Financial Stability Report

Fiscal year 2023/2024

Issue 16

Nepal Rastra Bank
Banks and Financial
Institutions Regulation Department
Baluwatar, Kathmandu

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Disclaimer

This *Sixteenth issue* of the Financial Stability Report is based on the provisional data of Bank and Financial Institutions (BFIs), financial markets, financial infrastructures, and other financial institutions of mid-July 2024. It summarizes the key developments in the Nepalese financial sector with policy measures taken during the review period (fiscal year 2023/2024). However, some selected developments are also presented in the publication.

Data used in the analysis may thus differ from the most recent statistics or audited financials published by BFIs. The colors, boundaries, denominations, or any other signs and symbols used in the report do not imply any metaphoric judgments. This report, unless, or otherwise stated elsewhere, covers the financial performance and phenomena observed during the fiscal year ended mid-July 2024. All the data and information in this report are retrieved from the financial Sector related institutions and publication of IMF & World Bank unless stated.

Nothing herein shall constitute or be considered a limitation upon or waiver of the provisions of existing rules, regulations, and legislations.

Published by:
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FOREWORD

The major upheaval in the financial markets emerging from the geopolitical unrest, trade tensions, high sovereign debt and economic uncertainties makes it challenging to conserve the global financial stability. The occurrence of extreme climate events, threats from use of technologies in financial system, and marred oversight in less regulated non-bank financial institutions are the new sources of risks in the global financial system. In the meantime, most of the central banks around the globe adopted cautiously eased monetary policy stance and as a result, both the global economic growth and inflation are on an improving side.

Amidst these impediments, Nepal's economy exhibited resilience with the gradual improvement in macroeconomic fundamentals. The gradual taming down of inflationary pressures, improvement in balance of payments and foreign exchange reserves has relieved the pressure exerted on the price and external sector stability. The timely introduction of prudent regulations contained the exuberances and aided to conserve the macroeconomic stability. Recent improvements in economic indicators are encouraging and symbolic of the resilience of our economy and financial system. With the gradual improvement in the domestic economic conditions, the domestic financial system has also remained sound and resilient.

The financial soundness indicators of Bank and Financial Institutions (BFIs) on capital adequacy, liquidity and leverage stood above the regulatory requirements while the gradual deterioration of asset quality has become a cause for concern. Nonetheless, BFIs tenacity has confirmed the financial system's ability to withstand the risks and turbulences. Similarly, the non-bank financial institutions also showed up resilience. On this point, in order to conserve financial stability and support higher growth trajectory, the way forward necessitates cautious, proactive, and vigilant regulation from all the regulators.

Finally, I would like to appreciate the Financial Stability Oversight Committee, led by the Deputy Governor and Financial Stability Sub-Committee for their untiring efforts at the working level to bring out this important publication in coordination with related departments and agencies. I hope this document provides a comprehensive overview regarding the stability of Nepalese financial system.

Thank You,

Dr. Neelam Dhungana Timsina

Acting Governor

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ADBL	Agricultural Development Bank Limited
AI	Artificial Intelligence
ALPA	Asset (Money) Laundering Prevention Act, 2008
AML	Anti-Money Laundering
APG	Asia Pacific Group on Money Laundering
ASBA	Application Supported by Blocked Amount
BCBS	Basel Committee on Banking Supervision
BFIs	Banks and Financial Institutions
CAR	Capital Adequacy Ratio
CD	Credit to Deposit Ratio
CCD	Credit to Core Capital plus Deposit Ratio
CFT	Combating the Financing of Terrorism
CSR	Corporate Social Responsibility
KSKL	Karja Suchana Kendra Limited
CIT	Citizen Investment Trust
DCGF	Deposit and Credit Guarantee Fund
DFS	Digital Financial Services
DoC	Department of Cooperatives
EGMONT	The Egmont Group of Financial Intelligence Units
EPF	Employees Provident Fund
FATF	Financial Action Task Force
FICPD	Financial Inclusion and Consumer Protection Division
FINGO	Financial Intermediary Non-Government Organization
FIU-Nepal	Financial Information Unit of Nepal
FY	Fiscal Year
GDP	Gross Domestic Product
GoN	Government of Nepal
HIDCL	Hydroelectricity Investment and Development Company Limited
IMF	International Monetary Fund
INR	Indian Rupees
IPO	Initial Public Offering
IT	Information Technology
JPY	Japanese Yen
LTV	Loan to Value
LEA	Law Enforcement Agencies
MFIs	Micro Finance Financial Institutions
ML	Money Laundering

MoU	Memorandum of Understanding
NBL	Nepal Bank Limited
NCBL	National Cooperative Bank Limited
NEPSE	Nepal Stock Exchange Limited
NIDC	Nepal Industrial Development Corporation
NPL	Non-Performing Loan Ratio
NPR	Nepalese Rupees
NRB	Nepal Rastra Bank
NSO	National Statistics Office
PSO	Payment System Operator
PSP	Payment System Provider
QII	Qualified Institutional Investors
QR	Quick Response
RBBL	Rastriya Banijya Bank Limited
ROA	Return on Assets
ROE	Return on Equity
REs	Reporting Entities
RWA	Risk Weighted Assets
RWE	Risk Weighted Exposure
SEBON	Securities Board of Nepal
SLF	Standing Liquidity Facility
SOB	State owned Banks
SSF	Social Security Fund
ToT	Training of Trainers
USD	US Dollar
UNODC	United Nations Office on Drugs and Crime

EXECUTIVE SUMMARY

1. In 2024, the global economy grew at a moderate pace; advanced economies, as well as emerging market and developing economies are expected to sustain a steady growth trajectory. The global economy grew by 3.2 percent in 2024.

2. Inflation rates have declined globally; influenced by easing supply chain disruptions and moderating commodity prices. The global headline inflation remained at 5.7 percent in 2024.

3. The Nepalese economy showed signs of recovery in the fiscal year 2023/24, primarily driven by a significant increase in service sector activities, and an uptick in agricultural and energy production. As a result, the Nepalese economy grew by 3.87 percent in the fiscal year 2023/24.

4. The Consumer Price Index (CPI) based inflation was slightly higher than the target, however it followed the soft landing and stabilized during the review year. The inflation remained at 3.57 percent, reflecting a disinflationary trend, primarily driven by decline in non-food inflation during the later months of the review period.

5. The external sector demonstrated resilience as the remittance inflows, balance of payments, and foreign exchange reserves followed an increasing trend. The external sector remains stable, supported by 16.5 percent increase in remittance inflows and favorable balance of payments.

6. The cautious accommodative monetary policy adopted by Nepal Rastra Bank (NRB), along with inflation and declining market interest rates, contributed to the growth of the monetary sector. Broad money grew by 13 percent, private sector credit increased by 5.8 percent, and total deposits of banks and financial institutions increased by 13 percent.

7. The number of Banks and Financial Institutions (BFIs) has been gradually decreasing over the years due to the merger and consolidation policies implemented by the NRB. With the consolidation of microfinance institutions, the number of financial institutions decreased and has aided in strengthening the resilience of the financial system. During the review period, 10 microfinance institutions undergone the mergers and acquisitions process. As of mid-July 2024, the total number of BFIs stood at 107.

8. During the review year, the share of assets of BFIs in the financial system decreased slightly to 78.26 percent as compared to 79.84 percent in mid-July 2023.

9. The total assets of commercial banks, development banks, finance companies, microfinance financial institutions, and infrastructure bank remained broadly stable. As of mid-July 2024, commercial banks held the largest share in terms of total assets (64.78 percent), followed by development banks (6.71 percent).

10. Additionally, insurance companies held the largest share in terms of total assets, followed by the Employees Provident Fund (EPF), Citizen Investment Trust (CIT), and reinsurance companies.

11. Credit growth of BFIs increased slightly to 6.11 percent compared to 8.73 percent in the previous year. The growth rate of deposit mobilization for BFIs stood at 13 percent, up from 12.34 percent in the previous year.

12. During the review year, sector-wise credit distribution of the BFIs showed concentration in the consumption loans (19.62%), wholesale and retail sector (19.34%), agriculture, forestry and beverage production (16.60%), and finance, insurance and real estate sector (7.67%).

13. The financial soundness indicators of banks and financial institutions demonstrated resilience and stability of financial system. The capital adequacy of BFIs continued to be well above the regulatory requirements. However, the declining trend of capital adequacy has raised supervisory concerns. As of mid-July 2024, the overall capital adequacy ratio and core capital ratio stood at 12.92 percent and 10.20 percent, respectively.

14. The ratio of non-performing loans remained high, highlighting the increased challenges in conserving the soundness of the financial system. The non-performing loan to total loans ratio of BFIs increased from 3.02 percent to 3.86 percent during the review year.

15. The elevation of non-performing loans constrained the BFIs balance sheet growth and affected their profitability, with net profit of Rs. 71.43 billion, marking a decrease of 7.22 percent compared to previous year.

16. As of mid-July 2024, the leverage ratio of commercial banks stood at 6.78 percent, well above the regulatory requirement. Similarly, the total liquid assets to deposit ratio of BFIs stood at 26.44 percent, slightly lower than the 27.10 percent recorded in the previous year. The net liquid assets to total deposits ratio remained well above the minimum regulatory requirement of 20 percent.

17. Market conduct regulations, including the interest spread and the base rate plus premium framework, have served the dual purpose of protecting financial consumers and fostering healthy competition. During the review year, the average monthly base rate of commercial banks stood at 9.18 percent.

18. During the review period, the US Dollar Index reached its highest value at 107. The Nepalese currency depreciated by 1.64 percent against the US Dollar. As of mid-July 2024, the exchange rate stood at Rs. 133.36 per US Dollar, compared to the exchange rate of Rs. 131.17 a year ago.

19. As of mid-July 2024, nine Payment System Operators and 26 Payment Service Providers were in operation. The use of digital payment modes, including the large-value payment system (RTGS) and retail payment systems such as Connect IPS, Fonepay IBFT, QR-based payments, mobile banking, internet banking, cardless cash withdrawals, and point-of-sale (POS) transactions are on the rise. Additionally, efforts have been made to strengthen Nepal's payment systems and establish a framework for identifying systemically important payment systems.

20. Financial inclusion and access has also been increasing, driven by inclusive policy initiatives undertaken by the NRB. The expansion of bank branches across all local levels, rising financial literacy, and the growing adoption of digital financial services have significantly boosted financial inclusion and accessibility.

21. Despite risks and vulnerabilities to the economic outlook, the domestic financial system remained resilient during the review year. The banking sector demonstrated its ability to withstand turbulence arising from both domestic and global financial conditions. This resilience was reflected in key financial soundness indicators such as capital adequacy, liquidity, and leverage, all of which remained well above regulatory standards. However, the steady decline in asset quality has raised supervisory concerns. In this context, maintaining financial stability while sustaining a high growth trajectory will require cautious, proactive, and prudent oversight from all regulators of financial system.

CHAPTER I: GLOBAL MACRO-FINANCIAL CONTEXT

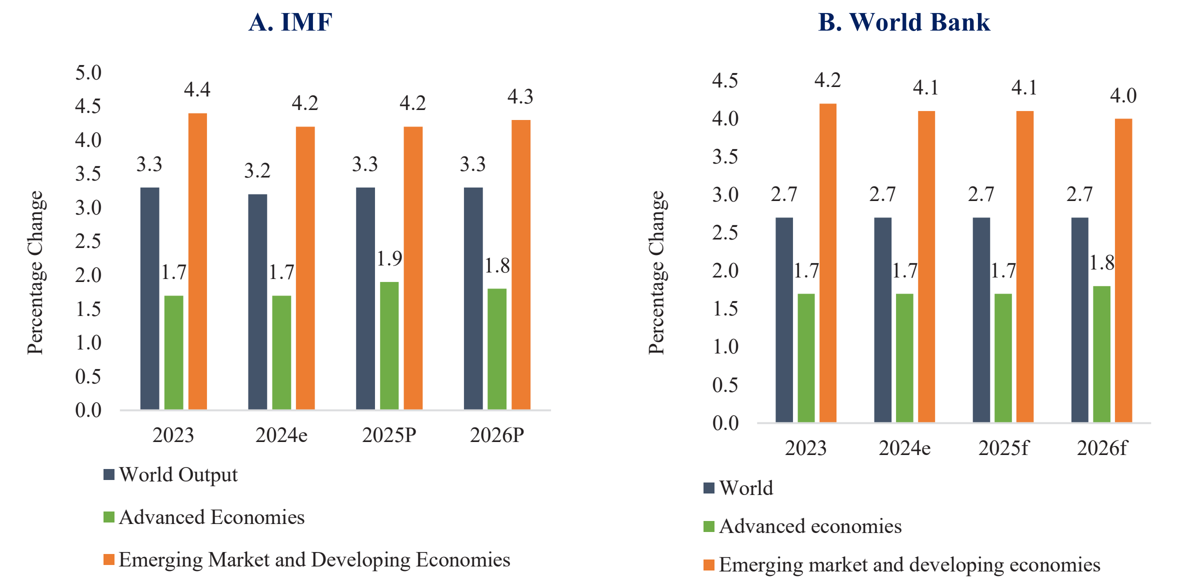
1.1 Global Macroeconomic Environment

1.1.1 Global Economic Growth and Inflation

The global economy is expected to remain stable, with moderate growth. The International Monetary Fund (IMF) estimates that the global economy grew by 3.2 percent in 2024 and is projected to expand by 3.3 percent in both 2025 and 2026. Advanced economies, as well as emerging market and developing economies, are expected to sustain a steady growth trajectory. Growth prospects have been revised for the United States and emerging Asian economies, particularly due to surging demand in Artificial Intelligence (AI) related sectors. Conversely, projections for Europe, the Middle East, and Sub-Saharan Africa have been downgraded due to conflicts, commodity supply disruptions, and climate impacts. Similarly, the World Bank projects global growth to remain stable at 2.7 percent from 2024 to 2026.

According to the IMF, global economic growth remains below pre-COVID-19 levels due to geopolitical tensions, structural challenges, insufficient investment, climate change, and natural disasters.[1]

Figure 1.1: Global Growth Outlook



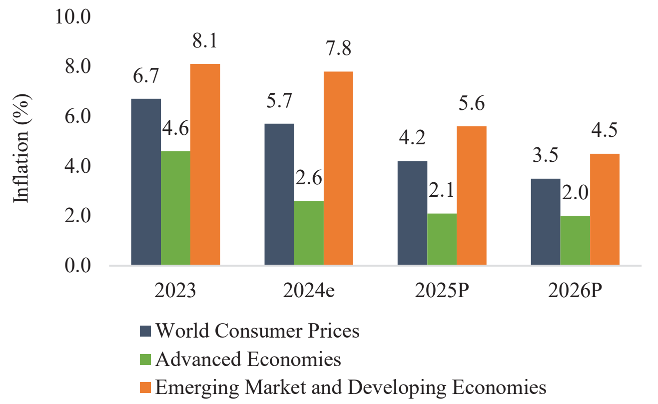
Source: World Economic Outlook, 2025 January

Source: Global Prospects, 2025 January

[1] World Economic Outlook (October 2024), International Monetary Fund (IMF)

Global inflation is gradually moving toward central banks targets. The global headline inflation rate was 6.7 percent in 2023 and is expected to decrease to 5.7 percent in 2024. It is projected to further come down to 4.2 percent in 2025 and 3.5 percent in 2026. Disinflationary trends have been expected in advanced economies and emerging market and developing economies (EMDEs).

Figure 1.2: Inflation



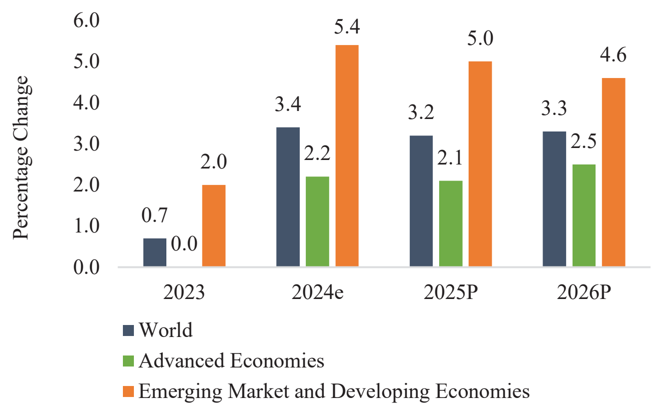
Source: IMF, World Economic Outlook, 2025 January

The key factors contributing to this soft landing include the improving supply chains, the lagged effects of stringent monetary policies, a decline in demand, and lower energy prices. While advanced economies are nearing central bank inflation targets, strong wage growth and persistent inflation in the service sector continue to put price pressures.

1.1.2 Trade

Global trade is facing a mix of recovery and challenges. IMF estimates that the global trade volume (goods and services) grew by 3.4 percent in 2024. The IMF projects growth in global trade volume by 3.2 percent in 2025 and 3.3 percent in 2026. Global trade volume has continued to expand but at a slower pace compared to pre-pandemic trends. The growth of trade volume lags behind economic activities as a result of persistent geopolitical tensions and shifts toward protectionist measures by some economies.

Figure 1.3: Trade Volume (Goods and Services)



Source: IMF, World Economic Outlook, 2025 January

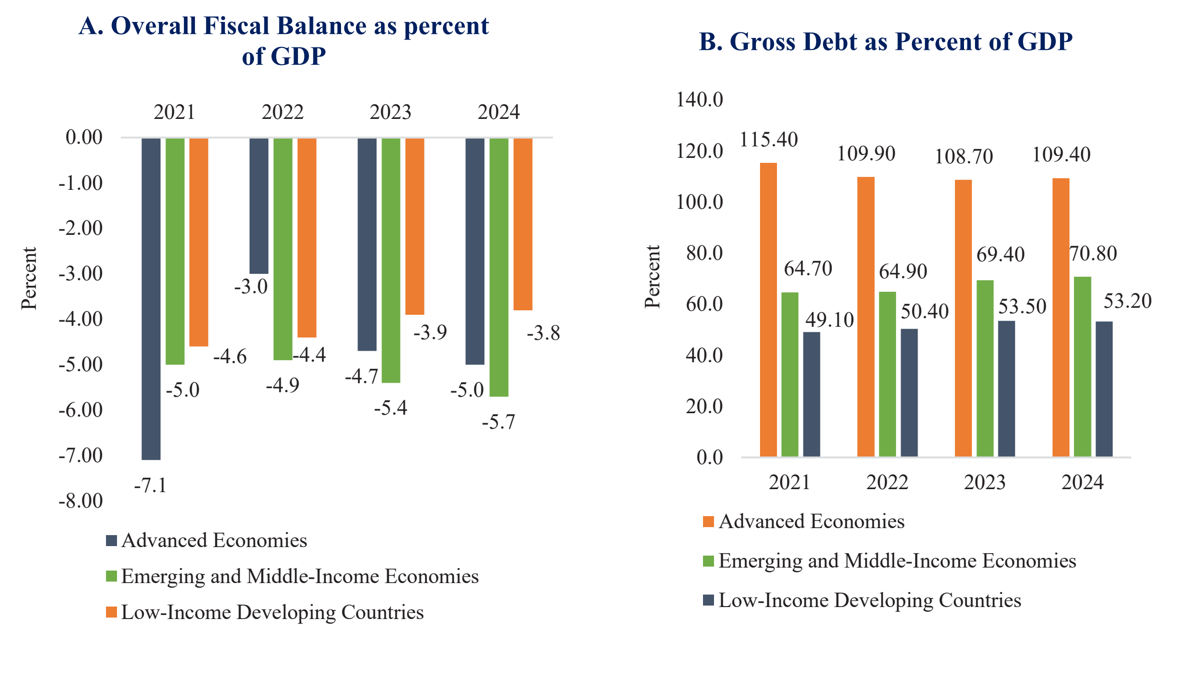
While global trade shows resilience in some areas, medium-term risks persist due to geopolitical instability, potential financial market disruptions, and structural inefficiencies. Demand for services has softened; trade in goods, particularly technology and green-energy-related products. Emerging economies, notably in Asia, continue to play a vital role in driving global trade growth.

1.1.3 Fiscal Balance and Public Debt

Persistent fiscal deficits have been observed to keep public debt levels elevated. The global fiscal balances worsened in 2024 compared to 2023. Overall, fiscal balances are estimated at -5.0 percent of GDP in advanced economies, -5.7 percent in emerging market and middle-income economies, and -3.8 percent in low-income developing economies.

As a result of the ongoing fiscal deficits, global public debt is estimated to surpass USD 100 trillion in 2024, which represents approximately 93 percent of global GDP. This amount is also expected to rise, nearing 100 percent of global GDP by the end of 2030. The gross public debt was recorded at 109.4 percent of GDP in advanced economies, 70.8 percent of GDP in emerging market and middle-income economies, and 53.2 percent of GDP in low-income developing economies.

Figure 1.4: Overall Fiscal Balance and Gross Debt as Percent of GDP



Source: Fiscal Monitor Report, IMF, October 2024

1.2 Global Financial Environment

Financial stability risk remains contained in the near term, although rising economic and geopolitical uncertainty increases the likelihood of adverse shocks, exposing fragilities. The stable economic activities and moderate inflation are prompting expectations of interest rate cuts by major central banks, particularly in advanced economies like the U.S. and Europe. This contributed to improved financial conditions and created a soft-landing scenario for the global economy. China's policy measures to support its property market and stimulate demand have helped stabilize its financial sector. However, some evidence of growing economic fragmentation has been observed. With the increasing protectionist policies, regional financial alliances and reducing market efficiency/integration the risks to the global financial stability has increased. Emerging and developing economies are facing higher risks due to tighter global financial conditions, limited fiscal space, and currency depreciation pressures[2]. Debt vulnerabilities are especially severe in countries with large external financing needs.

Medium-term negative shocks are increasing due to ongoing economic and geopolitical uncertainties. The Global Financial Stability Report (2024) highlighted several risks to future financial stability, including high asset valuations, a global rise in private and public debt, and increased leverage in non-bank financial institutions. Additionally, the uncertain policies of governments in some countries and the intensification of geopolitical tensions could further expose vulnerabilities. The increase in non-performing loans in financial system and rising number of cyber threats further complicates the efforts to maintain macroeconomic and financial stability.

Global financial conditions are anticipated to strengthen in 2025 following marginal tightening in 2024, marked by a complex interaction of regional dynamics and macroeconomic factors. With inflation anticipated to further moderate in 2025, advanced economies may prudently lower policy rates, therefore stabilizing financial conditions and alleviating borrowing costs. The developing markets may persist in facing risks like fiscal weaknesses, external financing constraints, and geopolitical risks. Coordinated, region-specific policies and strategies will be essential for managing varied recovery paths and promoting global financial stability.

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[2] Fiscal Monitor, October 2024 (IMF).

CHAPTER II: NEPALESE MACRO-FINANCIAL CONTEXT

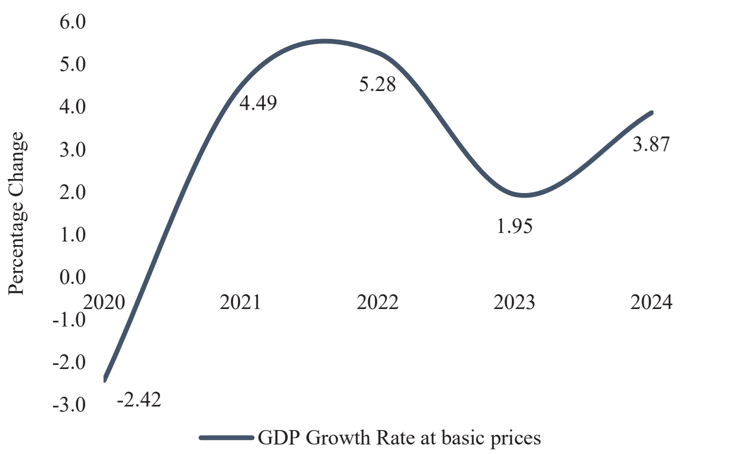
2.1 Overview of the Nepalese Macroeconomic Situation

The domestic macroeconomic situation shows signs of recovery, though challenges still persist. The annual data for the fiscal year 2023/24 showed positive trends, including subdued inflation, a robust external sector, and an improvement in GDP growth compared to the previous fiscal year. The banking system experienced ample levels of liquidity, which has led to a decline in interest rates on deposits and loans. However, the credit growth has remained lower than the projections. The non-performing loans in the overall banking industry have surged in recent periods. On the fiscal side, performance has been suboptimal. While these domestic indicators signal the resilience, the combination of subdued credit growth and fiscal underperformance underscores the need for targeted sector wise policies to sustain recovery and address structural challenges.

2.1.1 Economic Growth

Nepal's economic growth improved during the review year. According to the National Statistics Office (NSO), economic growth stood at 3.87 percent in the fiscal year 2023/24 compared to a growth of 1.95 percent a year ago. The growth is largely attributed to the food services, electricity and gas, and transportation and storage sectors. On contrary, the construction and manufacturing sectors experienced contraction during the review year.

Figure 2.1: Real GDP Growth Rate

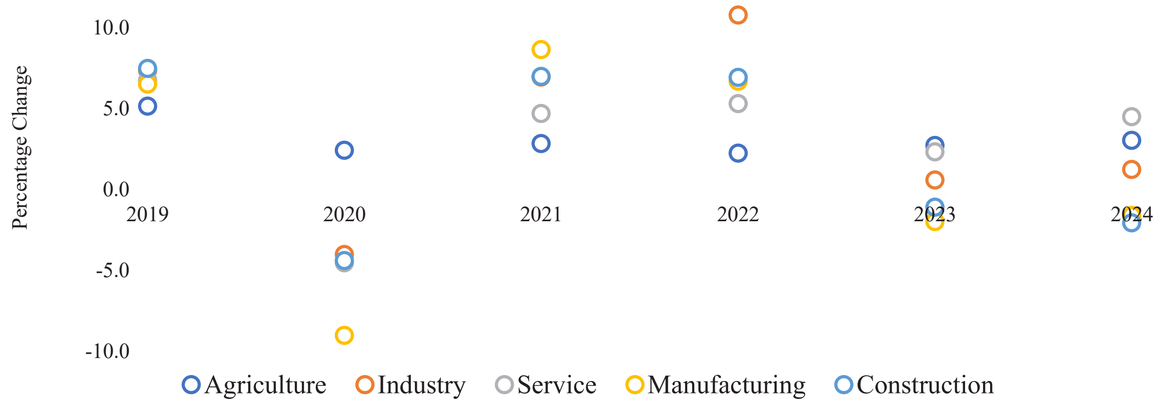


Note: Producer's Price *Source: National Statistics Office (2024)*

The agriculture sector grew by 3.05 percent, and the non-agriculture sector grew by 2.9 percent in the fiscal year 2023/24, compared to a growth of 2.7 percent and 2.1 percent, respectively, in the previous year. The industrial sector's growth remained weak within the non-agriculture sector. The manufacturing and construction sectors witnessed the ups and downs during, before, and after the pandemic. These sectors were on the rise before the breakout of the pandemic, aligning with the period of stable economic activities. The manufacturing sector contracted by 9.03

percent, the construction sector contracted by 4.39 percent, and the GDP decreased by 2.42 percent during the period of pandemic. It highlights the severe impact on GDP caused by lockdowns, business closures, disrupted supply chains, and construction site shutdowns during the pandemic period.

