

4. Money and Banking

Monetary Policy

- 4.1 Nepal Rastra Bank has been regularly making public the Annual Monetary Policy since 2002/03 as per the legislative provision of Nepal Rastra Bank Act 2002. Such policy includes subject matters such as credit, foreign exchange, micro-finance, regulation and supervision of financial system. Monetary policies announced so far have given high priority especially to internal stability (price stability and financial sector's stability) and external stability (favourable balance of payments as their main objectives. In addition, Policies and Programs are designed with priority accorded to other objectives as mentioned in Nepal Rastra Bank Act.
- 4.2 While formulating Monetary Policy for the fiscal year 2009/10, consideration was given to the latest monetary and fiscal situation of the fiscal year 2008/09, policy of gradual liberalization of the external sector of the economy as well as global economic events and their possible impact on Nepalese economy.
- 4.3 Despite tight ex-ante stance taken in view of the trend of rising prices at higher rates in 2008/09 while formulating the monetary policy for the current fiscal year 2009/10, the price level this year remained the highest in the past 17 years. Despite steep fall in prices of some internationally traded goods, pressure on the price of food grains persisted. Monetary stance in the fiscal year 2009/10 was felt necessary as supply constraint had exerted pressure on the price level and question was being raised on the effectiveness of monetary policy itself.
- 4.4 A cautious monetary stance than a flexible policy was felt necessary in a situation of adequate liquidity present in the economy due to encouraging inflow of remittance while formulating the Monetary Policy for the fiscal year 2009/10. Hence, no need was felt to change the cautious and tight stance for maintaining price stability.

Box 4(a): Salient features of Monetary policy FY 2009/10

1. Followings fiscal and monetary targets have been set for the fiscal year 2009/10:
 - Inflation rate projection revised from 7.0 to 10.7 percent upon mid term review of the Monetary Policy.
 - A surplus of Rs. 18 billion in the balance of payments.
 - Manage liquidity to facilitate the target of achieving 5.5 percent growth rate as announced through the budget speech for the fiscal year 2009/10.

- Annual growth rate of broad money supply revised from 17.0 percent to 14.0 percent upon the mid term review of the Monetary Policy.
 - The projected growth rate of commercial banks' credit to the private sector revised from 20.7 percent to 18.2 percent upon mid-term review of the Monetary Policy.
2. As development banks and finance companies have been covered by expanding the scope of counterparties in the process of conducting monetary policy, arrangements have been made to manage the excess liquidity under the Liquidity Monitoring Forecasting and Framework (LMFF) by covering for development banks and finance companies as well.
 3. Broad Monetary Survey based on balance sheets of Nepal Rastra Bank, commercial banks, development banks, and finance companies, will be processed and published within the fiscal year 2009/10,
 4. Bank rate to remain at the same level of 6.5 percent.
 5. The export refinancing facility in local currency is retained at 2.0 percent barring banks and financial institutions from charging more than 5 percent while extending credit by using such facility. Both these rates have been revised to 1.5 percent and 4.0 percent respectively upon mid-term review of the Monetary Policy by reducing 50 base points on the refinancing rate.
 6. Refinancing rate for sick industries maintained at 1.5 percent as before.
 7. The 2.5 percent interest rate applicable to banks and financial institutions on their credit flows to small and cottage industries remains unchanged.
 8. The maturity period of repo and reverse repo auction has been changed to a maximum of 45 days from 28 days upon mid-term review of the Monetary Policy.
 9. Cash Reserve Ratio (CRR) of 5.5 percent on domestic deposit liabilities remains unchanged.
 10. From the fiscal year 2009/10, all banks and financial institutions are required to maintain Statutory Liquidity Ratio (SLR). It is mandatory for all 'A', 'B', and 'C' classes banks and financial institutions to invest 6.0 percent, 2.0 percent, and 1.0 percent of domestic deposit liabilities respectively into the government securities by 14 January 2009, and 8.0 percent, 3.0 percent and 2.0 percent by 16 July 2010. While making such provision for maintaining liquidity ratio made through the mid-term review, the specified bond for maintaining the statutory liquidity ratio or cash balance held with the institution itself, or call deposits held in 'A' class commercial bank by specifying the purpose accordingly are considered eligible instruments for this purpose.
 11. The provision to provide standing liquidity facilities to commercial banks for 5 days and the existing 3.0 percent penal interest rate remains unchanged
 12. Commercial Banks will be allowed to open branches outside of Nepal if they wish to do so.
 13. The provision of limiting the Single obligor limit of up to 25 percent of core capital including the non-fund based limit is continued. Mid-term review of the Monetary

Policy, however, has raised such limit to 30 percent in some specified sectors while giving continuity to the existing arrangement of 50 percent limit set specifically for hydropower, transmission lines and cable car.

14. Foreign Exchange Encashment Receipt (FEER) is not required to avail the exchange facility of up to USD 100 on the bank counter at the International Airport.
15. The present limit of exchange facilities of up to US \$ 4,000 for individuals /organizations/institutions has been raised up to US \$ 6,000.

Fiscal and Economic Targets

- 4.5 The main objective of Monetary Policy for the fiscal year 2009/10 is to maintain price, external sector and financial sector stability towards creating environment for high and sustainable economic growth. To achieve the target, the preliminary average annual inflationary rate was estimated to contain at 7.0 percent in the fiscal year 2009/10. For the fiscal year 2009/10, 17.0 percent Broad Money Supply was projected on assumption of economic growth rate 5.5 percent, annual average inflation rate of 7.0 percent, and the surplus of balance of payment (BOP) Rs18 Billion. The credit growth rate of the private sector was estimated at 20.7 percent. These monetary targets, however, have been revised through the midterm review of the monetary policy.

Monetary Instruments Implementation policy

- 4.6 The earlier policy on operating target of monetary policy, the excess liquidity with commercial banks in addition to the CRR and day-to-day transaction requirements, is given continuity in the fiscal year 2009/10 as well. Open Market Operation is provided continuity as a major instrument of monetary policy as before. According to the needs, continuity is given to the policy of monetary operations of injecting or mopping up liquidity through outright purchase auction, repo auction, outright auction sale and reverse repo auction. Beginning the fiscal year 2009/10, a new system concerned with Statutory Liquidity Ratio (SLR) is adopted for strengthening the financial strength of banks and financial institutions. Under this mandatory provision, commercial banks and financial institutions have to mandatorily invest certain percentage of their total domestic deposit in government securities or other eligible instruments.
- 4.7 In the context extending the Standing Liquidity Facility (SLF) to development banks and finance companies in addition to commercial banks against the collateral of Treasury bill and development bonds issued by the government, the processing and publication of broad money survey will be carried out on the basis of the balance sheets of NRB, commercial banks, development banks and

finance companies by taking into consideration the excess liquidity with development banks and finance companies under the LMFF.

- 4.8 Bank rate, export refinancing rate for on foreign currency, refinancing rate for sick industries, refinancing rate for small and cottage industries, the CRR and the penal interest rate on standing liquidity facility remain unchanged. The mid-term review of the Monetary Policy for the fiscal year 2009/10 has adopted selective credit policy to cope with the credit shortage in the productive sector. Accordingly, provision is made for commercial banks and financial institutions to receive refinancing from NRB at 7.5 percent interest against the collateral of good loan of the same sector by under specified terms and conditions. Provision is also laid out for commercial banks and financial institutions not to charge above 10.5 percent interest to their borrowers against such refinancing facility they avail from NRB.

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

(Percent)

<i>Instruments</i>	<i>Fiscal Year</i>				
	2005/06	2006/07	2007/08	2008/09	2009/10
<i>Bank Rate</i>	6.25	6.25	6.25	6.5	6.5
<i>Refinancing Rates</i>					
<i>Export (credit local currency)</i>	3.5	3.5	2.5	2.0	1.5
<i>Export Credit (Foreign Currency)</i>	3.25	3.25	3.25	*+0.25	*+0.25
<i>Sick Industry</i>	1.5	1.5	1.5	1.5	1.5
<i>Cottage and Small Industries</i>		3.5	2.5	2.5	2.5
<i>Productive Sector**</i>					7.5
<i>Cash Reserve Ratio</i>	5.00	5.00	5.00	5.5	5.5
<i>Standing Liquidity Facility (Penal rate)</i>	-	1.5	2.0	3.0	3.0

* LIBOR plus

** Provision made through mid-term review of the Monetary Policy for 2009/10

Source: Nepal Rastra Bank

- 4.9 In order to facilitate the competitive capacity of exports, the export refinance rate in local currency has been reduced from 2.0 percent to 1.5 percent. The earlier provision of Rs 2 billion refinancing facility for the sick industries at 1.5 percent rate has been retained in the fiscal year 2009/10.
- 4.10 The existing 3.0 percent penal interest on standing liquidity facility availed to commercial banks and financial institutions by NRB against the collateral of Treasury bills and development bonds remains unchanged with slight changes in method of calculating its interest. Under the new arrangement, the interest rate will be determined by adding penal rate of 3.0 percentage points to the

weighted average interest rates applicable on latest 91-day Treasury bills or on the repo rate in practice in the last one month or on the prevailing bank rate whichever is higher.

Box 4 (b): Mid-term Review of Monetary Policy for the Fiscal Year 2009/10

NRB has been conducting mid-term reviews of Monetary Policy on a regular basis. The Bank made present mid-term review report public on 3 April 2010. Monetary stance is given continuity for the remaining period of the fiscal year 2009/10 in consideration with the operation of monetary policy up to its first six months. based on the observation of incidences developing in national and international arena and their possible impact on Nepal's fiscal and monetary sectors. Accordingly, the bank rate, CRR, penal interest rate on SLF remain unchanged while and refinancing rates for exports in the local currency has been maintained at 1.5 percent by reducing such rate by 50 base points. Under the selective credit policy, NRB has emphasized to flow the credit from unproductive to productive sector, promotion of export, import substitution as well as to curb on the shortage of credit in the energy and tourism sectors. For this, NRB has arranged a new policy of providing refinancing facilities at 7.5 percent to the commercial banks and financial institutions exclusively for lending against the collateral of good loan of the related sector only. However, commercial banks and financial institutions, enjoying such facility are not allowed to charge more than 10.5 percent interest rate from the borrowers. While conducting the mid-term review of the Monetary Policy, NRB maintained its alertness on possible decline in export and increasing import due to non-economic reasons that may lead into imbalances in the economy. The Bank is convinced that the continued tight stance of the current Monetary Policy will help to balance the economy, though to some extent.

