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Policy Analysis Unit (PAU)

Working Paper Series: WP 0606

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** The Bangladesh Bank (BB), in cooperation with the World Bank Institute (WBI), has formed the Policy Analysis Unit (PAU) within its Research Department in July 2005. The aim behind this initiative is to upgrade the capacity for research and policy analysis at BB. As part of its mandate PAU will publish, among other, several Working Papers on macroeconomic research completed by its staff every quarter. The precise topics of these papers are chosen by the Resident Economic Adviser in consultation with the PAU members. These papers reflect research in progress, and as such comments are most welcome. It is anticipated that a majority of these papers will eventually be published in learned journals after the due review process. Neither the Board of Directors nor the management of the Bangladesh Bank, nor WBI, nor any agency of the Government of Bangladesh or the World Bank Group necessarily endorses any or all of the views expressed in these papers. The latter reflect the judgement based on professional analysis carried out by the staff of the Policy Analysis Unit, and hence the usual caveat as to the veracity of research reports applies.*

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Consumer Confidence in Financial Markets

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March 2006

Abstract

The low level of consumer confidence in financial markets in many developing countries remains a serious bottleneck to the development of financial sector and the economy as a whole. In particular, it has been emphasized that asymmetric information, adverse selection and moral hazards are perversely related to consumer confidence in financial markets. Keeping the idea in view, this paper makes an attempt to identify major factors, like currency forfeiting, loan default, capital shortfall, capital flight, etc which undermine consumer confidence in the financial services sector of Bangladesh. The paper also provides a review of different legislative and regulatory measures introduced by the authorities over the past years to strengthen consumer confidence in the financial markets, such as enhancing the security features of currency notes, deposit insurance, capital adequacy requirement, loan classification and provisioning, credit rating for raising capital and putting in place a mechanism for prevention of money laundering. The paper concludes with some specific suggestions to further develop the country's financial infrastructure, which include, among others, provision of missing markets and institutions to cater to the needs of consumers.

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Consumer Confidence in Financial Markets

I. Introduction

The paper intends to provide an overview of key issues pertaining to consumer confidence in financial markets in Bangladesh. The formal financial sector in Bangladesh includes: (a) Bangladesh Bank as the central bank (b) 43 commercial banks, including four nationalized commercial banks, 30 domestic private commercial banks, 9 foreign commercial banks (c) 5 government-owned specialized banks (d) 28 non-bank financial institutions (e) one government-owned investment company (f) two government-owned insurance companies and a quite good number of private insurance companies and (g) two stock exchanges. The banking sector, however, dominates the country's financial system.

With the gradual adoption of market oriented economic policies by the Government of Bangladesh since early 1990s structure and operation of financial markets in Bangladesh underwent a significant transformation towards ensuring 'level playing field' and efficiency, needed to achieve consumer confidence in the markets. Although a silent revolution had occurred in financial services legislation and regulation in the direction of building consumer confidence in the markets, it is felt that there is a need for exploring ways for further improvement of market conditions to meet the expectation of consumers of financial services. In this backdrop the paper will discuss various factors undermining consumer confidence in the financial markets, retrace the legislative and regulatory measures undertaken in the past to protect consumer interest and suggest further actions needed to enhance consumer confidence in the financial services sector in Bangladesh. The organization of the paper is as follows. Section-II contains a brief discussion on the definition of consumer confidence and its role in the economy. Section-III contains a review of earlier empirical studies on consumer confidence. In section-IV attempt will be made to identify various types of consumer risks in financial markets in Bangladesh. In section-V legislative and regulatory measures introduced in the past to enhance consumer confidence in the financial markets are discussed. Section-VI provides some suggestions to improve consumer confidence in financial markets in Bangladesh and the last section contains concluding remarks.

II. Consumer Confidence: Definition and Significance

Consumer confidence may be defined as the consumer’s appraisal of the current economic conditions and his expectations of future economic conditions. Consumer confidence indicators were first developed by George Katona during 1950s (Katona, 1975), who argued that an appreciation of how psychological variables influence consumers could lead to a deeper understanding of the behavior of economic agents. Katona suggests that two broad factors influence consumer decision to buy. The first one is an objective factor what he called ‘ability to buy’, related to traditional economic factors. The second one is a subjective factor what he called the ‘willingness to buy’. This ‘willingness to buy’ is what the concept of consumer confidence exactly tries to capture. In the present paper which focuses on financial markets, consumer confidence relates to consumer perception and assessment of the level playing field and efficiency currently being maintained and also expected to be maintained in future in the operation of the markets. It, therefore, relates to the consumer concern regarding protection of his legitimate interest in the markets.

