

## PROJECT PREPARATORY TECHNICAL ASSISTANCE

### A. Justification

1. The PPTA is necessary to effectively formulate the CMDP III which will support the Government's commitment to meaningful capital market reform.

### B. Objective

2. The objective of the PPTA is to identify policy measures to support the development of a robust financial markets system in Bangladesh that is well balanced, sustainable and resilient and that is able to effectively intermediate savings to finance investment.

### C. Major Outputs and Activities

3. The PPTA will build upon the reforms being undertaken in the ongoing CMDP II. For developing the bond markets, the PPTA experts will also draw upon the results of the work currently being undertaken to assess Bangladesh's primary dealer system by experts engaged under ADB's ongoing Bangladesh Bank capacity development TA. The implications of shadow banking on Bangladesh's capital markets will also be examined. The PPTA will engage international and domestic consultants who will work closely with the Government, market participants, and ADB in the five areas below.

- (i) **Improved legal and regulatory structure.** Building upon reforms undertaken in CMDP II, the first output will assist the Government in further developing the legal and financial supervisory policy structure that strikes the right balance in financial regulation and enhances the stability of the Bangladesh financial system. The PPTA will assist in developing measures to remove inherent conflicts of interest, eliminate opportunities for arbitrage between the stock exchanges, and enhance liquidity and public trust. The PPTA will focus on options for legal and regulatory reforms as well as benchmarking regulatory efforts against international standards. Structural and institutional issues such as limited IDRA autonomy will be analyzed and measures will be recommended to alleviate such issues. The promotion and participation of private equity finance and Islamic finance (such as sukuks) in capital markets through legal and regulatory reforms will also be considered.
- (ii) **Bond market development and deepening the scope of securitization.** Building upon the fundamentals of bond market development in CMDP II, the second output will focus on measures that will lead to the extension of the government yield curve and therefore further corporate bond market development. The PPTA will analyze impediments to the development of a liquid debt market and recommend a debt market strategy that will foster a deep, liquid, and transparent debt market offering a wide range of products. On the supply side, emphasis will be placed on increasing the supply of high-quality corporate paper building on the benchmark yield curve of Government of Bangladesh tradable securities and thereby improving the functioning and efficiency of the fixed-income market. This output will also focus on developing competitive pricing of primary issuances including promoting the role of credit rating agencies and the use of credit enhancement products or risk mitigation instruments. On the demand side, initiatives to increase the demand for corporate securities will

be assessed including through contractual savings institutions (such as promoting the establishment of pension and provident fund management companies and enhancing their participation in capital markets). Regional experiences in developing resilient, liquid bond markets will be considered while formulating the strategy. The role of mutual funds in promoting capital market development and bond market development will also be further explored. As a logical sequence of this output, efforts will also focus on developing the securitization market.

- (iii) **Development of successful financial-instrument tax policies.** The third output will involve a systematic analysis of the tax structure of financial instruments based on amendments to the tax ordinance under CMDP II. It will recommend measures that are compatible with financial market development—and that also do not violate tax principles—to remove distortions between different types of financial assets. The potential impacts of a tax-neutral structure will be assessed and the likely benefits of such a structure will be weighed against the likely costs. This will be substantiated by an analysis of successful financial-instrument tax policies elsewhere in the region. A sequenced action plan will be developed that is compatible with financial market development.
- (iv) **Development of derivatives.** This output will focus on establishing a commodities exchange (including its regulatory framework) and developing key fundamentals of the derivative industry—particularly interest rate derivatives and exchange rate derivatives. The fourth output will help determine the capital adequacy, position limits, margin requirements, and sales practices to be adopted by dealers for derivatives. This output will also ensure that the structure of regulation and risk management in the derivatives market meets the market requirement.
- (v) **Development of insurance sector.** Building upon the insurance white paper roadmap developed under CMDP II and insurance regulations issued under CMDP II, the fifth output will focus on measures to strengthen the insurance sector such as recapitalization of the insurance companies which will be sequenced with actions to ensure active investment and participation of the insurance sector in the capital markets. The output will also consider steps on how to strengthen the qualifications of insurance professionals such as through establishing a Charter Insurance Institute.

4. The major outputs and activities are summarized in Table 1.

**Table 1: Summary of Major Outputs and Activities**

<b>Major Activities</b>	<b>Expected Completion Date</b>	<b>Major Outputs</b>	<b>Expected Completion Date</b>
Situational assessment and comprehensive analysis to address the prevailing weaknesses	January 2014	Legal and Regulatory structure	July 2014
Mapping of activities related to specific PPTA outputs	January 2014	Bond market and securitization	July 2014
Develop and agree on a sequenced action plan	July 2014	Taxation	July 2014
		Derivatives	July 2014
		Insurance	July 2014

Source: Asian Development Bank estimates.

