Welcome to the Presentation on “Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh”

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Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **Relative short history**
  - Issuance of corporate debt securities is a relatively recent phenomenon.
  - Investors’ experience is also not quite pleasant.
  - First public issue of listed corporate debenture happened in 1987.

Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **No benchmark rate or yield curve**
  - No government long-term ‘transferable’ debt instruments.
  - Administered interest rates on saving instruments.
  - No benchmarking possible.
  - Proxy ‘bank rate’ or ‘FDR’ rates were not reliable substitutes.
  - A mid- or long-term yield curve could not be developed.
  - But rates gradually being made market based now.

Historical Impediments in Development of a Debt Securities 'Market' in Bangladesh

- **High government borrowing at high rates**
  - Government a the major borrower through 'national savings schemes' at the highest interest rate bracket and unlimited amounts.
  - Government instruments crowding out corporate borrowers and bank deposits of comparable tenures.
  - Scenario shifting lately, with discontinuation and rate cuts.
  - This trend is credited to recent stock market surge.

Historical Impediments in Development of a Debt Securities 'Market' in Bangladesh

- **Non-transparency in public borrowing**
  - Public sector borrowing lacked transparency that failed to proffer reliable demand-supply scenario in which efficient market can function.
  - Frequent shifts, *ad hoc* culture and volatility of demand unhelpful in designing publicly traded instruments.
  - Initiatives are on to issue tradable securities and bring fiscal discipline.

Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **Entrenched buy & hold culture**
  - Since the popular high-yield saving certificates were non-transferable, an entrenched ‘buy & hold’ culture developed.
  - Even premature encashment was not a common.
  - The culture spilled over to listed corporate debenture market, testified by historically low trading volume.

Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **Low long-term borrowing requirement**
  - Colonial past and dearth of resources resulted in weak industrial base and formalized commercial activities.
  - Demand for long-term capital and credit at the formal market was at a lower level.

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- **High bank deposit rates**
  - Deposit interest rates of the commercial banks were high until recently vis-à-vis government securities, corporate issues had to offer unsustainable rates.
  - High bank deposit rates deterred public borrowing by the corporate bodies.

Historical Impediments in Development of a Debt Securities 'Market' in Bangladesh

- **Banks feeding project finance appetite**
  - Even with maturity mismatch, commercial banks has traditionally been providing long-term project finance largely through annual rollovers, distorting the long-term credit market.
  - Borrowers tend to prefer less disclosure requirement and prudential obligations in bank borrowing to a public issue.

Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **Absence of policy support**
  - For long there was no government initiative, policy support or expressed political will to develop the financial and infrastructure base where a debt market could grow.
  - Out crowding effect of NPL and fiscal deficit played a damper on viable debt securities market development.
  - Recently government has taken some measures that hint policy shift and discipline, including intended listing of two new sovereign bonds at the bourses.

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- **High tax incidence & issue cost**
  - Until recently debenture trusts had 2.5% registration fee (now fixed token at Tk2,500) and 2% stamp duty on total amount raised.
  - With firm commitment underwriting at 2.5%, public issue cost averaged about 8%, topping recurring annual 1% trustee fee and related listing fees.
  - In a prevailing high interest regime, a high establishment and issue cost base rendered most public issue of corporate debentures unviable.

Historical Impediments in Development of a Debt Securities 'Market' in Bangladesh

- **Lack of regulations and infrastructure**
  - Absence of a dedicated set of regulations and necessary infrastructure has not been helpful.
  - Despite absence of an umbrella law, there could have been notable activities had there been strong policy support.
  - Historical inheritance of Common Law along with various securities regulations provided a framework which could have a facilitating role had their been application of imagination.
  - The SEC has now framed a guideline for issuance of debt securities.

Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **Lack of expertise & innovation**
  - Lack of expertise and innovation and absence of institutions in bringing variations kept the market uninteresting.
  - Financial advisors, lawyers and other service providers have not been competent in identifying attributes, rights and obligations of parties in debt securities.
  - There is also absence of pertinent financial research institutions.
  - The BB has issued PD licenses to some banks and NBFIs and SEC initiated process of appointing stock brokers for trading of government securities at the bourses.

Historical Impediments in Development of a Debt Securities 'Market' in Bangladesh

- **Overlapping parastatal**
  - Bangladesh Bank and the SEC enjoy some overlapping powers on money and bond markets with potentials of confusion among issuers and intermediaries.
  - To qualify for tax incentives, zero coupon issue or for SVP, require NOC from the central bank, even when issuer is not a bank or NBFI and instrument is long-term (over 1 year).
  - Governance of the debt securities regime remained weak and a disincentive along with absence of arbitration institutions.

Historical Impediments in Development of a Debt Securities 'Market' in Bangladesh

- **Default culture erode confidence**
  - A large number of publicly traded debentures issued by reputed corporate houses failed to service interest and principal payment obligations in time.
  - In cases SEC had to intervene after a long and tangled process and there was no visible legal redress for the investors causing a general lack of confidence.
  - With the erosion of public confidence there has been no issue of new listed debentures since 1999.

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- **Unaccountable trustees**
  - The system failed to hold the Trustees of debenture responsible for failure to defend rights of investors in many cases when issuing companies declined to honor obligations.
  - Regulators could not take the Trustees to task, though they received but could or did not take effective action against recalcitrant issuers.
  - Trusteeship of debentures has in effect become an unaccountable and defunct institution.

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- **Absence of institutional investors**
  - Institutional investor community did not develop due to multifarious impediments.
  - Market is essentially retail based and prone to high risk.
  - Newly licensed merchant banks are yet to make any tangible mark.
  - Pension funds are essentially non-funded and non-accounted-for liabilities, provident and insurance funds restrained under qualitative and quantitative restrictions and growth of private mutual funds retarded under stringent regulatory framework and an uneven playing field.

Historical Impediments in Development of a Debt Securities ‘Market’ in Bangladesh

- **Cold capital market**
  - Capital market is yet to emerge as effective investment avenue to most small savers and attractive outlet for corporate houses in raising fund, especially since the boom and burst of 1996.
  - Negative spillover effect of the grim capital market performance dampened potential public issue of debt securities.
  - With recent resurgence of the stock market the appetite for investment grade securities has again been pronounced.

Thank You All

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