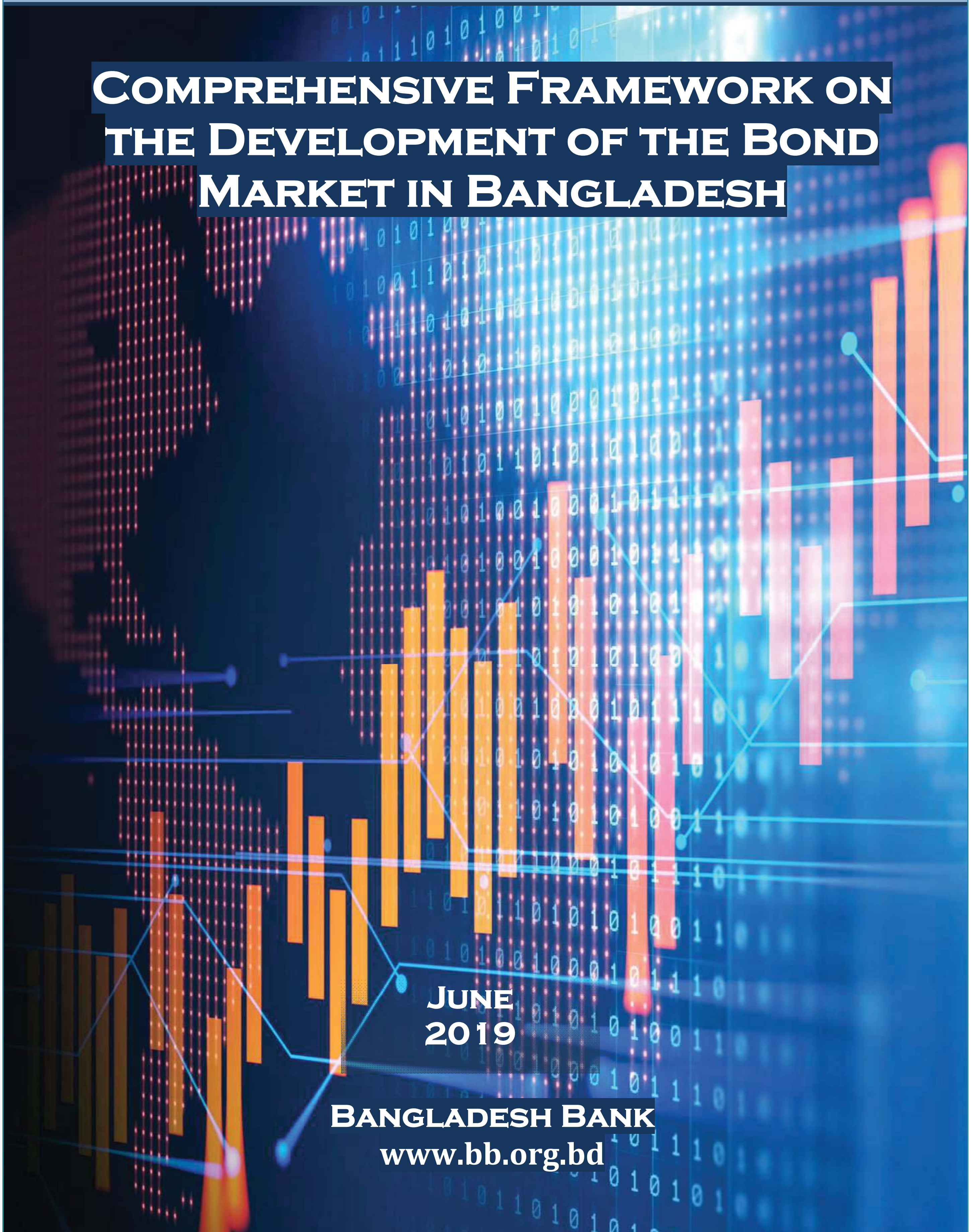
Comprehensive Framework on the Development of the Bond Market in Bangladesh



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Bangladesh Bank
www.bb.org.bd

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Governor
Bangladesh Bank
Dhaka.

Comprehensive Framework on the Development of the Bond Market in Bangladesh.

Dear Sir,

We, the Working Committee, for the preparation of a framework on 'the development of the bond market in Bangladesh', are honored to submit the comprehensive framework prepared in regards to the aforementioned subject. This framework highlights the pressing issues that need to be addressed in developing the fixed-income securities market in Bangladesh. Based on the experience, analysis and suggestions from the members as well as the market participants, this framework addresses and proposes a range of recommendations in developing both the government securities and the corporate bond market in Bangladesh. This framework also includes the names of the regulatory agencies to be tasked with the implementation of the recommendations.

We would like to take this opportunity to thank you and Bangladesh Bank for entrusting us with this colossal task. Bangladesh Bank may consider circulating it to the concerned ministries, agencies, and other stakeholders, and publishing this report on the website in a bid to smoothen the implementation process and for greater public awareness.

Yours Faithfully,

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Structure of the Report

List of Acronyms/Abbreviations

Acronym/Abbreviation	Elaboration
ABS	Asset-Backed Securities
BB	Bangladesh Bank
BGTB	Bangladesh Government Treasury Bond
BRPD	Banking Regulations and Policy Department
BSEC	Bangladesh Securities and Exchange Commission
CBS	Core Banking System
CCP	Central Counterparty
CDMC	Cash and Debt Management Committee
CDMTC	Cash and Debt Management Technical Committee
CDS	Central Depository System
CSE	Chittagong Stock Exchange
DFIM	Department of Financial Institutions and Markets
DMD	Debt Management Department
DOS	Department of Offsite Supervision
DSE	Dhaka Stock Exchange
DvP	Delivery versus Payment
FD	Finance Division
FID	Financial Institutions Division
FIDP	Financial Institutions Development Project
FSSSPD	Financial Sector Support and Strategic Planning Department
FX	Foreign Exchange
FY	Financial Year
G-Sec	Government Securities
GSOM	Government Securities Order Matching
HFT	Held-for-Trading
HTM	Held-to-Maturity
IDRA	Insurance Development and Regulatory Authority of
IPS	Investment Portfolio Securities
IRD	Internal Resources Division
ISIN	International Securities Identification Number
MI	Market Infrastructure
MoF	Ministry of Finance
NBFI	Non-Bank Financial Institution
NBR	National Board of Revenue
NSD	National Savings Directorate
NSS	National Savings Scheme
OTC	Over-the-Counter
PD	Primary Dealer
PDBL	Primary Dealers Bangladesh Limited
RJSC	Registrar of Joint Stock Companies
RMBS	Residential Mortgage-Backed Securities
SFD	Sustainable Finance Department
SGL	Subsidiary General Ledger
T-Bill	Treasury Bill
SLR	Statutory Liquidity Ratio
T-Bond	Treasury Bond
TWS	Trader Work Station

Summary of the Recommendations

Chapter No.	Issues/Focus Area	Recommendations	Implementing Agencies
Government Securities			
4.2.1	Proper Cash Management	✓ MoF should establish a central IT-based cash management cell, where all the stakeholders (different line ministries) could input their expenditure and revenue plans periodically to adopt a clear issuance strategy; ✓ CDMC should focus on the development of the financial market along with the cash and debt management of the Government; ✓ CDMC may adopt a policy in regards to the management and investment of the surplus cash amount in the market by exploring alternative investment opportunities.	FD, MoF
4.2.2	Introduction of a Medium-Term Auction Calendar	Planning and publication of an auction-calendar at least on a half-yearly basis and conducting auctions as a preannounced auction calendar.	FD, MoF, and DMD, BB
4.2.3	Open-Limit on the Sale of Savings Certificates	✓ To fulfill the borrowing from the banking sector as per the budgetary plan, the Government should sell the NSD instruments only to the targeted people (senior citizens, low-income people, etc.); ✓ While adding a social-security premium, the yield of the savings certificates could be set in line with the yield of the tradable securities.	IRD and FD, MoF
4.2.4	Lack of Sufficient Instrument Balance	Increasing the issuance of marketable government bonds to ensure a minimum net issuance every year.	DMD, BB, and FD, MOF
4.2.5	A Large Number of Securities (ISIN) in the Market	✓ An intensive program of buyback and switching should be taken; ✓ Reissuance of the securities with tenors close to the preceding slab issued as a lesser tenor bond rather than a fresh one; ✓ Increasing the upper limit (at present 3,000 crore) of the bonds against a single ISIN.	BB, and FD, MoF
4.2.6	Lack of Benchmark Securities	✓ Identifying benchmark securities in the market; ✓ Issuing securities with even longer tenors (e.g. 30-year, 40-year).	FD, MOF, and DMD, BB
4.2.7	Absence of an Effective and Realistic Secondary Yield Curve	✓ Frequency of trading in the secondary market has to be increased; ✓ Examining whether the already developed secondary market yield curve fulfills the international standards.	DMD, BB
4.2.8	Unavailability of Two-Way Price Quoting	✓ Selecting the benchmark securities liquid enough for the primary dealers to be able to quote on a two-way basis in the secondary market; ✓ Establishing the infrastructure to enable the two-way	DMD, BB

		price quoting system; ✓ Directing the PDs to quote two-way on a daily basis.	
4.2.9	Introduction of a Central Counterparty (CCP)	✓ To ensure secure transfer of securities and secondary trading of G-sec, we should have a depository guideline for smooth functioning; ✓ Analyzing the feasibility of introducing a legal entity like CCP to mitigate the counterparty default risks and settlement risks.	BSEC; DMD, BB; FD, MoF, and PDBL
4.2.10	Restructuring of the Held-to-Maturity (HTM) and Held-for-Trading (HFT) Portfolio	✓ Based on the market conditions, HTM and HFT portfolios should be restructured/revised from time to time.	DOS and DMD, BB
4.2.11	Absence of Established Pension/Provident Funds	✓ Forming separate pension funds for civil servants rather than depending for budget allocation; ✓ Investing the funds in tradable government securities; ✓ Establishing a separate regulatory body to formulate policies and to regulate the entities dealing with public and private pension funds; ✓ Directing the Government/semi-government/ autonomous corporations as well as the corporations/ organizations in the private sector to invest a certain percentage of their provident and gratuity funds in government bonds instead of NSS certificates.	FD, MOF
4.2.12	Other Recommendations	a) Introducing foreign currency-denominated G-sec to, ✓ Attract foreign investors; ✓ Increase inflow of foreign remittance; ✓ Reduce pressure on the local money market; ✓ Borrow funds at cheaper rates; ✓ Establishing creditworthiness in the global market; ✓ Widening the bond market.	FD, MOF, and DMD, BB
		b) Allowing G-sec to be traded on the DSE and CSE platforms along with the MI module to make the trading more convenient for the institutional/individual/foreign investors.	DMD, BB, and BSEC
		c) Implementing a uniform tax treatment for all the Government debt instruments and other saving instruments for individual investors.	FD, MoF, and DMD, BB
		d) Setting a holding period limit and the stop-loss limit for PDs based on the reviewed PD guidelines.	DMD, BB
		e) Establishing clear rules for market-making and ensure two-way quotes for the benchmark bonds by reviewing the PD guidelines, In this regard, Bangladesh Bank should redesign the PD guidelines by addressing the concerned issues.	DMD, BB
		f) Bangladesh Bank may consider securities trading activities to support the market making process. For BB to	DMD, BB

