



## Conference on Global Banking: Paradigm Shift

Hotel Grand Hyatt, Mumbai, India  
08 September, 2009

Keynote address by **Dr. Atiur Rahman**, Governor, Bangladesh Bank  
Email: governor@bangla.net

### **Safeguarding Financial Stability: shoring up regulation and supervision, fostering altruism-driven self discipline**

1.1 Background: Shortcomings in financial system regulation and supervision regimes are now under intense scrutiny everywhere, following the global financial turmoil that exacted heavy tolls in wealth destruction and recession, with particular severity in the mature advanced economies. Ironically, it was the placid stability of the preceding several years that lulled institutions, markets and regulators into complacency and inaction about the mounting global imbalances and the inordinate risk build-ups in the financial system eventually precipitating institutional failures, market freeze-ups and severe credit crunch. The gross disregard of basic cautions in risk-taking in large globally active financial institutions was prompted by quest of quick private gains for small inner circles in top managements and boards, imperiling longer term viability of the institutions and hurting interests of general shareholders and of broader citizenry as stakeholders in the financial system.

1.2 Revised regulatory and supervisory regimes are now being crafted for the financial systems bailed out with massive fiscal and monetary interventions, and we may expect the global economy to be back on path of sustained stable growth over the near term. Memories of crisis are quickly forgotten in better times, when words of caution and prudence tend to be taken lightly. Unless the motivations driving the top managements and boards of financial institutions are realigned appropriately towards longer term collective gains for shareholders and for communities they work in, it will be unsurprising to see another global crisis emerging after a spell of years in sustained stable growth. We shall be well advised to bear this in mind while refashioning the financial sector regulatory and supervisory regimes in our part of the world.

1.3 Because of the limited regulated external openness of the economy, the financial sector in Bangladesh suffered no contagion from the global financial turmoil. Rather than being afflicted by credit crunch, domestic markets remain awash with liquidity from bop current account surpluses, FY 09 growth in inflows of workers' remittances (22.4 percent) and export receipts (10.1 percent) were well in excess of the tepid 4.6 percent growth in import payments. Apart from a net FDI outflow of USD 159 million in FY 09 there has been no additional outflow pressure attributable to the global crisis, as resident corporate have no short term external borrowing exposure other than normal trade credit.

2.1 Regulatory/supervisory reforms in Bangladesh - brief recap: Ongoing reforms in financial sector regulation and supervision in Bangladesh, proceeding along the pre- global crisis sequence, aim at eventual full convergence with global best practice standards set by the Basel Committee for effective

Bank Supervision (BCBS). Post-crisis modifications in BCBS standards will be considered for adoption in Bangladesh after these are firmed up.

2.2 The post-liberation wholly nationalized financial sector in Bangladesh, beginning with directed lending at administratively prescribed interest rates, underwent the following sequence of basic changes in policy regime:

- a) Licensing of private sector banks, introduction of asset classification and provisioning requirements, in the nineteen eighties;
- b) Discontinuance of directed lending, freeing up of interest rates, introduction of (Basel-I) capital adequacy regime based on risk weighted assets; in the nineteen nineties, and
- c) Introduction of market based exchange rate regime for Taka, the domestic currency, from May 2003.

These transition steps to a market-based financial sector were accompanied by roll out of prudential supervisory regulations along lines of BCBS standards, covering inter alia the following:

- i) Financial statements and disclosures in conformity with internationally accepted accounting standards;
- ii) Good corporate governance; with fit and proper tests for directors and chief executives, clear delineation of roles, responsibilities and accountabilities for directors and chief executives, prior central bank clearance for appointments, removals and compensation structures for chief executives. In the recent past, the large four state owned commercial banks have been converted into public limited companies ('corporatized'), putting them in readiness for eventual partial or total privatization.
- iii) Sound risk management practices meeting the minimum standards set in guidelines for management of core risks issued by BB, now in the process of further revision.
- iv) Limits on large exposures to single borrowers, limits and disclosure requirements on loans and other facilities to directors, members of senior management and their connected interests.
- v) Internal control and compliance units reporting to Audit Committees of boards, annual external audits besides continuous on- and off-site BB supervision.
- vi) From 2009 onwards banks are to work out their capital requirements according to Basel II capital regime, alongside continuing compliance with the current 'Basel-I minimum plus two percent' capital requirement on risk weighted assets.

2.3 Regulatory and supervisory capacities in BB are being continually upgraded. Current supervision routines include supervisory CAMELS ratings of banks based on a set of performance indicators, early warning to banks with deteriorating trends in performance indicators, intensive oversight on problem banks with CAMELS rating below a specified minimum. Recently, steps have been initiated to build up an adequate pool of stress testing capabilities, towards introduction of stress testing routines for identifying institutional and systemic vulnerabilities in probable stress events. In view of recent trend of increasing engagement of commercial banks in capital market activities, oversight on their regulatory compliance this area has been intensified.

BB has engaged banks in major programs of upgrading their IT platforms with ample processing powers and online connectivity; to enable efficient data management, processing and analysis in banks for own risk management purposes and for reporting to BB. The IT platform in BB is

also undergoing similar up gradation, to enable timely and adequate supervisory analyses of various data received from banks.

3.1 Fostering engagement of the financial sector in the under-served priority areas, towards broader socioeconomic benefits: Besides regulation and supervision with usual focus on financial outcomes, Bangladesh Bank (BB) remains active in promoting and supporting deeper engagement of the financial sector in the under-served priority areas like agriculture, SMEs, low cost housing, renewable energy and environmental sustainability (solar/ biogas/ effluent treatment plants); in comprehensive programs with access to refinance support in case of need. Financial returns for the lenders in these engagements may often be below par (outright losses should be unlikely, given availability of reasonably priced refinance), but the below par returns will be defensible on grounds of broader socioeconomic benefits (by way of increase in employment, output and income for those involved in the activities financed). Well supervised healthy financial sectors using part of their resources in investments fetching below par financial returns but generating broader socioeconomic benefits will be more focused on longer term viability and growth, better protecting stability than financial institutions obsessed with maximizing quick short term gains from risky speculative investments.

4.1 Addressing issues in financial sector regulatory/supervisory regimes and in global financial architecture brought to surface by the global financial turmoil: The difficulties with and inadequacies of the current financial sector regulation and supervision regimes highlighted in market freeze-ups during the global crisis (like the procyclicality of capital and provisioning requirements, unworkability of marking to market valuation of trading book assets in situations of market collapse/ extreme market stress, institution specific rather than system-wide focus of supervision, permissiveness of inordinate buildup of risks and leveraging) are now under active remedial consultations in global expert forums. Smaller developing economies should have opportunity for representation in these global consultations to voice their needs and concerns.

Global dialogues for a new global financial architecture need also to start in right earnest; with coordinated voice of smaller economies for safeguards against buildup of global imbalances from negative spillovers of lax unbalanced policies of dominant economies. The new arrangements will also need some mechanism tethering global liquidity growth to the actual or potential rate of global growth in real sector output; to avoid overblown global liquidity fuelling speculation and asset price bubbles leading to a possible rerun of the crisis that the world is still busy coming to grips with.