# The Silver Bullet

### The Fast-track Development of Bond Market in Bangladesh

Sustainable development of any country or a company are primarily driven by Human Capital and Growth Capital. Bangladesh has already proven the potential of our most important asset, the hard-working citizens (human capital) at home and abroad. However, the nurturing of Human Capital requires Growth Capital. Unfortunately, the lack of growth capital is a material obstacle for Bangladesh and ignoring this glaring fact will not only risk the potential value of our Human Capital as well the country, but can also certainly set us back as a nation with disastrous consequences for the next generation. The second wave of Technology Revolution that is well underway will most certainly adversely impact Bangladesh since our dependency on less skilled labor both home and abroad coupled with shortage of required growth capital.

The challenges for many developing nations are similar and capital inflow as well as a well-functioning plumbing for capital flow can resolve multiple challenges simultaneously faced by many countries like Bangladesh. Given the current constraints of the country, a well-functioning Bond market is the ONLY sustainable solution for resolving the looming challenges for public and private financing for Bangladesh. Nevertheless, for various obstacles, the bond market in our country has not developed and the preferred source of financing for the government as well as the private sector continues to be banks and financial institutions. A well-functioning bond market will most certainly provide the fuel required to sustain our current growth trajectory, improving the skill sets of our human capital, and benefiting Bangladesh at all levels of the economy across public and private sectors, especially during and in the aftermath of this pandemic.

Given the magnitude of capital requirement for both the public and private sector, development of the bond market can no longer be ignored. The bond market can bring about positive transformational changes to our financing flexibility, transparency, accountability, and governance challenges propelling Bangladesh to a level that solidifies our global position and most importantly, the future for the next generation.

If we truly care for the future of Bangladesh, the bond market is not an option but a requirement benefitting all and achieving our true potential as a country. A strong, focused, and uncompromising leadership is required for the fast track development of the Bond market in Bangladesh. Although we are materially behind relative to neighboring India, we can be confident that we can achieve our objectives provided we realize the glaring challenges and visualize a bright and sustainable future benefiting all citizens.

We provide detailed analysis of the current state of the market, and recommend the fastest track road map for establishing a Bond Market building on what we already have.

# Summary Findings – Issues

The good news is that Bangladesh is one of the most rapidly growing economies in the world. In order to finance the growth capital, both the public and private sectors require a massive infusion of capital that we believe cannot be sourced from banks (Bank Loans/Banks & Treasury) as well as National Savings Certificates (NSC) singlehandedly.

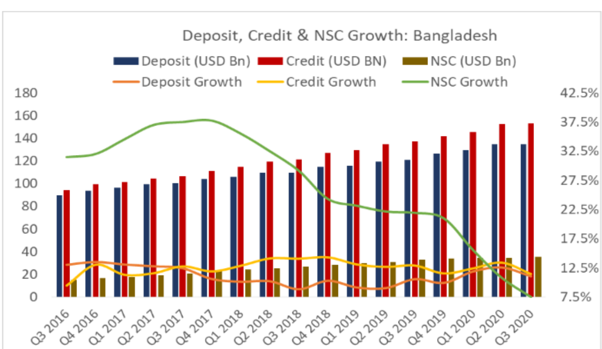
To put things into perspective, the country is required to invest USD 608 billion or BDT 51,343 billion from now to 2040 in infrastructure sectors such as water, energy, telecom, ports, airports, rail and road with multiple megaprojects underway, according to the Global Infrastructure Hub Report. This projected need is without including the increasing capital requirements for the financial sector, which is estimated to be at least USD 25 billion in the near term.

However, current trends indicate Bangladesh will be able to meet USD 417 billion (BDT 35,213 billion) investment in the infrastructure sectors. This should leave a gap of USD 192 billion (BDT 16,213 billion) between the required and current trend of infrastructure investments alone.

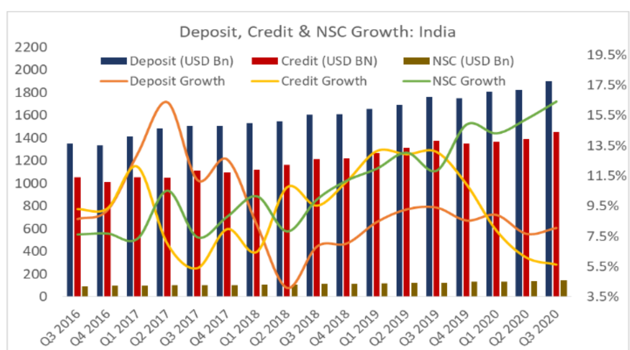
At present, the government is borrowing money heavily from the banking sector through treasury securities. Additionally, high rate of savings certificates is making traditional deposits in banks less attractive to the investors. Also, banks have been tasked with the implementation of the BDT 1.03 trillion stimulus package to support businesses and individuals during the pandemic. These factors are creating undue pressure on banks' limited capital. At the same time, private sectors are also dependent on the same institutions for financing their operations. The overreliance solely on banks is highly alarming considering the capital shortfall in Banks and NBFIs. In such a situation, an immediate sustainable equilibrium must be created to ensure proper flow of funds across the economy.

In addition, over the past years the credit growth of our banking sector has been much higher than the deposit growth rate and this discrepancy is not expected to improve anytime soon for various issues including alternative income sources for depositors. Under these circumstances, capital market and especially the bond market can play a pivotal as well as a positive role in the country's financial system.

Yet, the bond market of Bangladesh is still one of the smallest markets in Asia. A well-functioning bond market will not only ease off the growing strain on the banking and financial system, but also ensure adequate capital for government and private sector financing. This is highly essential in the present context to help the country maintain its growth trajectory.




*Source: Bangladesh Bank*




*Source: Reserve Bank of India*

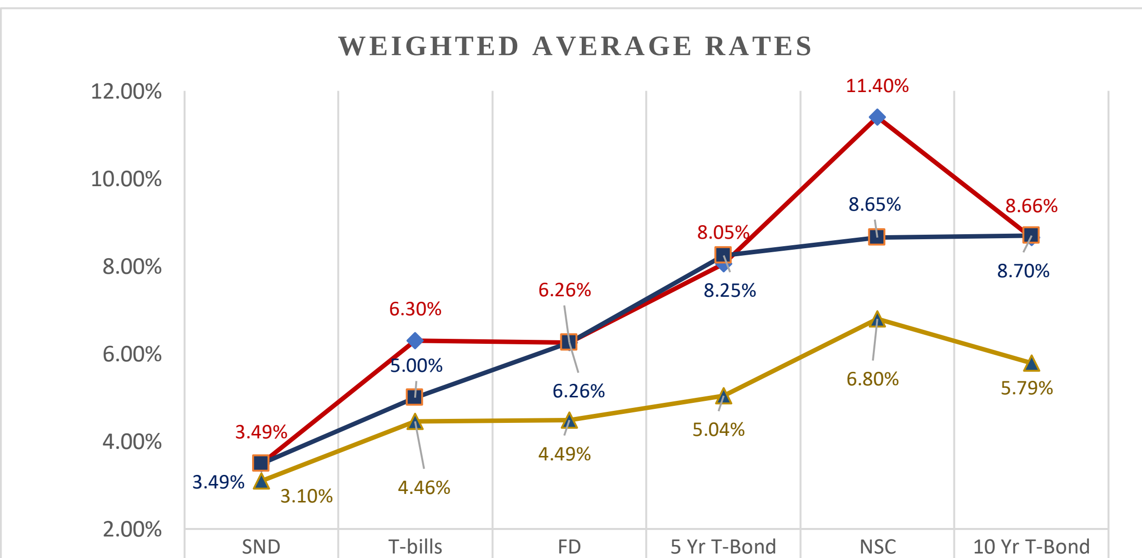
**In absolute term, Bangladesh consistently has more credit than the deposit where the scenario is completely reverse for India until recently. Although deposit growth of Bangladesh bounced back slightly in 2019, the overall trend is declining. On the other hand, NSC growth in Bangladesh has plummeted while India's NSC has been growing steadily. This is a conclusive indication that a bond market can serve an important role in bridging the gap in our financial system from current unsustainable trend.**

The table below demonstrates the relative proportion of outstanding treasury securities and NSD certificates for Bangladesh and India. Although Indian capital markets are materially advanced, using India as a benchmark the ratios of Government borrowing (Capital Structures) clearly indicates material gap between the current state and what will be required for the Bond Market in Bangladesh.

| | India | | Bangladesh | | Bangladesh Required Change | |
|---|---|---|---|---|---|---|
| **Instruments** | **Current (USD Bn)** | **%** | **Current (USD Bn)** | **%** | **Desired** | **% Change** |
| **T-bills** | 85.86 | 8% | 8.12 | 12% | **5.21** | **-4.4%** |
| **T- bonds** | 843.05 | 78% | 22.50 | 34% | **51.20** | **43.9%** |
| **NSD** | 146.55 | 14% | 34.69 | 53% | **8.90** | **-39.5%** |
| **Total** | **1,075.46** | **100%** | **65.31** | **100%** | **65.31** | |

*Source: BB & RBI*

**The chart below depicts the current and desired weighted average rates of different instruments in Bangladesh and the corresponding rates in India. There are rate misalignment issues in Bangladesh that are obvious that creates challenges for our entire financial system What may be somewhat surprising is that the Government borrowing rates are higher than SND and Fixed Deposit Rates. In comparison, India's rates are consistent.**




| | SND | T-bills | FD | 5 Yr T-Bond | NSC | 10 Yr T-Bond |
|---|---|---|---|---|---|---|
| Current | 3.49% | 6.30% | 6.26% | 8.05% | 11.40% | 8.66% |
| Desired | 3.49% | 5.00% | 6.26% | 8.25% | 8.65% | 8.70% |
| India | 3.10% | 4.46% | 4.49% | 5.04% | 6.80% | 5.79% |

*Source: BB & RBI*

The current yield curve indicates heavy short-term borrowing by the Government for most likely longer-term investments and material reliance on NSC at a very high relative rate. Among many issues with the current scenario, the most glaring issue is that the current structure is costing the Government incremental $1 billion of interest expense, which is not required and can be solved by issuance of longer dated Treasury Bonds instead of short-term T-Bills and NSC. However, shifting the Yield Curve parallelly lower depends on many factors, and much more complicated challenge. Never-the-less, issuance of longer-term Bonds and wider distribution beyond banks can resolve the most glaring issue of high funding cost.