Status of Monetary Aggregates

- 4.11 The broad money supply that expanded at the rate of 13.7 percent during the first eight months of the fiscal year 2008/09 is contained to 6.8 percent during the same period of current fiscal year.
- 4.12 As compared to the review period of the previous fiscal year, narrow money supply (M1) has shrunk from 11.9 percent to 4.6 percent during the review period of the current fiscal year. Despite the higher growth rate of internal asset, net foreign asset has resulted in low growth rate of monetary aggregates.

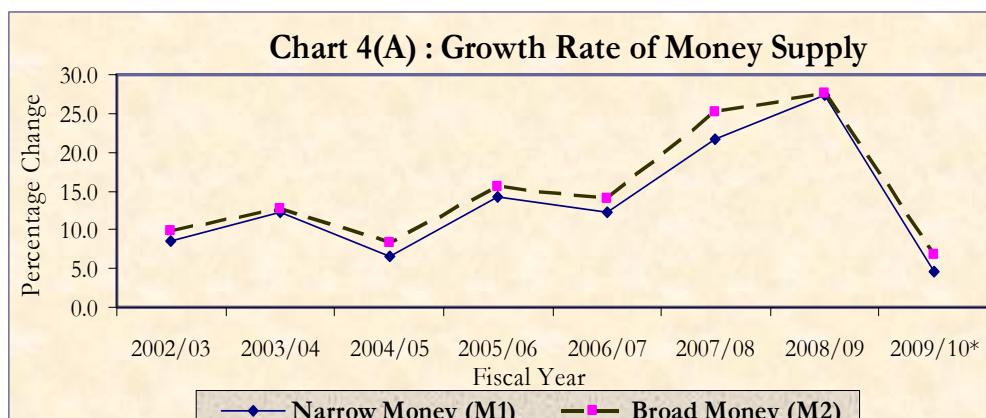


Table 4(b): Factors Affecting Money Supply
(Annual changes, in Million Rs. and percent)

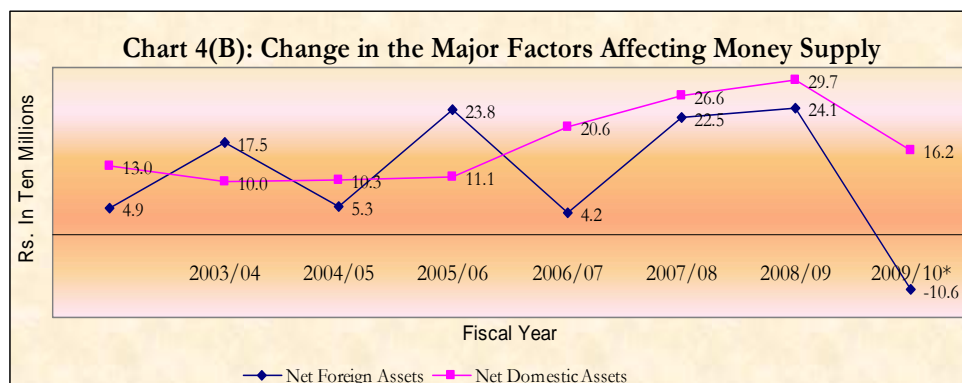
S.N.	Headings	First eight months			
		2008/09		2009/10	
1	Net Foreign Assets	34,810.2	20.3	-23,534.7	-10.6
2	Net Domestic Assets	32,833.9	10.1	66,725.9	16.2
3	Net Domestic Credit	32,601.3	7.5	56,569.3	10.2
4	Net Credit to Government	-20,118.7	-23.1	-13,715.2	-13.1
	a) Net Claims on Government	2,456.5	2.7	-12,892.1	-12.3
	b) Government Deposit	22,575.2	572.0	823.1	0.0
5	Claims on Public Enterprises	66.0	5.3	227.0	3.1
	(a) Financial	-231.0	-13.8	67.0	4.9
	(b) Non-Financial	298.0	5.3	160.0	4.9
6	Claims on Non-Government Financial Institutions	2,132.0	70.1	-1,811.0	-29.3
7	Claims on Private Sector	50,522.0	14.9	71,869.0	16.5
8	Net non-Monetary Liabilities	-233.0	-0.2	-10,157.0	-7.2
9	Money Supply M2 (10+11)	67,644.0	13.7	43,191.0	6.8
10	Money Supply, M1 (a)+(b)	18,307.0	11.9	8,992.0	4.6
	a) Currency	21,907.0	21.9	14,300.0	11.4
	b) Demand Deposits	-3,600	-6.6	-5,309	-7.5
11	Time Deposits+	49,337	14.5	34,200	7.8

* Provisional

+Including Margin Deposits

- 4.13 During the present review period net foreign assets (adjusting the exchange valuation gain) has decreased by 10.6 percent totalling Rs 23,530 million while it

was Rs 34,810 million with a growth of 20.3 percent during the same period of the previous year. The decline in net foreign asset is due to the high expansion in



trade deficit in the review period.

- 4.14 Reserve money has reached Rs 20,134 million in the review period marking a nominal growth of 2.9 percent against the notable growth of 14.5 percent during the same period of the previous year. The reason for such decline in reserve money is due to depletion in NRB's net foreign asset in comparison to the previous year.

Table 4(c) : Change in Reserve Money

(Rs. in million)

	Mid-July 2008	Mid-March 2009	Mid-July 2009	Mid-March 2010*	Percentage change in first 8 months	
					2065/66	2066/67*
Reserve Money	144,592	165,544	195,575	201,335	14.5	2.9
Narrow Money Multiplier	1.067	1.043	1.005	1.020	-2.3	1.5
Broad Money Multiplier	3.426	3.401	3.235	3.357	-0.7	3.6

Source: Nepal Rastra Bank

*Estimate

Gross Domestic Credit

- 4.15 During the first eight months of the fiscal year 2009/10, total domestic credit grew by 10.2 percent against the 7.5 percent growth in the same period of the previous year. Such expansion of total domestic credit owes to higher growth of credit to the private sector. During the review period, the net claim on the government has reached 13,720 million with a decline of 13.1 percent. Such claim over the government stood at Rs 20,120 million with a decline of 23.1 percent in the same period of the previous year. The reason for this reduction in the claim on government is due to its inability to match expenditure with the speed of resource mobilization. Government of Nepal's current cash Reserve in the NRB is Rs. 823.10 million.
- 4.16 Claims on private sector during this period rose by 16.5 percent totalling Rs. 718.70 million from Rs. 505.20 million in the same period of the previous fiscal year.
- 4.17 Claims of non-governmental financial institutions have decreased by 29.3 percent in the review period owing to the declining trend of commercial banks' investment in financial institutions, pension fund, and insurance companies. Such claims in the previous year had climbed up by 70.1 percent in the corresponding of the previous fiscal year.
- 4.18 Claims on non-financial government enterprises grew by 3.1 percent during the review period in comparison to the previous year's 5.3 percent growth. Such decrease is because National Trading Ltd., Nepal Airlines corporation, Janak Educational Materials Centre Ltd., and Nepal Electricity Authority paid some portion of their debt.

Status of Monetary Instruments

- 4.19 Net liquidity injection of 691,300 million has occurred by the end of the first eight months of the current fiscal year 2009/10, Of this total, Rs. 8,440 million liquid was absorbed including Rs. 7,440 million from outright sale auction of Treasury bills and Rs. 1,000 million from reverse repo auction while liquidity injection totaled Rs. 77,570 million comprising Rs. 74,190 million from repo auction and Rs. 3,380 million from outright purchase auction under the OMO. In the same period of the previous fiscal year, Rs. 20,720 million worth liquidity was absorbed including Rs. 7,460 million through and Rs 13,260 million through Reverse Repo action. and liquidity flow in the market totaled Rs. 9,000 million through the repo auction resulting a net liquidity absorption of Rs. 11720 million through OMOS.

Table 4(d): Open Market Operation

		Rs. in million		
<i>Description</i>		<i>2008/09</i>		<i>2009/10</i>
		<i>First Eight months</i>	<i>Annual</i>	<i>First eight months</i>
A	Liquidity Absorption	20,720.0	20,720.0	8,440.0
	Sale Auction	7,460.0	7,460.0	7,440.0
	Reverse Repo Auction	13,260.0	13,260.0	1,000.0
B	Liquidity Injection	9,000.0	11,000.0	77,570.0
	Purchase Auction	0	0	3,380.0
	Repo Auction	9,000.0	11,000.0	74,190.0
C	Net Liquid Absorption	11,720.0	9,720.0	-69,130.0

- 4.20 During the review period, NRB created liquidity of Rs 55,170 million by intervening in foreign exchange market with the purchase of USD 733.2 million from commercial banks. In the previous year NRB made a net purchase of USD 1,266.4 million from the commercial banks and created the liquidity of Rs 97,240.0 million. The purchase of US Dollar got reduced during the review period due to slow growth in the flow of remittances as compared to the previous year.
- 4.21 During the review period USD1,360.0 million was sold and Indian Currency (IC) Rs 63,620 million was purchased as compared to the sale and purchase of USD1,000.0 million and Indian Rs. 47,770 million respectively in the same period of the previous fiscal year. The increasing trade deficit with India is the reason for increased purchase of Indian Currency.

Standing Liquidity Facility and Inter Bank Transactions

- 4.22 During the first eight months of 2009/10, interbank transaction of commercial banks totaled Rs 188,540 million. Interbank transaction of commercial banks was Rs 192,990 million in the corresponding period of the previous fiscal year. During the review period, commercial banks have used SLF to the amount of Rs 85,170 million as against Rs 83,230 million in the previous year.