		actively participate in the trading of G-Sec, periodic discretionary trading-limits could be allowed to the DMD, BB.	
Corporate Bonds			
5.2.1	Prolonged Approval Period	The required time to get approval for issuing corporate bonds should be reduced while simplifying the process.	BSEC, and Respective Regulatory Bodies
5.2.2	Issuance of Bonds in Multiple Steps (Shelf Offering)	For efficient utilization of funds, the issuers should be allowed to get the approval in one step with the issuance taking place in multiple steps in case of public offerings.	BSEC
5.2.3	Absence of Debt-Instruments Issued by Different Government Bodies	✓ Government/autonomous corporations/local government bodies/utility companies (e.g. BPC, PDB, ICB, HBFC, Power Generation Companies, and Bangladesh Railway) could consider issuing bonds to raise funds for the long-term projects; ✓ Additionally, to avoid the crowding-out effect, emphasis should be given in promoting increased issuance of corporate debt instruments along with increased issuance of the government securities.	FD, MoF, and BSEC
5.2.4	Bonds Issued By Banks through Private Placement Not Being Listed	✓ BSEC may take steps to enlist the instruments issued through private placement;	DOS and BRPD, BB, and BSEC.
5.2.5	Overreliance on Bank Financing	✓ Policy measures are needed to be taken to ensure a competitive interest structure for the bonds in line with bank financing; ✓ In this regard, BSEC may conduct further studies to determine the aforementioned structure to smoothen the bond issuance process; ✓ Bangladesh Bank may consider revisiting the policies regarding loan rescheduling/restructuring to make those more rigorous and stringent.	BRPD and DFIM, BB, and BSEC
5.2.6	Absence of Instructions on Mandatory Issuance of Bonds after Reaching a Debt-Ceiling	Bangladesh Bank should conduct an analysis to determine the certain debt-ceiling after which a portion of the marginal fund to be raised by issuing debt instruments.	BRPD and DFIM, BB, and BSEC
5.2.7	Absence of Secondary Yield Curve/Effective Valuation Tools	✓ Introduction of diversified government debt instruments and frequent transactions of those instruments are needed for the secondary market to be able to offer an effective secondary yield curve; ✓ DMD, BB should take necessary steps to publish a reliable and effective yield curve for the G-Sec to be used as the benchmark/risk-free rate.	DMD, BB
5.2.8	Shortage of Special	Trust structures and favorable regulations should be formed to guarantee that the incomes generated through	BSEC

	Purpose Vehicle/Entity (SPV/E)	such assets are ring-fenced.	
5.2.9	Limited Role of the Trustees	The role and purview of the trustee should be defined by the BSEC clearly to ensure the protection of the funds of the investors in case of a default or late payment.	BSEC, and BRPD and DFIM, BB
5.2.10	Limited Confidence among the Investors in Relation to Credit Rating Agencies	The regulatory framework should be formulated for the local credit rating agencies to establish strategic partnerships with recognized international agencies (e.g. S&P, Fitch).	BSEC, and BRPD, DFIM, BB
5.2.11	Tax Disincentives to the Issuers	Consider removing the stamp duty and reducing the corporate tax rate/offer a tax-holiday period to the issuers.	BSEC; NBR, and FD, MoF
5.2.12	Tax Disincentives to the Investors	✓ The Government should consider introducing a uniform tax treatment on government and non-government debt instruments for a specific period; ✓ Income from the corporate bonds could be placed outside of the scope of source-taxation, which means, tax on the interest of corporate bonds could be allowed to be paid at the time of submitting income tax return instead of deduction at source.	BSEC; NBR, and FD, MoF
5.2.13	High Cost Related to Issuance and Secondary Trading	Issuance costs and secondary transaction costs (amounting almost 6% of issue size) should be reduced to incentivize bond issuance.	BSEC; FD, MoF, and NBR
5.2.14	Absence of a Separate Trading Platform for Fixed-income Securities	✓ Stock exchanges should consider establishing a separate platform for trading of fixed-income securities for enhanced liquidity; ✓ A separate platform would also make the debt instruments more accessible to individual investors for secondary transactions.	BSEC
5.2.15	Nonexistence of Legal Framework for Local and International Guarantors	✓ BSEC may draft the legal framework identifying the roles of local or international guarantors in ensuring the protection of investors' funds in the issuance of fixed-income instruments; ✓ The Government may consider establishing a separate credit guarantee corporation (or a regulatory body) to ensure the protection of the investors.	MoF, and BSEC
Additional Recommendations			
6.1	Amendment of the Insurance Rules 1958	The forthcoming Insurance Rules (to be issued under the Insurance Act, 2010) could be amended with instructions for the insurance companies to invest a minimum obligatory portion of their portfolio in Fixed-Income Securities	FID and FD, MoF, and IDRA
6.2	Amendment of the Mutual Funds Act	BSEC should consider reducing/abolishing the rule regarding the minimum requirement of obligatory equities in the mutual funds' portfolios.	BSEC
6.3	Awareness	Bangladesh Bank and BSEC may arrange training	BSEC, and

	Programs for the Investors and the Issuers	programs for the institutional investors (e.g. insurance companies, mutual funds) and individual investors as well as for the potential issuers on a regular basis to promote awareness regarding the fixed-income securities.	DMD, BB
6.4	Incentives for the Foreign/Non-Resident Investors	✓ The process of investing in corporate bonds should be simplified for the foreign/non-resident investors; ✓ Relevant hedging instruments need to be introduced to attract those investors.	FEPD, FEID and DMD, BB, and BSEC
6.5	Including Investment-Grade Instruments in SLR	✓ DOS and BRPD, BB may conduct further studies to analyze the viability of allowing investment-grade bond/debenture portfolio to be recognized as a part of the banks' SLR as well as in Repo transactions (with necessary haircut); ✓ The DFIM circular letter no. 01/2017 should be amended by setting the ceiling for the NBFIs in allowing maintaining their SLR with the balances held in banks and other NBFIs.	DFIM, DOS and BRPD, BB, and BSEC
6.6	Introduction of Inflation-Indexed Bonds	The Government, banks, NBFIs and other corporate bodies may consider issuing inflation-indexed bonds to attract foreign investors by guaranteeing an inflation-adjusted return.	FD, MoF, and DMD, BB
6.7	Introduction of Diversified Products	A detailed analysis should be conducted to study the feasibility of introducing Credit Default Swap, Interest Rate Swap, Residential Mortgage-Backed Securities (RMBS), Asset-Backed Securitizations, green bonds, Sukuk, and other types of project-specific bonds.	BSEC; FD, MoF, and BRPD, DFIM, SFD and DMD, BB
6.8	Introduction of Shariah-based Products	A detailed study should be conducted to analyze the feasibility of the introduction of Islamic finance products (e.g. Sukuk) in the market.	BSEC; FD, MoF, and DMD, BRPD, DFIM, BB
6.9	Separate Rules for Debt Securities	✓ Separate rules should be drafted by BSEC specifically focusing on the debt-securities as the tax, duty, and cost structure designed for equity issuance and trading can be disincentivizing for the fixed-income securities market as transaction sizes differ significantly; ✓ In order to stimulate the secondary trading of government securities, MoF and Bangladesh Bank may consider drafting rules allowing short-selling of government securities.	BSEC, MoF, and BB

1. Introduction

The fixed-income securities market plays a vital role in the economic development of a country. It presents long-term financing opportunities to the issuers by creating an alternative source of finance and provides a stable source of income to the investors. Although the stock market in Bangladesh is relatively well-established, the bond market is at an embryonic stage. Therefore, the majority of the debt financing need is fulfilled from the banking sources, which burdens the overall banking sector while presenting a major systemic risk. Therefore, the development of a well-functioning bond market would ensure financial stability by enhancing the ability of financial institutions to manage risks.

For any government, debt financing is a crucial issue in meeting the requirements of a deficit budget. These financing needs of our government are fulfilled by raising funds through the issuance of government debt instruments (e.g. T-bills, T-bonds, and Savings Certificates) or by accumulating funds from the external sources. In Bangladesh, until 2003, T-bills were available in the market with the maturity of 30-day, 91-day, 180-day, and 1-year, and only the commercial banks were permitted to purchase those securities. Back in those days, the secondary trading of such securities was not realistic due to the nonexistence of a secondary market along with a limited number of buyers and sellers. Therefore, a lot of initiatives have been taken to establish a vibrant secondary bond market along with an efficient primary auction system under the watchful eyes of the Financial Institutions Development Project (FIDP) financed by the World Bank. Later, the Non-Bank Financial Institutions were also permitted to engage in the secondary trading of the government securities along with banks. As per the recommendation of the project, in 2003, the trading of the government securities started through an electronic registration by listing in the Central Depository of Bangladesh Limited (CDBL).

Subsequently, Bangladesh Bank introduced the Primary Dealer (PD) system in 2003 by appointing 8 (eight) banks and 1 (one) Non-Bank Financial Institution (NBFI) as PD for primary issuance and secondary trading of the government securities (G-Sec). Along with the short term T-bills, 5-year and 10-year T-bonds were introduced to implement the long-term development plan of the Government. Consequently, the auction calendar was published by the Government for the first time in 2006 based on the deficit budget in Financial Year (FY) 2006-07.

To meet the long term financing requirements of the Government, 15-year and 20-year T-bonds were introduced in FY 2007-08. Later, the PD system was encouraged with incentives and liquidity support against the collateralized securities from the central bank. Bidding commitments and underwriting obligations on PDs were introduced for T-bills and T-bonds auction in 2007 to strengthen their position as the market makers. At present, 21 banks act as PDs to bring vitality in the primary and secondary markets for government securities. In 2011, Bangladesh Bank introduced the Market Infrastructure (MI) Module for the automation of the government securities that act as the depository system for the transaction and settlement of government securities to advance the primary auction and secondary market.

