Performance, Regulation and Supervision of NBFIs

7.1 Non-Bank Financial Institutions (NBFIs) 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 regulated and supervised by Bangladesh Bank under two core departments: (a) Department of Financial Institutions and Markets (DFIM) and (b) Financial Institutions Inspection Department (FIID). DFIM basically formulates the regulations, policies and guidelines, and conducts Off-site supervision on NBFIs. On the other hand, FIID basically performs On-site supervision and handle customer complaints regarding NBFIs.

License and Regulations

7.2 The authority of granting licenses to NBFIs and their regulations and control are vested in Bangladesh Bank by the Financial Institution Act, 1993. Under the Act, Financial Institution Regulation 1994 was issued with the approval of the government. Besides, there are prudential regulations and guidelines for NBFIs issued by BB under section 18 (Chha) of FI Act 1993. According to Circular no. 5 dated 24 July 2011 minimum paid up capital requirement for an ongoing FI is BDT 1.0 billion. However paid up capital and reserves cannot be less than minimum ratio of Risk Weighted Asset as set by Bangladesh Bank.

Table 7.1 Trends in Structure of NBFIs

	2014	2015	2016	2017	2018	2019	2020*
No. of NBFIs	31	32	33	34	34	34	35
Government-owned	3	3	3	3	3	3	3
Joint-venture	10	10	11	12	12	12	13
Private	18	18	19	19	19	19	19
New branches	20	15	14	30	8	11	3
Total branches	195	210	224	254	262	273	276

* As of 30 June 2020.
Source: DFIM, BB.

7.3 NBFIs may access public funds, either directly or indirectly through term deposits (minimum 3 months duration), commercial papers (CPs), bonds and debentures. Depositors of NBFIs are not covered under the Deposit Insurance Scheme by the Bangladesh Bank. NBFIs are not allowed to deal with 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 some prudential guidelines/limits in terms of income recognition, asset classification and provisioning norms; single and group borrower limits; capital market exposures; classification and valuation for the investment portfolio; CRR/SLR requirements; accounting and disclosure and supervisory reporting requirements.

7.4 At present, there are 35 NBFIs operating in Bangladesh (including Peoples Leasing & Financial Services Limited, which is under liquidation). Bangladesh Bank has issued license to a new financial institution named 'Strategic Finance and Investment Limited' in the year 2020. Among the NBFIs, three are government-owned, 13 are joint ventures with foreign participation, and the rest 19 are private-sector companies. The number of branches of

NBFIs stood at 276 as on 30 June 2020. Among the branches, 94 are set up in the district of Dhaka and the rest 182 are located in 36 districts across the country. The ownership structure of the NBFIs and their branch expansion related data are shown in Table 7.1.

Assets

7.5 Total asset of NBFIs at the end of June 2020 was BDT 860.33 billion, which was BDT 871.50 billion at the end of 2019.

Investment

7.6 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 2020 was as follows: industry 46.45 percent, real estate 19.41 percent, margin loan 2.22 percent, trade and commerce 13.84 percent, merchant banking 3.34 percent, agriculture 2.30 percent and others 12.44 percent (Chart 7.2).

7.7 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. At the end of December 2019, all NBFIs' total investment in capital market was BDT 18.83 billion compared to BDT 17.74 billion in December 2018. As of 30 June 2020, NBFIs total investment in capital market stood at BDT 17.98 billion which is accounted for 2.09 percent of the total assets of all NBFIs.

Deposits

7.8 Total deposits of the NBFIs at the end of December 2019 went down to BDT 451.93 billion (60.00 percent of total liabilities) from BDT 466.26 billion (63.03 percent of total liabilities) at the end of 2018 showing an overall decrease of 3.07 percent. At the end of June 2020, total deposit of NBFIs stood at BDT 441.17 billion (Table 7.2 and Chart 7.1).

