FINANCIAL STABILITY REPORT

Nepal Rastra Bank

Central Office

Baluwatar, Kathmandu

July, 2016

FINANCIAL STABILITY REPORT

(Issue No. 8)

Nepal Rastra Bank
Baluwatar, Kathmandu

Disclaimer

This *Eighth issue* of the Financial Stability Report is based on the provisional data of Bank & Financial Institutions (BFIs) and other financial institutions as of mid-July 2016. Data used in its analysis may thus differ from the most recent statistics or audited final data published by BFIs. All the findings, interpretation and conclusions expressed in this report do not necessarily reflect the views of Nepal Rastra Bank or its Board of Directors. The colors, boundaries, denominations or any other signs and symbols used in the report do not imply any metamorphic judgments. This report, unless or otherwise stated elsewhere, covers the developments and risks during the year to mid-July 2016. All the data and information in this report are retrieved from NRB depository, unless stated.

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Acronyms

ADBL	Agriculture Development Bank Limited
AE	Advanced Economies
ANNA	Association of National Numbering Agencies
ASBA	Application Supported by Blocked Amount
ATM	Automatic Teller Machine
BAFIA	Bank and Financial Institution Act
BFIs	Bank and Financial Institutions
BoD	Board of Director
CAR	Capital Adequacy Ratio
CB	Commercial Banks
CBS	Central Bureau of Statistics
CCB	capital conservation buffer
CD Ratio	Credit to Deposit Ratio
CEO	Chief Executive Officer
CIT	Citizens Investment Trust
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
CSR	Corporate Social Responsibility
DBSD	Development Bank Supervision Department
DCGC	Deposit and Credit Guarantee Corporation
DOC	Department of Cooperatives
ECB	European Central Bank
FI	Financial Institution
EMDE	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EPF	Employee Provident Fund
FINGO	Financial Non-government Organization
FEMD	Foreign Exchange Management Department
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness Indicators
GBBs	Grameen Bikash Banks

GDP	Gross Domestic Product
GFSR	Global Financial Stability Review
GoN	Government of Nepal
IC	Insurance Companies
IMF	International Monetary Fund
INR	Indian Rupees
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
IRC	Interest Rate Corridor
ISIN	International Securities Identification Number
LCR	Liquidity Coverage Ratio
LCY	Local Currency
LS	Left Scale
LLP	Loan Loss Provision
LMFF	Liquidity Monitoring and Forecasting Framework
LoLR	Lender of Last Resort
LTV	Loan to Value Ratio
MFFI	Microfinance Financial Institution
NBA	Non-Banking Assets
NBL	Nepal Bank Limited
NEPSE	Nepal Stock Exchange
NFSR	Net Stable Funding Ratio
NGO	Non-Government Organization
NIDC	Nepal Industrial and Development Corporation
NPA	Non-Performing Assets
NPLs	Non-Performing Loans
NRB	Nepal Rastra Bank
PCA	Prompt Corrective Action
PIRD	Problem Institution Resolution Division
RBB	Rastriya Banijya Bank
RS	Right Scale
ROA	Return on Assets
ROE	Return on Equity
RSRF	Rural Self Reliance Fund
RWA	Risk Weighted Assets
SOBs	State Owned Banks
SEBON	Security Board of Nepal

SLF	Standing Liquidity Facility
SLR	Statutory Liquidity Ratio
SOL	Single Obligor Limit
US	United States
WEO	World Economic Outlook

GOVERNOR

Foreword

Nepal Rastra Bank Act, 2058 has explicitly stated that Nepal Rastra Bank (NRB) will maintain stability of the domestic banking and financial system. In order to ensure the stability of Nepalese financial system, NRB has been focucing on assessing risks and vulnerabilities of the financial system and implementing international standard prudential regulations and supervision.

NRB has been publishing financial stability reports since 2012 by identifying the key risks of the Nepalese financial system with steps taken by NRB for the management of those risks. During the review period considered for this Report, the domestic banking sector witnessed an excess liquidity, the share market showed bullish trend and real estate transactions mildly expanded. The size of total assets and liabilities of the Banks and Financial Institutions (BFIs) continued to increase. At the same time, non-BFIs (NBFIs) witnessed huge increment of assets and liabilities. It is noteworthy that with effective implementation of prudential regulation/supervision, the banking system has reduced its high exposures in real estate and other unproductive sectors.

The current issue of the Financial Stability Report focuses significantly on the trends of macroeconomic indicators, performance of BFIs and NBFIs including their liquidity and capital adequacy, and the risk to and resilience of these sectors as well as capital market developments. Stringent micro-prudential regulation and supervision, judicious application of macro-prudential oversight and broad-based financial inclusion, all have contributed significantly to the stability of the domestic financial system. With an expanded structure of the financial sector, NRB has moved towards Basel III capital and liquidity framework in the banking sector to achieve a desired level of financial system stability.

This Report contains the analytical review of the banking and financial system and the achievements accomplished through the implementation of key regulations/policies. I would acknowledge the dedication and efforts of officials preparing this Report. I would also like to appreciate Financial Stability Oversight Committee (FSOC), Financial Stability Sub-committee (FSS) and the Financial Stability Unit (FSU) of the Bank for preparing this report. Moreover, I would highlight the contribution of Executive Director Mr. Narayan Prasad Paudel, Director Mr. Bimal Raj Khanal, Deputy Director Ms. Samjhana Dhakal and Assistant Director Mr. Madan Pandit for their untiring efforts in bringing out the report in this form.

I believe that this Report will facilitate the stakeholders to obtain important insights of Nepalese financial system and will provide awareness of emerging risks and fragilities in the financial system. I am also confident that this report would serve as a useful reference for those having interest on financial system of the country.

Dr. Chiranjibi Nepal

Executive Summary

World Economic Outlook (WEO Update July 2016) points out that the global economy was evolving broadly in line with the forecast of April 2016. In regards to indicators of real activity, the WEO states that output growth in the first quarter of 2016 was somewhat better than expected in emerging market and developing economies and roughly in line with projections for advanced economies, with better than- expected euro area growth counterbalancing weaker U.S. growth. Indicators of real activity were somewhat stronger than expected in China, reflecting policy stimulus, as well as in Brazil and Russia, with some tentative signs of moderation in Brazil's deep downturn and stabilization in Russia following the rebound in oil prices.

Assuming the better-than-expected economic activity before the June 23 vote in the United Kingdom and the likely impact of Brexit, the WEO revised the global forecasts for 2016 and 2017 down by 0.1percentage points relative to the April 2016 WEO, to 3.1 percent and 3.4 percent, respectively. The outlook worsens for advanced economies (down by 0.1 percentage points in 2016 and 0.2 percentage points in 2017) while that of emerging market and developing economies remains broadly unchanged.

The WEO data shows that headline inflation in advanced economies was 0.3 percent on average in 2015, the lowest since the global financial crisis, reflecting the sharp decline in commodity prices, with a pickup in the late part of 2015. Core inflation remained broadly stable at 1.6–1.7 percent but was still well below central bank targets.

Economic activity remained subdued in 2015/16. However, macroeconomic stability was intact. Government capital spending and the private sector activities were sluggish owing to disturbances in the southern border along with supply disruptions. Additionally, the agriculture sector did not expand as expected on account of unfavorable weather. Consequently, a lower economic growth is expected in 2015/16. The border disturbance did not allow Nepal to take advantage of lower price of petroleum and metal products in international market along with that of low inflation in neighboring countries. This resulted in inflation higher than targeted. Banking sector witnessed an excess liquidity from the beginning of the review year. It was mainly due to a lower than expected lending growth in the first half of the fiscal year. However, the excess liquidity has been managed through open market operations (OMOs). Real estate transactions mildly expanded, and the share market showed bullish trend in the review year.

According to the preliminary estimates of the Central Bureau of Statistics (CBS), the real GDP at basic price is expected to grow 0.8 percent in 2015/16 compared to a growth of 2.3 percent in the previous year. Similarly, the real GDP at producers' price is expected to grow 0.6 percent compared to a growth of 2.7 percent in the previous year. Delay in monsoon, prolonged strikes and obstructions in southern border points adversely affected the economy resulting in a lower growth in the review year.

The annual average consumer price inflation increased 9.9 percent in 2015/16 compared to 7.2 percent in the previous year. This is mainly due to strikes in Terai region, obstructions at border points and supply disturbances.

Merchandise exports decreased 17.8 percent to Rs. 70.12 billion in 2015/16 compared to a drop of 7.3 percent in the previous year. Exports to India and China decreased 29.3 percent and 24.6 percent respectively whereas exports to other countries increased 6.3 percent in the review year. The ratio of total exports to GDP remained at 3.1 percent in 2015/16 compared to 4 percent a year ago.

The workers' remittances grew 7.7 percent to Rs. 665.06 billion in the review year compared to a growth of 13.6 percent in the previous year. The ratio of remittances to GDP stood at 29.6 percent in 2015/16. The current account registered a surplus of Rs. 140.42 billion in the review year due to the increase in net surplus in current transfer. The surplus in current account was Rs. 108.32 billion in the previous year. The overall BOP recorded a significant level of surplus of Rs. 188.95 billion in the review year on account of the increase in current account surplus and capital inflows.

Global Financial Stability Report October 2016 finds that short term risks to global financial stability have abated since April 2016, but that medium-term risks continue to build. The rise of commodity prices from their lows, along with the ongoing adjustments in emerging markets, has supported a recovery in capital flows. In advanced economies, financial institutions face a number of cyclical and structural challenges and need to adapt to low growth and low interest rates, as well as to an evolving market and regulatory environment.

Nepalese banking system is in consolidation process through the merger and acquisition. As of mid-July 2016, the total number of financial institutions stood at 248 comprising of Commercial Bank 28, Development Bank 67, Finance Companies 42 and Microfinance Financial Institutions 42. Moreover, 40 other financial intermediaries licensed by NRB, 27 insurance companies including 1 reinsurance company and one each of EPF, CIT and Postal Saving Bank. Total number of "A", "B", "C" and "D" class financial institutions reduced to 179 in mid-July 2016 from 191 in mid-July 2015 due to merger and acquisition policy adopted by the NRB.

In terms of total assets and liabilities, banks and financial institutions shared 76.15 percent of total financial system of Nepal in mid-July 2016. The commercial banks remained the key player in the financial system occupying 60.72 percent of the system's total assets followed by development banks (9.75 percent), finance companies (2.88 percent) and micro finance financial institutions (2.80 percent). In case of contractual saving institutions, EPF is a dominant institution having 6.25 percent of shares, followed by insurance companies (4.40 percent), CIT (2.31 percent) and reinsurance company (0.17 percent) as of mid-July 2016.Total assets of BFIs increased by 20.89 percent and reached to Rs. 2639 billion. As on mid-July 2016, the commercial banks had provided 16.59 percent of their total loan on productive sector which includes 7.22% in agriculture, 2.73% in energy sector and 3.27% in tourism sector and 3.37% in cottage and small industries respectively. Commercial banks have lent 9.95% in combined agriculture and energy sector which is less than the regulatory limit of 12 %. The productive sector lending of commercial banks in mid-July 2015 was 22.5%.. The overall deprive sector lending by BFIs as on mid-July 2016 remained 5.65 percent where commercial banks, development banks and finance companies lend 5.52 percent, 6.77 percent and 4.57 percent respectively. The capital fund of BFIs increased by 31.84 percent to Rs.214.89 billion from 163.37 billion in mid –July 2015. The overall CAR of BFIs in mid-July 2016 stood at 12.91 percent which was 12.92 percent in previous year.

NPL of BFIs stood at Rs.36.40 billion in mid-July, 2016 which was Rs.37 billion in mid-July 2015. However, in terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2015 indicating the banking sector's resilience in large. NPL to total loans of commercial banks banking industry stood at 2.19 percent of total loan comrising 1.82 perent of commercial banks, 1.48 percent of development banks and 14.42 percent of finance companies.

Credit flows from BFIs grew significantly by 23.55 percent in mid-July, 2016 such increment was 20.5 percent in mid-July, 2015. Commercial Banks grew by 26.23 percent in mid-July 2016, such increment was 21.9 percent in mid-July 2015. Development banks credit expanded by 20.43 percent, whereas finance companies credit dropped by 12.9 percent in mid-July 2016.

The overall profitability of banking sector increased significantly by 32.29 percent and reached to Rs. 49 billion in mid-July 2016 from 37.04 billion in mid-July

2015. The commercial banks posted a higher share of profitability of the banking sector accounting 77.82 percent of the total in mid-July 2016.

After the issuance of the "Bank and Financial Institutions Merger By-laws, 2011", 113 BFIs have merged with each other forming 41 BFIs as of mid-July 2016. In the review period, 23 BFIs have merged and acquired to form 6 BFIs. As of mid-July 2016, the branch network of commercial banks reached 1869 followed by development banks (852), Finance companies (175) and Micro Finance Financial Institutions (1378). In mid-July 2016, on an average, a BFI branch has been serving approximately to 9,684 people; excluding the branches of “D” class financial institutions. The banking service served population comes down to 6562 people per branch when branches of "D" class also included.

The state owned commercial banks have 18.3 percent share in total deposit of commercial banks. Their market share in terms of total assets of all BFIs stood at 16.22 percent, whereas in total deposit and loan & advances, the ratio reached to 15.32 and 13.92 percent respectively in mid-July 2016. Capital fund of all three state owned banks are Rs. 7.51 billion, Rs. 9.78 billion and Rs. 20.85 billion respectively for NBL, RBB and ADBL.

As in mid-July 2016, share of commercial banks in total assets and liabilities of NRB regulated BFIs increased to 79.74 percent from 78.73 in mid-July 2015. Similarly, share of total assets and liabilities of commercial banks on total GDP increased to 97.15 percent from 68.85 percent in mid-July 2015.. Total deposit and credit of commercial banks stood at 78.46 and 61.39 of GDP in mid-July 2016 which was 68.8 and 51.9 percent of GDP in mid-July 2015 respectively. Total deposits grew by 20.62 percent to Rs.1764.59 billion during the period of mid-July 2016, against the previous growth of 21.4 percent during mid-July 2015. Total credit flows grew by 26.9 percent and reached to Rs.1380.36 in mid-July 2016.

Barring some instances, overall performances of the Development Banks were improving in an encouraging pace. Deposits at these banks grew by 17.52 percent to Rs.278.63 billion while credits grew by 20.43 percent to Rs.223.99 billion. The ratio of credit to domestic deposit and capital fund changed from the level in mid-July 2015 to stand at 74.41 percent in mid-July 2016.

Share of Finance companies in the overall economic activity is smaller in comparison to A and B class FIs, as shown by small deposit to GDP ratio. Such ratio is 2.86 percent in mid-July 2016, which was 3.21 percent of GDP in mid July

2015. The total assets and liabilities of finance companies decreased in mid-July 2016 by 4.22 percent to Rs.103 billion compared to mid-July 2015. Finance companies mobilized aggregate deposit of Rs.64 billion in mid July 2016 which is a decrease of 1.11 percent compared to mid-July 2015.

As of mid-July 2016, deposits of cooperatives totaled Rs.295.73 billion and total credit stood at Rs.289.42 billion. There are altogether 27 (17 non-life and 9 life 1 reinsurance) insurance companies. The data received from Insurance Board of Nepal, reveals that total assets/liabilities of insurance companies rose by 22.23 percent to Rs.158.24 billion during fiscal year 2015-16. Total assets of life insurance companies' and non-life companies' expanded by 25.24 percent and 10.14 percent respectively. According to unaudited figures of mid-July 2015, Employee Provident Fund (EPF) has provident fund amounting to Rs.217.61 billion, while total assets/liabilities of EPF stood at Rs.224.70 billion.

Short term and long term interest rates in the financial market remained relatively low in FY 2015/16. Nepalese currency depreciated by 5.2 percent against US dollar during end of 2015/16 compared to a depreciation by 5.2 percent in the same period of the previous year. The NEPSE index increased by 78.75 percent to 1718.15 points in mid-July 2016 on y-o-y basis. This was particularly due to the excess liquidity in the market and due to the capital increment of financial institutions. This index had decreased by 7.2 percent to 961.2 points a year ago. The NEPSE sensitive index stood at 369.07 point in mid-July 2016, as against 204.7 in mid-July 2015.

CHAPTER - ONE

MACROECONOMIC DEVELOPMENT

Global Macroeconomic Development and Outlook

World Economic Outlook (WEO Update July 2016) points out that the global economy was evolving broadly in line with the forecast of April 2016. The outcome of the U.K. vote, which surprised global financial markets, implies the materialization of an important downside risk for the world economy. As a result, the global outlook for 2016-17 has worsened, despite the better-than-expected performance in early 2016.

In regards to indicators of real activity, the WEO states that output growth in the first quarter of 2016 was somewhat better than expected in emerging market and developing economies and roughly in line with projections for advanced economies, with better than- expected euro area growth counterbalancing weaker U.S. growth. Indicators of real activity were somewhat stronger than expected in China, reflecting policy stimulus, as well as in Brazil and Russia, with some tentative signs of moderation in Brazil's deep downturn and stabilization in Russia following the rebound in oil prices.

Assuming the better-than-expected economic activity before the June 23 vote in the United Kingdom and the likely impact of Brexit, the WEO revised the global forecasts for 2016 and 2017 down by 0.1percentage points relative to the April 2016 WEO, to 3.1 percent and 3.4 percent, respectively. The outlook worsens for advanced economies (down by 0.1 percentage points in 2016 and 0.2 percentage points in 2017) while that of emerging market and developing economies remains broadly unchanged.

Taking into account the increase in uncertainty following the referendum in United Kingdom, the growth projection is revised down to 1.7 percentages for 2016 and to 1.3 percentages in 2017 in United Kingdom. In the United States, first-quarter growth was weaker than expected but in the euro area, growth was higher than expected at 2.2 percent in the first quarter, reflecting strong domestic demand— including some rebound in investment. Likewise, the WEO states that first-quarter activity in Japan came in slightly better than expected—even though the underlying momentum in domestic demand remains weak and inflation has dropped.

The WEO points out improved near-term outlook in China due to recent policy support. The outlook in other large emerging markets has changed slightly. Consumer and business confidence appears to have bottomed out in Brazil, and the GDP contraction in the first quarter was milder than anticipated. The outlook for other emerging market and developing economies remains diverse.

Table 1.1: Overview of the World Economic Outlook Projections (Percent change)

Particulars	2014	2015	Projections	
			2016	2017
World Output	**3.4**	**3.1**	**3.1**	**3.4**
Advanced Economies	**1.9**	**1.9**	**1.8**	**1.8**
United States	2.4	2.4	2.2	2.5
Euro Area	0.9	1.7	1.6	1.4
Germany	1.6	1.5	1.6	1.2
France	0.6	1.3	1.5	1.2
Italy	(0.3)	0.8	0.9	1.0
Spain	1.4	3.2	2.6	2.1
Japan	0	0.5	0.3	0.1
United Kingdom	3.1	2.2	1.7	1.3
Canada	2.5	1.1	1.4	2.1
Other Advanced Economies[1]	2.8	2.0	2.0	2.3
Emerging Market and Developing Economies	**4.6**	**4.0**	**4.1**	**4.6**
Commonwealth of Independent States	1.0	(2.8)	(0.6)	1.5
Russia	0.7	(3.7)	(1.2)	1.0
Excluding Russia	1.9	(0.6)	1.0	2.5
Emerging and Developing Asia	6.8	6.6	6.4	6.3
China	7.3	6.9	6.6	6.2
India[2]	7.2	7.6	7.4	7.4
ASEAN-5[3]	4.6	4.8	4.8	5.1
Emerging and Developing Europe	2.8	3.6	3.5	3.2
Latin America and the Caribbean	1.3	0	(0.4)	1.6
Brazil	0.1	(3.8)	(3.3)	0.5
Mexico	2.2	2.5	2.5	2.6
Middle East, North Africa, Afghanistan, and Pakistan	2.7	2.3	3.4	3.3
Saudi Arabia	3.6	3.5	1.2	2.0
Sub-Saharan Africa	5.1	3.3	1.6	3.3
Nigeria	6.3	2.7	(1.8)	1.1
South Africa	1.6	1.3	0.1	1.0

Source: World Economic Outlook Update July 2016

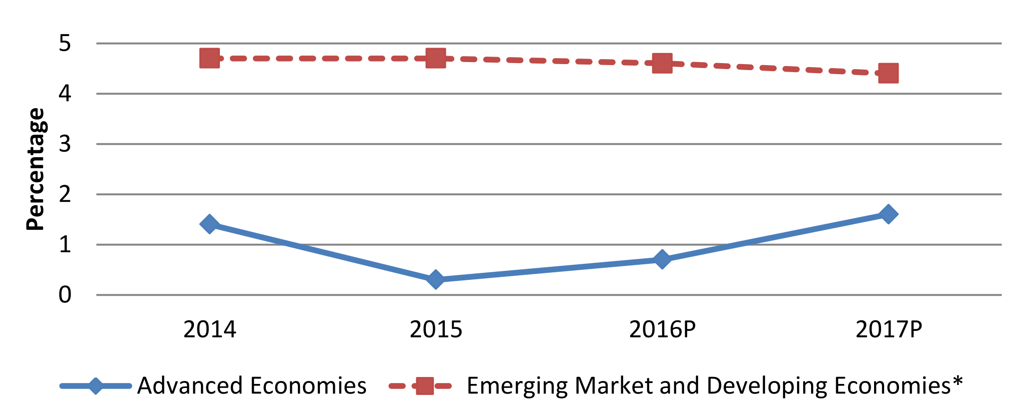
[1] *Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.*
[2] *For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with FY2011/12 as a base year.*
[3] *Indonesia, Malaysia, Philippines, Thailand, Vietnam*

The WEO views the positive scenario in the Middle East by stating that oil exporters are benefiting from the recent modest recovery in oil prices while continuing fiscal consolidation in response to structurally lower oil revenues, but many countries in the region are still plagued by strife and conflict.

Inflation

The WEO data shows that headline inflation in advanced economies was 0.3 percent on average in 2015, the lowest since the global financial crisis, reflecting the sharp decline in commodity prices, with a pickup in the late part of 2015. Core inflation remained broadly stable at 1.6–1.7 percent but was still well below central bank targets. In many emerging markets, lower prices for oil and other commodities (including food, which has a larger weight in the consumer price indices of emerging market and developing economies) have tended to reduce inflation, but in a number of countries, such as Brazil, Colombia, and Russia, sizable currency depreciations have offset to a large extent the effect of lower commodity prices, and inflation has risen.

Figure: 1.1 Consumer Price



**Excludes Argentina and Venezuela*

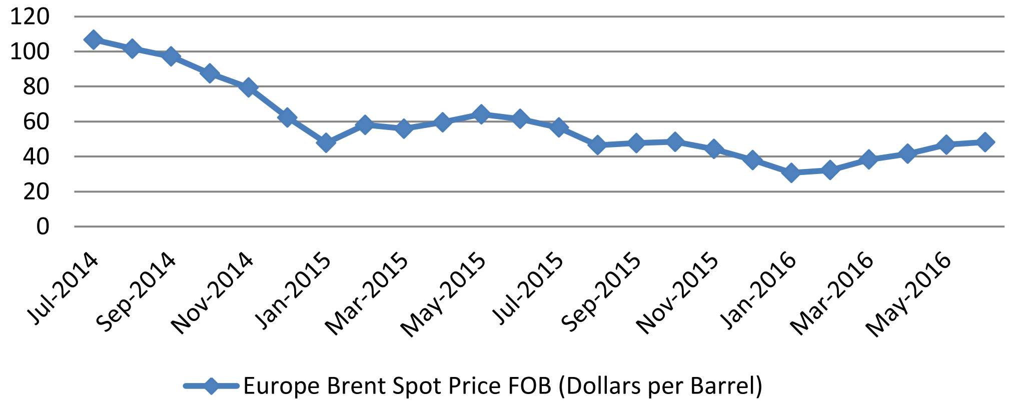
P= Projected

Source: World Economic Outlook Update July 2016

Crude Oil

The recovery in oil markets that started about mid-February broadly continued through June 23, as markets assumed the United Kingdom would remain in the European Union, the WEO states. Declines in excess oil supply—due mainly to a gradual slowdown in non-OPEC production and some supply disruptions (notably in Nigeria and Canada)—helped bolster oil prices. This was reflected in an easing of oil exporters' sovereign bond spreads from their February-March highs.

Figure 1.2 :Europe Brent Spot Price (FOB Dollars per Barrel)



Source: HTTPS://WWW.EIA.GOV/DNAV/PET/HIST/LEAFHANDLER.ASHX?N=PET&S=RBRTE&F=M

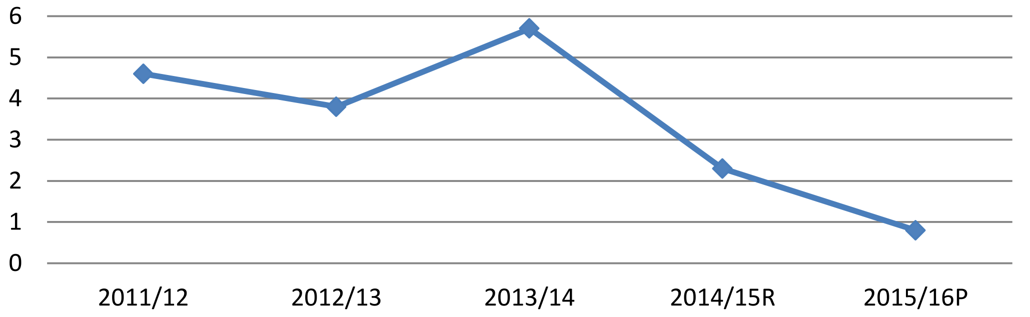
Domestic Macroeconomic Development

Economic activity remained subdued in 2015/16. However, macroeconomic stability was intact. Government capital spending and the private sector activities were sluggish owing to disturbances in the southern border along with supply disruptions. Additionally, the agriculture sector did not expand as expected on account of unfavorable weather. Consequently, a lower economic growth is expected in 2015/16. The border disturbance did not allow Nepal to take advantage of lower price of petroleum and metal products in international market along with that of low inflation in neighboring countries. This resulted in inflation higher than targeted. Banking sector witnessed an excess liquidity from the beginning of the review year. It was mainly due to a lower than expected lending growth in the first half of the fiscal year. However, the excess liquidity has been managed through open market operations (OMOs). Real estate transactions mildly expanded, and the share market showed bullish trend in the review year.

Economic Growth

According to the preliminary estimates of the Central Bureau of Statistics (CBS), the real GDP at basic price is expected to grow 0.8 percent in 2015/16 compared to a growth of 2.3 percent in the previous year. Similarly, the real GDP at producers' price is expected to grow 0.6 percent compared to a growth of 2.7 percent in the previous year. Delay in monsoon, prolonged strikes and obstructions in southern border points adversely affected the economy resulting in a lower growth in the review year.

Figure 1.3 GDP Growth Rate at basic prices (in percentage)



R= Revised; P=Preliminary

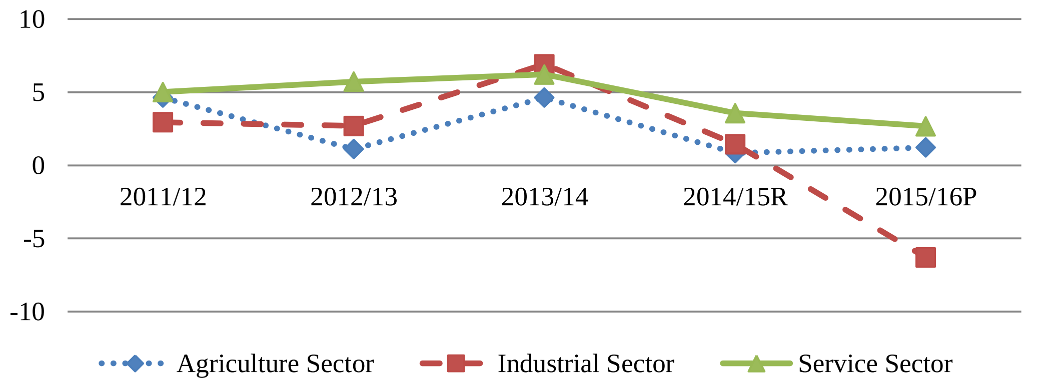
Source: Central Bureau of Statistics

In the review year, the agriculture sector is expected to grow 1.3 percent whereas the non-agriculture sector is expected to expand 0.6 percent. These sectors had grown 0.8 percent and 3.1 percent respectively in the previous year.

The industrial sector is estimated to shrink 6.3 percent as against a growth of 1.5 percent in the previous year. A fall in demand of industrial goods resulting from the earthquake of 2015, energy shortage, and disturbances in supply of fuel and raw materials adversely affected the output of the industrial sector.

The service sector is estimated to grow 2.7 percent compared to a growth of 3.6 percent in the previous year. A minimal tourist arrival owing to the lagged effect of earthquake and the prolonged border disruptions adversely affected hotels and restaurants and trade sectors resulting in a deceleration in service sector growth.

Figure 1.4: Sectoral GDP Growth (in percentage)



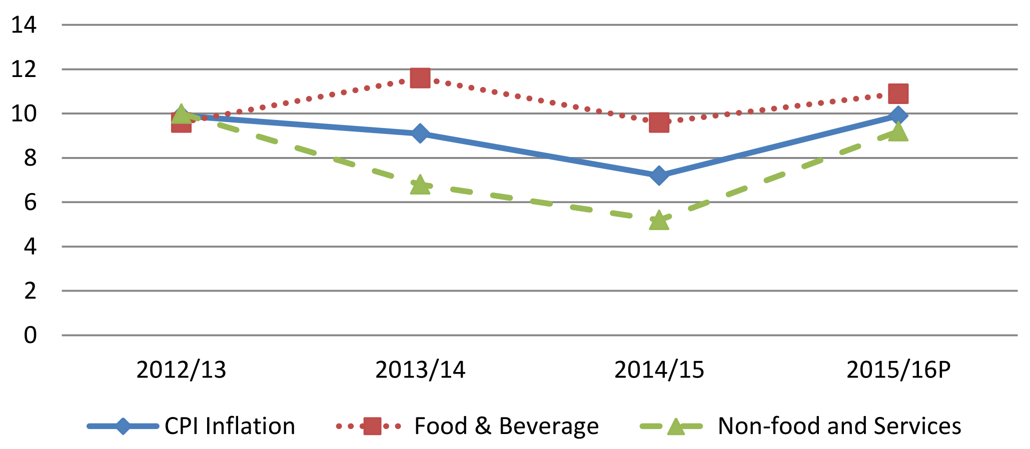
R= Revised; P=Preliminary

Source: Central Bureau of Statistics

Inflation

The annual average consumer price inflation increased 9.9 percent in 2015/16 compared to 7.2 percent in the previous year. This is mainly due to strikes in Terai region, obstructions at border points and supply disturbances. The y-o-y consumer price inflation stood at 10.4 percent in mid-July 2016 compared to that of 7.6 percent a year ago. The higher rate of increase in price indices of pulses and legumes, ghee and oil, clothes and footwear, spices, housing and utilities, among other sub-groups, exerted an upward pressure on overall consumer price inflation in the review year.

Figure 1.5: Changes in Consumer Price Index (in percentage)



Government Finance

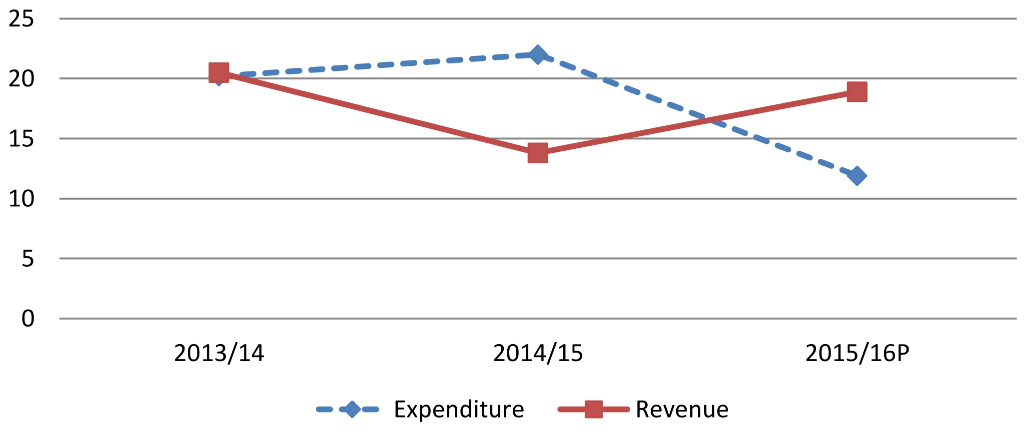
Despite the trade route disruption in the first half in 2015/16 the government revenue increased 18.9 percent to Rs. 482.75 billion. Thus, the actual revenue collection is 101.63 percent of annual target of Rs.475.01 billion. Of the total revenue, the share of tax revenue and non-tax revenue stood at 87.3 percent and 12.7 percent respectively in the review year. In the previous year, the shares of tax and non-tax revenue in the total revenue were 87.7 percent and 12.3 percent respectively.