The role of consumer confidence in influencing consumption and economic performance at both micro and macro levels is well recognized in modern economic literature, fostered by a rising level of income in advanced countries after World War II, giving a large number of consumers significant discretionary income--spending powers available after necessities have been purchased. It is argued that the consumer will postpone discretionary purchases (items other than necessities) if he perceives the current state of the economy and his personal situations as being unfavorable. Even if the current conditions are acceptable, but his expectations about future conditions are not positive he will postpone discretionary purchases. While the level of consumer confidence is of strong influence in the overall economy and in all types of markets it is of utmost significance in financial markets where consumers consist of depositors, lenders, investors, borrowers and others who purchase financial services. The low level of consumer confidence in financial markets in many developing countries remains a serious bottleneck to the development of the financial sector and the economy as a whole. Even in advanced economies with developed financial sector, the state of consumer confidence in financial markets is considered crucial in so far as any sudden collapse of confidence would lead to financial panics and economic crisis that produce large loss for the public and cause serious damages to the economy. As such government needs to apply regulations in the financial markets in order to protect the public and the economy from financial panics.

III. Review of Empirical Studies on Consumer Confidence

In advanced economies consumer confidence indicator known as consumer confidence index is prepared and published regularly. In the United States two different indexes of consumer confidence are produced and published: one by the University of Michigan and the other by Conference Board. The US confidence index developed by the University of Michigan is an un-weighted average of five questions: the evolution of own finances during the last and future 12 months, economic situation for the next 12 months and five years, and the opportunity to purchase big items. The Conference Board index is also based on five questions, which are similar to the Michigan survey. Empirical studies on consumer confidence were mainly aimed at assessing the predictive power of consumer confidence index. First such study undertaken by Eva Mueller (1963) showed that consumer confidence was a significant explanatory variable for the spending decision. Recent studies also showed that the inclusion of the consumer confidence index improves the forecast of real consumption (Carroll, Fuhrer, and Wilcox, 1994; Bram and Ludvigson, 1998). Several other studies have examined the ability of the confidence indexes to influence variables other than consumption. For example Eric Leeper (1992) shows that the Michigan index helps explain movements in industrial production and unemployment, but the explanatory power disappears when real stock prices and interest rates are added to the system of equations. To our knowledge, empirical study on consumer confidence in relation to the overall economy or to particular markets of Bangladesh is not available.

IV. Consumer Risks in the Financial Markets

Factors that undermine consumer confidence in the financial services sector of Bangladesh, of course with varying degrees of intensities, are many and prevail over all market segments including money, foreign exchange and equity markets. Some of the typical risks that consumer faces in the financial services area are:

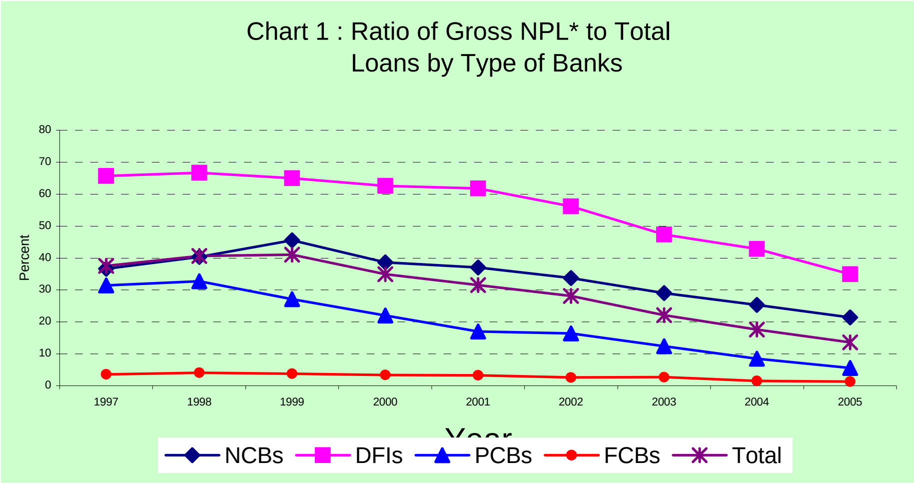
- **Prudential Risks**: in which a financial entity collapses and consumers lose their deposits. In Bangladesh collapse of financial institutions is yet a rare phenomenon. So far only two financial institutions: Bank of Credit and Commerce International (BCCI) and Bangladesh Commerce and Investment (BCI) collapsed as the central bank (Bangladesh Bank) closed their operation due to gross irregularities committed by them.
- **Misconduct Risks**: which arise from fraud, deliberate mis-selling or failure to disclose relevant information, which may be broadly termed as moral hazard and

