ADB

Completion Report

Project Number: 43477-013
Loan Numbers: 2951, 2952, 2953
September 2015

Bangladesh: Second Capital Market Development Program

Asian Development Bank

CURRENCY EQUIVALENTS

Currency Unit – taka (Tk)

		At Appraisal (24 June 2012)	At Program Completion (5 April 2013)
Tk1.00	=	$0.0122	$0.0128
$1.00	=	Tk81.916	Tk78.075

ABBREVIATIONS

ADB	–	Asian Development Bank
BSEC	-	Bangladesh Securities and Exchange Commission
CMDP II	–	Second Capital Market Development Program
CMDP III	–	Third Capital Market Development Program
CSE	–	Chittagong Stock Exchange
DGEN	–	Dhaka Stock Exchange General Index
DSE	–	Dhaka Stock Exchange
FRA	–	Financial Reporting Act
GDP	–	gross domestic product
ICB	–	Investment Corporation of Bangladesh
IDRA	–	Insurance Development and Regulatory Authority
IPO	–	initial public offering
MOF	–	Ministry of Finance
NBFI	–	non-bank financial institution
RRP	–	Report and Recommendation of the President
SEC	–	Securities and Exchange Commission
TA	–	technical assistance

NOTES

(i) The fiscal year (FY) of the Government of Bangladesh ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2015 ends on 30 June 2015.

(ii) In this report, "$" refers to US dollars.

Vice-President	W. Zhang, Operations 1
Director General	H. Kim, South Asia Department (SARD)
Director	B. Carrasco, Public Management, Financial Sector and Trade Division, SARD
Team leader	V. Rao, Principal Financial Sector Specialist, SARD
Team members	A. Alipio, Project Officer, SARD
	K. Recomono, Operations Assistant, SARD

CONTENTS

BASIC DATA

A. Loan Identification

1.	Country	Bangladesh
2.	Loan Numbers	2951, 2952, 2953
3.	Program Title	Second Capital Market Development Program
4.	Borrower	People’s Republic of Bangladesh
5.	Executing Agency	Bank and Financial Institutions Division–Ministry of Finance
6.	Amount of Loan	
	2951	$95,000,000
	2952	SDR101,839,000
	2953	SDR32,851,000
7.	Program Completion Report Number	1535

B. Loan Data

1.	Appraisal	
	– Date Started	24 June 2012
	– Date Completed	2 July 2012
2.	Loan Negotiations	
	– Date Started	5 September 2012
	– Date Completed	6 September 2012
3.	Date of Board Approval	28 November 2012
4.	Date of Loan Agreement	29 November 2012
5.	Date of Loan Effectiveness	
	– In Loan Agreement	27 February 2013
	– Actual	17 December 2012
	– Number of Extensions	0
6.	Closing Date	
	– In Loan Agreement	30 June 2014

	2951	2952	2953
– Actual	5 April 2013	18 Dec 2014	18 Dec 2014
– Number of Extensions	0	2	2

7. Terms of Loan

	2951	2952	2953
– Interest Rate	Libor-based	Fixed	Fixed
– Maturity (number of years)	15	24	24
– Grace Period (number of years)	3	8	8

8.	Terms of Relending (if any)	None
	– Interest Rate	
	– Maturity (number of years)	
	– Grace Period (number of years)	
	– Second-Step Borrower	

9. Disbursements

a. Dates

	Initial Disbursement	Final Disbursement	Time Interval
Loan 2951	19 December 2012	19 December 2012	0 months
	Effective Date	**Original Closing Date**	**Time Interval**
	17 December 2012	30 June 2014	18 months

	Initial Disbursement	Final Disbursement	Time Interval
Loan 2952	19 December 2012	16 December 2014	24 months
	Effective Date	**Original Closing Date**	**Time Interval**
	17 December 2012	30 June 2014	18 months

	Initial Disbursement	Final Disbursement	Time Interval
Loan 2953	19 December 2012	16 December 2014	24 months
	Effective Date	**Original Closing Date**	**Time Interval**
	17 December 2012	30 June 2014	18 months

b. Amount ($/SDR)

Loan	Currency	Tranche 1	Date	Tranche 2	Date	Total
2951	$	95,000,000	19 Dec 2012	NA		95.000.000
2952	SDR	16,426,000	19 Dec 2012	85,413,000	16 Dec 2014	101,839,000
	$	25,246,105		125,005,342		150,251,447
2953	SDR	19,711,000	19 Dec 2012	13,140,000	16 Dec 2014	32,851,000
	$	30,295,018		19,230,916		49,525,934
Total	$	150,541,123		144,236,258		294,777,381

10. Local Costs (Financed)
- Amount ($) N/A
- Percent of Local Costs
- Percent of Total Cost

C. Program Data

1. Program Cost ($ ‘000)

	Appraisal			Actual		
Cost	**2951**	**2952**	**2953**	**2951**	**2952**	**2953**
Foreign Exchange Cost	95,000	155,000	50,000	95,000	150,251	49,526
Local Currency Cost	0	0	0	0	0	0
Total	95,000	155,000	50,000	95,000	150,251	49,526

2. Financing Plan ($ million)

Cost	Appraisal			Actual		
	2951	2952	2953	2951	2952	2953
Implementation Costs						
Borrower Financed						
ADB Financed	95.000	155.000	50.000	95.000	150.251	49.526
Other External Financing						
Total	**95.000**	**155.000**	**50.000**	**95.000**	**150.251**	**49.526**
IDC Costs						
Borrower Financed						
ADB Financed	0.000	0.000	0.000	0.000	0.000	0.000
Other External Financing						
Total	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**

ADB = Asian Development Bank, IDC = interest during construction.

3. Cost Breakdown by Program Component

Component	Appraisal Estimate	Actual
Not applicable		
Total		

4. Program Schedule

Item	Appraisal Estimate	Actual
Release of First Tranche	27 Feb 2013	19 Dec 2012
Release of Second Tranche	31 Mar 2014	16 Dec 2014

5. Program Performance Report Ratings

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
Not applicable		

D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members[a]
Consultation Mission 1	15–17 Apr 2013	1	3	
Review Mission 1	24–27 Jun 2013	2	4	a, b
Consultation Mission 2	30–31 Jul 2013	1	2	a
Review Mission 2	2–4 Sep 2013	1	3	a
Review Mission 3	23–26 Sep 2013	1	4	a
Review Mission 4	25–26 Nov 2013	3	2	a,b,c
Review Mission 5	20–22 Jan 2014	1	3	b
Review Mission 6	24–25 Mar 2014	3	2	a,a, d
Consultation Mission 3	20–21 May 2014	1	2	
Review Mission 7	24–26 Jun 2014	1	3	
Review Mission 8	26–28 Aug 2014	3	3	a,b,d

[a] a = financial sector specialist, b = project officer (financial sector), c = young professional, d = director.

I. PROGRAM DESCRIPTION

1. On 28 November 2012, the Asian Development Bank (ADB) approved a program loan to the Government of Bangladesh for an equivalent of $300 million for the Second Capital Market Development Program (CMDP II).[1] The program consisted of (i) loans to support capital market reforms and (ii) a technical assistance (TA) grant of $750,000 to facilitate implementing reform actions. The program was approved following a stock market crash in late 2010, marked by a major sell-off and a drop in market capitalization by about $27 billion, equivalent to 22% of gross domestic product (GDP). Building on nearly 18 months of preparation and policy dialogue, the program was based on the results of the project preparatory TA.[2]

2. The objectives of CMDP II were to (i) strengthen market stability by enhancing the role and capacity of the Bangladesh Securities and Exchange Commission (BSEC) of, promoting financial stability through joint supervision of the financial system, strengthening regulation, and developing a market surveillance system; (ii) enhance market facilitation by developing a long-term vision for capital markets, upgrading accounting and auditing standards, expediting adjudication of enforcement actions, improving governance of listed companies, and pursuing demutualization of the Chittagong Stock Exchange (CSE) and the Dhaka Stock Exchange (DSE);[3] and (iii) incentivize the issuance of equities and bonds, develop liquid capital markets, and catalyze institutional investors. The first two objectives addressed the reasons behind the crash, and the third supported market expansion to finance the Sixth Five-Year Plan, 2011–2015 projected annual GDP growth of 8% by 2013 to be raised to 10% from 2017.[4]

1. Historical Perspective on Program Objectives

3. Following a market rise starting towards the end of 2008, the DSE General Index (DGEN) gained to an all-time high of 8,918.51 points on 5 December 2010, with a turnover of Tk32.50 billion. However, on 19 December 2010 DSE fell 551.76 points or 6.71%, and on 9 January 2011 all DSE indices declined almost 7.75%. On 10 January 2011, DGEN declined again by 660 points or 9.0%, and the CSE Selective Index declined by 914 points or 6.8% in less than an hour. In addition, the CSE All Share Price Index fell 6.77%, the CSE Selective Categories Index declined 914 points or 6.87%, and the CSE-30 lost 1,490.83 points or 8.28%. While the market recovered 15.6% on 11 January 2011, on 18 January 2011 it recorded its lowest turnover in 9 months—and SEC halted trading after DGEN fell 243 points and CSE declined 298 points. While action was taken, DGEN slipped to 5,579 points on 7 February 2011.

4. In January 2011, the government formed a committee under former Bangladesh Bank deputy governor Ibrahim Khaled Khandker to investigate the crash.[5] The committee found that market participants violated rules when the stock market had an abnormal rise and that securities

---

[1] ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-based Loans and Administration of Technical Assistance Grant to the People's Republic of Bangladesh for the Second Capital Market Development Program.* Manila (Loans 2951, 2952, 2953-BAN and Technical Assistance (TA) 8228-BAN).

[2] ADB. 2011. *Technical Assistance to the People's Republic of Bangladesh for Preparing the Capital Market Development Program II.* Manila (TA7811-BAN, approved on 23 May 2011).

[3] Demutualization is the transition from a mutual association of exchange members operating in a not-for-profit basis to a limited liability, for-profit company accountable to shareholders. Demutualization separates ownership (and voting rights) from the right of access to trading. It may or may not involve the stock exchange's own listing.

[4] Government of the People's Republic of Bangladesh, Bangladesh Institute of Development Studies and Planning Commission, Ministry of Planning. 2011. *Sixth Five-Year Plan of Bangladesh 2011–2015*. Dhaka.

[5] Investigation Report of Probe Committee in 2011.

were overpriced.[6] Historically, retail investors were responsible for a majority of DSE trading, with a long-run average trade size of about 325 shares and value equivalent to about $1,000.[7] The sharp increase in the DSE index in 2009 coincided with an average trade size consistently below the long-run average, suggesting small investors, attracted by the share price increase, fueled the increase. As DSE approached its peak, average trade size increased to levels above the long-term average, consistent with evidence that investors sold shares in late 2010 on year-end profit booking. The decline also coincided with volatility increases well outside the historical range.

5. Thus, CMDP II addressed the reasons behind the crash, including (i) the bursting in December 2010 of a bubble that had been accumulating, and (ii) the structural causes underlying the bubble. Using the crisis as an opportunity, CMDP II also supported policy actions designed to expand the market to channel financing to real economy in line with government objectives (para. 4) and address inefficient pricing resulting from poor corporate governance, high listing costs, and inadequate information disclosure that led to insider trading and volatility.[8] It is estimated that more than 3 million small investors lost their savings, including those who invested from borrowed funds and lost investments while also having to service debt.[9] Almost 50% of investors, including the unemployed and elderly, deployed borrowed funds.[10]

2. Overview of Program Components

6. **Strengthening market stability.** Drawing lessons from the crisis, the project preparatory TA suggested policy actions to promote market stability, including (i) reviewing capital requirements for intermediaries such as brokerages, (ii) reducing bank equity risk exposure by introducing amendments to the Bank Companies Act 1991, and (iii) improving BSEC’s surveillance and monitoring capacity and enforcement effectiveness. In December 2010, both BSEC and Bangladesh Bank frequently changed directives. On 6 December 2010, BSEC directed that buy orders were to be performed only after encashment of investor checks, followed by another directive on 7 December 2010 on “netting facilities,” which prevented investors from purchasing securities against sale of other securities during the settlement and clearance period. However, both directives were cancelled on 8 December 2010. BSEC also increased the margin loan ratio from 1:0.5 to 1:1 on 13 December 2010 and later raised it to 1:3 because of the sharp fall.[11]

7. The government responded by directing Investment Corporation of Bangladesh (ICB) and seven other state-owned entities, including banks and insurance companies, to create an open-ended mutual fund called the Bangladesh Fund.[12] The fund was to raise Tk50 billion to buy shares and stabilize the market. However, in a weak market with widespread fraud, fund injection could not stabilize the market, and it is unclear how efficiently the ICB managed these funds. Hardly any

---

6 The weighted price-earnings ratio for the DSE increased from 18.4 to 29.2 in the December 2008–December 2010 period, indicating that stock market valuations were well above levels supported by economic fundamentals, although part of the growth in market capitalization was attributable to increased listings.

