Bangladesh Economists' Forum

Sustaining Bangladesh's Growth and Development with Financial Stability and Inclusiveness

Atiur Rahman

21-22 June, 2014

The First BEF Conference | Radisson Blu Water Garden Hotel Dhaka

Sustaining Bangladesh's Growth and Development with Financial Stability and Inclusiveness

Abstract

The paper takes an overview of Bangladesh financial sector's performance in meeting the diverse and growing financial service needs of the economy abuzz with growth dynamism in attaining Bangladesh's aspirations of inclusive broad based growth in all segments of the economy ranging from MSMEs to large corporate; through groups of intermediaries focused on specific segments but interlinked between themselves and with markets abroad. Sustained central bank led thrust for ingraining an inclusive socially responsible financing ethos is now a defining feature of Bangladesh's financial sector development agenda. Besides helping uphold output and employment growth inclusive financing is also helping underpin financial stability, reducing credit and liquidity risks for financing institutions by diversifying their lending and deposit bases. A massive modernization of the financial sector IT infrastructure has hugely facilitated inclusive financing, bringing in cost-efficient off-branch mobile phone/smart card based delivery modes. The overview finds the financial sector's performance track record of stable steady growth of the economy as fair overall, but suboptimal and below true potential due to imperfections and deficiencies in regulatory and market infrastructure as also due to governance weaknesses originating from government encroachments on the much needed operational independence of the regulators in various segments of the financial sector, diluting accountability of regulators for the outcomes.

Besides mentioning possible options for dealing with the deficiencies, the overview also identifies key attention areas in equipping the financial sector for adequately responding to the economy's growing financial service needs on its aspired growth trajectory targeting upper middle income country group GNI per capita threshold by 2030; including sustained focus on (a) sector wide firm ingraining of socially responsible inclusive financing ethos, (b) continuing close fiscal-monetary policy coordination in safeguarding macro-financial stability while accelerating growth momentum, and (c) rapid buildup of strength and capacity in domestic financial institutions and markets to withstand destabilizing pressures from external turbulences as the economy and its financial sector opens up and integrates further with the global financial system to mobilize the massive investment volumes needed for realizing the nation's growth and development vision.

1. Evolution of Bangladesh's financial sector - a brief look back: At its birth in December 1971 after the country's nine month liberation war, Bangladesh's financial sector began as a bunch of banks and financial institutions nationalized overnight by the new country's government, alongside nationalization also of virtually all larger real sector businesses abandoned by their erstwhile West Pakistani owners. A foreign bank and a foreign life insurance company continued functioning alongside the nationalized ones. At the capital market end, operations of the sole stock exchange froze off due to nationalization of its member companies.

1.2. This sudden emergence of a large nationalized sector in the economy hugely overburdened the modest administrative capacities of the new government, predictably festering inefficiencies. Rather than acting as market based efficient allocators of credit resources, the nationalized banks and financial institutions began acting essentially as passive disbursement windows dispensing directed credit at dictated interest rates. Feeling disengaged from substantive role in lending decisions, officials in the nationalized banks also ceased feeling responsible for loan recovery. A vicious loan default culture festered among borrowers, snowballing non-performing assets in books of banks. Much of the directed credit for prioritized sectors like agriculture got usurped by influential rural and urban elites and diverted to other unauthorized uses, while productive pursuits of large swathes of rural and urban population languished in financial exclusion.

1.3. Civil society initiatives came forward early on to alleviate financial exclusion of micro enterprises of the rural poor. In the nineteen seventies microfinance NGOs (largely donor supported) registered with the government's NGO Bureau proliferated countrywide, extending financing for productive micro and small enterprises funded by donor grants and occasional borrowings. The microfinance NGOs began as largely self regulated, with only perfunctory oversight of the NGO Bureau. The Palli Karma Sahayak Foundation (PKSF) established by the government in 1990 took somewhat more substantive oversight role on the microfinance NGOs that it lent to. Major microfinance NGOs of Bangladesh like Grameen, BRAC and ASA grew fast in size and global repute, expanding operations abroad in many countries around the globe. Grameen Bank got reconstituted in 1983 by government statute as a Bangladesh Bank (BB) supervised specialized bank; other microfinance NGOs came under licensing and supervision of a new Microcredit Regulatory Authority (MRA) established by the government in 2006, chaired by BB Governor.