asymmetric information problem. This type of risks would appear rampant in Bangladesh in the form of currency forfeiting, misappropriation of depositors' money, willful default on loans, capital flight, manipulation of share prices in the stock exchanges, forfeiting of share certificates of listed companies, inadequacy of information disclosure and transparency.

- **Complexity Risk**: financial products and services are gradually becoming complex and their is real risk that consumer fails to understand a product or assess its suitability.
- **Performance Risk**: investment may not deliver the expected return to the investor depending on market environment or the particular product. For instance during 1970s and 1980s bank depositors got negative return in real terms on account of circumstances of the administered interest rate regime.
- **Access to redress**: without appropriate and affordable options of redress, when the market fails for whatever reason, consumer may lose their investment without hope for return. For instance, investors losing money on account of 1996 share market scam could find little or no redress for their suffering.

Information on the scale of consumer risk in the financial sector is inadequate. Data are available on only a few risk areas like currency forfeit, loan default, capital shortfall and capital flight, which are briefly discussed below.

Counterfeiting of Currency Notes: Data compiled by the Bangladesh Bank based on the reports provided by banks, police department and different offices of the Bangladesh Bank show that an amount of Taka 3.8 million of counterfeit notes of different denominations was discovered during FY05 compared to Taka 1.4 million in FY04. This was Taka 1.6 million in FY03. Counterfeiting--a menace to the currency system, has been contained through measures by the Bangladesh Bank as well as preventive steps taken by the police and allied law enforcing agencies, banks and by public (especially shopkeepers).



Loan Default: The most important indicator used to identify problems with safety and soundness of financial sector in Bangladesh is the percentage of non-performing loans (NPLs) to total loans of banks. The NPLs to total loans of all the banks in Bangladesh shows an improving trend since it declined from a peak of 41.1 percent in 1999 to 13.6 percent in December 2005. The aggregate ratio is, however, still on the high side due to very high NPLs of the Nationalized Commercial Banks (NCBs) and the Development Finance Institutions (DFIs[1]) (Table-1).

Table 1: Ratio of Gross NPLs* to Total Loans by Type of Banks

(Percent)

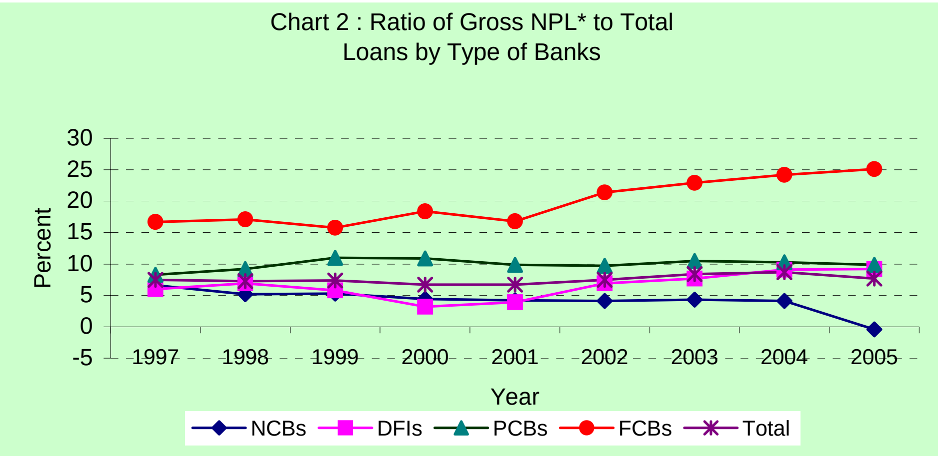
Bank type	1997	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	36.6	40.4	45.6	38.6	37.0	33.7	29.0	25.3	21.4
DFIs	65.7	66.7	65.0	62.6	61.8	56.2	47.4	42.9	34.9
PCBs	31.4	32.7	27.1	22.0	17.0	16.4	12.4	8.5	5.6
FCBs	3.6	4.1	3.8	3.4	3.3	2.6	2.7	1.5	1.3
Total	**37.5**	**40.7**	**41.1**	**34.9**	**31.5**	**28.1**	**22.1**	**17.6**	**13.6**

* Without adjustment for actual provision.