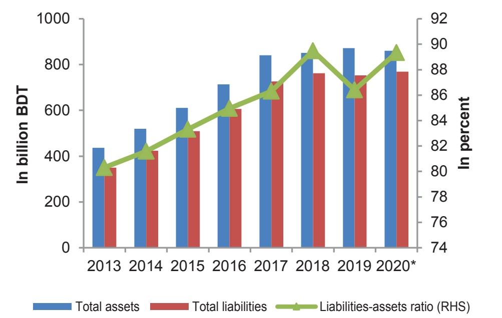
Table 7.2 Trends in Assets, Liabilities and Deposits of NBFIs

(billion BDT)

	2013	2014	2015	2016	2017	2018	2019	2020*
Total assets	436.3	520.1	611.0	713.9	839.9	851.6	871.5	860.3
Total liabilities	350.4	424.2	509.0	606.5	726.0	739.6	753.1	768.7
Liabilities-assets ratio	80.3	81.5	83.3	85.0	86.4	86.8	86.4	89.3
Total deposit	198.3	238.5	318.1	382.4	468.0	466.2	451.9	441.2
Deposit as % of total liabilities	56.6	56.2	62.5	63.1	64.4	63.0	60.0	57.4

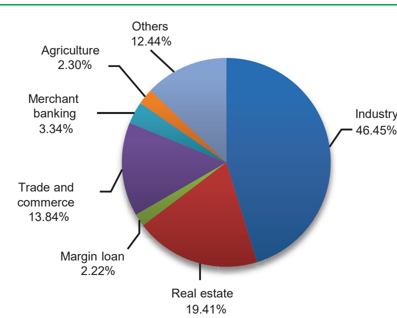
* As of 30 June 2020.
Source: DFIM, BB.

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



* As of 30 June 2020.
Source: DFIM, BB.

Chart 7.2 Investment Pattern of NBFIs as of 30 June 2020



Source: DFIM, BB.

Other Liabilities and Equity

7.9 Total liability of the industry increased to BDT 753.12 billion at the end of December 2019 from BDT 739.69 billion that of December 2018. At the end of June 2020, total liability and equity stood at BDT 768.71 billion and BDT 91.62 billion respectively.

Bond and Securitisation Activity

7.10 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, eleven instruments of bond with nominal value of BDT. 23.50 billion have been floated in the market up to June, 2020.

Performance and Rating of NBFIs

7.11 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

7.12 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 absorbing 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

7.13 Non Performing Loan (NPL) ratio is an indicator of asset quality. This is the ratio of gross non-performing loan/lease to total loan/lease. At the end of June 2020, the NPL for NBFIs was 13.29% percent. In the total asset composition of all NBFIs, the amount of loans, lease and advances was 77.82 percent during the said period. The trends of the ratio of gross non-performing loan/lease to total loan/lease is shown at table 7.3.

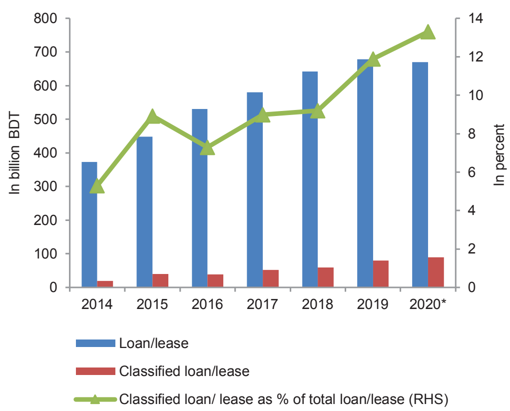
Table 7.3 Trends in Total Loan/Lease and Classified Loan/Lease

(billion BDT)

	2014	2015	2016	2017	2018	2019	2020
Loan/lease	372.8	448.5	530.7	580.4	641.9	678.1	669.54
Classified loan/lease	19.7	40.0	38.7	52.1	59.2	80.4	70.34
Classified loan/ lease as % of total	5.3	8.9	7.3	8.9	9.2	11.9	10.51

* As of 30 June 2020.
Source: DFIM, BB.

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



*As of 30 June 2020.
Source: DFIM, BB.

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 NBFIs in June 2020 were 0.24 and 2.21 respectively (Table 7.4).

Liquidity

7.15 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. Note that, at the end of FY 20, in order to mitigate the impacts of COVID-19 on financial institutions and their clients, the Cash Reserve Requirement (CRR) lowered from 2.50 percent to 1.50 percent on bi-weekly basis and from 2.00 percent to 1.00 percent on daily basis to increase the money supply at the Financial institutions end.