Government expenditure, on cash basis, increased 11.9 percent to Rs. 569.57 billion in 2015/16 compared to an increase of 22 percent 2014/15. During the review year, recurrent expenditure increased 6.5 percent to Rs. 356.50 billion compared to a growth of 12.9 percent in the preceding year. Similarly, capital expenditure increased 37.9 percent to Rs. 111.70 billion compared to its growth of 32.1 percent in the previous year.

In the review year, government budget on cash basis remained at a deficit of Rs. 37.49 billion. Such deficit was Rs. 45.88 billion in 2014/15. The ratio of budget deficit-to-GDP fell to 1.7 percent in the review year from 2.2 percent in the preceding year. The government mobilized Rs.87.77 billion gross domistic borrowing in 2015/16.

The outstanding foreign loan of the government stood at Rs. 381.74 billion in mid-July 2016. The outstanding domestic debt of the government increased from Rs. 196.79 billion to Rs. 234.16 billion in mid July 2016. The total government debt amounted to Rs. 615.90 billion, which stood at 27.4 percent of GDP. Likewise, the total debt servicing/revenue ratio stood at 17.6 percent in mid July 2016.

Figure 1.6: Government Expenditure and Revenue (growth in precentage)



External Sector

Merchandise exports decreased 17.8 percent to Rs. 70.12 billion in 2015/16 compared to a drop of 7.3 percent in the previous year. Exports to India and China decreased 29.3 percent and 24.6 percent respectively whereas exports to other countries increased 6.3 percent in the review year. The ratio of total exports to GDP remained at 3.1 percent in 2015/16 compared to 4 percent a year ago.

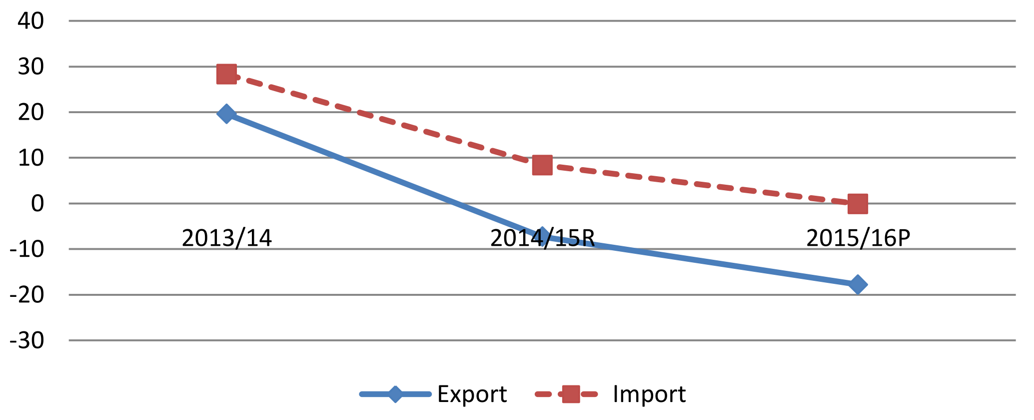
The large fall in imports of petroleum products resulted in 0.1 percent drop in merchandise imports to Rs. 773.60 billion in the review year. In the previous year, mercahandise imports had grown by 8.4 percent. Consequently, total trade deficit in the review year widened 2 percent to Rs. 703.48 billion compared to an expansion of 10.8 percent in the same period of the previous year.

The workers' remittances grew 7.7 percent to Rs. 665.06 billion in the review year compared to a growth of 13.6 percent in the previous year. The ratio of remittances to GDP stood at 29.6 percent in 2015/16. The current account registered a surplus of Rs. 140.42 billion in the review year due to the increase in net surplus in current transfer. The surplus in current account was Rs. 108.32 billion in the previous year. The overall BOP recorded a significant level of surplus of Rs. 188.95 billion in the review year on account of the increase in current account surplus and capital inflows.

The gross foreign exchange reserves increased by 26.1 percent to Rs. 1039.21 billion in mid-July 2016 from Rs. 824.06 billion a year ago. The increase in the remittances along with a large drop in imports resulted in such an increase in foreign exchange reserves. Based on the imports of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 16.5 months, and merchandise and services imports of 14.1 months.

The International Investment Position (IIP) shows that foreign assets and liabilities of Nepal were Rs. 1054.01 billion and Rs. 564.55 billion respectively in mid-July 2016. Accordingly, the net IIP remained in surplus of Rs. 489.46 billion. Such surplus was Rs. 316.78 billion a year ago.

Figure 1.7: Growth rate of Export and Import (in precentage)



R=Revised P=Provisional

Monetary Situation

The monetary aggregates remained slightly higher than target in 2015/16 due mainly to higher growth of net foreign assets. Broad money (M2) increased 19.5 percent in 2015/16 against the target of 18 percent. In the previous year, M2 had increased by 19.9 percent.

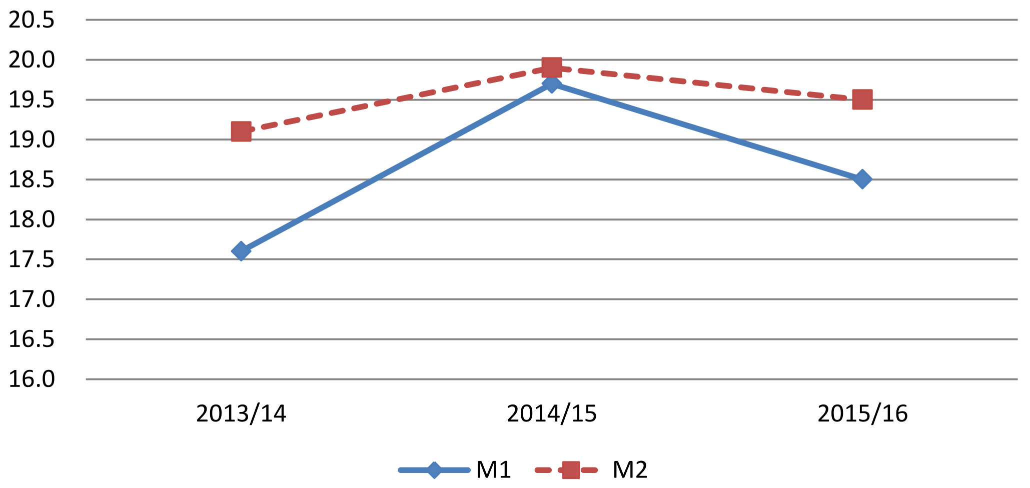
The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) increased Rs. 188.95 billion (25.3 percent) during the review year compared to a rise of Rs. 145.04 billion in the preceding year. Workers' remittance and compression in imports accounted for a significant growth in NFA. Reserve money increased 4.6 percent in the review year compared to an increase of 19.8 percent in the previous year.

Domestic credit increased 17.4 percent in the review year compared to a growth of 16.2 percent in the previous year. Likewise, claims on private sector increased 23.2 percent compared to a growth of 19.4 percent in the previous year.

Deposits at banks and financial institutions (BFIs) increased 19.4 percent in the review year compared to an increase of 20.1 percent in the previous year. Deposits at commercial banks and development banks increased 20.7 percent and 16.5 percent respectively, while that of finance companies decreased 12 percent in the review year. The merger and acquisition drive in the review year resulted in a contraction in finance companies' deposit.

Financial deepening accelerated further in the review year. The ratios of total deposit, loans and advances and claims on private sector to GDP increased significantly compared to those of the previous year

Figure 1.8: Growth rate of Money Supply (in percentage)



Liquidity Situation

As an effort to keep liquidity situation intact, the NRB has mopped up Rs 591.63 billion liquidity, on a turnover basis, through various instruments in 2015/16. In the previous year, Rs. 476.80 billion liquidiy was mopped up.

The NRB injected net liquidity of Rs. 471.35 billion through the net purchase of USD 4.45 billion from foreign exchange market (commercial banks) in the review period. Net liquidity of Rs. 396.72 billion was injected through the net purchase of USD 4.03 billion in the previous year.

The NRB purchased Indian currency (INR) equivalent to Rs. 385.47 billion through the sale of USD 3.4 billion and Euro 0.21 billion in the review year. INR equivalent to Rs. 348.09 billion was purchased through the sale of USD 3.5 billion in the previous year

CHAPTER - TWO

FINANCIAL SYSTEM PERFORMANCE AND STABILITY

Global Financial Stability Overview

Overall Financial Stability Outlook

Global Financial Stability Report October 2016 finds that short term risks to global financial stability have abated since April 2016, but that medium-term risks continue to build. The rise of commodity prices from their lows, along with the ongoing adjustments in emerging markets, has supported a recovery in capital flows. In advanced economies, financial institutions face a number of cyclical and structural challenges and need to adapt to low growth and low interest rates, as well as to an evolving market and regulatory environment. Weak profitability could erode banks' buffer over time and undermine their ability to support growth. A cyclical recovery will not resolve the problem of low profitability. Despite this decrease in short-term risk, the report finds that medium-term risks continue to build. The political climate is unsettled in many countries, making it more difficult to tackle legacy problems. Financial institutions in advanced economies face a number of structural and cyclical challenges. Corporate leverage in many emerging market economies remains high and would fall only gradually under the report's baseline scenario. Policymakers need a more potent and balanced policy mix to deliver a stronger path for growth and financial stability. There is an urgent need to raise global growth, strengthen the foundations of the global financial system, and bolster confidence. The report also examines how the rise of nonbank financing has altered the impact of monetary policy and finds that the fears of a decline in the effectiveness of monetary policy are unfounded. It appears that the transmission of monetary policy is in fact stronger in economies with larger nonbank financial sectors. Furthermore, the report also examines the link between corporate governance, investor protection, and financial stability in emerging market economies. It finds that the improvements over the past two decades have helped bolster the resilience of their financial systems. These benefits strengthen the case for further reform.

In Europe, more deep-rooted reforms and systemic management are needed. The solvency of many life insurance companies and pensions funds is threatened by a prolonged period of low interest rates. Japanese banks also face significant business model challenges. These banks are expanding abroad to offset thin margins and weak domestic demand, but this exposes them to greater dollar funding risks. A disruption of dollar funding sources could force Japanese banks to curtail their offshore lending and investment. Emerging markets are also adapting to an environment of lower global growth, lower commodity prices, and reduced global trade. The current favorable external environment, including low interest rates and the global search for investment opportunities, presents an opportunity for overly indebted firms to restructure their balance sheets. Corporate leverage in many of these markets may be peaking, since firms have slashed investment in the wake of commodity price declines and slowing demand.

According to *FSR* October 2016, to ensure financial stability, it has stated following recommendations.

1. The conduct of monetary policy will need to continue to adapt to changes in the transmission mechanism as nonbank financial intermediation grows. For example, as the relative importance of the risk-taking channel increases, the effects of monetary policy changes on the real economy may become more rapid and marked. At the same time, changes in nonbank regulation will also affect monetary policy transmission.
2. Monetary policymakers need to monitor the size and composition of key financial intermediaries' balance sheets. This is important in order to assess changes in the risk appetite of financial institutions.
3. Policymakers need to be mindful of the changing financial stability implications of monetary policy. Monetary policy actions are likely to have stronger consequences for financial soundness because they increasingly affect the risk-taking behavior of financial intermediaries. This suggests the need for greater vigilance by prudential and regulatory authorities.
4. Data provision on nonbank financial intermediaries needs to continue to be enhanced. In particular, many emerging market economies should collect more data on nonbank balance sheets.

The financial stability report further states that the financial stability benefits associated with improved corporate governance strengthen the case for further reform. Accordingly, this chapter makes the following policy recommendations:

1. All emerging market economies should continue to reform their legal, regulatory, and institutional frameworks to foster the effectiveness and enforceability of corporate governance regimes.
2. Most emerging market economies should continue to bolster the rights of outside investors, in particular minority shareholders.
3. Bringing disclosure requirements fully in line with international best practice is needed in many emerging market economies. Promoting greater board independence is also likely to yield benefits.

The GFSR concludes that policymakers must take a more comprehensive and collaborative stance to protect financial stability, advance financial inclusion, and revitalize the global economy to provide for a shared and secure future.

Impact of Brexit

The unexpected decision by U.K. voters to leave the European Union (EU) in June 2016 (Brexit) caught investors by surprise and initially roiled global markets. The post-referendum bout of market volatility faded after central banks responded promptly; no major disorderly market events surfaced, other than a sharp sell-off in some U.K.-based real estate funds. Yet the biggest challenges remain ahead. The shape of future trade arrangements and the uncertain impact of Brexit on the United Kingdom's large and globally integrated financial system have created uncertainty over the longer-term financial prospects of the United Kingdom. As noted in recent IMF publications, there is a high degree of uncertainty surrounding future arrangements and the implications for the U.K. financial sector. The impact on the financial sector and economy could work through three different channels:

1. *Bank operating costs.* Unless pass porting for banking services is preserved under future trade arrangements, banks could incur additional expenses associated with moving operations out of London or duplicating functions in the United Kingdom and EU. They may also have to bear the cost of setting up and maintaining subsidiaries rather than branches, including additional capital, liquidity, and total loss-absorbing requirements for new subsidiaries.

2. Changes in the financial services "rulebook." The financial sector more broadly could be subject to change depending on the outcome of negotiations. Some 60 percent of the current financial services "rulebook" is estimated to be composed of EU rules.

3. Macroeconomic impact. Protracted negotiations could weigh on confidence, not only postponing consumption and investment decisions, and thus reducing short-term growth, but also leading to permanently lower foreign investment and physical and human capital flows into the UKKingdom.

The U.K. economy's longer-term prospects could be affected. Sustained declines in portfolio inflows could create more challenging financing conditions for firms. Heightened concerns about the financial and macroeconomic impact of Brexit have contributed to a sharp drop in market participants' expectations of the (median) growth of U.K. GDP, especially for 2017, and the perceived risk of recession in 2017 remains elevated. This reflects major uncertainties about negotiations of several trade, financial, and regulatory arrangements not just with the EU, but also with the rest of the world. Further, the post-Brexit upward shift in investors' inflation expectations did not ease back in August reflecting the continued anticipation of a weaker exchange rate in lifting domestic inflation. Finally, investors' forecasts of U.K. 10-year government bond yields became even more widely dispersed in August signaling elevated uncertainty and a prolonged period of low interest rates, reflecting persistent economic and financial risks.

Commercial Real Estate and Housing

Expectations that Brexit would trigger investor outflows from the real estate market prompted especially pronounced market volatility for financial assets exposed to this sector, and broader concern over the funding of the external current account, given the sizable participation of foreign investors in these sectors. Commercial real estate transactions fell sharply in anticipation of the referendum. The exit of the United Kingdom from the European Union is expected to result in further significant declines in foreign investment in U.K. commercial real estate. These concerns triggered an abrupt wave of redemptions in U.K. property funds following the decision to leave the European Union.

See GFSR, 2016 for details

Overview of Nepalese Financial System

Size of the Overall Financial System

Nepalese financial system has been regulated by different independent regulators in the sectors of banking, insurance, securities markets, contractual saving institutions and other service sectors. In the system, NRB, as the central bank, regulates commercial banks, development banks, finance companies, micro finance financial institutions, FINGOs and cooperatives carrying limited banking activities. Besides this, NRB has made provisions to allow companies to work as hire purchase companies with pre-approval from NRB. The contractual saving institutions comprises of Employee Provident Fund (EPF) and Citizen Investment Trust (CIT) operating under the regulatory jurisdiction of Ministry of Finance. Similarly, Securities Board of Nepal (SEBON) regulates securities market which comprises of stock exchange, issuing and listed companies, central securities depository, stockbrokers, merchant bankers, credit rating agency, mutual funds, application supported by blocked amount (ASBA) members and depository participants. The financial system also embraces insurance companies under the purview of Insurance Board and cooperatives established under Cooperative Act which falls under the purview of Department of Cooperatives.

A high level committee to enhance financial stability through improved coordination between regulators, comprising NRB, SEBON, Insurance Board, Department of Cooperatives, office of the Company Registrar has been recently established. The financial sector is continuously evolving towards a more contemporary and efficient system of finance with supportive investment-friendly environment, and inclusive economic growth.

Due to financial liberalization policy adopted after the mid of 1980s, Nepal observed the proliferation in number of BFIs in the last couple of decades and the growth has moderated as NRB has imposed moratorium on licensing on BFIs except micro credit development banks (D-class financial Institutions). For the last two years, banking system of Nepal is experiencing an encouraging restructuring and consolidation, particularly through the merger and acquisition. As of mid-July 2016, the total number of financial institutions stood at 249 comprising of Commercial Bank 28, Development Bank 67, Finance Companies 42, and Microfinance Development Banks 42. Moreover, 40 other financial intermediaries licensed by NRB, 27 insurance companies that includes 9 life insurance companies, 17 non life insurance companies and one reinsurance company, one each of EPF, CIT and Postal Saving Bank. Total number of "A", "B", "C" and "D" class financial institutions reduced to 179 in mid-July 2016 from 191 in mid-July 2015 due to merger and acquisition policy adopted by the NRB. However, the number of "D" class financial institutions is in increasing as NRB has been quite liberal in licensing those institutions to enhance financial access to unbanked or under banked areas.

Table 2.1: Number of BFIs and Other Institutions

Banks and Financial Institutions	Mid-July	Mid-July	Mid-July
Commercial Banks	30	30	28
Development Banks	84	76	67
Finance Companies	53	47	42
Microfinance Financial Institutions Banks (MFFIs)	37	38	42
Sub-Total	**204**	**191**	**179**
NRB Licensed Cooperatives	15	15	15
NRB Licensed FINGOs	29	27	25
Insurance Companies	26	26	26
Reinsurance Company	-	1	1
Securities Market Institutions			
Stock Exchange	1	1	1
Central Depository Company	1	1	1
Stockbroker	50	50	50
Merchant Banker	14	16	17
Mutual Fund	2	5	6
Credit Rating Agency	1	1	1
Listed Company*	233	232	229
Depository Participant*	13	53	66
Sub-Total	**315**	**357**	**371**
Contractual Saving Institutions			
Employees Provident Fund (EPF)	1	1	1
Citizen Investment Trust (CIT)	1	1	1
Postal Saving Bank	1	1	1
Total*	**390**	**421**	**427**

***** *BFIs and Insurance Companies repeated as Listed Companies and Depository Participants not included in Total.*

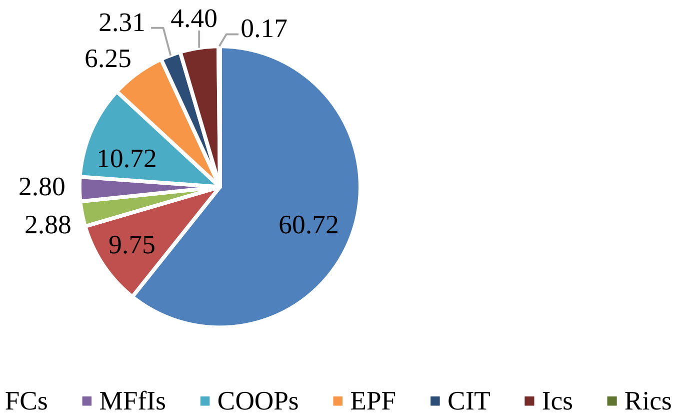
Table 2.2: Structure of the Nepalese Financial Sector (Assets/ Liabilities or Sources/Uses)

(In million Rupees)

Financial Institutions	**Mid-July 2012**	**Mid-July 2013**	**Mid-July 2014**	**Mid-July 2015**	**Mid-July 2016**
Commercial Banks	1,052,450.70	1,242,881.40	1,467,151.90	1,774,504.80	2,184,811.57
Development Banks	160,360.20	199,954.80	255,373.40	300,641.80	350,844.75
Finance Companies	109,687.50	100,856.70	110,342.30	108,007.40	103,443.22
MFFIs	29,815.50	35,774.90	49,395.80	70,880.40	100,770.60
Cooperatives (Capital, Fund and Savings)	166,634.86	191,614.00	233,715.55	265,551.90	385,721.81
Contractual Saving Institutions					
Employees Provident Fund	125,752.80	145,283.40	170,638.60	195,903.00	224,854.80
Citizen Investment Trust (Capital and Net Fund Balance)	38,068.50	42,753.60	54,621.30	67,675.00	83,013.40
Insurance Companies	73,825.00	84,650.40	101,097.20	129,450.00	158,241.60
Reinsurance Company	-	-	-	6,157.57	6,254.38
Total	**1,756,595.06**	**2,043,769.20**	**2,442,336.05**	**2,918,771.87**	**3,597,956.13**
Market capitalization (NEPSE)	368,262.10	514,492.10	1,057,165.80	9,89,403.96	1,889,451.74
Total (incl. market capitalization)	**2,124,857.16**	**2,558,261.30**	**3,499,501.85**	**2,918,771.87**	**5,487,407.87**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Commercial Banks	59.91	60.81	60.07	60.80	60.72
Development Banks	9.13	9.78	10.46	10.30	9.75
Finance Companies	6.24	4.93	4.52	3.70	2.88
Microfinance Financial Institutions Banks	1.70	1.75	2.02	2.43	2.80
Cooperatives (Capital Fund and Savings)	9.49	9.38	9.57	9.10	10.72
Contractual Saving Institutions					
Employees Provident Fund	7.16	7.11	6.99	6.71	6.25
Citizen Investment Trust (Capital and Net Fund Balance)	2.17	2.09	2.24	2.32	2.31
Insurance Companies	4.20	4.14	4.14	4.44	4.40
Reinsurance Company	-	-	-	0.21	0.17
Total	**100**	**100**	**100**	**100**	**100**

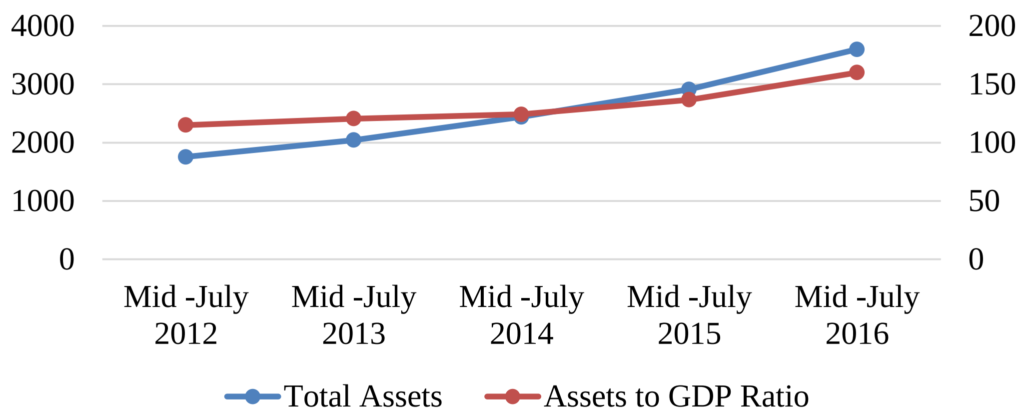
In terms of total assets and liabilities, banks and financial institutions shared 76.15 percent of total financial system of Nepal in mid-July 2016. The commercial banks remained the key player in the financial system occupying 60.72 percent of the system's total assets followed by development banks (9.75 percent), finance companies (2.88 percent) and micro finance financial institutions (2.80 percent). In case of contractual saving institutions, EPF is a dominant institution having 6.25 percent of shares, followed by insurance companies (4.40 percent), reinsurance company (0.17 percent) and CIT (2.31 percent) as of mid-July 2016.

Figure 2.1: Structure of Assets Holding in Financial System



In the Nepalese financial system, BFIs have the prominent share of assets among which commercial banks have the highest share in total assets. As evident from the figure 2.3, the assets size of financial system is increasing over the years. The total share of banking and non-banking financial institutions in GDP continued to expand in the mid-July 2016. The ratio of total assets & liabilities of Nepalese financial system reached 160 percent of GDP in mid-July 2016.

Figure 2.2: Total Assets (in Rs. billion) and Assets to GDP Ratio Growth (right scale)



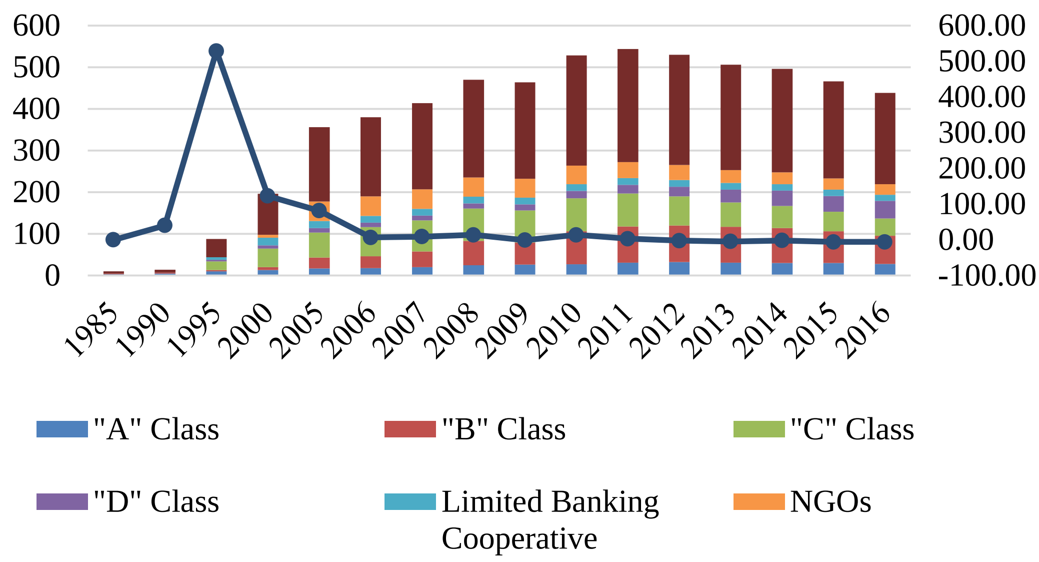
Total assets and liabilities of commercial banks remained at 97.16 percent of GDP followed by development banks (15.60 percent), finance companies (4.60 percent), MFFIs (4.48) percent and Coperatives (17.16) percent. Further, such ratio for contractual saving institutions stood at 20.73 percent comprising 10 percent of EPF, 3.69 percent of CIT, 7.04 percent of insurance companies in mid-July 2016.

Structure and Performance of Banks and Financial Institutions

Nepalese banking system in terms of number and structure changed significantly since 1985. The number of BFIs reached its peak in 1995 to 38 from only 3 BFIs till 1985. The impact of economic liberalization and its direct impact on the financial sector have been witnessed in that period in terms of establishment of banks and financial institutions. Thereafter along with the pace of financial liberalization, the establishment of BFIs took its speed each year and the number of BFIs reached to 218 in 2011. While the global financial system was deeply ridden in a risk with the financial crisis, Nepalese financial institutions were rapidly emerging with the argument and support that Nepal would not get affected by such crisis as economy is not exposed to international financial markets.

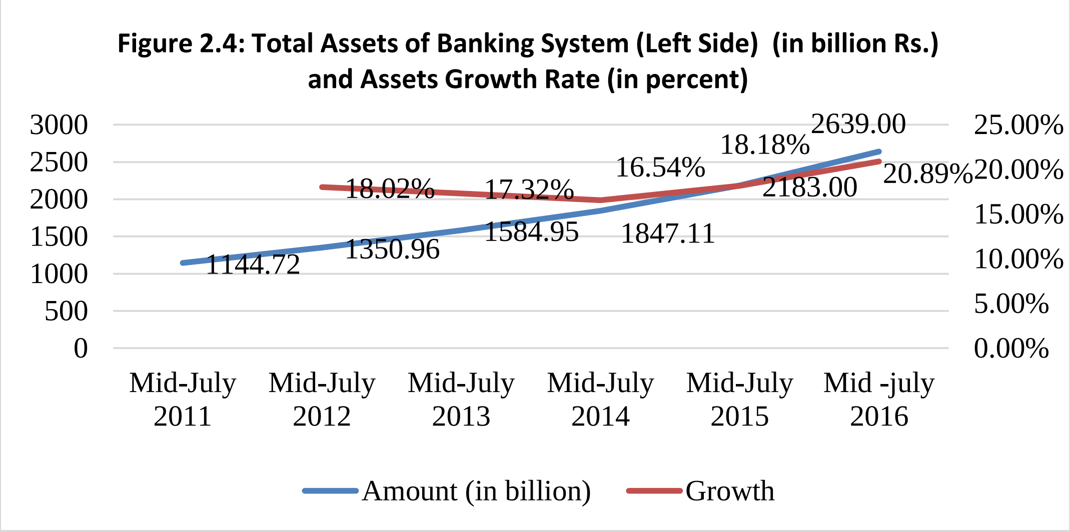
A stable financial system is determined by a sound and strong banking system as it shares a greater percentage in the national economy of many countries globally. Nepal cannot be separated from that universal landscape, however, in the past it lacked clear vision and strategies and it is expected that recently drafted financial sector development strategies, the amendments of BAFIA and NRB Act as well as related laws and legislations would fulfill all shortcomings related to the financial structure and adopt a long term financial sector vision and strategies with concrete policies/actions without changing the regulatory regime in a short period of time.

Figure 2.3: Number and growth of BFIs licensed by NRB



Assets Growth in Nepalese Banking System

The total assets and liabilities size of BFIs have continued to increase. As of mid-July 2016, total assets of BFIs increased by 20.89 percent and reached to Rs. 2639 billion in comparison to Rs. 2183 billion in the same period of last year. Though the licensing policy of BFIs is kept in moratorium, there is significant expansion on the balance sheet of BFIs mainly due to the increase in deposits and credits. Increase in deposits is mainly driven by ever increasing remittance inflows. The liabilities side of the balance sheet may also inflated on account of the increasing paid up capital and reserves through issuance of right shares, bonus share and increasing profit. Similarly, government has injected a large chunk of capital in state owned banks.

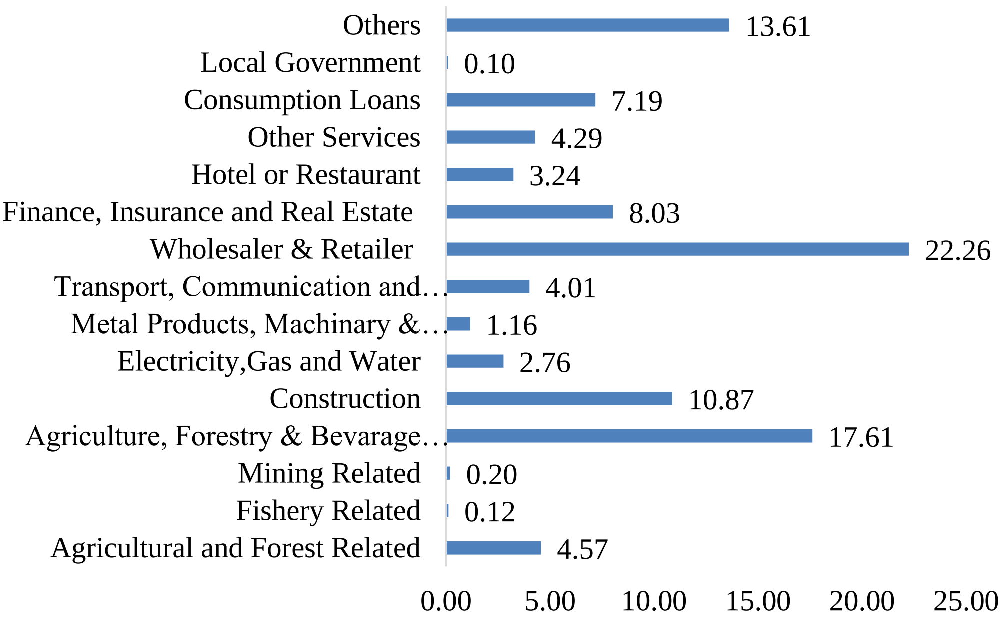


As on mid-July 2016, the five large commercial banks (LCBs) collectively accounted for 26.79 percent of total banking system assets and 32.36 percent of total commercial bank assets. As of mid-July 2016, the five large commercial banks, RBB, NABIL, NIBL, ADBNL, and EBL had total assets size of Rs.183.68 billion, Rs. 139.31 billion, Rs.137.82 , Rs.132.12 billion, Rs.114.99 billion respectively. This implies a high concentration of banking assets to few banks in Nepal. So any events of bank failure of large banks may have greater impact to financial stability of Nepal.