Source: Banking Regulation and Policy Department, Bangladesh Bank.

[1] DFIs are 5 Government-owned/controlled scheduled specialized banks. There are two more Government-owned DFIs (Anser VDP Unnayan Bank and Karmasangsthan Bank.) and a private DFI (Grameen Bank), which are not scheduled banks.

The NCBs and DFIs continue to have very high NPLs mainly due to substantial loans provided by them under directed credit programmes and on considerations other than commercial viability of projects, especially during the 70s and 80s. Besides poor appraisal, inadequate follow-up and supervision of the loans disbursed by the NCBs and DFIs in the past eventually resulted in massive build-up of poor quality assets, which continue to burden the portfolio of these banks. Further, reluctance on the part of the banks to write off the accumulated bad loans because of poor quality of underlying collaterals and to avoid any possible legal complication due to loopholes in legal framework helped to keep the NPL ratio on the high side. Recovery of NPLs however show some signs of improvement, mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and recovery drive and write off measures initiated in recent years. The loan default is a serious injustice and moral hazard problem in the banking system as borrowers who duly service their loan pay a much higher implicit rate of interest on their loan than borrowers who default. Defaulters in effect, through debt rescheduling and interest remission, gain a much longer period to service the loan, which lowers the cost of capital to them compared to the disciplined borrowers (Sobhan, 2000).



Capital Shortfall: Capital adequacy is intended to protect the depositors from the potential shocks of losses that a bank might incur. It helps absorbing major financial risks like credit risk, foreign exchange risk, interest rate risk and risk involved in off-balance sheet operations. Banks in Bangladesh are to maintain aminimum Capital Adequacy Ratio (CAR) of not less than 9.0 percent of their risk-weighted assets (RWA) with at least 4.5 percent in core capital or Taka 1.0 billion, whichever is higher. Table-2 shows that as on 31 December 2005 the

Private Commercial Banks (PCBs) and the Foreign Commercial Banks (FCBs) maintained CAR of 9.5 and 24.6 percent respectively. However, the CAR of NCBs and the DFIs continue to remain below the minimum required CAR owing to their high NPL and continuing losses. FCBs have CAR much higher than the required standard. The aggregate capital adequacy ratio of the banking sector shows a downward movement during 1997-2001. Thereafter, the trend reversed in 2002 as the ratio rose to 7.5 percent and in 2004 the ratio stood at 8.7 percent, the highest figure during last 9 years. In 2005, the ratio sharply declined to 7.7 percent due to adjustment for negative retained earnings of Agrani Bank resulting from a reassessment of its financial conditions.

Table 2: Capital Adequacy Ratio (CAR) by Type of Banks

(Percent)

Bank type	1997	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	6.6	5.2	5.3	4.4	4.2	4.1	4.3	4.1	-0.4*
DFIs	6.0	6.9	5.8	3.2	3.9	6.9	7.7	9.1	9.2
PCBs	8.3	9.2	11.0	10.9	9.9	9.7	10.5	10.3	9.9
FCBs	16.7	17.1	15.8	18.4	16.8	21.4	22.9	24.2	25.1
Total	**7.5**	**7.3**	**7.4**	**6.7**	**6.7**	**7.5**	**8.4**	**8.7**	**7.7**

Source: Department of Offsite Supervision, Bangladesh Bank.
** The ratio became negative due to adjustment for a large negative retained earnings of Agrani Bank.*

