

Performance, Regulation and Supervision of NBFIs

7.1 Non-Bank Financial Institutions (NBFIs), also termed as only Financial Institutions (FIs), have been playing a 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. The NBFIs are supervised by Bangladesh Bank through risk-based supervisory system.

7.2 The authority of granting licenses to NBFIs and their control are vested in Bangladesh Bank by the Financial Institutions Act, 1993. As per the Financial Institutions Regulation, 1994 issued by Bangladesh Bank the minimum paid up capital requirement for establishing a financial institution is BDT 1.0 billion. However, NBFIs' business line is narrow in comparison with banks in Bangladesh. NBFIs cannot accept any such deposit as is repayable on demand through cheque, draft, or order of the depositor. Therefore, they cannot provide operating account facilities like savings and current deposits, cash credits, overdrafts, etc. NBFIs may access public funds, either directly or indirectly through public deposits, commercial papers (CPs), debentures, and bank finance.

Table 7.1 Trends in Structure of NBFIs

	2013	2014	2015	2016	2017	2018	2019*
No. of NBFIs	31	31	32	33	34	34	34
Government-owned	3	3	3	3	3	3	3
Joint-venture	10	10	10	11	12	12	12
Private	18	18	18	19	19	19	19
New branches	7	20	15	14	30	8	11
Total branches	175	195	210	224	254	262	273

* As on 30 June 2019

Source: Department of Financial Institutions and Markets, BB.

However, they can only take term deposits with a minimum maturity of 3 months or more. They are not covered under the Deposit Insurance Scheme by the Bangladesh Bank. In addition, they are not allowed to deal in gold and foreign exchange. Nonetheless, they may obtain foreign currency loan from abroad subject to prior approval of the Bangladesh Bank. NBFIs are subject to the prudential guidelines/limits such as income recognition; asset classification and provisioning norms; capital adequacy norms; single and group borrower limits; prudential limits on capital market exposures; classification and valuation norms for the investment portfolio; CRR/SLR requirements; accounting and disclosure norms and supervisory reporting requirements issued by the Bangladesh Bank.

7.3 At present, there are 34 NBFIs operating in Bangladesh. Among them, 3 are government-owned, 12 are joint ventures with foreign participation, and the rest 19 are locally private-owned companies. The branch network of NBFIs increased to 273 as on 30 June 2019. Among the branches, 94 are set

up in the district of Dhaka and the rest 179 are located in 34 districts across the country. The ownership structure of the NBFIs and their branch expansion related data are shown in Table 7.1

Assets

7.4 The asset of NBFIs increased by 0.9 percent in December 2018. Total asset in December 2018 is BDT 851.6 billion and in December 2017 which was BDT 839.9 billion. At the end of June 2019, total assets of NBFIs increased to BDT 874.3 billion (Table 7.2 and Chart 7.1).

Investment

7.5 NBFIs are investing in different sectors of the economy, but their investments are mostly concentrated in industrial sector. Sector wise composition of NBFIs' investment at the end of June 2019 was as follows: industry 45.3 percent, real estate 19.4 percent, margin loan 2.0 percent, trade and commerce 14.5 percent, merchant banking 3.4 percent, agriculture 2.5 percent and others 12.9 percent (Chart 7.2).

7.6 NBFIs are allowed to invest in the capital market up to 25 percent of their paid up capital and reserve as per section 16 of Financial Institutions Act, 1993. In December 2018, all NBFIs' total investment in capital market was BDT 17.7 billion compared to BDT 21.7 billion in December 2017. As of 30 June 2019, NBFIs total investment in capital market stood at BDT 23.6 billion which is accounted for 2.7 percent of the total assets of all NBFIs.