# I. Current State of Bond Market in Bangladesh[1]

## Summary

The bond market of Bangladesh is still in its infancy. There are 221 government bonds, 8 debentures, and 2 corporate bonds listed in the capital market as of June, 2020. In Bangladesh, most of the government borrowings are done from the banking system through tradable and non-tradable government securities i.e. Treasury Bonds, Treasury Bills and National Savings Certificates. Over the past few years, the government has been using non-tradable National Savings Certificates extensively for its financing alongside Bangladesh Government Treasury Bonds (BGTBs). But in FY2020, this trend has reversed due to measures taken by the government to reduce interest burden from the high NSC rates. The table below summarizes the current status of our market as of March, 2020[2].

| Summary of Market: Bangladesh | | | | |
|---|---|---|---|---|
| **Type** | **Instrument** | **Outstanding Value (USD Bn)** | **Maturity[3] (yr)** | **Yield** |
| **Government** | T-Bills | 8.12 | 0.65 | 6.30% |
| | T-Bonds | 22.50 | 10.34 | 8.47% |
| | NSD certificates | 34.69 | 3.76 | 11.40% |
| | **Subtotal** | **65.31** | **5.64** | **9.76%** |
| **Corporate** | Bonds | 0.052 | Perpetual | |
| | Loans | 71.42 | 3-4 | 11-15% |
| | **Subtotal** | **71.47** | | |
| **Banks & NBFIs** | Deposits[4] | 149.00 | 1.5 | 5.24% |
| | **Total** | **285.78** | | |

*Source: Bangladesh Bank*

| Summary of Market: India | | | | |
|---|---|---|---|---|
| **Type** | **Instruments** | **Outstanding Value (USD Bn)** | **Maturity (yr)** | **Yield** |
| **Government** | T-Bills | 85.86 | 0.53 | 4.46% |
| | GOI Dated Securities | 843.05 | 10.72 | 5.79% |
| | Savings Instruments | 146.55 | 7.00 | 6.80% |
| | **Subtotal** | **1,075.46** | **9.40** | **5.82%** |
| **Corporate** | Corporate Loan | 770.01 | 2.97 | 15.13% |
| | Corporate Bond | 440.20 | 4.29 | 7.17% |
| | Commercial Paper | 48.23 | 0.5 | 8.64% |
| | **Subtotal** | **1,258.45** | | |
| **Banks & NBFIs** | Deposits | 1,921.75 | 2.52 | 4.49% |
| | **Total** | **4,255.66** | | |

*Source: Reserve Bank of India*

[1] There is a severe inadequacy of available data on corporate bonds in our stock exchanges. This serves as a major impediment to comprehensively analyzing the bond market.
[2] Data for the different instruments have been provided based on latest availability.
[3] Weighted average of maturity and yield has been taken for calculation
[4] The numbers of corporate loans and deposits of Bangladesh have been taken as of December, 2019.

Bangladesh vs. India - Comparison:

- The ratio of public to private finances is higher in Bangladesh compared to India. Government of Bangladesh is consuming 48% of the total financing compared to 46% in India. Private sector consumes rest 52% in Bangladesh against 54% in case of India.
- For public financing, Government of Bangladesh is raising relatively more from the savings certificates (53%) and treasury bond (34%) instead of treasury bills. On the contrary, India is relying more on Government dated securities (78%). In Bangladesh, savings certificate rates are materially higher than treasury securities rate but both of them has similar risk profile. Government is borrowing at a much higher rate. If savings certificate rates were similar to treasury rates, the cost savings would be material.
- In Bangladesh, corporations rely solely on banks as the source of financing. Corporate bond and other tradable instruments are non-existent. In contrast, Corporations of India has multiple sources of capital including bank loan, corporate bond and commercial papers. In India, more than one-third (39%) of the private financing comes from tradable corporate bond & commercial paper and rest (61%) is funded through bank loan.
- The rate misalignment is more prevalent in Bangladesh compared to India. Savings certificate rate is higher than treasury and deposit rates in both countries but the spread in India is much more reasonable.

## A. *Government Securities*

### <u>Treasury Bonds</u>

The primary government debt market is characterized by a very small number of participants as primary dealers dominated by mostly commercial banks. The treasury bond market consists of primary issues of treasury bonds with different maturities (2, 3, 5, 10, 15, and 20 years), and secondary trade therein through primary dealers. At present, only 20 banks are performing the role of Primary Dealers who participate directly in the primary auctions. Other bank and non-bank investors can participate in primary auctions and in secondary trading through their nominated Primary Dealers. Non-resident individual and institutional investors can also participate in the primary and secondary market, but only in treasury bonds.

### Size

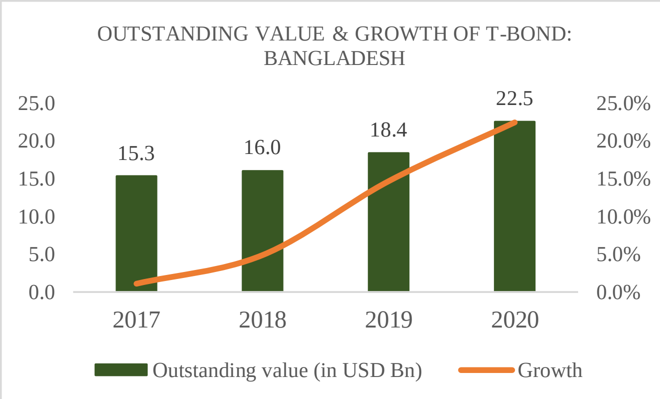
According to Bangladesh Bank, the treasury bonds issued have six different tenors. As of Feb, 2020, the total outstanding value for Treasury bonds of different tenors is **USD 22.50 Bn**.

| **Total outstanding value for Treasury bonds: BD** | | | |
|---|---|---|---|
| **Maturity** | **BDT Bn** | **USD Bn** | **Weighted Average** |
| 2-Year | 244.00 | 2.89 | ***Rate*** |
| 3-Year | 5.00 | 0.06 | 8.47% |
| 5-Year | 385.20 | 4.56 | |
| 10-Year | 648.75 | 7.68 | ***Maturity*** |
| 15-Year | 325.66 | 3.85 | 10.34 Years |
| 20-Year | 292.87 | 3.47 | |
| **Total** | **1,901.48** | **22.50** | |

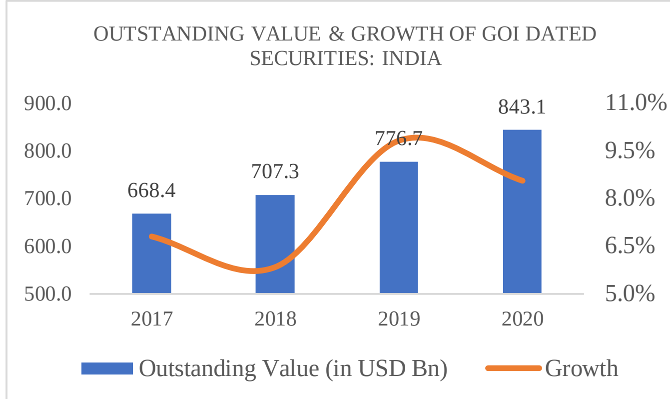
*Source: Bangladesh Bank* *As of February, 2020*

| **Outstanding value of GOI Dated Securities: India** | | | |
|---|---|---|---|
| **Maturity** | **Rs Bn** | **USD Bn** | **Weighted Average** |
| Less Than 1 Year | 2,350.77 | 32.91 | **Rate** |
| 1 to 5 Years | 15,095.20 | 211.33 | 5.79% |
| 5 to 10 Years | 18,074.00 | 253.04 | |
| 10 to 20 Years | 14,513.38 | 203.19 | **Maturity** |
| 20 Years & Above | 10,184.64 | 142.58 | 10.72 Years |
| **Total** | **60,217.99** | **843.05** | |

*Source: Reserve Bank of India* *As of March, 2020*




*Source: Bangladesh Bank*




*Source: Reserve Bank of India*

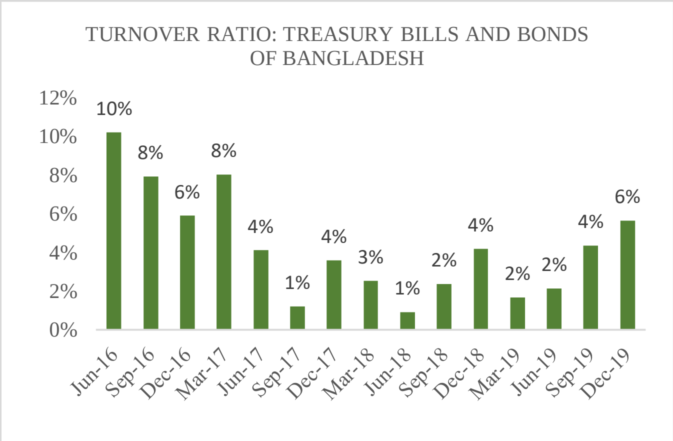
## Liquidity

The turnover for treasury bonds does not show a clear trend or pattern. The turnover of year 2019 and so far in 2020 is higher than that of the previous two years due to the increased dependency of the Government on the treasury instruments to finance budget deficit amid poor revenue collection growth compared to the target.

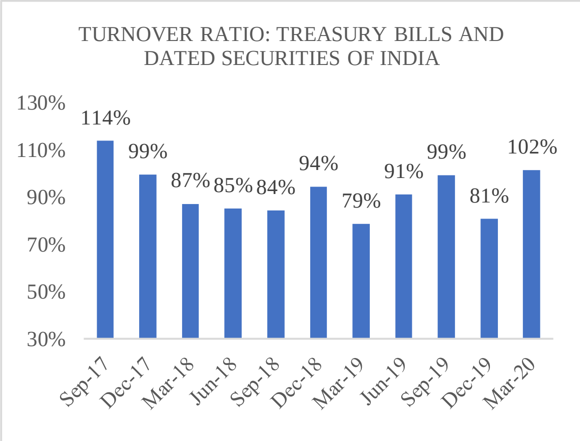
| Turnover of treasury bills and bonds (amount in Billion) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2016** | | **2017** | | **2018** | | **2019** | | **2020** | |
| | **BDT** | **USD** | **BDT** | **USD** | **BDT** | **USD** | **BDT** | **USD** | **BDT** | **USD** |
| **January** | - | - | 39.40 | 0.47 | 5.56 | 0.07 | 17.96 | 0.21 | 19.07 | 0.23 |
| **February** | 53.27 | 0.63 | 53.90 | 0.64 | 5.01 | 0.06 | 8.70 | 0.10 | 26.58 | 0.31 |
| **March** | 13.04 | 0.15 | 26.35 | 0.31 | 27.79 | 0.33 | 2.51 | 0.03 | 17.65 | 0.21 |
| **April** | 35.25 | 0.42 | 17.87 | 0.21 | 6.51 | 0.08 | 0.00 | 0.00 | 4.97 | 0.06 |
| **May** | 36.67 | 0.43 | 11.23 | 0.13 | 7.13 | 0.08 | 1.48 | 0.02 | 3.21 | 0.04 |
| **June** | 91.59 | 1.08 | 33.98 | 0.40 | 1.16 | 0.01 | 41.20 | 0.49 | | |
| **July** | 92.42 | 1.09 | 24.77 | 0.29 | 16.95 | 0.20 | 41.50 | 0.49 | | |
| **August** | 28.19 | 0.33 | 11.95 | 0.14 | 13.92 | 0.16 | 10.87 | 0.13 | | |
| **September** | 5.84 | 0.07 | 8.77 | 0.10 | 9.42 | 0.11 | 47.13 | 0.56 | | |
| **October** | 45.13 | 0.53 | 4.01 | 0.05 | 16.89 | 0.20 | 38.80 | 0.46 | | |
| **November** | 16.54 | 0.20 | 11.06 | 0.13 | 10.07 | 0.12 | 23.35 | 0.28 | | |
| **December** | 29.74 | 0.35 | 39.64 | 0.47 | 44.01 | 0.52 | 77.60 | 0.92 | | |
| **Total** | **447.68** | **5.30** | **282.91** | **3.35** | **164.41** | **1.95** | **311.10** | **3.68** | | |

*Source: Bangladesh Bank*

The turnover ratio[5] shows Secondary trading activity of the Government securities. The secondary market of Bangladesh is practically illiquid compared to India. On an average, 92% of the outstanding value is traded in every quarter which mostly moves around 2 to 6% in Bangladesh.