7 As part of due diligence, ADB conducted a study in June 2011 on stock market volatility focusing on the role of banks in driving the stock market surge and subsequent decline.

8 Market capitalization declined significantly in FY2010 to Tk389.5 billion, from Tk964.9 billion in FY2008. Even with the relatively high market in FY2008, market capitalization was around 16.5% of GDP compared to the 55.0% of the Bombay Stock Exchange. Average index volatility as measured by standard deviation was 46.2 in FY2008, indicating a significant rise over earlier years. Despite that volatility increases in rising markets, it was much higher than expected. While the index increased by 20.15%, volatility increased by 328.76% from December 2006 to May 2007. This level of volatility did not support market development.

9 More than 98% of those affected were small investors with investments of Tk500,000 or less.

10 Falling share prices also undermine a firm’s ability to raise equity and, subsequently, debt, as firms issue shares to signal an intention to raise debt because a well-received equity offer gives comfort to debt investors.

11 Changing margin requirements created a perception of moral hazard, as changes appeared to favor certain parties.

12 ICB is a statutory company of the government, established on 1 October 1976 under No. 40 Investment Corporation of Bangladesh Ordinance. Its objective is to promote industrialization and develop a securities market.

positive movement occurred in market indices following the Bangladesh Fund's establishment, indicating capital scarcity was the major factor inhibiting the market.

8. Adverse selection also caused instability when banks and non-bank financial institutions (NBFIs) provided credit to investors in high-risk and high-return stocks who offered to pay higher rates. In addition, banks started to invest in stocks, squeezing industrial credit. Acting on complaints that banks were investing in the market from reserves, Bangladesh Bank sent teams to Dhaka and Chittagong to investigate. Consequently, to comply with requirements, banks started selling shares, panicking investors. Bangladesh Bank's directives on 15 December 2010 to meet higher requirements—increasing the cash reserve ratio by 0.5% to 19.0% and statutory liquidity ratio by 0.5% to 6.0%—compounded selling. As December is the closing period, banks and other institutions sold shares to show higher returns.

9. With regard to longer-term structural factors, BSEC had few qualified accountants, analysts, and researchers. However, it was required to enhance the size of the team to monitor the market more effectively. The executive board of DSE and CSE consisted of elected and nominated members with elected members drawn from the investor pool. With elected member having a greater stake in the market, they exercised disproportionate control over the administration. Consequently, market players also acted as the primary regulator. Further, it was necessary to ensure compliance of disclosure requirements as well as issuance of adequate guidelines in private placement issues to protect the interest of the investors so that no scope left to the underwriters to manipulate the market.

10. **Enhancing market facilitation.** Project preparatory TA guidance supported market development through (i) submitting a Financial Reporting Act (FRA) to Parliament, (ii) promoting demutualization of stock exchanges, and (iii) further addressing BSEC functioning issues. With the collusion of auditors, companies generated artificial audit reports with overvalued assets. As a result, net asset value calculations provided incorrect pictures of companies' financials. Further, book building, which was introduced to attract more firms for enlisting through fair share pricing, became an instrument for manipulation. When the market declined, most investors, who were small and lacking adequate knowledge, sold shares instead of using a wait-and-watch approach. Manipulators compounded this by creating an artificial trading environment among themselves, through bulk transaction and increased share prices using serial trading and price manipulation by making buy-sell orders through different accounts and broker houses. Although shareholders and individual investors did not have accounts in their own names, "omnibus accounts" were used to manipulate.[13] ICB had nine omnibus accounts, and merchant banks had one omnibus account.[14]

11. **Expanding demand and supply of instruments.** Despite strong growth, market capitalization to GDP was small.[15] In FY2008, industrial term loans disbursed by banks and NBFIs totaled Tk201.5 billion (Tk23.9 billion from NBFIs), compared with new capital issues of only Tk6.9 billion via private, public, and right offerings. The capital market was characterized by (i) slow growth of institutional investments, including from mutual, pension, and portfolio funds; (ii) inadequate issuance of corporate bonds; (iii) poor dissemination of research; and (iv) weak regulatory capacity.

12. The listing growth was weak, at only 10 companies a year. Banks and insurance dominated the market followed by pharmaceuticals, power, and cement; telecommunications and real estate

---

[13] An omnibus account exists between two futures merchants. It involves the transaction of individual accounts that are combined, allowing for easier management by the futures merchant. This protects the identities of the individual account holders because the futures merchant transacts for them.
[14] At least Tk2.5 billion was traded from hidden or omnibus accounts, which were a major tool in market manipulation.
[15] In FY2008, market capitalization reached 25.0% of GDP, which was 14.5% in FY2007.

remained small. To expand the market, CMDP II exempted initial public offerings (IPOs) from the initial IPO tax, bonds from transaction taxes, and sale of receivables to special purpose vehicles for asset securitization from stamp duty.

13. Of the 5,000 companies in Bangladesh, only 265 were listed as of June 2014. At least 100 large domestic and foreign companies or groups were unlisted. Without shares of good companies, the market cannot expand. Most listed companies are small and have a weak financial base, allowing for market manipulation by large investors.[16] Further, DSE had only 41 mutual funds with a value of less than 2% of market capitalization.[17] Thus, given that most investors are retail and, by nature, speculative, more institutional investors are needed because they hold shares. Exchanges also need fixed-income products to diversify, as DSE has only three corporate and 221 treasury bonds, and treasury bonds are not traded.

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

14. CMDP II followed ADB's strategic focus in the financial sector and policy dialogue with the government by adopting a holistic approach toward addressing the crisis and expanding the capital market to finance the real economy. The problems manifested themselves by way of cartels that artificially drove up prices, insider and serial trading, spurious beneficiary owner accounts that facilitated market manipulation.

15. The crisis provided an impetus for reforms. Given the destruction of wealth, the government embraced reforms to make capital markets sustainable. Problems in accounting standards, tax evasion, IPO, and share price manipulation were well recognized. These problems manifested themselves through cartels that artificially drove up prices, insider and serial trading, false beneficiary owner accounts, weak BSEC regulatory and enforcement capacity, and a faulty book-building and IPO process. A detailed review of the immediate and long-term factors responsible for the crisis is provided in Appendix 4.

16. The solutions identified through the project preparatory TA included giving BSEC the resources and independent stature to become a rigorous and autonomous regulator, and ensuring policy and regulatory coordination. Working with BSEC, the project preparatory TA consultants identified opportunities and areas for development. Similarly, the project preparatory TA identified constraints hindering Bangladesh's capital markets in government policy, legal, regulatory, and supervisory systems, institutional bottlenecks, and operational capacity constraints. The master plan specified objectives and targets, implementation steps, and measures of success. Legal and regulatory issues, accounting standards, and the taxation policy were also analyzed. In addition, a capital market's principal components were examined, including the short-term money market, government and corporate debt markets, infrastructure bonds, the equity market, and derivatives and securitization markets.

17. The project preparatory TA also identified shortcomings in BSEC's monitoring and surveillance capacity due to poor staffing and remuneration, independence, and regulatory weaknesses. In addition, the market's small size and marked absence of a liquid secondary bond

[16] Major unlisted companies included Basundhara, Jamuna, Akij, Abul Khair, Nasir, Transcom, Partex, Concord, Walton, Rahimafrooz, Runner, PHP, TK, Habib, Bestway, Khaled Group, Standard Chartered Bank, Citibank NA, HSBC, Uniliver Bangladesh Limited, Nestle Bangladesh, Airtel, Siemens, Ericsson, and Chevron.

[17] In a developed market, the share of mutual funds is 40% or more of the total market.

and government securities market posed problems.[18] Policy actions identified under the project preparatory TA also provided a plan for expanding the capital market's role, as the financial sector was commercial bank centric (para. 11). The 47 banks accounted for more than half of credit, and even within banks there was a high concentration. The corporate debt market was also nascent and without investor interest and liquid marketable instruments. Thus, mechanisms did not exist to channel savings into the real economy. These aspects underlined the need for a broader and more diversified market to offset potential monopolistic actions by a few large players.

18. Finally, in addition to the project preparatory TA, ADB also undertook a study on demutualization of stock exchanges to reform the governance structure, resulting in this being supported under CMDP II.[19] The expected benefits included spreading ownership risks, making exchanges less susceptible to vested interests and adopting transparent governance, improving decision-making, diversifying products, facilitating links with other markets, and promoting management discipline. In this context, demutualization was designed to resolve conflicts of interest arising when brokers served as board members of exchanges and assumed regulatory roles. However, after demutualization, exchanges have to become profit-oriented and pay dividends to shareholders.

19. Initially, DSE had sufficient reserves and from FY2012 to FY2013 made profits of Tk940 million. Even if profits are maintained, DSE will be unable to pay even 10% in dividends. Thus, as paying dividend from reserves is inadvisable, DSE has to increase income. In this context, DSE is mainly equity-based with an insignificant number of corporate bonds and mutual funds. The exchanges thus have to expand products to include derivatives, corporate and government bonds, and mutual funds, and demutualization provides an in-built incentive to expand the market.

20. Through CMDP II, Bangladesh has made significant progress in the capital market. Critical legislation has been passed, including amendments to the SEC Act, Bank Companies Act 1991, Income Tax Ordinance 1984, and Stamp Act 2012, as well as enactment of the Demutualization Act. The FRA has also been submitted to Parliament. The achievements have set the stage for the next generation of reforms under the proposed Third Capital Market Development Program (CMDP III) to (i) extend the sovereign yield curve to promote a more liquid bond market; (ii) catalyze institutional investor demand, by diversifying the investor base to include pension and provident funds; (iii) strengthen the insurance sector to enhance coverage and outreach through recapitalization of insurance companies to create capital market investment and participation; (iv) promote Islamic-compliant instruments by creating an enabling environment to encourage issuance; and (v) promote hedging instruments to manage risks, using interest rate and foreign exchange derivatives.