Figure 2.2: - Sector-wise GDP Growth

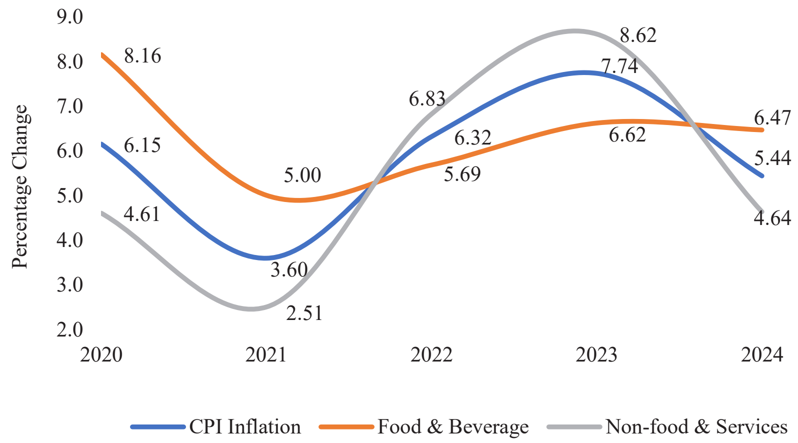


Source: National Statistics Office (2024)

2.1.2 Inflation

Consumer price inflation showed a disinflationary trend driven by non-food inflation during the later months of the review year. The inflation which started to surge during the pandemic and continued its upward trend in the fiscal year 2022/23 has recovered in the fiscal year 2023/24. The annual average consumer price inflation remained at 3.57 percent in the fiscal year 2023/24, compared to 7.44 percent a year ago. The non-food inflation showed slower growth compared to the previous year, mainly driven by the lowering demand of the non-essential items and stability in energy prices. The annual average food and beverage

Figure 2.3: Changes in Consumer Price Index



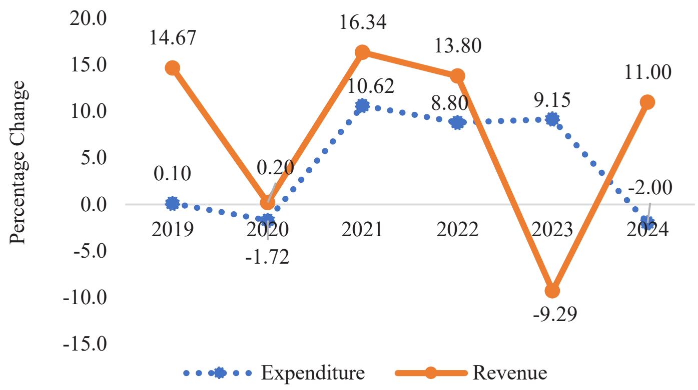
Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

inflation stood at 6.47 percent in the fiscal year 2023/24 compared to 6.62 percent a year ago, while the non-food inflation stood at 4.64 percent compared to 8.62 percent a year ago.

2.1.3 Government Finance

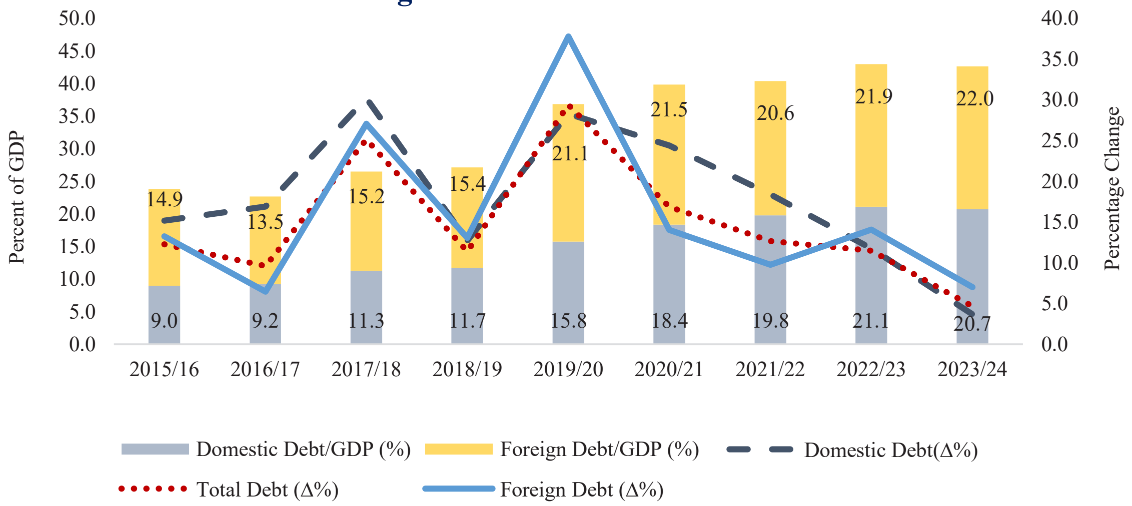
The government fiscal deficit decreased during the review year. In fiscal year 2023/24, the fiscal position of the Government of Nepal (GoN), stood at a deficit of Rs. 293 billion based on banking transactions, compared to a deficit of Rs. 486.9 billion in the previous year. In the review year, government revenue increased by 11 percent (based on banking transactions) to Rs. 1059 billion compared to a decrease of 10.25 percent in the previous year. The total government expenditure decreased by 2 percent to Rs. 1351.9 billion in fiscal year 2023/24 compared to an increase of 9.15 percent in the previous year.

Figure 2.4: Government Expenditure and Revenue Growth



Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

Figure 2.5:Government Debt



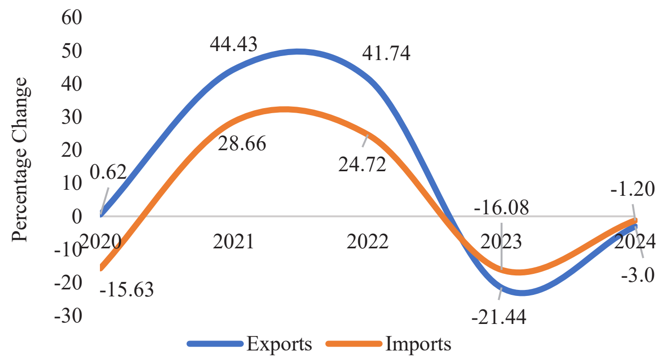
Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

The decrease in government spending and the signs of recovery in revenue collection have resulted in a lower budget deficit in the fiscal year 2023/24. In tandem, the government debt to GDP ratio slightly decreased as compared to the previous year. Domestic debt increased by 4.6 percent to Rs.1181 billion, and foreign debt increased by 7.01 percent to Rs. 1252 billion in the fiscal year 2023/24. The total government debt stood at 42.70 percent of the GDP in fiscal year 2023/24. Although the Government of Nepal's total debt is on the rise, the debt to GDP ratio has decreased slightly, which may be attributed to the higher growth rate of nominal GDP.

2.1.4 External Sector

The total merchandise trade decreased during the review year with the contraction in imports and exports. Merchandise import decreased by 1.2 percent and exports by 3.0 percent, resulting in total trade decreasing by 1.3 percent in the fiscal year 2023/24. The export sector faced challenges like limited competitiveness and reliance on a narrow range of products, further compounded by a strong currency and global trade uncertainties, which resisted the pace of recovery in export growth. As a result, the total trade deficit decreased by 1.0 percent and remained as 25.25 percent of the GDP.

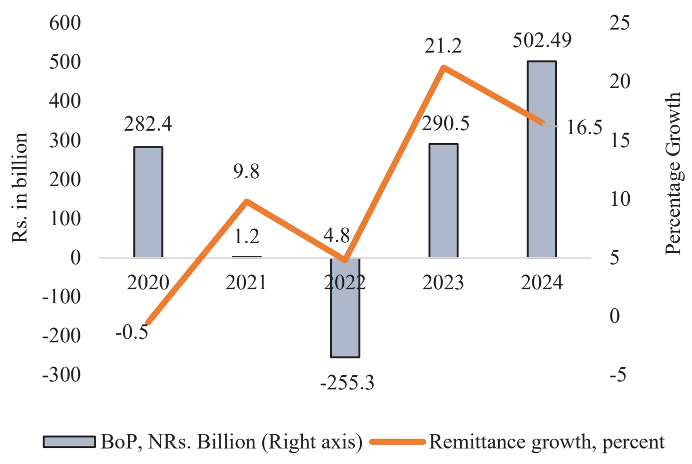
Figure 2.6: Growth Rate of Exports and Imports



Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

The external sector remained resilient with the remarkable growth of remittances. Worker's remittances inflows increased by 16.5 percent to Rs. 1445.32 billion in the fiscal year 2023/24, about 25.3 percent of GDP. As a result, gross foreign exchange reserves increased by 32.6 percent to Rs. 2041.10 billion in the fiscal year 2023/24 from Rs. 1539.36 billion in the previous fiscal year, increasing the merchandise goods and services import capacity to 13 months. The BoP remained at a surplus of Rs. 502.5 billion in the fiscal year 2023/24, compared to BOP surplus of Rs. 290.5 billion in the previous year.

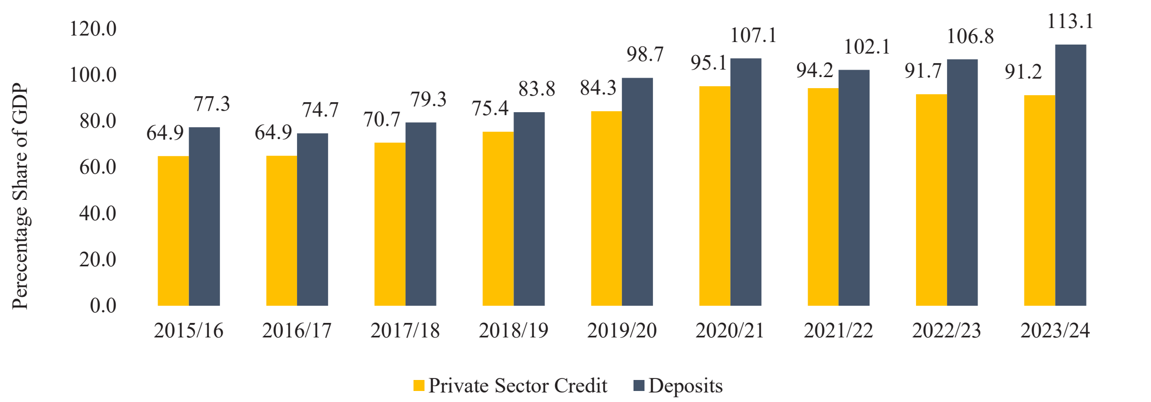
Figure 2.7: Foreign Exchange Reserves Situation



Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

2.1.5 Monetary Sector

The monetary sector expanded mainly with the support of external sources. The broad money grew 13 percent in the fiscal year 2023/24 compared to 12.7 percent in the previous fiscal year. The private sector credit increased by 5.8 percent in the fiscal year 2023/24, compared to 4.6 percent growth in the fiscal year 2022/23. Domestic credit increased by 6.1 percent compared to 8.8 percent in the previous fiscal year. The expansion of the monetary

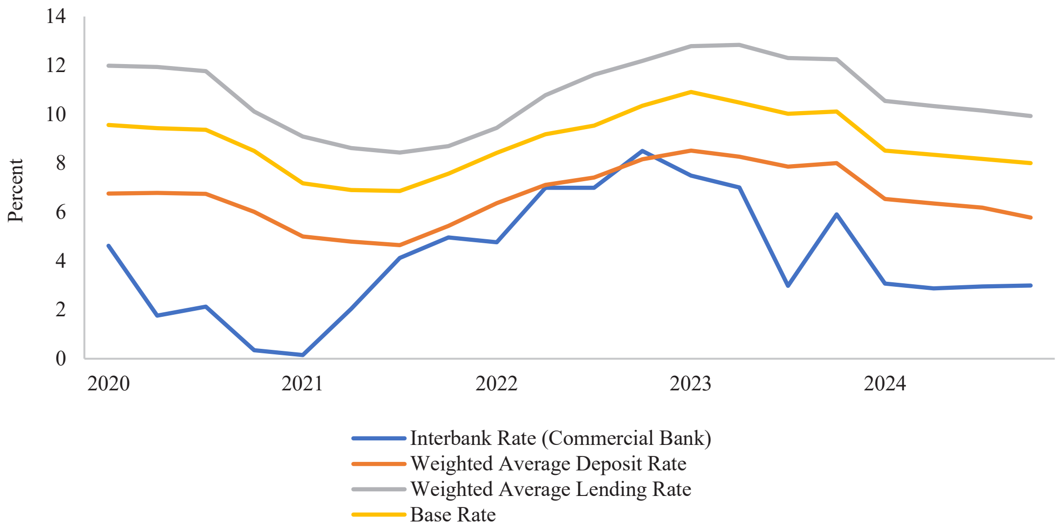


Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal sector is depicted by the surging up of credit to GDP ratio of Nepal. The credit to GDP ratio which stood at 64.9 percent in the year 2015, surged to reach 91.20 percent in fiscal year 2023/2024. The total deposits of banks and financial institutions grew by 13 percent compared to 12.3 percent in the previous year.

2.1.6 Interest Rates

The base rate, deposit rate, and lending rate followed declining trend in the review year. The short-term interest rates, both the weighted average interbank rate and the 91-day T-bill rate, remained at 3 percent and 2.99 percent, respectively, in the last month of 2023/24, compared to 3.14 percent and 6.35 percent a year ago. In the fiscal year 2023/24, the base rate, weighted average deposit, and lending rate showed a downward trend. Since the liquidity conditions have improved, the long-term interest rates have decreased in the fiscal year 2023/24.

Figure 2.9: Structure and Trends in the Interest Rate



Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

Box 1: Recent Macroeconomic Development

This box summarizes the recent macroeconomic development of 2024/25.

- The government of Nepal (GoN) expects economic growth of 6 percent in the fiscal year 2024/25. Such growth was 3.87 percent in fiscal year 2023/24, 1.95 percent in the fiscal year 2022/23, and 5.28 percent in the fiscal year 2021/22.
- The y-o-y consumer price inflation remained at 3.75 percent in mid-March 2025 compared to 4.82 percent a year ago.
- During the eight months of fiscal year 2024/25, the total expenditure of the federal government, according to data from Financial Comptroller General Office (FCGO), Ministry of Finance, stood at Rs.839.36 billion, the recurrent expenditure, capital expenditure, and financial management expenditure amounted to Rs. 584.13 billion, Rs.82.34 billion, and Rs.172.89 billion, respectively.
- During the eight months of fiscal year 2024/25, merchandise exports increased 57.2 percent to Rs.158.17 billion against a decrease of 4.0 percent in the same period of the previous year.
- The balance of payments (BOP) remained at a surplus of Rs.310.37 billion in the review period compared to a surplus of Rs.327.55 billion in the same period of the previous year.
- Gross foreign exchange reserves increased 18.0 percent to Rs.2409.25 billion in mid-March 2025 from Rs.2041.10 billion in mid-July 2024. Based on the imports in eight months of fiscal year 2024/25, the foreign exchange reserves is sufficient to cover the prospective merchandise imports of 17.2 months and merchandise and services imports of 14.3 months.
- Private sector credit from BFIs increased Rs.304.82 billion (6.0 percent) in the eight months of the fiscal year 2024/25 review period compared to an increase of Rs199.5 billion (4.2 percent) in the corresponding period of the previous year. Deposits at BFIs increased Rs.277.23 billion (4.3 percent) in the review period compared to an increase of Rs.435.87 billion (7.6 percent) in the corresponding period of the previous year.
- In eight months of fiscal year 2024/25, NRB absorbed, on a transaction basis, a total liquidity of Rs.16004.15 billion, including Rs.2013.60 billion through deposit collection auction and Rs.13990.55 billion through the Standing Deposit Facility (SDF). In the corresponding period of the previous year, Rs.597.24 billion net amount of liquidity was absorbed through various instruments of open market operations.
- In eight months of fiscal year 2024/25, BFIs' interbank transactions amounted Rs.1293.09 billion on a turnover basis, including Rs.1162.71 billion interbank transactions among commercial banks and Rs.130.38 billion among other financial institutions (excluding transactions among commercial banks).
- The average base rate of commercial banks decreased to 6.34 percent in the eighth months of fiscal year 2024/25 from 8.77 percent in the corresponding month of previous year. The weighted average deposit rate and lending rate of commercial banks stood at 4.54 percent and 8.40 percent, respectively in the eighth month of the review year.
- NEPSE index stood at 2736.49 points in mid-March 2025 compared to 2108.73 in mid-March 2024. Market capitalization in mid-March 2025 stood at Rs.4543.81 billion compared to Rs.3314.63 billion in mid-March 2024.

2.2 Overview of the Nepalese Financial System

2.2.1 Structure of Overall Financial System

The financial system of Nepal is broadly categorized into financial institutions, financial markets, and financial infrastructures. The financial institutions in Nepal mainly comprise the banks and financial institutions and non-bank financial institutions. The banks and financial institutions which are regulated by Nepal Rastra Bank (NRB), comprises of commercial banks, development banks, finance companies, micro finance institutions and infrastructure development bank. On the other side, the non-bank financial institutions comprises of insurance companies, cooperatives, Employees Provident Fund (EPF), Citizen Investment Trust (CIT), Social Security Fund (SSF) and other institutions such as national cooperative bank limited, remittance companies, money changers, hire purchase companies and hydroelectricity investment and development company limited. Amongst the non-bank financial institutions, the insurance companies that are regulated by the Nepal Insurance Authority (NIA) comprise of life insurance companies, non-life insurance companies, reinsurance companies, and micro-insurance companies. Likewise, the cooperatives fall under the regulatory jurisdiction of the Department of Cooperatives (DoC).

The domestic financial market in Nepal comprises of money market and capital market. The money market mainly encompasses monetary policy operations and management through the conduct of open market operations. On the other side, the capital market, regulated by Securities Board of Nepal (SEBON) comprises of stock exchange, listed companies, central securities depository, stockbrokers, stock dealers, merchant bankers, credit rating agencies, mutual funds, Application Supported by Blocked Amount (ASBA) members, qualified institutional investors, securities dealers, and depository participants.

In order to support the proper functioning of financial services and markets, Nepal's financial system comprises of foundational financial market infrastructures such as payment systems, clearing and settlement systems, credit information bureau, deposit and credit guarantee fund, and debt recovery tribunal.

The number of banks and financial institutions has been decreasing gradually over the years. As of mid-July 2024, the total number of BFIs stood at 107, which comprises 20 commercial banks, 17 development banks, 17 finance companies, 52 MFIs, and 1 infrastructure development bank. In addition, 14 life insurance companies, 14 non-life insurance companies, two reinsurance companies, and seven micro-insurance companies are in operation. The securities market comprises one stock market and one central depository and clearing institution. Similarly, with the major purpose of adding value in the price discovery process, 116 qualified institutional investors are in operation as of mid-July 2024. On the other side, the number of securities market participants like stock brokers, merchant bankers, mutual funds, and depository participants have remained stagnant over the years. Similarly, the non-bank financial institutions like Employees Provident Fund, Citizen Investment Trust, Social Security Fund, Deposit and Credit Guarantee Fund, Credit Information Bureau, and postal saving bank are also operational in the financial system.

Table 2.1: Number of Financial Institutions

Institutions	2020	2021	2022	2023	2024
Banks and Financial Institutions					
Commercial Banks	27	27	26	20	20
Development Banks	20	18	17	17	17
Finance Companies	22	17	17	17	17
Microfinance Financial Institutions	85	70	65	57	52
Infrastructure Development Bank	1	1	1	1	1
Total	**155**	**133**	**126**	**112**	**107**
Insurance Companies					
Life Insurance Companies	19	19	19	14	14
Non-Life Insurance Companies	20	20	19	14	14
Reinsurance Companies	1	2	2	2	2
Micro Life Insurance Companies	-	-	-	2	3
Micro Non-Life Insurance Companies	-	-	-	2	4
Total	**40**	**41**	**40**	**34**	**37**
Non-Bank Financial Institutions					
Employees Provident Fund	1	1	1	1	1
Citizen Investment Trust	1	1	1	1	1
Postal Savings Bank	1	1	1	1	1
Social Security Fund	1	1	1	1	1
Total	4	4	4	4	4
Financial Infrastructures					
Deposit and Credit Guarantee Fund	1	1	1	1	1
Credit Information Bureau	1	1	1	1	1
Nepal Clearing House Limited	1	1	1	1	1
Debt Recovery Tribunal	1	1	1	1	1
Total	4	4	4	4	4

Banks and Financial Institutions (BFIs) represent almost 80 percent of the total financial system assets in Nepal as of mid-July 2024. During the review year, the share of BFIs in the financial system decreased slightly. BFIs comprised 78.26 percent of the financial system's total assets/ liabilities.

Table 2.2: Structure of the Nepalese Financial Sector (Total Assets)

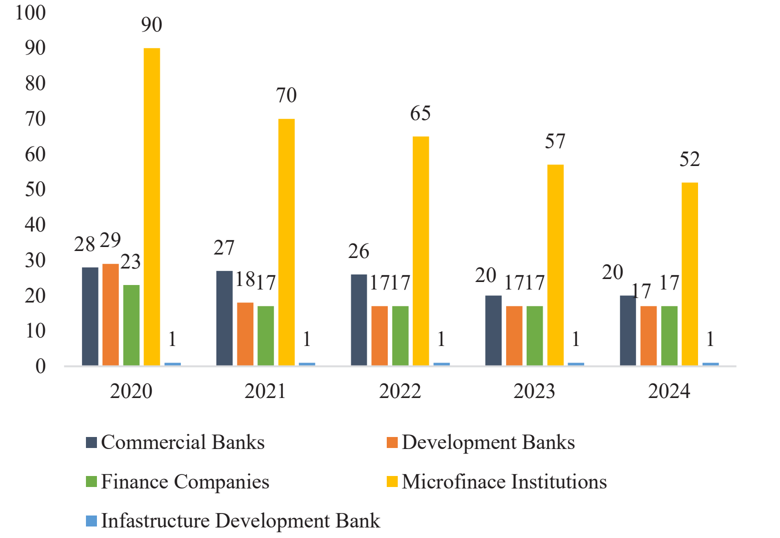
Institutions	(Rs. Billion)				
	2020	2021	2022	2023	2024
Commercial Banks	4,413.57	5420.35	6020.6	6465.9	7242.7
Development Banks	413.42	521.95	612.7	669.9	717.3
Finance Companies	126.75	126.68	152.0	155.2	171.31
Microfinance Financial Institutions	325.16	445.5	519.7	507.7	553.7
Infrastructure Development Bank	13.97	24.42	26.4	29.1	29.5
National Cooperative Bank	50.80	51.26	57.87	63.48	64.66
Cooperatives	383.14	383.14	383.1	383.1#	383.1#
Employees Provident Fund	388.71	444.47	459.0	515.0	574.02
Citizen Investment Trust	180.71	197.67	247.5	265.6	308.31
Insurance Companies	437.32	542.65	624.1	810.61	939.21
Reinsurance Companies	15.09	29.33	38.2	41.3	54.12
Social Security Fund	28.96	38.69	54.7	74.80	98.07
Total	**6777.60**	**8226.11**	**9195.87**	**9981.69**	**11136.00**
Market capitalization (NEPSE)	1,792.76	4010.96	2869.34	3082.52	3553.67
Total (incl. market capitalization)	**8570.36**	**12237.07**	**12065.21**	**13064.21**	**14689.67**
Percentage Share (Excluding NEPSE Market Capitalization)					
Commercial Banks	65.12	65.89	65.47	64.78	65.04
Development Banks	6.10	6.35	6.66	6.71	6.44
Finance Companies	1.87	1.54	1.65	1.55	1.54
Microfinance Financial Institutions	4.80	5.42	5.65	5.09	4.97
Infrastructure Development Bank	0.21	0.30	0.29	0.29	0.26
National Cooperative Bank	0.75	0.62	0.63	0.64	0.58
Cooperatives	5.65	4.66	4.17	3.84	3.44
Employees Provident Fund	5.74	5.40	4.99	5.16	5.15
Citizen Investment Trust	2.67	2.40	2.69	2.66	2.77
Insurance Companies	6.45	6.60	6.79	8.12	8.43
Reinsurance Company	0.22	0.36	0.42	0.41	0.49
Social Security Fund	0.43	0.47	0.59	0.75	0.88

Figures used the same as in earlier years due to the unavailability of updated figures on Cooperatives

2.2.2 Financial Sector Consolidation

The microfinance sector experienced mergers and acquisitions during the review year. The number of BFIs has been on a decreasing trend over the years. The Mergers and Acquisition Bylaws 2073 has facilitated the process of mergers and acquisitions. During the fiscal year 2023/24, ten microfinance financial institutions were involved in the mergers and acquisition process, among which eight were involved in the merger process and two were involved in the acquisition process. The total number of banks and financial institutions stood at 107 in mid-July 2024 as compared to 112 in mid-July 2023.

Figure 2.10: Number of Banks and Financial Institutions

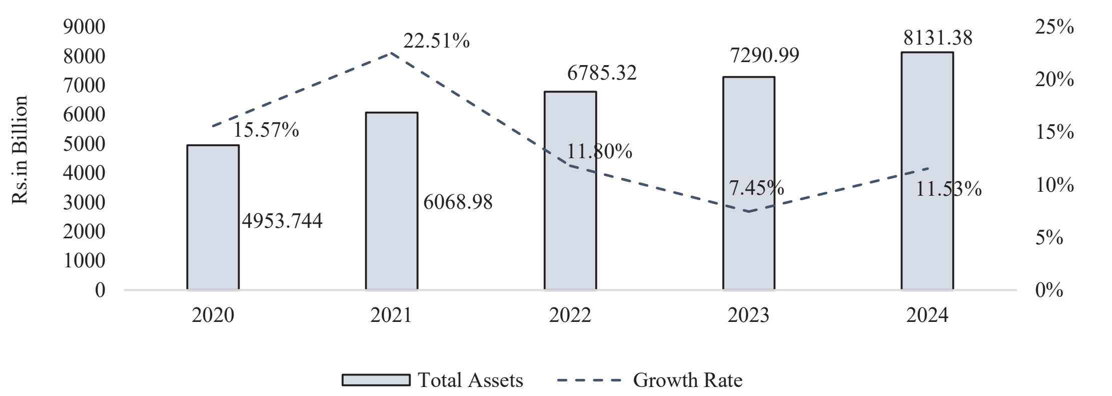


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.2.3 Assets Size of Banks and Financial Institutions

Despite the decreasing number of BFIs, the total assets showed up an increase. The assets of BFIs increased by 11.53 percent to Rs. 8,131.38 billion as of mid-July 2024.

Figure 2.11: Total Assets and Growth Rate



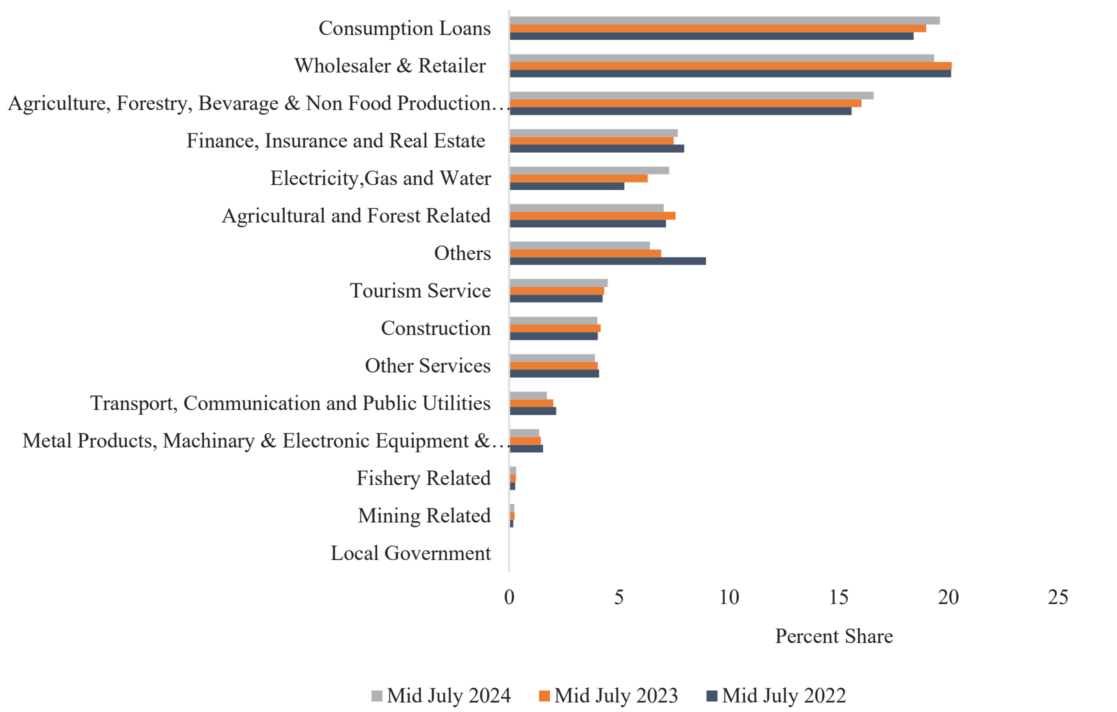
Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.2.4 Sector-wise Loans and Advances

BFI's loans and advances are heavily concentrated in consumption loans and wholesale & retail sector loans. As of mid-July 2024, consumption loans constituted 19.62 percent of total loans and advances, followed by wholesale and retail sector loans, which stood at 19.34 percent.

