Comparison of Financial Sector Regulatory Regimes in SAARC Region

(SAARCFINANCE Collaborative Study)

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Comparison of Financial Sector Regulatory Regimes in SAARC Region

Abstract

South Asian countries introduced far reaching reforms to their financial sectors aiming to promote competition in the financial sector, develop payment and settlement systems, and strengthen regulatory and legal frameworks during last few decades. The financial sector regulations have been strengthened in the SAARC region although member countries are in different phases of reforms. This study performs a close scrutiny and comparison of the reforms implemented in SAARC countries which will help them in collectively achieving a high standard of regulation and financial integration for sustainable economic growth in the South Asian Region. The study concludes with a few suggestions for further reforms and coordination for building efficient, competitive and resilient financial sector in the SAARC region.

JEL Codes: G18, G20, G21, G28, L51

Key Words: Regulations, Banks, Financial Sector, SAARC

1. Overview

South Asian countries introduced far reaching reforms to the financial sector in their respective economies during last few decades. However, the nature, intensity and the progress of these reforms vary from country to country. These reforms aimed at promoting competition in the financial sector, developing payment and settlement systems, and strengthening regulations. Despite numerous recommendations by regional and international organizations to advocating financial reforms and best practices, South Asian countries were not able to fully implement all phases of reforms. Besides, significant differences were observed in the financial sector regulatory regimes of member countries.

Literature on regional level financial sector reforms highlights that financial sector regulations are elevated in all the South Asian countries and it will help them in collectively achieving a high standard of regulations and financial integration for sustainable economic growth in the South Asian Region. The most useful process is the regulatory co-operation on the voluntary basis, and SAARC finance forums provide an excellent platform for such co-operations such as other initiatives namely ASEAN and Chiang Mai Initiative. Therefore, it is important to compare financial sector regulations introduced so far and the different dynamics across different jurisdictions in the SAARC region.

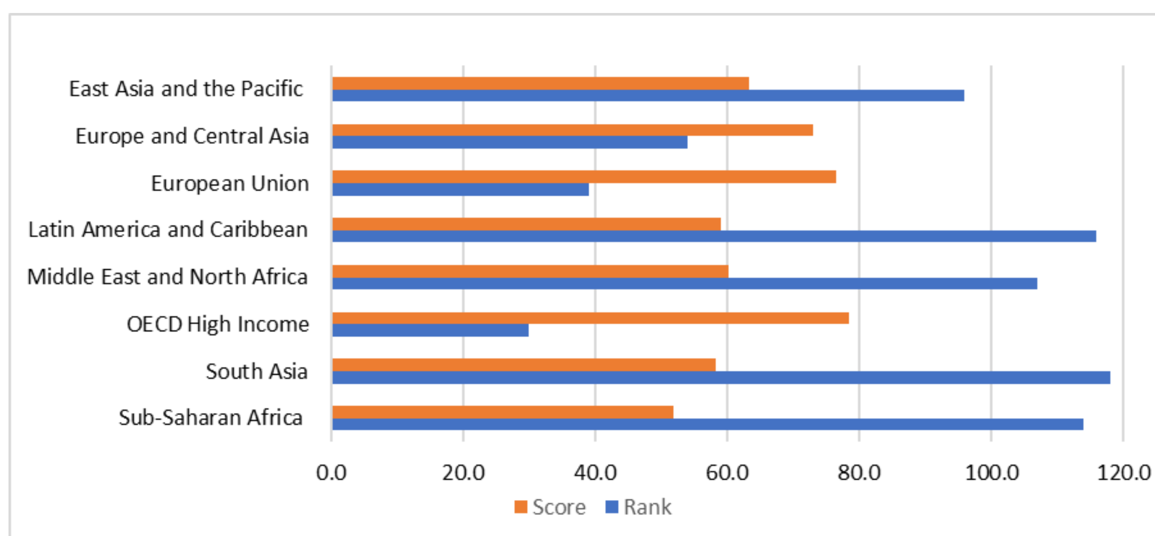
Section 2 of the study reviews the institutional setup and regulatory framework of financial sector in member countries and highlights the benefits of enhancing co-operation and sharing experiences while moving ahead to harmonization of financial sector regulations in the region. Section 3 reviews the current status of the regulations and institutional setup covering macroprudential surveillance, banking and collection of credit information based on the (i) findings of a survey conducted in all SAARC member countries on financial sector regulations, (ii) macroprudential policy survey conducted by International Monetary Fund (IMF) and (iii) the Bank Regulation and Supervision Survey conducted by the World Bank in 2019. This section also provides a comparison of regulatory frameworks available in member countries regarding above mentioned areas of financial sector. Section 4 concludes the study with some policy recommendations for reaping the benefits of enhancing the regulatory standards and adhering to global norms while achieving long term goal of harmonization of regulatory regimes in the region. There are significant benefits in learning from the best practices of regulations within the region through regional corporation. The financial sector structure and reforms introduced by each member country to their financial sectors are presented in Annex A to H. It gives a holistic view

about the emergence of the policy reforms and developments in financial sector particularly the banking sector the dominant players in financial sector of all member countries.

2. Review of Financial Sector Regulation in South Asian Region

It is widely accepted that the financial integration or union would enhance the capacity of member countries to promote regional capital accumulation, productivity, and economic growth. Empirical literature has identified major benefits of the financial integration through regional cooperation; namely enhanced risk sharing, pooling of resources available for investment and trade, expanding scale of financial intermediation and reduction in poverty, upgrading of financial infrastructure, emergence of banks and non-bank financial intermediaries (Tahari *et al.* 2007). Wakeman-Linn and Wagh (2008) caution that having a regional market does not immediately fix everything that is wrong with the domestic financial markets in fact underdeveloped financial market can have additional encumbrance to regional integration. The literature highlights that the convergence of financial regulation should not be left to market forces alone although it promotes the regulatory harmonization across jurisdictions particularly in financial sector. However, heterogeneity of financial sector regulations of member countries can be considered as the main challenge for the financial integration since they are in different stages of reforming the financial sectors.

Chart 1: Rank on the ease of doing business by region - 2020

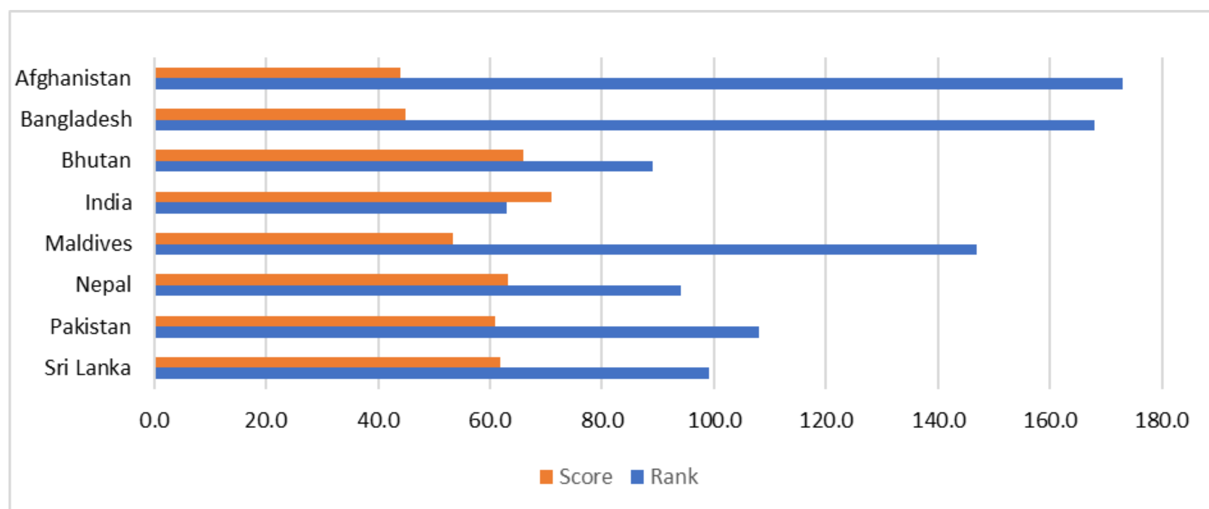


Source: World Bank 2020

South Asian nations initiated financial sector reforms in 1990s except Sri Lanka and Nepal. Sri Lanka initiated its reforms in late 1970s and Nepal introduced comprehensive financial sector reform strategy as late as 2002. The gradual approach followed by South Asia had the advantage of avoiding negative consequences of big bang liberalization adopted by some other countries

(Metzger 2008; Arora and Ratnasiri 2014). In 1998 with a view to opening dialogues on macroeconomic policies of the region and sharing mutual experiences and ideas, a Network of Central Bank Governors and Finance Secretaries of the SAARC Region (SAARCFINANCE) was established. Harmonization of financial sector regulations and practices, work towards a more efficient payment system mechanism, study global financial developments and their impact on the region and monitor reforms of the international financial and monetary system and to evolve a consensus among SAARC countries in respect of the reforms are among the main objectives of SAARCFINANCE Network.

Chart 2: Rank on the ease of doing business- SAARC Countries - 2020



Source: World Bank 2020

The ease of doing business ranking compiled by the World Bank indicates that the South Asian region has lagged behind all other regions in the world highlighting the necessity of further reforms to foster economic growth in the region. Greater heterogeneity in Doing Business ranking is also observed across South Asian Nations. Although South Asian nations are in different in phases of the financial sector reforms, the region is moving towards greater liberalization. Number of foreign banks established their branches in SAARC region with the liberalization of entry restrictions by reforms introduced to the banking sector. The reforms also encouraged the domestic private sector entry into the financial sector particularly in banking industry. The new entry to the market promoted competition compelling banks in the region including state-owned banks to adopt state-of-the-art technology. It was also observed that banks set up subsidiaries and business lines to engage in merchant banking, leasing and stock broking to enhance their fee-based activities thus expanding the financial services they offer.

Banking sector was highly dominated by the state owned banks prior to removal of the entry restrictions by reforms in the region. Although the high share of state ownership in banking assures the high degree of public confidence particularly in times of turbulence in the banking sector, the studies argue the lower level of efficiency in state-owned bank relative to the privately managed banks highlighting higher operating cost and lower assets quality due to priority lending and weak credit evaluation frameworks. Maintaining the credit quality at an optimal level continued to be a key challenge for deposit taking institution particularly for banks which dominate the financial sector.

Non-bank deposit taking institutes in the South Asian Region also play a vital role particularly in credit market catering to the rural community and Micro Small and Medium Enterprises (MSMEs) which are mostly excluded by the credit evaluation models of the banking sector. Unlike the banking sector, in many countries these non-bank institutions have lighter regulations as compared to their banking counterparts leading to acronym "Shadow banks". However, all regulators in the region have continuously enhanced their surveillance framework on shadow banking institutions recognizing their contribution to improve financial inclusion and financial sector penetration. Number of countries in the region introduced reforms to encourage the outreach of the banks and non-banks to achieve the inclusive growth targets.

Banking sector regulators in the world moved towards the risk-based supervision from compliance-based supervision with the interest of wider financial stability particularly after the Global Financial Crisis (GFC) in 2008/09 and no exception for the South Asian region. Adoption of Basel II contributed to enhance the banking sector risk management framework in the region and improve their data collection through advanced IT systems. Countries in this region are at various stages of implementation of Basel III framework. The major central banks in the region such Reserve Bank of India (RBI) and Bangladesh Bank (BB) have already adopted Basel III framework and now in the process of implementing required regulation in staggered basis. Central Bank of Sri Lanka (CBSL) also adopted Basel III. This would enhance risk management practices, loss absorbance capacities, transparency and disclosures and market discipline of the banking sector.

Failures of financial institution could threaten the financial system stability while causing significant adverse shocks to economies. The direct and indirect costs to the economy can be aggravated with eroded public confidence due to these failures. Therefore, financial sector

regulators should work towards to establish more effective resolution framework to mitigate the severe systemic disruptions resulting from failures of financial institutions. The main impediment in establishing a resolution and crisis preparedness framework in South Asian region is limited legal reforms introduced in this area. An independent resolution authority with a broad range of resolution powers and tools is required to take appropriate corrective measures to either turnaround a weak financial institution or setting out an appropriate exit strategy[1]. Effective cross-border cooperation and coordination of financial sector in the region would ensure efficiency of the resolution regimes and tools in a cross-border context.

In line with the developments of financial sector, countries in the region introduced reforms to address the issue of information asymmetry due to non-availability of sufficient information about credit histories of the people to access the credit worthiness of the prospective borrowers and to established credit registries. However, some countries in the region do not have centralized registries while some of them extended their coverage into ancillary function such as utility payments. Corporate governance is also an area of focus by the central banks in the region and directions were issued to maintain the fiduciary responsibility of the boards of the financial institution towards their stakeholders by the central banks in the region. New regulations have also been introduced in some member countries to obtain credit ratings from international Credit Rating Agencies for the financial institution with an aim of enhancing transparency and investor awareness. Further, member countries focused on customer protection and improving financial literacy among the customers with the objective of minimizing financial exploitation and increasing financial discipline while promoting financial deepening.

Secure and efficient payment and settlement system is considered as the backbone of the financial system of a country which facilitates to reduce transactions cost of the economy while providing a greater convenience to trading. In line with the global developments in payment and settlement systems, south Asian nations also upgraded and modernized their payment and settlement infrastructure to facilitating large value and time critical transactions. In the South Asian region Sri Lanka was the first to implemented Real Time Gross Settlement Systems (RTGS) in September 2003. India introduced RTGS in March 2004 followed by Pakistan in 2005 and Bangladesh in 2015 for inter-bank payments and settlements. RBI introduced 24x7x 365 RTGS in December 2020, enabling round the clock transfers and settlements. Such a system will provide extended flexibility to businesses for effecting payments and will enable introduction of additional

[1] India has set up Insolvency and Bankruptcy Code (IBC)

settlement cycles in ancillary payment systems. The regulators in the region also provided necessary guidance and regulatory space for enhancing Electronic Fund Transfer mechanisms and cheque imaging systems while facilitating emerging and innovative financial products, processes and businesses through advanced FinTech companies. The SAARC payments initiative was established in 2007 through the SAARC regional central banks to facilitate an efficient, robust, stable and convergent payments and settlement system for the region, that benchmarks with international standards. The SAARC payments initiative targeted to facilitate the implementation of comprehensive reforms in domestic as well as cross border payments and settlement system through close coordination, cooperation and experience sharing across the SAARC region to elevate the standard of regulations in the region.

Remarkable developments in stock markets were also observed in some countries with the regulatory reforms and trading platforms enabling foreign participation. However, regulatory loopholes and lack of diversified investment opportunities in small stock exchanges in the region limit the foreign participation. Despite the required reforms in place for the development of institutional framework and payment infrastructure, limited reforms have been introduced in the region with respect to the debt market and money market. Debt market is one of the key areas to be developed in achieving sustainable economic growth while enhancing the efficiency of capital market. Debt markets improves the efficacy of resource allocation in the region and thereby facilitates funding for the large-scale projects and corporates. Lack of reforms, delays in policy implementations and weaknesses in the current architecture of non-bank financial sectors are reflected by the under-developed debt and derivative market, limited access to finance and low level of financial deepening in the region.

The financial system in South Asia has become more interconnected and complex than ever before, increasing the risk of spreading the financial stress across the institutions, sectors and jurisdictions while creating systemic issues. GFC in 2008/09 and Asian financial crisis in 1997 proved that micro-prudential supervision alone is not enough to sustain the stability of the financial system. Accordingly, south Asian countries like the rest of the world strengthen their macroprudential frameworks to mitigate the risk emanating from bank, non-bank and financial infrastructures which could have a material impact on the overall financial system stability. However, the limited usage of macroprudential policy tools was observed in south Asian countries during recent past. Some of the countries have found that the main impediment to designed and implement macroprudential tool in the region is limited access to granular data relating to the economic and financial sectors. There were number of SAARCFINANCE initiatives to strengthen

the macroprudential policy frameworks of the member countries by organizing seminars and knowledge exchange programmes.

Given the continuous evolution in the financial landscape and financial integration in global markets, coordinated efforts to harmonize the regulations in financial sectors of member countries and to develop the financial infrastructure along with the adaptation of information technology are utmost important to enhance financial integration in South Asian region. Homogeneity in regulations, financial products and shared financial infrastructure promotes the cross-border investment within region while providing sandboxes to promote innovative financial products and services. This would also encourage the labour market mobility in the region enabling financial institutions to access large pool of skilled professionals required for their operations. Training synergies between member countries and knowledge sharing practices could be promoted through the regional cooperation as all member nations have similar challenges in reforming respective financial sectors and deepening financial sectors. Member countries which are in the higher phases in their specialized areas would be able to lift-up others in ahead on the learning curve through the regional cooperation.

3. Macroprudential Policies in South Asian Region

Over the last decade, the strengthening of global financial linkages was facilitated by the financial integration. Emergence of a deeper financial linkage in south Asian region have also been accompanied by greater financial integration albeit at a lower phase than the East Asian region and Europe. When the interconnectedness among the region is enhanced, more coordinated and potentially consistent macroprudential policies are essential to contain the systemic risks (Minsoo Lee, et al. 2017). This section explores the macroprudential policy frameworks of the SAARC member countries and highlights the important aspects, challenges and key issues in conducting macroprudential surveillance to foresee the buildup of risk at country level and regional level. Identifying and addressing key issues will help to enhance the existing macroprudential policy frameworks followed by the member countries.

3.1 Institutional framework of macroprudential surveillance in South Asian Region

In south Asian region capital markets are still developing and deepening while banks and non-bank financial institutions typically play a major role in providing affordable credit to businesses and consumers. Therefore, effective regulation and supervision is essential to ensure that banks are well positioned to maintain a sound, stable, and resilient financial system while catering to the

credit needs of the economy and encouraging savings enabling financial institutions to secure a stable funding source for their loan portfolio growth (Zamorski and Lee 2015a).

Recognizing the importance of maintaining financial stability to boost investments and achieve sustainable economic growth, member countries continued to strengthen their macroprudential Frameworks. Studies also highlighted the importance of establishing set of concrete policy instruments and synchronizing macroprudential policy framework with macroeconomic policies and microprudential supervision (Zamorski and Lee 2015b). Following four pillars have been identified in strengthening macroprudential policy frameworks (Saito 2014).

(i) Designing and making institutional arrangements to manage risks,
(ii) Establishing institutions and implementing policies to address the risks and their consequences,
(iii) Collecting information on risks to the financial system, and
(iv) Analyzing and assessing that information,

Institutional structure is the key to implement effective macroprudential measures. The roles and powers of relevant authorities should be clearly defined to prevent the conflict between regulators and other stakeholders while guaranteeing transparency, efficiency and accountability of policy implementation. As in most Asian economies, central banks in South Asian region play a leading role in formulation and implementation of macroprudential policies. Studies also recognized the primary role of the central banks in advocating and maintaining financial stability (Batunanggar 2013; Osiński 2013; Duncan and Nolan 2015).

Chart 3: Central Bank as the designated Macroprudential Authority

Source: Damodaran and Carol Lee (2014)

Table 1: Institutional arrangement to maintain financial stability in member countries

Country	Type of Mandate	Responsible Agency
Afghanistan	Executive decision	Financial Stability Committee (FSC)
Bangladesh	Legislation	Bangladesh Bank (BB)
Bhutan	Legislation	Royal Monetary Authority (RMA)
India	GOI Notification[2]	Financial Stability and Development Council (FSDC)
Maldives	Legislation	Maldives Monetary Authority (MMA)
Nepal	Legislation	Nepal Rastra Bank (NRB)
Pakistan	Legislation	State Bank of Pakistan (SBP) and Securities & Exchange Commission of Pakistan (SECP)
Sri Lanka	Legislation	Central Bank of Sri Lanka (CBSL)

Source: Macroprudential Policy Survey 2018, IMF.

Technical capabilities of central banks in assessing system wide risk and its political independence justify the suitability of the central banks to lead the macroprudential surveillance framework of a country. The committee or council to preserve the financial system stability is chaired by the central bank governors with deputy governors responsible for monetary policy, microprudential supervision and macroprudential supervision. Countries where supervisory and regulatory functions or powers lie under central bank authority commonly adopt this framework. This structure is also followed by the emerging Asian economies such as in Malaysia, the Philippines, and Singapore. In all member countries except Afghanistan, central banks have a mandate to formulate and implement policies for maintaining financial system stability as designated macroprudential authorities.

In 2012 inter-regulatory body was established for maintain financial system stability in Bangladesh with the chairmanship of governor Bangladesh Bank through a Memorandum of Understanding. Head of Bangladesh Securities and Exchange Commission (BSEC), the Insurance Development and Regulatory Authority (IDRA), and Microcredit Regulatory Authority (MRA) are the other members of this committee. This is a coordination body, and it does not have any power to issue macroprudential regulations. Heads of the regulatory authorities meet regularly, usually on a quarterly basis, under the chairmanship of the governor of the Bangladesh Bank, to discuss important market developments and to give directions to respective regulatory authorities on cross-cutting issues.

[2] Government of India Notification dated 30th December, 2010

State Bank of Pakistan (SBP) and Securities & Exchange Commission of Pakistan (SECP) established a Council of Regulators effective May 26, 2017, to deliberate on issues related to systemic risk, particularly those having cross-market and stability implications, and make efforts to suggest possible arrangements for crisis preparedness and issue a coordinated response. The Council includes members from the SBP and SECP. Governor, a Deputy Governor, and an Executive Director represent the SBP. The SECP representatives include its Chairman, a Commissioner, and an Executive Director.

Although a Financial Sector Oversight Council (FSOC) has been setup in Sri Lanka, there is no legal mandate for them to issue directions to implement the decisions taken at the council. Therefore, the committee works as a coordination council with the participation of representatives from Exchange Commission (SEC) of Sri Lanka, Insurance Regulatory Commission of Sri Lanka (IRCSL), Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB), Registrar of Companies, Co-operative Development Department, Bank Supervision Department of the CBSL and Attorney General Department. Further, there is no representative from Ministry of Finance who could play a key role in case of a systemic event. Therefore, representation from ministry of finance and required legal mandate is required for the FSOC to strengthening macroprudential surveillance in Sri Lanka.

A financial sector Co-ordination committee has been established in Nepal for formulating and implementing macroprudential policies with the participation of financial sector regulators. This Financial Sector Co-ordination Committee is headed by the finance minister.

The common issue in co-ordination committees of above member countries is that it lacks a mandate to issue directions of orders to relevant authorities regarding macroprudential surveillance. Therefore, legal infrastructure in the area of macroprudential surveillance in member countries to be enhanced for strengthening stability frameworks.

Chart 4: Stability council as the designated Macroprudential Authority

Source: Damodaran and Carol Lee (2014)

Another structure is that the designated inter-regulatory committee which acts as the macroprudential authority to preserve the financial system stability. This structure is mostly used where the central bank is not the microprudential supervisor. However, the inter-regulatory committee needs a mandate to formulate policies and implement the decisions taken to mitigate systemic risk. Although the central bank is not the designated macroprudential authority, Krishnamurti and Lee (2014) emphasized the importance of closer coordination and cooperation between the central bank and the inter-regulatory committee for this framework. This committee is typically established within the central bank with the participation of separate supervisory agencies. There are provisions to get the advices from external experts on matters relating to financial system stability (IMF-FSB-BIS 2016). The People's Republic of China, the Republic of Korea, Japan, and Australia are among the countries using this kind of institutional setup. In south Asian region, the inter-regulatory committee established in Afghanistan is vested with power to influence members to implement the decisions taken by the committee. In India Financial Stability and Development Council (FSDC) serves as an important forum for coordination and addressing the inter-regulatory issues. The Financial Stability and Development Council (FSDC) has been constituted vide GOI notification dated 30th December 2010. The Council is chaired by the Union Finance Minister and its members are Governor, Reserve Bank of India; Finance Secretary and/or Secretary, Department of Economic Affairs; Secretary, Department of Financial Services; Chief Economic Adviser, Ministry of Finance; Chairman, Securities and Exchange Board of India; Chairman, Insurance Regulatory and Development Authority and Chairman, Pension Fund Regulatory and Development Authority and Insolvency and Bankruptcy Board of India. Though the record of the FSDC meetings is not published, a press release is issued at the end of every meeting giving details of the issues discussed. The Sub-Committee of FSDC (FSDC-SC) is chaired by the Governor of RBI. Issues having any overlap of the regulatory domain would be

dealt with by an Inter-Regulatory Technical Group of FSDC-SC, while the implementation of macroprudential policies/tools will be undertaken by the concerned regulator. Following the formation of the Financial Stability and Development Council (FSDC), a Financial Stability Unit was established within RBI. It provides the Secretariat services to the Sub-Committee of the FSDC which is headed by the Governor. Executive Director (in charge of FSU) acts as the Member-Secretary of the FSDC Sub-Committee. The FSU is responsible for conduct of macro-prudential surveillance of the financial system on an ongoing basis, preparation of financial stability reports, development of a time series of a core set of financial indicators, conduct of systemic stress tests to assess resilience and development of models for assessing financial stability.

Financial Stability Committee (FSC) is the only authority to issue macroprudential regulation in Afghanistan Bank. FSC was established in 2018, by a presidential decree. The FSC comprised of representatives from the MOF and the Da Afghanistan Bank (DAB—Central Bank of Afghanistan) and chaired by the Minister. The decisions on issues relating to financial system stability are taken within FSC based on majority of votes and DAB provides Secretariat services to FSC.

3.2 Macroprudential policy tools used in South Asian Region

IMF defines Macroprudential policy as ‘‘the use of primarily prudential tools to limit systemic risk - the risk of disruptions to the provision of financial services that is caused by an impairment of all or parts of the financial system and can cause serious negative consequences for the real economy” (IMF, 2013a). Literature highlights two channels which could emanate the systemic risk and use of macroprudential tools to contain such risks. First, the over borrowings of the individual price-taking agents without assessing the full general-equilibrium impact of their decisions could originate systemic risk (Korinek, 2009; Bianchi and Mendoza, 2010; Jeanne & Korinek, 2010; Bianchi, 2011). Macroprudential tools can be used to encourage agents to internalize such negative externality avoiding build-up of the risk in the system. Second, procyclicality caused by financial frictions could emanate systemic risk (Zhang and Zoli 2016). Macroprudential policies are employed to dampen the procyclicality caused by these frictions while mitigating the cyclical effect of any macroeconomic shock.

Zhang and Zoli (2016) identified following macroprudential measures employed in 13 Asian economies including India and China and 33 countries from other regions from 2000 to 2013.

- Measures to address the build-up risk in housing market such as LTV ratios, DTI ratios, risk weights on housing loans in the calculation of capital-asset ratios, higher loan loss provisions on housing loans, and tax related to real estate.
- Measures to limit the consumer loans such as debt service limits on credit cards and personal loans.
- Limits on banking sector credit such as ceilings on credit growth or loan-to-deposit ratio.
- Measure to maintain the capital including countercyclical capital buffers and limits on profit distribution.
- Setting up dynamic provisioning measures enforcing banks to build reserve during the upswing phase of the business cycle.
- Imposing reserve requirements on local currency deposits to reduce the credit growth by declining credit demand and increasing cost of funds of the banks.
- Liquidity measures such as the minimum core funding ratio requiring banks to hold sufficient retail and longer-dated wholesale funding, or other liquidity ratio requirements like the liquidity coverage ratio and net stable funding ratio.
- Measures to limit the foreign exchange risk, such as limits on foreign borrowing, specific reserve requirements on foreign deposits and provisioning requirements on foreign exchange lending.
- Capital flow management measures to limit cross-border financial activities of non-residence such as unremunerated reserve requirements on non-resident deposits, restrictions on non-resident holdings of domestic assets and withholding tax on earning of non-resident deposits.

However, macroprudential policy survey (MPS) conducted by the IMF shows the limited usage of macroprudential tools in south Asian region compared to Emerging East Asian countries. The survey categorized the macroprudential tools into following six categories.

- Broad-Based Tools Applied to the Banking Sector such as countercyclical capital buffer, capital conservation buffer, limit on leverage ratio, forward-looking loan loss provisioning requirement, cap on credit growth and other broad-based measures to increase resilience or address build-up of risks.

- Household Sector Tools focused on household sector capital requirements such as cap on credit growth to the household sector, loan restrictions or borrower eligibility criteria,

exposure caps on household credit, fiscal measures to contain systemic risks and other measures to mitigate systemic risks emanate from loans to the household sector.

- Corporate Sector Tools based on corporate sector capital requirements such as cap on credit growth to the corporate sector, loan restrictions or Borrower eligibility criteria, exposure caps on corporate credit, fiscal measures to contain systemic risks and Other measures to mitigate systemic risks from loans to the corporate sector

- Liquidity Tools Applied to the Banking Sector, Liquidity buffer requirements such as Stable funding requirements, Levies or charges on noncore funding, Reserve requirements for macroprudential purposes, Limits on foreign exchange positions, Constraints on foreign exchange funding and other measures to mitigate systemic liquidity risks

- Tools to Address Systemic Liquidity Risk and Fire Sale Risk in Asset management industry, Insurance companies, Pension funds, Central counterparty clearing, Securities lending market, Securitization and Other

- Tools to Address Risks from Systemically Important Institutions and Interconnectedness within the Financial System, Measures to mitigate risks from systemically important institutions, Measures to mitigate risks from interconnectedness and Other measures to mitigate structural systemic risks

Table 2: Broad-Based Policy Tools Applied to the Banking Sector

	Country							
Macroprudential Tool	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Cap on credit growth	·	·	·	·	·	·	·	·
Capital conservation buffer	·	■	■	■	·	■	■	■
Countercyclical capital buffer	·	■	■	■	·	■	·	·
Limit on leverage ratio	·	■	■	■	■	■	■	■
Loan loss provisioning requirement	·	■	■	■	■	·	■	■
Other broad-based measures	·	■	·	■	■	·	·	■

Source: Macroprudential Policy Survey 2018, IMF and respective Central Bank websites.

Broad based tools applied to banking sector are designed to address credit growth or to achieve resilience to a broad range of shocks. These tools are commonly employed by the member countries as prudential measures to maintain the stability of the financial system. Use of these macroprudential tools has increased in recent past since it is embedded in Basel framework which

is being adopted by the member countries on staggered basis. Among these broad-based tools, the most frequently used measure by the member countries is capital conservation buffer which is used to ensure that banks have an additional layer of usable capital that can be drawn down when losses are incurred. All member countries except Maldives and Afghanistan adopted the capital conservation buffer to their banking sector regulatory framework. The capital conservation buffer is also the most commonly used broad based tools by 141 jurisdictions covered by the MPS. The survey revealed that 40 per cent of the broad-based tools used by the world is the capital conservation buffer. The framework to implement countercyclical capital buffer (CC_yB) is also established by 5 member countries namely India, Bhutan, Nepal, Sri Lanka and Bangladesh. However, none of the member countries has activated the positive countercyclical capital buffer. At global level, only 9 countries maintained positive countercyclical capital buffer rate by end 2018. Some of the member countries have adopted limit on leverage ratio and forward-looking loan loss provisioning requirement as prudential measures to safeguard the stability of the banking system. Risk weights are also used by some countries to contain the lending to overheating sector in the economy.

Table 3: Household Sector Policy Tools

	Country							
Macroprudential Tools	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Cap on credit growth to the household sector	·	■	·	■	·	■	·	·
Exposure caps on household credit	·	■	·	·	·	·	■	■
Fiscal measures to contain systemic risks	·	■	·	·	·	·	■	■
Household sector capital requirements	·	·	·	■	·	·	■	·
Loan restrictions or Borrower eligibility criteria	■	■	■	■	·	■	■	■
Other measure to mitigate systemic risks	·	·	·	·	·	·	■	·

Source: Macroprudential Policy Survey 2018, IMF and respective Central Bank websites.

The household sector could be an originator and amplifier of a substantial volume of risky claims held by financial institutions. Hence, macroprudential measures focused on household sector are designed to mitigate the vulnerabilities emanating from the household sector and their implications on the financial stability at an early stage. Among the household sector tools, restrictions on loan-to-value (LTV) is the commonly used macroprudential tool to minimize the build-up of risk emanating from household sector exposure. LTV is mainly targeted to mortgage loans and auto loans in the South Asian region. None of the member countries used Cap on loan-to-income ratio. Three countries namely Bhutan, Pakistan and Bangladesh have used cap on debt-service-to-income (DSTI) ratio as a macroprudential tool to mitigate the risk originating from household sector. However, assessment of borrowers' income could be a challenge for the financial institution due to limited reliable information on individual households. In general,

financial institutions also use their own DSTI ratios in credit evaluations to maintain the high credit quality. Studies highlighted that LTVs and DSTI are common particularly in Asia, Europe and the Middle East, with about half of the countries in those regions maintaining a restriction on the LTV ratio (IMF 2018). Tighter capital requirements on exposures to the household sector are also used by India and Pakistan in addition to LTVs imposed on the household sector lending. Further, limited use of cap on credit growth to the household sector and fiscal measures to contain systemic risks originated from household sector is observed in the South Asian region.

Table 4: Corporate Sector Policy Tools

	Country							
Macroprudential Tool	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Cap on credit growth to the corporate sector	·	·	·	·	·	·	·	·
Corporate sector capital requirements	·	■	·	■	·	·	■	■
Exposure caps on corporate credit	·	■	·	■	·	■	■	·
Fiscal measures to contain systemic risks	·	■	·	·	·	·	·	·
Loan restrictions or Borrower eligibility criteria	·	■	■	■	·	■	·	■
Other measure to mitigate systemic risks	·	■	·	■	·	■	■	·

Source: Macroprudential Policy Survey 2018, IMF and respective Central Bank websites.

Macroprudential surveillance on the dynamics of corporate sector is critical to foresee plausible systemic vulnerabilities since cohesive behaviour of corporates or conduct of a single systemically important corporate could influence the macroeconomy and the financial system. Therefore, a number of macroprudential tools are designed to contain such risks emanating from the corporate sector. The tools to manage the risk originated from corporate sector are much less than the household and banking sector. However, additional capital requirements on loans to the corporate sector is imposed by number of countries in the world while a few measures employing such as loan restrictions or borrower eligibility criteria are observed in the South Asian region.

Table 5: Liquidity Tools Applied to the Banking Sector

	Country							
Macroprudential Tools	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Constraints on foreign exchange funding	·	■	·	·	·	■	■	■
Levies or charges on noncore funding	·	·	·	·	·	·	·	·
Limits on foreign exchange positions	■	■	·	·	■	■	■	■
Liquidity buffer requirements	■	■	■	■	·	■	■	■
Other measure to mitigate systemic risks	■	■	·	■	·	·	·	■
Reserve requirements for macroprudential purposes	■	■	·	■	■	■	■	■
Stable funding requirements	·	■	·	■	·	■	■	■

Source: Macroprudential Policy Survey 2018, IMF and respective Central Bank websites.

Liquidity indicates institution's capacity to meet its obligations without incurring losses. Therefore, a number of tools have been designed to mitigate the liquidity risk in banking sector.

Tools to manage liquidity mismatches in the banking system are the most frequently used macroprudential policy tools in the world. In South Asian region, stable funding requirements and limits on foreign exchange positions are commonly used tools by the regulators to manage the liquidity in the banking system.

Performance of some financial institutions is important to the financial system stability due to its interconnectedness or size. Therefore, regulators use measures to address the risk in these systematically important institutions considering their structural dimension. As in other regions, additional capital surcharges for systemically important financial institutions (SIFIs), with limits on the exposures between financial institutions are used in south Asian region member countries who adopted Basel regulations. Financial institutions in the region are expanding operations within their respective jurisdictions as well as across the borders. Therefore, continuous surveillance is needed to monitor the emerging risk through the SIFIs into the financial system.

