

4. Money and Banking

- 4.1. Nepal Rastra Bank, as the Central Bank of the country with its responsibility for the overall monetary management, has been regularly making public the Annual Monetary Policy since 2002/03. Such policy includes credit, foreign exchange, micro-finance, regulation and supervision of financial system and programs of the monetary sector as a whole. These policies have given high priority especially to internal stability (price stability and financial sector's stability) and external stability (favourable balance of payments and consolidation) as the main objectives of monetary policy. In addition, Policy and Programmes are designed with priority accorded to other objectives as mentioned in Nepal Rastra Bank Act.
- 4.2. Important factors like events developing in the international arena, the fast-changing global economy and its possible impact on Nepalese economy were also duly considered while formulating of the Monetary Policy for 2008/09 and its stance, prioritizing the objectives, and making selection of monetary instruments. During the time of framing the current policy, not only in Nepal but price of food grains and petroleum products were on excessive increase throughout the world causing price situation as the main problem.
- 4.3. The monetary policy needs so wisely and carefully designed that national as well as international challenges like, managing and maintaining liquidity, containing interest rates in a desirable limit, expanding credit in productive areas, and eventually higher level of economic growth could be achieved. The reason for a cautious stance of the Monetary Policy became more critical in a situation whereby apart from the rising prices of consumer goods in general, rapidly rising prices of real estate and shares exerting pressure for excessive flow of credit to these sectors could lead to potential destabilization of the financial sector as a whole.
- 4.4. At the time of monetary policy formulation for 2008/09, the real interest rate was negative due to the big gap between the high rate of inflation and the low bank interest rate to depositors. Such situation becomes favourable for investing on real estates and shares while negatively affecting efficient distribution and mobilization of financial resources. Similarly, if import goes on increasing (due to soft loan) without bringing any improvement on the export front, the external stability gets challenged. Apart from this, the expanding remittance of private sector and the Government of Nepal budget for FY2008/09 being larger than that in previous years with possibility of the impact of monetary expansion on price, FY2008/09 called for a contractionary and stronger monetary policy than ever before.

Box 4 (a): Salient Features of Monetary Policy for FY2008/09

1. The monetary policy was made rigid than before in consideration with the consumer price inflation, and the unprecedented rise in the price of real estate and investment on shares. Accordingly, the existing bank rate of 6.25percent was increased to 6.50percent, the mandatory cash reserve ratio (CRR) from normal 5percent to 5.50percent and the penal interest rate was raised from 2percent to 3 percent while enjoying standing liquidity facilities.
2. The circle of counterparts was widened in the processes of exercising the fiscal policy. Breaking the earlier tradition of including only commercial banks for exercising the fiscal policy, FY2008/09 has recognized other development banks and financial companies as their counterparts for carrying out the policy and allowed to exercise the open market operations utilizing the standing liquidity facilities.
3. In order to widen fiscal inclusiveness, the compulsory obligation for commercial banks to issue 3percent of their total credit for the marginally poor is given continuity, while it is increased to 1.5percent from 1percent for development banks. Likewise, financial companies are also obliged to channel 1percent of their total credit for the poor and deprived groups.
4. Realizing the difficulties encountered in monitoring the growing numbers of banks and financial institutions, a new instrument, Prompt Corrective Action has been devised since 17 October 2008.
5. The following quantitative targets were set:
 - The Balance of Payment (BOP) surplus estimated to be Rs.12 billion.
 - Broad money supply growth projected at 17.5percent (against the previous18.5percent) based on the mid-term analysis.
 - Growth of the domestic credit of the banking sector projected at 18.5 percent.
 - The early estimate of consumer price inflation as 7.5percent reframed to reach 11percent through the mid-term assessment.
6. The rate of re-financing in national currency for exporters fixed at 2percent by reducing 0.5percent from the earlier 2.5percent.
7. No change made in refinancing rate of 3.5percent for Grameen Bikash (Rural Development) Banks.
8. The 1.5percent refinancing rate for sick industries unchanged.
9. The re-finance rate of 3.5percent for cottage and small industries reduced to 2.5percent.
10. The provision to provide standing liquidity facilities to commercial banks for 5 days unchanged.
11. More liberal and elastic policy adopted on foreign currency exchange under BOP. For instance, the one time provision of foreign exchange equal to 30,000.00 USD for advance payment through draft/T.T. raised toUSD50,000.00 for imports from countries other than India.
12. The present limit of exchange facilities equal to USD2,000.00 for individuals /organizations/institutions has been doubled to USD4,000.00.

Fiscal and Economic Targets

- 4.5. Like in previous years, the main objective of the Fiscal Policy of FY2008/09 has been to maintain internal price stability and consistency of external sector as far as possible. To achieve the target, other things remaining the same, the preliminary average annual inflation rate was estimated to be contained at 7.5 percent, The bases for 18.5 percent money supply forecast made for FY2008/09 was on assumptions of achieving 7.0 percent economic growth rate, annual inflation rate to remain at 7.5 percent, with the BOP savings of Rs.12 billion. The growth rate of the narrow money supply was estimated at 16.0 percent while that of credit growth was estimated at 25.0 percent.

Monetary Instruments Implementation Policy

- 4.6. Nepal Rastra Bank has been using Open Market Operations as an important tool of monetary management. Beginning FY2008/09, in addition to commercial banks, development banks as well as financial institutions have been recognized as counterparts for implementation of monetary policy. NRB has adopted a new policy to include development banks and financial institutions while conducting OMO as a monetary instrument, and providing short-term liquidity facility against the Government Treasury Bills and Development Bonds.
- 4.7. The mandatory CRR and the liquidity in excess of daily transactions to be considered as targets for the operation of monetary instruments is given continuity in FY2008/09 as well. The OMO has also been continued as one of the prime monetary instruments as before. In addition, continuity is given to: outright sale auction, outright purchase auction, repo auction and reverse repo auction for regulating the flow or absorption of liquidity as monetary instruments.
- 4.8. A couple of monetary measures are taken as a tough signal to mitigate the potential instability in the overall economy due to inflation, price pressure exerted on various types of assets, and unbalanced budget. Such measures included, raising the mandatory CRR of 5 percent to 5.5 percent on domestic credit, and raising of the bank rate from 6.25 percent to 6.50 percent.

Table 4 (a) : Bank Rate, Refinance Rate and Cash Reserve Ratio

	(Percentage)				
Instruments	2004/05	2005/06	2006/07	2007/08	2008/09
Bank Rate	5.5	6.25	6.25	6.25	6.5
Refinancing Rates					
Export Credit (Domestic Currency)	3.0	3.5	3.5	2.5	2.0
Export Credit (Foreign Currency)	2.0	3.25	3.25	3.25	*+0.25
Sick Industries	1.5	1.5	1.5	1.5	1.5
Small and Cottage Industries					3.5
Mandatory Cash Reserve Ratio	5.0	5.0	5.0	5.0	5.5
Standing liquidity facility (Penal rate)	-	-	1.5	2.0	3.0

* Add to LIBOR Rate; Sourc: Nepal Rastra Bank

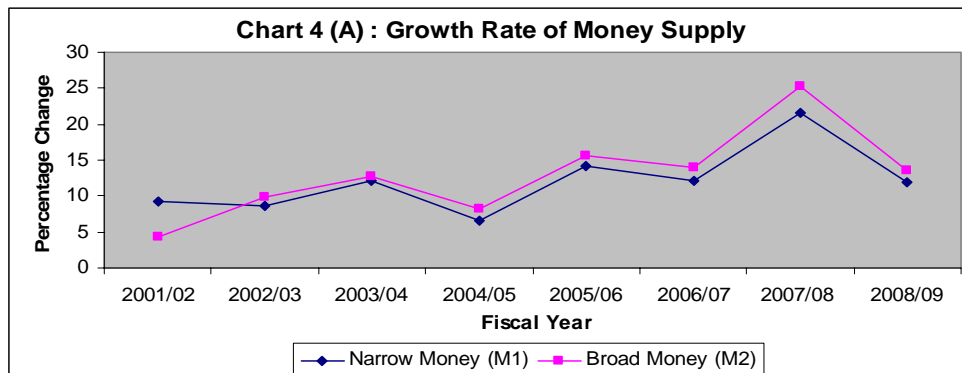
- 4.9 In order to facilitate the competitive capacity of exports, the refinancing rate of 2.5 percent in the past is reduced to 2.0 percent. The Rs.2.0 billion refinancing facility for sick industries has been retained in FY2008/09 by maintaining the 1.5 percent refinancing rate.
- 4.10. Excessive utilization of Standing Liquidity Facility (SLF) can bring about undesired results in the economy. With a view to check such potentiality and encourage inter-banking money market, the usual penal interest rate of 2 percent on SLF has been raised to 3 percent. The mandatory system of counting SLF by including penal interest rate on the average interest rate of the latest (91 days) Treasury Bill or the repo auction of the last one month, whichever is more has been given continuity.