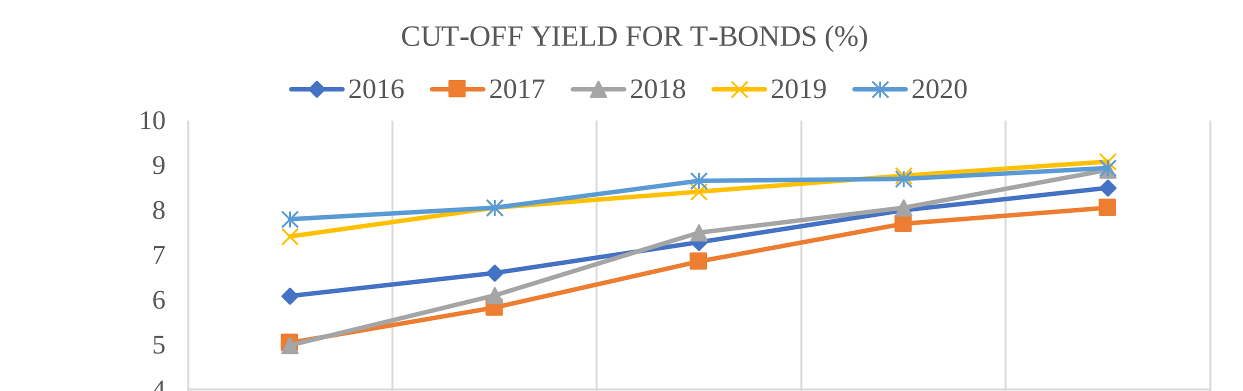

*Source: Bangladesh Bank*




*Source: Reserve Bank of India*

## Rate

The yield curve for T-bonds in 2020 is flatter than that of 2019. The cut-off yield for the 2-year T-bond has risen the highest (39 bps) from 2019 to 2020 while that of 5-year T-bond has dropped by 14 bps. The abrupt parallel shift in the yield curve in 2019 is mostly explained by increased supply of treasury bonds and lower capacity of the banks to absorb the supply.




| | 2-year | 5-year | 10-year | 15-year | 20-year |
|---|---|---|---|---|---|
| 2016 | 6.09 | 6.6 | 7.29 | 8 | 8.5 |
| 2017 | 5.05 | 5.83 | 6.86 | 7.7 | 8.05 |
| 2018 | 4.99 | 6.1 | 7.5 | 8.06 | 8.9 |
| 2019 | 7.41 | 8.05 | 8.42 | 8.77 | 9.08 |
| 2020 | 7.8 | 8.05 | 8.66 | 8.7 | 8.94 |

*Source: Bangladesh Bank*

[5] Quarterly turnover has been divided by Outstanding value to get the Turnover Ratio

**Issues**

- There is a lack of investment vehicles for local and foreign investors who may desire sovereign exposure. Foreign investors participation is almost zero in the treasury market.
- Treasury bond is practically illiquid in the secondary market due to lack of market participants.
- The illiquidity has created the absence of a proper benchmark rate curve which leads to mispricing of these securities. This is one of the main hindrances to develop a well-functioning bond market in our country.

## Treasury Bills

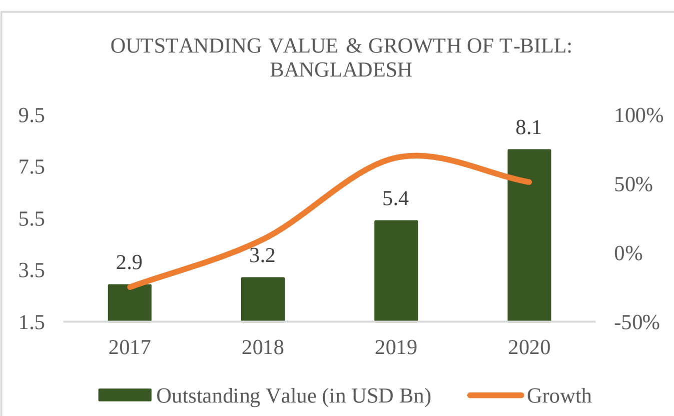
T-bills are risk-free money market instruments of the government. These are issued to meet short term funding requirements of the government account. The bills are issued in a scripless form at a discount and redeemed at the face value at maturity. Apart from providing money market securities with risk free yields, T-bills are used as cash management instruments.

**Size**

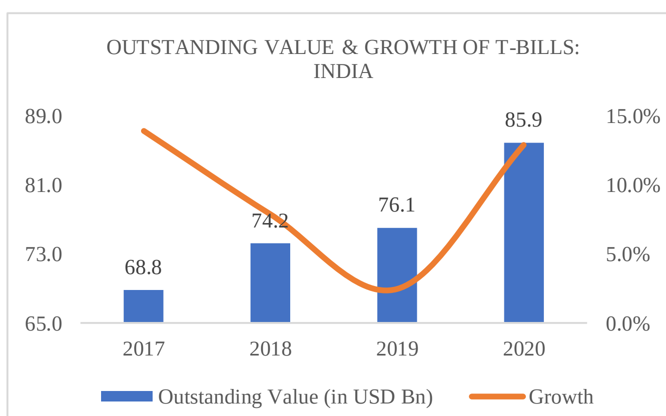
Currently, there are treasury bills of four different tenors: 14-day, 91-day, 182-day, and 364-day. The total outstanding value for the treasury bills stands at **USD 8.12 Bn** as of December, 2019. The 364-day T-bill constitutes almost half of the outstanding value with the 91-day T-bill being the least popular.

| **Total Outstanding Value Treasury Bills (USD Bn)** | | | | |
|---|---|---|---|---|
| **Maturity** | **Bangladesh** | **India** | **Weighted Average (BD)** | **Weighted Average (India)** |
| 14-Day | 0.36 | 21.69 | ***Rate*** 6.30% | ***Rate*** 4.46% |
| 91-Day | 1.74 | 11.56 | | |
| 182-Day | 2.34 | 22.14 | | |
| 364-Day | 3.68 | 30.47 | ***Maturity*** 0.65 Years | ***Maturity*** 0.53 Years |
| **Total** | **8.12** | **85.86** | | |

*As of December, 2019* *Source: Bangladesh Bank & Reserve Bank of India*




*Source: Bangladesh Bank*




*Source: Reserve Bank of India*

## Liquidity

T-bills are tradable in the secondary market. Due to cash management requirement, however, the net financing through T-bills for the financial year came positive implying that there was a higher order of fresh issuance compared to repayments. Basically, treasury bonds are illiquid because of its inaccessibility and lack of foreign investors. According to Bangladesh Bank, the total amount raised through treasury bills was BDT 904.94 bn or USD 10.86 bn while total repayments amounted to BDT 727.62 bn or USD 8.73 bn in FY 2018-19. Net issuance stood at BDT 177.32 bn or USD 2.13 bn during the FY 2018-19. Shorter-term treasury bills (91-day T-bills) remained as the most common instruments for the government, as these provide more flexibility to public fund management than long-term bonds.

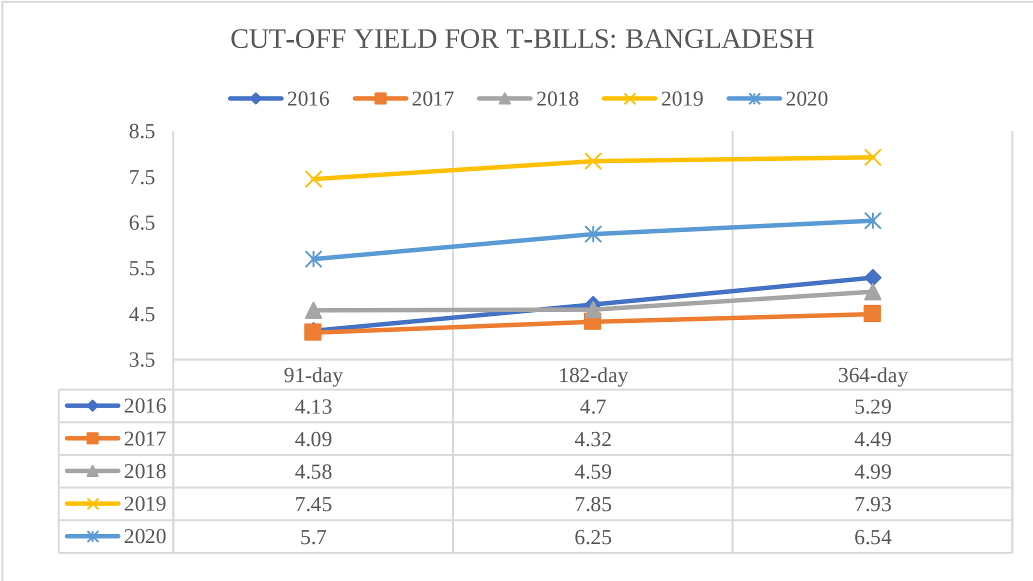
**Net issuance of T-bills (amount in billions)**

| FY | Issuance | 91 day | | 182 day | | 364 day | | Total | |
|---|---|---|---|---|---|---|---|---|---|
| | | in BDT | in USD | in BDT | in USD | in BDT | in USD | in BDT | in USD |
| 2015-16 | Issue | 314.74 | 3.78 | 137.11 | 1.65 | 122.82 | 1.47 | 574.68 | 6.90 |
| | Repayment | 309.43 | 3.71 | 159.03 | 1.91 | 161.15 | 1.93 | 629.62 | 7.56 |
| | Net | 5.31 | 0.06 | -21.92 | -0.26 | -38.33 | -0.46 | -54.94 | -0.66 |
| 2016-17 | Issue | 317.50 | 3.81 | 149.99 | 1.80 | 87.68 | 1.05 | 555.17 | 6.66 |
| | Repayment | 320.44 | 3.85 | 125.76 | 1.51 | 122.82 | 1.47 | 569.03 | 6.83 |
| | Net | -2.94 | -0.04 | 24.23 | 0.29 | -35.14 | -0.42 | -13.86 | -0.17 |
| 2017-18 | Issue | 301.51 | 3.62 | 125.38 | 1.50 | 71.88 | 0.86 | 498.78 | 5.99 |
| | Repayment | 258.78 | 3.11 | 134.37 | 1.61 | 87.68 | 1.05 | 480.84 | 5.77 |
| | Net | 42.73 | 0.51 | -8.99 | -0.11 | -15.80 | -0.19 | 17.94 | 0.22 |
| 2018-19 | Issue | 567.94 | 6.82 | 170.85 | 2.05 | 166.14 | 1.99 | 904.94 | 10.86 |
| | Repayment | 524.24 | 6.29 | 131.49 | 1.58 | 71.89 | 0.86 | 727.62 | 8.73 |
| | Net | 43.70 | 0.52 | 39.36 | 0.47 | 94.26 | 1.13 | 177.32 | 2.13 |