3.3 Banking Sector Regulations in South Asia

It is commonly accepted that financial surveillance and regulatory frameworks at national level is the workhorse and the first line of action for ensuring orderly functioning of financial institutions and financial markets and protecting investors to preserve financial system stability. Following the global financial crisis of 2008/09, there has been a wider appeal for global consensus on financial reform measures, establishing global surveillance unit and global financial safety net to strengthen the resilience of the world financial system. Masahiro Kawai and Peter J. Morgan(2014) highlighted the mediating role to be played by the regional-level institutions of financial regulation in Asia focusing on: (i)monitoring financial markets and capital flows to identify regional systemic risks such as capital flows; (ii) coordinating financial sector surveillance and regulation to promote regional financial stability; and (iii) cooperating with global-level institutions in rule formulation, surveillance, and crisis management. Potential value of regional-level cooperation in economic and financial policy formulation is also highlighted by the post-Asian crisis (1997-1998) reviews since the region found themselves subject to similar shocks and contagion.

Despite the high level of interest in harmonization and convergence of global financial regulations, there is a considerable gap in regulatory and supervisory approaches followed by South Asian countries, policy consistency and collecting up-to-date information. This section provides a review and a comparison of the banking sector regulations in the SAARC member countries to

evaluate the necessary policy recommendation for regulatory harmonization of regulation and economic integration at regional level. Information collected through Bank Regulation and Supervisory Survey (BRSS) conducted by the World Bank and data collected by researchers nominated by each SAARC member country for this study was employed to assess the regulatory regimes of the South Asian region.

Liquidity

(a) Countries in SAARC region had minimum regulatory Statutory Liquidity Ratios (SLRs) that were in the range of 7 per cent to 25 per cent as at end 2019. Bangladesh had separate SLR for Sharia-based Islamic banks which was lower than the regulatory minimum for conventional banks. Nepal had maintained a differentiated SLR for each banking class. Sri Lanka, Afghanistan and Bhutan had a regulatory requirement of 20 per cent while Maldives has not prescribed a SLR for its Banking Sector.

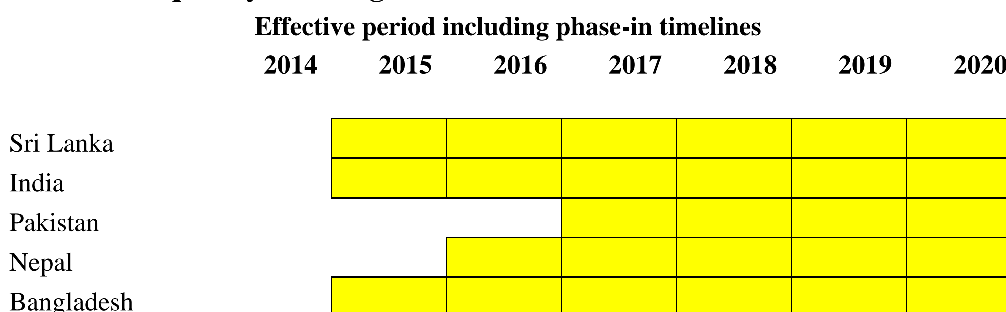
(b) Cash reserve requirement (CRR) or Statutory Reserve Requirement (SRR) of SAARC countries varied from 3 per cent to 10 per cent. This is the reserve requirement that banks and/or financial institutions shall maintain with their respective Central Banks. CRR/SRR is a key monetary policy instruments used across SAARC region. Afghanistan maintained two central bank reserve requirements for local currency and all foreign currencies[3]. In Pakistan CRR is required to be maintained at 5 per cent on average and is subject to a daily minimum requirement of 3 per cent. Maldives maintained the highest CRR/SRR ratio in the region which marked 10 per cent as at end 2019. India, Sri Lanka and Nepal maintained the CRR/SRR at 4 per cent. Banks in Pakistan are to maintain CRR at an average of 5 per cent, however on daily basis CRR should not be below 3%. Micro Finance Banks in Pakistan are required to maintain CRR of 5 per cent while Bangladesh maintained the CRR at 5.5 per cent on bi-weekly average basis with a provision of minimum 5.0 per cent on daily basis in 2019.

(c) India and Bangladesh are the only countries in the region which have imposed prudential limits on maturity mismatches in banks. Reserve Bank of India had imposed these prudential limits on negative cumulative mismatches under different maturity baskets viz. overnight, less than 7 days, 8-14 days and 15 -28 days. Bangladesh Bank (BB) limits maximum cumulative outflows up to 1 month to the sum of CRR and SLR of respective bank. Further, maximum cumulative outflow of BB should also be limited to 16.5 per cent of total cash inflows, nostro account balances and foreign currency balance of BB.

[3] 8% for AFN and 10% for foreign currencies.

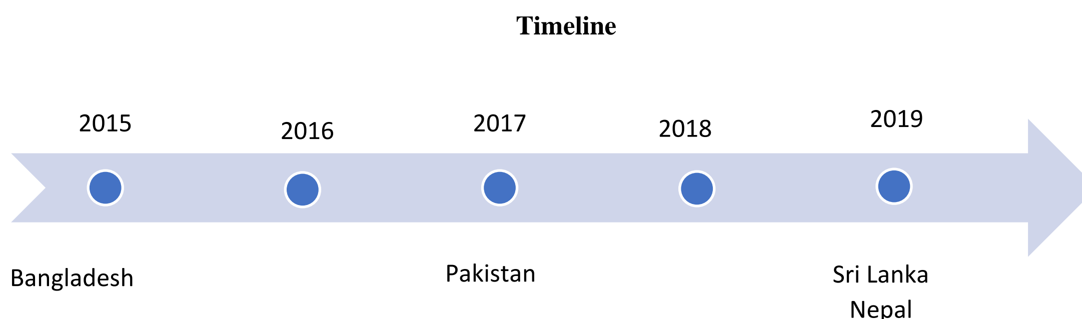
(d) Five SAARC countries namely India, Sri Lanka, Pakistan, Bangladesh and Nepal had fully implemented Liquidity Coverage Ratios (LCRs). The minimum LCR requirements of these countries were 100 per cent. Afghanistan, Bhutan and Maldives have not implemented LCR as a regulatory requirement. Pakistan has separate LCR requirement on local currency and foreign currency while Sri Lanka has separate LCR requirement for local currency and all currencies. India has LCR requirement for local currency, foreign currencies and all currencies. Nepal and Bangladesh have LCR requirement only on their local currency.

Chart 5: Liquidity Coverage Ratio



(e) Net Stable Funding Ratio (NSFR) have been implemented by 4 SAARC Countries viz. Sri Lanka, Pakistan, Nepal and Bangladesh as at end 2019. The minimum regulatory requirement of these countries at present is 100 per cent. RBI envisages implementing NSFR in late 2020.

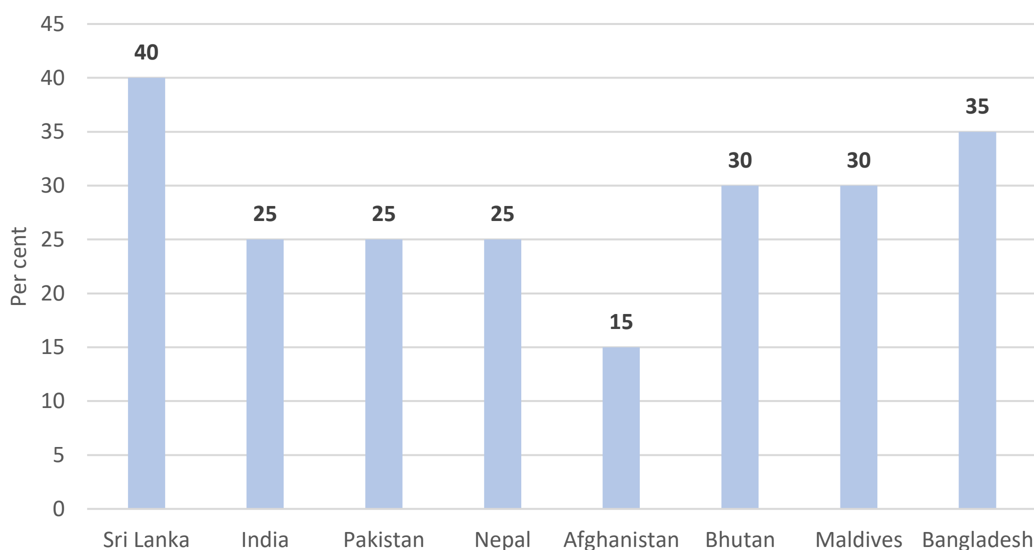
Chart 6: Net Stable Funding Ratio in SAARC Region



Credit

a) Regulations on enhanced limits of single/group borrower limit of SAARC countries ranged from 15 per cent to 40 per cent of the respective bank's regulatory capital as at end 2019. Single /group borrower limits in Pakistan are 20 per cent and 25 per cent respectively. India and Nepal reported the enhanced single/group borrower limit of 25 per cent, 30 per cent in Bhutan and Nepal, 35 per cent in Bangladesh and Maldives. Sri Lanka reported the highest enhanced limit of 40 per cent while Afghanistan reported the lowest regulatory limit of 15 per cent. Each country had several types of accommodations that were exempted from the regulation of single/group borrower limit. Exempted facilities in general were accommodation against cash or deposits, accommodations against government securities. Many SAARC countries apply credit equivalent value of off-balance sheet exposures by applying credit conversion factors when computing the limit of single/group obligor limit. However, Bangladesh had considered the nominal value/full value of off-balance sheet exposure for the purpose of this computation.

Chart 7: Maximum Lending Limit as a per cent of Regulatory Capital



b) Several regulators of SAARC countries had provided broad guidelines for banks directors to define the preferred level of credit diversification and concentration. Meanwhile, some SAARC countries had specified credit limits to identified specific economic sectors/activities with the view of containing the overall banking sector exposures to such sectors.

c) Despite the heterogeneity in types of classification, SAARC countries had clearly defined loan classification methodology implemented in their jurisdictions.

d) The time-based thresholds were used in classifying non-performing loans from that of performing loans. Except Afghanistan, other South Asian nations in general identify non-performing advances when the principal or interest is in arrears for 90 days or more. Afghanistan classifies loans non-performing loans subsequent to 120 days of past due status. However, by then non-performing advances are in doubtful and loss category in Afghanistan.

e) India, Afghanistan, Bhutan, Maldives and Bangladesh had a defined regulatory classification for its performing loans. Despite the heterogeneity in classification of performing loans, India and Afghanistan had three distinct classifications while Bhutan, Maldives and Bangladesh had two distinct classification of performing loans. Sri Lanka, Pakistan and Nepal had no regulatory classification for performing loans and advances.

f) Classifications of non-performing advances: Afghanistan had two classifications for non-performing advances viz. doubtful and loss. Sri Lanka had four non-performing loan classifications viz. special mentioned, substandard, doubtful and loss. Other six SAARC countries had three non-performing classifications despite the differences in their definitions.

g) Pakistan, Nepal and Bhutan had no exempted credit facilities from the requirement of non-performing classification. Most of other countries had exempted cash/deposit back loans, government securities backed facilities and government guarantee backed lending from the rules of NPLs classification.

h) The regulation of automatic classification of other advances of a single borrower when one such facility is classified non-performing is available in five SAARC Countries viz. India, Sri Lanka, Bangladesh, Afghanistan and Bhutan. The threshold limit used for the automatic classification of all other facilities of a given borrower was 30 per cent and 50 per cent in Sri Lanka and Bhutan respectively. India and Afghanistan have been classifying all facilities of a single borrower as non-performing when one facility becomes non-performing.

i) Principles prescribed in respective jurisdictions in reclassifying non-performing advances as performing across the SAARC countries remained virtually same except a few. A non-performing facility would generally be reclassified as performing when interest and principal in arrears are paid in full by the borrower. However, a re-scheduled non-performing loan will be reclassified as performing loan upon satisfactory performance.

j) Specific provisions requirement net of realisable security value on substandard (20 per cent), doubtful (50 per cent) and loss (100 per cent) categories were similar in Sri Lanka, Bangladesh, Bhutan[4] and Maldives. Pakistan, Nepal and Afghanistan reported similar provisioning requirements for substandard (25 per cent), doubtful (50 per cent) and loss (100 per cent) categories. India had a differentiated provisioning requirement for secured (15 per cent) and unsecured (25 per cent) loans in substandard category while provisioning requirement for doubtful loans varied depending on the age of the non-performing loan.

k) General provisions in SAARC region ranged from 0.4 per cent to 5 per cent. General provisions were mostly applied on performing advances and advances in special mentioned categories. However, Pakistan maintained a differentiated general provision requirement for secured loans and unsecured consumer loans. Bangladesh on contrary had a lower general provisions requirement for economically important sectors and a higher general provision for riskier economic sectors and facilities in "special mention account".

l) Loan write-off policies of some countries are formulated by board of directors of respective banks which have been designed with the aim of recovering the maximum salvage value. Nepal and Maldives regulators had the explicit loan write-off requirement which prescribed the timing for loan writing-offs.

Accounting

a) A locally incorporated accounting body/board in Sri Lanka, Nepal, Bhutan and Bangladesh is authorised in issuing the accounting standards in their respective jurisdictions. In India, a Government institute along with an accounting body notifies the accounting standards while in Afghanistan, A Government institute along with bank supervisor prescribe the accounting standards. In Pakistan, Securities and Exchange Commission is authorised to issue accounting standards while in Maldives, work is underway to establish an accounting body which is authorised to issue accounting standards.

b) In SAARC countries the publication formats of financial statements for banks are mostly prescribed by the bank supervisors/bank regulators. In Maldives, in addition to bank supervisor, stock exchange prescribes financial formats for publication.

c) Seven countries have adopted either International Financial Reporting Standards 9 or International Accounting Standard 39 for the banking sector. India had adopted IFRS for

[4] Bhutan specific provision requirement is on the loan outstanding not on the realisable security value.

their non-banking financial companies. SAARC countries are required to prepared consolidated financial statements when publishing their financial performance.

d) SAARC countries who have adopted IFRS 9 had a different regulatory requirement for measurement and classification of loans and advances, income recognition and provisioning to that of IFRSs.

Disclosures

a) Publication of quarterly financial statements, annual financial statements and display of interest rates, exchange rates, service charges and fees & commissions were mandatory disclosure requirements in all SAARC countries. In addition, disclosure requirements under corporate governance such as details of remunerations paid to key management personals and directors, risk management framework and periodic risk assessments, related party transactions and exposures, external auditors certification on the effectiveness of internal control mechanisms are some other disclosure requirements of several SAARC countries.

b) Disclosures are made in all official languages in SAARC countries. In addition, some disclosures are made in national languages where necessary.

Corporate Governance

a) Regulators of all SAARC Countries except Nepal exercise assessments of fitness and proprietary before the appointment of the board of directors. In Nepal, fitness and proprietary of directors are assessed when granting banking licenses to a prospective company. India, Pakistan, Afghanistan and Maldives exercise fitness and proprietary before the appointment of directors, key management personnel and major shareholders. SAARC regulators of banking sector are authorised to expel or black-list directors of banks and key management personals. Corporate governance requirements are mandatory in SAARC countries.

b) Corporate governance codes in Sri Lanka, India, Pakistan, Nepal, Afghanistan and Bangladesh require banks falling under their preview to establish audit committees, nomination committees, remuneration committees and integrated risk management committees. Requirement of minimum independent directors, rules and requirements pertaining to related party transactions and exposures and prescribed minimum disclosure requirements by the board of directors were effective in the SAARC region.

Capital

a) SAARC region has reformed its financial sector by introducing capital standards in line with the capital adequacy accords of Basel Committee on Banking Supervision of Bank for International Settlement, since 1992. India was the first country in the region to introduce these Basel I Capital Adequacy measures followed by Pakistan in 1997. Nepal introduced Basel II capital framework in the onset of global financial crisis in 2007 followed by Sri Lanka, India and Pakistan. India, Pakistan, Bangladesh, Nepal and Sri Lanka migrated to Base III introducing appropriate revisions to their regulatory frameworks while Bhutan implemented the relevant capital provisions under Basel III in 2017. As at End 2019, Afghanistan continued with Basel I accord while Bhutan and Maldives had effectively implemented Basel II capital standards in their jurisdictions.

Table 6: Basel Reforms on Capital Standards

Year of Implementation

	Base I	**Basel II**	**Basel III**
Sri Lanka		2008	2017
India	1992	2008-09	2013
Pakistan	1997	2008	2013
Nepal		2007	2015
Afghanistan	2006		
Bhutan	2005	2014	
Maldives	2009		
Bangladesh	2003	2009	2015

b) All SAARC countries had employed standardised approach in measuring risk weighted amount for credit risk. India had permitted banks to adopt Foundation Internal Rating Based (IRB) approach and advanced IRB approaches subject to Reserve Bank of India's approval.

Table 7: Credit Risk Measurement Methodologies Used in SAARC Countries

Credit Risk Measurement Methodology	Standardised Approach	India, Sri Lanka, Pakistan, Nepal, Bhutan, Maldives, Bangladesh
	Foundation IRB Approach	India
	Advanced IRB Approach	India

India, Sri Lanka, Pakistan, Nepal and Bangladesh adopt Standardised approach in measuring Market Risk for capital adequacy purpose. India, in addition to Standardised approach, has permitted banks to use internal model-based approaches.

Table 8: Market Risk Measurement Methodologies Used in SAARC Countries

Market Risk Measurement Methodology	Standardised Approach	India, Sri Lanka, Pakistan, Nepal, Bangladesh
	Internal Model Based Approach	India

Sri Lanka is the only country in SAARC region who has permitted banks to adopt all three alternative approaches for measuring operational risk subject to complying with qualifying criteria. Pakistan and Nepal have permitted their banks to adopt basic indicator approach and standardised approaches. India and Bhutan only practice basic indicator approach while Bangladesh practices standardised approach.

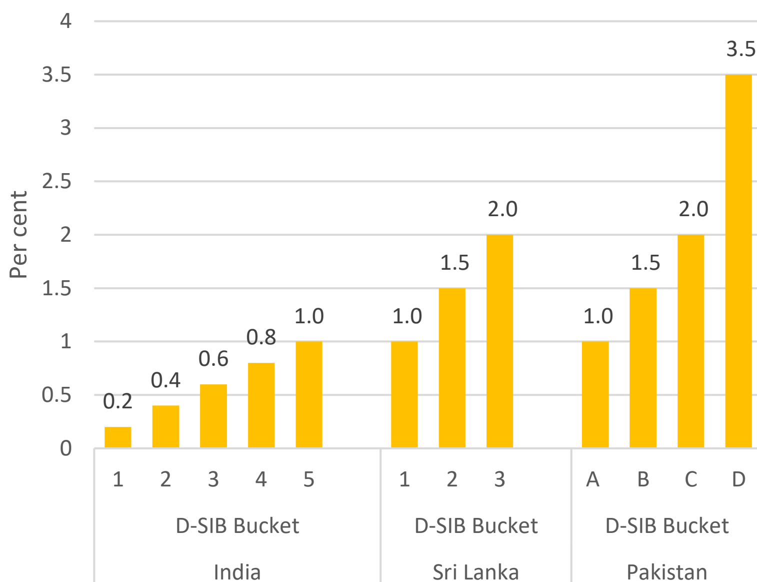
Table 9: Operational Risk Measurement Methodologies Used in SAARC Countries

Operational Risk Measurement Methodology	Basic Indicator Approach	India, Sri Lanka, Pakistan, Nepal, Bhutan
	Standardised Approach	Sri Lanka, Pakistan, Nepal, Bangladesh
	Advanced Measurement Approach	

c) Capital Conservation Buffer (CCB) is in place in six SAARC countries and the requirement has been 2.5 per of total risk weighted assets except in India where it was 1.88 per cent as at end 2019. India expects to complete its phases-in arrangement of implementing CCB in 2020. Maldives and Afghanistan have not implemented CCB in their jurisdictions as at end 2019.

d) The requirement of capital surcharge on Domestic-Systemically Important Banks (D-SIBs) is only available in three SAARC countries. Higher Loss Absorbency Requirement to be met with additional common equity Tier 1 expressed as a per cent of risk-weighted assets under different D-SIBs buckets have been illustrated below.

Chart 8: Higher Loss Absorbency Capacities under Different D-SIBs Buckets of SAARC Countries



e) Requirement of a capital surcharge on Global-Systemically Important Banks (G-SIBs) in not effective in the SAARC region except India. Despite India having the requirement, G-SIBs branch presence is not available in India.

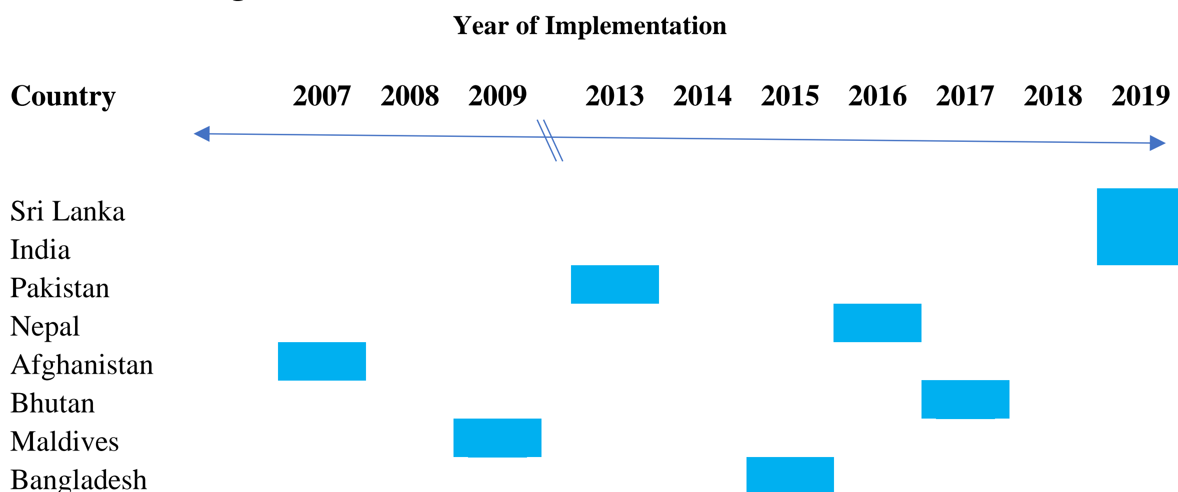
f) The requirement of countercyclical capital buffer (CCyB) is available in four SAARC countries viz. India, Bhutan, Sri Lanka and Nepal. In India current CCyB requirement is zero per cent and it is activated when the Credit to GDP Gap exceeds it long term trend by 3 per cent. In Nepal, implementation CCyB which was due in July 2020 was suspended due to COVID-19 pandemic. In terms of Banking Act Directions in Sri Lanka CCyB will be implemented as and when excess aggregate credit growth is judIn Bhutan, despite the requirement of CCyB as stipulated in regulations, it CCyB has not yet been implemented.

g) Minimum Capital Adequacy requirement of non-D-SIBs banks in SAARC region ranges between 9.0 per cent to 12.5 per cent of risk weighted assets. Indian non-D_SIBs had the lowest capital adequacy requirement amounting to 9.0 per cent while Sri Lankan, Pakistani, Bhutanese and Bangladeshi non-D-SIBs had the highest minimum capital adequacy requirement of 12.5 per cent as at end 2019.

h) Leverage ratio had been implemented in all countries in South Asian region and the ratio ranged from 3.0 per cent to 5.0 per cent. Afghanistan and Maldives were pioneers in

implanting this ratio. Bhutan and Maldives had the highest leverage ratio requirement of 5.0 per cent.

Chart 9: Leverage Ratio



i) India, Sri Lanka, Bangladesh and Afghanistan had the requirement for banks to submit the Internal Capital Adequacy Assessment Process (ICAAP) to their regulators under pillar II of Basel II Supervisory Review Process. India, Sri Lanka and Bangladesh required their banks to submit the ICAAP on an annual basis while Afghanistan required banks to submit it when needed.

j) Material ownership level of a bank that would trigger approval requirement by the supervisors in SAARC region range between 5 per cent to 20 per cent. Nevertheless, such a requirement does not exist in Afghanistan. India and Pakistan had the lowest material ownership level that triggered approval of the supervisors which stood at 5 per cent.

Branch Outreach

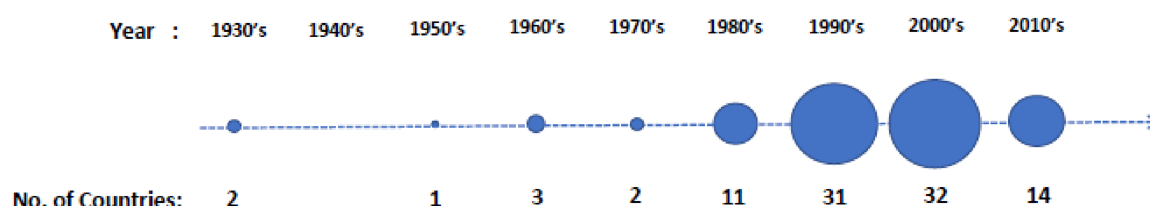
a) Sri Lanka, Pakistan and Bangladesh have regulatory rules on branch outreach to enhance financial inclusion and economic development in rural areas. These regulations ensure that certain percentage/ratio of total branches are established in rural suburbs.

3.4 Deposit Protection /Insurance

The establishment of deposit insurance schemes dated back to 19th century. The first deposit insurance scheme was established in US in 1934 to prevent bank runs which contributed to the great depression (Golembe 1960; Calomiris1990; Demirgüç-Kunt and Detragiache 2002). Since then, deposit insurance schemes have emerged as a key component of the financial systems to address threats related to the failure of deposit-taking financial institutions. These schemes contribute to the stability of the financial system by protecting small depositors when banks fail, maintaining public confidence to prevent bank runs and facilitating the exit of problem banks.

Studies highlight the benefits of deposit insurance arguing that having a stable and well-functioning banking sector is important for a country's economic development particularly when the banks dominate the financial sector (Anginer et al. 2014; Adema et al. 2019). In absence of the deposit insurance, state-owned banks might have a comparative advantage due to the implicit government guarantees for their deposits. Therefore, deposit insurance also provides a level playing field for private and smaller banks while increasing the public confidence and competition in bank sector (Ketcha 1999; Fecht and Weber 2019). However, deposit insurance can be counterproductive if it is not well structured. Specially, policy makers should weigh the moral hazard problem when establishing deposit insurance schemes. Market disciplines can be weakened if the government absorb all losses to the depositors when a depository institution goes bankrupt. This provides incentive for banks to invest in riskier assets than they would in the absence of deposit insurance while depositors are not motivated to exercise discipline in selecting a bank for their investments. FSF (2000) highlights the measures used by the policy makers to minimise moral hazard problem without negating the benefits of deposit insurance schemes. Imposing relatively low insurance-coverage limits, charging premiums based on the risk profiles of the financial institution, imposing losses on uninsured depositors, introducing personal liability incentives on directors and officers of banks to promote good corporate governance, requiring insured financial institutions to follow prudent accounting practices and to hold sufficient capital while promoting transparency are the main measures highlighted by the FSF(2000).

Chart 10: Timeline of number of countries establishing deposit insurance Schemes.



Source: International Association of Deposit Insurers, Annual Survey 2019

The Chart 10 shows that Majority of the countries in world have adopted deposit insurance schemes. Larger waves of adoption were observed during the two decades from 1990 to 2010.

A depositor protection scheme or a deposit insurance scheme was in place in all SAARC countries except Bhutan. Despite Afghanistan had no separate deposit insurance scheme, depositors are protected through comprehensive supervision of financial institutes. Deposit taking in the region is authorised for regulated financial institutions. Nevertheless, in Bangladesh, deposit taking is only authorised for schedule banks. Depositor protection scheme is mandatory for all authorised deposit taking financial institutions in SAARC countries where the depositor protection mechanism is effective. India, Pakistan and Nepal had a separate institutional infrastructure to operate deposit insurance scheme in their economies.

Table 10: Management Authority of Deposit Insurance in SAARC Region

Central Bank	Sri Lanka, Bhutan, Afghanistan, Maldives and Bangladesh
Separate Independent Authority	India, Pakistan and Nepal

Deposit Insurance and Credit Guarantee Corporation of India provides limited resolution by subvention in terms of financial support for mergers following the approval of the regulator. General scope of deposit insurance scheme in the region is to protect depositors from failure of financial institutions. However, in Sri Lanka, the scope of deposit insurance scheme also includes providing liquidity supports to member financial institutions against acceptable collaterals. Afghanistan, Maldives and Bangladesh have a deposit insurance premium that varies based on riskiness of member institutions. It appears that Afghanistan has pegged deposit insurance premium to CAMEL ratings of each member bank. Deposit insurance coverage in Nepal and Afghanistan is confined to ‘per depositor’ while for other SAARC member countries deposit insurance coverage is confined to ‘per depositor per financial institute’. In other SAARC countries heterogeneity in deposit exemption from deposit insurance scheme can be observed. None of the SAARC countries index the compensation payable to inflation, GDP and per capita income. Compensation payable to depositors in the region is fixed and is periodically reviewed for revisions. Upon cancellation/suspension of license of deposit taking institute, regional deposit

insurance schemes pay compensation to depositors within a specified period. In several SAARC countries, compensation is paid to depositors upon declaration of bankruptcy by the judicial.

Table 11: Events that Trigger Payments from Deposit Insurance Scheme in SAARC Countries

Court Declared Bankruptcy	India, Nepal, Maldives, Bangladesh
Suspension of License	India, Sri Lanka, Maldives
Cancellation of License	India, Sri Lanka, Nepal, Afghanistan, Maldives and Bangladesh

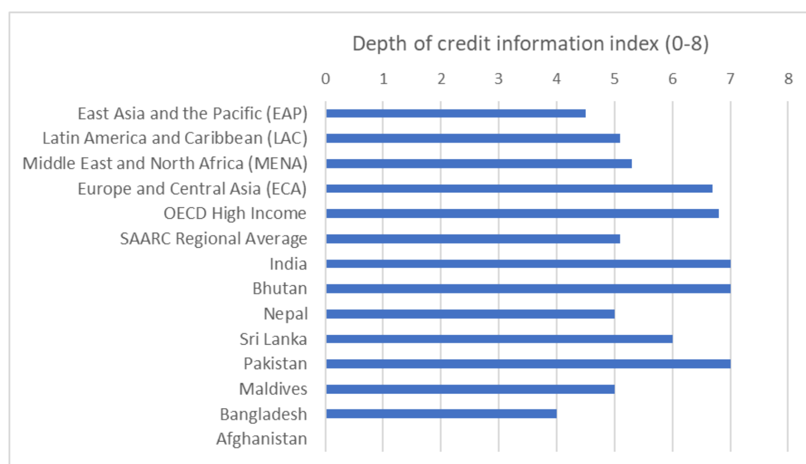
Note: In Pakistan, payments from Deposit Insurance is made when a member bank has been notified as a failed bank by the State Bank of Pakistan.

3.5 Developments in credit registries in South Asian Region

It is well accepted in economics that asymmetric information between the borrower and lender poses problems of adverse selection while disturbing market forces to determine the price of the credit or the interest rate (Stiglitz and Weiss 1981; Jaffee and Russell 1991). This asymmetric information problem contributes to deterioration in credit quality and profitability of the financial institutions due to the higher default rates and lower credit expansion. Therefore, reliable and transparent information on borrowers is a prerequisite for establishing a prudent risk management framework to ensure financial system stability. Credit registries support to address this issue by providing reliable information to financial institutions and regulators while improving credit market efficiency and preserving financial stability.

Today credit registries are one of the key components of any country's financial infrastructure. Financial institutions draw on credit registries to evaluate the prospective borrowers for new lending and monitor the existing loan portfolio to assess the risk. Empirical evidence proves that cost of borrowing of the financial institution can be reduced by improved availability of the credit information while enhancing the access to finance of underserved borrowers such as SMEs. Regulators employ the credit information to assess the contagion risk of financial institutions and systemically important borrowers. Information in credit registries can also be used to assess the dynamics of household sector and corporate sector debts particularly for macroprudential Surveillance.

Chart 11: Depth of Credit Information Index by Country/Region



Source: WB 2020

Credit information index compiled by the World Bank for doing business ranking measures rules and practices affecting the coverage, scope and accessibility of credit information available through a credit registry or a credit bureau. India, Pakistan and Bhutan recorded high standard of infrastructure for getting credit information with the reforms introduced by them for enhancing coverage, scope and accessibility of credit information.

All SAARC Countries had a mechanism to collect and record credit information of individuals and corporates in their respective jurisdictions. These credit information bureaus are regulated by the respective Central Banks with appropriate enactments and directives. Credit bureaus/registries in some nations were established/revived under financial sector reforms. India had four certified registered credit information companies while other SAARC nations had one credit information bureau/registry to record credit information. Provision of information to credit bureaus/registries by lending institutions is mandatory as per respective enactments. Scope of credit information collection in the region goes beyond the banking sector to cover non-bank financial institutions. However, Afghanistan confines its collection of credit information to licensed banks. Credit bureaus in SAARC countries have initiated providing value added services such as provision of credit scores, probability of defaults and other data analytic services.

4. Conclusions and Recommendations

South Asian region is heading towards achieving a high standard of integration for sustainable economic growth. Therefore, macroprudential policies will be subjected to a range of potential cross-border effects with the increase in regional integration. Studies highlight the positive and negative externalities of macroprudential policies in the region. Effective macroprudential policies

could support to contain the risk in one jurisdiction by reducing the scope for negative trade and financial spillovers at the regional or global level (Dimova *et al.* 2016; IMF 2014). On the other hand, macroprudential measures implemented by one jurisdiction to contain a systemic risk can influence off-shore lending by its domestic banks while creating undesirable spillovers for other jurisdictions. If the macroprudential actions are ill-timed, it could exert a pressure on financial sector and real sector of the regional countries. However, the negative spillovers could be avoided or minimized by designing the macroprudential tools with required calibration for the region. Therefore, these positive and negative externalities highlight the importance of regional coordination of macroprudential policies. Meetings among the heads of macroprudential authorities of the member countries would provide a forum to setup a mechanism for harmonization of macroprudential policies of the south Asian region. Although there is a heterogeneity in use of macroprudential policies among the member countries, harmonization of macroprudential policies in South Asian region may not be a challenge since the region is at formative stage in establishing macroprudential frameworks relative to the EU and few East Asian nations.

It is commonly accepted that the relevant and reliable information on dynamics of financial sector is a necessary ingredient for in-depth assessments and analyses required for macroprudential policy making. Therefore, demand for granular level cross sectional and time series data is high in the area of macroprudential surveillance. Although the Central Banks are in a better position to access the financial data of the institutions coming under their preview, the member countries have common challenges of getting granular level data due to shortfalls in data collection and automation. Further, member countries have limited access to non-financial sector data to complete the surveillance on sectors such as households, corporates and SMEs. As a result, limited use of corporate and household sector targeted tools for macroprudential surveillance is observed in South Asian region. Data on household sector and corporate sector is also lacking in the region. Some countries are trying to use alternative data sources such as information from credit registries to estimate the household and corporate sector exposure to formal financial institutions. However, quantifying borrowings from the informal sector and actual income of the household and corporate sector for formulation of macroprudential policies is a challenge for member countries.

Number of analytical approaches and models are used in macroprudential surveillance ranging from simple univariate and bivariate signaling to advanced machine-learning methods. However, there is a limited expertise in macroprudential surveillance as this is an emerging area in financial

sector. Macroprudential authorities of member countries use a wide spectrum of tools for their surveillance including dynamic stress testing, interconnected analysis and probabilistic models in forecasting and stability indicators while India is leading in this area in the region. Member countries used to get the technical assistance form IMF for adopting some advance multidimensional methodologies used in advanced economies. It is encouraged to share the technical know-how in macroprudential surveillance among the member countries which is a positive spillover of coordinated regulatory regimes of macroprudential surveillance in South Asian region.

Real estate sector is an emerging sector in South Asian region, and it provides a significant contribution to the regional economies. However, limited surveillance on real estate sector is observed in the region compared to the East Asian region. Limited digital information available on real estate transactions and valuations is the main obstacles in strengthening surveillance framework of the real estate sector in the south Asian region. It would be useful for all member countries to enhance the recording/reporting mechanisms of real estate transactions enabling their respective regulators to broaden surveillance on the real estate sector.

