



Report and Recommendation of the President to the Board of Directors

Project Number: 36197
February 2006

Proposed Technical Assistance Loan People's Republic of Bangladesh: Improvement of Capital Market and Insurance Governance Project

CURRENCY EQUIVALENTS

(as of 31 January 2006)

Currency Unit	–	taka (Tk)
Tk1.00	=	\$0.0150
\$1.00	=	Tk66.5800

ABBREVIATIONS

ADB	–	Asian Development Bank
CSE	–	Chittagong Stock Exchange
DSE	–	Dhaka Stock Exchange
EA	–	executing agency
EGBM	–	Enterprise Growth and Bank Modernization (Project)
FIRST	–	Financial Sector Reform and Strengthening Initiative
GDP	–	gross domestic product
IA	–	implementing agency
ICB	–	Investment Corporation of Bangladesh
IPO	–	initial public offering
IMF	–	International Monetary Fund
JBC	–	Jiban Bima Corporation
MOF	–	Ministry of Finance
MOF-FD	–	Ministry of Finance, Finance Division
NCB	–	nationalized commercial bank
NPL	–	nonperforming loan
NPRS	–	national poverty reduction strategy
OCCI	–	Office of the Chief Controller of Insurance
PIU	–	project implementation unit
PMU	–	project management unit
QCBS	–	quality- and cost-based selection
SBC	–	Sadharan Bima Corporation
SOE	–	state-owned enterprise
SEC	–	Securities and Exchange Commission
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends.
- (ii) In this report, “\$” refers to US dollars.

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CONTENTS

	Page
LOAN AND PROJECT SUMMARY	
I. THE PROPOSAL	1
II. RATIONALE: SECTOR PERFORMANCE, PROBLEMS, AND OPPORTUNITIES	1
A. Performance Indicators and Analysis	1
B. Analysis of Key Problems and Opportunities	3
III. THE PROPOSED PROJECT	6
A. Impact and Outcome	6
B. Outputs	6
C. Special Features	12
D. Cost Estimates	12
E. Financing Plan	13
F. Implementation Arrangements	13
IV. PROJECT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS	17
A. Expected Benefits and Impacts	17
B. Risk Analysis	17
V. ASSURANCES	19
VI. RECOMMENDATION	19
APPENDIXES	
1. Design and Monitoring Framework	20
2. Financial Sector Analysis	23
3. External Assistance in the Financial Sector	32
4. Cost Estimates and Financing Plan	34
5. Project Implementation Chart	37
6. Implementation Schedule	38
7. Indicative Contract Packages	39
8. Outline Terms of Reference for Consultants	40
9. Summary Poverty Reduction and Social Strategy	47

LOAN AND PROJECT SUMMARY

Borrower	People's Republic of Bangladesh
Classification	Targeting classification: General intervention Sector: Finance Subsector: Finance sector development Themes: Governance Capacity development Subthemes: Financial and economic governance Institutional development Organizational development
Environment Assessment	Category C.
Project Description	<p>Investor confidence has not fully recovered since the stock market crash in 1996. This lack of confidence is traceable in large part to weak governance practices. Lack of market interest has in turn marginalized the role of the capital market in mobilizing long-term funds for economic development.</p> <p>The Improvement of Capital Market and Insurance Governance Project (the Project) will improve good governance practices in the capital market and the insurance sector. The TA loan has two parts. Part 1 will enhance the governance and capacity of the capital market, and part 2 will enhance the governance and capacity of the insurance sector. Part 1 will be targeted at the regulator, stock exchanges, market practitioners, and investors. It reflects a continuing effort by the Asian Development Bank (ADB) to help develop the domestic market, which will be critical if resources are to be mobilized to support private sector activity and promote economic growth. Part 2 will support Government-led reforms currently being pursued in the insurance sector, including the establishment of a new regulatory authority following international best practices. These twin efforts are being undertaken in parallel with a reform program aimed at strengthening Bangladesh's banking sector supported by the International Monetary Fund (IMF) and the World Bank.</p>
Rationale	<p>To reduce poverty and accelerate the pace of social development, the Government's national poverty reduction strategy (NPRS) aims to substantially increase private investment, savings, and economic growth. Financial sector development—generating more financial resources and improving the efficiency of resource allocation by restoring investor confidence—is critical to this goal. The Government also recognizes that, to meet the NPRS targets, it needs to rely on the financial sector, and thereby develop an appropriate market and environment. Improving the practice of good governance in all aspects of the financial system is essential to its development.</p>

For the capital market, weak governance and associated capacity are considered to be the primary causes of low investor confidence. While efforts to improve insurance sector governance have also been initiated, the Government recognizes that much still needs to be done. Accordingly, the Government asked for a TA loan to address urgent issues in the capital market and the insurance sector, and in order to maintain the momentum in areas where reforms have been initiated. Successful implementation of the TA loan could provide the base for considering a large-scale program or project loan.

Impact and Outcome	The Project is intended to raise confidence in Bangladesh's domestic financial markets by improving capital market and insurance governance. With better governance and greater investor participation, it is expected that activities in the capital market and the insurance sector will increase, and that they will play a more significant role in mobilizing long-term funds for infrastructure and industry, and for spurring economic growth.
Cost Estimates	The total cost is estimated at \$4.0 million equivalent, of which \$2.5 million (63%) is foreign exchange cost and \$1.5 million equivalent (37%) is local currency cost.
Financing Plan	The proposed financing is for an ADB TA loan of \$3.0 million equivalent to finance 75.0% of the project cost, including \$0.5 million equivalent of the local currency cost. The Government will finance a minimum of \$1.0 million equivalent of the local currency cost.
Loan Amount and Terms	A loan of \$3.0 million in various currencies equivalent to Special Drawing Rights (SDR) 2.103 million will be provided from ADB's Special Funds resources. The loan will have a 32-year term, including a grace period of 8 years, an interest rate of 1% per annum during the grace period and 1.5% per annum thereafter.
Period of Utilization	30 June 2008
Estimated Project Completion Date	31 December 2007
Executing Agency	Ministry of Finance, Finance Division (MOF-FD)
Implementation Arrangements	The implementing agency (IA) for part 1 of the Project will be the Securities and Exchange Commission (SEC), except for the Investment Corporation of Bangladesh (ICB) component, for which ICB will be the IA. The IA for part 2 will be the Office of the Chief Controller of Insurance (OCCI), Ministry of Commerce. Each IA will be responsible for the effective day-to-day implementation of the TA loan components.

A project management unit (PMU) created under MOF-FD will be the working secretariat and will support the project activities. The PMU will (i) coordinate implementation, (ii) carry out administrative and fiduciary support, and (iii) support MOF-FD in reporting on the progress of the Project and the use of the TA loan funds.

Procurement

Procurement of goods and services will be in accordance with ADB's *Guidelines for Procurement*. Each supply contract for equipment, computers, or materials estimated to cost the equivalent of \$500,000 or less will be awarded on the basis of international shopping, and supply contracts valued at \$100,000 equivalent or less may be procured according to local procedures under the Government's *Public Procurement Regulations, 2003* and which are acceptable to ADB.

Consulting Services

Recruitment of consultants to be financed from the proceeds of the TA loan will be in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the selection and engagement of domestic consultants. A total of 53 person-months of international and 56 person-months of domestic consulting inputs will be financed. Consulting services will be engaged in three packages (two packages for consulting firms and one package for an individual consultant). For the packages for consulting firms, the quality- and cost-based selection method will be used. A domestic financial and administrative consultant will be selected by the EA to assist the project coordinator of the PMU to implement the Project.

Project Benefits and Beneficiaries

The Project will strengthen the regulation and supervision of the capital market, increase the capacity of the regulators, and is envisaged to lead reform of the operations of existing financial intermediaries to improve their efficiency and governance structures. The interventions will benefit domestic and international investors, public and private sector borrowers and issuers, and other market participants. The Project will create an environment of greater confidence in market activities in Bangladesh. Alternative pricing methods for initial public offerings will be recommended and implemented, thereby facilitating the flotation of new issues and helping to deepen the capital market.

Revamping the insurance legislation and strengthening the capacity of the regulator (OCCI, or any successor that may be established) will enable the insurance sector to play a greater role in providing new insurance products and services, thereby investing in the economic development of the country.

Risks and Assumptions

Lack of ownership of the reforms by the Government and IAs is the key risk threatening financial sector reforms in Bangladesh. This risk has been mitigated by fully engaging the EA and the IAs in the selection process, design, and details of each component.

The Project can only achieve its targeted impact through continued reforms in the financial sector. Given the shifting priorities of the Government, there is a risk that these reforms may be sidelined. The Project will recommend regulatory and practical measures to improve investor confidence. In addition, ADB will continue policy dialogue with the Government in order to heighten awareness of governance issues in the financial sector. Governance is also high on the agenda of the development community and included in the country strategy and program jointly prepared with other development partners: the Government of Japan, Department for International Development of the United Kingdom, and the World Bank.

There is a risk that the SEC may remain understaffed and therefore be unable to take full advantage of the training and new facilities to be introduced through the Project. This risk will be partially addressed through strong implementation arrangements that ensure the Government supports and facilitates the recruitment and retention of staff in the SEC. The risk could be further mitigated if the SEC gains financial autonomy, supported by diversified revenue sources, expanded market, and improved staff compensation package as identified by a previous ADB study.

The Project will support OCCI and its successor as the insurance sector regulator. However, if the enactment of the proposed new Acts for the insurance sector is delayed, some of the outputs of the Project may not be introduced as scheduled. To ensure the effective implementation of the Project, consultant services will be provided in a phased manner, depending on the progress of the enactment of legislation. In particular, the drafting of regulations to be implemented under the new laws will begin after the Cabinet approves the draft laws.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed technical assistance (TA) loan to the People's Republic of Bangladesh for the Improvement of Capital Market and Insurance Governance Project (the Project).

II. RATIONALE: SECTOR PERFORMANCE, PROBLEMS, AND OPPORTUNITIES¹

2. The economy of Bangladesh has been growing steadily. Real gross domestic product (GDP) grew at an average of 5.3% per annum during FY2000–FY2004 (from 4.8% in the 1990s). The GDP annual growth rate reached a record of 6.3% in FY2004. From 1991/92 to 2000, national poverty incidence fell from 59% to 50%. However, Bangladesh needs to move to a GDP growth rate of 7–8% a year to achieve its national poverty reduction objectives and the Millennium Development Goals (MDGs). Efforts to overcome poverty face numerous constraints, including the urgent need for strong law and order, good infrastructure, sound financial markets, high-quality social services that are accessible and affordable, and an enabling environment for private sector development.

3. The Government's national poverty reduction strategy (NPRS)² reaffirms that poverty reduction and accelerating the pace of social development are Bangladesh's most important long-term strategic goals. To achieve them, the strategy aims to substantially increase private investment, savings, and economic growth rates. Financial sector development is critical to achieving these targets and meeting the twin goals of economic growth and poverty reduction.

4. In order to increase resource mobilization and improve the efficiency of resource allocation by the financial sector, it is important to build investor confidence in the domestic financial market. Improving the practice of good governance of all aspects of the financial system is central to this objective. Key aspects of capital market and insurance governance and associated capacity issues of the selected subsectors are discussed below.³

A. Performance Indicators and Analysis

5. Bangladesh's capital market is still underdeveloped, despite recent improvements. There are two stock exchanges in Bangladesh, the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE).⁴ At the end of 2004, the total market capitalization of the DSE was \$3.8 billion, representing 6.7% of GDP (compared with \$1.7 billion at the end of 2003). The total market capitalization of the CSE was \$3.6 billion. Since then, the total market capitalization has slightly decreased. At end-June 2005, there were 277 listed securities on the DSE and 198 on the CSE. Since most of the companies and all mutual funds are listed on both exchanges, the exchanges offer limited investment alternatives. During FY2004, the total securities traded

¹ The Project is based on the findings of ADB. 2003. *Technical Assistance to the People's Republic of Bangladesh for Preparing the Financial Markets Governance Program* (TA 4246-BAN). Manila. The key components of the TA were: (i) strengthening regulatory and supervisory capacity; (ii) improving governance and operations of market intermediaries; (iii) strengthening corporate governance and public disclosures; (iv) strengthening accreditation system; and (v) strengthening debt recovery.

² General Economics Division, Planning Commission, Government of the People's Republic of Bangladesh. 2004. *Unlocking the Potential: National Strategy for Poverty Reduction*. Dhaka.

³ For details, refer to Financial Sector Analysis (Appendix 2) and External Assistance in the Financial Sector (Appendix 3).

⁴ The East Pakistan Stock Exchange Association Ltd. was incorporated in 1954 as a public company. In 1962 the name was revised to East Pakistan Stock Exchange Ltd. and again to Dhaka Stock Exchange Ltd. in 1964. The CSE was established in 1995.

amounted to \$420 million on the DSE and \$150 million on the CSE, representing low turnover ratios (trading volume/market capitalization), approximately 17.4% for the DSE and 7.1% for the CSE, and thereby low liquidity.

6. The DSE general share price index advanced to 1,971 by the end of 2004, a 104% gain for the year, but declined to 1,676 by the end of 2005. There has been a significant increase in trading volume since 2004.⁵ Progress in capital market development has been made possible by, among other things, the central depository system and the automated trading system, a substantial increase in the minimum capital requirement of banks and nonbank financial institutions, lower interest rates on long-term government savings instruments, and an increase in overseas workers' remittances. Nonetheless, long-term prospects for capital market development are mixed.

7. Investor confidence has not fully recovered since the stock market crisis in 1996.⁶ Few of the foreign direct investors who had divested holdings in the wake of the 1996 market crash have returned. There were only three initial public offerings (IPOs) in 2004. In 2005 there were 17 IPOs, however most of them were by insurance companies and nonbank financial institutions under regulatory obligation. Despite attempts at reform, the capital market continues to suffer from poor governance and inadequate market supervision. The major market players have no strategic long-term vision for market development and continue to have limited capacity. Consequently, there has been limited investment interest and the supply of capital market instruments remains inadequate. The overall transparency of market transactions is low by international standards and generally there has been slow development of the underlying market infrastructure. Market participants have identified many reforms that are needed in the capital market.

8. The bond market is in its infancy. Five- and ten-year Treasury bonds have been issued only recently, and banks started secondary trading of Treasury bonds only in 2005. In November 2004, the first asset-backed securitized bonds were floated. The issued amount of corporate debentures represented 0.2% (\$2 million) and Treasury bonds 20.4% (\$226 million) out of a total issued capital of \$1.1 billion, including shares and mutual funds, as at 30 June 2005.

9. The insurance sector, an important provider of long-term capital, is growing very rapidly in Bangladesh. As economic growth accelerates, there is greater need for insurance protection and new insurance products. During 2001-2003, premiums have grown by 22% annually for life insurance and by 11% for general insurance. However, the insurance premium per capita remained at 2.1% in 2003, slightly lower than in Pakistan (2.9%) and far below India (16.4%). There are 62 insurance companies in Bangladesh. They include two state-owned insurance corporations: Jiban Bima Corporation (JBC) for life insurance and Sadharan Bima Corporation (SBC) for general insurance. JBC and SBC account for around 15% of premium income in their respective subsectors. SBC benefits substantially from reinsurance premium income since it is compulsory for general insurance companies to reinsure with SBC up to 50% of their total reinsured assets.

⁵ The reintroduction of day trading in 2004 contributed to an increase in the trading volume in that year. Day trading means that the same position or positions can be established and liquidated within one day's trading. Since clearing a transaction takes several days, the objective of the day trader is to make short-term gains on the same day without investing any funds and without considering the fundamentals of a security. Day trading was banned in 2003, but reintroduced in 2004.

⁶ There have been general allegations of fraudulent acts and insider trading that have contributed to abnormal fluctuations in share prices.

B. Analysis of Key Problems and Opportunities

10. **Capital Market.** The Securities and Exchange Commission (SEC) and capital market participants are weak. The SEC lacks sufficient capacity to regulate, monitor, supervise, or enforce regulations effectively and has limited resources to devote to its development functions. As a result, the SEC's authority to oversee any structural changes at the two stock exchanges is being undermined. The managements of the two stock exchanges are unable to regulate and supervise their members' activities effectively: the exchanges are owned and dominated by brokers, so their businesses take precedence over the governance of their exchanges.

11. Neither the SEC nor the exchanges have effective automated surveillance systems that can detect, monitor, and prevent market abuses and malpractices. This has affected market confidence, which has often been cited by investors as the major constraint in the development of the capital market.