Credit Distribution in Banking Sector

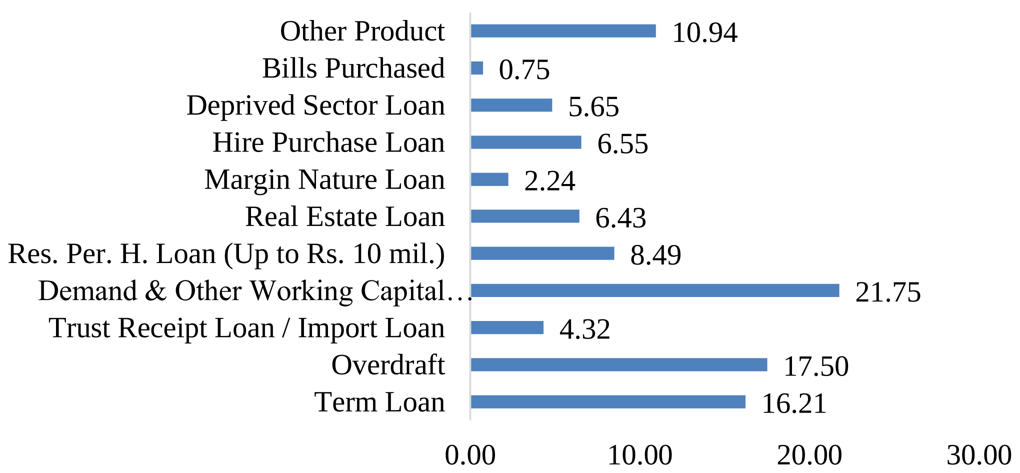
A large part of BFIs lending is concentrated in eight key areas of economic activities. As on mid-July 2016 trade (wholesaler & retailer) accounted for 22.26 percent, followed by manufacturing (17.61 percent), other services (13.61 percent), construction (10.87 per cent), finance, insurance and real estate (8.03 percent), consumption (7.18 percent), agriculture and forestry (4.56 percent) and transportation and communication (4.01 percent). Concentration of lending to a few sectors would expose bank to credit risk. Though NRB has made mandatory provision of lending in agriculture and productive sector to support economy, BFIS are still behind as expected to lend on productive sector. The deficiency of Capital in those sectors is one of the main reasons for low productivity and sluggish growth.

Figure 2.5: Major areas of Credit distribution of BFIs



Analyzing the type of loan products, BFIs has made highest lending in total in demand and working capital loan (21.75) percent followed by overdraft (17.5) percent and term loan (16.21) percent. The real estate loan has come below the regulatory requirement of 10 percent, the lending percentage of BFIs in real estate stood in 6.43 in mid- July, 2016. Figure 2.7 depicts the picture of the lending of BFIs in different products.

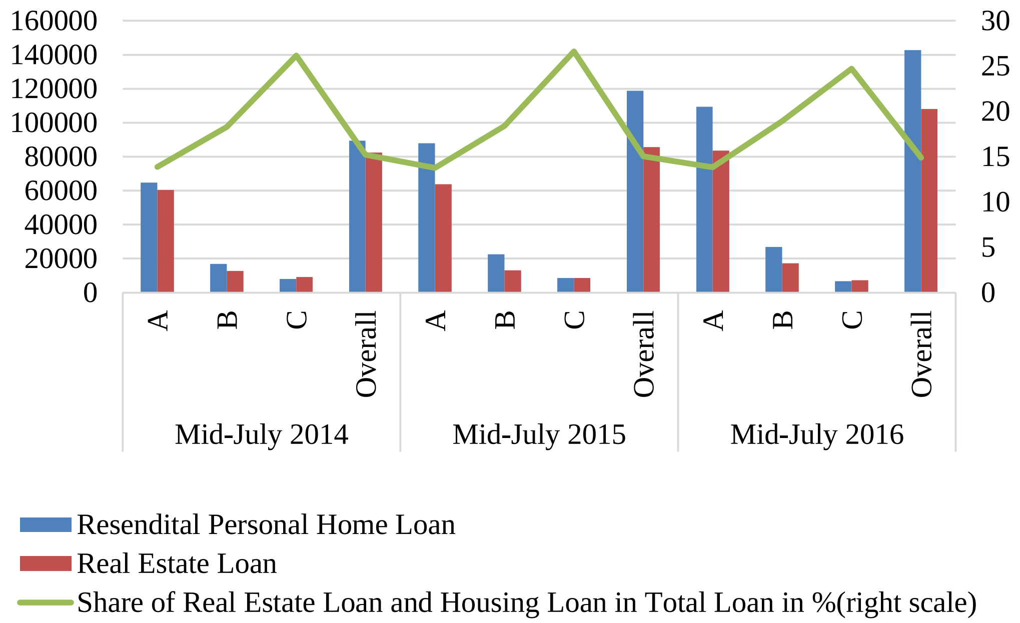
Figure 2.6: Product wise lending of BFIs



Real Estate Lending

NRB has deployed some macro prudential measures to address real estate lending such as caps on real estate loans and the loan-to-value ratio and sectoral capital requirements. Following this measures, NRB has directed BFIs to limit real estate and housing loan exposure to 25 percent of their total loans. The BFIs are also required not to issue loans of more than 60 percent of fair market value of the collateral/project. As for the real estate sector (which does not include the housing sector) BFIs are to reduce exposure to 10 percent. But, NRB has granted some relaxation on residential home loan whereby BFIs can lend up to Rs.10 million for individual residential home loan, which doesn't come under the real estate sector.

Figure 2.7: Real Estate Exposures of BFIs (in million Rs.)

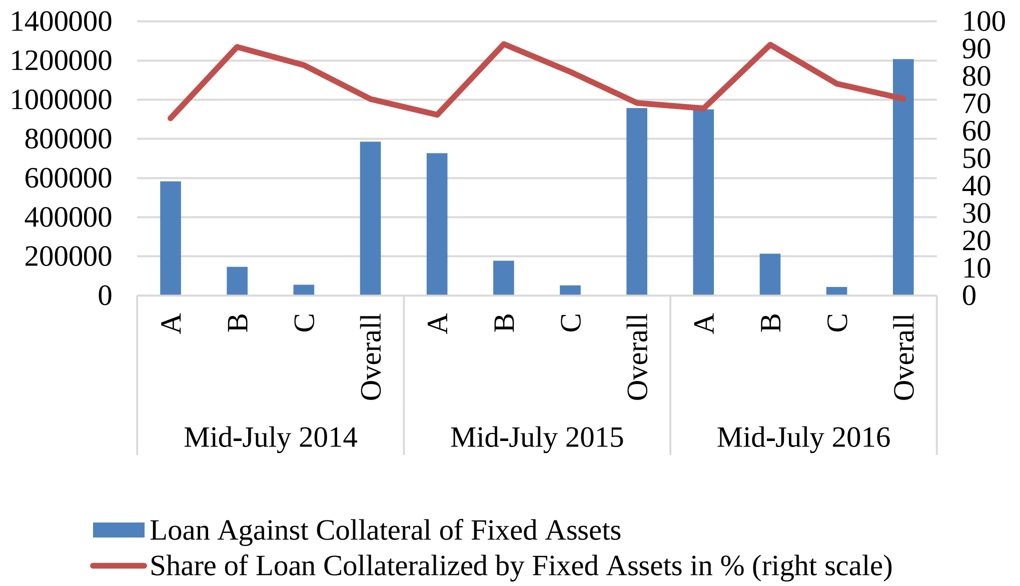


The banking system has reduced their high exposures in real estate after the introduction of some macro prudential measures. The direct real estate exposure amounted to Rs.108 billion which accounts for 6.43 percent of total loan in mid-July 2016 which was about Rs.85 billion (6.3 percent of the total outstanding) in mid-July 2015.

Commercial bank's direct exposure to real estate and housing has declined from 19.4 percent in Mid-July 2010 to 6 percent in mid-July 2016. The developments banks and finance companies have lent 7.41 and 12. 76 percentage of total loan portfolios in real estate and housing in mid-July, 2016.

In mid-July 2016, none of the Commercial Bank had exposures to real estate in excess of 20 percent against one in mid-July 2015. The situation was even worse in mid-July, 2014 as 3 commercial banks had real estate exposure of more than 20 percent of their total loan portfolio. The total real-estate-loan-to-GDP ratio has increased to 4.81 in mid-July, 2016 from that of 4.00 percent in mid-July 2015.

Figure 2.8: Loan against collateral of Fixed Assets



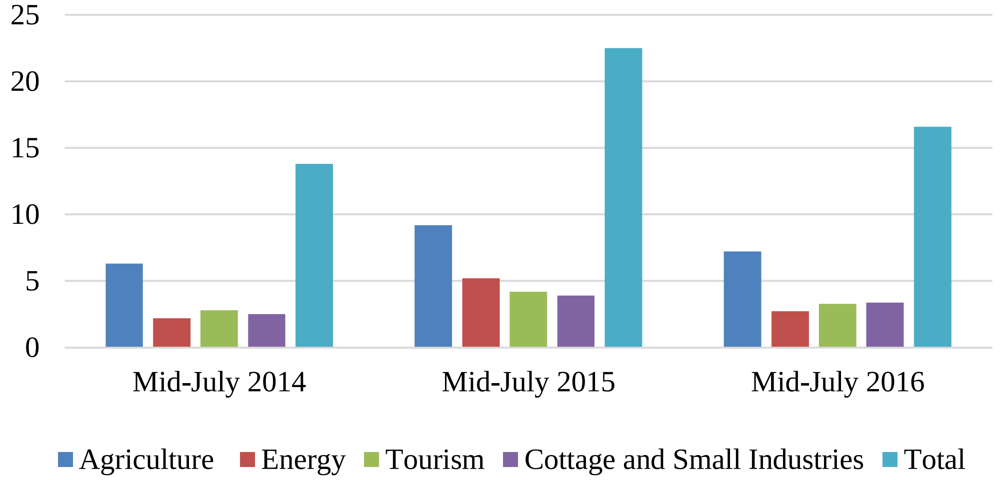
Directed Lending:

Productive Sector Lending

In order to achieve the sustainable economic growth of the country, NRB has directed BFIs to lend in some priority sector of the economy. Currently, such directed lending is focused on productive sector and deprived sector. NRB has made the mandatory requirement for BFIs to lend in those sectors, where class “A” commercial banks are required to lend 20 percent of their total loan on defined productive sector like agriculture, energy, tourism, cottage and small industry among which they are required to flow at least 15 percent of their credit in agriculture and energy sector by mid-July, 2017. Likewise, class “B” and “C” BFIs are required to lend 15 percent and 10 percent respectively on productive sectors. The main objective of this policy is to encourage the BFIs to diversify the loan in productive sector and discourage lending in unproductive sector to ensure economic dynamism and stability.

The monetary stance of NRB is designed to ensure the adequate credit for productive investments to support the attainment of the government's GDP growth target. As on mid-July 2016, the commercial banks had provided 16.59 percent of their total loan on productive sector which includes 7.22% in agriculture, 2.73% in energy sector and 3.27% in tourism sector and 3.37% in cottage and small industries respectively. Commercial banks have lent 9.95% in combined agriculture and energy sector which is less than the regulatory limit of 12 %. The productive sector lending of commercial banks in mid-July 2015 was 22.5%. Such figure clearly depicts that the policy introduced by NRB has been able to boost the lending in productive sector but it is not as expected.

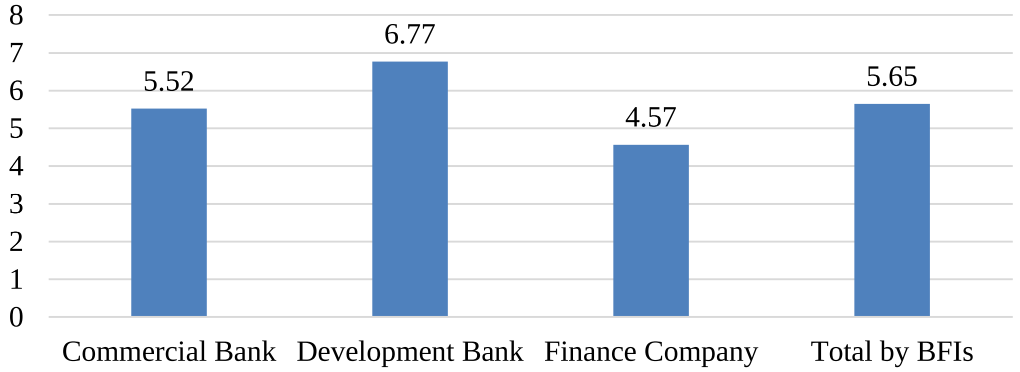
Figure 2.9: Productive Sector lending of commercial banks



Deprived Sector Lending

BFIs are required to disburse certain percent of their total loan portfolio in the deprived sector as stipulated by NRB. With the objective of gradual increment in the size of deprived sectors of the economy, NRB has fixed such lending requirement rate 5.0 for class "A", 4.5 for class "B" and 4.0 for class 'C'. The overall deprive sector lending by BFIs as on mid-July 2016 remained 5.65 percent where commercial banks, development banks and finance companies lend 5.52 percent, 6.77 percent and 4.57 percent respectively.

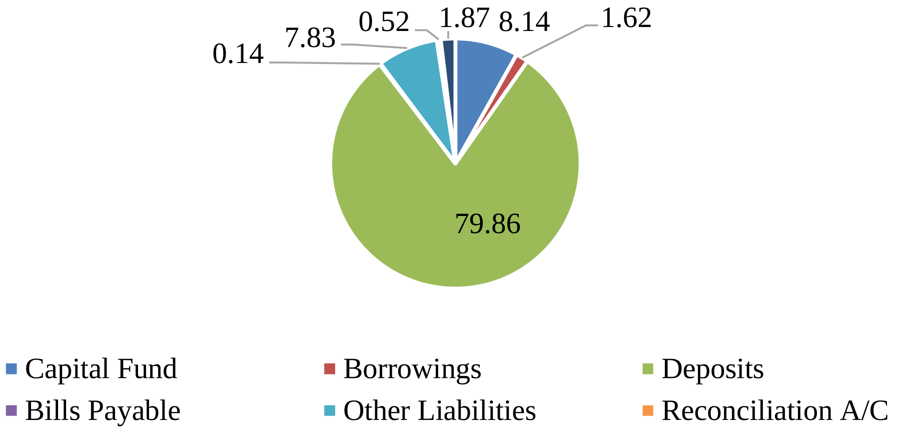
Figure 2.10 Deprived Sector Lending by BFIs



Liability Structure of the Banking Sector

Deposits are the largest source of external funds in the banking sector. The share of total deposits is 79.86 percent of the total liabilities as of mid-July 2016. As of mid-July 2016, total deposit increased by 18.93 percent against 19.9 percent in mid-July 2015. Likewise, borrowings increased by 100.51 percent which was increased by 17.32 percent in mid-July, 2015, whereas other liabilities increased by 9.89 percent in mid-July 2016.

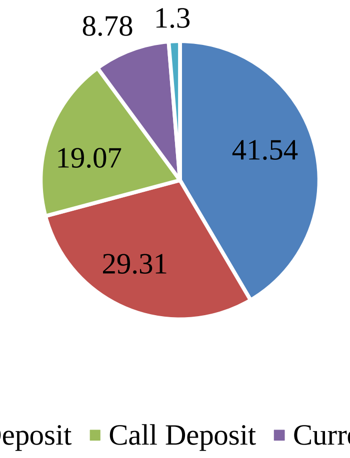
Figure 2.11: Liability Structure of BFIs



The share of saving deposits, fixed deposits, call deposits, current deposit and other deposit stood at 41.54 percent, 29.31 percent, 19.07 percent, 8.78 percent and

1.3 percent respectively at mid- July 2016. The relative proportions of deposits remain similar as in previous year. The deposit structure shows a greater reliance on saving deposits and fixed deposits which are regarded as more stable.

Figure 2.12: Deposit Liabilities by types of Account



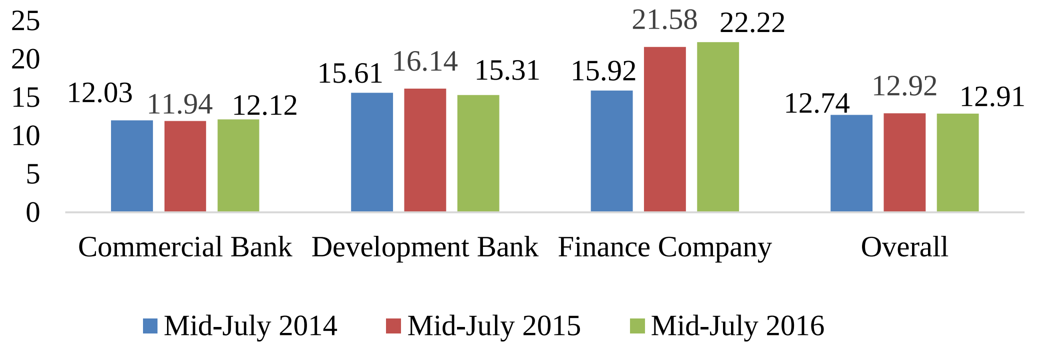
The total deposits of BFIs reached Rs.2107 billion in mid-July 2016 from that of 1772 billion in mid-July 2015. The share of top five BFIs depicts 25.71 percent of the total deposits which shows a significant concentration of top 5 BFIs in the total system in terms of deposit. The concentration ratio was 27.0 in previous year. Among top five banks, there are two state owned commercial banks and remaining 3 other commercial banks.

Financial Soundness Indicators

Capital Adequacy

In mid –July 2016, the capital fund of BFIs increased by 31.84 percent to Rs.214.89 billion from 163 billion in mid –July 2015. Such increment was 11.7 percent in the previous year. The capital fund is composed of paid-up capital (Rs.163.37 billion), statutory reserves (Rs.43.68 billion), retained earnings (Rs.11.17 billion in negative figure) and other reserves (Rs.19 billion). In mid-July 2016, the CAR of commercial banks registered 12.12 percent, with a y-o-y decrease of 0.19 percent point. In the same period, the CAR of development banks recorded 15.31 percent, with a y-o-y increase of 0.32 percent points and the CAR of finance companies stood at 22.22 percent, which was increased by 1.8 percent point y-o-y. The overall CAR of BFIs in mid-July 2016 stood at 12.91 percent which was 12.92 percent in previous year. The excess of capital adequacy ratio over the minimum requirement of banking system was mainly due to the consolidation among development banks and finance companies through merger and acquisition as well as the capital increment decision of NRB. The overall CAR of BFIs remained well above the standard requirements set by NRB which indicates that the banking system's capital soundness is in strong position.

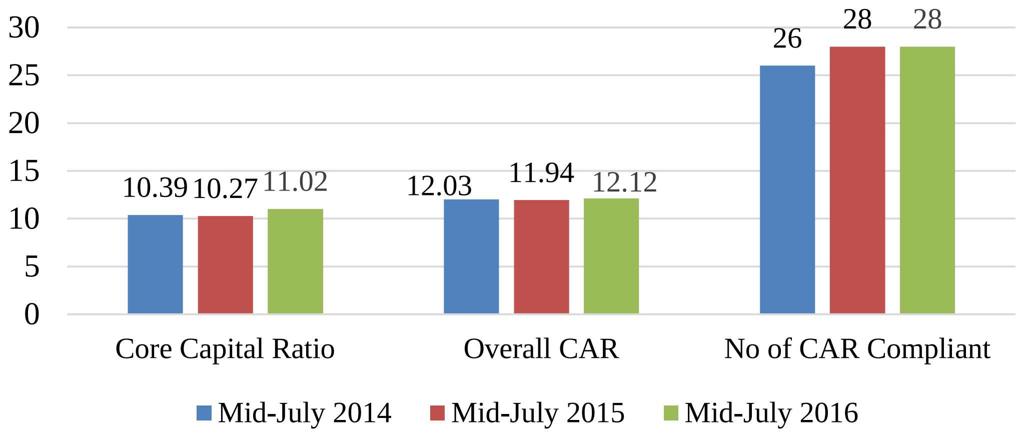
Figure 2.13 Capital Adequacy of BFIs



In mid-July 2016, commercial bank's compliance with the minimum Capital Adequacy Ratio (CAR) is 100 percent in comparison of 93 percent as on mid-July 2015. As evident from figure 2.15, all Banks complied with the minimum CAR in mid-July 2016. During the period of 2011-2014, state owned banks (SOBs), Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) are the only two commercial banks which were non-compliant with required CAR. With the injection of capital, RBB in mid-July 2015 met capital adequacy ratio with Tier1 capital 9.9 percent and CAR ratio 10.3 percent. Nepal Bank was also able to meet the core capital requirement with 6.6 percent, but it still fails to maintain the CAR ratio as per regulatory requirements. The bank has maintained CAR ratio 7.8 percent in mid-July 2015. But in the review period Nepal Bank was also able to meet the capital adequacy ratio of 11.41 percent with 10.15 percent of core capital.

The aforementioned analysis highlights that the Capital adequacy ratios of commercial banks are higher than regulatory standard over the period of mid-July 2011 to mid-July 2016. For instance, overall CAR of the commercial banks in mid-July 2016 is 12.12 percent which was 10.6 percent in mid-July 2011. In addition, Tier-1 ratios were 10.0 percent, 10.7 percent, 10.4 percent, 10.2 and 11.02 in mid-July 2012, 2013, 2014, 2015 and 2016 respectively.

Figure 2.14 Core Capital and Overall CAR of Commercial Banks and no of Compliants



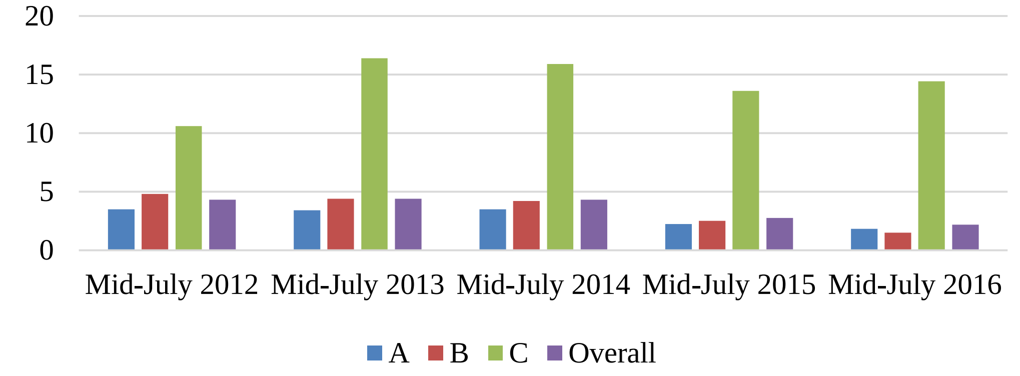
Assets Quality

Non-performing loans (NPL)[4] emanated from the deterioration in the quality of the loan portfolios which was expected to emerge due to the rapid growth of credit in recent years. Indeed, NPL of BFIs was Rs. 36.40 billion in mid-July, 2016 which was Rs. 37.43 billion in mid-July 2015. In terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2016 indicating the banking sector's resilience in large. NPL to total loans of commercial banks was decreased by 0.40 percentage point on y-o-y basis and recorded the ratio of 1.82 percent on mid-July, 2016.

Only one private sector commercial bank Prabhu Bank has the NPL above 5 percent in mid-July, 2016. State owned banks are able to bring down the NPL below 5 in mid-July 2016. Likewise, NPL ratio of development banks was decreased by 1.03 percentage point to 1.48 in mid-July, 2016 as compared to 2.52 in mid-July 2015. The NPL ratio of finance companies is still in double digit which stands at 14.42 percent in the same period.

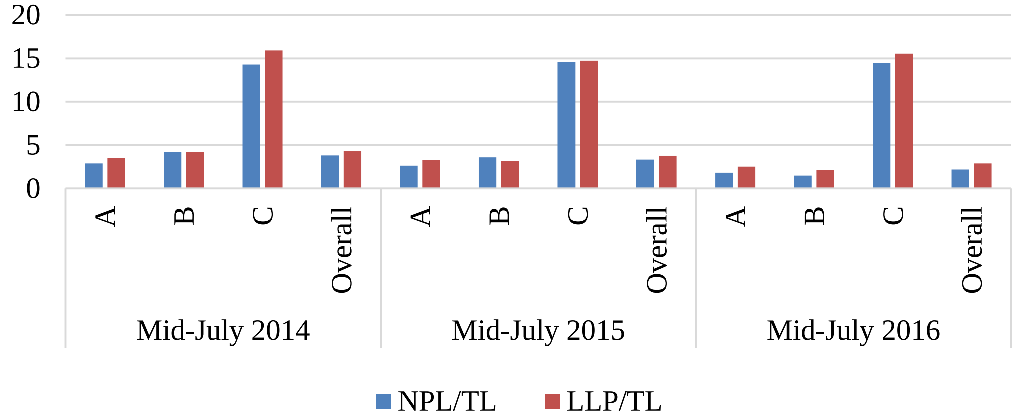
[4]Non-performing loans are those loans which are classified as ‘restructured/rescheduled’, ‘sub-standard’, ‘doubtful’ and ‘loss’ as per NRB unified directive, directive no. 2.

Figure 2.15: NPL of BFIs (percentage of total loans and advances)



NRB has introduced "watch list" as the new category of loan provision to discourage growing practice of borrowers not utilizing the loans in projects where they were supposed to go. According to this directive, any loan that has crossed the repayment deadline by a month will come under the "watch list". Also, short-term loans and operating loans whose deadline has been extended temporarily without renewal should be categorized under "watch list". Likewise, BFIs have to categorize the loans extended to a borrower whose loans from another bank have turned non-performing, and loans provided to a firm whose net worth and cash flow have remained negative for the past two years despite regular payment of principal and interest, under the "watch list". In mid- July 2015, BFIs watch list provision to total loan remains 0.11 percentages.

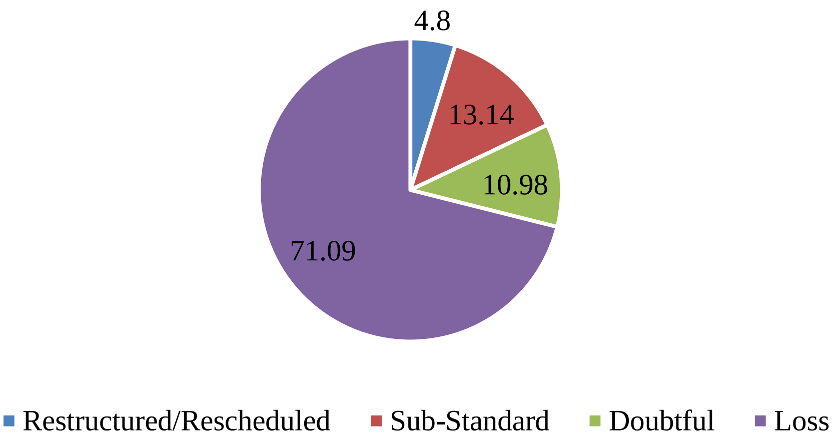
Figure 2.16: Provision Versus Actual Loan Loss (as a percentage of total Loan)



The NPL stood at Rs. 36.83 billion in mid-July 2016, which was Rs. 37.43 billion in mid-July 2015. As of mid-July 2016, LLP of banking system is sufficient to cover NPL of the same period which stood for 48.61 billion.

In the banking system, the loss loan is Rs. 25.88 billion in mid-July 2016 which was Rs. 28.5 billion in mid-July 2015. In total NPL, loss loan accounts for 71.09 percent in mid-July 2016. It is alarming that a bulk of NPL is loss loan. There is slight increment in ratio of loss loans to NPL to 71.09 percent in mid-July 2016 from 69 percent in mid-July 2015, which shows deterioration in the assets quality in banking system. NRB introduced the watch list category in loan loss provision. The NPL under sub-standard and doubtful categories, on the other hand, constituted 13.14 percent and 10.98 percent respectively. The ratio of restructured/rescheduled loans to total NPL remained around 4.8 percent in the current year.

Figure 2.17: NPL composition of BFIs (Mid-July 2016)



The adverse effect on bank balance sheets arising out of high classified loans is a major concern for the central bank. NRB's directives to the banks to take precautions while extending loans to high risk sectors, keeping single obligor limit, and prioritize loans to productive sectors, and also blacklisting the loan defaulters and similar other measures should help to further improve the classified loans situation in the country.

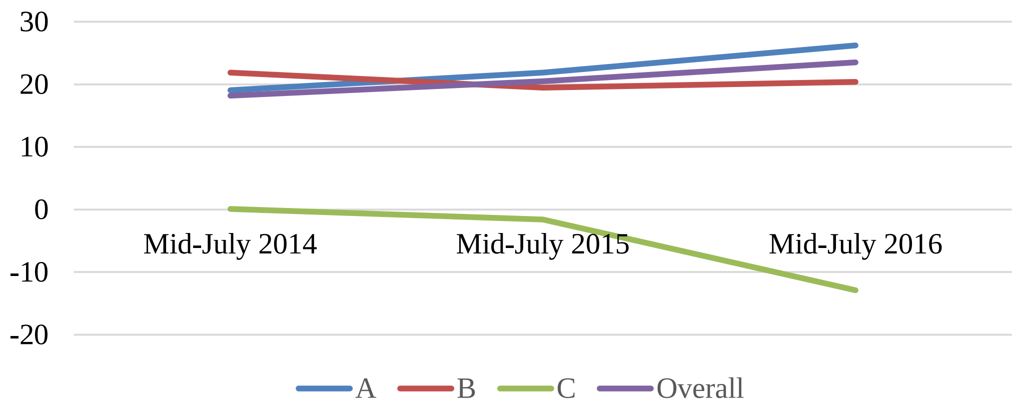
Leverage Ratio

Basel Capital for Banking Supervision has introduced leverage ratio which is complementary to the risk-based capital framework and aims to restrict the build-up of excessive leverage in the banking sector. The leverage ratio is defined as eligible Tier 1 capital divided by total assets and off balance sheet items which could originate pro-cyclicality that can originate from excessive lending that are inappropriate to measure risk weighted assets. A low ratio indicates a high level of leverage. To reduce pro-cyclicality and keep leverage ratios more stable the Basel III has set a minimum leverage ratio of 3 percent at all times.

Credit and Deposit Growth

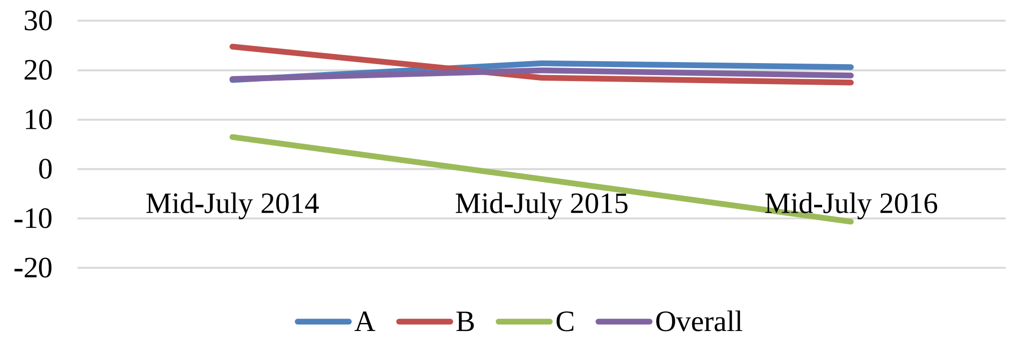
Credit flows from BFIs grew significantly by 23.55 percent in mid-July, 2016 such increment was 20.5 percent in mid-July, 2015. Commercial Banks grew by 26.23 percent in mid-July 2016, such increment was 21.9 percent in mid-July 2015. Development banks credit expanded by 20.43 percent, whereas finance companies credit dropped by 12.9 percent in mid-July 2016.

Figure 2.18: Trends in Credit Growth (in percent)



Deposits of BFIs increased by 18.94 percent in mid-July 2016 as compared to mid-July 2015. The deposit growth of commercial banks registered 20.62 percent followed by development banks 17.52 percent in mid-July 2016. However, there has been negative growth of deposits by 10.66 percent in finance companies mainly due to the merger with other financial institutions.

Figure 2.19: Trends in Deposit Growth (in percent)



There has been increment in overall credit to deposit (C/D) ratio to 79.80 percent in mid-July 2016 from 76.8 in mid-July 2015. The C/D ratio of finance companies stood (87.71 percent), development banks (83.62 percent) and commercial banks (78.91 percent). As of mid-July the share of total deposit to GDP reached to 93.75 percent comprising 78.5 percent share of commercial banks whereas the share of development banks remained 12.39 percent and finance companies 2.86 percent only.