Rural sector accounts for the largest share of population in the SAARC region. Member countries may encounter common issues in empowering the livelihood of rural community where non-bank deposit taking institutes play a key role in enabling access to credit. Therefore, successful business models in the region could be studied to design appropriate macroprudential modalities for non-bank deposit taking institutions while strengthening its regulatory and legal frameworks.

Training Synergies between member countries could be reaped through trainings and knowledge sharing practices and should be promoted through the regional cooperation since all SAARC member countries are in the process of reforming and deepening their financial sectors to achieve prudential standards and best practices. Achieving prudential standards and best practices in regulations, financial products and shared financial infrastructure would promote the cross-border investments. This would originate positive spillovers such as labour market mobility in the region enabling financial institutions to access a large pool of skilled professionals required for their financial sector operations.

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1. Structure of the Financial System of Afghanistan

The financial sector of Afghanistan is comprised of banks, non-bank institutions and the central bank (Da Afghanistan bank). The distinction that exists in most other countries for formal and informal sector does not exist in Afghanistan Therefore, it is difficult to recognise informal sector in financial sector of Afghanistan. Some small firms enter the market without license but soon they come under the order of law and get their license to continue their business. The banking sector is mainly comprised of domestic banks, branches of foreign banks and the non-bank financial institutions are comprised of Money Service Providers (MSPs), Foreign Exchange Dealers (FXDs), Electronic Money Institutions (EMIs), FOREX companies, Depository Micro Finance Institutions and leasing companies. The market is dominated by Banks but the MSPs and FXDs also own a considerable share of the financial market. Stock and Bond markets, Stock exchange brokers, and Derivatives market has not been developed in this country yet.

The Banking Sector

The banking sector of Afghanistan is comprised of 12 banks that include domestic banks and branches of foreign banks with total banking sector assets of 314,360 Million AFN equivalent to 4.08 billion USD as of August 2020. Out of 12 banks, 3 of them are state owned banks, 6 private conventional banks, one full fledge Islamic bank, and 2 branches of foreign banks. Beside one full-fledge Islamic bank, we have 6 Islamic banking windows within the conventional banks.

Central Bank of Afghanistan (Da Afghanistan Bank)

One of the key functions of Da Afghanistan Bank is to issue or register license, regulate and supervise banks and non-bank financial institutions. Da Afghanistan Bank supervise banks, FX dealers, MSPs and conduct on-site inspection, off-site analysis and assessment, take, disciplinary measures and enforcement in order to ensure a sound and stable financial system.

Central bank of Afghanistan carryout these tasks through its financial supervision directorate general which is responsible to supervise and examine both banking and non-banking financial institutions in the country. Beside Financial supervision directorate, Da Afghanistan bank has 23 departments all together working to achieve the objectives of the central bank. The departments are listed below:

1. Governor's office department;
2. Monetary policy department;
3. Financial risk management department;
4. Banking supervision department;

5. Directorate of non-banking financial institutions;
6. Islamic banking and financial department;
7. Market operation department;
8. Comptroller general's office;
9. Financial dispute resolution commission;
10. FinTRACA;
11. Afghan deposit insurance corporation;
12. Public credit registry department;
13. Accounting and finance department;
14. Information technology department;
15. Human resources department;
16. Regulatory affairs department;
17. Banking operation department;
18. Payments department;
19. Financial sector strengthening projects department;
20. General services department;
21. Procurement department;
22. Financial Inclusion department; and
23. Dissolved Banks' Coordination and Oversight General Directorate.

Banking sector

Banks are established as per the banking law of Afghanistan, corporations and limited liability companies' law and are being obliged to obey all laws and regulations of Afghanistan. In case there is a gap in law, the central bank is authorized to issue circulars and fill the existing regulatory gap.

As per the banking law of Afghanistan, Banks are allowed to do the following activities:

- Receive money deposits in the form of demand deposits or other types of deposit or other repayable funds, bearing interest or not;
- Extend credits whether secured or not secured by collateral or liens;
- Buying and selling its own account or for account of customers: money market instruments including checks, bills of exchange and promissory notes and certificates of deposit, foreign currencies, precious metals and precious stones, exchange and interest rate instruments, stocks and other securities;
- Entering into contingent commitments including guarantees and letters of credit;

- Providing clearing and settlement and transfer services for money, securities and payment instruments;
- Money brokering;
- Safekeeping and administration of valuables including securities;
- Providing financial information and credit reference services, including general market economy information;
- Issuing electronic money; and
- Providing credit-related insurance to borrowers in connection with credit granted by the bank.

Table A1: Assets of the Banking sector as at end of August, 2020

No.	Names of Banks	Ownership type	Assets in million AFN	Size of Indv. Banks as % of Total Assets of the sector
1	Afghanistan International Bank	Private	69,001.33	21.95
2	Bank-e- Milli Afghan	State -Owned	45,284.36	14.41
3	Azizi Bank	Private	42,216.17	13.43
6	Maiwand Bank	Private	27,340.66	8.70
7	Afghan United Bank	Private	22,530.36	7.17
4	Pashtany Bank	State -Owned	22,522.32	7.16
8	Islamic Bank of Afghanistan	Private	22,481.62	7.15
5	New Kabul Bank	State -Owned	19,720.06	6.27
9	Ghazanfar Bank	Private	13,941.00	4.43
11	Bank Alfalah Limited	Branch of a Foreign bank	12,868.18	4.09
10	First Micro Finance Bank	Private	11,860.00	3.77
12	National Bank of Pakistan	Branch of a Foreign bank	4,594.76	1.46
Total			314,360.82	100.00

Non-Banking Financial Institutions

Non-bank financial institutions in Afghanistan1) Financial Leasing, 2) Money Service Providers (MSPs) and Foreign Exchange Dealers (FXDs), 3) Electronic Money Institutions (EMIs) and Payment Service Providers (PSPs), and 4) FOREX. The details of the Non-bank financial institutions are given below:

Money Service Providers (MSPs)/Foreign Exchange Dealers (FXDs) in Afghanistan:

Foreign Exchange Dealers (FXDs) sole proprietorship has a long history in Afghanistan as Non-Banking FIs it dates back to pre-existence of banking system in Afghanistan. Indeed, this sector

has been providing its services since over 80 years. Therefore, due to its long history in Afghanistan, the trust of the people on this sector is much higher. There are approximately 3000 licensed MSPs and FXDs, and about 300 unlicensed MSPs & FXDs (hand sellers)operating in the non-banking sector of Afghanistan.

Distinguish between MSP and FXD:

MSPs sole proprietorships are providing the following services according to MSPs and FXDs regulation, and it is called Hawala dealer as well.

- Inward and outward Remittances,
- Exchange the currency,
- Cheque to cash,
- Currency forward contract,
- Participate in DAB dollar’s auction process,

Foreign Exchange Dealers (FXDs) sole proprietorship is providing the bellow services.

- Exchange the currency,
- Currency forward contract,
- Participate in DAB dollar’s auction process,

MSPs and FXDs sole proprietorship are limited pursuant to MSPs and FXDs regulation; they can have only 3 branches for their businesses throughout the country.

Foreign Exchange hand sellers are the first foreign currency sole proprietorship dealers in Afghanistan, which are still operating illegally in Afghanistan’s financial market. They have no shop, so they are working beside the roads, in front of the financial markets and business markets. As mentioned earlier, they are not licensed.

Structured MSPs and FXDs institutions (companies):

Da Afghanistan Bank decided to transfer FXDs and MSPs from a sole proprietorship into a well-structured and regulated financial institution to have a standard MS and FX providing system to comply with laws and regulations of Afghanistan and international standards and best practices, so that they can provide cross-selling in addition to the above mentioned legal services. Also, they can open unlimited branches for their business. Therefore, new structured MSP and FXD licenses are recently issued to only three companies and they are working in the mentioned sector as Joint Stock Company.

Microfinance Sector

The Microfinance emerged in Afghanistan in the year 2002 as a part of the rehabilitation process to provide an alternative means of livelihood to the poor after the fall of the Taliban regime in 2001. Nearly all of the Microfinance institutions were in NGO's (Non-government organisations) category.
The microfinance sector developed after the setup of Microfinance Investment Support Facility for Afghanistan (MISFA) in 2003 at the invitation of Afghan government. It was established as a vehicle through which the Afghan Government and international donors could channel technical assistance and funding to build Afghanistan's microfinance sector.

Recently, MISFA registered as a limited liability non-profit company whose sole shareholder is the Ministry of Finance of the Islamic Republic of Afghanistan. MISFA functions as either the exclusive or primary provider of funds to its partners. The legal status of microfinance institutions has been transformed from NGO's to that of non-profit companies registered with the Afghanistan Investment Support Agency (AISA) under the Ministry of Commerce and Industry as a permanent institution under the Law of Afghanistan. .MISFA is sponsored by donors, international development agencies and the Government of Afghanistan.

The total number of MFI's increased to around 15 after 2003 and then dramatically declined within few years due to lack of security and funding. Nowadays, we have four MFI's entities which offer microfinance service and these MFIs exist in different legal forms; in the form of the bank (First Microfinance Bank) and in the form of a non-profit organization. They are active across the country covering 14 provinces and 81 districts. The non-profit organization are affiliated to MISFA and FINCA (FINCA is an international non-profit corporation).
The above mentioned MFI's are not yet licensed and supervised by Da Afghanistan Bank (The Central Bank of Afghanistan). However, they will be coming under the supervision of Da Afghanistan Bank soon after getting the approval for amended Law.

Financial Leasing Sector:

Currently, there are no financial leasing companies licensed in Afghanistan. The International Finance Corporation (IFC) of the World Bank's group signed an agreement with Da Afghanistan Bank (DAB) to develop the leasing sector in Afghanistan through the creation of enabling legislation and capacity-building activities to various stakeholders. IFC and DAB started to improve the legal framework for financial leasing in the country. DAB has taken following action to establish leasing industry in the country.

Enactment of the Leasing Law, based on the UNIDROIT Model which is considered a global best practice in April 2014, and adoption of the Leasing Regulation by DAB's Supreme Council in December 2015 Are among them. In 2008, DAB created leasing unit within Financial Supervision Department. The leasing unit is responsible for supervising and regulating the financial leasing sector; drafting leasing law, regulation, circular, and procedure for financial lease; and developing subsequent amendments if required.

Currently, the Financial Supervision Department is working and is in close coordination with IFC to revise and update the legal framework for the financial leasing sector.
DAB's aim is to create an enabling environment through clear law and regulation for all types of entities that enter into leasing sector, i.e. Banks, independent leasing companies and captive leasing companies.

Electronic Money Institutions (EMIs):
In Afghanistan, the field of electronic money is regulated by Da Afghanistan Bank mainly under Electronic Money Institution's Regulation. Da Afghanistan Bank is responsible for licensing and inspection of Electronic Money Institutions (EMIs) or licensed Mobile Money Operators and Retail Payment service providers in the country.

Based on EMIs regulation, Non-Bank-led model especially MNO-led model is allowed to offer electronic money services in Afghanistan. But authorized commercial banks can also offer electronic money services under the current banking law and regulations.
Currently, Electronic Money Institutions are regulated by a Section operates under the Non-Banking Division of Financial Supervision Department. This section has two following deputy sections:

- Mobile Money Deputy Section which deals for Electronic Money institutions (EMIs); and
- Retail Payment Deputy Section which deals with Retail Payments or Payment Service Providers (PSPs)

There are three Electronic money institutions as bellow which are authorized by DAB:

- 1) Mobile Service Development Afghanistan (MSDA)/M-Paisa) – a fully subsidiary of Roshan telecommunication company which was established in 2011;
- 2) m-Hawala – a fully subsidiary of Etisalat Afghanistan Telecommunication Company which was established in 2013; and

- 3) Afghan Besim Mobile Money Company (ABMMC)/My-Money) – a fully subsidiary of Afghan Wireless Communication Company which was established in 2014.

EMIs Products and Services:

- Cash-in
- Cash-out
- Person-to-person payments (P2P)
- Loan Disbursement
- Loan Repayment
- Salary payment
- Airtime Top-Up
- Merchant payments
- Bill Payments

FOREX

Besides not being licensed by DAB, after a survey conducted it was found that currently three companies are delivering FOREX services in Afghanistan except for FOREX brokers which are linked with the foreign FOREX companies. Basically, the FOREX services have a history of more than two decades in Afghanistan and there are currently three to four thousand FOREX accounts which are traded in the country and approximately 30000 trades of FOREX are getting placed on daily basis.

According to the action plan and the current affairs of FOREX section within DAB, it is working on Forex regulatory framework; FOREX supervisory manual; FOREX licensing criteria and public awareness programs regarding FOREX activities. After drafting and provisioning of the mentioned tools, DAB will be able to license FOREX companies operating and potential future companies in Afghanistan.

Major banking sector reforms

Financial sector reforms have been taken place in Afghanistan from time to time and specifically from 2003 beside some challenges including insecurity and war. Some of these reforms include:

1. All laws and regulations has been revised/newly developed which are also available to download from www.dab.gov.af;
2. Some banks which existed previously were merged and created a new bank;
3. Two foreign bank branches have been closed;

4. There have been actions taken on AML/CFT issues including enactment of AML/CFT law and related regulations;
5. ML/TF National Risk Assessment (NRA) has taken place for the first time;
6. Cooperation with international organisations and counterparts has been continuously going on;
7. Some reforms regarding collateral requirements and ease of financing have taken place;
8. Measures for development of SME sector and SME financing is continuously going on;
9. Beside the outbreak of COVID-19, The banking sector has been smoothly continuing its operations;
10. Some new departments within Da Afghanistan Bank have been established.

2. Structure of the Financial Sector in Bangladesh

The key features of Bangladesh financial system are its segmented market operations and limited openness with the global system. However, like many other countries, the financial system of Bangladesh is comprised of three broad fragmented sectors: i) Formal Sector, ii) Semi-Formal Sector, and iii) Informal Sector. The sectors have been categorized in accordance with their degree of regulation. The formal sector includes all regulated institutions like banks, non-bank financial institutions (NBFIs), insurance companies, capital market intermediaries such as stock bourse, brokerage houses, merchant banks etc., and microfinance institutions (MFIs). The regulatory and supervisory arrangements for these entities are well defined with strong legal framework, and prudential and regulatory underpinnings. While the semi formal sector includes those institutions which are regulated otherwise but do not fall under the jurisdiction of central bank, Insurance Authority, Securities and Exchange Commission or any other enacted financial regulator. This sector is mainly represented by specialized financial institutions. In contrast, the informal sector includes private intermediaries that provide short-term lending facilities based on personal contacts and which are completely unregulated. Chart 1 represents a snapshot of the structure of financial sector of Bangladesh and the detailed and developments of the main contributing sectors are discussed in this section below.

2.1 Formal Sector's financial institutions

The formal sector's FIs are most organized and well regulated by enacted acts and laws. The sector almost covers the largest segment of financial sector in Bangladesh. However, the sector includes banks, NBFIs, insurance companies, capital markets and MFIs and providing financial services across the country. Banks and NBFIs are regulated by the Bangladesh Bank (BB), the Central Bank of Bangladesh; insurance companies are regulated by the Insurance Development and Regulatory Authority (IDRA), capital market intermediaries are regulated by the Bangladesh Securities and Exchange Commission (BSEC) and MFIs are by Microcredit Regulatory Authority (MRA). The formal sector's FIs are discussed in brief according to the regulatory framework. However, a large segment and well-regulated financial institutions come under the central bank of Bangladesh and their shares in assets and liabilities are shown in Table 1.

2.1.1 Central Bank (Bangladesh Bank)

Bangladesh Bank, the central bank and apex regulatory body for the country's monetary and financial system, was established in Dhaka as a body corporate vide the Bangladesh Bank Order, 1972 (P.O. No. 127 of 1972) with effect from 16th December, 1971. At present it has ten offices

located at Motijheel, Sadarghat, Chattogram, Khulna, Bogra, Rajshahi, Sylhet, Barishal, Rangpur and Mymensingh in Bangladesh. BB performs all the core functions of a typical monetary and financial sector regulator, and a number of other non core functions. The major functional areas include : formulation and implementation of monetary and credit policies, regulation and supervision of banks and non-bank financial institutions, promotion and development of domestic financial markets, management of the country's international reserves, issuance of currency notes, regulation and supervision of the payment system, acting as banker to the government , money laundering prevention, collection and furnishing of credit information, implementation of the Foreign Exchange Regulation Act, managing a Deposit Insurance Scheme. The BB pursues monetary policy on half-yearly basis in line with government's growth target, employment generation and poverty reduction; while ensuring price and financial stability–announces the Monetary Policy Statement (MPS) at every January and July publicly. The BB uses instruments– open market operations (OMO) and as what is necessary.

2.1.1.1 Banking sector

In Bangladesh, banks have traditionally been the most important financial intermediaries and played a central role in supporting the growth process by mobilizing savings to investment across the country. There are two types of banks operating in Bangladesh – scheduled banks and non-scheduled banks.

Scheduled banks

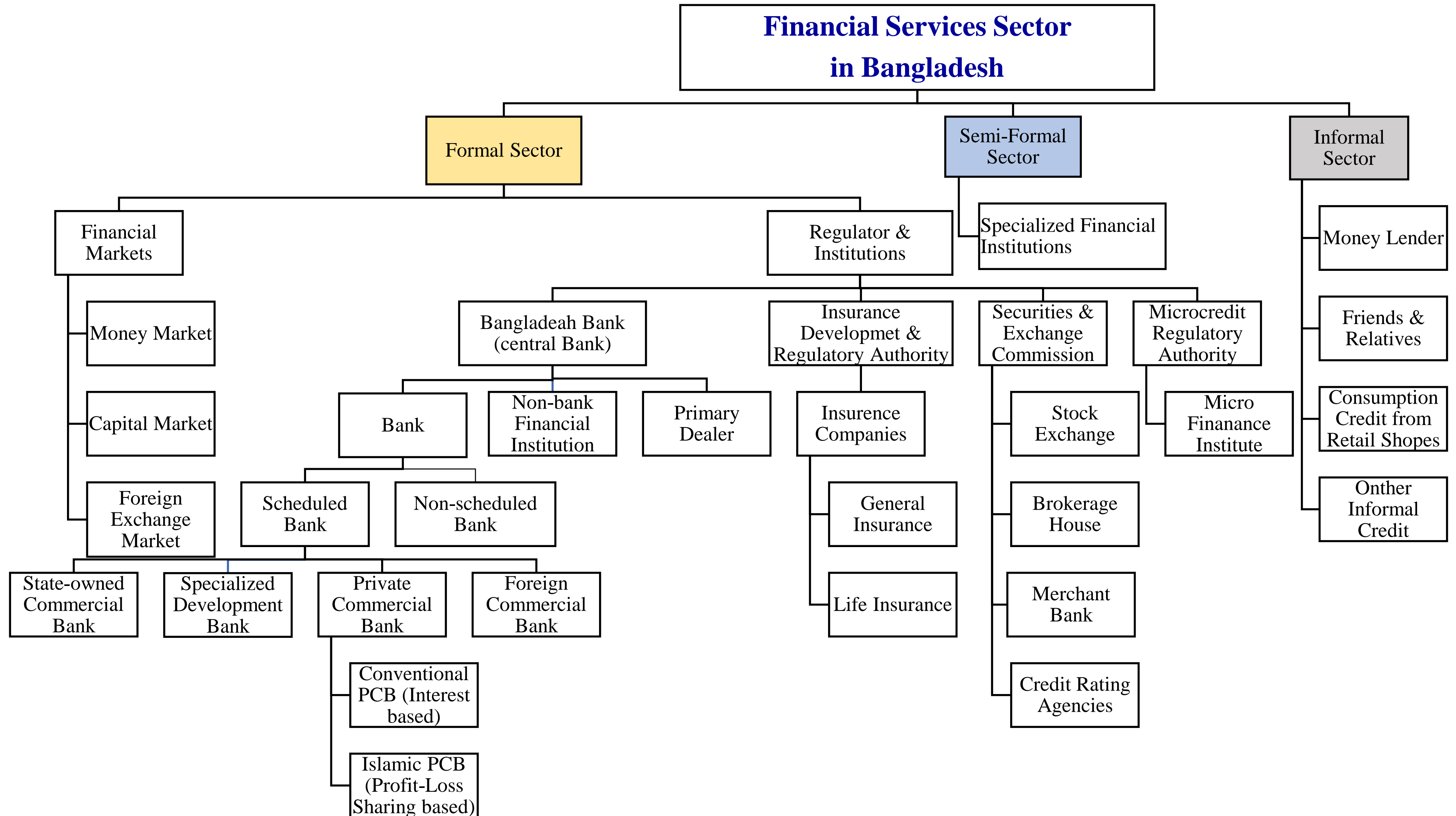
The banks that remain in the list of banks maintained under the Bangladesh Bank Order, 1972 and Bank Company Act, 1991 are the scheduled banks. These banks operate their functions under full control and supervision of Bangladesh Bank (the central bank of the country) which is empowered to do so through Bangladesh Bank Order, 1972. In Bangladesh, scheduled banks generally mean the banking sector, comprises four categories– state-owned commercial banks (SCBs), state-owned specialized development banks (SDBs), private commercial banks (PCBs)– domestic owned, and foreign commercial banks (FCBs). After the independence, the industry in Bangladesh started its journey with 6 nationalized commercialized banks, 3 state-owned specialized banks and 9 foreign banks. In the meantime, banking industry achieved a significant expansion with the entrance of private banks. Presently, there are 58 scheduled banks operating their banking activities of which 6 SOCBs which are fully or majorly owned by the Government of Bangladesh; 2 SDBs are operating for specific objectives like agricultural development those are also fully owned by the Government of Bangladesh. There are also 41 private commercial banks which are

majorly owned by individuals/the private entities. However, PCBs can be categorized into two groups– conventional PCBs (33) those perform the banking functions in conventional fashion i.e interest based operations and on the other hand, Islami Shariah based PCBs (8) those are execute banking activities according to Islami Shariah based principles i.e. Profit-Loss Sharing (PLS) mode. Besides, 9 FCBs (including one Islami Shariah based) are also operating in Bangladesh as the branches of the banks which are incorporated in abroad.

Non-scheduled banks

Non-scheduled banks are the banks which are established for special and definite objective and operate under any act but are not scheduled banks. These banks cannot perform all functions of scheduled banks but works on special objective emphasizing development a particular group of people. There are 5 non-scheduled banks in Bangladesh which are: Ansar VDP Unnayan Bank, Karmashangosthan Bank, Jubilee Bank, Palli Sanchay Bank.

Chart B1: Structure of the financial services sector in Bangladesh



2.1.1.2 Non-bank financial institutions (NBFIs)

Non-Bank Financial Institutions (NBFIs) are those types of financial institutions which are regulated under Financial Institution Act, 1993 and controlled and supervised by the Bangladesh Bank. Now, 34 FIs are operating in Bangladesh while the maiden one was established in 1981. Out of the total, 2 is fully government owned, one is the subsidiary of a SOCB, 15 are private and 15 are joint venture initiatives. Major sources of funds of NBFIs are term deposit (at least three months tenure), credit facility from banks and other FIs, call money as well as bond and securitization. The major difference between banks and NBFIs are as– NBFIs cannot issue cheques, pay-orders or demand drafts; cannot receive demand deposits; cannot be involved in foreign exchange financing. However, NBFIs can conduct their business operations with diversified financing modes like syndicated financing, bridge financing, lease financing, securitization instruments, private placement of equity etc.

2.1.1.3 Primary dealers

Bangladesh Bank introduced the Primary Dealer (PD) system in 2003. The system has been enhanced with incentives and liquidity support against collateralized securities from the central bank. Bidding commitments for TBs and underwriting obligations for BGTBs applicable to PDs were introduced in 2007 to strengthen their role as market makers in the government securities market. The BB's efforts for balanced allocation of government securities among the banking companies are continued. According to the latest mechanism the bidding obligation of each PD is equal to its underwriting obligation; the total of the bidding obligations is equal to the full notified amount of each auction. The total bidding/underwriting obligation will be allocated to individual PD on the basis as i) the obligation will be divided into two segments – a portion based on total demand and time liabilities (TDTL) of the PDs and the rest will be equally divided among the all PDs. The obligations and the ratio of the two segments will be announced by BB on a quarterly basis. BB will consider the TDTL of the 2nd month of the last quarter as the basis for allocating the underwriting obligations of the next quarter. PDs may also submit non-competitive bids on behalf of individual or institutional clients who have no current account with BB. PDs can submit noncompetitive bids on behalf of BB's "Amanat Bima Trust Tahabil" as an exception. The accepted amount of non-competitive bids in an auction will not exceed 30 percent of notified amount, allocated on pro-rata basis among the non competitive bidders at the weighted average rate/price of competitive bids accepted in the same auction.

If the notified amount in an auction is unsubscribed or the auction committee decides to accept an amount less than the notified amount, the remaining amount will be devolved on the PDs according to their underwriting obligations on pro-rata basis. BB may at its discretion take full or some portion of the devolvement on itself from time to time. The maximum amount that can be devolved on a PD will be equal to its underwriting obligation less the amount of its successful bids in that auction. All devolvement on PDs will be at the cut-off yield of that auction and PDs will be eligible for underwriting commission on the total amount of its successful bids and devolvement on it, not exceeding the amount of its bidding/underwriting obligations.

Table B1: Total assets of the financial sector of Bangladesh (at end 2017)

Institutions	Assets	
	BDT in billion	% share
A. Bangladesh Bank (the Central Bank of Bangladesh)	3144.6	18.4
B. Scheduled banks	13059.3	76.6
i. State owned commercial bank	3379.5	19.8
ii. Developments banks	317.6	1.9
iii. Private commercial banks	8758.3	51.4
iv. Foreign commercial banks	603.9	3.5
C. Non-bank financial institutions	841.1	4.9

Source: Annual Report 2017-2018, Bangladesh Bank

2.1.2 Insurance industry

Insurance sector in Bangladesh emerged after independence with 2 nationalized insurance companies (one Life and one General) and one foreign insurance company. In mid 1980s, private sector insurance companies started to enter in the industry and it got expanded. Presently, 62 companies are operating under Insurance Act 2010. Out of them- 18 are Life Insurance Companies including one foreign company and one is state-owned company, and 44 General Insurance Companies including one state-owned company. Insurance companies in Bangladesh provide services such as life insurance, general insurance, reinsurance, micro-insurance, and takaful or islami insurance.

2.1.3 Microcredit financial institutions (MFIs)

Microfinance has built a solid track record as a critical tool in the fight against poverty and has entered the financial mainstream. The rapid growth of the industry over the past 15 years has reached approximately 130 million clients according to recent estimates. Yet microfinance still reaches less than 20 percent of its potential market among the world's three billion or more poor.

Microfinance is an integral part of Bangladesh's economy–providing financial services for poor people as a powerful instrument for reducing poverty, enabling them to build assets, increasing incomes, and reducing their vulnerability to economic stress. Microfinance services such as savings, loans, and money transfers enable poor families to invest in enterprises, better nutrition, improved living conditions, and the health and education of their children. It has also been a powerful catalyst for empowering women. Microfinance has also been viewed as an inclusive financial program because it targets and reaches the poor, especially women, as well as small producers and entrepreneurs, who have often limited access to formal financial institutions. As its roles has become more diversified over time, microfinance has become more appealing to policy makers as an instrument for promoting universal access to finance rather than simply microcredit for employment generation and poverty reduction. Microfinance programs (MFP) in Bangladesh are mainly implemented by various formal financial institutions (nationalized commercial banks and specialized banks), specialized government organizations and Non-Government Organizations (NGOs)–the dominating sector proving a large segment of micro credit in the rural financial market (RFM) of Bangladesh. These institutions are well known as microfinance institutions (MFIs) and are generally member-based.

In Bangladesh, the growth in the MFI sector, in terms of the number of MFI as well as total membership, was phenomenal during the 1990s and continued till before enactment the Microcredit Regulatory Authority Act 2006. Microcredit Regulatory Authority (MRA) has been established by the Government of the People's Republic of Bangladesh under the "Microcredit Regulatory Authority Act 2006" to promote and foster sustainable development of microfinance sector through creating an enabling environment for NGO-MFIs in Bangladesh. MRA is the central body to monitor and supervise microfinance operations of NGO-MFIs. License from the Authority is mandatory to operate microfinance operations in Bangladesh as an NGO. But, Grameen Bank is out of the jurisdiction of MRA as it is operated

under a distinct legislation- Grameen Bank Ordinance, 1983. Despite the fact that more than a thousand of institutions are operating microcredit programs, but only 10 large MFIs and Grameen Bank represent 87 percent of total savings of the sector and 81 percent of total outstanding loan of the sector. Through the financial services of microcredit, the poor people are engaging themselves in various income generating activities and around 30 million poor people are directly benefited from microcredit programs. Credit services of this sector can be categorized into six broad groups: i) general microcredit for small-scale self employment based activities, ii) microenterprise loans, iii) loans for ultra poor, iv) agricultural loans, v) seasonal loans, and vi) loans for disaster management. In Bangladesh, around 65 percent of the total rural populations are somehow linked with MIFs.

2.1.4 Capital Market

Bangladesh Securities and Exchange Commission (BSEC) is the regulatory authority of capital markets in Bangladesh. There are two main bourses in the market are- the Dhaka Stock Exchange Limited (DSE) and the Chittagong Stock Exchange Limited (CSE). In both these bourses trading are conducted using Computerized Automated Trading System. The two exchanges are self-regulated and private sector entities must have their operating rules approved by the BSEC.

2.1.4.1 Bangladesh Securities and Exchange Commission

The Bangladesh Securities and Exchange Commission (BSEC) was established on June 8th, 1993 through the enactment of the Securities and Exchange Commission Act, 1993 as a capital market regulator with a mandate to ensure proper issuance of securities, protection of the interest of investors in securities, developments of the capital and securities markets, and regulation of the capital and securities market in Bangladesh. The Commission is a statutory body and is attached to the Ministry of Finance, Government of the People's Republic of Bangladesh. The Commission consists of the Chairman and four commissioners who are appointed for full time by the Government and have the overall responsibility to administer securities legislation. The Chairman acts as the Chief Executive of the Commission. The Commission formulates capital market related laws, rules and regulations for capital markets and related stakeholders such as issuer companies, stock exchanges, the intermediaries and institutions related with capital market. The Commission is responsible for monitoring the

activities of DSE and CSE, Merchant Bankers, Portfolio Managers, Mutual Funds, Stock-Brokers/Dealers, Issues and all other intermediaries as well as institutions operating within and externally for the securities market. BSEC is an 'A' category member of International Organization of Securities Commission (IOSCO) since December 2013.

2.1.4.2 Dhaka Stock Exchange Limited

The Dhaka Stock Exchange (DSE) Limited began formal trading in 1956. It was established on April 28th, 1954 and was named as East Pakistan Stock Exchange Association Limited (EPSEA). Few years later its name was changed to East Pakistan Stock Exchange Limited (EPSE) on June 23rd, 1962 and finally on May 13th, 1964 it was renamed as Dacca Stock Exchange Limited. After the independence of Bangladesh, DSE restarted trading on August 16th, 1976. DSE is a self-regulated, non-profit organization and its Council is the highest policy making body of the stock exchange. Its membership is pursuant to the Dhaka Stock Exchange Council and Administration Regulation 2000. The DSE calculates three major indices to reflect market behaviour namely i) DSE Broad Index (DSEX), ii) DSE 30 Index (DSE30) of top 30 companies and iii) DSEX Shariah Index (DSES). The indexes– DSEX and DSE30 were introduced in January 28, 2013 by taking technical assistance from S&P Dow Jones.

2.1.4.3 Chittagong Stock Exchange Limited

The second bourse of Bangladesh capital market, the Chittagong Stock Exchange (CSE) Limited, was set up in 1995 and it began formal trading on October 9th, 1995. It is also a self-regulated, non-profitable organization like the DSE. Council membership and processes are similar to that of the DSE. The exchange is administered under the Chittagong Stock Exchange (Board and Administration) Regulations, 2000 and also calculates four types of share price indices: i) CSE all share price index (CASPI), ii) CSE selective index (CSE30), iii) CSE selective categories index (CSCX) and iv) CSE all Shariah index (CSI).

2.1.4.4 Central Depository Bangladesh Limited

The Central Depository Bangladesh Limited (CDBL) the depository for paperless, electronic issuance and trading of securities was accorded registration under the Depository Rules 2000. Legal basis for CDBL's operations is set out in the Depositories Act 1999, Depositories Regulations 2000, Depository (User) Regulations 2003, and the CDBL Bye Laws. The CDBL

initiated its business operations by the end 2002. Live operations of the CDS commenced with the inauguration of the Electronic Government Securities Registry (EGSR) by the Governor of Bangladesh Bank on 20th October 2003. The EGSR also serves as a platform for secondary market sale/purchase as well as Repo transactions of government securities to commercial banks which are linked online to the Central Depository System (CDS) operated by CDBL. Equity market securities dematerialization process, script-less electronic securities transactions i.e. eliminating physical certificate as record of security ownership and substituting it with an electronic book entry record in the CDS commenced on January 24th, 2004 with the entry of Square Pharmaceuticals Limited into the CDS through CDBL. Network connectivity to Depository Participants (DP), Issuers, Banks, Stock Exchanges and Bangladesh Bank is through Front End interfaces accessed by WAN link and dial-up telephone lines.

CDBL's core services cover the efficient delivery, settlement and transfer of securities through computerized book entry system which includes recording and maintaining securities accounts and registering transfer of securities; changing the ownership without any physical movement or endorsement of certificates and execution of transfer instruments. The CDS has proven to be a convenient and reliable means to settle securities transaction. The investor has been freed from the hassles of physical handling of certificates, errors in paper work and the risks associated with damaged, lost and forged certificates.

2.1.4.5 Intermediately institutions

In Bangladesh, there is some other institution plays a key role in the capital market that acts as mediator on a link between parties/investors, such as stock dealer/stock broker, merchant banker and portfolio manager, asset management companies, credit rating companies, and trustees/custodians.

2.2 Semi-formal sector's financial institutions

The semi formal sector comprises some specialized financial institutions which are regulated by different departments of the government and otherwise but do not fall under the jurisdiction of central bank, Insurance Authority, Securities and Exchange Commission or any other enacted financial regulator. This sector includes institutions like Bangladesh House Building Finance Corporation (BHBFC), Palli Karma Sahayak Foundation (PKSF), Samabay Bank, and

Grameen Bank. Some Non Governmental Organizations (NGOs) and discrete government programs also act as semi-formal financial institutions for doing such activities.

2.3 Informal sector's financial Institution

The informal sector includes private intermediaries such as landlords, neighbours, shopkeepers, rich farmers, itinerant traders, marketing intermediaries, village moneylenders and other local income groups and also includes friends, relatives, kin members that provide short-term lending facilities to the poor based on personal contacts. The lending of this sector is well known as informal credit. Informal credit markets exist in both urban and rural areas where institutional credit facilities are absent or insufficient to cater to the needs of local professionals of different categories. However, the market dominates in the remote rural areas. The borrowers of this credit are mainly low income groups such as small farmer, landless farmer/share cropper, petty trader, rickshaw puller and so on. The most common forms of credit are rin/borrowing, karja/hawlat, bandaki rin, dadan, etc. Rin/borrowing refers to a loan requiring cash payment of both principal and interest. Dadan is a loan to the farmers which is given in cash for production of a crop or manufacture of a product and is to be repaid in the form of produce, the price of which is predetermined usually at lower than the normal market rate. Many studies find the interest rate that accumulated in the informal sector is very high and it is accounted at compound rate. Karja or hawlat refers to a loan without interest, usually from friends, relatives, neighbours and well-wishers. The informal credit is used for both consumption and capital purposes. Consumption purposes include meeting expenses in food, clothing and medicine/treatment, as well as various household expenses and expenses on occasions like marriage ceremonies or festivals. Capital purposes include meeting costs of agricultural inputs, buying livestock and land, investment in businesses or small ventures such as running a tea/grocery shop, buying a rickshaw, organizing inventory for vending etc, paying for workers, and meeting expenses for the education of children. Informal credit is also used to finance traditional rural businesses in commodities such as paddy or other agricultural products, handloom cloth, etc. However, the informal sector of financial sector till completely unregulated.

