

Performance, Regulation and Supervision of NBFIs

7.1 Non Bank Financial Institutions (NBFIs) are playing crucial role by providing additional financial services that cannot be usually provided by the banks. The NBFIs, with more multifaceted products and services have taken their place in the competitive financial market to satisfy the changing demands of the customers. NBFIs also play an important role in the capital market as well as in real estate sector of Bangladesh. Like the banks, most of the NBFIs have separate subsidiaries to operate merchant banking activities. NBFIs are supervised by Bangladesh Bank following a risk-based supervisory system. NBFIs showed strong performance in terms of growth in assets and deposits during FY 17.

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

7.3 Presently, out of 34 NBFIs, 3 are Government-owned, 12 are joint venture and the rest 19 are locally private-owned. The branch network of NBFIs increased to 246 as on 30 June 2017. The Structure of NBFIs is shown in Table 7.1.

Assets

7.4 The asset of NBFIs increased substantially by 16.83 percent to 713.87 billion in December 2016 from BDT 611.04 billion in

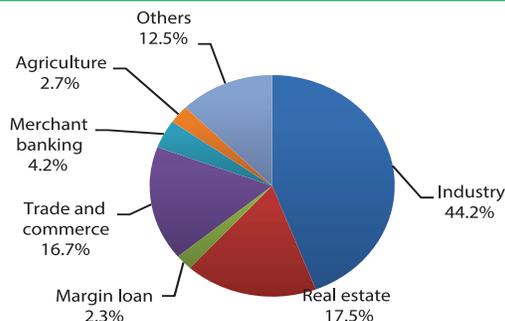
Table 7.1 Trends of Structure of NBFIs

	2011	2012	2013	2014	2015	2016	2017*
No. of NBFIs	31	31	31	31	32	33	34
Government-owned	2	3	3	3	3	3	3
Joint-venture	8	10	10	10	10	11	12
Private	20	18	18	18	19	19	19
New branches	53	8	7	20	15	14	21
Total branches	161	169	176	196	211	225	246

* As of 30 June 2017.

Source: Department of Financial Institutions and Markets, BB.

Chart 7.1 Investment pattern of NBFIs as of 30 June 2017



Source: Department of Financial Institutions and Markets, BB.

2015. At the end of June 2017, assets of NBFIs increased to BDT 755.33 billion.

Investment

7.5 NBFIs are investing in different sectors of the economy, but their investments are mostly concentrated in industrial sector. Sector wise composition of NBFIs' investment at the end of June 2017 was as follows: industry 44.21 percent, real estate 17.53 percent, margin loan 2.25 percent, trade and commerce 16.68 percent, merchant banking 4.17 percent, agriculture 2.67 percent and others 12.49 percent.

7.6 NBFIs are allowed to invest in the capital market up to 25 percent of paid up capital

and reserve as per section 16 of Financial Institution Act, 1993. In December 2016, all NBFIs' total investment in capital market was BDT 20.55 billion compared to BDT 19.35 billion in December 2015. Investment in capital market accounted for 2.88 percent of the total assets of all NBFIs. As of 30 June 2017, NBFIs total investment in capital market stood at BDT 19.90 billion.

Deposits

7.7 Total deposits of the NBFIs in December 2016 went up to BDT 382.43 billion (63.05 percent of total liabilities) from BDT 318.06 billion (62.48 percent of total liabilities) in 2015 showing an overall increase of 20.24 percent. At the end of June 2017, total deposit of NBFIs increased to BDT 418.85 billion.

Other Liabilities and Equity

7.8 The aggregate liability of the industry increased to BDT 713.87 billion in December 2016 from BDT 611.04 billion in 2015 while equity increased to BDT 107.41 billion compared with BDT 102.01 billion during the same period showing an overall increase by 16.83 percent and 5.29 percent respectively. At the end of June 2017, aggregate liability and equity increased to BDT 777.91 billion and BDT 109.63 billion respectively.

