

FINANCIAL ANALYSIS

1. The estimated cost of implementing the reforms under the Third Capital Market Development Program (CMDP 3) over the program period from January 2015 to December 2017 is \$285 million. The estimated cost of adjustment across program outputs is summarized in Table 1 below.

Table 1: Summary of Justification of Policy-Based Lending Amount

	FY2015 (Jan-Jun)	FY2016 (Jul-Jun)	FY2017 (Jul-Jun)	FY2018 (Jul-Dec)	Total	
						US\$ million
A. Market Stability						
1. BSEC capacity enhancement (staff, office, etc.)	0	40	35	2	77	110
2. Installation & operation cost of BSEC ICT system	0	2	3	1	6	
3. Establishment of a clearing and settlement company	0	6	6	1	13	
4. Intermediaries' recapitalization costs	0	0	9	5	14	
B. Market Facilitation						
1. Cost of demutualization	2	1	0	0	3	20
2. Operationalization of capital market tribunal	3	2	0	0	5	
3. Establishment and operationalization of FRC	0	6	6	0	12	
C. Supply Measures						
1. Foregone revenue on fixed income mutual fund tax	0	0	0	0	0	
D. Demand Measures						
1. Cost of raising interest rate for government securities	14	31	34	19	98	155
2. IDRA capacity enhancement	0	21	21	1	43	
3. Insurance companies' recapitalization costs	0	0	9	5	14	
Total	19	109	123	34	285	

BSEC = Bangladesh Securities and Exchange Commission, FRC = financial reporting council, ICT = information and communication technology, IDRA = Insurance Development and Regulatory Authority.
Source: Asian Development Bank estimates.

2. Methodologies for estimation of adjustment cost for each key item are summarized as follows:

a. **Cost of raising interest rate for government securities (\$98 million).** Policy measures to reduce devolvement will entail a rise in the interest rates at which government securities are issued. The incremental interest rate cost to the government is estimated at \$98 million assuming an interest rate increase of 0.70% and based on the government debt management plan in its annual budget for FY2015, the medium-term budgetary framework for FY2016-2017 and its progression for FY2018.

Table 2: Estimated Incremental Interest Rate Cost (FY2015-FY2018)

	FY2015 (Jan-Jun)	FY2016 (Jul-Jun)	FY2017 (Jul-Jun)	FY2018 (Jul-Dec)
	US\$ million			
Government securities issuance, net	1,950	4,419	4,846	2,701
Cost of raising interest rate for government securities	14	31	34	19

Source: Ministry of Finance, Government of Bangladesh. 2014. *Medium-Term Macroeconomic Policy Statement FY2015-2017*. Dhaka.

b. **BSEC capacity enhancement (\$77 million).** After government approval of the new BSEC organogram, the regulator will start hiring new staff in a phased approach during FY2016. Recruitment of an extra 465 full-time staff under the new BSEC organogram will entail staffing costs (training, new equipment, benefits, travel expenses, etc.) and the cost of new office space. Based on market prices for land and construction, the estimated cost for new office space is \$70 million while the mobilization cost for the 465 new recruits is estimated at \$7 million.

c. **Establishment and operationalization of FRC (\$12 million).** The FRC is organized into four divisions¹ whose mutually supportive duties are set forth in Sections 23-26 of the pending Financial Reporting Act. In addition, the FRA envisions an FRC under an 11 member Council. After adoption of the FRA, the government will start hiring new staff in a phased approach from FY2016. Recruitment of an estimated 100 full-time staff will entail staff costs (training, new equipment, benefits, travel expenses, etc.) and the cost of new office space. Based on market prices for land and construction, the cost for new office space is estimated at \$20 million and the cost for 100 new staff is estimated at \$2 million. The total estimated cost is \$22 million during the program period. The net cost of adjustment under CMDP 3 is \$12 million after deducting the earmarked portion of \$10 million for the same purpose under CMDP 2.

d. **IDRA capacity enhancement (\$43 million).** After government approval of the new IDRA organogram, the regulator will commence start of new staff in a phased approach during FY2016. Recruitment of additional 195 full-time staff will entail staffing costs (training, new equipment, benefits, travel expenses, etc.) and the cost of new office space. Based on market prices for land and construction, the cost for new office space is estimated at \$40 million and the staff cost for 195 new recruits is estimated at \$3 million.