#### D. Cost Estimate and Proposed Financing Arrangement

5. The PPTA is estimated to cost \$550,000 equivalent, of which \$500,000 equivalent will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-V). The government will provide counterpart support in the form of office accommodation and transport, remuneration and per diem of counterpart staff, and other administrative in-kind contribution. The detailed cost estimate is presented in Table 2. The Government has been informed that approval of the TA does not commit ADB to finance any ensuing project.

**Table 2: Cost Estimates and Financing Plan**

Item	Total Cost
<b>A. Asian Development Bank Financing<sup>a</sup></b>	
1. Consultants	
a. Remuneration and Per Diem	
i. International Consultants (15 person-months)	345,000.00
ii. National Consultants (8 person-months)	32,000.00
b. International and Local Travel	36,000.00
c. Reports and Communications	2,000.00
2. Seminars, and Conferences	30,000.00
3. Miscellaneous Administration and Support Costs	5,000.00
4. Contingencies	50,000.00
<b>Total</b>	<b>500,000.00</b>

Note: The technical assistance (TA) is estimated to cost \$550,000, of which contributions from the Asian Development Bank (ADB) are presented in the table above. The Government of Bangladesh will provide counterpart support in the form of office accommodation and transport, remuneration and per diem of counterpart staff, and other administrative in-kind contribution. The value of government contribution is estimated to account for 9% of the total TA cost.

<sup>a</sup> Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF-V).

Source: Asian Development Bank estimates.

#### E. Consulting Services

6. The PPTA will be implemented over 8 months, from November 2013 to July 2014. A team of 7 international consultants and 6 domestic consultants will provide a total of 23 person-months of consulting services. ADB will engage a consulting firm in accordance with the *Guidelines on the Use of Consultants* (2010, as amended from time to time). The Aries Group, Limited will be engaged through single-source selection to ensure continuity of services and prompt provision of consultancy services that will safeguard uninterrupted flow of the critical capital market reform process. Single source selection is appropriate in this case because the requirements of the proposed TA (i.e. formulating the CMDP III) represents a natural continuation of previous work carried out by the consulting firm (i.e. formulating the CMDP II). Continuity in the technical approach and experience acquired in the process is imperative to foster strong linkage and smooth transition in the development of the sequence-oriented capital market reform process. The firm has built strong relationships with all the key stakeholders and market participants. The confidence placed by all the stakeholders in the firm builds a strong platform to catalyze and accelerate the further structuring of the capital market development agenda. The proposed TA builds upon stabilization measures introduced by the CMDP II and implements the roadmap in the long-term national capital market master plan that was formulated as a first tranche CMDP II policy action. The government and ADB were also very

satisfied with the firm performance under the previous TA. The quality and technical depth of the reports were very good. All reports were submitted on time as per the original schedule. The firm also exhibited strong organization skills by formulating and conducting very effective stakeholder and dissemination workshops. The initial assignment was awarded on a competitive basis using ADB's quality- and cost-based selection process.

**Table 3: Summary of Consulting Services Requirement**

International		National	
Name of Positions	Person-months	Name of Positions	Person-months
Capital Market Development Expert/Team Leader	4.0	Capital Market Legal and Regulatory Expert	1.0
Capital Market Legal and Regulatory Expert	2.0	Capital Markets Products Risk Management Expert	1.0
Capital Markets Products Risk Management Expert	2.0	Taxation Expert	1.5
Taxation Expert	1.5	Capital Market Institutional Expert	1.0
Capital Market Institutional Expert	2.0	Auditing Expert	1.5
Auditing Expert	1.5	Insurance Expert	2.0
Insurance Expert	2.0		

Source: Asian Development Bank estimates.

7. The outline terms of references for the PPTA consultants are described in paras. 8 to 14.
8. **Capital Market Development Expert and Team Leader** (international, 4 person-months). The team leader is expected to have significant recent expertise (a minimum of 15 years) in capital market development. Experience in the Asia and Pacific region is preferable. The team leader will be responsible for implementing the master plan for the Bangladesh capital markets (developed under CMDP II) in coordination with SEC which embraces all relevant dimensions (including the equity market, bond market, derivative market [including commodity], and money market) and facilitate agreement on new initiatives to address policy, legal, regulatory, supervisory, institutional, and capacity constraints. In coordination with the legal and regulatory experts, risk management experts, taxation experts, institutional experts, insurance experts, and auditing expert, the team leader will (i) identify remaining impediments to development of the Bangladesh capital market based on impact assessment of CMDP II reforms, and (ii) draft a sequenced implementation plan over the next 10 years with performance Indicators for each measure.
9. **Capital Market Legal and Regulatory Experts** (one international, 2 person-months; one national, 1 person-month). These experts should have significant experience (a minimum of 10 years) in capital market regulation in developed and developing markets, and a working knowledge of the implementation of the best practice principles and objectives of the International Organization of Securities Commissions in securities regulation. Experience in the Asia and Pacific region is preferable. The principal aim of this assignment will be to build upon CMDP II reforms and further strengthen the regulatory framework governing Bangladesh's capital market. This will involve setting suitable supervisory policies, rationalizing institutional responsibilities across different products and sectors, and identifying any legal implications.
10. **Capital Markets Products Risk Management Experts** (one international, 2 person-months; one national, 1 person-month). The consultants will be risk management experts with extensive experience (a minimum of 10 years) in developing and trading in risk management

and derivative products. The experts will help the team leader identify measures for (i) developing the corporate bond market as a competitive source of financing; (ii) improving liquidity and market efficiency for secondary trading of securities; (iii) developing the derivative industry—interest rate, exchange rate derivatives, etc.; and (iv) introducing a wide range of capital market products, including structured products—new product development. For developing the bond markets, the experts will also draw upon the results of the work currently being undertaken to assess Bangladesh's primary dealer system by experts engaged under ADB's ongoing Bangladesh Bank capacity development TA.