Capital Flight: In general capital flight means illegal transfer of capital abroad violating the law of a country. Capital flight is a situation where capital seeks investment outside the home country. It is normally interpreted to reflect a low level of investors' confidence in the domestic economy. In the case of Bangladesh it is also underpinned by the existence of a hidden economy. Estimates by researchers found that 20% to 23% of GDP was produced in hidden economy (Reza, 1989; Barakat, 1991; Hassan, 1997 and Asaduzzaman, 1998). Similarly estimates by researchers showed the existence of capital flight from Bangladesh. As expected, however, the amount of capital flight depends on the definition used in the estimation. In their study Alam, Dowla and Rashid (1995) showed that capital flight from Bangladesh during 1973 to 1992 was for the most part substantially modest, except for a few years (1986, 1987 and 1990). They found, on average, around $176 million/year fled Bangladesh according to the method of World Bank and Erbe, $77 million/year by Cline's method, and Cuddington's method gives an amount of around $14 million a year. Similarly, a study conducted by Sarker (2004) covering the period from FY1993 to FY2003 showed that a large capital flight from Bangladesh occurred in FY1994, FY2000 and FY2002 to the amount of $1,060 million, $1,146 million and $1,231 million under the World Bank and Erbe method; $1,060.4 million, $1,149.9 million and $1,096.5 million under the Morgan Guaranty method and $1,139.1 million, $1,256.3 million and $1,197.6 million under Cline's method respectively (Table-3).

In their study Alam, Dowla and Rashid mentioned several means of capital flight from Bangladesh. These are: (i) carrying foreign exchange out of the country in a suitcase, (ii) investing proceeds from smuggling directly abroad (iii) over-invoicing of imports and under-invoicing of exports (iv) understating indenting commission and holding the same outside the country (v) the use of hundi (vi) corruption by government officials and politicians.

Table 3: Capital Flight from Bangladesh

(in million US$)

SL	Items/Year	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
A.	Current Account Balance	-255	-89	-664	-1291	-865	-463	-477	-337	-1018	240	328
	1. Travel Credit	-4	-2	-3	-3	-3	-3	-26	-9	-10	-8	
	2. Reinvested FDI income	0	0	0	0	0	0	0	0	0	0	0
	3. Other Investment Income	-54	-77	-65	-66	-76	-80	-11	-98	-89	-93	
B.	Net Foreign Direct Investment	7	16	6	7	16	249	198	194	174	65	92
C.	Non-Bank Private Short-Term Capital Outflow	0	0	0	0	0	0	0	0	0	0	0
D.	Portfolio Investments from Abroad: Bonds and Equities (Net)	9	53	61	-21	-132	3	-6	0	0	-6	2
E.	Banking System Foreign Reserves/Assets	-0.5	0.4	-0.4	-27.8	14.8	-1.4	0.0	3.9	89.6	-134.5	0
F.	Changes in Reserves	-518	-625	-274	1062	325	-14	205	-79	302	-276	-887
G.	Errors and Omissions	-283	-166	-79	-504	180	-88	267	125	-47	-356	-123
H.	Changes in Debts	285	1758	1394	-1601	-141	-992	810	1368	-1137	1202	663
1	World Bank Erbe (H+B+A+F)	-481	1060	462	-1823	-665	-1220	736	1146	-1679	1231	196
2	Morgan Guaranty (H+B+A+F+E)	-481.5	1060.4	461.6	-1850.8	-650.2	-1221.4	736.0	1149.9	-1589.4	1096.5	196.0
3	Cline (Morgan Guaranty-(1-3) in A)	-423.8	1139.1	529.8	-1781.9	-571.5	-1138.1	772.4	1256.3	-1490.6	1197.5	196.0
4	Cardington (-G-C)	283	166	79	504	-180	88	-267	-125	47	356	123
	Average	-275.82	856.37	383.10	-1237.92	-516.67	-872.88	494.347	856.82	-1177.99	970.25	177.75

Source: Sarkar (2004).

The causes of capital flight from Bangladesh are many which include the following: (i) depreciation of Taka over time (ii) financial sector constraints (iii) fiscal deficit (iv) high tax rates (v) restriction on outward movement of capital (vi) political instability and (vii) provision of attractive incentives to non-resident investors in developed countries.

V. Measures for Building Consumer Confidence

Over the past years the Government of Bangladesh and concerned regulatory agencies undertook different legislative and regulatory measures to strengthen consumer confidence in the financial markets. While some of these initiatives were aimed at protecting consumers of financial services specifically, other measures introduced to enhance efficiency and soundness of the financial sector through improved governance, information disclosure and transparency also contribute toward safeguarding against possible market failure and thereby build consumer confidence in markets and in the overall economy. Measures were also undertaken to develop missing markets and institutions to cater to the needs of the consumers. In this section we will discuss briefly some important measures introduced by the Bangladesh Bank and the Securities and Exchange Commission (the capital market regulator) to address consumer risks in the financial markets and to develop the financial infrastructure in Bangladesh.

