Banks’ Exposure to Stock Market: Boon or Bane?

*Md. Toufique Hossain*

Abstract

Banks’ overexposure to the stock market and the latter’s overdependence on the former are both unwarranted. Following the banking sector’s overexposure to the capital market, the central bank finally set the exposure limit at 25 percent of its capital as suggested by the International Monetary Fund in line with the global practice. The limit was earlier 10 percent while the Ministry of Finance revised it upward to 40 percent. The aim of this paper is to intended to analyze on which of the rates is better. It has been discussed here taking into account the Indian, Pakistani and other global experiences.

**Key Words:** Banks’ Exposure, Stock Market, Capital Market, Central Bank, IMF

1. Preamble

Bank is a type of financial intermediaries which plays a crucial role by channeling funds from surplus units like households to deficit units such as corporations. Bank-based financial system like the one prevailing in Bangladesh puts much emphasize on banking system for mediating financial resources. However, unlike other industries banking is a very sensitive business in the sense that the funds disburse by banks as loans are actually depositors’ money. As such, the regulatory body notably the central bank plays a guardian-like role ensuring depositors that banks are not assuming excessive risks. One of such regulations imposed on depository financial institutions is the limit on their exposure to the stock market because stocks are considered one of the most risky financial instruments which banks can invest their funds with. Earlier commercial banks in Bangladesh are allowed to invest 10% of their total liabilities (major portion of which is deposit) in the stock market. Very recently our finance minister has announced that the investment limit will be fixed at 40% of their paid-up capital aiming to address the liquidity crisis persists in the prime bourse, the Dhaka Stock Exchange. However, the limit will gradually cut down to 25% over the next three years. The proposed strategy to revive

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2 This article made extensive use of the book ‘Bangladesh Share market looking ahead after two big crashes by Md. Toufique Hossain. https://www.amazon.com/Bangladesh-Share-Market-looking-Crashes/dp/9849048565
the capital market has stirred the decade-old debate: to what extent banks should be allowed to
involve in the stock market?

Banks’ investment in the stock market is allowed even in developed countries (to a limited
extent) probably because of income diversification and keeping the stock market buoyant.
Likewise, banks in Bangladesh are also allowed to do so. Noninterest income of banks in the
recent years has been growing significantly which shows a shift in sources from charges on loans
to fees and investment income. This helps banks reduce concentration of their income on loan
sales and thereby lessen default risk. Schedule banks’ statistics shows that net interest income to
total assets increased from 2.17% in 2009 to 2.50% in 2010, which further declined to 2.47% in
2011. On the other hand, non-interest income to total assets increased from 3.01% in 2009 to
3.04% in 2010. The ratio further declined to 2.87% in 2011. This shows that more than half of
the income for bank is coming from non-interest income majority of which is investment income
from the capital market. For instance, a random sample of 20 private commercial banks (except
Islamic banks) shows that their investment income grew continuously over the last 6 years
ending 2010. Total investment income amounted to Tk.471 million in 2006 which rose to
Tk.1,445 million in 2009 and Tk.2,209 million in 2010. This shows that marvelous growth of
banks’ non-interest income is mainly due to capital gain from the stock market. Of course,
following the historic stock market crash in December 2010, this route of income has shrunk
significantly. This implies that more than half of banks’ income is vulnerable to stock price
fluctuations. Banks’ involvement in the stock market to such an extent cannot be construed as
sensible investment decision and healthy banking practice.