B. Program Outputs

1. Strengthened Market Stability

21. CMDP II (i) allowed BSEC unhindered access to the BSEC fund,[20] (ii) eliminated government approvals for BSEC budget and expenditures, and (iii) provided benefits to BSEC staff on par with Bangladesh Bank.[21] This allowed BSEC to monitor multiple beneficiary owners, cartels,

[18] The capital market was unable to channel finance to the real sector. The financial sector was bank-dominated and only 10% of capital invested came from debt and equity markets.
[19] Report on Study on Demutualization of Stock Exchanges in Bangladesh. RSC-C13447 (BAN). March 2012.
[20] The SEC Act of 1993 established the SEC fund from grants made by the government and local authorities, and/or any other sums received by SEC. The fund moneys are kept in the SEC name in any scheduled SEC-approved bank. Wages and allowances of SEC officers and employees, and other necessary expenditures, are paid from the fund.
[21] International Organization of Securities Commissions upgraded SEC to A-category from B-category.

insider and serial trading, and bank and investor activity.[22] BSEC's Supervision and Regulation of Intermediaries Department conducts daily surveillance using its "instant watch" system, where cases of contraventions are referred for enforcement. An analysis of registered cases also suggests quicker resolution.[23]

2. Enhanced Market Facilitation

22. CMDP II also enhanced BSEC capacity by creating a capital market tribunal to expedite resolutions of pending cases.[24] BSEC established best practices in accounting and auditing to promote reliability of financial information. The appointed chief accountant designed guidelines for empanelling auditors and established an accredited list of qualified auditors. Submitting the FRA to Parliament was a key policy action, and passage is critical for upgrading the accounting and auditing standards to enhance market confidence.[25]

23. CMDP II focused on improved governance through demutualization, segregating ownership, management, and trading. Demutualization will also facilitate new technology and alternative methods of raising capital (such as strategic investment into CSE and DSE by June 2017). The DSE demutualization scheme was approved on 2 November 2013. On 21 November 2013, the Registrar of Joint Stock Companies certified the amended Memorandum of Understanding and Articles of Association.[26] A firewall between business and regulatory functions now exists, and DSE's Regulatory Affairs Division reports to the Regulatory Affairs Committee board, consisting of independent directors (para. 18).[27] Further, under Demutualization Act, 2013 provisions, BSEC will instruct exchanges to sell at most 25% of total issued shares to a strategic investor.[28] To achieve this, DSE recorded a strategic international presence via signing memoranda of understanding with Kolkata and Korea stock exchanges; visiting Singapore, Thailand, and Mumbai exchanges; and applying for membership to the World Federation of Exchanges.

24. Financial stability was enhanced through improved regulatory coordination, by making the council of regulatory agencies more effective by including Bangladesh Bank, BSEC, Insurance Development and Regulatory Authority (IDRA), and Ministry of Finance (MOF). The council also adopted a mandate to include (i) macro-prudential oversight of the financial system and contingency planning, (ii) a forum for reviewing financial sector policies and identifying required

---

[22] Amended SEC Act in November 2012 removed the SEC's subordination to the Ministry of Finance (MOF).

[23] Officials observed 195 alerts were generated for "PIONEERINS" scrip from 28 November 2012 to 7January 2013. Further analysis indicated a trader acted as both buyer and seller in trades of Pioneer Insurance Company Limited. SEC formed a committee to investigate suspicious trading in DSE through Prilink Securities Limited. Also, from 4–25 February 2013, share price of Summit Purbanchol Power Company Limited increased by 42.96%. Surveillance revealed 82 different alerts were generated for Summit Purbanchol Power Company Limited, including for circular movements. It appeared several individual and omnibus beneficiary owner accountholders were involved in circular trading, and SEC referred the issue to DSE. In a case of short selling, market surveillance observed many unauthorized short-selling alerts were generated in different client codes of Sylhet Metro City Securities Limited 14 March–30 May 2013. SEC enquired into short-selling by Sylhet Metro City Securities Limited and referred to DSE.

[24] In total, 366 SEC cases were pending with various courts, including 15 cases from the 1996 market crisis.

[25] After the enactment an independent Financial Reporting Council will be established that will adopt International Accounting Standards and International Standards of Auditing for the concerned entities, as well as monitor and enforce them, and possess the authority to license auditors and accountants.

[26] The board of the demutualized DSE board was formed under the leadership of the immediate past board at the 52nd Annual General Meeting on 13 February 2014. This was done by electing the shareholder directors and the obtaining the approved list of independent directors from the SEC.

[27] As a result of demutualization, DSE and CSE published their settlement guarantee fund regulations. The regulations came into effect on demutualization date of the exchanges in November 2013. The funds reduce settlement risk and ensure settlement of trades as prescribed under DSE (Settlement of Transactions) Regulations 2013 and CSE (Settlement of Transactions) Regulations 2013.

[28] The shares are currently held in a blocked account.

amendments to the legal and regulatory framework, and (iii) a high-level forum for coordination and information sharing to consolidate supervision.

3. Enhanced Supply Measures

25. The corporate bond market is being supported by regulatory reform that balances investor protection with ease of issuance. To develop a liquid bond market and yield curve, CMDP II supported price discovery in auctioning government securities, entailing the government being a price-taker by issuing treasury bills and bonds at market rates. A strategy to create benchmarks is being pursued by reducing the number of issues while increasing their average size by reopening existing issues. Tenors are also being lengthened with insurance investment.

26. However, forced subscriptions (devolvement) occur in treasury auctions and dis-incentivize bank participation. Bangladesh Bank sets auction rates with the lowest yields of state-owned banks accepted as the cut-off. This results in lower-than-market clearing rates, hindering primary dealers from selling securities to investors, limiting secondary market development, and leading to financial repression. Expanded treasury issuance has added to liquidity pressures for primary dealers and reduced profitability, with holding yields below funding cost.

27. CMDP II reduced tax distortions to provide equal opportunities for ICB and mutual funds, promote bonds, and encourage equity financing. Following best practices, the IPO tax was eliminated to incentivize equity issuance. Bonds are also exempt from transaction taxes to promote secondary market activity and supply. The high yields on savings schemes were a major impediment for the bond market.[29] Government savings certificate rates are 2%–3% higher than rates on government paper, creating a high interest rate benchmark for corporate debt. With similar risks, yields in treasury bills and bonds cannot be lower than savings certificates. This norm violation, which impedes the bond market, is indicated in Table 1.

Table 1: Interest Rates of Different Savings Instruments (31 March 2014)

T-Bills	T-Bonds	Sanchaypatra[a]	DPS	STD	Savings	FDR
30 days: 7.10%–9.41%	2-year: 10.95%–10.98%	5-years: 13.19%	8.62%–11.59%	3.00%–6.00%	7.50%	
91 days: 8.13%–11.40%	5-year: 11.48%–11.82%	3-years: 12.59%				11.50%
182 days: 9.83%–11.42%	10-year: 11.65%–12.16%					11.50%
364 days: 10.13%–11.54%	15-year: 11.85%–12.40%					11.75%
2 years: 6.98%	20-year: 12.12%–12.48%					11.75%

DPS = deposit premium scheme, FDR = fixed deposit receipt, STD = savings and time deposits.
[a] Savings certificate that is a government savings mobilization scheme.
Source: Bangladesh Bank.

4. Enhanced Demand Measures

28. To promote institutional investments, CMDP II enhanced insurance industry participation by requiring compliance with minimum capital requirements of the Insurance Act, 2010 and encouraging investor demand through IDRA's investment guidelines. The white paper (renamed the National Insurance Policy Paper) was formulated in November 2012 and approved by the cabinet in June 2014. Implementation started in July 2014. The insurance regulations on IDRA

[29] The artificially high yields on savings drive up cost of bank deposits and deter private sector debt. While the government has reduced rates to relieve pressure on commercial bank rates and capital market yields, these were viewed as artificial and a one-off remedy. A case in point is that from FY2005 onwards, private banks closely mapped yields on national savings certificates of 10.0%–12.5%.

fund's senior management appointments were implemented from January 2013, and the appointment of chief executive officer for insurance companies and IDRA fund staff's salaries and benefits are processed under approved guidelines.

29. To develop a more liquid bond market, CMDP II supported the development of an efficient primary dealer system by fostering a more competitive auction system. This is expected to support price discovery in treasury bills and bonds in line with demand. CMDP II also supported corporate bonds by implementing a fast-track BSEC regulatory process for private placements that balances investor protection with the ease of approval.[30]

C. Program Costs

30. Program costs are summarized in Table 2.

Table 2: Program Costs Financed by ADB

Items	Allocation and Withdrawal of Loan Proceeds At Approval Amount Allocated ($'000)	At Closures[a] Disbursed ($'000)
Loan 2951	95,000	95,000
Loan 2952[b]	155,000	150,251
Loan 2953[b]	50,000	49,526
Total program cost	**300,000**	**294,777**

ADB = Asian Development Bank.
[a] No reallocation done.
[b] SDR amount has been fully disbursed and the difference in dollar amounts is due to exchange rate fluctuations
Source: Asian Development Bank.

31. The adjustment costs across program outputs were estimated at (i) $20 million for market stability (additional BSEC staff, coordination committee time, and maintenance and operation cost of surveillance equipment); (ii) $150 million for market facilitation (demutualization cost and establishment of a capital market tribunal, and operation costs of the Financial Reporting Council and its tribunal); (iii) $10 million for supply measures (foregone revenue on IPO tax, bond transaction tax, and stamp duties); and (iv) $150 million for demand measures (paying market prices for government securities and additional IDRA staff).

D. Disbursements

32. Loan 2951 was disbursed in a single tranche of $95 million 2 days after effectivity. The first tranche disbursements of $25.246 million under Loan 2952 and $30.295 million under Loan 2953 were also released 2 days after effectivity. The second tranche was originally to be released 15 months after the first tranche, in March 2014. However, the second tranche disbursements of $125.005 million under Loan 2952 and $19.231 million under Loan 2953 were released in December 2014. A breakdown of disbursements is in Table 3.

Table 3: Disbursements by Year
($ million)

Item	2012	2013	2014	Total
Loan 2951	95.000	0.000	0.000	95.000
Loan 2952	25.246	0.000	125.005	150.251
Loan 2953	30.295	0.000	19.231	49.526
Total	**150.541**	**0.000**	**144.236**	**294.777**

Source: Asian Development Bank.

[30] SEC framed Private Placement Debt Issue Rules 2012 to expedite the issuance of private placement debt. The government withdrew tax at source on the total income from bond sale in the National Budget for FY2014.

E. Program Schedule

33. The first tranche disbursements under Loans 2951, 2952, and 2953 were released on 19 December 2012 ahead of the loan agreement provision stipulating a 90-day timeframe. There were two extensions done under Loans 2952 and 2953. The first was until 31 October 2014 and the second was until 31 March 2015. These extensions gave the government time to complete three pending policy actions under the second tranche, namely: (i) submission of the FRA to Parliament, (ii) cabinet approval of the national insurance policy paper, and (iii) approval of a BSEC organizational structure and human resource program.

F. Implementation Arrangements

34. The MOF's Bank and Financial Institutions Division was the executing agency, and BSEC implemented the program. For coordination, the program established an inter-agency committee including MOF, Bangladesh Bank, National Board of Revenue, BSEC, and IDRA in July 2012 to implement first tranche policy actions.[31] Each agency had specific responsibilities: (i) BSEC for developing a market surveillance system and improving staffing and enforcement; (ii) Bangladesh Bank for reducing bank exposure to equities following the amended Bank Companies Act and developing the bond market; (iii) MOF for the FRA; and (iv) IDRA for implementing regulations for insurance companies and advancing the approved "Insurance White Paper."

G. Conditions and Covenants

35. Policy actions were designed to support program outcomes. The first tranche was released upon loan effectiveness on 17 December 2012 following full compliance of all 13 policy actions. The government remained strongly committed to the program, demonstrating full or substantial compliance with the 15 policy actions required for the second loan tranche release. There was also compliance with all non-tranche release policy actions. For the first tranche, while the BSEC Act amendment was undertaken in November 2012 as required under tranche release conditions, its operationalization took additional time to allow for approval of the service rules authorizing BSEC staff benefits on par with Bangladesh Bank. The second tranche experienced 7 to 8 months delay due to government requests for additional time for FRA preparation, cabinet approval for the National Insurance Policy paper, and BSEC staffing.

36. The program's success also rests in not reducing the compliance level of difficult covenants, such as FRA submission. However, while successful, the program did not meet a key outcome of expanding the corporate debt market. In this regard, policy actions geared towards addressing market distortions (para. 27), recovery mechanisms, and developing benchmarks in securities may have been fruitful.

H. Related Technical Assistance

37. The capacity development TA[32] had three components, namely (i) strengthening BSEC enforcement capacity, (ii) expediting adjudication to dispose capital market cases through a separate tribunal, and (iii) facilitating demutualization of DSE and CSE. The TA is rated *successful*.