12. The limited number of listed securities has always been a constraint on improving the liquidity and market capitalization of the stock market. The main impediments include an inefficient pricing mechanism, issuer's concerns over poor corporate governance, and high listing costs. For primary market development, the IPO approval process, pricing methods, and the capacity of merchant banks need to be improved. Mechanisms that facilitate securities transactions in the capital market, such as securities borrowing and lending, need to be introduced.

13. Market participants, including brokers, dealers, and merchant bankers, require a license to trade from the SEC. However there are no professional standards and minimal qualification requirements (e.g., examinations and professional training) imposed by the SEC or the exchanges on any of the intermediaries. To strengthen governance and the quality of market intermediaries, an examination and minimum qualification standards need to be introduced as a prerequisite for licensing by the SEC. Only qualified and duly licensed personnel should be allowed to deal with the public in transactions involving securities. Currently, there are no institutions in Bangladesh which offer courses specifically related to the functions and regulation of financial intermediaries.

14. The majority Government-owned Investment Corporation of Bangladesh (ICB) remains the single largest integrated capital market operator.⁷ ICB and its subsidiaries accounted for 32% of total combined turnover on the DSE and CSE in FY2004. To address conflicts of interest in its combined operations, three separate subsidiaries were created at ICB in 2002.⁸ However, all the objectives of unbundling ICB's operations have yet to be achieved. ICB's current functions include direct purchase of shares and corporate debentures, participation in and financing of joint-venture companies, provision of lease finance, acting as trustee and custodian, providing investment counseling to investors, and providing consumer credit. In addition, it manages investment accounts, mutual funds and a unit fund, and portfolios of businesses that existed before the establishment of three subsidiaries. ICB mutual funds created before 2002 are not regulated under the SEC mutual fund rules, and have no separate and independent trustee or custodian for the funds. They borrow regularly to finance equity investments, which is

⁷ The key shareholders of ICB are the Government of Bangladesh (27% of total shares), nationalized commercial banks (23%), state-owned development financial institutions (14%), state-owned insurance corporations (13%), and Bangladesh Bank (12%).

⁸ The three subsidiaries are: (i) ICB Capital Management Ltd. (a merchant bank); (ii) ICB Asset Management Ltd. (a manager of trusts and funds, including mutual funds); and (iii) ICB Securities Trading Ltd. (a stock broker and securities dealer).

not in line with international best practice and is a highly risky investment practice. The new mutual funds managed by an ICB subsidiary that was established in 2002 follow the SEC mutual fund rules.⁹ Considering the highly influential role of ICB in the capital market, it would be appropriate to introduce best international governance practices at ICB and its subsidiaries, including the adoption of accounting and audit standards based on international standards, and to improve the transparency of ICB operations.

15. **Insurance Sector.** Private insurance companies are currently regulated by the Office of the Chief Controller of Insurance (OCCI), Ministry of Commerce, under the Insurance Act, 1938. However, two state-owned insurance corporations (JBC and SBC) are regulated by the Government under the Insurance Corporation Act, 1973. Awareness of products and services in the insurance sector is low, and insurance representatives are poorly trained and lack motivation. Insurance companies have insufficient demographic statistics to serve as a basis for actuarial computation of premiums. There is no strong legal framework to enable customer grievances to be addressed, which has contributed to the industry failing to settle claims or defaulting on meeting claims, and a resulting erosion of the industry's reputation. The insurance sector is also constrained by a limited range of investment opportunities for premium income. As of the end of 2004, the substantial insurance reserves in the system (investment was estimated at Tk313.8 million or \$5.2 million) are mainly deposited with banks or invested in government securities. Under appropriate regulations, these funds should be more professionally managed and could be used to a certain extent to fund investments in the capital market and other long-term investments, such as financing infrastructure projects to stimulate economic growth.

16. To address key issues in the insurance sector, the Government is drafting three new insurance laws—the Insurance Regulatory Authority Act, the Insurance Act, and the Takaful (Islamic Insurance) Act—to replace the Insurance Act, 1938. One key reform is the establishment of a new Insurance Regulatory Authority. Based on good governance best practices, the Authority will be autonomous, and will regulate not only private insurance companies but also the two state-owned insurance corporations under a uniform regulatory framework. The OCCI will be phased out. The Cabinet is expected to approve the bills by mid-2006. The capacity of the present regulator is very limited to enforce the new laws and regulations, or to monitor the 62 existing insurance companies and the large number of potential companies waiting to be licensed. Strengthening the insurance regulator, restructuring the state-owned insurance entities, JBC and SBC, and liberalizing compulsory reinsurance arrangements are part of the reform agenda.

17. **National Poverty Reduction Strategy (NPRS) and the Financial Sector.** The NPRS recognizes the important role the capital market can play in raising funds cost-effectively and in enabling investors to gain access to alternative investment opportunities, and the substantial negative impact that financial market instability has on the plight of the poor. It also emphasizes the need for confidence by both issuers and investors, which requires effective monitoring, supervision, and enforcement of regulations by a competent regulatory authority, an adequate regulatory and institutional infrastructure, and diversification of investment products and services. The NPRS notes that, for an efficient and competitive banking system, financial stability must be maintained to meet the growing demand for financial resources and that the nationalized commercial bank (NCB) reforms and financial sector development programs must be implemented as soon as possible.

⁹ Of 12 listed mutual funds as of 30 June 2005, the parent ICB and the ICB subsidiary manage 8 and 2, respectively.

18. **Key Lessons Identified.** Capital market reforms will have to be based on continuing policy dialogue with the Government and supported by technical assistance for building capacity in the sector. Further program or large-scale project lending for capital market development should be considered only when upfront actions leading to substantive reforms have been demonstrated. With regard to the insurance sector, considering that ADB's previous Board-approved TA for the insurance sector was cancelled without becoming effective,¹⁰ ADB's future assistance in this sector should be based upon the readiness of the Government counterpart to undertake reforms and preparatory work rather than an *ex ante* agreement.

19. **Coordination of Development Partners.** In recent years, the World Bank and ADB have jointly helped the Government to improve financial market access for small and medium-sized enterprises (SMEs). They are also working together to expedite bank restructuring through privatization and to resolve the problem of nonperforming loans (NPLs). The World Bank is currently undertaking NCB reforms under its Enterprise Growth and Bank Modernization (EGBM) Project and the Second Development Support Credit.¹¹ It is also supporting Bangladesh Bank's dual role as the country's monetary authority and bank regulator and supervisor as part of the Central Bank Strengthening Project.¹² While ADB continues to be the lead funding agency in the capital market, the IMF and the World Bank have also been involved in bond market development related to effective monetary policy. ADB is also playing a lead role in dealing with various governance issues, including anticorruption measures and secured transactions. The Financial Sector Reform and Strengthening Initiative (FIRST) has recently provided TA to the insurance sector.¹³

20. **ADB's Financial Sector Strategy for Bangladesh.** ADB's financial sector strategy for Bangladesh, which is included in the new country strategy and program,¹⁴ is based on the NPRS, lessons from ADB's previous financial sector interventions, and coordination with other development partners. According to the strategy, ADB will provide assistance for capital market development when the Government demonstrates its strong commitment to meaningful reform with capacity-building measures to strengthen the regulatory and supervisory capacity of the SEC and to improve the governance of market intermediaries. ADB will continue to promote good governance in Bangladesh and to expand its focus to cover other financial subsectors, without being limited to the capital market.

¹⁰ ADB. 2000. *Technical Assistance to the People's Republic of Bangladesh for Pension and Insurance Sector Project*. Manila.

¹¹ World Bank. 2004. *Enterprise Growth and Bank Modernization (EGBM) Project*. Washington, DC continues the restructuring support of financial and nonfinancial state-owned enterprises (SOEs) that began with the June 2003 Development Support Credit. The project has a component "Resolution of the Problems of the Nationalized Commercial Banks" budgeted for \$34 million out of a total loan of \$250 million. The next phase of SOE reform is also being implemented under the Second Development Support Credit (2004), whose key support areas include: preparation for privatization and management support for some NCBs and issuance of prudential regulations; and supporting actions in a number of governance areas such as anticorruption initiatives, accounting, and auditing. The progress of privatization of the state-run Rupali Bank is one of key conditions of disbursement of IMF's Poverty Reduction Growth Facility (PRGF), and World Bank's Third Development Support Credit.

¹² World Bank. 2003. *Central Bank Strengthening Project*. Washington, DC supports implementation of Bangladesh Bank's strengthening program by providing assistance in three major areas: legal framework, reorganization and modernization, and capacity building.

¹³ The Insurance Law Reform Project (2003) of FIRST has provided recommendations for the insurance sector development as well as input for the draft insurance act. FIRST is a \$53 million multi-donor program (there were seven donors in 2004) to support capacity building and policy development projects in the financial sector. FIRST provides technical assistance grants for short- and medium-term projects in the areas of financial sector regulation, supervision and development.

¹⁴ ADB. 2005. *Country Strategy and Program (2006–2010): Bangladesh*. Manila.

21. **Rationale of the TA Loan.** While the TA loan focuses on governance, it was targeted mainly to selected subsectors taking into account the Government's commitment to subsector reform, ADB's new country strategy and program, activities of development partners, stakeholder consultation, and the expected contribution the Project will make to overall financial sector reform. Reflecting lessons identified from ADB's previous interventions in the financial sector, the strong commitment to subsector reforms, not only by the Government but by the institutions concerned, was given the highest priority for the success and sustainability of the Project.

22. For the capital market, weak governance and associated capacity are considered to be the primary causes of low investor confidence. The Government and ICB fully accept that transparency and corporate governance of ICB have to be improved. ICB needs to establish itself as an example of a good market participant if investor confidence is to be raised. While efforts to improve insurance sector governance have also been initiated, the Government recognizes that much still needs to be done. Accordingly, the Government asked for a TA loan to address urgent issues in the capital market and the insurance sector, and in order to maintain the momentum in areas where reforms have been initiated. Successful implementation of the TA loan could provide the base for considering a large-scale program or project loan.

III. THE PROPOSED PROJECT

A. Impact and Outcome

23. The Project will support the development of a sound and efficient capital market and insurance sector to help accelerate economic growth and poverty reduction. The specific project outcome will be improvements in governance and efficiency, thereby bolstering investor confidence in the capital market and in the insurance sector. The Project will provide the foundation for future reforms anchored on stronger market confidence and enhanced market institutions. The project framework is in Appendix 1.

B. Outputs

24. The Project has two parts: (i) enhancement of the governance and capacity of the capital market, and (ii) enhancement of the governance and capacity of the insurance sector.

1. Part 1: Enhancement of Governance and Capacity of the Capital Market

25. Part 1 will have four components covering the regulator, stock exchanges, market intermediaries, and the ICB.

a. Component 1: SEC

i. Strengthening the Market Surveillance Systems

26. To strengthen the SEC's operations and governance, (i) a real-time market surveillance system will be installed, and (ii) capacity building will be provided to improve monitoring, supervision, and enforcement capacity of the SEC.

27. The Project will help the SEC to install and operate an automated, online surveillance system. The surveillance system will help the SEC and the exchanges to detect trading

irregularities and market abuse as they occur and to reduce the amount of manual work. The Project will also train staff and provide manuals.

28. The key activities of the Project will include preparation of a request for proposals from international vendors, evaluation of the proposals in order to select the vendor shortlist, and assistance for contract negotiation. At the shortlist stage, officials from the SEC and elsewhere will visit overseas system reference sites. The chosen vendor will provide training and manuals.

29. The SEC surveillance system will complement the stock exchanges' own market surveillance activities and ensure that the exchanges are performing their regulatory functions well. The stock exchanges will establish a regulatory review committee to support the implementation of surveillance systems and to prevent vested interests of the exchanges' members from encroaching on the exchanges' regulatory functions. The committee will be composed of representatives from the legal and accounting professions, who will be independent of members of the exchanges, and an SEC representative who will participate as an observer. The committee will be responsible for establishing policy and direction in applying the regulations of the exchanges; reviewing existing regulations, regulatory practices, and procedures of the exchanges; and providing views on new regulations and recommending appropriate regulations. The two stock exchanges can form an inter-market surveillance unit, to share and discuss matters of mutual concern and to share information.

30. Staff of SEC, CSE, and DSE will be trained in modern market surveillance and enforcement techniques to enable them to be more effective at detecting trading irregularities and market abuses. The training will include examination of evidence and analysis of trading accounts of brokerage firms. In addition, staff will be trained not to contaminate evidence obtained from the surveillance system that could later be used in prosecuting a matter in the courts.

ii. Further Strengthening the Capacity of SEC

31. The Project will continue assistance provided to the SEC to progressively upgrade its capacity so it can meet more fully its current and future regulatory and market development functions, promote market stability and develop the capital market. The Project will support (i) capacity building programs, staff development and retention schemes, and a succession plan for employees leaving the SEC; (ii) the establishment of an in-house training unit within the SEC; (iii) overseas secondments for a small number of key staff, and (iv) a brief review of the overall risk management situation in the market.

32. **Capacity Building.** The capacity building programs will help develop the skills required by the SEC to meet gaps in its present operations and for future regulatory needs. The training needs to be met by the Project include, among others, effective risk management, enforcement, and market surveillance, which play an important part in the overall regulation of the capital market. The training for the SEC enforcement staff will concentrate on hands-on training and include exposure to actual cases.

33. Initially, SEC professional staff, who have yet to undergo training in different aspects of market regulation, will be trained in a broad range of capital market regulations. In constructing the overall design of a medium-term training program, the need to regulate the market based on

International Organization of Securities Commission (IOSCO) standards and principles,¹⁵ taking into account the developing market context, will be stressed. Particular emphasis will be given to dealing with the functions and objectives of, and approaches to, regulating and developing the capital market.

34. General courses will be given to all staff of SEC, while specific courses will be designed and undertaken for SEC management and its Board covering regulatory issues, market operations, and organizational management. The courses for the Board and top management will help them to understand the overall organizational perspective, vision and requirements needed to be able to formulate and implement strategic plans. Those for the other management will concentrate on developing an overall perspective on financial market operations, and provide in-depth exposure to various techniques of market operations.

35. The policy and procedures on selection of staff for local and international training, including a policy for retaining trainees, will be transparent. Policies and procedures will be introduced to recruit employees. An organizational and succession plan will be developed and implemented. There will be a facilitation plan of selected current senior staff to obtain professional qualifications appropriate to their posts.

36. **Establishment of In-House Training Unit.** The Project will help to establish a training unit within the SEC, to ensure that training is sustained. The unit will have a high profile in the SEC and be responsible for both initial and subsequent training of its staff. Trainers with expertise in the highly specialized regulatory functions of the SEC are rare in Bangladesh, so consideration will be given to using qualified retired officers from the SEC with the expertise and training skills to conduct in-house training programmes.

37. **Overseas Secondment.** In order for them to be able to formulate policies in line with international practices appropriate for Bangladesh, SEC staff as well as designated Ministry of Finance (MOF) officials will be helped to acquire in-depth understanding of how specific policies have been formulated and implemented in other jurisdictions. Secondments to SECs or financial institutions in other countries will be arranged for a few key staff from SEC and MOF. In order for others to benefit in the training, conditions will be set for back-to-office reporting, dissemination of knowledge to other staff and concerned persons outside the agency, and retaining staff when they return from secondment.

38. **Risk Management.** The Project will support a concise overall risk management review so that the SEC can identify potential weaknesses in the market structure. This will strengthen the SEC's preparedness for its supervisory functions.

b. Component 2: Stock Exchanges

39. The two subcomponents for the stock exchanges include (i) enhancing the capacity of management and governance of the stock exchanges; and (ii) increasing demand for and supply of securities.

i. Enhancing the Capacity of Management and Governance of the Stock Exchanges

¹⁵ IOSCO, as the principal international securities regulatory standards-setting organization, advocates the importance of the integrity of capital markets as essential to a country's financial stability and economic prosperity. It provides guidelines to enable regulators to identify and address possible weaknesses to a financial system.

40. The Project will ensure that high regulatory, operational, and governance standards are maintained by each exchange, thus helping the SEC to ensure effective regulatory oversight and enabling the exchanges to operate to international standards. This will include: (i) training staff of the two stock exchanges, and (ii) improving the exchanges' governance structures.

41. Management must be provided with the knowledge to operate the exchanges effectively and efficiently by international standards. The Project will provide training, coaching, and organizational development advice to management. Some of the local training may be combined with SEC staff training. The component will cover a needs assessment of designated staff at each exchange and the provision of courses based on those outlined in component 1 for the SEC. The Project will help to arrange (but not fund) secondment of selected exchange staff to overseas exchanges.