In contrast, the corporate bond market in Bangladesh is very small in size. As of June 30, 2018, the outstanding amount was only 0.013% of the GDP. Thus, the corporate bond market in Bangladesh is at a budding stage. During 1988-2019, only 3 corporate bonds and 14 debentures were issued by public offerings and listed with the stock exchange, but those debentures could not draw the attention of the investors as well as failing to pay the coupons and principal amounts. Many of these bonds and debentures were partially convertible to common stocks. The biggest issue of the corporate bond was first made in 2007. It was a perpetual bond named 'IBBL Mudaraba Perpetual Bond' with a size of Taka 300 crore. ACI Limited issued zero-coupon bonds with attractive tax incentives in 2010 and BRAC Bank issued BRAC Bank 25% Subordinated Convertible Bonds to raise Tier-II capital to comply with the regulatory requirements of Bangladesh Bank in 2011.

To develop a fully functioning fixed-income market, our initial focus was to establish a robust market infrastructure by concentrating on the dematerialization of instruments, the establishment of a secured settlement system and ensuring a transparent trade reporting to build confidence in the market. At present, despite addressing the initial obstacles related to the market-transparency, disclosure standards and dissemination of information, the secondary market is yet to function at the desired level. Currently, one of the biggest challenges we are facing is the incentivization of the investors as well as the issuers. The issuers needed to be encouraged to consider the debt raising alternatives away from traditional bank-financing. In order to implement and ensure the dynamism of the secondary market, the policy measures that we need to adopt are related to five different factors: issuers, investors, instruments, intermediaries, and infrastructure. Along with that, regulations related to intermediaries need to be established for merchant banks, trustees, exchanges, rating agencies, etc. Respective regulators also need to undertake concurrent reforms for their respective regulated segments.

An effective way to incentivize the issuance of bonds would be a tax exemption for a specific period. As we know, mutual funds can sometimes offer certain tax benefits leading the corporate investors to park liquid cash in such schemes. Regulators for the respective investor segments like insurance and pension funds could also be directed to hold a minimum allocation of fixed-income securities in their portfolios. In India, they incentivized using this model by allowing a tax-free bond issuance for a specific period. Over there, the banks are not allowed to act as a guarantor in the issuance of bonds; rather a trustee is mandatory for all listed bonds. The corporate bodies are permitted to offer a guarantee against the bonds issued by their group of companies subject to the specific Companies Act regulations.

2. The Need for a Vibrant Long-Term Bond Market

A developed and diversified financial system with a sound debt and equity market enhances risk- pooling and better risk-sharing opportunities for the investors and borrowers. The fixed-income securities market links the issuers having short and long-term financing needs with investors willing to place funds in short and long-term interest-bearing securities. It also makes the financial market more competitive by generating market-based interest rates. A well-functioning market offers the Government and the private investors the flexibility to diversify their sources of funding and provides them with alternative sources of raising funds having different maturities. Therefore, a vibrant fixed-income market is needed for several reasons:

2.1. An active market allows the Government to finance large fiscal deficits without resorting to financial repression or foreign borrowing. For that reason, the drive for the development of the government bond market typically comes from the Government to facilitate the financing of large fiscal deficits.

2.2. The development of a well-functioning fixed-income market supports the efficient implementation of the monetary policy. It offers the instruments needed for the execution of monetary policy and improves the transmission mechanism of the monetary policy. Long-term bonds also facilitate the sterilization operations by the central bank as exclusive reliance on short-term instruments tends to drive up the short-term interest rates and encourage further inflows into such instruments.

2.3. The development of a bond market, especially a vibrant G-Sec market, can improve access to local currency financing. An active G-sec market can offer local currency investors, such as retail and institutional investors, a way to invest in the local currency, and therefore, ensure better management of inflation and exchange rate risk. They are also provided with a safe alternative investment compared to local currency bank deposits.

2.4. The long-term fixed-income market, being accessible to foreign investors, increases financial integration by attracting foreign capital, which can lower the cost of borrowing for the Government and improve risk-sharing across countries.

2.5. Whilst the stock market capitalization of about 20% of the total financing requirement is well below the regional peers, the long term debt market is almost non-existent (World Bank Group Report on Bangladesh Capital Markets, August 2018). This means, 80% of debt financing comes from the banking sector, which cannot lend longer than around 5 years, given that 70% of bank deposits are for 1 year or less (Scheduled Banks Statistics, October-December, 2018). Financing long-term projects by borrowing from the banking sector's short-term deposits could pose a major systemic risk and wider maturity mismatch in the industry, which negatively affects the banks' resilience in regards to the liquidity crisis. Moreover, to materialize the objectives of the Vision-2021, our economy needs to achieve 8+% growth of the GDP, which is not probable solely depending on the bank-financing.

2.6. Moreover, the local currency government bond market can function as a catalyst for the development of corporate bond markets by providing a benchmark yield curve. Similarly, derivatives markets cannot flourish without a well-developed fixed-income market with underlying assets.

2.7. Without the presence of a vibrant corporate bond market, corporate lending by the banking system becomes oversized leading to maturity mismatch in the market. In Bangladesh, corporations tend to fund their long-term projects using loans from commercial banks. As we know, the banking deposits are chiefly of short-term tenures (3 months to less than 1 year). At present, around 70% of the deposits are within the 1-year bucket. Therefore, funding long-term assets with short-term liabilities creates a huge maturity mismatch in the banking sector.

Facing those aforementioned challenges, the banking sector is always under pressure to accumulate more deposits to address the maturity mismatch in their books. This creates an uneven competition in the market affecting the interest rates. In this context, in the absence of a long-term bond market, banks are financing long-term projects with the tenors of the loans that are indeed shorter than actually needed. This leads to the installment size of those loans becoming oversized to the capacity of the borrower, which ultimately creates asset quality impairments and overdue loan repayments leading to Non-performing Loans (NPL).

3. Bond Market in Bangladesh: An Overview

The fixed-income securities market consists of both government and corporate debt instruments. At present, the debt securities market in Bangladesh is somewhat lopsided as the size of government issuance is far higher than the corporate issuance. This section of the framework focuses on presenting a succinct overview of the fixed-income securities market in Bangladesh.

3.1. Government Securities Market

3.1.1. Primary Market Operation

As per the relevant laws and regulations, the Debt Management Department (DMD) of Bangladesh Bank acts as the debt manager of the Government in consultation with the MoF. These laws also empower Bangladesh Bank to issue new loans and manage public debt on behalf of the Government. A Cash and Debt Management Committee (CDMC) has been formed for the supervision of the Government's borrowings chaired by Secretary, Finance Division. It has been formed for efficient, effective and timely policy decision making regarding debt management and budget financing. In addition to CDMC, there is also a Cash and Debt Management Technical Committee (CDMTC) to assist CDMC.

BB is authorized to conduct auctions for raising loans on behalf of the Government of Bangladesh. The process of raising loans involves the issuance of government securities. It is primarily done through auctions and in some cases, through private placement. There is an auction committee chaired by Deputy Governor of BB to determine the cut-off rate of the auction of government securities.

An auction can either be price or yield-based multiple rates as per instruction issued by BB. In multiple rate method, successful orders are allotted at the offered rate. The bid amount is BDT one lac and its multiples. An auction is conducted for a predetermined notified amount as per the discretion of the Issuer. Member Dealers (PDs, Non-PD banks and NBFIs) can place orders within a prescribed cut-off time. Member Dealers can also submit bids on behalf of their clients (Resident individuals and institutions such as insurance companies, corporate entities, authorities responsible for the management of provident funds, pension funds, etc. and foreigners/non-resident individuals/ institutions). Allotment of securities would subsequently be credited to respective security accounts of successful bidders upon receiving confirmation of fund transfer.

Member Dealers may submit non-competitive bids on behalf of individual or institutional clients who have no current account with Bangladesh Bank. The maximum accepted amount of non-competitive bids in an auction is determined by BB. BB has started reissuance of instruments in 2013 to develop benchmark securities and to construct a secondary market yield curve. An additional issue of an existing instrument is handled in a way similar to an auction.

During FY 2017-18, Bangladesh Government Treasury Bonds (BGTBs) worth BDT 25,100.00 crore were issued, while total repayments amounted to BDT 18,800.00 crore. Issuance of T-Bonds in FY 2017-18 was 67% higher than that of the previous fiscal year. The details of issuance of BGTBs in FY 2015-16, 2016-17 and 2017-18 are illustrated in the following table:

Table: Net Issuance of BGTBs

(Taka in Crore)

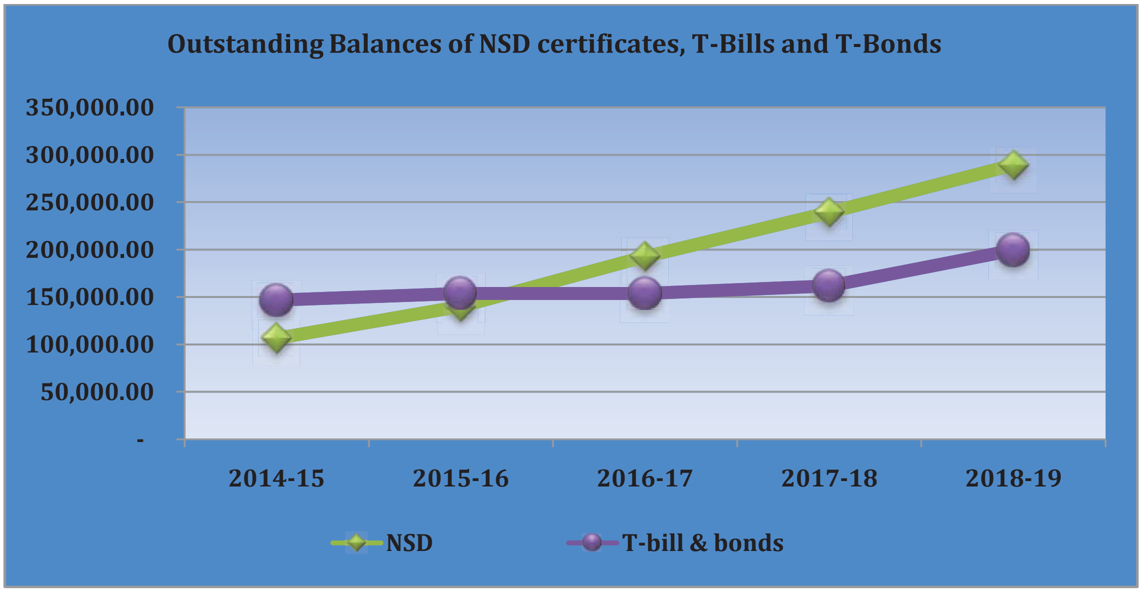
Financial Year	Issuance	02 year	05 year	10 year	15 year	20 year	Total
2015-16	a) Issue	5,800.00	6,000.00	5,800.00	3,450.00	3,100.00	24,150.00
	b) Repayment	5,700.00	5,250.00	746.66			11,696.66
	c) Net Issuance	**100.00**	**750.00**	**5,053.34**	**3,450.00**	**3,100.00**	**12,453.34**
2016-17	a) Issue	3,150.00	4,250.00	4,300.00	1,700.00	1,700.00	15,100.00
	b) Repayment	4,006.00	6,150.00	3,547.78			13,703.78
	c) Net Issuance	**(856.00)**	**(1,900.00)**	**752.22**	**1,700.00**	**1,700.00**	**1,396.22**
2017-18	a) Issue	6,900.00	5,700.00	6,800.00	3,000.00	2,700.00	25,100.00
	b) Repayment	5,800.00	8,200.00	4,800.00			18,800.00
	c) Net Issuance	**1,100.00**	**(2,500.00)**	**2,000.00**	**3,000.00**	**2,700.00**	**6,300.00**

Source: DMD, BB.