Short-Term Interest Rate

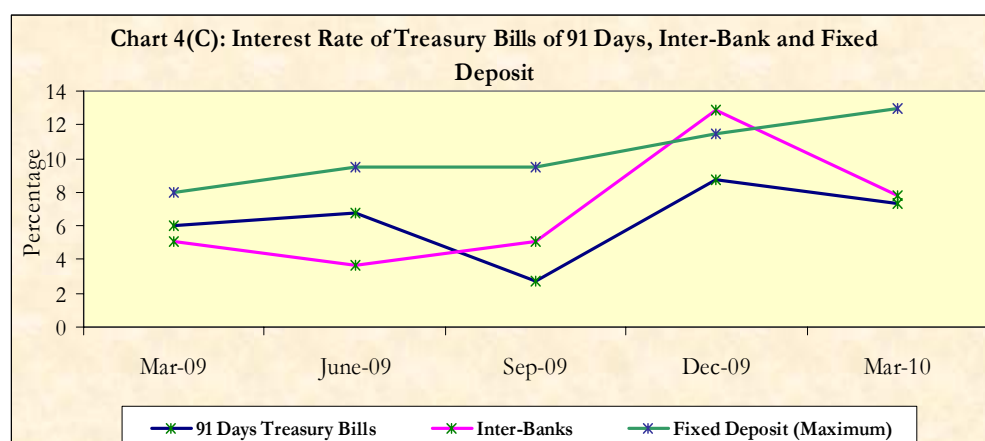
- 4.23 The monthly weighted average interest rate for 91-days Treasury Bills stood at 7.35 percent during the first eight months of the fiscal year 2009/10. Interest rate was 5.98 percent during the same period of the previous year. In the same period of the previous year, inter banking weighted average interest rate was 5.06 percent, which has increased to 7.81 percent by mid March of the current

fiscal year. In addition to the short term market interest rate, the interest offered by commercial banks on deposits has also increased. Compared to the interest rate of July 2009, annual interest rate on fixed deposits for 2 years and above is set up to 13.0 percent from 9.5 percent. The reason for such increase is due to fall in liquidity position during the review period.

Table 4(e): Interest rate in 91-days Treasury Bills, Inter-bank, and Fixed Deposits

<i>Description</i>	In Percent				
	<i>Mid-Mar 2009</i>	<i>Mid-Jul 2009</i>	<i>Mid- Oct 2009</i>	<i>Mid-Jan 2010</i>	<i>Mid-Apr 2010</i>
91-days Treasury Bills	5.98	6.80	2.73	8.74	7.35
Inter-bank	5.06	3.66	5.10	12.83	7.81
Fixed Deposit (Maximum)	8.0	9.5	9.5	11.5	13.0

Source: Nepal Rastra Bank



Expansion of Financial Sector and financial inclusiveness.

4.24 The expanding trend of financial sector continued in the current fiscal year as well. Consequently, financial sector is gradually deepening and becoming more intensive. The number of 'A' class commercial banks reached 27, 'B' class developmental banks 78, 'C' class finance companies 79, and 'D' class microfinance institutions (MFIs) 18 by Mid-April 2010. The sanction put on Nepal Industrial Development Corporation (NIDC), licensed from Nepal Rastra Bank to carry out banking functions as a 'B' class bank, from carrying out to do so since February 8, 2004 was lifted on March 25, 2009. Accordingly, it has resumed banking activities since February 8, 2010. Similarly, the number of cooperatives and non-governmental organizations authorized to carry out limited banking activities has reached 16 and 45 respectively. In addition to

banks and financial institutions, by mid April 2010 there were 25 insurance companies, the Employees Provident Fund, the Citizens' Investment Trust, and postal savings units, making a total of 291 such banks and financial institutions.

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

In numbers

<i>Bank and Financial Institutions</i>	<i>Mid-July 2007</i>	<i>Mid-Jul 2009</i>	<i>Mid-Jul 2009</i>	<i>Mid--Apr 2010</i>
<i>Commercial Banks</i>	20	25	26	27
<i>Development Banks</i>	38	58	63	78
<i>Finance Companies</i>	74	78	77	79
<i>Microfinance Institutions</i>	12	12	15	18
<i>NRB Licensed Cooperatives (limited banking transaction)</i>	17	16	16	16
<i>NRB Lincensed NGOs (Dealing in Microfinance)</i>	47	46	45	45
<i>Insurance Companies</i>	21	25	25	25*
<i>Employees Provident Fund</i>	1	1	1	1
<i>Citizens Investment Trust</i>	1	1	1	1
<i>Postal Saving Banks</i>	1	1	1	1
<i>Branches of Postal Saving Banks</i>	117	117	117	117
Total	232	263	270	291

Life Insurance - 8, Non-life Insurance - 16 and Joint Insurance - 1

Source: Nepal Rastra Bank

- 4.25 For the last few years, there has been notable expansion in the geographical and numerical presence of banks and financial institutions with expanded financial transactions as well. Subsequent expansion in the savings credit transactions and geographical spread of these banks and financial institutions has created the foundation for facilitating financial inclusiveness. Some indicators of financial activities are given in the following Table:

Table 4(g): Some Indicators of Banks and Financial Institutions

<i>Description</i>	<i>Mid-Jul 2007</i>	<i>Mid-Jul 2008</i>	<i>Mid-Jul 2009</i>
<i>Total Asset (in billion Rs.)</i>	582.48	706.62	988.89
<i>Total Capital Fund (in billion Rs.)</i>	6.90	25.78	52.68
<i>Total Deposits (in bmillion Rs.)</i>	391.15	508.91	674.58
<i>Total lending (in billion Rs.)</i>	291.60	391.54	511.75
<i>Savings/GDP ratio (percent)</i>	53.7	62.4	68.0
<i>Loans/GDP ratio (percent)</i>	40.1	48.0	51.6
<i>Market share of total deposits (percent)</i>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<i>Commercial Banks 'A' Class</i>	86.3	83.7	83.5
<i>Development Banks 'B' Class</i>	3.9	5.1	7.1

<i>Description</i>	<i>Mid-Jul 2007</i>	<i>Mid-Jul 2008</i>	<i>Mid-Jul 2009</i>
<i>Finance Company Banks 'C' Class</i>	8.8	10.3	8.5
<i>Other Institutions</i>	1.0	0.9	0.9
<u>Market Share of total lending (percent)</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<i>Commercial Banks 'A' Class</i>	79.5	78.3	77.8
<i>Development Banks 'B' Class</i>	5.3	6.0	8.3
<i>Finance Company Banks 'C' Class</i>	12.2	13.2	11.7
Other Institutions	3.0	2.5	2.2

** GDP at producers' Price (at current prices)

Source: Nepal Rastra Bank

The above table shows that deposit and lending of banks and financial institutions have been constantly growing in proportion to GDP. The gradual increase in deposit by 68.0 percent and lending by 51.6 percent by July 2009 shows the deepening of the financial sector. Commercial banks' share has reached to 83.5 percent in deposit while lending has reached 77.8 percent of the total banking activities by July 2009. Similarly, by transactions, finance companies and development banks rank second and third respectively. Besides, shares of transactions of development banks conducting micro finance activities, and governmental and non governmental organizations with limited banking activities are very low.

- 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 42,800 persons per branch by mid April 2009 has come down to 33,400 persons per branch by mid-April 2010. Calculating deposits based on total deposits of commercial banks shows per capita deposit of Rs 18,217 in mid April 2009 increased notably to Rs. 20,293 by mid-April 2010. Similarly, per capita credit channeled through commercial banks has reached Rs. 18,297 against the previous Rs. 15,197 during the same period.

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

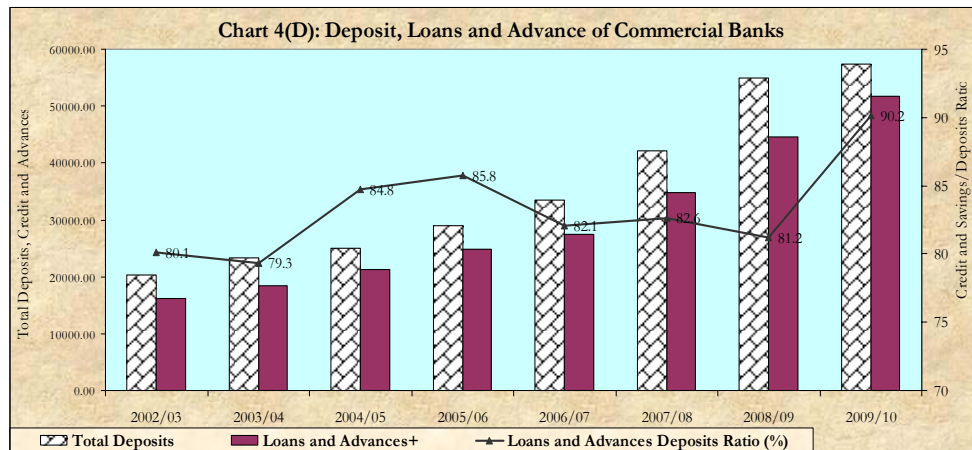
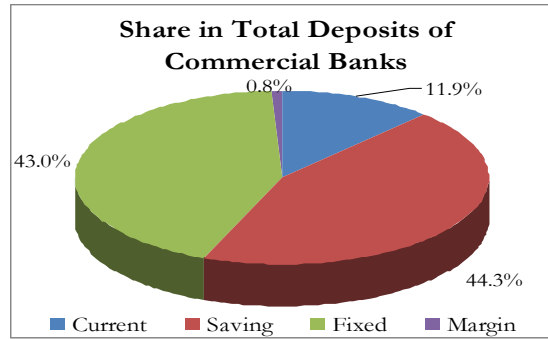
	<i>Mid April 2008</i>	<i>Mid-April 2009</i>	<i>Mi- April 2010*</i>
<i>Commercial Bank Branches</i>	591	617	845
<i>Population per Branch (In thousand)</i>	44.5	42.8	33.4
<i>Commercial Banks Deposit (in billion Rs.)</i>	375.6	481.4	572.7
<i>Per Capita Deposit (Rs.)</i>	14,282	18,217	20,293
<i>Commercial Banks lendings (in billion Rs.)</i>	387.1	401.3	516.4
Per Capita Loan (Rs.)	14,717	15,197	18,297

Source : Nepal Rastra Bank

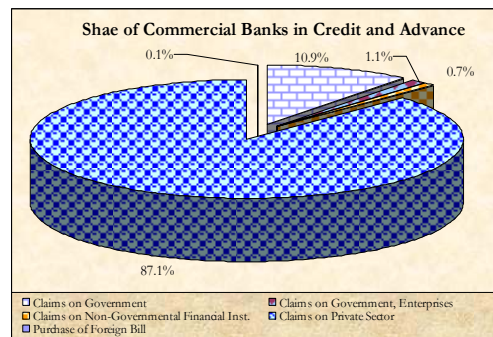
* Based on mid mid-March data

Deposit Mobilization and Credit Disbursement Status of Commercial Banks

4.27 Deposit mobilization of commercial banks that increased by Rs. 60,170 million with 14.3 percent growth in the first eight months of the fiscal year 2008/09 grew only by 4.2 percent, an increase of Rs 22,900 million in the review period of this fiscal year. In contrast, the credit increase of Rs. 53,180 million with 15.3 percent growth rate in the previous year has grown by 15.6 percent or by Rs. 69,770 million in this year. Such imbalance between the credit and deposit growth, the current Credit-deposit (CD) ratio has increased to 90.2 percent by March 2010. Likewise liquidity deposit ratio has decreased from 34.2 percent to 29.3 percent in the same period.