Figure 2.20: Credit ,Deposit (in million Rs.) and C/D Ratio (in percent) of BFIs

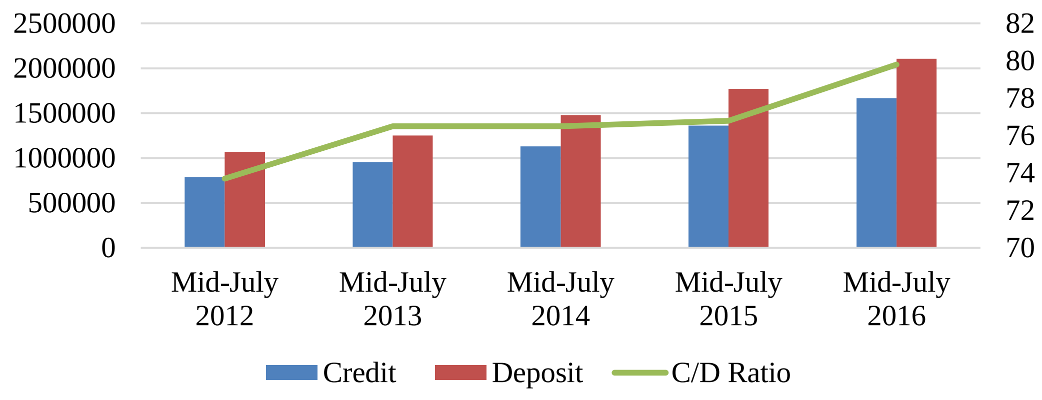
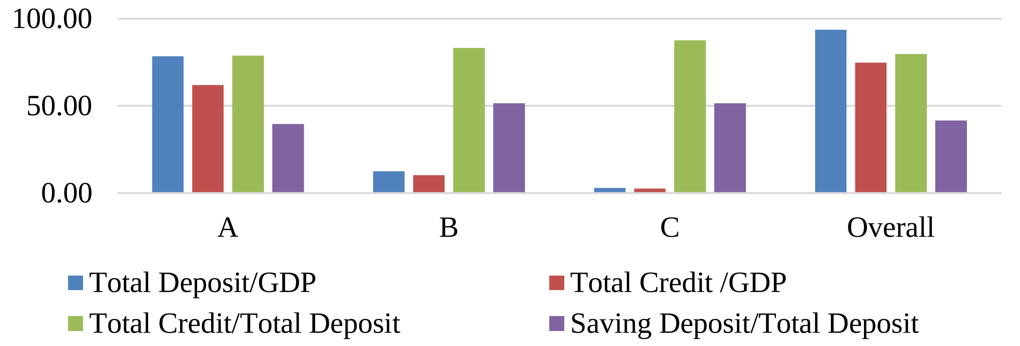


Figure 2.21: Credit, Deposit with GDP ratio and saving deposit ratio of BFIs



Profitability

The overall profitability of banking sector increased significantly by 32.29 percent and reached to Rs. 49 billion in mid-July 2016 from 37.04 billion in mid-July 2015. The commercial banks posted a higher share of profitability of the banking sector accounting 77.82 percent of the total in mid-July 2016. Credit growth of 23.54 percent mainly lead to increment in interest income significantly thereby contributing to more profitability in the review period.

Figure 2.22: Class wise Profitability of BFIs (in percent)

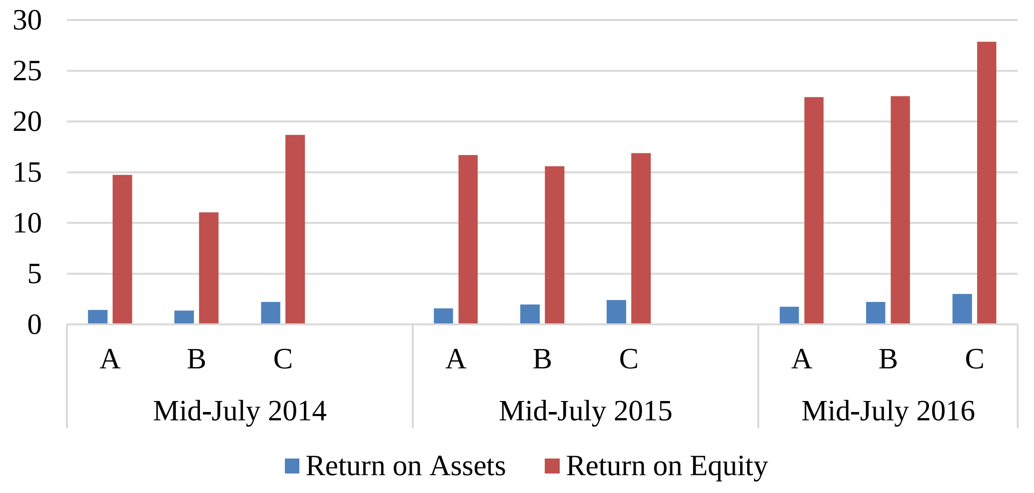
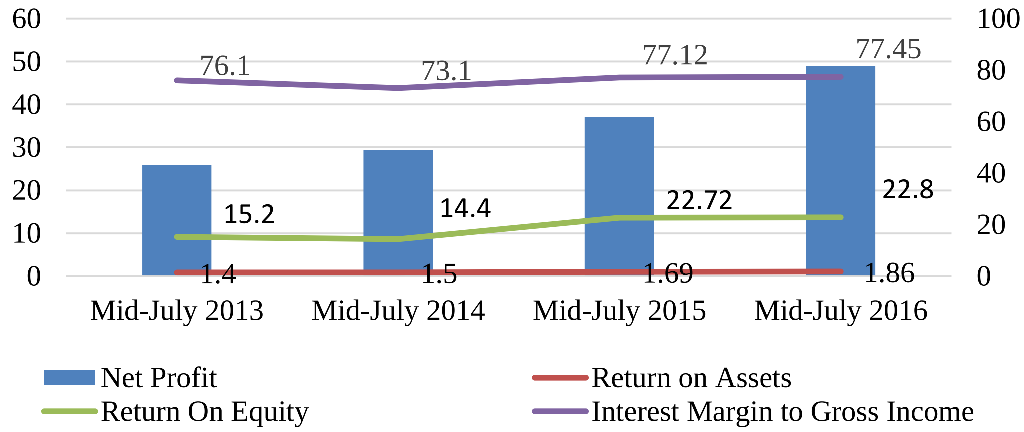


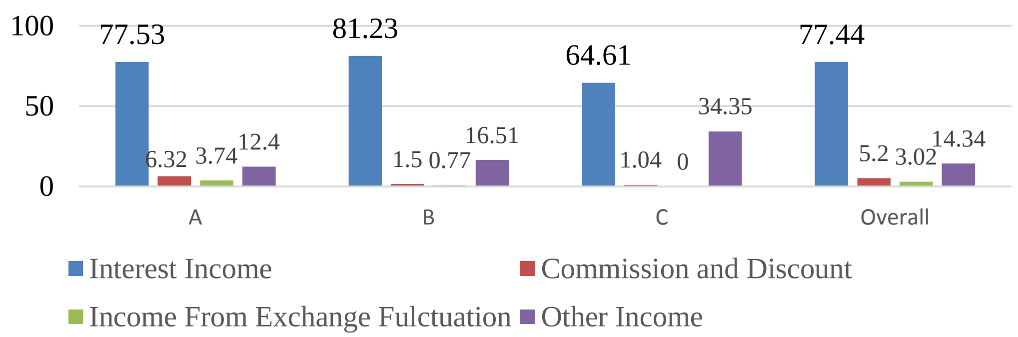
Figure 2.23: Net Profit (in billion), ROE, ROA and Interest Margin to Gross Income (In percent)



The interest margin to gross income stood at 77.45 percent in mid-July 2016 which was 77.12 percentages in mid-July 2015. The net profit of BFIs grew by 32.29 percent in mid-July 2016 from the growth of 26 percent in mid-July 2015. ROA increased to 1.86 percent from 1.69 percentage. Similarly, ROE also increased slightly to 22.80 percent from 22.72 percent in mid-July 2015.

Interest income has the biggest share in total income of BFIs which accounted for 77.45 percent in mid-July 2016, on which; interest income on loan and advance consists of 94.74 of total interest income, where as 1.85 percent of the total income is from investment on bonds and debentures. Commission based income contributed only 5.2 percent of total income which shows that banking sector has been concentrating in traditional activities of lending and deposit mobilization only. The gain from exchange fluctuation is 3.02 percent of total income of BFIs in mid-July 2016.

Figure 2.24: Income distribution of BFIs



Liquidity

Excessive liquidity has been the issue in financial sector since three years and more mainly due to increasing remittance inflows in the country and low credit growth against expectation due to lack of investment friendly environment. The prolonging political transition is mainly attributed to low credit growth which also contributed to excessive liquidity in the financial system. NRB is taking credit to deposit (C-D ratio), liquid assets to total deposits and liquid assets to total assets as a gross measure to calculate the liquidity condition in the banking system.

Total liquid asset to deposit ratio of BFIs stood at 27.6 percent in mid-July 2016 compared to 27.64 percent in mid-July 2015. The total liquid asset to deposit ratios for "A", "B" and "C" class institutions are recorded at 26.17, 32.75 and 44.80 in mid-July 2016. Such ratios were 26.45 percent, 31.34 percent and 41.52 percent respectively in mid-July 2015. Hence, the ratios for all BFIs stood above the regulatory requirements which has been increasing the cost of fund for BFIs, which is also creating some stress in liquidity management function to the central banks.

As at mid-July 2016, the credit to deposit ratio of BFIs stood at 79.80 percent. The credit to deposit ratios for "A", "B" and "C" class institutions stood at 78.91 percent, 83.62 percent and 87.72 percent respectively. Such ratios were 75.4 percent, 81.6 percent and 90 percent respectively in mid-July 2015. Despite the liquidity pressure being moderated at present, liquidity risk is likely to hit banks at any time, the ratios indicate finance companies are operating on very high risk, as they are operating under growing competition, poor asset/liability management practices, poor corporate governance and high dependence on corporate deposits. Likewise, large inflows of remittances as well as excessive surplus of government deposit with NRB since mid-July 2012 has been posing more pressure to liquidity management.

Figure 2.25: Liquidity in BFIs (in percent)

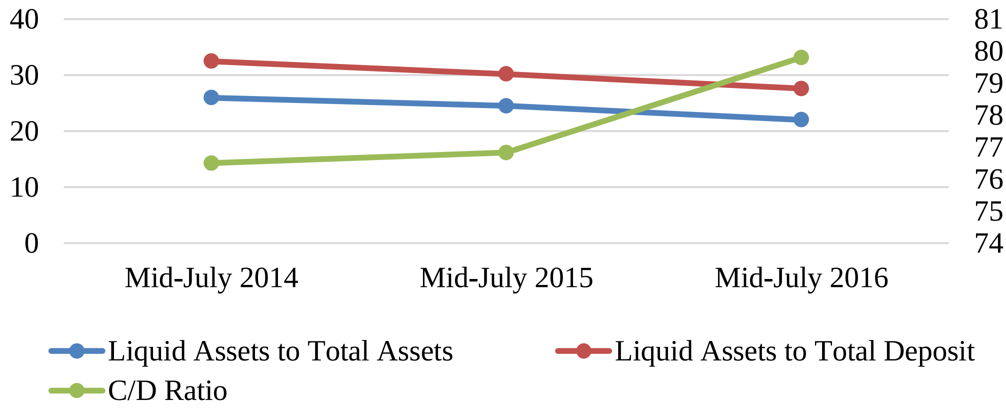


Table 2.3: Financial Soundness Indicators of BFIs (in percent)

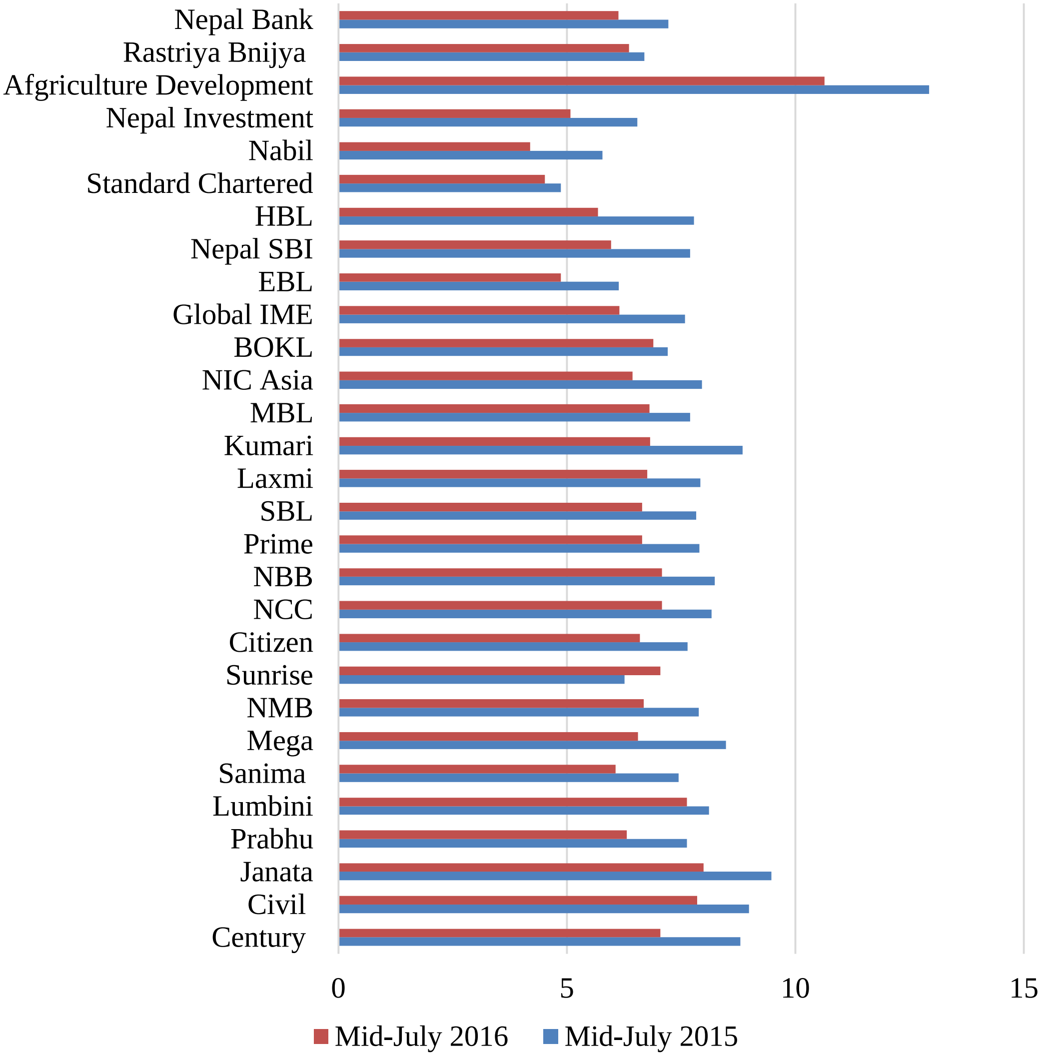
Indicators	Class "A"		Class "B"		Class "C"		Overall	
	mid-July 2015	Mid-July 2016	mid-July 2015	mid-July 2016	mid-July 2015	mid-July 2016	mid-July 2015	mid-July 2016
Credit and deposit related indicators								
Total deposit/GDP	68.8	78.47	11.1	12.39	3.3	2.86	83.4	93.72
Total credit/GDP	51.9	61.39	9.1	10.36	3.0	2.51	64.0	74.79
Total credit/ Total deposit	75.4	78.91	81.6	83.62	89.6	87.72	76.8	79.80
LCY credit/LCY deposit and core Capital	72.0	75.97	70.8	74.56	73.2	71.05	71.8	75.59
Fixed deposit/Total deposit	28.7	29.72	26.2	24.49	43.3	38.80	28.9	29.31
Saving deposit/Total deposit	38.2	39.60	50.9	51.56	47.6	51.43	40.3	41.54
Current deposit/Total deposit	10.5	10.10	2.1	2.42	0.1	0.2	8.9	8.78
Assets quality related indicators								
NPL/ Total loan	2.6	1.82	3.5	1.48	14.5	14.42	3.3	2.19
Total LLP/Total loan	3.2	2.51	3.1	2.12	14.7	15.54	3.7	2.89
Res. Per. H. Loan (Up to Rs. 10 mil.)/Total Loan	7.9	7.85	11.6	11.5	13.1	11.94	8.7	8.49
Real estate exposure/Total loan	5.8	6	6.8	7.41	13.4	12.76	6.2	6.43
Deprived sector loan/Total loan	5.1	5.52	5.9	6.77	3.7	4.57	5.1	5.65
Liquidity related indicators								
Cash and bank balance/Total deposit	15.7	14.39	16.9	16.94	22.9	28.48	16.1	15.15
Investment in Gov. security/Total deposit	12.0	10.61	1.4	1.97	3.5	5.16	10.2	9.30
Liquid assets/Total assets	14.11	12.56	26.54	24.45	23.04	24.63	16.19	14.62
Total liquid assets/Total deposit	26.45	26.17	31.34	32.75	41.52	44.80	27.64	27.6
Capital adequacy related indicators								

Indicators	Class "A"		Class "B"		Class "C"		Overall	
	mid-July 2015	Mid-July 2016	mid-July 2015	mid-July 2016	mid-July 2015	mid-July 2016	mid-July 2015	mid-July 2016
Core capital/RWA (percent)	10.2	10.62	15.2	14.41	20.6	21.28	11.3	11.52
Total capital/RWA (percent)	11.9	12.12	16.1	15.31	21.5	22.22	12.9	12.91
Wt. Avg. interest rate on deposit	3.9	3.28						
Wt. Avg. interest rate on credit	9.5	8.86						

Base Rate of BFIs

The base rate system is aimed at enhancing transparency in lending rate of BFIs and to strengthen monetary transmission mechanism. NRB has introduced a base rate monitoring system of BFIs from 2013 to “A” class commercial banks and from 2014 to “B” and “C” FIs so as to promote transparency in setting interest rate for different products to the clients and ensure sustainability of BFIs as they have been advised not to lend below the base rate. After the introduction of base rate, appropriate pricing of lending products has been the key objectives of BFIs. BFIs are required to publish their base rate on the monthly basis on their website and quarterly basis on national daily newspaper for public consumption. The introduction of base rate will promote transparency in setting the interest rate for different products; the interest of clients will be protected and healthy competition in the economy will be encouraged. The BFIs will be able to set their floating interest rate easily as they will use the cost of funds as a reference rate.

Figure 2.26: Base Rates of Commercial Banks



The base rates of majority of commercial banks are in declining trend in mid-July 2016 from that of mid-July 2015. Agriculture Development Bank Limited has posted a maximum base rate in mid-July 2016 with 10.64 percent followed by Janata Bank 7.99 percent whereas Nabil Bank registered a minimum base rate was 4.2 percent. Among state owned banks, NBL, RBB and ADBL have set base rate of 6.13 percent, 6.36 percent and 10.64 percent respectively in mid-July 2016. Their base rates were 7.22 percent, 6.7 percent and 12.93 percent respectively in mid-July 2015.

Interest Rate Spread

Interest rate spread is one of the major indicators reflecting the cost of financial intermediation. The spread, at any given time, is generally function of many factors, such as, expenses on deposits, the general level of competition in the banking sector, the amount of credit risk, the managerial efficiency of the concerned banks, and so forth. High spread is usually interpreted as an indicator of low efficiency and lack of competitiveness, which adversely affects domestic real savings and investment, leading to significant amelioration of growth. Due to high interest spread rate in the banking system, NRB has started monitoring the spread rate a few years ago. Highly risky investment sectors, near-to-two digit inflation rate, high operating costs, heavy reliance on interest income for survival, inefficiency of BFIs, diseconomies of scale due to small market size, poor access to finance weakening the negotiating power of borrowers etc. are some of the reasons for high interest rate spread among others.

With the objective to control randomness in fixing interest spread, NRB has directed BFIs to bring their interest spread rate at 5.0 percent and monitoring of interest spread was begun since mid-July 2014. BFIs are also directed to publish their spread in a monthly basis. As evident from the figure 2.29, the overall interest spread of the commercial banks stood at 3.67 percent whereas the interest spread of the state owned banks remained at 5.37 percent as of mid-July 2016. Agriculture Development Bank has registered the highest interest rate spread of 6.83 percent among commercial banks followed by Nepal Bank Ltd 6.46 percent. Bank of Kathmandu Lumbini bank has the lowest interest rate spread of 2.22 percent in the same period. Among the state owned banks RBB only has below the regulatory requirement, whereas ADBL and NBL has the spread of more than 5 percent in mid- July 2016 .

Figure 2.27: Net interest spread of CBs in percentage point

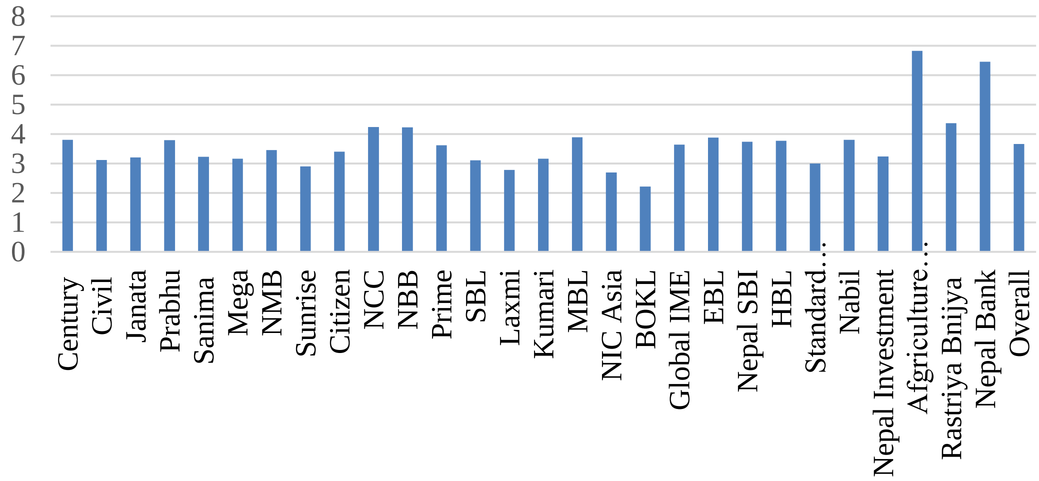
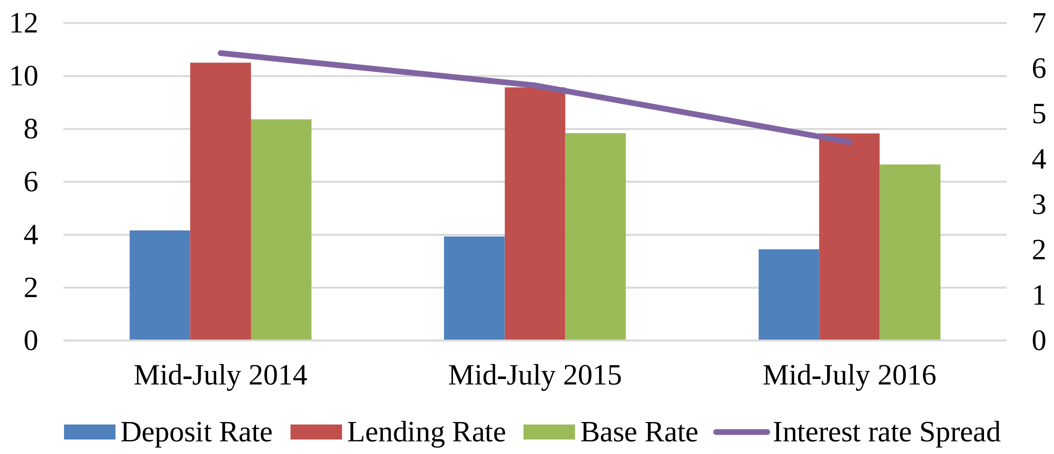


Figure 2.28: Deposit Rate, Lending Rate, Spread Rate & Base Rate of Commercial Banks



Banking Sector Consolidation: Merger & Acquisition

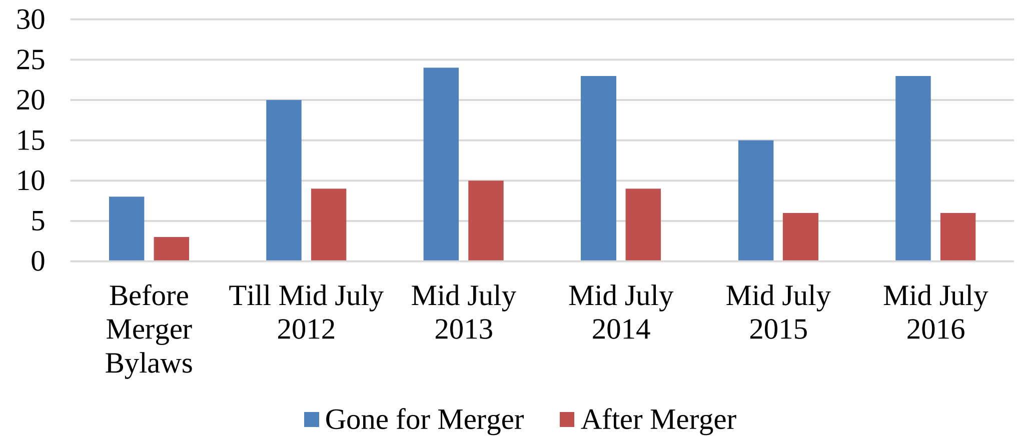
Consolidation is taken as one of the tools to enhance the capital base, achieve operational efficiency and strengthen the resilience of BFIs. Merger and acquisitions are considered one of the effective measure of financial consolidation. Increasing capital and asset bases through consolidation would enable BFIs to mobilize lower cost, long term funds and build greater resilience to shocks. The synergies that could be generated through consolidation would help make available a wider array of products to customers. Diversifying the products offered and in turn, the customer base would help diversify risks, thereby helping them to become more resilient. Having a smaller number of larger and stronger BFIs would create an industry that is fully compliant with the Central Bank's supervisory and regulatory norms.

NRB has taken consolidation in the financial sector as an important reform measure for building strong and competitive financial environment. In Nepal, financial sector consolidation is facilitated by the merger & acquisition. To strengthen the health and competency of BFIs, NRB has given high priority to merger between licensed financial institutions. It includes specific process of merger with several incentives, regulatory relaxations and indirect provision of forceful merger. NRB, through consolidation among BFIs, has expected to yield the benefits of becoming larger institutions, enhancing their capacity for providing modern financial products, enhance strong corporate governance culture, strengthen capital base and ability to introduce new products and use enhanced IT platforms, provides economies of scale and scope, lower the cost of funds and builds resilience to domestic and external shocks.

Merger and Acquisition

The number of BFIs opting for merger has been increasing after the introduction of merger policy. Till now 113 BFIs have merged to form 41 BFIs. In the review period, 23 BFIs have merged and acquired to form 6 BFIs. Last year 15 BFIs were merged to 6 BFIs. Likewise, during the review period, as per the provision of Acquisition Bylaw, 2070, one finance company Narayani National Finance Ltd were acquired by Sunrise Bank Ltd.

Figure 2.29: Status of BFIs Merger



Financial Access and Inclusion

Financial inclusiveness is understood as providing and ensuring reliable and affordable financial services to all segment of society. Although access to finance is necessary for all members of society, it is particularity more important for disadvantaged and low income segments of society, as it provides opportunities for them to save and invest, and protect themselves from various risks such as natural disasters, illness and loss of livelihoods. Access to finance will enable the poor and low income people to make self-reliant and give chances to break the vicious cycle of poverty. NRB in coordination with other donor partner's DFID, UNDP, UNCDF and FinMark conducted demand side study of financial inclusion for Nepal. The study reveals that about 40 percent of adult population is banked and 61 percent of adult population is served with formal financial institutions including cooperatives and 21 percent adult population is served throughout informal sectors and still 18 percent population is out of financial services. 82 percent of the adults agree that money lenders are an important part of their community for borrowing funds. 28 percent of adult population said that they are aware of insurance, while only 11 percent claim to have a form of insurance.

Financial Inclusion and Efforts of NRB

Recognizing the need for inclusive growth policy for Nepal, NRB in coordination with the government of Nepal, has taken numbers of policy measures to ensure reliable and affordable financial services to the poor people in the country. Liberal licensing policy for establishing micro finance institutions in unbanked 10 districts of Nepal, gradual increment in deprived sector lending requirement for licensed Banks and Financial Institutions (BFIs), mandatory requirements for them to invest certain percentage of their total credit in the productive sector, liberal branch open policy in VDC and Municipality except their center, special refinance facility to cottage and small industries, interest free loan to extend. Bank branches in remote and rural areas, establishment of Rural Self Reliance Fund for subsidized credit to the poor and marginalized population, directives on consumer protection, simplified provision to extend financial services through branchless banking and mobile banking services, and policy regarding financial literacy are some of the policy measures directed towards ensuring financial inclusion and inclusive growth in the country. For the expansion of economic activity, financial access plays a vital role. In this connection Government of Nepal has announced a policy to motivate for opening a bank account for each household.

NRB has put forward the overarching goal to increase access to financial services in the country. In order to achieve this goal NRB has pursued various policies and programs: (I) polices and regulatory environment that allows BFIs to offer financial services to the remote areas where there is lack of financial access, (ii) develop financial infrastructure that have capacity to provide high quality financial services (iii) innovative models of financial service provision that are used effectively to extend outreach to underserved regions and groups and (iv) increased capacity of clients to understand and utilize financial services effectively.

In addition to these, NRB has been also taking initiatives on financial literacy programs and financial consumer protection which is expected to enhance the banking habits of the people of unbanked areas.

Table 2.4: Branches of BFIs

Financial Institutions	Number of Branches		Share (in percent)	
	Mid-July 2015	Mid-July 2016	Mid-July 2015	Mid-July 2016
Commercial Banks	1672	1869	43.5	43.73
Development Banks	808	852	21.0	19.93
Finance Companies	242	175	6.3	4.09
Micro Finance Financial Institutions	1116	1378	29.1	32.24
Total	**3838**	**4274**	**100**	**100**

Financial access has been increasing with the expansion of network of financial institutions. As of mid-July 2016, the branch network of commercial banks reached 1869 followed by development banks (852), Finance companies (175) and Micro Finance Financial Institutions (1378). The number of branches of the respective categories of BFIs accounted to 1672, 808, 242 and 1116 respectively as of mid-July 2015. Due to the merger policy adopted by NRB, the number of branches of Finance Company (C Category) reduced by 67 to 175. However, the total number of bank branches of BFIs increased by 436 (11.36 percent) and reached to 4274 in mid-July 2016 from that of 3838 in mid-July 2015.

In mid-July 2016, on an average, a BFI branch has been serving approximately to 9,684 people; excluding the branches of “D” class financial institutions. The banking service served population comes down to 6562 people per branch when branches of "D" class also included.

Figure 2.30: Branches of BFIs

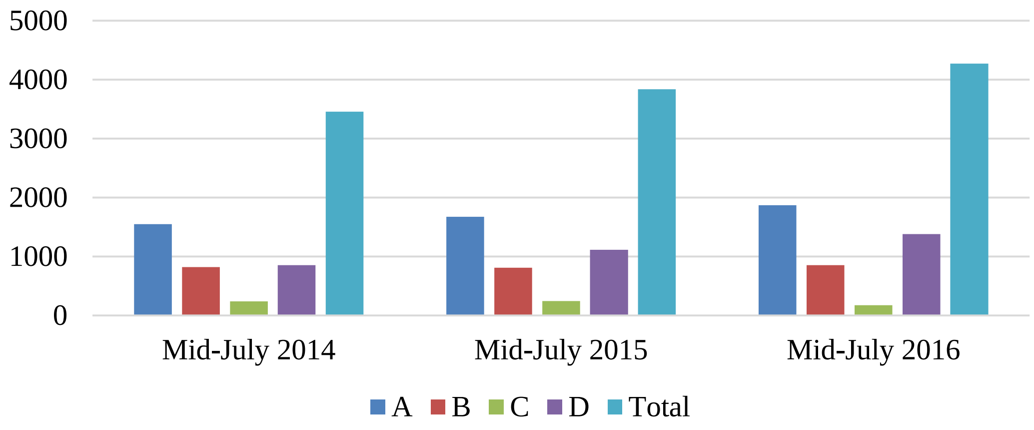
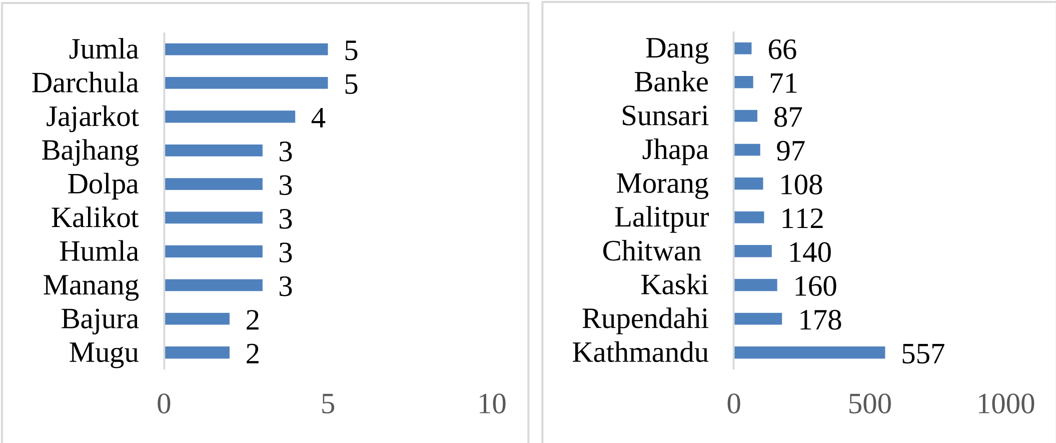


Table 2.5: Regional Allocation of BFI Branches

Region	BFIs			Total	Share (in percent)	Population (per branch)
	A	B	C			
Eastern	347	104	25	**476**	16.44	12730
Central	888	324	105	**1317**	45.48	7871
Western	350	311	35	**696**	24.03	7350
Mid-western	173	83	9	**265**	9.15	14281
Far-western	111	30	1	**142**	4.90	19150
Total	**1869**	**852**	**175**	**2896**	**100.00**	**9931**

Increase in number of branches indicates the increase in financial outreach or financial access, which is also considered as one of the indicators of financial inclusion. Banking industry occupies a bigger chunk in the financial system; despite the growth in number of BFIs and their branches; financial service providers are still mainly concentrated in urban or semi- urban areas where geographical access is relatively easy. Looking upon the region wise distribution, the majority branches of BFIs are situated in the central development region totaling of 1317 (45.48 percent), followed by western development region 696 (24.03 percent) and eastern development region 476 (16.44 percent). Kathmandu is highly concentrated district in terms of number of BFIs presence, followed by Rupendehi and Kaski. Despite continuous efforts from the NRB in increasing the outreach of financial services in remote areas, the result is still not satisfactory in terms of branch expansion in Far western region. Bajura and Mugu have still 2 bank branches only. Manang, Humla, Kalikot, Dolpa and Bajhang have only 3 branches, similarly Jajarkot has only 4 branches and Jumla, Okhalghunga and Darchula have only 5 branches.