38. The first component's focus was strengthening BSEC's inspection, investigation, and enforcement capacity. The aim was to ensure an effective structure for detecting insider trading and manipulation, and ensuring capital adequacy and anti-money laundering. As implementation

---

[31] A steering committee chaired by the Bank and Financial Institutions Division Secretary implemented CMDP II.

[32] ADB. 2012. *Technical Assistance to the People's Republic of Bangladesh for Enhancing Efficiency of the Capital Market*. Manila (TA 8228-BAN).

progressed, the focus changed to uncovering and analyzing evidence, as well as prosecution. For adjudication, the second component supported operationalization of the special tribunal following the amended BSEC Act of November 2012, and timely enforcement mechanisms. Finally, for demutualization, the third component focused on regulation, governance, and operations as defined by the Demutualization Act, 2013.[33] Several trainings were conducted to facilitate the tribunal's operationalization (training of judges) and to enhance the BSEC's enforcement capacity (training on using surveillance software). Overall, TA implementation was effective and activities were satisfactorily completed on time. The TA completion report is provided in Appendix 3.

I. Consultant Recruitment and Procurement

39. There were no consultants or procurement under the loans. The capacity development TA recruited a consulting firm to provide 17 person-months of international and 12 person-months of national consulting services. Using quality- and cost-based selection method, the TA recruited Intl. Securities Consultancy Ltd. (The) from 25 June 2013 to 24 June 2015. The firm was ranked satisfactory. Under the TA, BSEC procured equipment following ADB Procurement Guidelines (2010, as amended from time to time).

J. Performance of Consultants, Contractors, and Suppliers

40. The performance of the consultants under the capacity development TA is rated satisfactory. The reports were delivered on time and reflected the phasing of policy actions for tranche release. BSEC capacity development was integral to the consultancy, and on-the-job training was provided in conducting audits and inspections, and in developing internal procedures for investigation and enforcement. The consultants also provided perspectives from other markets. The consultancy trained judges, enacted legislation, and issued regulations for operationalizing the special tribunal. The consultants worked closely with the demutualization committee and reviewed the draft exchange companies' memorandum and Articles of Associations, ensuring the documents conformed to the demutualization scheme.[34] In addition, they prepared the proper criteria for relevant officers and reviewed demutualization regulations, including for listing, investor protection, settlements, and trading.

41. Trainings covered risk-based supervision for BSEC, enforcement in securities markets for the judiciary, administrative tribunal rules for the securities markets, and procurement of surveillance software. The consultants, including a sitting judge of the Supreme Court of England and Wales, were also appropriate for the assignment.

K. Performance of the Borrower and the Executing Agency

42. The performance of the borrower is rated *satisfactory*. The government agencies, including BSEC, Bangladesh Bank, IDRA, and MOF, worked closely with the mission and consultants in meeting program outcomes. The commitment of the stakeholders to reforms was evident from achievement of several tranche actions requiring parliamentary action, including submission of the FRA, approval of the Demutualization Act, passage of the SEC Act, submission of the Bank Companies Act, and amendment of the Stamp Act to assist in asset securitization. Securing cabinet approval of the insurance white paper required similar commitment levels. The nodal agencies, including BSEC, Bangladesh Bank, and IDRA, also assisted in adopting rules required

[33] The TA supported submission of demutualization schemes by DSE and CSE, and SEC's approval.

[34] The approved scheme was formally issued to the exchanges on 30 September 2013 and followed the draft scheme that had to be submitted to SEC 90 days after the publication of the Demutualization Act of April 2013.

for diversifying financial instruments, reducing bank exposure to the equity markets, and amending insurance regulations.

43. A significant aspect of borrower performance was the quality in stakeholder consultations that led to achieving a consensus for reforms when confronted with strong vested interest. Using consultants for internal capacity development also contributed to performance.

L. Performance of the Asian Development Bank

44. The performance of ADB is rated *satisfactory.* ADB fielded 10 loan review missions in 2013 and 2014 that were responsible for implementation progress and compliance with required policy actions. The mission proactively followed up on pending tranche conditions and participated in dissemination seminars to build stakeholder consensus on the reform process. The mission also pursued unmet first tranche policy actions to ensure compliance.[35] The mission also pursued policy dialogue at all levels to minimize delays and loan extensions. For the two loan extensions, first until October 2014 and subsequently until March 2015, the mission accommodated requests for FRA submission to Parliament, cabinet approval of the National Insurance Policy paper, and approval of BSEC's organization structure. Reasons outside the control of the mission and government, including political agitations, contributed to delays.

III. EVALUATION OF PERFORMANCE

A. Relevance

45. The program is rated *highly relevant*. The sector assessment in the Report and Recommendation of the President (RRP) correctly identified weaknesses, including the absence of BSEC institutional capacity, inadequate governance in the exchanges, poor corporate governance in listed companies, unreliable financial reporting, and bond market weaknesses. The RRP problem tree connects inadequate investment and weak economic growth, identifies capital market weakness as a factor, and provides a road map for sector development, regulatory capacity, and a framework for financial sector and corporate governance.

46. The market crash affected large sections of people, and short-term interventions failed to make an impact. Following the crisis, the Prime Minister met with stakeholders and suggested several directives and measures to improve governance, including corporate governance guidelines, exchanges reforms, FRA enactment, and control of insider trading. These were also mentioned in the investigation committee report (footnote 4).

47. As indicated in paras. 6–9, CMDP II addressed the factors behind the 2010 crisis and was based on findings from the project preparatory TA. The policy actions also supported market expansion, as required to channel financing to the real sector and in the context of the overall financial sector's identified inefficiencies and gaps (paras. 17–18).

48. The program was also consistent with ADB's financial sector strategy for Bangladesh as included in the country partnership strategy, 2011–2015[36] and the country operations business plan, 2012–2014.[37] The strategy is aligned with the Sixth Five-Year Plan, lessons from ADB's previous financial sector interventions, and development partners. The program is also consistent

---

[35] The January 2014 mission recorded the unmet action related to raising SEC staff benefits on par with Bangladesh Bank staff and pushed for early resolution significantly before the due release of the second tranche.
[36] ADB. 2011. *Country Partnership Strategy: Bangladesh, 2011–2015*. Manila.
[37] ADB. 2011. *Country Operations Business Plan: Bangladesh, 2012–2014*. Manila.

with Strategy 2020, which supports capital market development as a core ADB priority to facilitate private investment.[38]

B. Effectiveness in Achieving Outcome

49. The program is rated *effective* in achieving outcomes. The targeted outcomes included increasing market capitalization to Tk3000 billion by FY2014, enlisting of 545 securities in DSE by FY2015, and increasing the number of corporate bonds to 12 by FY2015. For the equity market, the program over-achieved these outcomes, resulting in it being rated as effective. However, the indicators in the corporate bond market were not achieved.

50. The equity market has improved due to stronger fundamentals in listed companies, BSEC measures, and investor opportunities. While the DSE index and capitalization was stable in FY2014, the DSE broad index and CSE increased by 9.2% and 8.1% in FY2013–FY2014. In addition, DSE's number of listed equity issuances increased to 553 in May 2015 from 525 the previous year, and CSE's number increased to 276 from 266.[39] In addition, DSE capitalization increased to Tk2,943.2 billion on 30 June 2014 from about Tk1,500.0 billion the previous year.[40]

51. With regard to valuation, price-earning ratio at its low of 10.6 in March 2013 was attractive compared with the 30.6 peak in February 2010. Accordingly, investor interest returned, and prices recovered, with the ratio reaching a 4-year high of 18.58 in September 2014. New money poured in, and by September 2014, the 12-month cumulative net investment increased to $825 million from negative $486 million in May 2010. DSE observed a 31% increase in value and 12% in volume over the FY2013–FY2014 period, with CSE remaining constant. The gross inflows by non-residents increased to about Tk41.3 billion in FY2014 from Tk18.0 billion in FY2013, indicating enhanced market confidence.[41] Recovery was also seen in IPOs. After market correction, nine IPOs were launched and raised Tk13.8 billion, primarily by companies that were already in the IPO pipeline before the crash. In total, 12 companies raised new equity of Tk6.6 billion in FY2014 following Tk12.2 billion raised by 14 companies in FY2013.[42] The FY2014 IPOs were 11 times over-subscribed, indicating confidence in the market and investor appetite for good quality paper.

52. As a result of these measures, DSE 30 index was launched on 28 January 2013 as an investable index and constructed following Standard & Poor's methodology, with 30 leading listed companies. The base value was 1,000 for the DSE 30 index and was at 1,644.75 on 30 June 2014, up from 1,532.55 at the end of the previous year. In addition, DSE launched the DSEX Shariah Index, also developed by Standard & Poor, with Islamic Shariah compliant companies. The DSEX Shariah Index has a base value of 1,000 and base year of 2011 starting on 20 January 2014 at 941.28 points and rose to 1,019.34 points by 30 June 2014. Under guidance from the new board, DSE entered into an agreement with NASDAQ OMX and FlexTrade Systems on 21 March 2014 to upgrade to a next generation system within a 9-month period to introduce new assets, support market expansion, and simplify trading.

53. However, CMDP II fell short in corporate bond market development. Only three corporate bonds exist, and the number has remained stagnant since 2011.[43] From 1987 to 2005, only 17 debentures were issued through public offerings, and the eight debentures outstanding in 2014

---

[38] ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020.* Manila.
[39] In December 2014, DSE's number of listed securities was 546, while the RRP's outcome indicator was 545 by FY2015.
[40] The RRP outcome indicator was stock market capitalization increase to Tk3,000 billion by FY2014.
[41] By way of comparison from April 1992 for June 2014, the gross investment inflow was at about Tk128.7 billion against the gross outflow as repatriation and sale of proceeds of Tk89.6 billion.
[42] Of the new equity raised, Tk2.4 billion was raised through private placements and Tk4.2 billion through public issues. In FY2013, equity raised through private placements was Tk1.0 billion, and through public was Tk11.2 billion.
[43] The RRP indicator was the number of corporate bonds outstanding increased to 12 by FY2015.

had a value of only $2 million.[44] The debenture market is small with few issuers and no liquidity. Investors avoid debentures due to weak disclosure norms, and no recourse in case of default.

C. Efficiency in Achieving Outcome and Outputs

54. The program is rated *efficient*. First the efficiency is derived from the program's timeliness, as Bangladesh was embarking on a financial recovery program. In the absence of CMDP II, only piecemeal reforms would likely have taken place, and Bangladesh would have lurched from one market bubble to crash into the next. Program costs were justified based on the policy action focus and adjustment costs. The policy actions enabled fundamental and difficult reforms that would otherwise have taken significantly longer to achieve. A key component was demutualization, where DSE and CSE were among the first demutualized exchanges in their peer group.[45] Also, the demutualization was achieved in a compressed timeline of about 2 years (by 2013). In addition, there were strong synergies leveraged to strengthen institutions and provide necessary inputs to implementing and executing agencies to meet policy targets in a timely manner. The scope of work allowed for capacity building through a hands-on approach, which reduced the time to achieve outcomes and improved sustainability. These factors ensured fundamental reforms in a short time, setting the stage for the next generation of reforms.

D. Preliminary Assessment of Sustainability

55. The program is *likely sustainable*. The enhanced capacity of BSEC in particular is critical to sustainability. The achievements in establishing the BSEC tribunal, implementing surveillance software, training staff, improving remuneration, establishing coordinating mechanisms, and—most importantly—implementing demutualization will enable the reform agenda to continue into the proposed Third Capital Market Development Program (CMDP III). For demutualization immediately after approval of the scheme, five committees were established to implement it, including a remuneration and human resource committee, regulatory affairs committee, audit and risk management committee, appeal committee, and conflict mitigation committee. In addition, beyond the program, policy actions being undertaken—including the proposed FRA enactment, secular reduction in devolvement of government securities on Bangladesh Bank, approval of a low-interest loan scheme for small investors to be administered through ICB, and steps to develop derivatives and securitization markets—will also assist in promoting market expansion sustainability. The capacity building described in paras. 40-41 also enhances sustainability.

