BANGLADESH BANK
Central Bank of Bangladesh

Future Banking in Bangladesh

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The views expressed in this presentation are those of the speaker and should not be attributed to Bangladesh Bank, its Board of Directors or its management

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Future Banking in Bangladesh

- Future Commercial Banking
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Future Commercial Banking

Outline: Future Commercial Banking

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  - Large scale mobile banking
  - Large scale financial inclusion
- Improvement in corporate governance
- Green banking at desired level
- Preparedness of banks in preparing own recovery and resolution plan
- Credit Concentration and Interconnectedness
- Product Innovation
- Implementation of Basel III and other best practices
- Challenges banks may face

Outline: Future Central Banking

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- Expected Relation among BB, Government and other Supervisors
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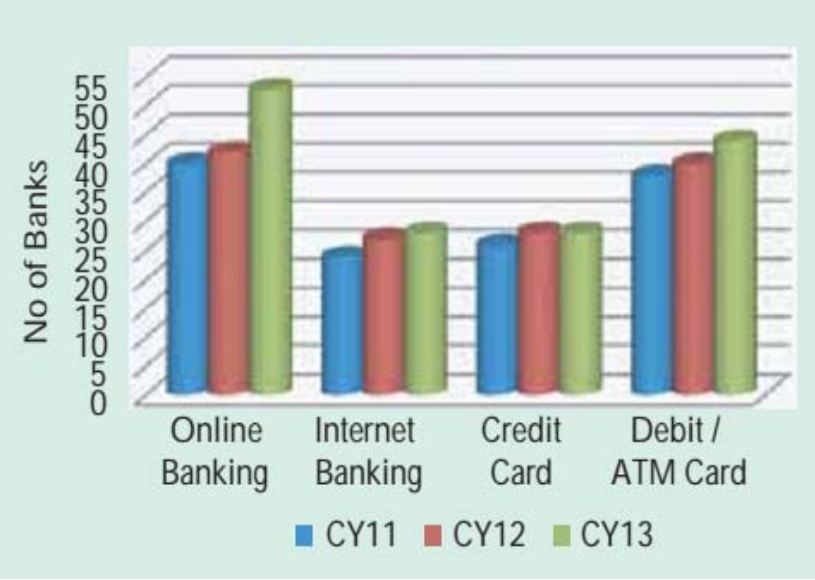
- Changing role of Bangladesh Bank after the crisis
- Emphasis on Corporate Governance
- Risk-based supervision

Future Commercial Banking:
Automation of almost all banks

- Most of the commercial banks have developed their Core Banking Solutions to facilitate better service. Currently, out of 56 scheduled banks, 52 provide full or partial online banking services (BB FSR 2013).
- It could be expected that in future almost all scheduled banks will embrace automation in full scale.
- Banks have to focus on continuous automation including computerization of the monitoring functions.
- Individual 'bank risks' should be evaluated while considering any loans or exposures based on bank acceptances or guarantee or in case of any additional comfort is drawn.



Automation of almost all banks:

Large scale financial inclusion

- The pursuit of financial inclusion and the pursuit of financial stability are no longer competing policy options, but rather complementary policy compulsions.
- Banks in Bangladesh are playing considerable role in implementing financial inclusion initiatives of Bangladesh Bank :
  - School banking to build habit of savings among the youngsters
  - Mobile banking facilitates
  - Agent Banking
  - Bank Account for Unemployed Youth, Hardcore Poor, Freedom Fighters
  - Beneficiaries under Social Security Programs
  - Banking Services for Physically Handicapped People
  - Corporate Social Responsibility (CSR)
- **Though a number of banks have made progress in most of the above areas, nevertheless all banks' more active role will be required to make the programs successful.**

Automation of almost all banks:

Large scale mobile banking

- Rapidly-expanding mobile communication system has opened up windows of opportunity for creative partnerships of banks and mobile telephone companies in devising cost effective arrangements for the delivery of financial services.

A holistic view of the Mobile Financial Service status	
Number of Banks Permitted	28
Started MFS Operation	19
Registered Customers	1,31,80,000
Agents	1,88,647
Transactions (BDT Billion)	6.64

- 19 banks commenced mobile financial services (MFS), out of 28 banks permitted to operate the same (as at end December 2013).
- In future, all the banks may be prompted to offer mobile banking services to bring un-banking people under banking net.
- Banks have to remain more cautious about fraud/forgeries in this area.