1.4. It took about a decade for corrective policy reforms in the economy's formal sector to begin seriously addressing the state ownership related inefficiencies by bringing back private sector ownership role in financial and non financial businesses. In the financial sector new private sector commercial banks began being licensed in the early nineteen nineties; and the 1993 Financial Institutions Act opened up licensing also of private sector owned non-bank financial institutions. Elaborate new loan classification criteria and provisioning requirements were introduced in 1989. New legislations to shore up loan recovery discipline included inter alia a clause in the new Bank Companies Act of 1991 barring fresh credit accommodation to borrowers in repayment default; a new Bankruptcy Act of 1997, and a new Money Loan Courts Act of 2003 to hasten defaulted loan resolution and recovery. BB's financial sector prudential regulation and supervision norms broadly tracked and adapted the evolving Basel based global best practice standards. The 2003 and 2013 amendments to the Bangladesh Bank Order vastly improved BB's operational autonomy in conducting both monetary policies and financial sector supervision inter alia by repealing the government's erstwhile prerogative of issuing directives; but BB's supervisory handle on nationalized banks still remains somewhat stymied by not being empowered to oust errant government appointed directors in boards of state owned banks, unlike in case of private sector banks.

1.5. Dictated Taka interest rate setting practices gradually gave way to market based flexibility, by early nineteen nineties abolishing directed lending and fully freeing up deposit interest rates and most of the lending interest rates. Taka's full current account convertibility came in the mid nineteen nineties alongside trade policy reforms widening the economy's external openness, gradually induced flexibility in exchange rate of Taka culminated in full transition to market based floating in May 2003. Full flexibility thus brought in both interest rates and exchange rates of Taka meant heightened exposure of banks and financial institutions to market risks from rates fluctuations, besides the usual credit and operational risks. Drawing upon ongoing international best practices, in 2003 BB issued a set of framework risk management guidelines as required minimum standards to be adhered to by banks. In line with post crisis global trends of financial sector supervision, mandatory periodical stress testing routines have been introduced in banks, against scenarios of shocks inter alia from adverse rate movements.

1.6. In the era of directed lending credit flows to the agricultural and SME sectors (perceived by lenders as riskier and costlier) used to be upheld by prioritizing official directives, abolition of directed lending left a void in this policy support. BB stepped in to fill this void with a more powerful motivational tool, invoking corporate social responsibility. BB's sustained initiative of ingraining and mainstreaming socially responsible financing in Bangladesh financial sector's corporate ethos has been the main driver of inclusive and 'green' or environmentally benign financing; with the modest low cost refinancing lines made available by BB playing a supportive secondary role. All banks operating in the local market, local and foreign, privately and state-owned have been engaging without demur and most often with spontaneous enthusiasm in inclusive and green financing in particular including agriculture and MSMEs, much of it using mobile phone/smart card based cost efficient new off branch service delivery modes made possible by a massive BB led modernization of the country's payments system and financial sector IT infrastructure. For green financing, the environmental risk assessment guidelines issued by BB has also played a key support role.

2.1: Financial market segments, regulatory coverage thereon:

2.1.1 At the economy's grass root level Grameen Bank and the MRA supervised MFIs are engaged in extending self employment microcredit, funded by deposits of borrower members, own capital & income surplus, bank/PKSF borrowings, and donor grants. In a credit program for tenant farmers BB, the central bank, has also lent directly to an MFI against guarantee from a commercial bank. The donor grant fund element figuring prominently in early years of NGO MFIs has dwindled steadily in significance, to below three percent by end June 2013. Outstanding microcredit extended by Grameen Bank and large MFIs as of end June 2013 amounted to about 2.5 percent of FY 13 GDP at current prices.

One hundred nineteen registered cooperative banks are active countrywide in urban and rural areas, with localized membership of cooperative credit societies formed by specific business or occupational groups. The deposit taking and lending activities of these mutually owned cooperative banks supervised by the office of the Registrar of Cooperative Societies are limited within their own membership. Available FY12 data on loan disbursement volume of cooperatives indicates this to be a minuscule fraction (less than one percent) of those of Grameen bank and large MFIs.