Figure 2.31: Lowest and Highest Concentration of BFIs (no. of Branches)



Investments in information technology (IT) based systems is vital to improve banking efficiency and service delivery in this competitive age. The resulting greater efficiency and outreach will help promote financial inclusion, reduce intermediation costs thereby improving the bottom line of the financial services. The growth observed in total numbers of ATM terminals, number of debit cards, credit cards depicted in table 2.7 shows that banking is getting more automated.

Table 2.6: Use of Financial Services

Services	Class "A"	Class "B"	Class "C"	Total
No. of ATM, Outlet	1661	230	17	1908
No. of Debit Cards	4142390	479318	35417	4657125
No. of Credit Cards	52014	0	0	52014
No. of Deposits Accounts	13010175	3302162	523680	16836017

Branchless banking has been developed to address the payment needs of people who do not have access to the financial system. Branchless banking is cheaper means of banking system which can be operated in the remote districts whilst mobile phone based payment systems have been introduced to enhance convenience in making payments at merchandise outlets using technologies and other banking transactions. In mid-July 2016, such branchless banking center accounted to 812. BFIs are encouraged to serve through branchless banking in remote areas where the branch operation is not viable due to high cost of financial intermediation.

After the implementation of full-fledged dematerialized trading system in January 2016, the number of dematerialized (Demat) account has been increased significantly. This reflects the scenario of securities market marching towards the era of automation. The following table shows the situation of demat account in last three years.

Table 2.7: No. of Demat Accounts

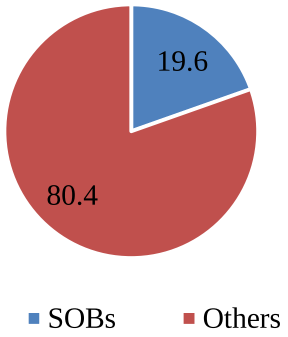
Service	Fiscal Year			Percent Change	
	2013/14	2014/15	2015/16	2014/15	2015/16
No. of Demat Accounts	534	40934	392359	7565.54	858.52

Performance and Reform of State Owned Banks

Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBB) and Agriculture Development Bank Limited (ADBL) are the three state owned commercial banks, which occupied 19.05 percent share in GDP in terms of total assets & liabilities. The share of total assets & liabilities of BFIs to GDP reached to 117.39 percent in mid-July 2016 shows the increment in financial deepening. The total assets of state owned banks (SOBs) reached to Rs. 428 billion in mid-July 2016 from Rs.360

billion in mid-July 2015. The total share of SOBs on total assets of commercial bank is 19.60 percent in mid-July 2016.

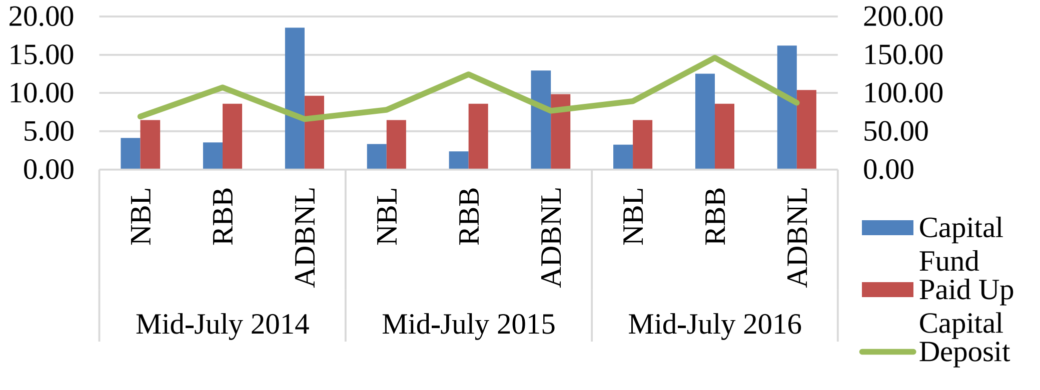
Figure 2.32: Share of SOBs in Total Assets of CBs



The state owned commercial banks have 18.3 percent share in total deposit of commercial banks. Their market share in terms of total assets of all BFIs stood at 16.22 percent, whereas in total deposit and loan & advances, the ratio reached to 15.32 and 13.92 percent respectively in mid-July 2016. Among these banks, financial and regulatory position of ADBL, especially in terms of capital base and capital adequacy remains in satisfactory level. The asset quality of NBL and RBB has been gradually improving in the review period.

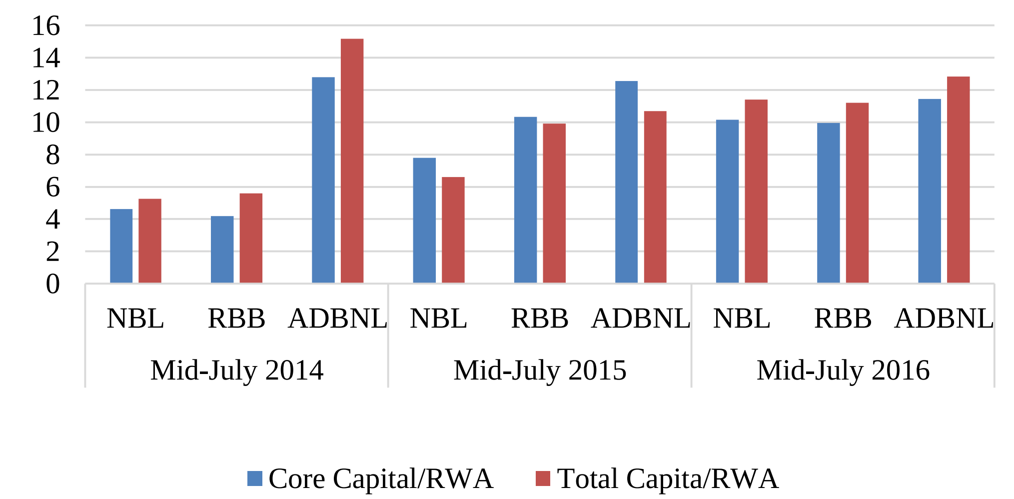
As of mid-July 2016, capital fund of all three state owned banks are Rs. 7.51 billion, Rs. 9.78 billion and Rs. 20.85 billion respectively for NBL, RBB and ADBL. The figure was Rs. 4.45 billion, 7.76 billion and 17.28 billion respectively for NBL, RBB and ADBL in mid-July 2015, showing a slight improvement in the capital base of SOBs. This calls for a regulators efforts and actions for the SOBs to improve the resilience.

Figure 2.33: Paid-up Capital, Capital Fund & Deposits of SOB (in billion Rs.)



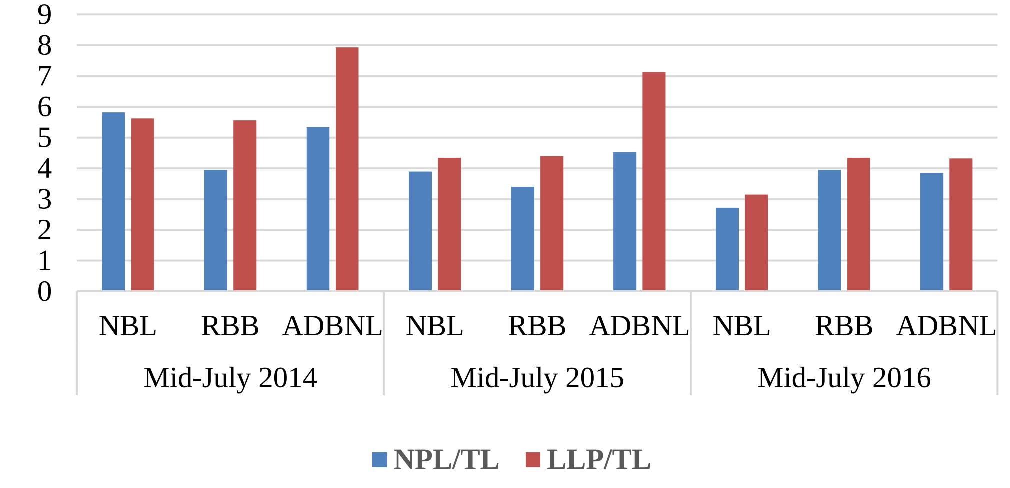
The core capital and total capital to risk weighted assets of ADBNL stood at 11.44 percent and 12.84 percent in mid-July 2016. Such capital was 10.7 percent and 12.5 percent respectively in mid-July 2015. Likewise, reform of two SOBs lead the improvement in core capital and total capital. RBB met the minimum capital requirement by maintaining core capital 9.96 percent and total capital 11.21 percent. NBL's capital adequacy met the minimum capital requirements by maintaining core capital of 10.15 and total capital of 11.45 percent in mid-July 2016, Improvement in capital adequacy ratio of SOB indicates improved resilience.

Figure 2.34: Capital Adequacy in SOBs (in percent)



The NPL ratio of state owned banks is being improved from 4.05 percent in mid-July 2015 to 3.58 percent in mid-July 2016. As on mid- July 2016 the NPL ratio of ADBNL, RBB and NBL stands on 3.85 percent, 3.95 percent and 2.72 percent respectively implying a gradual improvement in the assets quality towards international standard. Such ratios were 4.5 percent, 3.4 percent and 3.9 percent in mid-July 2015. The NPL ratio of ADBNL & NBL has also come down to the regulatory limit in the review period. With the better performance of SOB's in managing the loan portfolio, the overall NPL ratio of banking industry has come down to 1.82 percent from 2.6 percent last year.

Figure 2.35: NPL and LLP Ratios of SOBs



Since, state owned banks hold a major portion of share in total banking sector, the ups and downs in performance of these banks can alter the financial soundness indicators of the whole banking system. Therefore, timely reform of these BFIs is imperative to improve the performance indicators of financial sector and maintaining the financial stability.

CHAPTER – THREE

PERFORMACE OF FINANCIAL INSTITUTIONS

Performance of Commercial Banks

In the Nepalese financial system, BFIs have prominent share of assets and in which commercial banks have the dominant share in total assets. As in mid-July 2016, share of commercial banks in total assets and liabilities of NRB regulated BFIs decreased to 79.74 percent from 78.73 in mid-July 2015. Similarly, share of total assets and liabilities of commercial banks on total GDP increased to 97.15 percent from 68.85 percent in mid-July 2015. The dominance of commercial banks in total banking sector in terms of assets and liabilities as well as in terms of balance sheet component has been broadly remained stable. The total assets and liabilities of commercial banks increased by 23.12 percent to Rs.2184.81 in mid-July 2016 from Rs. 1774.50 billion in mid-July 2015.

Deposits and Credits

Total deposit and credit of commercial banks stood at 78.46 and 61.39 of GDP in mid-July 2016 which was 68.8 and 51.9 percent of GDP in mid-July 2015 respectively. Total deposits grew by 20.62 percent to Rs.1764.59 billion during the period of mid-July 2016, against the previous growth of 21.4 percent during mid-July 2015. Total credit flows grew by 26.9 percent and reached to Rs.1380.36 in mid-July 2016.

After loan and advances, investment in government securities has emerged as a second best option for the commercial banks to utilize the excess liquidity. Investment in government securities increased by 6.28 percent to Rs.187.27 billion in mid-July 2016. In the context where major balance sheet indicators such as capital, deposits, lending, investments, liquid funds, borrowings etc. have all shown a positive growth in mid-July 2016 as compared to that of mid-July 2015.

Capital

The capital fund of commercial banks rose by 39.27 percent to Rs.170.1 billion in mid-July 2016 from Rs.122.17 billion in mid-July 2015. Of which, paid up capital rose by 23.66 percent, whereas statutory reserves and other reserves rose and decline by 17.82 percent and -7.49 percent respectively during mid-July 2016. However, retained earnings remained in negative.

Assets

The aggregate NPL to total loan ratio of commercial banks decreased to 1.82 percent on mid-July 2016 in comparison to the ratio of 2.22 percent in mid-July 2015. The three states owned banks in total have NPL ratio of 3.58 percent where as that of private commercial banks is only 1.47 percent in mid-July 2016. As in mid-July 2015, average NPL ratio of three state owned commercial banks was 3.88 percent, whereas such ratio for private commercial banks was 2.14 percent. Credit quality of commercial banks has slightly improved and NPL ratio is below the regulatory standard of 5.0 percent, which does not warrant financial stability risk while measuring in terms of assets quality.

Figure 3.1: Capital Adequacy of Commercial Banks (in percentage)

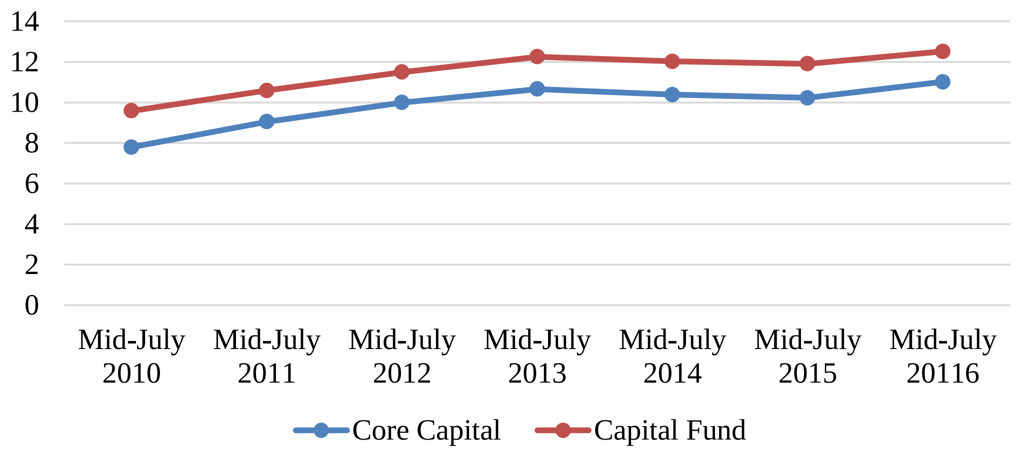


Table 3.1: Major Financial Indicators of Commercial Banks (in percentage)

Indicators	Commercial Banks
Tier 1 & Tier 2 Capital /RWE	12.12
Tier 1 Capital/RWE	10.62
NPL/Total Loan	1.82
Return on Equity	22.44
Net Interest Spread	3.67
Total Credit to Total Deposit	78.91
Total Liquid Assets/Total Deposit	26.17
Base Rate	6.66

Despite the directive of NRB to BFIs to invest at least 12.0 percent of total loan in agriculture and electricity sector, only 9.95 percent of total loans of commercial banks had been disbursed in agriculture sector and 3.05 percent in electricity, gas and water. Manufacturing (production) related sector availed 7.07 percent of total loan and retailer and wholesaler sector utilized 23.83 percent of total loan. Likewise, out of total loan 7.08 percent was disbursed to consumption sector and 6.0 percent was disbursed to real estate sector.

Comparing the product-wise loan with the previous year, commercial banks were less motivated to invest in real estate lending as such lending has declined to 6 percent in mid-July 2016. Investment in business purpose loans such as term loan, overdraft loan, demand and other working capital loan were 16.3 percent, 17.3 percent and 24 percent respectively in mid-July 2016, which were 16.4 percent, 18.1 percent and 21.6 percent in mid-July 2015. There was remarkable growth in residential and hire purchase loan, which shows that banking sector; especially the CBs have still attracted in such loans (retail lending) for their short term profitability and performance. Similarly, commercial banks have made 4.7 percent of total loan in deprived sector in the review period. Loan against properties have shown increasing trend in the review period. Out of total loan, 86.65 percent are backed by collateral of properties in mid-July 2016 which was 81.67 percent in mid-July 2015.

Profitability

Net Profit of the commercial banks posted a growth of 34.18 percent to Rs. 38.11 billion in mid-July 2016 compared to the growth of 33.3 percent as of mid-July 2015. All commercial bank registered a positive profit during the review period. Total assets of the banks rose by 23.1 percent in mid-July 2016 compared to the growth of 20.0 percent during mid-July 2015. Contribution of interest income was 77.49 percent of the total income in the review period, such contribution slightly increased from 76.2 percent of total income as of mid-July 2015.

Stress Testing of Commercial Banks

Credit Shock

Stress test results show that there is growing risk in credit among commercial banks. Stress testing results based on data of mid-July 2016 obtained from 28 commercial bank revealed that a combined credit shock of 15 percent of performing loans degraded to substandard, 15 percent of substandard loans deteriorated to doubtful loans, 25 percent of doubtful loans degraded to loss loans and 5 percent of performing loans deteriorated to loss loans categories which would push the capital adequacy ratio of 27 commercial banks below the minimum regulatory requirements of 10 percent. The numbers of such banks were 28 in mid-July 2015.

Stress testing results under the scenario of all non-performing loans under substandard category downgraded to doubtful and all non-performing loans under doubtful category downgraded to loss underscores a pessimistic scenario as the number of banks capable of withstanding such shock without deteriorating capital adequacy to below 10 percent came to none, down from previous reading of two in mid-July 2015. Similarly, stress testing results under the scenario of 25.0 percent of performing loans of real estate and housing sector directly downgraded to substandard showed same result: deteriorating capital adequacy of none banks to below minimum requirement of 10 percent. However, another scenario of 25.0 percent of performing loans of real estate and housing sector directly downgraded to loss loans showed some respite. Under this scenario, capital adequacy ratio of 6 commercial banks will come below the required level of 10 percent, which was 7 as on mid-July 2015. The result showed that majority of commercial banks maintained their resilience towards realty sector during the fiscal year.

In an another credit shock test, under the scenario of top two large exposures (loans) were downgraded from performing to substandard category, the capital adequacy ratio of 1 commercial banks would fall below the required level whereas the number of such commercial banks was 5 in mid-July 2015. Decrease in number of such banks shows they are strengthening their position by decreasing dependency on such exposures.

The overall credit shock scenario revealed that banks' credit quality has been improving as per the expectation due to various measures taken during the review period. However, banks are likely to face a difficult situation in case of slowdown in recovery, downgrade of loans to loss category of NPLs and increase in provisioning if the current situation moves to negative side.

Liquidity Shock

Results from stress tests under liquidity shock show encouraging improvements in liquidity resilience among commercial banks. The stress test under scenario of withdrawal of customer deposits by 2, 5, 10, 10 and 10 percent for five consecutive days' results showed that 22 of 28 commercial banks are vulnerable towards liquidity crisis.

Nine banks were prone to liquidity shock of withdrawal of 5 percent of deposits in a single day, while 17 banks' liquidity ratio would drop below 20 percent after withdrawal of 10 percent deposit in a single day. The number of banks seeing their liquidity ratio drop below 20 percent would grew to 24 if the single day deposit withdrawal increased to 15 percent. The numbers of banks prone to liquidity shock under single day deposit withdrawal of 5, 10 or 15 percent were 3, 12 and 22 respectively on mid-July 2015.

With the shock of withdrawal of deposits by top 2, 3 or 5 institutional depositors, liquid assets to deposit ratio of 17, 22 and 22 commercial banks would be below 20.0 percent in mid-July 2016. The numbers were 9, 19 and 22 in mid-July 2015. However, only one commercial bank was vulnerable among all commercial banks in case of deposit withdrawals from top 2, 3 or 5 individual depositors. This situation was same in mid-July 2015.

Market and Combined Credit and Market Shock

The stress testing result under market shock revealed that 28 commercial banks have maintained enough CAR to absorb the interest rate shock and maintain it above the regulatory requirement. The interest rates were calibrated by changes in deposit and credit interest rates from 1.0 to 2.0 percent.

Similarly, commercial banks found to be safe from exchange rate risks as the net open position to foreign currency was lower for 28 of them. Furthermore, since commercial banks have nominal equity investments, the impact of fluctuation in equity price is near to Zero.

When going through market shock, 28 commercial banks could maintain their capital adequacy ratio above the regulatory requirement of 10.0 percent.

The banks did not bear interest rate risks as they pass it directly to their clients; so, they are found to be less affected by interest rate shock as well.

The combined credit and market shocks based on a scenario of 25.0 percent of performing loan of real estate and housing sector directly downgraded to substandard category of NPLs and fall of the equity prices by 50.0 percent showed that CAR of none banks would fall below 10 percent. However, under a more adverse scenario of 15.0 percent of performing loans deteriorated to substandard, 15.0 percent of substandard loans deteriorated to doubtful loans, 25.0 percent of doubtful loans deteriorated to loss loans and the equity prices fall by 50.0 percent, the CAR of just 7 banks would remain above the regulatory minimum level.

The resilience of commercial banking system of Nepal towards key stress testing scenario analysis showed a sound and strong financial system through all three kinds of credit, liquidity and market shocks. However, the test showed high chances of vulnerability in public sector banks and moderate chances in private sector banks.

Performance of Development Banks

Overall performances of the Development Banks in FY 2015/016 were improving in an encouraging pace. In the financial front they have been able to expand their balance sheets, register profit growth and reduce non-performing loans. On the other hand, they have seen major consolidation with the encouraging numbers of merged and acquired institutions.

Deposits and Credits

Development banks have been able to record robust growth in deposit collection as well as credit disbursement during FY 2015-16. Deposits at these banks grew by 17.52 percent to Rs.278.63 billion while credits grew by 20.43 percent to Rs.223.99 billion. The ratio of credit to domestic deposit and capital fund changed from the level in mid-July 2015 to stand at 74.41 percent in mid-July 2016. The ratio of credit to domestic deposit and capital fund was 72.35 in mid-July 2015.

Assets

Total assets of development banks (B class institutions) reached to Rs.350.84 registering growth of 16.7 percent from Rs 300.64 billion in mid-July 2015. Non-performing loans accounted for Rs. 3.45 billion in mid-July 2016 which is 1.48 percent of total loan and advances of development bank, it was Rs.6.74 billion in mid-July 2014 which was 3.6 percent of total loan and advances.

Capital

Development banks have been able to maintain sufficient capital adequacy to meet the regulatory requirement. Indeed, they have significant cushion in capital adequacy after fulfilling regulatory requirement. As of mid-July 2016, development banks have capital adequacy ratio of 15.31 percent. The ratio was 16.1 percent in mid-July 2015. Current regulatory requirement demands 11 percent capital adequacy ratio from development banks. Capital Funds of development banks saw an appreciation in value during last fiscal year by 13.80 percent to Rs.34.48 billion at mid-July 2016. The increase was mainly propelled by increase in paid-up capital due to right issuance and dividend distribution of banks. Pad-up capital of development bank at mid-July 2014 amounted for Rs.30.3 billion.

Profitability

Development banks have recorded sound profit growth during FY 2015-16. The impressive growth of 31.08 percent is amongst the highest in recent years. Profit of the development banks totaled Rs.7.76 billion in mid-July 2016, while the figure was Rs.5.92 billion in mid-July 2015. Increased profit has also improved ROE and ROA of development banks during the fiscal year. Return on Equities of development banks improved by 5 percentage points to 26.56 percent while Return on Assets were improved by 24 basis points to 2.21.

Table 3.2: Major Indicator of Development Banks (as of mid-July 2016)

Particulars	Ratios (in percent)
Core Capital to RWA	14.41
Capital Fund to RWA	15.31
Credit to Deposit (LCY) Ratio	83.62
Credit to Deposit (LCY) & Core Capital	74.56
Non-Performing Loan to Total Loan	1.48
Liquid Assets to Total Deposits	32.75
Weighted Average Interest on Credit	12.82
Weighted Average Interest on Deposit	5.13
Weighted Average Interest on Govt. Sec.	4.10

Base Rates and Spread Rates

The average base rate of national level development banks stood at 9.14 percent in mid-July 2016, whereas it was 10.9 percent in mid-July 2015. Improvement in base rates shows declining interest rates due to decrease in cost of funds and excessive liquidity. Furthermore, lower base rate is the result of operating efficiency among Development Banks. As of mid-July 2016, Out of 21 national level Development Banks, base rates of 12 Developments Banks are below average and 8 Development Banks base rates are higher than the average rate. Government-owned NIDC Development Bank has the highest base rate of 13.86 percent followed by Triveni Bikas Bank with 11.51 percent. Similarly, Ace Development Bank has the lowest base rate among national level development banks, which stood at 6.26 percent.

Average spread rate of national level developments banks decreased by 75 basis points during the FY 2015-16 to 5.86 percent. The increase is believed to be the effect of relatively slower decline in lending rates compared with deposit rates. Muktinath Bikas Bank has the highest spread of 9.08 percent.

Stress Testing of Development Banks

National level development banks have emerged as strong institutions in the recent stress testing scenarios defined by NRB. Based on the data as of mid-July 2016, it was revealed that the banks have adequate buffer capital to absorb the perceived shocks. Stress testing results of 21 national level development banks on various shocks have been observed as follows.

Credit Shock

The stress testing results of national level development banks as of mid- July 2016 revealed that a standard credit shock would push the capital adequacy ratio of as much as 6 banks out of total 20 national level development banks below the regulatory minimum benchmark if 5 percent performing loans were to deteriorate as loss loans. Similarly, two banks would not comply the requirement if 25 Percent of performing loan of Real Estate & Housing sector loan downgraded to substandard category of NPLs.

Liquidity Shock

The stress test results found that seven banks would see their capital adequacy dip below minimum level if withdrawal of deposit by 2, 5, 10, 10 and 10 percent for five consecutive days as per liquidity maintained on mid July 2016.

Similarly, if there is a withdrawal of deposit by 5.0 percent, 10.0 percent and 15.0 percent the number of bank's whose liquid assets to deposit ratio below the regulatory minimum of 20.0 percent stood at 1, 7 and 11 in mid-July 2015. However, the number will reach 17 if 20 percent of the deposits were withdrawn.

With the shock on withdrawal of deposits by top 2 and 5 institutional depositors, liquid assets to deposit ratio of 1 and 4 banks respectively will be below 20 percent. This shows that very few banks are reliant on institutional depositors. Furthermore, no banks would face liquidity problem if up to 5 top individual depositors opt to withdraw their deposits.

Other Shocks

The stress testing results revealed that 20 out of the 21 national level development banks' CAR was above the regulatory requirement when calibrating through interest rate, exchange rate and equity price shocks. Similarly, since development banks are not allowed to make equity investments except in their subsidiaries, the impact of fluctuation in equity price is also low. The banks do not bear interest rate risks as they pass it directly to their clients, so that they are found to be less affected by interest rate shocks as well.

The resilience of national level development bank towards key stress tests analysis showed an improved, sound and strong financial condition through all three kinds of credit, liquidity and market shocks in stress testing analysis. The overall vulnerability test in aggregate of all 21 national level development banks found less vulnerable position except the Apex Development Bank. Apart from this, Yeti Development Bank is found to have to be stressed condition if 25 percent of performing real estate loans were to be categorized as non performing loan category.

Table 3.3: Summary Result Series of Stress Testing of National Level Development Banks

As of Asar end, 2073

		Number of Banks with CAR		
Events		**< 0%**	**0% - <10%**	**>=10%**
	Pre Shock	0	1	20
		Post Shocks		
A. After Credit Shock		**< 0%**	**0% - <10%**	**>=10%**
C1	15 Percent of Performing loans deteriorated to substandard	0	2	19
	15 Percent of Substandard loans deteriorated to doubtful loans	0	1	20
	25 Percent of Doubtful loans deteriorated to loss loans	0	1	20
	5 Percent of Performing loans deteriorated to loss loans	0	6	15
C2	All NPLs under substandard category downgraded to doubtful.	0	1	20
	All NPLs under doubtful category downgraded to loss.	0	1	20
C3	25 Percent of performing loan of Real Estate & Housing sector loan directly	0	2	19
	downgraded to substandard category of NPLs.			
C4	25 Percent of performing loan of Real Estate & Hosing sector loan directly	1	1	19
	downgraded to Loss category of NPLs.			
C5	Top 5 Large exposures downgraded: Performing to Substandard	0	1	20
B. After Market Shocks		-	-	-
(a) Interest Rate Shocks		**< 0%**	**0% - <10%**	**>=10%**
IR-1a	Deposits interest rate change by 1.0 percent point on an average.	0	1	20
IR-1b	Deposits interest rate change by 1.5 percent point on an average.	0	1	20
IR-1c	Deposits interest rate change by 2.0 percent point on an average.	0	1	20
IR-2a	Loan interest rate change by -1.0 percent point on an average.	0	1	20
IR-2b	Loan interest rate change by -1.5 percent point on an average.	0	1	20
IR-2c	Loan interest rate change by -2.0 percent point on an average.	0	1	20
IR-3	Combine Shocks (IR-1a & IR-2a)	0	1	20
(b) Exchange Rate Shocks				
ER-1a	Depreciation of currency exchange rate by 20%	0	1	20
ER-1b	Appreciation of currency exchange rate by 25%	0	1	20
(c) Equity Price Shocks				
EQ-1	Fall in the equity prices by 50%	0	1	20
C. After Liquidity Shocks		-	-	-
Events				

L-1a	Number of BFIs illiquid after on 1st day while withdrawal of deposits by 2%		0	
	Number of BFIs illiquid after on 2nd day while withdrawal of deposits by 5%		0	
	Number of BFIs illiquid after on 3rd day while withdrawal of deposits by 10%		0	
	Number of BFIs illiquid after on 4th day while withdrawal of deposits by 10%		1	
	Number of BFIs illiquid after on 5th day while withdrawal of deposits by 10%		6	
Number of Banks with Liquid Assets to Deposit Ratio		**< 0%**	**0% - <20%**	**>=20%**
	Pre-shocks	0	0	18
		After Shocks		
L-2a	Withdrawal of deposits by 5%	0	1	20
L-2b	Withdrawal of deposits by 10%	0	7	14
L-2c	Withdrawal of deposits by 15%	0	11	10
L-2d	Withdrawal of deposits by 20%	0	17	4
L-3a	Withdrawal of deposits by top 1 institutional depositors.	0	0	21
L-3b	Withdrawal of deposits by top 2 institutional depositors.	0	1	20
L-3c	Withdrawal of deposits by top 3 institutional depositors.	0	1	20
L-3d	Withdrawal of deposits by top 4 institutional depositors.	0	4	17
L-3e	Withdrawal of deposits by top 5 institutional depositors.	0	4	17
L-4a	Withdrawal of deposits by top 1 individual depositors.	0	0	21
L-4b	Withdrawal of deposits by top 2 individual depositors.	0	0	21
L-4c	Withdrawal of deposits by top 3 individual depositors.	0	0	21
L-4d	Withdrawal of deposits by top 4 individual depositors.	0	0	21
L-4e	Withdrawal of deposits by top 5 individual depositors.	0	0	21

Performance of Finance companies

Share of Finance companies in the overall economic activity is smaller in comparison to A and B class FIs, as shown by small deposit to GDP ratio. Such ratio is 2.86 percent in mid-July 2016, which was 3.21 percent of GDP in mid July 2015. The total assets and liabilities of finance companies decreased in mid-July 2016 by 4.22 percent to Rs.103 billion compared to mid-July 2015. Finance companies mobilized aggregate deposit of Rs.64 billion in mid July 2016 which is a decrease of 1.11 percent compared to mid-July 2015.