1. Prevention of counterfeiting of notes: Bangladesh Bank is in continuous efforts to enhance the security features of currency notes, especially of higher denomination ones. With a view to curbing the incidence of counterfeiting and assessing measures against spread of forged currency notes, the Department of Currency Management and Payment Systems of the Bangladesh Bank holds regular meetings with the representative of concerned ministries and agencies.

2. Demating of share certificates: In order to eliminate the investors' risk associated with paper certificates such as forgery, loss and theft and also provide efficient and quick transfer of securities, SEC introduced script-less electronic securities transactions through Central Depository Bangladesh Limited (CDBL) with effect from January 2004.

3. Statutory liquidity requirements: Statutory liquidity requirement (SLR) imposed by the Bangladesh Bank serves simultaneously as a monetary policy tool and as a safeguard against possible failure of banks to cash disbursements on demand by the depositors. At present SLR is set at 18 percent of demand and time liabilities for scheduled banks, excepting banks operating under the Islamic Shariah and the specialized banks. SLR for Islamic banks is 10 percent and specialized banks are exempted from SLR.

4. Deposit insurance: A depositor of a scheduled bank in Bangladesh is insured up to a loss of Taka 0.1 million under Bank Deposit Insurance Act 2000, to be paid to them within ninety days following liquidation of a bank.

5. Checking misappropriation of deposits: Bangladesh Bank alerts the banks, from time to time, through issuing circulars with instructions to put in place all the necessary preventive measures to check embezzlement of depositor funds by bank officials or by others in collusion with the bank officials with a rigorous internal control system and to take all measures including legal actions against the offenders.

6. Customer Complaint Cell: Bangladesh Bank has advised banks to set up 'Complaint Cell' to deal with all sort of complaints received by them directly or referred to them by different agencies/institutions, including the Bangladesh Bank. The Bangladesh Bank has also set up a 'Complaint Cell' in its Department of Banking Inspection to check the performance of complaint cells of banks and monitor status of customer complaints. Besides, a page regarding complaints has been opened in website of BB.

7. Representation in board: The Bank Company (Amendment) Act 2003 provides for two independent directors representing the depositors' interest among the maximum of 13 directors in a bank board.

8. Capital adequacy requirement: As mentioned earlier all scheduled banks in Bangladesh are required to maintain capital amounting Taka 1.00 billion or equivalent to 9.0 percent of risk-weighted assets, whichever is higher.

9. Loan classification and provisioning: Bangladesh Bank has prescribed loan classification and provisioning criteria for banks and non-bank financial institutions in line with international standards.

10. Exposure limits: In order to prevent concentration of bank loans among limited number of borrowers, single borrower/single borrower group exposure limit has been prescribed by the Bangladesh Bank, including funded and non-funded facilities, which is now set at 35 percent of the capital of a lending bank. Funded facility is however restricted to 15 percent of a bank's capital.

11. Risk management: Due to deregulation and globalization of banking business, banks are now exposed to diversified and complex nature of risks. In recognition of the importance of an effective risk management system, Bangladesh Bank has issued guidelines for managing risks in five core risk areas of banking viz. credit risks, asset and liability/balance sheet risks, foreign exchange risks, internal control and compliance risks and money laundering risks.

12. IT security: In order to ensure security in IT setup as well as in IT operation and to protect the interest of the clients, Bangladesh Bank has issued guidelines on information and communication technology for banks and financial institutions. These guidelines are intended to provide a base to develop banks' and financial institutions' own IT policy and security standards.

13. Criteria for appointment of chief executive and board members: 'Fit-and-proper' test criteria have been introduced by the Bangladesh Bank for approving appointments of directors, chief executives and advisers of private banks.

