# FINANCIAL STABILITY REPORT

**Nepal Rastra Bank**

**Central Office**

Baluwatar, Kathmandu

July, 2017

# FINANCIAL STABILITY

# REPORT

**(Issue No. 9)**

**Nepal Rastra Bank**
Baluwatar, Kathmandu

**Disclaimer**

This *Ninth 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 2017. 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 2017. All the data and information in this report are retrieved from NRB depository, unless stated.

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

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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 |

नेपाल राष्ट्र बैंक
NEPAL RASTRA BANK

गभर्नर
Governor

केन्द्रीय कार्यालय
बालुवाटार, काठमाडौं
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# Foreword

An objective of Nepal Rastra Bank (NRB), the Central Bank of the Federal Democratic Republic of Nepal, as mentioned in Nepal Rastra Bank Act, 2002 (2058 B.S.) is to maintain stability of the banking and financial sectors. In order to ensure this, NRB has been focusing on assessing risks and vulnerabilities of the domestic financial system and implementing international standard prudential regulations and supervision.

In this regard and to convey activities in a transparent manner as well as to stabilize expectation, NRB has been publishing financial stability reports bi-annually since 2012. The reports identify the key risks, issues and challenges of Nepalese financial system with steps taken by NRB for the management of those. During the review period the domestic banking sector witnessed crisis of loanable fund, the share market showed bearish trend and real estate transactions had mildly expanded. The size of total assets and liabilities of the Banks and Financial Institutions (BFIs) had continued to increase. Similarly, non-BFIs (NBFIs) had also witnessed huge increment. It is noteworthy that with effective implementation of prudential regulation/supervision by this bank, the banking system has reduced its high exposures in real estate and other unproductive sectors.

The current issue of this report focuses on the trends of macroeconomic indicators, performance of BFIs and NBFIs in Nepal (including their liquidity and capital adequacy), the risk as well as resilience of these sectors along with capital market developments. Stringent micro-prudential regulation and supervision, judicious application of macro-prudential oversight and broad-based financial inclusion, have all 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 domestic banking and financial system and the achievements accomplished through the implementation of key regulations/policies.

For preparing this high quality report, I would acknowledge the dedication and efforts of officials in the bank, Financial Stability Oversight Committee (FSOC), Financial Stability Sub-committee (FSS) and the Financial Stability Unit (FSU). I believe that this report will be essential to the stakeholders for facilitating them in obtaining 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 the financial system of the country.

**(Dr. Chiranjibi Nepal)**

# Executive Summary

World Economic Outlook Update, July 2017 projected global output to grow by 3.5 percent in 2017 and 3.6 percent in 2018, unchanged from its April forecast which had anticipated a pick-up in global growth. This projected global growth rates for 2017–18 is higher than the 3.2 percent estimated for 2016 but are below pre-crisis averages, especially for most advanced economies and for commodity-exporting emerging and developing economies. Further to break down this projection, the growth is forecast to accelerate in 2017 in both advanced economies and emerging and developing economies to 2 percent and 4.6 percent respectively while in 2018 the growth forecast for advanced economies is 1.9 percent and 4.8 percent for emerging and developing economies.

According to WEO Update, July 2017 inflation averaged to 0.8 percent for Advanced Economies in 2016, 0.5 percent higher than in 2015. Similarly, inflation recorded 4.3 percent for the Emerging and Developing Economies in 2016, 0.4 percent lower than in 2015. Inflation in 2017 for Advanced Economies and Emerging and Developing Economies is forecasted 1.9 percent and 4.5 percent respectively while in 2018 inflation forecast for advanced economies 1.8 percent and 4.6 percent for Emerging and Nepalese economy remained buoyant in 2016/17 marked by higher growth, contained inflation and balance of payments surplus. Favorable weather, increase in tourists arrival and improvement in overall supply situation steered the economy towards the positive direction. Agriculture sector witnessed a marked improvement due to favorable monsoon, smooth supply of agricultural inputs and an expansion in forest related output. The non-agricultural sector witnessed a higher growth on account of the improvement in power supply and investment climate. Consumer price inflation averaged 4.5 percent in 2016/17 as against the target of 7.5 percent mainly due to base price effect and improved supply situation. Aggressive lending by banks and financial institutions (BFIs) to consumption and riskier sector created some financial friction after the first quarter of 2016/17, however, the situation smoothened following various policy measures taken by this Bank, including the moral suasion.

Central Bureau of Statistics (CBS) estimated the growth in the real GDP (at producers' price) at 7.5 percent in 2016/17 compared to 0.4 percent in 2015/16. The growth in real GDP at producers' price of 7.5 percent in 2016/17 has been a record high since 1993/94. Similarly, the real GDP at basic price is estimated to grow 6.9 percent compared to a growth of 0.01 percent in the previous year. Good monsoon rains, improved power supply and normal supply situation helped accelerate growth from the low base of the preceding year.

The annual average consumer price inflation moderated to 4.5 percent in 2016/17 from 9.9 percent in the previous year. The annual average inflation of 2016/17 has been the lowest since 2004/05. The inflation rate of 4.5 percent has been lower than its target of 7.5 percent in 2016/17. The higher base price of the preceding year, improved supply situation and lower global prices including that of India contributed to inflation easing in the review year.

Merchandise exports witnessed a turnaround from a decline of 17.8 percent in 2015/16 to a growth of 4.2 percent to Rs. 73.05 billion in 2016/17. However, merchandise exports have not fully recovered from the level of Rs. 85.32 billion in 2014/15. In the review year, exports to India, China and other countries increased 5 percent, 1.2 percent and 3.3 percent respectively. Total merchandise exports as percentage of GDP shrank to 2.8 percent in the review year from 3.1 percent in the previous year.

Merchandise imports increased by 28 percent to Rs. 990.11 billion in the review year as against a drop of 0.1 percent in the previous year. In the review year, imports from India, China and Other countries increased 32.8 percent, 10 percent and 26.8 percent respectively. Total import-to-GDP ratio increased to 38.1 in the review year from 34.4 percent of the previous year.

The workers' remittances increased by 4.6 percent to Rs. 695.45 billion in the review year compared to a growth of 7.7 percent in the previous year. The ratio of workers' remittances to-GDP declined to 26.8 percent in 2016/17 from 29.6 percent in 2015/16. The net transfer receipts increased by 9.5 percent to Rs. 851.80 billion in the review year. Such receipts had increased by 9.6 percent in the previous year.

Global Financial Stability Report October 2017 finds that the global financial system continues to strengthen in response to extraordinary policy support, regulatory enhancements, and cyclical upturn in growth. The health of global systemically important banks (GSIBs) continues to improve. Global bank balance sheets are stronger because of improved capital and liquidity buffers, amid tighter regulation and heightened market scrutiny. Considerable progress has been made in addressing legacy issues and restructuring challenges. The health of banks in many advanced economies continues to improve, as progress has been made in resolving some weaker banks, while a majority of systemic institutions are adjusting the business models and restoring profitability. The upswing in global economic activity has boosted market confidence while reducing near-term threats to financial stability.

Nepalese banking system is in consolidation process through the merger and acquisition. As of mid-July 2017, the total number of financial institutions stood at 229 comprising of Commercial Bank 28, Development Bank 40, Finance Companies 28 and Microfinance Financial Institutions 53. 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 149 in mid-July 2017 from 179 in mid-July 2016 due to merger and acquisition policy adopted by the NRB.

In terms of total assets and liabilities, banks and financial institutions shared 76.74 percent of total financial system of Nepal in mid-July 2017. The commercial banks remained the key player in the financial system occupying 64.00 percent of the system's total assets followed by development banks (7.45 percent), micro finance financial institutions (3.27) and finance companies (2.02 percent). In case of contractual saving institutions, EPF is a dominant institution having 6.14 percent of shares, followed by insurance companies (4.54 percent), CIT (2.42 percent) and Reinsurance Company and mutual fund (0.24 percent) as of mid-July 2017.

Total assets of BFIs increased by 14.02 percent and reached to Rs. 3009 billion. As on mid-July 2017, the commercial banks had provided 18.22 percent of their total loan on productive sector which includes 7.04 % in agriculture, 3.12 % in energy sector and 3.30% in tourism sector and 7.76 % in cottage and small industries respectively. Commercial banks have lent 10.16 % 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 2016 was 16.59 %.

The overall deprive sector lending by BFIs as on mid-July 2017 remained 6.26 percent where commercial banks, development banks and finance companies lend 5.95 percent, 9.11 percent and 5.15 percent respectively. The capital fund of BFIs increased by 43.63 percent to Rs. 308.65 billion in mid –July 2017 Rs. 214.89 billion in mid –July 2016. The overall CAR of BFIs in mid-July 2017 stood at 15.40 percent which was 12.91 percent in previous year.

NPL of BFIs stood at Rs. 36.10 billion in mid-July, 2017 which was Rs. 36.83 billion in mid-July 2016. 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 2012-2017 indicating the banking sector's resilience in large. NPL to total loans of banking industry stood at 1.81 percent of total loan comprising 1.54 parent of commercial banks, 1.36 percent of development banks and 13.37 percent of finance companies.

Credit flows from BFIs grew significantly by 18.60 percent in mid-July, 2017 such increment was 23.55 percent in mid-July, 2016. Commercial Banks grew by 24.66 percent in mid-July 2017, such increment was 26.23 percent in mid-July 2016.

Development banks and finance companies credit dropped by 10.04 and 12.82 percent respectively due to merger and acquisition with commercial banks in review period.

The overall profitability of banking sector increased slightly by 11.57 percent and reached to Rs. 54.67 billion in mid –July 2017, last year the overall profit of banking sector was increased by 32.29 percent. Commercial banks posted a higher share of profitability of the banking sector accounting 83.10 percent of the total profit in mid-July 2017.

After the issuance of the "Bank and Financial Institutions Merger By-laws, 2011", 150 BFIs have merged with each other forming 39 BFIs as of mid-July 2017. In the review period, 60 BFIs have merged and acquired to form 24 BFIs. As of mid-July 2017, the branch network of commercial banks reached 2274 followed by development banks (769), Finance companies (130) and Micro Finance Financial Institutions (1895). In mid-July 2017, on an average, a BFI branch has been serving approximately to 8960 people; excluding the branches of “D” class financial institutions. The banking service served population comes down to 5610 people per branch when branches of "D" class also included.

The state owned commercial banks have 13.73 percent share in total deposit of commercial banks. Their market share in terms of total assets of all BFIs stood at 15.29 percent, whereas in total deposit and loan & advances, the ratio reached to 12.05 and 13.83 percent respectively in mid-July 2016. Capital fund of all three state owned banks are Rs. 8.25 billion, Rs. 15.08 billion and Rs. 19.63 billion respectively for NBL, RBB and ADBL.

As in mid-July 2017, share of commercial banks in total assets and liabilities of NRB regulated BFIs increased to 83.41 percent from 79.74 in mid-July 2016. Similarly, share of total assets and liabilities of commercial banks on total GDP increased to 100.80 percent from 97.15 percent in mid-July 2016. Total deposit and credit of commercial banks stood at 80.53 and 66.10 of GDP in mid-July 2017 which was 78.46 and 61.39 percent of GDP in mid-July 2016 respectively. Total deposits grew by 18.63 percent to Rs. 2093.26 billion during the period of mid-July 2017, against the previous growth of 20.62 percent during mid-July 2016. Total credit flows grew by 24.47 percent and reached to Rs. 1718.13 in mid-July 2017.

Overall Development banks portfolio has decreased during FY 2016-17 due to merger wave created by regulatory capital increment. Deposits of banks was decreased by 14.07 percent to Rs. 239.42 billion and credits too decreased by 10.04

percent to Rs. 209.60 billion mainly due to merger of existing development bank to commercial bank. The ratio of credit to domestic deposit and core capital stand at 76.82 percent in mid-July 2017. The ratio of credit to domestic deposit and core capital was 74.41 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 2.18 percent in mid-July 2017, which was 2.86 percent of GDP in mid July 2016. The total assets and liabilities of finance companies decreased in mid-July 2017 by 21.49 percent to Rs. 68 billion compared to mid-July 2016. Finance companies mobilized aggregate deposit of Rs. 50 billion in mid July 2017 which is a decrease of 17.77 percent compared to mid-July 2016.

As of mid-July 2017, deposits of cooperatives totaled Rs. 301.67 billion and total credit stood at Rs. 295.24 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 16.23 percent to Rs. 185.89 billion during fiscal year 2016-17. Total assets of life insurance companies' and non-life companies' expanded by 16.31 percent and 15.91 percent respectively. According to unaudited figures of mid-July 2017, Employee Provident Fund (EPF) has provident fund amounting to Rs. 244.15 billion, while total assets/liabilities of EPF stood at Rs. 251.28 billion.

Short term and long term interest rates in the financial market remained relatively high in FY 2016/17 in comparison to FY 2015/16. Nepalese currency appreciated by 3.8 percent against US dollar during the end of 2016/17 compared to a depreciation by 5.2 percent in the same period of the previous year. The exchange rate of one US dollar stood at Rs. 102.86 in mid-July 2017 compared to Rs. 106.73 in mid-July 2016. NEPSE index decreased by 7.89 percent to be 1582.67 points at the end of fiscal year 2016/17. It was at 1718.15 points at the end of previous fiscal year. Similarly, float index reached to 116.14 points which is decreased by 7.30 percent as compared to 125.41 points of previous fiscal year.

# CHAPTER - ONE
# MACROECONOMIC DEVELOPMENT

## Global Economic Growth

World Economic Outlook Update, July 2017 projected global output to grow by 3.5 percent in 2017 and 3.6 percent in 2018, unchanged from its April forecast which had anticipated a pick-up in global growth. This projected global growth rates for 2017–18 is higher than the 3.2 percent estimated for 2016 but are below pre-crisis averages, especially for most advanced economies and for commodity-exporting emerging and developing economies.

Further to break down this projection, the growth is forecast to accelerate in 2017 in both advanced economies and emerging and developing economies to 2 percent and 4.6 percent respectively while in 2018 the growth forecast for advanced economies is 1.9 percent and 4.8 percent for emerging and developing economies.

Taking the country level contribution to global growth projection, in Advanced Economies, the growth of U.S. is revised down for both 2017 and 2018 on account of weak growth outturn in the first quarter of this year and on the assumption that fiscal policy will be less expansionary than previously assumed. Likewise, the growth forecast has also been revised down for the United Kingdom for 2017 on weaker-than-expected activity in the first quarter. However, the growth projections for 2017 have been revised up for Canada and Euro area countries reflecting stronger momentum in domestic demand than previously anticipated. Likewise, Japan's growth projection is also revised upward following growth in private consumption, investment, and exports in first-quarter.

Regarding the Emerging and Developing Economies, China's growth is expected to remain at 6.7 percent in 2017, revised up by 0.1 percentage point, reflecting the stronger than expected outturn in the first quarter of the year underpinned by previous policy easing and supply-side reforms (including efforts to reduce excess capacity in the industrial sector) and 6.4 percent in 2018, the upward revision of 0.2 percentage point mainly reflecting an expectation that the authorities will delay the needed fiscal adjustment (especially by maintaining high public investment) to meet their target of doubling 2010 real GDP by 2020. Growth in India is forecast to pick up further in 2017 and 2018, in line with the April 2017 forecast.

**Table: 1.1 Overview of the World Economic Outlook Projection**

| | Year over Year | | | |
|---|---|---|---|---|
| | Estimate | | Projections | |
| | 2015 | 2016 | 2017 | 2018 |

| | | | | |
|---|---|---|---|---|
| **World Output** | **3.4** | **3.2** | **3.5** | **3.6** |
| **Advanced economies** | **2.1** | **1.7** | **2.0** | **1.9** |
| United States | 2.6 | 1.6 | 2.1 | 2.1 |
| Euro Area | 2.0 | 1.8 | 1.9 | 1.7 |
| Germany | 1.5 | 1.8 | 1.8 | 1.6 |
| France | 1.1 | 1.2 | 1.5 | 1.7 |
| Italy | 0.8 | 0.9 | 1.3 | 0.6 |
| Spain | 3.2 | 3.2 | 3.1 | 2.4 |
| Japan | 1.1 | 1.0 | 1.3 | 0.6 |
| United Kingdom | 2.2 | 1.8 | 1.7 | 1.5 |
| Canada | 0.9 | 1.5 | 2.5 | 1.9 |
| Other Advanced Economies 3/ | 2.0 | 2.2 | 2.3 | 2.4 |
| **Emerging Markets and Developing Economies** | **4.3** | **4.3** | **4.6** | **4.8** |
| Commonwealth of Independent States | -2.2 | 0.4 | 1.7 | 2.1 |
| Russia | -2.8 | -0.2 | 1.4 | 1.4 |
| Excluding Russia | -0.5 | 1.8 | 2.5 | 3.5 |
| Emerging and Developing Asia | 6.8 | 6.4 | 6.5 | 6.5 |
| China | 6.9 | 6.7 | 6.7 | 6.4 |
| India 4/ | 8.0 | 7.1 | 7.2 | 7.7 |
| ASEAN-5 5/ | 4.9 | 4.9 | 5.1 | 5.2 |
| Emerging and Developing Europe | 4.7 | 3.0 | 3.5 | 3.2 |
| Latin America and the Caribbean | 0.1 | -1.0 | 1.0 | 1.9 |
| Brazil | -3.8 | -3.6 | 0.3 | 1.3 |
| Mexico | 2.6 | 2.3 | 1.9 | 2.0 |
| Middle East, North Africa, Afghanistan, and Pakistan | 2.7 | 5.0 | 2.6 | 3.3 |
| Saudi Arabia | 4.1 | 1.7 | 0.1 | 1.1 |
| Sub-Saharan Africa | 3.4 | 1.3 | 2.7 | 3.5 |
| Nigeria | 2.7 | -1.6 | 0.8 | 1.9 |
| South Africa | 1.3 | 0.3 | 1.0 | 1.2 |
| *Memorandum* | | | | |
| Low-Income Developing countries | 4.6 | 3.6 | 4.6 | 5.2 |

| | | | | |
|---|---|---|---|---|
| World Growth Based on Market Exchange Rates | 2.7 | 2.5 | 2.9 | 3.0 |
| Consumer Prices | | | | |
| Advanced Economies | 0.3 | 0.8 | 1.9 | 1.8 |
| Emerging Market and Developing Economies 8/ | 4.7 | 4.3 | 4.5 | 4.6 |

*Source: World Economic Outlook Update, July 2017.*

*Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during May 3-May 31, 2017. Economies are listed on the basis of economic size. The aggregated quarterly data are seasonally adjusted.*

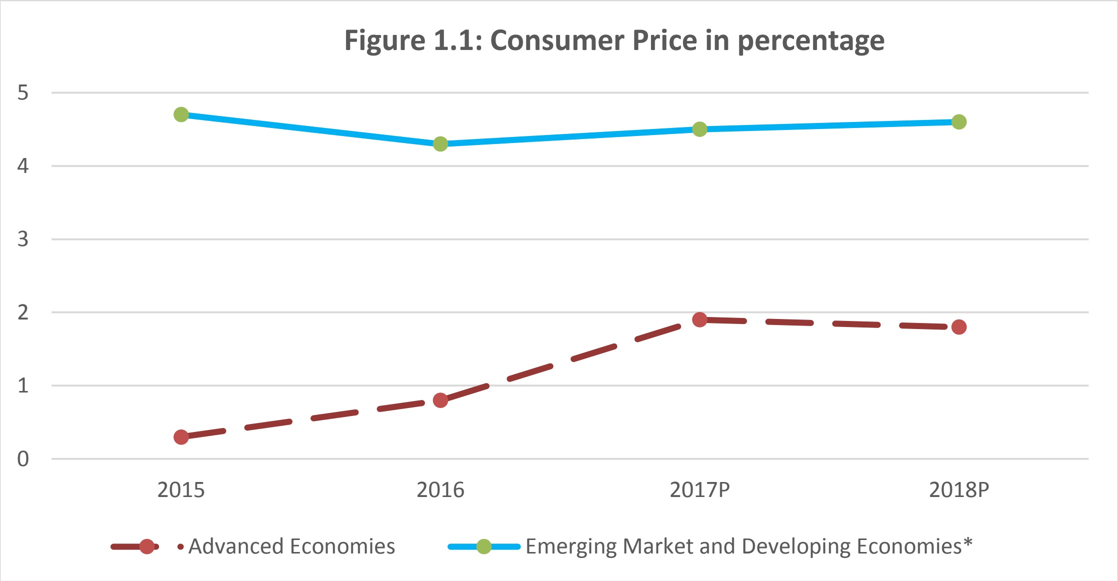
*3/ Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.*

*4/ 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.*

*8/ Excludes Argentina and Venezuela.*

## Inflation

According to WEO Update, July 2017 inflation averaged to 0.8 percent for Advanced Economies in 2016, 0.5 percent higher than in 2015. Similarly, inflation recorded 4.3 percent for the Emerging and Developing Economies in 2016, 0.4 percent lower than in 2015. Inflation in 2017 for Advanced Economies and Emerging and Developing Economies is forecasted 1.9 percent and 4.5 percent respectively while in 2018 inflation forecast for advanced economies 1.8 percent and 4.6 percent for Emerging and Developing Economies.




*Source: World Economic Outlook Update, July 2017.*

**Excludes Argentina and Venezuela*

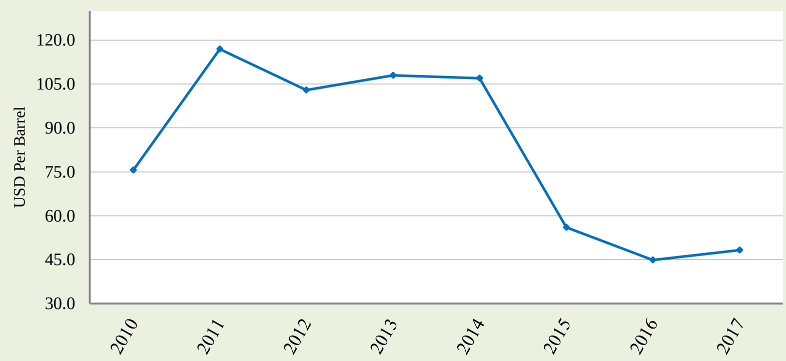
*P= Projected*

## Crude Oil

M-o-M average price of Brent Crude oil increased 4.2 percent in July 2017 compared to June 2017. The average monthly crude oil price remained at US dollar 48 in July 2017. It was at US dollar 46 per barrel in June 2017. Oil prices have receded, reflecting strong inventory levels in the United States and a pickup in supply.

Oil prices had increased since early 2016 ( 54.7 per barrel in January and 54.9 per barrel in February) mainly due to the agreement by the Organization of the Petroleum Exporting Countries (OPEC) and other producers to cut oil production. Stronger activity and expectations of more robust future global demand also contributed to strengthening oil prices.