E. Institutional Development

56. The institutional development is rated as *significant*. As indicated in paras. 61-62, policy coordination was integral to implementation. In addition, consultants for the project preparatory TA and capacity development TA worked closely with the implementing agency and other nodal departments, providing training in surveillance, monitoring, and enforcement, and equipping judges to facilitate the special tribunal (para. 22). The demutualization process was also supported by engaging relevant agencies and adopting a learning-by-doing approach (para 54).

F. Impact

57. The impact is *likely significant*. While private investment as a percent of GDP was targeted to increase to 23.0% by FY2016 from a baseline of 19.5%, in FY2011, it had already reached 22.0% by FY2014. In addition, the targeted long-term financing increase was 0.50% of GDP by FY2016 from the 0.09% baseline in FY2011, and the amount had increased to 0.20% by FY2014.

---

[44] The bonds are the IBBL Mudaraba perpetual bond, ACI zero coupon bond, and BRAC Bank subordinated bond.

[45] At the time of DSE and CSE demutualization, Colombo stock exchange was not demutualized, and Karachi stock exchange had been demutualized a short while earlier, more than 10 years after it was first proposed.

58. CMDP II's long-term impact is to support development objectives, including 10% GDP growth from 2017. CMDP II facilitated private sector investment and channeled saving to finance investments, while ensuring financial stability. Since the higher growth target requires an increase in investment rate from 24.4% of GDP at the start of Sixth Five-Year Plan to 32.5% by the end, a reinvigorated capital market is necessary for channeling savings into investment.[46] In the wake of the crisis, the government had to address structural deficiencies of capital markets by deregulating the financial system to promote private sector investment and better support the real economy. In this context, CMDP II was instrumental in achieving and hastening complex reforms, especially those requiring legislative action that contributed to the impact. CMDP II also fostered coordination among MOF, Bangladesh Bank, and BSEC, which had been absent.

59. In this regard, financial inclusion is a key concept, which was supported under CMDP II via insurance reforms. At the design phase, there was limited awareness for insurance services, especially among rural residents, as well as inadequate services, lack of qualified officials, archaic methods of premium calculations, and limited use of information technology. Thus, CMDP II correctly focused on the insurance sector for debt market development and catalyzing savings.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

60. The program is rated *successful*. CMDP II deliverables achieved have set the stage for significant financial sector expansion. Demutualization, BSEC's strengthened capacity to enhance surveillance, and other initiatives have restored market confidence. Other CMDP II initiatives, including the (i) reform of primary and secondary markets; (ii) better policy coordination among regulators; and (iii) improvements in trading, clearance, and settlement systems, will further expand the availability of market instruments. However, corporate debt market growth did not occur. Evidence of success is seen in recent market data on capitalization, IPOs, foreign investor interest (para. 51), and the expanded product range being offered. The final aspect can be attributed to demutualization (para. 19).

B. Lessons

61. Several sustainability lessons from CMDP II may be relevant to future interventions. A key aspect was following an integrated approach fostered through consultations. As indicated in para. 57, policy coordination under CMDP II resulted in ensuring identification of responsibility and minimal replication of effort. In addition, CMDP II correctly understood the shortcomings in the government's response to the crisis, related to poor surveillance and failure to address the underlying causes in weak governance and incompatible incentives. At the outset, CMDP II proactively proposed remedies with proven records in addressing governance issues in the exchanges, especially demutualization.

62. An important aspect of CMDP II was using a crisis as an opportunity to push reforms. This was reflected in CMDP II design that resulted in mutually reinforcing actions that simultaneously addressed the causes behind the crisis and expanded the financial sector to meet the needs of the real sector. In this regard, fundamental reasons for the crisis were the falsification of financial statements and the consequent exploitation of small investors. The accreditation system for auditors will help promote market information credibility. These actions provided mechanisms to restore investor confidence and encourage issuances and expanding products (paras. 18–19).

[46] As recognized in the Sixth Five Year Plan, an essential prerequisite for rapid poverty reduction is to attain high economic growth to provide for sustainable productive employment and incomes for the growing labor force.

63. However, the continuing weakness in the corporate debt market infers a lack of focus on issues related to market distortions and the absence of a recovery mechanism. Addressing these factors will fill gaps in the market and dovetail CMDP II achievements.

C. Recommendations

64. **Future monitoring.** The enactment of the FRA that has been submitted to Parliament is critical for promoting the quality and reliability of financial statements and credibility of capital market transactions. Further follow up through missions and reviews by BSEC are required.

65. **Covenants.** The covenants should be maintained in their existing form. However, additional covenants for recovery of security in case of corporate defaults may be included. In early 1990s, the interest payments of some corporate debentures defaulted, as regulations were not adequate and credit rating was not mandatory. Investor confidence eroded because of trustees' failure to protect investor rights, which made investors averse to invest in corporate bonds. Additional covenants to address pricing discrepancies may have been included (Table 3).

66. **Further actions.** To prepare for CMDP III, BSEC and Bangladesh Bank may develop a memorandum of understanding on collection, sharing and coordinating supervisory information, risk assessments, and enforcement. A tax review is now overdue, requiring consideration for treating stock market income on par with other income and avoidance of double taxation.

67. **Additional assistance.** Additional assistance via CMDP III may consider supporting the pension sector. As of 2013, the size of pension funds was estimated at Tk315 billion, or 4% of GDP and 5% of funds in government securities. Only 2.2 million employees had access to retirement savings. Increasing the pension access to the majority will add 0.9 million subscribers and increase assets by Tk220 billion in 5–7 years.[47] It is important to establish a credible yield curve and secondary market activity to price risk and reduce financial repression. Further, futures market will help promote liquidity and secondary market pricing.[48] Derivatives regulations are required by amending the companies, bank and non-bank financial institutions, and trust and bankruptcy acts. Finally, BSEC may consider options for expanding financial literacy.

68. **Timing of the program performance evaluation report.** It may be advisable to wait until FY2016, as impact indicators are targeted for fulfillment only by FY2016. In addition, the full impact of demutualization is yet to be felt especially in the corporate debt segment. The program design also suggested market reform to facilitate infrastructure investment. However, this will materialize only when PPP enablers scale up to encourage market investment in infrastructure.

69. **General.** Finally, while the program is likely on track to meet impact indicators, discussions with stakeholders are required to monitor targets with regard to achieving long-term financing availability to the tune of 0.50% of GDP. While the first tranche was released on program effectiveness, including policy actions on reducing devolvement and pricing discrepancies in corporate bonds may have been incentivized if the release had been programmed for later. This would have provided additional support for corporate debt market development.

---

[47] Based on Index Capital Group (2013) study. PF System – Final Report: The Development of Comprehensive and Sustainable Pension System in Bangladesh, 10 March 2013, Policy Guidelines for Formation and Operation of Comprehensive Pension/Provident Fund System. Index Capital Group: New York.

[48] Following other markets, it may be useful to concentrate liquidity in a few instruments, such as forwards or swaps in the 91-day treasury bill and 5-year bond and forward or currency swap (1–3 month dollar-taka pair). In addition, a general stock index derivative aimed at institutional investors and commodity hedges may also be considered.

PERFORMANCE AGAINST DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Current Status
Impact A well-functioning financial system that supports basic capital and investment needs, as well as Bangladesh's longer-term economic objectives	Private investment as the percentage of GDP increases to 23.0% by FY2016 (baseline: 19.5% in FY2011) Long-term financing as the percentage of GDP increases to 0.50% by FY2016 (baseline: 0.09% in FY2011)	Private investment as the percentage of GDP increased to about 22% in F20Y14. Long-term financing as the percentage of GDP increased to 0.20% in FY2014.
Outcome A deeper and more stable capital market	Stock market capitalization increases to Tk3,000 billion by FY2014 (baseline: Tk2,347.8 billion in July 2012) Enlistment of new securities increases to 545 by FY2015 (baseline: 507 in FY2011) Number of corporate bonds outstanding increase to 12 by FY2015 (baseline: 3 in FY2011)	DSE stock market capitalization increased to Tk3,186.4 billion in May 2015. 553 securities listed in DSE in May 2015. Two corporate bonds outstanding in May 2015.
Outputs 1. Strengthened market stability	SEC Act 1991 amendments adopted by Q2 2013 (baseline: limited SEC independence) MOU to strengthen inter-agency committee to guarantee financial stability adopted by Q4 2012 Limit of exposure to equity risk reduced to a percentage of capital by FY2013 (baseline: 10% of total liabilities) Margin lending limits reduced to 1:0.5 by FY2013 (baseline: 1:1 in July 2010) Electronic market surveillance operational by Q1 2013 (baseline: manual surveillance)	SEC Act amended. Complied with in line with tranche release conditions Reduced in line with BCA amendments. Complied with in line with tranche release conditions Surveillance software in use by SEC.
2. Enhanced market facilitation	SEC restructured to include the Office of Chief Accountant by FY2013 (baseline: no Office of Chief Accountant) Special tribunal for capital market related cases established by	Chief Accountant appointed and tribunal functioning.

Design Summary	Performance Targets/Indicators	Current Status
	FY2013 (baseline: no tribunal)	
	SEC Code of Governance implemented by Q4 2012 (baseline: voluntary)	Complied with in line with tranche release conditions
	Stock exchanges demutualized by FY2013 (baseline: mutualized stock exchanges)	Demutualization process complete.
	FRA bill adopted by Q2 2014	Complied with in line with tranche release conditions
3. Enhanced supply measures	IPO premiums reduced to 0% by FY2013 (baseline: 3% in FY2011)	Complied with in line with tranche release conditions
	SEC regulation on private placement adopted by Q4 2012 (baseline: no regulation)	Complied with in line with tranche release conditions
	Corporate bond transaction tax reduced to 0% by FY2013 (baseline: 0.10%–0.05% in FY2011)	Complied with in line with tranche release conditions
	Stamp tax for the securitization of assets removed by FY2013 (baseline: stamp tax in place)	Complied with in line with tranche release conditions
4. Enhanced demand measures	Assets management companies allowed to reduce their exposure to equity securities below 75% by FY2013 (baseline: restricted to reduce exposure below 75%)	Complied with in line with tranche release conditions
	Tax advantage for ICB open-ended mutual funds removed by FY2013 (baseline: 10% in FY2011)	Complied with in line with tranche release conditions
	Devolvement of government securities reduced to no more than 45.0% of total issuance by Bangladesh Bank by FY2014 (baseline: 65.0% in July 2012)	Devolvement of government securities reduced to 15.4% in FY2014.