*Source: Bangladesh Bank*

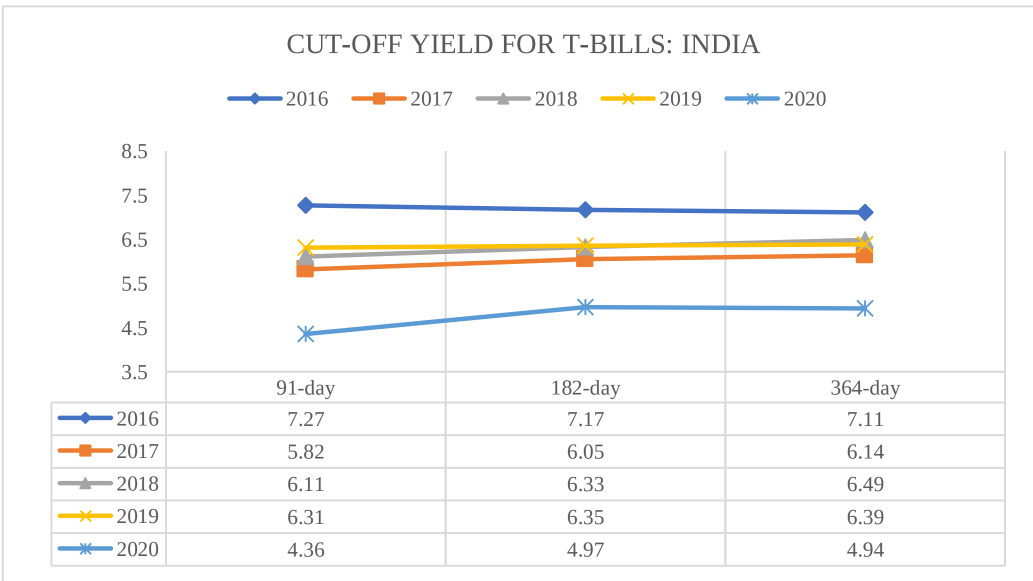
## Rate

In 2020, the T-bill rates have come down significantly from 2019. The 91-day T-bill has declined the most (175 bps). Short–term treasury rates of India are significantly lower than Bangladesh though their corporate loan and deposit rates are similar to Bangladesh. Lower treasury rates of India compared to Bangladesh can be explained by lower inflation rate in India. The inflation rates of Bangladesh and India are 5.50% and 3.34%, respectively. Additionally, the yield curve of Bangladesh and India have both flattened which indicates that the risk premium by duration is almost non-existent.




| | 91-day | 182-day | 364-day |
|---|---|---|---|
| 2016 | 4.13 | 4.7 | 5.29 |
| 2017 | 4.09 | 4.32 | 4.49 |
| 2018 | 4.58 | 4.59 | 4.99 |
| 2019 | 7.45 | 7.85 | 7.93 |
| 2020 | 5.7 | 6.25 | 6.54 |

*Source: Bangladesh Bank*




| | 91-day | 182-day | 364-day |
|---|---|---|---|
| 2016 | 7.27 | 7.17 | 7.11 |
| 2017 | 5.82 | 6.05 | 6.14 |
| 2018 | 6.11 | 6.33 | 6.49 |
| 2019 | 6.31 | 6.35 | 6.39 |
| 2020 | 4.36 | 4.97 | 4.94 |

*Source: Reserve Bank of India*

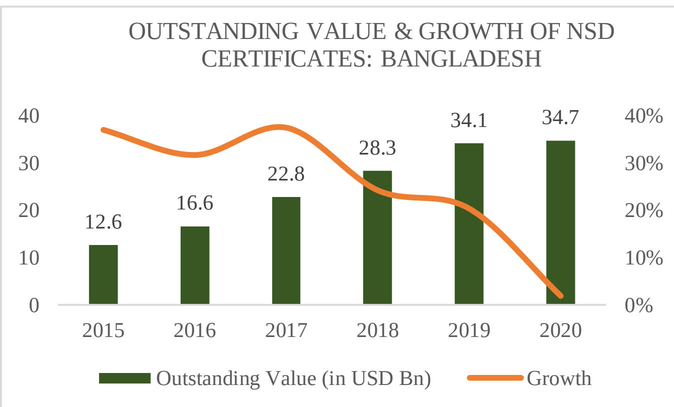
## Issues

- T-bills are illiquid in the secondary market due to lack of participants.
- The illiquidity creates the lack of proper benchmark curve for pricing.
- The high yield of T-bills skews the benchmark interest rates.
- Deposit rates and short-term treasury bill rates are very much closer.
- The high return on these risk-free assets also result in impeding growth of private sector credit.

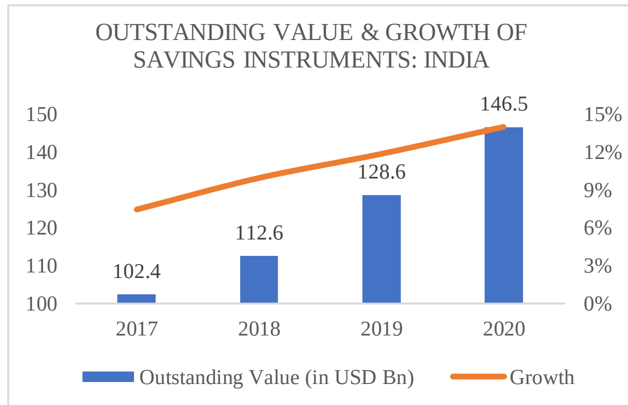
## NSD Certificates

### Size

At present, there are three different types of savings schemes with varying maturity periods available for investors: Sanchaypatra, Post Office Savings Bank Deposit, and NSD Bonds. The total outstanding value of these certificates amount to a whopping **USD 34.7 Bn** as of March, 2020. Sanchaypatras of various maturities constitute more than 80% of the outstanding value in NSD certificates.




*Source: Bangladesh Bank*




*Source: Reserve Bank of India*

Till 2016, tradable government securities were the popular mode for government financing. However, the weight shifted in 2017 towards National Savings Certificates because the interest rate of National Savings Certificate (NSC) is significantly higher than any other interest rate prevailing in the government securities market. Outstanding debt liabilities from NSD increased marginally in FY20 as the sales of Sanchayapatras have plummeted due to some government initiatives.

| **Comparison of outstanding values between NSC and T-bonds & bills: Bangladesh Vs. India** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Period** | **Outstanding balances (USD Bn)** | | | | **% of total (Bangladesh)** | | **% of total (India)** | |
| | **NSC** | | **T-bills & bonds** | | **NSC** | **T-bills & bonds** | **NSC** | **T-bills & bonds** |
| | Bangladesh | India | Bangladesh | India | | | | |
| 2015-16 | 16.60 | 95.28 | 18.44 | 686.23 | 47 | 53 | 12 | 88 |
| 2016-17 | 22.80 | 102.38 | 18.44 | 737.15 | 55 | 45 | 12 | 88 |
| 2017-18 | 28.31 | 112.56 | 19.41 | 781.56 | 59 | 41 | 13 | 87 |
| 2018-19 | 34.05 | 128.6 | 23.69 | 852.74 | 59 | 41 | 13 | 87 |
| 2019-20 | 34.69 | 146.5 | 30.62 | 928.92 | 54 | 46 | 14 | 86 |

**As of March, 2020.* *Source: Debt Management Department, Bangladesh Bank*

Adjusting for the market size, our exposure (54%) of the national savings certificate is almost four times higher than that of India (14%). While this is a serious concern in our public finance policy which is causing the government to pay materially higher expense, such high expenses might not linger in the long term as the sales process has been tightened and tax on its interest has been hiked. On the other hand, India has a consistency in their public finance policy.

### Liquidity

These debt securities cannot be bought or sold in the secondary market. NSCs can only be sold by National Saving Bureau, Bangladesh Bank, scheduled banks or post offices.

### Rate

The interest rate on NSD certificates is significantly higher than the rate of all other securities. This has made NSD certificates the most popular security among investors. The current rates on some of the major NSD certificates are as follows:

| Type | Tenor | on maturity | 1 year | 2 years | 3 years | 4 years | 5 years |
|---|---|---|---|---|---|---|---|
| 3-monthly | 3 years | 11.04% | 10% | 10.50% | 11.04% | | |
| 5-yr NSC | 5 years | 11.28% | 9.35% | 9.80% | 10.25% | 10.75% | |
| Pension NSC | 5 years | 11.76% | 9.70% | 10.15% | 10.65% | 11.20% | 11.76% |
| Family NSC | 5 years | 11.52% | 9.50% | 10% | 10.50% | 11% | 11.52% |
| | | **Average yield** | **9.64%** | **10.11%** | **10.61%** | **10.98%** | **11.64%** |

*Source: National Savings Directorate*

### Issues

- NSD Certificates are not tradable (illiquid) in the secondary market. However, investors can encash the Sanchaypatras before maturity accepting a lower rate.
- NSD certificates offer investors extraordinarily high returns with very low credit and liquidity risks.
- Although the purpose of NSD certificates is to benefit consumers, excessive use of it can create unintended consequences for the market. Government can use alternative ways like tax rebate to benefit consumers.

Excessive borrowing from the treasury markets and savings certificate at higher interest rates is making the interest burden huge for the government and crowding out the private sector credit and, thereby private investment.

## *B. Corporate Debt*

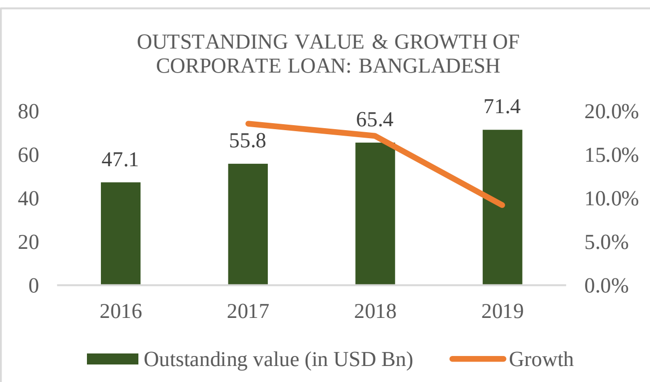
Corporate debts are issued through corporate bonds and loans. Compared to the treasury bond market, the corporate bond market is still negligible; companies seem to prefer taking on corporate loans over issuing corporate bonds.