The total outstanding public debt of the Government from the banking sector stood at BDT 1,61,767.56 crore constituting 7.23% of the GDP at the end of June 2018 compared to 7.78% at the end of June 2017. In FY 2017-18, the banking sector was the leading investor category accounting for 77.12% of the total stock holding. Long-term investors like insurance and provident funds accounted for 15.50% of the total holding.

As the interest rate of the NSD certificate is significantly higher than any other interest rate prevailing in the Government securities market, government borrowing is higher through the NSD certificate while the borrowing from the banking sector is decreasing over the periods. The percentage of outstanding domestic public debt compare with GDP from the banking sectors (T-bills and bonds) decreased gradually, whereas outstanding debt in the percentage of GDP from NSD certificates increased significantly due to the massive selling of non-marketable securities (i.e. Sanchayapatras).

A comparative illustration of the outstanding balance of NSD certificates and treasury instruments is presented below:



Source: NSD, and DMD, BB

3.1.2. Secondary Market

Government securities issued through an auction or private placement are eligible for secondary trading. Bangladesh Bank has initiated to automate the process of trading and settlement of government securities transactions in October 2011. The secondary market of government securities in Bangladesh is comprised of Over-the-Counter (OTC) and Trader Work Station (TWS). Both procedures are integral parts of the MI Module (an automated auction and trading platform of government securities).

3.1.2.1. Over-the-Counter (OTC)

In OTC, trades occur by the negotiation between members outside of the trading platform over the telephone. If the deal is confirmed through negotiation, it has to be reported in the system for settlement. Either the buyer or seller member inputs the transaction details and is referred to as the instructing party. The other member confirms/accepts the trade and is referred to as a confirming party. On confirmation, the trade is taken up for settlement. Once they complete the trading process and the system accepts trades, the data automatically flows to Core Banking System (CBS) for clearing and settlement of funds for completion of the settlement of funds in CBS on a real-time basis. Subsequently, the trading securities get transferred automatically to the buyer securities account in MI Module.

3.1.2.2. Trader Work Station (TWS)

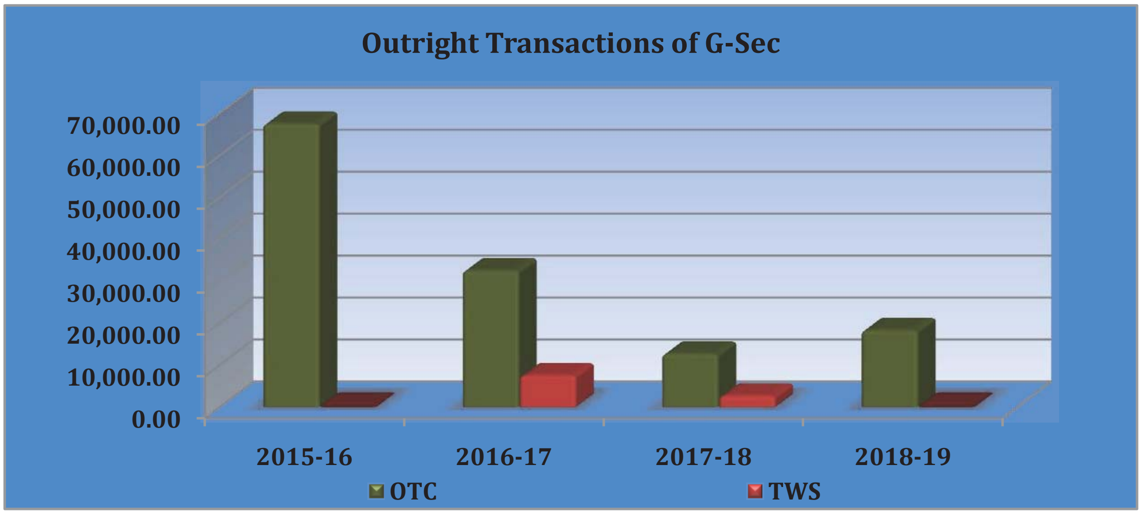
BB has introduced the TWS, an anonymous order matching system, which is an electronic, screen-based, order-driven trading system for dealing in government securities. It provides users access to trade in the secondary market on a real-time basis. Order management and matching are the core components of the trading solution. The matching engine of the trading solution provides the algorithms that enable the members to trade instantaneously. Furthermore, TWS has brought transparency in secondary market transactions in government securities. Members can place bids (buy orders) and offer (sell orders) directly on the TWS screen. In that system, trades are automatically sent to the CBS for fund settlement. Other investors (individuals and institutions, insurance companies, bodies corporate, authorities responsible for the management of provident funds, pension funds, etc) can buy-sell government securities through Banks and NBFIs working in Bangladesh.

3.1.2.3. Government Securities Order Matching (GSOM) Trading Platform

BB has introduced a web-based platform to make buy and sell orders of government securities visible through GSOM in August 2016. This web-based terminal (https://gsom.bb.org.bd) makes the order book (submitted bids and asks price/yield) including securities details visible to the members on a real-time basis. Resident individuals and institutions such as banks, NBFIs, insurance companies, bodies corporate, authorities responsible for the management of provident funds, pension funds, etc. as well as foreigners/non-resident individuals/institutions can watch and search the order information from GSOM. Those members are not authorized to change or modify the information directly in GSOM. Only Member Dealers are eligible to change or modify or cancel the order information through TWS.

3.1.2.4. Secondary Trading Volume of Government Securities

The total volume of government securities transacted on an outright basis in the FY 2017-18 stood at BDT 15,334.40 crore, which was considerably lower than the preceding financial year. The decrease in volume was largely due to less issuance of government securities through auctions. Moreover, there is a high demand for government securities to meet the SLR requirement of the banks, and therefore, they tend to hold securities under the Held-to-Maturity (HTM) portfolio. In FY 2017-18, the transaction volume of Treasury securities decreased by 61.72% compared to the FY 2016-17. The comparative illustration of the outright transactions is presented below:



Source: DMD, BB

3.2. Corporate Bonds Market

For issuance of debt securities through the private offer, an issuer should submit an application under the Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012. On the other hand, for issuance of debt securities through public offer, an issuer needs to submit an application under Bangladesh Securities and Exchange Commission (Public Issue) Rules, 2015 upon compliance of relevant requirements of the Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012. Issuer issued corporate bond and debenture through private offer and public offer are:

Issuance of Corporate Debt Securities in Bangladesh: Private Offer

FY	Corporate Bond (No. of Companies)	Corporate Bond Outstanding (crore BDT)	Corporate Debenture (No. of Companies)	Corporate Debenture Outstanding (crore BDT)	Total (No. of Companies)	Total Amount Outstanding (crore BDT)
2012-13	5	750.00	--	--	5	750.00
2013-14	8	3,840.00	6	70.00	14	3,910.00
2014-15	12	2,950.00	2	6.75	14	2,956.75
2015-16	13	4,059.12	2	27.20	15	4,086.32
2016-17	4	2,160.00	3	497.50	7	2,657.50
2017-18	29	10,698.50	3	518.00	32	11,216.50
2018-19	23	12,755.00	-	-	23	12,755.00
Total	**94**	**37,212.62**	**16**	**1,119.45**	**110**	**38,332.07**

Data Source: BSEC

Issuance of Corporate Debt Securities in Bangladesh: Public Offer

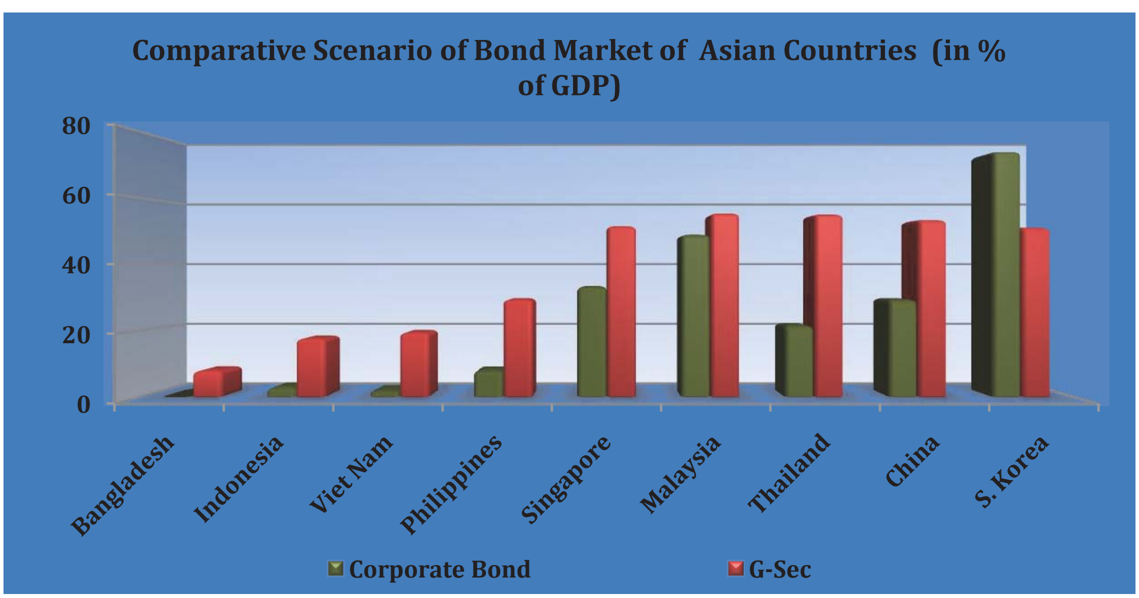
Serial no.	Corporate Bonds/Debentures	Year of issue	Features	Size (crore BDT)
1.	IBBL Mudaraba Perpetual Bond	2007	Profit Sharing	300.00
2.	ACI 20% Convertible Zero-Coupon Bonds*	2010	20% Convertible	107.00
3.	BRAC Bank 25% Subordinated Convertible Bonds*	2011	25% Convertible	300.00

**already been converted to equity* *Source: BSEC*

At present, the public offering of corporate bonds is very limited as only one issue (the IBBL Mudaraba Perpetual Bond, amounting to 300 crore Taka) is listed on the stock exchanges (DSE, CSE). The total market capitalization of this listed corporate bond is BDT 282 crore in 2018-19, where the secondary trading is very insignificant. Although there are a few subordinated bonds issued by the banks, the major portion of those is currently being held by other banks through private placement (which are not listed in the stock exchanges and thus, not contributing to the development of the secondary market).