Activities	Timeline	Current Status
1. Strengthened market stability		Complied with in line with tranche release conditions
1.1 Amend SEC Act to enhance SEC's operational and financial efficiency	Dec 2012	SEC Act amended in November 2012.
1.2 Establish a high-level committee with the mandate to preserve financial stability	Oct 2012	

Activities	Timeline	Current Status
through joint supervision of financial systems 1.3 Establish a working-level committee for the effective consolidated supervision of banks and their capital market subsidiaries 1.4 Amend Bangladesh Bank and SEC guidelines to prescribe margin lending requirement of 1:0.5 1.5 Undertake review of capital requirements for intermediaries 1.6 Strengthen regulatory measures, including limit for total direct and indirect exposure to equity risk as a percentage of capital	Oct 2012 Oct 2012 June 2013 July 2013	
2. **Enhanced market facilitation** 2.1 Develop a long-term capital market plan that embeds major milestones in the first and second tranches 2.2 Draft the required legislative and procedural framework for Demutualization Act 2.3 Enact the Demutualization Act 2.4 Adopt amendments to the SEC Code of Corporate Governance, 2006 2.5 Upgrade accounting and auditing standards by submitting the FRA bill to Parliament 2.6 Develop a model organizational framework for expedited adjudication of enforcement actions 2.7 Draft the required legislative and procedural framework for special tribunal 2.8 Operationalize the special tribunal 2.9 Train judges 2.10 Establish and staff the Office of Chief Accountant in SEC	Oct 2012 Oct 2012 Sep 2013 Oct 2012 Sep 2013 Apr 2013 Jun 2013 Aug 2013 Nov 2013 Nov 2013	Complied with in line with tranche release conditions
3. Enhanced supply measures 3.1 Draft and finalize SEC regulations for private placements	Oct 2012	Complied with in line with tranche release conditions

Activities	Timeline	Current Status
3.2 Amend the Income Tax Ordinance to ensure exemption of transactions taxes for bonds	Jun 2013	
3.3 Eliminate the 3% tax on IPO premiums by amending the Income Tax Ordinance	Jun 2013	
3.4 Ensure that the sale of receivables to an SPV in connection with the securitization of assets is exempted from the stamp duty on conveyance of assets, and that the issuance of debt instruments through private placement is exempted from the stamp duty on transfer of instruments	Jun 2013	
4. Enhanced demand measures		Complied with in line with tranche release conditions
4.1 Submit to cabinet a white paper to strengthen the insurance sector	Jul 2013	Cabinet paper approved.
4.2 Issue nine insurance regulations	Oct 2012	
4.3 Finalize a medium-term plan for managing the government debt portfolio by Bangladesh Bank	Oct 2012	
4.4 Amend SEC (Mutual Fund) rules, 2001	Oct 2013	

BCA = Bank Companies Act, DSE = Dhaka Stock Exchange, ICB = Investment Corporation of Bangladesh, IPO = initial public offering, FRA = Financial Reporting Act, GDP = gross domestic product, IPO = initial public offering, MOU = memorandum of understanding, SEC = Securities and Exchange Commission, SPV = special purpose vehicle.
Source: Asian Development Bank.

STATUS OF COMPLIANCE WITH TRANCHE RELEASE POLICY ACTIONS

A. TRANCHE 1

Covenant	Reference in Loan Agreement	Status of Compliance
Market Stability		
1. The Borrower shall submit to its parliament amendment of the SEC Act, 1993 to enhance SEC's operational and financial efficiency, including (a) composition of SEC, (b) delegation of the authority to appoint officers and employees to SEC on benefits comparable to that of Bangladesh Bank, and (c) providing access to SEC to SEC Fund without government approval of its budget.	*2952 Loan Agreement, Attachment 2 to Schedule 3, para. 1*	**Complied with.**
2. The Borrower shall cause a memorandum of understanding to be signed among key financial sector regulators to strengthen the existing financial regulators' committee to preserve financial stability and to identify potentially systemic financial firms for enhanced surveillance and supervision.	*Para. 2*	**Complied with.**
3. The Borrower shall achieve consolidated supervision of banks and their capital markets subsidiaries by (a) causing BB to require banks to report their balance sheet, income statement and key prudential exposures on a solo and consolidated basis, (b) requiring regular coordination meetings between BB and SEC, and (c) establishing mechanism for working-level exchange of supervisory information and cooperation.	*Para. 3*	**Complied with.**
4. The Borrower shall cause (a) SEC to issue a circular establishing margin lending requirement of 1:0.5 (advances of no more than 50% of the value of the collateral) for all margin loan providers; and (b) BB to issue a circular requiring full compliance with the SEC circular on margin lending.	*Para. 4*	**Complied with.**
5. The Borrower shall cause SEC to procure and initiate the installation of SEC's electronic market surveillance.	*Para. 5*	**Complied with.**
Market Facilitation		
6. The Borrower shall cause SEC to formulate and approve a long term capital market master plan to guide the direction and implementation of capital market development reforms.	*Para. 6*	**Complied with.**
7. The Borrower shall submit to its parliament a bill to amend section 25B of the Securities and Exchange Ordinance for the creation of a special tribunal to hear capital market-related disputes.	*Para. 7*	**Complied with.**
8. The Borrower shall cause SEC to adopt amendments to SEC's existing code of corporate governance to require (a) compulsory adherence	*Para. 8*	**Complied with.**

Covenant	Reference in Loan Agreement	Status of Compliance
to the existing code; (b) establishment of audit committee within the listed companies; and (c) increasing the percentage of independent directors from 10% to 20% if the board.		
9. The Borrower shall complete cabinet approval of the draft bill on demutualization.	*Para. 9*	**Complied with.**
Supply Measures		
10. The Borrower shall cause SEC to introduce simplified regulations for private placements of corporate bonds, which shall include (a) criteria for eligible investors; and (b) a requirement that the SEC shall approve corporate bond issues within 7 days after submission of supporting documentation.	*Para. 10*	**Complied with.**
Demand Measures		
11. The Borrower shall, to support a more efficient price discovery mechanism in the auctioning of government securities, cause BB to issue circulars, as necessary, such that (i) BB only devolve at a yield which is the average of all submitted bids by the primary dealers and non-primary dealers in an auction, excluding outliers; (ii) allocation of issuance across primary dealers should include the pro-rata share of bank liabilities (specifically their deposit base); and (iii) positive bids submitted by a primary dealer in an auction would receive offset/credit provision (volume based) while calculating the devolvement liability on the remaining bids of that primary dealer in the auction.	*Para. 11*	**Complied with.**
12. The Borrower shall cause the debt management department of BB to prepare a medium term plan for managing the government debt portfolio and submit it to the Ministry of Finance.	*Para. 12*	**Complied with.**
13. The Borrower shall issue regulations covering the following issues: (i) formulation of advisory committee, (ii) management of IDRA Fund, (iii) formulation of central rating committee, (iv) appointment of chief executive officer, (v) fees for registration rules, (vi) obligations of insurers to rural and social sectors, (vii) fees for licensing of branch and office of insurers, (viii) dispute resolution committee, and (ix) application for grant of license of branch and office of insurers.	*Para. 13*	**Complied with.**

BB = Bangladesh Bank, IDRA = Insurance Development and Regulatory Authority, SEC = Securities and Exchange Commission.
Source: Asian Development Bank.

B. TRANCHE 2

Covenant	Reference in Loan Agreement	Status of Compliance
Market Stability		
1. The Borrower shall submit to its parliament amendments to the Banking Companies Act to contain risks posed by equity markets through consolidated supervision of banks.	*2952 Loan Agreement, Attachment 3 to Schedule 3, para. 1*	**Complied with.** The Banking Companies Act was passed by Parliament on 7 July 2013.
2. The Borrower shall cause Bangladesh Bank to introduce guidelines to reduce the banks' equity risk exposure by putting a limit on the total direct and indirect exposure to equity risk as a percentage of capital, to be applicable on solo and consolidated basis.	*Para. 2*	**Complied with.** Bangladesh Bank issued the circular with regard to equity risk exposure as a percentage of capital applicable on a solo basis on 16 September 2013. Bangladesh Bank issued a circular regarding equity risk exposure as a percentage of capital applicable on a consolidated basis on 25 February 2014.
3. The Borrower shall cause SEC to undertake a review of the capital requirements for intermediaries through a risk-based supervision approach.	*Para. 3*	**Complied with.** SEC collected all relevant information for taking necessary action from banks and nonbank financial institutions, including International Organization of Securities Commissions studies. The review was completed on 5 October 2013.
4. The Borrower shall cause SEC to make reports generated from its market surveillance system to be part of the improved monitoring of the capital markets.	*Para. 4*	**Complied with.** A manual for surveillance system use and report generation was prepared. Activities were completed on 5 October 2013.
Market Facilitation		
5. The Borrower shall submit to its parliament a bill on financial reporting, which shall include provisions for (a) establishment of an independent financial reporting council to adopt international accounting and auditing standards for public interest entities, and to monitor and enforce them; (b) licensing of auditors and accountants; and (c) establishment of independent administrative tribunal to hear appeals on the decisions of the financial reporting council.	*Para. 5*	**Substantially complied with.** The Financial Reporting Act bill was approved by the cabinet on 10 November 2014 for submission to Parliament.
6. The Borrower shall ensure that SEC has established and staffed its office of the chief accountant and has adopted guidelines for the accountants and auditors to practice before SEC.	*Para. 6*	**Complied with.** SEC issued the directive to establish the office of the chief accountant in June 2014. Compliance with the policy action, through staffing of the Office of the Chief Accountant and adopting guidelines, was completed in July 2014.

Covenant	Reference in Loan Agreement	Status of Compliance
7. The Borrower shall establish a special tribunal to adjudicate capital market-related disputes and issue regulations to provide for (a) powers, functions, and jurisdiction of the tribunal; (b) status of appeals and adjournments; and (c) appointments of judges and their training.	*Para. 7*	**Complied with.** The Capital Market Tribunal was established on 7 January 2014. The rules and regulations associated with the tribunal's establishment fall under the purview of the Securities and Exchange Commission Ordinance 1969 and the Code of Criminal Procedure 1898.
8. The Borrower shall submit to its parliament the bill on demutualization.	*Para. 8*	**Complied with.** Parliament passed the Demutualization Act in April 2013.
Supply Measures		
9. The Borrower shall effect an amendment in sections 16E and 53L of the Income Tax Ordinance to exempt the 3% tax on initial public offerings.	*Para. 9*	**Complied with.** During the budget session in June 2013, this was included into the Finance Act. Parliament passed the Finance Act on 30 June 2013.
10. The Borrower shall exempt bonds from transactions tax by amending Section 53BBB of the Income Tax Ordinance.	*Para. 10*	**Complied with.** During the budget session in June 2013, this was included into the Finance Act. Parliament passed the Finance Act on 30 June 2013.
11. The Borrower shall ensure that sale of receivables to a special purpose vehicle in connection with the securitization of assets is exempted from stamp duty on conveyance of assets and that issuance of debt instruments through private placement of listed companies is exempted from the stamp duty on transfer of instruments, both by amending the Stamp Act, 1899.	*Para. 11*	**Complied with.** During the budget session in June 2013, this was included into an amendment to the Stamp Act. Parliament passed the amended Stamp Act on 30 June 2013.
Demand Measures		
12. The Borrower shall ensure that the circular aimed at supporting more efficient price discovery mechanism in the auctioning of government securities are implemented and fully operationalized.	*Para. 12*	**Complied with.** Fully implemented.
13. The Borrower shall cause SEC to amend the SEC's mutual fund rules to allow asset management companies to reduce their exposure to equity securities below the stipulated 75%, if so stated in the fund's prospectus.	*Para. 13*	**Complied with.** The rules were issued in March 2013.
14. The Borrower shall allow investors in private sector open-end mutual funds the same tax advantage as the one applicable to investors in the Investment Corporation of Bangladesh open-end mutual funds.	*Para. 14*	**Complied with.** During the budget session in June 2013, this was included into the Finance Act. Parliament passed the Finance Act on 30 June 2013.

Covenant	Reference in Loan Agreement	Status of Compliance
15. The Borrower shall: (a) obtain its cabinet approval on a white paper to strengthen the insurance sector by (i) agreeing to a timetable for recapitalizing all insurance companies in accordance with the Insurance Act and (ii) adopting investment regulations as required under Section 41 of the Act covering; (b) initiate implementation of the white paper; and (c) implement the following regulations: (i) management of IDRA Fund, and (ii) CEO appointment.	*Para. 15*	**Complied with.** (a) The draft white paper (being renamed the national insurance policy paper) has been formulated. Cabinet approved the policy paper in June 2014. (b) Implementation of the policy paper started in July 2014. (c) The insurance regulations with regard to CEO appointment and management of IDRA Fund have been implemented since June 2013.

CEO = chief executive officer, IDRA = Insurance Development and Regulatory Authority, SEC = Securities and Exchange Commission.
Source: Asian Development Bank.