42. To improve management efficiency and help to raise the operations and governance of the exchanges to international standards, the boards and committees of exchanges will be streamlined. The Project will help to review current governance regulations, such as the memorandum and articles of associations of the exchanges, and preparing draft papers to present to the SEC for approval. The Project will specify how to (i) optimize the number of members of the exchange boards,¹⁶ and the number of functional committees¹⁷; (ii) make the listing of securities a function of the exchange executive; and (iii) establish other market committees as advisory groups. To improve the governance and liquidity of the capital market in the longer term, the DSE and the CSE may consider demutualization and merger.

ii. Increasing Demand for and Supply of Securities

43. The Project will consider ways to facilitate transactions in the exchanges, through the use of various accepted trading mechanisms such as margin lending, borrowing and lending of securities, and the introduction of new products suitable for Bangladesh.

44. It will also consider ways in which the supply of securities may be increased by determining incentives to attract more companies to list on the exchanges, as well as reviewing current listing rules with a view to facilitating listing requirements. In particular, the Project will help review pricing practices and recommend an efficient approval process for IPOs. It will help the authorities to encourage the use of alternative pricing methods, including a book building system for pricing IPOs. It will also explore ways in which the cost and time for companies to go public can be reduced, and public distribution of shares can be made an attractive alternative for raising capital. The Project will also review and clarify the legal framework aiming to strengthen implementing regulations concerning the acquisition of shares via mergers and acquisitions in accordance with international best practices.

c. Component 3: Market Intermediaries—Enhancing Capacity and Operating Standards

45. The Project will improve the operating performance of market intermediaries through the adoption of sound practices, training programs, and sustainable facilities for training. The Project will conduct a review of the licensing regime for market intermediaries, including categories of licensed entities, capital requirements, codes of conduct, and the criteria for being a fit and proper institution. The licensing review will extend to securities brokers and dealers,

¹⁶ There are currently 24 board members in the DSE and 25 in the CSE.

¹⁷ There are currently 12 committees in the DSE and 14 in the CSE.

securities agents, authorized representatives, merchant bankers, underwriters, issue managers, portfolio managers, and investment advisors. Recommendations on new rules or codes, such as capital adequacy rules and sales practices codes, will help SEC to implement the licensing regime in light of international standards and Bangladesh business practices.

46. Training and accreditation are integral parts of the licensing scheme. The Project will help to ensure appropriate persons are registered and licensed in the capital market. A testing system consisting of courses and examinations will be established. The licensing regime will conform to international practices and procedures and will be appropriate to Bangladesh's level of market development. Measures will be taken to minimize conflicts of interest and to ensure that, within a given context, all clients are treated fairly and equally.

47. The Project will provide consultancy support to establish a national capital market institute that will train the full spectrum of market professionals.¹⁸ The institute will train staff from the securities industry who need to be licensed by the SEC, establish syllabi, and set and mark examinations.¹⁹ To ensure that the institute can provide services based on international best practices, and that it is sustainable, similar bodies in other countries will be studied and their experience incorporated into the legal and institutional framework of the institute. As it develops, the institute will be able to offer a wide range of other courses, for both professionals and investors.

48. As the rules and regulations change for brokers, investment advisors, and fund managers to permit the evolution of full-service investment banks, the knowledge and skills required will expand beyond basic licensing standards. The proposed institute could provide preparation for the chartered financial analyst (CFA) qualification and become a CFA testing center.

49. The Project will develop an awareness and training program for potential female investors and organizations run by women. Such investors and organizations can play a role in financial markets, but often lack knowledge of the markets. The training program could be adopted by interested institutes on the basis of needs.

**d. Component 4: Investment Corporation of Bangladesh (ICB)—
Enhancement of Governance and Capacity**

50. The Project will enhance the governance of ICB to bring its operations into line with international best practice. The Project will finance a review of accounting and audit standards and practices, and management practices of ICB, and its subsidiaries and affiliates.

51. Key standards and practices to be improved by the review will include:

- (i) the corporate structure and proper recording on the financial statements of ICB and/or its subsidiaries, including:

¹⁸ Securities institutes internationally usually focus on training securities market professionals for legally required examinations for licensing. Securities institutes may also offer higher-level qualifications for professional leading to a membership of the institute (e.g., the Hong Kong Securities Institute and the Securities Institute of Australia are membership structured). They may be sponsored by the industry, private organizations, including overseas institutions, or the SEC may take some part. There is no one standard model. An institute may need to be licensed by the SEC to give examinations and/or courses. Previous ADB TA (footnote 1) contains a detailed discussion of the requirement of the institute.

¹⁹ The SEC has already set up a steering committee for the capital market institute.

- (a) equity accounting for subsidiaries,
- (b) effects of consolidation, including intercompany eliminations,
- (c) accounting rules for the income statement,
- (d) intercompany portfolio transactions;
- (ii) the impact of ICB brokerage and other fees on managed mutual funds and unit trust shareholders;
- (iii) identification and write-off of bad assets and provision policy;
- (iv) inventory of assets and securities, including those of managed mutual funds;
- (v) matching of assets and securities based on specific identification with mutual funds; and
- (vi) determination of the net asset value of the mutual funds and the unit fund.

52. Based on the review, recommendations will be made on incorporating good governance principles and practices in these areas and on the adjustments needed for ICB management to meet international standards and to adopt international best practices. On-the-job training and dissemination of the findings and recommendations of the review will help strengthen related capacity of ICB, and its subsidiaries and affiliates. The Project will develop a capacity building program to support ICB and its subsidiaries in areas of weak governance.

2. Part 2: Enhancement of Governance and Capacity of the Insurance Sector

53. Key outputs will include capacity building of the regulatory authority, regulations for the new legislation, a development plan for state-owned insurance corporations, and updated mortality tables. The Project will undertake a capacity building program for the key staff of the current insurance regulatory authority (OCCI) who are likely to be employed by the new regulator under the proposed Insurance Regulatory Authority Act, the Insurance Act, and the Takaful (Islamic Insurance) Act. The support will include a review of the functions of the insurance regulator, structure and organization of regulatory authorities, powers and responsibilities, conduct of enforcement and surveillance, among others.

54. To protect insurance policyholders, the insurance regulator needs to monitor company performance through systematic reports, and to evaluate all aspects of the insurance business. Capacity enhancement will prepare the regulators to analyze:

- (i) underwriting and pricing operations,
- (ii) product introduction and marketing schemes and programs,
- (iii) risk management and reinsurance policies,
- (iv) portfolio management policies, systems, and practices,
- (v) expanding service availability, and
- (vi) service orientation, particularly responsiveness to claims, timeliness of payment, and adequacy of service.

55. The Project will also help the newly established regulatory authority to draft regulations that will be implemented by the regulator under the proposed acts when they are passed.

56. The Project will undertake an analytical study and formulate a development plan to deal with any impact from the proposed legislation and implementing regulations on the state-owned insurance corporations, including resource requirements, improvements to operations, restructuring, and the timing and process for the liberalization of compulsory reinsurance arrangements. The restructured operations may also be compared with those of similar institutions in the region.

57. The Project will help the insurance industry update mortality tables in use for life insurance and review current premium levels for life and general insurance. It will also help to provide statistical databases for life and general insurance.

58. The Project will support OCCI to become more automated and to develop a management information system, which will enable it to improve overall regulatory and supervisory efficiency, and to undertake timely and in-depth analysis of the insurance sector. Visits to overseas insurance regulators and insurance institutions will be arranged for selected OCCI staff to improve their exposure and facilitate learning. Conditions for the visits will include back-to-office reporting and a system to retain staff when they return.

C. Special Features

59. The Project is based on the joint strategy of development partners in Bangladesh²⁰ to help the Government to achieve the maximum result from deployment of public resources. The Project will complement other development partners' activities, particularly assistance to the banking sector by the IMF and the World Bank, and contribute to the balanced development of the financial sector.

60. The operating cost of training programs for the securities market will be financed by the capital market participants. The training programs will include an awareness program for women, who are potential investors but have to date been excluded from investment management education.

61. Extensive consultation has been undertaken with the Government and stakeholders for part 1. For part 2, a committee for updating the insurance act and rules, consisting of representatives from the Government and the private sector, is investigating insurance sector reform and drafting the proposed insurance acts.

62. The Project aims to prepare the groundwork so further financial market reforms across various subsectors can be pursued. Improving the capacity of regulators and of capital market participants will address a key impediment to the successful implementation of ADB financial sector projects. In addition, a reform agenda to be identified by the Project will pave the way for the next stage of reforms in financial market development.

D. Cost Estimates

63. The total cost of the Project is \$4.0 million equivalent, consisting of foreign exchange cost of \$2.5 million (63% of the project cost), primarily for the services of international consultants and information technology equipment, and local currency cost of \$1.5 million equivalent (37% of the project cost), primarily for national consultant inputs as well as taxes and duties. Interest during the implementation period will be capitalized. The cost estimates are summarized in Table 1. Detailed cost estimates are in Appendix 4.

²⁰ Participating development partners are ADB, the Government of Japan, Department for International Development of the United Kingdom, and the World Bank.

E. Financing Plan

64. ADB will provide a TA loan of Special Drawing Rights (SDR) 2.103 million (\$3.0 million equivalent) from its Special Funds resources to finance 75.0% of the project costs. The amount covers \$2.5 million equivalent of the foreign exchange cost and \$0.5 million equivalent of the local currency cost.²¹ The term of the proposed loan will be 32 years, including a grace period of 8 years, with an interest charge of 1% per annum during the grace period and 1.5% per annum thereafter, and other terms and conditions set out in the TA Loan Agreement. The TA loan will be implemented within a period of 2 years, taking into account the time to recruit consultants and the passage of enabling legislation. The loan closing date is expected to be 30 June 2008. The financing plan is in Table 2 and the detailed financing plan is in Appendix 4.

Table 1: Summary of Technical Assistance Loan Cost
(\$ million)

Source	Foreign Exchange	Local Currency	Total Cost
Part 1: Enhancement of Governance and Capacity of the Capital Market			
Component 1: SEC	0.9	0.4	1.3
Component 2: Stock Exchanges	0.2	0.1	0.2
Component 3: Market Intermediaries	0.3	0.2	0.5
Component 4: ICB	0.2	0.1	0.3
Part 2: Enhancement of Governance and Capacity of the Insurance Sector	0.9	0.4	1.3
Project Administrative Support and Others	0.1	0.4	0.5
Total	2.5	1.5	4.0

ICB = Investment Corporation of Bangladesh, SEC = Securities and Exchange Commission.

Note: Column and row totals may not exactly add up due to rounding.

Source: Asian Development Bank estimates.

Table 2: Financing Plan
(\$ million)

Source	Foreign Exchange	Local Currency	Total Cost	%
Asian Development Bank	2.5	0.5	3.0	75.0
Government of Bangladesh	0.0	1.0	1.0	25.0
Total	2.5	1.5	4.0	100.0

Source: Asian Development Bank estimates.

F. Implementation Arrangements

1. Project Management

65. The Ministry of Finance, Finance Division (MOF-FD) will be the Executing Agency (EA) for the Project. The SEC will be the implementing agency (IA) for part 1 components 1-3. In implementing part 1 component 2, the SEC will coordinate with the stock exchanges. ICB will implement part 1 component 4. OCCI will implement part 2. A project implementation unit (PIU)

²¹ The allocation of loan proceeds in the Loan Agreement will be presented in the SDR equivalent of US dollars, with reference only to total expenditure, in accordance with ADB. 2005. *Cost Sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach*. Manila.

will be designated in each IA for effective day-to-day implementation of the project component concerned. Each PIU will be headed by a project director, in the position of executive director level in the SEC, general manager level in ICB, and controller of insurance in OCCI. MOF-FD will be responsible for monitoring the use of the loan proceeds.

66. A project management unit (PMU) attached to MOF-FD and headed by a project coordinator at the level of joint secretary will be the working secretariat and will support the project activities. The PMU will (i) coordinate implementation, (ii) carry out administrative and fiduciary support, and (iii) support MOF-FD in reporting on the progress of the Project and the use of the funds. MOF-FD and the IAs will provide adequate office space and facilities, transport, secretarial support, and other qualified local counterpart staff as needed. Appendix 5 outlines the organization chart for the implementation arrangements.

2. Implementation Period

67. The Project will be implemented within a period of two years. It will be completed by December 2007. Initial activities will focus on selection and recruitment of loan consultants. For effective implementation, the drafting of implementing regulations in the insurance sector (part 2) will be launched after the draft acts for the insurance sector have been approved by the Cabinet, by mid-2006. The overall project implementation schedule is summarized in Appendix 6.

3. Procurement of Goods and Services

68. Procurement of goods and services will be in accordance with ADB's *Guidelines for Procurement*. Each supply contract for equipment, computers, or materials estimated to cost the equivalent of \$500,000 or less will be awarded on the basis of international shopping, and supply contracts valued at \$100,000 equivalent or less may be procured according to local procedures under the Government's *Public Procurement Regulations, 2003* and which are acceptable to ADB (Appendix 7).

4. Consulting Services

69. Recruitment of consultants to be financed from the proceeds of the ADB loan will be in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the selection and engagement of domestic consultants. A total of 53 person-months of international and 56 person-months of domestic consulting inputs will be financed. Consulting services will be engaged in three packages (two packages for consulting firms and one package for an individual consultant). For the packages for consulting firms, the quality- and cost-based selection method will be used. A full technical proposal will be used for part 1, while a simplified technical proposal will be used for part 2. A domestic financial and administrative consultant will be selected by the EA to help the project coordinator of the PMU to implement the Project. The breakdown of consulting inputs and selection methods for each component are summarized in Table 3. The outline terms of reference for consultants are in Appendix 8.

70. MOF-FD will take advance actions to expedite project implementation, particularly by short-listing firms to provide consultancy services. The advance actions will apply only until evaluation of bids. Contract awards and signing of agreements will take place only after loan effectiveness. It has been explained to the Government that ADB's concurrence with advance actions does not commit ADB to finance the Project.

Table 3: Summary of Consulting Services and Selection Method

Technical Assistance Loan Component	International (person-months)	Domestic (person-months)	Total (person-months)	Selection Method
Part 1: Enhancement of Governance and Capacity of the Capital Market				Firm by QCBS
Component 1: SEC	11	7	18	
Component 2: Stock Exchanges	5	3	8	
Component 3: Market Intermediaries	9	8	17	
Component 4: ICB	6	0	6	
Part 2: Enhancement of Governance and Capacity of the Insurance Sector	22	14	36	Firm by QCBS
TA Loan Administration	0	24	24	Individual
Total	53	56	109	

ICB = Investment Corporation of Bangladesh, QCBS = quality- and cost-based selection.
Source: Asian Development Bank estimates.

5. Disbursement Arrangements

71. Disbursements for the TA loan will be subject to imprest account and direct payment procedures in accordance with ADB's *Loan Disbursement Handbook* dated January 2001, as amended from time to time. An imprest account will be established for MOF-FD at a commercial bank. The imprest account will be replenished as eligible expenditures are incurred and liquidated. The initial advance to the imprest account will be based on estimated expenditures for the first 6 months of the TA loan or 10% of the loan amount (i.e., \$300,000 equivalent), whichever is lower. The imprest account will be established, managed, replenished, and liquidated in accordance with ADB's *Loan Disbursement Handbook*, and detailed arrangements as agreed by the Government and ADB. ADB's statement of expenditures procedures may be used to reimburse eligible expenditures and to liquidate advances made into the imprest account in accordance with ADB's *Loan Disbursement Handbook*. Statement of expenditures procedures will be applicable to individual payments amounting to \$50,000 or less.

6. Accounting, Auditing, and Reporting

72. MOF-FD will keep a record of the utilization of the loan and will ensure that the record keeping and accounting carried by the IAs follow accounting and financial management procedures acceptable to ADB. The IAs will maintain separate records and accounts for the loan components, which will be audited annually in accordance with sound accounting standards by independent auditors acceptable to ADB. Annual audited reports and financial statements, in English, will be submitted to ADB within 6 months after the end of each fiscal year. The auditor's opinion of that part of the examination relating to the imprest account and statement of expenditures will be separately set out in the auditor's report.

73. MOF-FD will monitor implementation of the Project. MOF-FD will prepare quarterly and semiannual consolidated progress reports on the Project in a format acceptable to ADB that provide information on implementation progress, issues encountered, and measures taken to resolve them, and the status of compliance with loan covenants. The progress reports will be submitted to ADB not later than 30 days after the end of the relevant period. MOF-FD will submit to ADB a completion report for the Project within 3 months of the end of the project period. The completion report will provide a detailed evaluation of the Project design and implementation, including performance of the EA and IAs, associated government entities,

consultants, financial sector implications, and the socioeconomic and outreach impact of the Project.