14. Information disclosure: In order to improve the quality of information disclosure and transparency of scheduled banks and enlisted companies concerned regulatory authorities have already issued necessary instructions. Disclosure requirements of financial information for banks have been substantially enhanced by the Bangladesh Bank prescribing revised forms and guidelines for preparation of financial statements as per the International Accounting Standards (IAS) with effect from end December 2003. The Securities and Exchange Commission made the preparation and presentation of financial statements as per IAS and statutory audit as per International Standards of Auditing (ISA) mandatory for the listed companies still earlier from the year 2000. To ensure compliance with international accounting and auditing standards and reflection of the correct state of affairs of the company rules have also been framed requiring the financial statements of the listed companies to be audited by partnership audit firms of at least two partners each having not less than seven years experience. The Commission is also empowered to direct the company, whose financial statements do not reflect the correct state of affairs, to get the financial statements audited by a Commission-appointed auditor at company's costs.

15. **Inspection and surveillance**: Inspection and surveillance by the regulatory authorities go a along way in addressing consumer risks in the financial markets. Bangladesh Bank conducts two types of inspection of banks--comprehensive inspection and special inspection. The former aims at evaluating the performance/conditions of banks including their compliance of rules and regulations under the annual inspection programme prepared well ahead of each calendar year. Special inspections are conducted on banks on specific/particular issue(s) as well as to investigate complaints received from the depositors, general public or institutions. The special inspections thus provide a mechanism to redress consumer problem in the banking sector. During FY04 the two banking inspection departments of the Bangladesh Bank conducted 1574 special inspections including 642 on money changers.

Following the 1996 stock market crash, the Securities and Exchange Commission strengthened its surveillance and enforcement activities imposing penalty for non-payment of declared dividend, conducting investigation and enquiry against listed companies, brokers/dealers and other persons involved in violation of securities laws and taking penal measures by way of suspension/cancellation of registration certificates, imposition of fines and where necessary instituting criminal cases against the violators. These measures along with fiscal incentives provided by the government have facilitated the restoration of investors' confidence in the equity market and thereby the recovery of the market from the tailspin following the 1996 crash.

16. Credit rating for raising capital: As per Credit Rating Companies Rules 1996 issued by the Securities and Exchange Commission, any company issuing share at premium, right share and debt instrument is required to incorporate credit rating in the prospectus or right share offer document. In order to bring transparency in investment in the banking sector and safeguard the interest of concerned investors, Bangladesh Bank made it mandatory to include credit rating report for banking companies floating shares through IPO at par like shares issuable at premium or right share with effect from 29 May 2004. There are two credit rating firms now in operation in Bangladesh. One is the Credit Rating Information and Services Ltd.(CRISL) and the other is Credit Rating Agency of Bangladesh (CRAB). The Securities and Exchange Commission approved the CRISL as a registered joint stock company in 1995, but it started its commercial activities from April 2002. On the other hand, the SEC issued registration to the CRAB in August 2003, and it started its commercial activities from February 2004.

17. Trading of public debt instruments in stock exchange: In order to facilitate investors' diversification, 5-year and 10-year Bangladesh Government Treasury Bond has been enlisted for secondary trading in Dhaka Stock Exchange from January 1, 2005, which are known as extra coupon bonds and initially issued through open market operations (auctions) conducted by the Bangladesh bank.

18. Prevention of money laundering: Under the Money Laundering Prevention Act promulgated in Bangladesh in April 2002, illegal acquisition of assets and the acts of transfer, transformation and concealment of such assets are identified as money laundering offences punishable with prison sentences from six months to seven years, along with fines up to twice the amount involved in money laundering. The Act entrusts the responsibility of its implementation and enforcement with the Bangladesh Bank, and makes it mandatory for banks, financial institutions and other entities engaged in financial intermediation to maintain customer identification and transaction records, and to furnish to the Bangladesh Bank such information as it may prescribe for identification, investigation and prosecution of money laundering offences. The Bangladesh Bank has issued guidelines to banks and financial institutions for identifying and reporting unusual/suspicious transactions to the Money Laundering Prevention Department in the Bank. Suspicious transactions with prima facie evidence of money laundering offences are referred to the Bureau of Anti-corruption (the Bureau has since been abolished in November 2004 with the establishment of Anti-Corruption Commission) or the Police authorities for formal investigation and eventual prosecution under the new law, where necessary with court orders for freezing or seizure of the assets involved. The new law is expected to curb illegal hundi transactions siphoning away remittances of Bangladeshi workers abroad. With effective implementation of the law, the volume of black money seeking safe haven abroad should be lower, reducing demand for hundi transactions. The local fund transfer against the workers' remittances diverted away abroad has been made more difficult because of the unusual and suspicious transaction identification procedures enforced in local banks and financial institutions. Anti-money laundering surveillance has indeed contributed to steady growth of remittances in recent years (22.4%, 10.1 % and 14.1% respectively in FY03, FY04 and FY05 in US dollar term).