4.28 During the first eight months of the current fiscal year, credit flows from commercial banks to the private sector has gone up to Rs. 66,700 million (16.5 percent growth) from Rs 50,000 million (16.3 percent growth rate) in the same period of the previous year. Out of the credit flow to the private sector, credit for productive sector has grown only by 9.5 percent this year against the 12.0 percent growth in the same period of the previous year. The credit flow to the private sector for



wholesale and retail trade; finance, insurance, and fixed assets; and service sector has increased by 23.2, 41.6, and 20.2 percents respectively as compared to 10.1, 23.6, and 11.9 percents in the same period of previous year. Credit flow to real estate from the previous year's increase of Rs 7,710 million expanded by Rs. 14,920 million in the current fiscal year.

- 4.29 The liquid fund of the commercial banks has decreased by 9.7 percent during the review period owing to the depletion in foreign bank balances of Nepal Rastra Bank and commercial banks. The foreign bank balance of commercial banks has decreased by Rs. 4,250 million and that of NRB by 10,800 million. In the same period, investment in government securities has also decreased by Rs. 8,820 million.

Expansion of Commercial Bank Branches

- 4.30 The number of the commercial banks that stood at 555 by mid July of 2008 reached 752 with the addition of 197 by mid-July 2009, with the number growing to 845 by mid-April 2010. Such an expansion is attributed to the improved peace and security in the nation as well as NRB's additional liberal policy for expansion of commercial banks. By Regions, the number of commercial banks has reached 150 in the Eastern, 426 in the Central, 160 in the Western, 64 in the mid-Western, 45 in the far-Western Region by mid-April 2010.

Table 4(i): Commercial Bank Branches

<i>S.No</i>	<i>Commercial Banks</i>	<i>Mid-July 2008</i>	<i>Mid-July 2009</i>	<i>Mid-April 2010</i>
1.	Nepal Bank Ltd.	99	100	105
2.	Rastriya Banijya Bank Ltd.	114	123	123
3.	Agricultural development Bank Ltd.	65	86	97
4.	Nabil Bank Ltd.	26	32	37
5.	Nepal Investment Bank Ltd	19	31	31
6.	Standard Chartered Bank Ltd	13	13	14
7.	Himalayan Bank Ltd	17	23	28
8.	Nepal SBI Bank Ltd.	17	33	34
9.	Nepal Bangladesh Banl :td	17	17	17
10.	Everest Bank Ltd	26	30	35
11.	Bank of Kathmandu Ltd	22	30	31
12.	Nepal Credit & Commerce Bank Ltd	17	17	17
13.	Lumbini Bank Ltd	5	5	5
14.	Nepal Industrial & Commercial Bank Ltd	16	21	25
15.	Machhapuchhre Bank Ltd	18	31	32
16.	Kumari Bank Ltd.	12	15	21
17.	Laxmi Bank Ltd	13	19	21

<i>S.No</i>	<i>Commercial Banks</i>	<i>Mid-July 2008</i>	<i>Mid-July 2009</i>	<i>Mid-April 2010</i>
18.	Siddhartha Bank Ltd.	7	10	18
19.	Global Bank Ltd	7	16	20
20.	Citizens Bank Ltd	9	10	17
21.	Prime Commercial Bank Ltd	1	8	9
22.	Sunrise Bank Ltd.	6	21	26
23.	Bank of Asia ltd	5	21	22
24.	Development Credit Bank Ltd	3	5	5
25.	NMB Bank Ltd.	1	9	11
26.	Kist Bank Ltd.	-	26	44
Total		555	752	845

Source: 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 wilful defaulters, 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 in private sector.

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

(Rs. in Million)

<i>Commercial Banks</i>	<i>Mid-July 2007</i>		<i>Mid July 2008</i>		<i>Mid January 2009</i>		<i>Mid-Jan 2010</i>	
	<i>Bad Loan</i>	<i>Percentage</i>	<i>Bad Loan</i>	<i>Percentage</i>	<i>Bad Loan</i>	<i>Percentage</i>	<i>Bad Loan</i>	<i>Percentage</i>
<i>Nepal Bank Ltd.</i>	1,856.0	13.5	1,952.0	12.38	1,051.9	4.94	831.2	3.77
<i>Rastriya Banijya Bank</i>	6,877.0	27.6	5,952.0	2,165.0	4,954.4	15.68	4,342.5	12.98
<i>Agricultural Development Bank Ltd.</i>	6,185.0	18.0	4,281.0	11.69	3,427.9	8.96	3,191.8	7.97
<i>Nabil Bank Ltd.</i>	178.0	1.1	161.0	0.74	224.9	0.8	340.1	1
<i>Nepal Investment Bank</i>	422.0	2.4	309.0	1.12	213.9	0.58	196.2	0.47
<i>Standard Chartered Bank</i>	197.0	1.8	128.0	0.92	91.1	0.66	128.6	0.83
<i>Himalayan Bank Ltd</i>	642.0	3.6	477.0	2.36	551.0	2.15	889.7	2.88
<i>Nepal SBI Bank Ltd.</i>	459.0	4.6	3005	31.73	315.9	2.02	309.2	1.68
<i>Nepal Bangladesh Bank</i>	3646	39.8	488.0	3.83	1762.4	19.3	1630.6	16.17
<i>Everest Bank Ltd</i>	113.0	0.8	127.0	0.68	117.9	0.48	110.8	0.39
<i>Bank of Kathmandu</i>	243.0	2.5	237.0	1.86	190.3	1.27	202.4	1.16
<i>Nepal Credit &</i>	1,607.0	31.4	86.7	16.42	197.1	2.74	181.8	2.1

<i>Commercial Banks</i>	<i>Mid-July 2007</i>		<i>Mid July 2008</i>		<i>Mid January 2009</i>		<i>Mid-Jan 2010</i>	
	<i>Bad Loan</i>	<i>Percentage</i>	<i>Bad Loan</i>	<i>Percentage</i>	<i>Bad Loan</i>	<i>Percentage</i>	<i>Bad Loan</i>	<i>Percentage</i>
<i>Commerce Bank</i>								
<i>Lumbini Bank</i>	1,007.0	20.4	800.0	14.92	514.5	9.06	382.0	6.37
<i>Nepal Industrial & Commercial Bank</i>	101.0	1.1	98.0	0.86	129.2	0.93	164.6	1.12
<i>Machhapuchhre Bank</i>	85.0	1.2	93.0	1.04	357.2	2.75	288.2	1.87
<i>Kumari Bank</i>	66.0	0.7	152.0	1.33	64.3	0.43	70.3	0.44
<i>Laxmi Bank</i>	23.0	0.4	13.0	0.13	6.3	0.05	16.3	0.11
<i>Siddhartha Bank</i>	22.0	0.3	65.0	0.69	51.6	0.38	70.8	0.43
<i>Global Bank</i>			10.0	0.19	8.6	0.09	15.8	0.13
<i>Citizen's Bank</i>					0	0	0.22	0.02
<i>Prime Bank Ltd.</i>					0	0	0	0
<i>Sunrise Bank Ltd.</i>					14.0	0.16	7.8	0.06
<i>Bank of Asia Ltd.</i>					0.4	0.01	3.8	0.04
<i>Development Credit Bank Ltd.</i>					102.3	1.58	96.3	1.34
<i>NMB Bank Ltd.</i>					25.7	0.49	24.3	0.35
<i>Kist Bank Ltd.</i>							28.3	0.24
Total	23729.0	10.30	19215.0	6.30	14373	3.64	13526	2.87

Source: Nepal Rastra Bank

Sources and Uses of Funds of Financial Institutions

Development Banks ('B' Class Financial Institutions)

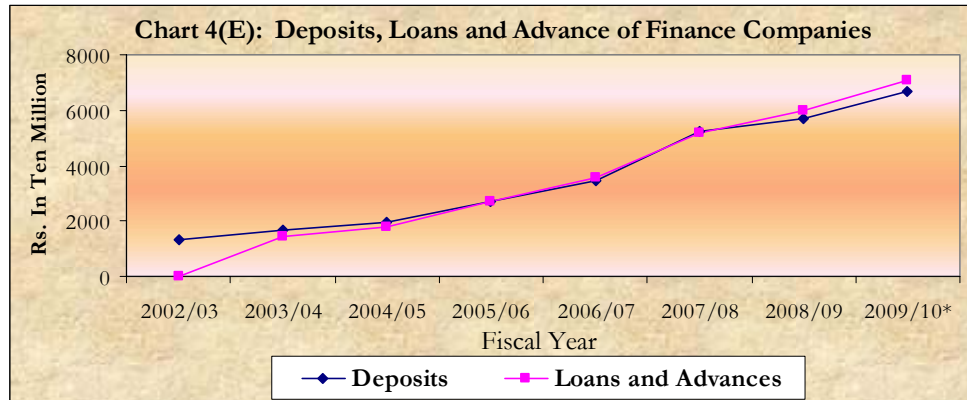
4.32 Total sources of funds of development banks reached Rs. 79,700 million by mid-January 2010 with 17.2 percent growth as compared to mid-July 2009. Total deposits of banks, their prime source of funds have increased to Rs. 56,090 million in the review period. The total capital fund of these banks has reached to Rs. 11,880 million with a growth of 27.5 percent during this period. Meanwhile, borrowings increased by 56.9 percent in the second-half of current fiscal year against Rs 4,110 million of the previous year. Loans and Advances that occupy a major part in uses of funds increased by 24.3 percent to Rs. 52,000 million.