Similarly, as the share of the wholesale and retail trade sector on total GDP stands at 13.84 percent, the concentration of loans and advances disbursed in the wholesale and retail sector also stood high during the review year. The credit on agriculture, forestry and beverage production stood at 16.60 percent, finance, insurance, and real estate stood at 7.67 percent, and electricity gas and water stood at 7.28 percent during the review year.

Figure 2.12: Sector-wise Loans and Advances

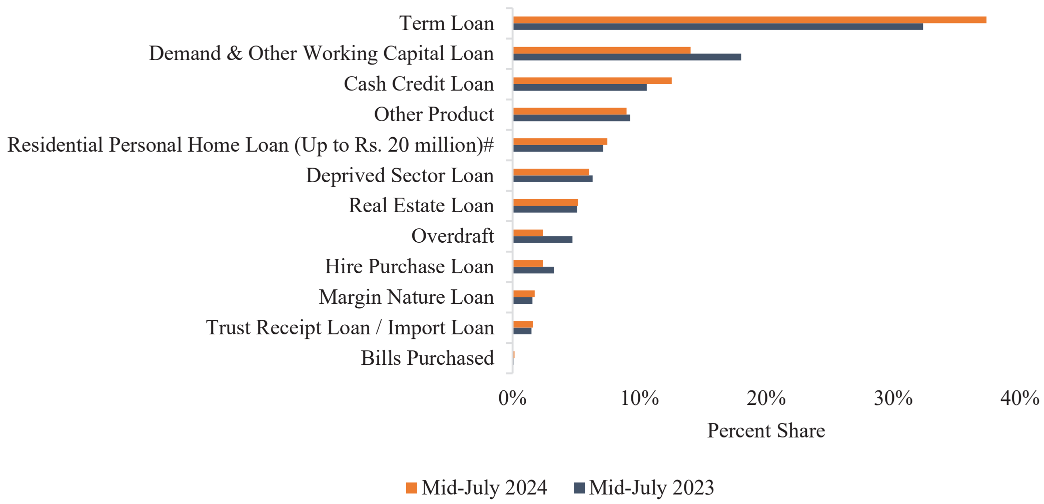


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.2.5 Product-Wise Loans and Advances

Loans and advances are concentrated to term loans and demand & working capital loans. As of mid-July 2024, term loans constituted 37.37 percent of total loans and advances, followed by demand & working capital loans, which stood at 14.04 percent, and cash credit loans, which stood at 12.55 percent. The y-o-y growth of term loans stood at 22 percent while the demand & working capital loan decreased by 18 percent during the review year.

Figure 2.13: Product-wise loans and advances

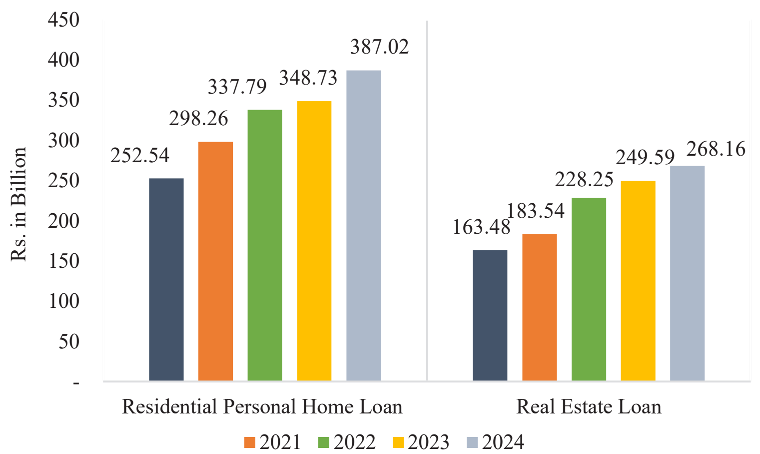


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.2.6 Real Estate and Residential Home Loans

Real estate and residential home loans increased during the review year. Loans to real estate and residential homes increased during the review year. The exposure on residential home loans reached Rs. 387.02 billion in mid-July 2024, which was Rs. 348.73 billion in the previous year. The exposure on real estate loans reached Rs. 268.16 billion in mid-July 2024, which was Rs. 249.59 billion in the previous year. The residential home loan and real estate loan increased by 10.98 percent and 7.44 percent, respectively.

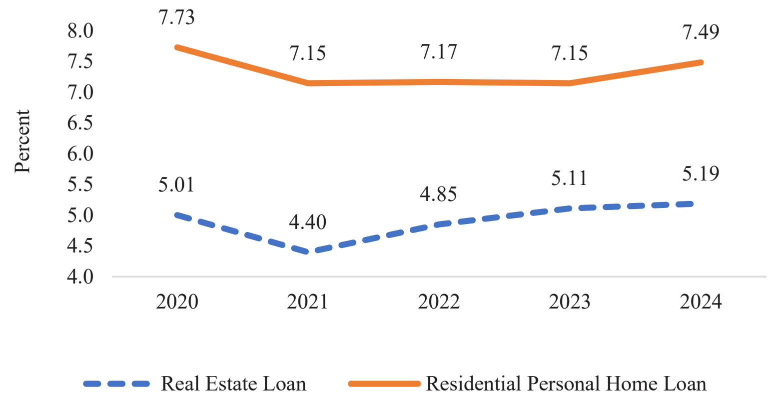
Figure 2.14: Residential Home Loan and Real Estate Lending of BFIs



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

As of mid-July 2024, the loan extended by BFIs in real estate accounted for 5.19 percent of total loans and advances. Similarly, the loan availed in residential personal home loans accounted for 7.49 percent of total loans and advances. Commercial banks, Development banks and finance companies availed 4.92 percent, 6.69 percent and 10.19 percent of the total loans and advances to the real estate sector in mid-July 2024.

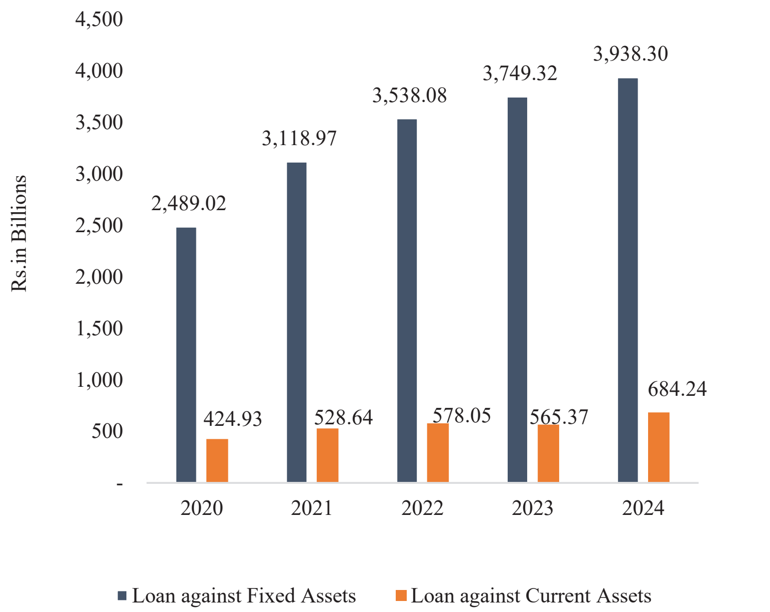
Figure 2.15: Real Estate Lending and Residential Home Loans to Total Loans



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

BFI's lending against collateral of fixed assets is consistently high. BFIs have disbursed Rs. 3,938.30 billion, which accounted for 76.22 percent of the total loans against the collateral of fixed assets as of mid-July 2024. Commercial banks, development banks, and finance companies have disbursed 75.01 percent, 86.26 percent, and 81.49 percent of their total loan against fixed assets collaterals as of mid-July 2024.

Figure 2.16: Loan Classification based on Collateral



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.3 Financial Soundness Indicators

2.3.1 Capital Adequacy

The banking industry remained well-capitalized; however, the capital adequacy ratios are on a declining trend. The overall capital adequacy ratio and core capital ratio stood at 12.92 percent and 10.20 percent respectively during the review year, which were 13.42 percent and 10.59 percent in previous year. The capital adequacy ratios demonstrate that BFIs are resilient and are adequately capitalized. However, the deterioration of asset quality has raised concerns in recent years. Despite the declining trend, the capital adequacy ratios stood well above the minimum regulatory requirement.

Figure 2.17: Capital Adequacy Ratio - Class wise

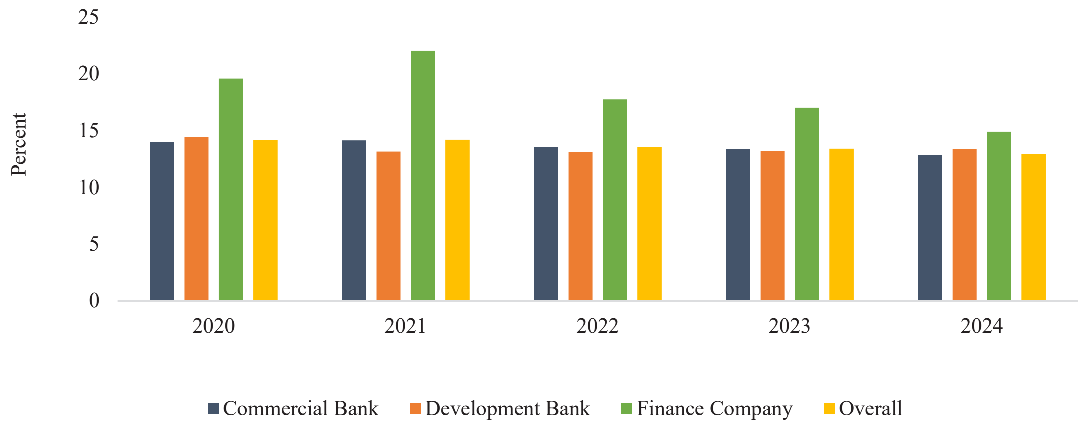
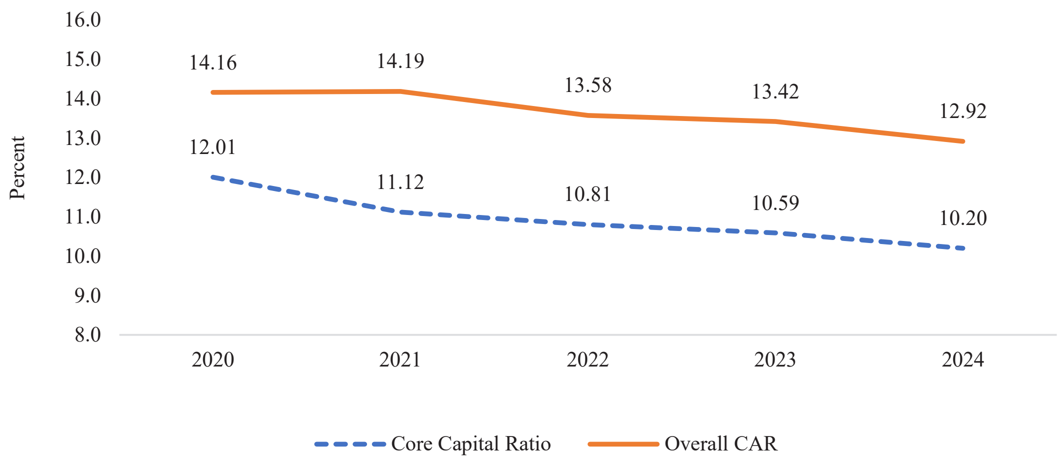


Figure 2.18: Core Capital and Overall Capital Adequacy Ratio

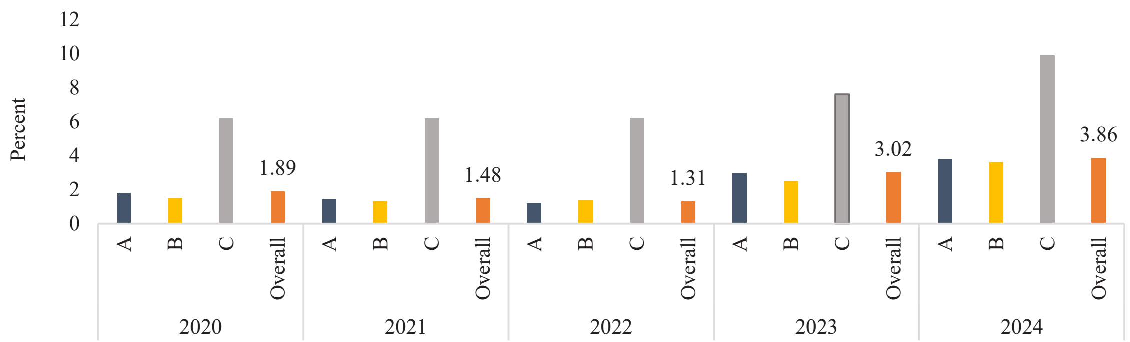


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.3.2 Asset Quality

The asset quality of BFIs deteriorated further during the review year. Sluggish economic activities leading to loan delinquencies remained a concern over the deteriorating asset quality.

Figure 2.19: Non-Performing Loans of BFIs (A, B and C)

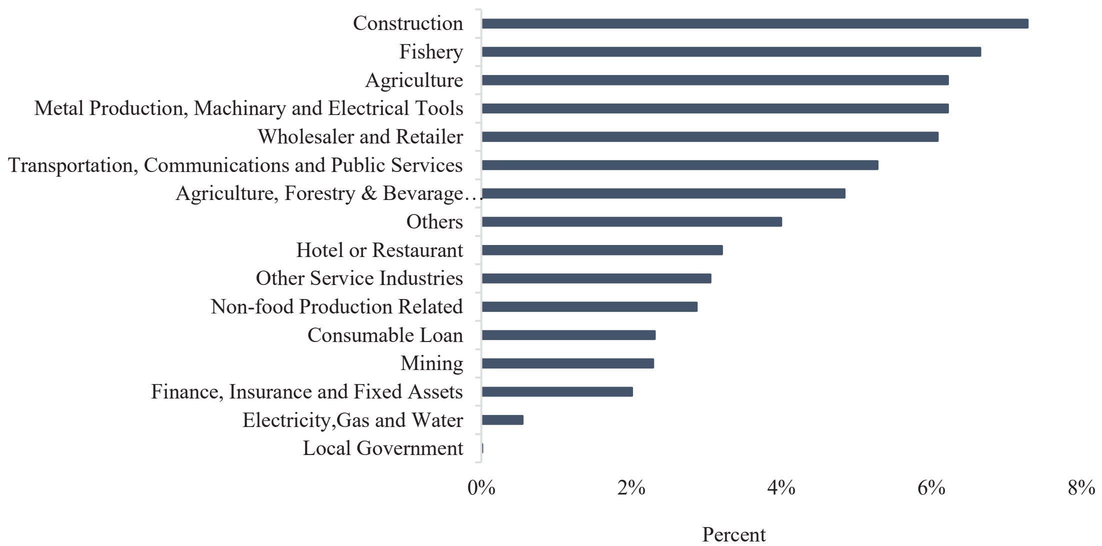


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

The overall Non-performing Loans (NPL to total loan ratio) of industry increased to 3.86 percent in the review year compared to 3.02 percent a year ago.

The construction sector experienced higher level of non-performing loans during the review year. The non-performing loans in the construction sector stood at 7.28 percent, followed by fishery, agriculture sector, and metal production, machinery & electrical tools, which stood at 6.65 percent, 6.22 percent, 6.22 percent, and 6.09 percent, respectively.

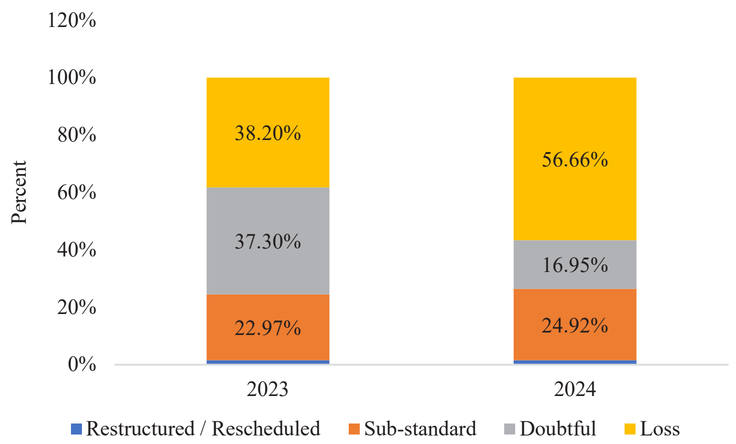
Figure 2.20: Sector-Wise Non-Performing Loans



Source: Nepal Rastra Bank, Reporting Portal, July 2024

Similarly, concerns remain over asset quality as a significant portion of non-performing loans falls under the loss category. Non-performing loans (NPLs) of BFIs increased to Rs.199.66 billion in mid-July 2024 from Rs.147.43 billion in mid-July 2023. A large share of NPLs in the banking sector falls into the loss category and represents 56.66 percent of the total NPLs. The share of doubtful loans has decreased significantly from 37.30 percent to 16.95 percent during the review year. The composition of NPLs shows signs of deterioration in asset quality with a rise in the non-performing loans of loss category.

Figure 2.21: Composition of NPL

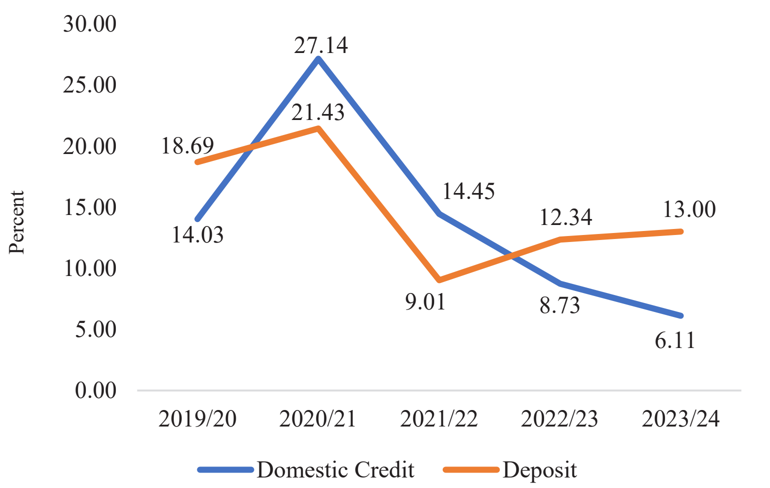


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.3.3 Domestic Credit and Deposit Growth

The banking system (BFIs) experienced the growth of credit and deposit during the review year. Domestic Credit growth remained at 6.11 percent during the review year as compared to a growth of 8.73 percent in previous year. The deposit mobilization increased by 13 percent in the review year compared to 12.34 percent in the previous year.

Figure 2.22: Domestic Credit and Deposit Growth



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

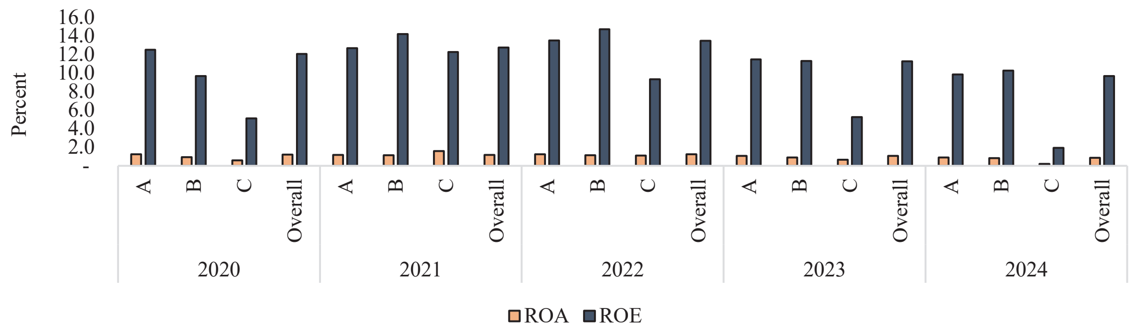
2.3.4 Leverage Ratio

The leverage ratio complemented the risk-weighted capital ratio and remained above the minimum regulatory requirement during the review year. The leverage ratio of commercial banks stood at 6.78 percent in mid-July 2024, above the minimum regulatory requirement of a 4 percent in the review year.

2.3.5 Profitability

The profitability of the banking sector decreased slightly during the review year. The net profit of the BFIs recorded a decrease of 7.22 percent and stood at Rs. 71.43 billion as of mid-July 2024 as compared to Rs. 76.99 billion in the previous fiscal year. Return on Assets (ROA) and Return on Equity (ROE) decreased marginally during the review year. The ROA decreased to 0.87 percent in the fiscal year 2023/24 from 1.06 percent in the fiscal year 2022/23. Similarly, the overall ROE decreased to 9.67 percent in the fiscal year 2023/24 from 11.27 percent in the previous year.

Figure 2.23: Return on Equity and Return on Assets



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.3.6 Liquidity

The banking sector maintained adequate liquidity during the review year. The total liquid assets to deposit ratio of BFIs stood at 26.44 percent in mid-July 2024 compared to 27.10 percent a year ago. The total liquid assets to deposit ratios for "A", "B" and "C" class institutions stood at 26.53 percent, 24.43 percent, and 32.08 percent, respectively, in mid-July 2024. These ratios were 26.93 percent, 27.17 percent, and 34.15 percent, respectively, a year ago.

The net liquid assets to total deposit ratios of BFIs stood at 31.81 percent in mid-July 2024 compared to 29 percent a year ago, which is well above the minimum regulatory requirement of 20 percent.

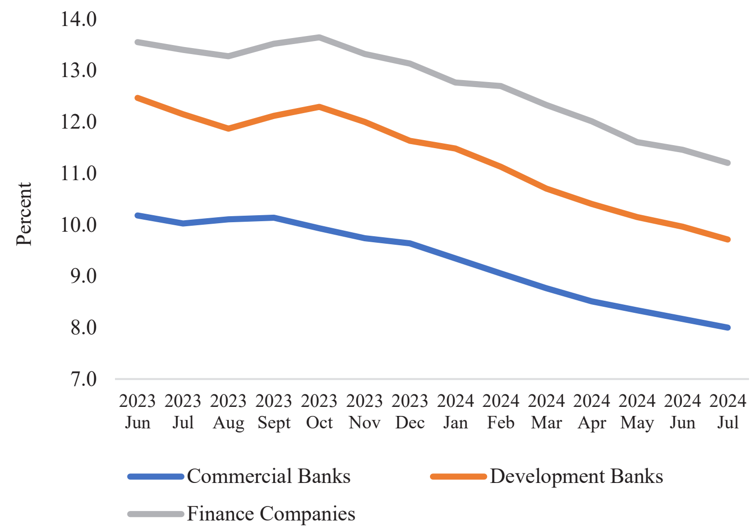
Table 2.3: Financial Soundness Indicators

Indicators	Commercial Banks		Development Banks		Finance Companies		Overall	
	2023	2024	2023	2024	2023	2024	2023	2024
Credit and Deposit-Related Indicators								
Total deposit/GDP	94.52	100.91	10.62	10.70	2.11	2.25	107.25	113.86
Total credit/GDP	80.15	80.09	8.77	8.79	1.73	1.75	90.65	90.63
Total credit/ Total deposit	84.80	79.37	82.56	82.18	81.93	77.52	84.53	79.60
CD Ratio	81.62	78.79	81.80	82.64	81.02	76.42	81.63	79.09
Fixed deposit/Total deposit	56.98	55.20	66.59	61.42	71.00	70.21	58.21	56.08
Saving deposit/Total deposit	26.87	30.44	23.24	28.97	17.41	19.81	26.32	30.09
Current deposit/Total deposit	8.68	6.40	1.93	1.89	1.25	1.25	7.87	5.88
Call Deposit /Total Deposit	6.56	7.22	8.19	7.68	8.91	7.81	6.77	7.27
Assets Quality-Related Indicators								
NPL/ Total loan	2.98	3.76	2.49	3.62	7.60	9.87	3.02	3.86
Total LLP/Total loan	2.52	4.40	2.42	3.86	5.80	9.40	2.58	4.45
Res. Personal Home Loan (Up to Rs. 15 million)/Total Loan	6.47	6.92	12.23	11.63	12.61	13.00	7.15	7.49
Real estate exposure/Total loan	5.05	4.92	4.64	6.69	10.46	10.19	5.11	5.19
Deprived sector loan/Total loan	6.49	6.03	8.78	7.74	8.76	7.27	6.75	6.22
Cash and bank balance/Total deposit	8.21	7.58	6.36	6.02	9.31	7.47	8.05	7.43
Investment in Government securities/Total deposit	18.07	18.23	15.87	15.17	17.76	17.45	17.84	17.92
Total liquid assets/Total deposit	26.93	26.53	27.17	24.43	34.15	32.08	27.10	26.44
Capital adequacy related indicators								
Tier 1 Capital/RWE	10.53	10.10	10.26	10.71	14.91	12.85	10.59	10.20
Tier 1 & Tier 2 Capital /RWE	13.37	12.84	13.21	13.38	17.01	14.89	13.42	12.92
Weighted average interest rate on deposit							7.86	5.77
Weighted average interest rate on credit							12.30	9.93

2.3.7 Base Rate and Interest Rate Spread of BFIs

The base rates of BFIs declined in the review year. The average monthly base rates of commercial banks during the review year stood at 9.18 percent, which was 10.32 percent a year ago. The base rate of commercial banks stood at 8 percent in the last month of the review year, which was 9.99 percent in the previous year. Similarly, the average monthly base rate of development banks during the review year stood at 10.60 percent, which was 12.36 percent in the corresponding month of the previous year. Similarly, the base rate of finance companies stood at 12.08 percent in the last month of the review year, which was 12.99 percent in the corresponding month of previous year.

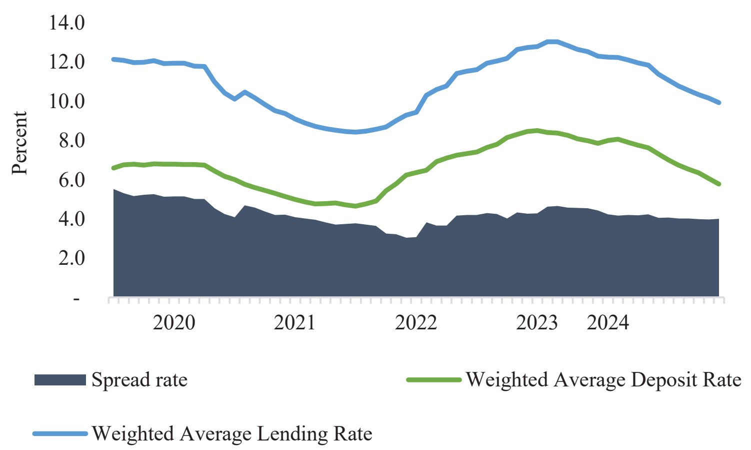
Figure 2.24: Monthly Base Rates of Banks and Financial Institutions



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

NRB continued the market conduct regulations on interest rate spread. NRB has directed commercial banks to maintain their interest spread rate within four percent. Similarly, development banks and finance companies are required to maintain their interest spread rate within 4.6 percent. The overall interest spread of commercial banks remained at 3.98 percent in

Figure 2.25: Spread Rate, Weighted Average Lending and Deposit rate of BFIs



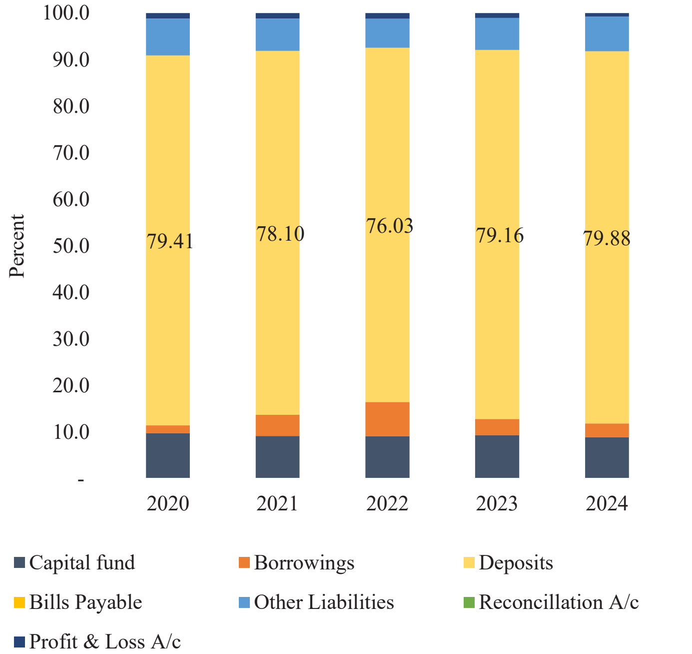
Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

mid-July 2024. The spread rate for development banks and finance companies stood at 4.55 percent and 4.54 percent, respectively, in mid-July 2024. Such rates for commercial banks, development banks, and finance companies were 4.45 percent, 4.55 percent, and 4.56 percent, respectively, in mid-July 2023. Regulation on interest charged to borrowers on base rate and interest spread has assured the twin goals of fostering healthy competition and protecting the financial consumers.