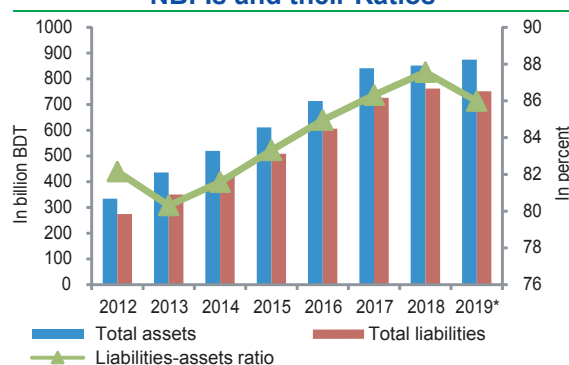
Table 7.2 Trends in Assets, Liabilities and Deposits of NBFIs (In billion BDT)

	2013	2014	2015	2016	2017	2018	2019*
Total assets	436.3	520.1	611.0	713.9	839.9	851.6	874.3
Total liabilities	350.4	424.2	509.0	606.46	726.0	762.0	751.8
Liabilities-assets ratio	80.3	81.5	83.3	84.95	86.4	87.6	86.0
Total deposit	198.3	238.5	318.1	382.43	468.0	480.1	458.1
Deposit as % of total liabilities	56.6	56.2	62.5	63.1	64.4	63.0	60.9

* As on 30 June 2019

Source: Department of Financial Institutions and Markets, BB.

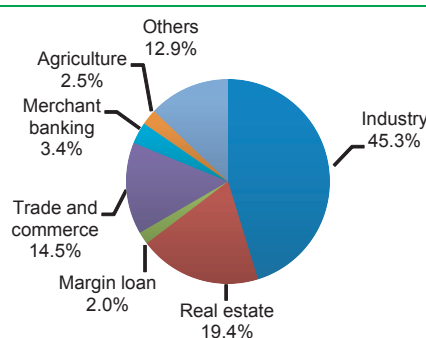
Chart 7.1 Trends in Assets, Liabilities of NBFIs and their Ratios



* As on 30 June 2019

Source: Department of Financial Institutions and Markets, BB.

Chart 7.2 Investment Pattern of NBFIs as of 30 June 2019



Source: Department of Financial Institutions and Markets, BB.

Deposits

7.7 Total deposits of the FIs in December 2018 went up to BDT 480.1 billion (63.0 percent of total liabilities) from BDT 468.0 billion (64.5 percent of total liabilities) in 2017

showing an overall increase of 2.6 percent. At the end of June 2019, total deposit of FIs stands at BDT 458.1 billion (Table 7.2 and Chart 7.1).

Other Liabilities and Equity

7.8 Total liability of the NBFIs increased to BDT 762.0 billion in December 2018 from BDT 726.0 billion in December 2017 while equity decreased to BDT 111.9 billion compared to BDT 114.8 billion during the same period of the previous year showing an overall increase in liability by 5.0 percent and decrease in equity by 2.5 percent. At the end of June 2019, total liability and equity stand at BDT 751.8 billion and BDT 122.5 billion respectively (Table 7.2).

Bond and Securitization Activity

7.9 NBFIs play a significant role for the development of bond market through issuing different types of Bonds. By taking NOC from the Department of Financial Institutions and Markets (DFIM) of BB, ten instruments of BDT 20.5 billion have been floated in the market up to June, 2019.

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.

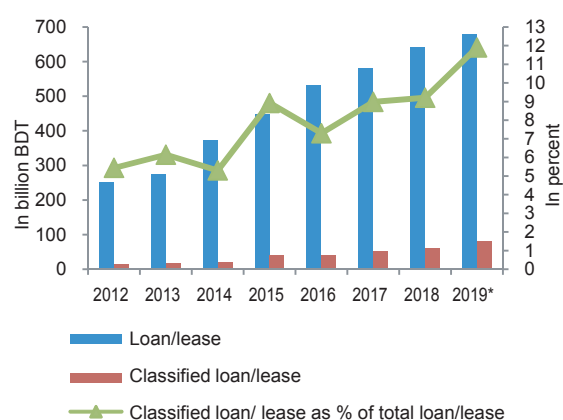
Table 7.3 Trends in Total loan/lease and classified Loan/Lease (In billion BDT)

	2013	2014	2015	2016	2017	2018	2019*
Loan/lease	273.6	372.8	448.5	530.7	580.4	641.9	678.1
Classified loan/lease	16.8	19.7	40.0	38.7	52.1	59.2	80.4
Classified loan/ lease as % of total	6.1	5.3	8.9	7.3	8.9	9.2	11.9

* As on 30 June 2019

Source: Department of Financial Institutions and Markets, BB.