**Figure 1.2: Average Oil Price Movement in July**




**(Source: http://www.eia.gov/dnav/pet/hist/)**

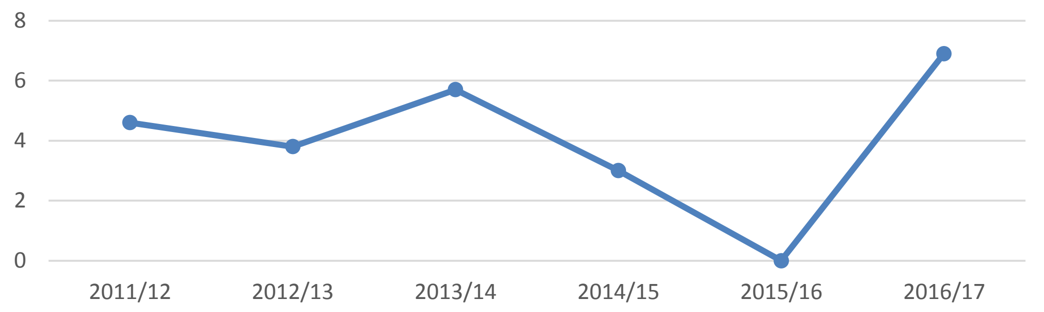
## DOMESTIC MACROECONOMIC DEVELOPMENT

Nepalese economy remained buoyant in 2016/17 marked by higher growth, contained inflation and balance of payments surplus. Favorable weather, increase in tourists arrival and improvement in overall supply situation steered the economy towards the positive direction. Agriculture sector witnessed a marked improvement due to favorable monsoon, smooth supply of agricultural inputs and an expansion in forest related output. The non-agricultural sector witnessed a higher growth on account of the improvement in power supply and investment climate. Consumer price inflation averaged 4.5 percent in 2016/17 as against the target of 7.5 percent mainly due to base price effect and improved supply situation. Aggressive lending by banks and financial institutions (BFIs) to consumption and riskier sector created some financial friction after the first quarter of 2016/17, however, the situation smoothened following various policy measures taken by this Bank, including the moral suasion.

## Economic Growth

Central Bureau of Statistics (CBS) estimated the growth in the real GDP (at producers' price) at 7.5 percent in 2016/17 compared to 0.4 percent in 2015/16. The growth in real GDP at producers' price of 7.5 percent in 2016/17 has been a record high since 1993/94. Similarly, the real GDP at basic price is estimated to grow 6.9 percent compared to a growth of 0.01 percent in the previous year. Good monsoon rains, improved power supply and normal supply situation helped accelerate growth from the low base of the preceding year.

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



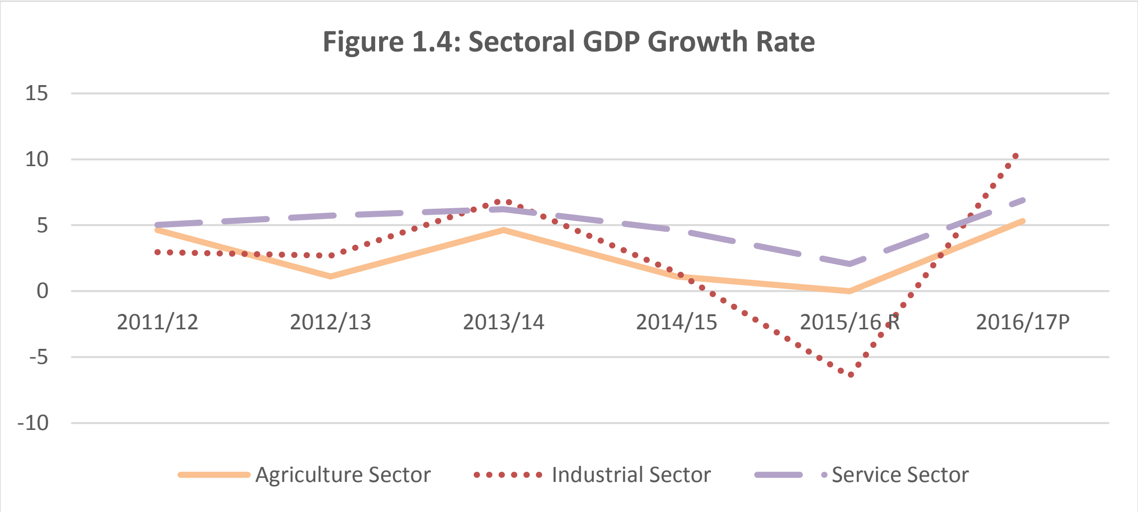

*R= Revised; P=Preliminary*

*Source: Central Bureau of Statistics*

In the review year, the agriculture sector grew by 5.3 percent, the higher growth derived primarily due to surge in paddy production which grew by 21.7 percent in the review year. Similarly, non-agricultural sector exhibited growth of by 7.7 percent compared to the growth of 0.2 percent in 2015/16.

Industrial sector is estimated to grow by 10.9 percent in the review year as against a contraction of 6.3 percent in the previous year. Industrial sector witnessed a higher growth on account of the improvement in power supply and investment climate.

In the review year, the service sector is estimated to grow by 6.9 percent compared to a growth of 2.1 percent in the previous year. Increased tourists' inflow, expansion of trade and communication sector accounted for the rise in service sector.

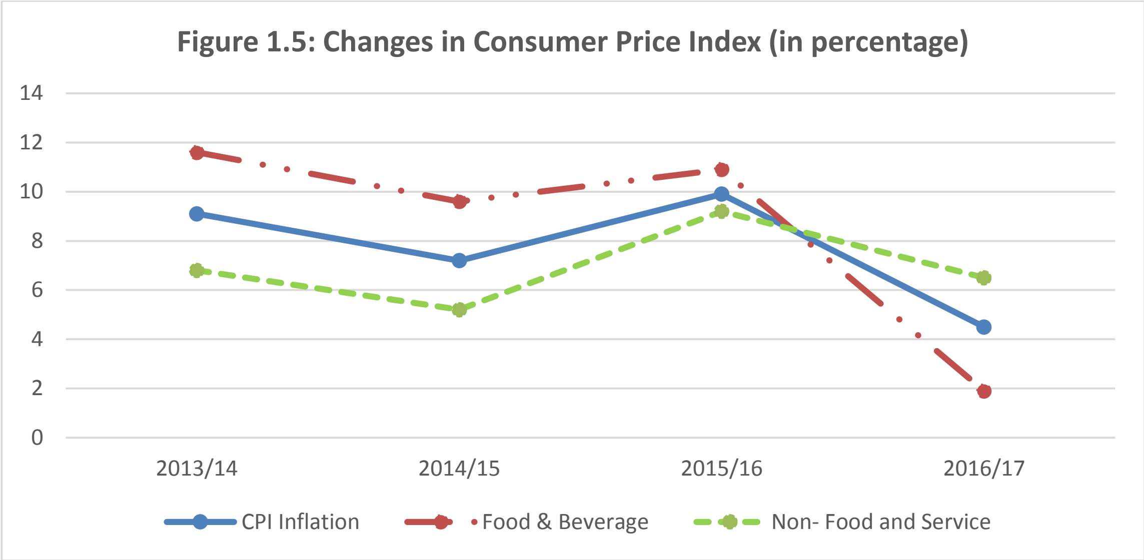



*R= Revised; P=Preliminary*

*Source: Central Bureau of Statistics (CBS)*

## Inflation

The annual average consumer price inflation moderated to 4.5 percent in 2016/17 from 9.9 percent in the previous year. The annual average inflation of 2016/17 has been the lowest since 2004/05. The inflation rate of 4.5 percent has been lower than its target of 7.5 percent in 2016/17. The higher base price of the preceding year, improved supply situation and lower global prices including that of India contributed to inflation easing in the review year. While the average food inflation eased to 1.9 percent in 2016/17 from 10.9 percent in the preceding year, the nonfood inflation moderated to 6.5 percent in the review year from 9.2 percent a year ago. The decline in prices of ghee and oil (6 percent), pulses and legumes (5.5 percent) and vegetable (2.5 percent) drove down overall food inflation in the review year.



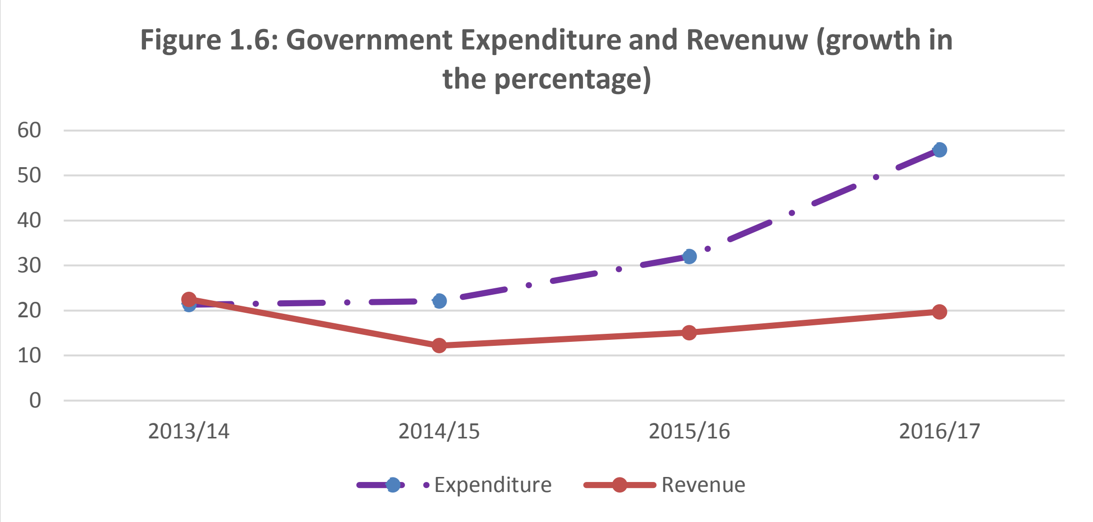

*Source: Nepal Rastra Bank (NRB)*

## Government Finance

The government revenue increased 26.4 percent to Rs. 609.17 billion in 2016/17. The revenue collection is 107.7 percent of its budget target of Rs. 565.90 billion. The revenue had risen by 18.8 percent to Rs. 481.98 billion in 2015/16. Revenue-to-GDP ratio increased to 23.4 percent in the review year from 21.4 percent in 2015/16. Of the total revenue, the share of tax revenue and non-tax revenue stood at 89.9 percent and 10.1 percent respectively in the review year. In the previous year, the shares of tax and nontax revenue in the total revenue were 87.4 percent and 12.6 percent respectively. While the share of direct tax in total tax revenue decreased to 34.6 percent in 2016/17 from 35.8 percent in the previous year, the share of indirect tax revenue increased to 65.4 percent from 64.2 percent in preceding year.

Government expenditure, on cash basis, increased 36.5 percent to Rs. 793.91 billion in 2016/17 compared to an increase of 14.2 percent to Rs. 581.7 billion in 2015/16. During the review year, recurrent expenditure increased 37.6 percent to

Rs. 501.62 billion compared to a growth of 8.8 percent in the preceding year. Such expenditure stood at 81.3 percent of its budget estimate. Likewise, capital expenditure increased 63.8 percent to Rs. 189.46 billion compared to its growth of 42.8 percent in the previous year. The capital expenditure in the review year accounted for 60.7 percent of its budget estimate of Rs. 311.95 billion. Financial expenditure increased 1.3 percent to Rs. 102.84 billion. The financial spending accounted for 85.8 percent of its budget estimate.



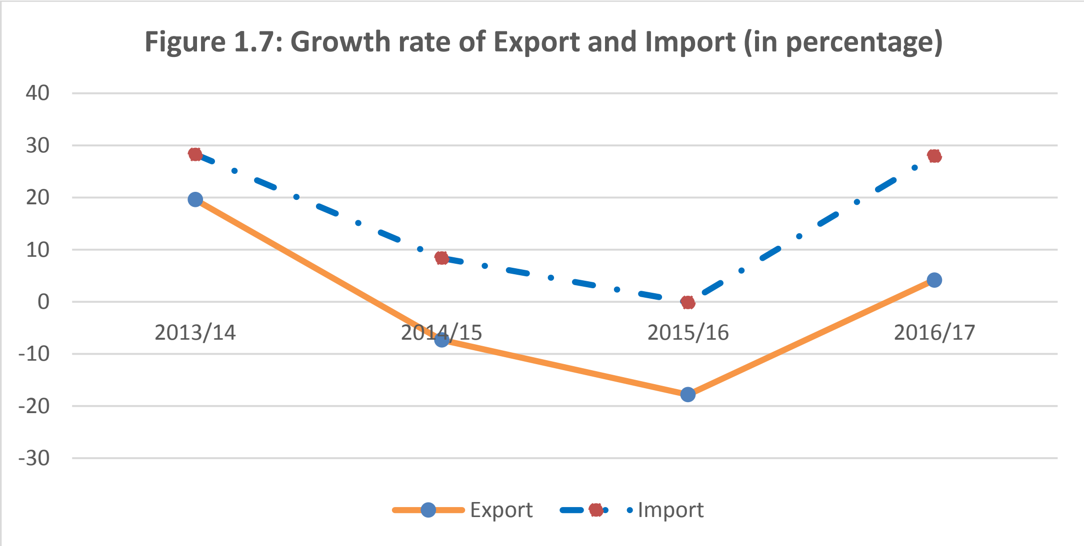

*Source: Nepal Rastra Bank (NRB)*

**External Sector**

Merchandise exports witnessed a turnaround from a decline of 17.8 percent in 2015/16 to a growth of 4.2 percent to Rs. 73.05 billion in 2016/17. However, merchandise exports have not fully recovered from the level of Rs. 85.32 billion in 2014/15. In the review year, exports to India, China and other countries increased 5 percent, 1.2 percent and 3.3 percent respectively. Total merchandise exports as percentage of GDP shrank to 2.8 percent in the review year from 3.1 percent in the previous year.

Merchandise imports increased by 28 percent to Rs. 990.11 billion in the review year as against a drop of 0.1 percent in the previous year. In the review year, imports from India, China and Other countries increased 32.8 percent, 10 percent and 26.8 percent respectively. Total import-to-GDP ratio increased to 38.1 in the review year from 34.4 percent of the previous year.

Merchandise trade deficit widened 30.4 percent to Rs. 917.06 billion in 2016/17. The export-import ratio declined to 7.4 percent in the review year from 9.1 percent in the previous year. Total merchandise trade deficit as percentage of GDP jumped to 35.3 percent in the review year from 31.3 percent of the previous year.




*Source: Nepal Rastra Bank (NRB)*

The total services receipts increased 14.3 percent and expenses rose to 20.8 percent in the review period. As a result, net services surplus stood at Rs. 2.89 billion in the review period compared to Rs. 9.85 billion in the same period of the previous

The workers' remittances increased by 4.6 percent to Rs. 695.45 billion in the review year compared to a growth of 7.7 percent in the previous year. The ratio of workers' remittances to-GDP declined to 26.8 percent in 2016/17 from 29.6 percent in 2015/16. The net transfer receipts increased by 9.5 percent to Rs. 851.80 billion in the review year. Such receipts had increased by 9.6 percent in the previous year.

Capital transfer of Rs. 13.36 billion and foreign direct investment (FDI) inflows of Rs. 13.50 billion were recorded in the review year. In the previous year, capital transfer and FDI inflows were Rs. 16.99 billion and Rs. 5.92 billion respectively.

The gross foreign exchange reserves increased by 3.9 percent to Rs. 1079.52 billion as at mid-July 2017 from Rs. 1039.21 billion in mid-July 2016. The share of reserves held by NRB increased 4.5 percent to Rs. 927.27 billion as at mid-July 2017 from Rs. 887.01 billion as at mid-July 2016. The share of Indian currency in total reserves stood at 23.3 percent as at mid-July 2017.

Foreign assets and liabilities of the country stood at Rs. 1107.79 billion and Rs. 666.41 billion respectively as at mid-July 2017. Accordingly, the net IIP remained in surplus of Rs. 441.38 billion as at mid-July 2017. Such surplus was Rs. 443.53 billion as at mid-July 2016.

## Monetary Situation

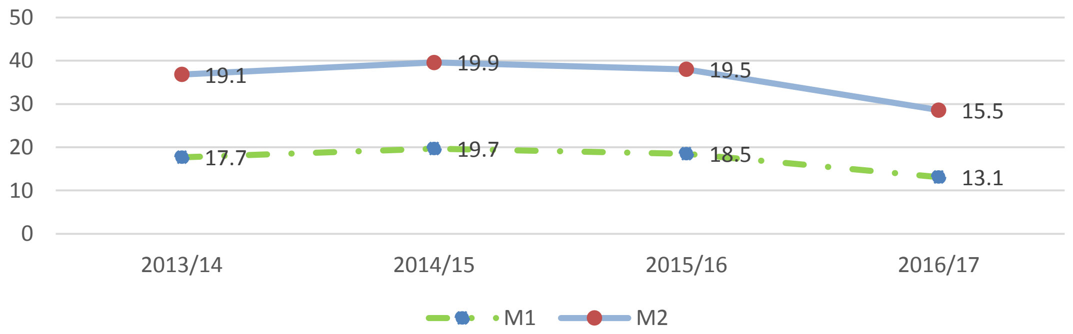
The growth in broad money (M2) was relatively lower at 15.5 percent in the review year compared to 19.5 percent in the previous year. The growth in M2 at 15.5 percent almost matched with the growth in nominal GDP of 15.7 percent in 2016/17.

The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) increased to Rs. 82.15 billion (8.6 percent) in the review year compared to an increase of Rs. 188.95 (25.3 percent) billion in the previous year. Reserve money increased by 20.1 percent in the review year compared to a rise of 4.6 percent in the previous year.

Domestic credit expanded by 19.4 percent in the review year compared to a growth of 18.2 percent in the previous year. Claims of monetary sector on the private sector increased 18 percent in the review year compared to a growth of 23.2 percent in the previous year.

Deposits at Banks and Financial Institutions (BFIs) increased by 14 percent in the review year compared to an increase of 19.4 percent in the previous year. Of the total deposits at BFIs, while the share of demand deposits fell to 8.7 percent from 9.1 percent and saving deposits to 35.4 percent from 43.3 percent, the share of fixed deposits increased to 43.2 percent in mid-July 2017 from 30.5 percent in 2015/16.

Figure 1.7: Growth rate of Money Supply (in percentage)




*Source: Nepal Rastra Bank (NRB)*

## Liquidity Situation

In the review year, Rs. 61 billion liquidity was injected through open market operations. Under this provision, NRB injected liquidity of Rs. 33.21 billion through repo auction including Rs. 5.4 billion under the corridor system. A total of Rs. 27.79 billion liquidity was availed through outright purchase auction.

Likewise, the BFIs used Rs. 62.39 billion standing liquidity facility (SLF) in 2016/17.

In the review year, the NRB injected net liquidity of Rs. 435.86 billion liquidity through the net purchase of USD 4.11 billion from foreign exchange market. Net liquidity of Rs. 471.35 billion was injected through the net purchase of USD 4.45 billion in the previous year.

In 2016/17, the NRB mopped up Rs. 124.45 billion through open market operations. Of which, Rs. 43.75 billion was mopped up through 14 days deposit collection auction under the corridor system, Rs. 16.45 billion under 90 days deposit collection auction and Rs. 64.25 billion through reverse repo auction on a cumulative basis. In the previous year, Rs. 542.55 billion liquidity was mopped up. This consists of Rs. 297.5 billion through deposit collection auction, Rs. 235.95 billion through reverse repo auction and Rs. 9.10 billion through outright sale auction.

The NRB purchased Indian currency (INR) equivalent to Rs. 451.89 billion through the sale of USD 4.12 billion and Euro 120 million in the review year. INR equivalent to Rs. 385.47 billion was purchased through the sale of USD 3.40 billion and Euro 210 million in the previous year

# CHAPTER - TWO

## FINANCIAL SYSTEM PERFORMANCE AND STABILITY

### Global Financial Stability Overview

#### *Overall Financial Stability Outlook*

*Global Financial Stability Report* October 2017 finds that the global financial system continues to strengthen in response to extraordinary policy support, regulatory enhancements, and cyclical upturn in growth. The health of global systemically important banks (GSIBs) continues to improve. Global bank balance sheets are stronger because of improved capital and liquidity buffers, amid tighter regulation and heightened market scrutiny. Considerable progress has been made in addressing legacy issues and restructuring challenges. The health of banks in many advanced economies continues to improve, as progress has been made in resolving some weaker banks, while a majority of systemic institutions are adjusting the business models and restoring profitability. The upswing in global economic activity has boosted market confidence while reducing near-term threats to financial stability.

The report also examines the short and medium term implications for economic growth and financial stability of the past decades' rise in household debt. It documents large differences in household debt-to-GDP ratios across countries but a common increasing trajectory that was moderated but not reversed by the global financial crisis. The report also develops a new macroeconomic measure of financial stability by linking financial conditions to the probability distribution of future GDP growth and applies to a set of 21 major advanced and emerging market economies. It also shows that changes in financial conditions shift the whole distribution of future GDP growth. The environment of continuing monetary accommodation necessary to support activity and boost inflation is also leading to rising assets valuations and higher leverage. The report also finds that the financial stability risks are shifting from the banking system toward nonbank and market sectors of the financial system. These developments and risks call for delicately balancing the eventual normalization of monetary policies, while avoiding a further buildup of financial risks outside the banking sector and addressing remaining legacy problems.

In China, financial policy tightening in recent quarters has eased concerns about a near-term slowdown and negative spillovers to the global economy. However, the size, complexity, and pace of growth in China's financial system point to elevated financial stability risks. Banking sector assets, at 310 percent of GDP, have risen from 240 percent of GDP at the end of 2012. Furthermore, the growing use of short-term wholesale funding and shadow credit to firms has increased vulnerabilities at banks. Chinese authorities face a delicate balance between tightening financial sector policies and slowing economic growth. Reducing the growth of shadow credit even modestly would weigh on the profitability and broader provision of credit by small and medium-sized banks.

India's financial system remains stable, even though the banking sector continues to face significant challenges. India's macroeconomic conditions remained stable and the expectations of accelerated reforms and political stability further reinforced the overall positive business sentiment. Reforms in foreign direct investment, implementation of goods and services tax (GST), and revival in external demand are likely to contribute to a better growth outlook. The capital market indices moved to a higher territory reflecting these positive sentiments.

According to G*FSR* October 2017, the policymakers should take advance of the improving global outlook and avoid complacency by addressing rising medium-term vulnerabilities and should take proactive measures as stated below.

