Performance, Regulation and Supervision of NBFIs

7.01 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.

Licence and Regulation

7.02 The authority of granting licenses to NBFIs and their regulations and control are vested in Bangladesh Bank by the Financial Institutions Act, 1993. Under the Act, Financial Institution Regulation 1994 was issued by Bangladesh Bank 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.

7.03 NBFIs may access public funds, through term deposits (minimum 3 months duration), commercial papers (CPs), bonds and debentures. Depositors of NBFIs are not covered under the Deposit Insurance Scheme of Bangladesh Bank. NBFIs are not allowed to deal in gold and foreign exchange. Nonetheless, they may obtain foreign currency loan from abroad subject to prior approval of Bangladesh Bank. NBFIs are subject to some prudential guidelines/limits in terms of income recognition, asset classification and provisioning norms, single borrower exposure, capital market exposures, classification and valuation for the investment portfolio, cash reserve ratio (CRR)/ statutory liquidity reserve (SLR) requirements; accounting and disclosure norms and supervisory reporting requirements.

7.04 At present, there are thirty five (35) NBFIs operating in Bangladesh. Among the NBFIs, three (3) are government-owned, thirteen (13) are joint ventures with foreign participation, and the rest nineteen (19) are private-sector companies. The number of branches of NBFIs stood at 277 as on 30 June 2021. Among the branches, 93 are set up in the district of Dhaka and the rest 184 are located in 36 districts across the country. The ownership structure of the NBFIs and their branch expansion related data are shown in Table 7.01.

Assets

7.05 Total asset of NBFIs at the end of June 2021 was BDT 914.25 billion, which was BDT 901.73 billion at the end of 2020.

Investments

7.06 NBFIs are investing in different sectors of the economy, but their investments are mostly concentrated in the industrial sector. Sector wise composition of NBFIs' investment at the end of June 2021 were: industry 47.24 percent, real estate 18.96 percent, margin loan 1.15 percent, trade and commerce 13.90 percent, merchant banking 3.09 percent, agriculture 2.46 percent and others 13.20 percent (Chart 7.01).

7.07 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 2020, all NBFIs' total investment in capital market stood at BDT 21.64 billion which was BDT 18.89 billion in December 2019. As of 30 June 2021, NBFIs total investment in capital market stood at BDT 22.96 billion which was accounted for 2.51 percent of the total assets of all NBFIs.

Deposits

7.08 Total deposits of the NBFIs at the end of June 2021 increased by 0.95 percent to BDT 445.4 billion (53.73 percent of total liabilities) from BDT 441.2 billion (57.39 percent of total liabilities) at the end of June 2021. (Table 7.02).

Other Liabilities and Equities

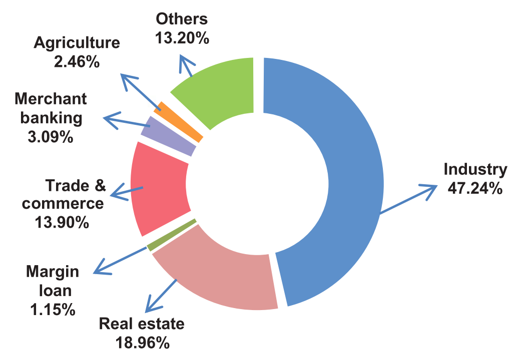
7.09 Total liability of the industry increased to BDT 828.8 billion at the end of June 2021 from BDT 768.7 billion at the end of June 2020. At the end of June 2021, total equity stood at BDT 85.5 billion.

Table 7.01 Ownership Structure of Total Branches of NBFIs

	FY15	FY16	FY17	FY18	FY19	FY20	FY21
No. of NBFIs	32	33	34	34	34	35	35
Government-owned	3	3	3	3	3	3	3
Joint-venture	10	11	12	12	12	13	13
Private	18	19	19	19	19	19	19
New branches	15	14	30	8	11	3	1
Total branches	210	224	254	262	273	276	277

Source: Department of Financial Institutions and Markets, Bangladesh Bank.

Chart 7.01 Investment Pattern of NBFIs as of 30 June 2021



Source: Department of Financial Institutions and Markets, Bangladesh Bank.

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 intended to protect the institution and protects the depositors from the potential shocks or losses that a NBFI 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 of Risk Weighted Assets (RWA) with at least 5.0 percent in core capital.

Asset Quality

7.12 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 2021, the NPL ratio of NBFIs was 15.4 percent. In the total asset composition of all NBFIs, the amount of loans, lease and advances was BDT 671.2 billion at the end of June 2021. The trend of the ratio of gross non-performing-loan/lease to total loan/lease is shown at Table 7.03.

Earning and Profitability

7.13 Earning and profitability of a NBFI reflects its efficiency in managing resources and its long term sustainability. Among various measures of earning 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 2021 were 0.4 and 4.3 percent respectively (Table 7.04).

Liquidity

7.14 Term liabilities of NBFIs 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, in order to mitigate the impacts of COVID-19 on financial institutions and their clients, the CRR was lowered from 2.5 percent to 1.5 percent on bi-weekly basis and from 2.0 percent to 1.0 percent on daily basis with effect from June 2020.