Loan and advances of finance companies stood at Rs.55.8 billion accounted for 2.51 percent of total GDP. It decreased marginally in mid-July 2016 from mid July 2015. Of the total loan and advances, private sector accounted for more than 99.02 percent, followed by financial institutions, with 0.89 percent. The investment of finance companies accounted to Rs.3.4 billion in mid-July 2016 which was Rs.2.5 billion in mid-July 2015. Almost all of such investment is in government securities.

Capital fund of finance companies stood at Rs.10.2 billion in mid-July 2016 which is 22.2 percent of risk weighted exposure of the same period. In mid-July 2015 such ratio was 20.4 percent amounting to Rs.10.5 billion.

The credit to deposit and core capital ratio of finance companies registered 71 percent in mid-July 2016, which is below the prescribed limit of 80 percent. Such ratio was 73.2 percent in mid-July 2015. Total non-performing loan of finance companies was very high with 14.4 percent of total loan and advances in mid July 2016 which was 13.6 percent in mid-July 2015. Non-banking assets of finance company have increased by 56.2 percent to Rs.1.2 billion in mid July 2016 from Rs. 800 million in mid-July 2015. Loan loss provision reached to Rs.8.9 billion in mid-July 2016 from that of Rs.9.5 billion in mid-July 2015.

Finance companies, as a whole, are in profit as exemplified by positive ROA (2.85 percent) and ROE (22.58 percent), despite some of them being declared problematic and few others are under prompt corrective actions.

Total liquid assets to total deposit of finance companies stood at 44.8 percent in the review period which implies that finance companies are in comfortable position in terms of liquidity. Out of total loan and advances wholesaler and retailer sectors has highest share accounting to 23.7 percent followed by agriculture, forestry and beverage with 20 percent. Share of fishery is minimal with 0.1 percent of the total, while 11.2 percent of the loan is provided to unclassified sectors, which clearly depicts that the one-tenth of finance companies credit is availed to unproductive sectors. Likewise, demand and other working capital loan and overdraft loan has 24 and 17.2 percent share in total loan portfolio. Deprived sector loan has 4.7 percent share which is above than prescribed limit of 4 percent in aggregate. Real estate sector received 13.85 percent of loan in total portfolio. In mid-July 2015 real estate loan had 13.7 percent share in total loan and advances.

Number of finance companies has decreased to 40 in mid-July 2016 from 48 in mid-July 2015. During the review period, eight finance companies have been merged with other bank and financial institutions. One finance company is degraded from development bank to finance company in review period.

Monetary policy of 2015 has mandated finance companies to increase paid up capital to Rs.800 million by the end of July 2017. To comply with regulatory requirement, finance companies are using different strategies, primarily merger and acquisition with other financial institutions. Fierce market competition coupled with regulatory requirement has led to a situation where a significant number of finance companies opted merger and acquisition.

Stress Testing of Finance Companies

NRB has mandated all the national-level finance companies to conduct stress tests and to report it to NRB on a quarterly basis. Among 40 finance companies 34 finance companies are national level. Among national level finance companies 7 are declared problematic. Stress testing result of rest of the 27 national-level finance companies found that finance companies remained less vulnerable to individual credit shocks and liquidity shocks in aggregate. However, for 7 finance companies, Capital adequacy ratio decreased to less than 10 percent after combined credit shocks. In the same way for 13 finance companies will have liquidity ratio less than 20 percent after liquidity crisis. Position of finance companies after stress testing scenarios is shown in the following table.

Table 3.4: Summary Result of Stress Testing of Finance Companies

Criteria	**Number**
No. of Finance Companies with CAR below 10 percent before shocks	**1**
A. Credit Shock	
No. of BFIs having CAR<10 percent	
15 Percent of Performing loans deteriorated to substandard	7
15 Percent of Substandard loans deteriorated to doubtful loans	7
25 Percent of Doubtful loans deteriorated to loss loans	7
5 Percent of Performing loans deteriorated to loss loans	7
All NPLs under substandard category downgraded to doubtful.	2
All NPLs under doubtful category downgraded to loss.	
25 Percent of performing loan of Real Estate & Hosing sector loan directly downgraded to Loss category of NPLs.	8
Top 5 Large exposures downgraded: Performing to Substandard	
B. Liquidity Shock	
No. of Finance Companies having Liquidity Ratio<20 percent	
Withdrawal of deposits by 5 percent	13
Withdrawal of deposits by 10 percent	13
Withdrawal of deposits by 15 percent	13
Withdrawal of deposits by 20 percent	13
Withdrawal of deposits by top 2 institutional depositors.	13
Withdrawal of deposits by top 3 institutional depositors.	13
Withdrawal of deposits by top 5 institutional depositors.	13

Withdrawal of deposits by top 2 individual depositors.	13
Withdrawal of deposits by top 3 individual depositors.	13
Withdrawal of deposits by top 5 individual depositors.	13

Performance of Microfinance Financial Institutions

As of mid-July 2016, there were altogether 42 micro finance financial institutions (MFFIs) operating as "D" class financial institutions. They consisted of Nepal Grameen Bikas Bank Ltd., 36 private sector micro finance financial institutions (MFFIs) replicating the 'Grameen Banking Model' and 4 wholesale lending microfinance development banks. The number of branches of all MFFIs reached to 1375, creating employment for 7123 persons as of mid-July 2016. Out of these, the wholesale MFFIs are operating 11 branches with 136 employees. As compared to previous year, the total members of MFFIs increased by 22.6 percent to 18,98,797 in mid-July 2016. The total outstanding loan of MFFIs as of mid-July 2016 rose by 40.65 percent to Rs. 77.23 billion as compared to the previous year, which was Rs. 54.91 billion in the same period of previous year.

Table 3.5: Key Performance Indicators of MFFIs

S.N.	Particulars	(Rs. '000)	
		Mid-July 2015	**Mid-July 2016**
1.	No. of MFFIs	36	42
1.2	*No. of Wholesale MFFIs*	*4*	*4*
2.	No. of Branches of MFFIs	1124	1375
2.1	*No. of Branches of Wholesale MFFIs*	*11*	*11*
2.2	*No. of Branches of NGBB*	*186*	*186*
3.	Total Members of MFFIs	1548987	1898797
3.1	*Members of NGBB*	*191787*	*202837*
4.	Total Capital of MFFIs (Rs.)	6,203,559	8,673,657
4.1	*Capital of Wholesale MFFIs (Rs.)*	*2,722,691*	*3,104,813*
4.2	*Capital of NGBB (Rs.)*	*73,053*	*386,657*
5.	Total Paid-up Capital of MFFIs (Rs.)	3,987,255	5,425,449
5.1	*Paid-up Capital of Wholesale MFFIs (Rs.)*	*1,062,682*	*1,321,650*
5.2	*Paid-up Capital of NGBB (Rs.)*	*557,500*	*557,500*
6.	Total Assets of MFFIs (Rs.)	70,832,902	100,723,951
6.1	*Assets of Wholesale MFFIs (Rs.)*	*17,828,523*	*22,849,995*
6.2	*Assets of NGBB (Rs.)*	*6,957,759*	*8,581,369*
7.	Total Loan and Advances of MFFIs (Rs.)	55,327,268	77,232,892
7.1	*Loans and Advances of Wholesale MFFIs (Rs.)*	*14,731,256*	*19,134,439*

S.N.	Particulars	(Rs. '000)	
		Mid-July 2015	Mid-July 2016
7.2	*Loan and Advances of NGBB (Rs.)*	*5,222,439*	*6,411,974*
8.	Total Savings in MFFIs (Rs.)	16,057,983	24,095,303
8.1	*Savings in NGBB (Rs.)*	*1,410,210*	*1,819,314*
9.	Total Borrowings of MFFIs (Rs.)	38,497,048	52,431,413
9.1	*Borrowings of Wholesale MFFIs (Rs.)*	*13,633,584*	*17,774,241*
9.2	*Borrowings of NGBB (Rs.)*	*3,517,015*	*4,296,156*
10.	Total Overdue (Loan&Interest) of MFFIs (Rs.)	1,048,804	1,276,801
10.1	*Overdue (Loan & Interest) of Wholesale MFFIs*	*10,154*	*5,914*
10.2	*Overdue (Loan+ Interest) of NGBB (Rs.)*	*752,353*	*750,969*

As of mid-July 2016, total capital of MFFIs increased by 39.8 percent to Rs. 8.67 billion compared to the same period of the last year. Out of total capital, capital of wholesale MFFIs stood at Rs. 3.10 billion and NGBBL's capital stood at Rs. 386.66 million. The paid-up capital of MFFIs increased by 36.1 percent to Rs. 5.42 billion. The ratio of paid-up capital to total capital stood at 62.6 percent. The paid-up capital of wholesale MFFIs stood at Rs. 1.32 billion while NGBBL's paid-up capital stood at Rs.557.5 million. Based on risk-weighted asset, MFFIs are required to maintain at least 4.0 percent as core capital and 8.0 percent as the capital fund.

Total asset of MFFIs in the review period increased by 42.2 percent to Rs. 100.72 billion. In this category, the share of wholesale MFFIs stood at 22.7 percent and share of NGBBL's asset stood at 8.5 percent. Out of the total assets, loan and advances registered a growth rate of 39.6 percent to Rs. 77.23 billion. Out of the total loans and advances; the wholesale loan shared 24.8 percent while individual loans shared remaining part. NGBBL's share in this category stood at 8.3 percent. The ratio of loan and advances to the total assets stood at 76.7 percent. MFFIs have not booked any asset as non-banking assets during the review period.

Total savings mobilized by the MFFIs increased by 50.1 percent to Rs. 24.10 billion in the review period. Out of the total savings, NGBBL mobilized Rs. 1.82 billion sharing 7.6 percent. As compared to total liabilities of these institutions, the share of savings remained at 23.9 percent. Out of total savings, compulsory savings shared 36.3 percent and public deposits shared 5.9 percent. Total borrowings of these banks during the review period increased by 36.2 percent to Rs. 52.43 billion. Out of total borrowings, wholesale MFFIs borrowed 17.77 billion with a share of 33.9 percent and NGBB borrowed Rs. 4.30 billion with a share of 8.2 percent. As compared to total liabilities of MFFIs, the share of borrowed amount remained at 52.1 percent.

The total amount of overdue loan, including interest, of these institutions significantly increased by 22.0 percent to Rs.1.28 billion as compared to the same period of the last year. The overdue of wholesale MFFIs stood at Rs. 5.91 million. NGBBL's overdue loan amounted to Rs.750.97 million with a significant share of 58.8 percent of total overdue of MFFIs. The number of borrowers with overdue loan in MFFIs has decreased by 31.3 percent to 46,007 persons during the review period. Out of these, NGBBL alone has 20341 persons with overdue loans. The decrease is resulted as there was a significant increment last year due to the effect of earthquake. Likewise, the amount of loan loss provision of these institutions increased by 39.6 percent to Rs. 1.37 billion during the review period. NGBBL had loan loss provision of Rs. 298.47 million which is 21.8 percent share of the total loan loss provision of MFFIs.

Financial Literacy, Financial Inclusion, Access to Finance

NRB has been involved in different activities to promote financial literacy in the country. Different financial literacy materials were disseminated in 2016. As NRB is affiliated with different international organizations like Alliance for Financial Inclusion (AFI), Child and Youth Finance International (CYFI) etc., to promote financial inclusion and financial literacy in the country; various financial literacy-programs were conducted in 2016 as well. As a member of AFI, NRB has made some commitments towards financial inclusion under the 'Maya Declaration 2013' and most of the commitments in this concern have been fulfilled.

With regard to financial literacy, NRB has been celebrating the global financial literacy week called 'Global Money Week' announced by the CYFI each year since 2013. In this connection, NRB has been organizing grand financial literacy rally in Kathmandu each year comprising students, teachers, BFIs, Cooperatives, NGOs, donor agencies, etc. during this week. Interaction programs on financial literacy focusing child and youths are also organized to mark this week. Participants are invited from school managements, students, teachers, BFIs, cooperatives, NGOs, donor agencies, journalists, etc. in these programs. NRB also distributes different financial literacy materials, like hand-book entitled 'NRB with Students', story-book called 'Paisako Bot', musical CD comprising financial literacy songs, etc. during these programs. Moreover, upon the request of NRB; BFIs, NGOs, Cooperatives, Bankers Training Institutes, etc. also carry out different promotional activities on financial literacy during the week. Different Radio and TV programs on 'Global Money Week' are also broadcasted during the week.

A special school-visit program, entitled 'NRB with Students' has been initiated by the NRB on financial literacy since 2013-14. During this on-going program, a team of NRB visits different schools to organize a brief presentation on financial literacy and distributes the financial literacy materials to the students. NRB has already organized number of such programs in different schools throughout the country. Most of these programs were chaired by the high-level authorities of NRB, including Governor himself in many occasions. NRB has also been working closely with the Ministry of Education to incorporate the issues of financial literacy in formal educational curriculum. A separate window has been developed within the web-site of NRB regarding the financial literacy. On the policy front, NRB has drafted and approved the National Financial Literacy Policy and has already forwarded it for the government-approval.

SEBON has conducted securities market education and awareness programmes in various part of country with coordination of Local Units of Federation of Nepalese Chamber and Commerce of Industries, FNCCI, educational institutes and other social organisations. The programme is educating peoples including investors, entrepreneur and businesspersons, students and academicians covering the various aspects of securities market. Board has published different types of educative materials relating to securities market in different years and has distributed among the public, lecturers, students etc.

Issues and Challenges

Although the rapid expansion of micro finance sector has been widely accepted as an effective tool of enhancing access to finance, reducing poverty, empowering women and uplifting the living standards of the poor people; their concentration are mostly in accessible areas accompanied with multiple financing and duplication in significant cases, comparatively higher interest rates being charged with the poorest section of the society, deviation from the social responsibility in many cases and more concentration on the middle and upper-middle classes rather than the deprived section are some of the major weaknesses witnessed in this sector, which need to be addressed. Although all the MFIs have been directed by the central bank to be the member of Credit Information Bureau compulsorily and should have received credit information while disbursing the loans more than Rs. 50,000; most of them have not yet been found affiliated to the Bureau. This has created the problem of addressing the issue of multiple financing and duplication in this sector. Even though the licensing of new MFIs is still open in some cases; however it is the right time to think about the appropriate size and number of the MFIs in Nepal.

Increasing trend of shadow banking practices by some of the larger cooperatives around the urban areas has brought challenges to the financial system. This kind of activities conducted by the cooperatives could also increase risk in the system as their deposit mobilization is being increased rapidly. Lack of stringent regulatory and supervisory mechanism for various types of micro finance institutions established and operated under different Acts is also the matter of concern. Saving and credit activities of larger cooperatives in urban areas should be monitored minutely on a regular basis. There is a need of a strong and separate regulatory entity to ensure the compliance of minimum financial standards by the larger cooperatives specially operating in urban and accessible areas.

Financial viability is necessary for the sustainability of MFIs. They is generally resource deficient in this sector. The capital base of most of the MFIs is comparatively small as compared to other BFIs. As MFIs generally borrow funds from other BFIs (A, B and C categories), the interest they charge for their clients is found relatively higher. At the same time, MFIs have relatively higher overhead cost as they mostly engage in small-sized business/transactions. As the interest rate in conventional banking system increases, it further pushes up the interest rate of MFIs making micro finance services more costly to the poor section of the society. This is another major challenging issue of this sector which needs to be addressed by effective policy responses.

Code-of-conduct and good governance practices are necessary for developing professionalism and to foster a healthy competition and uniform practices in microfinance sector. Besides, legal framework regarding the client protection, a effective mechanism for credit information sharing and a kind of institutional arrangement for the capacity enhancement of their employees are some other important issues that need to be addressed. All these measures will enhance the activities of the MFIs in a more productive and effective way in the rural credit sector and thereby rural financing effort.

On the policy front, legal framework regarding the establishment of *National Micro Finance Fund* is still under-way. A separate unified directive for 'D' class MFIs has been already put in place. Revision of directives issued to cooperatives licensed by the NRB is under consideration. Although all the FINGOs have already asked by the NRB to convert themselves into Micro Finance Financial Institutions, the conversion process has not been completed yet due to various technical reasons. Formulation of *National Financial Literacy Policy/Strategy* is underway as this has already been forwarded to the Government for necessary approval. Establishment of a separate credit information agency for the MFIs is at the final stage. . The major challenges for smooth and continuity of the education and awareness programmes conducted by SEBON are lack of sufficient resources and dedicated institution/academy etc. All these initiatives are expected to promote financial discipline and corporate governance, increase financial awareness, soundness and magnification of financial inclusion process that ultimately contribute for the financial stability

CHAPTER - FOUR

COOPERATIVES AND OTHER FINANCIAL INSTITUTIONS

Performance of Cooperatives

NRB Licensed Cooperatives

The number of cooperatives allowed for conducting limited-banking activities by the NRB stood at 16 as of mid-July 2016. Out of these cooperatives, National Cooperative Development Bank (NCDB) is involved in wholesale business while remaining others do retail business. The total asset of these 16 institutions increased by 30.16 percent to Rs. 32.52 billion during the review period. Share capital of these institutions increased by 20.3 percent to Rs. 3.25 billion during the period. Total deposits of these 16 cooperatives increased by 35.8 percent to Rs. 25.42 billion during the review period. Likewise, their loans and advances rose by 40.1 percent to Rs. 20.18 billion

Government Registered Cooperatives

According to statistics from Department of Cooperative, 33,599 cooperatives are operating throughout the country as on mid-July 2016. Amongst the different types of cooperatives, savings and credit cooperatives are dominant accounting 40.98 percent of the total number.

Financial Highlights of Cooperatives

As of mid-July 2016, deposits of cooperatives totaled Rs.295.73 billion and total credit stood at Rs.289.42 billion. Deposits of cooperatives grew by 46.11 percent during review period while credits grew by 54.11 percent. Cooperatives have total capital of Rs.71.36 billion and total funds amounted to Rs.18.64 billion.

Figure 4.1: Capital (LS), Deposit and Credit growth of Cooperatives (in percentage RS)

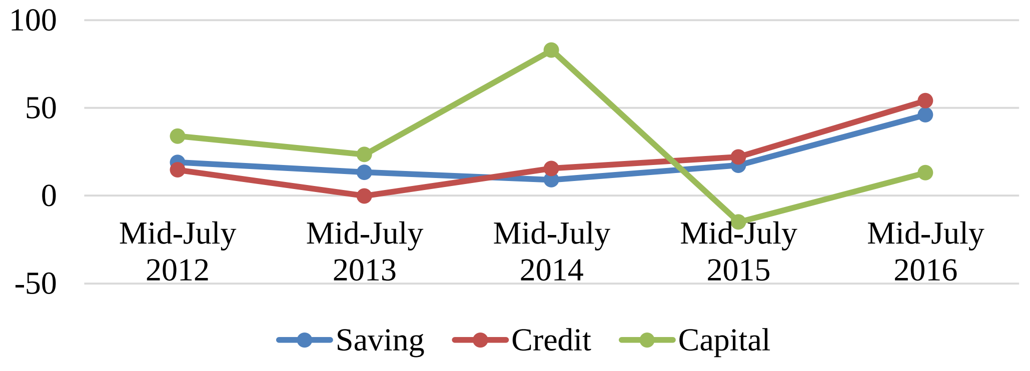


Table 4.1: Key Figures of Cooperatives (As of Mid-July 2016)

Indicators	Figures
No. of Cooperatives	33,599
Members (Nos.)	6,030,857
Male (Nos.)	*294,4539*
Female (Nos.)	*3,086,318*
Total Staff (Nos.)	56,475
Total Capital (in Rs.)	71,357,882,000
Total Fund (in Rs.)	18,636,130,000
Deposit (in Rs.)	295,727,802,000
Credit (in Rs.)	289,418,800,000
Credit to Deposit Ratio	97.87%
Credit to Capital and Deposit Ratio	78.84%

Source: Department of Cooperatives

Despite the increase in number of cooperatives, the growth rate has been very slow in recent year. This is particularly due to strict policy adopted by Government of Nepal for new cooperative registration in the recent years.

Table 4.2: Growth of Cooperatives over the Years

Fiscal Year	Number	Growth (Number)	Growth Rate
1997-98	4349	-	-
1998-99	4860	511	10.51%
1999-00	5671	811	14.30%
2000-01	6484	813	12.54%
2001-02	7074	590	8.34%
2002-03	7445	371	4.98%
2003-04	7598	153	2.01%
2004-05	8045	447	5.56%
2005-06	8530	485	5.69%
2006-07	9720	1190	12.24%
2007-08	11302	1582	14.00%
2008-09	15813	4511	28.53%
2009-10	20102	4289	21.34%
2010-11	23301	3199	13.73%
2011-12	26500	3199	12.07%
2012-13	29526	3026	10.25%
2013-14	31177	1651	5.30%
2014-15	32663	1486	4.77%
2015-16	33599	936	2.87%

Source: Department of Cooperatives

Department of Cooperatives has been adopting stringent policies for registration of new cooperatives, particularly for savings and credit cooperatives, as most of the cooperatives involved in saving and credit operation were found to be operating without following the Cooperative Standard issued by the department. Similarly, the department has been cautious over registration of new multipurpose cooperatives.

Financial Non-Government Organizations

As of mid-July 2016, there are altogether 25 Financial NGOs (FINGOs) with their 352 branches operating throughout the country. As directed by the NRB, all of these FINGOs are in the process of transforming themselves into 'D' class MFFIs. The FINGOs are registered under the Institutions Registration Act, 1977 at the office of the chief district officer and are carrying out microfinance activities with the permission of NRB as per the provision of the Financial Intermediary Act, 1999. The members of such institutions as of mid-July 2016 have reached to 5,82,433. As of the review period, the outstanding loan of these institutions reached Rs. 12.72 billion while total deposit of the members in these institutions is Rs. 5.64 billion.

Rural Self-Reliance Fund (RSRF)

The Rural Self Reliance Fund (RSRF) was instituted in 1991 with the joint efforts of NRB and the Government of Nepal. The objective of the Fund is to work for poverty reduction by the means of wholesale lending to those cooperatives which are involved in providing concessional loans to their poor and deprived members for conducting income generating activities. The total capital of the Fund as of mid-July 2016 reached Rs. 793.4 million with Rs.540.0 million contributed by the government and Rs. 253.4 million by the NRB. The loan-limit per individual borrower has been set at Rs. 90 thousand. As of mid-July 2016, total loan of Rs. 2.06 billion has been disbursed through this Fund to 1104 institutions throughout 70 districts of Nepal, benefitting some 55 thousand low-income households. The recovery rate of the fund was 96.3 percent during the review period.

OTHER FINANCIAL INSTITUTIONS

Insurance Companies

There are altogether 26 (17 non-life and 9 life) insurance companies. The data received from Insurance Board of Nepal, reveals that total assets/liabilities of insurance companies rose by 22.23 percent to Rs.158.24 billion during fiscal year 2015-16. Total assets of life insurance companies' and non-life companies' expanded by 25.24 percent and 10.14 percent respectively.

Table 4.3: Sources and Uses of Funds of Insurance Companies (in billion Rs.)

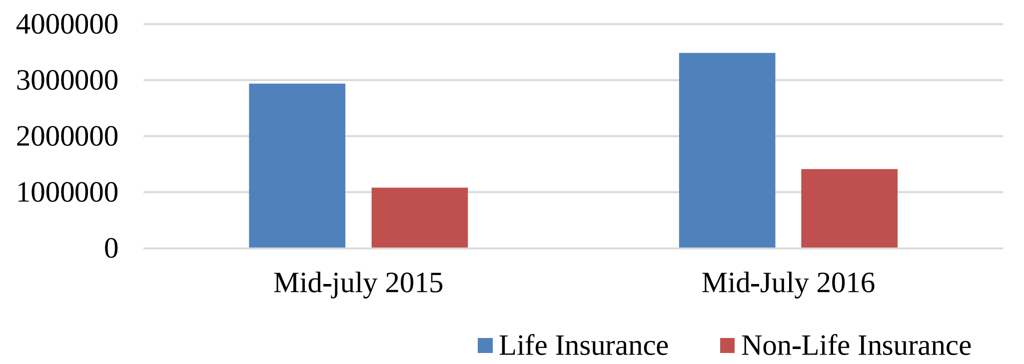
Sources	Life			Non-Life		
	2013/14	2014/15	2015/16	2013/14	2014/15	2015/16
Paid-up Capital	4.66	5.78	6.24	3.17	3.73	4.75
Reserve Funds	71.08	93.99	115.69	8.23	17.83	19.72
Other Liabilities	6.26	3.93	7.94	7.69	4.19	3.89
Total	**82.00**	**103.7**	**129.87**	**19.08**	**25.75**	**28.36**
Uses						
Cash and Bank	2.78	1.96	2.36	1.33	2.72	3.16
Investment	70.97	94.18	117.98	12.11	15.90	15.31
Fixed Assets	1.42	1.64	1.65	1.06	1.07	1.09
Other Assets	6.83	5.92	7.89	4.59	6.05	8.80
Total	**82.00**	**103.7**	**129.87**	**19.09**	**25.75**	**28.36**

Source: Beema Samiti (Insurance Board)

While the coverage of insurance penetration is very low in comparison to other financial services in Nepal, there have been some signs of significant growth in recent years. Number of policy holders in both life and non-life sectors grew by 21.94 percent in 2015-16 beating previous figure of 20.84 percent in 2014-15. Significant growth has been seed in individual sectors too. The number of life insurance policy holders went up by 18.72 percent in 20145-16 to reach 3.49 million from 2.94 million in 2014-15.

Similarly, non-life insurance coverage grew by 30.71 percent totaling to 1.41 million in 2015-16. Significant growth in non-life policy issuance coverage can be mainly attributed to the devastating earthquake. Policy issuance in non-life as well as life insurance sector is expected to register healthy growth rate in subsequent periods due to the devastating effects of earthquake.

Figure 4.2: No. of Policies issued by insurance companies (Rs. in thousands)



Source: Beema Samiti (Insurance Board)

Reinsurance Companies

There is only one reinsurance company in Nepal which was formally established in Nov 7, 2014. Before the establishment there was institution called insurance pool Nepal, looking after riot, strike, malicious, damage & terrorism (RMSDT) only. Since, the establishment the company has it been carrying out various reinsruance portfolio mostly in non life part. The total assets/liabilities of insurance company rose by only 1.57 percent to Rs. 62.54 billion during fiscal year 2015-16. The total sources of the fund is Rs. 91.72 billion in the year 2015-16 which is 2.76 percent growth comparing to previous year. The total use of fund is Rs. 75.72 billion in the year 2015/16 which is 1.97 percent growth than the previous year.

Employees Provident Fund (EPF)

According to unaudited figures of mid-July 2016, Employee Provident Fund (EPF) has provident fund amounting to Rs.217.61 billion, while total assets/liabilities of EPF stood at Rs.224.70 billion. The funds at EPF grew by 16.02 percent during last fiscal year. The savings (funds) in EPF shares 7.93 percent of total assets of NRB regulated BFIs. Similarly, it has reserve created from the profit worth of Rs.4.66 billion.

As of mid-July 2016, uses of EPF comprised of cash and bank balance, investment in national saving certificate and debentures, Investment in fixed deposit, investment in shares, project loans, lending to contributors, investment in fixed assets, fixed assets, assets on construction, miscellaneous assets. Within these, contributors lending accounts to 52.58 percentage of total and fixed deposits ranked second with 25.83 percentage share in the portfolio. The fund has been utilizing almost its total fund with loan and investment to total fund ratio at 96.68 percent and maintaining cash and bank balance of Rs.4.17 billion.

Table 4.4: Key Indicators of EPF Mid- July, 2016

Indicators	Amount (Billion Rs.)
Sources of Fund	**224.72**
Provident Fund	217.61
General Reserve and Funds	4.66
Liabilities	0.88
Provisions	1.56
Uses of Fund	**224.72**
Cash and bank	4.17
Bonds and Debentures	15.47
Fixed Deposits	58.04
Share Investments	2.22
Project Loan	23.37
Lending to Contributors	118.15
Investment in Fixed Assets	0.76
Fixed Assets	0.38
Assets under construction	0.02
Miscellaneous Assets	2.14
Loan and Investment to Total Fund Ratio	**96.68%**
Loan and Investment to Provident Fund Ratio	**99.83%**
Liquidity Ratio (Cash and bank to Total Fund)	**1.92%**

Source: Karmachari Sanchay Kosh (Employee Provident Fund)

Citizen Investment Trust (CIT)

Citizen Investment Trust (CIT) is another institutional fund mobilizer with mentionable market share. As of mid-July 2016, net fund collections of CIT stood at Rs.80.16 billion, recording a growth of 19.25 percent from the figures of Rs.67.22 billion in mid-July 2015. Apart from its capital of Rs.0.61 billion, regular contributions from members are the only and major source of fund for CIT. Investments of the Trust, which are diversified in five broad categories, stood at Rs.76.48 billion.

CIT has been heavily dependent on BFIs for its fund mobilization. Out of total funds, 71.41 percent has been put on BFIs and fixed deposits, while the fixed deposit accounts 74.84 percent of total investment of CIT, similarly 14.57 percent of total fund has been utilized as home loan to participants. Considering the nature of the funds, which have longer term prospect, it can be utilized for long term projects with high return.

Table 4.5: Key Figures of CIT Mid- July, 2016

Indicators	Figures (Billion Rs.)
Share Capital (Rs.)	0.61
Net Fund Balance (Rs.)	**80.16**
Net Fixed Assets	0.88
Investment (Rs.)	**76.48**
Government Bond (Rs.)	1.81
Fixed Deposit (Rs.)	57.24
Term Loan (Rs.)	1.93
Investment in Shares (Rs.)	3.82
Home Loan and Landings to Participant (Rs.)	11.68
Current Assets	5.65
Total Assets	**83.01**
Investment to Fund Ratio	95.42%
Average Return on Investment (percent)	5.28%
Interest cost of Fund	5.97%
Net Worth per Share	191
Earnings per Share	27

Source: Nagarik Lagaani Kosh (Citizen Investment Trust)

CHAPTER - FIVE

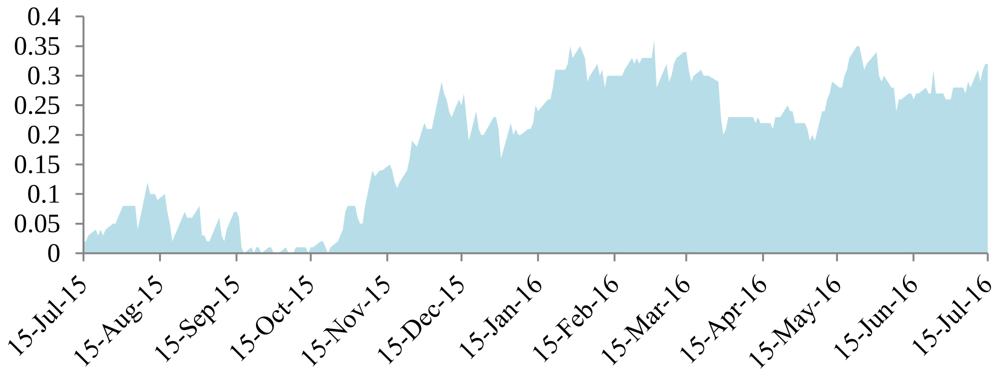
FINANCIAL MARKETS

Global Financial and Money Market Perspectives

3 Month US Government Treasuries

Yields on US government treasuries have been seeing slow and steady growth in recent times due to upward revision of federal funds rate by the Fed. During the twelve months period during mid-July 2015 to mid-July 2016, 3-month t-bill yield curve showed a highest return of 0.36 percent on 3, March 2nd 2016. However, it curves showed a return near to zero for more than a month between September and October 2015.

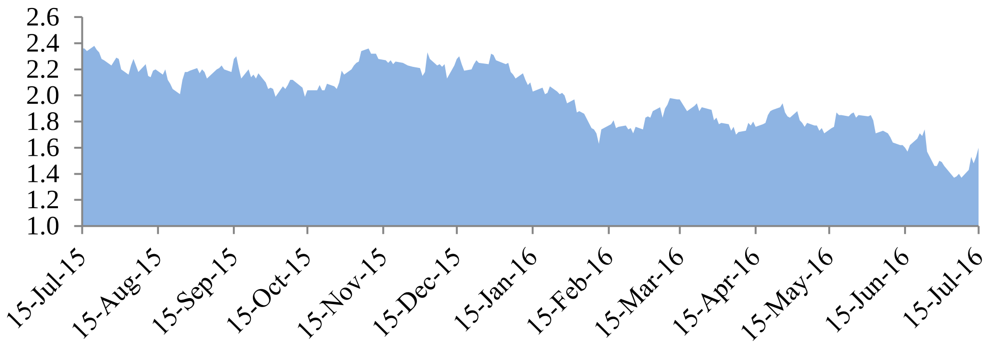
Figure 5.1: Daily Yield Curve Rates for 3-Month t-bill (in percenage)



10-Year US Government Treasury Bill

Contrary to the short term security, yields on 10-year US t-bills are on decline following the new regime of monetary policy with interest hikes. During the twelve months period between mid-July 2015 to mid-July 2016, long-term treasuries saw a high yield of 2.38 percent on 13, December 2015 where as the lowest return was 1.37 percent on 5th July 2016. With the interest rate increase, the safe long-term investment options are expected to see a fall in yields in the future.