Because of the nature of industry, equity participation of banks as source of fund is miniscule.
About 77% (in 2009) of schedule banks’ total liabilities are provided by depositors. Thus, any
adverse effects on banks resulting from the stock market fluctuations would severely hit the
depositors. In such a situation a trickle-down effect of one bank’s bankruptcy would definitely hit
others which might end up with a bank-run. If so, an emerging and financially shallow economy
like Bangladesh can hardly afford to bear the burden. In this sense, regulatory authority should
be very cautious in allowing banks for investment in the capital market. Moreover, banks’ strong
presence to the stock market might be deleterious in the sense that the ability of individual
investors to invest in the stock market is scant compared to the ability of a bank. As such, if the
purpose of capital market regulators is to ensure stability in the market they must encourage
individuals’ investors who are likely to invest for relatively longer period. Since supply of
securities in our market is very limited which results relatively low market capitalization, bank’s
increased presence would definitely have a crowding out effect on small but individual investors.
We should bear in mind that unless a capital market is blessed by diversified base of individual
investors, market dynamism cannot be achieved which is one of core principles of capital
market. If the current depressed stock market requires institutional support for the greater interest
of the economy, institutions like Investment Corporation of Bangladesh (ICB) and mutual funds can be utilized. Definitely the choice should not be banks.

2. Literature Review

This is a completely new study in the context of Bangladesh, so there is very little analytical research in this regard. This study has been highly reliant on the news published in the country’s daily newspapers.

As far as the global practice is concerned, the money market and the capital market are two different entities. Then what is the effect of bank-based finance on the capital market? Let’s delve deep into the question as follows.

Basically, the money market is a place where banks deal with short-term loans in the form of commercial bills and treasury bills while the capital market is a place where brokers deal with long-term debts and equity capital in the form of debenture, shares and public deposits. When an individual invests his own money in the stock market, he may not authorize a bank to invest his deposit in the share market.

The share price debacle in 2010-2011, the banks’ overexposure drew flak from various quarters. Different sources said that 10 to 12 banks violated the Bank Company Act and invested beyond the limit of 10 percent in the capital market. At the same time few banks focused more on stock business rather than mainstream banking. Maybe, questions were raised by some quarters from the ethical perspective, but the banks were not directly put in the dock. Now the question is why the Bangladesh Bank (BB) ignored this.

Levine (2002) in his paper “Bank-Based or Market-Based Financial Systems: Which is better?” He pointed out that the fact that classifying countries as bank-based or market is not a very fruitful way to distinguish financial systems. Moreover, he showed the first broad, cross-country examination of which view of financial structure is more consistent with the data. The results of this paper indicated that although overall financial development is robustly linked with economic growth, there is no support for either the bank-based or market-based view.
Beck and Levine (2002) in an article entitled “INDUSTRY GROWTH AND CAPITAL ALLOCATION: DOES HAVING A MARKET- OR BANK-BASED SYSTEM MATTER?” Authors have tried to point out that “the legal system efficiency and overall financial development boost industry growth, new establishment formation, and efficient capital allocation, having a bank-based or market-based system per se does not seem to matter much.”

Antoniou et al.(2008) discussed their article namely “The determinants of capital structure: capital market-oriented versus bank-oriented institutions.” Their paper investigates how firms operating in capital market oriented economies (the United Kingdom and the United States) and bank oriented economies (France, Germany and Japan) determine their capital structure. Authors used panel data to sort out the key ratio namely leverage ratio like how this ratio is positively affected by the tangibility of assets and the size of the firm, but declines with an increase in firm profitability, growth opportunities and share price performance in both types of economies.

Allen and Carletti (2008) conducted the study regarding mark-to-market accounting issue. They revealed that market prices do reflect future earning power and those where market imperfections imply that they do not. Their findings suggested that in financial crisis situations where liquidity is scarce and prices are low as a result, market prices should be supplemented with both model-based and historic cost valuations. The rest of the time and in particular when asset prices are low because expectations of future cash flows have fallen, mark-to-market accounting should instead be used.

Ahsan (2012) expressed that regulators responsible for the setting in appropriate exposure limit. According to the Daily Star report (2016) “Capital market exposure needs to be calculated on the basis of only listed securities in stock exchanges. In addition, the Dhaka Stock Exchange (DSE) also recommended calculating the banks' total exposure to the stock market without taking into
account their investment in non-tradable and non-listed securities such as investment in preference share or bond and subsidiaries.”