7. Performance Monitoring and Evaluation

74. The Government and ADB will closely monitor the implementation of the Project through a review of the quarterly and semiannual progress reports and loan review missions. ADB monitoring will include ongoing dialogue with the Government on the overall effectiveness of the Project in improving the financial sector governance. ADB will regularly review the progress of the proposed loan based on the Government's quarterly and semiannual progress reports, participate in the regular reviews, and require agreement on any revisions.

75. ADB and the Government will jointly conduct a comprehensive review within 12 months of the start of the Project. The review will assess the Government's progress in implementing the Project and its adherence to procurement, consulting services, and procurement arrangements. From the assessments, the midterm review will formulate, taking into consideration specific changes in circumstances affecting the Project, the necessary course of action for the Government and ADB to ensure successful implementation of the Project.

76. Benefit and performance benchmark indicators, based on the Government's project plan and agreed between the Government and ADB, will be incorporated in the design of the project performance monitoring system (PPMS) to facilitate the monitoring and evaluation of project benefits. PPMS will be applied to each project component to ensure that project facilities are managed efficiently and benefits are realized. PIUs will undertake data collection and monitoring. The PMU will oversee compliance with procedures, enhancement of governance practices, improvement in cost structures, and accuracy and timeliness of financial reporting and controls.

8. Environmental and Social Measures

77. The Project will have no direct environmental impact, and it is unlikely that involuntary resettlement or detrimental impacts on indigenous peoples will occur; therefore no mitigating measures are required. The awareness and training program for women in component 3, part 1 will generate an opportunity for women to increase their investment opportunities and thereby participate in economic development. Longer-term environmental and social impacts will result from a general increase in living standards.

9. Anticorruption Measures

78. ADB's anticorruption policy was explained to and discussed with the Government and the EA. Consistent with its commitment to good governance, accountability, and transparency, ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive, or coercive practices relating to the Project. To support these efforts, relevant provisions of ADB's anticorruption policy are included in the Loan Regulations and the bidding documents for the Project. In particular, all contracts financed by ADB in connection with the Project shall include provisions specifying the right of ADB to audit and examine the records and accounts of the EA and all contractors, suppliers, consultants, and other service providers as they relate to the Project.

IV. PROJECT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS

A. Expected Benefits and Impacts

79. The Project addresses deficiencies in governance of the capital market at various levels; the regulator, the exchanges, and the market intermediaries including ICB. The expected benefits include: more effective regulation and supervision, greater capacity of the regulator, and reform of the operations of financial intermediaries to improve their efficiency and governance structures. This will, in turn, benefit both domestic and international investors, who will be more confident that investments are made in well-regulated and fair markets. When they are implemented, recommendations on alternative pricing methods for IPOs, facilitation of transactions in the exchanges, and improvement in ICB governance will deepen the capital market by facilitating issuance of new issues, and promoting market competition.

80. An automated surveillance system will increase the capacity of the SEC and the exchanges to monitor and stop abuses in the market. Automation should raise confidence in the market that wrongdoings can be dealt with promptly and on a sound and objective basis. Staff at the SEC and the exchanges will be protected from accusations of unfairness. Regular training and documentation updates will motivate staff to develop and refine the system, adding to public confidence in the market.

81. The new capital market institute will provide teaching facilities and training in capital market issues. It will set examinations and administer the examination system on behalf of the SEC. By introducing a licensing regime that follows international standards, taking into account circumstances in Bangladesh, it will provide confidence to investors and issuers. Measures will be taken to minimize conflicts of interest and ensure that all clients are treated fairly and equally.

82. Revamping insurance regulations and providing capacity enhancement for responsible regulators will result in the insurance sector being better equipped to play a proper role in providing new insurance products and services, and investing in long-term economic development. Moreover, the focus on the two state-owned insurance corporations, JBC and SBC, will provide opportunities for restructuring and possible privatization.

83. The limited capacity of the financial markets (capital market and insurance) in Bangladesh is a serious impediment to achieving growth rates that will support a substantial rise in employment and education and training opportunities for the population as a whole. Improvements in governance, in the capacity of regulators and market participants, and in the ability of insurance companies to invest premium income to support economic growth will ultimately help to reduce poverty.

84. Educational courses designed for women will benefit women who have a relatively high disposable income but little current knowledge of investments or the role of the capital market. It is unlikely that the Project will entail social safeguard issues. The summary poverty reduction and social strategy is in Appendix 9.

B. Risk Analysis

85. Weak ownership of the reform programs by the Government and the IAs has led to difficulties in implementing previous financial sector reforms in Bangladesh. Stakeholders have become involved in projects without sufficient preparation or commitment. This risk has been reduced for this Project by the following: (i) for components for which the SEC is responsible,

the SEC has either asked for the component (e.g., a surveillance system) or has already fully consulted the stakeholders, including DSE and CSE; (ii) regarding training and accreditation, the SEC as an IA has already initiated the establishment of a steering committee for the capital market institute; (iii) ICB, which is an IA, and MOF fully support the ICB-related component; and (iv) OCCl has already shown its full ownership of the insurance component by preparing groundwork with FIRST, consulting stakeholders, and drafting the proposed insurance acts.

86. The Project will have the targeted impact when the Government implements the recommendations made under the Project, which mainly aim at good governance and fairness in the capital market and the insurance sector. Given the shifting priorities of the Government, as well as those of its development partners, there is a risk that the Government may overlook the reforms. Actions to improve investor confidence in the financial sector and intervention areas will be identified by the Project and recommended to the Government. ADB will continue discussions with the Government in order to maintain its awareness of governance issues in the financial sector. Governance is also high on the agenda of the development community and part of the country strategy and program jointly prepared with other development partners: the Government of Japan, Department for International Development of the United Kingdom, and the World Bank.

87. Experience of previous projects in the capital market indicates that there is a risk that the SEC will remain understaffed and therefore unable to take advantage of the capacity building, training, and new system facilities. This would hinder the SEC from undertaking the necessary changes for market development, including establishing the capital market institute and implementing a compulsory examination scheme for licensing intermediaries. The SEC has noted that, without proper training facilities, licensing examinations cannot be introduced. Therefore, lack of capacity is a severe hindrance. Thus the exchanges and intermediaries would continue to operate at low levels by international standards, deterring both domestic and international investors to the Bangladesh capital market. This risk will be partially addressed by strong implementation arrangements to ensure that the Government supports and facilitates the recruitment and retention of staff in the SEC. The risk could be further mitigated if the SEC becomes financially autonomous, supported by diversified revenue sources, expanded market, and improved staff compensation package.²² The Project will also benefit the stock exchanges and other market participants by helping to extend Government support, which will ensure their active cooperation.

88. The insurance regulator and the principal officers in the industry welcome the proposed developments in the insurance sector. However, progress is dependent on the Cabinet approving the proposed acts and, if the process is delayed, the Project will lose momentum. To ensure the effective implementation of the Project, consultant services will be provided in a phased manner according to the enactment process. Drafting implementing regulations for the regulator under the new acts will occur only after the Cabinet has approved the draft acts. The capacity of the current regulator is very limited. Consequently, the Project is to provide capacity support so that OCCl can play the role of implementing agency in the insurance sector. Measures to ensure competent staff are retained will also be developed.

²² Previous ADB TA (footnote 1) identified fees and charges to be used for SEC's financial autonomy. However the size of the capital market is crucial for SEC's financial autonomy. The TA also identified weak compensation packages that need to be strengthened for SEC staff.

V. ASSURANCES

89. In addition to the standard assurances, the Government has given the following assurances, which are incorporated in the legal documents:

- (i) That the targeted awareness and training program for women are developed to address their special needs, and women are part of the training that is undertaken;
- (ii) That ICB ensures that all reports and information necessary for the review of accounting and audit standards applied and practices of ICB and ICB subsidiaries and affiliates are available in a form as requested, both in a hard copy and electronically, and in a timely manner;
- (iii) That OCCl will commence drafting implementing regulations once the proposed laws are approved by the Cabinet to ensure early functioning of the proposed Regulatory Authority once the laws are enacted; and
- (iv) That OCCl ensures that all reports and information necessary for study and development plan to deal with any impact from the proposed legislation and implementing regulations on the state-owned insurance corporations are available in a form as requested, both in a hard copy and electronically, and in a timely manner.

90. **Condition for Loan Effectiveness.** The Government will establish the PMU and the PIUs in SEC, ICB, and OCCl, and appoint their key staff as a condition for the TA loan to become effective.

VI. RECOMMENDATION

91. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve the technical assistance loan in various currencies equivalent to Special Drawing Rights 2,103,000 to the People's Republic of Bangladesh for the Improvement of Capital Market and Insurance Governance Project from ADB's Special Funds resources with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; a term of 32 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft Loan Agreement presented to the Board.

Liqun Jin
Vice President

8 February 2006

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators ^a	Data Sources/Reporting Mechanisms	Assumptions and Risks
Impact			
<ul style="list-style-type: none"> Sound and efficient capital market and insurance sector to help accelerate economic growth and poverty reduction 	<ul style="list-style-type: none"> Ratio of market capitalization to GDP increased from 6.7% in 2004 to 10% in 2010 Growth rate (3-year moving average) of premium in life insurance increased from 22% in 2004 to 25% in 2010 and general insurance increased from 11% in 2004 to 15% in 2010. 	<ul style="list-style-type: none"> Annual reports (SEC, DSE, and CSE) Annual report (OCCI) 	Assumptions <ul style="list-style-type: none"> Government to continue taking reform actions in the financial sector, including implementation of key recommendations by the TA loan Capacity building of regulators and market participants in the sector sustained
Outcome			
<ul style="list-style-type: none"> Improvement of governance, efficiency and investor confidence in capital market and insurance sector 	<ul style="list-style-type: none"> Activities of Surveillance Department of SEC expanded in terms of numbers as well as analytical quality [by 2007] Benchmark numbers of trainees and licenses established [by 2007] Reports of the insurance regulator authority expanded in numbers as well as analytical quality [by 2007] 	<ul style="list-style-type: none"> Annual report (SEC) Feedback from market participants Annual report (SEC) Annual reports (OCCI, insurance companies) Feedback from market participants 	Assumption <ul style="list-style-type: none"> Two regulators (SEC and OCCI) able to maintain competent staff
Outputs			
Part 1. Enhancement of Governance and Capacity of Capital Market			
Component 1. SEC			
(i) Strengthening the Market Surveillance Systems			
<ul style="list-style-type: none"> Surveillance system installed at SEC Strengthened surveillance capacity 	<ul style="list-style-type: none"> Automated on-line surveillance system [5 quarters] Staff training [6 quarters] Regulatory review committee and intermarket surveillance unit established [6 quarters] 	<ul style="list-style-type: none"> Annual Reports (SEC, DSE, CSE) SEC website notices Training program and evaluation 	Assumption <ul style="list-style-type: none"> Technical staff available
(ii) Further Strengthening the Capacity of SEC			
<ul style="list-style-type: none"> Improved SEC capacity and governance capabilities Training unit established 	<ul style="list-style-type: none"> Strengthened linkage between training and assignment [7 quarters] SEC training unit established with 3 year plan to implement [3 quarters] In-house training [7 quarters] Overseas training [7 quarters] Risk management review [4 quarters] 	<ul style="list-style-type: none"> Annual Report, SEC SEC website notices Personnel information of SEC Certificates of course completion issued to SEC staff who have attended internal courses Training program and evaluation 	Assumption <ul style="list-style-type: none"> Existing SEC staff to be able to attend training without being sidetracked by other operational issues

Design Summary	Performance Targets/Indicators ^a	Data Sources/Reporting Mechanisms	Assumptions and Risks
		<ul style="list-style-type: none"> Presentations (with supporting documentation) to SEC staff by trainees who have undergone overseas training or secondment 	
Component 2. Stock Exchanges			
(i) Enhancing the Capacity of Management and Governance of the Stock Exchanges			
<ul style="list-style-type: none"> Enhanced stock exchange staff capacity Improved governance and management of stock exchanges 	<ul style="list-style-type: none"> Staff training [7 quarters] Board structure and committees rationalized [4 quarters] 	<ul style="list-style-type: none"> Annual reports (SEC, DSE, and CSE) Announcements of SEC, DSE, and CSE Training program and evaluation Certificates of completion of internal training courses issued to exchange staff Minutes of boards and committees 	
(ii) Increasing Demand for and Supply of Securities			
<ul style="list-style-type: none"> Recommendations made to deepen the capital market 	<ul style="list-style-type: none"> Consultant study report [4 quarters] 	<ul style="list-style-type: none"> Comments on consultant reports (SEC, DSE, CSE) 	
Component 3. Market Intermediaries—Enhancing Capacity and Operating Standards			
<ul style="list-style-type: none"> Licensing regime strengthened National capital market institute established 	<ul style="list-style-type: none"> New or revised rules made if necessary [4 quarters] Examinations system established and operational [4 quarters] Establishment of national capital market institute [5 quarters] Investment awareness courses for women developed [7 quarters] 	<ul style="list-style-type: none"> SEC's announcement Annual report (SEC) Intermediaries complying with licensing criteria by taking examinations SEC/institution website published examinations results Feedback from public sources and the trainees 	
Component 4. ICB—Enhancement of Governance and Capacity			
<ul style="list-style-type: none"> Recommendation of international best practices in accounting, audit, and management for ICB and its subsidiaries 	<ul style="list-style-type: none"> Reports to improve accounting, audit, and management [3 quarters] Capacity building program to improve governance [4 quarters] 	<ul style="list-style-type: none"> Consultants' reports Annual report (ICB) 	Assumptions <ul style="list-style-type: none"> Consensus between ICB and MOF on the benefits of the reform maintained ICB to cooperate in information disclosure
Part 2. Enhancement of Governance and Capacity of the Insurance Sector			
<ul style="list-style-type: none"> Capacity building and training programs for OCCI Revised rules and regulations based on new insurance acts 	<ul style="list-style-type: none"> Training for regulators and industry [7 quarters] New rules and regulations [5 quarters] MIS developed [5 quarters] Updated mortality tables for life insurance and premium levels for life and general insurance companies [6 quarters] 	<ul style="list-style-type: none"> Annual report (OCCI) Government's announcement Consultant reports 	Risk <ul style="list-style-type: none"> Cabinet's approval of proposed insurance acts significantly delayed

Design Summary	Performance Targets/Indicators ^a	Data Sources/Reporting Mechanisms	Assumptions and Risks
<ul style="list-style-type: none"> Recommendations made to improve the governance of state-owned insurance corporations 	<ul style="list-style-type: none"> Development plan for state-owned insurance corporations [4 quarters] 		
Activities with Milestones			Inputs
<p>1. Part 1. Enhancement of Governance and Capacity of the Capital Market</p> <p>1.1. Component 1: SEC</p> <ul style="list-style-type: none"> Design automated surveillance system Train SEC staff in surveillance techniques Improve SEC governance capability Design SEC training unit <p>Start: September 2006; Complete: December 2007; Responsibility: SEC</p> <p>1.2. Component 2: Stock Exchanges</p> <ul style="list-style-type: none"> Improve the board structures of the stock exchanges Enhance the staff competence of the stock exchanges Examine ways to facilitate transactions in stock exchanges and increase the supply of listed securities <p>Start: September 2006; Complete: August 2007; Responsibility: SEC</p> <p>1.3. Component 3: Market Intermediaries</p> <ul style="list-style-type: none"> Develop accreditation and licensing system Design national capital market institute <p>Start: September 2006; Complete: December 2007; Responsibility: SEC</p> <p>1.4. Component 4: ICB</p> <ul style="list-style-type: none"> Review accounting and audit practices of ICB and ICB subsidiaries Review management practices of ICB and its subsidiaries <p>Start: September 2006; Complete: January 2007; Responsibility: ICB</p> <p>2. Part 2. Enhancement of Governance and Capacity of the Insurance Sector</p> <ul style="list-style-type: none"> Enhance the regulatory capacity of OCCI Assist OCCI in implementing the new legislation Study impact of new legislation on the state-owned insurance corporations Strengthen management information system at OCCI Update mortality tables of life insurance and review premium levels for life and general insurance <p>Start: September 2006; Complete: December 2007; Responsibility: OCCI</p> <p>3. Project Monitoring</p> <ul style="list-style-type: none"> Conduct quarterly reviews and a mid-term review <p>Start: December 2006; Complete: December 2007; Responsibility: Project team members from HQ and BRM</p>			<p>ADB (\$ million)</p> <p>Consulting services: 1.8</p> <p>International: 53 person-months</p> <p>Domestic: 56 person-months</p> <p>Equipment: 0.4</p> <p>Training: 0.3</p> <p>Others: 0.5</p> <p>Total: 3.0</p> <p>GOB (\$ million)</p> <p>Counterpart staff: 0.3</p> <p>Counterpart facilities and equipment: 0.3</p> <p>Others: 0.4</p> <p>Total: 1.0</p>

ADB = Asian Development Bank, BRM = Bangladesh Residence Mission, CSE = Chittagong Stock Exchange, DSE = Dhaka Stock Exchange, GDP = gross domestic product, GOB = Government of Bangladesh, HQ = headquarters, ICB = Investment Corporation of Bangladesh, MIS = management information system, MOC = Ministry of Commerce, MOF = Ministry of Finance, OCCI = Office of the Chief Controller of Insurance, SEC = Securities and Exchange Commission, TA = technical assistance.