2.4 Liability Structure of Banks and Financial Institutions

Deposits continued to represent the major portion of total liabilities. As of mid-July 2024, the total liabilities of the BFIs stood at Rs. 7,290.99 billion. The share of total deposits to total liabilities in mid-July 2024 stood at 79.88 percent. Higher inflows of remittance can be attributed for the increasing deposit growth during the review year. Capital fund occupies the second largest share in the liability structure of BFIs, representing 8.96 percent of the total liability, while borrowings represented only 2.96 percent of total liabilities.

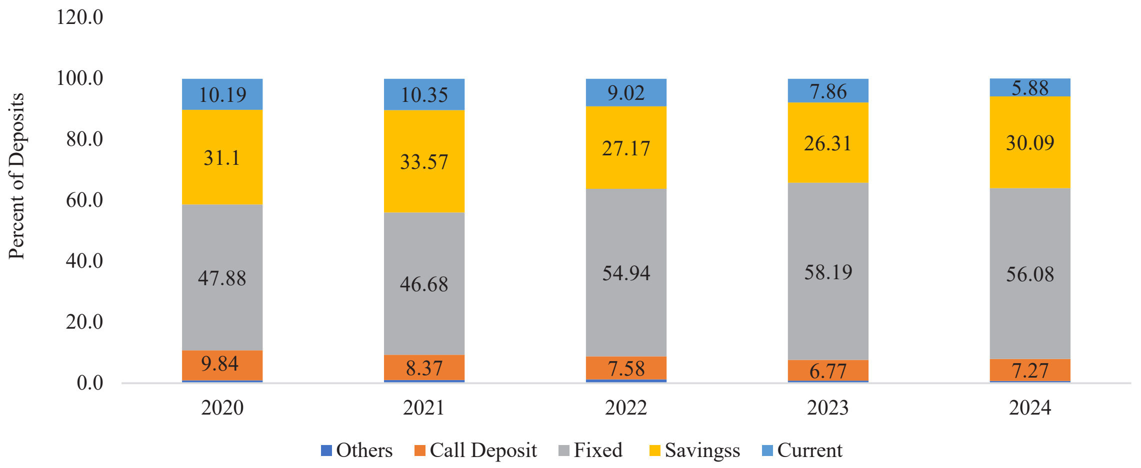
Figure 2.26: Liabilities Structure of BFIs



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

The fixed and saving deposits comprised a significant share of total deposits. The share of current deposits, saving deposits, fixed deposits, call deposits, and other deposits in total deposits stood at 5.88 percent, 30.09 percent, 56.08 percent, 7.27 percent, and 0.68 percent, respectively in mid-July 2024. These shares were 7.86 percent, 26.31 percent, 58.19 percent, 6.77 percent, and 0.83 percent, respectively in mid-July 2023.

Figure 2.27: Deposit Mix of BFIs



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

Saving deposits reported the highest growth in a year. The saving deposits grew by 28.66 percent during the review year. Among the other deposits categories, call deposits grew by 20.91 percent and fixed deposits grew by 8.44 percent during the review period. On the contrary, the current deposits decreased by 15.91 percent during the review year.

Deposits concentration to some institutions continued to increase during the review year. The share of the top five deposit holding banks stood at 33.43 percent of total deposits in the banking system, depicting a sizeable concentration of deposits in these institutions. Such concentration ratio of deposits was 32.06 percent in the previous year. Similarly, three state-owned banks hold 14.75 percent of total deposits.

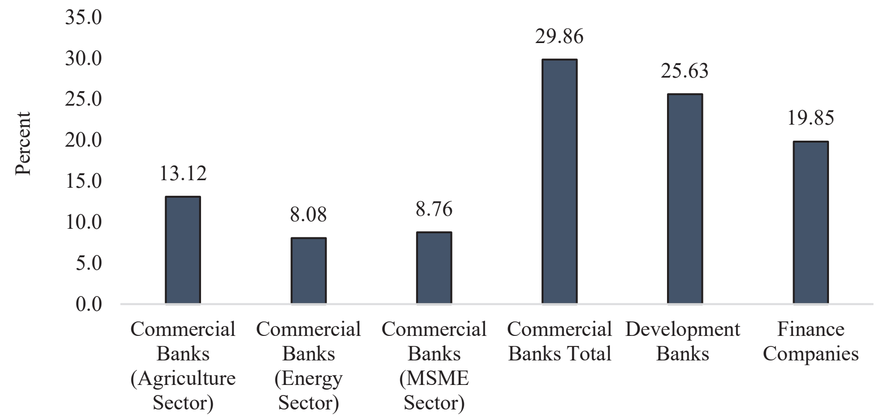
2.5 Directed Lending

2.5.1 Prescribed lending provisions

BFIs complied with the NRBs directive on prescribed lending provisions. By mid-July 2027, commercial banks must provide at least 15 percent of their total credit to the agricultural sector, 10 percent to the energy sector, and 15 percent to small, micro, cottage, and medium-sized businesses. Similarly, development banks have to disburse 20 percent of the total credit to agriculture, micro, cottage, and small enterprises/businesses, energy, and tourism sectors by mid-July 2027. Similarly, there is a provision that finance companies should disburse 15 percent of the total loan to such sectors by mid-July 2027.

As of mid-July 2024, commercial banks disbursed 13.12 percent of their total loans in the agricultural sector, 8.08 percent of their total loans in the energy sector, and 8.76 percent of their total loans in micro, cottage, small, and medium enterprises, respectively. Similarly, development banks disbursed 25.60 percent of their total loans in agriculture, energy, tourism, micro, cottage, and small and medium enterprises, while finance companies disbursed 19.85 percent of their total loans in such sectors.

Figure 2.28: Directed Sector Lending of BFIs

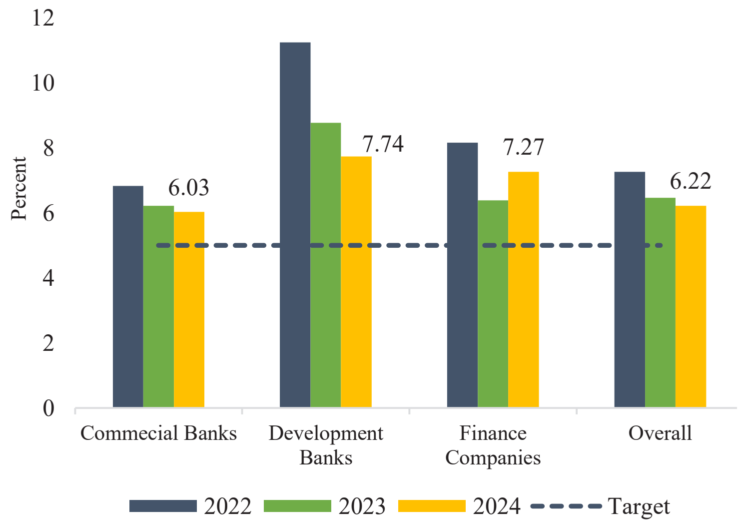


Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

2.5.2 Deprived Sector Lending

BFIs complied with the regulatory requirement to extend loans to the deprived sector. The overall deprived sector lending by BFIs as of mid-July 2024 remained at 6.22 percent, which is well above the regulatory requirement of 5 percent. The deprived sector lending by commercial banks, development banks, and finance companies accounted for 6.03 percent, 7.74 percent, and 7.27 percent of their total lending, respectively

Figure 2.29: Deprived Sector Lending



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

CHAPTER III: BANK AND FINANCIAL INSTITUTIONS

3.1 Performance of Banks and Financial Institutions

3.1.1 Commercial Banks

Nepal's financial system comprises a dominant share of commercial banks in terms of asset/liabilities. Commercial banks make up the major share amongst the BFIs. The proportion of commercial banks in BFIs total assets slightly increased from 88.68 percent in mid-July 2023 to 89.07 percent in mid-July 2024. Commercial banks represented a major share in the banking industry in terms of the size of the balance sheet. During the review year, the total assets of commercial banks grew by 12.01 percent to Rs. 7,242.74 billion from Rs. 6,465.94 billion.

Table 3.1 Major Financial Indicators of Commercial Banks

Indicators (Percent)	Mid-July 2023	Mid-July 2024
Tier 1 & Tier 2 Capital /RWE	13.37	12.84
Tier 1 Capital/RWE	10.53	10.10
Non-Performing Loan Ratio (NPL/Total Loan)	2.98	3.76
Return on Assets (ROA)	1.11	0.89
Return on Equity (ROE)	11.46	9.83
Net Interest Spread	4.45	3.98
Total Credit to Deposit Ratio (CD Ratio)	84.80	79.37
Total Liquid Assets/Total Deposit	26.93	26.53
Base Rate	9.99	8.00

Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

The State-Owned Banks (SOBs) predominantly holds 16.69 percent share of the total assets of commercial banks. During the review year, the total assets of three SOBs in Nepal - Nepal Bank Limited (NBL), Rastriya Banijya Bank Limited (RBBL), and Agriculture Development Bank Limited (ADBL) was 21.19 percent of GDP as compared to 18.59 percent in the preceding year. The total share of SOBs in total assets of commercial banks stood at 16.69 percent, which was 15.53 percent in mid-July 2023. The SOBs hold 16.64 percent share in total deposits of commercial banks and 14.75 percent share in total deposits of BFIs in mid-July 2024. Similarly, their market shares in terms of loans and advances stood at 14.80 percent of commercial banks and 13.09 percent of all BFIs at the same time.

3.1.1.1 Capital

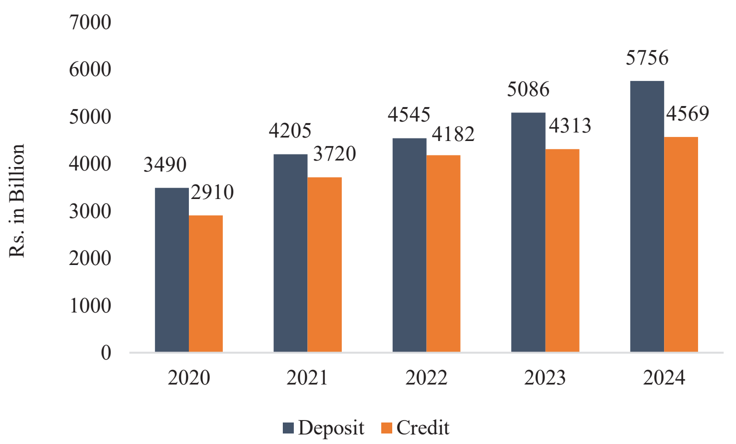
Capital adequacy ratios of commercial banks remain above the regulatory benchmark. However, aggregate CAR has slightly dropped to 12.84 percent during the review year as compared to 13.37 percent in the previous year. The capital fund of commercial banks has increased by 9.04 percent to Rs.713.70 billion in mid-July 2024 from Rs.707.30 billion a year ago. However, all the commercial banks have maintained the mandatory capital adequacy ratio as of mid-July 2024.

The total capital adequacy ratios of all the SOBs continued to remain well above the minimum regulatory requirement, albeit slightly decreased in the review year. During the review year, the core capital to risk weighted assets of NBL, RBBL, and ADBL stood at 10.95 percent, 10.21 percent, and 11.78 percent, respectively. Likewise, the total capital to risk weighted assets of NBL, RBBL, and ADBL stood at 13.62 percent, 11.91 percent, and 13.44 percent, respectively. The asset quality measured by the Non-Performing Loans (NPL) ratio of all the SOBs has deteriorated and stood at 3.47 percent as of mid-July 2024 compared to 2.78 percent in the previous year. As of mid-July 2024, the NPL ratio of NBL, RBBL, and ADBL stood at 3.28 percent, 3.65 percent, and 3.44 percent respectively.

3.1.1.2 Deposits and Credit

Deposits growth surpassed credit growth during the review year. Both deposits and credit grew and continued their upward trend during the review year. Total deposits grew by 13.17 percent to Rs. 5756 billion in mid-July 2024. Total credit grew by 5.93 percent to Rs.4569 billion in mid-July 2024 as compared to a growth of 3.12 percent in the previous year.

Figure 3.2: Deposits and Credit of Commercial Banks



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

Term loans constituted the major portion of the total loan disbursed. Term loans, overdraft loans (including cash credit), demand and other working capital loans, and hire purchase loans represent 37.32 percent, 14.88 percent, 15.53 percent, and 2.33 percent, respectively, of the total loan in mid-July 2024. However, such ratios were 32.19 percent, 15.24 percent, 19.68 percent, and 3.20 percent, respectively, in mid-July 2023. There has been sharp growth in term loans as compared to the previous year.

Lending by commercial banks in real estate slightly decreased to 4.92 percent from 5.05 percent, while margin nature loans have slightly increased and reached 1.54 percent from 1.36 percent.

Similarly, loans against the collateral of properties (fixed and current assets) slightly increased as compared to the previous year. Out of total loans, 89.98 percent is backed up by collateral of properties as of mid-July 2024. Such ratio stood at 88.75 percent in the previous year.

3.1.1.3 Asset Quality

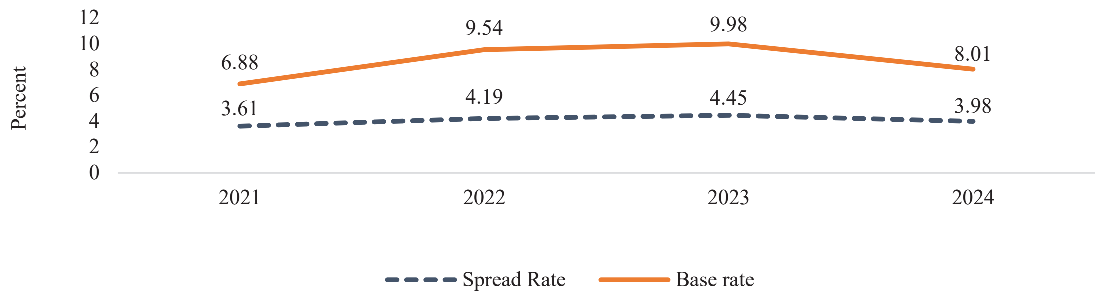
The share of term loans on total loans increased; however, concerns over assets quality exists. The assets qualities of commercial banks have been measured by the non-performing loan ratio (NPL) and net non-performing loans ratio. The non-performing loans to total loan ratio of commercial banks increased to 3.76 percent in mid-July 2024 as compared to 2.98 percent in mid-July 2023. The net NPL ratio of commercial banks stood at 1.06 percent in the review year.

The NPL ratio of commercial banks has deteriorated during the review period. The three state-owned banks in total have a combined NPL ratio of 3.47 percent, whereas that of private commercial banks stood at 3.81 percent in mid-July 2024 which was 2.78 percent and 3.01 percent respectively in the previous year.

3.1.1.4 Profitability

The profitability of commercial banks has decreased during the review year. As of mid-July 2024, both return on assets (ROA) and return on equity (ROE) has dwindled and stood at 0.89 percent and 9.83 percent, respectively, as compared to 1.11 percent and 11.46 percent in the previous year. However, as of mid-July 2024, the overall profit of the commercial banks has declined by 8.40 percent and stood at Rs. 64.15 billion.

Figure 3.3: Base Rate and Spread Rate of Commercial Banks



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

3.1.2 Development Banks

After commercial banks, development banks constituted the largest share of total assets/liabilities in the banking system. The number of development banks stood at 17, among which eight of them are of National Level and nine of them are of province level (one is operational in only one district and eight are operational in three to seven Districts). The share of development banks in the total assets/liabilities of BFIs decreased to 8.82 percent during the review year as compared to 9.19 percent of the previous year. The total assets/liabilities of development banks increased by 7.08 percent to Rs. 717.33 billion in mid-July 2024 as compared to Rs. 669.88 billion a year ago.

Table 3.2: Major Financial Indicators of Development Banks

Indicators (Percent)	Mid-July 2023	Mid-July 2024
Tier 1 & Tier 2 Capital /RWE	13.21	13.35
Tier 1 Capital/RWE	10.26	10.68
Non-Performing Loan Ratio (NPL/Total Loan)	2.45	3.62
Return on Assets (ROA)	0.60	0.66
Return on Equity (ROE)	7.55	8.0
Net Interest Spread	4.59	4.55
Total Credit to Deposit Ratio (CD Ratio)	84.37	82.52
Total Liquid Assets/Total Deposit	27.17	24.43
Base Rate	11.77	9.03

Source: Nepal Rastra Bank, Monthly Statistics, July 2024

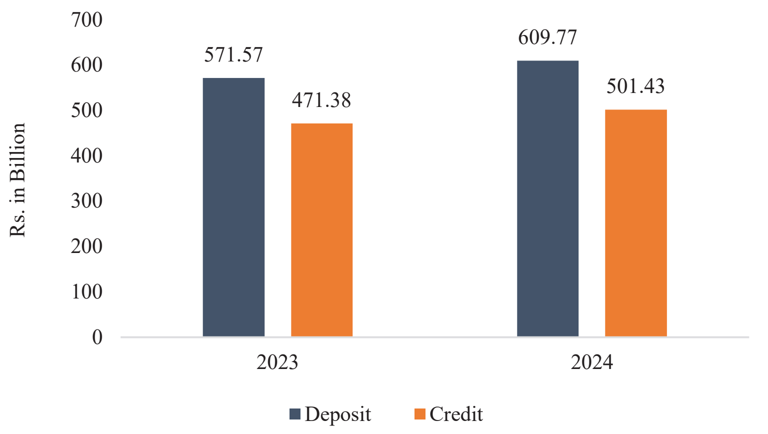
3.1.2.1 Capital

Development banks remained well-capitalized during the review period, but concerns remain. The core capital of development banks increased by 3.96 percent to Rs 53.10 billion as compared to 3.93 percent in the previous year. The ratio of core capital to risk-weighted assets increased to 10.68 percent as of mid-July 2024 from 10.26 percent a year ago. Likewise, the total capital fund to risk-weighted assets ratio increased to 13.35 percent in the review year. The regulatory provision requires development banks to maintain 8.5 percent of the core capital ratio and 11 percent of the capital adequacy ratio. Similarly, national-level development banks are required to maintain 6 percent of the tier 1 capital adequacy ratio and 10 percent of the total capital adequacy ratio. Except for three, all the other development banks maintained regulatory minimum capital funds during the review year.

3.1.2.2 Deposits and Credit

The total deposits of development banks increased by 6.68 percent to Rs 609.77 billion in mid-July 2024 as compared to Rs. 571.57 billion a year ago. Similarly, the loans and advances increased by 6.37 percent to Rs 501.43 billion in mid-July 2024 as compared to Rs.471.38 billion a year ago. Credit to deposit ratio stood at 82.52 percent during the review year as compared to 84.37 percent in the previous year.

Figure 3.3: Deposits and Credit of Development Banks



Source: Nepal Rastra Bank, Banking and Financial Statistics, July 2024

3.1.2.3 Asset Quality

The non-performing loan ratio of development banks increased to 3.62 percent in mid-July 2024 as compared to 2.45 percent a year ago.

3.1.2.4 Base Rate, Spread Rate, and Profitability

The base rate of development banks followed a declining trend during the review year. The average base rate of development banks decreased to 9.03 percent, which was 11.77 percent in the previous year. The decrease in the base rate can be attributed mostly to the surge in the liquidity in the overall banking system, followed by decrease in interest rates. Similarly, the interest rate spread decreased marginally from 4.59 percent to 4.55 percent during the review year. Similarly, the total net profit of development banks increased by 12.65 percent to Rs. 4.72 billion in the review year as compared to the net profit of 4.19 billion in the previous year. ROE and ROA increased to 8.0 percent and 0.66 percent as of mid-July 2024.

3.1.3 Finance Companies

The share of the total assets of finance companies among BFIs stood at 2.11 percent during the review year, which was 2.13 percent in the previous year. The ratio of total assets/liabilities of finance companies to gross domestic product has increased slightly to 3.0 percent in mid-July 2024 as compared to 2.88 percent a year ago. In this regard, the total assets/liabilities of finance companies increased by 10.40 percent to Rs. 171.31 billion in the review year as compared to Rs. 155.17 billion in mid-July 2023. Two finance companies (Nepal Share Market and Finance Ltd. and Capital Merchant Banking and Finance Ltd.) are in problematic status and under the resolution process. The major financial indicators of finance companies have been presented in Table 3.3.

Table 3.3: Major Financial Indicators of Finance Companies

Indicators (Percent)	Mid-July 2023	Mid- July 2024
Tier 1 & Tier 2 Capital /RWE	17.01	14.89
Tier 1 Capital/RWE	14.91	12.85
Non-Performing Loan Ratio (NPL/Total Loan)	7.60	9.87
Return on Assets (ROA)	0.03	-0.31
Return on Equity (ROE)	0.20	-2.97
Net Interest Spread	4.57	4.54
Total Credit to Deposit Ratio (CD Ratio)	83.52	77.63
Total Liquid Assets/Total Deposit	27.17	24.43
Net Interest Spread	4.57	4.54
Base Rate	13.00	10.71

Source: Nepal Rastra Bank, Monthly Statistics, July 2024

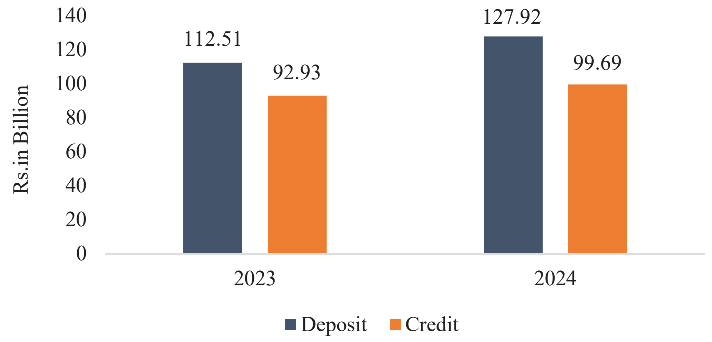
3.1.3.1 Capital

Finance companies remained well-capitalized during the review year. The tier 1 capital fund decreased by 13.01 percent to Rs 13.88 billion as compared to a decrease of 4.56 percent in the previous year. The ratio of tier 1 capital adequacy ratio decreased to 12.85 percent during the review year. In the same manner, the capital adequacy ratio decreased to 14.89 percent in mid-July 2024, from 17.01 percent in mid-July 2023. As the regulatory minima of tier 1 capital ratio and capital adequacy ratio for finance companies is 6 percent and 10 percent, all finance companies except one maintained their capital well above the regulatory requirements.

3.1.3.2 Deposits and Credit

Deposits and Credit increased during the review year. The total deposit and credit of increased by 8.86 percent and 5.27 percent, respectively. The aggregate deposits of finance companies stood at Rs 127.92 billion in mid-July 2024 as compared to Rs.112.50 billion in mid-July 2023. Total loans and advances stood at Rs. 99.69 billion in mid-July 2024 as compared to Rs.92.93 billion in the previous year. The credit-to-deposit ratio remained within the regulatory ceiling; it stood at 77.63 percent in mid-July 2024.

Figure 3.4: Deposits and Credit of Finance Companies



Source: Nepal Rastra Bank, Monthly Statistics, July 2024

3.1.3.3 Asset Quality

Non-performing loan ratio stood at Rs.7.01 billion during the review year. Non-performing loans to total loan stood at 7.25 percent in mid-July 2024, which was 4.51 percent in mid-July 2023.

3.1.3.4 Profitability

During the review year, the ROA and ROE of finance companies stood at a negative of 0.31 percent and 2.97 percent, respectively. Finance companies net profit dropped to Rs 0.49 billion in mid-July 2024 as compared to Rs.0.97 billion a year ago.

Box 2: Assessing the Stability of the Nepalese Banking System

Banking Stability Indicator (BSI) and Banking Stability Map

The BSI aggregates various financial metrics into a single composite index to provide an overall assessment of banking stability. This index typically includes metrics such as asset quality (NPL), soundness (Capital Adequacy Ratio), liquidity (Net Liquid Assets Ratio), efficiency, and profitability. It helps to assess the overall health of the domestic banking system considering different risk areas, comparing the present health of the banking system with its recent past.

The individual metrics used to construct the BSI are visualized in a radar chart, providing a detailed understanding of specific risk areas, commonly referred to as the Banking Stability Map.

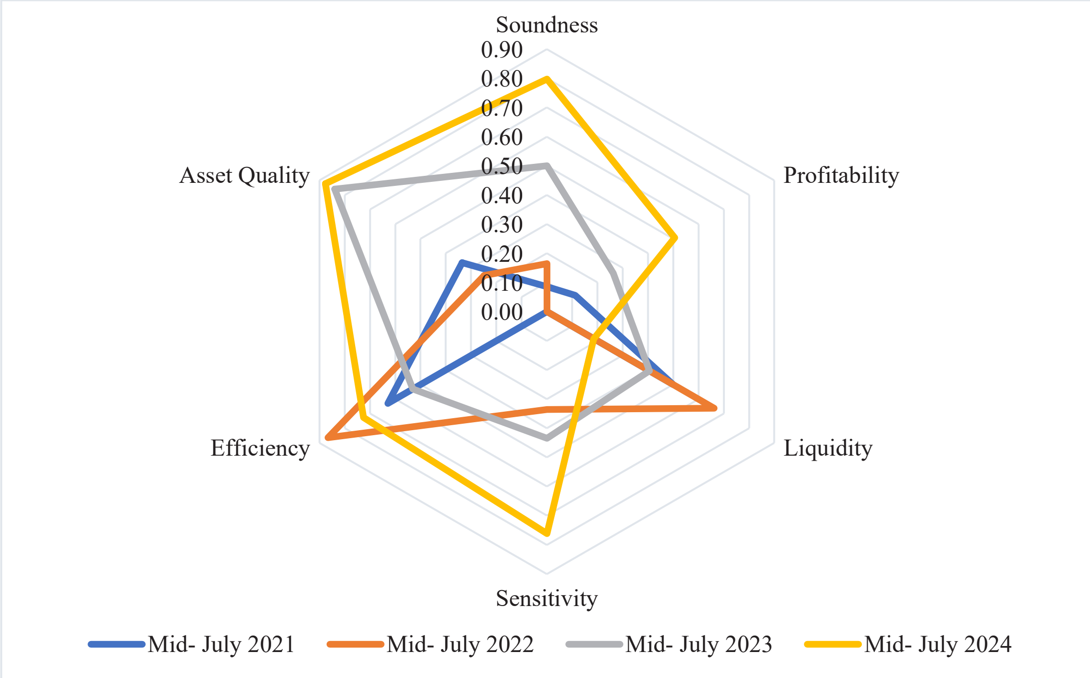
The BSI simplifies complex data into an easily interpretable index but might not capture the nuances of individual risk factors. The banking stability map, on the other hand, provides a more nuanced view, showing how different risk factors interact and contribute to the overall stability. This can help regulators, policymakers, and bank managers focus on specific areas that need attention. Together, these tools provide a comprehensive framework for assessing banking stability. The BSI offers a comprehensive overview, while the banking stability map allows for deeper analysis and more informed decision-making.

The BSI from mid-July 2021 to mid-July 2024 has shown continuous deterioration, driven by increased risks in most of the dimensions due to declining asset quality, which has led to reduced profitability and greater strain on capital requirements. Aided by increasing levels of NPL and restructured assets, the asset quality indicator has declined, and decreasing return-on assets (RoA) and return-on-equity (RoE) has degraded the profitability indicator too. The sensitivity dimension has also seen a steady increase in risk due to an increase in risk-weighted assets. However, the liquidity dimension has been improving over the period as net liquid assets have been increasing due to the growing deposits. On contrary, the efficiency indicator weakened due to an increase in the cost-to-income ratio.

The contribution of individual risk factors has also been shown to correspond to banking stability indicators in the subsequent analysis. An increase in an indicator's value signifies a higher risk level, and a decrease signifies a lower risk level. Understanding these concepts can help concerned stakeholders to identify which risk factors are most significant and need immediate attention, develop targeted strategies to mitigate the highest risks, monitor changes in risk levels over time, and adjust risk management practices accordingly.