Future Commercial Banking :

Improvement in corporate governance(1)

- Corporate governance is of relevance both to individual banking organization and to the international financial system as a whole.
- The public and the market have a high degree of sensitivity to any difficulties potentially arising from corporate governance deficiencies in banks.
- **Lack of corporate governance may result in significant public costs and consequences, for example, losses to depositors, a generalized loss of confidence that could ultimately trigger a bank run or liquidity crisis, adverse impacts on deposit insurance and payment systems, and broad macroeconomic and financial stability implications.**

Future Commercial Banking :

Improvement in corporate governance (2)

- Banks and their stakeholders have to realize to act according to sound governance practices in their own best interests.
- **Though the board of directors and senior management are primarily responsible for effective corporate governance; however, auditors, bank supervisors, deposit insurers, regulators of stock exchanges and securities firms, security analysts, and credit rating agencies all must have a voice in how a bank should operate.**
- Basel Committee on Banking Supervision has issued a set of principles for enhancing sound corporate governance practices at banking organizations (http://www.bis.org/publ/bcbs176.htm) which banks in Bangladesh could consult for their betterment.
- **Banks in Bangladesh will be compelled to improve corporate governance for the sake of viability of their business and for sustaining confidence to the banking system.**

Future Commercial Banking:
Green banking at desired level

- Bangladesh is one of the many countries vulnerable to adverse impacts from climate change.
- Comprehensive policy guidelines for Green Banking have been issued with a view to developing a strong and environment friendly banking system in Bangladesh.
- Top ten banks have been graded based on their overall Green Banking activities.
- More emphasis has been given on the bank`s operational policy, as reflected in the allocation of its budget for promoting Green finance, environmental risk rating, and expansion of programmes to foster greater access to online banking, ATM, internet and Mobile/SMS banking.
- **In future more focus may be given on Green Banking in policy stances of Bangladesh Bank; more active role of banks will be warranted in this regard.**

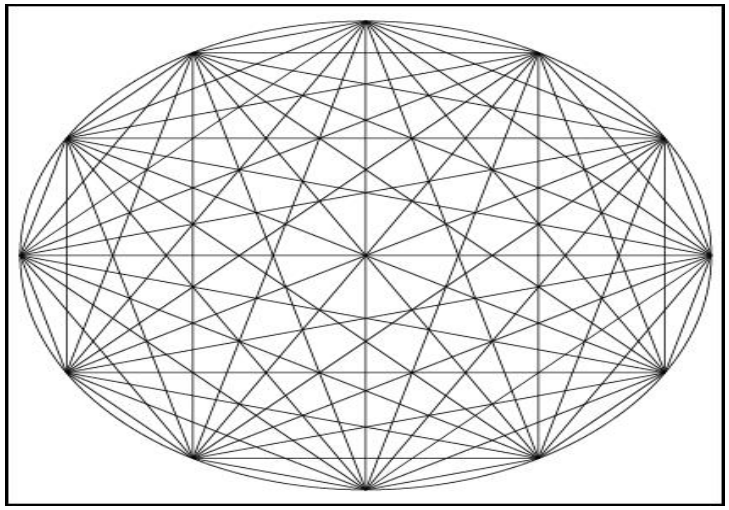
Future Commercial Banking:

Preparedness for Crisis Management

- Bangladesh Bank has been working on preparing Contingency Plans for Banks as part of its preparedness towards crisis management.
- **However, banks have to have their own recovery and resolution plan as part of their crisis preparedness.**
- **"Living wills". The Dodd-Frank Wall Street Reform and Consumer Protection Act, in the context of the US, requires that bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Federal Reserve periodically submit resolution plans to the Federal Reserve and the Federal Deposit Insurance Corporation.**
- Each plan, commonly known as a living will, must describe the company's strategy for rapid and orderly resolution in the event of material financial distress or failure of the company.

Future Commercial Banking:
Credit Concentration and Interconnectedness

- Banking system in Bangladesh is prone to credit concentration risk; impact of this risk has been found to be more adverse on the capital position of the banks among the various stress scenarios specified by Bangladesh bank.
- **Banking Sector capital adequacy ratio would get seriously impacted if 3, 7 or 10 large borrowers default. (BB FSR 2013)**
- In addition to credit concentration risk, threat may arise from contagion risk; if banking system gradually becomes more interconnected contagion risk will warrant more attention of the banks as well as Bangladesh Bank.