^a Numbers in parenthesis indicate the year to accomplish the targets or the number of quarters after loan effectiveness that is necessary to achieve the target.

FINANCIAL SECTOR ANALYSIS

A. Introduction

1. The Government's national poverty reduction strategy (NPRS), *Unlocking the Potential: National Strategy for Poverty Reduction*,¹ reaffirms that poverty reduction and accelerating the pace of social development are Bangladesh's most important long-term strategic goals. To achieve them, the NPRS aims to increase private investment substantially from 17.5% of GDP in FY2004 to nearly 22% in FY2007, and the economic growth rate from an average of 5.1% per annum during from 2000 to 2004 to an average of 7-8% per annum from 2000 to 2015. Bangladesh's domestic investment rate was 23% of gross domestic product (GDP) in FY2004 and the saving rate was 18%, both of which were very low compared with those in the faster-growing countries in the region. The gap between needs and available resources in Bangladesh is increasing, which implies that (i) domestic resources need to be mobilized prior to external resource mobilization, and (ii) resource allocation has to be more efficient. Financial sector development is critical to achieving these two targets and to increasing economic growth and reducing poverty.

2. For the financial sector to mobilize resources and allocate them more efficiently, it must build the confidence of both domestic and foreign investors. The key to success is improving all aspects of good governance in the financial sector. In the banking sector, banking institutions have to recover their financial soundness and come to terms with their substantial amount of nonperforming assets. At the same time, the nonbanking sector—including the insurance sector—and securities markets must complement the banking sector, meet the diversifying financial needs of economic agents, and encourage constructive competition. To strengthen the market, transparency must be enhanced, the capacity of the regulators improved, market discipline instilled, and the structure and operations of market intermediaries reformed.

3. **The Government's Financial Sector Strategy.** The NPRS recognizes the role of the capital market in raising funds in a cost-effective manner as well as in enabling investors to gain access to investment opportunities. It emphasizes the confidence needed by the issuers as well as investors. Such confidence depends on effective monitoring, supervision, and enforcement of regulations by a competent regulatory authority, an adequate regulatory and institutional infrastructure, and diversification of investment products and services. The NPRS also states that financial stability must be maintained to meet the growing demand for resources and that the nationalized commercial bank (NCB) reforms and financial sector development programs must be implemented as soon as possible.

4. **ADB's Financial Sector Strategy for Bangladesh.** ADB's financial sector strategy for Bangladesh, included in the new country strategy and program,² is based on the NPRS, lessons from the previous capital market development program,³ recommendations of the *Country Assistance Program Evaluation for Bangladesh*,⁴ and coordination with other development partners. According to the strategy, ADB will provide assistance for the capital market development when the Government demonstrates its strong commitment to meaningful reform,

¹ General Economics Division, Planning Commission, Government of Bangladesh. 2004. *Unlocking the Potential: National Strategy for Poverty Reduction*. Dhaka.

² ADB. 2005. *Country Strategy and Program (2006–2010): Bangladesh*. Manila.

³ ADB. 1997. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the People's Republic of Bangladesh for Capital Market Development Program*. Manila.

⁴ ADB. 2003. *Country Assistance Program Evaluation for Bangladesh*. Manila.

with capacity-building measures to strengthen the regulatory and supervisory capacity of the Securities Exchange Commission (SEC) and to improve the governance of market intermediaries. ADB will continue to help Bangladesh to promote good governance and to cover other financial subsectors beyond the capital market.

5. **Identification of Subsectors to be Assisted.** The Project will focus on the governance issues pertaining to the capital market and the insurance sector, taking into account the Government's NPRS, ADB's new country strategy and program, development partners' activities, consultation with stakeholders, and the expected contribution or value added of the Project to overall financial sector reform. The Project took into account lessons identified from ADB's previous interventions in the financial sector, and the strong commitment to subsector reforms by both the Government and other stakeholders, particularly on the part of the institutions concerned. Key governance and associated capacity issues in the financial sector, together with the Government's reform actions and development partners' activities, are summarized in Table A2.1. Overall financial sector assistance by development partners is summarized in Appendix 3.

Table A2.1: Development Coordination for Good Governance

Key Governance Issues	Government's Reform Actions	Other Development Partners' Projects ^a	ADB Projects
Core Governance Issues	<ul style="list-style-type: none"> • Creation of an independent Anti-Corruption Commission • Enactment of Anti - Money Laundering Act (2002) and establishment of AML Department in Bangladesh Bank • Strengthening of law enforcement agencies • Establishment of regular courts in the hill districts • Initial steps towards separating the judiciary from the executive • Various civil and criminal justice reforms • Initiation of a national integrity strategy, which is aimed at combating corruption in the upper reaches of the Government and in the political parties 	<ul style="list-style-type: none"> • A broad consultation process has begun with the support of Bangladesh's development partners • World Bank: Legal and Judicial Capacity Building Project (2001) • World Bank: Central Bank Strengthening Project (2004) • World Bank: Second Development Support Credit (2004) 	<ul style="list-style-type: none"> • TA 4140-BAN: Supporting Good Governance Initiatives (2003) • TA: Supporting Good Governance Initiatives II (being processed)
Banking			
<ul style="list-style-type: none"> • Credit information • Weak capacity of Bangladesh Bank, including weak anti-money laundering capacity • Inefficiency and high NPLs of NCBs 	<ul style="list-style-type: none"> • Bangladesh Bank: Credit Information Bureau established (1992) • MOUs signed between Bangladesh Bank and NCBs • Bangladesh Bank: Strengthening of prudential regulation and supervision 	<ul style="list-style-type: none"> • World Bank: Central Bank Strengthening Project (2004) • World Bank: Enterprise Growth and Bank Modernization Project (Resolution of the Problems of the NCBs, 2004) 	<ul style="list-style-type: none"> • TA 4140-BAN: Supporting Good Governance Initiatives (2003) • TA 4246-BAN: Preparing Financial Markets Governance Program (2003)

Key Governance Issues	Government's Reform Actions	Other Development Partners' Projects ^a	ADB Projects
<ul style="list-style-type: none"> Secured transactions and transparent electronic registry for movable assets 		<ul style="list-style-type: none"> World Bank: Development Support Credit II (2004) and III (2005) IMF: Poverty Reduction Growth Facility USAID: Banking Supervision Advisory to the Central Bank 	
Nonbanking <ul style="list-style-type: none"> Unfair competition between banks and nonbank financial institutions 			<ul style="list-style-type: none"> TA 4246-BAN: Preparing Financial Markets Governance Program (2003)
Capital Market <ul style="list-style-type: none"> Market irregularities Weak capacity of SEC Weak capacity of stock exchanges Weak capacity of market intermediaries Weak competition Poor corporate governance 	<ul style="list-style-type: none"> Establishment of a committee to consider the amendments to Companies Act, 1994 	<ul style="list-style-type: none"> World Bank: Economic Management TA Program—Component: Strengthening Accounting and Auditing Practices in the Corporate Sector (2003) Australia and SEDF: Automation of the Registrar of Joint Stock Companies and Firms 	<ul style="list-style-type: none"> Loan 1580-BAN: Capital Market Development Program (1997) TA 3533-BAN: Capacity Building of SEC and Selected Capital Market Institutions (2000) TA 4246-BAN: Preparing Financial Markets Governance Program (2003) TA Loan Part 1: Enhancement of Governance and Capacity of the Capital Market
Insurance <ul style="list-style-type: none"> Weak capacity of regulator (OCCI); Outdated Insurance Act 1938 Weak competition 	<ul style="list-style-type: none"> Committee for updating the Insurance Law and rules established 	<ul style="list-style-type: none"> FIRST: Insurance Law Reform Project (2004) 	<ul style="list-style-type: none"> TA Loan Part 2: Enhancement of Governance and Capacity of the Insurance Sector
Pension <ul style="list-style-type: none"> Expansion of fiscal burden of pay-as-you-go system Soundness of formal schemes Regulatory and supervisory framework of employer sponsored 			<ul style="list-style-type: none"> TA 2033-BAN: Study in the Insurance and Pension and Provident Fund Operations in Bangladesh (1993)
Microfinance <ul style="list-style-type: none"> Inadequate legal and regulatory framework 	<ul style="list-style-type: none"> Microfinance Research and Reference Unit established in Bangladesh Bank 	<ul style="list-style-type: none"> Various bilateral development partners and Islamic Development Bank 	—

CMDP = Capital Market Development Program, FIRST = Financial Sector Reform and Strengthening Initiative, IMF = International Monetary Fund, MOU = memorandum of understanding, NCB = nationalized commercial bank, NPL = nonperforming loan, OCCI = Office of the Chief Controller of Insurance, SEC = Securities and Exchange Commission, SEDF = South Asia Enterprise Development Facility, TA = technical assistance.

^a For further details, refer to Appendix 3. See also the "Development Coordination Matrix" in the country strategy and program (footnote 2).

Source: Asian Development Bank.

6. Performance indicators, analysis, and key issues related to the capital market and insurance sector are provided below. Given the banking sector's dominance in Bangladesh, banking issues are also reviewed.

B. The Capital Market

7. Bangladesh's capital market—the market for trading long-term debt and equity securities, consisting of primary and secondary markets—remains underdeveloped, despite recent improvements. The capital market is essentially equity-oriented, with two stock exchanges: the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE).⁵ Government securities and savings instruments account for almost all of the nonbank debentures that are issued. There were 277 listed securities on the DSE and 198 on the CSE at end-June 2005. Since most companies and all mutual funds are listed on both stock exchanges, the exchanges offer limited investment alternatives. During FY2004, the total securities traded amounted to Tk24.8 billion (\$420 million) on the DSE and Tk8.9 billion (\$150 million) on the CSE. The turnover ratios (trading volume/market capitalization) were low, approximately 17.4% for the DSE and 7.1%, for the CSE and liquidity was also low. At the end of 2004, the total market capitalization of the DSE was \$3.8 billion, or just 6.7% of GDP, although there has been an increase by 130% during the year. The total market capitalization of the CSE was \$3.6 billion. Since then, the total market capitalization has slightly decreased. There has been a significant increase in trading volume since 2004, partly because of the reintroduction of day trading in 2004.⁶ In the DSE, trading volumes were \$604 million for 2002 (daily trading volume, \$2 million), \$330 million for 2003 (daily trading volume, \$1 million) and \$882 million for 2004 (daily trading volume, \$3 million). Accordingly, the turnover ratios increased. The DSE general share price index advanced to 1,971 by the end of 2004, a 104% gain for the year, but declined to 1,676 by the end of 2005.

8. The bond market is in its infancy. Five- and ten-year Treasury bonds have been issued only recently, and banks started secondary trading of Treasury bonds only in 2005. In November 2004, the first asset-backed securitized bonds were floated. Of the total of 277 securities traded on the DSE on 30 June 2005, only eight were corporate debentures, and eighteen were Treasury bonds. On 30 June 2005, the total issued amount of the corporate debentures was 0.2% (\$2 million) of total issued capital including shares and mutual funds (\$1.1 billion), while for Treasury bonds it was 20.4% (\$226 million).

9. Progress in the capital market has been helped by the central depository system and the automated trading system; a substantial increase in the minimum capital requirement of banks and nonbank financial institutions,⁷ which led to them raising capital by issuing new shares; and the introduction of credit ratings before an initial public offering (IPO).⁸ Lower interest rates on long-term Government savings instruments, an increase in overseas workers' remittances, and

⁵ The East Pakistan Stock Exchange Association Ltd. was incorporated in 1954 as a public company. In 1962 the name was revised to the East Pakistan Stock Exchange Ltd. and again to the Dhaka Stock Exchange Ltd. in 1964. The CSE was established in 1995.

⁶ In day trading, the same position or positions are established and liquidated within one day's trading. The objective of the day trader is to make short-term gains on the same day without investing any funds and without considering the fundamentals of security. Day trading was banned in 2003, but reintroduced in 2004. Reflecting this, the DSE turnover ratios were 49.1% in 2002, 19.6% in 2003, and 23.6% in 2004.

⁷ Bangladesh Bank increased the minimum capital requirement from Tk0.4 billion to Tk1.0 billion for banks and from Tk0.1 billion and Tk0.25 billion for nonbank financial institutions.

⁸ All banks are required to mention their credit rating evaluation report in their prospectus when they go to the public to raise funds through IPOs from June 2004.

tax incentives for equity investment have also contributed to growth in capital market activity. Nonetheless, long-term prospects for capital market development are mixed.

10. The capital market has inadequate market supervision and the major market players (e.g., stock exchanges, brokers, dealers, and asset managers) have limited capacity. There are not enough securities, products, and services; transparency is poor both in trading and in the quality of information provided for listed companies; and the introduction of technology to support the market infrastructure has been slow. As a result, investor confidence is low. Market participants have identified the need for many reforms in the capital market.

11. **Capacity.** Both the regulator and market participants are weak, although there have been capacity building and training at the SEC for many years. Strengthening the capacity of the regulator and market participants is a prerequisite for comprehensive capital market reforms. The SEC must improve its capacity to carry out its operational and development mandates. It remains understaffed and most existing staff have not had enough training. Remuneration constraints make it difficult to attract high caliber staff. Recruitment and career progression are restricted and constrained by government policy. Staff turnover is high by local standards. As a result, the SEC does not have the capacity to regulate or monitor current activities within its remit and has limited resources to devote to development functions. This will, *inter alia*, undermine the SEC's authority to oversee any structural changes at the two stock exchanges.

12. Internationally, staff salaries at an SEC are rarely as high as those in the market. Nevertheless, significant strides towards reform could be achieved if remuneration of Bangladesh SEC staff could be made more competitive with that in the private sector. However, the Government would prefer to defer consideration of separating the SEC from the civil service pay scale. While a turnover fee may be contemplated it is unlikely that the market could bear a significant fee. The funds available in the near future will not support any significant increase in salaries, but training and promotion scheme will help to motivate SEC staff.

13. The managements of the two exchanges are weak at the strategic, senior- and mid-management levels. They are unable to regulate and supervise their members' activities effectively. The exchanges are owned and dominated by brokers, so their businesses take precedence over the governance of their respective exchanges. The SEC is required to monitor the activities of the exchanges and therefore the training of exchange executives must be included in the capacity building exercise.

14. **Systems and Surveillance.** The trading and surveillance systems and standards are inadequate. Good governance depends on having a sound technical infrastructure in place, but neither the SEC nor the exchanges have effective automated systems of surveillance to help them to detect market abuse. The Securities and Exchange Commission Automation System (SECAS), originally installed in 2001 with ADB funding, is a management information system developed to automate data recording and retrieval. It performs some analysis, but the surveillance module was not designed to provide on-line market surveillance. To properly fulfill its regulatory mandate, the SEC needs to have its own online market surveillance system.

15. At the CSE, the responsibility for surveillance, market operations and listings has been combined into one area called "market operations." The DSE is also in the process of combining operations into one area. However, at both exchanges, great care must be taken not to mix the distinct roles of surveillance and business development: attracting and approving companies for listing is a business development role, while ensuring their compliance with the continuing disclosure obligations of listing is a surveillance role.

16. Surveillance at the exchanges focuses on the issuers' obligation of disclosure and on monitoring the trading portfolio of brokers, market manipulation, and insider dealing. The present systems are relatively basic in design, and if they were all operated online, this would stretch the computing capacity of the trading platforms. For this reason, some of the activities are carried out offline.