Box 4 (b) : Mid-term Review of Monetary Policy for FY2008/09

NRB has continued making mid-term assessments of monetary policies each fiscal year. The present mid-term assessment report was made public on 22 March 2009. Monetary stance has been given continuity for the remaining period of FY 2008/09 in consideration with the operation of monetary policy up to the first six months of FY2008/09, based on the observation of developing incidences in national and international arena and their possible impact on Nepal's economic, financial and fiscal sector. Accordingly; bank rate, CRR, penal interest rate on SLF, and refinancing rates remain unchanged as per the arrangements made in the monetary policy. NRB has made it clear that it is alert about the prevailing situation of actual interest being negative, consumers' price inflation at a higher rate, the external situation unlikely to stay same in the remaining period, and the need to concentrate on monetary management in such a situation.

Status of Monetary Aggregates

- 4.11. During the first 8 months of FY2008/09, broad money supply has grown by 13.6 percent in contrast to 13.4 percent in the same period of the previous year. Despite some respite in the expansion of domestic credit than in the previous year, a substantial growth in net foreign assets in the monetary sector has resulted in the expansion of broad money supply this year.



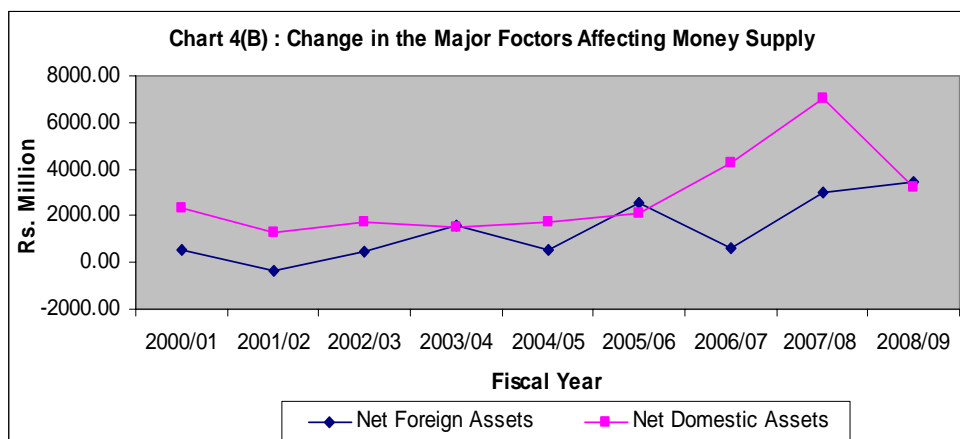
- 4.12. As compared to the review period of the previous fiscal year, the narrow money (M1) supply grew marginally from 11.3 percent to 11.9 percent during the same period of this fiscal year. Although there has been a decline in demand deposits by 6.6 percent, the growth of the money in circulation from the previous year's 13.9 percent to 21.9 percent this year is also one of the reasons for the growth in M1 during this period. During the review period, demand deposits decreased by 6.6 percent, while that of time deposits has increased by 14.4 percent in the review period like in the previous year.

Table 4 (b) : Factors Affecting Money Supply
(Annual changes, in Million Rs. and percent)

S.N.	Headings	First 8 months			
		2007/08		2008/09	
		Amount	Percent	Amount	Percent
1	Net Foreign Assets	13,633.0	103.0	3,4810.0	20.3
2	Net Domestic Assets	39,451.0	150.0	32,573.0	10.1
3	Net Domestic Credit	47,735.0	132.0	32,601.0	7.5
4	Net Credit to Government	-537.0	7.0	20,119.0	-23.1
	a) Net Claims on Government	3,805.0	-47.0	2,456.0	2.7
	b) Government saving	4,343.0	1,391.0	22,575.0	572.0
5	Credit to Public Enterprises	-613.0	-90.0	66.0	-5.3
	(a) Financial	-100.0	-58.0	-231.0	-13.8
	(b) Non-Financial	-513.0	-100.0	298.0	5.3
6	Lending to Non-Financial Institutions	2,102.0	1,101.0	2,132.0	70.1
7	Claims on Private Sector	46,783.0	171.0	50,522.0	14.9
8	Net non-Monetary Liabilities	8,284.0	85.0	282.0	-
9	Money Supply M2 (10+11)	53,084.0	134.0	67,383.0	13.6
10	Monety Supply, M1 (a) +(b)	14,327.0	113.0	18,307.0	11.9
	a) Currency	11,608.0	139.0	21,907.0	21.9
	b) Current Deposits	2,720.0	63.0	-3,600.0	-6.6
11	Time & Saving Deposits	38,756.0	144.0	49,076.0	14.4

*Unprocessed ; +Including Margin Savings

- 4.13. Net foreign assets (adjusted to profit/loss on foreign exchange valuation) increased by 20.3 percent to Rs. 34.81 billion during the first 8 months of current fiscal year against Rs. 13.63 billion in the same period of the previous fiscal year. The growth in net foreign assets is due to the encouraging growth in the inflow of remittances and foreign assistance to the Government.



- 4.14. During the review period, cash reserve has reached Rs20.95 billion with a growth of 14.5 percent against its increase of 12percent the previous year. Such growth in the cash reserve can be attributed to the growth in net foreign assets of NRB.

Table 4 (c) : Change in Reserve Money

(in Million Rs.)

	Mid-July 2007	Mid-March 2008	Mid-July 2008	Mid March 2009	Percent Change in First 8 Months*	
					2064/65	2065/66
Reserve Money	110,269.0	133,529.0	144,592.0	165,544.0	12.0	14.5
Narrow Money Multiplier	1.062	1.058	1.067	1.043	-0.6	-2.3
Broad Money Multiplier	3.316	3.360	3.426	3.399	1.3	-0.8

Source: Nepal Rastra Bank

* Estimates

Domestic Borrowing

- 4.15. Domestic borrowing has increased by 7.5 percent during the first eight months of FY2008/09 against the 13.2 percent in the previous year. Owing to Government of Nepal's low capital expenditure in comparison to high level of resource mobilization, the Government's cash reserve with NRB by mid-March has reached to Rs 26.52 billion. The growth rate of domestic lending has declined due to decrease in net claim on the Government by 23.1 percent accompanied by the reduced growth rate in the private sector lending.
- 4.16. During the review period, claim on non-financial institutions has increased by 5.3 percent or Rs. 297.8 million in contrast to the previous year's decrease of 10 percent or Rs. 513 million. Since Janakpur Cigarette Factory, Nepal Airlines Corporation, Janak Educational Materials Centre and Nepal Electricity

Authority used additional credit facilities, claims on them has increased accordingly.

- 4.17. The claim on financial institutions has grown by 40.45 percent or 1.90 billion in comparison to previous year's 55.3 percent or Rs.2.0 billion. The causal factor for such lower rate of growth is the decreased level of commercial banks' short-term investment on Grameen Bikash Banks.
- 4.18. Credit flow to the private sector has decreased by 14.9 percent during the review period as compared to the increase of 17.1 percent in the first 8 months of last year. Following the government's decision to write off the loan up to Rs.30,000 borrowed by small farmers and small entrepreneurs from the government owned banks, those commercial banks have written-off the above amount from their loan accounts. Hence, there is a resultant decrease in the credit flow to the private sector.

Status of Monetary Instruments

- 4.19. Till the first 8 months of FY2008/09, Rs.11.72 billion net liquidity were mopped up through OMO, among which Rs.7.46 billion was through direct sale auction and Rs 13.26 billion through reverse repo auction, totaling to Rs. 20.72 billion. Responding to the decreased liquidity absorption between February and March, liquidity flow worth Rs.9 billion has occurred through the repo auction. Despite high liquidity flow occurring through foreign exchange transactions, the huge cash reserve of the Government with NRB is the reason for a small decline in the liquidity of the banking sector. In the corresponding period of previous fiscal year, Rs.3.70 billion was absorbed through direct sale auction and Rs.5.57 billion through reverse repo auction totaling to Rs 9.27 billion. As Rs 9 billion was absorbed through repo auction, the net liquidity absorbed was Rs. 270 million during the period.

Table 4(d) : Open Market Operations

(In Million Rs.)