1. Policymakers and regulators should fully address crisis legacy problems and require banks and insurance companies to strengthen their balance sheets in advanced economies. This includes putting a resolution framework for international banks into operation, focusing on risks from weak bank business models to ensure sustainable profitability, and finalizing Basel III. Regulatory frameworks for life insurers should be enhanced to increase reporting transparency and incentives to build resilience. A global and coordinated policy response is needed for resilience to cyber attacks.
2. Major central banks should ensure a smooth normalization of monetary policy through well communicated plans on unwinding their holdings of securities and guidance of prospective changes to policy frameworks. Providing clear paths for policy changes will help anchor market expectation and ward off undue market dislocations or volatility.
3. Financial authorities should deploy macro-prudential measure, and consider extending the boundary of such tools, to curb rising leverage and contain growing risks to stability. For instance, borrower-based measure should be introduced and/or tightened to slow fast-growing overvalued segments, and bank stress tests must assume more stressed asset valuations. Capital requirements should be increased for banks that are more exposed to vulnerable borrowers to act as a cushion for already accumulated exposures and incentivize banks to grant new loans to less risky sectors.
4. Regulation of the non bank financial sector should be strengthened to limit risk migration and excessive capital market financing. Transition to risk-based supervision should be accelerated, and harmonized regulation of insurance companies with emphasis on capital should be introduced.

Tighter micro-prudential requirements should be implemented in highly leveraged segments.

5. Debt overhangs-especially among the largest borrowers as potential originators of shocks-must be addressed. Discouraging further debt buildup through measures that encourage business investment and discourage debt financing will help curb financial risk taking.
6. Emerging market economies should continue to take advantage of supportive external conditions to enhance their resilience, including by continuing to strengthen external positions where needed, and reduce corporate leverage where it is high. This would put these economies in a better position to withstand a reduction in capital inflows as a result of monetary normalization in advanced economies or waning global risk appetite. Similarly, frontier market and low-income-country borrowers should develop the institutional capacity to deal with risks from the issuance of marketable securities, including formulating comprehensive medium-term debt management strategies. This will enable them to take advantage of broader financial market development and access, while containing the associated risks.

## 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. 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 2017, the total number of financial institutions stood at 149 comprising of Commercial Bank 28, Development Bank 40, Finance Companies 28, and Microfinance Development Banks 53. 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 149 in mid-July 2017 from 179 in mid-July 2016 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 2014 | Mid-July 2015 | Mid-July 2016 | Mid-July 2017 |
|---|---|---|---|---|
| Commercial Banks | 30 | 30 | 28 | 28 |
| Development Banks | 84 | 76 | 67 | 40 |
| Finance Companies | 53 | 47 | 42 | 28 |
| Microfinance Finance Development Banks (MFFIs) | 37 | 38 | 42 | 53 |
| **Sub-Total** | **204** | **191** | **179** | **149** |
| NRB Licensed Cooperatives (with limited banking activities) | 15 | 15 | 15 | 15 |
| NRB Licensed FINGOs (with limited banking activities) | 29 | 27 | 25 | 25 |
| Insurance Companies | 26 | 26 | 26 | 26 |
| Reinsurance Company | - | 1 | 1 | 1 |
| **Securities Market Institutions** | | | | |
| Stock Exchange | 1 | 1 | 1 | 1 |
| Central Depository Company | 1 | 1 | 1 | 1 |
| Stockbroker | 50 | 50 | 50 | 50 |
| Merchant Banker | 14 | 16 | 17 | 24 |
| Mutual Fund | 2 | 5 | 6 | 9 |

| | | | | |
|---|---|---|---|---|
| Credit Rating Agency | 1 | 1 | 1 | 1 |
| Listed Company* | 233 | 232 | 229 | 208 |
| Depository Participant* | 13 | 53 | 66 | 65 |
| **Sub-Total** | **315** | **357** | **371** | **426** |
| **Contractual Saving Institutions** | | | | |
| Employees Provident Fund (EPF) | 1 | 1 | 1 | 1 |
| Citizen Investment Trust (CIT) | 1 | 1 | 1 | 1 |
| Postal Saving Bank | 1 | 1 | 1 | 1 |
| **Total** | **522** | **551** | **533** | **578** |

***** *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)

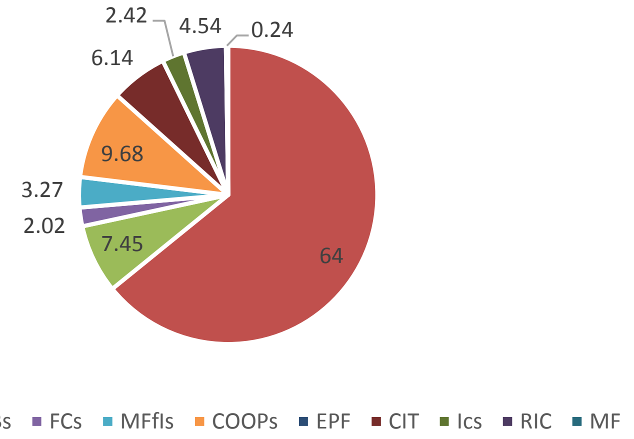
*(In million Rupees)*

| Financial Institutions | Mid-July 2013 | Mid-July 2014 | Mid-July 2015 | Mid-July 2016 | Mid-July 2017 |
|---|---|---|---|---|---|
| Commercial Banks | 1,242,881.40 | 1,467,151.90 | 1,774,504.80 | 2,184,811.57 | 2,621,230.38 |
| Development Banks | 199,954.80 | 255,373.40 | 300,641.80 | 350,844.75 | 305,079.44 |
| Finance Companies | 100,856.70 | 110,342.30 | 108,007.40 | 103,443.22 | 82,609.84 |
| MFFIs | 35,774.90 | 49,395.80 | 70,880.40 | 100,770.60 | 133,765.0 |
| Cooperatives (Capital, Fund and Savings) | 191,614.00 | 233,715.55 | 265,551.90 | 385,721.81 | 396,534.8 |
| **Contractual Saving Institutions** | | | | | |
| Employees Provident Fund | 145,283.40 | 170,638.60 | 195,903.00 | 224,854.80 | 251,283.35 |
| Citizen Investment Trust (Capital and Net Fund Balance) | 42,753.60 | 54,621.30 | 67,675.00 | 83,013.40 | 99,101.60 |
| Insurance Companies | 84,650.40 | 101,097.20 | 129,450.00 | 158,241.60 | 185,890.00 |
| Reinsurance Company | - | - | 6,157.57 | 6,254.38 | 10,020.89 |
| Mutual Fund | - | - | - | - | 9,750.00 |
| **Total** | **2,043,769.20** | **2,442,336.05** | **2,918,771.87** | **3,597,956.13** | **4,095,265.30** |
| Market capitalization (NEPSE) | 514,492.10 | 1,057,165.80 | 9,89,403.96 | 1,889,451.74 | 1,856,829.39 |
| Total (incl. market capitalization) | **2,558,261.30** | **3,499,501.85** | **2,918,771.87** | **5,487,407.87** | **5,952,094.69** |
| **Percentage Share (Excluding NEPSE Market Capitalization)** | | | | | |
| **Financial Institutions** | | | | | |
| Commercial Banks | 60.81 | 60.07 | 60.80 | 60.72 | 64.00 |
| Development Banks | 9.78 | 10.46 | 10.30 | 9.75 | 7.45 |

| | | | | | |
|---|---|---|---|---|---|
| Finance Companies | 4.93 | 4.52 | 3.70 | 2.88 | 2.02 |
| Microfinance Finance Financial Institutions | 1.75 | 2.02 | 2.43 | 2.80 | 3.27 |
| Cooperatives (Capital Fund and Savings) | 9.38 | 9.57 | 9.10 | 10.72 | 9.68 |
| **Contractual Saving Institutions** | | | | | |
| Employees Provident Fund | 7.11 | 6.99 | 6.71 | 6.25 | 6.14 |
| Citizen Investment Trust (Capital and Net Fund Balance) | 2.09 | 2.24 | 2.32 | 2.31 | 2.42 |
| Insurance Companies | 4.14 | 4.14 | 4.44 | 4.40 | 4.54 |
| Reinsurance Company | - | - | 0.21 | 0.17 | 0.24 |
| Mutual Fund | - | - | - | - | 0.24 |
| **Total** | **100** | **100** | **100** | **100** | **100** |

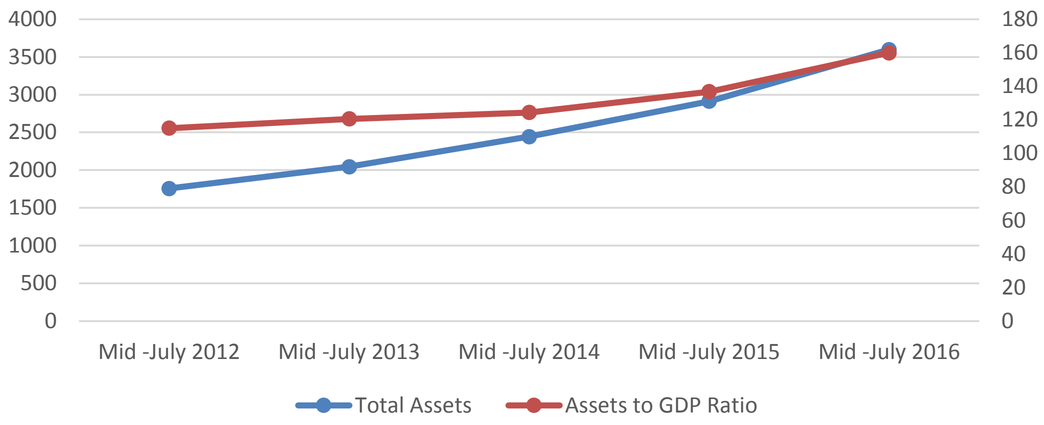
In terms of total assets and liabilities, banks and financial institutions shared 76.74 percent of total financial system of Nepal in mid-July 2017. The commercial banks remained the key player in the financial system occupying 64.00 percent of the system's total assets followed by development banks (7.45 percent), finance companies (2.02 percent) and micro finance financial institutions (3.27 percent). In case of contractual saving institutions, EPF is a dominant institution having 6.14 percent of shares, followed by insurance companies (4.54 percent), Reinsurance Company (0.24 percent) and CIT (2.42 percent) as of mid-July 2017. The share of cooperatives on total financial system is 9.68 percent in mid July 2017 which was 10.72 in mid July 2016, the share of cooperatives on total financial system has reduced due to the increased interest rate of bank and financial institutions in the review period.

**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 2017. The ratio of total assets & liabilities of Nepalese financial system reached 157.41 percent of GDP in mid-July 2017.

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



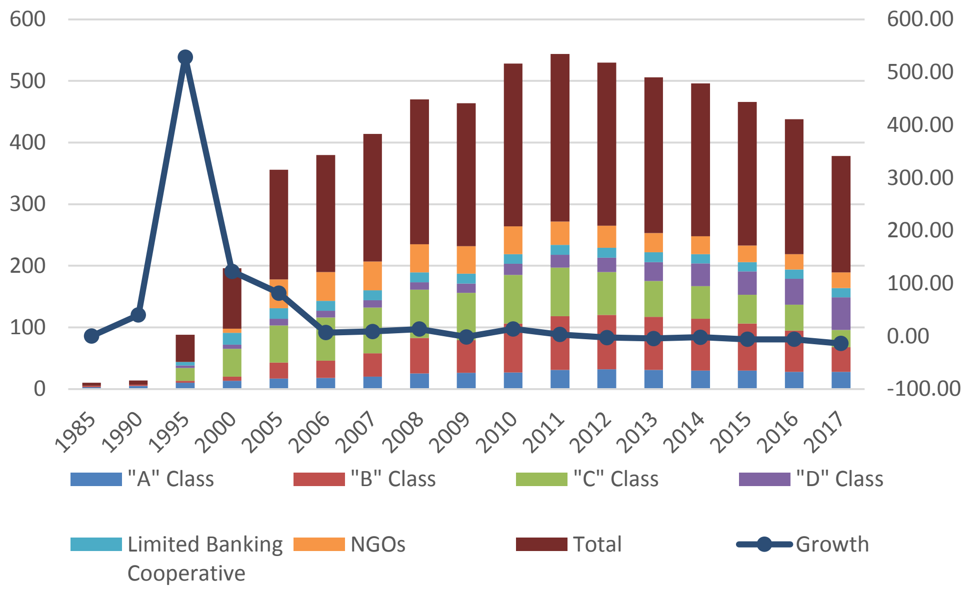

Total assets and liabilities of commercial banks remained at 100.85 percent of GDP followed by development banks (11.74 percent), finance companies (3.18 percent), MFFIs (5.15) percent and Cooperatives (15.26) percent. Further, such ratio for contractual saving institutions stood at 21.25 percent comprising 9.67 percent of EPF, 3.81 percent of CIT, 7.15 percent of insurance companies, 0.24 percent of Reinsurance Company and 0.38 percent of mutual fund in mid-July 2017.

**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.

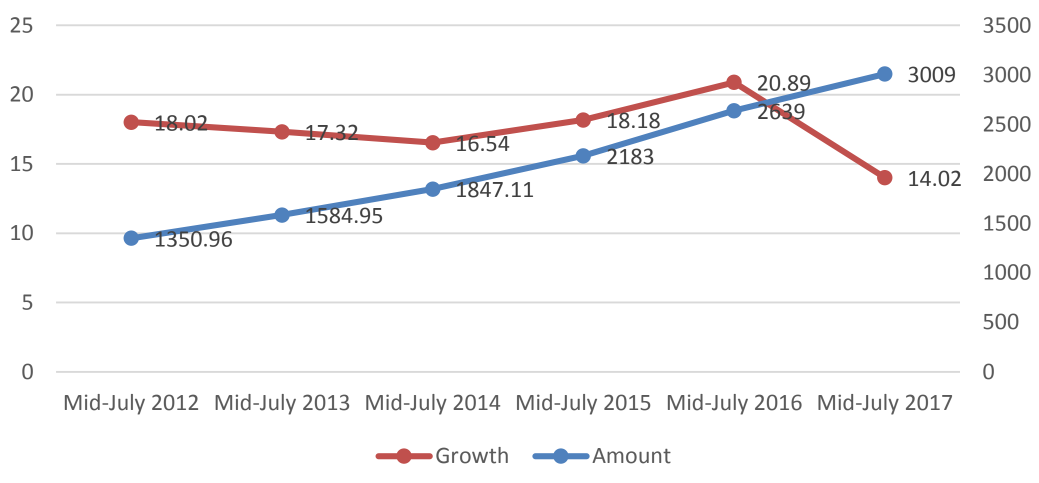
Figure 2.3: Number and growth of BFIs licensed by NRB




## Assets Growth in Nepalese Banking System

The total assets and liabilities size of BFIs have continued to increase. As of mid-July 2017, total assets of BFIs increased by 14.02 percent and reached to Rs. 3009 billion in comparison to Rs. 2639 billion in the same period of last year. Total assets of bank and financial institutions have increased by 14.02 percent in review period though the rate has been decreased by 6.87 percent in review period mainly due to sluggish growth rate of remittance and capital expenditure of government. 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.

**Figure 2.4: Total Assets of Banking System (Left Side) (in Rs. billion) and Assets Growth Rate (in percent)**



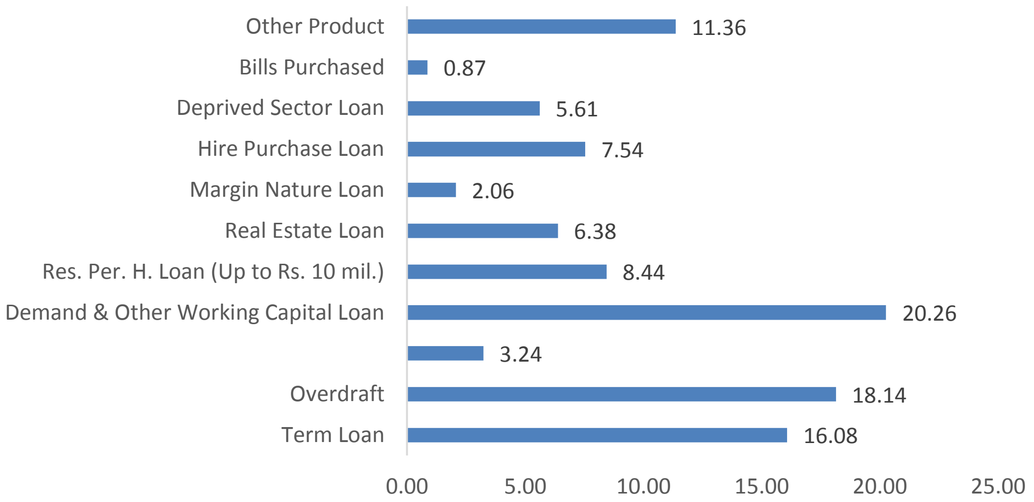

As on mid-July 2017, the five large commercial banks (LCBs) collectively accounted for 25.93 percent of total banking system assets and 29.76 percent of total commercial bank assets. As of mid-July 2017, the five large commercial banks, RBB, NIBL, NABIL, ADBNL, and GLOBAL had total assets size of Rs. 193.13 billion, Rs. 162.9 billion, Rs. 154.07, Rs. 149.60 billion, and Rs. 120.46 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 2017 trade (wholesaler & retailer) accounted for 21.88 percent, followed by agriculture, forestry and beverage production related (16.54 percent), other services (13.68 percent), construction (10.68 per cent), finance, insurance and real estate (8.34 percent), consumption (7.94 percent), other services (4.52 percent) agriculture and forestry (4.41 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.

Analyzing the type of loan products, BFIs has made highest lending in total in demand and working capital loan (20.26) percent followed by overdraft (18.14) percent and term loan (16.08) percent. The real estate loan has come below the regulatory requirement of 10 percent, the lending percentage of BFIs in real estate stood in 6.38 in mid- July, 2017. Figure 2.6 depicts the picture of the lending of BFIs in different products.

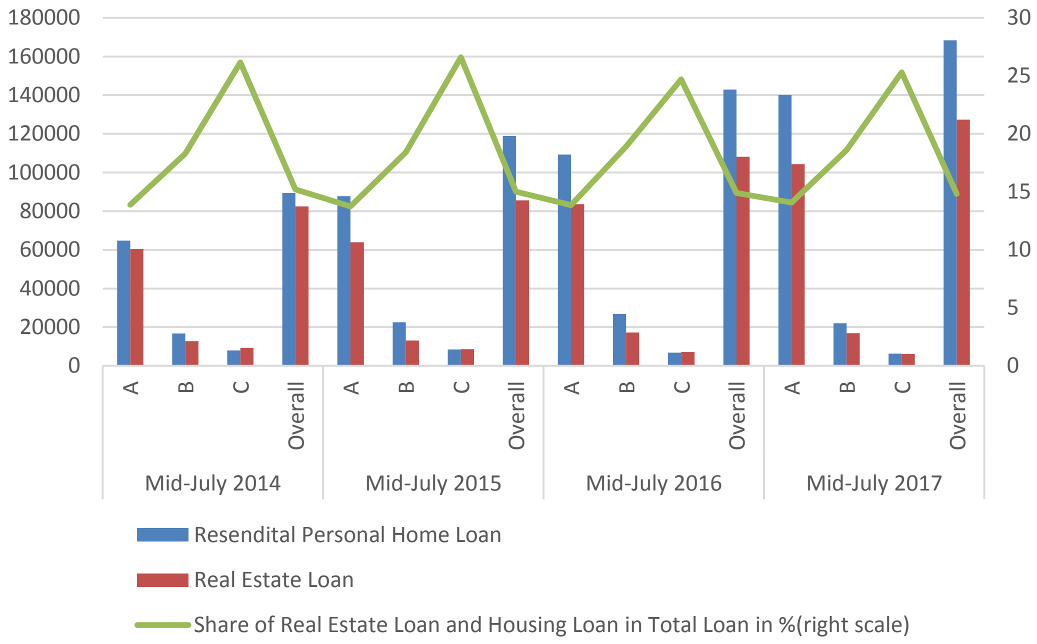
Figure 2.5: Product wise lending of BFIs




## 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 50 percent of fair market value of the collateral/project outside of Kathmandu valley and 40 percent inside Kathmandu valley. The maximum loan-to-value (LTV) ratio for residential housing loan is 50 percent for Kathmandu valley and such ratio is 60 percent for other places. 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 2.6: Real Estate Exposures of BFIs (in Rs. million )

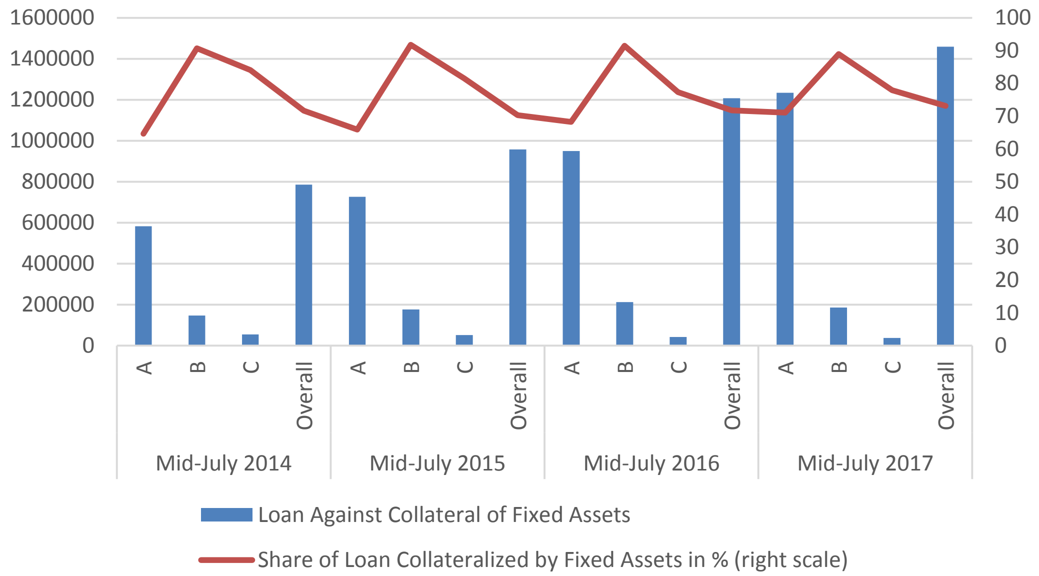



The banking system has reduced their high exposures in real estate after the introduction of some macro prudential measures. The direct real estate exposure amounted to Rs. 127.32 billion which accounts for 6.38 percent of total loan in mid-July 2017 which was about Rs. 108 billion (6.43 percent of the total outstanding) in mid-July 2016.

Commercial bank's direct exposure to real estate and housing loan has declined from 19.4 percent in Mid-July 2010 to 14.07 percent in mid-July 2017. The developments banks and finance companies have lent 18.59 and 25.30 percentage of total loan portfolios in real estate and housing in mid-July, 2017.

In mid-July 2017, 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 4.90 in mid-July, 2017 from that of 4.81 percent in mid-July 2016.