17. Neither exchange has an effective system designed specifically to monitor market abuse or suspected market abuse,⁹ nor do they have adequate automated information control systems to maintain and monitor progress on suspected cases or companies' failure to comply with their disclosure obligations. Cases are handwritten and/or typed and are not retained in a central surveillance monitoring system. A computerized monitoring system should be used to manage progress and the results of the investigation, and action taken, if necessary. Names and details of all parties should be recorded in a database and should be used to cross-check with other suspected violations for patterns or relationships between involved parties (this is particularly useful in the case of insider dealing and/or market manipulation involving collusion by a brokerage firm).

18. The staff at the exchanges should be trained in market surveillance, evidence gathering, and analysis of data. A common complaint from brokers is that surveillance staff, in their eagerness to identify cases of market manipulation, often mistake basic trading strategies for something more sinister.

19. SEC staff use a surveillance terminal from the CSE, together with a remote terminal (not a surveillance terminal) from the DSE. SEC, CSE, and DSE staff monitor the same surveillance and trading screens to identify abnormalities in trading. The SEC should have an independent system for monitoring the CES and the DSE.

20. **Demand for and Supply of Securities.** The limited number of listed securities has constrained increases in the liquidity and market capitalization of the stock exchanges. In addition, would-be investors have restricted investment choices because of the lack of high-quality equity issues, investment-grade equities, and debt instruments in the market. There were 277 securities listed on the DSE as on 30 June 2005, including 239 companies, 12 mutual funds, 8 corporate debentures, and 18 Treasury bonds. On the CSE, there were 198 securities listed including 184 companies, 12 mutual funds, and 2 corporate debentures. The total number of listed companies increased by seven over the past 3 years. There were only three IPOs in 2004, which was the smallest number since 1993. In 2005 there were 17 IPOs, however most of them were by insurance companies and nonbank financial institutions under regulatory obligation. The main impediments to increasing the number of new listings are the inefficient pricing mechanism, the owner's concerns over poor corporate governance, and the high cost of listing. For primary market development, the IPO approval process and alternative pricing methods, including the book building system, need to be improved,¹⁰ and the capacity of merchant banks enhanced. The legal framework for corporate mergers and acquisitions also needs to be brought into line with international best practices. To promote demand for securities

⁹ Market manipulation and insider dealing.

¹⁰ The company discloses all particular materials to the issue manager who fixes the price and submits it, complying with the legal requirements of the SEC. After permission has been received from the SEC, the prospectus has been circulated. In fixing the price, underwriters are not involved in the pricing mechanism, so investors are not aware of the actual price. No stabilization action process is undertaken by the underwriters after and IPO and the system is absent of penalty bids.

and increase the number of transactions, margin lending, borrowing and lending of securities, and the introduction of other products suitable for Bangladesh.

21. **Qualifications and Licensing.** The categories of market participants requiring a license from the SEC include: (i) brokers, who provide trading services to clients; (ii) dealers, who are permitted to trade for their own account; (iii) merchant bankers, who provide underwriting, issuing manager, and portfolio investment services; (iv) investment advisors, who provide investment advice to clients (there are none currently licensed); and (v) authorised representatives, who are engaged in a broker's office to trade on the exchange on behalf of a broker or dealer. Although there are over 320 licensed brokers and over 270 authorised representatives, there are no professional standards and minimal qualification requirements (courses, examinations, or continuous professional training) imposed by the SEC or the exchanges on any of the intermediaries.

22. To strengthen governance and the quality of market intermediaries, an examination and minimum qualification standards need to be introduced. Following international best practice, the SEC should make it a legal requirement for intermediaries to pass the examinations. In Bangladesh there are no institutions which offer courses specifically related to the functions and regulation of intermediaries. While in other countries SECs are not necessarily the driving forces behind the establishment of training institutes, the realities in Bangladesh mean that the SEC needs to take a lead role in establishing such an institution. Currently, the SEC does not have the capacity to do this.

23. The current licensing system does not permit brokers to be advisors. This needs to be reviewed in accordance with international best practices, taking into account the particular difficulties in Bangladesh in managing conflicts of interest. In addition, the licensing system needs to be streamlined and proper test requirements introduced.

24. **Investment Corporation of Bangladesh (ICB).**¹¹ The majority Government-owned ICB remains the single largest integrated capital market operator. ICB and its subsidiaries accounted for 32% of the total turnover of the DSE and CSE in FY2004. To address conflicts of interest in its combined operations and to make the capital market fairer, three separate subsidiaries were created at ICB in 2002.¹² However, all objectives of the unbundling of ICB's operations have yet to be achieved. ICB mutual funds created before 2002 are not regulated under the SEC mutual fund rules, and there is no separate and independent trustee or custodian for the funds. The funds managed by ICB borrow regularly to finance equity investments, which is not in line with international best practice and is a highly risky investment practice. The new mutual funds managed by an ICB subsidiary established in 2002 follow the SEC mutual fund rules.¹³

¹¹ The ICB was established on 1 October 1976 under the Investment Corporation of Bangladesh Ordinance, 1976, to accelerate the pace of industrialization and develop a sound securities market in Bangladesh. The ICB provides various types of investment, banking, and nonbanking services. The key shareholders of ICB are the Government of Bangladesh (27% of total shares), nationalized commercial banks (23%), state-owned development financial institutions (14%), state-owned insurance corporations (13%), and Bangladesh Bank (12%).

¹² The three subsidiaries are: (i) ICB Capital Management Ltd. (a merchant bank), (ii) ICB Asset Management Ltd. (a manager of trusts and funds, including mutual funds), and (iii) ICB Securities Trading Ltd. (a stock broker and securities dealer). Examples of current business activities being conducted by ICB include: direct purchase of shares and debentures; participation in and financing of joint-venture companies; provision of lease finance; management of existing investment accounts, mutual funds and a unit fund, and portfolios of existing businesses that existed before the establishment of the three subsidiaries; acting as trustee and custodian; providing investment counseling to investors; and providing consumer credit.

¹³ Of the 12 listed mutual funds as on 31 January 2005, the parent ICB managed eight and the ICB subsidiary managed two.

25. For further development of the market, the capacity for private investment and portfolio management needs to be improved and best international governance practices need to be introduced at the ICB and its subsidiaries. Appropriate accounting and audit standards need to be introduced, based on international standards, and the transparency of ICB operations improved.

C. The Insurance Sector

26. The insurance sector, an important provider of long-term capital, is growing very rapidly in Bangladesh. As economic growth accelerates, the need for insurance protection and new insurance products increases.¹⁴ However, the insurance premium per capita was only 2.1% in 2003, slightly lower than in Pakistan (2.9%) and much lower than in India (16.4%). Penetration remained very low: only 1.5% of the population has a life insurance policy, compared with 7.5% in India and 4-5% in Pakistan. There are 62 insurance companies in the market, including two state-owned insurance corporations: Jiban Bima Corporation (JBC) for life insurance and Sadharan Bima Corporation (SBC) for general insurance. JBC and SBC account for about 15% of premium income in their respective subsectors. SBC benefits substantially from reinsurance premium income, since it is compulsory for general insurance companies to reinsure with SBC up to 50% of their total reinsured assets.

27. Private insurance companies are currently regulated by the Office of the Chief Controller of Insurance (OCCI), Ministry of Commerce, under the Insurance Act, 1938. The two state-owned insurance corporations (JBC and SBC) are regulated by the Government under the Insurance Corporation Act, 1973. Awareness of products and services offered in the insurance sector is low, and insurance representatives are poorly trained and lack motivation. The insurance sector has been recognized by the Government as an industrial sector rather than as part of the financial sector. It has therefore been difficult to include the insurance sector in financial sector regulations. There is no strong legal framework for addressing customer grievances, which has contributed to the industry practice of failing to settle claims, or of defaulting on meeting claims, and a resulting erosion of the industry's reputation. Insurance companies do not have enough demographic statistics for actuarial computations. The industry is constrained by a limited range of possibilities for generating additional investment income from premiums received. At the end of 2004, the substantial reserves in the system (insurance investment was estimated at Tk313.8 million) are either deposited in banks or invested in government securities. These funds should be more professionally managed under appropriate regulations. They could be used as long-term investment capital to stimulate economic growth.

28. To address key issues in the insurance sector, three new insurance acts—the Insurance Regulatory Authority Act, the Insurance Act, and the Takaful (Islamic Insurance) Act—are being drafted to replace the Insurance Act, 1938.¹⁵ One key element of the new legislation is the establishment of a new Insurance Regulatory Authority. Following good governance best practices, the authority will be autonomous, and will regulate not only private insurance companies but also the two state-owned insurance corporations under a uniform regulatory framework. The OCCI will be phased out. The Cabinet is expected to approve the draft acts by mid-2006. However, the regulator has limited capacity to enforce the acts and regulations, or to

¹⁴ Premiums have grown by 22% a year for life insurance and 11% a year for general insurance during 2001–2003.

¹⁵ A Committee for Updating the Insurance Act and Rules consisting of representatives from the Government and the private sector contributed to the report of the Financial Sector Reform and Strengthening Initiative (FIRST), Insurance Law Reform Project (2003). The report made recommendations for the insurance industry and provided inputs for the draft insurance act.

monitor the 62 insurance companies and the large number of companies waiting to be licensed. Strengthening the OCCI, restructuring the state-owned insurance entities following international best practices, and liberalizing compulsory reinsurance arrangements are part of the reform agenda for the insurance sector.

D. The Banking Sector and NPLs

29. The financial sector is predominantly bank-based, with 49 banks¹⁶ accounting for about 95% of the sector's total assets. Five nationalized commercial banks (NCBs) account for about half of bank deposits. The banking sector has been heavily burdened by high levels of nonperforming loans (NPLs) that accumulated over many years and by weak management of NCBs. The reported ratio of net NPLs to total loans declined to 18% at the end of 2004 from 41% at the end of 1999. This reduction was achieved by provisioning and write-off and by a sharp reduction in new bad debt. The reduction is also due to stronger regulations, enhanced legal powers of the banks to collect problem loans (e.g., due through money loan courts¹⁷), and better screening of new loans (facilitated by the Credit Information Bureau). The Government strategy, being implemented by Bangladesh Bank with assistance from the IMF and World Bank, includes limiting NCBs' annual credit portfolio growth to 5% and this has played a key role in enhancing NCB's soundness.

30. However, the major NCBs and the government specialized banks are still burdened with significant NPLs and are technically insolvent. The gross NPL ratio for NCBs had declined to 24% at end-June 2005 (compared with 29% at the end of 2003), while the ratio for specialized banks had declined to 35% (compared with 47% at the end of 2003). The NPL ratio of NCBs is very high compared with those of banks in other countries affected by the Asian crisis. The high NPLs adversely affect profitability and capital adequacy ratios, and constrain the supply of credit for economic development. If the Government is required to recapitalize the banks, there could be significant adverse fiscal implications. The money loan court has filled many of the gaps left by the statutes and has, by enhancing banks' legal powers, been very effective at recovering bad debts. However, the debt recovery framework needs to be broadly examined, the capacity to resolve NPLs has to be strengthened, and an institutional framework has to be established.

31. NCBs face many other serious problems including large and growing capital shortfalls and operational inefficiencies, stemming from excessive numbers of staff, extensive and loss-making branch networks, and low levels of computerization. The poor state of the NCBs and their impact on the financial sector as a whole has moved the Government to push for reforms. Banking sector structural reform is well underway with the assistance of the World Bank Enterprise Growth and Bank Modernization Project and the IMF Poverty Reduction Growth Facility. Bangladesh Bank has taken a number of stock and flow measures to improve the soundness of the banking sector. One of the NCBs (Rupali) will be privatized soon and the management structures of the three remaining NCBs are being changed. However, reforms of the NCBs and resolution of the NPL issues will require concerted efforts by the banks, the Government, and Bangladesh's development partners.

¹⁶ There are 4 NCBs, 5 government-owned specialized banks, 30 private commercial banks, and 10 foreign commercial banks. NCBs account for about 50% of total deposits in the banking sector and specialized banks account for about 5%. The share of NCBs is declining.

¹⁷ The Money Loan Court Act, 1990 introduced a court of exclusive jurisdiction for the recovery of NPLs to expedite adjudication of creditors' claims. Significant improvements in the execution of the Money Loan Courts were made as part of the Money Loan Court Act, 2003. The money loan court process, which is accepted by the banks, has been instrumental in improving the speed and efficiency of collateral acquisition and disposal, and in gaining judgments against uncooperative debtors.

EXTERNAL ASSISTANCE IN THE FINANCIAL SECTOR^a

Table A3.1: Asian Development Bank's Assistance for the Financial Sector (1990–2005)

Project	Year Approved	Commitment Amount (\$'000)
TA 1351-BAN: Capital Market Development	1990	100
TA 1943-BAN: Institutional Strengthening of the SEC	1993	586
TA 2033-BAN: Study in the Insurance and Pension and Provident Fund Operations in Bangladesh	1993	577
TA 2045-BAN: Audit, Valuation, and Study of Restructuring Options for ICB	1993	479
TA 2830-BAN: Establishment of an Automated Depository System	1997	100
Capital Market Development Program		
Loan 1580-BAN: Capital Market Development Program	1997	80,000
TA 2913-BAN: Capacity Building of Securities and Exchange Commission and Stock Exchanges	1997	1,100
TA 2914-BAN: Institutional Strengthening of the Privatization Board	1997	440
TA 2915-BAN: Insurance Industry and Pension and Provident Fund Reforms	1997	500
TA No. 3078-BAN: Establishment of the Framework for Sustainable Microfinance Operations	1998	800
Loan 1634-BAN: Rural Livelihood Project	1998	42,600
TA 3533-BAN: Capacity Building of SEC and Selected Capital Market Institutions	2000	850
TA 3590-BAN: Pension and Insurance Sector Project	2000	600 ^b
TA 3698-BAN: Finance, Industry and Trade Sector Review and Strategy Formulation	2001	150
TA 3787-BAN: Central Depository Capacity Building	2001	150
TA 3879-BAN: SME Development and Export Expansion Program	2002	600
TA 4104-BAN: Assistance to the Privatization Commission	2003	150
TA 4140-BAN: Supporting Good Governance Initiatives	2003	1,050
TA 4246-BAN: Financial Markets Governance Program	2003	550
SME Sector Development Program (SMESDP)		
Loan 2148-BAN: Program Loan	2004	15,000
Loan 2149-BAN: Project Loan	2004	30,000
Loan 2150-BAN: TA Loan	2004	5,000
TA 4507-BAN: Support program implementation and coordination of SMESDP	2004	600
Loan: Improvement of Capital Market and Insurance Governance TA Loan	Being processed	3,000
TA: Support for Good Governance Initiatives II	Being processed	250

BAN = Bangladesh, SEC = Securities and Exchange Commission, ICB = Investment Corporation of Bangladesh, SME = small and medium enterprise, TA = technical assistance.

^a Including small and medium enterprise sector.

^b Cancelled.

Source: Asian Development Bank.

Table A3.2: Recent Assistance of Other Development Partners

Project	Year Approved	Commitment Amount (\$'000)
IMF		
Poverty Reduction Growth Facility (PRGF)	Since 2003	507,700 (total)
World Bank		
Private Sector Infrastructure Development	1997	235,000
Financial Institutions Development	1999	46,900
Second Poverty Alleviation Microfinance Project (Microfinance II)	2001	151,000
Legal and Judicial Capacity Building Project (2001)	2001	30,600
Financial Services for the Poorest	2002	5,000
Bangladesh Central Bank Strengthening Project ^a	2003	37,000
Development Support Credit	2003	300,000
Enterprise Growth & Bank Modernization Project ^b	2004	250,000
Economic Management TA Program (EMTAP) ^c	2004	20,000
Development Support Credit II	2004	200,000
Development Support Credit III	2005	200,000
Infrastructure Promotion and Finance Facility (IPPF) Project	Pipeline	25,000
Export Infrastructure Development Project	Pipeline	85,000
Financial Sector Reform and Strengthening Initiative (FIRST)		
Insurance Law Reform Project	2003	59
Capacity Building for Capital Market Intermediaries	2004	270
DFID		
Value Added Tax (VAT) Phase II	2002	1,900
Reforms in Revenue Administration (RIRA)	2002	9,600
Financial Management Reform Program (FMRP)	2003	40,000
SIDA		
PROSPER-program, a joint donor DFID, SIDA, IFAD microfinance-project	Being negotiated	—
Multi-Donors		
Private Sector Development Support Project	Being processed	—

— = not available, DFID = Department for International Development of the United Kingdom, EMTAP = Economic Management TA Program, FIRST = Financial Sector Reform and Strengthening Initiative, FMRP = Financial Management Reform Program, IFAD = International Fund for Agricultural Development, IPPF = Infrastructure Promotion and Finance Facility, PRGF = Poverty Reduction Growth Facility, RIRA = Reforms in Revenue Administration, SIDA = Swedish International Development Agency, VAT = value added tax

^a Key components are: I. Strengthening the Legal Framework, including anti-money laundering and countering financing of terrorism; II. Reorganization and Modernization (A. Functional Reorganization; B. Automation; C. Human Resources Development); III. Capacity Building (A. Strengthening Research Department; B. Strengthening Prudential Regulations and Supervision; C. Strengthening Accounting and Auditing).