19. Free floating of Taka: With the introduction of free floating exchange rate regime for Taka since end May 2003, a significant step has been taken towards promotion of inward remittances and checking capital outflows, because the shift to the new exchange rate regime is expected to help maintain exchange rate of Taka consistent with the country's economic fundamentals.

VI. Observations and Suggestions

The legislative and regulatory arrangements to deal with financial irregularities and poor governance of the financial sector are evolving over time to meet the increasing protection needs of the consumers. The following measures may be considered as part of on-going efforts to develop financial infrastructure and enhance the security and soundless of the financial sector.

1. The on-going implementation of the plan to strengthen the institutional capacity of Bangladesh Bank should be completed successfully in order to see that the institutional autonomy and authority bestowed upon it through recent legislative reforms for the purpose of effective supervision of the financial sector is realized.

2. Bangladesh Bank needs to continue efforts to upgrade prudential regulations consistent with latest international practices.

3. All nationalized banks should be restructured, capitalized and ultimately privatized. Unless these banks are privatized, the banking sector is likely to remain non-competitive, bureaucratic and inefficient.

4. In order to overcome the moral hazard problem in the financial sector, the Government may consider a better compensation package for staff and officers of the government-owned banks and financial institutions. Bangladesh Bank may also issue guidelines on the code of conduct for bankers to promote ethics in banking.

5. Adequate surveillance and supervision are necessary for efficient operation of financial intermediaries. In this regard, the Government may like to establish a separate agency to carry out supervision responsibility over the banks and financial institutions, allowing Bangladesh Bank to concentrate more on formulation and implementation of monetary and other financial policies.

6. In dealing with problem loans one option that the government may consider is to encourage the establishment of a debt collection agency to handle all bad loans of NCBs and DFIs, especially of the top defaulters. This would enable banks to focus on new lending and on raising efficiency.

7. In view of alleged ineffectiveness of the existing mechanism to redress consumer complaints against banks and financial institutions an independent Financial Mediation Bureau to redress grievances of consumers may be established.

8. Bangladesh Bank may establish a Consumer Information Bureau for providing information and advisory services to consumers of financial services to promote informed and well-judged investment decisions.

9. In order to cater to the needs of consumers of financial services the central bank should strongly encourage the banks to introduce modern banking products and information technology systems.

10. Poor access to credit (especially long-term credit), and high cost of borrowing, particularly for small and medium-sized enterprises have been identified as a major hurdle towards achieving the appropriate investment climate in Bangladesh (World Bank and BEI, 2003). In this regard, on-going efforts to reduce lending rates should be pursued vigorously.

11. Bangladesh Bank may embark upon a plan to liberalize gradually restriction on outward capital movement, which may ultimately help, to some extent, avoid the capital flight problem.

12. To overcome the menace of smuggling, appropriate economic policies should be adopted, along with enhancing the capacity of the concerned agencies responsible for checking this illegal activity.

13. Enforcement authority and institutional capacity of the Securities and Exchange Commission need to be enhanced.

14. The Securities and Exchange Commission should expand its investors' education programme to guide investors on issues relating to securities laws and stock exchanges.

15. To meet the investors' appetite, especially for good quality securities, government may consider divesting its holdings in the multinational companies and state-owned enterprises through public offerings in the capital market, and develop a broad-based secondary market for public debt.

16**.** To raise investors' confidence and facilitate their choice, credit rating firms operating in the country should make all efforts to maintain international standards in their operations.

VII. Conclusion

It is expected that the implementations of the above suggestions would help strengthen consumer confidence in the country's financial sector through ameliorating concerns regarding market failure and redressing problems arising from missing markets and institutions. As consumer confidence is positively related to economic activities, measures to promote consumer confidence would be helpful in achieving high economic growth, which is one of the core national objectives. The present study, which brings the concept of consumer confidence to the forefront in the context of Bangladesh, provides only an overview of key issues on the subject. In recognition of the importance of consumer confidence as a crucial determinant of economic performances at both micro and macro levels, it is felt that in-depth research on the subject should be undertaken on the basis of which one may come up with a proposal for the design and publication of consumer confidence index regularly in Bangladesh.

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