Description	2007/08		2008/09
	First 8 Months	Annual	First 8 Months
A Liquidity Absorption	927.0	2,142.0	20,72
Open Bidding	370.0	148.55	7,46
Reverse Repo Bidding	557.0	657.0	13,26
B Liquidity Flow	900.0	900.0	9,00
Purchase Bids	0	0	0
Re:p Bids	900.0	900.0	900
C Net Liquid Absorption_	270.0	1242.0	11,72

Source: Nepal Rastra Bank

- 4.20. During the review period, NRB purchased USD 1,266.4 million from commercial banks, out of which Rs. 972.4 million net liquidity was availed in the market. In the same period of last year, NRB had purchased USD 860.2 million from commercial banks and put net liquidity worth Rs.54.98 billion in the open market. The purchase of USD became higher from foreign exchange market owing to the higher inflow of remittances.
- 4.21. However, USD 1.0 billion was sold for purchasing Indian Currency (IC) worth 47.77 billion in the review period. During the corresponding period of the previous year, USD 9.10 million was sold to purchase Indian Currency worth 36.19 million.

Standing Liquidity Facility and Inter Bank Transactions

- 4.22. During the first 8 months of FY2008/09, commercial banks have spent Rs.83.23 billion in total under SLF in contrast to the total Rs.72.50 billion expensed in the corresponding period of the previous fiscal year. Meanwhile the inter banking transactions of commercial banks has reached to Rs 192.99 billion against Rs.190.82 billion in the previous Fiscal Year.

Short-Term Interest Rate

- 4.23. The short-term interest rate has increased in the eighth month of FY2008/09. The monthly weighted average interest rate of 91-days Treasury Bills remained at 6.83percent in mid-March which was 5.54percent during the same period of the previous fiscal year. In the same period last year, inter banking weighted average interest rate was 5.07 percent, which has slightly increased to 6.38percent by mid March this year.

Expansion of Financial Sector

- 4.24. The trend of financial sector expansion continued in the current fiscal year as well. As a result, financial sector is gradually becoming more intensified and consolidated. The number of (A Class) commercial banks has reached 25, (B Class) development banks 61, (C Class) finance companies 78, and (D Class) Micro Finance Institutions (MFIs) 13 by mid -April 2009. Likewise, the number of authorized cooperatives for operating limited banking activities and non-governmental organizations has reached 16 and 45 respectively. In addition to banks and financial institutions, there are 25 Insurance Companies, Employees Provident Fund, Citizens' Investment Trust and Postal Saving Banks making a total of 266 such institutions serving by mid- April.

Table 4 (e) : Number of Banks and Financial Institutions

Banks and Financial Institutions	Mid-July 2006	Mid-July 2007	Mid-July 2008	Mid-April 2009
Commercial Banks	18	20	25	25
Development Banks	29	38	58	61
Finance Companies	70	74	78	78
Microfinance Institutions	11	12	12	13
NRB Licensed Cooperatives (limited banking transaction)	19	17	16	16
NRB Lincensed NGOs (Dealing in Microfinance)	47	47	46	45
Insurance Companies	-	21	25	25
Employees Provident Fund	1	1	1	1
Citizens Investment Trust	1	1	1	1
Postal Saving Banks	1	1	1	1
Branches of Postal Saving Banks	-	117	117	117

Source: Nepal Rastra Bank

Financial Inclusion

- 4.25. In recent years, the financial sector has experienced significant expansion in the numbers as well as economic activities. Such credit expansions through diverse agencies and the wider area covered by commercial banks have laid the foundation and eased the process of financial inclusion.

Table 4(f) : Indicators of Financial Expansion and Deepening

	Mid April 2007	Mid-April 2008	Mi- April 2009*
Commercial Bank Branches	546	591	617
Population per Branch	47,120	44,499	42,832
Deposits in Commercial Banks (in Million Rs.)	325,770.0	375,590.0	481,440.0
Per Capita Deposit (Rs.)	12,663	14,282	18,217
Loan and Advance of Commercial Banks (in Million Rs.)	324,100.0	387,050.0	47,127
Per Capita Loan (Rs.)	12,598	14,717	17,833

Source: Nepal Rastra Bank

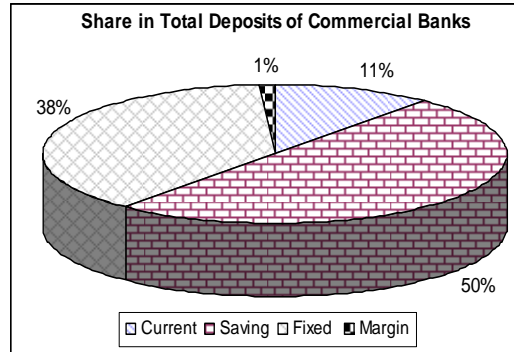
*Based on the data up to Mid-March 2009

- 4.26. A fair degree of progress is observed while associating the number of commercial banks and their branches with the total population of the country. The earlier ratio of 44,499 persons per branch by mid April 2008 has come down to 42,832 persons per branch by mid-April 2009. In the meantime, per capita

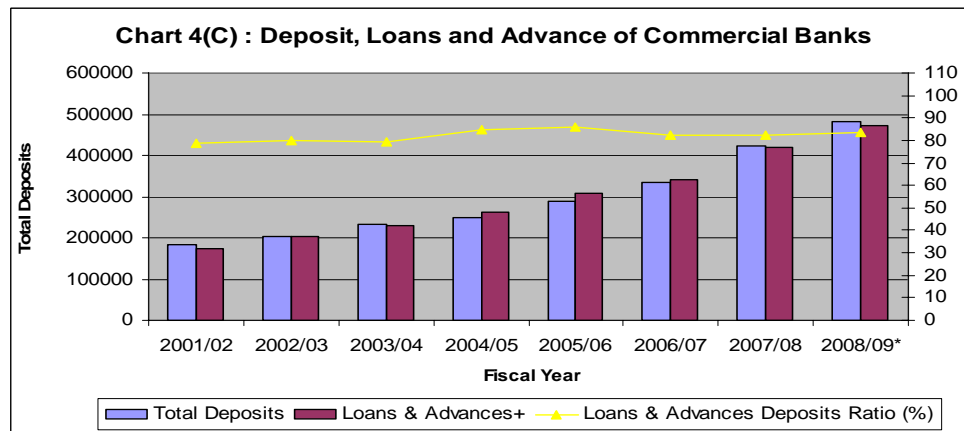
deposit of Rs.14,282 in April 2008 has increased notably to Rs.18,217 by April 2009. Likewise, per capita credit channeled through commercial banks has reached to Rs.17,833 by mid-April 2009 against the earlier Rs.14,717. This data shows the steadily rising trend of bank credits.

Deposit Mobilization and Credit Disbursement Situation of Commercial Banks

4.27. During the first eight months of FY 2008/09, the total deposit mobilization of commercial banks has increased by 14.2 percent (Rs.59.91 billion) amounting to Rs.481.44 billion against the growth of 12.3 percent or Rs.41.14 billion during the same period of the previous fiscal year. In the review period, saving deposits has increased by 14.1 percent and fixed deposit by 20.7 percent against the previous year's expansion of 12.2 percent and 14.5



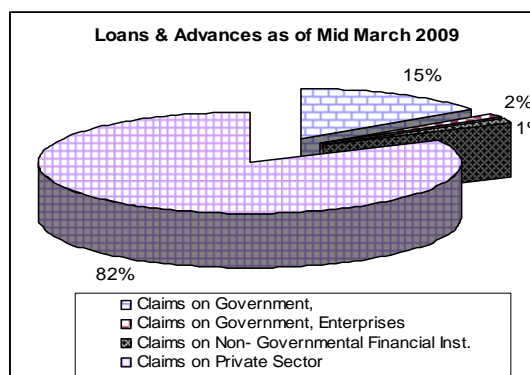
percent respectively. The increased periodic deposit rate owes to the public issue of shares by the Citizens' Bank and the Bank of Asia, with the collected amount deposited in commercial banks by the authorized banks and financial institutions.



4.28. The rate of credit flows of commercial banks to the private sector has declined during the review period. In the previous year, credit flow stood at 18.9 percent, which grew only by 15.1 percent this year. Out of the credit circulated to the private sector in the last fiscal year, 17.6 percent (10.99 billion) was to the productive sector, while it was 37.2 percent (7.35 billion) for construction sub-sector. The credit flow to the private sector on productive and construction-sub sector has increased by 10.7 percent (Rs.9 billion) and 16 percent (Rs.6.17 billion)

respectively. There is a decline in metal-based production, machinery, electric apparatuses, wholesale and retail business and services whereas consumption credit has increased.

- 4.29. During the review period, the liquid fund of commercial banks rose by 14.9 percent against 7.2 percent rise last year. This higher deposit growth is attributed mainly to the promising inflow of remittances. The deposit with NRB, one of the constituent factors of liquid fund, has increased by 6.7 percent against the growth of 7.9 percent in the previous year. Likewise, commercial banks' stock in foreign banks has increased by 22 percent to Rs.50.16 billion against the growth of 5.2 percent last Fiscal year.