2.4 Financial Liberalization and Banking Reforms in Bangladesh

Bangladesh inherited its banking system from the British colonial regime. There were 44 banks working in erstwhile Pakistan before the partition of India and Pakistan. Following the

emergence of Pakistan in 1947, 36 banks were in operation till 1971. Just after the liberation of Bangladesh, the whole banking system (excepting a few foreign bank branches) was restructured and nationalized. During 1972-1982, the banking system used to operate under a regime of rigid government control and central bank regulations. During the period, the banking system expanded very rapidly, specially for providing banking and credit services in the rural areas. On the other hand, the banks were motivated and directed to channelize credit to national priority sectors such as nationalized industries, small entrepreneurs, farmers etc. It is a fact that because of the rapid expansion of bank branches and services, the financial soundness as well as quality of services to a great extent was adversely affected.

2.4.1 Banking Reforms - First Phase (1971–2000)

With the gradual change in economic policy towards a more market based system, the government in early 1980 encouraged private sector banks to flourish in the country. It was expected that as a result of a process of reform of the NCBs, some privatization and the emergence of a number of new private banks, banking services would reduce their spread within the managerial capacity of the banks and thereby improve services to their clients. Accordingly, in response to the call of the government some of the private banks (Arab Bangladesh Bank limited, National Bank Limited, IFIC Bank Ltd., and Islami Bank Bangladesh Limited) have started their banking operation. With the success of the new private banks and keeping in view the performance of loss recurring NCBs, government disinvested or transferred the Uttara Bank and the Pubali Bank in the private sector during 1984-85.

Only privatization was proved not enough in bringing about desired improvement in the financial sector in Bangladesh owing to a number of deep- seated structural problems. Interest rates, despite modest attempts to liberalize, remained administered. Banks remained under a regime of rigid government and central bank control. Directed credit channeled to the priority sectors which did not cover the cost of funds and the risk of lending. There were widespread loan defaults and delinquencies. The credit delivery and recovery system was poor and defective.

In this backdrop, the first phase of a Financial Sector Reform started in 1990. The program was an outcome of the recommendations put forward by the National Commission on Money, Banking and Credit and a World Bank study. The principal objectives of the reform were

liberalization of interest rates, adoption of indirect control in monetary management, creation of credit information bureau, enactment of Money Loan Court Act & Bankruptcy Act to improve debt recovery, declaration of convertibility of taka on current accounts, strengthening the nationalized commercial banks and improving the Bangladesh Bank's prudential regulation and supervision. These policy measures however could not take the economy into dramatic development because of inherent rigidities.

2.4.2 Banking Reforms - Second Phase (2001–2009)

The Second Phase reforms, started in late 2001, were home grown and introduced after discussions with the banking industry. The reforms accorded greater flexibility to the banking system to manage both the pricing and quantity of resources. Since then Bangladesh Bank is continuously replacing authoritarian guidelines with general guidelines and now leaves it to individual banks' boards to set their guidelines on credit decisions. The mandatory component of market financing of Government borrowing is being decreased gradually. Some major items of these reforms are:

- To strengthen the banking system to cope up with the changing environment, prudential standards have been imposed in a progressive manner. Thus, while banks have greater freedom to take credit decisions, prudential norms setting out capital adequacy norms, asset classification, income recognition and provisioning rules, exposure norms, and asset liability management systems have helped to identify and contain risks, thereby contributing to greater financial stability.
- Prudential regulation and supervision norms have been progressively tightened over the years. A supervisory strategy comprising on-site inspection, off-site monitoring and control systems internal to the banks, based on the CAMELS methodology for banks have been instituted. BB has also instituted a mechanism for the presentation of BB's onsite inspection reports before their boards to provide an external assessment of the health of the bank.
- Bank exposures to sensitive sectors such as equity and real estate have been curtailed. The Bank Companies Act 1991 limits connected lending (i.e. lending by banks to directors or companies in which directors are interested).
- Appropriate legal, institutional, technological and regulatory framework has been put in place for the development of financial markets. There is now increased transparency in respect of financial sector operations. The format of income statements and balance sheets

of commercial banks are prescribed by the BB with disclosure standards on vital performance and growth indicators, provisions, net NPAs, etc. appended as 'Notes of Accounts'. To bring about greater transparency in banks' published accounts, the BB has also directed the banks to disclose data on movement of non-performing assets (NPAs) and provisions as well as lending to sensitive sectors. These disclosure norms brought the disclosure standards almost on par with the international best practice.

- Major amendments were made in Financial Loan Courts Act, providing for alternative dispute resolution (ADR) mechanisms, setting up of special courts in each district to deal exclusively with defaulted loans, monetary disincentives for successive appeals against court judgments, prescribing time limits for courts to give judgments on loan default cases, and mandating banks to sell collaterized security before filing court cases.
- The criteria for loan rescheduling were rationalized, particularly to discourage habitual loan defaulters, by making successive rescheduling more costly for the borrowers.
- Appointment of external auditor in banks requires prior approval of the BB. There is an elaborate procedure by which banks select auditors from an approved panel circulated by the BB.
- The Internal Control and Compliance (ICC) risk management guidelines issued by BB in 2003 set the minimum standards of arrangements that are required to be in place in banks on internal control and audit. The head of IC&CD reports directly to the CEO and indirectly to the Audit Committee of the Board.
- Guidelines to manage the core risk for banks were introduced by the Bangladesh Bank. These guidelines lay out policies, procedures, processes and structures to core risks. Information Technology security guidelines, prudential regulations for banks and procurement guidelines were also put into place to improve supervision.
- In the light of deregulation and greater autonomy given to banks in their operations, the role of the board of directors has become more significant. Boards have been required to lay down policies in critical areas such as investments, loans, asset-liability management, and management and recovery of NPAs. As a part of this process, three Board level committees including the Audit Committee and Risk Management Committee are required to be appointed by banks.
- Appointment of Directors and Managing Directors of all banks is done with prior approval of Bangladesh Bank. These persons are required to fulfill the fit-and-proper criteria set by

Bangladesh Bank. To avoid the concentration of power in the hands of a single individual and, in recognition of the pivotal roles of the Board, Chairman and the Chief Executive Officer in securing good corporate governance, their individual roles have been separated and clearly demarked.

2.4.3 Most Recent Banking Reforms - Third Phase (2010–till)

In the recent years, the central bank has formulated new corporate governance guidelines, prudential regulations and some other guidelines for the commercial banks, guidelines for different areas of risk management. These are designed to structure the banking sector and harmonize them with international standards. The system is yet to become full proof, as there are loopholes.

- BB has introduced Risk Based Capital Adequacy (RBCA) framework for banks Basel Accord. Basel-II has fully come into force from January 2010 as a regulatory compliance. We are now in the transition phase towards adopting Basel III.
- In 2013, major amendments to the Bank Company Act were made, introducing requirement of “fit and proper” management, explicitly clarifying the pivotal roles of the Board, Chairman, Board Committees and the Chief Executive Officer in securing good corporate governance, limits on connected lending, limiting exposures to capital market etc., among others.
- To address the growing demand for a fast, secure and state-of-the art payment system in Bangladesh, initiatives were taken to establish country-wide electronic payment infrastructure replacing the traditional paper based clearing and settlement system. The change initiatives are focused on the following core areas - Payment Systems Strategy, Automated Cheque Processing System, Electronic Funds Transfer, Mobile Financial Services, E-Commerce and m-Commerce, National Payment Switch, and Legal & Regulatory Framework for electronic payment systems.
- In its attempt to strengthen credit discipline and to bring loan classification in line with the international standards, Bangladesh Bank has introduced new guidelines in 2012. Qualitative judgment criteria for classifications have also been streamlined. Bangladesh Bank has introduced “Large Loans Rules” to improve the NPL situation. The rule prescribes that the banks with net classified loan of up to certain percentage will be allowed to sanction a certain percent of the total loan and advances as “large loans".

- As a prudential measure intended for ensuring improved risk management through restriction on credit concentration, Bangladesh Bank has from time to time advised the scheduled banks in Bangladesh to fix limits on their large credit exposures and their exposures to single and group borrowers.

Table B2: Major banking sector reforms since 2010

Year	Reforms/Direction
2010	Bangladesh Bank (BB) has introduced a uniform accounting procedure for repo operation as a prudential measure aimed at better risk management. Banks are free to engage in repo transactions with BB and with other banks and financial institutions which maintain a current account with BB. An action-plan/roadmap has been circulated to banks to implement Basel-II Accord from January 2012. Banks and NBFIs are instructed to provide and extend financial assistance (interest-free loan or scholarship program) to meritorious poor students including the children of poor freedom fighters and also poor students of remote and underdeveloped area (Char, Haor, Coastal area) to eradicate prevailing inequality, deprivation and poverty of the greater population of the country and to upgrade the living standards of underprivileged people of the country under CSR activities.
2011	Financial Institution Regulation, 1994 has been amended to raise minimum paid up capital to Taka 100 crore for the financial institutions. Bangladesh Electronic Funds Transfer Network (BEFTN) started its live operation with credit and debt transactions and also EFT operations and to facilitate all kinds of transactions.
2012	"Guidelines on Stress Testing" was issued to ensure the soundness and sustainability of the financial industry and make the banks and FIs more shock resilient. It has been introduced National Payment Switch Bangladesh (NPSB) in order to create a common platform for the cards (Debit/Credit/Prepaid), internet and mobile based payments in the country.
2013	Banks/NBFIs are directed to bring the contents of amended Anti-Terrorism Act, 2013 to ensure the compliance of its regulations. Banks are also advised to bring the contents of amended Bank Company (Amendment) Act, 2013 to ensure its implementation.

Year	Reforms/Direction
2014	It has been made some amendments on Single Borrower Exposure Limit and definition and interpretation of "Capital", Exposure", "Non-conforming Exposure", "Person", "Group" and Exposure Limits, Expectations, Prudential Norms, Risk Management Expectations etc; and banks are directed to follow that. The limit of bullet repayment, against external import financing for eligible deferred payment imports for terms not exceeding six months, has been enhanced from USD 0.5 million to USD 1.0 million.
2015	A direction has been made to banks and NBFIs for appointing an honest, skilled, experienced and appropriate chief executive to follow specify criteria– character credentials, experience and eligibility, transparency and financial credentials, age limit and terms & conditions– tenure, re-appointment, policy for salary and allowance, cancellation of appointment, and demission/exemption/removal and resignation. It has been instructed banks & NBFIs to follow the "Money Laundering and Terrorist Financing Risk Assessment Guidelines for Financial Institution" to identify, assess and mitigate money laundering and terrorist financing risks. All scheduled banks and financial institutions have been instructed to follow the direction of 'New CIB Online Solution'. All scheduled banks have been directed to undertake necessary steps to prepare themselves for the live operation of BD-RTGS. BB has introduced a new oversight framework for large exposures to identify and manage the low quality assets well ahead of time before they appear as a cause to financial distress. BB has established a Central Database for Large Credit (CDLC) to monitor the large exposures in a more structured way. For obtaining foreign loan easily, BB has allowed the AD banks to hold collaterals on behalf of foreign lenders in respect of external borrowing by industrial enterprises as approved by the Bangladesh Investment Development Authority (BIDA) without prior approval from BB.
2016	In line with international best practices, it has been directed financial institutions to adopt with improved policies and procedures following the 'Integrated risk

Year	Reforms/Direction
	management guidelines'. The guidelines encompass all the probable risks associated with financing companies. With a view to implementing monetary policy and effective liquidity management, BB has introduced 7-day and 14-day BB Bills alongside its existing 30-day BB Bill.
2017	In order to make environment friendly and easy to understand financing and to accelerate the implementation of the Perspective Plan of Bangladesh 2010-21, National Sustainable Development Strategy 201021 and Sustainable Development Goals and to ensure easier flow of private sector credit to environment friendly products, BB has published an eligible products list of green financing for the banks and financial institutions from their own sources. To encounter the risk of money laundering and terrorist financing, BB has issued a Uniform KYC Profile Form for insurance company according to Money Laundering Prevention Act, 2012 and Antiterrorism Act, 2009. It has been issued a code of conduct guidelines for banks and NBFIs aiming to implement the strategy of virtuousness in the financial sector.
2018	In order to promote financial inclusion, risk-free and easy transactions of illiterate customers, BB has issued guidelines for banks on cash withdrawal through cheque of illiterate customers. BB has advised that all scheduled banks (including Shariah based banks) will have to maintain 5.5 percent CRR with BB on bi-weekly average basis with a provision of minimum 5.0 percent on daily basis of their average total demand and time liabilities. The existing Repo interest rate of BB has been reduced by 75 basis points and re-fixed at 6.0 percent from 6.75 percent while Reverse Repo rate to remain unchanged at 4.75 percent. To facilitate transactions under ACU mechanism, BB has advised the ADs to resume transactions in 'ACU Euro' along with 'ACU Dollar' to settle current account transactions among ACU member countries. Accordingly, 'Japanese Yen (JPY)' has been incorporated as a settlement currency in ACU mechanism.

Source: Bangladesh Bank's Annual Report, 2010-2018

3. Structure of the Financial sector of Bhutan

Introduction

Bhutan is a small open country with strong economic ties to India which is its largest trading partner. Its currency is pegged to the Indian Rupee. The Kingdom of Bhutan, today, is experiencing a gradual transition from a mostly agriculture based economy to broad based economy characterized by increasing levels of education, shifting expectations and changing demographics, particularly among the country's youth who are looking beyond a rural based economy. The hydropower sector and the resulting exports of electricity to India is its principle driver of economic growth. However, the Government of Bhutan is relying not only on hydropower revenues, but also on a diversified economic growth. The financial system is therefore expected to play an important role in driving the economic needs of the country.

Financial system of Bhutan is still at its initial stage with lots of structural deficiencies and currently undergoing major institutional changes in line with its mandate to meet the requirements of a growing financial sector and economy. The development of Bhutanese financial system until 2009 was limited to only two banks, one agricultural development bank, one insurance company accompanied by a small stock exchange and a Pension Fund Bureau. Beginning 2009, Major changes have occurred in the financial system. In 2009, two new banks and one insurance company were licensed to begin operation in 2010. Further, the agricultural development bank was granted a specialized deposit-taking bank license in 2010 to expand its business to the urban areas.

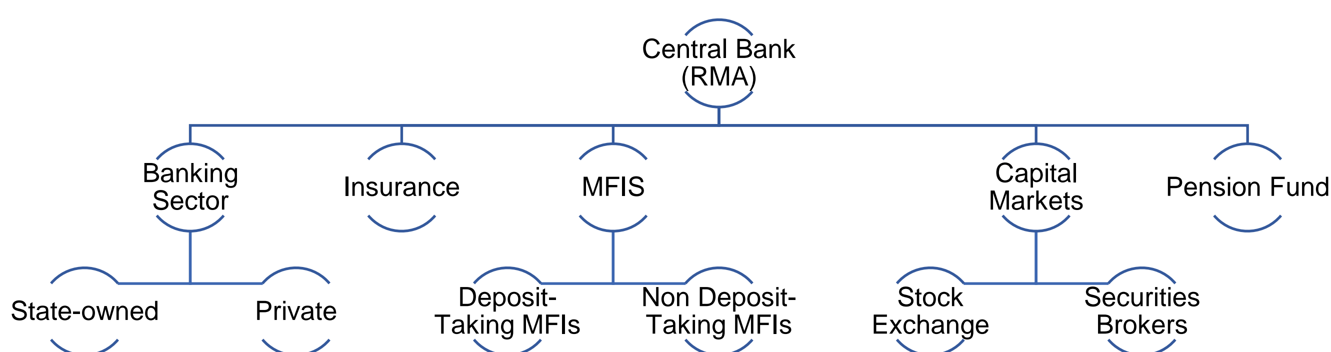
Although the financial sector is at its initial stage, it is however, experiencing a steady growth as financial institutions develop to provide financial services to more people, thereby, registering an increase in asset size, expressed as a proportion of GDP. Banking sector continues to dominate the financial sector, though its share of assets has been falling over the years.

Royal Monetary Authority of Bhutan (Central Bank)

Established under the Royal Monetary Authority (RMA) Act in 1982, the Royal Monetary Authority of Bhutan serves as the central bank of Bhutan. It is in charge of regulating the financial sector and formulating the monetary policy. In 1992, the National Assembly passed the Financial Institutions Act, which provided the RMA with the legal framework to license, regulate, supervise, and inspect financial institutions.

After Bhutan made transition to a Democratic Constitutional Monarchy in 2008, the RMA Act 2010 passed by the Parliament in June 2010 replaced the RMA Act (1982). With the enactment of the RMA Act (2010), the status of the RMA has been elevated to that of an autonomous central bank with greater powers in terms of its mode of functioning and decision making process. This was expanded upon in with the passage of the Financial Services Act (FSA) of 2011 replacing the Financial Institution Act 1992.

Chart C1: Structure of Financial System in Bhutan



The Banking Sector

The number of banks has grown from 1968 when the Bank of Bhutan was established as the sole commercial bank until today when there are five banks providing banking services to the economy, i) Bank of Bhutan (BOB); ii) Bhutan Development Bank Ltd. (BDBL); iii) Bhutan National Bank (BNB); vi) Druk Punjab National Bank (DPNB); v) T Bank (T-Bank).

Bank of Bhutan Limited is the oldest bank in Bhutan and was established on 28 May 1968. It enjoyed a complete monopoly until 1997 when the Unit Trust of Bhutan, an undertaking of the Government of Bhutan, was converted into country's second national bank, the Bhutan National Bank Limited. Bhutan Development Finance Corporation Limited was established on 1 January 1988 as a financial institution to cater to the financial needs of the micro, small and medium enterprises with a special focus on agricultural development. The Bhutan Development Finance Corporation Ltd. was transformed into Bhutan Development Bank Ltd. in 2010. Two new private sector banks were set up in 2010 viz. T-Bank Limited and Druk PNB Bank Limited.

Table C1: Banking Sector Assets for the year end 2018 (Nu. in million)

Banks	Ownership	Assets	Market Share
Bank of Bhutan Limited	Stated Owned	55,772.73	39%
Bhutan National Bank Limited	Private	38,653.30	27%
Bhutan Development Bank Limited	Stated Owned	24,501.93	17%
T-Bank Limited	Private	9,052.91	6%
Druk PNB Limited	Joint Venture	15,133.52	11%

Source: Author's own calculation

As depicted in table 1, Bank of Bhutan has the largest market share of 39% followed by Bhutan National Bank with 27%, BDB with 17%, Druk PNB with 11% and T Bank with 6% respectively. In terms of asset size, as of December 2018, Bank of Bhutan has the highest asset with Nu. 55.7 billion followed by BNB with Nu.38.65 billion, BDBL with Nu. 24.5 billion, Druk PNB with Nu.15.1 billion and T bank with Nu.9.1 billion respectively.

The Insurance Sector

The Royal Insurance Corporation of Bhutan (RICBL) was established in 1975 as the country's sole insurance company to offer both life and non-life insurance covers. Bhutan Insurance (BIL) was chartered in July 2009 to deepen Bhutan's insurance sector. Unlike RICBL, BIL was licensed to carry out only non-life insurance business. Further, in 2013, RMA granted license to first reinsurance company, GIC-Bhutan Re to undertake reinsurance business in Bhutan. As seen in table 2, RICBL being the oldest insurance company in Bhutan has the dominant market shares in terms of asset composition with market share of Nu. 19.04 billion (90%) and Bhutan Insurance limited with only Nu. 2.03 billion (10%).

Table C2: Insurance Sector Assets for the year end 2018 (Nu. in million)

Insurance	Ownership	Assets	Market Share
Royal Insurance Corporation of Bhutan Limited	Private	19,040.44	90%
Bhutan Insurance Limited	Private	2,038.57	10%

Source: Author's own calculation

National Pension and Provident Fund

The National Pension and Provident Fund(NPPF) is entrusted with the responsibility of administrating the social security plan of the government agencies, corporation and armed forces and managing those fund in line with the investment policy approved by the Board. As of December 2018, NPPF had asset composition of Nu.33.06 billion. NPPF is also with the lending business with a total loan of Nu.12.33 billion

Micro Finance Institutions

Micro-finance Institution is very new to Bhutan. In order to maintain balance economic growth of the country, the central bank (RMA) issued licence to Rural Enterprise Development Corporation Ltd (REDCL) in 21st May 2016. As part of the inclusive growth and for easy access of credit to remotest part of the country, RMA also issued licence to three more non-deposit taking MFI.

Table C3: MFIs in Bhutan

MFIs	License Type	Date of Issue of License
Rural Enterprise Development Corporation Ltd (REDCL)	Microloan Institution	21-May-16
RENEW Microfinance Private Ltd.	Deposit-Taking Microfinance Institution	21-Aug-18
BAOWE Microloan Institution	Microloan Institution	26-Jan-17
Bhutan Care Credit Limited	Microloan Institution	1-Jul-18
Tarayana Foundation	Microloan Institution	12-Sep-18

Source: Author's own calculation

Capital Market

The Royal Securities Exchange of Bhutan (RSEB) was established in August, 1993. It was established as a non-profit making and quasi-public organization under the aegis of the Royal Monetary Authority (RMA).The objectives of the company are to encourage wider spread of share ownership in the enterprises, mobilize savings, provide platform to raise equity capital for new ventures and to provide liquidity to the existing shareholders. RSEB was incorporated under the Companies Act of the Kingdom of Bhutan, 2000 and is regulated by the Financial Services Act 2011.In July 1996, RSEB was delinked from the RMA as an autonomous body.

In 2012, RSEB moved its securities market to a new and enhanced trading system. The RSEB Integrated System replaced the traditional system that was used for 19 years ever since it was launched in 1993.

Other Developments

In recent years, Bhutan has taken steps to deepen the financial sector by establishing credit and collateral registries. The Credit Information Bureau (CIB) was established within the RMA in 2009 to facilitate monitoring of borrowers to improve access to credit. The Central Registry for Secured Transactions for moveable properties was formally established in July 2014 within the RMA to encourage secured transactions and ease collateral requirements imposed by lenders, thereby improving access to credit. In 2013, CIB was delinked from the RMA and became an independent institution.

Financial Sector Regulation in Bhutan

The Financial Services Act of Bhutan 2011 has empowered the RMA to promulgate sound banking and financial policies within the economy. The RMA is the primary regulator in Bhutan, responsible for regulating and supervising not only for banks, but also non-banks, the stock market, and pension funds. The implementation of appropriate prudential regulations and guidelines for financial sector to operate within is in the scope of the RMA's regulatory function.

The Prudential Regulations of RMA sets out micro-prudential regulations related to institutional framework of financial institutions; related party transactions; shares trading; credit concentration; capital, liquidity, and provisioning requirements designed to preserve the health of individual financial institutions. Issues of licensing, disclosure requirements, and general structural regulations governing banking, insurance, securities businesses, and other financial services are covered in the Financial Services act of 2011.

Basic prudential regulations in place for Bhutan since enactment of the Prudential Regulations 2002 are requirements on capital adequacy and liquidity as well as limits on credit concentration. Capital serves as reserves for financial institutions and thus it is necessary for

financial institutions to have sufficient capital to withstand unforeseen losses. The RMA sets out a minimum capital paid–up requirement for licensing of financial institutions. Also, financial institutions are required to maintain a minimum the CAR and core capital adequacy ratio (CCAR). Aside from maintaining adequate capital, financial institutions must keep a liquidity position to ensure that contractual obligations are met. Minimum requirements for liquidity management are the cash reserve ratio and SLR. Concentration of credit to a certain borrower, or group of borrowers, also exposes financial institutions to risks, as any unfavourable developments in the business or the sector to which the borrower belongs to can severely affect the position of the institution. A credit ceiling limits concentrations to a maximum of 30% of the total capital fund has been set. There is also a limit on the amount of credit that can be extended to a financial institution's ten largest borrowers, equal to 30% of total credit. The credit cap not only minimizes financial institution exposures, but also encourages portfolio diversification.

In addition to the micro-prudential regulation and to strengthen the regulatory framework for Bhutan, a framework for a more comprehensive macro-prudential regulation was developed during 2013–2014. The regulations in the framework developed are: (i) the leverage ratio, (ii) the loan-to-value (LTV) and loan-to-income (LTI) ratios, (iii) the debt-to-equity ratio, (iv) restrictions on the distribution of profit, (v) countercyclical capital buffer (CCCB), and (vi) sectoral capital requirement (SCR). The RMA has also adopted high standards of corporate governance principles and practices.

Health of Financial Sector in Bhutan

Table 4 presents a series of financial soundness indicators (FSIs) for the Bhutanese financial system for the period ended December 2018. These FSIs cover capital adequacy, asset quality, earnings, and liquidity.

Table C4: Financial Stability Indicator for the period ended December 2018

INDICATORS	Banks	Insurance	Total FIs
CAPITAL	**Dec-18**	**Dec-18**	**Dec-18**
Core Capital Ratio (7.5%)	13.20%	4.55%	11.80%
Capital Adequacy Ratio (12.5%)	16.71%	6.89%	15.12%
Leverage Ratio (5%)	10.15%	4.57%	9.43%
Capital Fund	19,658.95	1,570.50	21,229.45
OBS Items	9,170.35	1,484.53	10,654.88
ASSETS			
Total Assets	143,114.39	21,079.01	164,193.40
Total Loans and Advances	99,542.63	20,696.16	120,238.79
Total Non-performing loans	6,995.90	5,546.04	12,541.94
Provision to NPL Ratio	71.80%	64.53%	68.59%
Ten Largest Exposures	14.55%	8.72%	13.56%
Single Largest Exposure	12.61%	25.44%	13.56%
Gross NPL ratio	7.03%	26.80%	10.43%
EARNINGS			
Profit after tax/Loss	2,455.94	(1,839.87)	616.07
Overhead Ratio	1.42%	2.45%	1.56%
Return on equity	13.94%	-58.53%	2.97%
Return on Asset	1.77%	-8.37%	0.38%
Interest Spread	2.69%	-26.41%	1.84%
LIQUIDITY			
Statutory Liquidity Requirement (Position) Banks:20%, Insurance:10%	23.23%	15.98%	22.24%
Liquidity position (in Nu.)	3,988.86	1,166.85	5,155.71
Credit to Deposit Ratio	85.69%	166.64%	93.50%

In general, the financial system has been well capitalized. As shown in table 4, the capital adequacy ratio (CAR) for the industry has been well above the 12.5% regulatory minimum. Asset quality as measured by the ratio of NPLs to total loans stood at 10.43% during the period under review. Profitability as measured by return on assets (ROA) stood at 0.38%. The liquidity for banks stood at 23.23% and for non-banks at 15.98% against the statutory liquidity requirements for banks at 20% and non-banks at 10%.

5. Chronology of Major Financial Sector Developments

1982

- The RMA Act was passed during the 56th session of the National Assembly in August 1982.

1983

- The RMA commenced operations from April 1, 1983 by taking over the issue of the national currency, the management of external reserves, and foreign exchange operations.

1984

- The Cash Reserve Ratio was introduced for liquidity management and prudential purposes.

1988

- In March 1988, the RMA took over the additional function of banker to the Government, by holding the bulk of government deposits, and to provide short term advances to the Government, whenever necessary.

1992

- The Financial Institutions Act, 1992 was passed by the National Assembly in November 1992 to provide the RMA with the necessary legal framework to issue licenses to financial institutions and to regulate, supervise, and inspect their operations.
- The FI Act 1992 is superseded by the Financial Services Act of Bhutan, 2011.

1993

- The RMA initiated the establishment of the Royal Securities Exchange of Bhutan to facilitate the development of Bhutan's capital market and to enable public participation in public and private companies.
- RMA Discount Bills were introduced as a monetary policy tool. In December 2009, the RMA Discount Bills were discontinued and replaced by RGoB Treasury Bills.

1996

- In order to improve its liquidity management functions, the RMA introduced the reserve repurchase as its second debt instrument in September 1996. The repurchase was rolled over until January 2002, after which it was discontinued.

1997

- To enhance competition in the banking sector, the Unit Trust of Bhutan was converted into Bhutan National Bank,a full-fledged commercial bank, in January 1997.

- Cheque clearing facilities were established in the country (the first in Thimphu in 1997 and the second in Phuentsholing in 1999) to enable commercial banks to settle claims against each other involving cheques and other negotiable instruments.

1997

- In line with the Government's program of liberalizing trade and industrial policies, the RMA Board approved the new Foreign Exchange Regulations 1997, removing various restrictions on foreign exchange transactions.
- The Foreign Exchange Regulations 1997 and all related past notifications, circulars and guidelines is superseded by the Foreign Exchange Regulations, 2013.
- The RMA partially liberalized interest rates from October 1997, allowing FIs to determine their rates in accordance with the "spread system". The spread system allowed financial institutions to determine their deposit and lending rates, while maintaining an overall interest spread of a maximum of six percentage points.

1999

- To further encourage competition among financial institutions, the RMA fully liberalized interest rates on both deposits and advances of the FIs in April 1999.
- The Moveable and Immovable Property Act and the Bankruptcy Act were enacted to provide the legal framework for loan recovery and collateral requirement.

2000

- The Negotiable Instruments Act was passed in July 2000 to provide legal support for cheque clearing houses and use of negotiable instruments in the payments and settlement system.
- As part of the financial sector reform program, the Government Employees Provident Fund was transferred from the RICBL to the newly created National Pension and Provident Fund.

2002

- The RMA made arrangements with the Reserve Bank of India to participate in the auctions of Government of India securities by investing in the Indian Rupee and from January 2003 the RMA started investing in GoI T-bills.

2007

- The NPPF formally came under the purview of the RMA on March 9, 2007.

2009

- Bhutan's first issue of RGoB Treasury Bills was auctioned on December 14, 2009, replacing the RMA discount bills.
- On August 17, 2009, RMA issued license to Bhutan Insurance Ltd. to carry on non-life insurance business. The BIL officially commenced business transactions from August 20, 2009.
- The RMA launched Bhutan's Credit Information Bureau on September 9, 2009.

2010

- The RMA issued commercial banking license to Druk PNB Bank Ltd., an FDI joint venture bank, on January 19, 2010.Druk PNB Bank Ltd. commenced its business on January 27, 2010 and established its first branch office in Phuentsholing on February 7, 2010.
- On March 1, 2010, the RMA granted license to the BDBL, formerly the Bhutan Development Finance Corporation, to operate as a specialized deposit-taking commercial bank. The license allowed BDBL to engage in depository banking, excluding foreign exchange transactions.
- On March 10, 2010, the RMA issued commercial banking license to TBank Ltd. TBank Ltd. formally commenced its business on March 12, 2010 and set up its Phuentsholing branch office on September 14, 2010.
- The RMA delegated transactions in gold and silver as well as distribution of fresh notes to the commercial banks in May 2010.
- The Royal Monetary Authority Act of Bhutan, 2010 was formally enacted during the 5th session of Parliament on June 2, 2010, superseding the RMA Act 1982

The RMA formally launched the Electronic Funds Transfer and Clearing System on June 11, 2010.

2011

- The Financial Services Act of Bhutan, 2011 was formally enacted during the 7th session of the Parliament on May 26, 2011. The FSA 2011 came into force from July 5, 2011superseding the FI Act 1992.
- The RMA formally launched the National Electronic Fund Transfer System and Bhutan Financial Switch on December 2, 2011.

2012

- The RMA granted license to Nubri Capital Pvt. Ltd. in November 2012 to operate as Bhutan's first Fund Management Company and to conduct fund management business in terms of improving and developing the capital market in Bhutan with the objective of providing the Bhutanese investors with an alternative source of investment besides equities and debt instruments.

- On March 8, 2012, following the growing external imbalances with India and rising pressures on the demand for Indian Rupees, the RMA temporarily suspended access to Indian Rupees to finance imports of personal transport vehicles and private housing construction materials that were approved after March 8, 2012. Specifically, the RMA issued a circular to FIs titled "Circular on Foreign Currency" explicitly highlighting the status of the Indian Rupee as a foreign currency. The Circular outlined the eligibility and limits for access to Indian Rupees by residents; closure of the accounts of non-resident foreigners; and the requirement to channel all export proceeds via the banking channel within 91 days of the date of export.

A year later, in March 2013, the RMA (i) lowered the international credit card limit from USD 3,000 p.a to USD 1,000 p.a and (ii) lowered the transaction limit on point-of-sale (POS) machines in India (through debit cards) from INR 1 lakh per month to INR 15,000, to ease pressures on Rupee reserves since INR outflows from these channels were escalating. Housing and vehicle loans were reintroduced with effect from September 1, 2014.

- The RMA introduced the RMA Short Term Liquidity Adjustment Window Facility (RSTLAW) on March 29, 2012 to provide short-term liquidity to liquidity-deficient banks to meet daily operational requirements and short term outstanding liabilities only and not for long term lending activities. To ensure that liquidity injected through the RSTLAW was prudently utilized and not directed towards further credit creation, prudential guidelines and criteria were issued.

- Indian Rupee management and public access to the Rupee were streamlined to reflect its status as a foreign currency, following growing imbalances with India. The Operational Guidelines for Indian Rupee Transactions to facilitate the operational arrangements relating to the access of Indian Rupees for transactions was issued in May 2012.

In consultation with the FIs, the RMA finalized the structure of the Base Rate and with effect from September 1, 2012 each FI launched and implemented their respective base rates. The base rate is the minimum rate below which it is not viable for FIs to lend. The base rate will also serve as the reference benchmark rate for floating rate loan products, apart from other external market-based benchmark rates.

2013

- The RMA issued license to Kubera Insurance Brokerage Pvt. Limited in February 2013 to conduct composite insurance brokerage business with the objective to facilitate the public and companies in smoothly conducting insurance transactions through a third party.
- Exercising the powers conferred by Section 117 of the RMA Act of Bhutan 2010, the RMA Board of Directors endorsed the new Foreign Exchange Regulations, 2013 with effect from March 30, 2013.The new regulation supersedes the Foreign Exchange Regulations, 1997 including all related past notifications, circulars and guidelines.
- On March 8, 2013, the RMA in collaboration with the Royal Government entered a Rupee Currency SWAP agreement with the RBI for a total of INR 5.4 billion at 5.5% p.a for the duration of 6 months (3 month-period with an additional 3 months rollover). Such financing was taken to provide short-term relief to meet immediate BOP transactions. The Swap was liquidated in September 2013.
- The Financial Intelligence Unit was formally established with the enactment of the Financial Services Act 2011. Although the FIU operated as part of the FRSD since October 2010, it was officially instituted as a separate unit from the FRSD on May 16, 2013.
- The RMA established the Central Registry for movable properties in September 2013, with the objective to facilitate secured credit transactions and provide secured creditors' rights as provided under the Movable and Immovable Property Act (MIPA) 1999. The registry will enable creditors to register movable assets with the central registry which will then facilitate smooth credit appraisal and the foreclosure of bad loans. It will also enable the public and other entities to inquire any lien by any creditor on any kind of movable assets that they intend to transact.
- In August 2013, the RMA issued license to GIC-Bhutan Re Limited, the first reinsurance company in Bhutan, to conduct general reinsurance business. The company is owned by two Bhutanese promoters and GIC India.

2014

- The RMA reintroduced housing and vehicle loans with effect from September 1, 2014(after access to Indian Rupees to finance imports of personal vehicles and housing construction materials was temporarily suspended in March 2012). New housing, vehicle and consumer loans guidelines were also issued to guide FIs in prudently managing and monitoring credit to these sectors thereby mitigating any potential systemic risk that could arise.

2015

- In February 2015, the RMA issued Securities Broker's license to Drukyul Securities Private Limited under the Securities Brokers Regulations 2011 to carry out securities broking business.
- In March 2015, the CRR was increased to 10 percent from 5 percent in order to sterilize persistent excess liquidity in the banking system. The CRR was first revised and reduced in March 2012 from 17 percent to 10 percent to address liquidity shortages in the banking system, with retroactive effect from March 2012. Subsequently, with effect from June 2012 the CRR was further revised and reduced from 10 percent to 5 percent to address the continued liquidity shortage in the banking system.