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



* As on 30 June 2019

Source: Department of Financial Institutions and Markets, BB.

Capital Adequacy

7.11 Capital adequacy focuses on the total position of NBFIs' capital and protects the depositors from the potential shocks of losses that a FI might incur. It helps absorb major financial risks related to credit, market, interest rate, etc. NBFIs in Bangladesh have been instructed under the Basel III Accord to maintain Capital Adequacy Ratio (CAR) of not less than 10.0 percent with at least 5.0 percent in core capital.

Asset Quality

7.12 This indicator intends to identify problems with asset quality in the loan

portfolio. This is the ratio of gross non-performing loan/lease to total loan/lease. At the end of June 2019, the NPL for NBFIs was 11.9 percent. In the total asset composition of all NBFIs, the concentration of loans, lease and advances was 77.6 percent. The trends of the ratio of gross non-performing loan/lease to total loan/lease is shown in table 7.3 and chart 7.3.

Management Efficiency

7.13 Sound management is the most important prerequisite for the growth of any financial institution. The total expenditure to total income, operating expenses to total expenses, earnings and operating expenses per employee and interest rate spread are generally used to understand the management efficiency.

Earnings and Profitability

7.14 Earnings and profitability of an FI reflects its efficiency in managing resources and its long term sustainability. Among various measures of earnings and profitability, the best and widely used indicator is the return on assets (ROA) which is supplemented by return on equity (ROE). ROA and ROE of all the FIs in June 2019 were 0.3 and 2.0 respectively (Table 7.4).

Liquidity

7.15. 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.

Table 7.4 Trends in Profitability of NBFIs

	2012	2013	2014	2015	2016	2017	2018	2019*
Return on equity (ROE)	10.4	7.5	9.9	9.9	6.9	8.3	2.5	2.0
Return on asset (ROA)	1.9	1.5	1.8	1.8	1.0	1.1	0.3	0.3

* As on 30 June 2019

Source: Department of Financial Institutions and Markets, BB.

The SLR for the NBFIs operating without taking term deposit is 2.5 percent.

Sensitivity to Market Risk

7.16 The sensitivity to market risk reflects the degree to which changes in interest rates or equity prices can adversely affect an FI's asset-liability position, earnings and capital. When evaluating this sensitivity component, consideration 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 FI in a stressed situation emanated from either an interest rate or equity price shock (or both) should be taken under consideration to evaluate sensitivity. For many FIs, the primary source of market risk arises from non-trading positions and their sensitivity to changes in interest rates.

Composite CAMELS Rating

7.17 At the end of June 2019, out of 34 FIs, the composite CAMELS rating of 14 were "2 or Satisfactory", 10 were "3 or Fair", 7 were "4 or Marginal" and 1 were "5 or Unsatisfactory". One FI is yet to come under this rating & another one is on liquidation process.

Legal Reform and Prudential Regulations

7.18 As part of the ongoing efforts, in FY19, some legal and regularity policy measures have been taken to improve the financial strength of FIs and to ensure the transparency in their operation.

Capital Adequacy and Progress of BASEL Accord Implementation in NBFIs

7.19 Basel-II has been implemented in the FIs 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. Under Basel-II, NBFIs operating in Bangladesh are instructed to maintain the Minimum Capital Requirement (MCR) at 10.0 percent of the Risk Weighted Assets (RWA) or BDT 1.0 billion whichever is higher.

Corporate Governance in NBFIs

7.20 BB has taken some policy measures in order to put in place good corporate governance in NBFIs. BB has clearly specified the authority, responsibility and functions of the Board of Directors, Executive Committee, Audit Committee, Management and Chief Executive Officer of NBFIs. The number of Directors in the Board ranges from 9 to 11. The Board sets and approves the vision/mission, annual

Table 7.5 Inspections Conducted by FIID

Name of Inspection	Number
Head office comprehensive inspection of FIs	21
Branch comprehensive inspection	21
Core Risk Inspection (off-site)	13
FICL Inspection (Quick Summary Report)	34
Special Inspection (on request)	07

Source: Financial Institutions Inspection Department (FIID) Bangladesh Bank.

strategic business plan, key performance indicators, core risk management guidelines, etc. The Chief Executive Officer (CEO) is responsible to conduct day to day functions and materialization of the strategic business plan.