Further Daily Star report (2016) showed that “Banks to make fresh investments in stocks, although the stock market exposure ceiling remains unchanged at 25 percent of their capital. In December 2015, the banks' capital given to their stock market subsidiaries were kept out of their stock market exposure. The decision came into effect in January 2016. But the move had failed to boost the capital market, which has been witnessing a steep fall in recent days. Moreover, The Banking Companies Act 1991, which was amended in 2013, has limited a bank's stock market exposure to 25 percent of its capital by July 21 2016.”

According to Financial Express report (2017) “In 2014, the central bank asked the banks to limit their total investment in capital market on consolidated basis along with the existing solo one to minimise risk in investment portfolios. Under the exiting provisions, the market value of total investment of a banking company in the capital market on consolidated basis will not exceed 50 per cent of the sum of its consolidated paid-up capital, balance in share-premium account, statutory reserves and retained earnings as stated in the latest audited financial statements. On the other hand, the banks are now allowed to invest maximum 25 per cent in the capital market of their total capital on solo basis in line with the Banking Companies (Amended) Act 2013.”

3. Objectives of the study

The main objective of this paper is to analyze the reasons regarding why banks, capital market should maintain a distance in a financial system. The others crucial objectives are the following:

1. To analyze the effect of bank-based finance on the capital market;
2. To overview the risks of bank-capital market interrelation;
3. To analyze the underlying reasons behind the bank’s over exposures issues;
4. To determine which exposure limit is good for the market, in keeping with the global standard;
5. To draw a forward looking plan how to keep two markets in safe distance.
4. Methodology

Basically, it is an investigative study, which has highlighted the recent events namely bank’s exposure in capital market of Bangladesh's. This study has been prepared in conjunction with various secondary relevant documents.

5. The excessive reliance on banking sector

The following tables 1 present data on the banking sector that was dominating the stock market during 2009-10 as well as some more years.

Table 1: Overall market Vs Banks performance

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</thead>
<tbody>
<tr>
<td>Overall market</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend</td>
<td>23.32</td>
<td>35.58</td>
<td>37.35</td>
<td>30.57</td>
<td>36.47</td>
<td>34.96</td>
<td>35.4</td>
<td>27.78</td>
</tr>
<tr>
<td>P/E</td>
<td>25.65</td>
<td>29.16</td>
<td>13.68</td>
<td>12.07</td>
<td>15.07</td>
<td>17.77</td>
<td>15.23</td>
<td>14.29</td>
</tr>
<tr>
<td>EPS</td>
<td>40.21</td>
<td>40.5</td>
<td>49.5</td>
<td>41.05</td>
<td>31.58</td>
<td>30.59</td>
<td>31.38</td>
<td>34.68</td>
</tr>
<tr>
<td>Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend</td>
<td>26.16</td>
<td>29.16</td>
<td>31.13</td>
<td>24.88</td>
<td>14.42</td>
<td>15.13</td>
<td>16.08</td>
<td>1.29</td>
</tr>
<tr>
<td>P/E</td>
<td>16.46</td>
<td>25.24</td>
<td>10.5</td>
<td>8.68</td>
<td>10.01</td>
<td>8.63</td>
<td>7.4</td>
<td>8.14</td>
</tr>
<tr>
<td>EPS</td>
<td>36.37</td>
<td>37.78</td>
<td>43.69</td>
<td>32.11</td>
<td>22.17</td>
<td>22.82</td>
<td>24.85</td>
<td>25.37</td>
</tr>
</tbody>
</table>

In the table 1 find that in 2010 the overall market dividend was 35.58 percent, the overall P/E ratio was 29.16 and the earnings per share (EPS) were 49.50 with the banking sector alone accounting for 29.16, 25.24 and 37.78 respectively. In 2011 the same trend was observed. This proves how the banking sector alone dominated the capital market.