Table 7.02 Trends in Assets, Liabilities and Deposits of NBFIs

(Billion BDT)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Total assets	611.0	713.9	839.9	851.6	871.5	860.3	914.3
Total liabilities	509.0	606.5	726.0	739.6	753.1	768.7	828.8
Liabilities-assets ratio	83.3	85.0	86.4	86.8	86.4	89.3	90.6
Total deposit	318.1	382.4	468.0	466.2	451.9	441.2	445.4
Deposit as % of total liabilities	62.5	63.1	64.4	63.0	60.0	57.4	53.7

Source: Department of Financial Institutions and Markets, Bangladesh Bank.

Table 7.03 Trends in Total Loan/Lease and Classified Loan/Lease

(Billion BDT)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Loan/lease	448.5	530.7	580.4	641.9	678.1	670.2	671.2
Classified loan/ lease	40.0	38.7	52.1	59.2	80.4	89.1	103.3
Classified loan/ lease as % of total loan/ lease	8.9	7.3	8.9	9.2	11.9	13.3	15.4

Source: Department of Financial Institutions and Markets, Bangladesh Bank.

Sensitivity to Market Risk

7.15 The sensitivity to market risk reflects the degree to which changes in interest rates or equity prices can adversely affect a NBFI'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 NBFI in a stressed situation emanated from either 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 change in interest rates.

Composite CAMELS Rating

7.16 Out of 35 NBFIs, the composite CAMELS rating as of December 2019 was finalised. It shows 14 NBFIs were "2 or Satisfactory", 11 were "3 or Fair", 6 were "4 or Marginal" and 2 were "5 or Unsatisfactory". One NBFI was waiting to come under this rating and another one was on liquidation process during that period.

Legal Reform and Prudential Regulation

7.17 As part of the ongoing initiative, Bangladesh Bank emphasises the improvement in financial strength and transparency of NBFIs and undertakes some legal and regulatory policy measures. "Guidelines on Commercial Paper (CP) 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 organised way. As part of the regulation, a number of circulars and circular letters have been issued in FY21 on various issues specially to ensure proper utilisation of loan/lease/advances and cyber security and database backup of NBFIs.

Capital Adequacy and Progress of BASEL Accord Implementation in NBFIs

7.18 Basel-II norms has been implemented in the NBFIs since 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 have been 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

7.19 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 materialisation of the strategic business plans.

Table 7.04 Trends in Profitability of NBFIs

(In percent)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Return on equity (ROE)	9.9	6.9	8.3	7.5	25.2	3.9	4.3
Return on asset (ROA)	1.8	1.0	1.1	1.0	2.6	0.4	0.4

Source: Department of Financial Institutions and Markets, Bangladesh Bank.

Asset Classification and Provisioning

7.20 NBFIs are required to maintain provision for probable 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 2021, the total outstanding of loan/lease was BDT 671.15 billion of which NPL was BDT 103.28 billion (15.39 percent of total loan/lease, Table 7.03). Some prudential measures were taken during FY21 with a view to minimise risk of fraud and forgeries and also to ensure good corporate governance. A circular was issued on 28 February 2021 to ensure proper utilisation of loan/lease/advances.

Loan Rescheduling Policy

7.21 Loan/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 and Market) circular. As per the circular, NBFIs will have to 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 the first, second and third times rescheduling respectively.

Core Risk Management

7.22 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. Moreover, with a view to address and manage all the risks in a more prudent and organised way the 'Integrated Risk Management Guidelines for Financial Institutions' have also been issued to adopt improved policies and procedures in line with internationally accepted 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

7.23 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 NBFI 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 now conducting stress testing on quarterly basis.

Table 7.05 Inspections Conducted by FIID in FY21

Name of Inspection	Number
Head office comprehensive inspection of NBFIs	27
Branch comprehensive inspection	0
Core risk inspection (Off-site)	0
FICL inspection (Quick summary report)	26
Special inspection (On request)	03

Source: Financial Institutions Inspection Department, Bangladesh Bank.

Non Bank Financial Institutions Inspection

7.24 During FY21, Financial Institutions Inspection Department (FIID) conducted a total of 27 comprehensive inspections on head offices of financial institutions. Details of inspections conducted by the department are shown in Table 7.05. This department also monitors implementations status of recommendations made in the inspection reports.

Consumer Protection Regulations

Schedule of Charges

7.25 BB has rationalised 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 it. 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 on their clients by NBFIs.

Guidelines on Products and Services for Non Bank Financial Institutions in Bangladesh

7.26 Along with the banks, the non bank financial institutions with their customised products and services have emerged as the competitive financial intermediaries to meet the growing and changing demands of customers. In this regard, the already issued “Guidelines on Products and Services of Financial Institutions in Bangladesh” has outlined the different characteristics of products and services offered by NBFIs which is helping financial institutions to adapt with the changing environment and to promote 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 it 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 NBFI's at the end of December 2020 was 7.66 percent which decreased to 6.64 percent at the end of June 2021.

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

7.28 As part of formulation and implementation of national integrity strategy (NIS), a circular has been issued for the preservation and use of information of the found guilty employees of financial institutions through corporate memory management system (CMMS).

Measures to Mitigate Impact of Coronavirus on Non Bank Financial Institutions

7.29 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 impact of COVID-19 on non bank financial institutions and their clients. Some of the key policies are: relaxation on loan/lease/advance classification, lowering the 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 non bank financial institutions and banks under the government stimulus packages for providing working capital in industry and service sector and cottage, micro, small and medium enterprises (CMSME) sector. These prompt policy supports and responses from Bangladesh Bank in sync with the government's stimulus packages and other policies helping widely to mitigate COVID’s negative impact on Bangladesh's economy.