Bond and Securitisation Activity

7.9 The bond market in Bangladesh is yet to be modernized. There are few players with a limited number of instruments. NBFIs play a significant role for the development of bond market through issuing different types of Bonds. By taking NOC from the Department of Financial Institutions and Markets (DFIM) of BB, four instruments have been floated in

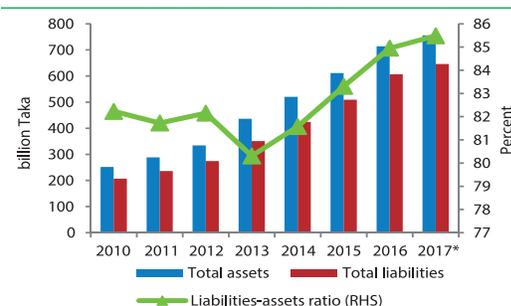
Table 7.2 Trends of Assets, liabilities and deposits of NBFIs

	(billion BDT)						
	2011	2012	2013	2014	2015	2016	2017*
Total assets	288.4	333.9	436.3	520.1	611.0	713.9	755.3
Total liabilities	235.7	274.3	350.4	424.2	509.0	606.46	645.7
Liabilities-assets ratio	81.7	82.2	80.3	81.5	83.3	84.95	85.5
Total deposit	112.6	145.4	198.3	238.5	318.1	382.43	418.9
Deposit as % of total liabilities	47.8	53.0	56.6	56.2	62.5	63.1	64.9

* As of 30 June 2017.

Source: Department of Financial Institutions and Markets, BB.

Chart 7.2 Trends of Assets, liabilities and their ratios of NBFIs



*As of 30 June 2017.

Source: Department of Financial Institutions and Markets, BB.

the market up to June, 2017 namely (a) BDT 2.45 billion "IDLC Infrastructure and SME Zero Coupon Bond" issued by IDLC Finance Limited; (b) BDT 3.0 billion non-convertible zero coupon bonds issued by Lanka Bangla Finance Limited; (c) BDT 1.0 billion Fixed Rate Non-convertible Subordinated Bond issued by Reliance Finance Limited and BDT 1.5 billion zero coupon Bond issued by IPDC Finance Limited.

Performance and Rating of NBFIs

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

Capital Adequacy

7.11 Capital adequacy focuses on the total position of NBFIs' capital and protects the depositors from the potential shocks of losses that a NBFI might incur. It helps absorb major financial risks related to credit, market, interest rate, etc. NBFIs in Bangladesh have been instructed under the Basel-III Accord to maintain Capital Adequacy Ratio (CAR) of not less than 10.0 percent with at least 5.0 percent in core capital. At the end of June 2017, out of 34 NBFIs, (two NBFIs are yet to come under this operation) 3 were evaluated as "1 or Strong", 17 were "2 or Satisfactory", 10 were "3 or Fair", 1 were "4 or Marginal" and 1 were "5 or unsatisfactory" in the capital adequacy component of the CAMELS rating.

Asset Quality

7.12 This indicator intends to identify problems with asset quality in the loan portfolio is the ratio of gross non-performing loan/lease to total loan/lease. At the end of December 2016, the NPL for NBFIs was 7.29 percent. In the total asset composition of all NBFIs, the concentration of loans, lease and advances was 74.34 percent. At the end of June 2017, out of 34 NBFIs, 8 were evaluated as "2 or Satisfactory", 14 were "3 or Fair", 9 were "4 or Marginal" and 1 was "5 or unsatisfactory", in the asset quality component of the CAMELS rating matrix (The remaining two NBFIs are yet to come under this rating).

Management Efficiency

7.13 Sound management is the most important prerequisite for the growth of any NBFIs. The total expenditure to total income, operating expenses to total expenses, earnings and operating expenses per employee and interest

Table 7.3 Trends of Total loan/lease and classified loan/lease

	2011	2012	2013	2014	2015	2016	2017*
Loan/lease	209.7	252.1	273.6	372.8	448.5	530.7	582.43
Classified loan/lease	10.3	13.7	16.8	19.7	40.0	38.7	52.03
Classified loan/ lease as % of total	4.9	5.4	6.1	5.3	8.92	7.29	8.93

* As of 30 June 2017.

Source: Department of Financial Institutions and Markets, BB.

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



*As of 30 June 2017.