Figure 2.7: Loan against collateral of Fixed Assets




Bank and financial Instutions have lent 73.19 percent of their total loan against collateral of fixed assets. Commercial banks have lent 71.14 percent and Development bank and Finance Company have lent 89.00 and 77.93 percentage respectively**.**

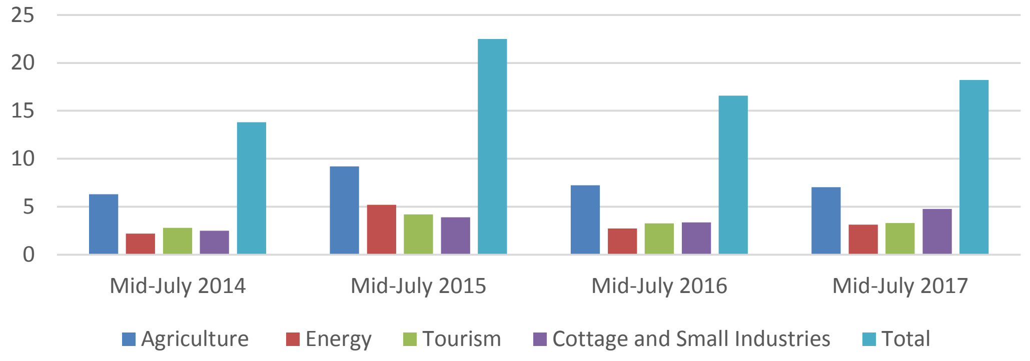
**Directed Lending:**

**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 25 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 10 percent of their credit in agriculture 5 percent to hydropower, and 5 percent to tourism and remaining to other priority sectors by mid-July, 2018. 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 2017, the commercial banks had provided 18.22 percent of their total loan on productive sector which includes 7.04% in agriculture, 3.12% in energy sector and 3.30% in tourism sector and 4.76% in cottage and small industries respectively. Commercial banks have lent 10.16% 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 2016 was 16.59%. 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.

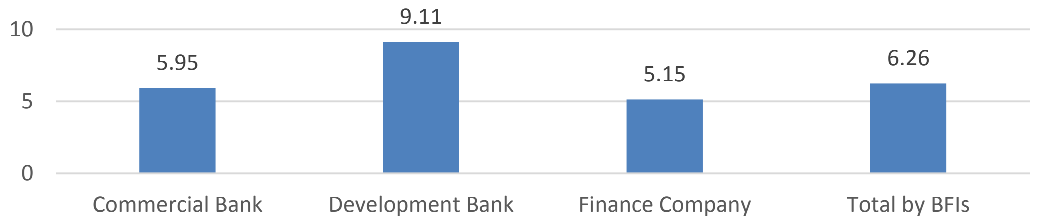
Figure 2.8: Productive Sector lending of commercial banks ( in percentage of Total Loan)




## 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 2017 remained 6.26 percent where commercial banks, development banks and finance companies have lent 5.95 percent, 9.11 percent and 5.15 percent respectively.

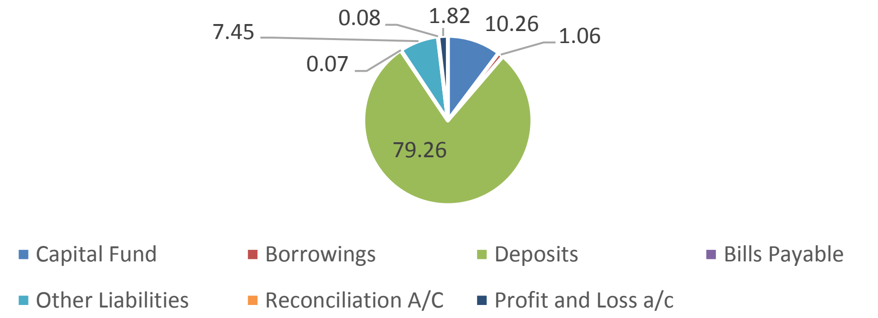
Figure 2.9 Deprived Sector Lending by BFIs



## Liability Structure of the Banking Sector

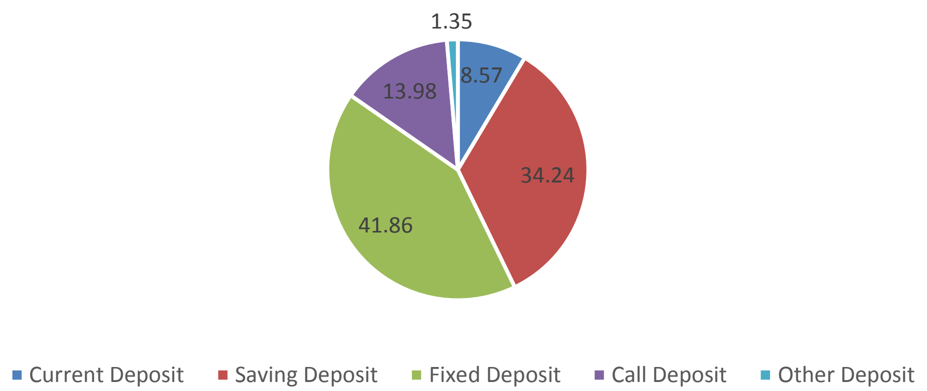
Deposits are the largest source of external funds in the banking sector. The share of total deposits is 79.26 percent of the total liabilities as of mid-July 2017. As of mid-July 2017, total deposit increased by 13.16 percent against 18.93 percent in mid-July 2016. Likewise, capital fund increased by 43.63 percent mainly due to capital increment plan of Nepal Rastra Bank, borrowings decreased by 25.74 percent which was increased by 100.51 percent in mid-July, 2016, whereas other liabilities increased by 8.47 percent in mid-July 2017.

**Figure 2.10: Liability Structure of BFIs**




The share of saving deposits, fixed deposits, call deposits, current deposit and other deposit stood at 34.24 percent, 41.86 percent, 13.98 percent, 8.57 percent and 1.35 percent respectively at mid-July 2017. The relative proportions of of deposits remain as 41.54 percent, 29.31 percent, 19.07 percent, 8.78 percent and 1.3 percent respectively at mid- July 2016. The deposit structure shows a drastic change in review period due to the liquidity crunch in financial sector as a proportion of saving deposit has reduced and proportion of fixed deposit has increased significantly.

**Figure 2.11: Deposit Liabilities by types of Account**



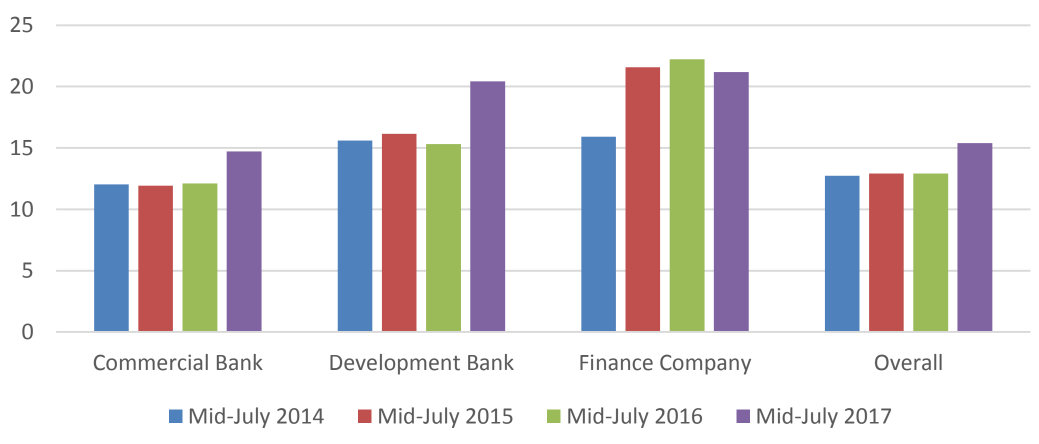
The total deposits of BFIs reached Rs. 2384.81 billion in mid-July 2017 from that of 2107.5 billion in mid-July 2016. The share of top five BFIs depicts 25.16 percent of the total deposits which shows a significant concentration of top 5 BFIs in the total system in terms of deposit. The concentration ratio was 25.71 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 2017, the capital fund of BFIs increased by 43.63 percent to Rs. 308.65 billion from 214.89 billion in mid –July 2016. Such increment was 31.84 percent in the previous year. The capital fund is composed of paid-up capital (Rs. 225.31 billion), statutory reserves (Rs.53.67 billion), retained earnings (Rs. 3 billion in negative figure) and other reserves (Rs. 32.68 billion). In mid-July 2017, the CAR of commercial banks registered 14.72 percent, with a y-o-y increase of 2.60 percent point. In the same period, the CAR of development banks recorded 20.44 percent, with a y-o-y increase of 5.13 percent points and the CAR of finance companies stood at 21.19 percent, which was decreased by 1.03 percent point y-o-y. The overall CAR of BFIs in mid-July 2017 stood at 15.40 percent which was 12.91 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.

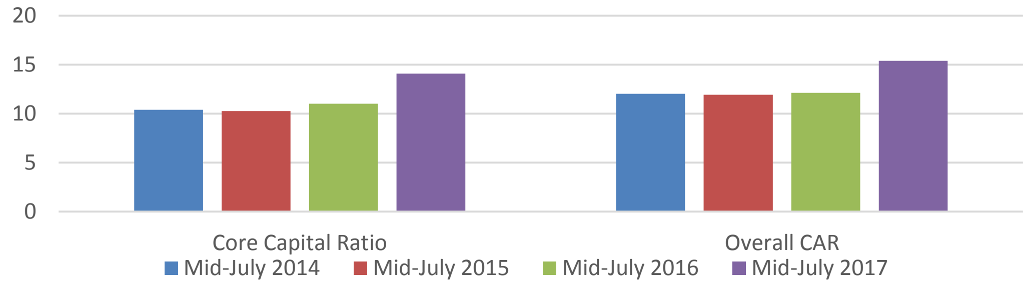
Figure 2.12 Capital Adequacy of BFIs



In mid-July 2017, commercial bank's compliance with the minimum Capital Adequacy Ratio (CAR) is 100. As evident from figure 2.15, all Banks complied with the minimum CAR in mid-July 2017. During the period of 2011-2014, state owned banks (SOBs), Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) were 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 Tier 1 capital 9.9 percent and CAR ratio 10.3 percent. In the review period Nepal Bank was also able to meet the capital adequacy ratio of 15.16 percent with 14.33 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 2014 to mid-July 2017. For instance, overall CAR of the commercial banks in mid-July 2017 is 15.40 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, 11.02 and 14.07 percent in mid-July 2012, 2013, 2014, 2015,2016 and 2017 respectively.

Figure 2.13 Core Capital and Overall CAR of Commercial Banks



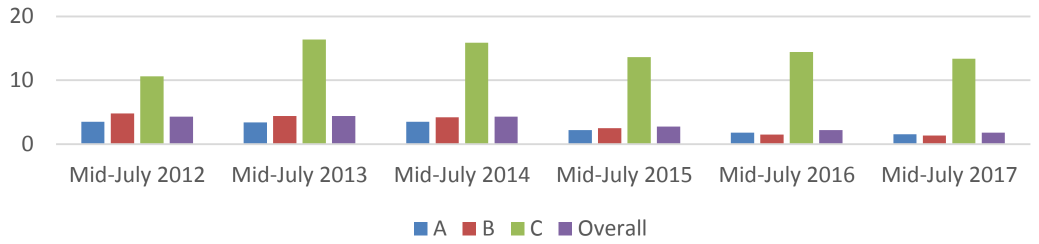

## Assets Quality

Non-performing loans (NPL)[1] 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. 36.10 billion in mid-July, 2017 which was Rs. 36.83 billion in mid-July 2016. In terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2017 indicating the banking sector's resilience in large. NPL to total loans of BFIs was decreased by 0.38 percentage point and stood at 1.81 in mid-July 2017 which was 2.19 in previous year. NPL to total loans of commercial banks was decreased by 0.28 percentage point on y-o-y basis and recorded the ratio of 1.54 percent on mid-July, 2017.

[1]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.

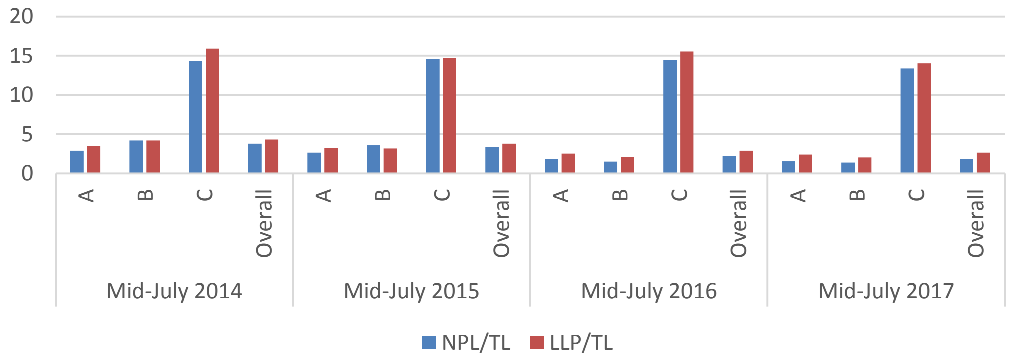
None of the commercial banks have NPL above 5 percent in mid-July, 2017. Likewise, NPL ratio of development banks was decreased by 0.12 percentage point to 1.36 percent in mid-July, 2017 as compared to 1.48 in mid-July 2016. The NPL ratio of finance companies is still in double digit which stands at 13.37 percent in the same period.

Figure 2.14: 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 2017, BFIs watch list provision to total loan remains 2.59 percentage.

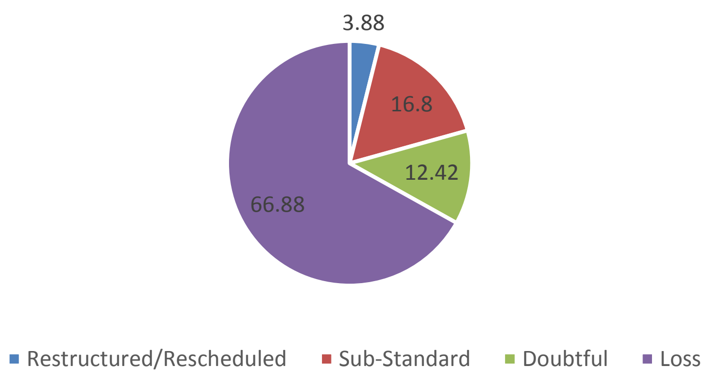
Figure 2.15: Provision Versus Actual Loan Loss (as a percentage of total Loan)



The NPL stood at Rs. 36.10 billion in mid-July 2017, which was Rs. 36.83 billion in mid-July 2016. As of mid-July 2017, LLP of banking system is sufficient to cover NPL of the same period which stood for 52.33 billion.

In the banking system, the loss loan is Rs. 24.15 billion in mid-July 2017 which was Rs. 25.88 billion in mid-July 2016. In total NPL, loss loan accounts for 66.88 percent in mid-July 2017. It is alarming that a bulk of NPL is loss loan. There is slight decrease in ratio of loss loans to NPL to 66.88 percent in mid-July 2017 from 71.09 percent in mid-July 2016, which shows increase in 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 16.8 percent and 12.42 percent respectively. The ratio of restructured/rescheduled loans to total NPL remained around 3.88 percent in the current year.

Figure 2.16: NPL composition of BFIs (Mid-July 2015)




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**

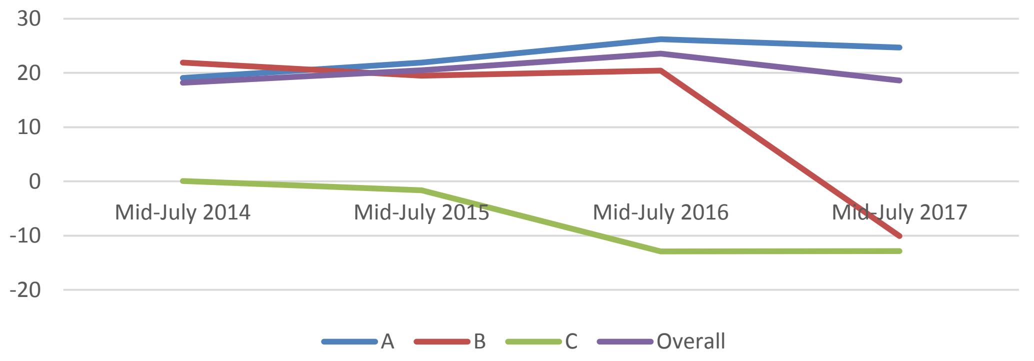
Basel Capital for Banking Supervision has introduced leverage ratio which is complementary to the risk-based capital framework and aims to restrict the build-up of excessive leverage in the banking sector. The leverage ratio is defined as eligible Tier 1 capital divided by total assets and off balance 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 where as NRB has set a minimum leverage ratio of 4 percent at all times.

**Credit and Deposit Growth**

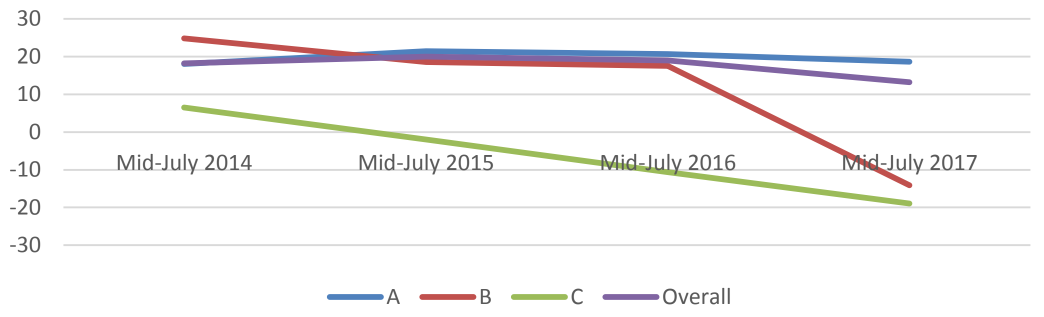
Credit flows from BFIs increased by 18.60 percent in mid-July, 2017 such increment was 23.55 percent in mid-July, 2016, the decrease in credit growth rate is mainly due to the sluggish deposit growth in last year.

Figure 2.17: Trends in Credit Growth (in percent)



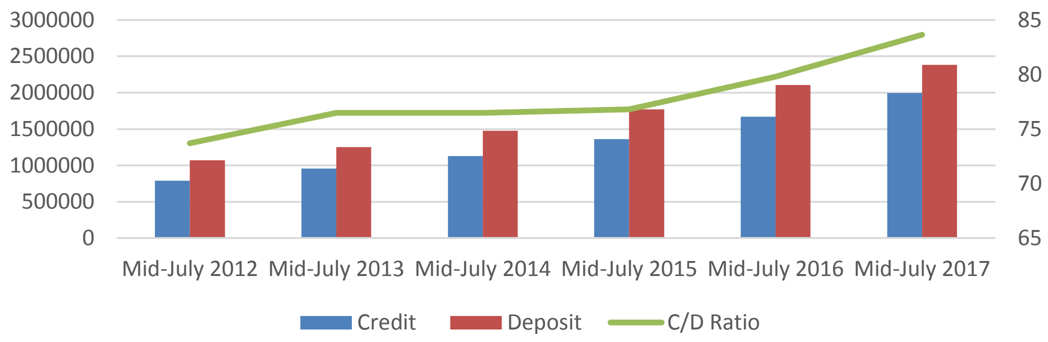

Credit of Commercial Banks grew by. Development banks credit dropped by 10.04 percent, whereas finance companies credit dropped by 12.82 percent in mid-July 2017, credit expansion of development bank and finance company dropped mainly due to the merger and acquisition with commercial bank.

Figure 2.18: Trends in Deposit Growth (in percent)



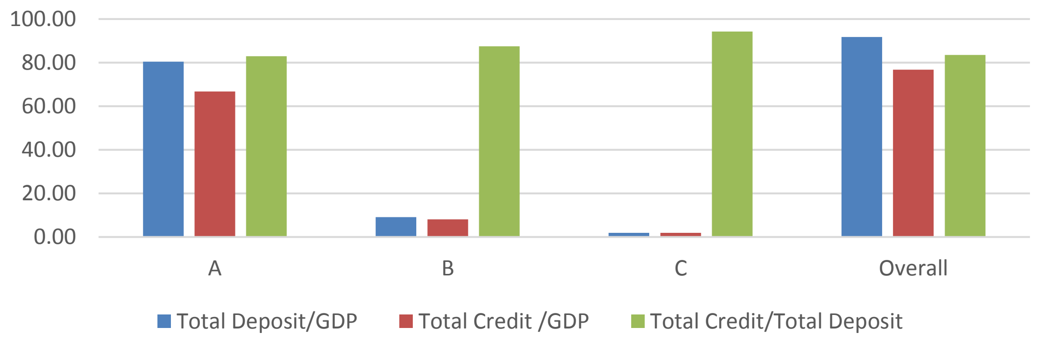

Deposits of BFIs increased by 13.16 percent in mid-July 2017 as compared to mid-July 2016. The deposit growth of commercial banks registered 18.63 percent in mid-July 2017. However, there has been negative growth of deposits by 14.07 percent and 18.90 percent in development bank and in finance companies respectively mainly due to the merger and acquisition with other financial institutions.

**Figure 2.19: Credit ,Deposit (in million Rs.) and C/D Ratio (in percent) of BFIs**




There has been increment in overall credit to deposit (C/D) ratio to 83.64 percent in mid-July 2017 from 79.80 in mid-July 2016. The C/D ratio of finance companies stood (94.28 percent), development banks (87.54 percent) and commercial banks (82.93 percent).

**Figure 2.20: Credit, Deposit with GDP ratio and saving deposit ratio of BFIs**

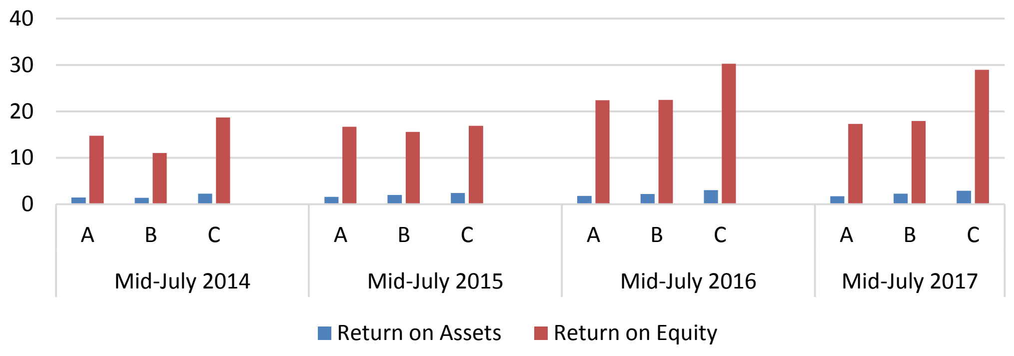



As of mid-July 2017 the share of total deposit to GDP reached to 91.75 percent comprising 80.53 percent share of commercial banks whereas the share of development banks remained 9.21 percent and finance companies 2.01 percent only. The share of total credit to GDP reached to 76.74 percent comprising 66.78 percent share of commercial banks whereas the share of development banks remained 8.06 percent and finance companies 1.89 percent.