### Corporate Loans

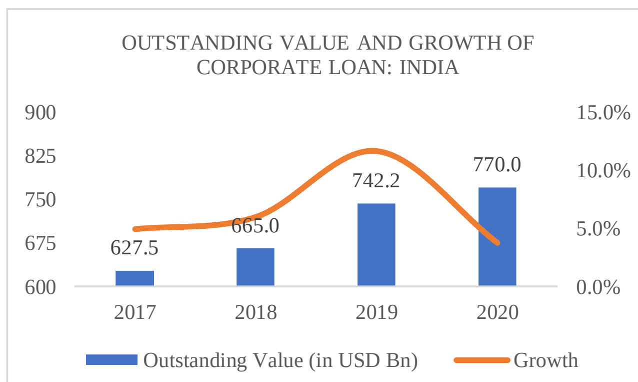
The size of corporate loans is increasing year-on-year which reflects the overall affinity of taking on corporate loans instead of issuing bonds. Furthermore, the outstanding value of loans in every industry has seen substantial growth over the last three years. Therefore, the preference for taking loans is prevalent in every industry of the country, which can be quite alarming in our current financial context.

| Sector | *Outstanding Value of Corporate Loans (amount in billion)* | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Industrial (Manufacturing)** | **2016** | | **2017** | | **2018** | | **2019** | |
| | **BDT** | **USD** | **BDT** | **USD** | **BDT** | **USD** | **BDT** | **USD** |
| RMG | 758.7 | 9.10 | 930.3 | 11.16 | 1,079.2 | 12.95 | 1,142.7 | 13.52 |
| Textile | 543.7 | 6.52 | 619.9 | 7.44 | 710.4 | 8.52 | 822.6 | 9.73 |
| Ship building and Ship breaking | 117.2 | 1.41 | 117.7 | 1.41 | 135 | 1.62 | 158.4 | 1.87 |
| Agro-based Industry | 343.7 | 4.12 | 483.2 | 5.80 | 585.6 | 7.03 | 700.9 | 8.29 |
| Other Industries (Large Scale) | 1,002.2 | 12.03 | 1,174.8 | 14.10 | 1,451.6 | 17.42 | 1,482.9 | 17.55 |
| Other Industries (Small, Medium, and cottage) | 331.1 | 3.97 | 329.8 | 3.96 | 396.1 | 4.75 | 438.7 | 5.19 |
| **Industrial (Services)** | | | | | | | | |
| Construction | 482.8 | 5.79 | 542.2 | 6.51 | 614.3 | 7.37 | 694.6 | 8.22 |
| Transport and Communication | 118.9 | 1.43 | 139.9 | 1.68 | 150.9 | 1.81 | 211.3 | 2.50 |
| Other Service Industries | 227.8 | 2.73 | 313.9 | 3.77 | 326.6 | 3.92 | 382.6 | 4.53 |
| **Total outstanding corporate loan** | **3,926.10** | **47.11** | **4,651.70** | **55.82** | **5,449.70** | **65.40** | **6,034.70** | **71.42** |

*Source: Financial Stability Report, Bangladesh Bank*




*Source: Bangladesh Bank*




*Source: Reserve Bank of India*

## Liquidity

The liquidity status of these corporate loans is very low. There is no securitized debt or any such product in our financial industry to allow for the transfer of these loans. Given the gargantuan value of outstanding loans, the lack of liquidity poses some severe issues on the event of failure to repay the loans.

### Rate

There is no fixed rate on corporate loans. The rate generally varies based credit quality of the borrowers and terms & conditions of the particular banks. The rates on corporate loans previously ranged from ~11-15% but have now been capped at 9%.

### Issues

- Corporate loans give the borrowers the ultimate flexibility. Companies can access corporate loan in far more easy and faster way than issuing a corporate bond. Corporate loans can be availed within four to six weeks from banks or NBFIs while it takes almost six to twelve months to get an approval to issue corporate bond. This flexibility is good but in reality, lack of proper due diligence and fraud (inconsistent documentation or insufficient collateral) make this flexibility a perverse incentive. Thus, the mismanagement and misallocation of corporate loans causes serious obstruction for the growth of bond market as well as equity market.
- Often, the lenders even allow companies to renegotiate the terms of loan repayment for single time or multiple times at easier conditions.
- Easy accessibility of corporate loans leads to more corruption.

## Corporate Bonds

The corporate bond market is practically non-existent. Only a few corporate bonds have been issued over the last ten years. To illustrate, there are just two corporate bonds i.e. Islami Bank Bangladesh Ltd (IBBL) Mudaraba perpetual bond, APSCL Non-Convertible and Fully Redeemable Coupon Bearing Bond and only eight debentures listed in the market as of June, 2020. Advanced Chemical Industries (ACI) zero-coupon bond and BRAC bank subordinated convertible bonds were two other listed corporate bonds but both of these have been delisted upon maturity.

### Size

The par value, number of shares, issue size, market capitalization, and price range of the two corporate bonds and all eight debentures are provided as follows:

**Listed Corporate Bond and Debentures**

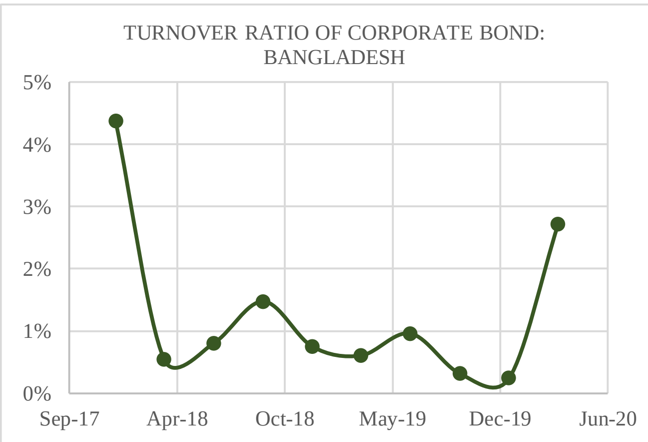
| Name | Type of bond | Face value (USD) | No. of shares | Issue size (USD) | Market Cap (USD) |
|---|---|---|---|---|---|
| IBBL Mudaraba Perpetual Bond | Corporate bond | 11.83 | 3,000,000 | 35,502,959 | 33,869,822 |
| APSCL Non-Convertible and Fully Redeemable Coupon Bearing Bond | Corporate bond | 59.17 | 200,000 | 11,834,320 | 11,978,698 |
| Aramit Cement Ltd. | Debenture | 22.07 | 45,000 | 993,195 | 993,195 |
| Bangladesh Luggage Ind. Ltd. | Debenture | 4.73 | N/A | N/A | N/A |
| BD Welding Electrodes Ltd. | Debenture | 4.73 | 8,000 | 37,870 | 134,296 |
| Bangladesh Zipper Ind. Ltd. | Debenture | N/A | N/A | N/A | N/A |
| Beximco Denims Ltd. | Debenture | 2.05 | 120,000 | 245,680 | 2,059,172 |
| Beximco Fisheries Ltd. | Debenture | N/A | 40,000 | N/A | 395,266 |
| Beximco Knitting Ltd. | Debenture | N/A | 100,000 | N/A | 1,065,089 |
| Beximco Textiles Ltd. | Debenture | 2.05 | 96,000 | 1,965,444 | 1,476,923 |

*Source: DSE*

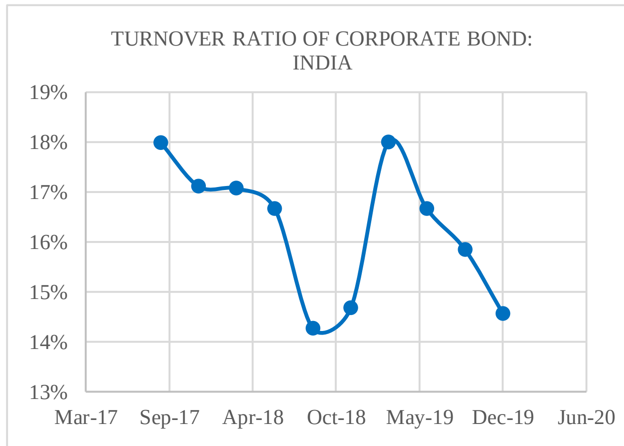
In addition to the listed corporate debt securities, over the last three years, 55 companies have privately issued bonds worth USD 2.7 billion. In 2018, bonds worth USD 1.2 billion were issued, which was 66.3% more than the capital raised by privately placed bonds in FY 2017, as per ADB data.

### Liquidity

The liquidity status of the listed corporate bonds is poor. There is barely any trade activity of the two listed corporate bonds. When compared against India, the turnover ratio indicates that Indian corporate bond market is vibrant with 14 to 18% of the total outstanding amount changes hand in every quarter.




*Source: DSE*




*Source: SEBI*

### Rate

The companies issued different types of bonds such as non-convertible, redeemable, and unsecured bonds at floating rates. More than 20% of the companies issued zero-coupon bonds. These bonds have a maximum maturity period of seven years.

### Issues

- The corporate bond market is almost non-existent. Even if companies issue bonds, they prefer private placements over public listing. So, the listed bond market lacks depth.
- There are multiple issues barring companies from entering the bond market. As discussed in previous sections, flexibility creates overreliance on corporate loan market.
- The regulatory framework of bond market is not well-developed yet.
- Lack of proper rating agencies and a proper benchmark yield curve make pricing of the bond cumbersome.
- Furthermore, it is a long and often an arduous process to issue corporate bonds which further deter issuers from coming to the market. Investors as well lack adequate incentives to invest in corporate bonds.

Over reliance of the government in the banking sector has been making it increasingly difficult for the private sector to obtain easy credit from banks as well. The single digit lending rate cap means that banks can no longer charge high interest from corporations. Banks are now more reluctant to sanction loans especially to the small businesses. Hence, corporate bond remains the only possible window for corporations to finance their operations.

### *C. Banks & NBFIs*

**<u>Borrowings by Banks and NBFI through Deposits</u>**

**Size**

As a plumbing system in any economy, Banks and NBFIs are playing very important role. In our country, it is a common practice to deposit money in Banks & NBFIs instead of directly investing. As a result, the size of our Bank & NBFI deposits amount to a gargantuan sum of **USD 149.00 Bn.** The depositors should not only opt for higher rates but also analyze the risk of the institution while depositing money.

| **Bank & NBFIs Deposit (As of Dec, 2019)** | | | |
|---|---|---|---|
| **Type of Account** | **Amount (BDT Bn)** | **Amount (USD Bn)** | **Weighted Average** |
| Current | 2,454.80 | 29.05 | ***Rate*** 5.24% |
| Savings | 2,477.10 | 29.31 | |
| Term | 6,686.70 | 79.13 | ***Maturity*** 1.5 Years |
| Other | 972.20 | 11.51 | |
| **Total** | **12,590.80** | **149.00** | |
| ** Excluding Interbank Deposits* | | | |

*Source: Financial Stability Report, Bangladesh Bank*

**Liquidity**

Over the last 5 years, the proportion of type of the accounts are stable. The breakdown below demonstrates a slightly rising trend of deposits in Current and Savings Accounts. This is indicative that investors are wary about the liquidity shortfall in banking sector and hence opt for less liquidity risk.

| **Bank & NBFI Sector Deposits (% of Total Deposit)** | | | | | | |
|---|---|---|---|---|---|---|
| **Type of Account** | **2019** | **2018** | **2017** | **2016** | **2015** | **2014** |
| Current | 19.5% | 19.9% | 19.3% | 19.3% | 18.2% | 18.0% |
| Savings | 19.7% | 20.0% | 19.0% | 19.1% | 17.6% | 17.0% |
| Term | 53.1% | 53.0% | 51.3% | 53.9% | 57.4% | 56.7% |
| Other | 7.7% | 7.1% | 10.3% | 7.7% | 6.8% | 8.4% |
| **Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

*Source: Financial Stability Report, Bangladesh Bank*

## Rate

In comparison to government securities, the rates on deposits are quite low. To illustrate, risk-free assets such as Treasury bonds and NSD certificates have higher rates despite the higher risk in banks.