3.3. Comparison with a Few Other Asian Countries:

The current outstanding amount of the bond market of Bangladesh (G-Sec and corporate) is a small percentage of the GDP. In comparison with some other developing countries in Asia, the outstanding amount of the Bangladeshi bond market gets significantly dwarfed. With respect to their GDPs, the comparative scenario of the outstanding amount of the respective bond markets at the end of the FY 2017-18 is presented below:



Data Source: BB, DSE, ADB

4. Government Securities (G-Sec) Market

4.1. Regulations for the G-Sec Market

Bangladesh Government Treasury Bonds (BGTB) is issued and operated under the notification of the Finance Division, MoF in pursuant of the rule-4 of the Public Debt (Central Government) Rules, 1946.

4.2. Existing Impediments in Developing the Government Bond Market and Recommendations to Resolve the Issues

4.2.1. Proper Cash Management

At present, without proper cash forecasting with respect to government borrowing, the Government cannot adopt a clear issuance strategy. As a result, the public sector borrowing is riddled with a lack of clarity that fails to offer any reliable demand-supply scenario. Consequently, the Government fails to implement the auction calendar properly, under which an efficient G-sec market cannot function. Thus, the lack of sound cash forecasting and frequent shifts/instability of demand hinder the development of the bond market. Moreover, with its current role, CDMC focuses only on the cash and debt management of the Government.

Recommendations: The Government should adopt a clear issuance strategy and conduct proper cash forecasting in every financial year. In this regard, the Finance Division, MoF should establish a central IT-based cash management cell, where all the stakeholders (different line ministries) could input their expenditure and revenue plans periodically. Moreover, CDMC may focus on the development of the financial market along with the cash and debt management of the Government. CDMC may also adopt a policy in regards to the management and investment of the surplus cash amount in the market by exploring alternative investment opportunities.

Implementing Agency: Finance Division, MoF

4.2.2. Introduction of a Medium-Term Auction Calendar

The Government formulates an auction calendar for T-bonds and T-bills, but the offer amounts are not dictated by a clear debt management strategy, rather considered as the source to collect residual volume after NSS borrowings. As a result, sometimes the Government cancels the auctions of government securities or issue a lesser amount through the auctions due to a huge cash surplus in the government accounts maintained with Bangladesh bank. Because of the frequent changes in the auction calendar, the investors cannot forecast the supply of the government securities leading to affecting their investment plans.

Recommendations: The Government should prepare a concrete auction calendar based on budgetary needs as per the annual borrowing plan. The Government needs to publish an auction calendar at least on a half-yearly basis and conduct auctions as a preannounced auction calendar. The auction should not be frequently canceled or changed. If there are regular auctions, the supply of securities will be available to the investors. It will create confidence among the investors regarding the consistent supply of G-Sec, thus ensuring the frequency and volume of trading.

Lead Implementing Agency: Finance Division, MoF

Associate Agency: DMD, Bangladesh Bank

4.2.3. Open-Limit on the Sale of Savings Certificates

The interest rate of savings certificates is almost one and a half times as much as the interest rates on T-bills and T-bonds. The rate of interest of 5-year T-bond is 8.10%, where the interest rates of 3-year and 5-year savings certificates are 11.04% and 11.28% respectively. The increased interest rate on savings certificates induces the public to purchase more, which in turn compels the Government to cut short the borrowing from the banking sector. Thus, high-interest rates on savings certificates as well as the Government's open-tap policies regarding its sales are crowding out corporate borrowers and bank deposits in comparable tenures. As a result, the overreliance on NSS (e.g. Shanchaypatra) is affecting the government debt market by,

- ✓ Reducing the size of the tradable government bond market,
- ✓ Distorting auction strategies and treasury operations,
- ✓ Impacting the maturity structure of the deposits in the banking sector,
- ✓ Distorting market rate of interest (risk-free rate, govt. securities rate), which is much higher than the risk-added rate.

Recommendations: The Government should fulfill the fiscal deficit based on the target set in the budget from the banking sector. To fulfill the borrowing from the banking sector as per the budgetary plan, the Government should sell the NSD instruments only to the targeted people (senior citizens, low-income people, etc.). While adding a social-security premium with the market interest rate, the yield of the savings certificates could be set in line with the yield of the tradable securities.

Implementing Agencies: Internal Resources Division and Finance Division, MoF

4.2.4. Lack of Sufficient Instrument Balance

The demand and time liabilities of the banking sector are increasing over time, which in turn leads to mandatory holding of more securities for SLR by banks and NBFIs. But, due to frequent cancellation of the auctions over the past few years, the Government's borrowing from the banking sector is decreasing which directs the negative net issuance of G-sec. Consequently; after maintaining SLR, the supplies of tradable instrument balances in the market are declining, which discourages the investors to trade their holdings in the secondary market. As a result, some active banks cannot trade and contribute to the development of the market.

Recommendations: The government needs to increase the issuance of marketable government bonds by ensuring a minimum net issuance every year. The outstanding balances of G-sec should be increased by issuing more tradable securities by conducting regular auctions as per the announced auction calendar.

Lead Implementing Agency: Finance Division, MoF

Associate Agency: DMD, Bangladesh Bank

4.2.5. A Large Number of Securities (ISIN) in the Market

Currently, we have 274 outstanding G-Sec in the market. So, it is difficult for investors to identify their preferred securities with the desired International Securities Identification Number (ISIN) and features to invest. It also creates an impediment in identifying the benchmark securities.

Recommendations: The number of securities should be reduced to a reasonable standard. Though the number is reducing gradually because of the reissuance, the volume of the upper limit of each ISIN is now 3,000 crore only, which is not sufficient to reduce the number of securities. The upper limit should be increased to a reasonable level, particularly for long term maturities bonds. Furthermore, to reduce the number of securities, an intensive program of buyback and switching should be taken by the Government. Moreover, reissuance of the securities with tenors close to the preceding slab (a 20-year T-bond with the remaining maturity close to 15 years and with a nominal outstanding amount could be reissued as a 15-year T-bond) could be issued as a lesser tenor bond rather than the fresh issuance of another one.

Lead Implementing Agency: Finance Division, MoF

Associate Agency: DMD, Bangladesh Bank

4.2.6. Lack of Benchmark Securities

At present, there is no benchmark G-sec in Bangladesh. The outstanding balance of govt. securities against a single ISIN is BDT 3,000 crore in the market, which is not sufficient to build benchmark securities. As a result, it is difficult to identify the benchmark securities and without benchmark securities, it is reasonably tough to construct a benchmark yield curve.

Recommendations: To build a vibrant and efficient secondary market of G-sec, we need to identify the benchmark securities in the market. Those securities would be traded more frequently and thus, function as a benchmark for trading. Moreover, we should ponder issuing securities with even longer tenors (e.g. 30-year, 40-year) as well as increasing the upper limit to make the benchmark securities more effective.

Lead Implementing Agency: Finance Division, MoF

Associate Agency: DMD, Bangladesh Bank

4.2.7. Absence of an Effective and Realistic Secondary Yield Curve

The secondary market yield is a risk-free rate, which is used as a benchmark rate in pricing the corporate bonds. The absence of a yield curve makes it difficult for the multilateral and corporate to pursue off-shore local currency bond issuance. It is also holding back the issuance of foreign currency-denominated infrastructure project bonds or housing bonds. In spite of a few limitations, BB is constructing the yield curves for both primary as well as secondary debt market. The primary yield curve is well-functioning and all market stakeholders are using it for the pricing purpose. However, the secondary market's yield curve is still at its earlier (test) stage due to the limited secondary transaction of G-Sec. The published secondary market yield curve will be helpful to determine the movement of interest rates in the economy. It will also be helpful for the valuation of the Held-for-Trading (HFT) securities.

Recommendations: With a higher frequency of trading in the secondary market, we will be able to construct and publish a more effective secondary market yield curve on a regular basis for the pricing requirements of the securities. In this regard, the frequency of trading in the secondary market should be increased. Moreover, Bangladesh Bank should check whether the already developed secondary market yield curve fulfills the international standards.

Implementing Agency: DMD, Bangladesh Bank

4.2.8. Unavailability of Two-Way Price Quoting

Like any efficient market, the primary dealers should quote two-way prices in the market. At present, the PDs do not quote on a two-way basis, rather only quote either on the buy or the sale of the book because of the absence of benchmark and available securities in their holding. Furthermore, at present, there is no infrastructure allowing the PDs to quote two-way prices.

Recommendations: BB should consider selecting the benchmark securities that are liquid enough for the primary dealers to be able to quote on a two-way basis in the secondary market. The infrastructure should be established to facilitate the two-way price quoting system. Moreover, the PDs should be directed to quote two-way on a daily basis; and thus, making the secondary market more efficient by bringing in the required liquidity.

Implementing Agency: DMD, Bangladesh Bank

4.2.9. Introduction of a Central Counterparty (CCP)

Investors, especially foreign investors, always concentrate on legal protection and safekeeping services while investing. They also keep in mind the counterparty risk in case of a default by the counterparty. In Bangladesh DvP (Delivery versus Payment) system is followed for the transfer of G-Sec to avoid settlement risk. But to avoid the counterparty default risks of corporate bonds, we need to have a CCP (Central Counterparty) and specific guidelines. We still do not have central counterparty along with clear guidelines for G-sec as well as for the corporate bonds to avoid such circumstances which discourage some banks from trade in the market.

Recommendations: To reduce the risk associated with the counterparty, to maintain the securities balance through SGL and IPS, to ensure secure transfer of securities and secondary trading of G-sec, BB should have a depository guideline for the smooth functioning of those activities. Moreover, BSEC and BB should also focus on analyzing the feasibility of introducing a legal entity like CCP to mitigate the settlement risks for the G-Sec and corporate bonds.