Finance Companies ('C' Class Financial Institutions)

4.33 The aggregate resources of finance companies have reached Rs. 99,380 million with a growth of 13.7 percent as compared to the Rs 87,430 million by July 2009. Deposit as the major source of such finance companies has reached to Rs 66,990 million marking a growth of 17.4 percent during the review period. Similarly,

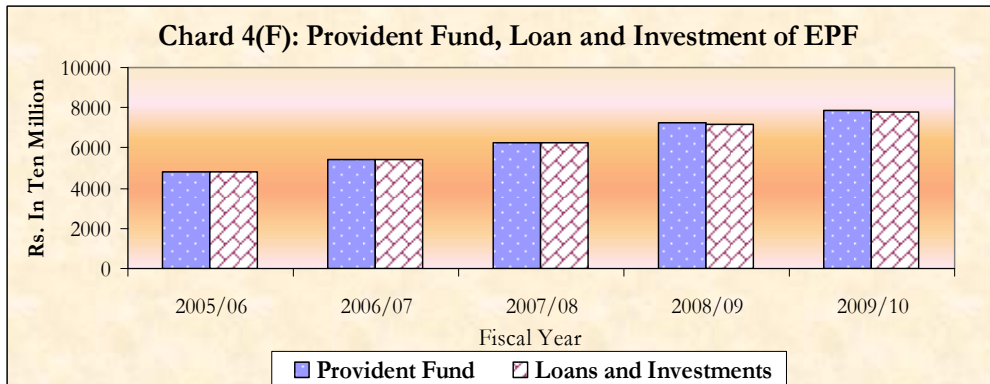
the capital funds for these companies increased by 44.1 percent arriving at Rs 15,180 million while the credit Rs 5,190 million with one 1.0 percent growth.

4.34 On the uses side of the fund, loan and advances of finance companies has increased by 17.9 percent to Rs 70,810 million between mid-July 2009 and mid-January 2010. This sum stood at Rs 60070 million by mid-July of 2009. There has been a higher growth of 74.6 percent worth Rs 5,700 million in investment in the review period. The liquid asset, however, has declined by 13.5 percent and limited to Rs 14,180 million by mid-January 2010.



Employees Provident Fund

4.35 The Employees' Provident Fund was established in 1964 under the Employees Provident Fund Act 2019 (1964). The main responsibilities of this Fund is to manage provident Fund collected from civil servants, military and police personnel, teachers, personnel of public enterprises and some other employees in the private sector. The total resources/liabilities of this Fund has reached to Rs 85,220 million by mid-Januray 2010, while such fund stood at Rs. 79,120 million by Mid-July 2009. Similarly, the total fund of depositer has reached Rs. 78,430 million by mid-Jan 2010 from Rs. 72,650 million in mid-July 2009.



Citizen's Investment Trust

- 4.36 Founded on March 18, 1991 under the Citizen Investment Trust Act 1990, the Trust is primarily involved in activities like collection and mobilization of deposits from individual and institutions, and providing credit and loans. Moreover, it acts as the issue manager for facilitating share and bonds on behalf of various organized institutions. The Fund's asset/liability grew phenomenally (28.3 percent) to Rs. 20,130 million between mid-July 2008 and 2009. Such asset/liability, however, grew only marginally between mid-July 2009 and mid-January 2010 and stood at Rs. 20,300 million. Collection of funds, which is a critical factor of its liabilities, totaled Rs. 18,430 million by mid-January 2010 against Rs 16,460 million in mid-July 2009. Likewise, on the asset side, its investment reached Rs 17,830 million by mid-January 2010 from 16,150 million in mid-July 2009.

Insurance companies

- 4.37 By mid-March 2010 altogether there were 25 insurance companies in operation established under the Insurance Act 1992. There are 8 Life Insurance Companies, 16 non Life Insurance Companies and one company dealing with both life and nonlife insurance. From the prospective of ownership, 3 insurance companies are operating with full foreign capital investment while 3 of them are operating as joint capital venture of foreign Insurance companies. Similarly, 18 companies are under private ownership and the government of Nepal owns one Insurance company. Total asset/ liabilities of these insurance companies increased by 17.2 percent to Rs. 37,010 million by mid-July 2009, which has reached Rs. 40,800 million with 10.2 percent increase by mid-January January 2010.

Postal Saving Units

- 4.38 Postal saving units, under the Department of Postal Service of the Government of Nepal, are in operation since 1974. Although 117 Post Offices are authorized to collect deposits, only 62 post offices were carrying out banking services by mid-January 2010. The total deposit of postal saving banks, which was Rs 980.062 million in July 2009, has reached Rs 1035.1 million by January 2010. The total number of such postal saving bank accounts reached 46,469 by mid-March 2010 from 43,059 in mid-July 2009.

Deposit and Credit Guarantee Corporation

- 4.39 Deposit and Credit Guarantee Corporation was established in October 1974 with objective to encourage commercial banks for investing resources in priority sectors and avail banking services to deprived people at their doorsteps. It has

continued guaranteeing loans and credits availed in priority sector including livestock, vegetable crop farming, foreign employment, micro-finance to deprived groups and credit for small and medium industries. Out of the corporation's paid up capital of Rs 100 million, the share of Government of Nepal equity is 45.97 percent, NRB's 47.13 percent, Nepal Bank Ltd 4.60 percent and Rastriya Banijya Bank 2.30 percent. The Corporation, which guaranteed credits worth Rs. 429.0 million by mid-July 2009 stood at Rs. 500 million by mid-January 2010.

Credit Information Center Limited

4.40 This center was established in 1990 on initiation of Nepal Rastra Bank for collecting information about repayment of loans and availing such information to banks and financial institutions while preparing information on blacklisted credit defaulters. The ownership of this center is shared by NRB (10 percent), commercial banks (60 percent), development banks (15 percent) and financial institutions (15 percent). According to the record available from the center, the number of blacklisted defaulters of banks and financial institutions has reached 3,465 by mid-January 2010 from 2,051 in mid-July 2009 while 1,440 defaulters have been delisted from the black list.

Micro-finance and Deprived Sector Credit

4.41 Despite the growing numbers of Banks and financial institutions, most of them are found to be urban centered. It is highly desirable to ensure the access over the financial and other resources for the deprived low income and ultra poor groups of people for their capacity enhancement through inclusiveness, for which the issue of financial inclusiveness needs to be equally addressed. In this context, expansion of micro finance institutions in rural areas is considered a positive step forward.

Micro Finance Institutions ('D' Class)

4.42 Among the micro-finance companies are five rural development banks, eleven rural banking replicators, and two wholesale micro finance institutions. Grameen Bikas Banks are operating in each region with the objective to avail necessary financial resources for engaging rural deprived sector women in income generating activities through group formation. Similarly, 11 Grameen Bank replicators (Nirdhan Uthtan Bank Ltd, Chimek Bikash Bank Ltd., Swabalamban Bikash Bank Ltd., DEPROCS Bikash Bank Ltd., NERUDE Bittiya Sanstha Ltd., Naya Nepal Laghu Bitta Bikash Bank Ltd., Mithila Laghu Bitta Vikash Bank Ltd., Simmit Micro Finance Development Bank Ltd., Swarojgaar

Laghu Bitta Vikash Bank Ltd., First Micro Finance Vikash Bank Ltd., and Nagbeli Laghu Vitta Vikash Bank Ltd), are operating in the private sector. Beside 11 micro finance institutions in the private sector and 5 Grameen Vikash Banks, the Rural Micro-finance Development Center (RMDC) established October 30, 1998 and Sana Kishan Vikash Bank Ltd. (Small Farmers Development Bank) established in July 6, 2001 are operating as wholesale micro-finance institutions.

- 4.43 The total assets/liabilities of 'D' class financial institutions carrying out micro-finance services has reached Rs 17,200 million. By mid-January, 2009/10, total deposits and lending of these institutions put together stood at Rs 2,360.0 million and Rs. 10,020 million respectively, while their total investment has reached Rs. 2,770.0 million.
- 4.44 Among the micro finance institutions engaged in wholesale lending, the paid up capital of RMDC as of mid-March 2010 stood at Rs 320 million. By the same date, its investment through micro finance institutions totaled Rs 3,984.8 million, of which Rs 2,308.6 million has been recovered with Rs1,676.2 million still as outstanding. Likewise Small Farmers Development Bank, another institution engaged in wholesale microfinance activities has invested Rs. 1090 million by January 2010.

Rural Self-Reliance Fund

- 4.45 Rural Self-Reliance Fund, which flows wholesale credit to cooperatives and non governmental organizations for micro financing, has its paid up capital of Rs 490.0 million as of mid-March 2010. The Fund has disbursed Rs 339.1 million by mid-March 2010, of which Rs 175.4 million has been recovered.

Table 4(k): Transaction Details of Rural Self-Reliance Fund

<i>Description</i>	<i>Mid-July 2008</i>	<i>Mid-July 2009</i>	<i>Mid-March 2010</i>
<i>Credit Distributed Districts (Nos.)</i>	50	51	55
<i>Credit Recipient Institutions (Nos.)</i>	334	404	477
<i>Beneficiary Households (No.)</i>	14,862	17,990	19,541
<i>Credit Disbursement Amount (in million Rs.)</i>	193.4	269.9	319.0
<i>Amount recovered (in million Rs.)</i>	102.3	141.9	175.4
<i>Outstanding amount (in million Rs.)</i>	91.0	128.0	143.6
<i>Overdue credit as percentage of outstanding credit</i>	9.0	7.48	7.15
<i>Recovery rate</i>	91.0	92.52	92.85

Source: Nepal Rastra Bank

Cooperatives and Non-Governmental Organizations with Limited Banking Activities

- 4.46 A number of co-operatives, established under the Cooperatives Act, 1991 (Amended 2060) and licensed by NRB, are also carrying out limited financial activities. The number of such co-operatives has reached 16 by April 2009. The total capital fund of these cooperatives is Rs. 476.4 million by mid-July 2009, which was Rs 400.9 million in mid-July 2008. During the review period, the total deposit of these institutions has reached Rs. 3,900.0 million while credit and loans totals Rs. 3,630.0 million. Although there are only 16 NRB licensed cooperatives, the number of saving and credit cooperatives registered under the Cooperatives Act, 1991, has exceeded 6000. These cooperatives have contributed remarkably to increase the membership, savings and credits.