STATUS OF COMPLIANCE WITH LOAN COVENANTS

Form of Reform Policy Actions	Reference in Loan Agreement	Assessment of Progress (with Supporting Documents)
1. (a) The Borrower shall cause the Program to be carried out with due diligence and efficiency and in conformity with sound applicable technical, financial, business and development practices. (b) In the carrying out of the Program, the Borrower shall perform, or cause to be performed, all obligations set forth in Schedule 4 to the Special Operations Loan Agreement.	*Loan 2951 Article IV, Section 4.01*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
2. The Borrower shall make available, promptly as needed and on terms and conditions acceptable to ADB, the funds, facilities, services as required, in addition to the proceeds of the Loan, for the carrying out of the Program and for the operation and maintenance of the Program facilities.	*Loan 2951, Article IV, Section 4.02*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
3. The Borrower shall ensure that the activities of its departments and agencies with respect to the carrying out of the Program are conducted and coordinated in accordance with sound administrative policies and procedures.	*Loan 2951, Article IV, Section 4.03*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
4. In the carrying out of the Program, the Borrower shall perform, or cause to be performed, all obligations set forth in Schedule 4 to this Loan Agreement.	*Loans 2952 and 2953, Article IV, Section 4.01*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
5. (a) The Borrower shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible items financed out of the proceeds of the Loan and to record the progress of the Program. (b) The Borrower shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a).	*Loan 2951, Article IV, Section 4.04* *Loans 2952 and 2953, Article IV, Section 4.02*	**Complied with.** Records and accounts were managed satisfactory to requirements of ADB.
6. (a) As part of the reports and information referred to in Section 6.05 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (i) the Counterpart Funds and the use thereof; and (ii) the implementation of the Program, including the accomplishment of the targets and the carrying out of the actions set out in the Policy Letter. (b) Without limiting the generality of the foregoing or Section 6.05 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB quarterly reports on the carrying out of the Program and on the accomplishment of the targets and the carrying out of the actions set out in the Policy Letter.	*Loan 2951, Article IV, Section 4.05* *Loans 2952 and 2953, Article IV, Section 4.03*	**Complied with.** The Borrower cooperated with ADB missions in providing any required information.

Form of Reform Policy Actions	Reference in Loan Agreement	Assessment of Progress (with Supporting Documents)
7. BFID, as the Program Executing Agency, shall be responsible for (a) overseeing all Policy Actions to be taken in connection with the Program; and (b) ensuring that all Policy Actions set out in the Policy Letter and Policy Matrix are duly carried out in a timely manner. SEC and BB shall be implementing agencies and shall be responsible for undertaking the policy, legal and regulatory measures falling under their respective ambits.	*Loan 2952, Schedule 4, para. 1*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
8. The inter-agency Tracking Committee, chaired by the Joint Secretary of the Economic Relations Division and comprising of representatives from Finance Division, Bank and Financial Institutions Division and Internal Resources Division of the Ministry of Finance; BB; SEC; National Board of Revenue and Insurance Development Regulatory Authority shall be responsible for coordinating the First Tranche Policy Actions. After compliance with First Tranche Policy Actions, A Program Steering Committee comprising of member of the Tracking Committee, but chaired by the Secretary of BFID, shall oversee the implementation of the Program. BFID shall also be responsible for the overall implementation of the Program, including reporting to ADB, administering and disbursing the Loan proceeds, and maintaining Program records and accounts.	*Loan 2952, Schedule 4, para. 2*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
9. In addition, BFID shall be responsible for: (a) overall coordination and monitoring of the Program, including the Policy Actions; (b) preparing and submitting all required reports to the PSC and ADB; (c) submitting the audited financial statements to ADB, and (d) implementing the TA.	*Loan 2952, Schedule 4, para. 3*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
10. The Borrower and Program Executing Agency shall ensure that: (a) the Program and the TA as applicable shall conform to all applicable ADB policies including those concerning safeguards, gender, anticorruption measures, procurement, consulting services and disbursement; and (b) the recommendations of the TA as also other necessary actions shall be undertaken in a timely manner to ensure completion of the required Policy Actions and the Program on time.	*Loan 2952, Schedule 4, para. 4*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
11. The Borrower shall ensure that all policy actions adopted under the Program, as set forth in the Policy Letter and the Policy Matrix, continue to be in effect for the duration of the Program.	*Loan 2952, Schedule 4, para. 5*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
12. The Borrower shall keep ADB informed of policy discussions with other multilateral and bilateral aid agencies that may have implications for the implementation of the Program and shall provide ADB with an opportunity to comment on any	*Loan 2952, Schedule 4, para. 6*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.

Form of Reform Policy Actions	Reference in Loan Agreement	Assessment of Progress (with Supporting Documents)
resulting policy proposals. The Borrower shall take into account ADB's views before finalizing and implementing any such proposal.		
13. The Borrower shall ensure that consolidated supervision of banks and their capital markets subsidiaries are effectively implemented, including by ensuring that the banks report balance sheet, income statement and key prudential exposures on a solo and consolidated basis, the coordination meetings are held regularly and the mechanisms for exchange of supervisory information is working.	*Loan 2952, Schedule 4, para. 7*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
14. The Borrower shall ensure that the amendments to the SEC's code of corporate governance are effectively implemented, including establishment of audit committees by listed committees and increasing the percentage of independent directors.	*Loan 2952, Schedule 4, para. 8*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
15. The Borrower shall ensure that the simplified regulations for private placements of corporate bonds are effectively implemented.	*Loan 2952, Schedule 4, para. 9*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
16. The Borrower shall ensure that the Counterpart Funds are used to finance the implementation of certain programs and activities consistent with the objectives of the Program.	*Loan 2952, Schedule 4, para. 10*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
17. The Borrower, the Program Executing Agency, and the implementing agency shall: (a) comply with ADB's Anticorruption Policy (1998, as amended to date) and acknowledge that ADB reserves the right to investigate directly, or through its agents, any alleged corrupt, fraudulent, collusive or coercive practice relating to the Program; and (b) cooperate with any such investigation and extend all necessary assistance for satisfactory completion of such investigation.	*Loan 2952, Schedule 4, para. 11*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
18. Without limiting the generality of Section 2.06 of the Program Agreement, the Borrower, SEC, BB and ADB shall closely monitor the completion of the Program and its impact. The Borrower shall ensure that BFID is responsible for: (a) establishing and maintaining a PPMS in a form and with a composition acceptable to ADB within 3 months after the Effective Date; (b) carrying out monitoring and evaluation of the Program for at least 1 year after completion of the Program; and (c) maintaining all relevant monitoring data to evaluate the benefits of the Program.	*Loan 2952, Schedule 4, para. 12*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
19. The Borrower shall ensure that reporting on the progress of the Program through periodic meetings at least every 6 months is made by BFID to ADB in accordance with the performance indicators described in the preceding paragraph.	*Loan 2952, Schedule 4, para. 13*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.

Form of Reform Policy Actions	Reference in Loan Agreement	Assessment of Progress (with Supporting Documents)
20. The Borrower and ADB shall jointly conduct periodic reviews of the macroeconomic and fiscal conditions of the Borrower's economy and assess the impact and evaluate the benefits of the Program, in accordance with the PPMS. The BDID shall prepare and submit to ADB at least every 6 months a progress report on policy and institutional reforms implementation. In addition to the periodic reviews, a Program review shall take prior to the Second Tranche Release. BFID shall submit a Program completion report to ADB not later than 3 months after Program completion that assesses compliance with, and impact of, the agreed actions under the Program on each sector and describes lessons identified during the Program implementation period.	*Loan 2952, Schedule 4, para. 14*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement.
21. (a) SEC and BB shall carry out the Program with diligence and efficiency, and in conformity with sound applicable technical, financial, business, and development practices. (b) In the carrying out of the Program and operation of the Program facilities, SEC and BB shall perform all obligations set forth in the Loan Agreements to the extent that they are applicable to SEC and BB, respectively.	*Program Agreement, Article II, Section 2.01*	**Complied with.** The Borrower fully complied with obligations in Loan Agreement
22. SEC and BB shall make available, promptly as needed, and on terms and conditions acceptable to ADB, the funds, facilities, services, and other resources as required, in addition to the proceeds of the Loan, for the carrying out of the Program.	*Program Agreement, Article II, Section 2.02*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.
23. SEC and BB shall carry out the Program in accordance with plans, specifications, schedules and methods acceptable to ADB.	*Program Agreement, Article II, Section 2.03*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.
24. (a) SEC and BB shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible items financed out of the proceeds of the Loan and to indicate the progress of the Program. (b) The Borrower shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) of this Section.	*Program Agreement, Article II, Section 2.04*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.
25. (a) ADB, SEC and BB shall cooperate fully to ensure that the purposes of the Loan will be accomplished. (b) SEC and BB shall promptly inform ADB of any condition which interferes with, or threatens to interfere with the progress of the Program, the performance of its obligations under the Program Agreement, or the accomplishment of the purposes of the Loan. (c) ADB, SEC and BB shall from time to time, at the request of either party, exchange views through their representatives with regard to any matters	*Program Agreement, Article II, Section 2.05*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.

Form of Reform Policy Actions	Reference in Loan Agreement	Assessment of Progress (with Supporting Documents)
relating to the Program, and the Loan.		
26. SEC and BB shall furnish to ADB all such reports and information as ADB shall reasonably request concerning (i) the Program; and (ii) any other matters relating to the purposes of the Loan, and shall indicate, among other things, a plan for the implementation of the Second Tranche Policy Actions, progress made and problems accounted during the period under review, steps taken or proposed to be taken to remedy these problems, and proposed Program activities and expected progress during the following period.	*Program Agreement, Article II, Section 2.06*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.
27. (a) SEC and BB shall, promptly as required, take all action within its powers to maintain their corporate existence, to carry on their operations, and to acquire, maintain and renew all rights and powers which are necessary in the carrying out of the Program or in the conduct of their operations. (b) SEC and BB shall at all times conduct their operations in accordance with sound applicable technical, financial, business, development and operational practices, and under the supervision of competent and experienced management and personnel.	*Program Agreement, Article II, Section 2.07*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.
28. SEC and BB shall promptly notify ADB of any proposal to amend, suspend or repeal any provision of their constitutional documents, which, if implemented, could adversely affect the carrying out of the Program. SEC and BB shall afford ADB an adequate opportunity to comment on such proposal prior to taking any affirmative action thereon.	*Program Agreement, Article II, Section 2.08*	**Complied with.** The Borrower fully complied with obligations in Program Agreement.

ADB = Asian Development Bank, BB = Bangladesh Bank, BFID = Bank and Financial Institutions Division, PPMS = program performance monitoring system, PSC = program steering committee, SEC = Securities and Exchange Commission.

Source: Asian Development Bank.

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: Public Management, Financial Sector and Trade Division (SAPF)

Technical Assistance No., Country, and Name TA 8228-BAN: Enhancing Efficiency of the Capital Market				Amount Approved: $750,000 Revised Amount: $750,000	
Executing Agency: Bank and Financial Institutions Division–Ministry of Finance		Source of Funding: Japan Fund for Poverty Reduction		Amount Undisbursed: $132,700.05	Amount Utilized: $617,299.95
TA Approval Date: 28 Nov 2012	TA Signing Date: 6 Mar 2013		Fielding of First Consultant: 17 Jun 2013	TA Completion Date Original: 31 Dec 2014 Account Closing Date Original: 31 Dec 2014	 Actual: 17 Jul 2015 Actual: 28 Aug 2015

Description: The technical assistance (TA) supported implementation of the Second Capital Market Development (CMDP II) program, which was approved by the Asian Development Bank (ADB) in November 2012. The TA had three components, including (i) strengthened enforcement capacity of the Bangladesh Securities and Exchange Commission (SEC); (ii) expedited adjudication of enforcement actions; and (iii) improved regulation, governance, and operation of stock exchanges. The components were aligned with the tranche policy actions, which supported the Government of Bangladesh's Sixth Five-Year Plan, 2011–2015 objectives to expand the capital market, as well as the more immediate need to restore confidence by improving governance following the 2010 stock market crash. The TA met the SEC's capacity building needs to help SEC discharge its capital market oversight functions more effectively and the government's efforts to make changes in the ownership and governance structure of the Dhaka Stock Exchange (DSE) and Chittagong Sock Exchange (CSE) to enhance their governance and management.