| Special Notice Deposit (SND) Rates | |
|---|---|
| **Amount in BDT** | **Rates** |
| < 1 crore | 2.81% |
| 1 crore but < 25 crore | 3.19% |
| 25 crore but < 50 crore | 3.50% |
| 50 crore but <100 crore | 3.84% |
| 100 crore and above | 4.12% |

| Fixed Deposit (FD) Rates | |
|---|---|
| **Maturity** | **Rates** |
| 3 months but <6 months | 5.89% |
| 6 months but <1 year | 6.19% |
| 1 year but <2 years | 6.35% |
| 2 years but <3 years | 6.38% |
| 3 years and above | 6.51% |
| *Source: Bangladesh Bank* | *As of Mar, 2020* |
| **Average of all banks* | |

| Change of Deposit Rate | |
|---|---|
| **Year** | **Weighted Average Deposit rate** |
| 2015 | 6.80% |
| 2016 | 5.54% |
| 2017 | 4.84% |
| 2018 | 5.50% |
| 2019 | 5.43% |
| 2020 | 5.24% |

*Source: Bangladesh Bank*

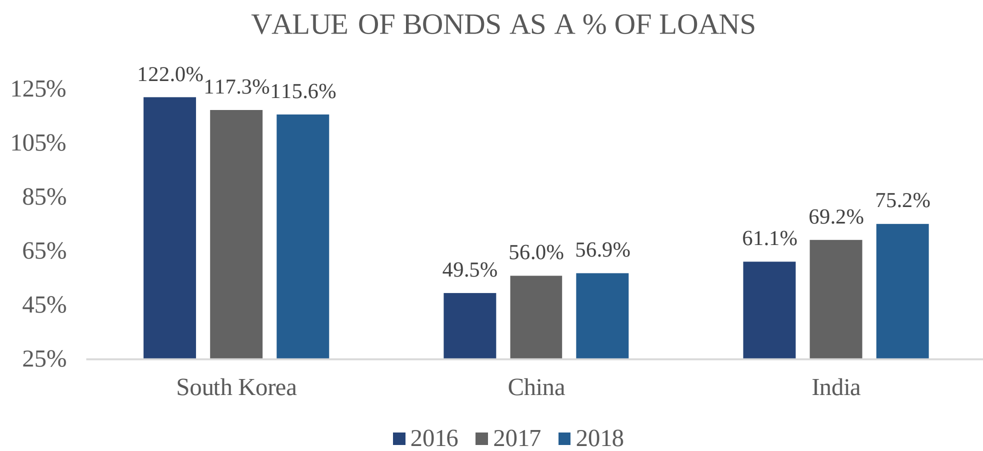
Weighted average deposit rate decreased over the years while the opposite is happening with the risk free government instrument rates i.e. T-bill, T-bond & Saving Certificates. Lower deposit rates and higher NSC rates led to lower deposit growth rate, which is expected to worsen further by the interest rate cap imposed on banks.

## Issues

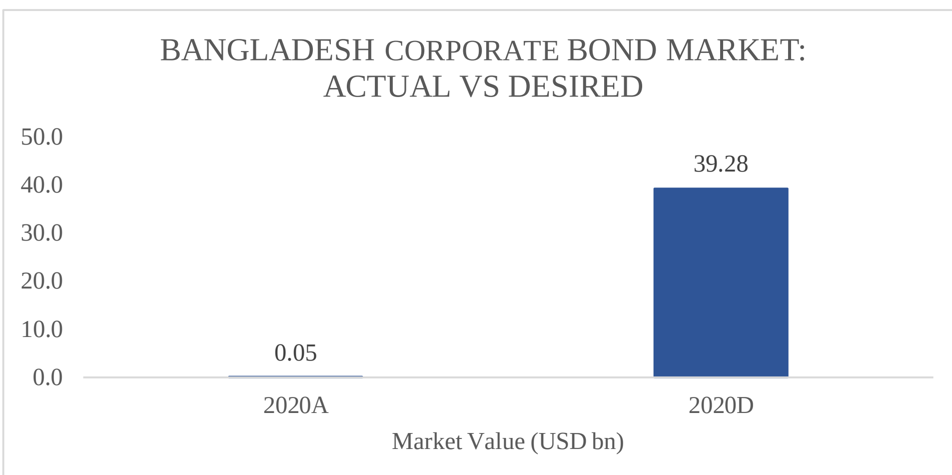
- Depositors don't get the idea that higher rates come with a higher risk. They mostly focus on the rates not on the risk of the depository institutions.
- Deposit insurance coverage is very negligible in Bangladesh. The maximum deposit insurance payment is BDT 100,000. This deposit insurance coverage should get more attention to strengthen confidence in the financial system.
- Additionally, the comparatively lower rates on deposit have deterred investors as well.
- Most recently, the liquidation of People's Leasing and Financial Services Limited (PLFSL) has further eroded investor confidence and spread mass alarm regarding the financial sectors.

## *D. Comparison with Other Regional Countries*

When we observe the bond-to-loan ratio of our regional peers, we find a scenario contrary to that of our country. We see that these countries rely more on bonds than loans. In especially India and China, the bond-to-loans percentage is growing year-on-year. The capital market and specifically, the bond market has been key in the financial development of these countries. In order to release the inevitable strain on the financial system, it is imperative that bonds be issued in our country as well, both locally and from overseas.



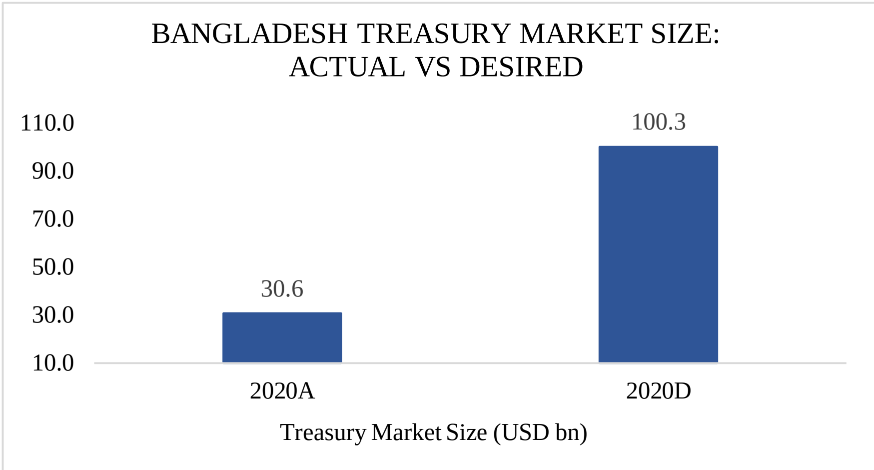

*Source: ADB*




*Source: LR Global Research*

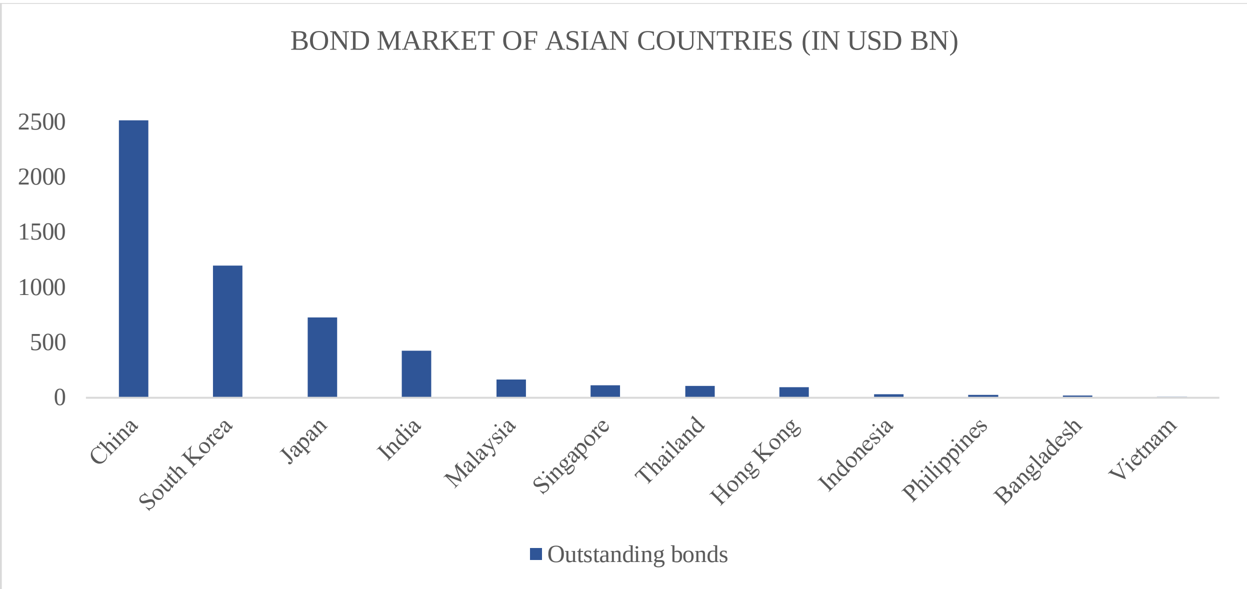
If we use India as a benchmark, according to the corporate bond value to loan ratio, we will need a bond market worth at least **USD 39.28 bn** (55% of the corporate loan amount**)** to keep pace with credit demand in Bangladesh and foster a healthy and balanced financial system. In India, the bond value as a percentage of loan has an eight-year average of 60%. As Indian corporate bond market is already developed, applying the ratio for our market provides a very rough estimation.

Our treasury securities market as percentage of our Gross Domestic Product (GDP) averages to 7.8% which is 28.8% for India. If we take the percentage of India to calculate the treasury market size of Bangladesh, the desired treasury market size becomes USD 100.3 billion which is more than three times of the existing market size.




*Source: LR Global Research*

Furthermore, comparing our bond market with other regional countries reveal that Bangladesh is lagging behind not only in terms of the size of the market but also the growth rate. Only Hong Kong and Japan have lower growth rates than ours but the size of their bond market is much greater than ours. This, again, is an alarming trend for us; at this meager YoY growth rate of 4.9%, our bond market will be nowhere close to catching up with the regional peers.




*Source: ADB*

To develop a well-functioning corporate bond market, at first, we have to identify the missing elements in our country that are necessary to develop a bond market. Following regional comparable countries' bond market development process, we can create our base.

## E. *Prevailing Regulations*

The regulations in their current form have some major flaws that often deter both issuers and investors from entering the bond market. Following are some of the regulations pertinent to our market:

- Securities and Exchange Commission (Issue of Capital) Rules, 2001: applicable for public or private companies raising capital;
- Securities and Exchange Commission (Public Issue) Rules, 2015: applicable for public issuance of debt securities or IPOs (fixed price and book building method);
- Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012: applicable for companies issuing privately placed debt securities (corporate bonds, subordinate bonds, zero-coupon bonds, and short-term bonds);
- Treasury Rules, 1998: applicable for

Following these guidelines, the process of getting an approval from BSEC to issue bonds is a very long and arduous. Considering the duration of each step as stated in "Securities and Exchange Commission (Private Placement of Debt Securities) Rules 2012", it would take a minimum of three to four months to receive all the approvals required. Moreover, inefficiencies within the system further delays the process and it may even take six to twelve months to get BSEC's approval for issuing a bond. Therefore, issuers generally prefer to take the easier route of availing bank loans which are much faster (4-6 weeks) to process as well.