2015

- The Macro Prudential Regulations on Disclosure Requirement was approved by the RMA Board in January 2015 and issued to financial institutions for implementation.
- The Investment Guidelines for Insurance Business was issued in January 2015 for implementation by the insurance companies from January 2016.
- The RMA issued a directive on Abandoned Property (in line with Section 245 of FSA) duly approved by the Board in February 2015.
- The Credit Information Bureau Regulations was issued in March 2015 to safeguard the credit data and consumers' interests.
- On November 6, 2015, the RMA launched the Commemorative coins for the 60th Birth Anniversary celebration of His Majesty the Fourth Druk Gyalpo Jigme Singye Wangchuck.

2016

- On January 12, the RMA launched INR exchange counters.
- On March 3, the RMA launched the Global Money Week.
- On March 17, the RMA renewed the Bilateral Currency Swap arrangement with RBI for INR/NU equivalent of USD 100 million.
- On May 21, registration of REDCL and RENEW as micro-Loan Institutions.
- On August 1, the RMA implemented the new Interest Rate Policy- Minimum Lending Rate.
- On September 21, His Excellency, Lyonchhen DashoTshering Tobgay launched the Nu.1000 Denomination Commemorative Banknote to celebrate the birth of the Gyalsey.
- Remit Bhutan was also launched on the same day to provide Foreign Currency Account facility for Non-Resident Bhutanese. In addition, the RMA Handed over surplus profit (of new Nu.874 Million to the RoGB).
- On November 28, Parliament endorsed the RMA's proposal on tax waiver on interest earned from fixed deposits.
- On December 2, RMA's Historic growth in the country's INR reserves to 31.74billion

- On December 29, the RMA approved the Rules and Regulations for Deposit Taking Microfinance Institution (DTMFI).

2017

- Bhutan Immediate Payment Service (BIPS) was launched on 27th January, 2017.
- The design of Nu.100 Denomination Commemorative Banknote was launched on February 5, 2017 to celebrate the First Birth Anniversary of His Royal Highness The Gyalsey, Jigme Namgyel Wangchuck.
- The RMA implemented the Private Money Lending Rules and Regulations on April 1, 2017.
- As the inaugural BEFIT event, the International Financial Inclusion Summit on the theme "Equitable Growth through Financial Inclusion" was hosted in from 24 to 26, May 2017.
- On June 15, the RMA in collaboration with the commercial banks and the Department of Trade, Ministry of Economic Affairs (MoEA), launched the Internet-based Point of Sales (PoS) service at fuel stations.
- The RMA signed the MoU on money laundering and terrorist financing with Bhutan Narcotic Control Authority on July 7, 2017.
- The Financial Intelligence Unit of Bhutan has signed MoU on money laundering and terrorist financing with FIU Sri Lanka and FIU Cambodia on July 16 and 19, 2017 respectively. The RMA Board approved the e-Money Issuer Rules and Regulations during its 130th Board Meeting held on September 29, 2017 to promote Financial Inclusion through available digital financial services technologies.
- The RMA signed a MoU with Myanmar Financial Intelligence Unit concerning cooperation in the exchange of financial intelligence to money laundering associated predicate offences and terrorist financing on 31st October 2017.

2018

- Implemented the Reserve Management Policy with effect from January 1, 2018.
- The RMA Board endorsed the adoption of the BAS in Accounting Policy from January 1, 2018.
- Signed a Memorandum of Understanding (MoU) with Royal Bhutan Police and Civil Society Organizations Authority on February 20, 2018.
- Launched Druk MicroFin an integrated MFI and CSI banking platform on May 16, 2018.
- Approved the Amended Regulation for establishment of commercial banks and RENEW's proposal for establishment of DMFI (RENEW Microfinance Private Ltd) on May 22, 2018.
- Implemented Rules and Regulations for Insurance & Reinsurance Companies in Bhutan, and the Corporate Governance Rules and Regulations 2018 (CGRR 2018) on July 1, 2018.
- Issued the Rules and Regulations for Cottage and Small Industries (CSI) Bank.

Source: RMA annual reports (2017 and 2018)

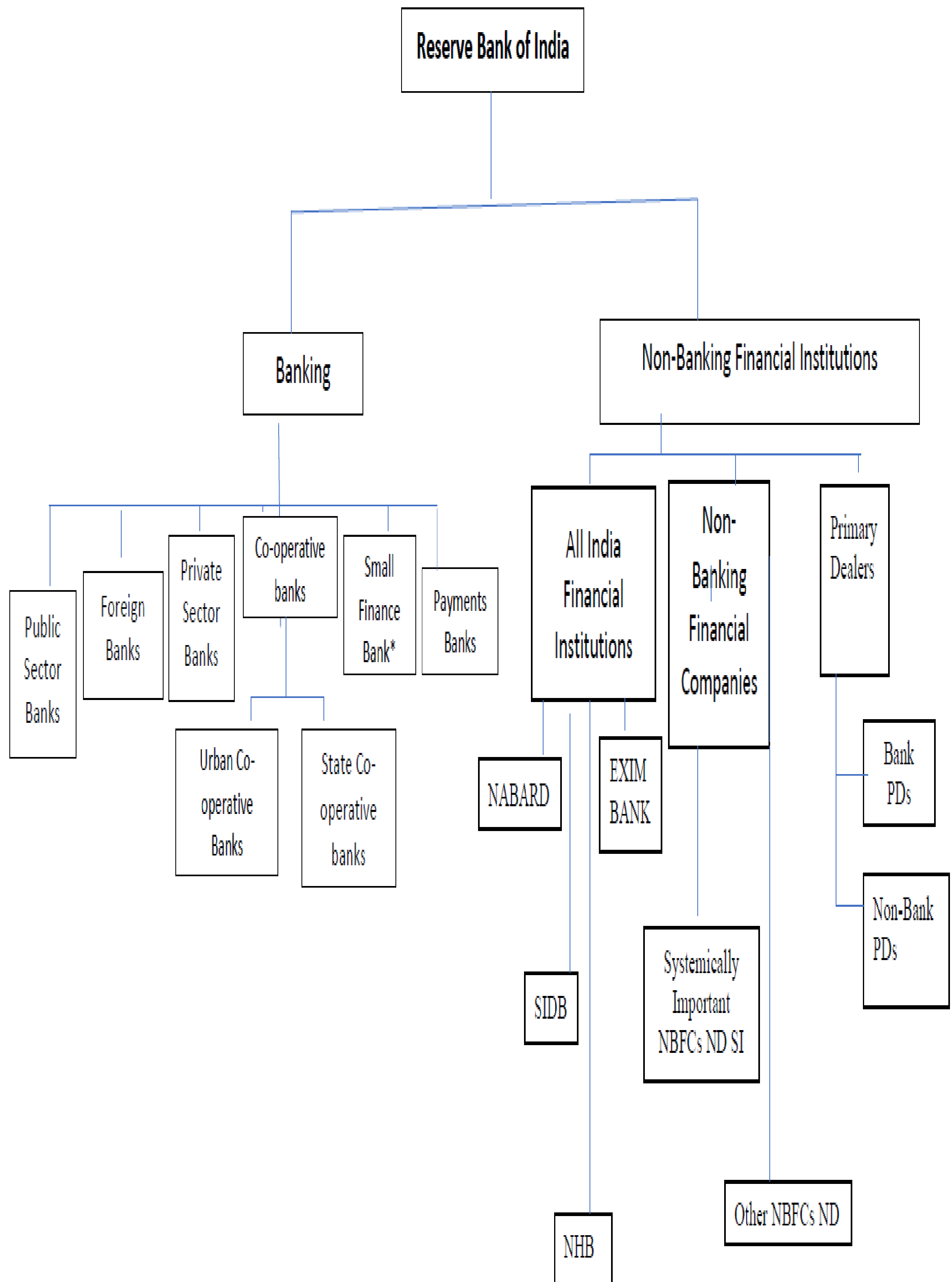
4. Structure of Banking in India

Introduction

Banking regulation in India is said to have evolved with establishment of Reserve Bank of India (RBI) from mid-thirties. The legal framework for Banking regulations in India is largely enshrined in two main legislations the Reserve Bank of India Act, 1934 (RBI Act) and the Banking Regulations Act, 1949 (BR Act). These two Acts together empower RBI to control and supervise operations of commercial banks in India. The RBI is the monetary and banking authority as established by the RBI Act. As the banking authority, the RBI is responsible for regulation, supervision and control of the banking sector under the provisions of the Indian BR Act. That is, the RBI has the statutory power to issue banking licenses and to carry out supervisory inspections of any banking entity in India. The regulatory department issues regulatory guidelines and is also responsible for model validation for advanced approaches while the supervisory department of the RBI is responsible for supervision of banks. Over the years, regulatory and supervisory policies have evolved in sync with global developments and changing pace of India's financial system.

Structure of Banking in India

RBI thus regulates and supervises major part of the Indian financial system that includes working of Commercial Banks, Small Finance Banks (SFBs), Payment Banks (PBs), Urban Cooperative Banks (UCBs), some Financial Institutions (FIs) and Non Financial Banking Companies (NBFCs). There are other regulatory authorities like Insurance Regulatory Development Authority (IRDA) which deals with Insurance sector, Securities and Exchange Board of India (SEBI) which deals with credit rating agencies and capital markets, National Bank for Agriculture and Rural Development (NABARD) which supervises Regional Rural Banks (RRBs) and State and Central Cooperative Banks. Further, Registrars of Cooperative Societies of individual State in case of single state Cooperative Bank and the Central Government in case of multi state Cooperative Banks along with RBI regulate UCBs. There are different platforms and Inter-regulatory groups including the Financial Stability Development Council(FSDC) that facilitate inter regulatory coordination.


Reserve Bank of India
Banking
Non-Banking Financial Institutions
Public Sector Banks
Foreign Banks
Private Sector Banks
Co-operative banks
Small Finance Bank*
Payments Banks
Urban Co-operative Banks
State Co-operative banks
All India Financial Institutions
Non-Banking Financial Companies
Primary Dealers
NABARD
EXIM BANK
SIDB
NHB
Systemically Important NBFCs ND SI
Other NBFCs ND
Bank PDs
Non-Bank PDs

Evolution of Banking Regulation in India

RBI as a regulator has handled various challenges ranging from under developed markets to trade openness, higher volumes of capital inflows and recently globalisation. Regulatory reforms were periodically undertaken to address these challenges. This chapter provides insight into these transitions and responses of RBI to evolving situations. This chapter also makes an attempt to trace how India's banking regulation was reformed time and again to keep pace with the changing market dynamics. With the passage of time, the regulatory and supervisory approaches of RBI were modified. Focus of RBI's role shifted from micro regulation to macro supervision of commercial banks. The endeavour was to permit managements of banks to take commercial decisions based on their own judgement while ensuring that they operated within the framework of regulations. In this chapter some major developments tracing the evolution of RBI's role as Financial Regulator and supervisor of commercial banks, Cooperative Banks, NBFCs and Financial Institutions are also presented.

In the initial years the institutional factors like the underdeveloped nature of the credit markets limited the scope of banking activities. With nationalisation of the 14 major commercial banks in July 1969, social objectives received increased emphasis; the foremost of these was increasing the flow of credit to the priority sectors of the economy. The monetary policy during this phase continued to be constrained by the developmental goals of the Government. The most spectacular attainment during the post nationalisation period was the rapid bank-branch expansion. Spread of banking increased the monetisation in the economy and increased the saving habit of the population. The large expansionary effect of the plan outlays increased the income, and increase in savings habit was a very crucial development. The monetary policy had to be tightened through a series of direct instrument changes as well as the interventionist instruments and the direct controls on expansion of credit creation by the commercial banks. One important element in the conduct of monetary policy that affected banking was the phenomenal increase in reserve money due to RBI credit to Government, during the 1970s and 1980s. To control monetary expansion, the central bank tried various controls to influence the value of the money multiplier by raising reserve ratios. Large part of the regulation was focused on administering the interest rates to promote investment and

support large government borrowing[5]. Deficits were either financed through ad hoc treasury bills or through indirect borrowings. Automatic monetization caused reserve money expansion and the only way to restrain inflation was to operate by reducing the credit multipliers through the cash reserve ratio (CRR), statutory liquidity ratio (SLR), variations in the cost and availability of Reserve Bank accommodation to banks, changes in the deposit and lending rates of banks, selective credit controls, and quantitative guidelines on credit expansion. The Committee to Review the Working of the Monetary System, Chakravarty Committee, in 1985 suggested the use of "monetary targeting with feedback". Committee's Recommendations were implemented in 1985-86 and continued till adoption of multiple indicators approach in 1998. The approach used M3 growth as a nominal anchor, reserve money as the operating target and bank reserves as the operating instrument and broad money (M3) as the intermediate target till 1997-98.

First set of Reforms in 1991

India faced balance of payments crisis in 1991 and the rupee was devalued by 18 per cent in two stages. The crisis was a boon in disguise as most of the sectors of the economy were reformed after the crisis. In November 1991 the Narsimham Committee was appointed and its report recommended reforms in regulations in the Indian banking sector. These included a phased reduction in the SLR and CRR as well as change in accounting standards. It also introduced new income recognition and capital adequacy norms. In April 1992 RBI introduced income recognition and asset classification norms and specified the requirements of provisioning and capital adequacy that were to be adhered to by banks by 1994 and 1996. In order to infuse competition in the banking sector, in 1993, entry of some more new private sector banks was permitted and a fit and proper criteria and guidelines for the establishment of such banks were issued. This heralded a new policy approach aimed at fostering greater competition. After 15 July 1994, the Nationalised Banks were allowed to tap the capital market to strengthen their capital base.

With the initiation of reform from the year 1991-92, a number of initiatives were taken on the interest rate and monetary policy front. These were crucial in imparting flexibility to the

[5] The ad hoc treasury bills were discontinued in 1997.

banking sector. The deposit and advances side regulations were dismantled. The period saw a brick-by-brick deregulation effort that spread over half a decade. In October 1994 the structure of lending rates was deregulated and banks were given complete freedom to offer fixed/floating Prime Lending Rates (PLR). Banks were expected to declare their PLR and keep the process of fixing PLR and the spread transparent. Starting with October 1995 the banks were also allowed to fix their own interest rates on domestic term deposits with maturity of two years. The SLR was reduced to its then statutory minimum level of 25 per cent of the Net Demand and Time Liabilities (NDTL). A phased reduction in the SLR and the CRR was undertaken beginning January 1993. There was a sharp reduction in the Central Government's fiscal deficit in the initial years of reforms. Interest rates on Government securities were also made more or less market determined. Consequently, there was less of a need to use the banking sector as a captive source of funds, which enabled the reduction in the SLR. Banks, however, continued to hold Government securities in excess of the statutory minimum SLR, reflecting their risk-return perceptions. There were significant reforms simultaneously on the front of the government security market. Through the entire process of regulatory reforms, care had to be taken to sequence the reforms and deal with additional complexities arising in transiting from a relatively closed to a progressively open economy.

Alongside the developments grew a debate about separation of the regulation and supervision in central banks. In order to separate regulatory and supervisory functions the Department of Supervision(DoS) now called Department of Banking Supervision (DBS) was set up as a separate department from the Regulation Department, within the Reserve Bank in 1993 to strengthen the institutional framework. A high-powered Board for Financial Supervision (BFS), comprising the Governor of Reserve Bank as Chairman, one of the Deputy Governors as Vice-Chairman and four Directors of the Central Board of the Reserve Bank as members was constituted in November 1994. Further, various prudential measures that conformed to the global best practices were also implemented. One of the major objectives of banking sector reforms has been to enhance efficiency and productivity through enhanced competition.

Following the Narsimham Committee's recommendations, guidelines to facilitate entry of the private sector banks were issued in 1993 to foster greater competition with a view to achieve higher productivity and efficiency of the banking system. A related issue was also to assess the true health of the banking sector as the health code system being followed then was based on subjective considerations. In order to address these issues, several mutually reinforcing measures were initiated. With a view to improving the health of the banking sector, internationally accepted prudential norms relating to income recognition, asset classification and provisioning, and capital adequacy were introduced in April 1992 in a phased manner. Banks were advised that they should not charge and take to income account, interest on any non-performing asset. For this purpose, nonperforming assets were clearly defined based on objective criteria. As compared with the then existing system of eight health codes, banks were required to classify their advances into four broad groups, viz., (i) standard assets, (ii) sub-standard assets, (iii) doubtful assets, and (iv) loss assets. In order to strengthen the capital base of banks, capital to risk-weighted assets ratio (CRAR) system was also introduced for banks (including foreign banks) in India in a phased manner.

With a view to restoring and maintaining financial soundness of banks, as also enabling them to meet the gap created by the application of the first stage of prudential accounting standards and capital adequacy norms, the Government embarked on a recapitalisation programme of nationalised banks beginning from the financial year 1993-94. To enable banks to fulfil further provisioning norms and take care of additional capital needs as capital adequacy guidelines were fully implemented, the Government decided to allow public sector banks to approach the capital market directly to mobilise equity funds from the public by amending the relevant acts. However, it was prescribed then that the Government ownership would remain at least at 51 per cent of equity in nationalised bank. Raising of capital by banks led to diversification of ownership of PSBs, which made a significant qualitative difference to their functioning due to induction of private shareholding and attendant issues of shareholder's value and representation of private shareholders on boards.

In order to contain fresh NPAs arising on account of adverse selection, banks were put on guard against the defaulters to other lending institutions. For this purpose, the Reserve Bank

put in place a scheme on sharing credit data in April 1994. Apart from containing the fresh NPAs from arising, the issue was also to recover the NPAs which had already accumulated. The various measures initiated had a favourable impact on the quality of banks' balance-sheets. In a short span, banks were able to bring down their non-performing assets significantly.

In order to strengthen the banking system, it was considered necessary to introduce capital adequacy norms to ensure uniform standards of capital structure and progress towards Basel Committee norms (Basel I). The adoption of Basel Core Principles for Effective Banking Supervision requires adherence to the principles of 'consolidated accounting and supervision' of the affairs of the bank's subsidiaries. The Indian banks migrated from Basel I to Basel II and now to Basel III. The Reserve Bank has been focusing on encouraging market discipline and ensuring good governance. Over the years, the regulatory and supervisory polices in India have transformed significantly in line with the global norms.

Data based policy and Disclosure

The banking system has various layers of supervision, viz., onsite monitoring, offsite monitoring, internal control system in banks and use of external auditors. The periodic statutory examinations were to be supplemented by different types of regular and cyclical on-site assessments, viz., targeted appraisals, and targeted-appraisals at control sites, commissioned audits and monitoring visits. The Off-site Monitoring and Surveillance (OSMOS) system was operationalised as early as 1995 as a part of crisis management framework for early warning system and as a trigger for onsite inspections.

As a step towards building a safe and sound banking system backed by a strong supervisory regime, a system of Prompt Corrective Action (PCA) was envisaged as early as 2002. Prevention of money laundering activities assumed importance in international financial relationships in recent years. In November 2004, the Reserve Bank revised the guidelines on 'Know Your Customer' (KYC) principles in line with the recommendations made by the Financial Action Task Force (FATF) on standards for Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT). Comprehensive credit information, which provides details pertaining to credit facilities already availed of by a borrower as well as his payment

track record, has become critical. Accordingly, a scheme for disclosure of information regarding defaulting borrowers of banks and financial institutions was introduced. In order to facilitate sharing of information related to credit matters, a Credit Information Bureau (India) Limited (CIBIL) was set up in the year 2000.

RBI introduced the Credit Information on Large Credits – Central Repository of Information on Large Credits (CRILC) in 2014. It has been a great step forward in addressing the issue of stressed assets. Various guidelines have been provided by the RBI to individual Financial Institutions and Banks to highlight the status of their stressed assets. The data provided by them is stored in a central database and is accessible not only by RBI but also by individual banks and Financial Institutions. This collaborative system not only helps individual banks and Financial Institutions to evaluate their own NPAs and share the information with other banks but also helps RBI in taking holistic view of the situation. Besides, the system also now enables RBI to objectively asses if the divergent classification adopted earlier was indeed justified. The database thus gives details of credit given and the state of health of these loans. This is useful to other lenders to this firm who can take corrective actions or be vigilant in dealing with these accounts.

Risk Based Supervision

To keep ahead of the curve in terms of the evolution of various financial products and their complexities and emerging product innovations with complex risk profiles, the Reserve Bank initiated measures to implement Risk Based Supervision (RBS). The RBS process has been revised and made more risk-sensitive and objective. In India, the idea to move towards risk-based supervision(RBS) of banks was first mooted in 2000. The RBS framework of the Reserve Bank evaluates the risk profile of the banks through an analysis of various risks faced by a bank. There were two rounds of pilot runs of RBS on sample banks. Based on the experience gained, the RBS process was revisited in October 2005 to make the risk profiling exercise more risk-sensitive, objective and user-friendly. A new rating framework was thereafter designed for proper risk assessment and risk aggregation. The regulatory and supervisory framework for banks in India has undergone considerable transformation during the last one and half decades in line with changes in the operating environment and international norms/practices relating to

regulation and supervision of banks. The focus of regulation has shifted from micro to macro prudential elements with a view to strengthening the banking sector and providing the banking sector with greater operational flexibility.

The Basel III framework in India, for bank risk-based capital requirements came into force in April 2013 through the Circular on Implementation of Basel III Capital Regulations in India issued on 2 May 2012, it applies to all scheduled commercial banking institutions, including the public-sector banks. The framework has since been periodically updated to include amendments.

The Asset Quality Review (AQR)

Asset Quality Review was undertaken in 2015-16 for all major banks together and was aimed at making banks recognise their asset quality realistically. It provided valuable insights on asset quality at the individual bank/ system level and ensured uniformity in identification of non-performing assets (NPAs) at the system level. Further, the early finalisation and communication of divergences in provisioning gave banks more time for effecting the additional provisioning over subsequent quarters. AQR is a part of the continuing endeavour of the Reserve Bank to strengthen the supervisory and regulatory framework to ensure timely recognition and disclosure of incipient stress and to facilitate effective and meaningful resolution. The AQR exercise undertaken in 2015-16 was a critical step in recognising the aggregate stock of non-performing assets across the banking system – it was a form of "catch-up". Alongside this a number of measures were put in place to provide a mechanism for coordinated resolution of stressed assets. In particular, the decision to do away with the regulatory forbearance regarding asset classification on restructuring of loans and advances effective April, 2015, was a significant step from the perspective of aligning the regulatory norms with international best practices. AQR was extensively based on off-site data from the Central Repository for Information on Large Credits (CRILC). The exercise clearly brought out the importance of data analysis for effective supervision. In particular, it emphasised the importance of collecting relevant data, ensuring robust data quality and integrity and the use of IT infrastructure for carrying out an incisive off-site analysis which, in conjunction with onsite assessment, ensures an effectively continuous supervisory assessment. Asset Quality Review backed by CRILC

now enables identification of NPAs which were not recognised as such by banks earlier due to divergent classifications. It also provides early signals to prevent problems in future and also alerts other banks to take remedial actions in time. The system has resulted in recognising the true quality of the assets of the banks and this is one of the reasons why there was sudden spurt in NPAs after AQR.

Prudential Regulation Basel III Framework for Indian banks:

Basel III is a comprehensive set of reform measures to strengthen the regulation, supervision and risk management of the banking sector. It aims to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source. Regulation is designed to improve the risk management and governance in the banking sector and to strengthen banks' transparency and disclosures in the banking sector. The emphasis is on both micro-prudential regulation- to enhance resilience of individual banks during periods of stress and macro-prudential regulations -to address system wide risks.

Basel III Capital Regulations

Capital Regulation in India is as per the Basel norm. The stipulations of Basel III for Improving the quality, quantity, and transparency of capital have been taken on Board. Capital is required for loss absorbency to sustain a going concern and to meet requirements of a gone concern like paying its dues. In this context the quality, quantity, consistency and transparency of capital is important. Capital should be adequate in quantity and must be better quality capital, i.e. should be predominantly common equity capital(CET1). The CET 1 capital is important as the primary loss absorption buffer that absorbs the losses of a bank. A higher level of capital can absorb unanticipated losses and inspire confidence in the minds of the public so as to keep the bank as a going concern, even in a stress scenario it does not pass on the losses to bank creditors. If the capital is low it is quickly consumed by the deteriorating financials and exposes the unsecured creditors, including depositors to bear the losses. Banks are permitted to raise Additional Tier 1 Capital which can be raised in form of subordinated, discretionary noncumulative dividends or coupons, without maturity date, where there is no incentive to redeem these. The transparency of the capital is important hence disclosure of all elements and detailed reconciliation is crucial. Basel III Capital Regulations for Indian banks will be fully

phased in as on March 31, 2020.Table 1 below gives details of the phase wise transit of commercial banks to Basel III.

Table 1: Transitional Arrangements-scheduled Commercial Banks (excluding LABS and RRBs)

% of RWAs

Minimum capital ratios	April 2013	March 31, 2014	March 31, 2015	March 31, 2016	March 31, 2017	March 31, 2018	March 31, 2020
Minimum Common Equity Tier 1 CETI	4.5	5	5.5	5.5	5.5	5.5	5.5
Capital conservation buffer (CCB)				0.625	1.25	1.875	2.5
Minimum CETI+ CCS	4.5	5	5.5	6.125	6.75	7.375	8
Minimum Tier 1 capital	6	6.5	7	7	7	7	7
Minimum Total Capital*	9	9	9	9	9	9	9
Minimum Total Capital +CCB	9	9	9	9.625	10.25	10.875	11.5
Phase-in of all deductions from CETI (in $^{0}/0$) #	20	40	60	80	100	100	100

The difference beüeen the minimum total capital requirement of 9% and the Tier 1 requirement can be met with Tier 2 and higher forms of capital;

The same transition approach will apply to deductions from Additional Tier 1 and Tier 2 capital.

Liquidity Regulation:

The Basel Ill International framework revised the norms for measurement of liquidity risk and monitoring. The effort was to try and make the banking sector ‘crisis-proof’ by addressing each of the lacuna in Basel II. A Liquidity Coverage Ratio(LCR) was introduced as part of Basel III Disclosure Standards to ensure adequate liquidity of banks starting June 2014. In India the LCR implementation commenced from January 1, 2015 (at 60%) and reached 100 per cent effective January 1, 2019. Banks are required to maintain Liquidity Coverage Ratio (LCR) in identified High Quality Liquid Assets (HQLA). Given that banks in India are already required to maintain SLR (of 20% as on date), special carve outs were permitted so as not to overburden banks in maintaining liquid assets. Periodically banks were allowed to reckon additional portions of the Government securities held by them within SLR requirement as HQLA under FALLCR. Ultimately aligning the SLR with the LCR. Net Stable Funding Ratio (NSFR) was introduced to promote resilience over a longer time horizon by creating additional incentives for a bank to fund its activities with stable sources of funding on an ongoing basis. NSFR has a time horizon of one year and has been developed to provide a sustainable maturity structure of assets and

liabilities. In India the circular for implementing the NSFR has already been issued and it will be implemented effective April 2020.

Large Exposures (LE) Framework

Introduced along the lines of Basel Committee recommendation in order to supplement the risk-based capital framework for banks. Large Exposure Framework has been put in place in order to avoid a build-up of high concentration of credit risk at the system level resulting from individual banks' large exposures to some of the large corporate entities. It places limits on banks exposures to a counterparty and a group of connected counterparties. Definition of a large exposure: equal to or greater than 10 per cent of the banks eligible capital base to a single counterparty.

It should not exceed 20 per cent of the bank's eligible capital base; additional 5 per cent as per Board approved policy for connected counterparties: not to exceed 25 per cent of the bank's eligible capital base. Eligible capital base is the effective amount of Tier 1 capital. Inter-bank exposures to address concentration risk of the banking system arising from its exposures to a single counterparty have been introduced.

The Prompt Corrective Action

The Prompt Corrective Action (PCA) framework for banks was first introduced by the Reserve Bank in December 2002 as an early intervention mechanism. The Board for Financial Supervision (BFS) decided to implement the provisions of the revised PCA framework with effect from April 1, 2017, The PCA matrix notified under the revised framework specifies indicators and risk thresholds. The revised PCA defines certain risk thresholds, breach of which would lead to invocation of PCA and invite certain mandatory and discretionary actions. The PCA framework will apply to all banks operating in India including small banks and foreign banks operating through branches or subsidiaries.

Table D2: PCA Risk Thresholds

Indicators	Risk Threshold 1	Risk Threshold 2	Risk Threshold 3
Capital (breach either CRAR or CET 1)	upto 250 bps below indicator	>250 bps below but not greater than 400 bps below indicator	
Profitability (RoA)	Negative for 2 years	Negative for 3 years	Negative for 4 years
Leverage	3.5 to 4 %	< 3.5 %	
Asset quality	NPAs 6% to 9%	NPAs 9 %to 12%	NPAs > 12 %

Resolution Frameworks in India and Insolvency and Bankruptcy Code (IBC)

Effective 2016, Government has introduced Insolvency and Bankruptcy Code (IBC) 2016. The Code seeks to resolve in a time bound manner defaults of borrower through collective decision-making process. Before the introduction of IBC, there were various schemes that tried to emulate the best features of resolution framework. These schemes did not curb the NPAs that continued to mount. With the IBC, there is a framework in place for quick resolution. With IBC, it is the creditor in possession regime. Besides the Board of Directors of the borrower is also replaced by Committee of Creditors. The Code is not only process oriented but is also time oriented. There is now a single window and time bound process. The clear emphasis is promotion of business and entrepreneurship and maximisation of value of the asset and balancing interests of stake holders. For a lender, the borrower firm should be a going concern for better recovery of the loan. Insolvency and Bankruptcy Code while transferring the management of borrower company into the hands of creditor also stipulates that resolution process should be time bound (180 days and extendable only once by further 90 days). If no resolution is reached, National Company Law Board (NCLT) the adjudicating authority is required to pass liquidation/winding up order of the borrower company.

Basel III Leverage Ratio Framework

The experience drawn from the global financial crisis suggests that the build-up of excessive on-balance sheet, as well as off-balance sheet leverage in the banking system was at the core of the financial fragilities that were witnessed during the global financial crisis. Based on recent recommendations of the Basel Committee on Banking Supervision (BCBS), the Reserve Bank

will issue revised guidelines on the leverage ratio. The tightening of exposure norms will also help in risk mitigation during cyclical downturns as banks' exposure under the framework will be more granular and diversified to a large number of unrelated counterparties rather than being concentrated to a handful of large and related counterparties.

Conversion to IFRS and Implementation of Ind AS in India

The Reserve Bank has finalised a roadmap for implementation of Ind Accounting Standards to be adopted by banks and Non-Banking Finance Companies. Indian Accounting standards (Ind AS) are accounting standards that converge with International Financial Reporting Systems (IFRS) and banks in India will soon transit to Indian Accounting Standards. There would be entities such as certain categories of corporates, UCBs, certain categories of NBFCs, RRBs , etc. which would continue to be under the extant accounting standards (AS). In transiting to Ind AS India's commitment to G-20 in 2009 to align accounting standards in India with IFRS is fulfilled.

Non-Banking Financial Companies (NBFCs)

The regulation of NBFCs is entrusted to the RBI vide Section 45-IA of the RBI Act. This Act mandates that the NBFC has to obtain a registration from the RBI and has to maintain net owned fund as indicated by the RBI in the Official Gazette, before commencing such non-banking financial business. NBFCs have seen immense growth in recent periods and have been complementing the banks as financial intermediaries by leveraging on their efficient and nimble operations for niche areas. The NBFCs cater to a variety of activities like providing comprehensive services to their foreign portfolio investment clients offer them foreign exchange products and securitisation transactions. There are numerous NBFCs operational in India. Table 3 below gives details of type of NBFCs and their activities:

Table D3: Type of NBFCs and their Activities

Type of NBFC	Activity
1. Asset Finance Company (AFC)	Financing of physical assets e.g. automobiles, tractors and generators.
2. Loan Company	Provision of loan finance.
3. Investment Company	Acquisition of securities for purpose of selling.

Type of NBFC	Activity
4. NBFC-Infrastructure Finance Company (NBFC-IFC)	Provision of infrastructure loans.
5. NBFC-Systemically Important Core Investment Company (CIC-ND-SI)	Makes investments and loans to group companies.
6. Infrastructure Debt Fund-NBFC (IDF-NBFC)	Facilitation of flow of long-term debt into infrastructure projects.
7. NBFC-Micro Finance Institution (NBFC-MFI)	Credit to economically dis-advantaged groups.
8. NBFC-Factor	Acquisition of receivables of an assignor or extending loans against the security interest of the receivables at a discount.
9. NBFC-Non-Operative Financial Holding Company (NOFHC)	Facilitation of promoters/ promoter groups in setting up new banks.
10. Mortgage Guarantee Company (MGC)	Undertaking of mortgage guarantee business.
11. NBFC-Account Aggregator (NBFC-AA)	Collecting and providing information about a customer's financial assets in a consolidated, organised and retrievable manner to the customer or others as specified by the customer.
12. NBFC–Peer to Peer Lending Platform (NBFC-P2P)	Providing an online platform to bring lenders and borrowers together to help mobilise funds.
Source: Report on Currency and Finance 2018	

The Reserve Bank has been striving to harmonise regulatory requirements of various classes of NBFCs while putting in place specific policy measures for particular classes of NBFCs such as core investment companies and legacy NBFCs as needed. NBFCs are classified on the basis of a) their liability structures; b) the type of activities they undertake; and c) their systemic importance. India also has some Government Owned NBFCs, in 2017-18, the Reserve Bank aligned the regulatory requirements of government owned NBFCs with those of privately owned NBFCs these NBFCs now have to adhere to all regulations on income recognition, provisioning norms, corporate governance, conduct of business regulations, deposit directions and reserve funds. Asset classification norms have to be complied by March 31, 2020 and capital adequacy, leverage, exposure norms and statutory provisions are to be phased in progressively by March 31, 2022.

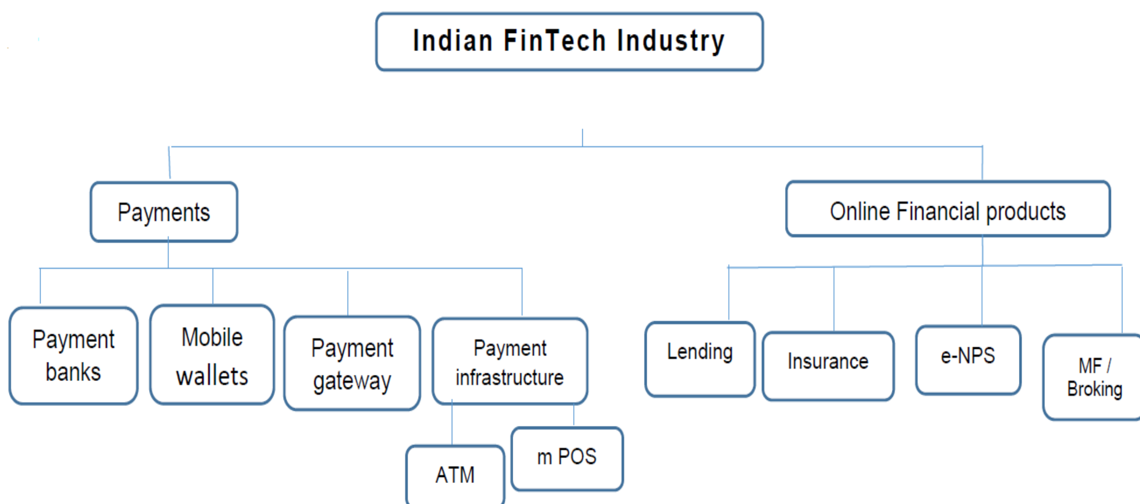
A category of NBFCs called the Core Investment Companies are registered as NBFCs primarily invest in group companies and do not carry out any other NBFC activity. They are

required to invest up to 90 per cent of their net assets in equity shares, preference shares, bonds, debentures, debt or loans of group companies, while equity investments in group companies must constitute at least 60 per cent of net assets.