Source: Department of Financial Institutions and Markets, BB.

rate spread are generally used to understand management efficiency. At the end of June 2017, out of 34 NBFIs, 2 were evaluated as "1 or Strong", 20 were "2 or Satisfactory", 3 were "3 or Fair", 5 were "4 or Marginal" and 2 were "5 or unsatisfactory", in the Management Capacity component of the CAMELS rating. (The remaining two NBFIs are yet to come under this rating).

Earnings and Profitability

7.14 Earnings and profitability of an NBFIs reflects its efficiency in managing resources and its long term sustainability. Among various measures of earnings and profitability, the best and widely used indicator is the return on assets (ROA) which is supplemented by return on equity (ROE). ROA and ROE of all the NBFIs in June 2017 were 1.04 and 6.90 respectively. At the end of June 2017, out of 34 NBFIs, 1 was evaluated as "1 or Strong",

17 were “2 or Satisfactory”, 10 were “3 or Fair” and 4 were “4 or Marginal” in the earnings and profitability component of the CAMELS rating. (The remaining two NBFIs are yet to come under this rating).

Liquidity

7.15 NBFIs are allowed to mobilize term deposit only. At present, term liabilities are subject to a statutory liquidity requirement (SLR) of 5.0 percent inclusive of average 2.5 percent (at least 2.0 percent in each day) cash reserve ratio (CRR) on bi-weekly basis. The SLR for the NBFIs operating without taking term deposit is 2.5 percent. The Infrastructure Development Company Limited (IDCOL) established by the Government of Bangladesh is exempted from maintaining the SLR. At the end of June 2017, out of 34 NBFIs, 16 were evaluated as “2 or Satisfactory”, 12 were “3 or Fair”, 2 were “4 or Marginal” and 2 were “5 or unsatisfactory”, in the liquidity position component of the CAMELS rating. (The remaining two NBFIs are yet to come under this rating).

Sensitivity to Market Risk

7.16 The sensitivity to market risk reflects the degree to which changes in interest rates or equity prices can adversely affect an NBFIs’ asset-liability position, earnings and capital. When evaluating this sensitivity component, consideration should be given to management’s ability to identify, measure, and control market risk via the implementation of effective Core Risk Management System. Vulnerability of the NBFIs in a stressed situation emanated from either an interest rate or equity price shock (or both) should be taken under consideration to evaluate sensitivity. For many NBFIs, the primary source of market risk arises from non-

Table 7.4 Trends of Profitability of NBFIs

	2010	2011	2012	2013	2014	2015	2016	2017
Return on equity (ROE)	24.4	11.7	10.4	7.5	9.9	9.9	6.9	5.9
Return on asset (ROA)	4.3	2.1	1.9	1.5	1.8	1.8	1.0	0.8

(percent)

Source: Department of Financial Institutions and Markets, BB.

trading positions and their sensitivity to changes in interest rates. At the end of June 2017, out of 34 NBFIs, 2 were evaluated as “1 or strong”, 11 were evaluated as “2 or Satisfactory”, 13 were “3 or Fair”, 5 were “4 or Marginal” and 1 was “5 or Unsatisfactory” in the sensitivity to market risk component of the CAMELS rating matrix (The remaining two NBFIs are yet to come under this rating).

Composite CAMELS Rating

7.17 At the end of June 2017, out of 34 NBFIs, the composite CAMELS rating of 1 was “1 or Strong”, 17 were “2 or Satisfactory”, 10 were “3 or Fair”, 2 were “4 or Marginal” and 2 were “5 or unsatisfactory” (The remaining two NBFIs are yet to come under this rating).

Legal Reform and Prudential Regulations

7.18 As part of the ongoing efforts some legal and regularity policy measures have been taken to improve the financial strength of NBFIs and to ensure the transparency in their operation. Some legal and policy measures have been continued in FY 2017.