- Bangladesh Bank recently developed an **Interbank Transaction Matrix to indentify the magnitude of interconnectedness among banks and non-bank financial institutions.** Full-fledged cooperation of the banks and NBFIs will be required to make the analysis on the Matrix more fruitful.

Future Commercial Banking:
Product Innovation/New Products- Commercial paper

- Commercial paper is a promissory note with a fixed maturity of 1 to 365 days.
- A money-market security issued by large corporations to get money to meet short term debt obligations.
- Backed by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note.
- Not backed by collateral

- **Only firms with excellent credit ratings from a recognized rating agency will be able to sell their commercial paper at a reasonable price.**
- Usually sold at a discount from face value, and carries higher interest repayment rates.
- Typically, the longer the maturity on a note, the higher the interest rate the issuing institution must pay. Interest rates fluctuate with market conditions, but are typically lower than banks' rates.

Future Commercial Banking:
Product Innovation/New Products-Commercial paper

- Eastern Bank Ltd (EBL) has recently launched **Commercial Paper deal.**
- EBL acted as the Arranger and Agent for the recent issuance of Commercial Paper, a low-cost alternative to bank loans amounting BDT 500 million by ACI Limited where different corporate entities, financial institutions and asset management companies participated .
- This is a 180 days interest bearing commercial paper, cent per cent backed by Bank Guarantee issued by EBL.

Future Commercial Banking:
Product Innovation/New Products-
Options, forward contracts and swaps

- Options, forward contracts and swaps will become more popular among the banks

- Regulators have to identify the need for action on the potential for the mis-selling of complex products. Central banks may jointly work with regulators of the derivative products to identify early stability threats.

Future Commercial Banking:

Product Innovation/New Products – Lease financing

- Lease financing became a thrust sector for individual and small enterprise besides medium and large enterprises.
- A number of banks have been providing lease finance facility to its customer for acquisition of manufacturing and service equipments for all major industrial sectors.
- The facility helps the customer to have better financial flexibility under budgetary constraints and to enjoy tax benefit.
- Some areas are financing for: vehicles, CNG conversion, refueling plant, sea or river transport, capital machinery, / plat, etc.
- **In future, banks may get more involved with this sort of financing.**

Future Commercial Banking:

Consortium financing/Syndication Financing

- **Joint financing by more than one bank to the same borrower against common terms and condition governed by common documents.**
- **Major Objectives:**
  - To spread and share the credit risk among all the participating banks or
  - financial institutions.
  - In case of large loan to comply central bank's instructions.
  - Analyzing the project viability from various angles by the syndicate members.
  - To promote entrepreneur to establish large industry.
- This type of financing is already practiced by a number of banks in Bangladesh
- **In future, this type of financing may be offered the banks to a large volume**.

Future Commercial Banking:
Implementation of Basel III and other best practices

- Roadmap on implementing Basel III has already been released
- Finalized guidelines will be released soon.
- Banks have get them well prepared for effective implementation of this framework.
- Banks have to be serious about other best practices like “Principles for the Sound Management of Operational Risk” issued by BCBS

Future Commercial Banking:

Challenges Banks may face

- Making progress in automation and rendering e-banking services
- Bringing most of the unbanked population segment under banking services
- Ensuring deployment of skilled human resources
- Adapting to with global best practices
- Addressing corporate governance concerns
- Take necessary measures for mitigating credit concentration risks

Future Central Banking

Future Central Banking:
Continuous banking licenses

- Though there is no strict **"Stop and Go"** bank licensing policy, in reality, however, Bangladesh Bank entertained application for private banking license at quite some interval.
- **In future Bangladesh Bank might consider continuous banking license keeping the application window always open**.
- Continuous licensing will help keeping a competitive pressure on the existing banks. Such stance will not strain the banking system as the "Stop and Go" licensing may do.