Table 4(1): A Glimpse of Activities of Saving and Credit Cooperatives

<i>Description</i>	<i>Mid-July 2008</i>	<i>Mid-July 2009</i>
<i>Cooperatives (No.)</i>	5162	6289
<i>Membership (in 000)</i>	714	870
<i>Savings (in million Rs.)</i>	16240	19790
<i>Credit (in million Rs.)</i>	20120	24520

Source: Department of Cooperatives, Ministry of Agriculture & Cooperative, Government of Nepal

Similarly, 45 non-governmental organizations established under the Institutions Registration Act, 1977, have been operating under the Financial Intermediary Act, 1999 by mid-March 2010. The credit flow of such institutions, which was Rs. 961.2 million by mid-July 2009, grew to Rs 982.5 million by mid-January 2010.

Financial Sector Reform Program

- 4.47 The Financial Sector Reform Program (FSRP) is considered as an important constituent factor for the wider reform strategy of the financial sector as a whole. Following the Financial Sector Reform Strategy Paper by the Government of Nepal that introduced on November 22, 2000 through a public announcement, the NRB, with clear-cut guidelines given, is assigned with the responsibility to execute this program.
- 4.48 The main target of this reform program is to help financial sector become healthy, competitive, efficient, and professional thereby enabling to contribute largely to 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 Program. The main activities under the program include (1) re-engineering of NRB, and (2) restructuring of Nepal

Bank Ltd. (NBL) and Rastriya Banijya Bank (RBB) on one hand, and, capacity enhancement of the financial sector as a whole on the other.

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, the NRB is carrying out the programs like- Human Resource Development (HRD) and management; more effective and empowered regulatory and supervisory framework; 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 The taskforce formed to implement the reengineering programs of NRB has already submitted its proposals with recommendations and are in the process of implementation.
- 4.50 The contract signed between Information Technology Consultant, appointed for reengineering of NRB's and capacity enhancing of information technology is cancelled with the consent of the World Bank as he was found not to be so responsive and did not provide necessary cooperation. NRB has now decided to make its own long-term plan and implement it for strengthening the Bank's information technology system.
- 4.51 Nepal Rastra Bank, upon expiration of the contract with the consultant working as the Public Relation Officer on April 8, 2009 has been appointing Public Relation Officers from its own sources as per the requirement.

Box 4(d) : Restructural Reform of Nepal Bank Ltd. and Rastriya Banijya Bank Limited

1. Nepal Ratra Bank has taken over the control of NBL until mid-March 2011 in accordance with the Section 86 (C) of **NRB Act 2002**. Pertaining to the restructuring of NBL, a consultant was appointed whose term of contract came to an end on 21 July 2007. Currently, the management of NBL is being looked after by NRB personnel. Meanwhile, necessary processes are underway for the appointment of a new Chief Executive Officer of the bank through open competition.
2. The contract between the Management and Group of Management Consultants of RBBL has been extended till mid-July 2010. The management team comprising the Chief Executive as well as Chief Information Officer of the Bank's Management will give continuity to the restructuring activities.
3. There is a program to appoint a Bank Restructuring Advisor for both RBB and NBL in connection with their restructuring.
4. While reviewing the progress made so far by both these banks under restructuring program, they have earned net profit since the fiscal year 2003/04 and gradually reduced the negative capital fund. The management group has prepared and adopted various directives, policies and regulations in order to provide stability to these banks.

Several reform arrangements have been made in accordance with some internationally accepted trends and standards. Overall, the progress made so far can be considered as positive.

- 4.52 Both the NBL and RBBL have made some progress since the initiation of their restructuring programs. NBL, which was continuously at loss of billions of rupees since 1999, has been gradually reducing such losses, limiting at Rs. 250 million by the fiscal year 2002/03. By mid-July 2009, NBL has made a net profit of Rs 660 million before tax. Likewise, according to the preliminary draft of Financial Report, the Bank has earned a before tax profit of Rs. 460 million by mid-January 2010.
- 4.53 In contrast to the accumulated net loss of Rs 4,840 million in 2002/03, RBB has earned a net profit worth Rs. 2,090 million by mid-July 2009. As per the provisional financial report, the Bank has registered a profit of Rs. 1,150 million by mid-January 2010.
- 4.54 The negative net worth of both NBL and RBB is gradually improving. After undergoing restructuring program, the negative net worth of NBL Rs 9,800 million in 2004 has decreased to Rs 4,880 million by July 2009. The provisional financial report presents the Bank's estimated negative net worth at Rs 4,860 million by mid-January 2010. Similarly, the negative net worth of RBB, which totaled Rs. 22,390 million in mid-July 2003, has come down to Rs 13,480 million by mid-July 2010. The Bank's present net worth is estimated at Rs 12,310 million by mid-January 2010, as the draft report mentioned.

Table 4(m) Negative Net-Worth of NBL & RBB

Rs. in Billion

<i>Mid-July</i>	<i>Nepal Bank Ltd</i>	<i>Ratriya Banijya Bank</i>
2003	9.80	22.39
2004	8.90	21.00
2005	7.16	20.00
2006	6.30	18.59
2007	6.25	17.21
2008	5.72	15.50
2009	4.88	13.48
Mid-Jan 2010	4.86	12.31

Source: Nepal Rastra Bank

- 4.55 Out of the total credit of NBL, non-performing loan (NPL) by mid July 2003 stood at 60.47 percent, which has been gradually coming down in the subsequent years. The NPL by mid-July of 2004, 2005, 2006, 2007, 2008 and 2009 gradually came down to 53.74 percent, 49.64 percent, 18.18 percent, 13.50

percent 12.38 percent and 5.40 percent respectively. Eventually, it has come down to 3.63 percent by mid-January 2010. Though RBB's NPL, as such has not decreased in quantitative term as expected, its level however, is decreasing. The non-performing loan of RBB by June 2002/03 was 60.15 percent of the total credit which gradually came down to 57.64 percent in 2003/04; 50.70 percent in 2004/05; 37.0 percent in 2005/06; 27.60 percent in 2006/07, 21.65 percent in 2007/08 and 15.67 percent in 2008/09 respectively. The NPL of this bank by mid-January 2010 remained 13.29 percent.

Table 4(n): NPA out of the total credit

(Percent)

<i>Mid-July</i>	<i>Nepal Bank Ltd.</i>	<i>Rastriya Banijya Bank</i>
<i>2003</i>	60.47	60.15
<i>2004</i>	53.74	57.64
<i>2005</i>	49.64	50.70
<i>2006</i>	18.18	37.00
<i>2007</i>	13.50	27.60
<i>2008</i>	12.38	21.65
<i>2009</i>	5.40	15.67
<i>Mid-January 2010</i>	3.63	12.98

Source: Nepal Rastra Bank

- 4.56 The statutory auditing of both the banks that was overdue for several years in the past has resumed. The audit report of NBL from fiscal year 1999/2000 to 2008/09 has already been completed while the audit report for the fiscal year 2008/09 has already been submitted to NRB for final approval. In case of RBB, the financial details are regularly being published on a quarterly basis. After the resumption of newly appointed Management, RBB's external auditing up to the fiscal year 2008/09 has been already completed. Likewise, the internal audits also are carried out as scheduled.
- 4.57 Four consecutive voluntary retirement schemes (VRS) have already been executed as an attempt of right-sizing the NBL. Besides, after the implementation of the fourth VRS in June 2009, service tenure has been set at 30 years. The total number of 6,030 staffs in mid-July 2001 came down to 2,442 by mid-July 2009, totaled to 2,454 by mid-Jan 2010. Similarly, RBB has submitted its succession plan to NRB while it has also introduced the performance-based reward system. RBB has also succeeded in reducing the size of its staff gradually. The 5,583 employees in mid-July 2002 were reduced to 2,697 by mid-July 2009, and to 2,705 by mid-January of 2010.
- 4.58 The Management Team of NBL has formulated and adopted various plans, policies and directives for making banking system more robust and competent

internally. In the process, it has implemented credit policy and Manual for improving its credit management system. The new Accounting Manual, Internal Audit Manual, and Accounts Classification Manual are prepared and adopted. It has started writing off credits upon preparation and adoption of Credit Write Off by-laws. Similarly, the Management Group of RBB has implemented various plans, policies, and guidelines to strengthen its banking system. Especially, Anti-money laundering policy, Investment and Treasury Operation Manual, Internal Audit Manual, Trade Finance Manual as well as Credit Policy and Directives are also implemented. In addition, it has implemented the Credit Write-off By-laws.

- 4.59 NBL by preparing IT Plan, has computerized its 66 branches (out of 107 branches) to ensure prompt, efficient and well-managed banking services, to its clients. Similarly, RBB also has computerized 120 branches out of its 124 branches.

Table 4(o): Status of NBL and RBB

<i>Description</i>	<i>Mid0July 2003</i>	<i>Mid-July 2009</i>	<i>Mid-January 2010*</i>
<i>Nepal Bank Ltd.</i>			
<i>Net Profit (in million Rs.)</i>	(252)	660	460
<i>Capital Fund (in million Rs.)/ () negative</i>	(9800)	(4880)	(4860)
<i>Non-performing loan (percent)</i>	60.47	4.40	3.63
<i>Staff (No.)</i>	5,250	2,442	2,454
<i>Rastriya Banijya Bank</i>			
<i>Net Profit (in million Rs.)</i>	(4850)	2090	1152
<i>Capital Fund (in million Rs.)/ () negative</i>	(22390)	(13,480)	(12,310)
<i>Non-performing loan (percent)</i>	60.15	15.67	13.29
<i>Staff (No.)</i>	5402	2697	2705

* Provisional

- 4.60 Necessary work has been initiated for strengthening Credit Information Center Limited(CICL) and Debt Recovery Tribunal under the program for overall strengthening of the financial sector.