## Profitability

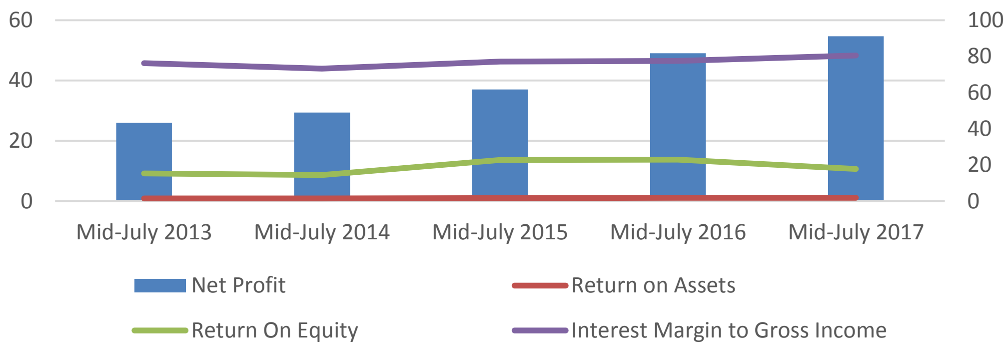
The overall growth rate of profitability of banking sector has reduced mainly due to liquidity crunch in review period. The overall profitability of banking sectored has increased by 11.57 percent in mid –July 2017 and reached to 54.67 billion from 49 billion in mid-July 2016, the growth rate of profitability of banking sector in last year was 32.29 percent. The commercial banks posted a higher share of profitability of the banking sector accounting 83.10 percent of the total in mid-July 2017. In the review period credit has increased by only 18.60 percent in comparison to 23.55 percent in last year which has resulted slow growth rate of profitability of banking sector.

Figure 2.21: Class wise Profitability of BFIs (in percent)



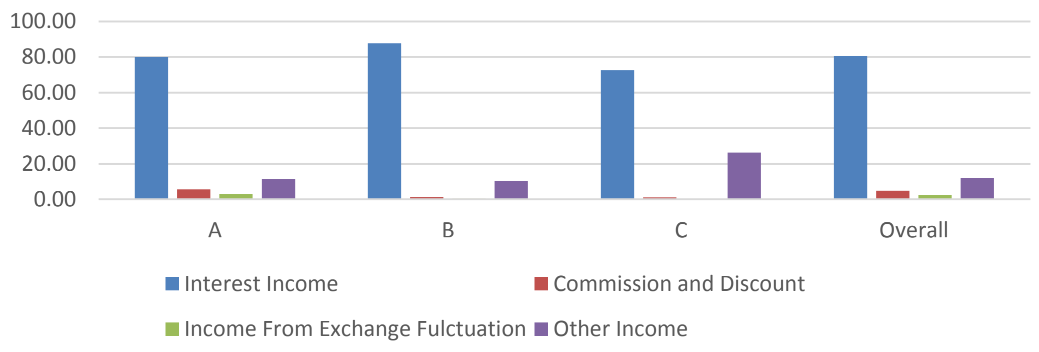

The ROE of bank and financial institutions have reduced in mid July 2017 mainly due to increase in capital of bank and financial institutions. The ROE of commercial bank stood at 17.32 percent whereas development banks and finance companies stood at 17.95 percent and 28.99 percent respectively. Such ratio was 22.41 percent, 22.51 percent and 30.31 percent respectively.

**Figure 2.22: Net Profit (in Rs.billion), ROE, ROA and Interest Margin to Gross Income (In percent)**



The interest margin to gross income stood at 80.49 percent in mid-July 2017 which was 77.45 percentages in mid-July 2016. The net profit of BFIs grew by 11.57 percent in mid-July 2017 from the growth of 32.29 percent in mid-July 2016. ROA decreased to 1.82 percent from 1.86 percentage. Similarly, ROE also decreased to 17.71 percent from 22.80 percent in mid-July 2016.

Figure 2.23: Income distribution of BFIs




Interest income has the biggest share in total income of BFIs which accounted for 80.49 percent in mid-July 2017, on which; interest income on loan and advance consists of 90.34 of total interest income, where as 1.85 percent of the total income is from interest on call deposit. Commission based income contributed only 4.89 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 2.59 percent of total income and other income consists of 12.03 percent of total income of BFIs in mid-July 2017.

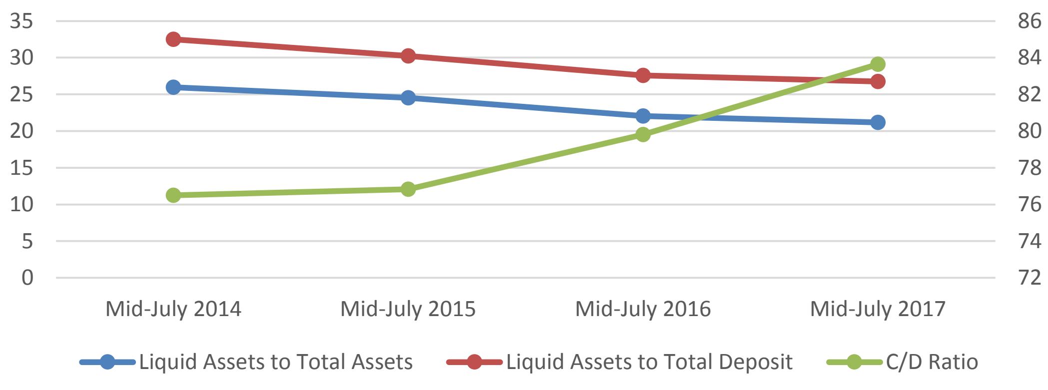
## Liquidity

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 till FY 2072/73. But after the promulgation of new constitution in year 2072 and after the subsequent strike new investment environment has been originating and banks were aggressive to lend in order to maintain their profitability though there were sluggish growth of remittance and weak expenditure capacity of government, which has created lack of adequate loanable fund in financial system till last of FY 2073/2074. Capital increment plan of NRB is mainly attributed to high credit growth though deposit was sluggish which also contributed to lack of adequate loanable fund in the financial system. NRB is taking credit to deposit (C-D ratio), net 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 26.74 percent in mid-July 2017 compared to 27.60 percent in mid-July 2016. The total liquid asset to deposit ratios for "A", "B" and "C" class institutions are recorded at 26.00, 31.52 and 34.27 in mid-July 2017. Such ratios were 26.17 percent, 32.75 percent and 44.80 percent respectively in mid-July 2016. 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 2017, the credit to deposit ratio of BFIs stood at 83.64 percent, which was 79.80 in mid-July 2016. The credit to deposit ratios for "A", "B" and "C" class institutions stood at 82.93 percent, 87.55 percent and 94.27 percent respectively. Such ratios were 78.91 percent, 83.62 percent and 87.72 percent respectively in mid-July 2016. Sluggish growth rate of remittance and government expenditure resulted sluggish deposit growth in review period but banks were aggressive to maintain their profitability in the scenario of increasing capital. Liquidity pressure being tight at present, liquidity risk is likely to hit financial institutions at any time, the ratios indicate most of the financial institutions 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, sluggish inflows of remittances as well as excessive surplus of government deposit with NRB at present has been posing more pressure to liquidity management.

**Figure 2.24: Liquidity in BFIs (in percent)**



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

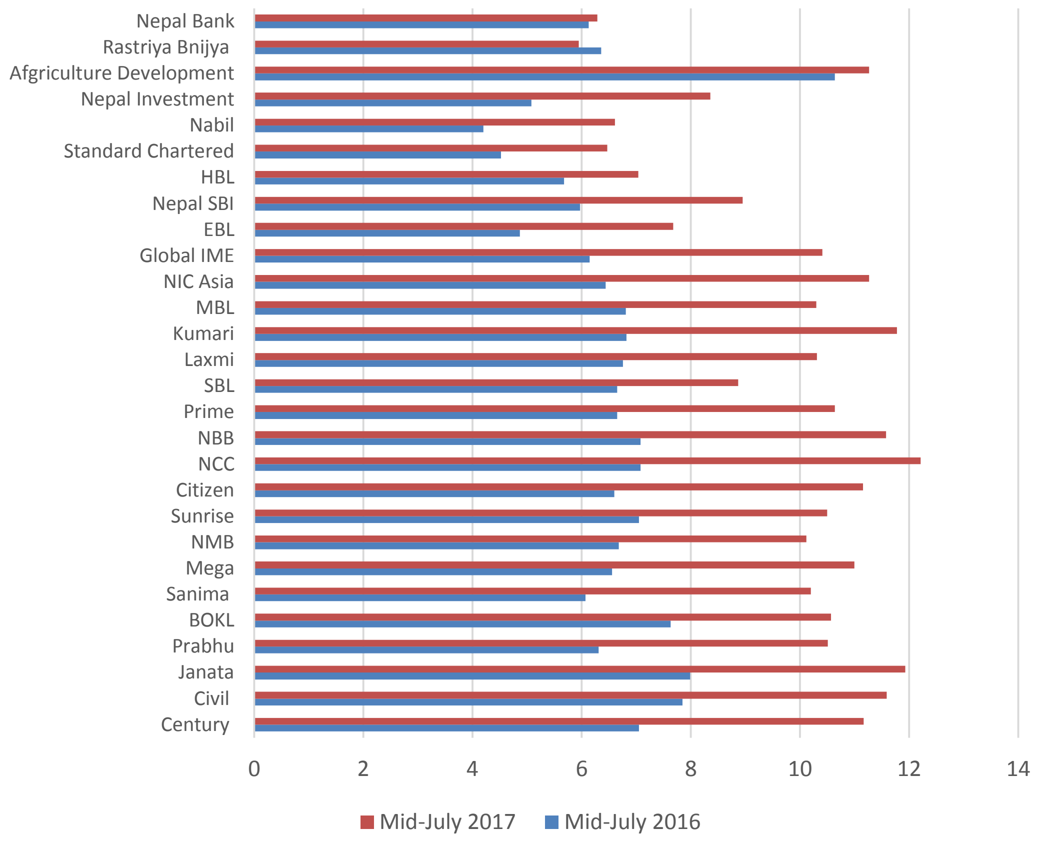
| Indicators | Class "A" | | Class "B" | | Class "C" | | Overall | |
|---|---|---|---|---|---|---|---|---|
| | mid-July 2016 | Mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 |
| ***Credit and deposit related indicators*** | | | | | | | | |
| Total deposit/GDP | 78.47 | 80.53 | 12.39 | 9.21 | 2.86 | 2.01 | 93.72 | 91.75 |
| Total credit/GDP | 61.39 | 66.78 | 10.36 | 8.06 | 2.51 | 1.89 | 74.79 | 76.74 |
| Total credit/ Total deposit | 78.91 | 82.93 | 83.62 | 87.54 | 87.72 | 94.28 | 79.80 | 83.64 |
| LCY credit/LCY deposit and core Capital | 75.97 | 79.57 | 74.56 | 76.82 | 71.05 | 76.00 | 75.59 | 79.17 |
| Fixed deposit/Total deposit | 29.72 | 42.00 | 24.49 | 39.37 | 38.80 | 47.67 | 29.31 | 41.86 |
| Saving deposit/Total deposit | 39.60 | 33.59 | 51.56 | 39.69 | 51.43 | 35.51 | 41.54 | 34.24 |
| Current deposit/Total deposit | 10.10 | 9.52 | 2.42 | 2.05 | 0.2 | 0.17 | 8.78 | 8.57 |
| Call Deposit /Total Deposit | 19.32 | 13.63 | 21.26 | 18.42 | 2.68 | 7.23 | 19.07 | 13.98 |
| Other Deposit/Total Deposit | 1.26 | 1.26 | 0.27 | 0.39 | 6.88 | 9.05 | 1.30 | 1.35 |
| ***Assets quality related indicators*** | | | | | | | | |
| NPL/ Total loan | 1.82 | 1.54 | 1.48 | 1.36 | 14.42 | 13.37 | 2.19 | 1.89 |
| Total LLP/Total loan | 2.51 | 2.39 | 2.12 | 2.01 | 15.54 | 14.03 | 2.89 | 2.63 |
| Res. Per. H. Loan (Up to Rs. 10 mil.)/Total Loan | 7.85 | 8.07 | 11.5 | 10.51 | 11.94 | 12.84 | 8.49 | 8.44 |
| Real estate exposure/Total loan | 6.00 | 6.00 | 7.41 | 8.09 | 12.76 | 12.45 | 6.43 | 6.38 |
| Deprived sector loan/Total loan | 5.52 | 5.95 | 6.77 | 9.11 | 4.57 | 5.15 | 5.65 | 6.26 |
| | | | | | | | | |
| Cash and bank balance/Total deposit | 14.39 | 15.19 | 16.94 | 17.42 | 28.48 | 20.05 | 15.15 | 15.52 |
| Investment in Gov. security/Total deposit | 10.61 | 9.97 | 1.97 | 1.82 | 5.16 | 2.53 | 9.30 | 8.99 |

| Indicators | Class "A" | | Class "B" | | Class "C" | | Overall | |
|---|---|---|---|---|---|---|---|---|
| | mid-July 2016 | Mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 |
| Liquid assets/Total assets | 12.56 | 19.59 | 24.45 | 24.73 | 24.63 | 21.63 | 14.62 | 21.19 |
| Total liquid assets/Total deposit | 26.17 | 26.00 | 32.75 | 31.52 | 44.80 | 34.27 | 27.6 | 26.74 |
| Net liquid assets/Total Deposit | 24.06 | 24.59 | 31.68 | 31.15 | 40.82 | 31.84 | 25.58 | 25.40 |
| ***Capital adequacy related indicators*** | | | | | | | | |
| Core capital/RWA ( percent) | 10.62 | 13.35 | 14.41 | 19.43 | 21.28 | 20.21 | 11.52 | 14.07 |
| Total capital/RWA ( percent) | 12.12 | 14.72 | 15.31 | 20.44 | 22.22 | 21.19 | 12.91 | 15.40 |
| Wt. Avg. interest rate on deposit | 3.28 | 6.15 | | | | | | |
| Wt. Avg. interest rate on credit | 8.86 | 11.39 | | | | | | |

### 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 2.25: Base Rates of Commercial Banks**




The base rates of most of the commercial banks are in increasing trend in mid-July 2017 from that of mid-July 2016 except Rastriya Banijya Bank Limited. Nepal Credit and Commerce Bank Limited has posted a maximum base rate in mid-July 2017 with 12.21 percent followed by Janata Bank 11.93 percent whereas Rastriya Banijya Bank registered a minimum base rate of 5.95.  Among state owned banks, NBL, RBB and ADBL have set base rate of 6.29 percent, 5.95 percent and 11.27 percent respectively in mid-July 2017. Their base rates were 6.13 percent, 6.36 percent and 10.64 percent respectively in mid-July 2016.

## 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 2.26, the overall interest spread of the commercial banks stood at 4.18 percent whereas the interest spread of the state owned banks remained at 5.26 percent as of mid-July 2017. Agriculture Development Bank has registered the highest interest rate spread of 5.87 percent among commercial banks followed by Standard Chartered Bank Nepal Ltd 5.01 percent. Nepal Credit and Commerce bank has the lowest interest rate spread of 2.55 percent in the same period. Among the state owned banks RBB and NBL have below the regulatory requirement, whereas ADBL has the spread of more than 5 percent in mid- July 2017.

Figure 2.26: Net interest spread of CBs in percentage point

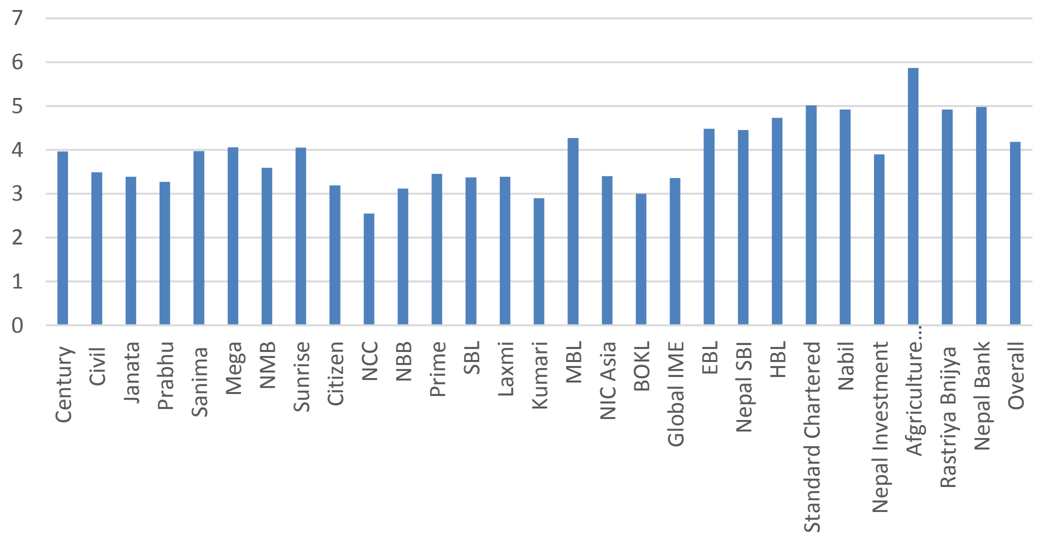
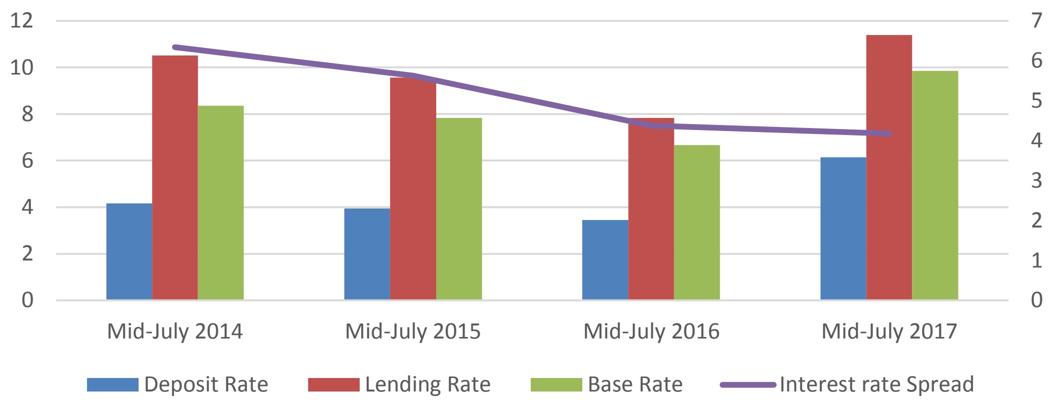


Figure 2.27: Deposit Rate, Lending Rate, Spread Rate & Base Rate of Commercial Banks




## Banking Sector Consolidation: Merger & Acquisition

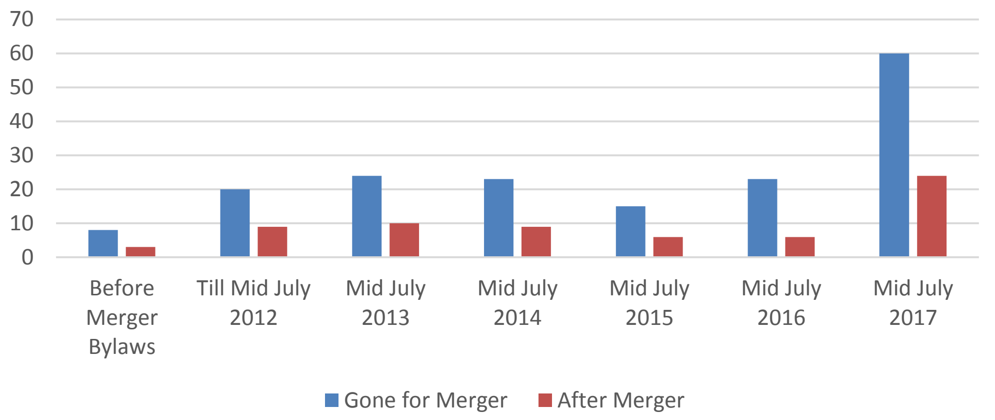
Consolidation is taken as one of the tools to enhance the capital base, achieve operational efficiency and strengthen the resilience of BFIs. Merger and acquisitions are considered one of the effective measure of financial consolidation. Increasing capital and asset bases through consolidation would 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 150 BFIs have merged to form 39 BFIs. In the review period, 60 BFIs have merged and acquired to form 24 BFIs. Last year 23 BFIs were merged and acquired to form 6 BFIs.

Figure 2.28: 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 Fin Mark 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 through 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. Policy of establishing a branch of Bank and Financial institution in every local level of government, 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 2016 | Mid-July 2017 | Mid-July 2016 | Mid-July 2017 |
| Commercial Banks | 1869 | 2274 | 43.73 | 44.87 |
| Development Banks | 852 | 769 | 19.93 | 15.17 |
| Finance Companies | 175 | 130 | 4.09 | 2.57 |
| Micro Finance Financial Institutions | 1378 | 1895 | 32.24 | 37.39 |
| **Total** | **4274** | **5068** | **100** | **100** |

Financial access has been increasing with the expansion of network of financial institutions. As of mid-July 2017, the branch network of commercial banks reached 2274 followed by development banks (769), Finance companies (130) and Micro Finance Financial Institutions (1895). The number of branches of the respective categories of BFIs accounted to 1869, 852, 175 and 1895 respectively as of mid-July 2016. Due to the merger policy adopted by NRB, the number of branches of Development Bank and Finance Company (C Category) reduced by 83 to 769 and 45 to 130 respectively. However, the total number of bank branches of BFIs increased by 794 (18.58 percent) and reached to 5068 in mid-July 2017 from that of 4274 in mid-July 2016.

In mid-July 2016, on an average, a BFI branch has been serving approximately to 8,960 people; excluding the branches of "D" class financial institutions. The banking service served population comes down to 5610 people per branch when branches of "D" class also included.