Fin Tech in India

FinTech is an umbrella term coined in the recent past to denote technological innovation having a bearing on financial services. Major FinTech products and services currently used in the market place are Peer to Peer (P2P) lending platforms, Big Data, smart contracts, E-aggregators, etc. These FinTech products bring together the lenders and borrowers, seekers and providers of information. India's FinTech sector may be young but is growing rapidly, fuelled by a large market base, an innovation-driven start up landscape and friendly government policies and regulations. The Indian FinTech industry grew 282% between 2013 and 2014, and reached USD 450 million in 2015. At present around 400 FinTech companies are operating in India and their investments are expected to grow by 170% by 2020.

The structure of the Indian Fin Tech Industry is illustrated in the flow Chart D2 below:



In India, FinTech has the potential to provide workable solutions to the problems faced by the traditional financial institutions. Indian banking and financial services sector could be changed dramatically with development of this area. The Indian FinTech software market is forecasted to touch USD 2.4 billion by 2020 from a current USD 1.2 billion, as per NASSCOM. The

transaction value for the Indian FinTech sector is estimated to be approximately USD 33 billion in 2016 and is forecasted to reach USD 73 billion in 2020.

Insurance Sector in India

The insurance sector in India is said to have begun with the establishment of Oriental Insurance company in 1818. The sector today is diversified and has 63 insurance companies comprising 24 in life and 39 in other insurance sectors. The single largest insurance company is the Life Insurance Corporation of India that is state owned. The Insurance Regulation and Development Authority of India (IRDA) regulates the insurance sector. The gross premia written in India have reached the ₹ 5 trillion mark. The sector has been growing at above 15 per cent in recent years, owing to rising incomes and greater recognition of the need for insurance[6]. The sector also received a boost from Government of India's Ayushaman Bharat Scheme that will provide insurance cover of ₹ 5 lakh to 100 million families.

Mutual Fund Industry

The Mutual fund industry has also seen a phenomenal rise in their assets under managements (AUM) that stood at ₹ 23 trillion. The high growth of the mutual funds sector is due to the innovations in products, adoption of technology and use of alternate distribution channels as well as some tax concessions granted to this industry.

[6] https://www.irdai.gov.in/ADMINCMS/cms/NormalData_Layout.aspx?page=PageNo4&mid=2

5. Contemporary financial structure of Maldives

The financial sector of Maldives comprise of banking sector, non-banking financial institutions and the capital market. Banks constitute the largest and most important category of financial institutions while non-banking financial institution and capital market play a secondary role in the financial intermediation process.

Banking sector financial institutions

The banking sector controls most of the financial flows and possesses most of the financial assets. Banks are significant participants in the payment system since deposits are used as means of payment alongside cash. They have the exclusive right to accept deposits from the public and account for the largest share of lending. Private individuals and businesses hold accounts in banks in order to receive or make payments. Banks also play an important role in the development of private sector businesses; from large corporates to SME's and individuals. The banking sector consists of eight commercial banks: three locally incorporated banks, four branches of foreign banks and one subsidiary of a foreign bank.

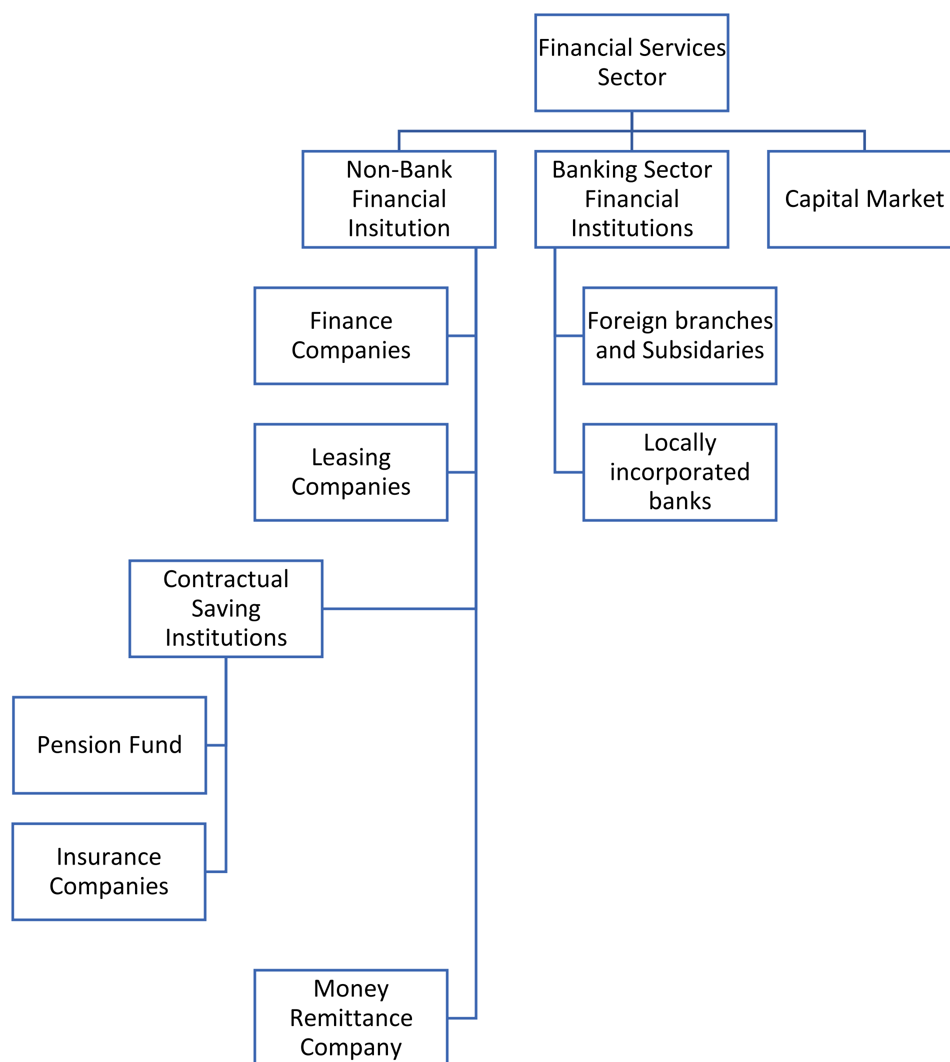
Maldives Monetary Authority

Maldives Monetary Authority (MMA) is the central bank of the Maldives and the main regulator of the financial sector in the country. Established in 1981, the MMA derives its scope, regulatory powers and mandate from the MMA Act (1981). The core objectives of MMA are specified as to issue currency and regulate the availability and international value of the Maldivian Rufiyaa; provide advisory services to the government on banking and monetary matters; supervise and regulate banking so as to promote a sound financial structure; promote in the country and outside the country the stability of Maldivian currency and foster financial conditions conducive to the orderly and balanced economic development of Maldives.

The formulation and implementation of the monetary policy in the Maldives is one of the foremost responsibilities of the MMA. The key objective of the MMA's monetary policy is to achieve price stability in the economy. To achieve this objective, the MMA regularly intervenes in the foreign exchange market through sales of foreign exchange to banks and State-Owned Enterprises (SOEs), while maintaining an adequate level of foreign exchange

reserves to keep the exchange rate within the stipulated band. In addition, the MMA manages excess liquidity in the banking system, keeping it in line with inflation.

Figure 1: Structure of the financial services sector



Source: Author's classification

The monetary policy instruments of the MMA are the Minimum Reserve Requirement (MRR), Open Market Operations (OMO), foreign currency swaps and standing facilities, which comprise the Overnight Deposit Facility (ODF) and the Overnight Lombard Facility (OLF).

Commercial banks are required to maintain a percentage of their foreign currency and local currency deposits with the MMA as the MRR. No revisions were made to the MRR during 2017 since it was revised down to 10% in August 2015.

The two standing facilities utilised by the MMA are the ODF and the OLF. After meeting the MRR, commercial banks can invest any excess local currency liquidity in the ODF on an overnight basis. The OLF allows commercial banks to borrow funds in local currency for overnight, from the MMA, to meet any short-term liquidity shortages.

The MMA is responsible for regulating and supervising the Financial Sector except for the securities market, which is governed by the Capital Market Development Authority (CMDA). MMA also regulates the payment system and houses the credit information system, both of which are financial infrastructure facilitating the effective operation of the financial intermediaries.

The Credit Information Bureau (CIB) established within the MMA, provides a national credit information registry, which will aid the financial sector to make more informed credit decisions, increase access to credit by SMEs by enabling borrowers to build reputational collateral against which they can obtain credit.

The MMA also houses the Financial Intelligence Unit (FIU), an operationally independent Unit mandated as the central national agency for receiving, analysing and disseminating information concerning money laundering and terrorism financing activities, and proceeds of crime.

An important development that took place in 2015 was the Third Amendment to the Maldives Monetary Authority Act (1981) which was passed by the Parliament and ratified by the President on 17th August 2015. The main purpose of this Amendment is to strengthen the MMA's regulatory mandate by enabling it to act as the exclusive regulator for all non-bank

financial services, except for those related to the securities market. Pursuant to the enactment, MMA plans to license and regulate all non-bank financial businesses and services by issuing regulations for each type of financial business or service separately, until such financial businesses can be regulated under a specific legislation. The amendment further enabled the MMA to regulate payment systems and to act as an operator for such payment systems.

The banking sector is governed by the provisions of the Banking Act (2010) and eleven prudential regulations formulated under this Act which sets out banking policies and ensure that the banking system operates in accordance with such policies in order to achieve the ultimate objective of stability and soundness of the sector.

Table E1: Total assets and liabilities of the institutions in the financial sector at the end of 2017

Institutions	Assets	
	MVR (in 000s)	% Share
Central Bank of Maldives	17,498,799	26.78%
Financial Institutions Regulated by the Central Bank		
Demand Deposit Taking Institutions		
Licensed Commercial Banks	45,950,031	70%
Other Financial Institutions		
Insurance Companies	1,180.25	0.0018%
Leasing and Finance companies	1,902,893	3%

Banking sector

Inclusive of three locally incorporated banks, four branches of foreign banks and one fully owned subsidiary of a foreign bank, the banking sector is assembled by a total of 8 licensed banks. Out of 8 banks six banks were incorporated before the *Maldives Banking Act (2010)* and prudential regulation formulated under this Act.

The first bank in Maldives was State bank of India (SBI) which was established in 1974. The branch held all banking activities of the government of the Maldives until setting up of the Central Bank viz. the Maldives Monetary Authority in 1982. Subsequently, two additional foreign banks which were Habib Bank Limited (HBL) in 1976 and bank of Ceylon (BOC) in 1981 were established. In the following year Bank of Maldives (BML) was inaugurated on

November 11, 1982. This was the first bank to initiate commercial operations as a joint venture bank with 60% shares held by the government of Maldives and 40% shares owned by International Finance Investment Company Limited (later IFIC Bank Limited), Dhaka, Bangladesh. The bank is currently listed on Maldives Stock Exchange with the government holding 62.2%, State Owned Enterprises 4.1% and the balance is held by public shareholders. After a considerable period of time, Hong Kong Shanghai Banking Corporation Ltd (HSBC) was established as a foreign branch in 2002. Later, Maldives Islamic Bank (MIB) solely owned by Islamic Corporation for the Development of the Private Sector (ICD) and the Government of Maldives operationalized in 7th March 2011. MIB is a domestic bank which is solely devoted to provide transaction in conformity with Shariah requirements. Subsequently, BML opened their first Islamic banking branch in 2016 due to Maldives being a 100 percent Islamic Nation and the increasing demand for the Islamic banking.

Apart from MIB all the other banks are not restricted to provide banking services regardless of being a domestic or a foreign bank. The banking sector is regulated by the Maldives Monetary Authority (MMA) under the provisions of the *Maldives Banking Act (2010)* and prudential regulations formulated under this Act. Additionally, *Islamic Banking Regulations (2011)* were set out to specifically regulate the newly establish Islamic banks. Furthermore, the MMA plays an integral role in regulating the banking sector by conducting on-site and off-site supervision to ensure the capital strength, viability of business plans and whether the bank conforms with the Regulations and Guidelines formulated by the MMA. Generally, the banks are free to offer their customers' array of Individual and Business financial services such as Deposits, Loans and Advances, ATM Services, Trade Finance, Remittance Services, Internet Banking, Card Services, Credit Facilities and Islamic Finance services such as Murabaha, Diminishing Musharaka, Isthisna etc.

The banking sector remained sound and well-capitalised during 2017, showcasing strong profitability ratios. Furthermore, the banking sector expanded its outreach during the year by inaugurating seven new branches across four atolls in the Maldives. Additionally bank profit tax and the full year effect of remittance tax which was implemented in 2016 contributed to the growth in the tax revenue during the year. The key indicators of the capital adequacy and assets

quality of the banking sector remained at the same level and maintained strong profitability levels in 2017.

Table E2: Market share of the banks in Maldives at end 2017

ank	Ownership type	Business type	Total assets (in thousands of MVR)	Market Share as % of assets
1. Bank of Maldives Plc	Private	Commercial and Islamic	21,817,597	47.48
2. State Bank of India (SBI)	Foreign	Commercial	8,942,090	19.46
3. Habib Bank Limited (HBL)	Foreign	Commercial	1,516,985	3.30
4. Bank of Ceylon (BOC)	Foreign	Commercial	4,136,022	9.00
5. Hong Kong Shanghai Banking Corporation Ltd. (HSBC)	Foreign	Commercial	4,228,213	9.20
6. Mauritius Commercial Bank Maldives Pvt. Ltd. (MCB)	subsidiary of a foreign bank	Commercial	1,574,385	3.43
7. Maldives Islamic Bank Pvt Ltd. (MIB)	Private	Islamic	2,780,042	6.05
8. Commercial Bank of Maldives Pvt Ltd. (CBM)	Private	Commercial	954,697	2.08

Non-bank financial institutions

Generally, the non-financial institutions include any institution that is not restricted by the Maldives banking Act (2010) and provides financial services to Individuals and Businesses. These financial institutions have their own Act and Guidelines regulating and monitoring them. These institutions are regulated by the MMA and the Capital Market Development Authority (CMDA). The non-bank financial institutions regulated by MMA include five Insurance Companies, two finance companies, five money remittance providers and two payment service providers. The other non-financial institutions are regulated by CMDA which are security market intermediaries and the pension fund.

Finance Companies

The non-bank financial sector includes a finance leasing company and specialised housing finance company. Housing Development Finance Corporation Plc. (HDFC) was established in 2004 which currently is the only licensed Housing finance provider in Maldives. Similarly, Maldives Finance Leasing Company Pvt. Ltd. which was established in 2002 is the only licensed leasing finance provider in Maldives. Both of these institutions are licensed and regulated by the MMA under Regulations for the Finance Leasing Companies and Finance Leasing Transactions (2001).

International Money Transfer Companies

Money Remittance Companies in Maldives primarily provide international remittance services via reputable global remittance providers including Western Union Money Transfer Services, Xpress Money Services Limited, Wall Street Exchange Centre and Instant Cash FZE etc. In order to ensure the businesses are conducted in a safe and sound manner, MMA issued the Regulation for Remittance Businesses with the objective of supervising, licensing and safeguarding their customers.

During the year 2017, MMA licensed an additional company to conduct international remittance using the network of Western Union, while two remittance companies cease their operation. Overall outward remittance for 2017 was amounted to US$66.8 million which was a substantial decline of 39% associated to the preceding year. Similarly total outward remittance by foreign nationals accounted for 71%, a decline from 83% in the last year. However, remittances by Maldivians' throughout the year remained fairly stable

with an improvement toward the end of the year. The aforementioned discrepancies were observed since the implementation of the expatriate remittance tax which initiated on 1 October 2016. Furthermore, the top remittance destination with 46% of outward remittance was sustained by Bangladesh. India remained second with 15% of outward remittance followed by Sri Lanka (11%), Nepal (6%) and the Philippines (5%). Additionally, inward remittance recorded an increase in 1% amounted to US$4.7 million in 2017.

Mobile Payments

An era exposed to rapid technological improvements and Maldives being a geographically dispersed country, making financial transactions via conventional bank branches are considered very costly and wastes a significant amount of time. Mobile payment services promote a more cost effective electronic payments and overlays an approach for a less cash-based financial system.

Therefore, MMA has licensed Ooredoo Mobile Payment Services which allows customers to register for "Mobile Wallet Account" to deposit, withdraw, pay and send money in Maldives instantly through mobile phones, both USSD and Mobile Application. This mobile system allows customers to pay bills, top-up airtime etc as well as enables person-to-person (P2P) or person to merchants (P2M) through their mobile wallet accounts.

Furthermore, BML also allows their customers to use mobile payments via BML MobilePay, a mobile application which enables their customers to make safe and secure methods of making payments and transfers without the presence of the physical card. Additionally, the customers are unrestricted to integrate their card to the mobile application and use this on BML card terminals.

Recently, the MMA licensed Dhivehi Raajjeyge Gulhun Plc to provide mobile payment services in the Maldives in July 2017 and commenced their services in October 2017 with more than 100 agents and merchants. The expansion of the mobile payment services in 2017 accumulated to more than 370 agents and merchants, further covering 37% of the inhabited islands. Payment service providers were able to connect forty-three islands that

did not have a bank branch or an ATM with an agent/merchant further reducing the discrepancies in the payments systems in Maldives.

Insurance Sector

Till the end of 2017, Maldivian insurance sector consisted of 5 Insurance companies where one offering both general and life insurance. Amongst the 5 there are three domestic insurance providers which are Allied Insurance Company of the Maldives being the default monopoly to provide life insurance services, Solarelle Insurance and Dhivehi Insurance. The foreign companies are namely Amãna Takaful which is a fully fledged Takaful services provider and Ceylinco Insurance Company. Allied Insurance Company also provides Takaful services through their Islamic branch named Ayady Takaful making it the second Takaful provider in the Maldives. The sector is built around a direct distribution model in acquiring business. Nevertheless, there are licensed brokers and agents engaged in the market. Currently there are 8 Insurance brokers and 41 insurance agents. The sector is regulated by MMA under jurisdiction provided under MMA Act (1981) and administrated by the guidelines, specific criteria for authorisation and regulatory requirements under The Insurance Industry Regulation (2004).

The first insurance company in Maldives was the Sri Lanka Insurance Corporation which established its branch office in 1976. The insurance company pulled out and ceased their operations in 2013 due to increasing competition in the market. The first domestic insurance company commenced in 1985 as a joint venture between Commercial Union Assurance Company, UK and State Trading Organization (STO), the nationwide leader of all commercial activities in Maldives. In 1987, STO bought back shares of Commercial union Assurance chartering Allied Insurance to resume business as a Subsidiary of STO. Currently, Allied Insurance is one of the largest financial institutions in the Maldives with tremendous growth over the past decade. Allied insurance started selling long-term (Life) insurance policies in 2008 and is the sole provider of life insurance. Allied Insurance also launched its Islamic Window on 2014 in order to deliver and cater more customers with wide variety of products. The third company to this industry is Amãna Takaful, a company from Sri Lanka which initiated its operation in 2003. This is the only company to solely provide Shari'ah compliant Takaful to the market and is currently the only publicly quoted insurance company listed in the Maldives Stock Exchange (MSE).

Ceylinco Insurance Company was a Sri Lankan company represented through a local agent RSH Financial Services Ltd in 2005. Ceylinco Insurance Company was the first company to expand their branches outside the capital atoll to Addu to atoll.

Insurance companies were running under the radar with nominal competition with three competitors until 2016 where two domestic insurance companies were introduced. Dhivehi Insurance Company was found by the former Managing director of Allied Insurance for the past years. The other Insurance Company, Solarelle Insurance Company was founded by a local businessman who was known for his prior Executive posts in the government ministries and largest companies in the Maldives.

Capital Market

Initially an interim security trading facility for Capital Market Development Authority (CMDA), Maldives Stock Exchange was established in pursuant to the Maldives Securities Act (2/2006) conceptualized by CMDA. Later the Interim Securities Trading Facility operated by CMDA was transferred to Maldives Stock Exchange (MSE) which was subsequently licensed by CMDA to operate Maldives Stock Exchange in January 2008. The incorporation of MSE as a private sector exchange was established to ascertain a mechanism and to provide a regulatory framework standardizing the trading and settlement of securities in the Maldives. Akin to the incorporation, on January 2008 Maldives Securities Depository Company Pvt. Ltd. (MSD) was licensed as a subsidiary of MSE in order to undertake the Central Depository and Clearing Settlement function of MSE. Additionally, CMDA is responsible to review quarterly reports published by Listed Companies to ensure whether the companies comply and adhere to Securities (Continuing Disclosure Obligation of Issuers) Regulation 2010 (2011/R-10) and corporate governance code and enforce actions towards entities that are in breach of the regulatory requirements or who fail to disclose the required information as instructed.

Mutually with the initial establishment of MSE two stock brokers emerged the market. The first licensed brokerage firm was Stock Brokers Maldives Pvt. Ltd. which embarked their operations in the field of dealing with securities and providing a range of financial services whilst centralizing on the development of the Maldivian capital market at large. It is worth mentioning that the Stock brokers Maldives was registered in August 2006,

months after the Maldives Securities Act 2006 which is owned by a well-established company in Maldives further facilitating the company to become the leading specialist in the Capital Market. Subsequently, Aariya Securities Pvt. Ltd. was formed on November 2006 with the primary function of facilitating trading of shares of listed companies at the MSE. Both of these companies are licensed under the Dealers and Dealers Representative Licensing Regulation contemplated by CMDA.

Credit Analysis and Research Ltd. (CARE), second largest rating agency in India was the first credit rating agency in Maldives licensed by CMDA. It decided to not renew its license to operate in Maldives due to past operations and future prospects and was closed since 6th January 2017. Currently there is no registered Credit rating agency in Maldives. Nevertheless, recent developments include CMDA registering the first Investment Fund in Maldives under the name Watercress Growth fund Pvt. Ltd. This fund operates on the basis of collecting subscriptions from anyone who wishes to participate and distribute interest, profits, dividends and/or any other benefit attained amongst the subscribers. Additionally, MSE announced a future direction by capitalizing on the financial technology and introducing an online solution, “Infinity” which enables users to subscribe to shares online which is said to eradicate the prevalent market challenges through futuristic solutions.

Currently there are 8 listed companies with over 31,000 investors and MVR 14.5 billion Market Capitalization. Maldives enjoyed a stable growth rate averaging 7.5 percent over the past 15 years. Generally, there are two types of securities that a company can list on MSE which are Equity and Debt (Bond and Sukuk). A company can list by making offers to the public of the company’s own securities, by company’s existing security holders making an offer to the public or in extenuating circumstances by way of introduction where MSE grants a security issued by a company listing without the requirement of a public offering of its securities.

Pension fund

The Maldives Pension Administration Office (MPAO) established as an independent legal entity on 2009 after the ratification of Maldives Pension Act (8/2009). The main functions the Maldives Pension Act (8/2009) allows MPAO to administer Maldives

Retirement Pension Scheme (MRPS), pay state-funded Old Age Basic Pension Scheme (BP), disbursement of Other State-funded Pensions, collateralization of Retirement Savings Account (RSA) for Housing Finance, manage pension funds, establish standards, rules and guidelines related to the schemes and create public awareness and educate scheme participants.

Currently 389 public sector employers and 1503 private sector employers are participated in MRPS, aggregating the amount of total employees to 88,716 where monthly contribution to MRPS is MVR 85.17 million. BPs disbursed during 2017 amounted to an average of 36.27 million per month to 16,533 beneficiaries in total. Furthermore Average State-funded other pensions disbursed averaged to 22.55 million and average seniors citizen allowance disbursed per month was 44.92 million. Out of 54 MRPS members with a total of 33 applications, 41 eligible members with 27 applications collateralized RSA balance for housing schemes with funds equivalent to MVR 6.99 million.

CMDA is mandated to supervise the vision and performance of pension assets, formulation of guidelines for reporting and disclosure in relation to the Maldivian Retirement Pension Scheme. In this regard, CMDA supervises investment of pension assets which is carried out on a quarterly basis to examine whether the investments aligned Statement of Investment Principles (SOIP) and the Asset Allocation Policy of MPAO. Furthermore, the authority has the responsibility to evaluate candidates shortlisted and proposed for the positions in the board of MPAO.

SME Development Finance Corporation

The most recent development in the financial sector of the Maldives is SME Development Finance Corporation (SDFC), a 100 percent State-owned corporation which was licensed by MMA on 28th February 2019. SDFC was developed to improve economic development of Maldives and to increase the competition of the financial sector. Principally, SDFC will facilitate financial aids through the formulation of relevant polices to SME’s largely engaged in three main industries, tourism, fisheries and agriculture. Furthermore, as some of these industries require technological advancements to expedite the growth and development, SDFC aims to provide technological capacity to cater for these requirements.

Table E3: Major banking sector reforms since 2008

Year	Reform/Direction
2008	Established Islamic Finance Unit (IFU) in the MMA to facilitate the set up of the Maldives Islamic Bank (MIB).
2009	The MMA started using Open Market Operations (OMOs) using one week Repurchase and Reverse facilities. MMA converted part of the outstanding government debt into government bonds, and they are held as collateral in the conduct of OMOs. OMOs are conducted with licensed commercial banks on a weekly basis in order for MMA to manage liquidity (to absorb or to inject liquidity) in the banking system. Commencement of Treasury Bills Auctioning To develop the government securities market and to finance the budget deficit with the least possible cost, the T-Bills auction system was introduced on 28th December 2009. Until 28th December 2009 Treasury Bills were issued on a tap system. Under the "Agency Agreement for Cash and Domestic Debt Management" signed between MMA and the Government of Maldives, MMA acts as the agent of the government in issuing Treasury Bills (T-Bills) to Commercial Banks and SOEs in order to finance the government budget deficit1. T-Bills are issued for 28 days and 91 days and are denominated in rufiyaa, sold at a discount to par and carry no coupon. With the introduction of the T-Bills, the Certificate of Deposits (CDs) has been temporary halted.
2010	The Prudential regulation on Foreign Currency Exposure Limits came into effect on 12th January 2010. A banking license was issued on 2nd August 2010 to Maldives Islamic Bank Pvt Ltd to conduct Islamic banking business in the Maldives. Under this license the bank shall commence operation within 180 calendar days from the date of the license. Maldives Islamic Bank Pvt Ltd is a locally incorporated company, owned by Islamic Corporation for the Development of the Private Sector (ICD) and Government of Maldives.

Table E3: Major banking sector reforms since 2008

Year	Reform/Direction
	The Mauritius Commercial Bank Limited Male' branch which operated in the Maldives since 2008 was converted to a subsidiary bank of Mauritius Commercial Bank Ltd and was locally incorporated on 8th September 2010. The banking license issued to Mauritius Commercial Bank Ltd was transferred to The Mauritius Commercial Bank Maldives Pvt. Ltd. on 29thSeptember 2010. The MMA's Board established a Shariah Council to oversee Shariah aspects of Islamic banking and finance in the Maldives on 17th October 2010. The Maldives Banking Act came into effect on 12th December 2010.
2011	Establishment of an Islamic Bank in the Maldives MMA issued the Payment Systems Regulation and Financial Transaction Reporting Regulation during 2011.
2012	Facilitate the specific regulation needs of Islamic banking, the 'Islamic Banking Regulation' of 2011 sets out specific requirements governing the licensing, financial, prudential and supervisory matters relating to Islamic banking business in the Maldives.
2013	The "Customer Charter" which was formulated in 2012, was implemented on 14 January 2013. The charter sets key standards of banking practices that can be expected by customers when conducting transactions with banks, and provides guidance to banks for adopting a "Code of Conduct" for customer service and protection. The charter also defines a set of customer obligations towards banks. A license was issued to Bank of Maldives Plc. to operate as a corporate agent of Allied Insurance Company of the Maldives on 2 April 2013.
2015	A Deposit Insurance Scheme, a key financial safety net, was introduced during 2015 with the issuance of the Deposit Insurance Scheme Regulation on 24th August 2015. The MMA issued the Regulation for Offshore Banks Operating in the Special Economic Zone on 14th June 2015, to provide a licensing and regulating regime applicable to offshore banks interested in

Table E3: Major banking sector reforms since 2008

Year	Reform/Direction
	establishing themselves in the Maldives under the Special Economic Zone Act. The MMA issued three regulations under Law No. 10/2014 (Prevention of Money Laundering and Financing of Terrorism Act), which came into effect on 15th January 2015. These regulations were a) Regulation for Banks on Prevention of Money Laundering and Financing of Terrorism; b) Regulation for Life Insurance and Family Takaful Insurance Businesses on Prevention of Money Laundering and Financing of Terrorism; and c) Regulation on Prevention of Money Laundering and Financing of Terrorism for Money Transfer Businesses and Money Changing Businesses. The MMA issued the Regulation of Cross Border Cash Declaration Amount on 22nd March 2015 to set a limit for the enforcement of cross-border cash declaration provisions under Law No. 10/2014 (Prevention of Money Laundering and Terrorism Financing Act).
2016	Pursuant to Law no. 24/2014 (Special Economic Zones Act), the MMA issued the 'Regulation for Non-Bank Financial Businesses Operating in the Special Economic Zone', which came into effect on 4 February 2016. Pursuant to Law no. 10/2014 (Prevention of Money Laundering and Financing of Terrorism Act), the MMA issued the 'Regulation for Securities Institutions on Prevention of Money Laundering and Financing of Terrorism', which came into effect on 5 April 2016. Pursuant to Law no. 6/81 (Maldives Monetary Authority Act), the MMA issued the 'Regulation on Mobile Payment Services', which came into effect on 17 July 2016. The regulation's purpose is to regulate and supervise mobile service providers. Pursuant to Law no. 6/81 (Maldives Monetary Authority Act), the MMA issued the 'Regulation on Fees and Charges Payable

Table E3: Major banking sector reforms since 2008

Year	Reform/Direction
	by Financial Institutions', which came into effect on 21 August 2016. The First Amendment to the Maldives Banking Act was passed by the Majlis and ratified by the president on 4th January 2015.
2017	Pursuant to Law no. 24/2010 (Maldives Banking Act), the MMA issued amendments during 2017 to Regulation no. 2015/R-151 (Regulation on Limits on Loans to Related Persons) and Regulation no. 2015/R-173 (Regulation on Transactions with Related Persons).

Source: Annual Reports, Maldives Monetary Authority

6. Contemporary financial structure of Nepal

As in other countries, the financial sector of Nepal is comprised of both formal and informal sectors. Banking institutions dominate the formal financial sector while other markets such as the capital market and money market play a limited role in facilitating the efficient and effective allocation and deployment of resources in the economy. In contrast, the informal financial sector does not have an organised setup and mainly provides short-term lending facilities based on personal contacts. Studies have found a significant role played by the informal sector as a source of credit for consumption loans to poor households. This section provides a holistic overview of the structure of the formal and informal sectors of the financial sector while highlighting the role of each player in the sector. Nepalese financial system has been regulated by different independent regulators in the sectors of banking, insurance, securities markets, contractual saving institutions and other service sectors.

Banking sector financial institutions

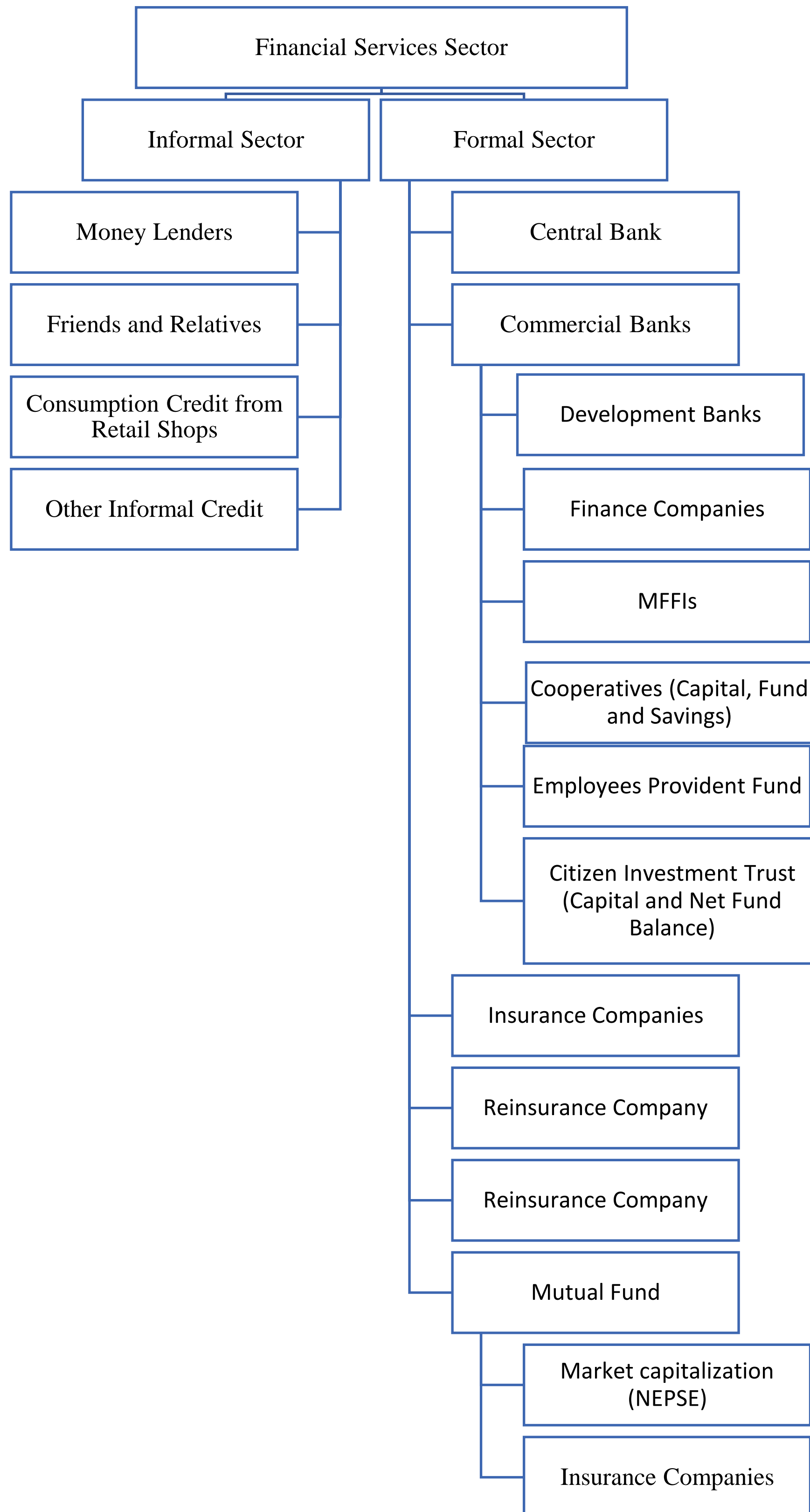
The banking sector dominates the financial sector in Nepal. It controls most of the financial flows and possesses most of the financial assets. Figure 1 shows the current institutional structure of the financial sector of Nepal. The banking sector comprises the Nepal Rastra Bank licensed commercial banks, licensed specialised banks, merchant banks, cooperative banks and some other thrift societies. Total number of "A", "B", "C" and "D" class financial institutions increased to 151 in mid-July 2018 from 149 in mid-July 2017 despite of merger and acquisition policy adopted by the NRB due to increase in the number of "D" class financial institutions as NRB has been quite liberal in licensing those institutions to enhance financial access to unbanked or under banked areas.

Nepal Rastra Bank

NRB, the central bank of Nepal, established in 1956 under the Nepal Rastra Bank Act 1955 is the monetary, regulatory and supervisory authority of banks and financial institutions. The new Nepal Rastra Bank Act 2002 which replaces the erstwhile Act has ensured operational autonomy and independence to the Bank. Key objectives of the Bank are to achieve price and balance of payments stability, manage liquidity and ensure

financial stability, develop a sound payments system, and promote financial services. The Board of Directors, chaired by the Governor, is the apex body of policy making and the Governor also discharges his duty as the chief executive of the Bank.