Lead Implementing Agency: BSEC, and DMD, Bangladesh Bank

Associate Agencies: Finance Division, MoF, and PDBL

4.2.10. Majority of the Portfolio Being in Held-to-Maturity (HTM) Category

As per Bangladesh Bank DOS circular no. 01/2014, PD banks are allowed to maintain G-Sec in HTM up to 125% (Non-PD-110 %) against the SLR requirement of their holding. As a result, to avoid revaluation loss in HFT, they maintain the maximum of their holdings in HTM, which they cannot trade in the secondary market. Moreover, the maximum portion of G-Sec is in the portfolio of the state-owned banks. But, their contribution to the secondary trading of G-Sec is very insignificant. This scenario deeply impedes the development of the G-sec market.

Recommendations: Based on the market conditions, HTM and HFT portfolios should be restructured/revised from time to time.

Lead Implementing Agency: DMD, Bangladesh Bank
Associate Agency: DOS, Bangladesh Bank

4.2.11. Absence of Established Pension/Provident Funds

By law, the Government of Bangladesh provides a pension to its civil servants upon retirement, but that is administered based on annual budget allocation. As such, there is no separate public or private pension fund as of now. The Government's defined benefit pension scheme for civil servants operates on a non-funded, pay-as-you-go basis. It is estimated that semi-government and autonomous bodies' provident funds' assets are mostly invested in the NSS instruments.

Recommendation: The Government should consider forming separate pension funds for the civil servants rather than depending on the budget allocation every financial year and invest the amount accumulated in those funds in tradable government securities. Moreover, the Government may consider establishing a separate regulatory body to formulate policies and to regulate the entities dealing with public and private pension funds. On the other hand, the Government-owned companies, corporations, semi-government, autonomous corporations and corporations/organizations in the private sector may be directed to invest a certain percentage of their provident and gratuity funds in government bonds instead of NSS instruments.

Implementing Agency: Finance Division, MOF

4.2.12. Other Issues and Recommendations

a) **Introducing Foreign Currency Denominated G-sec:** The Government may consider introducing G-sec in different foreign currencies (e.g. USD, EUR, and GBP). Foreign Currency denominated Government Securities would have different benefits like attracting more foreign investors, increasing the inflow of foreign remittance, reducing the pressure on the local money market, establishing our country's creditworthiness in the global market, and opening up opportunities for the Government to borrow more funds at cheaper rates.

   Lead Implementing Agency: Finance Division, MoF

   Associate Agency: DMD, Bangladesh Bank

b) **Allowing G-Sec to Be Traded on the DSE and CSE Platforms:** In order to enable the individual, private, corporate and foreign investors trading the G-sec in the secondary market, BB may consider letting the G-sec being traded on the DSE and CSE platforms along with MI Module. Listing of the G-sec to exchanges (e.g. DSE, CSE) will attract foreign equity investors while ensuring liquidity.

   Lead Implementing Agency: BSEC

   Associate Agency: DMD, Bangladesh Bank

c) **Implementing a Uniform Tax Treatment for All the Government Debt Instruments:** NSS instruments enjoy significant tax advantages to the marketable government securities. The taxation of the marketable and non-marketable instruments is different. Although the capital gain tax is not applied for the marketable instruments, the interest revenue is part of the personal income tax base, where the highest rate is 30%. The highest tax rate in the progressive personal income tax system of Bangladesh has applied already at a moderate income level, which means that those individuals who can afford to invest in government securities most likely fall into the category of the highest rate; i.e. their interest revenue will be taxed by 30%. As oppose to this NSS instruments enjoy significant tax benefits or exemptions. The tax benefits further widen the gap between the available return of the NSS products and government instruments hindering the development of the bond market. It is recommended that the tax treatment of debt instruments, as well as other saving instruments, should be the same for the individual investors.

Lead Implementing Agency: Finance Division, MoF

Associate Agency: DMD, Bangladesh Bank

d) **Proactive Market Making Activities by PDs:** Primary dealers need to be more proactive in quoting a price in the market as they hold a large volume of securities above their SLR requirements. If they regularly trade the surplus securities, the market will become more liquid and secondary trade will increase by manifold. For this, BB can advise PDs to set a holding period limit and stop-loss limit based on the mark-to-market of their HFT portfolio. If this limit is actively monitored, secondary trade would increase rapidly;

Implementing Agency: DMD, Bangladesh Bank

e) **Revising the PD Guidelines:** The procedures for PDs' market-making obligation have not yet been established and the rules are not defined clearly. According to the Guidelines on the operations of Primary Dealers, they have to quote two-way prices on the TWS system. However, BB needs to set clear rules for the market-making; only the maximum bid-offer spread is defined as 50 basis points (under the current PD guidelines). Beyond that, the minimum quoting amount should be requested. BB should decide how many PDs should quote one instrument and assign market makers to each quoted bond. Given the fragmented government portfolio and a large number of outstanding instruments, only bonds exceeding a certain outstanding amount (e.g. BDT 1,000 crore) should be included in the market making framework. It is recommended that BB sets clear rules for market-making and ensure two-way quotes for the benchmark bonds. In this regard, Bangladesh Bank should redesign the PD guidelines by addressing the aforementioned issues.

Implementing Agency: DMD, Bangladesh Bank

f) **Active Participation of BB in Market Making:** Bangladesh Bank may consider securities trading activities to support the market making process. BB could actively participate in the trading of government securities in the secondary market. A periodic (daily) discretionary trading-limit could be allowed to the DMD, BB. Further analysis could be conducted regarding this approach.

Implementing Agency: DMD, Bangladesh Bank

5. Corporate Bond Market

5.1. Legal Framework for the Corporate Bond Market and Fees

5.1.1. Approval/Rejection Period under the Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012

Section 5 of the rule states, "the Commission shall accord consent in writing to the issue of debt securities, as sought for, within 07 (seven) working days of receipt of the application with all required documents…If the Commission finds that the application does not fulfill all the requirements of rule 4, it may, within 15 (fifteen) days of receipt of the application, direct the applicant to fulfill the requirements within such time as the Commission may determine, and on fulfillment of such requirements the Commission shall accord the consent as prayed for, within 07 (seven) working days of such fulfillment." Section 6 states, "the applicant whose application has been rejected by the Commission may apply to the Commission for review of its decision within 30 (thirty) days from the date of such rejection and the decision of the Commission thereon shall be final."

5.1.2. Bangladesh Securities and Exchange Commission (Public Issue) Rules, 2015

For issuance of debt securities through a public offering, an issuer needs to submit an application under this rule upon compliance of relevant requirements of the Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012.

5.1.3. Issuance Fees

Sl. No.	Type of fees	Public Offer (Fixed Price)	Private Offer
1.	Application fee for the Commission	BDT 50,000.00 (non-refundable)	BDT 10,000.00
2.	Consent fee for the Commission	0.40% on the public offer amount.	0.10% of the total face value
3.	Issue Management Fee	Maximum 2% (two percent) of the public offer amount.	Optional
4.	Underwriting fee	Maximum 1% (one percent) on 35% (thirty-five percent) of the public offer amount.	Optional
5.	Annual Trustee Fee	0.25% of the outstanding amount	0.25% of the outstanding amount

6.	Trust Deed Registration Cost (Stamp Duty and other fees)	2% (of issue size) stamp duty	2% (of issue size) stamp duty
7.	Charge Creation Fee (for secured bonds)	Registration fees at the RJSC	Registration fees at the RJSC
8.	Credit Rating Fee	As per agreement	As per agreement
9.	Fees for Exchange(s)	See chapter 5.1.4	Not yet applicable
10.	Tax and other fees	See chapter 5.1.5	See chapter 5.1.5
11.	Fees for debt securities, funds, ABS and others	As per relevant rules.	As per relevant rules.

5.1.4. Depository and Trading-Related Fees

Sl. No.	Type of fees	Amount/Percentage	Remarks
1.	Demat Fee	0.0075%	On face value, at the end of the month
2.	Annual depository/Listing fee	BDT 5,000 to 20,000	Yearly, depending on the face value
3.	Transaction Fee	BDT 100.00	Per transaction (CDBL 25.00, Stock Exchange 50.00 and Brokerage House 25.00)
4.	New Issue/IPO Fee	0.015%	On face value, at the time of application/end of month

5.1.5. Tax, Duties and Other Fees

Sl. No.	Type of fees	Amount/Percentage	Remarks
1.	Tax on Transaction	0.10%	On the value of securities (Buyer 0.05% and seller 0.05%)
2.	Tax on Coupon	10%	At source (required to be adjusted at the time of final tax payment)
3.	Tax on Capital Gain	10%	Final and applicable for corporate clients only

5.2. Existing Impediments in Developing the Corporate Bond Market and Recommendations to Resolve the Issues

5.2.1. Prolonged Approval Period

Although as per the Securities and Exchange Commission Private Placement of Debt Securities Rules, 2012, consent for the issuance of debt securities is accorded within 7 (seven) working days of receipt of a complete application, the time length of the approval process in practice (which is much longer than stipulated 7 days) creates disincentives for the issuers of the corporate bonds. For issuing any corporate bond, approval from the BSEC is mandatory. Moreover, as per the Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012, the issuer needs to obtain necessary permissions or consents from its primary regulator to issue debt securities. Therefore, for banks and NBFIs, an NOC from BB is required in issuing bonds. This process takes up a significant time, which discourages the corporate entities to issue bonds in order to raise funds. As the approval process from the BSEC usually takes a certain period, the targeted price and other market parameters change during that period.

Recommendations: Approval times from BSEC may be reduced so that the targeted price and other market parameters would not change. The required time to get approval for issuing a corporate bond should be adjusted accordingly while simplifying the process.

Lead Implementing Agency: BSEC

Associate Agencies: Respective regulatory bodies

5.2.2. Issuance of Bonds in Multiple Steps (Shelf Offering)

At present, we have the framework for the bonds to be approved and issued in one-shot. As the issuers raise the whole amount in a one-shot, they sometimes struggle to utilize the funds accordingly as normally the projects are implemented phase by phase. At present, the shelf-offering is approved on-demand only in case of private placements.

Recommendation: In case of public offerings, an alternative method should be considered that allows the issuers to get the approval in one step, while the issuance process lasting over a specified period in multiple steps according to the utilization capacity of the issuer. This process would ensure the efficient utilization of the funds.

Implementing Agency: BSEC

5.2.3. Absence of Debt Instruments Issued by Different Government Bodies

At present, different government corporations/autonomous bodies/Local Government bodies/utility companies (e.g. BPC, PDB, ICB, HBFC, Power Generation Companies, and Bangladesh Railway) make their expenditures from the allotted amount in the national annual budget. Various organizations like these from our neighboring countries raise funds for their long-term projects through the issuance of bonds.