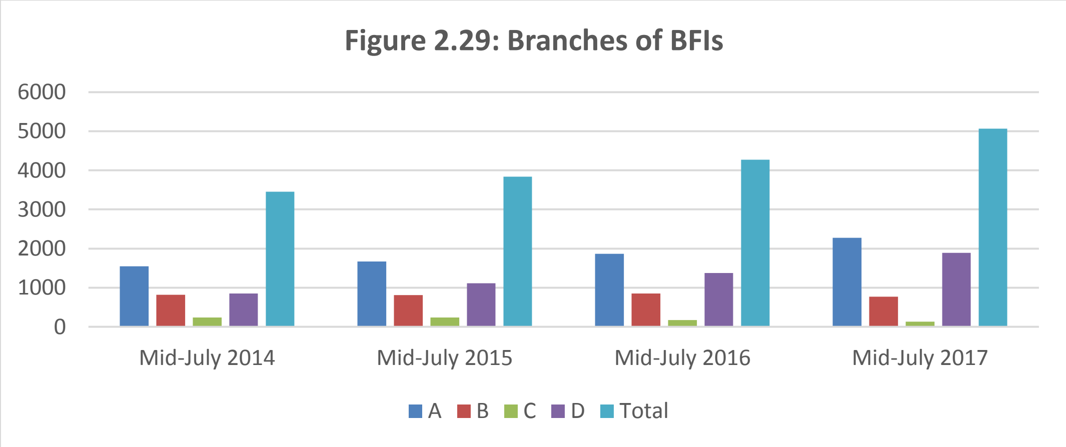
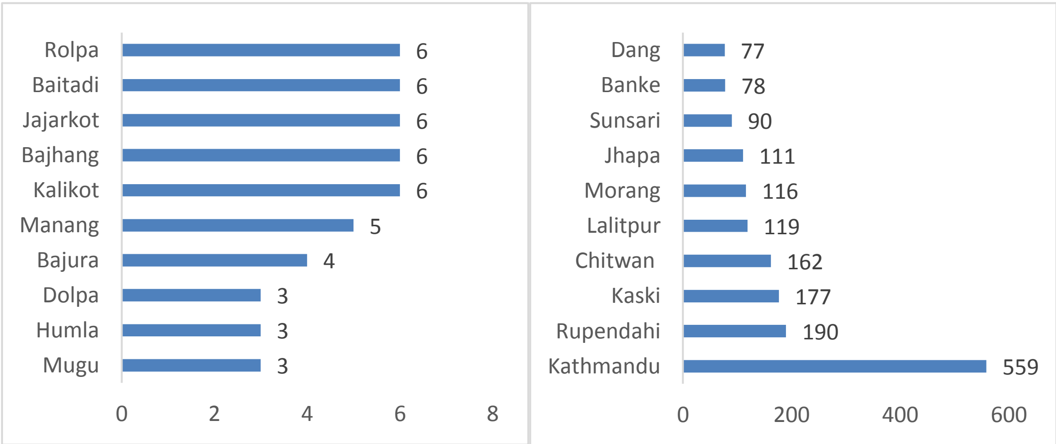



**Table 2.5: Regional Allocation of BFI Branches**

| Region | BFIs | | | Total | Share (in percent) | Population (per branch) |
|---|---|---|---|---|---|---|
| | A | B | C | | | |
| Eastern | 419 | 85 | 18 | **522** | 16.45 | 11,726 |
| Central | 1043 | 257 | 71 | **1371** | 43.21 | 7,690 |
| Western | 464 | 318 | 31 | **813** | 25.62 | 6,349 |
| Mid-western | 212 | 79 | 8 | **299** | 9.42 | 12,856 |
| Far-western | 136 | 30 | 2 | **168** | 5.29 | 16,434 |
| **Total** | **2274** | **769** | **130** | **3173** | **100.00** | **8,960** |

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 1371 (43.21 percent), followed by western development region 813 (25.62 percent) and eastern development region 522 (16.445 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. Mugu, Humla and Dolpa have still 3 bank branches only, Bajura has only 4 branches, Manang has only 5 branches whereas kalikot, Bajhang, Jajarkot, Baitadi and Rolpa has only 6 branches.

**Figure 2.30: 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 2.6 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 | 1874 | 177 | 30 | 2081 |
| No. of Debit Cards | 4694066 | 260225 | 26667 | 4980958 |
| No. of Credit Cards | 68966 | 0 | 0 | 68966 |
| No. of Deposits Accounts | 16119614 | 3204718 | 429704 | 19754036 |
| No. of Loan Accounts | 898710 | 285897 | 31484 | 1216091 |

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 2017, such branchless banking center accounted to 1008. 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.

Demat account has been made mandatory in public offerings with effect from Mid-July 2016 in Kathmandu valley and from Mid-January 2017 all over the country. As a result, the number of demat account has been increased significantly during the review period. The situation of demat account of last three years is presented in Table 2.7.

**Table 2.7: No. of Demat Accounts**

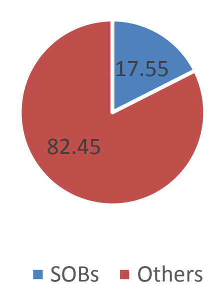
| Service | Fiscal Year | | | Percent Change | |
|---|---|---|---|---|---|
| | 2014/15 | 2015/16 | 2016/17 | 2015/16 | 2016/17 |
| No. of Demat Accounts | 40,934 | 392,359 | 870,702 | 858.52 | 121.91 |

## 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 17.70 percent share in GDP in terms of total assets & liabilities. The share of total assets & liabilities of BFIs to GDP reached to 115.76 percent in mid-July 2017 shows the increment in financial deepening. The total assets of state owned banks (SOBs) reached to Rs. 459.94 billion in mid-July 2017 from Rs.428

billion in mid-July 2016. The total share of SOBs on total assets of commercial bank is 17.55 percent in mid-July 2017.

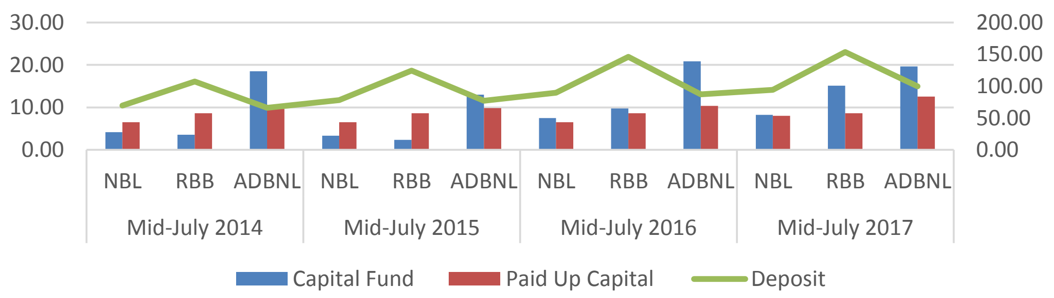
Figure 2.31: Share of SOBs in Total Assets of CBs




The state owned commercial banks have 13.73 percent share in total deposit of commercial banks. Their market share in terms of total assets of all BFIs stood at 15.29 percent, whereas in total deposit and loan & advances, the ratio reached to 12.05 and 13.83 percent respectively in mid-July 2017. 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.

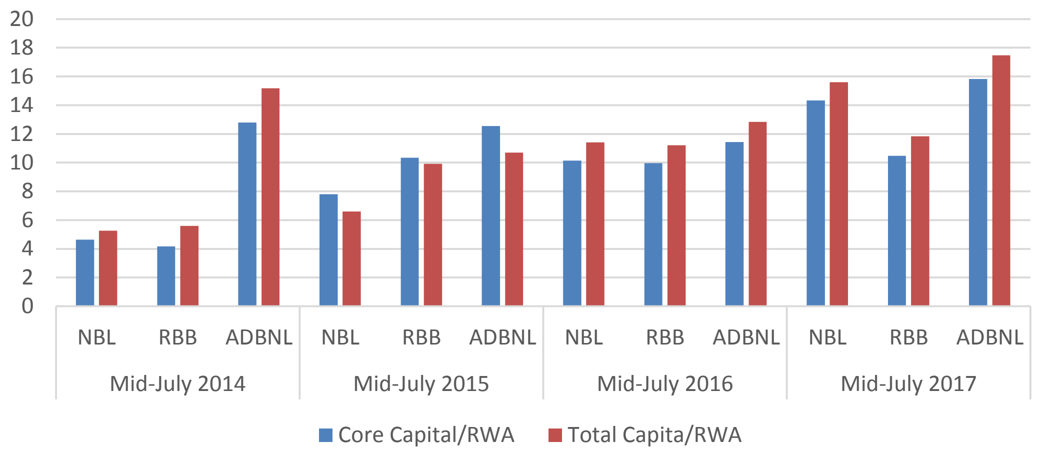
As of mid-July 2017, capital fund of all three state owned banks were Rs. 8.25 billion, Rs. 15.08 billion and Rs. 19.63 billion respectively for NBL, RBB and ADBL. The figure was Rs. 7.51 billion, 9.78 billion and 20.85 billion respectively for NBL, RBB and ADBL in mid-July 2016, showing a slight improvement in the capital base of SOBs. This calls for a regulators efforts and actions for the SOBs to improve the resilience.

Figure 2.32: Paid-up Capital, Capital Fund (Left) & Deposits (Right) of SOB (Rs. in Billion)



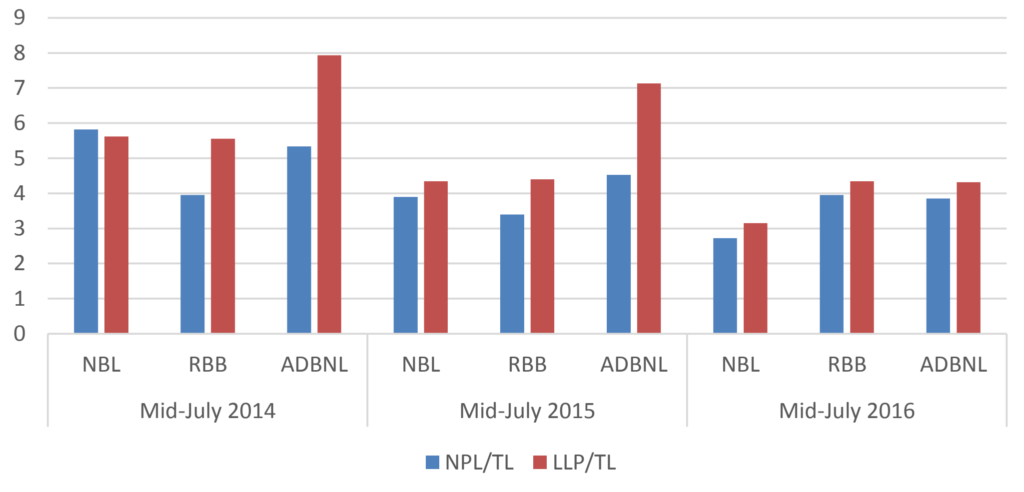
The core capital and total capital to risk weighted assets of ADBNL stood at 15.82 percent and 17.47 percent in mid-July 2017. Such capital was 11.44 percent and 12.84 percent respectively in mid-July 2016. Likewise, reform of two SOBs lead the improvement in core capital and total capital. Both the Banks RBB and NBL met the minimum capital requirement. The core capital and total capital to risk weighted assets of NBL stood at 14.33 percent and 15.61 percent similarly core capital and total capital to risk weighted assets of RBB stood at 10.48 percent and 11.83 percent respectively in mid-July 2016, Improvement in capital adequacy ratio of SOB indicates improved resilience.

**Figure 2.33: Capital Adequacy in SOBs (in percent)**




The NPL ratio of state owned banks is being improved from 3.58 percent in mid-July 2016 to 2.73 percent in mid-July 2017. As on mid- July 2017 the NPL ratio of ADBNL, RBB and NBL stands on 2.97 percent, 2.37 percent and 2.95 percent respectively implying a gradual improvement in the assets quality towards international standard. Such ratios were 3.85 percent, 3.95 percent and 2.72 percent in mid-July 2016. The NPL ratio of all state owned banks have 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 1.81 percent from 2.19 percent in review period .

Figure 2.34: 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

# PERFORMANCE 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 2017, share of commercial banks in total assets and liabilities of NRB regulated BFIs increased to 83.41 from 79.74 percent in mid-July 2016. Similarly, share of total assets and liabilities of commercial banks on total GDP increased to 100.8 percent from 97.15 percent in mid-July 2016. 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 19.98 percent to Rs. 2621.23 in mid-July 2017 from Rs. 2184.81 billion in mid-July 2016.

### Deposits and Credits

Total deposit and credit of commercial banks stood at 80.53 and 66.10 of GDP in mid-July 2017 which was 78.46 and 61.39 percent of GDP in mid-July 2016 respectively. Total deposits grew by 18.63 percent to Rs. 2093.26 billion during the period of mid-July 2017, against the previous growth of 20.62 percent during mid-July 2016. Total credit flows grew by 24.47 percent and reached to Rs. 1718.13 in mid-July 2017.

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 8.03 percent to Rs. 208.70 billion in mid-July 2017. 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 2017 as compared to that of mid-July 2016.

### Capital

The capital fund of commercial banks rose by 54.12 percent to Rs. 262.23 billion in mid-July 2017 from Rs. 170.15 billion in mid-July 2016. Of which, paid up capital rose by 52.79 percent, whereas statutory reserves and other reserves rose by 27.61 percent and 76.43 percent respectively during mid-July 2017. However, retained earnings stood positive from this fiscal year.

### Assets

The aggregate NPL to total loan ratio of commercial banks decreased to 1.54 percent on mid-July 2017 in comparison to the ratio of 1.82 percent in mid-July 2016. The three states owned banks in total have NPL ratio of 2.73 percent where as that of private commercial banks is only 1.34 percent in mid-July 2017. As in mid-July 2016, average NPL ratio of three state owned commercial banks was 3.58 percent, whereas such ratio for private commercial banks was 1.47 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)

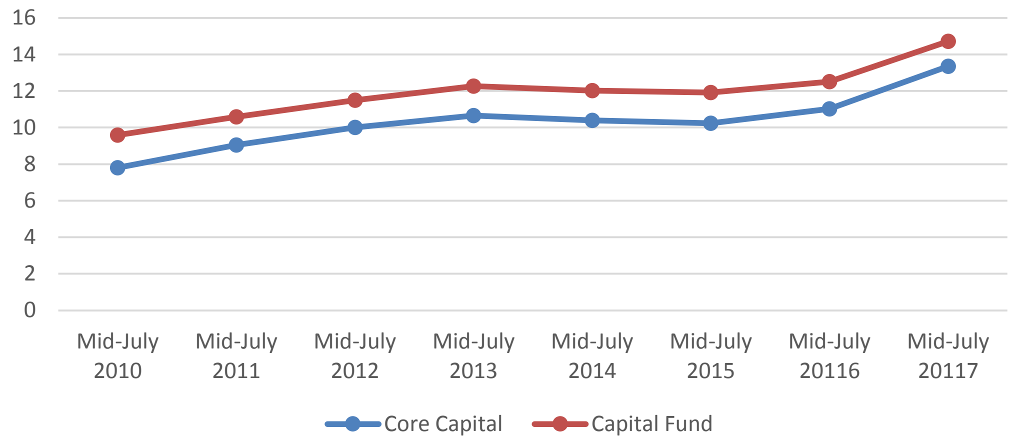



**Table 3.1: Major Financial Indicators of Commercial Banks (in percentage)**

| Indicators | Commercial Banks |
|---|---|
| Tier 1 & Tier 2 Capital /RWE | 14.72 |
| Tier 1 Capital/RWE | 13.35 |
| NPL/Total Loan | 1.54 |
| Return on Equity | 16.02 |
| Net Interest Spread | 4.18 |
| Total Credit to Total Deposit | 82.08 |
| Total Liquid Assets/Total Deposit | 26.00 |
| Base Rate | 9.75 |

Despite the directive of NRB to BFIs to invest at least 12.0 percent of total loan in agriculture and electricity sector, only 8.36 percent of total loans of commercial banks had been disbursed in agriculture sector and 8.50 percent in electricity, gas and water. Manufacturing (production) related sector availed 6.45 percent of total loan and retailer and wholesaler sector utilized 22.92 percent of total loan.

Likewise, out of total loan 7.73 percent was disbursed to consumption sector and 8.55 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 increased to 6.1 percent in mid-July 2017. Investment in business purpose loans such as term loan, overdraft loan, demand and other working capital loan were 16.2 percent, 17.9 percent and 22.2 percent respectively in mid-July 2017, which were 16.3 percent, 17.3 percent and 24 percent in mid-July 2016. 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 5.4 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, 71.11 percent are backed by collateral of properties in mid-July 2017 which was 86.65 percent in mid-July 2016.

**Profitability**

Net Profit of the commercial banks posted a growth of 19.15 percent to Rs. 45.43 billion in mid-July 2017 compared to the growth of 34.18 percent as of mid-July 2016. All commercial bank registered a positive profit during the review period. Total assets of the banks rose by 19.9 percent in mid-July 2017 compared to the growth of 23.1 percent during mid-July 2016. Contribution of interest income was 79.45 percent of the total income in the review period, such contribution slightly increased from 77.49 percent of total income as of mid-July 2016.

**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 2017 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 10 commercial banks below the minimum regulatory requirements(including conservation buffer) of 11 percent. The numbers of such banks were 21 in mid-July 2016.

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 11 percent came to one, down from previous reading of one in mid-July 2016. 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 one bank to below minimum requirement of 11 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 1 commercial banks will come below the required level of 11 percent, which were 6 as on mid-July 2016. 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 1 in mid-July 2016. 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 19 of 28 commercial banks are vulnerable towards liquidity crisis.

Five banks were prone to liquidity shock of withdrawal of 5 percent of deposits in a single day, while 14 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 23 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 9, 17 and 24 respectively on mid-July 2016.

With the shock of withdrawal of deposits by top 2, 3 or 5 institutional depositors, liquid assets to deposit ratio of 11, 18 and 23 commercial banks would be below 20.0 percent in mid-July 2017. The numbers were 17, 22 and 22 in mid-July 2016. 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 2016.

***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, 27 commercial banks could maintain their capital adequacy ratio above the regulatory requirement of 11.0 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 one banks would fall below 11 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 10 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 2016/17 were improving at steady 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

Overall Development banks portfolio has decreased during FY 2016-17 due to merger wave created by regulatory capital increment. Deposits of banks was decreased by 14.07 percent to Rs. 239.42 billion and credits too decreased by 10.04 percent to Rs. 209.60 billion mainly due to merger of existing development bank to commercial bank. The ratio of credit to domestic deposit and core capital stand at 76.82 percent in mid-July 2017. The ratio of credit to domestic deposit and core capital was 74.41 in mid-July 2016.

**Assets**

Total assets of development banks stands at Rs. 305.08 billion which registering decline of 13.04 percent from Rs 350.84 billion in mid-July 2017. Non-performing loans accounted for Rs. 2.85 billion in mid-July 2017 which is 1.36 percent of total loan and advances of development bank; it was Rs. 3.45 billion in mid-July 2016 which was 1.48 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 2017, development banks have capital adequacy ratio of 20.44 percent. The ratio was 15.31 percent in mid-July 2016. Current regulatory requirement demands 10 percent capital adequacy ratio for national level development banks and 11 percent for other development banks. Capital Funds of development banks saw an appreciation in value during last fiscal year by 11.02 percent to Rs. 38.28 billion at mid-July 2017. The increase was mainly propelled by increase in paid-up capital due to right issuance and stock dividend distribution of banks. Paid-up capital of development bank at mid-July 2017 amounted to Rs. 30.21 billion.

**Profitability**

Net Profit of Development banks decline by 11.42 percent as compared to last year which is due to decrease in number of development banks in this year as compared to last year. Profit of the development banks totaled Rs. 6.87 billion in mid-July 2017, while the figure was Rs. 7.76 billion in mid-July 2016. Return on Equities of development banks improved by 4.55 percentage points to 17.95 percent while Return on Assets were improved by 4 basis points to 2.25.

**Table 3.2: Major Indicator of Development Banks (as of mid-July 2017)**

| Particulars | Ratios (in percent) |
|---|---:|
| Core Capital to RWA | 19.43 |
| Capital Fund to RWA | 20.44 |
| Credit to Deposit (LCY) Ratio | 87.55 |
| Credit to Deposit (LCY) & Core Capital | 76.82 |
| Non-Performing Loan to Total Loan | 1.36 |
| Liquid Assets to Total Deposits | 31.52 |
| Weighted Average Interest on Credit | 13.98 |
| Weighted Average Interest on Deposit | 7.82 |
| Weighted Average Interest on Govt. Sec. | 3.06 |

### Base Rates and Spread Rates

The average base rate of national level development banks stood at 12.18 percent in mid-July 2017, whereas it was 9.14 percent in mid-July 2016. Increase in base rates was due to increase in cost of funds lead by credit crunch in last year. As of mid-July 2017, Out of 13 national level Development Banks, base rates of 6 Developments Banks are below average and 7 Development Banks base rates are higher than the average rate.

Average spread rate of national level developments banks decreased by 44 basis points during the FY 2016-17 to 5.42 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 2017, it was revealed that the banks have adequate buffer capital to absorb the perceived shocks. Stress testing results of 13 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 2017 revealed that a standard credit shock would push the capital adequacy ratio of as much as 1 development bank out of total 13 national level development banks below the regulatory minimum benchmark if 15 percent performing loans were to deteriorate as substandard loans. Similarly, 1 development bank would not comply the requirement if 5 Percent of performing loans were to deteriorate as loss loans.

#### *Liquidity Shock*

The stress test results found that 4 development banks would see their capital adequacy dip below minimum level if withdrawal of deposit by 2 percent, 5 percent, 10 percent, 10 percent and 10 percent for five consecutive days as per liquidity maintained on mid July 2017.

Similarly, if there is a withdrawal of deposit by 5 percent, 10 percent, 15 percent and 20 percent the number of bank's whose liquid assets to deposit ratio below the regulatory minimum of 20.0 percent stood at 1, 4, 10 and 11 in mid-July 2017.

With the shock on withdrawal of deposits by top 2 to 5 institutional depositors, liquid assets to deposit ratio of 1 development banks 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 all 13 national level development banks' CAR was above the regulatory requirement when calibrating through interest rate, exchange rate and equity price shocks. 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 13 national level development banks found less vulnerable position.

## 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 2.18 percent in mid-July 2017, which was 2.86 percent of GDP in mid July 2016. The total assets and liabilities of finance companies decreased in mid-July 2017 by 21.49 percent to Rs. 68 billion compared to mid-July 2016. Finance companies mobilized aggregate deposit of Rs. 50 billion in mid July 2017 which is a decrease of 17.77 percent compared to mid-July 2016.

Loan and advances of finance companies stood at Rs. 43.89 billion accounted for 1.91 percent of total GDP which was 2.51 percent of GDP in mid July 2016. The investment of finance companies accounted to Rs. 2.91 billion in mid-July 2017 which was Rs. 4.53 billion in mid-July 2016. Almost all of such investment is in government securities.

Capital fund of finance companies stood at Rs. 11.3 billion in mid-July 2017 which is 21.25 percent of risk weighted exposure of the same period. In mid-July 2016 such ratio was 23.53 percent amounting to Rs. 14.6 billion.

The credit to deposit and core capital ratio of finance companies registered 72.13 percent in mid-July 2017, which is below the prescribed limit of 80 percent. Such ratio was 66.53 percent in mid-July 2016. Total non-performing loan of finance companies was 3.08 percent of total loan and advances in mid July 2017 which was 4.16 percent in mid-July 2016. Non-banking assets of finance company have decreased by 40.86 percent to Rs. 330 million in mid July 2017 from Rs. 5.6 billion in mid-July 2016. Loan loss provision reached to Rs. 1.7 billion in mid-July 2017 from that of Rs. 2.4 billion in mid-July 2016.