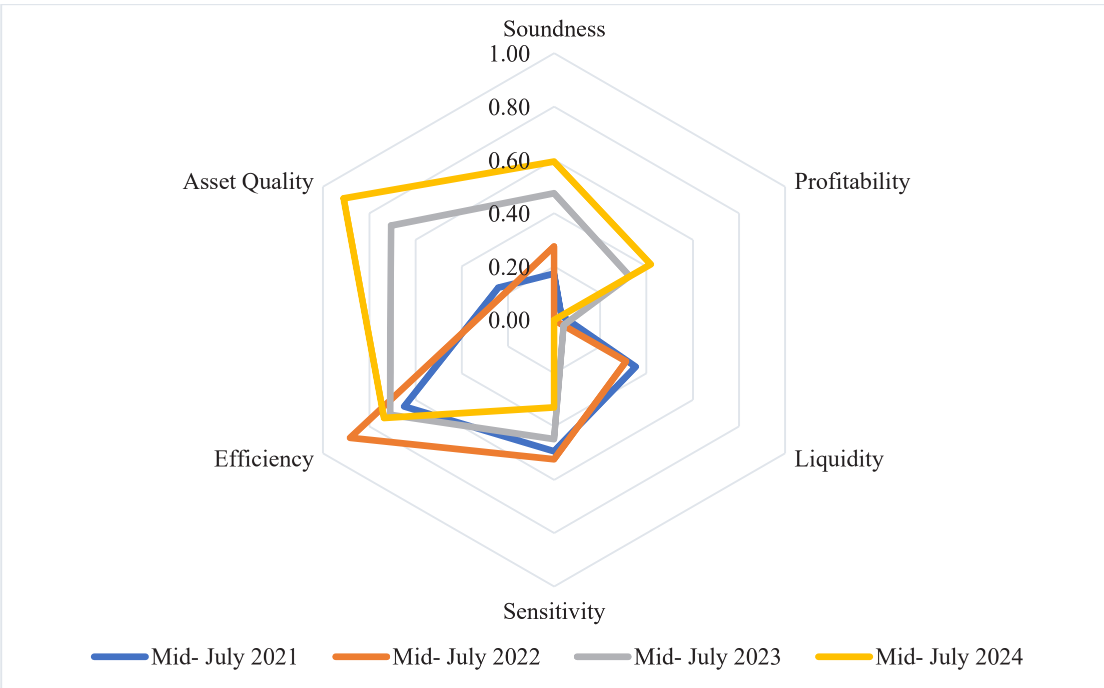
The banking stability map is presented below for A, B, and C class institutions and the industry as a whole. Additionally, the composite index of the banking stability indicator, along with sub-financial metrics, is presented for the aggregate of A, B, and C class banks.

Figure S1: Banking Stability Map (A class Commercial Banks)



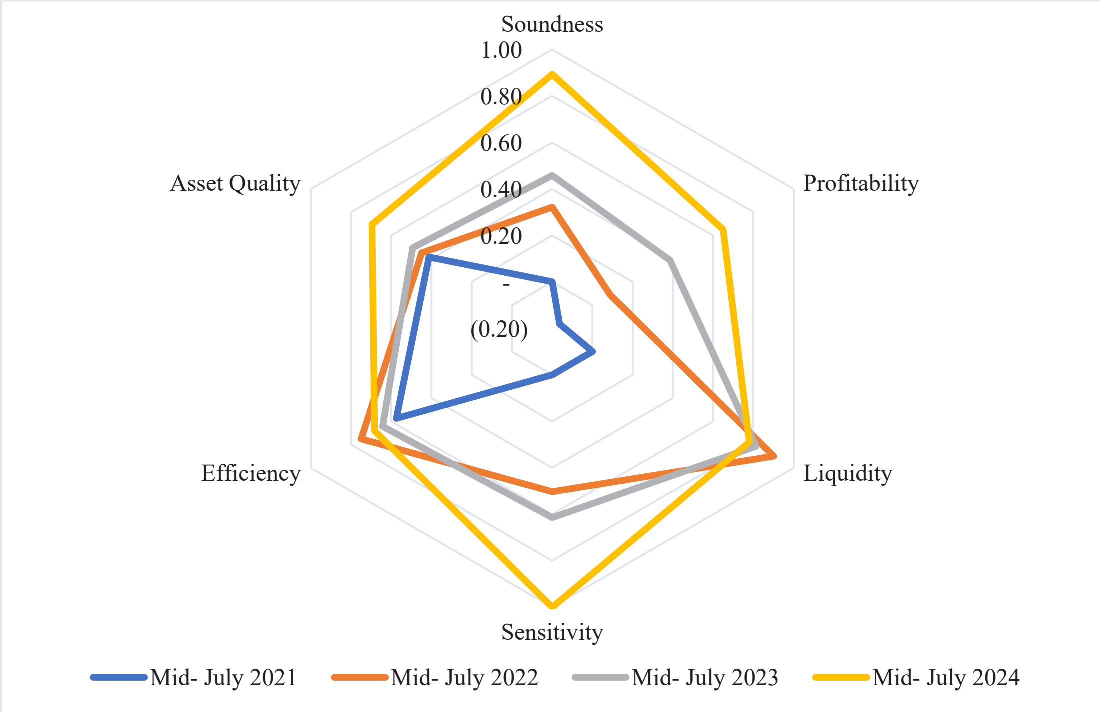
Note: Away from the center indicates increase in risk

Figure S2: Banking Stability Map (B class Develpment Banks)



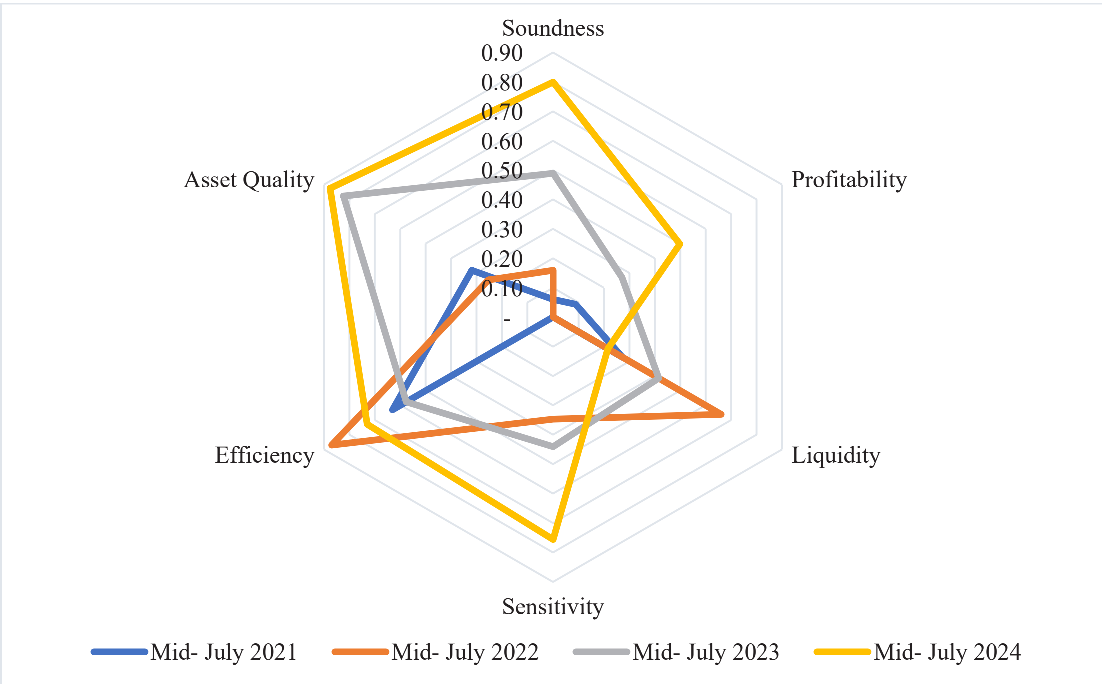
Note: Away from the center indicates increase in risk

Figure S3: Banking Stability Map (C class Finance Companies)



Note: Away from the center indicates increase in risk

Figure S4: Banking Stability Map (Banking Industry)



Note: Away from the center indicates increase in risk

Banking Stability Indicator – Composite Index

The individual index and composite index of the banking industry (A, B, and C class aggregate) calculated for the different periods is shown in Table S1.

Table S1: Banking Stability Indicator – Composite Index (A, B, and C class aggregate)

Period/Indicator	Soundness	Profitability	Liquidity	Sensitivity	Efficiency	Asset Quality	Composite Index
Mid- July 2021	0.06	0.09	0.27	0.00	0.63	0.32	0.23
Mid- July 2022	0.16	0.00	0.66	0.35	0.87	0.25	0.38
Mid- July 2023	0.49	0.27	0.42	0.44	0.58	0.82	0.50
Mid- July 2024	0.80	0.50	0.22	0.76	0.73	0.88	0.65

The composite index of the Banking Stability Indicator (A, B, and C class aggregate) has increased steadily from 0.23 in mid-July 2021 to 0.65 in mid-July 2024. The surge in the composite index depicts the increased level of overall risk in banking stability. Liquidity has been on the comfortable side and visibly shows no risk at the end of the period taken under study. Efficiency indicators shows an improvement over the period. However, risk in the soundness has surged significantly and stood at score of 0.80. Similarly, the asset quality, profitability, and sensitivity have been sticky at a higher side as of mid-July 2024, indicating the concentration of risks in these indicators.

3.1.4 Microfinance Financial Institutions

As of mid-July 2024, there are 52 Microfinance Financial Institutions (MFIs) operating as "D" class licensed institutions. Among them, three are wholesale lending MFIs, while out of the remaining 49 retail-lending MFIs, two are public deposit-taking institutions.

Table 3.4 Major Financial Indicators of MFIs

Indicators (Percent)	Mid-July 2023	Mid-July 2024
Tier 1 Capital/RWE	11.99	11.20
Tier 1 & Tier 2 Capital /RWE	13.33	12.47
Loans to Agricultural Sector	48.32	56.48
Non-Performing Loan Ratio	4.85	5.72
Collateral Based Loan Ratio	20.48	18.99
Return on Assets (ROA)	0.81	1.16
Return on Equity (ROE)	6.52	9.22

Source: Nepal Rastra Bank

3.1.4.1 Capital Adequacy

Microfinance institutions maintained the regulatory capital requirement. As of mid-July 2024, the total capital fund of MFIs increased by 7.75 percent to Rs.63.91 billion. The industry average of core capital and capital fund ratio to total risk-weighted assets stood at 11.20 percent and 12.47 percent during the review year. The total paid-up capital of MFIs increased by 4.08 percent to Rs. 35.84 billion, showing an increment of Rs.1.41 billion during the review year (Table 3.5). The ratio of paid-up capital to total capital fund stood at 56.07 percent, which was 58.05 percent in the previous fiscal year. The paid-up capital of wholesale MFIs increased by 12.07 percent to Rs.5.98 billion in the review year while that of retail MFIs increased by only 2.61 percent to Rs. 29.85 billion. As per the regulatory requirement, MFIs are required to maintain at least 4.0 percent of total risk-weighted assets as core capital and 8.0 percent as the capital fund.

3.1.4.2 Assets Quality

Non-performing loans followed an upward trend during the review year. The total outstanding loan has increased by 5.46 percent to Rs.455.84 billion as of mid-July 2024 in comparison to Rs.432.22 billion a year ago. In the review period, the ratio of loans and advances to the total assets stood at 82.32 percent in mid-July 2024 as compared to 85.13 percent a year ago. The total amount of overdue loans, including interest of these institutions increased by 21.68 percent to Rs.61.75 billion in the review year from Rs. 50.75 billion a year ago. The overdue of wholesale MFIs stood at Rs. 1.06 billion, an increment of 187.45 percent in a year, while that of the retail MFIs stood at Rs.60.69 billion, showing increment of 20.46 percent compared to the previous year. The loan loss provision increased by 18.85 percent to Rs.21.98 billion during the review year.

Table 3.5: Capital Adequacy and Assets Quality of MFIs

Particulars (Rs. Billion)	Mid-July 2023	Mid-July 2024	% Change
Total Capital Fund	**59.31**	**63.91**	**7.75**
Capital Fund of Retail MFIs	49.19	52.28	6.27
Capital Fund of Wholesale MFIs	10.12	11.63	14.92
Total Paid-up Capital	**34.43**	**35.84**	**4.08**
Paid-up Capital of Retail MFIs	29.09	29.85	2.61
Paid-up Capital of Wholesale MFIs	5.34	5.98	12.07
Total Assets	**507.74**	**553.73**	**9.06**
Assets of Retail MFIs	440.93	491.27	11.42
Assets of Wholesale MFIs	66.81	62.46	-6.51
Total Loan and Advances	**432.22**	**455.84**	**5.46**
Loan and Advances of Retail MFIs	371.92	401.98	8.08
Loan and Advances of Wholesale MFIs	60.30	53.85	-10.69
Total Overdue (Loan & Interest)	**50.75**	**61.75**	**21.68**
Overdue (Loan & Interest) of Retail MFIs	50.38	60.69	20.46
Overdue (Loan & Interest) of Wholesale MFIs	0.37	1.06	187.45
Total Loan Loss Provision	**18.49**	**21.98**	**18.85**
Loan Loss Provisions of Retail MFIs	16.93	19.99	18.08
Loan Loss Provisions of Wholesale MFIs	1.56	1.98	27.23

Source: Nepal Rastra Bank

3.1.4.3 Profitability and Liquidity

Savings/Deposits, borrowing, and profitability of MFIs have increased significantly. Net profit increased in the review period by 55.05 percent to Rs. 6.40 billion compared to Rs. 4.13 billion as of mid-July 2023. During the period, the industry average ROA and ROE stood at 1.16 percent and 9.22 percent respectively. Total savings mobilized by the MFIs increased by 5.96 percent to Rs. 177.05 billion in the review year (Table 3.6). Out of the total liabilities, the share of savings remained at 31.97 percent. Out of total savings, public deposits accounted for only 2.24 percent, despite an increment by 82.60 percent in the review period to Rs.3.96 billion as compared to Rs. 2.17 billion as of mid-July 2023, which was collected by two public deposit-taking MFIs, namely Nirdhan Uththan Laghubittta Bittiya Sanstha Limited and Chhimek Laghubitta Bittiya Sanstha Limited, while the rest was collected from the members of all MFIs. Total borrowings of these MFIs during the review year increased by 7.71 percent to Rs. 230.75 billion. Out of the total borrowings, wholesale MFIs borrowed Rs. 43.91 billion, comprising 19.03 percent of total borrowing, depicting a decline by 13.71 percent, a decrement by Rs. 6.98 billion during the review period. The share of total borrowing by MFIs to the total liabilities stood at 41.67 percent during the review year.

Table 3.6: Profitability and Liquidity of MFIs

Particulars (Rs. Billion)	Mid- July 2023	Mid- July 2024	% Change
Net Profit	4.13	6.40	55.05
Total Savings in MFIs	167.09	177.05	5.96
Total Borrowings of MFIs	**214.23**	**230.75**	**7.71**
Borrowings of Retail MFIs	163.34	186.83	14.38
Borrowings of Wholesale MFIs	50.89	43.91	(13.71)
Public deposit	2.17	3.96	82.60

Source: Nepal Rastra Bank

3.1.5 Infrastructure Development Bank

Nepal Infrastructure Bank Limited is the only infrastructure development bank in Nepal. The bank has total assets of Rs. 29.49 billion as of mid-July 2024. The total assets of the bank have slightly increased by 1.20 percent as compared to the previous year.

3.1.5.1 Capital

Capital adequacy and leverage ratios declined during the review year. The capital and reserves fund stood at Rs. 22.91 billion as of mid-July 2024. The total capital to risk-weighted exposure ratio declined from 93.48 percent to 91.68 percent as of mid-July 2024. The leverage ratio has increased to 81.62 percent in mid-July 2024 from 78.78 percent in mid-July 2023. Return on equity (ROE) has slightly decreased to 5.50 percent in the review period from 5.93 percent. Similarly, return on asset (ROA) has also decreased to 4.72 percent during the review year from 5.20 percent.

Table 3.7: Major Financial Indicators of Infrastructure Development Bank

Indicators (Percent)	Mid-July 2023	Mid-July 2024
Tier 1 Capital/RWE	92.69	90.87
Tier 1 & Tier 2 Capital /RWE	93.48	91.68
Return on Equity	5.93	5.50

Return on Assets	5.20	4.72
Leverage Ratio	78.78	81.62

Source: Nepal Rastra Bank

3.1.5.2 Deposits and Credit

Reduction in deposit collection and credit disbursement continued to increase. The deposit size decreased by 7.05 percent to Rs.829.86 million in mid-July 2024 as compared to Rs.892.82 million in the previous year. The loans and advances in infrastructure development projects stood at Rs.21.14 billion in mid-July 2024 as compared to Rs.20.33 billion in the previous year.

3.1.5.3 Profitability

The net profit decreased by 9 percent in the review year. The contribution of interest income stood at 87.27 percent of the total income in the review year, which was 96.81 percent in the preceding year.

3.2 Stress Tests of Banks and Financial Institutions

3.2.1 Stress Test of Commercial Banks

Stress Testing Results as of mid-July 2024 have been carried out as per the revised Stress Testing Guidelines, 2023 issued by Nepal Rastra Bank.

3.2.1.1 Credit Shock

Stress testing results revealed that if 15 percent of pass loans are downgraded to the substandard category, the Capital Adequacy Ratio (CAR) of 6 banks would fall below 11 percent. Such numbers would rise to 9 if 5 percent of pass loans are downgraded to the loss category. Additionally, if 5 percent of pass loans are downgraded to the loss category, the CAR of a bank would fall below 8.5 percent.

If 15 percent of substandard loans deteriorated to doubtful and 25 percent of doubtful loans deteriorated to the loss category, none of the bank’s CAR would fall below 11 percent. In case all substandard loans are downgraded to doubtful, the CAR of 1 bank would fall below 11 percent. None of the bank's CAR would fall below 11 percent if all doubtful loans were downgraded to loss loans.

3.2.1.2 Liquidity Shock

The liquidity stress test under the scenario of withdrawal of deposits by customers by 2, 5 and 10 percent for five consecutive days showed that by the end of 5th day, 1 out of 20 commercial banks would become illiquid.

The net liquid assets (NLA) of 1 bank would fall below 20 percent if 15 percent and 20 percent of deposits (other than fixed deposits) are withdrawn in a single day. Out of 20 commercial banks, the NLA of one bank would fall below 20 percent in case of withdrawal of deposits by 5 percent, 3 banks in case of withdrawal of deposits by 10 percent, 11 banks in case of withdrawal of deposits by 15 percent and 15 banks in case of withdrawal of deposits by 20 percent.

Stress test results revealed that most of the banks have deposit concentration on a few large depositors. NLA of 2 banks would fall below 20 percent if their top 2 institutional depositors withdraw their deposits. The number of banks that would face liquidity problems would increase to 3 and 7 if deposit is withdrawn by their top 3 and top 5 institutional depositors, respectively.

3.2.1.3 Market Shock

Market Shock includes interest rate shock, exchange rate shock, and equity price shock. A stress test is conducted with each shock separately. A combination of credit shock and market shock has also been used for stress tests. Commercial banks were found to be resilient against interest rate and exchange rate shocks. Furthermore, since commercial banks have nominal equity investments, the impact of fluctuation in equity price is minimal. If fall in equity prices by 50 percent, 3 banks will have CAR below 11 percent.

3.2.1.4 Operation Shock

Operation shocks analyses the impact on CAR of the banks if the gross income of the banks decreases due to cyber security frauds/other frauds and other operational losses. The result shows that the CAR of 2 and 10 banks would fall below 11 percent if the gross income of banks declines by 20 percent and 50 percent respectively due to some IT/operations related lapses.

The resiliency of the commercial banks as of mid-July 2024 to credit shock, liquidity shock, market shock, and combined shocks assessed by the stress tests is presented in Table 3.8.

Table 3.8: Summary Results of Stress Test of Commercial Banks (mid-July 2024)

Summary Results of Stress Tests – Commercial Banks								
		Number of Banks with NPL		**Number of Banks with CAR**			
		≤5%	**>5%**	**< 0%**	**0%-<8.5%**	**8.5% - <11%**	**>=11%**
Pre-Shock		**20**	**0**	**0**	**0**	**0**	**20**
Post-Shock							
Credit Shocks							
C-1 a	15 Percent of Pass loans deteriorated to substandard	0	20	0	0	6	14
C-1 b	15 Percent of watch list loans deteriorated to substandard	11	9	0	0	0	20
C-1 c	15 Percent of Substandard loans deteriorated to doubtful loans	20	0	0	0	0	20
C-1 d	25 Percent of Doubtful loans deteriorated to loss loans.	20	0	0	0	0	20
C-1 e	5 Percent of Pass loans deteriorated to loss loans.	0	20	0	1	9	10
C-1 a to e	Combination of C-1 a to e	0	20	0	5	14	1
C-2 a	All substandard loans downgraded to doubtful.	20	0	0	0	1	19
C-2 b	All doubtful loans downgraded to loss.	20	0	0	0	0	20
C-2 a and b	Combination of C-2 a and b	20	0	0	0	1	19
C-4a	Sectoral Impact-Pass loan converted into Loss @% mentioned in assumption sheet	1	19	0	0	8	12
C-4c	Sectoral Impact-Watch list loan converted into Substandard @% mentioned in assumption sheet	12	9	0	0	0	20
C-5	Top 2 Large exposures downgraded: Performing to Loss category	3	17	0	1	6	13
C-6a	10 percentage of guarantee is converted into funded and 30 percentage of such claims is converted into loss	14	6	0	0	0	20
Market Shocks							
Interest Rate Shocks							
IR-1a	Deposits interest rate change (+,-) by 1% on an average.			0	0	0	20
IR-1b	Deposits interest rate change (+,-) by 1.5% on an average.			0	0	0	20

IR-1c	Deposits interest rate change (+,-) by 2% on an average.			0	0	0	20
IR-2a	Loan interest rate change (+,-) by -1% on an average.			0	0	0	20
IR-2b	Loan interest rate change (+,-) by -1.5% on an average.			0	0	0	20
IR-2c	Loan interest rate change (+,-) by -2% on an average.			0	0	0	20
Exchange Rate Shocks							
ER-1a	Depreciation of currency exchange rate by 20%			0	0	0	20
ER-1b	Appreciation of currency exchange rate by 25%			0	0	0	20
Equity Price Shocks							
Eq-1	Fall in the equity prices by 50%			0	0	3	17

Liquidity Shocks					
				Number of Banks becoming illiquid after shock of	
				3 days	**4 days**
L-1	Withdrawal of deposits other than fixed deposit by 2%, 5% and 10% for five consecutive days respectively.			0	0
L-6	Withdrawal of deposits by 2%, 5% and 10% for five consecutive days respectively.			0	0
				Number of Banks with Liquid Assets to Deposit Ratio	
				< 0%	**0% - <20%**
Pre-Shock				0	0
Post-Shock					
L-2-a	Withdrawal of deposits other than fixed deposits by 5%			0	0
L-2-b	Withdrawal of deposits other than fixed deposits by 10%			0	0
L-2-c	Withdrawal of deposits other than fixed deposits by 15%			0	1
L-2-d	Withdrawal of deposits other than fixed deposits by 20%			0	1
L-7-a	Withdrawal of deposits by 5%			0	1
L-7-b	Withdrawal of deposits by 10%			0	3
L-7-c	Withdrawal of deposits by 15%			0	11
L-7-d	Withdrawal of deposits by 20%			0	15
L-3a	Withdrawal of deposits by top 2 institutional depositors.			0	2
L-3b	Withdrawal of deposits by top 3 institutional depositors.			0	3

L-3c	Withdrawal of deposits by top 5 institutional depositors.			0	7
L-3d	Withdrawal of deposits by top 2 individual depositors.			0	0
L-3e	Withdrawal of deposits by top 3 individual depositors.			0	0
L-3f	Withdrawal of deposits by top 5 individual depositors.			0	0
				< 0%	**0%-<8.5%**
L-4	Top 2 Inter Bank Lending goes bad Number of Banks with CAR			0	0
				< 0%	**0% - <20%**
	Number of Banks with Liquid Assets to Deposit Ratio			0	0
		CD ≤ 90%	**CD > 90%**		
L-5	50% of Irrevocable loan commitments turns to Loans and Advances	**17**	**3**		

Operational Shocks					
		Number of Banks with CAR			
		< 0%	**0%-<8.5%**	**8.5% - <11%**	**>=11%**
O-1	20 percent of Gross Income is decreased due to cyber security frauds/Other Frauds and Other Operational Losses	0	0	2	18
O-2	50 percent of Gross Income is decreased due to cyber security frauds/Other Frauds and Other Operational Losses	0	2	10	8

3.2.2 Stress Test of Development Banks

The stress test results as of mid-July 2024 indicate that most of the development banks are resilient to the various shocks. The results of the standard credit shock test, in which 5 percent of performing loans deteriorated into loss loans, shows that the capital adequacy ratio of 12 development banks falls below the regulatory requirement of 10 percent. The result indicates that existing regulatory oversight needs to be enhanced to avoid further deterioration of the situation.

The liquidity stress test indicates that liquidity ratios would fall below the regulatory minimum level for 6 development banks if deposits were withdrawn by 2 percent on the first day, 5 percent on the second day, and 10 percent on the third consecutive day. Additionally, a 5 percent deposit withdrawal would reduce the liquidity ratios of 4 national-level development banks to below the regulatory requirement of 20 percent.

In case the two biggest corporate depositors withdraw their deposits, the 4 development banks liquid assets to deposit ratio falls below 20 percent. However, if the top 5 personal depositors withdraw their deposits, only one national development bank's liquid assets to deposit ratio would fall below 20 percent, while the others remain unaffected.

All development banks were found to be resilient to standard interest rate, exchange rate, and equity price shocks, with none of the institutions experiencing a reduction in their Capital Adequacy Ratio below the regulatory minimum of 10 percent.

3.2.3 Stress Test of Finance Companies

The stress test findings as of mid-July 2024 primarily indicated that most finance companies are resilient in terms of credit and liquidity shocks; nonetheless, regulators must be attentive to the potential susceptibility of finance companies. The results of the credit shock test, in which 15 percent of pass loans deteriorated into substandard loans, show that the capital adequacy ratio of 3 finance companies falls below the regulatory requirement of 10 percent, and 1 finance company's capital adequacy ratio seems to be negative. Similarly, 5 finance companies capital adequacy ratio falls below the regulatory minimum if 5 percent of pass loans deteriorated into the loss category. In addition, if 25 percent of real estate and home loans deteriorated into the loss category then 2 finance companies capital adequacy ratio fell below the regulatory requirement.

The liquidity stress test indicates that liquidity ratios of 2 finance companies would be negative if deposits were withdrawn by 10 percent in 5 consecutive days. Similarly, the liquidity ratios of 1, 4, 6, and 7 finance companies would fall below the regulatory minimum if deposits were withdrawn by 5, 10, 15, and 20 percent of total deposits, respectively. In case, top 5 corporate depositors withdraw their deposits, the liquidity position of 3 finance companies falls below 20 percent. If the top 5 individual depositors withdrew their deposit, none of the finance company's liquidity positions would fall below 20 percent.

CHAPTER IV: NON-BANK FINANCIAL INSTITUTIONS

4.1 Remittance Companies and Money Changers

4.1.1 Remittance Companies

Remittance companies are licensed by Nepal Rastra Bank in accordance to the Foreign Exchange (Regulation) Act, 1962, and the Nepal Rastra Bank Act (NRB Act), 2002 to facilitate inward remittance transactions. These companies collaborate with foreign partners to bring remittances into Nepal. As of mid-July 2024, 36 remittance companies are licensed by the NRB. However, only 22 companies actively conducted remittance transactions during the review period.

Table 4.1: Financial Indicators of Remittance Companies

Indicators*	Rs. Billion		Percent Change
	Mid-July 2023	Mid-July 2024	
Paid-Up Capital	2.86	3.07	7.34
Assets	11.06	10.63	-3.89
Revenue	4.27	2.74	-35.83
Expenses	2.73	2.19	-19.78
Reserves	2.15	1.73	-19.53

Source: Financial Reports of Remittance companies

** Aggregate data of the remittance companies that carried out transactions during the review year*

The total paid-up capital of the remittance companies increased by 7.34 percent to Rs.3.07 billion during the review period. On the other hand, the aggregate revenue, expenses, and reserves declined to Rs.2.74 billion, Rs.2.19 billion, and Rs.1.73 billion, respectively.