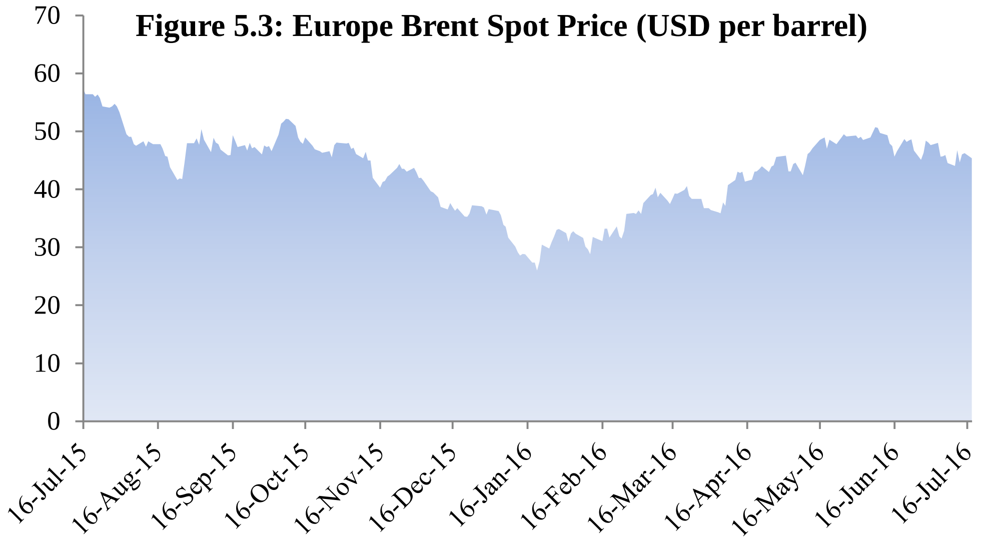
Figure 5.2: Daily Yield Curve Rates for 10-Year t-bill (in percenage)



Crude Oil

Crude oil prices went through rollercoaster during the twelve months period between mid-July 2015 and mid-July 2015 with price ranging between 26.01 to 57.31 dollars per barrel. Brent Crude oil prices reached as higher as 57.31 dollars per barrel on 16, July 2015 with the lowest point being 26.01 on 20, January 2016. The decrease was mainly due to no consensus over production cut between OPEC members. However, with the possibility of production cut in near future crude prices rose from mid-Jan 2016. The future of oil prices are more or less hanging on sword with eyes on next round of OPEC meetings.

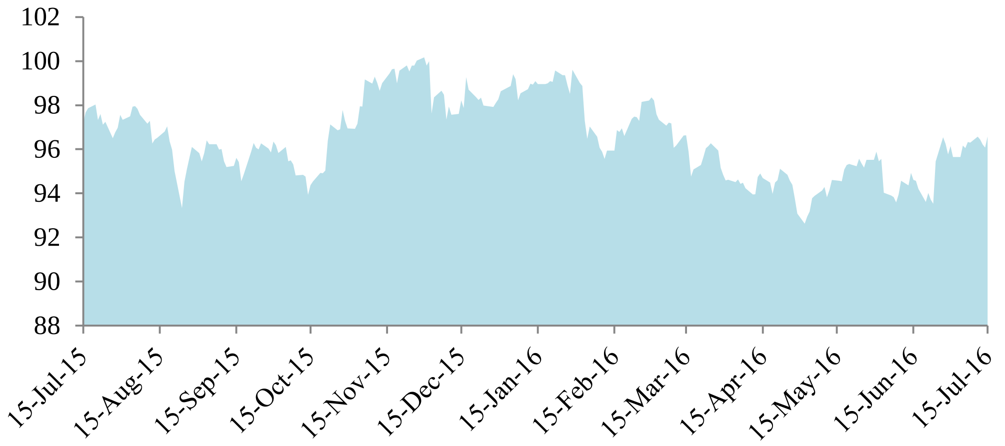
Figure 5.3: Europe Brent Spot Price (USD per barrel)



Dollar Index

The relative strength of US dollar showed high degree of volatility during the twelve months period during mid-July 2015 to mid-July 2016. The index went as low as 92. 626 on 2 may, 2016 to the highest 100.17 on 30 December 2015. The dollar saw a high level of volatility with concerns over federal interest rates hikes as well geo-political tensions in Middle-East. The move was further aggravated with gains by Yen and Euro in recent times.

Figure 5.4: Movement of US Dollar Index

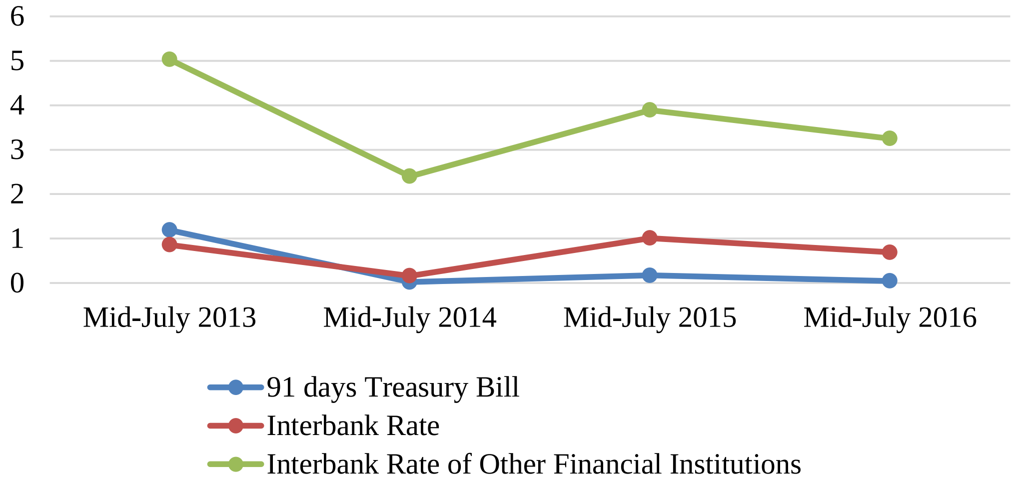


Domestic Financial Market

Money Market

Short term and long term interest rates in the financial market remained relatively low in FY 2015/16. Both the weighted average of 91-day Treasury bill rate and inter-bank transaction rates decreased in the last month of 2015/16 compared to a year ago. The weighted average 91-day Treasury bill rate decreased to 0.0456 percent in the review month from 0.1739 percent a year ago. The weighted average inter-bank transaction rate among commercial banks that was 1.01 percent a year ago reached 0.69 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions decreased to 3.25 percent from 3.89 percent a year ago.

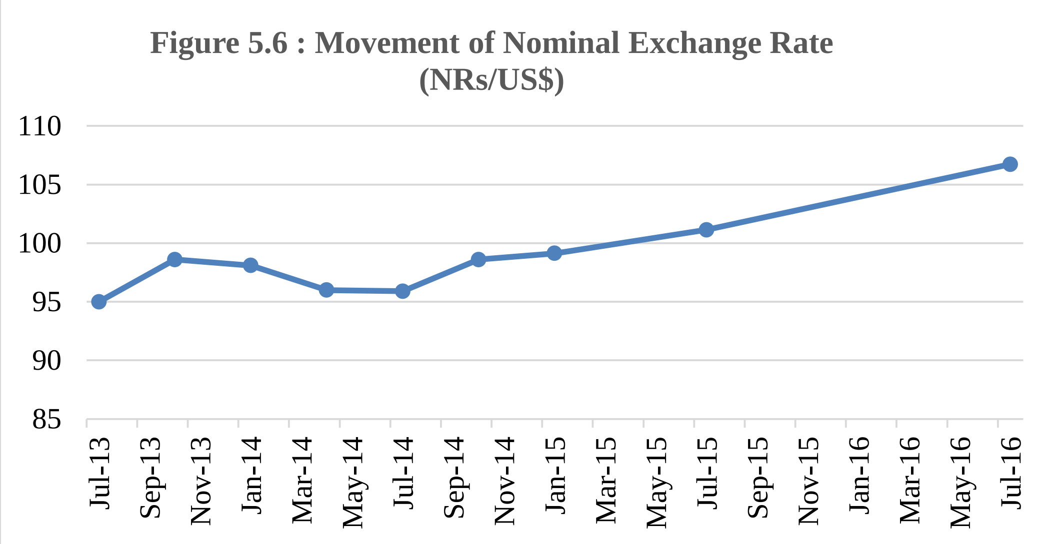
Figure 5.5: Weighted Average Treasury Bill Rate and Inter Bank Transaction including other Financial Institututions (in percent)



Weighted average interest rate spread of commercial banks decelerated to 3.67 percent in the review period from 4.6 percent a year ago and the average base rate came down to 6.66 percent from 7.8 percent a year ago.

Dollar-Rupee Exchange Rates

Nepalese currency depreciated by 5.2 percent against US dollar during end of 2015/16 compared to depreciation by 5.2 percent in the same period of the previous year. The depreciation of Nepalese rupee against US dollar accounted because of the improving US economy as well as decreasing the export and decreasing trend of remittance income in Nepalese economy. Due to the depreciation in Nepalese currency import has become expensive as well as it has increased the foreign debt liability of the government. The exchange rate of one US dollar stood at Rs.106.73 in mid-July 2016 compared to Rs.101.1 in mid-July 2015.



Securities Market

Nepalese securities market witnessed significant growth in fiscal year 2015/16 as SEBON was actively involved in the development and reforms of securities market to make it more fair, efficient, reliable and transparent. In fiscal year 2015/16, major indicators of securities market increased in comparison to the previous year. Significant growth on both primary and secondary market is attributed to the factors like reform and development initiatives undertaken by SEBON, high liquidity and low interest rate in financial market, insufficient investment alternatives and capital increment by BFIs.

Primary Market

Status of primary market during last three fiscal years remained satisfactory. In review period, 55 companies mobilized Rs. 18.99 billion through public offering which is 31.51 percent higher than previous fiscal year (2014/15). In fiscal year 2014/15, 48 companies had mobilized capital of Rs. 14.44 billion through public offering. Public offering amount was increased by 74.82 percent in previous fiscal year as compared to fiscal year 2013/14. The public issue trend of 3 years shows that right offering has been issued significantly by BFIs for raising the capital.

Table 5.1: Primary Market Status

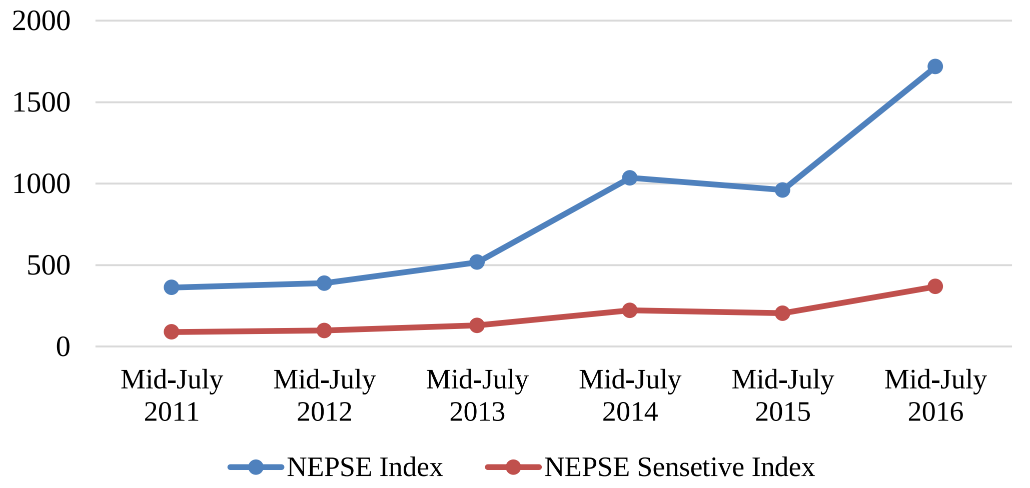
Offering	Fiscal Year						Percentage Change			
	2013/14		2014/15		2015/16		In Number		In Amount	
	Nos	**Amount In billion**	**Nos**	**Amount In billion**	**Nos**	**Amount In billion**	**2014/15**	**2015/16**	**2014/15**	**2015/16**
IPOs	16	1.57	18	6.98	14	2.76	12.5	(22.22)	344.59	(60.46)
Right offerings	26	4.24	22	2.31	37	9.40	(15.38)	68.18	(45.52)	306.93
FPOs					3	5.83				
Mutual Fund	1	1	3	2.25	1	1	200	(66.67)	125	(55.55)
Debenture	3	1.45	5	2.90			66.67		100	
Total	46	8.26	48	14.44	55	18.99	4.35	14.58	74.82	31.51

Secondary Market

The NEPSE index increased by 78.74 percent to 1718.15 points in mid-July 2016 on y-o-y basis. This was particularly due to the excess liquidity in the market and due to the capital increment of financial institutions. This index had decreased by 7.23percent to 961.2 points a year ago. The NEPSE sensitive index stood at 369.07 point in mid-July 2016, as against 204.67 in mid-July 2015.

The y-o-y stock market capitalization increased by 91.04 percent to Rs. 1890.13 billion in mid-July 2016. The ratio of market capitalization-to-GDP stood at 84.02 percent in mid-July 2016 compared to 46.6 percent a year ago. Of the total turnover during the year, the share of banks and financial institutions (including insurance companies) stood at 84.59 percent. Hydropower, manufacturing and processing companies, hotels, mutual fund and others recorded a share of 6.19 percent, 0.14 percent, 0.68 percent, 0.67 percent and 0.55 percent respectively.

Figure 5.7: NEPSE and Sensitive Index



The total number of companies listed at the NEPSE decreased from 232 in mid-July 2015 to 229 in mid-July 2016. Merger of some banks and financial institutions during this period resulted in a decline in the number of listed companies. Total market capitalization of group A companies reached to Rs. 1681.99 billion. Total paid up capital of listed companies reached to Rs. 321.82billion in Mid-July 2016. The average daily turnover has reached to Rs. 70.66 crore.

Table 5.2: Secondary Market Indicators

S. No.	Indicators	Fiscal Year			% Change 2014/15	%Change 2015/16
		2013/14	2014/15	2015/16		
1.	No. of Listed Companies	233	232	229	(0.43)	(1.29)
2.	No. of listed Securities (In billion)	1.6077	2.5531	3.6429	37.67	42.68
3.	Annual Turnover (Rs. in billion)	77.30	65.33	163.95	(15.49)	150.96
4.	Average Daily Turnover (Rs in billion)	33.68	30.29	70.66	(10.07)	133.28
5.	Trading Days	230	216	233	(6.09)	7.87
6.	No. of Scripts Traded	269	271	274	0.74	1.11
7.	No. of Trading Securities (In million)	214.10	159.7	302	(25.42)	89.10
8.	No. of Transaction	566390	477278	831997	(15.73)	74.32

9.	Market Capitalization (Rs in billion)	1057.17	989.40	1890.13	(6.41)	91.04
10.	Float Market Capitalization (Rs in billion)	331.06	281.78	718.96	(14.88)	155.15
11.	Turnover/Market Capitalization (In%)	7.31	7.72	8.67	5.61	12.30
12.	Market Capitalization/ GDP (In %)	54.82	46.60	84.05	(27.20)	110.59
13.	Float Market Capitalization/ GDP (In %)	17.17	13.29	31.97	(22.60)	140.56
14.	NEPSE Index	1036.11	961.23	1718.15	(7.23)	78.74
15.	Sensitive Index	222.45	204.67	369.07	(7.99)	80.32
16.	Float Index	73.11	68.47	125.41	(6.35)	83.16

CHAPTER - SIX

FINANCIAL SECTOR POLICIES AND INFRASTRUCTURES

International Financial Regulatory Reforms and Nepal

6.1 Implementation of BASEL in Nepal

6.1.1 In order to enhance the stability, Nepal Rastra Bank has been adopting various international good practices. Accordingly, regulatory provisions of Basel III are being implemented. Commercial banks are required to meet minimum capital adequacy based on BASEL –III with effect from mid-August, 2016. Nepal Rastra Bank has already issued circular in this regard and has already instructed the commercial banks to calculate their capital fund either under BASEL - II or BASEL - III till mid-January, 2017. After that period, they have to calculate their capital fund according to Capital Adequacy framework, 2015 published by NRB which is based on Basel-III.

BASEL II has been fully implemented in national level development banks. National level development banks are required to calculate their capital fund according to Capital Adequacy framework, 2007 (updated 2008) in contrast; other development banks and finance companies are required to report under Basel I. Meanwhile, NRB has directed national level finance companies to report their capital fund in parallel way under the provisions of Basel I & Basel II.

6.1.2 In order to enhance the quality and level of capital NRB has been focusing on common Equity. Commercial banks should maintain minimum common equity tier 1 capital ratio of 4.5 percent from mid-July 2016, based on Basel III requirement. Likewise, National level development banks are required to maintain minimum tier 1 capital of 6 percent and other development banks and finance companies are required to maintain minimum tier 1 capital of 5.5%. However, the national level finance companies are also required to maintain 6 percent of tier 1 capital as they are in parallel run of Basel I and Basel II.

6.1.3 In order to enhance the risk absorption capacity of banks by strengthening the capital base, a provision is made for commercial banks to maintain capital conservation buffer (CCB) equal to 2.5 percent of total risk weighted assets. Instruments under common equity tier 1 capital will be used for such calculation. BFIs failing to maintain such buffer will be allowed to distribute profit only after allocating for capital conservation buffer (CCB).

The capital conservation buffer is designed to ensure that banks build up capital buffer during normal times (i.e. outside periods of stress) which can be drawn down as losses as incurred during a stressed period. The requirement is based on simple capital conservation rule to avoid breaches of minimum capital requirements. The framework of capital conservation buffer is expected to strengthen the ability of banks to withstand adverse economic environment conditions, will help increase banking sector resilience both going into downturn, and provide the mechanism for rebuilding capital during the early stages of economic recovery. The CCB has been introduced in 2016 and will be fully effective on mid-July 2019. In the first round, it will execute 1.25 percent by 2016, 1.5 percent by 2017, and two percent by 2018 on top of the capital adequacy ratio

6.1.4 NRB has introduced counter cyclical buffer in "Capital Adequacy Framework, 2015" to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its aim is to protect the banking sector form periods of excess aggregate credit growth that have often been associated with the build up of system wide risk. Therefore, to minimize the adverse impact of pro-cyclicality and fluctuations in macroeconomic variables on financial sector, this provision has been made for banks to maintain an additional counter cyclical buffer up to maximum 2.5 percent age point of total risk weighted assets by mid-July 2017.

Monetary policy 2016/17 has announced banks to set countercyclical buffer requirement for commercial banks, as part of implementing the Basel III standard, at a maximum of 2.5 percent. Currently, commercial banks have to maintain 8.5 percent minimum total capital ratio based on total risk weighted assets. Further, they require another 2.5 percent capital conservation buffer to distribute dividends. The NRB is planning to execute two percent counter cyclical buffer by mid-July, 2017. It is assumed that the policy may have adverse effect on the credit expansion capacity of banks.

6.1.5 Commercial banks are required to maintain minimum Tier 1 leverage ratio of 4% during the period from mid-July, 2016 to mid-July, 2018. The banks are required to maintain the leverage ratio on a quarterly basis. The ratio will be reviewed based on the BASEL committee guideline beginning mid-July 2018. Non-risk-based leverage ratio that includes off-balance sheet exposures will serve as a backstop to the risk-based capital requirement. Also helps contain system wide build up of leverage.

Basel III Liquidity Framework

6.1. 6 Global financial crisis began with the liquidity problems in some banks. Many banks with adequate capital levels also experienced difficulties because of their poor practices in liquidity management. Importance of robust liquidity risk management was felt necessary during the crisis. BCBS issued guidelines, "Basel III: International framework for liquidity risk measurement, standards and monitoring (December 2010). BCBS has established some principles for Sound Liquidity Risk Management and Supervision. In addition to the principles, Basel III introduced two ratios for liquidity monitoring and management in banks; (i) Liquidity Coverage Ratio (LCR) &, (ii) Net Stable Funding Ratio (NFSR).

6.1.6.1 LCR is introduced to promote short-term resilience by requiring sufficient high-quality liquid assets to survive acute stress lasting for 30 calendar days. The bank which maintains the ratio more than hundred percent during the short period of time is considered to be the sound bank in terms of short-term liquidity.NRB has developed its own liquidity monitoring framework for the short-term liquidity monitoring of the banks. NRB will fully implement LCR by end of 2017 which requires Commercial Banks to maintain 100 percent LCR.

6.1.6.2 NSFR is aimed at promoting resilience over longer term through incentives for banks to fund activities with more stable sources of funding. The ratio is developed to address the maturity mismatch between liabilities and assets in the financial sector and to make sure that banks have sufficient stable funding to withstand a yearlong liquidity crisis. NRB will introduce minimum standard based on BASEL III by end of 2017, and fully implement NFSR by 2019.

6.2 Crisis Management and Bank Resolution Framework

6.2.1 Financial Safety Net – Deposit Insurance

NRB has introduced policy provisions with the motive of enhancing public confidence towards the financial system, for insuring deposit up to Rs 0.2 million of small and medium size depositors. In this regard, NRB has issued circulars on August 9, 2010 for ‘D’ class & on February 2011for ‘B’ & ‘C’ class FIs and on July 18, 2011 for ‘A’ class commercial banks regarding the provision of deposit guarantee up to Rs 200 thousand in saving and fixed account held by natural person

Deposit and Credit Guarantee Corporation (DCGC), with the view to protecting the financial system of Nepal and contributing to financial stability, is committed to ensure the interest of the depositors by broadening the financial safety net which involves the provision of a deposit guarantee that protects depositors against the loss of their guaranteed deposits placed with BFIs in the case of unlikely event of the BFIs failure. DCGC has given the statutory responsibility to perform both the deposit guarantee and credit guarantee function through Company Act.

6.2.2 Problem Bank Resolution Framework:

NRB has established a separate division as Problem Institution Resolution Division (PIRD) for the effective management of problem banks and financial institutions. After establishment of this division, it has helped to manage weak banks and financial institution in an objective, transparent and cost effective manner so as to ensure stability in the financial system. Furthermore, NRB has issued Bylaw, “Resolution Bylaw 2014” for the purpose of implementation of the framework. The current Resolution framework is not specifically targeted to SIFIs, and there is need to develop proper regime to identify SIFIs and effective resolution framework for SIFIs in the country.

6.2.3 Lender of Last Resort (LOLR)

Effective bank supervision should include enforcement measures and allowances for early intervention before a bank’s capital falls to a low level. ELA, used judiciously, may prevent a liquidity problem from turning into a solvency problem. NRB has issued policy on lender of the last resort in 2011 to develop an effective resolution regime for financial institutions. NRB provides LOLR to BFIs which need to be revived due to its systemic importance on economy and financial system.

6.2.4 Contingency Management

Most of the banks have substantial weaknesses in almost all aspects of the risk management framework. They have no contingency plans for event of natural disaster. So, NRB has directed the BFIs to adopt necessary precautions regarding probable disasters and implement Contingency Management Framework to guarantee their services are not disrupted during unfavorable situations like natural calamities. The recovery plans will help BFIs to continue their services despite difficulties induced by nature and other possible accidents like fire, among others.

6.3 **Provisions Related to CSR**

6.3.1 Client Protection Fund

NRB has directed all MFFIs to establish separate fund named "Client Protection fund" by allocating one percent of their net profit. MFIs declaring dividend exceeding 20 percent are also required to allocate 25 percent of such exceeding dividend amount in that fund. The fund created should be used for the welfare of borrowers and institutional development. Such fund should be spent for problem borrowers, for security and reestablishment of problem borrowers, education of clients and their capacity development. MFFIs are required to prepare working procedure manual and should take approval from NRB to use that fund. This provision is effective from the FY 2015/16.

6.3.2 Corporate Social Responsibility Fund

There is also mandatory provision requiring banks earning a high profit to spend some percent of that on social service and institutional good governance. They will have to invest one percent of profit on corporate social responsibility and three percent of total expenditure on training and development of staffs. Similarly, there is also mandatory training for board members which will also help in institutional good governance.

6.3.2.1 Nepal Rastra bank has made it mandatory for banks and financial institutions to set up a corporate social responsibility (CSR) fund and allocate at least one per cent of their net profit. Some of the areas where money collected in CSR fund could be utilized are: education, health, natural disaster management, environmental conservation, cultural promotion, rural infrastructure up gradation, capacity enhancement for income generation of people belonging to social backward communities, enhancing financial literacy and consumer protection. The money could also be extended to cover education and healthcare expenses of the poor or build infrastructure of organizations working to promote interests of the poor. The money could also be used to build child day care centers at banks and financial institutions or extend direct or indirect financial support to help Nepal achieve 17 Sustainable Development Goals.

As directed by NRB, the money collected in the CSR fund, however, should not be spent on activities aimed at promoting the brand of banks and financial institutions, or to serve individual and political interests of board directors. Furthermore, those spending should not concentrate in limited sectors, such as health or education, or certain geographical areas. In addition, BFIs must publicly call for applications from interested parties before approving CSR-related projects and programs. In this regard, the board of directors of banks and financial institutions should frame a guideline identifying areas where spending could be made and the process of finalizing programs and projects. Also, CSR fund operation and management manual should also be framed and approved from BOD of related BFIs.

6.3.2.2 NRB has issued a policy of mandatory training for staff and board of directors. As per the provision of the monetary policy, the BFIs must mandatorily earmark 3 percent of their staff expenses towards training fund to enhance HR capacity. The policy has also provisioned Board of Directors Education Program to strengthen corporate governance and risk management. Board of Directors, due to lack of understanding, are seen playing less effective role, and the executives have been influencing decision making of the BFIs.

Domestic Regulatory Reforms

6.4 Capital Enhancement of Wholesale MFIs

NRB had made a six-fold increment in the paid-up capital requirement for MFIs involved in wholesale lending. The initiations will have to increase their capital to Rs. 600 million by mid-July 2018 from existing Rs100 million.

Currently, four MFIs—Rural Microfinance Development Centre, Sana Kisan Bikas Bank, First Microfinance and RSDC Microfinance—are involved in wholesale lending.

6.4.1 Capital Increment and Financial Stability

As far the capital increment of BFIs (except microfinance institutions) is concerned, the Central Bank had decided to increase the capital of BFIs up to four folds through Monetary Policy in the FY 2015/16. BFIs have to meet the capital requirement criteria by the end of this fiscal. As capital has been increased, BFIs need to expand credit to achieve desired profits. The new capital requirement of the central bank aims to strengthen financial soundness of BFIs there by establishing highly capitalized bank with wider capital base to absorb external shocks. Similarly, it also helps avail adequate financial resources for mega projects to support economic growth.

Through increasing minimum capital requirement of BFIs, NRB had expected many small BFIs to go for merger and acquisition to meet the required capital and become stronger one. However, only few banks merge and acquire to increase teir capital base, in contrast, even small and weak banks increases their capital through issuing right share which had adverse impact of financial stability.

In addition, there would be challenges for the central bank to regulate the possible credit expansion in unproductive sectors and haphazard lending to boost the profitability.

6.5 Moratorium on Establishment of MFFIs

NRB has imposed on establishing MFFIs until the formulation of necessary policies arrangement based on study regarding federal structure and e-mapping. The formulation of policies will be based on the factors such as access to finance, up-gradation, merger/acquisition and operation of MFFIs. However, NRB has still opened its licensing for those MFFIs which will operate in remote ten districts with low financial access namely Manang, Jumla, Dolpa, Kalikot, Mugu, Jajarkot, Bajhang, Bajura and Darchula.

6.6 Provisions to promote Agriculture and Tourism Sector

6.6.1 NRB has made it mandatory for commercial banks to invest 15 percent of total loan mobilization in agriculture and hydropower keeping the threshold for productive sector unchanged at 20 percent. This may lead to rise in investment in agriculture and hydropower. This, however, can result in fall in investment in other productive sectors apart from the two. The thresholds for investment in productive sector for development banks and finance companies have been kept unchanged to 15% and 10% respectively.

6.6.2 In order to enhance tourism industry in the country, NRB has made policy provision of providing refinance to open hotels for the first time. It also has provision for normal refinancing for establishing standard hotels at places like Pathibhara, Maipokhari, Halesi, Langtang, Swargadwari, Upper Mustang, Gadimai, Janakpurdham, Rara and Khaptad with tourism potential but that have not been relatively developed in terms of tourism. It has also encouraged banks to invest in tourism.

6.6.3 NRB has also made provision of providing special refinancing at interest rate of one percent equal to the amount of export if one were to rear ostrich and bee and grow cardamom, and export them to promote agriculture.

6.6.4 The provision of special refinance to BFIs at 1 percent interest to encourage agriculture and small business based income generating activities in poverty stricken areas is continued. These include Bajura, Kalikot, Bajhang, Humla, Darchula, Jumla, Doti, Achham, Mugu and Baitadi as well as 114 Village Development Committees and 4 Municipalities located in the southern border of Parsa, Bara, Rautahat , Sarlahi, Mahottari, Dhanusha, Siraha and Saptari

6.7 Deprived Sector Lending

6.7.1 The NRB has also brought tougher provisions to increase lending to the impoverished class. The threshold for impoverished class loan has been left untouched at five percent but there is a mandatory provision requiring banks to make direct investment for two percent out of that. Banks earlier were investing that through microfinance institutions and FINGOs. The banks that were ready to pay fine instead of lending the set proportion will now must go to villages to reach to the impoverished class. However, as per the current provision, Commercial Banks have to lend two percent of their total lending directly to the deprived sector, the monetary policy has allowed commercial banks to count loan up to Rs one million issued in agriculture sector as deprived sector loans. This provision may help commercial banks to meet the target of two per cent lending in the deprived sector.

Commercial banks are required to lend 1.25% of their total loan portfolio to the deprived sector directly by mid-October, 2016, 1.5% by mid-Jan, 2017, 1.75% by mid-Jan, 2017 and 2% by mid-July, 2017.

6.8 Provisions Limiting Real Estate Exposures and Lending Against Share Collateral

NRB has taken some tough measures on margin lending and real estate loans probably deeming that banks and financial institutions may have been increasing investment there at a time when they have excess liquidity and interest rate is low. Banks will have an added challenge of looking for new sectors to invest as a result

6.8.1 Real Estate Policies

The maximum loan-to-value (LTV) ratio for real estate loan is lowered to 50 percent from the existing 60 percent. Such ratio in the case of residential housing loan is lowered to 60 percent from the existing 66 percent.

6.8.2 Margin Lending Policies

6.8.2.1 NRB has also revised the policy of margin lending or loans against share collateral. BFIs are allowed to extend loan against the collateral of shares only up to 50 percent of the valuation of average trading price of shares of the last 180 days or the prevailing market price of the share, whichever is less. Earlier, BFIs were allowed to issue up to 60 percent loan against share collateral on the aforementioned valuation. The Central Bank has tightened the margin lending to curb the flow of finance towards stock market as the countries only trading house has been roaring due to cheaper financing facility from the banking system. The provision allowing BFIs to extend credit against the collateral of shares only up to the amount of core capital is kept unchanged. However, a new provision is introduced requiring BFIs not to lend more than 20 percent of their core capital against the share collateral of an individual listed company. The provision restricting BFIs' promoters holding more than 1 percent shares to borrow, by pledging more than 50 percent shares as collateral, remains unchanged.

6.8.2.2 Loan against the collateral of the promoter share will be extended only up to 50 percent of the calculated value. The share value for such purpose will be calculated by taking the 50 percent of the average closing price for the last 180 days or the prevailing market value of ordinary shares, whichever is less.

6.9 Spread Rate in Microfinance

NRB has also imposed seven percent interest rate spread to the MFIs. As per the provision, MFIs cannot add more than 700 basis point (or seven percent points) on interest rate in which the MFIs borrowed from other financial institutions while lending. This provision on MFIs was introduced following the five percent interest spread cap on commercial banks. Seven percent interest cap for MFIs is on the cost of fund of microfinance institutions. In general, interest spread refers to the difference between the interest rates that a financial institution charges on its loans and the interest rates that it provides on deposits. Here for MFIs, deposit means the money borrowed from other financial institutions. NRB introduced this provision to safeguard borrowers in remote areas compelled to pay high interest rate to the MFIs which they practice in remote areas citing high operation costs. There are complaints that microfinance institutions have been charging exorbitant interest rate. Interest rate charged by microfinance institutions can now fall to around 15 percent from around 24. Though, this will reduce profit of microfinance institutions.