2.1.2. Fifty five BB licensed 'scheduled' commercial and specialized banks, local and foreign, state owned and private, are active in business lending to broad client segments ranging from MSMEs to large corporates, and in household sector lending mainly for purchase of houses and consumer durables. Two state owned banks are mandated to specialize in agricultural lending and another two in industrial lending, but they also engage in commercial banking; just as the commercial banks have substantial engagement in agricultural and industrial lending.

The 'scheduled' commercial banks are members of the countrywide payment and settlements system, maintaining in current accounts with BB specified minimum percentage of their deposits and other liabilities in cash balances. Besides deposit taking, lending and payments services in domestic currency scheduled banks offer trade related and other external transactions in foreign exchange, with Authorized Dealership license from BB. A few ‘nonscheduled’ banks established by government enactments like the Karma Sangsthan Bank, Ansar VDP bank and Probashi Kalyan Bank extend employment promotion related loans funded by Government’s budgetary allocations besides own equity and retained earnings. Although under BB’s supervisory oversight, these non scheduled banks are not deposit takers, have no account with BB, and conduct transactions solely in domestic currency through accounts with scheduled commercial banks. Outstanding total bank credit as of end June 2013 amounted to around 41 percent of FY 13 GDP at current prices. Credit policies in Bangladesh have consistently prioritized financing of output activities over financing of consumption, hence the percentage share of consumer financing in total bank credit remains modest, in single digit levels. Over three quarters of funding for bank financing come from customer deposits, around ten percent from equity and retained earnings, and the remainder from inter-bank and other borrowings.

2.1.3. Besides banks, thirty one mainly urban-based BB licensed Non-Bank Financial Institutions (NBFIs) are engaged in financing the business and household sectors. Their lending to the business sector is mainly in the form of lease financing, while housing finance constitutes the large bulk of their household sector lending. Two of the NBFIs are housing finance focused, as is the government-owned House Building Finance Corporation (HBFC). Like banks, most of the NBFIs now have substantial engagement with SMEs; increasing trend of NBFI engagements in factoring or financing against receivables bear promise of factoring emerging as a new financing window for SMEs.

Intended to develop as the debts trading segment of the financial market, NBFIs are free to raise finance by borrowing but restricted in deposit taking only to terms of six month or more. Deposits constituted little over one half of total NBFI liabilities as of end June FY13, against over three quarters for banks. Like nonscheduled banks, the NBFIs can lend and transact only in domestic currency. Outstanding NBFI assets as of end June FY13 amounted to around three percent of FY13 GDP at current prices.

2.1.4. Bangladesh Securities and Exchange Commission (BSEC) is the regulatory and supervisory authority of the capital market for direct raising of financing by corporates from households and institutional savers with equity and debt issues. The country’s two stock exchanges and other capital market intermediaries including more than fifty merchant banks, and nearly four hundred stock dealers and brokers involved in primary issuances and secondary trading are regulated and supervised by the BSEC; as also are eight rating agencies awarding credit ratings to the equity and debt issues. Credit ratings of corporates awarded by BSEC licensed rating agencies are now also increasingly being used by banks in computing the required risk weighted capital charges on corporate loans in their books. Most of the BB licensed banks and NBFIs play role as capital market intermediaries, but within strict statutory limits to their capital market exposures. Aggregate market capitalization of listed stocks as of end June 2013 amounted to about twenty five percent of FY13 GDP at current prices.

2.1.5. Forty six non-life and twenty one life insurance companies are active in the insurance segment of the country's financial sector, all of these excepting one in each of the two categories are private sector owned, one life insurance company is wholly foreign owned entity continuing from pre-liberation years. Insurance sector regulatory oversight responsibility was transferred from the office of Controller of Insurance under the Ministry of Commerce to a new Insurance Development and Regulatory Authority (IDRA) under the Ministry of Finance in 2010. Both life and general (non-life) insurers are linked with insurance markets abroad for reinsurance covers etc. According to latest available data (2012), insurance penetration measured in premium income as percent of GDP remained low, at 0.7 percent for life business and 0.2 percent for non-life business.