6. The causes of overexposure and the reasons behind the crisis

Basically, the money market is a place where banks deal with short-term loans in the form of commercial bills and treasury bills while the capital market is a place where brokers deal with long-term debts and equity capital in the form of debenture, shares and public deposits. When an

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3 Author calculative based on different DSE Monthly Review.
individual invests his own money in the stock market, he may not authorize a bank to invest his
deposit in the share market. So the banks and the capital market should maintain a safe distance.

During 2009, the country’s stock market showed a bullish trend and many banks invested in the
stock market beyond their limits. But after the share price debacle in 2010-2011, the banks’
overexposure drew flak from various quarters. Different sources said that 10 to 12 banks violated
the Bank Company Act and invested beyond the limit of 10 per cent in the capital market. At the
same time few banks focused more on stock business rather than mainstream banking. Two main
factors worked behind the latest share market debacle: a) The banks saw their overexposure to
the stock market, and (b) the market was excessively dependent on the banking sector. If the
capital market and the banking sector maintained a safe distance, the two problems could be
averted.

A large number of banks made big profits from the share market by investing beyond their
ceiling stipulated in the Bank Company Act 1991. The Act limited a bank’s investment in the
capital market to 10 per cent of its total liabilities which comprise total deposits and borrowings.
However, the banks’ overexposure came under criticism. What is the rationale of investing
investors’ money in a risky venture like the capital market? Investing the depositors' money in
the capital market without their consent is unfair. It seems to be more appropriate to invest in a
productive sector. Banks’ excessive investment in the capital market does not always solidify the
capital market.

The major cause of any of the market crashes that happened so far across the world was a lot of
commercial banks participated in investment or merchant banking activities. Normally the
investment of a commercial bank in the share market is limited. The Bank Companies
(Amendment) Act, 2013 fixed the limit at 25 per cent of their total regulatory capital. The IMF
earlier said the exposure of banks to the capital market should be 25 per cent. The Asian
Development Bank (ADB) also suggested that the banks’ investment in the capital market should
be 25 per cent of their equities instead of liabilities. Then in the draft of the amendment to the act
the ministry of finance (MoF) proposed the exposure limit at 40 per cent instead of the 25 per
cent, in place of the earlier limit of 10 per cent of liabilities. If the earlier limit of 10 per cent of
liabilities is compared with the 40 per cent of the regulatory capital, then obviously the 10 per
cent would be higher than the 40 per cent in value. The IMF, for the sake of safekeeping, proposed the limit at 25 per cent of the capital.

Banks that have still retained maximum exposure to the stock market will have to reduce it to 25 per cent of their capital. The banks get three years to cut the exposure limit to 25 per cent. So three years’ time is still in their hand.

Now let’s look at table-2(a) and 2(b) that’s how banks were aggressively trading in the stock market during 2009-10.4