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Future Central Banking:

Shift in focus of BB –from Price Stability to Financial Stability

- History shows us that the role of Central Banks generally shifted after system wide crises took place.
- The recent events suggests that the role of Central Banks is expected to shift once again. Two such events may be mentioned:
  - **The near collapse of financial system during the global financial crisis.**
  - **The European Debt crisis and the present ominous trajectory of public debt existing in a number of advanced economies.**
- **Following the Global Financial Crisis and European Debt Crisis, like other central banks the focus of BB is gradually moving towards maintaining financial stability.**

Future Central Banking:

Separation of Bank Supervision Function from Monetary policy Function

- The question of whether central banks should be involved in bank supervision is an old chestnut that central bankers and academics have debated for many years and practice in the years before the global financial crisis had swung towards separate bank regulators.
- A major argument for divorcing the monetary authority from the bank regulatory authority is that the combination of functions might lead to a conflict of interest. Sometimes this conflict is supposed to bring about a bias towards extra injections of high powered reserves into the banking system.
- In contrast, arguments exist in favor of combination of monetary and bank supervisory authorities; it is believed that an integrated approach to monetary policy and bank supervision would provide most efficient set of procedures for diagnosing problems with banks and then prescribing the correct mix of solvency and liquidity measures required to resolve these problems.
- In future, one prudent solution may emerge regarding this debate.

Future Central Banking:

Expected Relation among BB, Government and other Supervisors

- Ensuring financial stability requires cooperation among different supervisors. There may be debate about who should be in charge of handling the integrated stability issues. However, it can be assumed that Central Banks will more likely be in charge.
- In mitigating systemic risk, financial regulatory policies have important roles to play but they alone will not suffice to address systemic risk in all its complexity. Other policies – especially monetary and fiscal policy - also have a role to play.
- Policy coordination is essential nationally among monetary, fiscal and macro- and microprudential policies, as well as internationally.

Future Central Banking:

Expected Relation among BB, Government and other Supervisors

- Bangladesh Bank is an operating entity and has at the same time an oversight responsibility for clearing, settlement and payment systems. This allows it to have access to direct market information which enables it to identify stability issues earlier than other supervisors.
- In future, BB is expected to be the main supervisor of Financial Stability issues. It will take help from other supervisors and indemnification from government will be warranted in case of involvement of public money.
- In future, Financial Stability may arise as the main goal of Bangladesh Bank and this may change its relation with Government and other supervisory authorities.

Future Central Banking:

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Expected Changes in the Supervisory Environment and BB's Response

- **Changes that might occur in the future are unknown to all; however, there are a few probable developments which might turn out to be crucial for BB:**
  - **Money:** Transmission from fiat money to virtual/ electronic money
  - **Capital Flow:** Full convertibility of both current and capital account
  - **Exchange rate:** Floating rates to Real Effective Exchange Rate
  - Imposition of **Special Bank Taxes or Tax for biggerness or interconnectedness**.

Future Central Banking:
Expected Changes in the Supervisory Environment and BB's Response

- Shadow banking and informal economies under the surveillance of BB/other Supervisors.
- New Challenges from Environment Issues.
- Central Bank Policy Style: Rule Based or Discretionary?
- Replacing Traditional or rule based bank supervision method by risk-based approach.

Future Central Banking:

Transmission from Fiat Money to Virtual/ Electronic Money (1)

- Virtual/electronic Money has already announced its importance in setting financial transactions in Bangladesh. In future, it is expected that virtual/electronic money will be a very large portion of money in circulation.
- Virtual/electronic money will help addressing traditional note forgery and counterfeiting. But there will remain chances of IT based fraud & forgeries and sophisticated techniques of money laundering.

Future Central Banking:
Transmission from Fiat Money to Virtual/ Electronic Money (2)

- It will be possible to identify and reflect contribution of informal economies in the national accounts.
- Better track record for economic events.
- All economic transactions can be traced which will facilitate better and earlier identification of potential threats.
- Capacity development of Bangladesh Bank will be needed to prevent hackers and more involvement of IT experts in central banking will be warranted.

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Future Central Banking:
Full Convertibility of Current and Capital account

- Bangladesh Bank has already made current account convertible; however, capital account still is not convertible.
- In future, convertibility of capital account may materialize which will make the capital market more integrated and may encourage "Hot money" entering and exiting a specific market.
- Banks portfolio investment will be more diversified as investment in many developing countries will be possible.
- Convertibility of capital account might, of course, increase the frequency of crises such as the Asian Financial Crisis of the late 1990s.
- There will be potential stability issues arising from speculative investment.
- Bangladesh Bank will have to work closely with BSEC to formulate regulations to address emergence of systemic threats.