Capital Adequacy and Progress of BASEL Accord Implementation in NBFIs

7.19 Basel-II has been implemented in the NBFIs since 1 January 2012. Prudential guidelines on capital adequacy and market discipline (CAMD) has been issued to promote international best practices and to make the capital of NBFIs more risk-based as well as more shock resilient. NBFIs have to follow

the guidelines as statutory compliance. In this regard, a high-level Steering Committee (SC) headed by a Deputy Governor of BB comprising NBFIs' Chief Executive Officers has been formed for working on policy decisions. Furthermore, a Working Group (WG) headed by an Executive Director of BB has been assisting the SC in decision-making.

Corporate Governance in NBFIs

7.20 BB has taken some policy measures in order to put in place good corporate governance in NBFIs. BB has specified clearly the authority, responsibility and functions of the Board of Directors, Executive Committees, Audit Committees, Management and Chief Executive Officer of NBFIs. The number of Directors in the Board is ranges from 9 to 11. The Board sets and approves the vision/mission, annual strategic planning, key performance indicators, core risk management guidelines, etc. Chief Executive Officer is responsible to conduct day to day functions and materialization of the strategic business plan.

Asset Classification and Provisioning

7.21 NBFIs are required to maintain provision for expected losses on loans, advances, leases, investments considering aging analysis. Aging analysis of overdue loan/lease classifies them to standards, special mention accounts, sub-standards, doubtful and bad/losses, requiring the NBFIs to keep provision by 1percent, 5 percent, 20 percent, 50 percent and 100 percent respectively. At the end of June 2017, the total outstanding of loan/lease was BDT 580.4 billion of which NPL was BDT 52.1 billion (8.97 percent).

Loan Rescheduling Policy

7.22 For the purpose of rescheduling of

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

Core Risk Management

7.23 Guidelines on five core risk areas, namely, credit risk management, internal control and compliance, asset-liability management, prevention of money laundering and terrorist financing and information and communication technology (ICT) security have been issued for NBFIs. Besides, with a view to address and manage all the risks in a more prudent and organized way the 'Integrated Risk Management Guidelines for Financial Institutions' have also been issued to adopt improved policies and procedures in line with international best practices for their risk management framework. For this purpose, the Guidelines encompass all the probable risks that include credit risk, market risk, liquidity risk, operational risk, compliance risk, strategic risk, reputation risk, environmental risk, and money laundering risk.

Stress Testing

7.24 NBFIs have been conducting stress testing on quarterly basis since 2010. A new financial position indicator, insolvency ratio (IR), *artificial intelligence to auto-generate recommended action plan, rating scale of 1 to 5, zonal positioning (Green, Yellow & Red) through weighted average resilience- weighted insolvency ratio (WAR-WIR) matrix* have been included in the revised guideline for NBFIs. As per the new guideline, NBFIs carry out stress testing on quarterly

basis. As of June 2017, out of 34 NBFIs 4 were in Green Zone, 17 were in Yellow Zone and the rest 12 were in the Red Zone. (The remaining one NBFIs is yet to come under this rating).

Consumer Protection Regulations

Schedule of Charges

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

Guidelines on Products and Services of Financial Institutions in Bangladesh

7.26 Along with the banks, the financial institutions with their customized products and services have emerged as the competitive financial intermediaries to meet the growing and changing demands of customers. The “Guidelines on Products and Services of Financial Institutions in Bangladesh” has outlined the different characteristics of products.

These guidelines protect clients’ interest as well as provide greater flexibility to financial institutions to adapt with changing environment. This also helps to promote of sound risk management system and bring discipline in launching new products and services.

Cost of Funds Index for NBFIs

7.27 NBFIs are regularly submitting their monthly statements of base rate and cost of funds to BB as per guideline published in 2013. On the basis of these statements, BB prepares an aggregate cost of funds index, uploads that in the BB website and updates on a monthly basis. The cost of funds index is used as an acceptable reference rate. The base rate system facilitates the interest rate determining process and ensures more transparency and accountability in the NBFIs.

Guidelines on Commercial Paper for Financial Institutions:

7.28 In order to set some regulations regarding commercial paper the ‘Guidelines on Commercial Paper for Financial Institutions’ has been introduced in 29 May, 2016. Financial Institutions are allowed to be involved in commercial paper as Investor, Issuer, Guarantor, and Issuing and Paying Agent by fulfilling the terms and conditions as mentioned in the guidelines.