^b It includes a component for financial sector governance, Resolution of the Problems of the Nationalized Commercial Banks.

^c It includes a component for financial sector governance, Strengthening Accounting and Auditing Practices in the Corporate Sector.

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. ADB Financing			
Part 1: Enhancement of Governance and Capacity of the Capital Market			
Component 1: Securities and Exchange Commission			
1.1: Strengthening the Market Surveillance Systems			
i. Consultant Remuneration and Per Diem	133	4	137
ii. International and Local Travel	17	1	18
iii. Reports and Communication	1	1	2
iv. Equipment	310	0	310
v. Training	20	10	30
vi. Contingency	58	2	60
Subtotal (a1.1)	539	18	557
1.2: Further Strengthening Capacity of SEC			
i. Consultant Remuneration and Per Diem	160	25	185
ii. International and Local Travel	17	1	18
iii. Reports and Communication	1	1	2
iv. Equipment	30	0	30
v. Training	100	30	130
vi. Contingency	37	7	44
Subtotal (a1.2)	345	64	409
Component 2: Stock Exchanges			
i. Consultant Remuneration and Per Diem	133	13	146
ii. International and Local Travel	17	1	18
iii. Reports and Communication	1	1	2
iv. Equipment	0	0	0
v. Training	0	0	0
vi. Contingency	18	4	22
Subtotal (a2)	169	19	188
Component 3: Market Intermediaries			
i. Consultant Remuneration and Per Diem	240	34	274
ii. International and Local Travel	29	1	30
iii. Reports and Communication	1	1	2
iv. Equipment	0	0	0
v. Training	0	30	30
vi. Contingency	32	8	40
Subtotal (a3)	302	74	376
Component 4: ICB			
i. Consultant Remuneration and Per Diem	160	0	160
ii. International and Local Travel	17	0	17
iii. Reports and Communication	1	1	2
iv. Equipment	0	0	0
v. Training	0	20	20
vi. Contingency	21	3	24
Subtotal (a4)	199	24	223
Subtotal (A1=a1.1 + a1.2 + a2 +a3 + a4)	1,554	199	1,753
Part 2: Enhancement of Governance and Capacity of the Insurance Sector			
i. Consultant Remuneration and Per Diem	586	59	645
ii. International and Local Travel	63	2	65
iii. Reports and Communication	3	3	6
iv. Equipment	90	0	90

Item	Foreign Exchange	Local Currency	Total Cost
v. Training	20	30	50
vi. Contingency	91	11	103
Subtotal (A2)	853	105	959
Project Administrative Support			
i. Interest	38	0	38
ii. Consultant	0	101	101
ii. Contingency	5	12	17
Subtotal (A3)	43	113	156
Contingency (A4)	74	59	133
Subtotal (A = A1+A2+A3+A4)	2,524	476	3,000
B. Government Financing			
Part 1: Enhancement of Governance and Capacity of the Capital Market			
Component 1: Securities and Exchange Commission			
1.1: Strengthening the Market Surveillance Systems			
i. Local Counterpart Staff	0	39	39
ii. Counterpart Facilities	0	33	33
iii. Equipment	0	22	22
iv. Local Transport	0	28	28
v. Duties and Taxes	0	33	33
vi. Contingency	0	19	19
Subtotal (b1.1)	0	175	175
1.2: Further Strengthening Capacity of SEC			
i. Local Counterpart Staff	0	29	29
ii. Counterpart Facilities	0	25	25
iii. Equipment	0	16	16
iv. Local Transport	0	20	20
v. Duties and Taxes	0	25	25
vi. Contingency	0	14	14
Subtotal (b1.2)	0	128	128
Component 2: Stock Exchanges			
i. Local Counterpart Staff	0	13	13
ii. Counterpart Facilities	0	11	11
iii. Equipment	0	8	8
iv. Local Transport	0	9	9
v. Duties and Taxes	0	11	11
vi. Contingency	0	6	6
Subtotal (b2)	0	59	59
Component 3: Market Intermediaries			
i. Local Counterpart Staff	0	26	26
ii. Counterpart Facilities	0	23	23
iii. Equipment	0	15	15
iv. Local Transport	0	19	19
v. Duties and Taxes	0	23	23
vi. Contingency	0	13	13
Subtotal (b3)	0	118	118
Component 4: ICB			
i. Local Counterpart Staff	0	16	16
ii. Counterpart Facilities	0	13	13
iii. Equipment	0	9	9
iv. Local Transport	0	11	11
v. Duties and Taxes	0	13	13

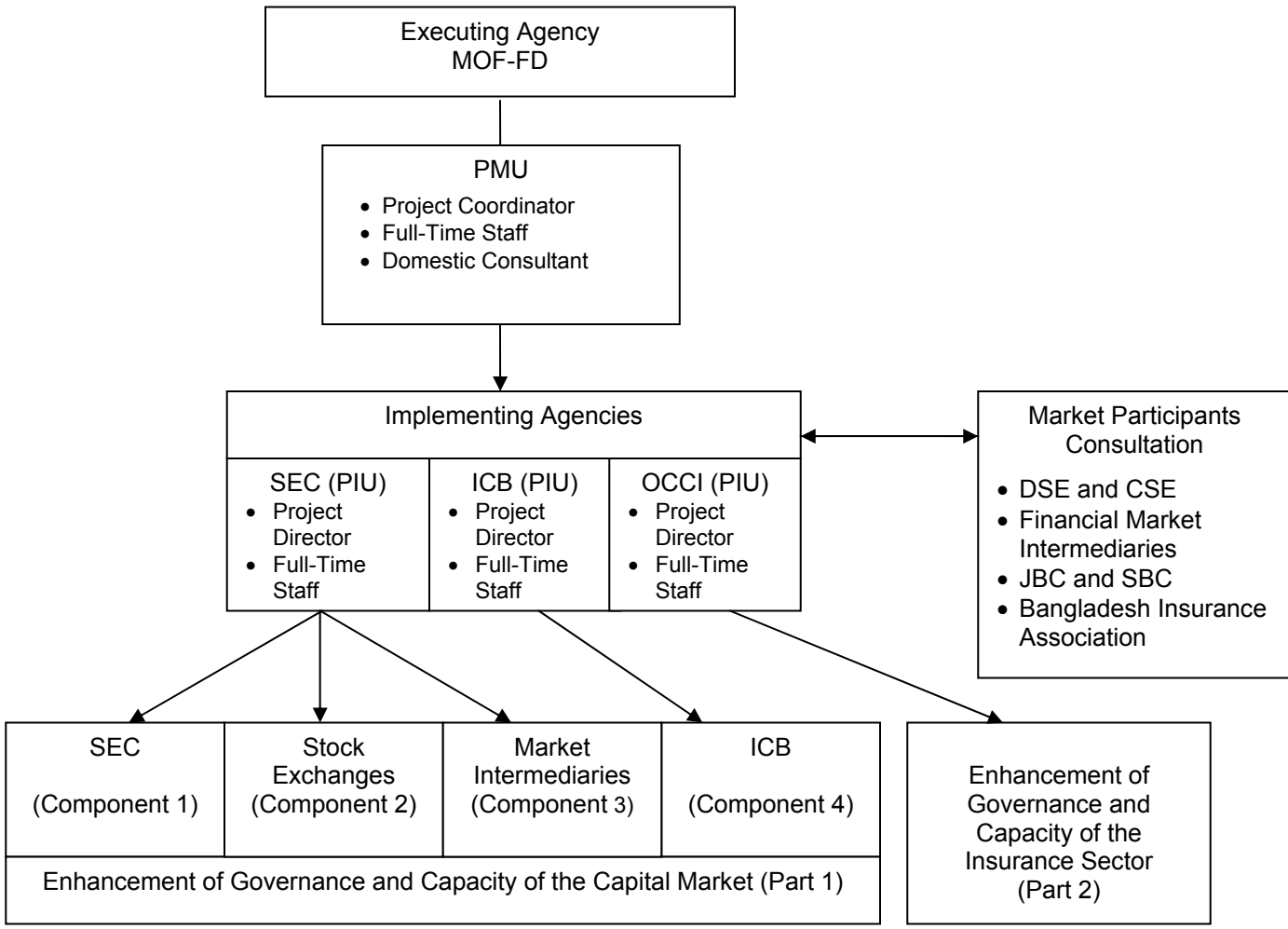
Item	Foreign Exchange	Local Currency	Total Cost
vi. Contingency	0	7	7
Subtotal (b4)	0	70	70
Subtotal (B1=b1.1+b1.2+b2+b3+b4)	0	550	550
Part 2: Enhancement of Governance and Capacity of the Insurance Sector			
i. Local Counterpart Staff	0	67	67
ii. Counterpart Facilities	0	58	58
iii. Equipment	0	38	38
iv. Local Transport	0	48	48
v. Duties and Taxes	0	58	58
vi. Contingency	0	32	32
Subtotal (B2)	0	301	301
Project Administrative Support			
i. Local Counterpart Staff	0	75	75
ii. Counterpart Facilities	0	9	9
iii. Equipment	0	6	6
iv. Local Transport	0	8	8
v. Duties and Taxes	0	9	9
vi. Contingency	0	17	17
Subtotal (B3)	0	121	121
Contingency (B4)	0	29	29
Subtotal (B = B1+B2+B3+B4)	0	1,000	1,000
Total (A+B)	2,524	1,476	4,000

ICB = Investment Corporation of Bangladesh, SEC = Securities and Exchange Commission.

Note: Column and row totals may not exactly add up due to rounding.

Source: Asian Development Bank estimates.

PROJECT IMPLEMENTATION CHART



CSE = Chittagong Stock Exchange; DSE = Dhaka Stock Exchange; ICB = Investment Corporation of Bangladesh; JBC = Jiban Bima Corporation; MOF-FD = Ministry of Finance, Finance Division; OCCI = Office of the Chief Controller of Insurance; PIU = project implementation unit; PMU = project management unit; SBC = Sadharan Bima Corporation; SEC = Securities and Exchange Commission.

Source: Asian Development Bank.

IMPLEMENTATION SCHEDULE

Component	2006			2007			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Preparatory Actions							
Establishment of PMU and PIUs	■						
Selection of International Consultant Firms	■	■					
Part 1: Enhancement of Governance and Capacity of the Capital Market							
Component 1: SEC							
1.1 Strengthening the Market Surveillance System							
Define Requirements and Write RFP		■					
Evaluate Responses and Sites Visit			■				
Contract Negotiations				■			
Test and Introduce					■		
Training and Manuals				■	■	■	
Strengthening of Surveillance of Exchanges					■	■	
1.2 Further Strengthening the Capacity of SEC							
Training Unit Establishment		■					
In-House Training		■	■	■	■	■	■
Overseas Secondments				■		■	
Organization of Training		■					
Risk Management Review				■			
Component 2: Stock Exchanges							
Training		■	■	■	■	■	■
Study to Facilitate Exchange Transaction and to Increase Market Supply			■	■			
Improvement of Governance				■			
Component 3: Market Intermediaries							
Licensing Review		■					
Overseas Institute Visits		■					
New Rules			■				
Training Prepared		■	■	■	■	■	■
Capital Market Institute Establishment				■			
Capital Market Institute Operation					■	■	■
Examination Start						■	■
Women's Courses							■
Component 4: ICB							
Review of Accounting, Audit, and Management Practices		■	■				
Dissemination of Recommendations				■			
Part 2: Enhancement of Governance and Capacity of the Insurance Industry							
Review of Legal Framework		■					
Drafting New Regulations			■	■	■		
Overseas Institution Visits				■			
Study on State-Owned Corporations			■				
Strengthening of Regulator		■	■	■	■	■	■
Management Information System Installment				■			
Update of Mortality Tables and Review of Premium					■	■	

ICB = Investment Corporation of Bangladesh, PIU = project implementation unit, PMU = project management unit, Q1 = first quarter, Q2 = second quarter, Q3 = third quarter, Q4 = fourth quarter, RFP = request for proposal, SEC = Securities and Exchange Commission.

Source: Asian Development Bank.

INDICATIVE CONTRACT PACKAGES

Component/Item	Base Cost (\$ million)	Estimated Number of Packages	Mode of Procurement	Type of Technical Proposal
Consulting Services				
Part 1: Enhancement of Governance and Capacity of the Capital Market ^a	1.42	1	Firm by QCBS	FTP
Part 2: Enhancement of Governance and Capacity of the Insurance Sector	0.96	1	Firm by QCBS	STP
Domestic Financial and Administrative Consultant	0.11	1	Individual	
Equipment (Surveillance System)	0.34	1	International Shopping	
Total	2.83	4		

FTP = full technical proposal, QCBS = quality- and cost-based selection, STP = simplified technical proposal.

^a Excluding the purchase of a surveillance system.

Source: Asian Development Bank.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Part 1: Enhancement of Governance and Capacity of the Capital Market

1. Component 1: Securities and Exchange Commission

a. Strengthening the Market Surveillance Systems

1. **International Market Surveillance Systems Consultant** (5 person-months). The consultant will assist the SEC to

- (i) determine the nature and scope of the requirements for an effective monitoring and surveillance system;
- (ii) prepare specifications for a suitable monitoring and surveillance system and vendor selection criteria;
- (iii) advise on the distribution of the request for proposals to suitable international vendors;
- (iv) based on the selection criteria, conduct a comparative evaluation of the systems proposed and short-list two or three vendors for consideration by the procurement review committee to be set up by the SEC;
- (v) arrange visits to surveillance system reference sites outside Bangladesh;
- (vi) assist in carrying out contract negotiations with selected vendors;
- (vii) assist in testing the new system;
- (viii) prepare manuals on monitoring and surveillance to guide process;
- (ix) train staff of the SEC and the two stock exchanges on monitoring and surveillance and specific actions to be taken regarding enforcement if irregularities are indicated;
- (x) undertake train-the-trainer courses to ensure continuity of training; and
- (xi) help to establish a regulatory review committee and an intermarket surveillance unit covering the DSE and CSE.

2. **Domestic consultant** (1 person-month). The consultant will help to design and deliver surveillance courses.

b. Further Strengthening the Capacity of SEC

3. **International SEC/Exchange Skills Development and Training Consultant** (6 person-months). The consultant who will be the team leader for part 1 components 1-3 will:

- (i) draw up a work plan for the consulting team and supervise their work;
- (ii) assume responsibility for the timely submission of the deliverables that meet quality standards;
- (iii) in coordination with international consultants undertake consultations and workshops for the stakeholders to disseminate their findings and recommendations;
- (iv) review and update human resources development policies for staff at the SEC and stock exchanges;
- (v) identify training needs of stock exchange officers and staff;
- (vi) help implement SEC staff development and retention schemes;
- (vii) help current senior SEC staff to obtain professional qualifications appropriate to their posts;

- (viii) organize and conduct structured training courses for SEC and stock exchange staff as recommended by previous ADB technical assistance (TA)¹—(a) general courses for all staff of SEC/stock exchanges; (b) specific courses for strategic professionals (members, chairman, executive directors); (c) specific courses for management (directors and deputy directors); and (d) specialized courses for strategic professionals and management;
- (ix) arrange secondments of SEC staff and designated Ministry of Finance officials to other regulators outside Bangladesh and take further measures to upgrade the skills of SEC staff;
- (x) develop transparent internal policy and procedure in SEC for the selection of staff for training locally and internationally;
- (xi) set conditions for the back-to-office reporting and job retention;
- (xii) help to establish a training unit within the SEC, to ensure training continues; and
- (xiii) undertake a brief overall risk management review.

4. **Domestic Training Consultant** (6 person-months). The consultant will assist in international skills development and training consultants to:

- (i) organize and conduct structured training courses for SEC and stock exchange staff as recommended under the previous TA (footnote 1);
- (ii) establish a training unit within the SEC, to ensure training continues;
- (iii) establish of a system for training of trainers;
- (iv) prepare presentation materials and other documentation; and
- (v) prepare and process training feedback and evaluation forms.