Table 2 (a): Income of Banks

<table>
<thead>
<tr>
<th>Sl No</th>
<th>Banks Name</th>
<th>2010</th>
<th>2009</th>
<th>Growth (%)</th>
<th>Sl No</th>
<th>Banks Name</th>
<th>2010</th>
<th>2009</th>
<th>Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>National Bank</td>
<td>361 Crore, 64 lakh, 6 thousand, 755 Tk.</td>
<td>50 Crore, 39 lakh, 83 thousand, 449 Tk.</td>
<td>718</td>
<td>7</td>
<td>The City Bank</td>
<td>55 Crore, 93 lakh, 44 thousand, 608 Tk.</td>
<td>27 Crore, 99 lakh, 3 thousand, 627 Tk.</td>
<td>200</td>
</tr>
<tr>
<td>2</td>
<td>AB Bank</td>
<td>326 Crore, 84 lakh, 88 thousand, 614 Tk.</td>
<td>177 Crore, 44 lakh, 26 thousand, 855 Tk.</td>
<td>184</td>
<td>8</td>
<td>Standard Bank</td>
<td>54 Crore, 43 lakh, 79 thousand, 739 Tk.</td>
<td>9 Crore, 36 lakh, 99 thousand, 515 Tk.</td>
<td>581</td>
</tr>
<tr>
<td>3</td>
<td>Southeast Bank</td>
<td>219 Crore, 66 lakh, 2 thousand, 322 Tk.</td>
<td>79 Crore, 50 lakh, 46 thousand, 381 Tk.</td>
<td>276</td>
<td>9</td>
<td>NCC Bank</td>
<td>40 Crore, 86 lakh, 77 thousand, 346 Tk.</td>
<td>10 Crore, 75 lakh, 88 thousand, 489 Tk.</td>
<td>380</td>
</tr>
<tr>
<td>4</td>
<td>Pubali Bank</td>
<td>149 Crore, 56 lakh, 9 thousand, 550 Tk.</td>
<td>15 Crore, 99 lakh, 42 thousand, 287 Tk.</td>
<td>935</td>
<td>10</td>
<td>Trust Bank</td>
<td>31 Crore, 78 lakh, 41 thousand, 405 Tk.</td>
<td>9 Crore, 26 lakh, 39 thousand, 63 Tk.</td>
<td>343</td>
</tr>
<tr>
<td>5</td>
<td>Exim Bank</td>
<td>129 Crore, 21 lakh, 4 thousand, 250 Tk.</td>
<td>19 Crore, 24 lakh, 47 thousand, 997 Tk.</td>
<td>671</td>
<td>11</td>
<td>IFIC Bank</td>
<td>27 Crore, 85 lakh, 73 thousand, 31 Tk.</td>
<td>15 Crore, 16 lakh, 39 thousand, 246 Tk.</td>
<td>184</td>
</tr>
<tr>
<td>6</td>
<td>Premier Bank</td>
<td>126 Crore, 4 lakh, 30 thousand, 253 Tk.</td>
<td>4 Crore, 76 lakh, 99 thousand, 436 Tk.</td>
<td>2642</td>
<td>12</td>
<td>Dhaka Bank</td>
<td>27 Crore, 40 lakh, 29 thousand, 997 Tk.</td>
<td>1 Crore, 28 lakh, 43 thousand, 751 Tk.</td>
<td>2165</td>
</tr>
</tbody>
</table>

4 Information is collected from the BanikBarta. June 30, 20111. Vol:36

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Table 2 (b): Income of Banks

<table>
<thead>
<tr>
<th>Sl No.</th>
<th>Banks Name</th>
<th>2010</th>
<th>2009</th>
<th>Growth (%)</th>
<th>Sl No.</th>
<th>Banks Name</th>
<th>2010</th>
<th>2009</th>
<th>Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Eastern Bank</td>
<td>122 Crore, 56 lakh, 43 thousand, 74 Tk.</td>
<td>2 Crore, 61 lakh, 52 thousand, 226 Tk.</td>
<td>4687</td>
<td>17</td>
<td>Duth-Bangla Bank</td>
<td>19 Crore, 91 lakh, 994 thousand, Tk.</td>
<td>11 Crore, 25 lakh, 82 thousand, 261 Tk.</td>
<td>177</td>
</tr>
<tr>
<td>14</td>
<td>BRAC Bank</td>
<td>86 Crore, 14 lakh, 72 thousand, 265 Tk.</td>
<td>361 Crore, 192 lakh, 94 thousand, 263 Tk.</td>
<td>4465</td>
<td>18</td>
<td>Bank-Asia</td>
<td>11 Crore, 78 lakh, 70 thousand, 745 Tk.</td>
<td>8 Crore, 74 lakh, 76 thousand, 255 Tk.</td>
<td>135</td>
</tr>
<tr>
<td>15</td>
<td>One Bank</td>
<td>119 Crore, 29 lakh, 50 thousand, 577 Tk.</td>
<td>45 Crore, 80 lakh, 1 thousand, 281 Tk.</td>
<td>260</td>
<td>19</td>
<td>Mutual Trust Bank</td>
<td>10 Crore, 5 lakh, 81 thousand, 831 Tk.</td>
<td>3 Crore, 24 lakh, 60 thousand, 821 Tk.</td>
<td>310</td>
</tr>
<tr>
<td>16</td>
<td>United Commercial Bank</td>
<td>88 Crore, 4 lakh, 30 thousand, 266 Tk.</td>
<td>21 Crore, 89 lakh, 19 thousand, 242 Tk.</td>
<td>402</td>
<td>20</td>
<td>Jamuna Bank</td>
<td>4 Crore, 3 lakh, 33 thousand, 104 Tk.</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>21</td>
<td>First Security Bank</td>
<td>22 Crore, 4 lakh, 9 thousand, 973 Tk.</td>
<td>1 Crore, 28 lakh, 43 thousand, 751 Tk.</td>
<td>1153</td>
</tr>
</tbody>
</table>