Finance companies, as a whole, are in profit as exemplified by positive ROA (2.81 percent) and ROE (23.19 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 34.64 percent in the review period which implies that finance companies are in comfortable position in terms of liquidity. Out of total loan and advances Construction has highest share accounting to 14.8 percent followed by wholesaler and retailer sectors 12.36 percent, agriculture and forest related with 6.15 percent. Share of fishery is minimal with 0.1 percent of the total, while 24.56 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 Term loan has 15.74 percent and 12.22 percent share in total loan portfolio. Deprived sector loan has 5.51 percent share which is above than prescribed limit of 4 percent in aggregate. In mid-July 2017 real estate loan had 8.20 percent share in total loan and advances.

Number of finance companies has decreased to 21 in mid-July 2017 from 28 in mid-July 2016. During the review period, seven finance companies have been merged with other bank and financial institutions.

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 21 finance companies 16 finance companies are national level. Stress testing result of rest of the 16 national-level finance companies found that finance companies remained less vulnerable to individual credit shocks and liquidity shocks in aggregate. However, for 2 finance companies, Capital adequacy ratio decreased to less than 10 percent after combined credit shocks. In the same way for 6 finance companies will have liquidity ratio less than 20 percent after withdrawal of deposits by 20 percent. Position of finance companies after stress testing scenarios is shown in the following table.

**Table 3.3: Summary Result of Stress Testing of Finance Companies**

| **Criteria** | **Number** |
|---|---|
| **No. of Finance Companies with CAR below 10 percent before shocks** | **0** |
| ***A. Credit Shock*** | |
| | **No. of BFIs having CAR<10 percent** |
| 15 Percent of Performing loans deteriorated to substandard | 2 |

| | |
|---|---|
| 15 Percent of Substandard loans deteriorated to doubtful loans | 2 |
| 25 Percent of Doubtful loans deteriorated to loss loans | 2 |
| 5 Percent of Performing loans deteriorated to loss loans | 2 |
| All NPLs under substandard category downgraded to doubtful. | |
| 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. | |
| 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 | 0 |
| Withdrawal of deposits by 10 percent | 2 |
| Withdrawal of deposits by 15 percent | 3 |
| Withdrawal of deposits by 20 percent | 6 |
| Withdrawal of deposits by top 2 institutional depositors. | 1 |
| Withdrawal of deposits by top 3 institutional depositors. | 1 |
| Withdrawal of deposits by top 5 institutional depositors. | 2 |
| Withdrawal of deposits by top 2 individual depositors. | 0 |
| Withdrawal of deposits by top 3 individual depositors. | 0 |
| Withdrawal of deposits by top 5 individual depositors. | 1 |

## Performance of Microfinance Financial Institutions

As of mid-July 2017, there were altogether 53 microfinance financial institutions (MFFIs) operating as "D" class financial institutions which are working in Grameen Banking Model. Among them, there are 4 wholesale lending microfinance Institutions, viz, RMDC, RSDC, Sana Kisan Microfinance Financial Institutions and First Microfinance Financial Institution. The number of branches of all MFFIs reached to 1899, creating employment facility for 8905 people as of mid-July 2017. Comparing to previous year, the total members of MFFIs increased by 23.16 percent to 23,38,618 in mid-July 2017. The total outstanding loan of MFFIs as of mid-July 2017 rose by 37.85 percent to Rs. 106.46 billion as compared to Rs. 77.23 billion in previous year.

**Table 3.4: Key Performance Indicators of MFFIs** **(Rs. '000)**

| S.N. | Particulars | Mid-July 2016 | Mid-July 2017 | Change % |
|---|---|---|---|---|
| 1 | No. of MFFIs | 42 | 53 | 26.19 |
| *1.2* | *No. of Wholesale MFFIs* | *4* | *4* | 0.00 |
| 2 | No. of Branches of MFFIs | 1375 | 1,895 | 38.11 |
| *2.1* | *No. of Branches of Wholesale MFFIs* | *11* | *11* | 0.00 |

| | | | | |
|---|---|---|---|---|
| *2.2* | *No. of Branches of NGBB* | *186* | *186* | 0.00 |
| 3 | Total Members of MFFIs | 1898797 | 2,338,618 | 23.16 |
| *3.1* | *Members of NGBB* | *202837* | *210,250* | 3.65 |
| 4 | Total Capital of MFFIs (Rs.) | 8,673,657 | 15,993,991 | 84.40 |
| *4.1* | *Capital of Wholesale MFFIs (Rs.)* | *3,104,813* | *3835848* | 23.55 |
| *4.2* | *Capital of NGBB (Rs.)* | *386,657* | *578,155* | 49.53 |
| 5 | Total Paid-up Capital of MFFIs (Rs.) | 5,425,449 | 7,739,787 | 42.66 |
| *5.1* | *Paid-up Capital of Wholesale MFFIs (Rs.)* | *1,321,650* | *1705770* | 29.06 |
| *5.2* | *Paid-up Capital of NGBB (Rs.)* | *557,500* | *557,500* | 0.00 |
| 6 | Total Assets of MFFIs (Rs.) | 100,723,951 | 133,913,749 | 32.95 |
| *6.1* | *Assets of Wholesale MFFIs (Rs.)* | *22,849,995* | *26903281* | 17.74 |
| *6.2* | *Assets of NGBB (Rs.)* | *8,581,369* | *9,729,506* | 13.38 |
| 7 | Total Loan and Advances of MFFIs (Rs.) | 77,232,892 | 106,463,012 | 37.85 |
| *7.1* | *Loans and Advances of Wholesale MFFIs (Rs.)* | *19,134,439* | *24090809* | 25.90 |
| *7.2* | *Loan and Advances of NGBB (Rs.)* | *6,411,974* | *7,721,787* | 20.43 |
| 8 | Total Savings in MFFIs (Rs.) | 24,095,303 | 34,396,259 | 42.75 |
| *8.1* | *Savings in NGBB (Rs.)* | *1,819,314* | *2,257,377* | 24.08 |
| 9 | Total Borrowings of MFFIs (Rs.) | 52,431,413 | 66,878,993 | 27.56 |
| *9.1* | *Borrowings of Wholesale MFFIs (Rs.)* | *17,774,241* | *20955844* | 17.90 |
| *9.2* | *Borrowings of NGBB (Rs.)* | *4,296,156* | *4,536,232* | 5.59 |
| 10 | Total Overdue (Loan&Interest) of MFFIs (Rs.) | 1,305,328 | 1,662,245 | 27.34 |
| *10.1* | *Overdue (Loan & Interest) of Wholesale MFFIs (Rs.)* | *27292* | *29940* | 9.72 |
| *10.2* | *Overdue (Loan+ Interest) of NGBB (Rs.)* | *722,128* | *739,550* | 2.41 |
| 11 | Total Loan Loss Provision of MFFIs (Rs.) | 1,352,160 | 1,696,099 | 25.44 |
| *11.1* | *Loan Loss Provisions of Wholesale MFFIs (Rs.)* | *264633* | *320092* | 20.96 |
| *11.2* | *Loan Loss Provission of NGBB (Rs.)* | *298,468* | *327,413* | 9.70 |

As of mid-July 2017, total capital of MFFIs increased by 84.40 percent to Rs. 15.99 billion compared to the same period of the last year. Out of total capital, capital of wholesale MFFIs stood at Rs. 6.00 billion and NGBBL's capital stood at Rs. 578.55 million. The paid-up capital of MFFIs increased by 42.66 percent to Rs. 7.74 billion. The ratio of paid-up capital to total capital stood at 48.41 percent. The paid-up capital of wholesale MFFIs stood at Rs. 1.71 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 32.95 percent to Rs. 133.91 billion. In this category, the share of wholesale MFFIs stood at 20.09 percent and share of NGBBL's asset stood at 7.27 percent. Loan and advances registered a growth rate of 37.85 percent to Rs. 106.46 billion. Out of the total loans and advances; the wholesale loan shared 22.63 percent while individual loans shared the rest. NGBBL's share in this category stood at 7.25 percent. The ratio of loan and advances to the total assets stood at 79.50 percent. MFFIs have not booked any asset as non-banking assets during the review period.

Total savings mobilized by the MFFIs increased by 42.75 percent to Rs. 34.40 billion in the review period. Out of the total savings, NGBBL mobilized Rs. 2.26 billion sharing 6.57 percent. As compared to total liabilities of these institutions, the share of savings remained at 25.69 percent. Out of total savings, public deposits shared only 5.11 percent which was collected by two microfinance institutions and the rest is collected from the members of 51 microfinance institutions. Total borrowings of these banks during the review period increased by 27.56 percent to Rs. 66.88 billion. Out of total borrowings, wholesale MFFIs borrowed 20.96 billion with a share of 31.34 percent and NGBB borrowed Rs. 4.54 billion with a share of 6.79 percent. As compared to total liabilities of MFFIs, the share of borrowed amount remained at 49.94 percent.

The total amount of overdue loan, including interest, of these institutions significantly increased by 27.34 percent to Rs. 1.66 billion as compared to the same period of the last year. The overdue of wholesale MFFIs stood at Rs. 29.94 million. NGBBL's overdue loan amounted to Rs.739.65 million with a significant share of 44.49 percent of total overdue of MFFIs. Likewise, the amount of loan loss provision of these institutions decreased by 25.44 percent to Rs. 1.70 billion during the review period. NGBBL alone had loan loss provision of Rs. 327.41 million which is 19.30 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 2017. 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 2017 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. To mark this occasion various promotional events like financial literacy rally comprising of students, teachers, BFIs, Cooperatives, NGOs, donor agencies, etc., Interaction programs on financial literacy focusing child and youths, distribution of different financial literacy materials, different Radio and Tv programs are conducted during this 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. The SEBON as well as The FNCCI also help educate peoples including investors, entrepreneurs and businesspersons, students and academicians through various programmes.

**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 Centre compulsorily and should have received credit information while disbursing the loans above Rs. 50,000; most of them have got the membership of the center. But this center is still under process to convey credit information among all D class microfinance financial institution. 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. Since the capital base of microfinance institutions is small, the financial resources seems undersupplied for this sector. 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.

Microfinance Financial Institutions are lacking skillful and efficient manpower. As the manpower having well experiences in the field of microfinance is very limited in the market. The institutions have to recruit inexperience or under experience staffs which results in poor performance for the organization. There is a trend of turning round the various organizations by the staffs, specially, in managerial position.

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 is ongoing. 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 licensed for conducting limited-banking activities by the NRB stood at 15 as of mid-July 2017. In 2017 the license of one cooperative was revoked as it didn't work as per rule and regulation of NRB and the related Act. Among them, National Cooperative Development Bank (NCDB) is involved in wholesale business while remaining others do retail business. The total asset of these 15 institutions increased by 1.72 percent to Rs. 33.08 billion during the review period. Share capital of these institutions decreased by 2.53 percent to Rs. 1.93 billion during the period. Total deposits of these 15 cooperatives decreased by 0.07 percent to Rs. 25.40 billion during the review period. Likewise, their loans and advances rose by 5.85 percent to Rs. 21.37 billion. The non banking assets of all cooperatives rocketed to Rs. 126.31 million at rate of 59.19 percent, which is an evidence for increasing non performing loans.

### Government Registered Cooperatives

According to statistics from Department of Cooperative, 34,646 cooperatives are operating throughout the country as on mid-July 2017. Amongst the different types of cooperatives, savings and credit cooperatives are dominant accounting 40.57 percent of the total number.

### Financial Highlights of Cooperatives

As of mid-July 2017, deposits of cooperatives totaled Rs. 301.67 billion and total credit stood at Rs. 295.24 billion. Both Deposits and credit of cooperatives grew by 2.01 percent during review period. Cooperatives have total capital of Rs. 76.50 billion and total funds amounted to Rs. 18.64 billion.

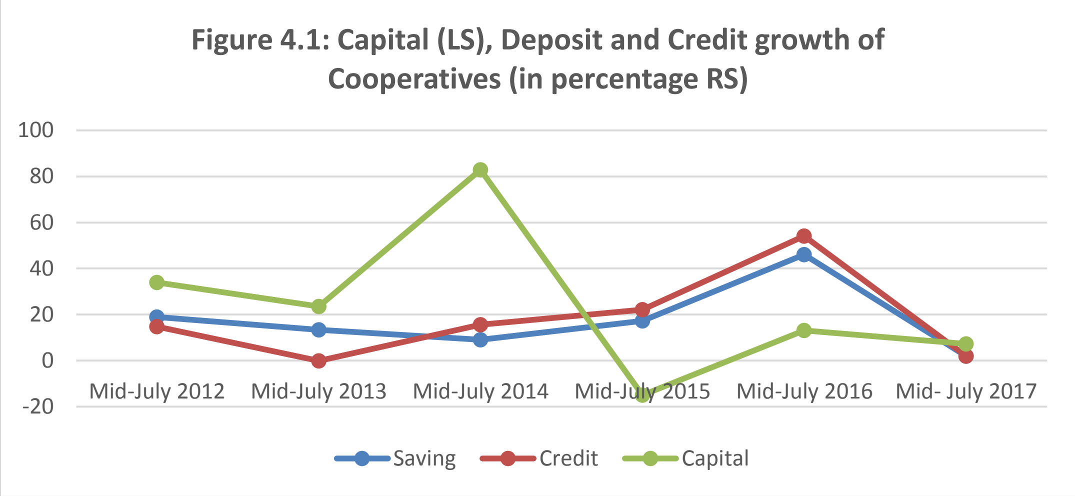



**Table 4.1: Key Figures of Cooperatives (As of Mid-July 2017)**

| Indicators | Figures |
|---|---|
| No. of Cooperatives | 34,646 |
| Members (Nos.) | 6,123,926 |
| *Male (Nos.)* | *2,989,522* |
| *Female (Nos.)* | *3,134,169* |
| Total Staff (Nos.) | 57,40 |
| Total Capital (in Rs.) | 76.50 |
| Total Fund (in Rs.) | 18.63 |
| Deposit (in Rs.) | 301.67 |
| Credit (in Rs.) | 295.24 |
| Credit to Deposit Ratio | 97.87% |
| Credit to Capital and Deposit Ratio | 78.07% |

*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. 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.

**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% |
| **2016-17** | 34646 | 1047 | 3.12% |

*Source: Department of Cooperatives*

## Financial Non-Government Organizations

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. As directed by the NRB, all of these FINGOs are in the process of transforming themselves into 'D' class MFFIs. Some of them have got the license for operating as D class microfinance financial institutions.

## 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 2017 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 2017, total loan of Rs. 2.29 billion has been disbursed through this Fund to 1165 institutions throughout 70 districts of Nepal, benefitting some 59 thousand low-income households. In 2017 the bank could recover Rs. 1.89 billion including principal and interest amount out of Rs. 1.99 to be recovered at the recovery rate of 94.97 percent whereas it was 94.67 percent in previous year.

## 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 16.23 percent to Rs. 185.89 billion during fiscal year 2016-17. Total assets of life insurance companies' and non-life companies' expanded by 16.31 percent and 15.91 percent respectively.

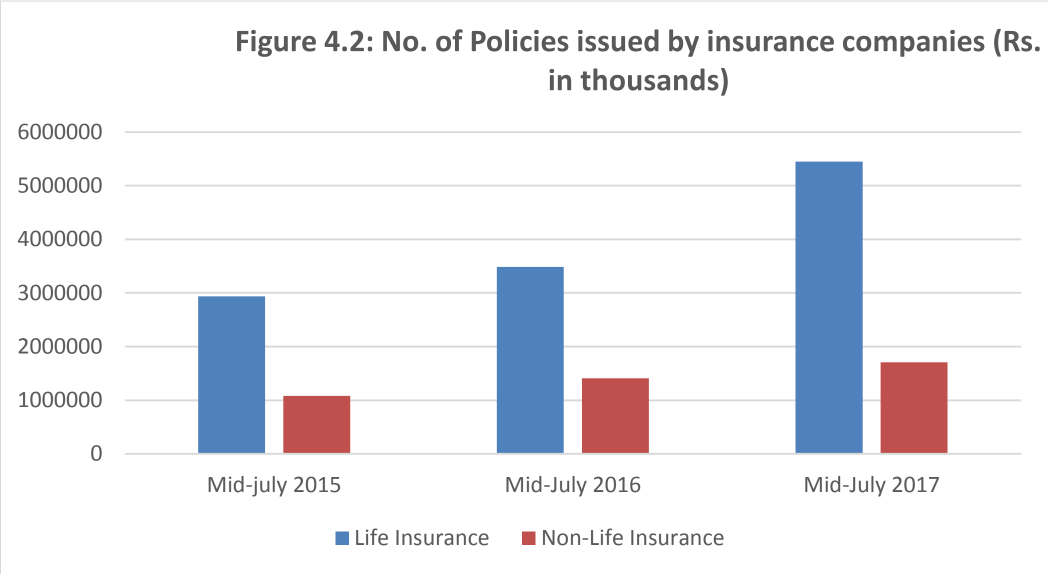
**Table 4.3: Sources and Uses of Funds of Insurance Companies (in billion Rs.)**

| Sources | Life | | | Non-Life | | |
|---|---|---|---|---|---|---|
| | **2014/15** | **2015/16** | **2016/17** | **2014/15** | **2015/16** | **2016/17** |
| Paid-up Capital | 5.77 | 6.24 | 8.30 | 3.75 | 4.75 | 6.22 |
| Reserve Funds | 93.99 | 115.69 | 138.41 | 17.82 | 21.07 | 24.41 |
| Other Liabilities | 3.93 | 7.95 | 4.35 | 4.18 | 4.23 | 4.2 |
| Total | **103.69** | **129.88** | **151.06** | **25.75** | **30.05** | **34.83** |
| **Uses** | | | | | | |
| Cash and Bank | 1.96 | 2.36 | 2.25 | 2.72 | 3.18 | 2.37 |
| Investment | 94.18 | 117.98 | 138.83 | 15.91 | 16.82 | 22.42 |
| Fixed Assets | 1.64 | 1.66 | 1.64 | 1.07 | 1.1 | 1.36 |
| Other Assets | 5.91 | 7.89 | 8.34 | 6.05 | 8.96 | 8.67 |
| Total | **103.69** | **129.88** | **151.06** | **25.75** | **30.05** | **34.83** |

*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 46.10 percent in 2016-17 beating previous figure of 21.94 percent in 2015-16. Significant growth has been seed in individual sectors too. The number of life insurance policy holders went up by 56.27 percent in 2016-17 to reach 5.49 million from 3.49 million in 2015-16.

Similarly, non-life insurance coverage grew by 20.99 percent totaling to 1.71 million in 2016-17. 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.




*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 reinsurance portfolio mostly in non life part. The total assets/liabilities of insurance company rose by only 28.46 percent to Rs. 10.02 billion during fiscal year 2016-17. The total sources of the fund is Rs. 6.87 billion in the year 2016-17 which is 9.57 percent growth comparing to previous year. The total use of fund is Rs. 6.27 billion in the year 2015/16.

## Employees Provident Fund (EPF)

According to unaudited figures of mid-July 2017, Employee Provident Fund (EPF) has provident fund amounting to Rs. 244.15 billion, while total assets/liabilities of EPF stood at Rs. 251.28 billion. The funds at EPF grew by 12.43 percent during last fiscal year similarly total assets/liabilities grew by 11.83 percent during last fiscal year. The savings (funds) in EPF shares 8.11 percent of total assets of NRB regulated BFIs (A,B,C). 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 54.99 percentage of total and fixed deposits ranked second with 24.08 percentage share in the portfolio. The fund has been utilizing almost its total fund with loan and investment to total fund ratio at 97.95 percent and maintaining cash and bank balance of Rs. 2.52 billion.

**Table 4.4: Key Indicators of EPF mid- July, 2017**

| Indicators | Amount (Billion Rs.) |
|---|---|
| **Sources of Fund** | **251.28** |
| Provident Fund | 244.15 |
| General Reserve and Funds | 4.66 |
| Liabilities | 0.91 |
| Provisions | 1.56 |
| **Uses of Fund** | **251.28** |
| Cash and bank | 2.52 |
| Bonds and Debentures | 15.39 |
| Fixed Deposits | 60.52 |
| Share Investments | 2.78 |
| Project Loan | 28.47 |
| Lending to Contributors | 138.19 |
| Investment in Fixed Assets | 0.78 |
| Fixed Assets | .40 |
| Assets under construction | 0.01 |
| Miscellaneous Assets | 2.22 |
| **Loan and Investment to Total Fund Ratio** | **97.95%** |
| **Loan and Investment to Provident Fund Ratio** | **100.81%** |
| **Liquidity Ratio (Cash and bank to Total Fund)** | **1.03%** |

*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 2017, net fund collections of CIT stood at Rs. 93.55 billion, recording a growth of 16.70 percent from the figures of Rs. 80.16 billion in mid-July 2016. Apart from its capital, reserve and other liabilities of Rs. 5.55 billion, regular contributions from members are the only and major source of fund with 93.55 billion for CIT. Uses of fund of the Trust, which are diversified in five broad categories, stood at Rs. 99.10 billion.

CIT has been heavily dependent on BFIs for its fund mobilization. Out of total funds, 63.29 percent has been put on BFIs and fixed deposits, while the fixed deposit accounts 91.48 percent of total investment of CIT, similarly 23.32 percent of total fund has been utilized as loan and advances 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, 2017**

| Indicators | Figures (Billion Rs.) |
|---|---|
| **Sources of Funds** | |
| Paid up Capital | 0.74 |
| Reserve Fund | 2.32 |
| Fund Collection | 93.55 |
| Other Liabilities | 2.49 |
| **Total** | **99.10** |
| **Uses of Fund** | |
| Cash and Bank Balances | 2.28 |
| **Investments** | **68.56** |
| a) Fixed Deposits | 62.72 |
| b) Governments Bonds | 1.81 |
| c) Shares | 3.06 |
| d) Debentures | 0.97 |
| Loan and Advances | 23.11 |
| Fixed Assets | 0.81 |
| Other Assets | 4.33 |
| **Total** | **99.10** |

*Source: Nagarik Lagaani Kosh (Citizen Investment Trust)*

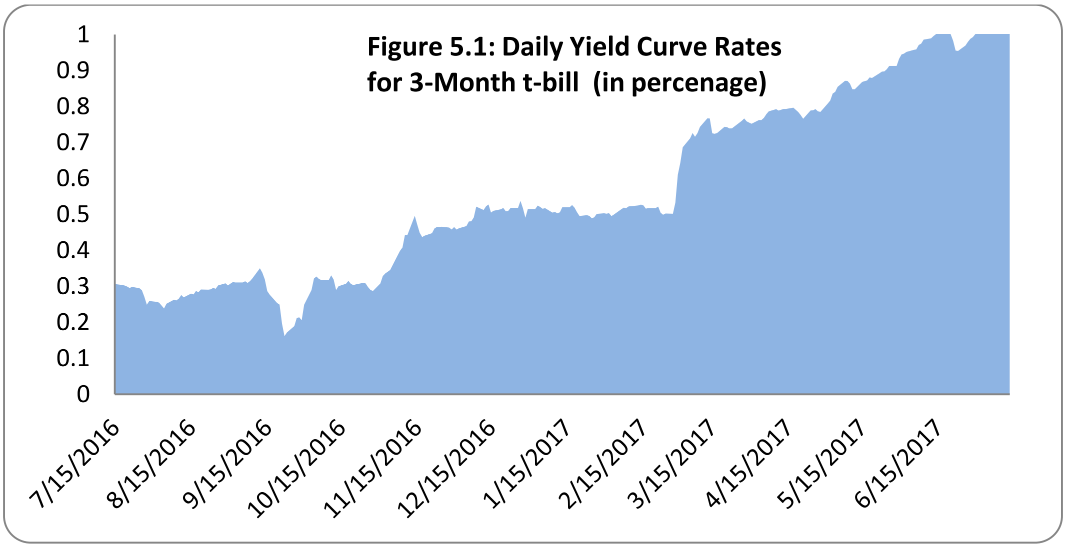
## CHAPTER - FIVE

## FINANCIAL MARKETS

### Global Financial and Money Market Perspectives

#### 3 Month US Government Treasuries

Yields on US government treasuries picked up gradually in FY 2016/17 due mainly to continuous hike in US federal funds rate. The Fed hiked interest rates three times (December 2016, March 2017 and June 2017) in the review year to 1.25 percent. The yield on three months t bills that averaged at below 0.30 percent in the beginning of the review year further dipped to below 0.20 percent at the end of the first quarter but picked up gradually from the second quarter. The three months T-bill yield curve showed the lowest yield of 0.16 on 22 September, 2016 and the highest return of 1.02 on 10 July 2017.