¹ The four divisions are Standard Setting Division, Financial Reporting Monitoring Division, Audit Practice Review Division and Enforcement Division.

Table 3: Estimated Cost for BSEC, IDRA capacity enhancements and establishment and operationalization of FRC (FY2015-FY2018)

	FY2015 (Jan-Jun)	FY2016 (Jul-Jun)	FY2017 (Jul-Jun)	FY2018 (Jul-Dec)
	US\$ million			
BSEC capacity enhancement, total (\$million)	0	40	35	2
(i) Land, Building and Construction, etc.	0	37	33	0
(ii) Staff Mobilization Cost	0	3	2	2
Establishment of FRC, total (\$million)	0	11	11	0
(i) Land, Building and Construction, etc.	0	10	10	0
(ii) Staff Mobilization Cost	0	1	1	0
IDRA capacity enhancement, total (\$million)	0	21	21	1
(i) Land, Building and Construction, etc.	0	20	20	0
(ii) Staff Mobilization Cost	0	1	1	1

Note: Estimated staffing costs are based on cost data in Bangladesh Bank. Land, building and construction costs are estimated based on informed market prices. Source: Bangladesh Bank. 2014. *Annual Report 2013-2014*. Dhaka.

e. **Intermediaries' recapitalization costs (\$14 million).** For adoption of the recapitalization plan, the minimum capital base for each broker/dealer (230 total) will be raised from Tk2.5 million (\$0.03 million) to Tk50 million (\$0.6 million). Total capital deficit of the 230 broker/dealers resulting from the proposed capital rule is estimated at \$131 million, and government support for a portion of the total capital deficit will facilitate recapitalization either through new equity issuance or promoting consolidation in the intermediaries industry.

f. **Insurance companies' recapitalization costs (\$14 million).** For adoption of the recapitalization plan, the minimum capital of non-life insurance companies (46 total) will be raised from Tk150 million (US\$1.8 million) to Tk400 million (US\$5.0 million) and that of life insurance companies (31 total) will be raised from Tk10 million (\$0.1 million) to Tk300 million (\$3.8 million). Government support for a portion of the total capital deficit will facilitate recapitalization either through new equity issuance or promoting consolidation in the insurance industry. Total capital deficit is estimated at \$68 million for non-life insurance companies and \$68 million for life insurance companies.

Table 4: Estimated Cost for recapitalization cost of Insurance companies and Intermediaries (FY2017-FY2018)

	Minimum Capital base (\$ million)	Number of companies	Estimated Capital Deficit (\$ million)	% of ADB assistance	Estimated Cost (\$million)
Brokers and Dealers	0.03 => 0.6	230	131	11%	14
Insurance Companies					14
(i) Non-life Insurance	1.8 => 5.0	46	147	5%	7
(ii) Life Insurance	0.1 => 3.8	31	115	6%	7

Source: Bangladesh Securities and Exchange Commission. 2013. *A Review Report of the Capital Requirements for Capital Market Intermediaries through a Risk Based Supervision Approach: Bangladesh Context*. Dhaka; Bangladesh Insurance Association. 2013. *Annual Report 2012*.

g. **Establishment of a clearing and settlement company (\$13 million).** \$3 million is earmarked to establish and operationalize a clearing and settlement company that includes staffing costs (training, new equipment, benefits, travel expenses, etc.) and the cost of new office space. The government also envisions supporting the creation of a securities guarantee

fund (SGF) at the clearing and settlement company to mitigate settlement risk. The two exchanges have agreed to contribute Tk1,500 million (US\$18.8 million) to the guarantee fund under the SGF regulations published by Dhaka Stock Exchange and Chittagong Stock Exchange. Government support for a portion of the SGF will facilitate establishment of an effective and sustainable clearing and settlement company.