The TA focused on developing an effective and efficient structure for detecting possible violations of securities laws, investigating irregularities, and prosecuting cases. In addition, the TA assisted in developing and promoting mechanisms to ensure disposition of capital market enforcement actions in an effective manner. Finally, the TA supported the demutualization of the Dhaka and Chittagong stock exchanges by introducing best practices in their governance structures.

Expected Impact, Outcome, and Outputs: The TA impact was a better-regulated capital market to help accelerate Bangladesh's economic growth and poverty reduction. The outcome was enhanced effectiveness of the supervisory and regulatory authority for capital markets. The outputs were technical reports, training seminars, and policy guidance provided by the consultants, which led to enhanced effectiveness of the supervisory and regulatory authority for capital markets and market expansion.

Delivery of Inputs and Conduct of Activities: The TA provided for firm recruitment with 17 person-months of international and 12 person-months of national consulting services. The firm, Int. Securities Consultancy Ltd (The), was recruited using quality- and cost-based selection method. The contract was from 25 June 2013 to 24 June 2015. Consultant recruitment was done based on ADB's guidelines. The consultants' reports were satisfactory and contributed to the success of the eventual outcome of the program loans. The TA terms of reference were based on earlier assessment done under the project preparatory TA that provided CMDP II's overall framework and policy focus.[1] The consultants provided reports as per the agreed timelines and closely matched the timing of tranche release. TA activities provided the executing and implementing agencies with the necessary support to achieve tranche release actions. The TA consultants provided support as required to institutionalize capacity within key nodal agencies, such as SEC, to ensure long-term sustainability of reform efforts. As part of TA activities, the consultants developed supported documentation and structures to help in ground-level operationalization to improve SEC effectiveness and demutualization. Procurement of UPS, laptops, printers, photocopier and desktop computer was done following ADB Procurement Guidelines (2010, as amended from time to time) and were turned over to SEC upon TA completion.

The expected completion date of the TA was extended at the time of contract negotiation to accommodate all consultants' inputs.

Evaluation of Outputs and Achievement of Outcome: CMDP II is rated successful based on the program achievement as reflected in meeting most outcome indicators agreed upon at the time of design. A key success factor was to promote ownership in the products within the executing and implementing agency by way of training,

[1] ADB. 2011. *Technical Assistance to the People's Republic of Bangladesh for Preparing the Capital Market Development Program II.* Manila (TA7811-BAN, $600,000, approved on 23 May 2011).

outreach, seminars and working together, and knowledge sharing of international best practices. The consultants engaged with stakeholders in ensuring participation and developing a constituency for reforms. It should be mentioned that a key program gap with regard to expanding the corporate debt market did not benefit from TA support.

The TA assisted BSEC in conducting audit and inspection of the stock exchanges and member brokers of the stock exchanges and in providing on-the-job training to SEC officials in the conduct of audit and inspection of the operations of stock exchange members and other market participants. The TA also helped in developing an effective structure for the BSEC's enforcement activities (including organizing a sustainable program to follow up on customer complaints and termination for cause of members of the stock exchanges), and developing internal guidelines and procedures for investigation and enforcement. This included establishing a "for cause" investigation program and training SEC officials in performing this function. Further, a BSEC training workshop on risk based supervision "Inspection process for Intermediaries and the exchanges/Depository" was held on 19 June 2014

Overall Assessment and Rating: The TA is rated successful. SEC capacity development was integral to the consultancy, and knowledge sharing was provided through on-the-job training in audits and inspections of the exchanges and developing internal guidelines and procedures for investigation and enforcement. The consultants also provided perspective on experiences in other markets for surveillance and monitoring. For adjudication, the consultants helped train judges to handle security-related cases and assisted in enacting legislation and issuing regulations that lead to operationalizing the special tribunal. For demutualization, the consultants undertook a review of supporting regulations for demutualization, including for administration, investor protection, settlements, trading, and listing. In addition, the consultants worked with the demutualization committee to review a draft Memorandum and Articles of Associations of the exchange companies and ensured these conformed to the demutualization scheme.

Major Lessons: A key lesson is linked to the weakness in implementation in the absence of expanding corporate debt instruments. As mentioned earlier, the TA did not support policy actions in this respect, and additional covenants that could have been inserted to promote the debt market were absent. Thus, TA support may be used to provide a more comprehensive support as part of a holistic package.

Recommendations and Follow-Up Actions: The follow-up actions reflect the need to ensure program achievements are taken forward. The program provides a platform from which to further develop the market to channel financing to the real sector. The follow-up actions should ensure initiatives involving support pension funds, price discovery in government and corporate securities, passage of the Financial Reporting Act, derivatives market development including a currency swap market, and financial repression reduction. These policy actions are required to take the market to the next level.

Prepared by: <u>Vivek Rao</u> Designation and Division: <u>Principal Financial Sector Specialist, SAPF</u>

OVERVIEW OF IMMEDIATE AND LONG-TERM FACTORS RESPONSIBLE FOR THE STOCK MARKET CRISIS

1. Policy actions under Second Capital Market Development Program focused on the immediate and structural factors behind the December 2010 stock market crisis. The key factors that may be described as the proximate causes for the crisis are described below, and these were also the focus of the policy actions.

2. **Beneficiary owner accounts.** Beneficiary owner accounts were characterized by (i) multiple accounts by accountholders, (ii) inaccurate account information, and (iii) misreporting of transaction income earned. This implied weaknesses in registration and opening of accounts and in scrutiny and sharing of information.[1] Beneficiary owner accounts on 20 December 2010 totaled 3.21 million, representing a 150% increase during 2010.[2]

3. **Bull cartels.** Lack of proper monitoring of the various market-related activities, such as trading operation at Chittagong Stock Exchange (CSE) and Dhaka Stock Exchange (DSE) and activities of merchant banks and brokerage houses, as well as weak capacity in regulatory bodies, made the market by and large unprotected from possible market manipulators.[3]

4. **Book building.** Introduction of book building in 2010 became a tool for manipulation. Instead of ensuring competition via price discovery, the system was abused through share placement at artificially high prices, which was maintained for the 15-day lock-in period, allowing investors to sell shares at the artificially high price.

5. **Placement shares.** Rules on placement shares distribution issued by the Securities and Exchange Commission (SEC) on 31 May 2010 were ineffective because unauthorized beneficiary owner accounts allowed distribution beyond permitted levels and prevented the rules from having the desired effect.

6. **Serial and insider trading.** Given the unauthorized beneficiary owner accounts, ample opportunity existed for serial trading. With weak monitoring, it was easy to manipulate the market using several accounts to artificially create demand for certain shares and raise prices, and then sell those shares to less-informed small investors. Weak monitoring and enforcement, and an absence of insider trading rules restricted rule-based trading.

7. **Bank operations.** Merchant banks disbursed margin loans over the SEC limit. Commercial banks also failed to invest within the exposure limit (below 10% of total liabilities), and to maintain single party exposure limits (below 75% of total bank advances). Banks also did not monitor end use of funds.

8. **Retail behavior of institutional investors.** A few institutional investors did not comply with secondary market regulations. Wide variations existed among banks in capital gains from trading. This was potentially due to certain financial institutions with a withdrawal-deposit ratio

[1] A beneficiary owner account serves as an account for holding shares and is opened with Central Depository Bangladesh Limited through a depository participant. An investor needs to open a beneficiary owner account with a broker to transact shares.

[2] A number of factors encouraged the influx of investors, such as the opening of brokerage houses at the district level (590 branch offices of 238 brokerage houses of Dhaka Stock Exchange (DSE) operated in 32 districts in 2011). *Share Melas (fairs)* in districts, internet trading, and market information access through the media also contributed.

[3] The number of bull cartels operating in the stock market was believed to be more than 10. Such bull cartels were operational in 1996 as well, and played a major role in instigating the market crash at that time.

over 1 indicating they were likely acting as retail traders. Such trading allowed institutions to enjoy high capital gains, incentivizing them to bend best practices, enabled by weak oversight.

9. **Oversight.** There was an inadequate needs assessment of establishing merchant banks as commercial bank subsidiaries. There was also an inadequate legal framework to supervise subsidiaries' operations and enforce market discipline when the situation deteriorated.

10. To facilitate market development, the program addressed the following factors:

11. **Faulty audit reports.** Audit reports often did not reflect the true picture of company financials and were used to manipulate the market (e.g., issuance of right shares by companies in 2010 through revaluation of assets allowed them to mop up significant amounts of cash).[4] The lack of accredited institutions to monitor reporting of audited firms, SEC capacity, and rules to monitor audits allowed for misuse.[5]

12. **Weak coordination.** The relationship between Bangladesh Bank and SEC was not clearly defined and did not facilitate efficient regulation. For example, while possible diversion of industrial credit to the capital market was anticipated by Bangladesh Bank in its Monetary Policy Statement for July–December 2010, necessary surveillance came only at a much later stage.

13. **Faulty operations at Chittagong and Dhaka stock exchanges.** In listing initial public offerings (IPOs), the Chittagong Stock Exchange (CSE) and Dhaka Stock Exchange (DSE) had direct influence in raising the initial price of certain shares. There was a conflict of interest in DSE and CSE's involvement both as a price fixer and in enlistment of the same companies, as well as in the management board of DSE and CSE and brokerage houses, with directors of brokerages also present in the DSE and CSE boards. SEC also engaged investigators from the alleged companies themselves.

14. **Regulatory weakness.** Frequent changes in margin requirements created unnecessary volatility.[6] Insider trading could not be monitored effectively as SEC used DSE and CSE software in the absence of its own. Application of lock-in period in case of placement shares' sale was not properly monitored, and there was inadequate due diligence on the real reasons behind the offering of right shares.[7] The IPO process was unreliable with discrepancies involving (i) conflict of interest with issue managers who also owned the issues, (ii) submission of bids with a view to drive up prices and re-sell shares within 15 days in the secondary market, (iii) manipulation of asset value and earnings, and (iv) collusion between stakeholders to fix low offer prices for insiders to buy the issues.

15. Policy actions to address the crash also facilitated market expansion. The 1996 and 2010 crashes eroded market trust, resulting in most IPOs taking place in private markets. Since the exchanges' deficiencies were structural, new organizational structures were needed to

[4] Only 19% of listed companies were audited by firms that had official affiliations with international audit firms. About 60% of listed companies were audited by firms that were enlisted with the NGO Affairs Bureau or Bangladesh Bank. More than 20% of listed companies were audited by firms that had no affiliation other than with the Institute of Chartered Accountants of Bangladesh.

[5] SEC operated without qualified legal and accounting staff and could monitor only two brokerage houses a month.

[6] In 2010, SEC issued 81 notifications, circulars, and directives; 32 were related to the changing of margin loan ratio.

[7] One reason for floating right shares by some companies was to comply with the BASEL II requirements of minimum paid-up capital and the Insurance Act 2013. A total of Tk20.16 billion was raised by 16 companies through announcing right shares between July 2010 and the second week of December 2010.

ensure sustainability. Consequently, demutualization was supported to help exchanges serve a broader set of stakeholders and adhere to higher standards of governance.

16. In addition, the corporate bond market was weak with only 3–4 privately placed issues and only 14 bonds and debentures listed. The lack of sovereign yield curve and secondary market to price bonds contributed to the lack of supply, as did the high transaction cost of offerings. The approvals for corporate issues could take more than 6 months with no separate regime for bonds and equity, and issues requiring a full prospectus whether via private or public offering.

17. The insurance industry had market penetration of only 1%–2% even though private insurers were allowed from 1984 and the market had 44 general and 18 life companies. Despite private insurers, state-owned companies had a monopoly. High concentration (top five life insurance companies controlled nearly 70% of assets) and a weak legal framework led to defaults in claims and predatory practices. The regulator, Insurance Development and Regulatory Authority, was underfunded, understaffed, and unable to promote the sector.