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 NBFIs, 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 NBFIs, 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 and another one is on liquidation process.

Table 7.4 Trends in Profitability of NBFIs

(percent)

	2012	2013	2014	2015	2016	2017	2018	2019	2020*
Return on equity (ROE)	10.4	7.5	9.9	9.9	6.9	8.3	7.45	7.64	2.21
Return on asset (ROA)	1.9	1.5	1.8	1.8	1	1.14	0.98	1.04	0.24

* As of 30 June 2020.
Source: DFIM, BB.

Legal Reform and Prudential Regulations

7.18 As part of the ongoing initiative, Bangladesh Bank emphasizes the improvement in financial strength and transparency of NBFIs and undertakes some legal and regulatory policy measures."Guidelines on Commercial Paper for Financial Institutions" has been revised to introduce some best practices and to set standards that will facilitate financial institutions to perform efficiently regarding CP in a more organized way.

Capital Adequacy and Progress of BASEL Accord Implementation in NBFIs

7.19 Basel-II norms was implemented in the NBFIs from 1 January 2012. Prudential guidelines on capital adequacy and market discipline (CAMD) have been issued to promote international best practices and to make the capital of NBFIs more risk sensitive 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 framework for 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 required number of Directors in the Board ranges from 9 to 11. The Board sets and approves the vision/ mission, annual strategic business plan, key performance indicators, core risk management guidelines, etc. The Managing Director/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 some objective criteria as well as qualitative judgment. Assets are classified as standard, 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 2020, the total outstanding of loan/lease was BDT 670.21 billion of which NPL was BDT 89.05 billion (13.29 percent of total loan/lease, table 7.3).

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 test the resilience of different Financial Institutions under a set of exceptional, but plausible assumptions through a series 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 have been introduced to develop auto-generated Recommended Action Plan.

NBFIs are 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.

Table 7.5 Inspections Conducted by FIID

Name of Inspection	Number
Head office comprehensive inspection of NBFIs	16
Branch comprehensive inspection	0
Core Risk Inspection (off-site)	0
FICL Inspection (Quick Summary Report)	33
Special Inspection (on request)	05

Source: FIID, BB.

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 NBFIs 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.

Guidelines on Products and 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.

7.28 In order to set some regulations regarding commercial papers 'Guidelines on Commercial Papers for Financial Institutions' have been introduced. This allowed Financial Institutions to get involved in commercial papers as investor, issuer, guarantor, and Issuing and paying agent by fulfilling the terms and conditions as mentioned in the guidelines. The existing guidelines have been revised by DFIM circular letter no-02 dated on February 27, 2020 to ensure best practices and to set standards that will facilitate financial institutions to perform efficiently regarding commercial papers in a more organized way.

Cost of Funds Index for NBFIs

7.29 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 FI's in December 2019 was 9.20 percent which decreased to 8.74 percent in June 2020.

Regulations on CMMS (Corporate Memory Management System) for Financial Institutions

7.30 As part of formulation and implementation of National Integrity Strategy (NIS), a circular has been issued for preservation and use of information of the Penalized Employees of Financial Institutions through CMMS.

Measures To Mitigate Covid-19 Impact on Financial Institutions

7.31 Like elsewhere across the globe, the COVID-19 pandemic has brought uncertainties in financial and economic sector in Bangladesh. Bangladesh Bank has taken several policy measures to mitigate the impacts of COVID-19 on financial institutions and their clients. Some of those policies are: keeping classification status of loan/lease/advance unchanged from January to September 2020, lowering the Cash Reserve Requirement (CRR) from 2.5 percent to 1.5 percent on bi-weekly basis and from 2.0 percent to 1.0 percent on daily basis, restructuring and revolving loan renewal facilities on easy terms and conditions. Moreover, Bangladesh Bank facilitates interest rate subsidy and refinance scheme for pandemic affected clients of Financial Institutions and Banks under the government stimulus packages for lending working capital in industries and service sector, and CMSME (Cottage, Micro, Small, and Medium Enterprises) sector.