Region-wise Remittance Inflows

The share of Remittance companies in total remittance inflows stood at around 55% in the review period. The remaining amount is transferred through BFIs. The total remittance inflows during the review period amounted to USD 10.86 billion, a 14.5 percent increase compared to the previous year. The Asia Pacific region, including India, and the Middle East region are the largest sources of remittance inflows.

Disbursement through Sub-agents

Remittance companies are allowed to appoint sub-agents to distribute remittances to beneficiaries. As of mid-July 2024, remittance companies disbursed remittance through 7,693 sub-agents located throughout the country. Bagmati Province had the most number of sub-agents, whereas Karnali Province had the least number of sub-agents.

4.1.2 Money Changers

Money changers are licensed to exchange Indian Rupees (INR) and convertible foreign currencies (CFCs). A three-year renewable license is provided through both the Foreign Exchange Management Department and seven Provincial offices of NRB. As of mid-July 2024, a total of 330 money changers are operationalinside and outside the Kathmandu valley. The three types of license provided are:

(i) Purchase and sale of INR (Minimum required paid up capital of Rs.1 million)

(ii) Purchase of CFC (Minimum paid up capital of Rs.1.5 million)

(iii) Conduct both (i) and (ii)

Table 4.2: Details of Licensed Institutions

Licensing Office	Buy CFC Only	INR Buy & Sale	Both (INR & CFC)	Total
FEMD	138	-	16	154
Biratnagar	1	57	1	59
Janakpur	-	5	4	9
Birgunj	4	9	2	15
Pokhara	35	-	-	35
Siddharthanagar		37	10	47
Nepalgunj	-	6	3	9
Dhangadi	-	2	-	2
Total	**178**	**116**	**36**	**330**

Source: FXOL System

4.2 Hire Purchase Companies

As of mid-July 2024, 10 hire purchase companies operated to extend loans and advances. During the review year, the total loans and advances extended by the hire purchase companies stood at Rs.20.22 billion, an increase of 8.42 percent. Similarly, borrowings from banks and financial institutions elevated by 19.81 percent to Rs.12.76 billion. These borrowings are utilized to fund the hire purchase loans provided by these companies.

Table 4.3: Sources and Uses of Fund - (Hire Purchase Companies)

Indicators	Rs. Billion		
	Mid-July 2023	Mid-July 2024	Percent change
Sources of Fund	**21.25**	**22.28**	**4.85**
Share Capital	3.70	3.70	-
Reserves and Surplus	2.28	2.73	19.74
Borrowings	10.65	12.76	19.81
Other Liabilities	4.62	3.09	-33.12
Uses of Fund	**21.25**	**22.28**	**4.85**
Cash and Bank	0.58	0.66	13.79
Loan and Advances	18.65	20.22	8.42
Fixed Assets	0.32	0.36	12.50
Other Assets	1.69	1.04	-38.46

Source: Financial Reports of Hire Purchase Companies

4.3 National Cooperative Bank Limited

National Cooperative Bank Limited (NCBL) was established on 9th July 2003 as per Section 26 (5) of the Cooperative Act, 1992 (First Amendment, 2000). NCBL obtained its license from NRB to conduct limited banking activities on 26th July 2010. Since then, NCBL has been providing financial services, including accepting deposits from and providing loans to its member cooperatives.

NCBL operates through its 68 branch offices spread across 37 districts. Out of its 16,341 member cooperatives, 2,259 (13.8%) cooperatives availed loans from NCBL.

Table 4.4 Sources and Uses of Funds - (NCBL)

Indicators	Rs. Billion		Percent Change
	Mid-July 2023	Mid-July 2024	
Uses of Funds	**63.48**	**64.66**	**1.86**
Cash and Cash Equivalent	15.86	19.04	20.05
Deposit at NRB	0.33	0.33	-
Fixed Deposit at BFIs	6.58	13.37	103.19
Loans and Advances to cooperatives	31.65	22.24	-29.73
Investment in Securities	7.39	6.30	-14.75
Tax Assets	0.32	0.37	15.63
Investment in Assets	0.14	1.11	692.86

Property and equipment	0.62	0.58	-6.45
Other Assets	0.59	1.12	89.83
Sources of Fund	**63.48**	**64.66**	**1.86**
Share Capital	2.81	2.79	-0.71
Retained Earnings	(0.08)	(3.40)	4150.00
Reserves and Surplus	2.11	3.68	74.41
Deposit from Members	58.24	61.08	4.88
Other Liabilities	0.40	0.51	27.50

Source: NCBL Audited Financials

During the review period, deposits from member cooperatives increased by 4.88 percent to Rs.61.08 billion. However, loans extended to member cooperatives declined sharply by 29.73 percent to Rs.22.24 billion. Additionally, retained earnings further deteriorated to a negative figure of Rs.3.40 billion.

Table 4.5: Key Financial Indicators of NCBL

Indicators (Percent)	Mid-July 2023	Mid-July 2024
Core Capital to Risk Weighted Assets Ratio	10.83	2.44
Capital Adequacy Ratio	11.96	3.35
Loan loss Provisioning	1.68	6.10
Credit to Deposit Ratio	54.33	36.41
Non-Performing Loans (NPL to Total Loan Ratio)	8.2	25.54
Net Interest Income	1.61	1.16
Net Profit (Loss)	0.20	(1.67)
Liquidity Ratio	36.46	48.40

Source: Financial Report of NCBL

The financial condition of NCBL worsened during the review period. Loan loss provisioning surged from Rs.1.68 billion to Rs.6.10 billion, reflecting a sharp deterioration of asset quality. As of mid-July 2024, 25.54 percent of total loans are classified as non-performing, a substantial increase from 8.2 percent in the previous year.

The decline in the credit to deposit ratio has negatively impacted net interest income, which decreased to Rs.1.16 billion. Furthermore, NCBL reported a net loss of Rs.1.67 billion compared to a modest profit of Rs.0.20 billion in the previous year. The decline in profitability, coupled with the sharp rise in loan loss provisioning, has severely affected NCBL's capital position. The capital adequacy ratio dropped to 3.35 percent, while the core capital to risk-weighted assets ratio decreased to 2.44 percent, indicates the deteriorating financial health.

4.4 Hydroelectricity Investment and Development Company Limited

Hydroelectricity Investment and Development Company Limited (HIDCL), a state-owned enterprise, is primarily focused on mobilizing funds for investments in hydroelectricity generation, transmission, and distribution projects.

During the review year, the reserves grew significantly by 36.32 percent, reaching Rs.3.19 billion. The total sources of funds increased by 4.89 percent to Rs.26.58 billion during the period. However, loans extended to hydro-power projects declined by 20.81 percent and stood at Rs.7.27 billion as of mid-July, 2024. Out of the total fund of HIDCL, 51.84 percent was held as term deposits in banks, which stood at Rs. 13.78 billion at the end of the review period.

Table 4.6: Sources and Uses of Funds - (HIDCL)

Indicators	Rs. Billion		Percent Change
	Mid-July 2023	Mid-July 2024	
Sources of Fund	**25.34**	**26.58**	**4.89**
Share Capital	22.77	22.87	0.44
Reserves	2.34	3.19	36.32
Current Liabilities	0.16	0.45	181.25
Non-Current Liabilities	0.07	0.07	-
Uses of Fund	**25.34**	**26.58**	**4.89**
Cash and Bank Balance	0.36	1.15	219.44
Term Deposits with Banks	12.35	13.78	11.58
Other Current Assets	0.05	0.08	60.00
Loan to Power Projects	9.18	7.27	-20.81
Investment in Equity	3.23	4.15	28.48
Investment in Corporate Bonds	0.08	0.08	-
Other Non-Current Assets	0.09	0.07	-22.22

Source: Financial Report of HIDCL

4.5 Employees Provident Fund

The Employees Provident Fund (EPF) was established under the Employees Provident Fund Act, 2019, and manages the Provident Fund in Nepal on behalf of the Government of Nepal for government, public enterprises, and private-sector employees. It has been entrusted to manage the Contributory Pension Scheme for the employees of the Federal Government of Nepal and other public sector employees appointed from the fiscal year 2019/20 as per the Pension Fund Act, 2019. The total assets of EPF increased by 11.46 percent during the review year to Rs. 574.02 billion in mid-July 2024. The funds collected by the EPF grew by 11.50 percent to Rs. 518.48 billion in mid-July 2024. The general reserves and other reserves stood at Rs. 38.48 billion.

Table 4.7: Key Indicators of Employees Provident Fund

Indicators	Rs. Billion	
	Mid-July 2023	Mid-July 2024
Sources of Fund		
Provident Fund	465.02	518.48
Pension Fund	6.43	11.22
General Reserve and Other Reserves	37.32	38.48
Liabilities	1.97	1.78
Provisions	4.24	4.08
Total	**514.98**	**574.02**
Uses of Fund		
Cash and Bank	1.18	18.25
Investment in Government Savings Bonds	-	-
Investment in Government Debt Bonds	1.05	1.05
Investment in Fixed Deposit	147.21	167.90
Investment in Equity Shares	26.81	25.21
Investment in Debentures	4.39	6.09
Project Loan	84.25	87.32
Lending to Contributors	244.53	262.50
Staff Loan and Advances	2.34	2.32
Investment Properties	0.87	0.88
Property, Plant and Equipment	0.66	0.76
Assets Under Construction	0.17	0.25
Miscellaneous Assets	1.52	1.49

Total	**514.98**	**574.02**
Loan and Investment to Total Fund Ratio	0.99:1	0.96:1
Loan and Investment to Provident Fund Ratio	1.09:1	1.06:1

Source: Employees Provident Fund

4.6 Citizen Investment Trust

Citizen Investment Trust[3] (CIT) was established under the Citizen Investment Trust Act, 1991 and it has been formally operating its activities since 1992. It operates and manages various types of retirement schemes and programs, as well as various unit schemes and mutual fund programs for both domestic and foreign investors.

As of mid-July 2024, fund collections of CIT stood at Rs. 226.83 billion, recording a growth of 12.25 percent from Rs. 202.07 billion in mid-July 2023. Regular fund collection from members is the major source of funds for CIT, which is almost 74 percent of the total funds available. Loans to members and fixed deposit investments are the major segments of its fund mobilization. CIT has placed Rs. 129.50 billion of their investments as fixed deposits in the banks and financial institutions. Likewise, CIT has invested Rs.39.28 billion in the shares and debentures of different institutions. Similarly, CIT availed Rs.74.68 billion of loans and advances as of mid-July 2024.

Table 4.8: Key Indicators of Citizens Investment Trust

Indicators	Rs. Billion	
	Mid-July 2023	Mid-July 2024
Sources of Funds		
Paid-Up Capital	5.31	6.06
Reserve Fund	18.22	19.45
Fund Collection	202.07	226.83
Other Liabilities	49.69	55.97
Total	**275.29**	**308.31**
Uses of Fund		
Cash and Bank Balances	2.69	12.28
Investments	**151.95**	**169.29**
a) Fixed Deposit	113.95	129.50
b) Government Bonds	0.50	0.50

[3] https://www.nlk.org.np/

c) Shares and Debentures	37.50	39.28
Loans and Advances	71.11	74.68
Fixed Assets and Assets in WIP	2.23	2.22
Other Assets	47.31	49.84
Total	**275.29**	**308.31**

Source: CIT

4.7 Social Security Fund

The Social Security Fund (SSF) executes social insurance policies to its members. SSF consists of three main sources of funds: contributions collected from members, national welfare fund, and social security tax. Contribution-based social security schemes are based on individual and organizational contributions. As of mid-July 2024, the national welfare fund of SSF stood at Rs. 26.90 billion. As of mid-July 2024, the placements made by SSF with banks and financial institutions stood at Rs. 66.15 billion, indicating the concentration of investment in fixed deposits.

Table 4.9: Key Indicators of Social Security Fund

Indicators	(Rs. Billion)	
	Mid-July 2023	Mid-July 2024
Sources of Fund		
Employees Facility Related Liability	0.05	0.006
Social Security Related Liability	0.05	0.26
Loan and other liability	0.27	0.11
Formal Scheme Fund	35.18	52.85
Migrant Employee Fund	0.40	2.11
Informal and Self-Employed Fund	-	0.004
National Welfare Fund	25.72	26.90
Social Security Tax Fund	0.47	0.47
Accumulated Profit/ (loss)	12.64	15.27
Total Sources of Fund	**74.80**	**98.07**
Uses of Fund		
Cash and Cash Equivalents	15.31	20.35
Placement with Bank and Financial Institutions	42.97	66.15
Other Assets	1.63	1.45
Loan to Contributors	1.19	3.91

Investment on securities	13.62	6.11
Property, Plant and Equipment	0.05	0.07
Total Uses of Fund	**74.80**	**98.07**

Source: Social Security Fund

4.8 Insurance Companies

There are altogether 37 (14 Life insurance, 14 Non-Life Insurance, 2 Reinsurance, 3 Micro life insurance, and 4 Micro non-life insurance) insurance companies as of mid-July 2024. There has been a steady growth in the gross premium collection from insurers over time. The gross premium collection amount increased by 8.23 percent to reach Rs. 197.97 billion in the review year. A steady ratio of gross premium to GDP suggests that the insurance sector is keeping pace with overall economic growth. The percentage of the population covered by life insurance has decreased marginally to 43.27 percent during the review year. The insurance density (Rs. per Capita) increased by 7.27 percent to Rs 6,444.94 in mid-July 2024. The insurance density represents the average insurance premium paid per person in a given year, reflecting the level of insurance market penetration. The gross claim paid amount an insurance company pays out to policyholders increased by 7.33 percent to Rs. 84.49 billion in the review year. The number of licensed surveyors has increased steadily, aligning with the sector's growth and demand for risk assessment and claims evaluation. The number of agents shows consistent growth, mirroring the sector's expansion and its push to reach more customers. Employment in the insurance sector is growing, which correlates with the overall expansion of the industry. The number of branches has also increased over the years, indicating improving financial inclusion.

Table 4.10: Key Indicators of the Insurance Sector

Indicators	Mid-July 2023	Mid-July 2024
Gross Premium Collection (Rs. Billion)	182.91	197.97
Growth (Percent)	2.87	8.23
Gross Premium to GDP	3.40	3.47
Insurance Density (Rs. per Capita)	6,008.27	6,444.94
Gross Claim paid (Rs. Billion)	78.72	84.49
Surveyors	1,217	1,249
Agent	277,626	329,572
Employment	11,496	11,951
Branches	2,801	2,984

Source: Nepal Insurance Authority

4.8.1 Total Assets, Equity and Liabilities of Life and Nonlife Insurance Companies

As of mid-July 2024, the total assets of life insurance companies stood at Rs. 801.54 billion, which was Rs.676.23 in mid-July 2023. Similarly, the total assets of nonlife insurance companies increased to Rs.133.46 billion in mid-July 2024. Similarly, the combined total assets of both life and nonlife insurance companies increased by 15.83 percent to Rs.935 billion in the review year. The total assets of nonlife insurance companies increased by 1.89 percent, whereas the total assets of life insurance companies increased by 18.53 percent.

Table 4.11: Total Assets, Equity and Liabilities of Life and Nonlife Insurance Companies

Indicators	Life		Nonlife	
Amount in NRs. 10 million	Mid-July 2023	Mid-July 2024	Mid-July 2023	Mid-July 2024
Goodwill and Intangible Assets	13.51	16.42	43.10	42.84
Property and Equipment	420.60	468.19	406.97	444.14
Investment Properties	155.87	212.48	40.69	40.57
Deferred Tax Assets	254.94	251.63	67.99	56.71
Investment and Loans	62,598.97	74,221.10	7,526.77	7,980.62
Reinsurance Assets	11.63	13.43	3,012.82	2,890.60
Other Assets	2,693.15	2,965.67	1,712.18	1,624.14
Cash and Cash Equivalent	1,474.06	2,004.72	287.64	266.32
Total Assets	67,622.73	80,153.62	13,098.15	13,345.93
Share Capital	5,192.01	5,850.51	2,526.19	2,569.99
Reserves and other funds	2,594.99	2,958.66	4,530.84	4,840.33
Provisions	129.63	206.06	247.16	273.75
Gross Insurance Contract Liabilities	57,079.36	68,569.08	4,544.57	4,474.45
Deferred Tax Liabilities	135.02	153.53	62.47	38.50
Other Liabilities	2,491.72	2,415.78	1,186.91	1,148.93
Total Liabilities	59,835.73	71,344.45	6,041.11	5,935.62
Total Equity and Liabilities	67,622.73	80,153.62	13,098.15	13,345.93

Source: Nepal Insurance Authority

4.8.2 Total Assets, Equity and Liabilities of Micro (life and nonlife) Insurance Companies

Micro-insurance companies are established to provide services to the low-income group. Micro-insurance companies are relatively new in insurance sector. During the review year, two new micro non-life insurance companies started their operation in Nepal. With this, as of mid-July 2024, seven micro insurance companies (three life and four nonlife) are in operation. The total assets of the micro life insurance companies increased to Rs.1.74 billion in mid-July 2024. Similarly, the total assets of the micro nonlife insurance companies increased to Rs.2.50 billion in mid-July 2024. The combined total assets of both micro life and micro non-life insurance companies increased by 21.09 percent to Rs.4.23 billion in the review year. Likewise, the total assets of micro nonlife insurance companies increased by 33.10 percent, whereas that of micro life insurance companies increased by 7.21 percent during the review period.

Table 4.12: Total Assets, Equity and Liabilities of Micro life and Micro nonlife Insurance

Indicators	Micro Life		Micro Nonlife	
Amount in Rs. 10 million	Mid-July 2023	Mid-July 2024	Mid-July 2023	Mid-July 2024
Goodwill and Intangible Assets	0.26	0.46	1.75	2.89
Property and Equipment	6.36	8.41	9.66	13.94
Investment Properties	-	-	-	-
Deferred Tax Assets	-	-	0.01	0.01
Investment and Loans	146.25	157.12	157.18	201.03
Reinsurance Assets	-	0.26	0.00	9.45
Other Assets	0.78	2.46	2.05	8.37
Cash and Cash Equivalent	8.73	5.39	16.98	14.04
Total Assets	162.38	174.09	187.62	249.72
Share Capital	157.50	157.50	157.50	210.00
Reserves and other Funds	0.92	2.22	23.87	3.36
Total Equity	158.42	159.72	181.37	213.36
Provisions	0.07	0.10	0.05	0.22
Gross Insurance Contract Liabilities	0.02	8.65	0.00	13.58
Deferred Tax Liabilities	0.10	0.10	0.05	0.05
Other Liabilities	3.76	5.52	6.15	22.51
Total Liabilities	3.95	14.37	6.25	36.36
Total Equity and Liabilities	162.38	174.09	187.62	249.72

Source: Nepal Insurance Authority

4.8.3 Total Assets, Equity and Liabilities of Reinsurance Companies

As of mid-July 2024, two reinsurance companies are operating in Nepal. The total assets of reinsurance companies increased by 31.70 percent to reach Rs.54.12 billion, which was 41.10 billion as of mid-July 2023.

Table 4.13: Total Assets, Equity, and Liabilities of Reinsurance Companies

Indicators *Amount in Rs. 10 million*	Reinsurance	
	Mid-July 2023	Mid-July 2024
Goodwill and Intangible Assets	1.35	4.06
Property and Equipment	65.28	64.66
Investment Properties	0.00	0.00
Deferred Tax Assets	14.67	19.54
Investment and Loans	3028.46	3781.18
Reinsurance Assets	259.94	318.76
Other Assets	700.96	1149.43
Cash and Cash Equivalent	39.03	75.03
Total Assets	4,109.69	5,412.66
Share Capital	1981.35	2382.22
Reserves and other Funds	645.59	1123.85
Total Equity	2,626.94	3,506.07
Provisions	81.89	103.72
Gross Insurance Contract Liabilities	1175.05	1529.16
Deferred Tax Liabilities	0.00	0.00
Other Liabilities	225.81	273.71
Total Liabilities	1,482.75	1,906.59
Total Equity and Liabilities	4,109.69	5,412.66

Source: Nepal Insurance Authority

4.9 Cooperatives

As of mid-March 2024, the total number of cooperatives stood at 31,450, the number of shareholders stood at 7.85 million, while the share capital stood at Rs. 94.72 billion. During the review year, savings of Rs. 478.11 billion and credit of Rs. 405.30 billion were mobilized, which were Rs. 478.03 billion and Rs. 426.35 billion in the previous year. The total number of direct employments generated in the cooperative sector increased to 94,002 from 93,771. Considering the expanding sphere of cooperatives in the financial system, a cooperative ordinance has been enacted. Recently, the National Cooperative Regulation Authority has also been established for the regulation and supervision of the saving and credit cooperatives.

Table 4.14: Key Indicators of Cooperatives

Indicators	Mid-March 2023	Mid-March 2024
No. of Cooperatives	31,373	31,450
Members (Millions)	7.38	7.85
Total Staff	93,771	94,002
Total Capital (Rs. Billion)	94.15	94.72
Savings (Rs. Billion)	478.03	478.11
Credit (Rs. Billion)	426.35	405.30

Source: Economic Survey 2024

CHAPTER V: FINANCIAL MARKETS

5.1 Domestic Financial Markets

5.1.1 Money Markets

Liquidity absorption was done mainly through the standing liquidity facility in the review year. NRB monitors and stabilizes the short-term interest rate of the banking system through monetary management instruments such as repo, reverse repo, outright purchase, outright sale, and deposit collection along with the interest rate corridor influencing market interest rate through its policy rate. NRB absorbed Rs.4673.60 billion of liquidity including Rs.3522.35 billion through the standing deposit facility (SDF) and Rs.1151.25 billion through the deposit collection auction. Meanwhile, the NRB injected Rs.804.76 billion liquidity on the turnover basis, of which, Rs.1.20 billion was through the standing liquidity facility (SLF) and Rs.803.56 billion through the Overnight Liquidity Facility (OLF). Consequently, NRB absorbed Rs.3868.84 billion net amount of liquidity through various instruments. On the other side, NRB injected liquidity of Rs.783.47 billion through the net purchase of USD 5.89 billion from the foreign exchange market.

Figure 5.1: Liquidity Absorption

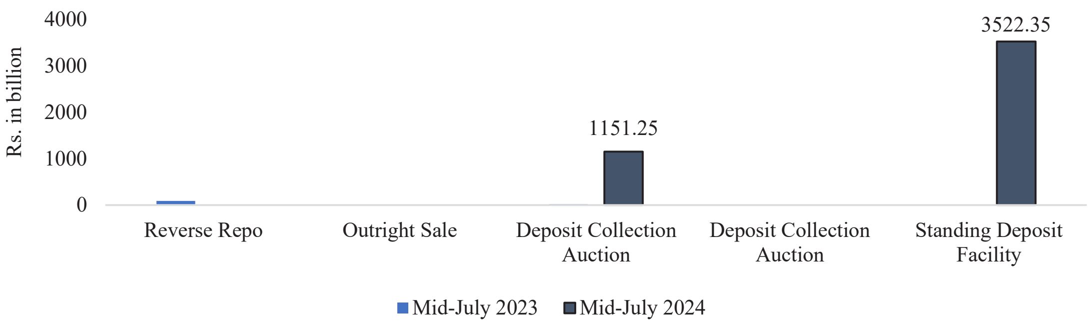
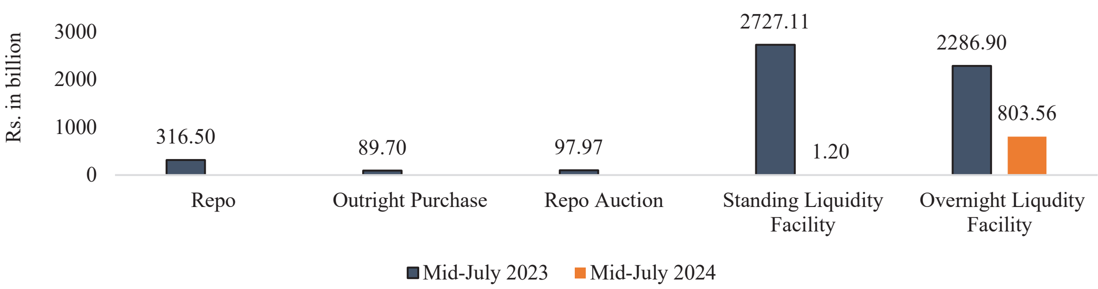


Figure 5.2: Liquidity Injection



Source: Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, July 2024

5.1.2 Capital Markets

Securities markets serve a decisive purpose in enhancing economic activity by effectively mobilizing scattered savings, managing liquidity, and diversifying risk. The improved securities markets can help to strengthen economic growth and create a more resilient financial system. The Government of Nepal (GoN) has prioritized the securities markets as an essential medium for capital accumulation, aiming to achieve economic growth and sustainable development goals.

The Securities Board of Nepal (SEBON) is the regulatory body of securities markets and commodity derivatives markets. It has been regulating and supervising the securities markets under the Securities Related Act, 2006. Similarly, SEBON is also mandated to regulate the commodity derivatives market after the enactment of the Commodities Exchange Market Act, 2017.

GoN has created the necessary legal and institutional arrangements for the systematic, transparent, efficient, stable, and fair operation of these markets. SEBON administers the legal provisions by regulating and supervising the market participants and securities markets activities. Recently, SEBON adopted a free pricing method for initial public offerings (IPOs) through the book-building directives to encourage the real sector companies to mobilize funds from the securities markets. SEBON also facilitates to develop private equity/venture capital (PE/VC) ecosystem by approving PE/VC fund managers and their schemes for managing and financing the funds for promoting private business spirits, entrepreneurship, and innovation. SEBON has also regularly and effectively supervised the market participants and securities trading activities to make the securities markets transparent and competitive and protect the interests of general investors.

5.1.2.1 Nepalese Securities Markets Ecosystem

In recent years, with the licensing of additional market intermediaries and their operation, securities market services have been more competitive with the increased market access to the investors. In the review period, the number of market participants reached 730 in the securities markets, with an increase in the number of listed companies, depository participants, stockbrokers, and Qualified Institutional Investors (QIIs) in the fiscal year 2023/24. In regard to the number of listed companies, the number of real sector companies, including the hydroelectricity sector, has increased, thereby reducing the BFIs concentration in securities markets. The details of the securities markets participants is in Table 5.1.

Table 5.1 Securities Market Participants

Participants	Mid-July 2023	Mid-July 2024
Stock Exchange	1	1
Central Depository Company	1	1
Stockbrokers	67	90
Merchant Bankers	30	29
Mutual Fund Managers	20	20
Credit Rating Agencies	3	3
Listed Companies	254	270
Depository Participants	91	109
ASBA BFIs	49	43
Qualified Institutional Investors	132	150
Stock Dealers	2	2
Specialised Investment Fund Managers	12	12
Total	**662**	**730**

Source: Securities Board of Nepal and Nepal Stock Exchange Ltd.

5.1.2.2 Primary Market

The primary market is the part of the securities markets that deals with the issuance and sale of securities to purchasers directly by the issuer, with the issuer being paid the proceeds. This market is a source of new securities and resources where private and government companies manage long-term funds through the issue of debt-based or equity-based securities.

The primary market helps channel the funds from the surplus areas to the productive investment sector. Merchant Bankers, ASBA BFIs, CDS and Clearing Limited (CDSC), and QIIs play key roles in the functioning of the primary markets. In the fiscal year 2023/24, funds of Rs.62.92 billion were mobilized via the primary market. The total fund mobilization decreased by 26.44 percent in the review period as compared to the previous year.

Similarly, schemes funds of Rs.10.5 billion were mobilized by specialized investment funds. It has helped to expand the scope of Nepalese securities markets.

The details of the fund mobilization through the primary market and the specialized fund for the last two fiscal years are presented in Table 5.2.

Table 5.2: Primary Market

Particulars (Rs. Billion)	Mid-July 2023		Mid-July 2024	
	No.	Amt.	No.	Amt.
Initial Public Offerings	42	22.37	7	35.51
Right Offerings	7	15.98	7	7.64
Further Public Offerings	1	0.037	3	0.034
Debentures	12	31	4	15.04
Mutual Fund Schemes	16	16.15	6	4.7
Total	**78**	**85.54**	**27**	**62.92**
Specialized Investment Fund Schemes	4	10.5	4	20

Source: Securities Board of Nepal

5.1.2.3 Secondary Market

The secondary market is the financial market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold. In the fiscal year 2023/24, the number of listed companies stood at 270, average daily turnover increased by 62.09 percent, total turnover increased by 57.28 percent, NEPSE index increased by 6.83 percent and market capitalization increased by 15.28 percent.