2.2. External openness of the financial sector: Local commercial banks have only limited direct presence in markets abroad with branches/ subsidiaries and exchange houses, allowed mainly to facilitate migrant workers' remittance inflows and to facilitate export marketing. A number of foreign banks have branches in Bangladesh, some local banks and financial institutions have foreign participation in their equity. All authorized dealer banks have correspondent banks abroad for handling of trade related and other external transactions. Non-resident owned FDI inflows are free of restrictions; so are their FPI inflows into equity and bond markets, but not to short term inflows in Treasury bills and other short term money markets. Post-tax profits/dividends and disinvestment proceeds on non-resident FDI and FPI are freely transferrable abroad; as also are balances in foreign currency accounts of non residents with authorized dealer banks in Bangladesh. Residents can freely access short term external borrowing for trade related payments; they can also access medium/long term external borrowing for industrial projects with prior approval of Board of Investment (BOI) Scrutiny Committee. Residents can freely access foreign exchange for all current external transactions; but outflows of resident-owned investments are subject to prior BB approval accorded only sparingly, mainly for market promotion of exports from Bangladesh, and for setting up branches/subsidiaries/exchange houses etc. in countries hosting Bangladeshi migrant workers.

2.3. Financial Sector Policy Coordination: All financial sector regulators (MRA, BB, BSEC, IDRA) now being under one umbrella of one government ministry (the Finance Ministry) is a factor facilitating coherence and coordination in financial sector policies. This is advanced further by regular periodical (usually once every quarter) coordination meetings convened by BB in terms of an MOU signed by all financial sector regulators to discuss and decide on policy coordination issues of current and future concern; the Registrar of Joint Stock Companies also participates.

At the macro level, the BB Governor presents perspectives of the financial sector in quarterly meetings of the apex Macroeconomic Policy Coordination Council chaired by the Finance Minister, aiming at optimal coordination of monetary, fiscal and financial policies towards safeguarding and bolstering macro-financial stability. Continual coordination efforts have kept government's annual budget deficits in percentage of GDP consistently in lower single digits, and have kept rates of domestic credit growth tethered loosely to nominal GDP growth rates, with public and private sectors complementing rather than crowding out each other in utilizing domestic credit resources.

3. Financial sector performance report card – strengths, shortcomings:

3.1. A look at the outlines of the Bangladesh economy's progress over the decades is needed to see how the financial sector has performed in its expected role in supporting and promoting sustainable inclusive growth. Over the past more than four decades since liberation <u>Bangladesh's nominal GDP in USD terms have grown more than eighteen-fold,</u> while population has grown about two- fold. Real GDP growth has steadily gained pace from annual averages of 1.1 and 3.2 percent respectively in the nineteen seventies and eighties to 5.8 percent in the first decade of the new century, pacing up further to six- plus percent annual average in the last ten years amid global financial crisis and global growth slowdown. The semi-feudal agrarian economy of the seventies has transformed vastly over the decades into a predominantly manufacturing and services driven open economy. Openness in external trade has widened from about twenty percent of GDP in the nineteen seventies and eighties to around forty five percent now, a level typical for middle-sized open economies well integrated with the global economy, with firm footing at the leading edge of global trade in apparels and textiles. Poverty is receding faster with sustained spell of inclusive growth, and with steadily rising per capita GNI already at USD 1190 Bangladesh is well on course for coming out soon from the low income and least developed country group categorizations.