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

The third component of Financial Sector Reform Program aims at overall capacity enhancement of the financial sector. Progress so far includes initiation of mechanization in CICL. Meanwhile, the center staffs are imparted with overseas training. Similarly, mechanization in the Debt Recovery Tribunal and necessary training for enhancing their capacity is in the offing.

Establishment of Banks and Financial Institutions

- 4.61 Concerning applications for opening up of new banks, Janata Bank Nepal Ltd has been granted operating license of class 'A' bank to carry out banking business. Total number of commercial banks after its operation will reach 27. The proposed Civil Bank Ltd is in the process of obtaining letter of intent, while the proposed State Bank of Nepal is undergoing the verification of necessary documents.
- 4.62 The proposed Commerz and Trust Bank Nepal Ltd. have obtained letter of intent from NRB for operating banking business.
- 4.63 The proposed Century Commercial Bank Ltd. and Mega Bank Nepal Ltd. are in the process of registration with the Company Registrar's Office after getting letter of intent for operating license.
- 4.64 The total number of Development Banks has reached 78 at present. In the review period, 2 development banks, namely International Development Bank Ltd. and Tourism Development Bank Ltd. have been approved for conducting financial activities throughout the country. Similarly, 6 development banks are given approval for operating in 3 districts while 10 development banks are approved to launch their actives limiting to a single district. All the development banks permitted for one district/ three districts have already started operating in their approved geographical areas. Additionally, 10 more development banks have already been approved for letter of intent and are awaiting approval for carrying out financial business. During the review period, Sidhartha Developemnt Bank Ltd., which was licensed to confine its banking business in three districts, has been approved for extending its business as a national level development bank. Likewise, Bhrikuti Development Bank got approval to expand its operation in 10 districts from the present three districts.
- 4.65 Currently, the number of finance companies is 79. Of these, 57 companies are working within the valley and 22 are out of the valley. The proposed three more companies are in the process of obtaining operating license.
- 4.66 The number of micro-finance development banks under operation is 18 at present. Besides, during this period the following micro-financing development banks namely have already been licensed, namely - Mithila Laghu Bitta Bikash Bank Ltd. at Dhalkebar, Dhanusha; Summit Micro-Finance Development Bank Ltd. at Anarmani, Jhapa; Sworojagar Laghu Bitta Bikash Bank Ltd. at Banepa; and First Micro-finance Development Bank (National Level) in Kathmandu, Nagbeli Micro-finance Development Bank Ltd. at Anaramni, Jhapa.

- 4.67 The number of cooperatives registered under The Cooperative Act and licensed to carry out banking activities stood at 16 by mid-March 2010, without any increment in their number from the previous year.
- 4.68 The number of non-governmental organizations operating as financial intermediaries remained 45 by mid-March 2010. Earlier, they were barred to expand their outreach; however, recently a new policy has been adopted them and those meeting specified criteria can expand their geographical outreach once in a fiscal year in another one district adjacent to their working area.

Regulatory Arrangements for Banks and Financial Institutions

- 4.69 The existing mandatory provision for promoters concerned with purchase and sale of their shares has been simplified with the removal of the earlier obligatory pre-approval by NRB. Promoters, who have 2 percent or less shares of the issued capital of banks and financial institutions, need no pre-approval to carry on transactions of their shares remaining within the existing laws and regulations. However, new promoters have to fulfill the designated fit and proper tests for such transactions while the promoters having more than 2 percent of shares are restricted to enjoy such facility by breaking their block shares.
- 4.70 Some of the provisions concerning the establishment of banks and financial institutions have been amended and improvised in the Licensing Policy and Procedures: 2006. In case of investment in banks and financial institutions by Non-Resident Nepali Citizens, they have to present the tax clearance certificate issued by the local tax office, and/or the proof of tax filing, and/or the proof of not exceeding taxable income level before making such investment. Amount meant for such investment should be remitted through the proper channel along with self-declaration document. Meanwhile, the deadline of commitment to submit the prescribed amount of issued capital has been extended from mid-July 2010 to mid-March 2011.
- 4.71 Single obligor Limit (SBL) has been fixed at 25% of the core capital, including fund based or non-fund based facilities, which is in effect since mid-Jan 2010. However, the SBL for export sector, small and medium enterprises pharmaceuticals, agriculture sector, tourism industries, cement industry, iron industry and other productive industries can go up to 30 percent at the maximum. The existing limit of 50 percent for hydropower project, hydropower transmission line and cable car industries remain unchanged.

- 4.72 By mid-July 2010, all banks and financial institutions are required to maintain Statutory Liquidity Ratio (SLR). It is mandatory for all 'A', 'B', and 'C' classes banks and financial institutions to invest 8.0 percent, 3.0 percent and 2.0 percent of their domestic deposits in the government securities. For this provision, designated bonds or call deposits maintained by specifying the purpose in 'A' class Commercial banks are also considered as eligible instruments while maintaining SLR. In addition, the amount maintained as balance in excess of CRR can also be used for proportionate counting under the SLR.
- 4.73 The interest rate chargeable by NRB to banks and financing companies for export refinancing in local currency is set at 1.5 percent with such banks and financial institutions eligible to charge up to 4.0 percent interest to their borrowers such export refinancing facility availed by NRB. Similarly, a new provision of refinancing has been made for 'A', 'B' and 'C' class banks and financial institutions under which they, by complying the specified terms and condition, can avail refinancing facility from the NRB for the purpose extending credit to specified productive sectors.

Box 4(f): Arrangements for Productive Sector Refinancing Facilities

- (a) Refinancing up to 80 percent at the maximum can be availed against the collateral of good loans but not exceeding 40 percent of the core capital of concerned bank and financial institution.
- (b) Such facility will be availed at 7.5 percent for 6 months only.
- (c) The concerned institution should maintain its rate of interest not exceeding 3 percentage points to the NRB's interest rate.
- (d) Apart from the required capital adequacy ratio, an additional 0.5 percent capital adequacy should be maintained.
- (e) Banks and financial institutions having above 80 percent of the core capital and domestic deposits while using the refinancing facility, have to maintain the prescribed CD ratio which should not exceed the proportion at the time of borrowing.
- (f) The credit flow to real-estate sector should be within the set limit.
- (g) Such refinancing facilities will be provided against the collateral of good loan of the same sectors and these sectors include: export sector, small and medium industries, pharmaceuticals, agricultural sector, tourism industries, cement industry, iron industry, other productive industries, hydropower project, hydropower transmission lines and cable car. Refinancing facilities cannot be used for personal loan of undisclosed purpose, purchase of land and house/real-estate/ commercial complex; construction loan, vehicle loan, loan against share and tobacco related industries (cigarette, bidi, Cigar, khainai) and distilleries.

- 4.74 Arrangements is made for 'A' and national level 'B' class banks and financial institutions to operate activities of various derivative instruments such as forward, options, swap and futures within in yardsticks as decided by their respective boards. Banks and financial institutions can also issue new shares

within the frame of the existing securities loans. Commercial banks and national-level development banks are also authorized to operate mobile banking by complying the terms and condition set for the same and to conduct branchless banking outside Municipalities in Kathmandu Valley, sub-metropolitan cities. In addition, provision has been made for commercial banks to provide non-fund based technical service in overseas by incorporating such provision in their own memorandums.

- 4.75 The provisions of margin call and renewal on margin lending type loans against the collateral of share have been amended.

Box 4(g): Amendment on Margin Lending Type Loan

- While making necessary margin call caused by changes in the share- value in the market, concerned banks, and financial institution should monitor the value and timely inform the creditors; then they have to make the margin call within 21 days of the given margin. However, margin call will not be obligatory if the market value of shares pledged as collateral falls to the extent of 10 percent.
- Creditors enjoying margin type of lending can renew the remaining 75 percent of it if they have returned 25 percent of their credit paid with the accrued interest.

- 4.76 Financial institutions of 'B', 'C', and 'D' class are allowed to carry out inward remittances, companies of B and C class can purchase and sell Indian Currency, whereas B class national level financial institutions can accept foreign currency deposits, buy and sell foreign currency, provide exchange facilities against passports, open foreign currency accounts, and open nostro – accounts. 'B' and 'C' class financial institutions can act as co-agent of licensed commercial banks to issue debit and credit card in Nepalese and Indian currencies while 'B' class financial institutions (other than national level) are allowed to buy foreign currency and sell it to NRB and/or/ to commercial banks. Development banks and financial institutions can operate automated Teller Machine (ATM) under specified directives. Policy decision is made for 'D' Class financial institutions carrying retail banking transactions, remaining within the given conditions, to mobilize public deposit. Likewise, those national level "C" class finance companies meeting the set criteria can avail safe deposit vault and locker facilities.

- 4.77 Promoters of the concerned banks and financial institutions, directors or their families are restricted from buying the shares reserved for public issue unless the such share remains unsubscribed within the specified period. Share holders in promoters group are restricted to file their candidacy for board directors other than allocated for the promoters group. In case of the renouncement of rights shares, the existing promoters can do so by making necessary arrangements in

memorandum and articles of association. Promoters holding one percent or less share of the paid up capital, are free to renounce their rights under the given conditions of banks and financial institutions concerned.

- 4.78 The existing arrangement for standing liquidity facility (SLF) has been revised. While determining the interest rate of this facility, the weighted average interest rate for the latest 91-day treasury bills, or the latest interest on repo auction in the last one month or the prevailing bank rate whichever is higher, is maintained by adding extra 3 percent point as penal rate.
- 4.79 Arrangements for limiting lending and other facilities in the same sector of the economy by banks and financial institutions have undergone some changes. The limit on lending against the collateral of land and housing as well as real estate has been fixed.

