Removal of Debt Securities from Capital Market Exposure Limit of Banks, Possibility for Increased Investment by Banks?

Capital market exposure limit of banks in Bangladesh has been a buzzword in the market for many years. Many had proposed to remove investment in bonds from the exposure limit before, but finally it has become a reality. Recently, the Bank Company Act 1991 was amended and the new amendment states that the investment in bonds, debentures and Islami Shariah based securities such as sukuks will be excluded from the calculation of the capital market exposure limit of banks.

What Constitutes of the Exposure Limit?

According to the Bank Company Act 1991, a bank can invest a maximum of 25% of its paid-up capital, share premium, statutory reserves and retained earnings in to capital market. The investment arenas will consist of (A) investments in shares and mutual funds valued at cost price, (B) investments in subsidiary company(s) operating in the capital market, (C) providing loans to company(s) operating in the capital market and (D) any fund created for investment in the capital market. The 25% limit will be calculated based on all such factors.

Will any Positives Come out due to such Removal?

The burning question now is, will the market experience any positives from the exclusion of bonds, debentures and Islami Shariah based securities from the exposure limit? The answer is both Yes and No.

A. Positives for the market

1. The investment capability of the banks will increase, as the usage amount of the exposure limit of the banks will be reduced. For example, suppose a bank has investment of 24% of its paid-up capital, share premium, statutory reserves and retained earnings into the capital market. Removing of bonds, debentures and Islami Shariah based securities from the exposure limit will help to reduce the usage amount and as a result, the bank will be able to invest more into the capital market. The probability of this scenario is high considering the high investment in debt securities by banks.

2. The bond market will become more vibrant as banks will be able to invest in debt securities without worrying about the exposure limit. Although, the recently amended Bank Company Act 1991 states that Bangladesh Bank will give directives regarding the investment limit in bonds, debentures and Islami Shariah based securities from time to time, it may be assumed that the trading of bonds in the bond market will be more vivid than before.

B. Negatives for the market

1. As seen in several news reports, published a year before, many banks have yet to fully utilize the investment limit in the capital market even with the calculation of debt securities involved. Such news reports suggested that many banks have exposure limit below 15%. The bankers also commented that banks were reluctant to invest due to the high risk and instability of the market. From the news reports published a year ago to the date of publishing of this document, the market has fallen by 6.4%. Therefore, it is highly unlikely that banks will increase their investments into the capital market despite the removal of debt securities from the exposure limit, considering the unstable market.

2. The recent monetary policy of July-Dec 2023 removed the lending rate cap for the banks and replaced it with a market driven reference rate + a margin. Banks are now focusing on rebalancing their loan portfolios. As a result, banks are increasing deposit rates to attract depositors, countering high inflation and the ongoing liquidity crunch. They are also increasing lending rates for the high risky borrowers. Therefore, it may be assumed that banks will concentrate more on their core functions rather than increase investments in the capital market.

Only time will tell whether such policy will be fruitful for the market.

Disclaimer

Data Sources

Bangladesh Bank. (https://www.bb.org.bd/en/)

Article Available at

Bangladesh Merchant Bankers Association (Research Tab) (http://www.bmba.com.bd/research/)

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