Asset Classification and Provisioning

7.21 NBFIs are required to maintain provision for expected losses on loans, advances, leases, investments considering aging analysis. Aging analysis of overdue loan/lease classifies them to standards, special mention accounts, sub-standards, doubtful and bad/losses, requiring the NBFIs to keep provision by 1 percent, 5 percent, 20 percent, 50 percent and 100 percent respectively. At the end of June 2019, the total outstanding of loan/lease was BDT 678.1 billion of which NPL was BDT 80.4 billion (11.9 percent of total loan/lease, table 7.3). The amount of provision kept during period was BDT 29.5 billion at the end of June 2019.

Loan Rescheduling Policy

7.22 Loans/Lease rescheduling is an arrangement to accommodate the borrower in financial difficulty, to avoid a default situation. For the purpose of rescheduling of

loans/leases, NBFIs must receive down payments from clients as specified in relevant DFIM (Department of Financial Institutions & Market) circular. NBFIs will take minimum of 15 percent, 30 percent, 50 percent of overdue amount or 10 percent, 20 percent, 30 percent of outstanding amount, whichever is lower, as down payment in cash for first time, second time and third time rescheduling respectively.

Core Risk Management

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

Stress Testing

7.24 Stress testing is a simulation technique used to determine the reactions of different Financial Institutions under a set of

exceptional, but plausible assumptions through a series of battery of tests. Stress testing alerts FI management to adverse unexpected outcomes related to a variety of risks (Interest rate, Credit, Equity and liquidity). Stress Test rating scale of 1 to 5 and zonal positioning through Weighted Average Resilience-Weighted Insolvency Ratio (WAR-WIR) Matrix has introduced which helps to develop auto-generated Recommended Action Plan. NBFIs have been conducting stress testing on quarterly basis.

Non Bank Financial Institutions Inspection

7.25 During FY19, Financial Institutions Inspection Department (FIID) conducted total 42 comprehensive inspections on Head offices and branches of financial institutions. Details of inspections conducted by the department are shown in table 7.5. This department also monitors implementation status/progress of the recommendations made in the inspection reports.

Consumer Protection Regulations

Schedule of Charges

7.26 BB has rationalized the charges of some services to ensure the interest of depositors/investors/customers and advised all NBFIs to display the complete schedule of charges in suitable places in their branches and head offices so that the clients can easily notice them. They are also advised to post the same information in their websites. BB

monitors these issues and FIs are required to submit semi-annual statements in these regard. No charge/commission like commitment fee, supervision fee and cheque dishonor fee can be charged. A circular has been issued in the year 2018 to bring uniformity in the schedule of fee/charges/commission against the loan/lease accounts by financial institutions and for the protection of customer interest.

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

7.27 Along with the banks, the financial institutions with their customized products and services have emerged as the competitive financial intermediaries to meet the growing and changing demands of customers. The "Guidelines on Products and Services of Financial Institutions in Bangladesh" has outlined the different characteristics of products and services offered by NBFIs which helps financial institutions to adapt with the changing environment also to promote sound risk management system and bring discipline in launching new products and services.

In order to set some regulations regarding commercial paper 'Guidelines on Commercial Paper for Financial Institutions' has been introduced, which allowed

Financial Institutions to get involved in commercial paper as investor, issuer, guarantor, and issuing and paying agent by fulfilling the terms and conditions as mentioned in the guidelines.

Cost of Funds Index for NBFIs

7.28 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. The cost of fund of NBFIs in December 2018 was 9.2 percent which increased to 9.7 percent in June 2019.

Guidelines on 'Code of Conduct' and 'Integrity Award' for Financial Institutions

7.29 As part of formulation and implementation of National Integrity Strategy (NIS), guidelines on 'Code of Conduct, 2017 & Integrity Award, 2018 have been introduced to increase the integrity, morality, efficiency, responsibilities of the employees of financial institutions.