Analysis: In both the table-2(a) and the table 2(b) we see that profits of twenty-one listed commercial banks in the share market. The banks made profits aggressively. The banks invested in share market above the limit and withdrew the money capitalizing on indifference of the
Bangladesh Bank. Even after the Bangladesh Bank’s instruction those banks did not give any dividend on the profit they made from the share market. So it is urgent to establish the merchant banks as separate subsidiaries. If it was done earlier, the aggressive profit-taking might not happen.

7. Overall scenario of banks’ investments in 2010

The private commercial banks exhibited a momentous ascending movement of the curve on their investments in the share market, as we see in the graph below, during 2010 just before the stock market’s fall. However, exposure of banks to the capital market was coming down after the debacle of the stock market before swelling in the recent months.

8. International norms

Stock market investments should be from the market’s own capital. Banks cannot invest depositors’ money in the share market, because, customers do not authorize banks to invest their deposits in the stock market. If necessary, the customers themselves can invest the money in the stocks. For that reason, the Indian and Pakistani bank company acts stipulate that the banks’

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5 Bangladesh Bank and CPD Publications(2nd Reading)
exposure to stocks will be based on banks’ equity or owners’ capital, not deposit or liability. But in Bangladesh the earlier Bank Company Act provided for investment of banks’ 10 percent of liabilities in the stock market.

A similar thing happened in the USA during the stock market/Wall Street crash in 1929. The Wall Street (US stock market) entered a bubble territory, when investment/merchant banks were ponderously lending from commercial banks to meet the rising customer demand for funds. During the period of Wall Street crash, we observed many banks purchased poor fundamental-based stocks for resale to the public. Clients were highly motivated to invest such types of stocks. During the Wall Street Crash the average P/E ratio of S&P Composite index stood at 32 in September in 1929. Then the bubble burst happened in October, the investors lost large amounts of money due to heavy margin buying.

After the Wall Street crash in 1929 the US policy makers adopted a special law to draw an absolutely separate line between commercial banks and investment banks. The U.S. Congress passed in 1933 the special Banking Act, which is known as the Glass-Steagall Act. The main goal of this special Act was to prevent “infelicitous banking activities” in the capital market. Here infelicitous banking activities mean demonstrative participation of commercial banks in the stock market investment, which was presumed the major reason of the financial crash. Commercial banks took too many risks with the depositors’ money. So it is clear that the Glass-Steagall Act was not favourable for the financial market and it was abolished in 1999. It was gradually watered-down by the Congress and finally repealed in 1999.

Later USA former President Barack Obama took some good steps. He introduced the “Volcker PLAN” on June 21, 2010 with the help of his economic advisor Paul Volcker. The main objective of this law is to regulate the U.S. banking system in the event of speculative investments.
9. What is appropriate, 25% or 40%?

Obviously there are a few investments of commercial banks in the capital market. But that should not cross the limit. It is better for commercial banks to invest 5 to 10 per cent of capital in the stock market. If compared with 25 per cent exposure of banks to the stock market as practiced internationally, both 10 per cent of liabilities and 40 per cent of capital are far higher than that. Here are some numerical or logical analyses of two prospective banks’ investments in the share market in 2010:
Now let us sum up here what the logical analysis of Bank Exposure above on the two banks’ e to the stock markets denote.