Expansion of Commercial Banks Branches

- 4.30. The number of commercial banks that stood at 23 by mid- April 2008, has reached 25 by mid- March 2009. The number of branches has reached 617 by mid- December 2009 (with additional 62 branches) from 555 in 2008. The credit for this expansion goes to the improved situation of peace and security in the country boosted by the liberal policy adopted by NRB. To present the region-wise statistics of bank branches, there are 119 in Eastern Region, 302 in the Central, 120 in Western region, 48 in mid- West and 28 branches in Far-Western region by December 2009. During the first 6 months of FY 2008/09, one more development bank were established contributing to further expansion. The total number of banks and financial institutions, ranging from class A to class D has reached 173 at present. Notably the two new commercial banks added this year were upgraded from development bank and financial institution.

Table 4 (g) : Commercial Bank Branches

	Commercial Banks	Mid-July 2007	Mid-July 2008	Mid-April 2009
1.	Nepal Bank Ltd.	96	99	99
2.	Rastriya Banijya Bank Ltd.	114	114	119
3.	Nabil Bank Ltd.	17	26	28
4.	Nepal Investment Bank Ltd	14	19	24
5.	Standard Chartered Bank Ltd	10	13	12
7.	Himalayan Bank Ltd	15	17	18
7.	Nepal SBI Bank Ltd.	16	17	22
8.	Nepal Bangladesh Banl :td	17	17	17

	Commercial Banks	Mid-July 2007	Mid-July 2008	Mid-April 2009
9.	Everest Bank Ltd	20	26	29
10.	Bank of Kathmandu Ltd	13	22	25
11.	Nepal Credit & Commerce Bank Ltd	17	17	17
12.	Nepal Industrial & Commercial Bank Ltd	10	16	17
13.	Lumbini Bank Ltd	5	5	5
14.	Machhapuchhre Bank Ltd	12	18	23
15.	Kumari Bank Ltd.	8	12	15
16.	Laxmi Bank Ltd	9	13	16
17.	Siddhartha Bank Ltd.	5	7	10
18.	Agricultural Development Bank Ltd.	147	65	65
19.	Global Bank Ltd	1	7	9
20.	Citizens Bank Ltd	0	9	9
21.	Prime Bank Ltd	0	1	7
22.	Sunrise Bank Ltd.	0	6	12
23.	Bank of Asia ltd	0	5	10
24.	Development Credit Bank Ltd	0	3	5
25.	NMB Bank ltd.	0	1	4
	Grand Total	546	555	617

Sourc: Nepal Rastra Bank

Status of Non-Performing Assets of Commercial Banks

- 4.31. There have been some improvements on the non-performing loans of commercial banks in recent times due mainly to effective regulations and improved supervision by NRB, strong actions being taken against the black-listed debtors, and commercial banks' own willingness to stand themselves as efficient, capable and competitive entities in the current huge competitive environment. However, expected reforms are yet to be noticed on some government owned commercial banks and a few banks from private sector.

Table 4 (h) : Status of Non-performing Loan of Commercial Banks

(in Million Rs.)

Description	Mid-July 2007			Mid July 2008			Mid January 2009		
	Total Loan	Bad Loan	Percentage	Total Loan	Bad Loan	Percentage	Total Loan	Bad Loan	Percentage
Nepal Bank Ltd.	137,570.0	18,560.0	1,350.0	157,650.0	19,520.0	12,380.0	170,910.0	15,350.0	8,980.0
Rastriya Banijya Bank	2,487.1	687.7	27.6	2,749.5	595.2	21.65	2,821.0	528.2	18.72
Nabil Bank Ltd.	1,590.3	17.8	1.1	2,175.9	16.1	0.74	2,544.0	20.7	0.82
Nepal Investment Bank	1,776.9	42.2	2.4	2,752.9	30.9	1.12	3,313.6	40.4	1.22
Standard Chartered Bank	1,079.0	19.7	1.8	1,396.4	12.8	0.92	1,375.2	11.3	0.82

Description	Mid-July 2007			Mid July 2008			Mid January 2009		
	Total Loan	Bad Loan	Percentage	Total Loan	Bad Loan	Percentage	Total Loan	Bad Loan	Percentage
Himalayan Bank Ltd	1,779.4	64.2	3.6	2,018.0	47.7	2.36	2,141.6	40.1	1.87
Nepal SBI Bank Ltd.	1,006.5	45.9	4.6	947.0	300.5	31.73	1,339.7	35.8	2.67
Nepal Bangladesh Bank	916.9	364.6	39.8	1,274.6	48.8	3.83	958.4	278.0	29.01
Everest Bank Ltd	1,408.3	11.3	0.8	1,883.6	12.7	0.68	2,094.7	10.4	0.50
Bank of Kathmandu	969.4	24.3	2.5	1,274.8	23.7	1.86	1,365.2	24.3	1.78
Nepal Credit & Commerce Bank	512.2	160.7	31.4	528.1	86.7	16.42	631.3	65.2	10.32
Lumbini Bank	912.9	10.1	1.1	1,146.5	9.8	0.86	1,261.0	11.7	0.93
Nepal Industrial & Commercial Bank	494.4	100.7	20.4	536.6	80.0	14.92	556.9	68.7	12.33
Machhapuchhre Bank	732.0	8.5	1.2	896.4	9.3	1.04	1,044.3	56.6	5.42
Kumari Bank	906.2	6.6	0.7	1,144.1	15.2	1.33	1,303.1	13.8	1.06
Laxmi Bank	652.9	2.3	0.4	979.4	1.3	0.13	1,102.2	1.1	0.10
Siddhartha Bank	632.0	2.2	0.3	948.1	6.5	0.69	1,213.3	7.5	0.62
Agricultural Development Bank	3,444.0	618.5	18.0	3,660.5	428.1	11.69	3,654.1	473.3	12.95
Global Bank	260.3	-	-	514.0	1.0	0.19	593.1	0.7	0.12
Citizen's Bank	204.7	-	-	479.8	-	-	649.9	0.1	0.01
Prime Bank	-	-	-	515.6	-	-	787.0	-	-
Sunrise Bank	-	-	-	405.8	-	-	699.8	0.1	0.02
Bank of Asia	-	-	-	275.5	-	-	511.9	-	-
Development Credit Bank	-	-	-	369.2	-	-	513.6	9.1	1.76
NMB Bank	-	-	-	201.0	-	-	294.0	4.5	1.52
Total:	23,141.2	2,372.9	10.25	30,649.7	1,921.5	6.27	34,478.0	1,854.8	5.38

Sources and Uses of Funds of Financial Institutions

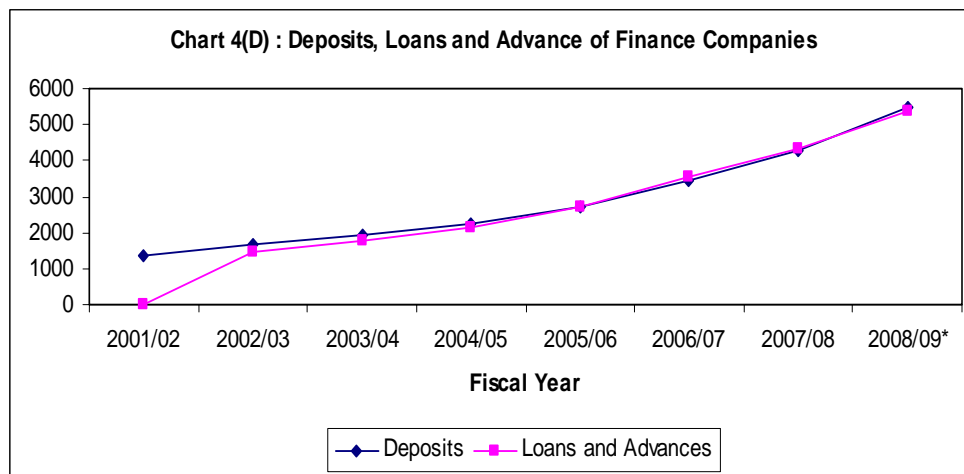
Development Banks ("B" Class Financial Institutions)

4.32 Total sources of funds of development banks reached Rs.50.2 billion by January 2009 with 25 percent growth as compared to July 2008. Total deposits of banks, their prime source of income, has increased to Rs. 37.09 billion in the review period. The total capital fund of these banks has reached to Rs.7.61 billion with a growth of 16.8 percent during the review period while the total borrowing declined by 8 percent in the second-half of current fiscal year which is a little more than Rs. 2.40 billion of the previous year. Loan and Advances that occupy a major part in mobilization of resources increased by 36.7 percent to Rs.32.40 billion.

Finance Companies ("C" Class Financial Institutions)

4.33 The aggregate sources of finance companies have reached Rs. 77.64 billion with a growth of 19.4 percent during the review period from Rs. 65.3 billion in the first half of 2008. The deposits of finance companies increased significantly by 27.7 percent to Rs. 54.72 billion in the review period. Similarly, the capital fund of those companies has reached Rs.10.50 billion (with a growth of 24.7 percent) whereas borrowings declined by 14.2percent to Rs.3.38 billion by January 2009.