Recommendation: The Government corporations/autonomous bodies/local government bodies/utility companies (e.g. BPC, PDB, ICB, HBFC, Power Generation Companies, and Bangladesh Railway) could raise funds for the long-term projects by issuing bonds (backed by government guarantees). Additionally, to avoid the crowding-out effect, emphasis should be given in promoting increased issuance of corporate debt instruments along with increased issuance of the government securities.

Lead Implementing Agency: Finance Division, MoF

Associate Agency: BSEC

5.2.4. Bonds Issued By Banks through Private Placement Not Being Listed

Banks can fulfill their capital requirements with the private placement of Tier-II subordinated bond issuances. However, in practice, these have largely been purchased by other banks/FIs, which do not contribute to the development of the secondary market.

Recommendation: BSEC may consider taking steps to enlist the bonds issued through private placement. Furthermore, BSEC may also consider taking steps to encourage the corporate bodies in issuing bonds to raise funds; and consequently, increasing the number of corporate bonds available in the market for investment.

Lead Implementing Agency: BSEC

Associate Agencies: DOS and BRPD, Bangladesh Bank

5.2.5. Overreliance on Bank Financing

In practice, credits through commercial banks are easier, cheaper and quicker. In contrast, issuing debt instruments/raising debts through the capital market is subject to higher issuing costs and rigorous regulatory due diligence/approval process by BSEC, which takes a longer time. Due to this, rather than obtaining funds by issuing bonds, the majority of the corporations currently prefer bank-financing. Moreover, the current practice of multiple times rescheduling/restructuring of loans encourages the corporations to prefer bank financing over debt securities issuance. This not only overburdens the systemic risk of the banking sector but also hinders the development of the bond market.

Recommendation: Policy measures should be taken to ensure a competitive interest/cost structure for the bonds in competition with bank financing. In this regard, BSEC may conduct further studies to determine the aforementioned structure to smoothen the bond issuance process. Furthermore, Bangladesh Bank may consider revisiting the policies regarding loan rescheduling/restructuring to make those more rigorous and stringent.

Lead Implementing Agency: BRPD, Bangladesh Bank

Associate Agencies: DFIM, Bangladesh Bank, and BSEC

5.2.6. Absence of Instructions on Mandatory Issuance of Bonds after Reaching a Debt-Ceiling

At present, almost all corporations depend on bank financing to finance their total long-term projects rather than raising funds through the issuance of corporate bonds or other debt instruments. This practice can pose a major threat to the asset-liabilities management strategies of the banks and NBFIs as well as making the private financing market a lopsided one.

Recommendation: The corporations with superior credit ratings should be directed to raise a certain percentage of their total long-term financing through the issuance of corporate bonds after reaching a certain debt-ceiling through bank-financing. BRPD and DFIM of Bangladesh Bank may conduct an analysis to determine that certain debt-ceiling.

Lead Implementing Agency: BRPD, Bangladesh Bank

Associate Agencies: DFIM, Bangladesh Bank, and BSEC

5.2.7. Absence of Secondary Yield Curve/Effective Valuation Tools

The secondary market yield curve of the government securities functions a risk-free rate that is used as a benchmark rate in pricing the corporate bonds. The absence of a yield curve of the government securities makes it difficult for the corporate bodies issuing long-term bonds.

Recommendation: With the introduction of diversified government debt instruments and with more frequent trading, the secondary market would be able to offer an effective yield curve, which is integral for the valuation of the bonds. DMD, BB should take necessary steps to publish a reliable and effective yield curve for the G-Sec to be used as the benchmark/risk-free rate.

Implementing Agency: DMD, Bangladesh Bank

5.2.8. Shortage of Special Purpose Vehicle/Entity (SPV/E)

A Special Purpose Vehicle (SPV) is a legal entity (usually a limited company of some type or, sometimes, a limited partnership) created to fulfill narrow, specific or temporary objectives. SPVs are typically used by companies to isolate the firm from financial risk. Therefore, an SPV is a fenced organization having limited predefined purposes and a legal structure. The legal framework for an SPV needs to be examined and strengthened to make it securitization-supportive. Regulations need to clarify that if bonds are issued by a pass-through SPV under the Trust Act, there will only be nominal stamp duty and that the SPV will be a non-taxable entity. It should be mentioned that BSEC has recently formulated a Notification on May 22, 2019, namely the Bangladesh Securities and Exchange Commission (Investment Sukuk) Rules, 2019 under which rules the issuer can initiate the issuance of Sukuk, in line with Shariah principles and respective rules, through Special Purpose Vehicle or similar mechanism.

Recommendations: Trust structures, as well as favorable regulations, need to be formed to guarantee the investors that the income generated through such assets are ring-fenced.

Implementing Agency: BSEC

5.2.9. Limited Role of the Trustees

Under the Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012, the chief role of the trustee is to act on behalf and for the exclusive interest of -the investors. The trustee needs to monitor timely payment of all dues of the issuer to the investors and any delay in payment of any dues by the issuer needs to be approved by the trustee. But in case of a potential final default, the effective role of a trustee is still in need to be clearly defined the recovering of the funds of the investors. In the early 1990s, the interest payments of some corporate debentures defaulted. Back then, the regulations of the financial market were not adequate and credit ratings were not mandatory. Besides, investors' confidence eroded due to the failure of trustees to protect the debenture holders' rights which makes the investors averse to invest in corporate bonds.

Recommendation: The role and purview of the trustee should be defined by the BSEC clearly to ensure the protection of the funds of the investors in case of a default or late payment.

Lead Implementing Agency: BSEC

Associate Agencies: BRPD and DFIM, Bangladesh Bank

5.2.10. Limited Confidence among the Investors in Relation to the Credit Rating Agencies

There is little confidence among the investors in the ecosystem of professional services that support the issuance of corporate bonds. Lack of internationally recognized credit rating agencies is also hurting the development of the market. There are several local credit rating agencies, but the majority of them do not have strategic partnerships with recognized international or regional agencies (e.g. S&P, Fitch or Moody's) leading to a lack of public confidence in them.

Recommendation: The regulatory framework should be formulated for the local credit rating agencies to establish strategic partnerships with recognized international agencies. As far as the credit ratings of banks and NBFIs are concerned, Bangladesh Bank should maintain and periodically update a list of approved credit rating agencies after evaluating the credentials.

Lead Implementing Agency: BSEC

Associate Agencies: BRPD and DFIM, Bangladesh Bank

5.2.11. Tax Disincentives to the Issuers

The tax structure is not supportive of the development of corporate bond markets. Stamp duty of two percentage points on the notional value is a significant disincentive in issuing bonds compared to accessing bank financing which is an impediment in developing the bond market. Currently, there is no specific tax incentive for the issuers to issue bonds in order to raise funds. Without any proper stimulus, the issuers are not incentivized enough to raise funds through the issuance of bonds. Moreover, the tax and duty structure is not incentivizing the corporate bond market effectively.

Recommendation: We may consider removing the stamp duty and reducing the corporate tax rate/ offer a tax-holiday period to those who would raise funds by issuing bonds.

Lead Implementing Agency: BSEC

Associate Agencies: Finance Division, MoF, and NBR

5.2.12. Tax Disincentives to the Investors

Although the zero-coupon bonds are tax-exempted for the retail and corporate investors, the institutional investors like the insurance companies still cannot enjoy the same tax benefit (World Bank Group Report on Bangladesh Capital Markets, August 2018), It is not clear why only zero-coupon bonds are subject to this exemption while other types of bonds (e.g. vanilla bullet bonds, other asset-backed and structured debt) are not. On the other hand, NBFIs have almost stopped investing in zero-coupon bonds as the Government does not offer tax benefits to those financial institutions. Moreover, unlike the G-sec market, at present, there is dual taxation on corporate bond investments. The application of source tax on the income from the investment in bonds creates a disincentive for the investors.

Recommendation: The Government may consider equal tax treatment for different government and non-government bond market instruments. Similar to government securities, the income from the corporate bonds could be placed outside of the scope of source-taxation to incentivize the investors. Therefore, the tax on the interest of corporate bonds may be paid at the time of submitting the income tax return instead of deducting it at the source. Moreover, the existing rate of tax on the profit of bonds may be rationalized to attract retail investors.

Lead Implementing Agency: BSEC

Associate Agencies: Finance Division, MoF, and NBR

5.2.13. High Cost Related to Issuance and Secondary Trading

At present, there is a high issuance cost in the primary market as well as high-cost of trading in the secondary market. Different types of costs and duties are related to issuance and trading. The main costs related to issuance are: application fee, consent fee, Issue management fee, underwriting fee, trustee fee, trust deed registration cost, credit rating fee, etc. (see 5.1.3 for details). There are some fees and charges associated with the trading of the public offers, which are: demat fee, annual depository/listing fee, transaction fee, new issue fee, etc. (see 5.1.4). All of these aforementioned charges and fees amount up to approximately 6.00% of the issue size (e.g. for the issuance of BDT 500 crore, those expenses would amount approximately up to BDT 30 crore). The other duties and taxes are a tax on the transaction; tax on coupon and tax on the capital gain (see 5.1.5). These issuance and trading costs are enormous disincentives to the issuers as a huge cost incurs at the time of issuance, while all those costs essentially shoot up the effective rate of interest on the instrument by nearly 1%.

Moreover, taxes and duties designed for equity trading can be much more harmful in the fixed-income market as transaction sizes are significantly higher. Regarding the government securities market, the Advance Income Tax (0.05%) is paid by the seller and the buyer at the same time on the transactions conducted on the stock exchange should be abolished.

Recommendation: Issuing costs (trustee fee, arranger fee, legal counseling fee, credit rating fee, consent fee, trust deed registration cost, issue management/corporate advisory fee, stamp duty and post issue management fee) and secondary transaction costs (annual depository/listing fee, transaction fee, new issue fee) that amount to nearly 6% of issue size should be reduced to incentivize bond issuance. Moreover, the CDS charges for issuing a bond in dematerialized form should also be reduced.

Lead Implementing Agency: BSEC

Associate Agencies: Finance Division, MoF, and NBR

5.2.14. Absence of a Separate Trading Platform for Fixed-Income Securities

DSE and CSE have automated 'screen-based' trading systems for equities/shares, but there is no separate trading system for fixed-income securities (bonds and debentures). Moreover, although trading facilities are available for publicly offered bonds (same platform as the equity offers), there is no trading facility at present for the bonds placed through private offers.

Recommendation: Stock exchanges may consider establishing a separate platform for the trading of fixed-income securities. This opportunity will enhance liquidity and provide an exit route to the investors. Moreover, a separate platform would also make debt instruments more accessible to individual investors for secondary transactions.