3.2. The positives and strengths in Bangladesh financial sector's report card: Looking from a bird's eye view distance, the economy's above outlined growth track record is evidence enough that the financial sector has overall played its due role in mobilizing savings resources and allocating these to meet financing needs of the economy in ascending pace of sustained growth and structural transformation. Financial deepening measured in broad money as percentage of GDP now at around fifty six percent matches the level of neighboring India. Bangladesh's financial market structure developing as interlinked chain of intermediaries focused on specific market segments makes for better responsiveness to needs specific to the various market segments. BB's thrust for ingraining socially responsible financing ethos has served well in inducing financing flows to output initiatives of all population segments in all economic sectors. Small holder agriculture and MSMEs in Bangladesh suffered no credit crunch during or after the last global financial crisis; on and off branch payments, savings, and lending services of banks and MFIs are now available countrywide including in remote rural areas, aided by cost efficient mobile phone/smart card based service delivery through local area agents. Inclusive financing has upheld real sector output and employment growth momentum while also at the same time enhancing financial stability, reducing credit and liquidity risk exposures of lenders by diversifying and broadening their asset and deposit bases. Bangladesh's financial sector remained free of contagion from toxic assets of markets abroad afflicted by the global financial crisis; and rather than needing any rescue for themselves, banks in Bangladesh helped out export and other real sector segments affected by the global financial crisis. Foreign exchange reserves swelling from sustained export growth at double digit annual rates amid global slowdown and robust remittance inflows from migrant workers indicate that the financial sector has served the exporters and the Bangladeshi Diaspora well with trade finance and settlement, inward remittance and savings services offerings. Bangladesh's sustained spell of steady real GDP growth with moderate (single digit) CPI inflation, and her pioneering promotion of socially responsible inclusive, green financing is attracting widespread attention and interest of other countries and supra-nationals like the UN agencies, IMF and WB.

Bangladesh's financial sector has also maintained an impressive stability track record, except in the capital market segment which is typically more volatile everywhere. There has thus far been no episode of systemic instability at all in the MFI, bank, NBFI and insurance sector segments. While this may in large part be attributable to macroeconomic stability, institutional instability episodes requiring major restructuring of troubled institutions also remain sparse, barely around half a dozen in more than four decades. As already mentioned earlier Bangladesh's financial sector came out virtually unscathed from the last global financial crisis; to safeguard and enhance the sector's systemic and institutional stability in face of various internal or external shocks, prudential regulatory requirements regarding asset quality, liquidity, capital adequacy and provisioning, risk management, governance, internal controls and disclosures etc. are continually being drawn towards full convergence with international best practice standards.

3.3.1. The negatives and shortcomings in Bangladesh financial sector's report card: Just as the above bird's eye view provides glimpses of the financial sector's many strengths, zooming in for a closer look also reveals many remaining shortcomings in its capacity of offering to diverse output initiatives the financing packages in compositions and maturity mixes they need. The shortcomings make up an extensive to-do list in the path ahead for financial sector development, involving issues both from the domestic business environment as also from the global market scene awash in surfeit of liquidity surfeit from prolonging monetary laxity and ultra low interest rates in major advanced economies.

3.3.2. Firstly, access of businesses and households to medium and longer term financing is inadequate. Let alone long gestation large infrastructure projects, even modest projects like hospitals and hotels needing financing of ten years or longer tenor usually have to make do with five to seven year tenors at most, leaving themselves exposed to cash flow difficulties going forward. Outstanding industrial term loans (amounting to Taka 903.3 billion, a little over twenty percent of total private sector credit as of end June, 2013) are mostly medium rather than long term. Long term housing finance needs of households are likewise insufficiently met, much of the outstanding housing loans (amounting to Taka 421.1 billion, around ten percent of total private sector credit as of end June, 2013) being medium rather than long term. Eventual cash flow difficulties of businesses and households forced to use financing of shorter than needed tenors create overdues and asset quality impairments in the books of lenders. The paucity of longer term financing arises from paucity of longer term savings. Of the Taka 6.1 trillion total bank deposits as of end December 2013, only Taka 0.558 trillion was for tenor of 3 years and above, funding less than half their total term lending. The entire aggregate of equity, reserves and subordinated debt stocks of banks was barely enough to cover the long term funding gap.