Table 5.3 Secondary Market

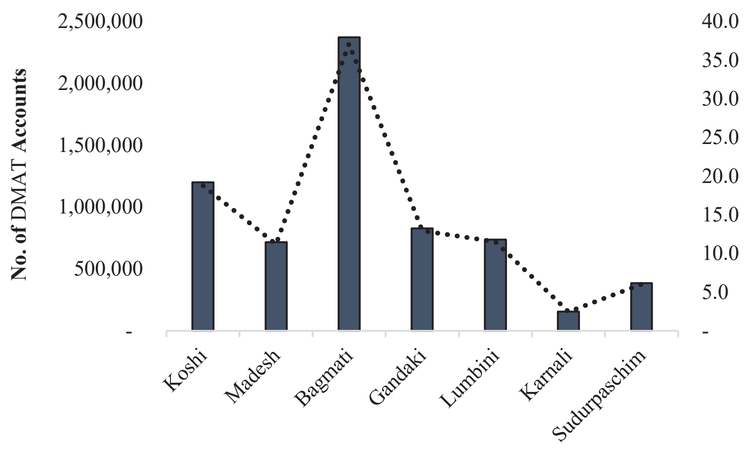
Particulars	Unit			Percentage Change	
		Mid-July 2023	Mid-July 2024	Mid-July 2023	Mid-July 2024
No. of Listed Companies	Number	254	270	8.55	6.30
No. of Listed Securities	Number in 10 million	738.71	832.25	9.10	12.66
Total Paid-Up Capital of Listed Securities	Rs in billion	728.95	825.05	9.17	13.18
Turnover	Rs in billion	467.13	734.68	-61.14	57.28
Trading Days	Days	236	229	-1.26	-2.09
Average Daily Turnover	Rs in 10 million	197.93	320.82	-60.65	62.09
No. of Securities Traded	Number in 10 million	127.72	205.22	-48.75	60.68
No. of Transactions	Number	86,44,715	14,795,645	-41.24	71.15
Market Capitalization	Rs in billion	3082.52	3553.68	7.43	15.28

Float Market Capitalization	Rs in billion	1088.65	1215.43	5.56	11.65
Turnover/Market Capitalization	Annual Percentage	15.15	20.67	-63.83	36.44
Turnover/Float Market Capitalization	Annual Percentage	42.91	60.45	-63.19	40.88
NEPSE Index	Points	2097.1	2240.41	4.36	6.83
NEPSE Float Index	Points	144.97	152.62	4.02	5.28

Source: Nepal Stock Exchange Ltd

5.1.2.4 Inclusion and Participation in Securities Markets

Figure 5.3: Province-wise DMAT Account



Source: Securities Board of Nepal, Figures as of as of mid-July, 2024

The number of investors has grown significantly in recent years. SEBON has been facilitating the outreach of stockbrokers and merchant bankers outside Kathmandu Valley and granting new licenses to the stockbrokers as well. SEBON has encouraged market participants to adopt the technology to provide securities market services more efficiently to spur financial access and inclusion. During the review year, around 6.39 million investors participated in securities markets through their own Dematerialized (DEMAT) accounts. On a provincial basis, the highest number of DMAT accounts were opened in Bagmati Province (37.1 percent), whereas 2.4 percent of DMAT accounts were opened in Karnali Province, which is the lowest. Similarly, 3.78 million investors were involved in trading activities in the secondary market, out of which 2.25 million were online user investors.

Table 5.4: Investors Participation in Securities Markets

Particulars	Mid-July 2023	Mid-July 2024
DEMAT Account Holders	5,823,000	6,395,000
MERO Share Accounts	4,826,000	5,369,000
No. of Investors in Secondary Markets	3,283,966	3,782,720
Online Users	176,3301	2,258,410
Active Investors	1,644,380	2,116,222

Source: Nepal Stock Exchange Ltd and CDS and Clearing Ltd

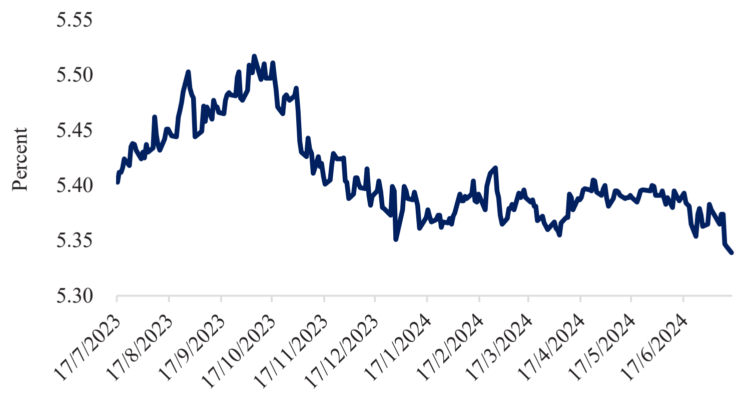
5.1.2.5 Commodity Derivatives Markets

The Commodity Exchange Act, 2017, has assigned the regulatory responsibility of the commodity derivatives markets to SEBON. SEBON formulated and implemented the Commodity Market Regulations, 2017, using the powers conferred by the Act. During the year 2021, the “Directives Related to Policy and Procedures to Issue License to Commodity Derivatives Exchange, 2021” was also implemented. SEBON issued a public notice for interested corporate bodies to submit applications for the operation of commodity derivatives exchange in Nepal as per the prevailing laws. A study conducted by the external expert has recommended to the SEBON for providing licenses to two companies considering the nation’s economy, industrial development, and the scope of commodity derivatives trading in Nepal. Following the SEBON notice, four companies have applied for pre-approval to establish the Commodity Derivatives Exchanges. SEBON board formed a committee to work on vetting the application. Granting of commodity derivatives exchange license is in the process. It is expected that with the licensing of commodity derivatives exchanges and intermediaries, including the necessary market infrastructures, the investors will be facilitated in hedging, price discovery, and arbitrage of contracts of the underlying commodities.

5.2 Foreign Exchange Market

5.2.1 US Government Treasuries

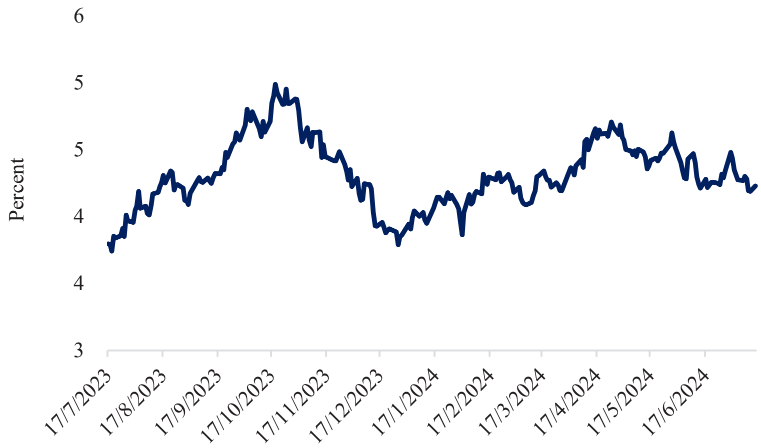
Figure 5.4: Daily Yield on 3-Month US T-Bills



Source: Refinitiv

Yield on three-month US Treasury Bills has decreased in the review period. The yield on three month T-bills stood at 5.41 percent in mid-July 2023, which decreased to 5.34 percent in mid-July 2024. The average yield on three-month T-bills remained 5.41 percent which was 4.30 percent in the same period of the previous year. The highest yield of 5.52 percent was recorded on October 6, 2023 and the lowest yield of 5.34 percent on mid-July 2024.

Figure 5.5: Daily Yield on 10-Year US Government Bond



Source: Refinitiv

Yield on long-term securities has increased in the review period. The average yield on 10-year US Government Bond stood at 4.23 percent which was 3.80 percent in the same period of the previous year. During the review period, the highest yield was 4.99 percent on October 19, 2023 and the lowest yield of 3.74 percent was on July 19, 2023.

5.2.2 Crude Oil

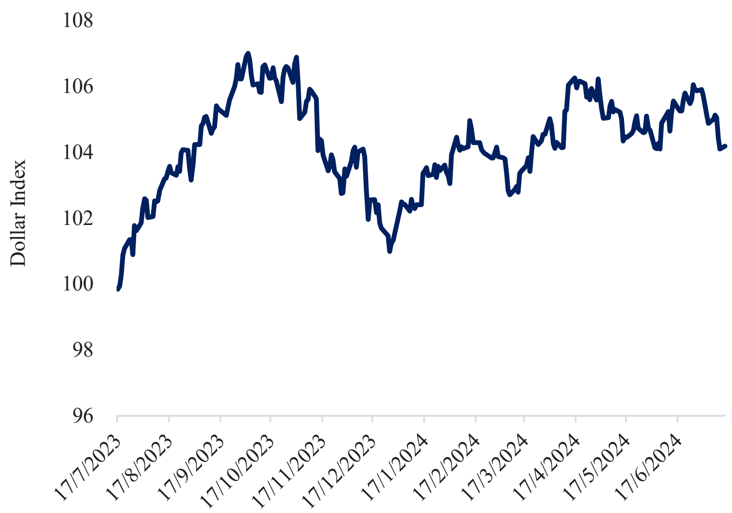
Brent crude oil price, the international benchmark, which was trading at US Dollar 78.50 per barrel in mid-July 2023 increased to US Dollar 84.85 per barrel in mid-July 2024. During the review period, crude oil traded from US Dollar 73.24 to US Dollar 96.55 per barrel. Crude oil price stood highest at US Dollar 96.55 per barrel on September 27, 2023 and the lowest at US Dollar 73.24 on December 12, 2023.

Figure 5.6: Brent Crude Oil Price

Source: Refinitiv

5.2.3 Dollar Index

Figure 5.7: Movement of US Dollar Index



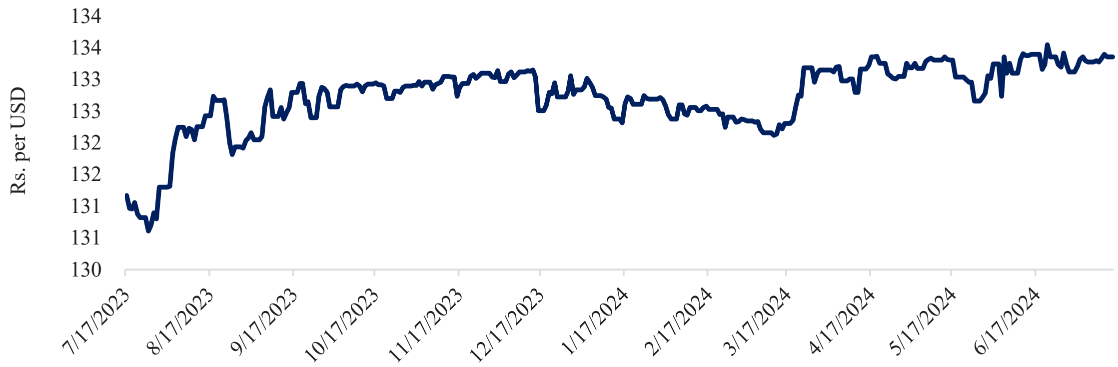
Source: Refinitiv

The US Dollar Index is an index measure of the value of the United States Dollar relative to a basket of foreign currencies including Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish Krona and Swiss Franc. During the review year, the US Dollar index recorded the highest value of 107.00 in October 3, 2023 and the lowest value of 99.84 in July 17, 2023. The index, which was 99.84 in mid-July 2023, has increased to 104.19 in mid-July 2024.

5.2.4 Dollar-Rupee Exchange Rate

Nepali currency has depreciated by 1.64 percent against US Dollar during fiscal year 2023/24 compared to 2.79 percent in the same period of the previous year. The exchange rate of one US Dollar stood at Rs.133.36 in mid-July 2024 compared to Rs.131.17 in mid-July 2023.

Figure 5.8: Movement of Nominal Exchange Rate



Source: Refinitiv

CHAPTER VI: FINANCIAL INFRASTRUCTURES

6.1 Payment Systems

6.1.1 Nepal's Payment Systems

Nepal's digital landscape has seen remarkable growth and adoption over the past decade, transitioning from traditional, physical transactions to technology-infused financial transformations. The transformation of Nepal's payment system is largely driven by the National Payment Systems Development Strategy (NPSDS) formulated in 2014. This strategy, aligned with the NRB Act, 2002, aims to develop a secure, efficient, and healthy payment system. The Payment and Settlement Act, 2019, also based on the NPSDS, mandates that entities wishing to operate payment services must obtain a license from the NRB. The Payment Systems Department (PSD) is responsible for issuing licenses for Payment System Operators (PSOs) and Payment Service Providers (PSPs) and overseeing their activities. As of mid-July, 2024, there are nine institutions licensed as Payment System Operators (PSOs) and 26 institutions licensed as Payment Service Providers (PSPs). Additionally, all 20 commercial banks, all 17 development banks, 15 finance companies, and 11 microfinance financial institutions have been licensed as PSPs by NRB.

The COVID-19 pandemic accelerated the adoption of digital payment solutions, as demand for contactless transactions grew. This led to innovations such as Quick Response (QR) codes, connectIPS (Instant Payment System), Cardless Withdrawal, Smart Point-of-Sale (POS), Contactless Cards based on Near-Field Communication (NFC) technology, Virtual Cards, and Digital Lending. Financial literacy plays a crucial role in promoting digital transactions, and in response, the Nepal Rastra Bank (NRB) introduced the Financial Literacy Framework in 2020, along with the Financial Literacy Guidelines (2022) and the Financial Inclusion Policy (2024) to improve financial access and standardize financial literacy programs. These initiatives have helped millions of small businesses to shift their payments towards digital payments, enhancing their operations.

Nepal has operationalized the Retail Payment Switch (RPS) for settling retail transactions within the country, and the full-fledged operation of the National Payment Switch (NPS) is underway. RPS, launched in November 2021, is the first phase of the NPS project, with the second phase involving the launch of the National Card Switch (NCS). The readiness of NCS and domestic card scheme - Nepal Pay was announced in March 2025. The final phase will route all domestic electronic transactions through the National Payment Switch.

This initiative signifies the country's move towards a fully digital banking landscape, with plans to facilitate cross-border payments using new payment system instruments.

As of recent, 4G/LTE services now cover 741 of 753 local levels across 77 districts in Nepal[4]. The smartphone penetration rate stands at 72.94%, 15% have access to computers/laptops and 38% of households have access to internet services5. The cost of connectivity has also significantly reduced, from USD 2.25/GB in 2019 to USD 0.27/GB in 2024, gradually narrowing the digital divide, particularly in rural and gender dimensions

6.1.2. Recent Developments in the field of Payment System of Nepal

Box 3: Mapping of Achievements of Strategies Specified in NPSDS, 2014

The NPSDS, 2014 consists of 9 pillars, with several strategies planned for the development of the payment system in Nepal. In line with such strategies, the following developments have been made under each pillar:

Pillar 1: Legal Framework

- 2016: Established Payment System Department (PSD)
- 2016: Issued Licensing Policy for Payment related institutions/mechanism (Replaced with First Amendment)
- 2019: Issued Payment and Settlement Act, 2019
- 2019: Issued Retail Payment Strategy, 2019
- 2019: Implemented RTGS System Rules, 2019
- 2020: Issued Payment and Settlement Bylaws (First Amendment 2023), 2020
- 2021: Issued Digital Lending Framework, 2021
- 2021: Issued Nepal QR Standardization Framework and Guidelines, 2021

Pillar 2: Large and Critical Value Payments

- 2019: Implemented the Real Time Gross Settlement (RTGS) System

Pillar 3: Retail Payment System

- Implemented faster payment systems like cards, *connect*IPS, Fonepay Interbank Fund Settlement System (IBFT), etc. Other payment solutions like mobile banking, internet banking, QR codes, interbank payment system (IPS), payment gateway (ecommerce), point-of-sale (POS) have also been implemented.

Pillar 4: Government Payments

- Person-to-government (P2G) payments like Inland Revenue Department (IRD) tax payments and traffic penalties have been integrated in faster payment systems like *connect*IPS, ewallets, etc.
- Government-to-person (G2P) payments like salary payments are routed through bank accounts.
- G2P payments like pension, gratuity, etc. through ewallets are being explored.

Pillar 5: Securities Depository, Clearing and Settlement Mechanisms

5.1 Capital Market Development

- 2011: Established CDS and Clearing Limited, a subsidiary of Nepal Stock Exchange (NEPSE), in 2011

[4] See. NTA (2024)

5 See Nepal Census, 2021, available at https://censusnepal.cbs.gov.np/results/files/result-folder/National%20Report_English.pdf

- 2015: Implemented dematerialization of physical shares
- 2016: Implemented Nepal Stock Exchange (NEPSE) App
- 2018: Implemented Centralized Account Supported by Blocked Accounts (CASBA)
- 2019: Implemented online trading system (TMS/x)
- 2020: Implemented Meroshare app

5.2 Public Debt Management

- 2018: Established Public Debt Management Office (PDMO) under the Ministry of Finance (MOF)
- 2022: Implemented Public Debt Management Act, 2022
- 2024: Signed RTGS membership agreement for settlement of cash leg of DvP payments
- 2024: Implemented Debt Operation and Management Software (DOMS) for the entire lifecycle management of government securities (from issuance to settlement or sale)
- 2024: RTGS-DOMS integration currently under testing phase

Pillar 6: Interbank Money Market Management

- Open market operations integrated with the RTGS system through the Olympic Banking Software (OBS) of the NRB.
- Implemented Intraday Liquidity Facility (ILF) and Overnight Liquidity Facility (OLF), integrated with the RTGS system.

Pillar 7: International Remittance

- Inward remittances are allowed through remittance companies to ewallets
- Remittance service providers are licensed through the Foreign Exchange Management Department (FEMD)
- P2P transfers to Indian bank accounts allowed up to INR. 15,000 per day and INR. 100,000 per month[6]

Pillar 8: Oversight

- 2018: Implemented Payment System Oversight Framework
- 2021: Implemented Payment System Oversight Manual
- 2021: Implemented Payment System Inspection and Supervision Bylaws
- 2023: Issued Cyber Resilience Guidelines
- 2024: Implemented Procedure for Onsite Inspection of Payment-related Activities of Banks and Financial Institutions, 2024

Based on these frameworks, PSD undertakes onsite and offsite supervision of the licensed institutions.

Pillar 9: Cooperation

- Established National Payment Board with representation from the Ministry of Finance, Nepal Telecommunication Authority, and FCGO

In addition to payments-related developments in fiscal year 2023/24, several initiatives have been made to strengthen the payment systems in Nepal. NRB has issued a consultative document on the Framework for Identifying Systemically Important Payment Systems (SIPS) in April 2025. Based on the said framework, payment systems of Nepal will be designated as SIPS and such payment systems will be subject to enhanced regulation and supervision based on the Principles Of Financial Market Infrastructures (PFMIs).

[6] Circular No. 09/2080-81, dated January 11, 2024, of the Foreign Exchange Management Department, NRB

Central Bank Digital Currency (CBDC) in Nepal

The NRB's strategic plan envisions the launch of a CBDC pilot by 2026. A dedicated CBDC Division has been established within the Payment Systems Department (PSD). A concept report on " CBDC: Identifying Appropriate Policy Goals and Design for Nepal" was released for public consultation by NRB. With CBDC in place, payment-related innovations are further expected to flourish in Nepal. The prototype for a Wholesale CBDC has been developed and is in the process of demonstration. The full rollout is expected to take into account Nepal's economic situation, technological readiness, regulatory environment, and public preferences, with a target launch date set for 2026.

Cybersecurity and Digital Financial Literacy

As digitalization advances nationwide, cybersecurity and financial literacy have become critical priorities. To address these, NRB issued the Cyber Resilience Guidelines (CRG) in 2023, supplementing the Principles of Financial Market Infrastructures (PFMI) to enhance the cyber maturity of licensed institutions (LIs) in payment transactions, ensuring operational continuity and recovery from cyberattacks. NRB's directives for Payment System Operators (PSOs) and Payment Service Providers (PSPs) mandate comprehensive IT governance, including policies on physical security, access control, audit trails, incident response, cybersecurity, and resilience. Additionally, the Financial Inclusion and Consumer Protection Division has institutionalized measures like the Financial Consumer Protection and Complaint Management Procedure (2022), Financial Literacy Guidelines (2023), and Financial Inclusion Policy (2024), alongside campaigns to enhance digital financial literacy. Chapter 13 of the unified directives further ensures consumer protection through transparency, fair pricing, grievance handling, confidentiality, and robust record-keeping, fostering trust and safety within the digital payment ecosystem.

Money Laundering Risks and Regulatory Oversight

The rise of digital platforms has heightened concerns over money laundering (ML), terrorism financing (TF), and proliferation financing (PF) linked to emerging payment methods. To mitigate these risks, NRB established the Money Laundering Prevention Division (MLPD) for risk-based supervision of licensed institutions, including Payment System Operators (PSOs) and Payment Service Providers (PSPs). NRB enforces the Money Laundering Prevention Directive (No. 14/080) and has mandated all PSOs and PSPs to transition into public companies by mid-April 2025 to strengthen governance and accountability. The "Procedure for Onsite Inspection of Payment-related Activities of Banks and Financial Institutions" and the AML/CFT Supervisory Framework and Risk-Based

AML/CFT Supervision Manual are actively used for inspections, with a risk-based oversight framework underway. The agent-related directives for PSPs have been amended to address several areas systematically. These include setting a transaction ceiling, ensuring proper record-keeping, and implementing stringent reporting requirements to the Board and Nepal Rastra Bank (NRB). PSPs are now mandated to evaluate the fit and proper criteria for agents, requiring agents to submit a specified set of documents, including a criminal record certificate. These measures aim to enhance transaction monitoring and effectively mitigate money laundering risks.

The Nepalese payment system has seen a remarkable stride in the adoption of digital payments, especially after the Covid-19 pandemic. The surge in digital financial services is driven by the adoption of digital technologies, regulatory reforms, and increasing consumer demand for seamless financial services. Although significant developments in the payment systems have been observed after the Covid-19 pandemic, the onset of electronic payments can be traced back to 1990 when credit cards were issued for the first time in Nepal. Followed by many landmarks and achievements and Licensing Policy for Payment Related Institutions, 2023; Simplified KYC for Small Merchants, and NepalQR Standardization Framework and Guidelines, 2021, Manual for Onsite Inspection of Payment-related Activities of Banks and Financial Institutions, 2024, among others. Nonetheless, NRB is wary of new forms of risks, technical, operational, and risks related to money laundering/ terrorism financing/proliferation financing, using new payment methods and digital financial services. In this regard, NRB issues directives, circulars, and policies and undertakes the supervisory/ oversight function for the licensed institutions. The Access and Usage of Payments systems is tabulated below:

Table 6.1: Access of Payments Systems

Particulars	Mid-July 2023	Mid-July 2024	% Change
Payment System Operators (PSO) *	10	9	-10.00%
Payment Service Providers (PSP) *	27	26	-3.70%
PSP Agents	14,123	17,563	24.36%
Wallet Users	18,941,793	23,461,107	23.86%
ATM Machines (Terminals)	4,855	5,193	6.96%
Debit Cards	12,245,485	12,893,528	5.29%
Credit Cards	283,772	289,239	1.93%
Prepaid Cards**	139,777	181,724	30.01%
Mobile Banking Customers	21,363,989	24,648,846	15.38%
Internet Banking Customers	1,856,195	1,919,322	3.40%
Branch Less Banking	1,319	1,129	-14.40%
RTGS Participants	44	44	0.00%

Connect IPS Users	1,108,436	1,276,886	15.20%
ECC Members	53	54	1.89%
IPS Members	115	132	14.78%
* Other than BFIs			
** Also includes card issued by PSPs			

Table 6.2: Usage of Payments Systems

Particulars	Mid-July 2023		Mid-July 2024		Change (%)	
	No. of Transactions	Total Amount Rs. in Million	No. of Transactions	Total Amount Rs. in Million	No. of Transactions	Total Amount
RTGS	815,180	34,289,975	809,769	38,520,229	(0.66%)	12.34%
ATM-Cash Withdrawal	122,052,298	968,397	130,542,215	1,057,847	6.96%	9.24%
ECC	12,348,969	6,207,166	11,976,235	5,899,069	(3.02%)	(4.96%)
IPS	15,380,646	2,135,705	27,458,863	2,435,888	78.53%	14.06%
Connect IPS	50,252,944	4,114,628	70,501,884	5,665,121	40.29%	37.68%
Debit Cards	131,774,747	1,010,493	139,817,383	1,100,398	6.10%	8.90%
Credit Cards	2,868,591	18,351	3,243,907	21,733	13.08%	18.43%
Prepaid Cards	744,620	4,840	1,145,510	7,542	53.84%	55.85%
Internet Banking	3,216,663	156,828	3,512,720	169,738	9.20%	8.23%
Mobile Banking	283,420,597	2,185,999	424,047,710	3,478,668	49.62%	59.13%
Branchless Banking	878,368	18,049	873,608	18,579	(0.54%)	2.93%
Wallet	213,367,144	219,807	294,543,696	302,694	38.05%	37.71%
QR-Based Payments	78,029,200	245,412	169,346,467	499,795	117.03%	103.66%
Point of Sales (POS)	12,315,919	59,045	12,171,542	64,158	(1.17%)	8.66%
E-Commerce	990,135	6,182	1,474,296	8,816	48.90%	42.61%

Box 4: Regulatory Developments undertaken by NRB

One of the major developments during the year 2023 is the issuance of **Cyber Resilience Guidelines, 2023**. The Cyber Resilience Guideline has been issued to offer direction to Financial Market Infrastructures (FMIs) in improving their cyber resilience, with the goal of bolstering public confidence and supporting financial stability. Aligned with the principles of financial market infrastructures (PFMIs), this document tackles issues pertaining to the governance, risk management framework, settlement finality, operational risks, and link-related risks of FMIs. The guideline focuses on strengthening the resilience capabilities of licensed institutions by addressing aspects such as identifying cyber threats, implementing protective measures against such threats, detecting them, and formulating responses and recovery strategies in the face of cyber threats.

In addition to payments-related developments in fiscal year 2023/24, several initiatives have been made to strengthen the payment systems in Nepal. NRB is also preparing the **Framework for Identifying Systemically Important Payment Systems (SIPS)** Based on the said framework, existing payment systems of Nepal will be designated as SIPS and such payment systems will be subject to enhanced supervision based on the PFMIs.

NRB has issued **AML/CFT Supervisory Framework and Risk-Based AML/CFT Supervision Manual** for PSOs and PSPs. The guideline has been forwarded to the AML/CFT Division, Bank Supervision Department for implementation.

For fiscal year 2024/25, the department is in process of amending the existing unified directive and implementing the **Payment System-related Unified Directives.**

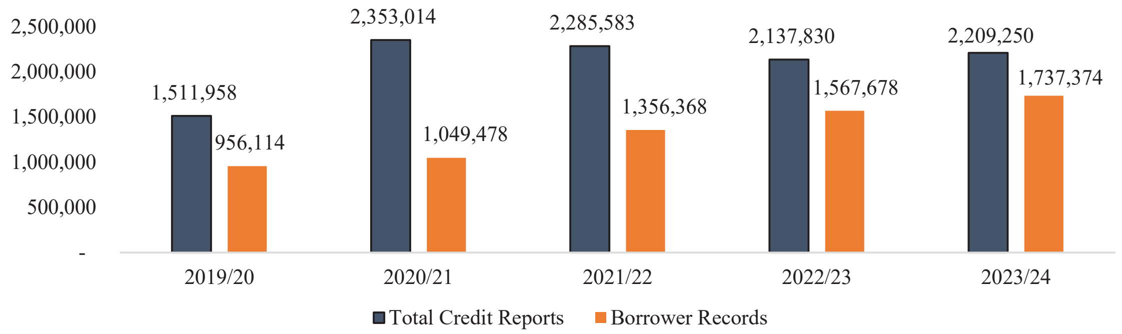
A study titled *"A Study on Cross-border Payments"* was conducted to guide policy decisions on cross-border transactions by licensed institutions, resulting in amendments to Directive No. 16 of the Payment System-related Unified Directives, 2080. The revised provisions allow cross-border payments through Mobile Banking, Internet Banking, Interbank Payments, and QR codes. In February 2024, Nepal Rastra Bank (NRB) signed a MoU with the Reserve Bank of India (RBI) to integrate cross-border payments. Additionally, Fonepay Payment Service Limited has been approved for UPI P2M transactions, NCHL for UPI P2P transactions, and Himalayan Bank Limited, with Focusone Payments Solution Limited as facilitator, for acquiring Alipay+ transactions in Nepal. Existing cross-border initiatives and related statistics further highlight the growing integration of Nepal's payment systems with international platforms.

