commitment fee, supervision fee and cheque dishonor fee can be charged. A circular has been issued in the year 2018 to bring uniformity in the schedule of fees/ charges/ commissions against the loan/lease accounts by financial institutions and for the protection of customer interest.

Guidelines on Products, Services and Commercial Paper of Financial Institutions in Bangladesh

7.25 Along with the banks, the financial institutions with their customized 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 products and services offered by NBFIs, which helps financial institutions to adapt with the changing environment and also to promote sound risk management system and bring discipline in launching new products and services. In order to set some regulations regarding commercial paper 'Guidelines on Commercial Paper for Financial Institutions' has been introduced. It has allowed financial institutions to get involved in commercial paper as investor, issuer, guarantor, and issuing and paying agent by fulfilling the terms and conditions as mentioned in the guidelines.

Cost of Funds Index for NBFIs

7.26 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 those statements, BB prepares an aggregate cost of funds index, uploads that in the BB website and updates on monthly basis. 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 of the NBFIs. The cost of funds of NBFIs' was 7.89 percent in December 2017, which increased to 9.34 percent in June 2018.

Guidelines on 'Code of Conduct for Banks and Non-Bank Financial Institutions'

7.27 As part of formulation and implementation of National Integrity Strategy (NIS), a 'Code of Conduct for Banks and Non-Bank Financial Institutions' has been introduced in 2017 to increase the integrity, morality, efficiency and responsibilities of banks and financial institutions, and to ensure transparency in their products and services delivery and also to promote rationale behavior between/amongst banks, NBFIs and their stakeholders.