Chart F1: Structure of the financial services sector



Sources: Financial Stability Report

Instruments, mainly CRR and OMO, to maintain price level stability which is conducive to economic development. Financial system stability is maintained through an effective regulatory environment, a reliable payments and settlements system, efficient financial markets and sound financial institutions. Financial sector supervision is a vital role played by the NRB in maintaining financial sector stability in the country. Financial institutions come under the supervision of the NRB and their shares in assets and liabilities are shown in Table 1.

Table F1: Total assets and liabilities of the institutions in the financial sector at the end of 2018

Financial Institutions	Mid-July 2017	Mid-July 2018
Commercial Banks	2,621,230.38	3,104,271.42
Development Banks	305,079.44	374,701.11
Finance Companies	82,609.84	96,012.96
MFFIs	133,765.0	175,747.6
Cooperatives (Capital, Fund and Savings)	396,534.8	388,130.00*
Employees Provident Fund	251,283.35	292,160.00
Citizen Investment Trust (Capital and Net Fund Balance)	99,101.60	114,061.30
Insurance Companies	185,890.00	260,316.10
Reinsurance Company	6,858.52	10040.00
Mutual Fund	9,750.00	12955.20
Total	**4,092,102.93**	**4,828,395.69**
Market capitalization (NEPSE)	1,856,829.39	1,435,137.67
Total (incl. market capitalization)	**5,952,094.69**	**6,263,533.36**

**Based on first 8 Month's data of FY 2017/18*

Banking sector

There are 28 licensed commercial banks, 33 Development Banks, 25 Finance Companies and 65 microfinance finance companies with the total 151 licensed institutions Nepal . At the same time NRB has licensed 15 cooperatives and FINGO with limited banking amounted to 25 in number. Most of the private domestic banks and financial institutions entered the market after the 2005.

Although some banks were already established before 2005 but the development in the banking sector has evolved since then. The 28 commercial banks are allowed to do all banking activities such as deposit taking, granting loans, forex transactions and dealing with derivatives. The development banks are mostly focused on savings and development banking rather than commercial banking activities. The finance company are not allowed to accept demand deposits, which are not entitled to receive interest payments from the banks. Three of the commercial banks have been owned by government with more than 51 percent of share. Its role involves conducting on-site and off-site supervision of these institutions. Merchant banks are established by the commercial banks in the form of subsidiary as permitted by the unified directive issued by NRB. and they cater to the specific banking needs of their corporate customers and to the demand for financial services in the capital market. There are twenty five merchant banks operating in the country today.

Cooperative banks micro finance financial institutions also accept deposits and grant credit in the country, catering in particular for the poor and lower middle class households to meet their savings and credit needs. These institutions, focusing on rural development, are regulated and supervised by the Central Bank . Although cooperative banks cooperative societies cater to a large number of households, they account for less than 8.04% of total banking sector assets due to the small scale of their transactions.

Table F2: Percentage Share (Excluding NEPSE Market Capitalization)

Financial Institutions	2016	2017
Commercial Banks	64.00	64.29
Development Banks	7.45	7.76
Finance Companies	2.02	1.99
Microfinance Finance Financial Institutions	3.27	3.64
Cooperatives (Capital Fund and Savings)	9.68	8.04
Contractual Saving Institutions		
Employees Provident Fund	6.14	6.05
Citizen Investment Trust (Capital and Net Fund Balance)	2.42	2.36
Insurance Companies	4.54	5.39
Reinsurance Company	0.24	0.21
Mutual Fund	0.24	0.27
Total	**100**	100.00

Sources Financial Stability Report July 2018

Table F3: Province wise Presence of Banks and Financial Institutions of Nepal

Province	BFIs			Total	Share (in percent)	Population (per branch)
	A	B	C			
Province No 1	486	135	38	659	15.68	43,730
Province No 2	359	56	18	433	10.30	66,555
Province No 3	1031	258	72	1361	32.39	21,174
Gandaki	345	219	24	588	13.99	49,011
Province No 5	481	265	29	775	18.44	37,185
Karnali	122	9	3	134	3.19	215,061
Province No 7	199	51	2	252	6.00	114,358
Total	3023	993	186	4202	100.00	

Sources Stability Report Mid July 2018

Non-bank financial institutions

In general, financial institutions which collect deposits from the public are considered to be banks, and non-bank financial institutions are not allowed to accept deposits from the public. In practice, it is difficult to distinguish between the financial services provided by banks and non-bank financial institutions since there are a number of similarities in the services that they provide. Differences can be seen in practices, regulatory environments and legal or formal definitions of the non-bank financial institutions in different countries. In the Nepalese context, some non-banking institutions such as contractual saving companies are insurance companies, citizen investment trust, employees provident fund also provides financial services but are not regulated by NRB in fact they have got their own Act from which they were formulated.

Contractual savings institutions

The two main categories of contractual savings institutions, namely employees provident fund and citizen investment trust also play a vital role in the financial market in Nepal with their ability to accumulate significant amounts of long-term saving from the public. Social security funds in Nepal comprise the Employees' Provident Fund (EPF), the Employees' Trust Fund (ETF), the Public Service Provident Fund and some other provident funds run by semi-government entities or private sector employers. EPF

dominates social security funds as the largest fund in terms of member accounts, assets and investments.[1] The minimum contribution of the EPF should comprise 10% of the basic of an employee and 10% from the employer totalling 20% of gross earnings of the employee. Karmachari Sanachaya Kosh (KSK), also known as Employees Provident Fund (EPF) in English. manage Provident Fund (PF) in Nepal on behalf of the Government of Nepal (GoN) for government, public and private sector employees and come under Ministry of Finance as an approved retirement fund of GoN, and the PF that manage is supposed to help contributors financially on retirement or separation from their jobs. Besides managing PF of their contributors, it also provides certain social benefits to the contributors. In Nepal, the history of Provident Fund (PF) dates back to 1934 when the PF scheme came into existence with the establishment of Sainik Drabya Kosh (Army Provident Fund) during the Rana Regime. The scheme was initiated with the intentions of removing financial hardships to the army personnel after their retirement. Under the scheme, the army staffs were required to contribute a specific percentage of their salary to their provident fund (PF) account in Sainik Drabya Kosh. A decade later the scheme was broadened to cover the employees of civil services as well.

A separate organization named Nijamati Provident Fund was established in 1944 to manage the scheme for civil servants working within Kathmandu. In 1948 the coverage of the scheme was extended to provide coverage to the entire civil servants working through out Nepal. In 1959, Employees Provident Fund (EPF) Department was established under the Ministry of Finance and Economic Affairs. This department was entrusted with the management of both Sainik Drabya Kosh and Nijamati Provident Fund. With this, the scope of the scheme was extended to cover all government employees including the police.

Three years after the establishment of EPF Department, a special Act called "Karmachari Sanchaya Kosh (KSK) Act" was legislated in the year 1962. The same year the present KSK, or EPF in English, was established under the act as an autonomous provident fund organization. After the establishment of KSK the erstwhile Sainik Drabya Kosh, Nijamati Provident Fund and Provident Fund Department were merged into KSK. Since then KSK has grown by leaps and bounds and today it stands as a strong social security providing organization in Nepal.

The insurance industry is also a leading player in the economy for mobilising savings and improving investment. In the beginning the insurance industry comprised only foreign companies American Life Insurance company was passed. Later, a number of private sector players entered into the insurance business by establishing companies to provide insurance services. There are currently 19 life insurance company 20 non life insurance companies and 1 reinuurance company in Nepal. Beema Samiti (Insurance Board) is the Insurance Regulatory Authority of Nepal, the line ministry of the Ministry of Finance, Government of Nepal. The word 'Beema' means 'Insurance' and 'Samiti' connotes 'Board'. Hence, the Word 'Beema Samiti' is synonymous to Insurance Board which is constituted to systematize, regularize, develop and regulate the insurance business within the country under Insurance Act, 1992. This Samiti (Board) looks after all the insurance related activities in the Federal Democratic Republic of Nepal. As a regulatory body, the Board's main concern is to create a professional, healthy and developed insurance market in Nepal. Furthermore, after the restoration of democracy in 1990 AD, insurance environment began to change simultaneously along with other factors. Thus to meet the requirements of the changing situation, Insurance Act, 1968 was repelled by new Insurance Act, 1992 (Beema Ain, 2049). The preamble of the Act clearly states the purpose of the Act, thus "to establish an Insurance Board to systematize, regularize, develop and regulate the insurance business". To achieve the goal of the preamble, Beema Samiti (Insurance Board) is formed as an autonomous body the Insurance Act of 1992.

Citizen Investment Trust

Citizen Investment Trust (Nagarik Lagani Kosh), a statutory institute under Citizen Investment Trust Act, 2047, has ownership of Nepal Government as a public financial organization. It was established on 18th March, 1991(4th Chaitra, 2047B.S) as an autonomous body. Formally it has been operating its activities since 15th January, 1992 (1st Magh, 2048. It operates and manages various types of retirement schemes / programs as well as various unit schemes and mutual fund program for both domestic and foreign investors to encourage the people for saving in order to expand fund and increase the investment opportunities along with the dynamic development of the capital market to contribute economic development of the nation.

CIT has successfully completed its two decade challenging years with the simultaneous growth of dynamic capital market in Nepal. At present, it has been launching various types of voluntary retirement schemes (Pension funds, Gratuity funds etc.) and mandatory

insurance fund programs on the basis of fully funded and individual account. CIT, at the same time, encouraging the long-term saving mobilizations by operating Employee Savings Growth Retirement Fund (ESGRF), Insurance Funds for Civil Service's employees, Teachers, Nepal Army's Employees, Nepal Police's Employees, Armed Police Force's Employees and others institute's employees to help the depositors for saving to expand fund and increase opportunities to investment along with the development of the capital market. The head office of CIT is at New Baneshor, Kathmandu and branch offices are at Pokhara and Biratnager.

Security Exchange Board of Nepal

Securities Board of Nepal (SEBON) was established by the Government of Nepal on June 7, 1993 as an apex regulator of Securities Markets. It has been regulating the market under the Securities Act, 2006. The Governing Board of SEBON is composed of seven members including one full time chairman appointed by the Government for tenure of four years. Other members of the Board include joint secretary of Ministry of Finance, joint secretary of Ministry of Law, Justice and Parliamentary Affairs, representative from Nepal Rastra Bank, representative from Institute of Chartered Accountants of Nepal, representative from Federation of Nepalese Chambers of Commerce and Industries, and one member appointed by the Government from amongst the experts pertaining to management of securities market, development of capital market, financial or economic sector currently there are 50 stocker borker that have been licensed by SEBON.

Informal financial sector

As in other developing countries, the informal financial sector is also an important component in Nepalese financial sector. Although there is no well-established definition for the informal or unorganised financial sector, in general the informal financial sector consists mainly of money lenders, pawn brokers, and friends and relatives who provide financial assistance with or without collateral and interest. Further, rural retail shops in Nepal also have a practice of providing consumption items on credit to their customers without any collateral.

Banking sector expansion under the open market economy (1977–2016)

The history of banking in Nepal dates back to the year 1937 AD with the establishment of Nepal Bank Limited as the first commercial bank in Nepal. It was established as a semi-government bank with METALLIC COINS worth NRs 10 million as the authorized capital. Banknotes in Nepal weren't introduced up until the mid-1940s. It was in the year 1945 that

the earliest banknotes were issued by the treasury *"Sadar Muluki Khana"*. These notes were signed by a *"Khajanchi"*, the head of the treasury who also was a high Hindu Priest.

Later in the year 1955, Nepal Rastra Bank Act was formulated for a better banking system and Nepal Rastra Bank was established in 1956 as the Central Bank of Nepal accordingly. After this date, the banknotes were issued by the Central Bank with the signatures of the governors of the institution. Till the 1980s, the banking sector was wholly owned by the government, with Agriculture Development Bank, Rastriya Banijya Bank, NBL and NRB being the pillars of financial institution in Nepal.

1984 saw the start of the private banking industry with the establishment of Nabil Bank and the introduction of foreign banks such as the Nepal Arab Bank, Nepal Indosuez Bank and Nepal Grindlays. The banking sector in Nepal has faced many hurdles and hindrances. It has undergone various political conflicts and instability. But today, it stands more liberalized and modernized. There are various types of banks working in the modern banking system in Nepal. As per the list issued by NRB as of Mid-June 2018, the modern banking sector includes 28 Commercial Banks, 33 Development Banks, 25 Finance Companies, and 63 Micro Credit Development Banks.

Financial Sector Reform Program in Nepal Phase I (1984-1990)

The first phase of the financial sector reform was initiated in mid-1980s under the liberal economic policy of HMG/N. Under this policy, HMG/N first opened up the banking sector to foreign investors. In 1984, the Nepal Arab Bank Limited was established as the first joint venture commercial bank of the country. The bank was established with 50 percent equity participation of a foreign bank. In July 1985, commercial banks were allowed, for the first time, to accept current and fixed deposits on foreign currencies (U.S. dollar and sterling pound) Before May 26, 1986, the interest rates of commercial banks were totally controlled by Nepal Rastra Bank (NRB), the central bank of Nepal. The Agriculture Development Bank of Nepal (ADB/N) and the Nepal Industrial development Corporation (NIDC) were allowed to issue debentures to increase their financial resources.

Phase II (1991- 1998)

After the restoration of democracy, the democratic governments under its open and liberal economic policy gave more emphasis on the liberalization of the financial sector. As a result, the Nepalese financial sector has grown very rapidly since 1990s. There has been a dramatic rise in the number of banking and nonbanking financial institutions. Till mid-July 1990, there were 5 commercial banks, 2 development banks, 2 insurance companies,

and other few financial and quasi financial institutions. As at mid-July 2000, there were 11 commercial banks, 2 development banks, 5 regional rural development banks (RRDBs), 44 finance companies, 2 insurance companies, 29 savings and credit co-operative societies and 30 NGOs licensed by NRB and few other financial and quasi financial institutions (EPF, Deposit Insurance and Credit Guarantee Corporation, Citizens Investment Trust, Nepal Stock Exchange Limited, Securities Board, Insurance Board, Credit Economic Review 81 Information Bureau). There has been a tremendous increase in the volume of financial transactions and financial markets as well.

Phase III(1999-March 2004)

Financial sector reforms introduced in the last one and a half decades made significant improvements in certain sectors such as liberalization of interest rates, creation of a basic regulatory and supervisory frameworks, development of a longer-term government securities market, secondary market of government securities, establishment of several types of banking and financial institutions, functioning of stock exchange, competitive environment in the insurance services due to establishment of more insurance companies etc. But serious problems remained with two largest commercial banks (RBB and NBL) and two largest development banks (ADB/N and NIDC). The World Bank, the IMF and the Asian Development Bank (ADB) found some weaknesses in NRB's regulatory and supervisory capacity to effectively and efficiently regulate and supervise banking and other financial institutions There were Government mandates seriously distorting operating incentives of the banking sector. Commercial banks requirement to lend in the priority and deprived sectors, problems in opening of new branches to private banks, and restrictions on entry of foreign banks in the financial market.

Some of the main elements of financial sector reform strategy published by HMG/N in December 2000 are as follows: 1. Implementing restructuring plans for the to large commercial banks-the RBB and NBL 2. Identifying restructuring strategies for the two development banks, ADB/N and NIDC. 3. Strengthening banking sector regulation and accounting and auditing standards. 4. Strengthening the NRB's supervisory capacities and its ability to enforce compliance with prudential regulations. 5. Improving the regulation and supervision on non-bank deposit taking institutions. 6. Modernizing the legislative framework with a view to reducing legislative overlap and the segmentation and fragmentation. 7. Strengthening corporate governance and the framework for loan recovery. 8. Phasing out the role of NRB and commercial banks in providing directed credit.

The deposits/GDP ratio of commercial banks rose to 44.9 percent at mid-July 2003, which was only 34.1 at mid-July 1998. Likewise, the credit/GDP ratio Economic Review 87 increased to 27.4 from 22.8 during the same period. But the total liquid fund/total deposit ratio declined to 20.2 from 33.6. The capital adequacy ratio improved to 5.8 from 4.8 during the same period. The deposits of the banking sector rose to Rs 189.39 billion from Rs 90.84 billion. The total gross insurance premium increased to Rs 2.93 billion in FY 2002-03 from 0.57 billion in FY 1992-93

The details of the major monetary and regulatory measures taken during the period from 1979 to 2014 are summarised in Table 3.

Table 3: Major banking sector reforms since 1984

Year	Reform/Direction
1985	Commercial banks were allowed, for the first time, to accept current and fixed deposits on foreign currencies (U.S. dollar and sterling pound)
1989	Commercial banks were required to increase their capital adequacy ratio (CAR) gradually. They were required to maintain CAR of 2.5 percent by mid July 1989 and 3.0 percent by mid-July 19990.
1996	NRB laid more emphasis on open market operations as main monetary policy instrument.
1966	The regulation of interest rate was started by fixing the interest rates on deposits and lending.
1974	NRB introduced SLR .
1984	NRB began deregulation of interest rate and finally the complete deregulation of the interest rate took place in 1989.
1988	Treasury Bill auction system was introduced.
1994	NRB introduced outright purchase and sale of treasury bills in 1994 and repos in treasury bill in 1997.
1991	NRB strated issuing own bonds to mopup excess liquidity.
1992	Despite the policy of interest rate liberalization the policy to control interest rate spread was introduced which was later removed in 2002
2002	Nepal Rastra Bank Act was formulated and implemented.
2002	Though there was no formal announcement of monetary policy with explicit framework until 2002, the exchange rate peg served as a nominal anchor during that period. The explicit goals of monetary policy framework include monetary stability financial sector stability and balance of payment stability.
2005	Nepal Rastra Bank issued and changed the bank rate from 5.5 to 6 percent
2006	Licensing policy for the banks and financial institutions were formally introduced and

Table 3: Major banking sector reforms since 1984

Year	Reform/Direction
2006/7	Licensing policy was revised with the minimum capital requirement for the banks to be maintained at least 2 billion.
2008	Adoption of Capital Adequacy Framework 2007 (updated July 2008) with the adoption of basel II for commercial banks
2009	Limit was been fixed so that proportion of the total loan and advance may not exceed 80 percent in resource mobilization (local deposit and core capital) of the bank and financial institution popularly known as CCD. Licence of the new commercial banks was stopped.
2011	Loan to value ratio for Real Estate loan was only up to 60% of the fair market value and for the residential real estate the Loan to value ratio was 2/3 of the total fair market value.
2012	The CRR rate was fixed at the rate of 5% of total deposit and SLR was fixed at 15%. And any bank with NPL more than 5% were not allowed to open bank branches. Banks have to provide a sum equal to 3% of the total loan to deprived sector.
2013	Guidelines have been issued for the SOL single obligor limit which was set at 25% of core capital for the single firm or company (fund based+ non fund based). And for the priority sector the SOL limit was set at 30% of the core capital. Interest rate of the bank and financial institutions were set at the base rate. Directives regarding AML and CFT were issued with CDD. Directives regarding the Branchless Banking electronic banking and mobile banking were issued
2014	Provisioning regarding the watch list customers were put into place with provisioning requiring upto 5% of the loan itself.
2015	Nepal was struck by a huge earth quake in the month of march and April Nepal Rastra Bank was forced to announce Earthquake loan at the subsidised interest rate of 2%. Capital Adequacy Framework 2015 were put in place of Capital Adequacy Framework 2007.(updated 2008) Basel III implementation phases were announced to be put into place from 2015 to 2019 timeline for the commercial banks. Few relaxations were given to the banks regarding the provisioning pertaining to the earthquake.
2016	Capital adequacy of the commercial banks was required as per the Capital adequacy framework 2015. Capital requirement for the commercial banks were raised from 2 billion to 8 billion likewise capital requirement for the development bank were raised to 2.5 billion and for finance companies to 80 crore. The capital increment was one of the landmark reforms program as it laid the foundation for the banks to have a strong base of capital for the going concern and maintaining the stability in banking sector. Merger and acquisition bylaws were introduced pertaining to the fact that the number of banks and financial instructions were in large numbers that the economy could handle.

Table 3: Major banking sector reforms since 1984

Year	Reform/Direction
2017	Restrictions were imposed on the cash transactions of cash limiting upto 1 million. The total directions regarding AML and CFT were updated as per the requirement of the act passed by the government. Directions were issued to maintain a maximum loan to value (LTV) ratio on loans and advances granted for the purpose of purchase of real estate loan. And vehicle loans. NFRS was implemented for the commercial banks to prepare the financial reports based upon Nepalese Financial Reporting Standard.
2018	Circulars were issued to the commercial banks to open branch at every local level. Licensing policy were issued for the establishment of Infrastructure Development Bank. Accordingly Letter of Intent was issued to the NEFRA Bank. Risk management guidelines 2018 were introduced in place of risk management guidelines 2010.
2019	Circulars were issued for the broker licence for the commercial banks. Circulars were issued for the margin trading. LTV ratio for the private vehicle was put at 50 % for the cars and for electronic cars it was 80%.

Source: NRB Circulars and Unified Directives of (various years)

7. Structure of the Financial Sector - Pakistan

Financial Sector

The financial sector in Pakistan comprises of commercial banks, development finance institutions (DFIs), microfinance banks (MFBs), Exchange Companies, Non-banking finance companies (such as leasing companies, investment banks, discount houses, housing finance companies, venture capital companies, asset management companies and mutual funds), Modarabas, Stock Exchange, Commodity Exchange, Brokerage firms, depository companies, clearing and settlement companies, credit rating companies, share registrars and insurance companies.

The State Bank of Pakistan (SBP), the central bank of Pakistan, supervises banks, DFIs, MFBs and exchange companies, while the Securities and Exchange Commission of Pakistan (SECP) monitors the rest of the financial institutions.

Besides the above two main regulators of the financial sector, Ministry of Finance, Government of Pakistan, monitors the operations of Central Directorate of National Savings (CDNS). CDNS objectives include promotion of financial savings in the economy and to generate funds for the Government to finance the budgetary deficit and infrastructure projects.

Like other economies, Pakistan also has an informal financial sector. There is no well-established definition for the informal or unorganized financial sector, generally speaking, money lenders, pawn brokers, and friends and relatives who provide financial assistance with or without collateral and interest, are categorized as main players of the informal financial sector. Further, retail shops in rural areas and suburb of the cities also provide daily consumable items on credit to their customers without any collateral.

State Bank of Pakistan

The State Bank of Pakistan (SBP) is incorporated under the State Bank of Pakistan Act, 1956, which gives the Bank the authority to function as the central bank of the country. The SBP Act mandates the Bank to regulate the monetary and credit system of Pakistan and to foster its growth in the best national interest with a view to securing monetary stability and fuller utilization of the country’s productive resources.

The SBP Act, 1956 is the main statute that governs SBP’s functions. Banking Companies Ordinance 1962 also empowers the SBP to supervise and regulate banking companies.

State Bank of Pakistan performs both the traditional and developmental functions to achieve macro-economic goals. The traditional functions are broadly classified into functions:

a) **Primary functions** include conducting monetary policy, issuance of notes, management of public debt, management of foreign exchange, banker to Government, advising the government on policy matters and maintaining close relationships with international financial institutions
b) **Secondary functions** include regulation and supervision of the financial systems, bankers' bank, lender of the last resort.

The State Bank of Pakistan also performs some non-traditional or promotional functions. These includes, development of financial framework, institutionalization of savings and investments, provision of training facilities to bankers, and provision of subsidized credit to the banks for priority sectors of the economy. The State Bank of Pakistan has also been playing an active role in the islamization of the banking system.

SBP is an autonomous entity supervised by a 10 members Board of Directors. The Government of Pakistan appoints all board members. The Board comprise of Governor SBP, who is the Chairman of the Board, the Secretary Ministry of Finance and eight other directors, including at least one from each province. The Governor is appointed for a term of three years, which is extendable for another three-years. Other members of the Board are also appointed for a period of three years.

The Board is empowered to regulate the monetary, exchange rate policy, and the credit system of Pakistan. The Governor SBP, on behalf of the Board, has the authority to conduct the business and affairs of the SBP.

Securities and Exchange Commission of Pakistan (SECP)

The Securities and Exchange Commission of Pakistan (SECP) was set up in pursuance of the Securities and Exchange Commission of Pakistan Act, 1997. The Commission is a collegiate body with collective responsibility. Operational and executive authority of the Commission is vested in the Chairman who is the Commission's CEO. The Chairman is assisted by the Commissioners, especially for overseeing the working of various operational units.

The Commission is fully autonomous and works though a Securities and Exchange Policy Board (Policy Board). The Policy Board provides guidance to the Commission in all matters relating to its functions and formulate policies in consultation with the Commission. The Policy Board is also responsible for advising the Government on

matters falling within the purview of the Act and other corporate laws; and to express its opinion on policy matters referred to it by the Government or the Commission.

The Policy Board consist of a maximum of eleven members appointed by the Federal Government, including five ex-officio members and six from the private sector.

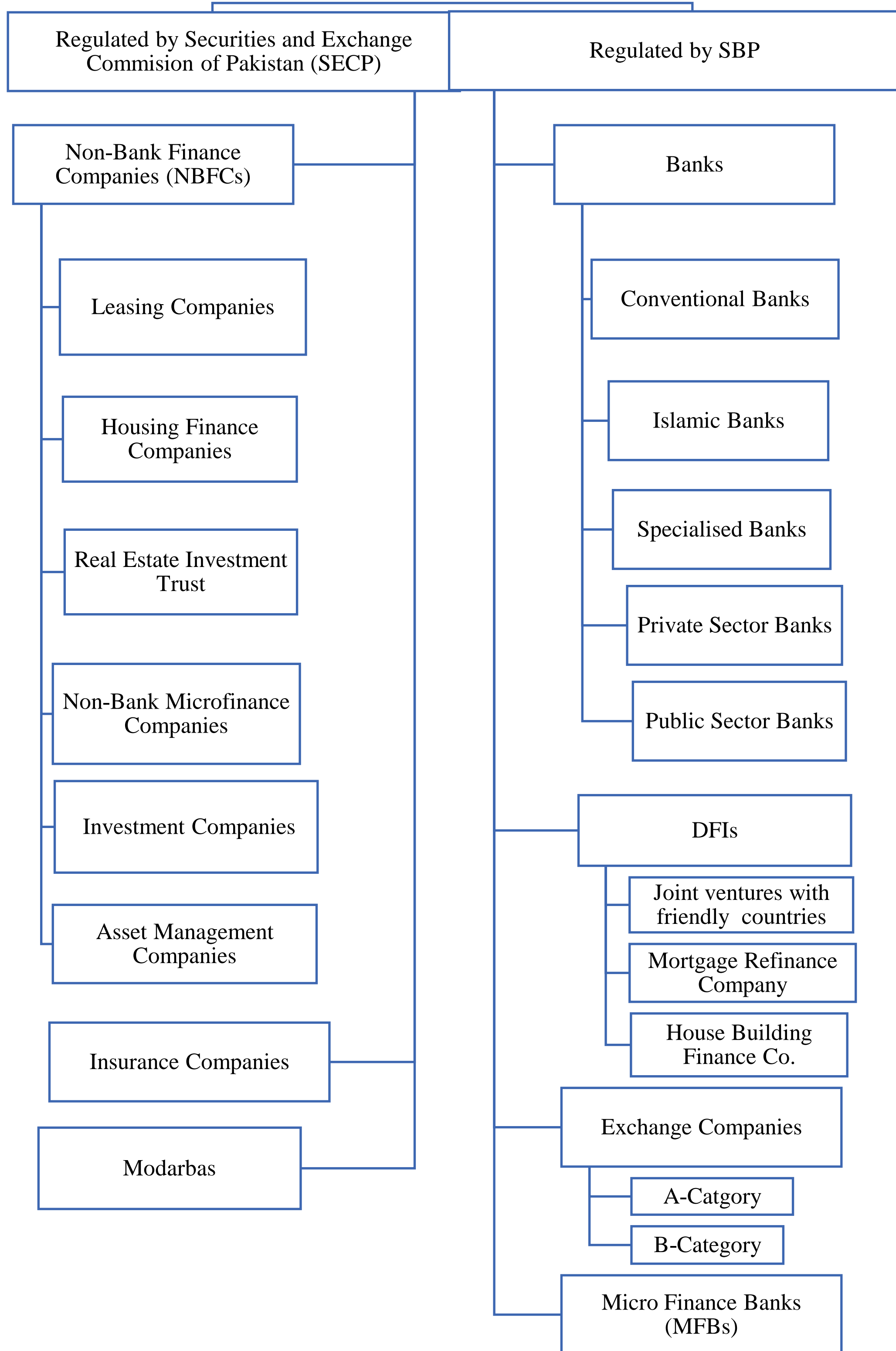
Central Directorate of National Savings (CDNS)

National Saving is one of the primeval institutions in the country with a legacy of more than 140 years that came into existence with the promulgation of Government Savings Bank Act in 1873. During the World Wars II, the British Government used this channel to raise funds to meet war related expenditures. In 1943-44, National Savings Bureau (NSB) was set up as an attached department of the undivided Government of India. After acquiring independence in 1947, this organization remained operational in Pakistan in various forms. The Bureau was re-named as Central Directorate of National Savings (CDNS) in 1953.

In September 1960, the CDNS was made an Attached Department of the Ministry of Finance with the powers to formulate policies and execute various **National Savings Schemes (NSS). In 1**972, CDNS was made responsible for all policy matters and execution of various National Saving Schemes.

Currently the National Savings is the largest investment and financial institution in Pakistan having a portfolio of over Rs. 3.4 trillion with more than **7 million** investors that are served through **376 branches** nationwide. Figure 1 shows the current institutional structure of the financial sector of Pakistan.

Chart G1: Structure of the Financial Services Sector



Banking Sector

The banking sector of Pakistan consists of 34 commercial banks, 09 DFIs and 11 MFBs. The commercial banks comprise of 05 public sector banks, 15 private sector banks, 05 Islamic commercial banks, 05 foreign banks (operating through branches) and 04 specialized banks.

Commercial Banks

The overall performance of the banking sector, which dominates the financial sector of Pakistan, has remained relatively strong over the last few years despite macroeconomic challenges and structural issues. Its asset base stood at Rupees 19.7 trillion as at 31 December 2018. Asset growth in the banking sector decreased to 7.3 per cent in calendar year 2018 as compared to 15.9 per cent in calendar year 2017. This decrease in asset growth is primarily due to negative growth in net investments (principally in Government securities) by 9.3 per cent due to the shift in Government's borrowing from commercial banks to the SBP.

Islamic Banks

The State Bank of Pakistan, since 2002, has been actively promoting Islamic banking in parallel with conventional banking by allowing:

a) Opening of full-fledged Islamic commercial banks in the private sector;
b) Conventional banks to establish Islamic banking subsidiaries; and
c) Conventional banks to open separate branches for Islamic banking.

The asset base of the Islamic banks/institutions stood at Rs 2,658 billion as at 31 December 2018. The industry's asset base accounted for 13.5 per cent of the overall banking system in the country as at 31 December 2018.

Development Finance Institutions (DFIs)

Development Finance Institutions are authorized to accept deposits of more than thirty days' tenor only, therefore, DFIs cannot offer checking account facility. Out of total nine (09) DFIs, seven (07) are joint ventures between Government of Pakistan and friendly countries. One DFI (i.e. HBFCL) offers loans for the construction of residential buildings and is fully owned by the Government of Pakistan. While the remaining one (i.e. RMRC) offers mortgage refinance facilities to the financial institutions. PMRC is owned by commercial banks and can raise finances by issuing debt-based securities. As of year end 2018, assets base of DFIs stood at Rs 239 billion, constituting 0.71% of the total assets base of the financial sector.

Microfinance Banks

The Government of Pakistan and the SBP aim promotion of financial inclusion through a nationwide financial literacy programme. The programme focuses on dissemination of financial education's concepts, products and services, budgeting, savings, investments, debt management and consumer rights and responsibilities.

As at 31 December 2018, the microfinance sector collectively served 6.9 million borrowers. This sector has achieved 35.5 per cent growth in its aggregate loan portfolio, which grew by Rupees 72.0 billion to Rupees 274.7 billion during the calendar year ended 31 December 2018.

Exchange Companies

In year 2002, Government of Pakistan, in order to regulate the business of sale/purchase of foreign exchange conducted by the foreign exchange dealers/money changers, amended the Foreign Exchange Regulations Act, 1947. Initially SBP allowed formation of A-Category Exchange Companies with paid up capital of PKR 100 million. Currently this requirement is PKR 200 million. A-Category Exchange companies can handle in-out ward remittances beside sale-purchase foreign currency notes and coins.

Subsequently, in year 2003, SBP allowed establishment of B-Category Exchange Companies with minimum paid up capital of PKR 20 million. Currently this requirement is PKR 25 million. B-Category Exchange companies can only sale and purchase foreign currency notes and coins.

Currently, 27 A-Category Exchange Companies and 25 B-Category Exchange companies are operating in Pakistan.

Non-Bank Finance Companies (NBFCs)

NBFCs are specialized companies, regulated by the SECP and conduct housing finance, leasing investment banking, asset management, investment advisories or REIT management. business. Insurance companies and M*odarabas,* (An Islamic mode of business in which one person participates in the business with his money and another with his efforts or skill or both) are other form of specialized companies engaged in the financial services. Table-1 shows the asset composition of the Pakistani financial sector.