High transaction cost of bond issuance is another major deterrent for issuers. Approximately, 1.5% to 2% of the total issuance cost is spent in registration fees, stamp duties, issue manager fees, underwriting fees, credit rating, legal and auditing fees, central depository fees, and listing fees. The registration fees for bond issuance is higher than the fees for debentures issuance. The trustee fees can be as high as 5% of the total issue value.

The regulations also have some ambiguous definitions that need further clarity. "Securities and Exchange Commission (Private Placement of Debt Securities) Rules 2012" does not clearly define terms such as "delay of payment" or "an event of default" and leaves it at the discretion of the trustees. There needs to be regulations or guidelines that clearly state for the issuers what constitutes a default against a delayed payment.

## F. *Bond market in the Budget of FY21*

The two changes in the FY21 budget for the bond market are as follows:

- Bond discount and interest at the time of payment will be subject to 5% TDS in place of the existing upfront 5% source tax on the same.
- Introduction of withholding tax deduction on commission in place of the existing withholding tax deduction on the bond value that is transacted.

However, since the benefits from these two clauses are minor, it is likely to do little to encourage investors to come to the bond market. Rather what was needed was some form of tax exemption or reduction to give the market its much needed push.

The 5% source tax imposed on the profits made from investments in bills and bonds in the Finance Bill 2020 is an also unwelcome move. This is likely to deter individuals and corporate entities from investing in government securities, and banks will consequently have to fill in by lending more to the government. Investors in the secondary bond market too will shy away from buying and selling securities as they will likely find themselves in a dispute regarding who will pay the source tax and how the amount will be divided if the security is sold before the maturity date as the source tax will have to be paid every 6 months even though income tax is paid once a year. The source tax was previously withdrawn in 2012 with a view to boost the bond market but re-imposing the source tax now contradicts the previous decision.

### *G. Post pandemic need for bonds and interest rate cap*

The pandemic is a very critical time for Bangladesh and calls for a pragmatic and innovative approach to hoist the economy. At this juncture, the largely untapped bond market is an attractive option to acquire funds to combat the pandemic and can also be a viable solution for tackling liquidity issues in the banking sector in the long run and avert a fund crisis in the country.

The success of the stimulus package will require a more practical approach. Given the bold size of the Bangladesh's stimulus package (BDT 1.03 trillion, 3.7% of GDP), expecting the banking sector to shoulder a significant portion of the responsibility to implement the package will take a large toll on the sector. In addition, the sector is already distressed with heavy government bank borrowing to finance the budget deficit due to poor revenue collection. In FY20, the government borrowing from the banking system vaulted to an all-time high of BDT 722.46 billion, up 108.89% from the previous FY, risking macroeconomic imbalance in the economy.

In FY21, the national budget, that has an outlay of BDT 5.68 trillion, is likely to cross the projected deficit of 6% of GDP as the country's already-weak tax collection is likely to aggravate as businesses and individuals are facing financial challenges with the health crisis in the country, which will drive an even deeper hole in the banking sector. The crowding out effect that this will have on the private sector will likely result in an even more slower-than-expected recovery for these businesses that support a majority section of the labor force in the country, which in turn will have a spillover effect on employment. Employment generation is crucial to support spending in order to help the economy bounce back.

Slow growth in deposits and single digit interest rate cap and ballooning non-performing loans, similar to that of China, is likely to compound significantly amid the virus outbreak, are also other factors that are weighing down the banking sector.

Therefore, Bangladesh now needs to take bond issuance into serious consideration to keep the economy buoyant and help it achieve the V-shaped recovery that it is hoping for.

Corporations should issue bonds to meet their financing needs instead of waiting in line to receive a pie of the stimulus package. Also given how banks are now likely to disburse loans more cautiously as lending rates cannot be adjusted above 9% to compensate for risk. Hence, a large chunk of companies will no longer be able to enjoy bank loans like before. Instead, lending out to the government by investing in T-bills and bonds is a far more preferable risk-free option for banks.

Taking these caveats into consideration, the bond market presents an attractive alternative for companies to meet their financing needs in current times.

The bond market also offers a less risky investment option with a fixed return for investors who want to avoid the volatility in the stock market during the pandemic. The recent mandatory rule imposed to list bank-issued perpetual bonds will offer more variety for investors as well.

Similar to corporations, the government too can capitalize on the global financial market by issuing government-backed sovereign bonds to finance the budget deficit as well as source funds for the stimulus package. The 30% oversubscription of the Taka-denominated Bangla bonds, worth a total of USD 9.5 million, issued on the London Stock Exchange in 2019, offers substantial reassurance that issuing a similar tranche again will not disappoint Bangladesh. Also, development bonds too can be issued to fund infrastructural projects. Apart from this, a platform can be created for government affiliated organizations to issue bonds to meet their financing needs rather than opting for direct government support.

George Soros' suggestion to the EU of issuing perpetual bonds so that the principal amount does not have to be paid can also be a sensible solution for Bangladesh.

# II. Challenges

There are a plethora of challenges barring the development of the bond market in our country. It is essential to address the following challenges that affect the issuers and investors of the bond market in varying degrees.

| | Issuers | Investors |
|---|---|---|
| Lack of governance and regulatory implementation | ✓ | ✓ |
| Absence of benchmark yield curve & misalignment of rates | ✓ | |
| Lack of new debt products in the bond market | ✓ | ✓ |
| Lack of transparency in risk pricing & liquidity | | ✓ |
| Lack of legitimate rating agencies | | ✓ |

Public debt management mechanism of the Government, regulatory gaps, corporate malpractices are creating continuous pressure on the banking and NBFI sector of Bangladesh. To fund the growth capital need of the public and private sectors, tapping this single sector repeatedly creating vulnerability to the financial system as a whole. In such a situation, developing a well-functioning bond market is a necessity.

The first problem that we face in the development process is proper regulatory framework that will ensure a balance between the rights of issuers and investors. The practically illiquid secondary market of treasury securities poses the next biggest challenge creating the absence of proper benchmark curve to price bond. Additionally, the misalignment of rates between risk free and risky investment vehicles is creating an overall imbalance in the financial system. High rate of savings certificate attracts fund from the investors causing the outstanding NSC balance to rise exponentially.

Moreover, there is a serious lack of the new debt instruments. Corporations are heavily dependent on the banking sectors for financing. The bureaucratic process of approval of corporate bond and flexibility of taking loans deterring the demand side of the corporate bond market. There are barely any legitimate credit rating agencies in our country. Any complex debt instrument market can never be developed without proper rating agency. Bad practices in our corporate governance system is another major challenge to overcome. Attracting foreign investors through proper incentive after developing the bond market is the ultimate challenge to develop a well-functioned corporate bond market.

# III. Recommendations

In order to develop our bond market, we have devised a 7-step recommendation along with actionable tasks in each step. The accountability of executing the steps lie on different parties which have been identified as well. The steps are as follows:

**STEP 1: Utilizing sovereign rating to jumpstart the municipal bond market**

Bangladesh has sovereign rating of BB- rated by S&P & Fitch and Ba3 rated by Moody's. All of these globally recognized rating agencies assigned a stable outlook to Bangladesh. Utilizing the Sovereign rating, the municipal bond market can be jumpstarted at the onset with domestic and local currency bonds pegged to the certain assets or overall government guarantee.

| **Key Actions** | **Potential Accountability** |
|---|---|
| 1. Develop debt indenture template | SEC |
| 2. Assign Sales agent | Merchant bank/ financial institutions |
| 3. Set up a security agreement | Issuers, Investors, SEC |
| 4. Set up reserve requirements/ collateralization of cash flow | Finance ministry/dedicated 3rd party |
| 5. Set up bond trustee | Issuer |

**STEP 2: Setting up quasi-governmental financial guarantor who will guarantee private sector debt.**

Quasi government organizations are privately managed organizations that are similar to public-private partnerships (PPP). Like any insurance guarantor, these institutions will clearly define proper capital requirement, scope of business, and risk pricing methodology. The purpose will be to reduce credit and liquidity risk.

| **Key Actions** | **Potential Accountability** |
|---|---|
| 1. Set up a private financial institution preferably with foreign insurance companies engaged in finding the best joint venture partner for the quasi-government guarantor based on local market. | Insurance Development and Regulatory Authority of Bangladesh |
| 2. Raise capital through joint venture partners or 3rd party capital. This entity can be itself listed in DSE. The companies must be managed as a self-sustaining business. The primary purpose of the entity is to provide guarantee of debt obligation of corporations who can issue a debt at a minimum sovereign rating in Bangladesh. | |

**STEP 3: Encouraging foreign rating agencies to cover debt and materially improving the rating industry.**

Debt instruments are complex; hence, without reliable, reputed, and predictable ratings by credible firms, fixed income market will never develop. It is imperative that foreign rating agencies (like S&P, Moody's, Fitch Group etc.) are directly engaged in rating local corporate debt.

<table>
<tr><th>Key Actions</th><th>Potential Accountability</th></tr>
<tr><td>1. Ministry of Finance in combination with public and private sector professionals and institutions must approach foreign ratings agencies to establish local presence</td><td rowspan="2">Ministry of Finance, private sector professionals; SEC (for implementation)</td></tr>
<tr><td>2. Foreign rating agencies to begin evaluation and provide local currency ratings for corporates. International standards must be followed by independent and & local rating agencies so that the local ratings are reasonably consistent across issuers.</td></tr>
</table>

**STEP 4: Setting up a market-driven process for assessing the risk of bond instruments.**

<table>
<tr><th colspan="2">Key Actions</th><th>Potential Accountability</th></tr>
<tr><td>1. Assessing credit risk and liquidity risk</td><td>Every issuer must have a rating that reflects credit & liquidity issues</td><td>Rating agencies</td></tr>
<tr><td rowspan="3">2. Risk-free benchmark set-up</td><td>A. Treasury yield and curve and consequently, initial pricing bands to be set by the market (i.e. issuers, investors, institutions, etc.)</td><td rowspan="3">Central Bank</td></tr>
<tr><td>B. Once the bond starts trading, it will trade at an effective rate.</td></tr>
<tr><td>C. Set up an OTC (over-the-counter) bond trading platform.</td></tr>
<tr><td>3. Price discovery process</td><td>Once the risk and risk premium for the bond is determined, the pricing of the bond will be done accordingly.</td><td>Institutional investors and OTC exchange</td></tr>
</table>

| | | |
|---|---|---|
| 4. Debt-instrument conditions & definitions | Set up guidelines for the conditions and definitions<br>-what “the event of a default” implies to,<br>-what a secured bond means vs. an unsecured bond,<br>-what rights bondholders possess including the conversion of issues<br>It is imperative for the issuer and investor to be completely clear of the definitions and conditions to avoid ambiguity and increase transparency. | SEC in conjunction with legal authority, and private and foreign legal agencies |
| 5. Disclosure of requirements | The requirements for the issue have to be clearly stated for both the issuer and investors. | SEC |

**STEP 5: Debt Securitization & Capital Efficiency**

Once the aforementioned steps are successfully implemented, the market can move towards debt securitization to improve efficient use of capital and to make debt investments/fixed income investments more accessible to a wider range of investors with varying levels of risk-return appetite.