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6 Author calculation based on different annual Reports.
In a balance sheet of a bank the total liability consists of borrowing from other banks, financial institutions, agents and various deposit accounts. On the other hand, Owners’ Capital/Shareholders’ Equity consists of paid-up capital, statutory reserve, General Reserve, Other Reserve and Retained earnings. So the above analyses reveal that (a) The banks’ 40% of total capital are smaller than 10% of the liabilities; (b) The banks’ 25% of total Capital also is smaller than both the 40% of total capital and 10% of the liabilities.

10. Policy measures and Recommendations

According to the amended Bank Company Act, banks’ exposure to the capital market has been lowered to 25 percent of their total regulatory capital. Besides, if any bank buys shares of other companies, it will not be more than 5 percent of the bank’s capital. Basically the new bank companies act stipulates the banks’ stock exposure. At the time of calculation of banks’ total investment in stocks, the banks will have to take into consideration the components including all kinds of shares, debenture, corporate bonds, mutual fund units and other securities. Moreover, banks will have to follow all prerequisite banking rules and regulations in lending credit to their subsidiary companies like brokerage firms, merchant banks and other allied institutions.

Four agendas are notable here-

(i) The existing exposure ceiling of banks is calculated only based on the paid-up capital under the Tier -1. But the IMF suggests that the 25 percent exposure limit should be calculated also on the reserve, retained earnings and share premium as practiced globally under the Tier–II and the Tier-III of the BASEL compulsion;

(ii) Of course, the commercial bank’s investment should be limited in the capital stock market, whether the stock market is bullish or not;

(iii) Investment in a share market is always risky. So it is better to invest 25-30 percent of capital in the capital market and

(iv) Exposure should be excluded with non-tradable and non-listed securities like preference share, bond etc.
10.1 Recommendation of IMF

Normally the investment of a commercial bank in the share market is limited. The bank cannot cross the limit, which has been fixed now at 25 percent in the Bank Companies (Amendment) Act, 2013. The International Monetary Fund (IMF) earlier said the exposure of banks to the capital market should be 25 percent. The IMF and the Asian Development Bank (ADB) suggested that the banks’ investment in the capital market should be 25 percent of their equities instead of liabilities. The donor agencies suggested it before disbursement of US$ 150 million, the second installment of a $300 million loan under a capital market development programme. Then in the draft of the amendment to the act the ministry of finance (MoF) proposed the exposure limit at 40 percent instead of the 25 percent suggested by the IMF in place of the earlier limit of 10 percent of their respective liabilities. If the earlier limit of 10 percent of liabilities is compared with the 40 percent of the regulatory capital, then obviously the 10 percent will be higher than the 40 percent in value. The IMF, for the sake of safekeeping, has proposed the limit at 25 percent of the capital.
11. Conclusion

The overexposure of banks to the stock market and too much dependence of the market on the banking sector led to the debacle in 2010-11 after the skyrocketing share prices in 2009-10 that happened without any valid reason. The million dollar question now is: should banks invest more in a volatile share market to accelerate growth of the market? Pumping money into the stock market from the banking sector would not ensure development of the market.

After the debacle in 2010-11 a good number of banks faced a severe liquidity shortage. Actually when a decision was made about the banks’ investment limit of 10 percent, already many banks invested 30 to 35 percent of their liabilities in the share market. It could be better if the Bangladesh Bank (BB) monitored the situation since the very beginning. In addition, when the Bangladesh Bank instructed those commercial banks to overcome the situation by January, 2011, they readjusted the limit by selling shares. The ultimate result was all the banks started selling their holdings leaving the market under pressure.

The new limit on banks’ exposure to the stock market might prove helpful, provided the central bank keeps a close and constant watch on the flow of funds into the market from the banking sector.


http://www.thedailystar.net/business/extend-banks-stock-exposure-deadline-1204531