6.10 Relaxations in Branch Opening Policies

BFIs are exempted from taking prior approval of this bank to open branches outside Metropolitan and Sub-metropolitan areas and center of municipalities. In addition, BFIs are not required to take prior approval of this bank to relocate Bank branches in another area of the same district severely affected by earthquake except the Kathmandu valley. However, BFIs need to inform this bank on such developments.

6.11 Increased Consortium Loan Ceiling:

Nepal Rastra Bank has instructed the class ‘A’, ‘B’ and ‘C’ financial institutions to issue larger amount of credit only in consortium. After the instruction of the NRB, new loans amounting to Rs 1 billion and above will be issued on consortium basis. As per the direction, borrowers who have already taken loan of the said amount will have to convert their loans to consortium financing within this fiscal. . This move of the central bank is aimed at controlling multiple banking practices and is expected to help maintain financial discipline. The limit for converting loans borrowed from multiple banks to consortium financing is was Rs. 500 million before. Consortium loan provision has been introduced to downsize the risks of credit flow to ventures of influential people who have hold in particular banks. The provision of consortium will control the chances of credit flow to influential businesspersons and control them to get more than required credit sanctioned for a project because there will be two to three banks involved in loan of above Rs one billion as per the recent provision of NRB. Moreover, this move of NRB will aid in controlling misuse of funds. In addition, BFIs will be able to deflect huge financial shocks in case of some lending defaults and chances of more credit than required being sanctioned will be less.

6.12 Interest Rate Corridor

NRB made provision for Interest Rate Corridor (IRC) which will help in maintaining the interest rate of banks within a certain range. IRC guides short term market interest rates towards the policy rate. The upper limit for the IRC will be determined by the rate of facility for stable liquidity and the lower by the interest rate of deposits collected in the last two weeks. Inter-bank rate and the rate for repo also should fall within the range. It is expected to promote more active liquidity management of BFIs. All types of interest rates like in repo, reverse repo, treasury bills, government bond, deposit, and lending, inter-bank rates among others will move in this corridor. For two week deposit collection, SLF rate will be upper bound while interbank will be lower bound in contrast SLF rate will act as an upper bound and the interest rate on two week deposit collection auction rate will act as a lower bound of the corridor for repo.

Normally, there will not be a huge gap in any type of interest rate from the policy rate or repo rate of the NRB which moves from the centre of the corridor. NRB has been using interest rate corridor for deposit collection in order to mop up excess liquidity from the system and for reqpo in order to inject liquidity in the system in case of shortage. Similar to the existing provision, SLF will remain as a window for collateralized liquidity facility up to 5 days. Interbank rate and two weeks repo rate will remain within the IRC.

Implementation of Interest Rate Corridor (IRC) in Nepal

Procedures to issue Deposit collection and Repo Instruments, 2016

As announced by Monetary Policy 2016/17, in order to implement IRC, SLF rate is taken as upper bound of IRC. In order to issue two weeks deposit collection and repo, following procedures is adopted to determine lower bound and policy rate of IRC:

Two weeks deposit collection

In order to determine the lower bound of IRC, OMOC adopts following procedures to issue two weeks deposit collections.

a) Weighted average IB rate of commercial banks of two working days before is taken and 10 basis points is deducted to determine interest rate.
b) Collect the deposits according to the requirement. "A", "B" and "C" class FIs can participate in auction of deposit collection.
c) OMOC has right to accept the deposits either fully or partially.
d) The collected bidding amount is debited from the related banks and credit in separate account and at maturity the deposit amount along with interest amount is credited in related bank's account.

Two weeks Repo

Upper bound of this repo is SLF rate while lower bound is determined by two weeks deposit collection. OMOC can issue two weeks repo through following procedures:

a) Weighted average IB rate of commercial banks of two working days before is taken and 200 basis points is deducted to determine interest rate.
b) Deposits so collected can't be counted as CRR but can be maintained as SLR and liquidity ratio.

Source: Public Debt Management Department, Nepal Rastra Bank

6.13 Earthquake and Regulatory Relief

Policy to extend concessional housing loan to earthquake victims was introduced immediately after the earthquake on 25 April 2015. Under this provision, a loan up to Rs. 2.5 million to inside Kathmandu valley residents and up to Rs. 1.5 million to outside valley residents at a 2 percent concessional interest for reconstruction of houses is to be granted by the BFIs. This was further extended to include loans up to Rs. 3 hundred thousand per client by micro-finance institutions (MFIs) against group guarantee. BFIs can get refinance of such loans at a zero percent interest from this bank. Under this scheme, a sum of Rs. 59 million has been extended as of 23 June 2016.

The NRB Introduced regulatory relief measures in order to boost the credit disbursement from the BFIs and bring dynamism in economic activity in the aftermath of the disastrous earthquake and border disturbance. Such regulatory reliefs include the relaxation of loan loss provisioning, rescheduling or restructuring of loan for up to one year, additional time for accounting interest income, one year grace period for loans extended to industry, trade, education, health, tourism and energy related projects, and the extension of trust receipt (import) loan period from 120 days to 180 days, among others.

The GoN established the "Economic Rehabilitation Fund (Establishment and Operation), 2015 " to minimize the effect of earthquake and border obstruction related supply disturbances on agriculture, tourism, industry and business, and bring dynamism in economy. The Economic Rehabilitation Fund of Rs. 100 billion, to be operated under this bank, will provide interest subsidy at 4 percent up to the credit of Rs. 100 million and 2 percent for more than Rs. 100 million for the loan extended in the specified sectors during the first six months of 2015/16. Likewise, BFIs can extend loan to earthquake victims at a maximum of 5 percent interest for specified business. The refinance facility can be availed from the Fund at 1.5 percent. Such facility will be provided for the entire amount of loan up to Rs. 50 million and, above that limit, the refinance facility will be provided only up to 20 percent of the excess of such credit amount.

6.14 Full-fledged Dematerialized Trading of Securities

Full-fledged dematerialized trading of securities has been made mandatory since 15 January 2016. With the commencement of mandatory dematerialized trading, the securities trading, clearing and settlement process are eased thereby increasing liquidity in the secondary market. Investor’s confidence and attitude towards securities market has been boosted with the implementation of this process. The full-fledged dematerialized trading led to fully comply T+3 clearing and settlement provision. Earlier this process used to take about 15-45 days in an average. The volume of transaction was increased significantly by 129.08 percent after the mandatory dematerialized trading system. Securities worth NPR 114.13 billion were traded in last six months of FY 2015/16 (after full-fledged implementation of demat share) which was NPR 49.82 billion in first six months of FY 2015/16 (before full-fledged implementation of demat share).

6.15 Membership of IOSCO and ANNA

SEBON has become an Associate member of International Organization of Securities Commissions (IOSCO), an association of securities regulators with effect from July 2016 after completing different processes laid down by IOSCO for becoming member. High level survey was responded to undertake the membership. There are 126 Ordinary members, 25 Associate members and 66 Affiliate members of IOSCO at present. After becoming an Associate member of IOSCO Nepalese securities market has also been in an international arena and also is a step towards setting internationally recognized and consistent standards of regulation. Similarly, SEBON initiated and coordinated the whole process to facilitate CDS and Clearing Limited (CDSC), a company providing centralized depository, clearing and settlement services in Nepal, to become the 92^{nd} member of Association of National Numbering Agencies (ANNA). Based on standard/criteria set by ANNA, CDSC provides the International Securities Identification Number (ISIN) to the listed securities.

6.16 Access in Market Depth

The practice of providing market depth to the investors initiated with the directives by SEBON in the fiscal year 2015/16. The market depth allows investors to get information of top five highest quoted buying and top five lowest quoted selling price of the securities that assists investors for informed decisions in securities investment.

Annex-1
Structure of Nepalese Financial Sector (Assets/Liabilities)

In million Rupees

Financial Institutions	**Mid-July 2012**	**Mid-July 2013**	**Mid-July 2014**	**Mid-July 2015**	**Mid-July 2016**
Commercial Banks	1,052,450.70	1,242,881.40	1,467,151.90	1,774,504.80	2,184,811.57
Development Banks	160,360.20	199,954.80	255,373.40	300,641.80	350,844.75
Finance Companies	109,687.50	100,856.70	110,342.30	108,007.40	103,443.22
MFFIs	29,815.50	35,774.90	49,395.80	70,880.40	100,770.60
Cooperatives (Capital, Fund and Savings)	166,634.86	191,614.00	233,715.55	265,551.90	385,721.81
Contractual Saving Institutions					
Employees Provident Fund	125,752.80	145,283.40	170,638.60	195,903.00	224,854.80
Citizen Investment Trust (Capital and Net Fund Balance)	38,068.50	42,753.60	54,621.30	67,675.00	83,013.40
Insurance Companies	73,825.00	84,650.40	101,097.20	129,450.00	158,241.60
Reinsurance Company	-	-	-	6,157.57	6,254.38
Total	**1,756,595.06**	**2,043,769.20**	**2,442,336.05**	**2,918,771.87**	**3,597,956.13**
Market capitalization (NEPSE)	368,262.10	514,492.10	1,057,165.80	9,89,403.96	1,889,451.74
Total (incl. market capitalization)	**2,124,857.16**	**2,558,261.30**	**3,499,501.85**	**2,918,771.87**	**5,487,407.87**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Commercial Banks	59.91	60.81	60.07	60.80	60.72
Development Banks	9.13	9.78	10.46	10.30	9.75
Finance Companies	6.24	4.93	4.52	3.70	2.88
Microfinance Development Banks	1.70	1.75	2.02	2.43	2.80
Cooperatives (Capital Fund and Savings)	9.49	9.38	9.57	9.10	10.72
Contractual Saving Institutions					
Employees Provident Fund	7.16	7.11	6.99	6.71	6.25
Citizen Investment Trust (Capital and Net Fund Balance)	2.17	2.09	2.24	2.32	2.31
Insurance Companies	4.20	4.14	4.14	4.44	4.40
Reinsurance Company	-	-	-	0.21	0.17
Total	**100**	**100**	**100**	**100**	**100**

Annex-2
Aggregate Statement of Assets and Liabilities of BFIs
(Aggregate)

In mllion Rupees

Particulars		Mid-July			Mid-June	Mid-July
		2013	2014	2015	2016	2016
Liabilities		1	2	3	4	5
1	**CAPITAL FUND**	131724.33	145861.43	162992.51	205700.70	214892.48
	a. Paid-up Capital	119506.94	128985.27	140794.10	161180.15	163370.74
	b. Statutory Reserves	26038.22	32722.08	37149.85	43483.46	43680.58
	c. Retained Earning	-22344.20	-27214.24	-27802.05	-17753.11	-11166.95
	d. Others Reserves	8523.37	11368.33	12850.60	18790.20	19008.11
2	**BORROWINGS**	26999.28	18202.84	21355.96	38619.25	42822.19
	a. NRB	2884.28	2010.04	3291.48	3607.44	6855.13
	b. "A"Class Licensed Institution	10466.63	5182.01	5504.53	19481.52	20083.07
	c. Foreign Banks and Fin. Ins.	2954.26	4.12	0.00	0.00	0.00
	d. Other Financial Ins.	2438.25	1306.53	1119.81	4757.92	5111.62
	e. Bonds and Securities	8255.86	9700.14	11440.14	10772.37	10772.37
3	**DEPOSITS**	1250061.98	1477832.61	1771946.15	2002140.77	2107502.69
	a. Current	111686.53	129108.41	158746.16	161301.44	185135.30
	b. Savings	471215.43	587593.46	714466.16	844557.06	875419.91
	c. Fixed	423478.43	453408.61	513283.02	582445.54	617634.95
	d. Call Deposits	225704.81	285024.29	363041.66	386216.11	401829.34
	e. Others	17976.78	22697.85	22409.16	27620.61	27483.20
4	**Bills Payable**	1561.63	1553.13	1729.91	3186.87	3927.13
5	**Other Liabilities**	140770.30	169227.44	188093.19	225462.29	206694.45
	1. Loan Loss Provision	42223.77	48932.49	51482.56	52460.34	48593.77
	2. Interest Suspense a/c	27920.72	30453.76	31256.97	43869.87	32000.69
	3. Others	70625.81	89841.19	105353.66	129132.07	126099.99
6	**Reconcillation A/c**	7290.04	2869.47	280.36	11614.16	13817.41
7	**Profit & Loss A/c**	26544.74	31566.75	36755.88	36621.31	49443.18
TOTAL		**1584952.29**	**1847113.68**	**2183153.96**	**2523345.34**	**2639099.54**
Assets						
1	**LIQUID FUNDS**	259224.93	319196.62	353397.28	345401.61	385746.01
	a. Cash Balance	35728.20	41862.07	48642.45	46867.48	56937.25
	Nepalese Notes & Coins	34876.14	41073.72	47305.51	44607.29	55937.33
	Foreign Currency	852.06	788.35	1336.94	2260.19	999.92
	b. Bank Balance	173856.67	220546.60	237957.23	230749.59	262419.81
	1. In Nepal Rastra Bank	130802.82	162286.93	165070.53	151455.39	180498.18

	2. "A"Class Licensed Institution	23269.10	34656.48	37838.00	36538.42	41730.30
	3. Other Financial Ins.	5673.35	5302.85	6882.80	8040.55	8437.01
	4. In Foreign banks	14111.40	18300.33	28165.90	34715.23	31754.32
	c. Money at Call	49640.06	56787.95	66797.60	67784.54	66388.94
2	**INVESTMENTS**	151339.99	162544.89	206160.48	218389.94	238675.86
	a. Govt.Securities	149700.83	160867.12	182112.29	207943.27	196070.31
	b Others	1639.16	1677.78	24048.18	10446.67	42605.55
3	**SHARE & OTHER INVESTMENT**	66725.48	72656.22	85675.60	117965.43	131777.67
4	**LOANS & ADVANCES**	945698.45	1119260.81	1345671.32	1611218.29	1669203.04
	a. Private Sector	915010.01	1084965.27	1230999.56	1557457.70	1542024.97
	b. Financial Institutions	21910.20	26247.72	30678.62	47141.13	121291.82
	c. Government Organizations	8778.24	8047.82	83993.14	6619.46	5886.25
5	**BILLS PURCHASED**	9007.88	9805.60	14548.03	11957.53	11601.52
6	**LOANS AGT. COLLECTED BILLS**	1015.49	737.25	1132.63	1128.62	1075.28
7	**FIXED ASSETS**	28916.79	30477.72	31732.63	33653.98	35044.21
8	**OTHER ASSETS**	104448.21	123962.34	135346.49	159545.60	144135.22
	a. Accrued Interests	30638.63	32041.34	32792.14	49643.40	34038.25
	b. Others	73809.58	91920.99	102554.35	109902.20	110096.97
9	**Expenses not Written off**	622.02	491.99	392.16	351.25	319.21
10	**Non Banking Assets**	3731.30	4756.96	5250.92	5140.96	4797.21
11	**Reconcillation Account**	10394.09	-1032.54	2947.32	17770.42	16089.93
12	**Profit & Loss A/c**	3827.69	4255.78	899.11	821.72	634.40
	TOTAL	**1584952.31**	**1847113.65**	**2183153.98**	**2523345.34**	**2639099.55**

Annex-3
Profit and Loss Statement of Bank and Financial Institutions

In million Rupees

Particulars	Mid-July			Mid-June	Mid-July
	2013	2014	2015	2016	2016
1 Interest Expenses	65347.35	68151.35	67271.02	61142.28	64943.04
1.1 Deposit Liabilities	64029.79	66485.63	65418.33	59712.53	63252.25
1.1.1 Saving A/c	21211.31	21763.14	22494.48	20354.30	21234.79
1.1.2 Fixed A/c	33220.30	34583.20	31594.10	29870.00	31710.65
1.1.2.1 Upto 3 Months Fixed A/c	1471.28	2866.37	1995.01	1755.08	1914.75
1.1.2.2 3 to 6 Months fixed A/c	1574.49	1065.31	1043.26	972.60	1240.54
1.1.2.3 6 Months to 1 Year Fixed A/c	15584.32	15136.29	14308.11	14883.42	15369.26
1.1.2.4 Above 1 Year	14590.21	15515.23	14247.72	12258.90	13186.09
1.1.3 Call Deposit	9552.50	10108.65	11302.25	9483.36	10301.47
1.1.4 Certificate of Deposits	45.69	30.64	27.50	4.86	5.34
1.2 Others	1317.56	1665.72	1852.69	1429.76	1690.79
2 Commission/Fee Expense	385.30	448.04	509.46	482.78	546.23
3 Employees Expenses	15947.51	18747.82	21218.85	19711.25	22715.53
4 Office Operating Expenses	14673.00	15067.83	17624.25	15444.69	18123.58
5 Exchange Fluctuation Loss	30.53	30.99	64.81	195.85	197.03
5.1 Due to Change in Exchange Rates	14.83	16.21	64.83	178.08	182.01
5.2 Due to Foreign Currency Transactions	15.70	14.77	-0.01	17.78	15.02
6 Non-Operatiing Expenses	1309.70	143.87	89.80	124.11	106.14
7. Provision for Risk	14903.98	14274.84	12781.47	9089.51	9649.95
7.1 Loan loss Provision	12280.32	12362.41	11018.41	7990.12	8451.80
7.1.1 General Loan loss Provision	2998.01	2835.44	4071.38	3758.89	5107.97
7.1.1.1 Pass Loan Loss Provision	0.00	0.00	3210.53	3184.97	4530.40
7.1.1.2 Watch List Provision	0.00	0.00	860.85	573.91	577.57
7.1.2 Special Loan Loss Provision	8865.40	9424.45	6627.48	3835.93	3028.49
7.1.3 Additional Loan Loss Provision	416.91	102.52	319.54	395.31	315.34
7.2. Provision for Non-Banking Assets	1916.95	1498.26	1429.51	827.80	1012.22
7.3. Provision for Loss on	204.60	40.12	101.98	16.03	14.53

Investment					
7.4. Provision for Loss of Other Assets	502.11	374.06	231.58	255.56	171.40
8 Loan Written Off	942.54	623.54	439.90	251.20	355.03
9 Provision for Staff Bonus	2879.03	3452.11	4053.16	4227.28	5851.53
10 Provision for Income Tax	8638.47	10677.75	12158.39	12877.51	17591.64
11 Others	481.92	45.06	495.79	22.00	61.16
12 Net Profit	25958.90	29331.59	37039.32	36007.01	49004.93
TOTAL EXPENSES	**151498.22**	**160994.78**	**173746.23**	**159575.47**	**189145.80**
Income					
1. Interest Income	120744.64	127191.89	134011.48	125274.78	146483.09
1.1. On Loans and Advance	111530.06	119484.79	127175.43	118772.42	138782.71
1.2. On Investment	4109.86	3502.98	2309.29	2971.40	3487.02
1.2.1 Government Bonds	3700.66	3049.44	1982.25	2530.71	3005.11
1.2.2 Foreign Bonds	22.70	28.74	76.54	126.22	136.72
1.2.3 NRB Bonds	336.67	234.04	160.24	172.13	199.66
1.2.4 Deventure & Bonds	49.84	190.76	90.26	142.33	145.54
1.3 Agency Balance	1183.87	962.10	716.42	512.15	589.35
1.4 On Call Deposit	2528.67	2108.65	2633.89	2010.15	2513.39
1.5 Others	1392.18	1133.37	1176.47	1008.66	1110.61
2. Comission & Discount	7162.36	8051.43	8935.14	8729.29	9828.97
2.1 Bills Purchase & Discount	212.27	231.80	248.42	288.92	300.48
2.2 Comission	5444.04	6517.57	7494.65	7326.82	8074.48
2.3 Others	1506.06	1302.07	1192.07	1113.54	1454.01
3 Income From Exchange Fluctuation	3225.60	4168.69	4761.74	5188.27	5708.82
3.1 Due to Change in Exchange Rate	731.73	220.18	983.31	1249.87	1342.09
3.2 Due to Foreign Currency Trans.	2493.87	3948.52	3778.43	3938.40	4366.73
4 Other Operating Income	4603.37	5508.69	7326.73	8045.40	9123.21
5 Non Operating Income	2359.48	4041.44	4743.47	2670.92	4775.86
6 Provision Written Back	8345.00	8679.68	11842.55	8257.40	11550.65
7 Recovery from Written off Loan	1274.79	806.02	1508.63	1010.60	**1276.09**
8 Income from Extra Ordinary Expenses	434.89	526.32	157.81	191.01	231.44
9 Net Loss	3348.21	2020.61	458.66	207.75	167.67
TOTAL INCOME	**151498.33**	**160994.77**	**173746.22**	**159575.42**	189145.79

Annex-4
Major Financial Indicators of Microfinance Financial Institutions

In million Rupee

Liabilities		Mid-July			Mid-Jun	Mid-July
		2013	2014	2015	2016	2016
1	**CAPITAL FUND**	3801.3	4950.7	6147.3	8595.0	8684.9
	a. Paid-up Capital	2234.0	2974.3	3987.3	5313.3	5436.5
	b. Statutory Reserves	383.5	523.1	750.3	1165.8	1214.8
	c. Retained Earning	208.2	220.6	8.9	333.7	363.6
	d. Others Reserves	975.6	1232.7	1400.8	1782.2	1670.0
2	**BORROWINGS**	20216.3	27897.3	38244.9	49152.8	52434.4
	a. NRB	210.3	526.4	306.6	101.1	91.1
	f. Others	20006.0	27371.0	37938.3	49051.7	52343.3
3	**DEPOSITS**	7221.6	11001.2	15775.5	22626.9	24095.3
4	**BILLS PAYABLE**		0.0	0.0	0.0	0.8
5	**OTHER LIABILITIES**	3009.7	3777.5	5205.7	8256.7	7205.0
	a. Loan Loss Provision	694.0	829.4	986.0	1364.4	1345.6
	b. Interest Suspense a/c	446.9	475.0	575.3	740.0	652.7
	c. Others	1868.8	2473.1	3644.3	6152.2	5206.8
6	**RECONCILIATION A/c**	688.6	1088.2	2330.2	4508.9	5031.9
7	**PROFIT & LOSS A/c**	837.9	1473.7	2524.8	3299.5	3318.2
Total		**35775.3**	**50188.7**	**70228.2**	**96439.7**	**100770.6**
	Assets					
1	**LIQUID FUNDS**	6322.8	7202.8	6597.2	9211.6	11096.2
	a. Cash Balance	42.8	39.2	62.2	110.1	75.5
	b. Bank Balance	3561.6	3710.6	3900.5	5895.7	6327.0
	c. Money at Call	2718.5	3452.9	2634.4	3205.9	4693.6
2	INVESTMENT IN SECURITIES EXCEPT SHARES	116.2	116.2	116.2	116.2	38.7
3	**SHARE & OTHER INVESTMENT**	2963.6	2894.2	2350.1	2788.7	2809.8
4	**LOANS & ADVANCES**	23401.7	35689.3	54915.5	74993.3	77232.9
	Institutional	6740.3	9863.5	14853.5	18512.7	19194.3
	Individual	16661.4	25825.8	40062.0	56480.6	58038.6
5	**FIXED ASSETS**	444.6	624.4	775.2	930.5	961.1
6	**OTHER ASSETS**	1685.8	2485.4	3205.4	4040.3	3598.2
7	**EXPENSES NOT WRITTEN OFF**	9.8	9.4	7.2	5.6	4.5
8	**NON BANKING ASSETS**	0.0	0.0	0.0	0.0	0.0
9	**RECONCILIATION A/c**	699.6	1085.2	2215.3	4344.7	5017.3
10	**PROFIT & LOSS A/c**	131.2	81.8	46.2	8.9	11.9
Total		**35775.4**	**50188.7**	**70228.2**	**96439.7**	**100770.6**

Annex-5

Sector wise, Product wise and Security wise credit flow from BFIs

In million Rupee

Particulars	Mid-July			Mid-June	Mid-July
Sectorwise	**2013**	**2014**	**2015**	**2016**	**2016**
Agricultural and Forest Related	39147.82	48152.08	61783.87	75009.26	76816.32
Fishery Related	657.80	2747.06	3355.59	1855.86	1980.46
Mining Related	3897.30	3580.05	3525.74	3717.96	3404.03
Agriculture, Forestry & Bevarage Production Related	190575.19	222489.70	255534.57	290722.63	296097.02
Construction	96067.34	118632.87	152480.40	178381.36	182851.94
Electricity,Gas and Water	20694.25	25606.61	34540.43	44031.68	46417.77
Metal Products, Machinary & Electronic Equipment & Assemblage	13050.42	13994.97	16208.31	18824.69	19473.46
Transport, Communication and Public Utilities	41298.89	43707.55	48451.67	64311.24	67489.25
Wholesaler & Retailer	198319.29	243966.15	297286.58	358823.86	374322.54
Finance, Insurance and Real Estate	84683.50	90353.77	107293.66	129201.92	135000.17
Hotel or Restaurant	25087.38	32909.63	44028.90	53611.00	54426.26
Other Services	46718.82	54154.23	63957.60	70040.85	72146.41
Consumption Loans	69436.96	87003.21	101450.14	118037.63	120843.49
Local Government	1255.49	1182.73	1714.14	1649.88	1654.98
Others	124829.52	141309.64	169740.36	216084.63	228955.74
TOTAL	**955719.96**	**1129803.67**	**1361351.97**	**1624304.44**	**1681879.83**
Productwise					
Term Loan	136442.95	173069.81	223149.61	260157.09	272694.42
Overdraft	184614.72	211367.58	245994.73	280005.47	294326.89
Trust Receipt Loan / Import Loan	41471.44	48161.32	55141.88	75373.93	72678.07
Demand & Other Working Capital Loan	220401.50	250607.47	293603.14	361353.81	365785.23
Residential Personal Home Loan (Up to Rs. 1 Crore)	66210.53	89484.87	118861.54	138623.38	142815.41
Real Estate Loan	86062.16	82482.16	85678.07	104019.95	108071.88
Margin Nature Loan	12935.41	20031.63	24084.77	34133.61	37681.04
Hire Purchase Loan	53933.61	63653.90	80966.96	103203.49	110094.35
Deprived Sector Loan	39549.07	50576.56	63889.82	74960.59	81239.19
Bills Purchased	8024.25	10045.08	13511.29	12420.67	12530.80
Other Product	106074.30	130323.28	156470.18	180052.42	183962.55

Total	**955719.96**	**1129803.66**	**1361351.98**	**1624304.43**	**1681879.83**
Collateral wise					
Gold and Silver	28785.76	31102.67	31374.67	30649.82	30642.25
Government Securities	3004.07	992.12	784.73	809.25	1014.67
Non Governmental Securities	8218.97	14092.14	18776.93	27944.98	29668.70
Fixed Deposit Receipts	11671.47	10774.58	9824.90	11931.55	10553.39
Own	10995.52	9893.47	8925.88	10405.67	9577.14
Other Licences Institutions	675.95	881.11	899.02	1525.88	976.25
Collateral of Properties	820463.46	936410.77	1131830.49	1404557.88	1463645.87
Fixed Assets	681424.84	785804.82	957231.98	1177481.68	1207217.80
Current Assets	139038.62	150605.95	174598.50	227076.19	256428.07
Against security of Bill	7710.77	11927.48	13969.01	15441.30	15710.45
Domestic Bills	1010.89	2817.51	3532.80	3820.91	3525.87
Foreign Bills	6699.89	9109.97	10436.21	11620.39	12184.58
Against Guarantee	21747.59	29975.14	40479.05	51690.39	52993.07
Government Guarantee	3394.30	2155.95	2385.24	2562.78	2364.19
Institutional Guarantee	13009.84	20737.62	27833.31	31048.85	33209.50
Personal Guarantee	959.91	2001.69	2350.72	4215.90	4054.12
Collective Guarantee	1364.92	2167.66	3581.03	5152.20	4855.55
International Rated Foreign Bank's Guarantee	115.10	192.25	93.08	4921.22	4226.93
Other Guarantee	2903.51	2706.26	4235.68	3789.44	4282.79
Credit Card	373.59	410.98	427.58	554.17	416.03
Others	53744.25	94117.78	113884.53	80725.12	77235.40
Total	**955719.94**	**1129803.67**	**1361351.89**	**1624304.45**	**1681879.83**

Annex-6
Major Financial Indicators
(Mid-July 2016)

		Class "A"	Class "B"	Class "C"	Overall
A. Credit, Deposit Ratios (%)					
1	Total Deposit/GDP	78.47	12.39	2.86	93.72
2	Total Credit/GDP	61.93	10.36	2.51	74.79
3	Total Credit/ Total Deposit	78.91	83.62	87.72	79.80
4	Lcy Credit/Lcy Deposit & Core Capital	75.97	74.56	71.05	75.59
5	Fixed Deposit/Total Deposit	29.72	24.49	38.80	29.31
6	Saving Deposit/Total Deposit	39.60	51.56	51.43	41.54
7	Current Deposit/Total Deposit	10.10	2.42	0.20	8.78
8	NPL/ Total Loan	1.82	1.48	14.42	2.19
9	Total LLP/Total Loan	2.51	2.12	15.54	2.89
10	Deprived SectorLoan/Total Loan $	5.52	6.77	4.57	5.65
B. Liquidity Ratios (%)					
1	Cash & Bank Balance/Total Deposit	14.39	16.94	28.48	15.15
2	Investment in Gov. Security/Total Deposit	10.61	1.97	5.16	9.30
3	Total Liquid Assets/Total Deposit	26.17	32.75	44.80	27.61
C. Capital Adequacy Ratios (%)*					
1	Core Capital/RWA	10.62	14.41	21.28	11.52
2	Total Capital/RWA	12.12	15.31	22.22	12.91
D. Financial Access					
1	No. of Branches	1869	852	175	2896
2	No. of Deposit Accounts	13010175	3302162	523680	16836017
3	No.of Loan Accounts	753636	303934	39000	1096570
4	No. of Branchless Banking Centers	812			812
5	No. of Branchless Banking Customers	213084			213084
6	No. of Non-operated Branchless Banking Centers	102			102
7	No. of Mobile Banking Customers	1604578	133561	16427	1754566
8	No. of Internet Banking Customers	489835	23036	2594	515465
9	No. of ATMs	1661	230	17	1908
10	No. of Debit Cards	4142390	479318	35417	4657125
11	No. of Credit Cards	52014			52014
12	No. of Prepaid Cards	82797			82797
E. Interest Rate(%)					

1	**Wt. Avg Interest on Deposit**	**3.28**			
	(a) Saving	2.24			
	(b) Fixed	5.57			
	(c) Call	3.81			
2	**Wt. Avg Interest on Credit**	**8.86**			

Annex - 9
Composition of Financial Stability Oversight Committee

Name and Designation	Status
Mr. Chintamani Siwakoti, Deputy Governor	Chairperson
Mr. Shiba Raj Shrestha, Deputy Governor	Member
Mr. Narayan Prasad Paudel, Executive Director, Bank and Financial Institution Regulation Department	Member
Mr. Nara Bahadur Thapa, Executive Director Research Department	Member
Mr. Bhishma Raj Dhungana, Executive Director, Foreign Exchange Management Department	Member
Mr. Laxmi Prapanna Niraula, Executive Director, Development Bank Supervision Department	Member
Mr. Maheshwor Lal Shrestha, Executive Director, Bank Supervision Department	Member
Mr. Upendra Kumar Paudel, Executive Director Micro-Finance Promotion and Supervision Department	Member
Mr. Ejendra Prasad Luite, Executive Director, Finance Company Supervision Department	Member
Mr. Bimal Raj Khanal, Director, Bank and Financial Institutions Regulation Department	Member Secretary
Registrar, Department of Cooperative	Invitee Member
Chief Executive, Insurance Board	Invitee Member
Chief Executive, Security Board of Nepal	Invitee Member
Administrator, Employee Provident Fund	Invitee Member
Chief Executive Officer, Citizen Investment Trust	Invitee Member
Related Sectors Experts (maximum 2)	Invitee Member

Annex - 10

Composition of Financial Stability Sub-Committee

Name and Designation	Status
Mr. Bimal Raj Khanal, Director, Bank and Financial Institutions Regulation Department	Coordinator
Ms. Mina Pandey, Deputy Director, Foreign Exchange Management Department	Member
Mr. Kamal Acharya, Deputy Director, Development Bank Supervision Department	Member
Dr. Dilli Ram Pokharel, Deputy Director, Research Department	Member
Mr. Dinesh Kumar Singh, Deputy Director, Finance Company Supervision Department	Member
Mr. Ram Hari Dahal, Deputy Director, Micro Finance Promotion and Supervision Department	Member
Mr. Satyendra Raj Subedi, Deputy Director Bank Supervision Department	Member
Ms. Samjhana Dhakal, Deputy Director Bank and Financial Institutions Regulation Department	Member Secretary