6.2 Credit Information Bureau

Karja Suchana Kendra (KSKL), the credit information bureau of Nepal, plays an enabling role in deepening the credit lines in a financial system. The KSKL collects and collates the credit data of borrowers from its member financial institutions. The financial data is then aggregated in the system, and the resulting information (Credit Report) is shared with different users, which are mostly contributing financial institutions. The credit report is then used for the assessment of credit history and credit payment behavior of borrowers. In this regard, KSKL helps to reduce information asymmetry in financial system. As the inability of the lender to accurately assess the creditworthiness of the borrower may pose the risks of adverse selection and contribute to higher default rates and affects the profitability of the financial institution, credit bureau reduces information asymmetry, which results in reduced rates applied and enhanced access to credit. In this regard, as a part of KSKL's mission to offer member institutions the most integrated and seamless services possible, KSKL is collecting and disseminating trustworthy credit data that promotes responsible lending and strengthens banking oversight.

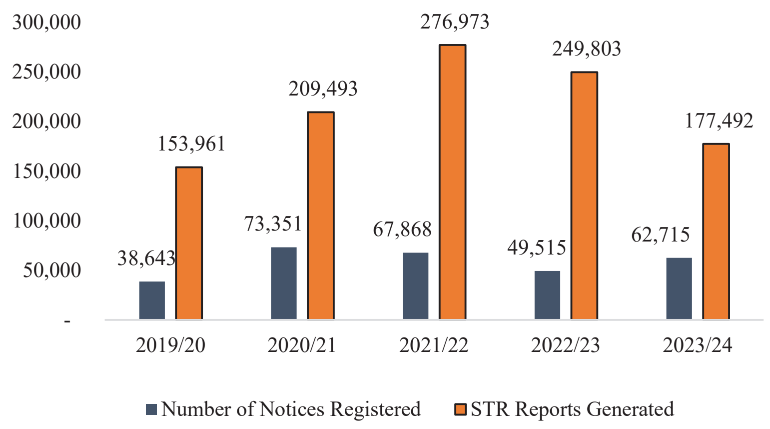
As of mid-July 2024, KSKL has 1.7 million borrower records in its repository and has generated about 2.2 million credit reports. The growth of credit reports generated by member institutions increased by 325 percent in the review year. Likewise, the borrower records uploaded by member institutions increased by 10.76 percent in the review year.

Figure 6.1: Credit Reports and Borrowers' Growth



Source: Credit Information Bureau, Annual Report 2023/24

Figure 6.2: Secured Transaction Registry Notices registered and Reports Generated



Source: Credit Information Bureau, Annual Report 2023/24

The Secured Transaction Registry by the KSKL registers the notices related to lending made by any entity against the movable assets of the debtor. The notices registered in the registry are growing at a very slow pace, with the total registry of 0.06 million in the fiscal year 2023/24 and a growth of 26.65 percent. Similarly, the registry generated 0.18 million reports in the fiscal year 2023/24, which is a decline of 29 percent from the previous fiscal year.

6.3 Deposit and Credit Guarantee Fund

The Deposit and Credit Guarantee Fund (DCGF), a deposit insurer, launched the deposit guarantee program in Nepal in 2010. DCGF has been given the statutory responsibility to perform both the deposit guarantee and credit guarantee functions through its own "Deposit and Credit Guarantee Fund Act, 2016". The total number of deposit guarantee accounts has increased to 45.79 million in the fiscal year 2023/24, a 10.65 percent rise from last fiscal year. The total deposit guarantee amount stood at Rs 1400.30 billion, and the total credit guarantee amount stood at Rs 296.44 billion as of mid-July 2024.

6.4 Debt Recovery Tribunal

Debt Recovery Tribunal plays an integral role in expediting the legal processes involved in recovering debt from defaulting borrowers. The Debt Recovery Act 2001 serves as the framework for the Debt Recovery Tribunal (DRT), which was founded on July 17, 2003, to guarantee the prompt and effective settlement of problematic loans in the banking and financial institution sectors. In this regard, only the debts owed to BFIs with a principle of at least Rs. 0.5 million can be settled through DRT, and cases also need to be reported within four years of exceeding the specified time frame.

The number of cases filed with the tribunal has started to increase as a result of problems in recovering loans. As of mid-July 2024, there were 451 pending cases to be settled at the Debt Recovery Tribunal. However, banks and financial institutions recovered a total Rs.35.28 billion through DRT during the review year.

6.5 Anti-Money Laundering and Countering the Financing of Terrorism

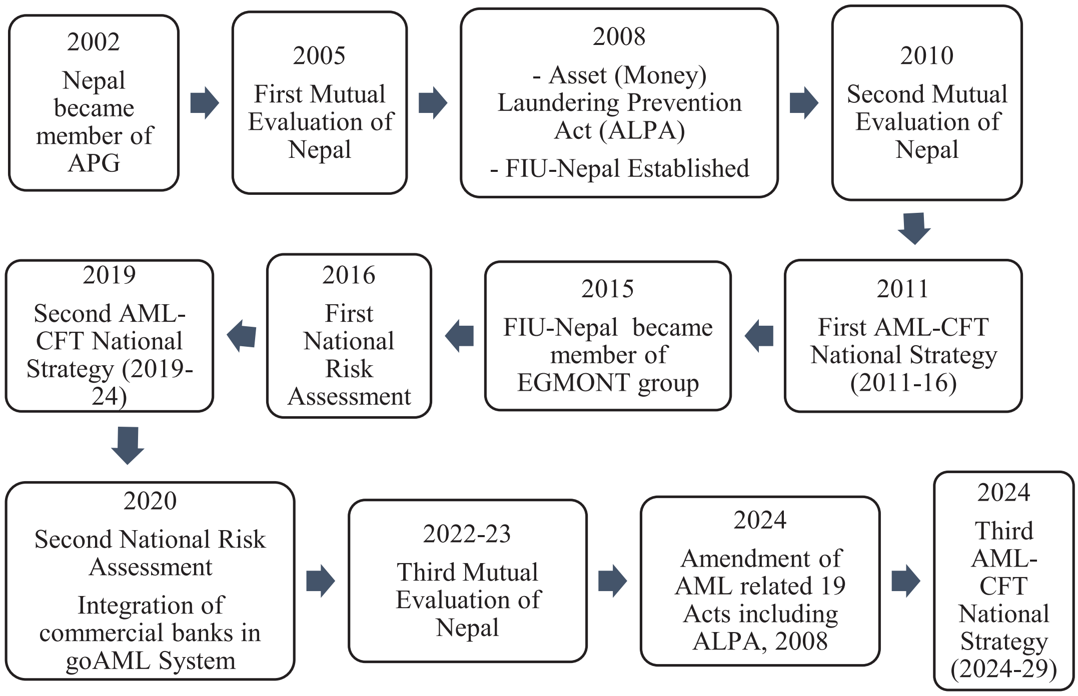
6.5.1 Background

Nepal obtained membership of APG in 2002 and has expressed its commitment to fully comply with international AML/CFT standards. Then after, Nepal made critical reforms and took key steps against Money Laundering, Terrorism financing, and Proliferation financing (ML/TF/PF). Asset (Money) Laundering Prevention Act was enacted in 2008, and the Financial Intelligence Unit was established in the same year[7]. Nepal has made progress in implementing legal, preventive, and institutional measures in place to control financial crimes and build a resilient financial system. Engagement and co-operation among all the stakeholders of the

[7] Further details on Nepal's Comprehensive journey on AML/CFT is available on website of Financial Intelligence unit at https://www.nrb.org.np/departments/fiu/

economy and international communities has been playing a vital role to strengthen Nepal's AMT/CFT measures.

Figure 6.3: Key Timeline of AML-CFT implementation in Nepal



Source: FIU-Nepal, Annual Report

6.5.3 Financial Intelligence Unit (FIU-Nepal)

FIU-Nepal is one of the key agencies of AML-CFT regime of Nepal. It is the national agency responsible for receiving, processing, analyzing and disseminating financial intelligence on possible ML/TF/PF activities to the relevant law enforcement/investigative agencies for further investigation or concerned regulators/supervisors for necessary actions. FIU-Nepal is the secretariat of High-Level Coordination Committee and maintains coordination among Reporting Entities (REs), Law Enforcement Agencies (LEAs), Regulators/Supervisors and all the other stakeholders to enhance AML/CFT regime of Nepal. It is a centralized, autonomous, independent, administrative authority with pivotal role to play in AML/CFT/CPF regime of Nepal. It has also signed a memorandum of understanding (MoU) with 18 domestic agencies and 20 foreign FIUs for coordination, cooperation and intelligence exchanges. FIU-Nepal is also active in capacity building of stakeholders in the AML/CFT regime by conducting several interaction and orientation programs.

FIU-Nepal uses goAML Software System, developed by United Nations of Drugs and Crime (UNODC), which provides a platform to REs to submit reports to FIU-Nepal and provides facility for the rapid exchange of information between the FIU-Nepal and regulators/supervisors or law enforcement agencies/investigative agencies, while ensuring confidentiality of the data/intelligence exchanged.

Operational Analysis: In the fiscal year 2023/24, FIU-Nepal received 7338 Suspicious Transaction Reports (STRs) or Suspicious Activity Reports (SARs) from REs. Among these, 1635 STR/SARs have been thoroughly analyzed and 889 have been disseminated to LEAs for further investigation. Some of these STR/SARs have been also disseminated to concerned regulators/supervisors for necessary actions. During the review year, FIU-Nepal also received 1,697,712 Threshold Transaction Reports (TTRs) from REs.

Strategic Analysis: Strategic Analysis Report, 2024 published by FIU-Nepal focuses on the emerging trend of cyber-enabled frauds in Nepal. Similarly, Strategic Analysis Report 2023 focuses on 'tax evasion' through the use of personal accounts for business transactions. These reports shared red flags to identify suspicious transactions and recommendations to REs, regulators/supervisors, and LEAs.

CHAPTER – VII: RECENT DEVELOPMENTS IN FINANCIAL SECTOR

7.1 Financial Inclusion and Consumer Protection

Financial inclusion plays a crucial role in reducing poverty and promoting prosperity. Access to affordable financial products and services, such as transactions, payments, savings, credit, and insurance, empowers individuals to manage risks, accumulate wealth, and invest in businesses. It ensures that both individuals and businesses can access financial products and services that cater to their needs, provided in a responsible and sustainable manner.

The NRB Act of 2002 has entrusted NRB with improving access to financial services and fostering public trust in the financial system. NRB's initiatives - such as requiring commercial banks to open branches in every local level, setting lending targets for underserved sectors, establishing sector-specific lending requirements, providing special refinancing options for cottage and small industries, and implementing directives on consumer protection and financial literacy have greatly enhanced financial access and inclusion. The NRB Unified Directives for BFIs include 21 sections and annexes covering governance, interest rates, consumer protection, and more. Recently, NRB established a dedicated Financial Inclusion and Consumer Protection Division (FICPD) to further promote access and safeguard consumers. The newly developed Financial Inclusion Policy 2024 aims to expand financial services, extend their reach, boost financial literacy, and strengthen consumer protection.

Significant progress has been made in increasing financial access through NRB's continuous efforts to extend financial services to unserved population. This progress has been driven by regulatory measures targeting specific sectors, underserved populations, and small borrowers. The resulting increase in financial inclusion is expected to enhance financial stability, diversify bank assets, stabilize the deposit base, and improve the effectiveness of monetary policy. However, challenges remain, including the concentration of financial services in urban areas and the need for improved financial literacy to keep pace with the evolution of financial products and services.

As financial inclusion expands, ensuring consumer protection becomes increasingly complex. Many low-income individuals gaining access to financial products for the first time may lack the necessary knowledge to make informed decisions. This makes them more vulnerable to scams, predatory lenders, and financial missteps that could lead to long-term losses. To mitigate these risks, financial education, awareness programs, proper onboarding, and protective measures must be implemented before granting access. Additional threats include fraud, identity theft, and fund mismanagement. As more people enter the financial system, the risk of exploitation grows, as evidenced by the rising number of related complaints in recent times.

Recent advancements in Artificial Intelligence (AI) have introduced a new dimension to financial inclusion. AI has the potential to enhance financial accessibility by improving credit scoring, loan origination, robo-advising, and portfolio construction. Although still in its early stages in Nepal, AI is expected to make a significant impact on the financial sector.

7.1.2 Financial Literacy

The financial literacy level is on increasing trend. In December 2022, NRB published the results of a Baseline Survey on Financial Literacy in Nepal[8] According to which the national financial literacy for Nepal is 57.9 percent. Using the methodology of the Organization for Economic Co-operation and Development (OECD) and the International Network on Financial Education (INFE), the survey measured financial literacy across three key components-financial knowledge, financial behavior, and financial attitudes. The survey revealed that the overall national financial literacy score is 11.59 out of the maximum score of 20.

To systematize the financial literacy efforts of NRB, BFIs, and NBFIs, NRB has formulated the Financial Literacy Framework 2022. In line with this, the Financial Literacy Guideline 2022 has also been issued to BFIs to enhance the effectiveness of the financial literacy programs conducted by BFIs.

The National Financial Inclusion Strategy (NFIS) has been approved by the NRB for its implementation. NFIS has established financial literacy as one of the four pillars to be focused on for enhancing financial inclusion in the country. Likewise, NRB has formulated the Financial Inclusion Policy, 2024, which focuses on the expansion of financial access, increase in usage of financial services, expansion of entrepreneurship and economic activities, promotion of financial literacy, and financial consumer protection.

NRB has been actively promoting financial literacy at the grassroots level through a variety of initiatives. These efforts include one-day literacy programs conducted primarily in remote areas as well as awareness campaigns facilitated through BFIs and non-governmental organizations (NGOs). These programs aim to educate the public on topics such as the importance of saving, the functioning of the banking system, different types of banking

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[8]This survey based on OECD/INFE Toolkit 2022 with some national customization explored the status of financial inclusion by collecting data on some indicators such as usage of payment products, usage of saving, investment, or retirement products, usage of insurance products, usage of credit products, awareness of financial product, and availability of family financial support.

services, benefits and risks associated with digital transactions, clean note policy, and different types of financial service providers, among others.

Furthermore, NRB has developed a roster of financial literacy trainers through its Training of Trainers (ToT) program. This initiative is designed to build a network of skilled trainers who can continue to promote financial education throughout the country. NRB also regularly publishes various educational materials, including books, knowledge resources, and audiovisual content, to support its ongoing efforts in advancing financial literacy. In addition, NRB has also been collaborating closely with the Ministry of Education to integrate financial literacy topics into the school curriculum.

In accordance with NRB directives, Banks and Financial Institutions (BFIs) are mandated to allocate a portion of their profits towards Corporate Social Responsibility (CSR) initiatives, and a portion of such amount needs to be spent on promoting Digital Financial Services (DFS) and enhancing financial literacy, particularly among women and underserved communities.

7.1.3 Financial Consumer Protection

A strong consumer protection framework contributes to a more resilient financial system. It safeguards individuals while reinforcing the health and stability of the entire financial system by fostering trust, mitigating risks, and promoting responsible financial behavior.

NRB has a separate unit under the FICPD for consumer protection through the grievance handling mechanism[9]. In fiscal year 2023/24, 3,977 grievances were received through various channels, of which 3,430 were resolved while 547 remained in the process of resolving.

Table 7.1: Grievances Received and Resolved

Modes of Grievances	Received	Resolved	In Process
Written Complaints	404	234	170
Grievance Portal	3,075	2,785	290
Others (Telephone, Email, or Oral)	498	411	87
Total	**3,977**	**3,430**	**547**

Source: NRB, FICPD

[9]portal: http://gunaso.nrb.org.np/

Box 5: Financial Sector Development in Nepal

- The finance sector regulation and supervision started in 1956 when the government established NRB under Nepal Rastra Bank Act, 1955. Prior to the establishment of NRB, only one banking institution, namely, Nepal Bank Limited was in existence.
- In 1957, Industrial Development Bank was established as the first development bank of the country to function as the specialized financial institution providing term credit for the industrial sector. Later on, Industrial Development Bank was converted into Nepal Industrial Development Corporation (NIDC) on 5 July 1959.
- First directive issued by NRB as part of regulation was in 1961 when it fixed interest rate on deposit and credit. Moving further from interest rate fixation, NRB introduced different monetary instruments and guidelines related to credit control, namely, margin rate, refinance rate, cash reserve requirement, liquidity requirement and credit limit during the late 1960s.
- Then, RBBL, the second commercial bank, owned by the Government, was established on 23 January 1966 under RBB Act, 1965. Likewise, with the objective of providing long term and medium term credit facilities to the agricultural sector, ADBL came into operation on 21 January 1968 as per Agricultural Development Bank Act, 1967.
- In 1967/68, NRB adopted the policy of opening branch office of commercial banks in all districts by formulating banking development plan and establishing banking development fund.
- NRB introduced the Directed Credit Policy in 1974 for the first time. The requirement of this policy was to invest a specified percent of total deposits in the underprivileged sector to increase the flow of credit to small farmers and businesses.
- Prior to 1984, there were only two commercial banks and two development banks. Establishment of banks and financial institutions gained momentum since mid-1980s when the government initiated liberal economic policy. Banks such as Nepal Arab Bank (now Nabil Bank Ltd.), Nepal Indosuez Bank (now Nepal Investment Mega Bank Ltd.) and Nepal Grindlays Bank Ltd. (now Standard Chartered Bank Nepal Ltd.) were established.
- In 1989, CIB was established with an objective of improving the functionality of the country's financial system.
- In 1991 CIT was established.
- To address the need for specialized institutions Finance Company Act, 1985 was enacted, and Nepal Housing Development Finance Company Ltd. was established under this Act in 1992.
- SEBON was established by the Government of Nepal on June 7, 1993 as an apex regulator of Securities Markets.
- To specifically serve the people in rural areas, the concept of rural development banking model was introduced in 1993 with the establishment of region-based rural development banks.
- Earlier interest rates were determined by NRB and there were around 20 controlled lending rates in different sectors which was mainly determined in 1975. In 1984, NRB started interest rate deregulation. Initially, commercial banks were given partial relaxation to fix loan interest rates from 1.0% to 1.5% above the

deposit rates. In 1986, this range was eliminated, allowing banks to offer higher interest rates to any level above the fixed minimum level. In 1989, the interest rate was completely deregulated.

- In 1988, NRB further introduced a set of prudential norms, including capital adequacy requirement, loan classification, loan loss provisioning, interest income recognition, single borrower limit, and account disclosure norm.
- In 2002, NRB Act, 1955 was revamped and replaced with the NRB Act, 2002, which served as a breakthrough in areas of role, responsibility and autonomy of the central banking in the country.
- Even though NRB used prudential regulatory measures since the mid-1960s, the formal practice of prudential regulations started since 2001 when it issued regulations in the form of directives.
- With certain amendments and updates consistent with the changing context, these directives have been continued by NRB till date. The Unified Directives currently consist of 23 different headings under which regulations on different aspects are given.
- To replace the fragmented banks and financial institution Acts, Banks and Financial Institutions Ordinance, 2004 came into force as an Umbrella Act with effect from February 2004. In 2006, the Ordinance was approved as BAFIA, 2006. This Act categorized all the banking institutions under the following four groups: Class 'A' - Commercial Banks; Class 'B' - Development Banks; Class 'C'- Finance Companies; and Class 'D'- Microfinance Development Banks. After the liberalization, within a short time span, the country's banking sector witnessed a huge jump in terms of number of BFIs.
- On the regulatory note, NRB, just like other regulator and supervisor, adopted micro prudential policies before the global financial crisis of 2007-2009. NRB issued several macro prudential measures to make the situation in BFIs more resilient then after.
- The major macro prudential policies implemented by NRB relate to Leverage Ratio, CD ratio, Deposit Guarantee, Single Obligor Limit, Sectoral Credit Limit, Loan against Shares, Loan-to-Value (LTV) Ratio, risk management guidelines for banks, stress testing guidelines etc.
- As of mid-July 2024, the total number of BFIs stood at 107 which comprises 20 commercial banks, 17 development banks, 17 finance companies, 52 MFIs, and 1 infrastructure development bank. As a result of the consolidation process due to merger and acquisition, the number of banking institutions has been declining in recent years.

7.2 Aligning with Global Policy Developments

The use of artificial intelligence (AI) in the financial system is on the rise. The use of AI in capital market activities and non-bank financial institutions, such as investment funds and fintechs, has been rising in recent years. The use of AI may lower the risks to financial stability as it aids in improving market liquidity, facilitating better risk management, and enhancing market surveillance by both players and regulators (Global Financial Stability Report , 2024). However, new dangers could also appear at the same time as the increased use of AI could pose cyber/market manipulation risks and operational risks through high reliance on AI service providers that dominate computational power and large language model services. Cybercriminals using AI to produce deep fakes, manipulating audio and video to impersonate key individuals in the financial sector or spread of misinformation, could lead to fraudulent transactions and erode the trust in financial institutions. In this context, NRB is conducting a study on the use of artificial intelligence in the financial sector and preparing a guideline related to identifying and mitigating the potential risks.

Still, structural change has created vulnerabilities. Because extreme weather events are occurring more frequently, there is growing concern about the possible risks that climate change may bring to financial stability. The financial system may become unstable if physical risks and an uncontrolled transition to a low-carbon economy result in a drop in asset values and wealth. (Patrick Bolton, 2019) states physical and transition risks can materialize in terms of financial risk in five main ways, namely credit risks, market risk, liquidity risk, operational risk, and insurance risks. The need to address the climate risks seems to be an urging need for central banks and policy makers to assure the stability of prices and the financial system.

In this context, considering the gravitas of climate-related risks, Nepal Rastra Bank has published Green Finance Taxonomy, 2024. The Green Finance Taxonomy provides a classification system for economic activities (including assets, projects, and sectors) that qualify as "green" or environmentally sustainable. Its purpose is to assist financial sector stakeholders in identifying, tracking, and verifying the green credentials of their activities, ultimately channeling capital, resources, and expertise toward building a green, resilient, and inclusive economy in Nepal. In addition, to facilitate the integration of sustainability into credit risk management within the financial sector, the Nepal Rastra Bank introduced the Environmental and Social Risk Management (ESRM) Guidelines.

Non-bank financial institutions are the next source of risk in the financial system. The IMF's Global Financial Stability Report highlights vulnerabilities within the NBFI sector, particularly in areas such as leverage, liquidity mismatches, and interconnectedness with traditional banking institutions. These vulnerabilities can amplify financial shocks, as NBFIs often engage in maturity and liquidity transformation without the same regulatory oversight as traditional banks. The Global Monitoring Report by the Financial Stability Board (FSB) states that the NBFI sector experienced growth at twice the pace of the traditional banking sector in 2023, now representing a substantial portion of global financial assets. In this context, considering the risks stemming from NBFIs like cooperatives, NRB has also issued the directive for saving and credit cooperatives.

7.3 Key Regulations Implemented for the Financial Sector Stability

Measures taken by Banks and Financial Institutions Regulation Department	
Regulation Area	**Regulation**
Relaxation to Construction sector Circular No. 1 Issued on 2024/07/31	Relaxation provided to construction businesses facing problems due to special circumstances regarding the loans repayments. Time period for loan repayment extended and charging of interest on interest on such loans restricted. Similarly, provision made for construction business not to be blacklisted solely based on the cheque dishonor till September end.
Policy Rates Circular No. 1 Issued on 2024/07/31	Bank rate reduced from 7 percent to 6.5 percent. Repo rate reduced from 5.5 percent to 5 percent.
Loan Loss Provision Circular No.1 Issued on 2024/07/31	The loan loss provision for the pass category loans reduced to 1.1 percent from 1.20 percent.
Capital Instruments Circular No. 9 Issued on 2024/11/26	New Capital instrument, Perpetual Non-cumulative Preference Share (PNCPS) introduced.
Debt Service to Gross Income Ratio Circular No. 9 Issued on 2024/11/26	Debt to Income Ratio (DTI) increased to 70% for the purpose of home and land purchase.
Restructuring and Rescheduling of credit Circular No. 6 issued on 2023/12/24	Restructuring and rescheduling of credits availed to specific sectors has been introduced. Along with this, credit up to Rs 50 million availed in any other sector. Loan rescheduling and restructuring can be carried out after repayment of at least 10 percent of the outstanding interest amount by analyzing the cash flow and income of the industry and business at the request of debtors. Similarly

	credit up to Rs 20 million availed to small and medium enterprises can also be restructures and rescheduled.
Risk Weights Circular No. 6 issued on 2023/12/24	Real Estate loans for land acquisition and development shall attract risk weight of 125%. Lending against shares (above Rs. 5 Million) shall attract risk weight of 125%.
Loan to Value Ratio Circular No. 3 issued on 2023/06/05	Loan to Value Ratio has been restricted to 50 percent.
Deposit and Credit Guarantee Circular No. 3 issued on 2023/06/05	Deposit insurance increased to Rs 0.5 million from Rs. 0.3 million.
Counter Cyclical Buffer	Counter Cyclical Buffer of 0.5 percent for commercial banks has been reintroduced.
Mergers and Acquisition	Special incentives have been provided by NRB for BFIs undergoing mergers and acquisitions.
Capital Adequacy Framework Circular No. 1 issued on 2023/06/05	Capital Adequacy Framework 2015 implemented for National level B class development banks.
Base Rates Circular No.11 issued on 2023/05/08	Following requirements have been introduced in base rate regulation: • Publish the monthly and last three-month average base rate • Not to avail loans below the last three-month average base rate and, Set the interest rates within the higher and lower limits of base rate fluctuations.
Measures taken by Foreign Exchange Management Department	
Regulation Area	**Regulation**
Ceiling for DAP and DAA Circular No. 2 Issued on 2023/08/07	The ceiling of import through DAP and DAA has been increased to USD 60K at a time from erstwhile ceiling of USD 50K. Furthermore, better clarity has been made for imports between successive DAP and DAA.
Back-to-back letter of credit Circular No. 2 Issued on 2023/08/07	Back-to-back letter of credit facility has been provided to exportable items identified by Nepal Trade Integration Strategy along with readymade garments.
Foreign currency facility for service export	Foreign currency facility up to 10% of foreign exchange earnings has been provided to IT and service exporting industries to establish representative office or to purchase software/program/equipment's abroad.

Circular No. 2 Issued on 2023/08/07	
Gold import ceiling Circular No. 3 Issued on 2023/09/27	Ceiling of gold import has been increased to 20 kg per day from erstwhile 10 kgs per day.
Inflow of foreign currencies Circular No. 5 Issued on 2023/12/28	Inflow for foreign currencies for various purposes without having liability to repatriation has been allowed through banks and financial institutions, with approval from related government agencies, if required as per prevailing laws.
Inflow of foreign currencies Circular No. 5 Issued on 2023/12/28	Amount, for various purposes without having obligation of repatriation, up to Rs.2 million in a day has been allowed to be remitted in Nepal through licensed remittance companies, which was Rs.1.5 million earlier.
Foreign currency accounts Circular No. 5 Issued on 2023/12/28	Savings and fixed deposit accounts to Non-Resident Nepalese with automatic repatriation facility has been allowed to development banks as well, which was previously allowed to commercial banks only.
Financial Guarantees Circular No. 8 Issued on 2024/02/11	Financial bank guarantees issued by foreign banks has been allowed as security for lending by commercial banks in Nepal.
Remittances Circular No. 9 Issued on 2024/03/15	Peer to Peer remittances between Nepal and India has been allowed with mobile banking/internet banking/electronic banking, along with Indo-Nepal Remittance Facility Scheme.
Merchant Payments Circular No. 9 Issued on 2024/03/15	Nepali merchants have been allowed to receive payments through Quick Response (QR) codes.
Quick Response Code Circular No. 9 Issued on 2024/03/15	Foreign exchange facilities has been allowed through QR code.

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Printed at NRB Press