4.34 On the uses side of funds, loan and advances of finance companies, has increased by 23.3 percent during the second half of 2008 and has reached Rs.53.50 billion against such amount of Rs. 43.37 billion by mid-July of the previous year. There has been a marginal decline of 1.4 percent worth Rs. 4.43 billion on investment during the review period. Likewise, the liquid fund has declined by 6.4percent and limited toRs. 12.16 billion during the first half of 2009.



Micro Credit Development Banks ("D" Class Financial Institutions)

- 4.35 Among the micro-credit development banks of ("D" class), there are five *Grameen Bikash Banks*, six *Grameen Bank Replicators* and 2 institutions for wholesale lending.
- 4.36 Total assets/liabilities of the wholesale lending micro-finance companies reached Rs.9.68 billion by January 2009. These institutions' total deposit and credit stood at Rs. 1.09 billion and Rs. 5.83 billion respectively whereas total credit and investment reached Rs. 5.53 billion and Rs. 670 million respectively in the review period.
- 4.37 The total paid-up capital of Rural Micro-finance Development Centre (RMDC), involved in wholesale lending of micro-finance, amounted to Rs.320 million by mid- March 2009. Its outstanding credit investment is 133.4 million during the review period.

Rural Self-Reliance Fund

- 4.38. Capital of Rural Self- Reliance Fund, availing wholesale credit to the Cooperatives and NGOs, stood at Rs.34.34 billion by mid-March 2009. Out of the total loan of Rs.229.4 million disbursed by the Fund till January 2009, it has collected Rs 117 million as principal.

Table 4 (i) : Transaction of Rural Self Reliance Fund

<i>Description</i>	Mid July 2007	Mid-January 2008	Mid-January 2009
<i>No. of districts (Credit Flow)</i>	48	50	50
<i>No. of Credit Recipient Institutions</i>	277	305	343
<i>Beneficiary Households</i>	12,228	13,420	14,962
<i>Loan Disbursed (in Million Rs.)</i>	132.6	165.0	229.4
<i>Loan Realized (in Million Rs.)</i>	81.2	89.8	117.0
<i>Loan Arrears (in Million Rs.)</i>	51.4	71.7	112.4
<i>Percentage of Overdue Loan</i>	8.5	9.85	9.00
<i>Payback (Percentage)</i>	91.5	91.15	91.00

Source; Nepal Rastra Bank

Cooperatives Operating Limited Banking Transactions

- 4.39. The number of NRB licensed financial institutions, established under the Cooperatives Act 2048 (1991) has reached 16 by April 2009. The total financial resources/capital fund of these cooperatives is Rs.431.6 million by mid-January 2009. Their combined deposits is Rs.3.17 billion, the credit and loans have reached Rs.2.82 billion.

Table 4 (j) : A Glimpse of Activities of Saving and Credit Cooperatives

<i>Description</i>	Mid-July 2007	Mid-April 2008
<i>No. of Cooperatives</i>	3,392	4,432
<i>Members (in '000)</i>	403	686
<i>Saving (in Million Rs.)</i>	89,630.0	15,730.6
<i>Investments (in Million Rs.)</i>	15,098.0	19,959.0

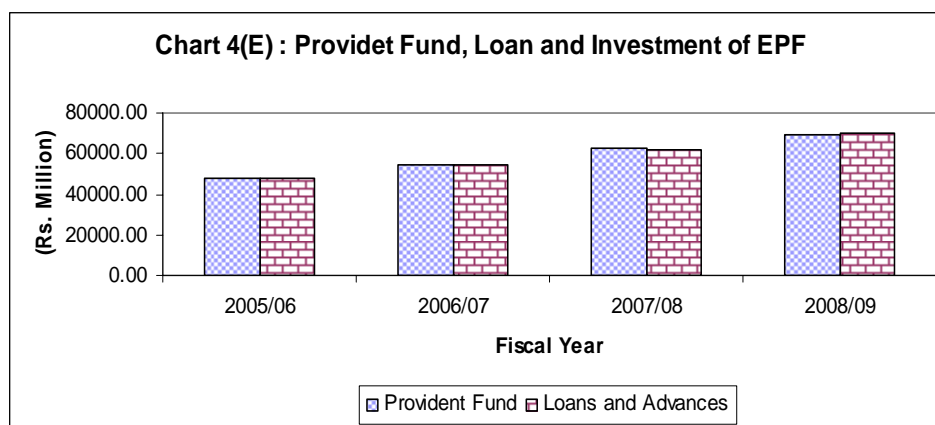
Source: Government of Nepal, Ministry of Agriculture & Cooperatives

Non-Government Organizations

4.40. Established under the Institutions Registration Act, 2034 (1977) and licensed by NRB for limited banking activities as provisioned by Financial Mediation Act 2055 (1999), these institutions have been expanded to 45 branches. The total credit flow of these institutions stood at Rs.982.5 million by mid-January as compared to Rs.961.2 million of credit flow by mid-June 2008.

Employees Provident Fund

4.41. Employees Provident Fund, established in 2019 B.S. (1964) under Employees Provident Fund Act 2019, manages provident fund collected from civil servants, military and police personnel, teachers, personnel of public enterprises and some other employees of private sector. The total resources/liabilities of this Fund has reached to Rs.74.92 billion by mid- March 2009 against Rs.67.94 billion by mid- June 2008. Meanwhile, the fund collected from employees has reached Rs.68.97 billion by mid- March 2009.



Citizens Investment Trust

4.42. Founded under the Citizen Investment Trust Act 2047 B.S. (1990) in April 1990, the Trust is primarily involved in activities like collection and mobilization of deposits from individual and institutions, and providing credit and loans. In addition, it acts as the issue- manager for facilitating shares and bonds on behalf of various organized institutions. The Fund's resources have reached Rs.14.53

billion by mid-March with a growth of 6.2 percent as compared to the sum collected by mid- July 2008. Collection of Funds, which is a crucial factor for liabilities has reached Rs.13.77 billion while investment of resources has reached Rs.11.37 billion during the review period.

Insurance Companies

- 4.43. Established under Insurance Act 2049, (1992) there are 25 insurance companies in operation by mid- April 2009. There are eight life insurance companies, 16 non-life insurance and one company dealing with both life and non-life insurance. From ownership perspective, three of them are operating with full foreign capital investment and three companies on joint capital venture of foreign insurance companies. Similarly, 18 companies are under private ownership, while the Government of Nepal owns one company. The total resources/liabilities of these insurance companies have increased by 10.2 percent to Rs.44.15 billion between mid-July 2008 and mid-January 2009.

Postal Savings Bank

- 4.44. Postal Savings Bank, under the Department of Postal Services of the Government of Nepal, launched its operations since 2033 B.S. (1974). Although 177 post offices were permitted to collect deposits, only 68 offices were carrying out banking services by mid-Jan 2009. The total deposit of Rs.820.7 million in mid- June has come down to Rs.783.7 million by January 2009. The total number of accounts holders is 39,383 so far.

Deposit and Credit Guarantee Corporation

- 4.45. Deposit and Credit Guarantee Corporation was established in October 1974 with objectives to encourage commercial banks for investing resources in the priority sectors and avail banking services to deprived people at their doorsteps. It has gone on guaranteeing loans and credit concerned with livestock, vegetable crops- farming, foreign employment, microfinance, deprived group, and credit for small and large industry in addition to credit in the priority sectors. The Corporation by mid-July had guaranteed Rs.421.9 million, which has shrunk to Rs. 277.5 million by mid-April 2009.

Credit Information Bureau

- 4.46. This Bureau initiated by NRB and established in 1990, is responsible mainly for collecting information about repayment of loans and availing such information to banks and financial institutions while preparing information on the black-listed credit defaulters. The ownership of this Bureau is shared by NRB, commercial banks, development banks and financial companies with 10percent, 60percent, 15percent, and 15percent respectively. The record available with the Bureau reveals that the number of blacklisted defaulters of banks and financial institutions has reached 3,432 from 3,423 6 between 6 months period of mid-

January and mid-April 2009. Nevertheless, 1,298 such defaulters were delisted from the black list during the review period.

Financial Sector Reform Program

- 4.47. The Financial Sector Reform Program (FSRP) is considered an important constituent factor for the wide-ranging reform of the financial sector as a whole. Following the Financial Sector Reform Strategy Paper 2000 AD, the Government of Nepal introduced this program with clear-cut guidelines through an announcement made in October of the same year. NRB is assigned with the responsibility of executing this program.
- 4.48. The main target of this reform program is to help financial sector become healthy, competitive, efficient, and professional by enabling it for sufficient contributions in the country's economic growth. The World Bank, Department for International Development (DFID) of UK Government, and loans and grants from Government of Nepal, are assisting the Programme. The main activities under the program include (1) re-engineering of NRB (11) restructuring of Nepal Bank Ltd. (NBL) and Rastriya Banijya Bank (RBB) in addition to capacity enhancement of the financial sector as a whole.