Table G1: Total assets and liabilities of the institutions in the financial sector at the end of 2018

Institutions		Assets	
		PKR (bn)	% Share
State Bank of Pakistan*		11,467	33.99
Financial Institutions Regulated by the Central Bank			
Banks		20,085	59.53
Micro Finance Banks		34,792	0.10
Development Finance Institutions		239.00	0.71
Exchange Companies		15.98	0.05
Institutions Regulated by the SECP			
Leasing Companies		31.82	0.09
Investment Banks		10.12	0.03
Mutual Funds		20.38	0.06
Venture Capital		0.043	0.00
Modaraba Companies		51.23	0.15
Insurance Companies		1,493	4.43
Life Insurance	1,240.64		
Non-Life insurance	223.45		

* As of end Jun 2019

Table G2: Market share of the banks in Pakistan at end 2018

Sr. No	Bank	Ownership type	Business type	Total assets (US$ mn)	Market Share as % of assets
1	HABIB BANK LTD	Private	Commercial	20,738.77	14.34
2	NATIONAL BANK OF PAKISTAN	State-owned	Commercial	20,155.90	13.93
3	UNITED BANK LTD	Private	Commercial	13,609.32	9.41
4	MCB BANK LTD	Private	Commercial	10,789.87	7.46
5	ALLIED BANK LTD	Private	Commercial	9,727.37	6.72
6	BANK AL-HABIB LTD	Private	Commercial	7,549.65	5.22
7	BANK ALFALAH LTD	Private	Commercial	7,247.01	5.01
8	MEEZAN BANK LTD	Private	Commercial (Islamic)	6,755.08	4.67
9	THE BANK OF PUNJAB	Private	Commercial	5,145.12	3.56
10	ASKARI BANK LTD	Private	Commercial	5,088.60	3.52
11	HABIB METROPOLITAN BANK LTD	Private	Commercial	4,849.95	3.35
12	FAYSAL BANK LTD	Private	Commercial	4,320.72	2.99
13	STANDARD CHARTERED BANK (PAKISTAN) LTD	Private	Commercial	4,149.07	2.87
14	INDUSTRIAL AND COMMERCIAL BANK OF CHINA LTD	Foreign	Commercial	3,307.72	2.29
15	JS BANK LTD	Private	Commercial	3,289.65	2.27
16	SONERI BANK LTD	Private	Commercial	2,754.83	1.90

17	SUMMIT BANK LTD	Private	Commercial	1,678.48	1.16
18	DUBAI ISLAMIC BANK PAKISTAN LTD	Private	Commercial (Islamic)	1,669.64	1.15
19	THE BANK OF KHYBER	State-owned	Commercial	1,606.78	1.11
20	BANKISLAMI PAKISTAN LTD	Private	Commercial (Islamic)	1,553.83	1.07
21	ZARAI TARAQIATI BANK LTD	State-owned	Specialized	1,552.52	1.07
22	SINDH BANK LTD	State-owned	Commercial	1,472.73	1.02
23	SILKBANK LIMITED	Private	Commercial	1,250.86	0.86
24	CITI BANK N. A.	Foreign	Commercial	1,015.14	0.70
25	ALBARAKA BANK (PAKISTAN) LTD	Private	Commercial (Islamic)	927.74	0.64
26	SAMBA BANK LTD	Private	Commercial	884.18	0.61
27	MCB ISLAMIC BANK LTD	Private	Commercial (Islamic)	683.45	0.47
28	DEUTSCHE BANK AG	Foreign	Commercial	254.90	0.18
29	FIRST WOMEN BANK	State-owned	Commercial	178.82	0.12
30	THE PUNJAB PROVINCIAL COOPERATIVE BANK LTD	State-owned	Specialized	166.96	0.12
31	BANK OF CHINA LIMITED	Foreign	Commercial	106.34	0.07
32	SME BANK LTD	Private	Specialized	79.19	0.05

33	MUFG BANK LTD	Foreign	Commercial	64.66	0.04
34	INDUSTRIAL DEVELOPMENT BANK LTD	State-owned	Specialized	30.79	0.02

Table G3: Major banking sector reforms since 1974

Year	Reform/Direction
1974	All commercial banks in Pakistan were nationalized in January 1974, to, inter-alia, make bank credit available to all segments of the society and extend banking services to the rural areas.
1984	**Introduction of Islamic Banking. All banking companies were advised to make finances available to their customers only in the any of the permissible mode of Islamic financing. Banks were advised to accept deposits only based on participation in profit and loss instead of interest-bearing deposits.**
1990	• Introduction of neo-liberal financial reforms. • Start of gradual liberalization of controls on banking activities and credit creation, as well as a rationalization of the interest rate structure. • Denationalization of two commercial banks.
1991	• The government started auctioning the public debt in the open market with the introduction of treasury bills and federal investment bonds. • The stock exchange was opened to foreign investors. • Ten private commercial banks were given permission to start operations.
1992	• State Bank abolished the scheme of credit ceilings and replaced it with a system of credit/deposit ratios, which allowed commercial banks to extend credit up to thirty per cent of their rupee deposits and thirty per cent of their foreign currency deposits. • Commercial banks were allowed to open foreign currency accounts of depositors. • SBP issued a set of prudential regulations requiring banks and Non-Bank financial institutions (NBFIs) inter alia to follow prescribed limits on debt equity ratios and finance facilities to single companies and individual investors.
1999	Establishment of National Accountability Bureau through enactment of National Accountability Ordinance 1999 (NAO) to combat corruption and money laundering.
2003	• SBP allowed banks to raise funds from the capital market in the form of rated and listed subordinated debt instruments (like TFCs/Bonds), which can also be included in the banks' supplementary capital. However, in order to be eligible for inclusion in supplementary capital, the instrument needs to be fully paid up, unsecured, subordinated as to payment of principal and profit to all other indebtedness of the • SBP revised the applicable minimum paid up capital requirements to PKR 1,000 million. Banks not able to comply with the requirement faced conversion of their status into Non-Scheduled Bank (NSB) with restrictive activities. • A separate Prudential Regulations was issued outlining the responsibilities of a financial institution's Board of Directors.

Table G3: Major banking sector reforms since 1974

Year	Reform/Direction
2012	• Banks were advised to open at least one ATM in their network against each new branch to be opened in a CY. Banks having less than 1:1 ATM per branch ratio were advised to cover the gap in 5 years starting from CY-2013 • Issuance of Revised AML/CFT Regulation and introduction of Risk Based Approach for AML/CFT • Banks were advised to develop an application and behavioural scorecards for their retail borrowers including consumer portfolio. • Banks were advised to pay profit to depositors on average monthly balances. • Banks were allowed to maintain Cash Reserve Requirement (CRR) and Statutory Liquidity Requirements (SLR) on fortnightly basis instead of weekly.
2013	• Minimum Capital Requirements for Islamic Banking Subsidiary was revised to Rs6 billion subject to raising the paid-up capital (net of losses) to Rs10 billion within a period of 5 years from the date of commencement of operations • Currency Transaction Report (CTR) under Anti-Money Laundering Act, 2010 was set at Rs 2 million for reporting to Financial Monitoring Unit under Section 7 of the Anti-Money Laundering Act, 2010 • Banks were advised to install biometric machines, by 31-12-2015, at all their branches for efficient and instant verification of their customers. • Exchange Companies were allowed to conduct branchless banking activities as agents of authorized financial institutions (commercial/Islamic/microfinance banks) offering these services • In order to protect customers from exploitation, Banks were that maximum spread between the buying and selling rates of foreign currencies must not exceed twenty-five (25) paisa, at any given time. • State Bank of Pakistan started online auction process of Market Treasury Bills and Pakistan Investment Bonds through Bloomberg auction module. • Implementation of Basel III Capital Instructions.
2014	• Introduction of limit on banks' exposure in Real Estate Sector**:** 10 percent of banks total advance and investments (excluding government securities) • To facilitate the branchless banking service providers and bring systemic harmony through standardization and set benchmarks for mobile / branchless banking interoperability, SBP and Pakistan Telecommunication Authority (PTA) have developed the regulations for market participants including banks, mobile network operators and technology service provider • To make the Board and senior management of banks / DFIs more accountable and responsible, and to align their compensation with risk adjusted performance, SBP issued *Guidelines and Disclosures on Governance and Remuneration Practices. Under these guidelines, t*he banks are required to prepare a comprehensive, transparent and fair remuneration policy and remuneration setting mechanism.

Table G3: Major banking sector reforms since 1974

Year	Reform/Direction
	• To minimize risks in the settlement of non-performing loans (NPLs), SBP issued regulations for Debt Property Swap for the banks/DFIs. • In order to facilitate Islamic Banking industry in their liquidity management, Government of Pakistan (GOP) may outright purchase the *Ijara Sukuk* (GIS) on deferred payment basis *(Bai-Muajjal)* and sell these GIS on ready payment basis through uniform price based competitive bidding auction process. • SBP allowed the authorized Exchange Companies (ECs) to import cash US Dollars against export of permissible foreign currencies. ECs may also continue to export permissible foreign currencies against repatriation of equivalent US Dollars in their foreign currency accounts maintained with banks in Pakistan as per existing procedure
2016	• SBP though Guidelines on Performance Evaluation of Board of Directors, advised banks/DFIs to inter-alia, performance evaluation of Board of Directors including individual board members and committees. The guidelines provide basic mechanism, techniques and approaches to be incorporated in performance evaluation model of each bank/DFI. The evaluation is also required to be undertaken by an external independent evaluator at least once in every three years. • To promote the concept of responsible banking, SBP issued Conduct Assessment Framework (CAF) for the banks
2017	• With a vision to provide a baseline technology governance and risk management principles to Financial Institutions, SBP developed a framework on *'Enterprise Technology Governance & Risk Management in Financial Institutions'*. • Amendment in the Foreign Exchange Regulation Act, 1947, empowered SBP to impose monetary penalty on its regulatees for violation of foreign exchange rules/regulations or instructions issued there under. • In order to enhance the oversight of Payment Systems under the various provisions of Payment Systems & Electronic Funds Transfer Act, 2007 (PS&EFT), SBP issued Payment Systems Designation Framework for Payment Systems Operators (PSOs) and Payment Service Providers (PSPs). • With a view to provide banking industry a uniform and systematic approach for identification, assessment and management of compliance risk, SBP issued compliance risk guidelines for the promotion of 'compliance culture' in the banks. • In order to with align with international standards, SBP developed a framework for designation and supervision of Domestic Systemically Important Banks (D-SIBs). Under the framework, SBP identify the sample of D-SIBs and announce designation by end June each year. The designated DSIBs are required to meet both higher loss absorbency requirements and enhanced supervisory requirements. Remaining banks in the sample of D-SIBs are required to meet the enhanced supervisory requirements only.

Table G3: Major banking sector reforms since 1974

Year	Reform/Direction
	• To facilitate the public in accessing cash related services via A TMs, SBP allowed non-banking entities to offer White Label ATM services in the country under PS&EFT Act, 2007
2019	• In order to remove the entry barriers and provide level playing field to the non-banking entities and to foster innovation in the payment industry and promote financial inclusion in the country, SBP issued guidelines on Electronic Money Institutions.

8. Contemporary financial structure of Sri Lanka

As in other countries, the financial sector of Sri Lanka is comprised of both formal and informal sectors. Banking institutions dominate the formal financial sector while other markets such as the capital market and money market play a limited role in facilitating the efficient and effective allocation and deployment of resources in the economy. In contrast, the informal financial sector does not have an organised setup and mainly provides short-term lending facilities based on personal contacts. Studies have found a significant role played by the informal sector as a source of credit for consumption loans to poor households. This section provides a holistic overview of the structure of the formal and informal sectors of the financial sector while highlighting the role of each player in the sector.

Banking sector financial institutions

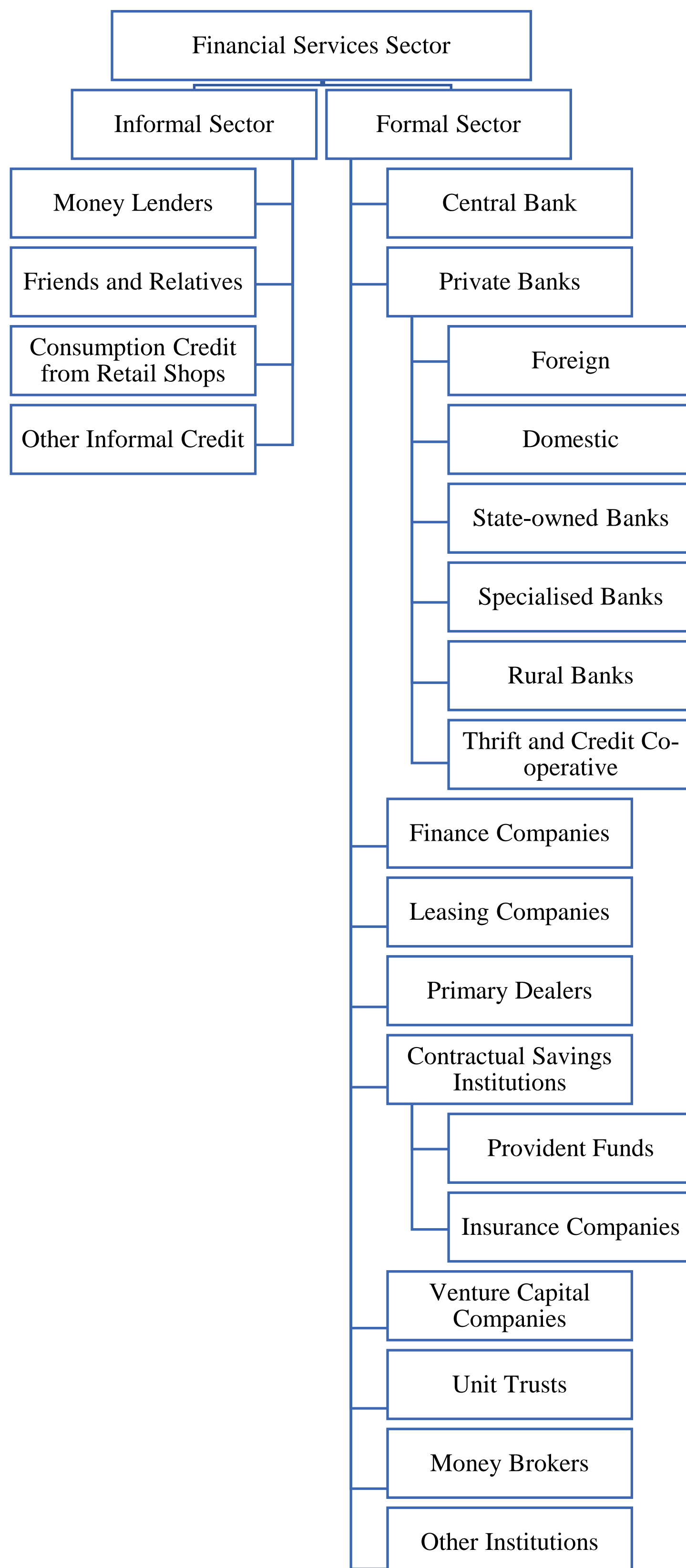
The banking sector dominates the financial sector in Sri Lanka. It controls most of the financial flows and possesses most of the financial assets. Economic reforms introduced after independence from the United Kingdom in 1948 brought structural change in the financial sector with the establishment of government banks to provide banking services to all segments of Sri Lankan society. Figure 1 shows the current institutional structure of the financial sector of Sri Lanka. The banking sector comprises the Central Bank of Sri Lanka (CBSL), licensed commercial banks, licensed specialised banks, merchant banks, cooperative banks and some other thrift societies.

Central Bank of Sri Lanka

Financial sector developments in the post-independence era started with the establishment of the CBSL in 1950, the apex body of the financial system of Sri Lanka. The CBSL was set up in place of the currency board system (CBS) by the Monetary Law Act no.58 of 1949, with the broad objective of enhancing economic growth through creating an active monetary policy regime and dynamic financial sector. Prior to the establishment of the CBSL central banking functions were handled by the CBS which was established by the Currency Ordinance no.32 of 1884. The core objectives of the CBSL are specified as being the maintenance of price stability

and financial system stability for the economic prosperity of the country. Central banks use their monetary policy

Chart H1: Structure of the financial services sector



Source: Author's classification

instruments, mainly SRR and OMO, to maintain price level stability which is conducive to economic development. Financial system stability is maintained through an effective regulatory environment, a reliable payments and settlements system, efficient financial markets and sound financial institutions. Financial sector supervision is a vital role played by the CBSL in maintaining financial sector stability in the country. Financial institutions come under the supervision of the CBSL and their shares in assets and liabilities are shown in Table 1.

Table H1: Total assets and liabilities of the institutions in the financial sector at the end of 2019

Institutions	Assets	
	Rupees bn.	% Share
Central Bank of Sri Lanka	1,919.4	9.5
Financial Institutions Regulated by the Central Bank		
Demand Deposit Taking Institutions		
Licensed Commercial Banks	10,944.0	54.3
Other Financial Institutions		
Licensed specialised Banks(a)	1,578.7	7.8
Licensed Finance Companies(a)	1,484.7	7.4
Primary Dealers (b)	77.5	0.4
Specialized Leasing companies	43.7	0.2
Institutions not Regulated by the Central Bank(c)	3,787.5	18.8

(a) Licensed specialised Banks and Licensed Finance Companies are not allowed to accept demand deposits and only accept other types of deposits such as fixed deposits, savings deposits or investment type deposits of customers.

(b) Bank Primary Dealer Units have been excluded since their assets are recorded under Licensed Commercial Banks.

(c) Institutions not regulated by the Central Bank of Sri Lanka include Rural Banks, Thrift and Credit Co-operative Societies, Employees' Provident Fund, Employees' Trust Fund, Approved Pension and Provident Funds, Public Service Provident Fund, Insurance Companies, Stock Brokers, Unit Trusts/ Unit Trust Management Companies, Market Intermediaries (Underwriters, Margin Providers, Investment Managers and Credit Rating Agencies) and Venture Capital Companies.

Banking sector

There are 25 licensed commercial banks and seven licensed specialised banks operating in Sri Lanka. Out of the 25 commercial banks, two are fully owned by the government while the domestic private sector and foreign parties own 10 and 13 respectively. Most of the private domestic banks entered the market after the policy reforms of 1977. These reforms encouraged private sector participation in the provision of financial services.

Although some foreign banks were already established before independence was achieved in 1948, most large foreign banks, such as the Hong Kong and Shanghai Banking Corporation (HSBC), entered into the market in the early 1990s with the shift in government policies that provided equal opportunities for private sector as well as for state sector-owned banks. The 25 commercial banks are allowed to do all banking activities such as deposit taking, granting loans, forex transactions and dealing with derivatives. The seven specialised banks are mostly focused on savings and development banking rather than commercial banking activities. These specialised banks are not allowed to accept demand deposits, which are not entitled to receive interest payments from the banks. Five of the specialised banks are owned by the government while the remainder is a private domestic bank. The CBSL is the regulator of both commercial banks and specialised banks. Its role involves conducting on-site and off-site supervision of these institutions. Merchant banks are established by the commercial banks and they cater to the specific banking needs of their corporate customers and to the demand for financial services in the capital market. There are six merchant banks operating in the country today. The market share and regional coverage of the commercial and specialised bank branches are presented in Table 2.

Cooperative banks and thrift/credit cooperative societies also accept deposits and grant credit in the country, catering in particular for the poor and lower middle class households to meet their savings and credit needs. These institutions, focusing on rural development, are regulated and supervised by the Ministry of Cooperative Development which was established to enhance regional economic conditions and development. Although cooperative banks and thrift/credit cooperative societies cater to a large number of households, they account for less than 2% of total banking sector assets due to the small scale of their transactions.

Table H2: Market share and geographical coverage of the banks in Sri Lanka at end 2019

Bank	Ownership type	Business type	Total assets (US$ mn)	Market Share as % of assets
1. Bank of Ceylon	State-owned	Commercial	13,371	18.79
2. People's Bank	State-owned	Commercial	10,283	14.45
3. Commercial Bank of Ceylon	Private	Commercial	7,630	10.72
4. National Savings Bank	State-owned	Specialised	6,382	8.97
5. Hatton National Bank PLC	Private	Commercial	6,232	8.76
6. Sampath Bank PLC	Private	Commercial	5,326	7.48
7. National Development Bank	Private	Commercial	2,928	4.11
8. Seylan Bank PLC	Private	Commercial	2,863	4.02
9. HSBC	Foreign	Commercial	2,539	3.57
10. DFCC Bank	Private	Commercial	2,212	3.11
11. Nations Trust Bank	Private	Commercial	1,785	2.51
12. Regional Development Bank	State-owned	Specialised	1,122	1.58
13. Standard Chartered Bank	Foreign	Commercial	972	1.37
14. PABC	Private	Commercial	841	1.18
15. Union Bank of Colombo	Private	Commercial	668	0.94
16. Sanasa Development Bank	State-owned	Specialised	591	0.83
17. Amana Bank Ltd.	Private	Commercial	476	0.67
18. Indian Bank	Foreign	Commercial	366	0.51
19. HDFC	State-owned	Specialised	296	0.42
20. Citibank, N.A.	Foreign	Commercial	291	0.41
21. Deutsche Bank AG	Foreign	Commercial	276	0.39
22. SMIB	State-owned	Specialised	252	0.35
23. Indian Overseas Bank	Foreign	Commercial	248	0.35
24. Cargills Bank	Private	Commercial	216	0.30
25. Bank of China	Foreign	Commercial	191	0.27
26. MCB Bank Ltd.	Foreign	Commercial	170	0.24
27. State Bank of India	Foreign	Commercial	146	0.21
28. ICICI Bank Ltd.	Foreign	Commercial	70	0.10
29. Axis Bank Ltd.	Foreign	Commercial	54	0.08
30. Public Bank Berhad	Foreign	Commercial	54	0.08
31. Sri Lanka Savings Bank	State-owned	Specialised	64	0.10
32. Habib Bank Ltd.	Foreign	Commercial	50	0.07

Non-bank financial institutions

In general, financial institutions which collect deposits from the public are considered to be banks, and non-bank financial institutions are not allowed to accept deposits from the public. In practice, it is difficult to distinguish between the financial services provided by banks and non-bank financial institutions since there are a number of similarities in the services that they provide. Differences can be seen in practices, regulatory environments and legal or formal definitions of the non-bank financial institutions in different countries. In the Sri Lankan context, some non-banking institutions such as finance companies and leasing companies supplement the banks by providing financial services in segments of society which are not reached by the banking sector. Some non-banking institutions compete with banks in the provision of financial services. Other non-banking institutions such as contractual savings institutions and primary dealers mostly concentrate on their specialised sectors and enjoy the advantages of specialisation. This section provides a brief review of the financial services provided by non-banking institutions in Sri Lanka.

Finance and leasing companies

Finance companies also accept short-term, medium-term and long-term deposits from the general public and maintain diversified loan portfolios while offering higher returns to their depositors than either the licensed commercial banks or licensed specialised banks. There was a significant increase in the number of finance companies after economic liberalisation in 1977, with most of the funds invested in higher purchase and leasing businesses. There were 72 finance companies registered with the CBSL at the end of 1989. The CBSL introduced new reforms including stringent regulations to ensure the viability of finance companies after some of them failed in the 1980s. The new regulations led to a decline in the number of finance companies to 24 by the end of 1996. With economic expansion after the end of the ethnic conflict in 2009, the CBSL allowed expansion in this sector, issuing new licences to meet the increasing demand for financial services in the economy. Simultaneously, the CBSL introduced the Finance Business Act, no 42 of 2011 to improve the regulation and supervision of finance companies and to ensure stability of the financial sector in Sri Lanka. Today there are 46 finance companies operating.

In addition to commercial banks, specialised banks and finance companies, specialised leasing companies are also engaged in leasing activities. Unlike commercial banks, specialised banks and finance companies, these specialised leasing companies are not permitted to accept deposits from the general public. Specialised leasing companies have been engaged in leasing activities since the early 1980s and currently there are 7 of them operating in the country. The CBSL has been

vested with powers to regulate and supervise specialised leasing companies by the Finance Leasing Act no.56 of 2000**.**

Unit Trusts

With the expansion of the capital market, the Security Exchange Commission of Sri Lanka (SEC) issued four licences to establish unit trust in 1992 as a strategic move aimed at stimulating the security market, creating a new way of attracting savings into the capital market. Unit trusts are governed by the SEC as specified in an act passed to establish the SEC and the unit trust code. Although the contribution of unit trusts to the capital market in Sri Lanka is not significant, they contributed to changing the way savings are mobilised in the capital market. There are 35 unit trusts currently established in Sri Lanka. Out of these, 33 are operated as open-ended funds and the other two are closed. The investment portfolios of unit trusts consist mainly of equity and government securities.

Contractual savings institutions

The two main categories of contractual savings institutions, namely social security funds and insurance companies, also play a vital role in the financial market in Sri Lanka with their ability to accumulate significant amounts of long-term saving from the public. Social security funds in Sri Lanka comprise the Employees' Provident Fund (EPF), the Employees' Trust Fund (ETF), the Public Service Provident Fund and some other provident funds run by semi-government entities or private sector employers. EPF dominates social security funds as the largest fund in terms of member accounts, assets and investments. The minimum contribution of the EPF should comprise 8% of the gross salary of an employee and 12% from the employer totalling 20% of gross earnings of the employee. From its inception in 1961 EPF has invested mainly in government securities. Currently 97% of the EPF's portfolio is invested in treasury bills, bonds and rupee loans while 3% is invested in the Colombo Stock Exchange (CSE).

The ETF is the second-largest social security fund in Sri Lanka. ETF was established in 1981 to enhance the stock ownership of employees. Although most of the features of the EPF are also included in the ETF, members are allowed to withdraw their money upon termination of employment. Further, membership is open to people in self-employment and the ETF provides health insurance to its members. The ETF contribution, 3% of the employee's salary, is financed by the employer if the member is not self-employed. The ETF invests mainly in government securities which account for 80% of its current investment portfolio. The government also

maintains a social security fund called the Public Sector Pension Scheme, an unfunded, non-contributory pension scheme for civil servants and other government employees. In addition, some Approved Private Provident Funds are maintained by private and semi-government institutions, with finance provided by employers and employees. These contractual savings institutions contribute to the economic development of the country through their investments and provide social security schemes for the workforce of Sri Lanka.

The insurance industry is also a leading player in the economy for mobilising savings and improving investment. The introduction of the coffee and tea industries by the British rulers provided the ingredients for establishing the insurance industry. Therefore, the insurance industry dates back to the pre-independence era. In the beginning the insurance industry comprised only foreign companies and the first Sri Lankan insurance company, the “Sri Lanka Insurance Company” was established after the Company Act of 1938 was passed. Later, a number of private sector players entered into the insurance business by establishing companies to provide insurance services. In 1961 the government established Insurance Corporation of Sri Lanka (ICSL) in line with their policy framework for nationalisation. The Control of Insurance Act no.25 of 1962 provided monopoly power of the life insurance industry to ICSL.

After the economic reforms of the late 1970s, the government established a second state-owned insurance company in 1981 with the objective of improving services through increased competition. To encourage private investment in the insurance industry, the Control of Insurance Act no.25 of 1962 was amended in 1986. An expanding economy and legislative provisions paved the way for a gradual expansion in the insurance industry. At present there are 21 insurance companies operating in the country and the Insurance Board of Sri Lanka (IBSL) was established under the Insurance Industry Act no.43 of 2000 as the regulator and supervisory body of the insurance industry. The insurance industry in Sri Lanka accounts for only 3% of total financial sector assets of the country but has huge potential for rapid expansion, due to the low penetration of insurance services compared to the situation in other lower middle-income countries.

Primary dealers

Primary dealers play a significant role in the money market in Sri Lanka, particularly in the government securities market, having exclusive rights vested in them for purchasing government securities at primary auctions. Investors can invest in government securities, namely treasury bills and treasury bonds, through these primary dealers. The main objectives of a primary dealer system

are: to maintain stable demand for government securities, provide liquidity to the secondary market, provide intermediary services for investing in government securities, and improve market information about government securities. The CBSL is the regulator of primary dealers who are appointed under the Local Treasury Bills Ordinance, No 8 of 1923 and the Registered Stock and Securities Ordinance no. 7 of 1937. Most domestic commercial banks are active in the government security market and in establishing primary dealers companies. In 2014 the total assets of all 15 primary dealer companies was 191 billion rupees, accounting for 1.6% of total financial sector assets in Sri Lanka.

Informal financial sector

As in other developing countries, the informal financial sector is also an important component in Sri Lanka's financial sector. Although there is no well-established definition for the informal or unorganised financial sector, in general the informal financial sector consists mainly of money lenders, pawn brokers, and friends and relatives who provide financial assistance with or without collateral and interest. Findings of the Consumer Finances and Socio Economic Survey (CFS) conducted by the CBSL in 2003/04 recorded that the credit provided by the above informal sources accounted for 18% of the total borrowings of the household sector in Sri Lanka. Further, rural retail shops in Sri Lanka also have a practice of providing consumption items on credit to their customers without any collateral.

Banking sector expansion under the open market economy (1977–2016)

By 1977 the banking sector comprised the CBSL, seven foreign commercial banks, four domestic commercial banks, two development banks for long-term lending, the National Savings Bank (a fully state-owned specialised bank) and the rural banks managed by the cooperatives. Except for the seven foreign commercial banks and the two private commercial banks, all other banks were controlled by the government. This oligopolistic market structure of the banking sector with public sector dominance did not provide a favourable environment for improving efficiency and competition in the banking industry.

Reforms in the financial sector were aimed at repositioning the banking sector to cater to the government's export-oriented economic development strategy. Accordingly, the Sri Lankan currency was devalued to reflect trade competitiveness and in 1978 a managed floating exchange rate system was introduced with control over international capital flows. The current account was

partially liberalised and all the commercial banks were allowed to start foreign currency banking units (FCBUs) to meet the demand for the expected momentum in foreign trade. The prohibition on entry of new foreign banks which had prevailed since 1961 was removed and foreign commercial banks were encouraged to establish branches in Sri Lanka. Having the most open economy and financial sector in South Asia, Sri Lanka attracted a large number of foreign financial institutions in the late 1970s and early 1980s. Although foreign banks entered the banking sector, their operations were limited to the major cities.

With the expansion in the economy, the two fully state-owned domestic commercial banks gave priority to corporate-sector customers while moving away from-grass root level customers in the agriculture and SME sectors. Further, most of their services were concentrated in the capital city of Colombo and other urban areas. The establishment of 17 Regional Rural Development Banks (RRDBs) in 1987 with capital provided by the CBSL was also an effort to address the gap in financial services between the Western region and other areas. In the late 1980s, identifying the growing demand for financial services in the country, two private local banks were also established. Although the private local commercial banks adopted information technology into their operations, state-owned banks were not ready for IT penetration. Therefore, common infrastructure development in the banking sector was limited during this period. The CBSL was vested with more powers, particularly for bank supervision and regulation, by the Banking Act 1988 passed by parliament.

By 1990, six local commercial banks and 18 foreign commercial banks were operating in the country. In addition, one savings bank, 17 regional banks (RRDBs), three development banks, three merchant banks and a number of small cooperative banks were also in the banking industry. Despite the continuation of open market economic policies for more than a decade with financial sector reforms, private banks were not in a position to compete with the state-owned banks which operated as an oligopoly and were supported by a favourable regulatory environment relative to that of the private banks.

Although the government was concerned about improving banking sector efficiency, and despite the privatisation of state-owned enterprises during the 1990s, the privatisation of state banks was not on the agenda. However, in line with the privatisation of other state-owned institutions, directions were issued to the state banks on the need to make necessary provisions for non-performing advances (NPA) as a restructuring initiative. A major reason for the exclusion of

banking sector privatisation was trade union action against it. Other than that, the government also used state banks as a tool for resource allocation into priority sectors such as agriculture, small industry and regional development. Despite the changed political regime in 1994, the momentum for banking sector expansion continued into the 1990s with the gradual expansion in banking services and the entry of new players into the banking sector. Four domestic commercial private banks and three foreign banks entered into banking business during the period 1990–2000. As mentioned in the manifesto of the newly elected government in 2005, three specialised banks were established by the government catering to the financial needs of the SME sector, which at this time accounted for 70% of employment generation and 18.5% of the country's value added production. A new bank, Amana Bank Ltd, was established in the post-conflict period as an Islamic commercial bank catering to the needs of the Muslim community. After the end of armed conflict in mid-2009 all banks showed a tendency to expand their branch networks. In addition, various regulatory and monetary policy measures were implemented by the CBSL in the post-liberalisation period to maintain stability and improve the efficiency of the banking sector. The details of the major monetary and regulatory measures taken during the period from 1979 to 2014 are summarised in Table 3.

Table 3: Major banking sector reforms since 1979

Year	Reform/Direction
1979	Restrictions on the entry of foreign banks into Sri Lanka and branch network expansion of existing foreign banks were relaxed. Commercial banks were allowed to open FCBUs.
1981	The Central Bank of Sri Lanka started to use open market operations (OMO) and statutory reserve requirements (SRR) to control the money supply.
1982	Ceilings on credit for the purchase of real estate or immovable property were removed.
1983	Ceilings on credit for non-priority sectors were removed.
1987	Limits on commercial bank certificates of deposits (CDs) were removed.
1988	The CBSL was empowered with more regulations and controls over the banking sector in Sri Lanka by the Banking Act 1988.
1991	Directions issued by the CBSL to make provision for non-performing advances of state-owned banks and rescheduling their loan portfolios.
1992	Establishment of a loan recovery mechanism for commercial banks and disclosure requirements.
1993	Establishment of a Repo market as a measure to fix the lower end of the call money market.
1999	Single borrower limit fixed to 30% of bank's capital recorded in the previous year annual financial accounts.
1994	Permission granted to issue international credit cards to commercial banks.
2000	The limit on foreign ownership of local commercial banks was increased to 60% of shares.

Table 3: Major banking sector reforms since 1979

Year	Reform/Direction
2002	The lower limit on SRR was removed. Prudential norms introduced for domestic banks were extended to offshore banking units.
2003	The risk-weighted capital adequacy ratio was fixed at 10% for banks. The CBSL started to determine the SRR on a daily basis for commercial banks.
2006	A direction was issued by the CBSL for all banks to publish quarterly accounts.
2007	The CBSL issued directions to limit single share ownership in commercial and specialised banks to between 10% and 15%.
2008	Directions were issued on commercial and specialised by CBSL to adapt the standardised approach for credit risk and market risk while the basic indicator approach for operational risk in assessing banking sector risk under Basel II.[8] With the aim of achieving a sound and healthy banking sector, directions on corporate governance for the banking sector was issued by the CBSL covering responsibility and accountability of the board of directors in banking business. Branch opening in the Western region was restricted and permission was only granted to open a branch in the Western region for a bank which opened two branches in other regions to expand the geographical distribution of the bank branch network.
2010	Started a special loan scheme "Awakening the North" to provide required funds for the development of the conflict-affected Northern region with a concessionary interest rate. An insurance scheme was implemented to cover customer deposits of the commercial banks, specialised banks and registered finance companies under the Banking Act, direction no. 6 of 2010
2011	Guidelines for mobile payment were issued by the CBSL with the aim of regularising and monitoring mobile payments. A licence was issued to the first Muslim commercial bank "Amana Bank" which was to operate-on Islamic principles. A draft on Advanced Approaches on Operational Risk under Pillar I of Basel II was issued to all banks enabling them to be familiar with risk management and governance practices in relation to operational risk. A loan scheme was introduced in the Northern and Eastern regions to facilitate the repair of houses damaged during the armed conflict.
2012	The CBSL announced more flexibility in the exchange rate and limited market intervention in the future through a quantity-based strategy instead of the previous price-based intervention strategy.

[8] Basel I and II are the set of international banking regulations established by the Basel Committee on Bank Supervision. Basel I is the first international regulatory accord which provided a framework for bank supervision with the assessment of capital adequacy of banks. Extending the Basel I framework, Basel II incorporates credit risk of assets held by financial institutions in determining regulatory capital adequacy.

Table 3: Major banking sector reforms since 1979

Year	Reform/Direction
	The second phase of the loan scheme "Awakening the North" started. It aimed at further enhancing the funding facilities for development of conflict-affected areas. A consultation paper was issued to all commercial and specialised banks to ensure that they were maintaining adequate capital requirements to cover their exposure to all risks under Pillar 2 of the Basel II framework.
2013	Commercial banks were permitted to invest in International Sovereign Bonds issued by the Government of Sri Lanka The SRR was reduced from 8% to 6% enabling banks to expand their credit disbursements. A Direction on Pillar 2 of Basel II on banks to maintain capital adequacy above the minimum regulatory capital requirement was issued to cover their exposure to all risks. A consolidation plan of the financial sector was announced by the CBSL to reduce the number of small banking and finance companies. The plan aimed at improving the resilience and stability of the financial sector.
2014	With the aim of minimising the NPA during a period of plummeting gold prices, a credit guarantee scheme for pawning the advances of banks was introduced. The CBSL issued directions for the implementation of the liquidity coverage ratio in line with the Basel III Liquidity Standards.
2015	Guidelines were issued on tax incentives to promote financial sector consolidation. Directions were issued to licensed banks to implement the Liquidity Coverage Ratio under Basel III Liquidity Standards from 01 April 2015. Directions were issued to maintain a maximum loan to value (LTV) ratio on loans and advances granted for the purpose of purchase or utilisation of motor vehicles.
2016	All licensed banks were instructed to submit information on the occurrence of events related to cyber security to the Director of Bank Supervision.
2017	A consultation paper was issued on 'Basel III Leverage Ratio Framework for Licensed Banks. Banking Act Directions on enhancing the Minimum Capital Requirement of licensed banks were issued. Banking Act Directions on financial derivatives were issued to licensed banks.
2018	Banking Act Directions on Net Stable Funding Ratio (NSFR) under Basel III liquidity standards were issued to licensed banks requiring licensed banks to maintain a minimum NSFR of 90 per cent and 100 per cent commencing 01 January 2019 and 01 July 2019, respectively. Banking Act Directions on Leverage Ratio under Basel III were issued to licensed banks requiring the minimum leverage ratio of 3 per cent which will be applicable to licensed banks commencing 01 January 2019.

Table 3: Major banking sector reforms since 1979

Year	Reform/Direction
	A Circular was issued to licensed banks on Guidelines on the Adoption of Sri Lanka Accounting Standard-SLFRS 9: Financial Instruments for immediate implementation with a view to establishing consistent and prudent practices on the adoption of SLFRS 9.
2019	Banking Act Directions were issued introducing a new framework for dealing with Domestic Systemically Important Banks (D-SIBs), in line with international best practices and determining four licensed banks as D-SIBs in terms of the new framework. Accordingly, licensed banks determined as D-SIBs will be allocated into 3 buckets with varying Higher Loss Absorption requirements in the range of 1-2 per cent, which should be met from Common Equity Tier 1.

Source: Annual Reports, Central Bank of Sri Lanka (various years)