Box 4 (h): Highlights of the Directives on Housing/Real-Estate Lending and Total Lending

- a. Credit disbursement should not exceed 60 percent of the fair market value of the housing and real estate asset.
- b. Only 25 percent of the total credit can be disbursed to real-estate and about 40 percent of the total credit can be disbursed for real-estate plus residential house loans.
- c. A new limit has been provisioned for both real estate and real-estate plus residential housing loan based on the total credit. Credit on real estate should not exceed 15 percent by mid-July 2011 and it should be brought down to 10 percent limit by mid-July 2012. Likewise, the credit to real-estate and residential housing loan should be brought down to 30 percent and 25 percent by mid-July 2011 and 2012 respectively.
- d. Banks and financial institution failing to bring their exposure within the given limit by mid-July 2011 and 2012, will be considered as in breach of directives. Such credit in excess of the set limit will carry a 150 percent risk for the purpose of calculating risk weighted asset.
- e. Total credit to total resource mobilization (domestic deposit plus core capital) ratio should not exceed 80 percent. However, institutions, which have already exceeded the 80 percent limit before the enforcement of the directives, need compulsorily to bring down their limit to 95, 85 and 80 percent by mid-July 2010, mid-July 2011 and mid-January 2012 respectively.

- 4.80 Policy arrangements have been made for the expansion of NGOs working territory in the adjacent districts under the Financial Intermediation Act and Regulations. Organizations fulfilling other additional specificities and conditions can however, expand their branches even in other districts otherthan those where they were registered.
- 4.81 Policy arrangements have been made for A, B, and C class banks and financial institutions willing to operate merchant bnking business by establishing a

separate subsidiary company. But, it has to be approved by Nepal Securities Board in compliance with the existing policy and other legal arrangements.

- 4.82 Following to the Monetary policy of 2009/10, A, B, and C class institutions can open 'D' class Micro- finance Institution as the subsidiary company and disburse credit to deprived groups. For single, family, firm, company, or organised institution or company of the same group, up to 25 percent of the paid capital can be invested by those institutions as in the earlier arrangement. However, the policy arrangement for subsidiary company allows the promoters to invest 51 percent to 70 of percent of the paid up capital at a special request of such banks and financial institutions.
- 4.83 A new version of unified directives-2009 consisting of 20 directives has been issued by incorporating all circulars/directives/guidelines and any amendments/modifications their own by mid-July 2009.
- 4.84 Banks and financial institutions, while calculating the interest amount for their depositors on a weekly, or monthly or quarterly or any other bases as per their policy should consider at least the average balance of that period.
- 4.85 The provision of doing banking activities under consortium financing for the borrowing firm/company only with lead bank or participating bank is equally applicable to loose consortium without forming group under which two or more banks and financial institutions finance a single project on a paripasu basis.
- 4.86 Deprived sector lending requirement of 3 percent of the total credit for commercial banks is unchanged while development banks and finance companies are required to extend at least two and one percent respectively in the fiscal year 2009/10.
- 4.87 Compulsory provision has been made to make payment only through account payee cheques for any kind of transaction above Rs 5 million.
- 4.88 In case of action taken with regard to shares of banks and financial institutions belonging to general public or promoters group, such individual and his undivided family members' share investment will be confiscated, auctioned and utilized for loan recovery.
- 4.89 Banks and financial institutions are barred from buying the cheques from founders/directors/staff and their household members. In cases of buying cheques from other clients, they are bound to collect such cheque or send for collection within three days including the day of purchase.

- 4.90 In case of 'D' class micro-finance development banks having more than 51 percent ownership of promoters group, promoters can sell the remaining shares as general public share through secondary market provided that at least they retain 51 percent.
- 4.91 Promoter's share of the licensed banks and financial institutions, pledged as security for loan cannot be accepted by the concerned banks or financial institutions for loan recovery purpose as it appears in the form of cross holding, which is against the legal provision laid down in Banks and Financial Institution Act, 2063.
- 4.92 Any individual enlisted with NRB for the purpose of professional director and auditor of banks and financial institutions or any partnership firm, company or institutions with his or her direct involvement will be automatically if any sort of case is filed by the competent authority against him/her. Similarly, he/she will be automatically listed after clearance.
- 4.93 Investment made in a newly established company not yet listed with the stock exchange should be listed within 2 years of its operation or from the date of such investment otherwise, the equivalent amount of investment fund should be created.
- 4.94 All the credit documents of banks and financial institutions, promissory note, mortgage deed, hypothecation agreements and trust receipt agreements should compulsorily be prepared in Devnagari script Nepalese language.
- 4.95 Directors, chief executive officers and other staffs of banks and financial institutions failing to respect the directives and penalized in cash, will be enlisted in the black list until such fines are realized. Directors/managing directors are restricted to receive any sort of remuneration, allowances and other benefits before getting license for carrying out financial activities. Non-executive chairperson and other directors are barred from receiving any kind of fringe benefits except the entitled benefit. The benefits being enjoyed by them cannot be raised until the first annual general meeting with representation of public director.
- 4.96 Publications of Annexes and details concerned with financial details have been revised, processed, and simplified with time. Likewise, arrangements have been made to prepare and implement the code of conducts and to form a corporate governance unit for monitoring governance level on a monthly basis.

Other Activities Related with Banking and Financial Sector

- 4.97 The policy guidelines and procedures have already been implemented that allows "A" class commercial banks to open branch offices in foreign countries by meeting the designated standard.
- 4.98 Policy Arrangement has been issued under the Section 34 of Banks and Financial Institutions Act, 2003 for foreign banks/financial institutions that allows opening their branches in Nepal for wholesale banking. This arrangement is made in accordance with Nepal's commitment to financial service sector while entering the World Trade Organization (WTO) on 23 April 2004, as its 147th member.
- 4.99 Permission has been granted to foreign banks and financial institutions for opening up representative office in Nepal. In this context, Mashreq Bank, PSC of United Arab Emirates, Dubai has got the license on March 17, 2010.
- 4.100 Study on the postponement of acceptance of applications for setting up new banks and financial institutions since July 30, 2009, meant to review of the existing policy and procedures of licensing, and has reached at its final stage. However, 'D' class micro-finance development banks willing to serve in rural area (except in municipalities and sub municipalities), and those 'B' class development banks, who have already applied for establishment with a proposal of 1 to 3 districts coverage are being considered for licensing purposes. Policies for licensing new banks and financial institutions of other classes will be adopted from the beginning of the next fiscal year, based on the conclusion of the study being made.
- 4.101 Willful defaulters of banks and finance companies have been penalized e.g. impounding of passport following the Government's decision of February 11, 2009. For monitoring the efficiency and taking further actions against them, a high level monitoring committee on action against willful defaulters has been formed under the Chairmanship of Hon. Mr. Hari Rokka, member of Constituent Assembly. As per the decisions of the committee, 32 out of 355 defaulters have been released after the repayments of their respective loans amounting to Rs 461.3 million.
- 4.102 The Grievances Hearing Cell, which was formed for hearing complaints from either side during transactions with banks and financial institutions, has been restructured as per the Cabinet's decision on December 15, 2006. Similarly, the Grievance Hearing Management Committee for the same purpose has also been formed on January 4, 2007. Giving continuity to the Deputy Governor of NRB as

coordinator, the Committee has now one representative each from the Ministry of Finance and the Chairperson of Nepal Bankers' Association as member while one representative from the Federation of Nepal Chamber of Commerce and Industry remains as an observer. Out of 415 complaints registered since January 4, 2007, hearing over 371 cases has already been completed by mid-March 2010 and correspondence with concerned financial institutions is ongoing for the remaining 44 cases.

- 4.103 In relation of maintaining a panel of professional experts under section (13) of the Banks and Financial Institutions Act, 2063, additional 12 persons with required qualifications are enlisted, totaling to 89 in the current Fiscal Year.
- 4.104 In order to maintain coordination among the agencies concerned with banks and financial sector more effective and to continue making necessary improvements, NRB has conducted various meetings under the convenorship of Deputy Governor. These meetings have made several timely decisions in relevant matters so far. Apart from the coordinator, Executive Director of NRB, Chairperson of Stock Exchange, Chairperson of Insurance Board, Registrar of the Company Registrar's Office and representative from the Ministry of Finance are the other members engaged in deliberations and decision-making.
- 4.105 The NRB Banking Promotion Committee, which was under NRB initially, is now operational under Nepal Banker's Association.

Inspection and Supervision of Banks and Financial Institutions

- 4.106 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 with the growing number of banks and finance companies and viewing the limited supervision capacity, risk based supervision, as an instrument to gradually implement in the coming years, is emphasized. Inspection and supervision processes at micro-level have been regularly advanced.
- 4.107 The consolidated supervision of the overall banking and financial sector is continued also in the fiscal year 2009/10. Weaknesses and deficiencies encountered during supervision are addressed on the spot as far as practicable. Regular directions on corrective measures are given 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 up to mid-March 2010

Overall On-site Inspections

The overall site supervision of 21 commercial banks has been completed by the end of mid-March 2010. Similarly, inspections of 32 Development Banks, 35 Finance Companies 5 Micro Finance Development banks, 6 Cooperative with limited banking activities, 1 NGO on micro finance have been supervised on the site.

Off-Site Supervision

During the review period, off-site supervision of 24 Commercial Banks have been conducted giving necessary directions and giving clearance to publish their financial reports. Likewise, clearance is given to 52 Development Banks, 47 Finance Companies, and 7 Micro Finance Development Banks for publishing their annual financial details. Besides, 10 Development Banks, 11 Finance Companies, and 1 Micro-Finance Banks were fined for not disbursing the credit in directed proportions. Two finance companies have undergone actions as per Rapid Improvement Action Regulation 2064.

Special Inspection

Special supervision has been conducted in 16 commercial banks and 12 development banks, 18 finance companies as per the need felt during the review period. Similarly, 10 more (out of 16) special supervisions are also completed to ensure the adequacy of capital (under BASEL II) and liquidity situation of commercial banks.

Follow-up and Targeted Supervision

Follow-up supervision of 7 development banks; targeted supervision of 2 micro finance banks; physical infrastructure supervision of 11 development banks, 2 finance companies and 3 micro finance banks have already been completed, while follow up supervision of one development bank, and five finance companies have been made during the review period.

- 4.108 The provision for commercial banks to take compulsory clearance of NRB to publish their financial details is given continuity. After making the overall supervision with the analyses of financial position and current issues, Annual Bank Supervision Report 2008 has been published and posted on the NRB's Website.
- 4.109 The draft of risk based supervision guidelines has already been prepared in order to implement risk management guideline (RMG) and risk based supervision to guide commercial banks to carry out their services being more risk-sensitive. Processes are being advanced for the selection of appropriate methods on stress testing, considered as an important tool for risk management.