Box 4 (c) : Re-engineering of Nepal Rastra Bank

Continuity is being given to the re-engineering of NRB under the FSRP to make it stand as a sound, competent and efficient Central Bank while negotiating with the changing economic environment, both at home and abroad. In order to achieve these goals, NRB is carrying out the programs like- Human Resource Development (HRD) and management; more effective and empowered regulatory and supervisory strategies; restructuring the Bank depending on the services; computerization of the Bank; standardization of Bank's audit system and right-sizing, making banking services more accessible, easier and efficient.

- 4.49. Following World Bank's recommendation to appoint six Chartered Accountants to implement the re-engineering programs in the process of financial reform, NRB formed a task force of seven chartered accountants already employed in the NRB. This body has already submitted its proposals with practical recommendations and they are in the process of implementation.
- 4.50. The two separate Bid Specification on Software/Hardware Communication and Disaster Recovery System developed by international IT Consultants for the restructuring of the Bank's Information Technology that were submitted to the Bank were returned to the consultants for making necessary revisions and submit it by 20th April 2008. Since there was no response from the other end by the given deadline, the contract signed between the IT consultants and NRB the Bank cancelled the contract with the World Bank's approval.

- 4.51 Upon completion of the contract period of the consultant working as the Public Relation Officer and expired on 1 July 2008, the process to appoint a new Public Relations Officer is underway. However, the Bank has not extended its contract signed with the Human Resource Consultant upon its expiration in April 2009.

**Box 4 (d) : Structural Reform of Nepal Bank Ltd. and
Rastriya Banijya Bank**

NRB has taken over the control of NBL until mid-March 2011 in accordance with the Section 86 (C) of NRB Act 2002. A three-member team from NRB succeeded the management since the expiry of the contract with the Consultant of the Bank of Scotland (Ireland) on 21 July 2007. The team of experts has been appointed at the recommendation of the CEO to work under his direct supervision. Meanwhile, NRB has taken the initiative to request the World Bank for further grant assistance for the remuneration of the newly recruited management team.

The re-structuring of RBB is being carried out by a management committee composed of the Chief Executive Officer (CEO) and Chief Information Technology Officer (CITO). In order to continue the restructuring of the Bank, the contract of the present management team has been extended (with World Bank's consent) until 15 January 2010.

Both of the banks undergoing reform programs have been generating net profit since FY2003/04. They have not only formulated and implemented internationally accepted practices to maintain sustainability but also have reduced the negative capital fund. Needless to mention both of these banks still need more reforms to advance and make progress.

Source: Nepal Rastra Bank

- 4.52 There has been some progress in Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) after the introduction of their Restructuring Program. NBL, which was continuously at loss of billions of rupees since 1999, has constantly reduced such losses limiting at Rs.250 million by FY2002/03. The net loss during Fiscal Years of 2003/04, 2004/05, 2005/06, 2006/07, and 2007/08 has made net profit worth Rs.710 million, 1.73 billion, 1.21 billion, 230 million and 530 million respectively. Similarly, the bank has made a net profit of Rs.450 million by January 2009.
- 4.53 The net loss of RBB which was Rs 7.07 billion in FY2001/02 and Rs.4.84 billion in 2002/03, was turned into net profits of Rs 1.04 billion in FY2003/04; Rs.1.32 billion in FY 2004/05; Rs.1.62 billion in FY2005/06; Rs.1.68 billion in FY2006/07 and Rs 1.77 billion in FY2007/08. Meanwhile the targeted profit of Rs.940 million by January 2009 has reached to Rs.1.11 billion showing a promise.
- 4.54 There seems a gradual progress in taking both banks - NBL and RBB - away from their negative net worth status in the past. After undergoing restructuring program, the negative net worth of NBL, Rs 9.80 billion in June 2004, gradually decreased to Rs.8.90 billion in 2005, Rs.7.16 billion in 2006, Rs.6.30 billion in 2007, Rs.6.25 billion in 2008 and Rs.5.72 billion by January 2009. Similarly, RBB's

capital fund, which was negative by Rs.22.39 billion in 2004, has marginally improved to Rs.21 billion in 2005; Rs.20 billion in 2006; Rs.18.59 billion in 2007; Rs.17.21 billion in 2008; and Rs.15.50 by June 2008 that shows the reversing trend of negative net worth. Likewise, the target to limit the negative net worth at Rs14.57 billion during the first 6 months of FY2009 has marginally crossed having Rs 14.49 billion negative net worth by January 2009. Nevertheless, rapid and substantial progress in this direction is imperative.

Table 4 (k) : Negative Net Worth

(In billion Rs.)

<i>Mid-July</i>	Nepal Bank Ltd.	Rastriya Banijya bank
2003/04	9.80	22.39
2004/05	8.90	21.00
2005/06	7.16	20.00
2006/07	6.30	18.59
2007/08	6.25	17.21
2008/09	5.72	15.50
Mid-Jan 2009	5.56	14.49

Source: Nepal Rastra Bank

- 4.55 Out of the total credit of NBL, Non-Performing Assets (NPA) till mid July 2004 stood at 60.47 percent, which gradually decreased in the subsequent years. The NPA between by mid-July of 2004, 2005, 2006, 2007 and 2008 gradually came down to 53.64 percent, 49.64 percent, 18.18percent, 13.49 percent and 12.38 percent respectively. Eventually, it has come down to 8.9 percent by mid-January 2009. The sliding down of NPA since 2005/06 onwards is due to writing-off of bad loans, which has again showed the trend of reviving back. The recovery of the written- off loan is a challenge in itself for the banks. Similarly, RBB's non-performing asset as such has not decreased in quantitative term as desired, its level, however, is decreasing. The non- performing loan of RBB by June 2003/04 was 60.15 percent of the total credit which has been limited to 57.64 percent in 2004/05; 50.70 percent in 2005/06; 37 percent in 2006/07; 28.63 percent in 2007/08 and 21.65 percent in 2008/09. During the first 6 months of the current fiscal year, out of the total credit of RBB the ratio of non-performing asset has remained at 18.72 percent.

Table 4 (l) : Overdue Loan in Total Loan and Advances

(Percentage)

<i>Mid-July</i>	Nepal Bank Ltd	Rastriya Banijya Bank
2003/04	60.47	60.15
2004/05	53.74	57.64
2005/06	49.64	50.70
2006/07	18.18	37.00
2007/08	13.50	27.60
2008/09	12.38	21.65
Mid-Jan 2009	8.98	18.72

Source: Nepal Rastra Bank

- 4.56 The obligatory auditing of both banks that were overdue for the last several years were resumed in case of NBL since 1999/2000 covering up to the period of 2007/08. In addition to updating of the audit, financial statements on activities are regularly being published on quarterly basis. The external audit of RBB, that remained pending for some years, has been resumed after the new management took over. By far the external audit of FY2007/08 has been completed while the preliminary audit report for FY2008/09 has been submitted to NRB. Meanwhile, all the details concerned with the recent external audit are updated and internal audit has been completed as well.
- 4.57 Both NBL and RBB have developed and put into practice their Management Plan, HRD Plan, and Skill Enhancement Plan for necessary human resource and right- sizing of institutions. Staff Needs Assessment has been completed and both banks have submitted their respective Capital Plan and Successor Plan to NRB.
- 4.58 The Volunteer Retirement Scheme as an attempt of right-sizing in NBL has been successful to reduce the total number of staff of 6,300 in June 2001 to 2,885 by January 2009. Similarly, HR Information System, HRD Plan etc. are exercised for developing human resource and rightsizing it. HR Need Assessment has been completed and Performance-based Rewarding System is implemented. To right size the employees call for Volunteer Retirement Scheme has implemented for the 5th time. The RBB has also succeeded in reducing the size of its staff slowly. The 5,583 employees in 2002 were brought down to 3,417 by June 2005; 3,301 by next June 2006; 3127 in June 2007 and 3002 by June 2008, and 2,939 by January 2009.
- 4.59 The Management Team of NBL has formulated and adopted various plans, policies and directives for making banking system more robust and competent, especially by improving the credit management, credit policy and directives. Assets and Liabilities Management (ALM) Guidelines designed and applied, and Asset Liability Committee (ALCO) formed especially for better credit management. Besides, strategic policies like New Audit Manual, Internal Audit Manual, and classification of Accounts heads, HR Plan, Skill Enhancement Plan, Portfolio Status and Plan, Budget Plan, Strategic Plan etc are designed and applied. NBL has prepared and implemented. a number of Manuals and Guidelines such as - the Credit Write-off Regulations Anti-money Laundering Policy, Investment and Treasury Operation Manual, Review of Internal Audit Manual, Trade Finance Manual as well as Credit Policy and Directives in addition to the application of Credit Write- off.
- 4.60 To provide prompt, efficient and well-managed banking services, computerization of 44 branches of NBL is completed and additional 38 branches are identified where computerized system are going to be applied. NBL has

recently introduced Any Branch Banking System (ABBS) in 27 of its branches. The total deposit and credit of the bank have undergone computerized system with 79 and 89 percent respectively. As in the case of RBB, computerized system for efficient, prompt and manageable services, Information Technology Policy has been formed and accordingly, Pumory Plus (a banking software) is in operation among the 40 branches of RBB. Pumory Plus is also applied in two departments under the Head Office while in other 37 branches outside Kathmandu, Rastriya Banijya Bank System (RBBS) is in operation. Integrated Banking Information System (IBIS) are already in full implementation. About 86 and 96 percent of deposit and credit of RBB has undergone computerized system by January 2009. Under restructuring of NBL and RBB, processes to appoint a new Chief Executive Officer through open competition has already been started.