Future Central Banking:
Exchange Rate Regime

- In future, it is likely that managed floating will be difficult to sustain because the market factors will be stronger than the capacity of BB to intervene.

- There is a possibility that real effective exchange rate (REER) measurement will be a popular and widely used system.
- As REER provides more meaningful insights about purchasing power of any currency, it is expected to be measured and quoted regularly. Uniform methodology for calculating REER is most likely to be evolved.

Future Central Banking:
Extended Taylor Rule for Interest rate Forecasting with Additional Financial Stability Variables

- A simple rule like approach from central banks is preferable for effective communication and for setting expectations of the market participants. One such widely used rule is the Taylor rule where the nominal target policy rate is determined based on three factors:
  - Economy's long-run real interest rate plus the target rate of inflation.
  - The deviation of inflation from the central bank's target; and
  - The departure of real GDP from some measure of potential GDP.
- The rule implies that when inflation is above target, the target rate should be increased and when GDP is below "potential", the target rate should be reduced.
- In future, an additional variable related to financial stability (i.e., credit to GDP gap) could be added to the existing Taylor rule.

Target Policy Rate= ƒ(long run interest rate, target inflation rate, GDP growth rate, financial stability indicator variable such as credit to GDP gap)

Future Central Banking:
Institutional Reforms

- As financial stability is a shared responsibility of the regulators, the role and responsibility of each regulator will be specified.
- Bangladesh Bank will coordinate the activities of agencies for achieving financial stability goals.
- Financial Stability Group or Committee is expected to appear for handling systemic issues for which Bangladesh Bank may work as the Technical Secretariat.
- This Group or Committee will possibly be headed by Minister of Finance; other members would be deputies to the Minister of Finance, Governor of Bangladesh Bank, and heads of regulators of other financial intermediaries.

Future Central Banking:

Central Bank Independence

- The debate on Bangladesh Bank's independence will continue.
- Bangladesh Bank might enjoy greater independence but the question of full autonomy might remain unresolved for a quite long period as the Bank is not an elected body and it may be kept accountable to the public through some control mechanism.
- Separation of bank supervisory function from Bangladesh Bank , while the latter focusing more with monetary policy and other relevant functions.

Future Central Banking:
Convergence to Globally Uniform Reporting Standards

- Full convergence of financial reporting standards to a uniform set of standards is expected to take place in future.
- Some expected developments are:
  - Full convergence of US GAAP and IFRS into uniform set of standards.
  - Uniform market disclosure practices for banks and financial institutions.
- Uniform reporting standards will help Bangladesh Bank to assess the cross border performance of the regulated institutions. Uniform standards will also help in understanding the business models of divergent institutions.

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Future Central Banking:

Bank Resolution Regime and ELA

- Key to dealing with problems posed by systemic and non-systemic banks will be the setting up of effective recovery and resolution frameworks as recommended by the Financial Stability Board (FSB).
- Taking into account the lessons of the global financial crisis and the policy responses to the same by several countries, Bangladesh Bank has prepared roadmaps of "Contingency Planning and Bank Intervention/Resolution Framework" and "Lender of Last Resort /ELA Framework". There is a strong possibility that these framework will come into force within mid 2015.
- In designing LOLR/ELA policies systemic impact and cost of providing liquidity support are taken into account. Besides, moral hazard problem and excessive risk taking by G-SIBs and D-SIBs need to be considered.

Future Central Banking:

Informal Economies under the Surveillance of BB/Supervisors

- **In future, the informal sector of the economy is expected to come under the surveillance of Bangladesh Bank and other supervisors.**
- This might happen due to the following reasons:
  - The shift from fiat money to virtual/electronic money will ensure that any kind of financial transaction is done via a bank account or any electronic account.
  - As most transactions from informal economies can be traced there will be less possibility of any surprise or undetected systemic threats arising from these sectors.

Future Central Banking:
New Challenges from Environmental Issues

- Environmental issues are likely to be very crucial factor in future.

- Expected developments may be:
  - valuing ecosystems in national accounts
  - Increasing demand for “green bonds”
  - Mandatory carbon reporting
  - Popularity of weather insurance products enabled by technology
  - Higher asset allocation from institutional investors in climate change-mitigating financial instruments.

Future Central Banking:

Bangladesh Bank's Policy Style- Rule Based or Discretionary?