11. **Taxation Experts** (one international, 1.5 person-months; one national, 1.5 person-months). The experts should have an extensive background in financial sector tax and legal matters, and should be experienced in the implications of taxation of financial instruments on financial sector development (a minimum of 10 years). The taxation experts should coordinate with the team leader as well as the other consultants to address financial sector tax issues. The experts will help develop a liquid and integrated capital market by identifying a tax system that meets the needs of different market participants and encourages savings and investments. The experts will develop a well-defined tax implementation framework that will help determine the impact of the recommended tax reforms and introduce a level playing field across products and institutions. The experts will recommend how to make tax treatment consistent with international accounting standards.

12. **Capital Market Institutional Experts** (one international, 2 person-months; one national, 1 person-month). The experts will have first-rate experience and credentials in enhancing the knowledge and understanding of capital market principles and operations. In coordination with the team leader as well as the other consultants working under the PPTA project, the experts will do the following: (i) focus on building and understanding financial markets, financial regulations, and trends in financial integration; (ii) enhance participants' conceptual understanding and practical skills in capital market development; and discuss conceptual and practical policy issues concerning capital market development, particularly the bond market; and (iii) share best practices and information that would be beneficial to develop and manage the capital market in Bangladesh, the analytical framework for capital market development, institutional and legal settings, infrastructure issues, and strategies and policy recommendations.

13. **Auditing Experts** (one international, 1.5 person-months; one national, 1.5 person-months). The experts will have a strong background in International Standards on Auditing and International Financial Reporting Standards and be familiar with capital market operations. The expert should be fully familiar with International Accounting Standards and best practices in the disclosure of financial information. The experts will build upon the impending enactment of the Financial Reporting Act to recommend policy measures that will strengthen accounting and auditing standards at IDRA and SEC, thereby raising market confidence. The experts will (i) review the capacities of regulators to assess the quality of audits, and (ii) help IDRA design procedures for an independent review of audit practices adopted by auditors of insurance companies, their work process and systems including developing relevant databases, format of reporting, internal quality assurance system, and enforcement.

14. **Insurance Experts** (one international, 2 person-months; one national, 2 person-months). The experts will have 10 years or more of international professional experience in insurance supervision. The experts will build upon the insurance white paper roadmap developed under CMDP II by providing detailed analysis and policy recommendations for the (i) improved governance and regulation of the insurance industry in conformance with international

best practices to facilitate achievement of the industry's potential, as well as (ii) enhanced insurance industry participation in Bangladesh's equity and bond markets.

## **F. Implementation Arrangements**

15. The Bank and Financial Institutions Division of Ministry of Finance will be the Executing Agency for the PPTA. The SEC will be the Implementing Agency for the PPTA. In support of the PPTA activities, the Government will provide (i) furnished office space for the consultants, and access to a conference room; (ii) secretarial support; and (iii) local communication facilities for the consultants in Dhaka. The Government will provide counterpart staff, available on a part-time basis, as necessary. A PPTA inter-agency working group chaired by the Secretary, Bank and Financial Institutions Division with representatives from the Bangladesh Bank and the SEC will provide comments, suggestions, and guidance at different stages of PPTA implementation. The Technical Assistance Project Proposal (TPP) is required to be approved by the Government before signing of the TA letter and TA implementation. All disbursement under the TA will be made in accordance with the Technical Assistance Disbursement Handbook (2010, as amended from time to time).

16. The consultants will submit an inception report to the Government, ADB, and the PPTA working group within 2 weeks of the start of work; an interim report—midway through the engagement to report on the progress of the work, and a draft final report 2 weeks before the end of the engagement. A capital market development workshop will be held at the early part of the engagement to discuss with the concerned stakeholders in the public sector and private sector their major concerns to ensure these are identified early and given sufficient attention under the proposed PPTA and follow-on program loan. At the end of the engagement, a national conference involving stakeholders, including the various donors, the private sector, and the Government will be held to discuss the findings of the report that will be used as the basis for CMDP II loan. The interim and the finalization of the draft final reports will be discussed at tripartite meetings involving the Government (including the PPTA inter-agency working group), the consultants, and ADB. The final report will incorporate results from the workshop, national conference and tripartite meeting and be made available 2 weeks prior to the end of the consultants' engagement.