- 4.61 Review of the restructuring process of both banks shows that there has been an increase in net profit since FY2003/04; the negative net worth of both banks gradually reduced; various plans, policies and directives of international standard has been designed and implemented to ensure stability of banks. Likewise, internationally accepted management practice and rightsizing models are introduced. Hence, the progress made so far seems positive. Despite this, repayment of non - performing loans is not satisfactory.

Table 4 (m) : Status of Nepal Bank and Rastriya Banijya Bank

Description	Mid-July 2002/03	Mid-July 2007/08	Mid-January 2009*
Nepal Bank Ltd.			
Net profit (in Million Rs.)	(252.0)	529.0	450.0
Capital Fund (in Million Rs.)/() Negative	(98.3)	(57.2)	(55.6)
Non-Performing Loan (Percent)	60.47	12.38	8.98
No. of staff	5,250	2,885	2,852
Rastriya Banijya Bank			
Net profit (in Million Rs.)	(48.5)	1,770.0	110.0
Capital Fund (in Million Rs.)/() Negative	(22,390.0)	(155.0)	(14,490.0)
Non-Performing Loan	60.15	21.65	18.72
No. of staff	5,402	3,002	2,939

* Unprocessed

- 4.62 While reviewing the progress made so far on the overall capacity enhancement of financial sector, computerization of the Credit Information Centre Ltd. is launched. The Information Centre's Committee is involved in necessary discussions and forwarding the processes concerned with Bid Documents submitted to the project for its computerization. Likewise, trainings/studies /observation tours and visit programs are being conducted for capacity

enhancement of the staff of the Credit Recovery Tribunal. The computerization of the Tribunal will soon be carried out.

Box 4 (e) : Capacity Enhancement of Overall Financial Sector

The Phase III of Financial Sector Reform Program aims at overall capacity enhancement of the overall financial sector. In order to consolidate the Central Bank's role on regulatory and supervisory responsibilities to enable the bank perform its role in an efficient manner enactment of a tough law is necessary. For this, integration of existing laws is essential as well. Such integrated and consolidated Acts and regulations will certainly ease to control/regulate other banks and institutions of similar nature. Meanwhile, programs of gradual reform on legal structure of the financial sector and their capacity enhancement are continued.

Establishment of Banks and Financial Institutions

- 4.63. Responding to the applications for the establishment of six banks namely, Janata Bank, Century Bank, Mero Bank, Sangrila Bank, Civil Bank Ltd., and State Bank of Nepal, processes (in different phases) are underway to issue licenses to banks.
- 4.64. Following the decision of in April 2009, NMB Bank with its Head Office in Kathmandu metropolitan, is granted license to operate banking services of class "A" in May 2009. Similarly DCBL Bank Ltd. and Kist Merchant Banking and Finance Ltd. are granted license in May 2009 for conducting "A" Class banking services.
- 4.65. The request letters received so far about the merger of five 5 financial institutions namely, Mahalaxmi Finance Ltd. Butwal Finance Ltd. Siddhartha Finance Ltd. Birgunj Finance Ltd and Himchuli Development Bank, have been studied. Nepal Rastra Bank responded to applicants based on its circular of 5 September 2008 that it can be considered if application for such merger is received subsequent to raising the level of their capital fund.
- 4.66. During the review period, the number of "B" class banks reached 60 from 58 banks. Meanwhile, Development Credit Bank Ltd. (DCBL) of "B" class has been upgraded to "A" class whereas 3 new development banks have been established. Among the new banks, Jyoti Development Bank is located in Kathmandu, Purnima Development Bank Ltd. at Siddhartha Nagar Municipality and Shine Development Bank is located at Butwal Municipality of Rupandehi district. Processes in various phases are underway for 39 new banks planned for establishment.
- 4.67. Since no "C" class financial company was established in the review period their number is contained to the previous⁷⁸ by mid-March 2009. Out of these, 53 financial companies are based in Kathmandu, whereas 25 are located outside

valley. Meanwhile, 8 more financial companies are in the different phases of their establishment process.

- 4.68. The number of "D" class microfinance companies has reached 13 against earlier 12 with one more Micro Finance Development Bank added during the review period. The new one, Shree Naya Nepal Micro-finance Development Bank is based at Dhulikhel of Kavre district.
- 4.69. There has been no change in the number of cooperatives with limited banking services registered under Cooperative Act and limited to 16 (as before) by mid-March 2009.
- 4.70. The number of non- governmental organizations working as intermediary agency, has limited to 45 by mid-March following the cancellation of licenses of Nepal Gramin Bikash Samaj Kendra Biratnagar, and Chhimek Samaj Sewa Sanstha, Kathmandu.

Regulatory Arrangements for Banks and Financial Institutions

- 4.71 Following the directives and defined conditions, the credit channeled to hospitals through commercial banks (A), development banks (B), financial companies (C) will be considered as the credit to deprived group.
- 4.72 Actions have been taken for further steps including payments against deposits of defaulters listed in the black list. The list has so far 70 creditors in the first list, 33 in the second list and 238 in the third list totaling to 341 individuals.
- 4.73 Licensed financial institutions (except national banks and financial institutions) are obliged to flow credit against security of fixed capital within their designated geographical area by not going beyond the district. However, there is no such restriction on project loans.
- 4.74 Regarding promoter shareholders' claim on right shares, preferential shares or debenture, it should first be approved by the Credit Information Bureau and proved as delisted from the blacklist. Provisions are made to handover the promoters' shares to shareholder themselves unless they are legally distributed, bought, sold, or forfeited.
- 4.75 Regarding managers, CEOs, auditors and Secretary of bank and financial institutions; or individuals or their family members directly involved in the management of bank and financial institutions' auditing are restricted to carry on defined activities while in office or till one year after retirement. Individuals from the above positions, or working at any other organization/ institution under their ownership or control are barred from performing the defined activities.

Box 4 (f) : Major Highlight of the Directives on Margin Lending

1. Credit having the nature of Margin lending should not exceed the period of one year of circulation. Neither the renewal nor restructuring/re-tabulating can be made on such types of credit.
2. Credit flow against the guarantee of shares with nature of margin lending could be provided up to 50 percent of the average value of the closing price of the shares for the last one hundred eighty working days or up to fifty percent of prevailing market price, whichever is less. This system is continued while the provision is made for margin call based on defined conditions.
3. Provision has been made to make coupon rate transparent on the deposit and no other fee or commission or perks can be taken while accepting deposits of any kind.
4. Provision has been made to prepare compulsorily all the necessary documents in Devnagari scripts and Nepali language from 3 May 2009. However, this is not compulsory in transaction with foreign citizens.

- 4.76. Arrangements have been made to consider the promoters' share investment in D class financial institutions by licensed banks of A, B and C class and financial institutions as the credit flow to the deprived group.
- 4.77. In addition to submission of Directives Form Nos. 9.1 to 9.13, a Form 9 (a) has been added to be filled up by Banks and Financial Institutions with all financial details as mentioned in the form. These forms should be submitted to the Financial Institutions Regulation Department and the concerned Supervision Department of Nepal Rastra Bank within two weeks of the end of every month.
- 4.78. While issuing Subordinated Term Debt and Redeemable Non-convertible Preference Share unguaranteed by banks or financial institutions, the existing provisions are given continuity under the defined conditions.
- 4.79. Banks and financial institutions are bound to avail credit and loans against security of Fixed Deposit Receipt (FDR) of their own banks/financial institutions only. They have to obtain pre-approval from NRB in case they have to avail credit/loans against other banks'/financial institutions' Fixed Deposit Receipt.
- 4.80. While making quarterly payments of interest on the credit/loan, banks and financial institutions are obliged to add interest on the account of depositors in the same manner.
- 4.81. Banks and financial institutions are not allowed to lend more than one-third of their net deposit liabilities while mobilizing their financial resources.
- 4.82. There is an obligatory provision for the managers/directors of banks to submit details on Self-Declaration (of income) in the defined form to NRB. Financial institutions should submit to NRB details/ registration/log books about their promoters.