Implementing Agency: BSEC

5.2.15. Nonexistence of Legal Framework for Local and International Guarantors

At present, there is no existing legal framework or an arrangement for bodies to guarantee the payments of bond-liabilities. An additional guarantee like this could be a crucial factor to boost investors' confidence, which would lead to the improvement of the fixed-income market conditions.

Recommendation: In this regard, BSEC may consider drafting the legal framework identifying the roles of local or international guarantors in ensuring the protection of investors' funds in the issuance of fixed-income instruments. In evaluating the prospects related to international guarantee, a representative from FEPD of BB could be included in the process. Moreover, the Government may consider establishing a separate credit guarantee corporation (or a regulatory body) to ensure the protection of the investors.

Implementing Agencies: MoF, and BSEC

6. Additional Recommendations

6.1. Amendment of the Insurance Rules, 1958: As per section 27 of the Insurance Act, 1938 and section 10A of the Insurance Rules, 1958 (issued under section 114(1) of the said Act), the insurance companies are required to invest 30% of their assets in government securities and the rest of their portfolio to be invested in non-government securities, including land and housing, mutual funds, bridge financing, and other investments. Therefore, at present, around 30% of their assets are held in government securities in line with the prescribed assets minimum holding. Of the remaining 70%, around half is held as term deposits in commercial banks, 20% in listed equities (maximum according to investment regulations) and a small amount in real estate (World Bank Group Report on Bangladesh Capital Markets, August 2018). With average liabilities of 10-15 years, the asset allocation leaves the insurance companies with a considerable asset-liability mismatch on their balance sheets partly due to lack of attractive bonds or equities, so far.

Recommendation: The Insurance Act, 1938 has already been repealed and replaced by the Insurance Act, 2010. But, the Insurance Rules, 1958 is yet to be amended in accordance with the Insurance Act, 2010. Therefore, the forthcoming Insurance Rules could be amended with instructions for the insurance companies to invest a minimum obligatory portion of their portfolio in fixed-income securities. At least a certain percentage of General and Life Insurance Fund must be invested in long-term bonds matching with their liabilities. In this regard, IDRA may take necessary steps while drafting the forthcoming Insurance Rules.

Lead Implementing Agencies: Financial Institutions Division and Finance Division, MoF

Associate Agency: IDRA

6.2. Amendment of the Mutual Funds Act: Individual investors do not usually have the expertise and the amount to invest in fixed-income instruments (e.g. corporate bonds). Considering that, fixed-income mutual funds can come into play as facilitators like other developed countries. Mutual funds' contribution to the bond market development is negligible. There is no specialization among the mutual funds, their investment policies are guided by SEC regulations.

According to the SEC rules, mutual funds must invest at least 70% of their assets in the equity market (World Bank Group Report on Bangladesh Capital Markets, August 2018). Because of this regulation mutual funds' investment in the government securities market is negligible, accounting for merely 0.2% of their total assets. Consequently, mutual funds become very risky instruments, which can attract just a fraction of the individuals' savings.

The obstacles of current Rules of MF for the fixed-income mutual funds are,

a) Clause 55, Chapter 8 of Mutual Funds Rules directs that a minimum of 60% of the fund must be invested in capital market securities and a minimum of 50% of that investment must be in listed securities;

b) Schedule 5 under rule 56 of Mutual Fund Rules in section 5 states that a fund cannot invest more than 25% of its total assets in securities issued by a single industry;

c) Schedule 5 under rule 56 of Mutual Fund Rules in section 2 states that a fund cannot invest more than 10% of its total assets in shares of a single company.

Recommendation: BSEC should consider amending the rules regarding the minimum requirement of obligatory equities in the mutual funds' portfolios. Separate regulations for the establishment of fixed-income mutual funds should be drafted by BSEC to address the aforementioned issues.

Implementing Agency: BSEC

6.3. Awareness Programs for the Investors and the Issuers: There is an apparent lack of awareness among most of the corporate and individual investors regarding the investment opportunities in G-sec. There is also a lack of understanding among the issuers and investors regarding the advantages of long-term financing through corporate bonds and fixed returns.

Recommendation: BSEC can promote awareness to the issuers through financial literacy programs. Bangladesh Bank and BSEC can arrange training programs for the institutional investors (e.g. insurance companies, mutual funds) and individuals as well as for the potential issuers on a regular basis to promote awareness regarding the fixed-income securities.

Implementing Agencies: BSEC, and DMD, Bangladesh Bank

6.4. Incentives for the Foreign/Non-Resident Investors: Foreign investors' market access is not restricted or limited by BB, though it is cumbersome. Foreign investors need to have a contract with a local custodian and open a Non-Resident Investor Taka Account (NITA) for this purpose. In the absence of liquid derivatives market, hedging of the FX exposure is almost impossible; the FX swap market exists for up to 3 months, however, only the overnight market can be considered liquid. With a lack of short-term reference rates, the pricing of the hedging instruments is challenging.

Recommendation: The process of investing in corporate bonds should be simplified for foreign/non-resident investors. Moreover, relevant hedging instruments need to be introduced to attract those investors.

Lead Implementing Agency: FEPD, Bangladesh Bank

Associate Agencies: FEID and DMD, Bangladesh Bank, and BSEC

6.5. Including Investment-Grade Instruments in SLR: Currently, the banks are allowed to use the unencumbered approved securities (G-Sec only) for the purpose of fulfilling the SLR. Bangladesh Bank may consider allowing a portion of the commercial banks' investment-grade bond/debenture-portfolio to be recognized as a part of their SLR. Moreover, at present, the NBFIs maintain the majority portion of their SLR with the balances (e.g. FDR) held with other banks and NBFIs as per the instructions of the DFIM circular letter no. 01/2017. This poses a major hindrance in mitigating the different types of risks as well as disincentivizing them in investing in government debt instruments.

Recommendation: DOS, DFIM and BRPD, BB may conduct further studies in this regard to analyze the viability of allowing investment-grade bond/debenture portfolio to be recognized as a part of the banks' SLR as well as in Repo transactions (with necessary haircut). Moreover, the DFIM circular letter no. 01/2017 should be amended by setting the ceiling for the NBFIs in allowing maintaining their SLR with the balances held in banks and other NBFIs.

Lead Implementing Agency: DOS, Bangladesh Bank

Associate Agencies: BRPD and DFIM, Bangladesh Bank, and BSEC

6.6. Introduction of Inflation-Indexed Bonds: Inflation can have a dampening effect on fixed-income investments by reducing their real value of returns over time. This happens especially in countries like ours with a relatively moderate to the high inflation rate.

Recommendation: In order to attract foreign investors by guaranteeing an inflation-adjusted return, the Government, banks, NBFIs and other corporate bodies may consider issuing inflation-indexed bonds.

Lead Implementing Agency: Finance Division, MoF
Associate Agency: DMD, Bangladesh Bank

6.7. Introduction of Diversified Products: At present, there is a severe lack of diversity in government and corporate debt products available in the market. IFC is also considering issuing green bonds to finance the eco-friendly projects that should have a promising market. Other Asset-Backed Securities would also increase diversity in the market.

Recommendations: We need to study the practicality of introducing Residential Mortgage-Backed Securities (RMBS), Asset-Backed Securitizations, green bonds, and other types of project-based bonds. Moreover, Strip Bonds, Treasury STRIPS (Separate Trading of Registered Interest and Principal of Securities), Interest Rate Swaps could also be introduced as an instrument of mitigating the reinvestment risk. Additionally, Credit Default Swap (CDS) may be introduced to protect the interest of the investors in getting their money back. Respective agencies/authorities may take initiatives to conduct such studies to analyze the feasibilities of the aforementioned products. Bangladesh Bank may conduct an analysis in this regard.

Implementing Agencies: BSEC; Finance Division, MoF, and BRPD, DFIM, SFD, DMD, Bangladesh Bank

6.8. Introduction of Shariah-based Products: The Islamic finance products have a huge demand in the market as those could become a crucial liquidity component for the Shariah-based banks, which comprise around 25% of the banking sector in Bangladesh. Currently, there is only 1 (one) bond (Bangladesh Government Islami Investment Bond) available in the market fulfilling this criterion.

Recommendations: A detailed study should be conducted by respective agencies/authorities to analyze the feasibility of the introduction of Islamic finance products (e.g. Sukuk) in the market.

Implementing Agencies: BSEC; Finance Division, MoF, and DMD, BRPD, DFIM, Bangladesh Bank

6.9. Separate Rules for Debt Securities: At present, there are uniform rules for the issuance of equity and debt instruments through private and a public offering. Tax, duty, and cost structure designed for equity issuance and trading can be disincentivizing for the fixed-income securities market as transaction sizes differ significantly. As we know, a significant portion of the investors in the equity market are small investors, whereas the fixed-income instruments are mostly held by the institutional investors in large volumes.

Recommendation: Separate rules should be drafted by BSEC specifically focusing on the debt securities. In order to stimulate the secondary trading of government securities, MoF and Bangladesh Bank may consider drafting rules allowing short-selling of government securities.

Implementing Agencies: BSEC, MoF, and Bangladesh Bank

7. Concluding Remarks

As an emerging economy of the 21st century, Bangladesh needs to foster the fixed-income securities in order to ensure efficient financing options for long-term development projects. This framework attempts to provide comprehensive guidance in outlining the existing issues faced in developing the fixed-income securities market in Bangladesh. Along with highlighting the probable issues related to our underdeveloped fixed-income securities market, various pragmatic recommendations are mentioned in this framework for the G-Sec and the corporate debt market. To overcome the obstacles that we are facing in developing the debt securities market, there is a number of initiatives that can be taken by the concerned agencies.

To address the challenges and barriers for the development of this debt securities market and to implement the recommendations mentioned in this framework, we need to promote inter-organizational cooperation among different primary regulatory bodies like the Ministry of Finance (MoF), Bangladesh Bank (BB), National Board of Revenue (NBR), Bangladesh Securities and Exchange Commission (BSEC), Insurance Development and Regulatory Authority (IDRA), and other primary regulators. As this framework provides a detailed guideline in regards to the development of this market, the implementation of those recommendations would now essentially be the area to focus on.

To monitor the implementation phase of this framework to establish a vibrant fixed-income securities market in Bangladesh, a joint collaboration committee consisting Bangladesh Bank (BB), Bangladesh Securities and Exchange Commission (BSEC), Insurance Development and Regulatory Authority (IDRA), National Board of Revenue (NBR) and the Ministry of Finance (MoF) could be formed. To monitor the development of the long-term bond market development, a standing committee could also be formed comprising the members from different regulatory bodies.

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