Redressing the longer term funding gap will require policy and market reforms to bring in new long term savings and to create alternative liquidity augmenting mechanism at the long term end. Life insurers and pension/provident funds carrying long term liabilities are the main sources of long term funds, as they need long term assets to match the liabilities. As was mentioned earlier, life insurance penetration remains very thin in Bangladesh, with premium income amounting to only 0.2 percent of GDP in 2012. <u>Deepening life insurance penetration</u> comes up therefore as an item in action agenda for augmenting long term savings. Pension/provident fund schemes in the public sector are mostly unfunded and run on pay as you go basis, in the small organized private sector such schemes are not in very widespread use, and none exists at all for the broader population including professionals and self-employed others. <u>Widening of provident/pension fund coverage</u> comes up hence as another item in action agenda for augmenting long term savings. Defined benefit schemes as now existing in the public sector and organized private sector are proving burdensome even for affluent economies; instead defined contribution pension/provident fund schemes are spreading in both developed and developing economies including neighboring India, where it was introduced in 2003 for the general population regardless of employment status. The only fiscal liabilities involved in defined contribution pension/provident fund schemes are firstly the income tax waiver on such savings, and secondly in running a pension/provident fund regulator’s office. It is high time for Bangladesh to go for earliest possible introduction of defined contribution pension/provident fund schemes for the general adult population. Loan securitization or offloading of loans from lender’s books by selling to investors in securitized packages, a widely used liquidity augmenting mechanism in advanced markets, took place in Bangladesh only on a couple or so of past occasions where buyers held the asset backed securities to maturity, with no secondary trading taking place. The broad demand base of pension/provident funds, life insurers, merchant banks and other institutional investors needed for debt issuance and loan securitization to thrive hasn't developed yet in Bangladesh, and capital market intermediaries lack familiarity with their various roles as issue managers, underwriters, trustees, market makers etc involved in primary securitization and secondary trading. Prospective debt securities issuers also find the steps in issue process costlier in fees and expenses than for bank borrowings. The action agenda for enhancing longer term funding availability need therefore include promotion of loan securitization by concerted BB-BSEC initiative of streamlining the issue processes and paring down the issue costs. Access to long term housing finance will be hugely facilitated by activation of market in mortgage backed securities; the government owned HBFC can conveniently be utilized for this purpose in lines similar to those of Freddie Mac, Fannie Mae in the US; mandating it to assume roles of underwriter and market maker in issuance and trading of securities backed by mortgage loans extended by other primary lenders, instead of its present role as a primary mortgage lender itself.

3.3.3. Absence of a well functioning mechanism for debt restructuring and resolution comes next as a major shortcoming, leaving distressed businesses starved of financing needed for recovery and tying up lending resources in irrecoverable overdues. Banks and NBFIs in Bangladesh are barred by law from fresh lending to defaulting borrowers regardless of circumstances. BB's guidelines for loan rescheduling permit waivers from interest dues but none from the principal. Court supervised settlements in the alternative dispute resolution route under the Money Loan Courts Act can be with downsized claims on principal, but this route remain very little used. Bankruptcy court processes of debt resolution through the insolvency route by court appointed administrators likewise also remain virtually unused. Availability of private equity and other hybrid bridge financing options that could help out debt distressed businesses is as yet insignificant and rudimentary in the local markets. Allowed neither to recover nor to die, the debt distressed businesses remain in limbo, claims on them continue as uncollectible deadweights of overdues in books of lenders. The market failure in helping distressed businesses recover entails significant loss to the economy, not only in lost output and employment in the stricken businesses, but also in competitiveness erosion of other businesses that face higher cost of borrowing from lenders burdened with overdues from the debt distressed businesses in limbo. This is a major cause behind the downward stickiness of lending interest rates and the intermediation spreads in the market.

Redressing the shortcomings and their negative consequences outlined above will require careful rethinking and revision of current legal and regulatory provisions on handling of debt defaults, in light of practices in neighboring countries and elsewhere, to enable prompt resolution of debt distress of troubled businesses that have realistic possibility of turnaround and recovery; and prompt dissolution of the others through effective use of the insolvency route under the Bankruptcy Act. Financing options available to businesses also need widening, with policy steps promoting private equity and other debt-equity hybrid financing transactions by intermediaries at the capital market-financial market interface. A good start in this respect could be the restructuring of the government financed small Equity and Entrepreneurship Fund (EEF) for startups in a few specific sectors into a broader hybrid financing platform to support needed restructuring of ongoing businesses in all sectors, enlarging the fund with both increase in government's contribution and induction of private sector investment and management participation.