- 4.83 The minimum balance of the capital fund of banks and financial companies must be maintained any time at the defined ratio. Failing to do this, they are subject to face actions.
- 4.84 All banks of A, B and C class and financial companies, while lending to or investing on other banks and financial institutions; are obliged to consider and accept them as Inter bank Transactions/Borrowing/Investment and not as Regular Credit facility.
- 4.85 Licensed banks and financial institutions can assist in making pre-investment on promoters' shares at their will for the purpose of capital sufficiency. But, the defined criteria should be met.
- 4.86 While flowing the credit of any kind, banks and financial companies must compulsorily prepare the document, guarantee paper or approval letter in *Devnagari* script and Nepali language under the existing law. This is obligatory to any borrower or guarantor (individual, firm, company and institution).

Box 4 (g) : Directive on Upgrading of Bank and Financial Institutions

1. On request made by NRB Licensed Financial Institutions of B and C class for upgrading, necessary arrangements to proceed would be made.
2. Provision of upgrading financial institutions of D to C class is made on request from them provided the request submitted to NRB and requirements fulfilled.

- 4.87 According to the Clause 69 of the Bank and Financial Institution Act 2063 (2006), two or more banks or financial institutions can merge with each other and request for the license on upper class Bank. However, process will advance only after finalizing the accumulated and increased capital fund.
- 4.88 New arrangement has been made for licensed banks and financial companies for their cross-holding promoter shares and their right share as defined by NRB.

Box 4 (h) : Directive on Deprived Sector Lending

- (i) Continuity is given to the present obligation of disbursing at least 3 percent of total credit for commercial banks in deprived sector in FY2008/09 as well. Development banks and financial companies are obliged to disburse minimum 1.5 percent and 1 percent respectively for deprived class since 18 October 2008.
- (ii) Concerned with foreign employment, especially, for Dalit, ethnic groups, women, oppressed, Madheshi, minority and backward societies (as defined by Government of Nepal) NRB has continued availing refinance to commercial and development banks equal to Rs.500 million as/ on loan security for these groups at the interest rate of 1.5 percent. Commercial and development banks can not take interest more than 4.5 percent from these deprived groups as long as they enjoy re-finance facilities from NRB.
- (iii) Banks and financial institutions would be entitled to lend youth and small

enterprisers up to Rs.200 thousand without security under Youth and Small Entrepreneurs Fund Act 2009. Such loans will be considered as deprived sector credit in turn.

- (iv) Under the Renewable Power Technique ,Micro Hydro Power Project of 50 kilowatt, Solar Home System, Solar Cooker, Solar Dryer, Solar Pump, Bio-gas, Improved Water Mill, Improved Cook Stoves, and Wind Energy, not exceeding Rs 60,000 per family is counted as deprived sector credit
- (v) The loan up to Rs.0.4 million for purchase/construction of house to individuals qualified for deprived sector under defined circumstances would be considered as deprived sector credit.

- 4.89 Relating to capital increase for any purpose, they must compulsorily present the details of income source in the designated pattern to be invested while purchasing promoters' shares.
- 4.90 Banks and financial institutions maintaining capital fund ratio can issue public shares with pre-approval of NRB. However, they are obliged to automatic cancellation of the portion of right shares (except on mentioned circumstances), in case shareholders do not purchase shares, or deny to sell or transfer the right of share to others.
- 4.91 Policy arrangement has been made for individuals/firm,/company/household or organized institution to limit their investment of 15percent paid amount on promoters' shares of banks(class A,B,C) or financial institutions. Promoters' share holders of banks and financial companies who fail to do this or cross the limit are restricted from cash debenture, bonus shares, and right shares availed by banks/financial institutions.
- 4.92 Banks and financial companies are bound to make the final decision within five days of claim, if for any reason, the beneficiaries claim the repay of bank guarantee they have secured after completing all formalities.
- 4.93 The "D" class micro- finance companies are provisioned for providing micro credit up to Rs.60 thousand against adequate security to individuals even though they are not integrated in groups.
- 4.94 Banks and financial companies enriched with SWIFT (Society for Worldwide Interbank Financial Telecommunication) technology can transfer the amount from NRB's account in Thapathali through SWIFT Message.
- 4.95 Licensed banks and financial companies are allowed to invest on hydropower projects; they can do this as per their own rules and regulations up to 25percent of their preliminary capital. Nevertheless, they are bound to make Power Purchase Agreement with concerned agency along with other obligations, in case they invest 25 to 50 percent on such projects.

- 4.96 Arrangements have been made for inclined companies to pay through electronic payment of purchased goods and services such as internet, mobile etc under the existing laws and regulations.
- 4.97 NRB has reframed Capital Adequacy Framework 2007 according to the new standard (BASEL II) as per demand of time. The updated Capital Adequacy Framework 2008 is under full implementation since July 2008.
- 4.98 Provisions are made to complete share distributions allocated for general public within two years of operation of licensed banks and financial institutions.
- 4.99 While disbursing credit on security of fixed deposit (FDR Loan) and other guarantee papers, the interest rate should not be below the coupon rate. This system is applicable to inter banking credit services of all licensed banks and financial institutions; excluding other companies.
- 4.100 Licensed banks (A, B and C) and financial institutions can carry out Share Deposit Policies under designated conditions.
- 4.101 Policy arrangements have been made for approving permission for additional shareholding ratio by changing the capital structure of commercial banks, provided that they make formal request to NRB for consideration.
- 4.102 NRB has clarified that besides holding Promoters' shares, those who hold shares of banks and financial institutions fulfilling the due process of public offerings by such authorized institutions, any national or international person or institution holding shares acquired through the Promoter, the Promoter's group or private placement would be considered as the Promoter and Promoter's Group for the regulatory purpose of NRB.
- 4.103 After the formation of Complaints Hearing Unit and Complaints Management Committee 386 complaints were registered by mid-March 2008. Out of these, hearings on 305 complaints have already been completed while necessary inter - bank/inter- finance companies' exchange of documents is underway for the remaining 81 complaints.

Inspection and Supervision of Banks and Financial Institutions

- 4.104 NRB has adopted a policy of scientific inspection and supervision for sustainable growth of economy by developing healthy and competitive banking and financial institutions and increasing public confidences .Such supervisions are based on standards defined by international agencies and universal principles and practices. In order to minimize the risks emerged by the growing number of banks and finance companies and viewing the limited supervision capacity, Risk Based Supervision as an instrument has been emphasized in recent years. Inspection and supervision processes at micro- level have been

regularly advanced, especially for troublesome banks and financial institutions. A separate monitoring mechanism has been developed for the purpose.

- 4.105 The inspection and site-supervision of the overall banking and financial sector is continued also in FY2008/09. Weaknesses and deficiencies encountered during site supervision are addressed on the spot as far as practicable. Regular directions on corrective measures are provided based on the supervision report, to make the implementation more effective. Based on the reports from site supervision reforms are being made in organizational structure and restructuring of supervision unit giving high priority to monitoring and implementation of these reforms.

Box 4 (i) : Progress of Inspection and Supervision upto mid-March 2009

On-site Inspection

The overall site supervision of 21 commercial banks has been completed by the end of mid-March 2009 while inspection of 4 other banks will have completed by the end of the current Fiscal Year. Likewise, 14 development banks, 42 finance companies, 6 cooperatives with limited banking services and 4 non governmental organizations on micro finance have been supervised on the site.

Off-Site Supervision

During the review period off-site supervision of 72 financial institutions have been completed while the off-site supervision of 6 financial companies is pending as the details of their audit of FY2006/07 has not been availed.

Special Inspection

During the review period special supervision of 9 development banks and one micro-finance development bank has been as per felt need.

Follow-up and Targeted Supervision

Follow-up supervision of one development bank and one finance company was made while targeted supervision of 17 development banks and 10 finance companies' have been completed during the review period.

- 4.106 Continuity is given to take pre- approval by commercial banks from NRB before publishing their financial details. A few banks are made to pay fine for not maintaining compulsory reserve fund as directed and for not disbursing credit on deprived sector. The structural reforms are made on Off-site supervision in order to make it more effective and time relative. Software Data base of big borrowers has been prepared and commercial banks have been informed about it. The regular updating of Check List on Early Warning System is being carried on the desks of concerned banks.
- 4.107 Continuity is given to the regular follow-up programs on liquidity in order to address problems concerned with commercial banks' existing liquidity. The daily follow up on commercial banks' liquidity through a separate supervisory unit has been helpful in identifying the real liquidity in banking sector.