2. Component 2: Stock Exchanges

a. Enhancing the Capacity of Management and Governance of the Stock Exchanges

5. **International Exchange Governance Expert** (1.5 person-months). The consultant will carry out the following tasks:

- (i) review the current operations and structure of two stock exchanges, and prepare an action plan to improve them, encompassing the recommendations of the previous TA (footnote 1); and
- (ii) help stock exchanges to introduce best international practices relating to good governance.

b. Increasing Demand for and Supply of Securities

6. **International Capital Market Specialist** (3.5 person-months). The consultant will:

- (i) identify constraints to increasing trading activity on the stock exchanges;
- (ii) develop ways to facilitate trading transactions on the stock exchanges through trading mechanisms such as margin lending, borrowing and lending of securities, and the introduction of new products suitable for Bangladesh;
- (iii) develop ways to increase the supply of securities by determining appropriate incentives for attracting more companies to list and float their securities in the market, as well to review listing rules with a view to increasing the number of listed companies under current rules;

¹ ADB. 2003. *Technical Assistance to the People's Republic of Bangladesh for Preparing the Financial Markets Governance Improvement Program* (TA 4246-BAN). Manila.

- (iv) explore ways of reducing costs and times for companies to go public, making public distribution of shares an attractive alternative for raising funds;
- (v) review pricing practices for initial public offerings (IPOs) and recommend an efficient approval process for IPOs;
- (vi) assist the authorities in shifting to alternative pricing methods, including a book building system for pricing IPOs; and
- (vii) review and clarify existing legal framework aiming to strengthen implementing regulations concerning the acquisition of shares via corporate mergers and acquisitions, focusing on Securities and Exchange Commission (Substantial Acquisition, Takeover, and Merger) Rule, and offer suggestions for changes in view of international best practices.

7. **Domestic Capital Market Specialist** (3 person-months). The consultant will assist the international capital market specialist in performing his or her tasks, including supporting stakeholders' consultations by identifying appropriate stakeholders and coordinating consultation meetings.

3. Component 3: Market Intermediaries—Enhancing the Capacity and Standard of the Market Intermediaries

8. **International Regulatory Consultant** (3 person-months). The consultant will carry out the following activities in coordination with SEC staff:

- (i) review and assess the status of governance practices of brokers and dealer firms, merchant banks, underwriters, portfolio managers/advisers, selling agents, etc. in Bangladesh and recommend adoption of international best practices where appropriate;
- (ii) help SEC to start a licensing and accreditation process for covered registered persons (who deal with clients directly in the purchase and sale of securities), beginning with a review of basic qualifications of registered persons and setting a time period for correcting deficiencies, if any;
- (iii) determine preparedness of market participants to undergo licensing and accreditation process, prepare phased training for registered persons, where needed;
- (iv) within a phased time period, prepare examination syllabi and examination standards that covered registered persons will need to pass in order to be licensed or accredited; and
- (v) draft regulations and reporting requirements for covered registered persons for purchasing and dealing in securities to avoid conflicts of interest and insider trading.

9. **Domestic Regulatory Consultant** (2 person-months). The consultant will assist the international regulatory consultant to:

- (i) review current laws and rules governing licensing of market intermediaries;
- (ii) review and assess the status of governance practiced by brokerage firms and merchant banks in Bangladesh; and
- (iii) draft regulations and reporting requirements.

10. **International Securities Training Consultant** (3 person-months). In coordination with the stock exchanges, the consultant will determine the feasibility of setting up a local capital market institute and will:

- (i) design and provide an organizational plan for a capital market institute;

- (ii) prepare a business plan for the capital market institute, including estimating the number of possible participants, defining costs of operating the institute, estimating fees, designing courses for various levels of market participants, determining the length and scope of each course, recommending other possible revenue sources, and determining capital requirements; and
- (iii) consider legal requirements and prepare organizational chart and job descriptions for the institute.

11. **Domestic Securities Training Consultant** (3 person-months). The consultant will help the international securities training consultant conduct a feasibility study, gather data, conduct surveys, and arrange meetings, among others.

12. **International Training Development Consultant** (3 person-months). In coordination with the international regulatory consultant, the consultant will:

- (i) develop reference modules, training guides, and examination papers for licensing representatives and supervisors in six modules—(a) financial markets—generic knowledge paper (core), (b) fundamentals of securities trading (specialist knowledge paper for securities trading at foundation level), (c) regulation of securities (specialist knowledge paper for securities training at advanced level), (d) fundamentals of investment management (specialist knowledge paper for investment management and investment advisory services at foundation level), (e) regulation of investment management and investment advisory services (specialist knowledge paper at advanced level), and (f) corporate finance);
- (ii) design specifications incorporating recommendations of the previous TA (footnote 1);
- (iii) draft the content of the syllabus for each module, incorporating recommendations of (footnote 1);
- (iv) consult with working group (consisting of the regulator and industry practitioners) on the content of the syllabus;
- (v) from the syllabus, draft a detailed topic specification;
- (vi) write the reference module, based on the approved detailed specification of the syllabus;
- (vii) submit the draft for discussion and approval, then finalize the workbook and conduct training courses;
- (viii) develop the training guide, based on the reference book, for trainers;
- (ix) identify the specific training needs of women, prepare and give or arrange courses; and
- (x) develop a module to build up capacity for initial public offerings.

13. **Domestic Training Development Consultant** (3 person-months). The consultant will assist the international training development consultant to:

- (i) develop and write the six modules, consisting of reference modules, training guides, and examination papers;
- (ii) prepare case studies with reference to local examples; and
- (iii) carry out the women's courses.

4. **Component 4: Investment Corporation of Bangladesh (ICB)—Enhancement of Governance and Capacity**

14. **International Accounting and Audit Specialist** (4 person-months). In coordination with ICB:

- (i) the consultant will review accounting and audit standards and practices for asset valuation, particularly for equity accounting for subsidiaries and intercompany portfolio transactions adopted by ICB and ICB subsidiaries and identify the differences between these and the internationally accepted accounting standards. The consultant will examine the books and records of ICB and conduct sampling of transactions, as appropriate; and
- (ii) the consultant will:
 - (a) describe the management and financial accounting standards and procedures followed by ICB, particularly, intercompany accounts; highlight differences between these and the international standards and procedures; and provide an estimate of the impact of these differences on ICB's profit and loss statement and balance sheet; more specifically, in (1) recalculating reserves required against impaired assets in accordance with the internationally accepted accounting standards that are no less stringent than the Bangladesh Bank's prescribed regulations, and that are currently in use for assessing the capital adequacy under the Basel II standards of the Bank for International Settlements; (2) preparing an inventory of assets and securities, including those in custody, under managed funds, and match them against mutual funds;(3) conducting a valuation of the portfolios of the mutual funds and the unit fund using both reasonably conservative, and worst-case (liquidation) values; (4) quantifying net asset value (NAV) of the mutual funds and the unit fund and assess the adequacy of the NAV definition presently being used; and (5) quantifying the amount of funds available for payment of dividends to fund holders using properly segregated accounting procedures;
 - (b) the consultant will provide their view, based on comparison between accounting and audit standards used by ICB and international standards on the financial status of ICB, its subsidiaries and affiliated mutual funds as going concerns; and
 - (c) design a capacity building program for ICB officials and staff in order to strengthen accounting and audit standards.

15. **International Governance Expert** (2 person-months). In coordination with ICB:

- (i) the consultant will undertake a review of governance practices of ICB and ICB subsidiaries in relation to international best practice; and
- (ii) the consultant will: (a) recommend adoption of international governance principles and practices into ICB operations; and (b) design and offer a capacity building program for ICB officials and staff in order to address weak governance practices.

B. Part 2: Enhancement of Governance and Capacity of the Insurance Sector

16. **International Insurance Capacity Building Specialist** (6 person-months). To strengthen the Office of the Chief Controller of Insurance (OCCI), the consultant who will be the team leader for part 2 will:

- (i) draw up a work plan for the consulting team and supervise their work;

- (ii) assume responsibility for the timely submission of the deliverables that meet quality standards;
- (iii) in coordination with international consultants undertake consultations and workshops for the stakeholders to disseminate their findings and recommendations;
- (iv) examine the current regulatory regime in OCCI, covering (a) staffing levels, (b) work-flow and controls, and (c) consistency with legal requirements;
- (v) organize capacity enhancement and training for the regulator, to include; (a) training programs in insurance practices; (b) review and familiarization with rules for monitoring, supervising, and surveillance; (c) on-the-job training and assistance to improve experience and insight on functions, activities, and responsibilities of insurance regulators, structure and organization, and conduct of enforcement and surveillance; and (d) preparation of training and inspection manuals, and teaching agency staff to train others;
- (vi) help OCCI to establish and enhance professional bodies so that the industry is able to assess risk properly;
- (vii) help OCCI to strengthen automation and management information system (MIS); and
- (viii) help OCCI to develop measures to retain competent staff.

17. **International Insurance Regulatory Specialist** (5 person-months). The consultant will undertake the following tasks with OCCI:

- (i) review the proposed insurance acts;
- (ii) identify gaps between existing and required regulations and orders;
- (iii) draft regulations and regulatory orders in line with international best practices;
- (iv) prepare training programs for OCCI and insurance companies; and
- (v) conduct workshops to upgrade the knowledge of staff in charge of regulation and supervision of the insurance sector.

18. **International Life Insurance Specialist** (4 person-months) and **International General Insurance Specialist** (4 person-months). The consultants will examine the impact of the proposed new insurance legislation on the operations of the two Government-owned insurance companies. In the light of the proposed new acts and proposals for a new regulatory agency, each consultant will, in conjunction with Jiban Bima Corporation (for life insurance) and Sadharan Bima Corporation (for general insurance), respectively, undertake the following tasks:

- (i) evaluate solvency and underwriting risks, capital adequacy, reserves, funding base, liquidity, operating costs and revenues, adequacy of revenue and cost spread, and the general financial status and performance over the past 5 years;
- (ii) evaluate the companies' insurance underwriting operations, sales and product policies, pricing policies, and geographical spread;
- (iii) assess the companies' investment policies and decision process, and the competitiveness with other insurance companies in light of new acts and regulations;
- (iv) review credit policies, analytical support, the decision process and detailed loan administration procedures to ensure funding in accordance with management's decisions and validation of the claim on the obligor;
- (v) assess operational risk by surveying the company's portfolio records, safekeeping, transactional flows and clearing protocols, and recommend refinements as appropriate; and
- (vi) recommend restructuring options to make both companies competitive, including introducing private sector ownership participation.

19. **International Actuary** (3 person-months). The consultant will:
 - (i) update mortality tables and reassess premium rates;
 - (ii) review current risk assessment practices and recommend improvements according to international best practice for life insurance;
 - (iii) review current premium levels for general insurance and provide appropriate statistical database for general insurance; and
 - (iv) review current risk assessment practices and recommend international best practice for general insurance.

20. **Domestic Insurance Capacity Building Specialist** (6 person-months) The consultant will:
 - (i) help the international insurance capacity building specialist;
 - (ii) collect and provide information to international consultants; and
 - (iii) liaise with international consultants and OCCl.

21. **Domestic Regulatory Specialist** (4 person-months). The consultant will undertake the following tasks with OCCl:
 - (i) in general, collaborate with the international insurance regulatory specialist by providing legal support;
 - (ii) collect and provide information to the international insurance regulatory specialist; and
 - (iii) liaise with the international insurance regulatory specialist and OCCl.

22. **Domestic Insurance Specialist** (4 person-months). The consultant will:
 - (i) assist the international life insurance and general insurance specialists;
 - (ii) collect and provide information to international consultants; and
 - (iii) liaise with international consultants and OCCl.

- C. TA Loan Administration**

23. **Domestic Financial and Administrative Consultant** (24 person-months). The consultant will:
 - (i) assist the project coordinator of PMU to implement the TA loan;
 - (ii) assist the project coordinator of PMU with accounting and financial management;
 - (iii) collaborate with all consultants and liaise with the ADB project officer; and
 - (iv) undertake any other businesses linked to the TA loan, as appropriate.

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

A. Linkages to the Country Poverty Analysis

Is the sector identified as a national priority in country poverty analysis?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Is the sector identified as a national priority in country poverty partnership agreement?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<p>Contribution of the sector or subsector to reduce poverty in Bangladesh:</p> <p>The Government's national poverty reduction strategy (NPRS), <i>Unlocking the Potential: National Strategy for Poverty Reduction</i>, reaffirms that poverty reduction and accelerating the pace of social development are Bangladesh's most important long-term strategic goals. Considering that Bangladesh's domestic investment and saving rates are very low compared with those of the fast-growing countries in the region, and that the resource gap in Bangladesh is increasing: (i) there should be a more comprehensive domestic financial resource mobilization effort; and (ii) resource allocation has to be more efficient. Financial sector development is crucial to Bangladesh's economic growth and poverty reduction. In particular, the NPRS target—to increase private investment from 17.5% of GDP in FY 2004 to nearly 22% in FY2007, and to increase the annual economic growth rate from 5.1% during 2000-2004 to 7-8% by 2015—cannot be achieved without financial sector development.</p> <p>The NPRS recognizes the role of the capital market in raising funds in a cost-effective way and in enabling savers to gain access to investment opportunities. It emphasizes the importance of the confidence of issuers as well as investors. Increasing confidence requires an appropriate regulatory and technology infrastructure, diversification of instruments, and effective monitoring and supervision by the regulatory authority.</p> <p>The Project will help improve governance in the capital market and the insurance sector. Improved governance should increase the flow of resources to finance productive investments, improve the process of financial intermediation, and promote efficiency through enhanced market competition. It will promote private-sector-led economic growth, and enhance the potential for economic growth and job creation for the poor. It will also reduce the fiscal burden.</p> <p>The TA loan will have an indirect but important strategic role in reducing poverty. Different social groups (investors, market participants, issuers and their employees, suppliers, and customers, and other stakeholders) will benefit from a deeper, more sound, and more stable financial system. With enhanced efficiency in mobilizing and allocating funds and proper enforcement mechanism in place, the Government may use cost savings from efficient financial markets for poverty reduction and social development programs. Transparency in the flow of financial resources is expected to remove structural impediments to financial sector growth that result from an inefficient, opaque financial system.</p> <p>The benefits of the Project are expected to be magnified when the strengthened market capacity establishes the groundwork for additional financial market reforms. In the long run, beneficiaries are expected to include the poor and near-poor. As the Asian financial crisis demonstrated, a sound, stable, and more balanced financial system has positive implications for the vulnerable poor.</p>			

B. Poverty Analysis

Targeting Classification: General intervention

What type of poverty analysis is needed?

Inappropriate governance leads to irregular practices in financial markets, including insider trading, accounting, and auditing offenses, etc. It constrains overall private sector growth and potential investor participation. To enhance investor confidence and promote economic growth, intensified reforms are needed to strengthen the regulatory and supervisory framework, strengthen corporate governance and market discipline, and apply international accounting and auditing standards. The reforms should be backed by fiscal incentives, including investment in human capacity development, with broader poverty and social impacts. The poor and disadvantaged may be expected to have a smaller share of benefits to be realized from the reforms. The key focus of poverty analysis is on identifying structural impediments to adopting and implementing proper governance reforms.

C. Participation Process

Is there a stakeholder analysis?

Yes No

Is there a participation strategy?

Yes No

The participation strategy will involve consultation and feedback from stakeholders concerned on issues concerning financial markets governance. The derived outcome will be used to identify, prioritize, and address governance concerns and develop recommendations. For part 1, extensive consultation has been undertaken with the

Government and stakeholders, including workshops held under Preparing the Financial Markets Governance Program (TA 4246-BAN). For part 2, a committee for updating the insurance act and rules consisting of representatives from the Government and the private sector contributed to the report of the Financial Sector Reform and Strengthening Initiative (FIRST) on insurance sector reform.

D. Gender Development

Strategy to maximize impacts on women:

There will be gender-specific education courses held by the SEC. These courses will be targeted at women with disposable income but who currently do not consider investments in the capital market, because they are unfamiliar with the process.

Generally, it is envisaged that encouraging the financial markets to function properly will lead to more direct and indirect investments from foreign and domestic institutional and individual investors. Companies will benefit as a result because there will be more financial resources at lower cost. Greater profitability, asset growth, and expansion of business will generate more employment and increase disposable incomes for average households, where women have a central role.

Has an output been prepared? Yes No

E. Social Safeguards and Other Social Risks

Item	Significant/ Not Significant/ None	Strategy to Address Issues	Plan Required
Resettlement	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	None	<input type="checkbox"/> Full <input type="checkbox"/> Short <input checked="" type="checkbox"/> None
Affordability	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	None	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Labor	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	None	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Indigenous Peoples	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	None	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Other Risks and/or Vulnerabilities	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	None	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No