3.3.4. Small-sized entities in overly large numbers characterize all segments of Bangladesh's financial sector. Justifiable only in the microfinance sector, for all the other segments this can count as the third major shortcoming; spawning unhealthy competition among intermediaries securing licenses with overt and covert pressures from governments in power, delivering generally mediocre (if not worse) performance, none showing the kind of cutting edge dynamism seen in, say, India's ICICI or in Bangladesh's own leading MFI NGOs. The sixty-odd banks crowding the market tend to accommodate larger business houses far in excess of need, tempting them into imprudent risk taking leading to eventual troubles both for the borrower businesses and the lenders, as in some recent past episodes of loans to bulk commodity importers in Chittagong. Even worse consequences are added by political allegiance based Government appointment of chairpersons and other directors in boards of state-owned banks and financial institutions, weakening central bank's disciplining hand in dealing with loan scams and fraudulences abetted by lax corporate governance, as in a couple of recent episodes. Financial sector regulators also face overt and covert pressures from government for delaying urgently needed but unpopular steps in coping with buildups of market instabilities from irrational bullishness occasionally foamed up by manipulators. Such obstructions of regulators from doing their jobs only worsen damages, by deepening and prolonging the subsequent busts.

The overall outcome thus is one that keeps the financial sector stuck in mediocre sub optimal performance, for which accountability of the regulators stands diluted by government encroachments on their operational independence. The remedy lies in making financial sector regulators fully accountable by the government's scrupulous refraining from exerting any kind of direct or indirect influence on their licensing and supervisory decisions, on the same basis for both private sector and state-owned intermediaries. Truly given free hands, sector regulators will be in a position to rationalize the numbers of licensed intermediaries in various segments by substantially raising minimum capital and other entry threshold requirements, forcing mergers among existing small entities and licensing new ones based on evolving actual market needs. Allowing conversion of stronger, more mature MFIs and NBFIs into banks will mark a rational progression path across the sequence of financial sector segments.

3.3.5. Besides the major shortcomings enumerated in the preceding few paragraphs, limited diversity of available risk management products is another significant concern, particularly following transition to market based flexible Taka interest and exchange rates bringing in heightened and interest rate risks. Apart from plain vanilla forward exchange rate covers and swap transactions, more complex derivative transactions like options, credit default swaps etc. are as yet largely absent in the local markets. Cautiousness in widening external openness of the economy is largely the reason why the needs and responding products have remained slower to arise in the local markets; and BB permits banks and their clients to access external markets on occasional needs of such products. However, this market deficiency is also indicative of slow pace of adoption of a proactive forward looking risk management culture in financial intermediaries, urgency of which will heighten as the economy's openness widen further. BB has accorded high priority to addressing this deficiency by steps of phasing in Basel II and III risk based capital adequacy and forward looking liquidity management disciplines in banks and financial institutions both in letter and spirit; alongside prescribing guidelines laying down requisite minimum standards managing the various risks along lines of international best practices. At the same time, steps for firmly instilling a risk based financial sector supervision culture in BB have also been prioritized.

4. The path ahead for Bangladesh's financial sector: To summarize the overview of track record thus far, the financial sector has performed fairly well overall in supporting steady, stable and inclusive growth in the real economy, upholding its own systemic stability through episodes of domestic and external shocks, including the global financial crisis. However, various shortcomings in market development and debt distress resolution practices, coupled with governance weaknesses arising from encroachments on operational independence of regulators are holding financial sector performance stuck at sub optimal levels below the sectors potentials. Appropriate corrective steps including those suggested in the relevant foregoing paragraphs brook no delay if the financial sector is to rise up to its call of supporting realization of the nation’s inclusive sustainable growth vision of attaining upper middle income country group per capita GNI level by 2030. The forefront priorities will include (i) continuing the sustained thrust for ingraining a corporate ethos of socially responsible financing in the financial sector; (ii) continuing the support thrust for agricultural and SME financing, including for adoption of new environmentally benign output techniques and lifestyles to avoid jobless growth trap; and (iii) rapid buildup of strength and capacity of the financial sector for withstanding pressures from increasing external shocks as the economy opens up and integrates faster with the global economy, driven by the need for mobilizing investment resources for attainment of the ambitious growth goals. Regulators in the various financial sector segments will likewise need fast upgrading of their capabilities of supervising a much more open and hence a much more vulnerable financial sector than before, besides essential freeing up from government’s encroachments on their operational independence.