| **Key Actions** | **Potential Accountability** |
|---|---|
| 1. Set up a well-defined set of procedures for the securitization of debt | SEC |
| 2. Commercial banks and other financial structures will then structure the asset backed securities whilst complying with the procedures set by SEC. | Merchant banks |
| 3. The previously mentioned rating agencies will rate the securities to ensure transparency. | Rating agencies |

**STEP 6: Fast-track approval of bond issues separating qualified and unqualified issuers**

| **Key Actions** | **Potential Accountability** |
|---|---|
| 1. According to the risk rating, the bonds need to be segregated into two classes: qualified and unqualified. | SEC |
| 2. Once the classification has been done, the two classes of bonds will go through two different processes. The qualified bond issues will be processed as quickly as possible while the unqualified bonds will go through more meticulous procedures. | |

**STEP 7: Provide incentives to high retail net-worth investors**

| Key Actions | Potential Accountability |
|---|---|
| 1. Provide tax benefits to high retail net-worth institutional investors including NRB & foreign investors tantamount to the benefits received by local investors in order to attract more foreign investment alongside the local ones. | National Board of Revenue (NBR) |
| 2. Ensure a security yield that is attractive relative to similar assets. | Institutional investors and OTC exchange |
| 3. To provide investors with transparency and liquidity, there needs to be a secondary market where investors can buy and sell bonds. Without a strong secondary market, investors will remain exposed to the liquidity risks, thereby being deterred from investing in the bond market. | SEC, OTC, and institutional investors |

# IV. Conclusion

Given the magnitude of capital requirement for both public and private sector, development of the bond market can no longer be ignored. The bond market can bring about positive transformational changes to our financing flexibility, transparency, accountability and governance challenges propelling Bangladesh to a level that solidifies our global position and most importantly, the future for the next generation.

If we truly care for the future of Bangladesh, the bond market is not an option but a requirement benefitting all and achieving our true potential as a country. A strong, focused and uncompromising leadership is required for the fast track development of the bond market in Bangladesh. Although we are materially behind relative to neighboring India, we can be confident that we can achieve our objectives provided we realize the glaring challenges and visualize a bright and sustainable future benefiting all citizens.

# Appendix A: Securities and Exchange Commission (Private Placement of Debt Securities) Rules, 2012

**Conditions to be fulfilled prior to making an application for issuance of debt securities**

- Total debt of the issuer, including the proposed issue, does not exceed 60% (sixty percent) of its total tangible assets - Provided that in case the debt-equity or capital adequacy ratio of an issuer is determined by its primary regulator, the issuer fulfills that requirement.
    - The commission may consider variation in the rule if it deems relevant considering industry scenario
- Issuer must have good track record of profitability and forecasted profitability of liquidity and profitability based on reasonable basis.
- Issuer should be rated by registered credit rating agency.
- Issuer must have enforceable right over its asset.
- Issuer must obtain consent from its primary regulator.
- Issuer’s financial statements should be prepared as per Bangladesh Accounting Standards (BAS)
- Issue must be approved by Board of Directors.
- Trustee must provide a Due Diligence Certificate.

**Application for consent to the issue of debt securities**

- Issuer to submit application with audited financial statement and other required papers.

**Consideration of the application and decision thereon**

- Commission will approve/decline the application within 7 days of receiving application
- If commission declines the application, the issuer may appeal to the commission. The decision of commission on appeal will be final.
- If approved 0.10% of total face value to be deposited as consent fee

**Conditions to be fulfilled after getting consent for issuance of debt securities**

- Consent of commission will remain valid for 1 year
- Issuer have to submit required papers within stipulated times as mentioned in consent letter.

**Registration of Trustee**

- Trustee must be registered with the commission
- Trust must have a minimum paid up capital of taka one hundred million
- Appointed a compliance officer for the trust having a minimum of five years’ service experience in the financial market
- Neither the trustee, nor any of its affiliates or directors have any relation with the issuer
- The trustee shall not act as arranger of the issue and shall not pursue any eligible investor to or not to invest
- Trustee must have no track record of default, negligence or non-compliance with any of the securities laws for discharging its duties, if it is in any way connected with the securities market.

**Duties of Trustee**

- The trustee shall call the eligible investors' meeting and shall enforce the decisions within such time of any default or any act of the issuer which may affect the interest of the eligible investors as specified in the deed of trust and in the information memorandum
- Delay in payment of any dues by the issuer, which is not approved by the trustee shall be treated as final default, in such a case the trustee shall enforce its rights over the collateral securities and other securities or guarantees of the issuer observing due legal process and thereafter the trustee shall dispose-off the same to pay the proceeds proportionately to the eligible investors after deduction of costs related thereto
- In case the delay is approved by the trustee for a certain period upon any reasonable ground, the trustee shall ensure repayment of the dues within the approved delay period along with interest for the delay period at a rate of 2% (two percent) p.a. above the usual rate of return of the debt instrument
- The trustee shall be liable to sue or to be sued on behalf of the eligible investors
- The trustee may, if required, inspect or call for books of accounts, records, register of the issuers and the trust property to the extent necessary for discharging its obligation
- A trustee can resign with prior approval of the Commission which shall not be effective until appointment of a new trustee and handing over charges by the resigning trustee
- If the trustee resigns or fails to perform its duties under the deed of trust or these rules, the debt security holders' association shall appoint a substitute trustee

**Arrangement on Default**

- If an event of default as defined in the deed of trust is known to the trustee, the trustee shall mail a notice of the default within 07 (seven) days after it occurs to debt holders, each stock exchange upon which the debts are traded, and the Commission
- The officers of the debt holders' association shall inform the trustee that the debt security holders' association will meet to consider the default, the trustee shall not act until instructed in writing by the debt holders' association
- If all efforts of negotiation by the trustee fail, it can take legal action against the issuer for recovery of the outstanding including principal and interest of the debt securities as per existing laws

**Penalties for Violation**

- No civil penalty may be imposed by the Commission nor criminal proceedings begun without notice and an opportunity to be heard. The Commission shall make a record of its proceedings
- Appeals from civil penalties assessed by the decision of the Commission shall be to the Commission and then to the superior court.

# Appendix B: Criteria for public offer/listing

General requirements (as per Rule 3, sub-rule (2) of BSEC (Public Issue) Rules, 2015): An issuer may make an application for public offer of its securities, if -

- it has prepared its financial statements in accordance with the requirements of the Securities and Exchange Rules, 1987, the provisions of IFRS /IAS as adopted in Bangladesh and audited the same as per Bangladesh Standards on Auditing (BSA) as well as the Companies Act, 1994 and other applicable legal requirements;
- it has not made any material change including raising of paid-up capital after the date of audited financial statements as included in the prospectus;
- the issue manager or any of its connected persons is in no way connected with the issuer or any of its connected person nor does hold any securities thereof;
- it has got cost audit by professional accountants as per the Companies Act, 1994, if applicable;
- it has got its latest financial statements audited by the panel auditors as declared by the Commission from time to time;
- it has been regular in holding annual general meeting (AGM);
- it has complied with the provisions of Corporate Governance Guidelines as published by the Commission from time to time;
- it has complied with all the requirements of these Rules in preparing prospectus;
- it has no accumulated retained loss at the time of application;
- it has complied with the provisions of guidelines regarding valuation of assets, if any, as published by the Commission from time to time; and
- The issuer or any of its directors and shareholders holding 10% or more shares is not loan defaulter as per the latest CIB report of Bangladesh Bank.

Additional requirements for fixed price method (as per Rule 3, sub-rule (3) of BSEC (Public Issue) Rules, 2015):

- it offers at least an amount equivalent to 10% (ten percent) of its paid-up capital (including intended offer) or Tk. 15 (fifteen) crore at par value, whichever is higher; and
- it has minimum existing paid up capital of Tk. 15 (fifteen) crore.
- if it has been in commercial operation at least for preceding 3 (three) years, it has positive net profit after tax and net operating cash flow for the latest 1 (one) financial year;
- if it has been in commercial operation for a period less than 3 (three) years, it has positive net profit after tax and net operating cash flow at least for the latest financial year;
- if it has not started its commercial operation or not completed any financial period yet, it has positive projected net profit after tax and net operating cash flow; and"
- thirty five percent (35%) of the issue has been underwritten on a firm commitment basis by the underwriter(s).

Additional requirements for book-building method (as per Rule 3, sub-rule (4) of BSEC (Public Issue) Rules, 2015):

- it intends to raise at least an amount of Tk. 50 (fifty) crore through the public offer; and
- it has minimum existing paid up capital of Tk. 30 (thirty) crore.
- it has been in commercial operation at least for preceding 3 (three) years;

- it has made net profit after tax at least for immediately preceding 2 (two) financial years;
- it has positive net operating cash flow at least for immediately preceding 2 (two) financial years;
- it has appointed separate persons as issue manager and registrar to the issue for managing the issue;
- the issuer has been rated by a credit rating company registered with the Commission;
- Thirty five percent (35%) of the issue has been underwritten on a firm commitment basis by the underwriter(s).

"eligible investor or EI" (as per rule 2, sub-rule (1), clause (e) of BSEC (Public Issue) Rules, 2015):

"eligible investor or EI" means the following institution who has business operation or investment in Bangladesh and registered with the electronic subscription system of the exchanges:

(i) Merchant Bankers and Portfolio Managers;
(ii) Asset Management Companies;
(iii) Mutual Funds and Collective Investment Scheme (CIS)
(iv) Stock Dealers;
(v) Banks;
(vi) Financial Institutions;
(vii) Insurance Companies;
(viii) Alternative Investment Fund Managers;
(ix) Alternative Investment Funds;
(x) Foreign Investors having account with any Securities Custodian registered with the Commission;
(xi) Recognized Provident Funds, Approved Pension Funds and Approved Gratuity Funds; and
(xii) Other Institutions as approved by the Commission;

- Direct Listing:

Salient Pre-requisites of an issuer for becoming eligible for direct listing (as per Regulation 9 of the Dhaka Stock Exchange (Listing) Regulations, 2015):

The concerned applicant-

- shall have minimum paid up capital of Taka 300 (three hundred million;
- shall have no accumulated loss;
- shall be in commercial operation for at least immediate last 5 (five) years;
- shall have profit in 3 (three) years out of the immediate last 5 (five) completed accounting/financial years with steady growth pattern;
- is regular in holding of annual general meeting (AGM);
- has not raised capital (excluding bonus issue) within preceding 2 (two) years;
- has not issued the same class of securities in any manner other than bonus issue within the preceding 2 (two) years of submitting application of listing;
- shall have positive net current assets (Current Assets less Current Liabilities) at the end of immediately preceding 3 (three) accounting/financial years;
- shall have net positive cash flows from its operating activities for immediately preceding 3 (three) accounting/financial years;

- shall comply with the provisions of Corporate Governance Guidelines as prescribed by the Commission from time to time;
- any of its sponsors/directors is not a bank defaulter;
- has been assigned rating by a credit rating company;
- has prepared its financial statements in accordance with the requirements of the Securities and Exchange Rules, 1987 as well as the provisions of International Financial Reporting Standards (IFRS)/International Accounting Standards (IAS) as adopted in Bangladesh and audited the same as per requirements of International Standards on Auditing (ISA) as adopted in Bangladesh.

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