- To communicate effectively and to set market expectations, rule-based policies will be preferred and widely used.
- **In future, it is expected that rule-based models will dominate over discretion, especially for stability issues.**
- However, the rules will be updated compared to current practice. Banks will accumulate experience about how to tackle financial stability issues over the years.
- Discretionary policies might be used selectively when the situation calls for.

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Future Central Banking:

Changing role of Bangladesh Bank after the crisis (1)

- Prior to the global financial crisis, emanated in late 2007, like most central banks, Bangladesh Bank, kept itself limited to a predominantly micro-prudential approach to regulation and supervision and focused mainly on the soundness of individual institutions.
- The financial crisis compelled central banks to adopt, along with robust monetary policy responses, exceptional measures and an unprecedented expansion in their balance sheets. Their joint, coordinated action stopped the dangerous spiral of financial deterioration and economic contraction in which the world economy found itself at the end of 2008 and in the first few months of 2009.
- After the crisis, BB created a specialized department namely **Financial Stability Department** to monitor and address systemic risk and convey assessment of Bangladesh Bank about financial system's stability to the stakeholders of the financial system.

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Future of Central Banking:
Changing role of Bangladesh Bank after the crisis (2)

- One of the main lessons of the crisis is that price stability, without financial stability, does not guarantee macroeconomic stability.
- Based on the lessons learnt from financial crisis, Bangladesh Banking has been moving away, to a certain extent, from the old monetary policy model.
- Bangladesh Bank feels the need to develop a specific new area of economic policy, termed as "macroprudential policy" "with a preventive focus and the explicit objective of ensuring the stability of the financial system as a whole.
- It could be expected that, in future, BB will use two sets of policies – monetary and macroprudential policies – to ensure a broadly defined financial stability objective.
- It can be expected that macroprudential approaches will get more attention of the policy makers.

Future of Central Banking:
Changing role of Bangladesh Bank after the crisis (3)

- From a macroprudential perspective in financial regulation, Bangladesh Bank is going to strengthen capital and liquidity requirements.
- Bangladesh Bank already issued roadmap of Basel III framework on 31 March 2014 vide BRPD Circular No 07. The draft guidelines has been posted in the website of Bangladesh Bank for comments and it is expected that the final framework will be released soon.
- Basel III contains, along with basic capital and liquidity requirements, a counter-cyclical capital buffer.
- **Introduction of a new leverage ratio.** Two different approaches, one risk-weighted based and the other one non risk-weighted, will coexist under the roof of Basel III.

Future of Central Banking:

Future Central Banking: Regulation (1)

- Basel III in Bangladesh will bring in convergence in the numerator of capital ratios – which is a positive development; however, improvements will be necessary in the calculation of its denominator.
- Maturity transformation is intrinsic to banking activity, however, an excessive mismatch between assets and liabilities increases the vulnerability of banks to negative liquidity shocks.
- Under Basel III there will be two liquidity standards (LCR and NSFR) aimed at addressing the deficiencies in liquidity risk management that became evident during the crisis.

Future of Central Banking:
Future Central Banking: Regulation (2)

Dynamic provisioning:

- Introduced in Spain in 2000. This may be a pioneering case of a macroprudential response.
- The tool proved to be useful in Spain during the financial crisis in the two dimensions : mitigating the build-up of risks and providing capacity of loss absorption to the banks.
- Bangladesh Bank now conducting research on examining the possibility of this macroprudential tool.

Future Central Banking:

Emphasis on Corporate Governance

- Bangladesh Bank will continue promoting the strengthening of corporate governance in banks. The Bank's important focus may include:
  - strengthening boards and management further;
  - promoting the risk management function in banksl;
  - improving risk disclosure

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Future Central Banking:

Risk-based supervision

- Refers to "A forward-looking approach where the supervisor assesses the various business areas of the [bank], and the associated quality of management and internal controls to identify the areas of greatest risk and concern...[and] directs supervisory focus to these areas." (Basel Committee)
- Bangladesh Bank is going give attention on risk-based supervision.
- **Risk-based approach will aim to:**
  - Identify systemic risks (affecting all banks)
  - Identify idiosyncratic risks (affecting only specific banks)
  - Identify those banks in which risks are greatest
  - Identify within each bank those areas in which risks are greatest
  - Apply scarce supervisory resources in order to minimize overall risk in the system
  - Engage in a constant dialogue with bank management to judge their effectiveness

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Open Discussion…..

Thank you