#### 10-Year US Government Treasury note

Contrary to the yield on short term security, the yields on long term securities though inched up gradually remained more fluctuating in the review year. The yield remained broadly stable at around 1.55 percent in the first couple of months and hovered around 1.75 percent in the next three months. The yield then grew gradually and reached the peak of 2.63 percent on 13 March, 2017. From January onwards, the yield fluctuated between the lowest 2.16 percent on 18 April 2018 and the highest 2.63 percent on 13 March 2017.

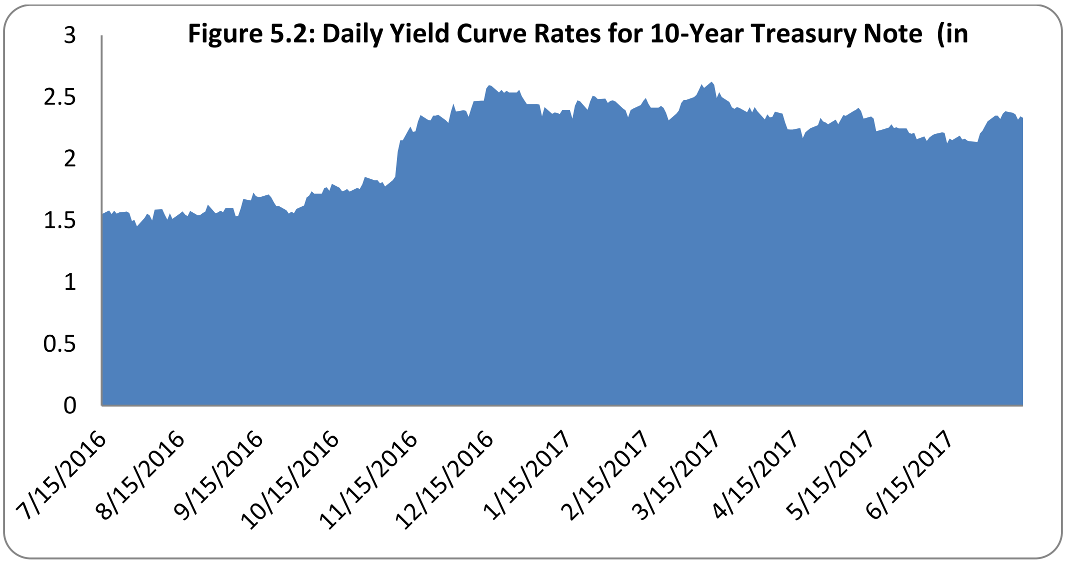


**Figure 5.2: Daily Yield Curve Rates for 10-Year Treasury Note (in**

## Crude Oil

Brent crude oil, the main international benchmark, was trading between US dollars 45 to 55 per barrel during the review period. The crude oil prices reached the highest level of US dollar 55.94 per barrel on 2 February, 2017 with the lowest point being US dollar 40 on 2, August 2016. The crude oil price, though fluctuating in the short term, was broadly on a rising trend in the review year. Generally, oil prices fluctuate because of changes to supply and demand, but there are multiple factors at play like weather events, supply interruptions, broader demand trends such as the emergence of renewable energy, OPEC decisions, or other events that can have an immediate effect on supplies that can affect those fundamentals. The disruption in oil supply across the world as a result of terrorism, strikes, sabotage or lack of maintenance were all sharp reasons for price fluctuations in the review year.

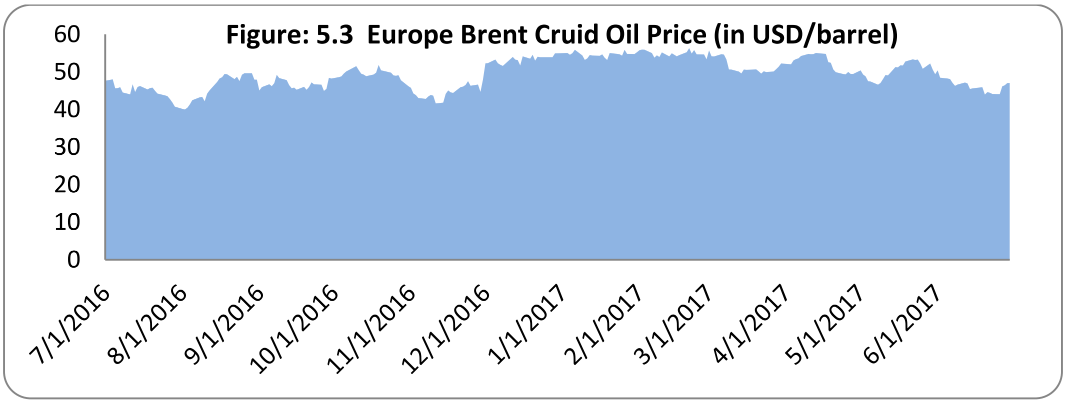
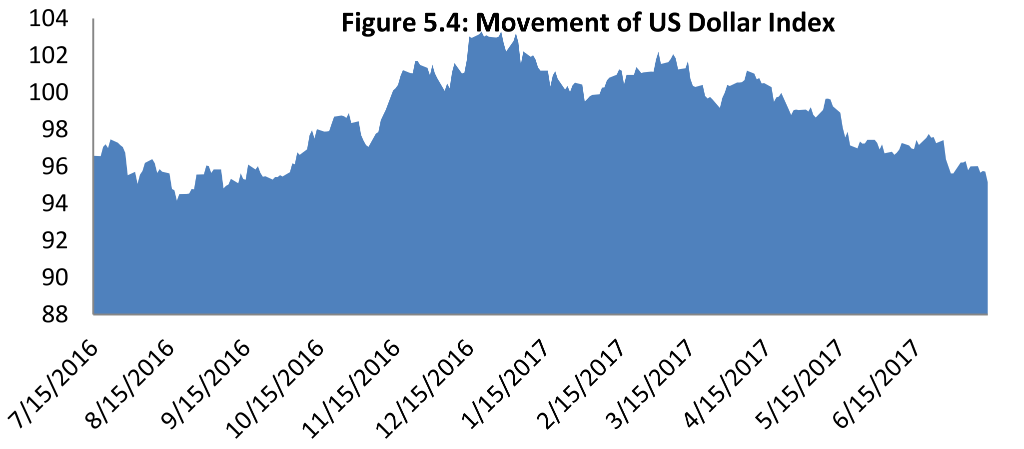


**Figure: 5.3 Europe Brent Cruid Oil Price (in USD/barrel)**

### Dollar Index

The U.S. Dollar Index is an index is a measure of the value of the United States dollar relative to a basket of foreign currencies including Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish Krona and Swiss Franc. The US dollar index swung between gains and losses in the review year due to lack of clear clue. The index went as low as 94.16 on 18 August, 2016 to the highest 103.29 on 20 December 2016. The dollar saw a high level of volatility with the Fed's rate hikes as well geo-political tensions in Middle-East, Russia and North Korea.

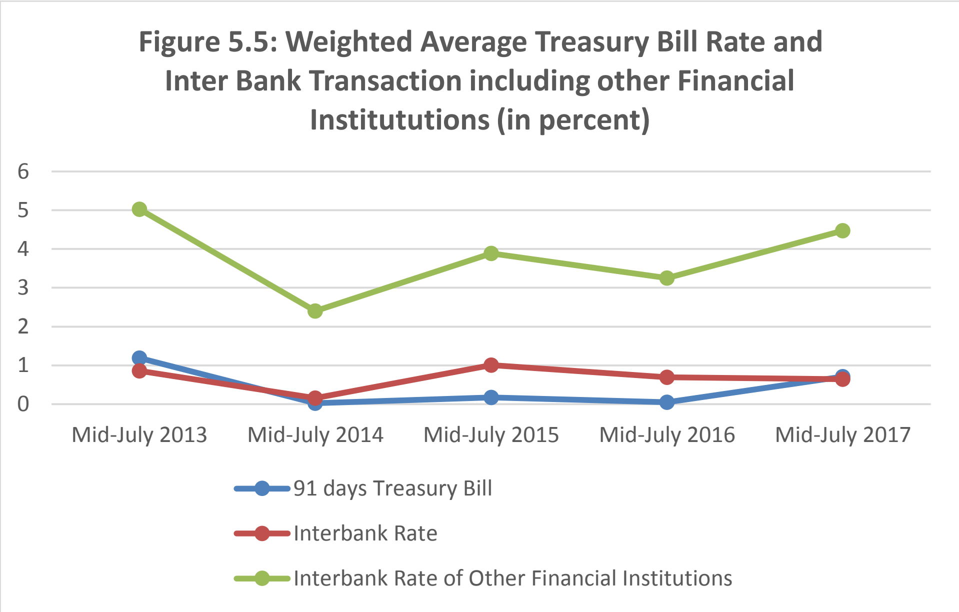
Figure 5.4: Movement of US Dollar Index




## Domestic Financial Market

### Money Market

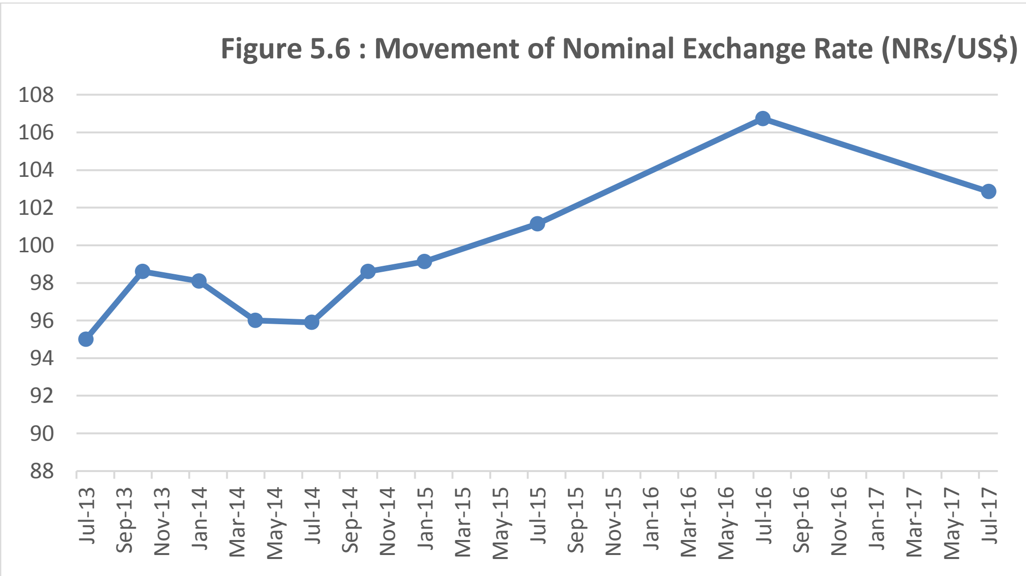
Short term and long term interest rates in the financial market remained relatively high in FY 2016/17 in comparison to FY 2015/16. Weighted average rate of 91-day Treasury bill increased in the last month of FY 2016/17 and inter-bank transaction rates decreased in the last month of 2016/17 compared to a year ago. The weighted average 91-day Treasury bill rate increased to 0.71 percent in the review month from 0.05 percent a year ago. The weighted average inter-bank transaction rate among commercial banks that was 0.69 percent a year ago reduced to 0.64 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions increased to 4.47 percent from 3.25 percent a year ago.




Weighted average interest rate spread of commercial banks decreased to 5.2 percent in the review period from 5.6 percent a year ago and the average base rate increased to 9.9 percent from 6.5 percent a year ago.

**Dollar-Rupee Exchange Rate**

Nepalese currency appreciated by 3.8 percent against US dollar during the end of 2016/17 compared to a depreciation by 5.2 percent in the same period of the previous year. The exchange rate of one US dollar stood at Rs. 102.86 in mid-July 2017 compared to Rs. 106.73 in mid-July 2016.



## Securities Market

Nepalese securities market witnessed mixed growth during fiscal year 2016/17. SEBON introduced various structural reforms in primary market including implementation of Application Supported by Blocked Amount (ASBA) system to ease application process in primary market, issuance of new Securities Registration and Issue Regulations, 2016 and securities Issue and Allotment Guidelines, 2017 to attract real sector companies in securities market. Total fund mobilization through primary market increased significantly by more than two folds during the review period. Right share issue and mutual fund issue increased by three folds as compared to previous fiscal year. NEPSE index, market capitalization, number of listed companies decreased slightly; and annual turnover/volume, float market capitalization increased in the fiscal year 2016/17 as compared to the fiscal year 2015/16.

## Primary Market

Nepalese securities market witnessed significant growth in primary market in fiscal year 2016/17. In Fiscal Year 2016/17, funds amounting to Rs. 59.39 billion has been mobilized through 101 issues consisting 17 IPOs (Rs. 1.51 billion), 76 right issues (Rs. 45.64 billion), four FPOs (Rs. 7.99 billion) and four mutual fund schemes (Rs. 4.25 billion). The number of issues increased by 83.64 percent and amount of capital mobilization increased by two folds in fiscal year 2016/17 as compared to capital mobilization amounting to Rs 19.0 billion through the 55 issues in the fiscal year 2015/16.

During the review period, the number of initial public offerings increased by 21.43 percent whereas the issue amount decreased by 45.29 percent as compared to fiscal year 2015/16. Out of the 17 corporate bodies issuing shares to public, 13 are from hydropower sector which shows the attraction of hydropower companies towards public offerings to get more benefit from the market based financing. The contribution of right offerings to total funds mobilization is 76.8 percent. In fiscal year 2016/17, primary market witnessed multifold growth in number of issue and amount. During the review period, SEBON approved 76 companies for right offerings amounting to Rs. 45.6 billion, an increase of more than 3 times as compared to 37 issues worth Rs. 9.4 billion in previous fiscal year. Most of the Banks and Financial Institutions offered right shares to raise their paid up capital as mandated by the directives issued by Nepal Rastra Bank. Four listed companies raised Rs. 7.99 billion through FPOs in the review period, an increase of 37.1 percent as compared to the previous fiscal year. In fiscal Year 2015/16, three companies raised Rs. 5.83 billion capital through FPOs. FPOs have been increasingly used in recent years to mobilize fund by listed companies. In the same period, four mutual funds issued their scheme worth Rs. 4.3 billion, more than 3 times as compared to previous fiscal year. In fiscal year 2015/16, only one mutual fund scheme worth Rs. 1.0 billion was issued. The trend of primary market is presented in Table 5.1.

**Table 5.1: Primary Market** **Amount in Rs billion**

| Offering | Fiscal Year | | | | | | Percentage Change | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2014/15 | | 2015/16 | | 2016/17 | | In Number | | In Amount | |
| | No. | Amount | No. | Amount | No. | Amount | 2015/16 | 2016/17 | 2015/16 | 2016/17 |
| IPOs | 18 | 6.98 | 14 | 2.76 | 17 | 1.51 | -22.22 | 21.43 | -60.46 | -45.29 |
| Right Offerings | 22 | 2.31 | 37 | 9.40 | 76 | 45.64 | 68.18 | 105.41 | 306.93 | 385.53 |
| FPOs | - | - | 3 | 5.83 | 4 | 7.99 | - | 33.33 | - | 37.05 |
| Mutual Fund | 3 | 2.25 | 1 | 1.00 | 4 | 4.25 | -66.67 | 300.00 | -55.56 | 325.00 |
| Debenture | 5 | 2.90 | - | - | - | - | - | - | - | - |
| **Total** | 48 | 14.44 | 55 | 18.99 | 101 | 59.39 | 14.58 | 83.64 | 31.51 | 212.74 |

**Secondary Market**

The major indicators of secondary market in fiscal year 2016/17 reflected the mixed growth. NEPSE index, NEPSE float index, number of listed companies, market capitalization decreased marginally as compared to the fiscal year 2015/16 and turnover, number of transactions, float market capitalization, etc. increased during the same period. NEPSE index decreased by 7.89 percent to be 1582.67 points at the end of fiscal year 2016/17. It was at 1718.15 points at the end of previous fiscal year. Similarly, float index reached to 116.14 points which is decreased by 7.30 percent as compared to 125.41 points of previous fiscal year. In the review period, turnover of Rs. 205.02 billion was recorded, an increase of 24.52 percent as compared to Rs. 164.65 billion of the fiscal year 2015/16. Similarly, average daily turnover increased by 14.29 percent to be Rs. 0.89 billion. Ratio of market capitalization to GDP is 71.4 percent in FY 2016/17 which was decreased by 15.05 percent during the review period as compared to the fiscal year 2015/16. However, Turnover to market capitalization increased by

26.75 percent in the fiscal year 2016/17 as compared to fiscal year 2015/16. Turnover to market capitalization was 11.04 in fiscal year 2016/17. The trend of secondary market is presented in Table 5.1.

**Table 5.2: Secondary Market**

| Indicators | Fiscal Year | | | Percentage Change | |
|---|---|---|---|---|---|
| | 2014/15 | FY 2015/16 | FY 2016/17 | 2015/16 | 2016/17 |
| No. of Listed Companies | 232 | 229 | 208 | -0.92 | -9.17 |
| Turnover (Rs in billion) | 65.43 | 164.65 | 205.02 | 151.64 | 24.52 |
| Average Daily Turnover (Rs in billion) | 0.30 | 0.71 | 0.89 | 136.67 | 14.29 |
| Trading Days | 216 | 233 | 230 | 7.87 | -1.29 |
| No. of Transaction | 477287 | 838987 | 1356515 | 75.78 | 61.68 |
| Total Paid up value of Listed Shares (Rs. in billion) | 157.58 | 204.02 | 289.59 | 29.47 | 41.94 |
| Market Capitalization (Rs in billion) | 989.40 | 1890.13 | 1,856.82 | 91.04 | -1.76 |
| Float Market Capitalization (Rs in billion) | 318.72 | 632.66 | 641.69 | 98.50 | 1.43 |
| Turnover to Market Capitalization (In %) | 6.61 | 8.71 | 11.04 | 31.77 | 26.75 |
| Market Capitalization/ GDP (In %) | 46.45 | 84.10 | 71.44 | 81.05 | -15.05 |
| Float Market Capitalization/ GDP (In %) | 14.96 | 28.15 | 24.69 | 88.17 | -12.29 |
| NEPSE Index (In Points) | 961.23 | 1718.15 | 1582.67 | 78.74 | -7.89 |
| NEPSE Sensitive Index (In Points) | 204.67 | 369.07 | 336.04 | 80.32 | -8.95 |
| NEPSE Float Index (In Points) | 68.47 | 125.41 | 116.14 | 83.16 | -7.39 |

## CHAPTER - SIX

# FINANCIAL SECTOR POLICIES AND INFRASTRUCTURES

### Global Systemically Important Banks Requirements and Assessment Criteria

The Financial Stability Board (FSB) has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. The FSB member authorities apply the following requirements to Global Systemically Important Banks G-SIBs:

- ***Higher capital buffer:*** There have been a number of changes to the position of banks in relation to the buckets of higher capital buffers that national authorities require banks to hold in accordance with international standards.
- ***Total Loss-Absorbing Capacity (TLAC):*** G-SIBs are required by national authorities to meet the TLAC standard, alongside regulatory capital requirements set out in the Basel III framework.
- ***Resolvability:*** These include group-wide resolution planning and regular resolvability assessments. The resolvability of each G-SIB is also reviewed in a high level FSB Resolvability Assessment Process (RAP) by senior regulators within the firms' Crisis Management Groups.
- ***Higher supervisory expectations:*** These include heightened supervisory expectations for risk management functions, risk data aggregation capabilities, risk governance and internal controls.

The Basel Committee has set methodology for assessing and identifying global systemically important banks (G-SIBs). The assessment methodology for G-SIBs based on an indicator-based approach and comprises five broad categories: size, interconnectedness, lack of readily available substitutes or financial institution infrastructure, global (cross-jurisdictional) activity and complexity.

### 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 III will be implemented at national level development banks and national level finance companies gradually.

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 based on Basel III requirement. There has been provision requiring banks to maintain capital conservation buffer equal to 2.5 percent of total risk weighted assets. 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.

6.1.5 Commercial banks are required to maintain minimum Tier 1 leverage ratio of 4%. 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 Licensing Policy for BFIs

### 6.2.1 Moratorium on Establishment of BFIs and MFFIs

NRB has imposed moratorium on establishing new MFFIs and has been kept moratorium on providing new license to BFIs for long time. Previously, it had 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. However, MFIs will be encouraged to expand their branches in districts of mountain and hilly regions, with low financial access and comparatively high poverty.

### 6.2.2 Licensing Policy for Infrastructure Development Bank

NRB has issued the licensing policy for the establishment of infrastructure development banks after the recently amended and integrated Banks and Financial Institutions Act, 2073 (BAFIA). According to the policy, the minimum paid up capital requirement for Infrastructure development bank is NPR 20 billion. The establishment of such banks will promote infrastructure projects within the country. While the NRB has currently issued a moratorium on the licensing of a new bank or financial institution, the new policy to allow the establishment of infrastructure development bank comes in the wake of demands from the private sector of a new financial institution having the capital and capacity to finance big-scale infrastructure projects that existing BFIs are unable to do. Furthermore, the establishment of infrastructure development bank can bankroll big projects like roads and mega hydropower projects to help bridge the infrastructure gap of the country.

## 6.3 Problem Bank Resolution Framework

**6.3.1** NRB issued directive to provide two years time to the banks and financial institutions that had been termed “problematic” and have been revived within July, 2017 will get two years’ time to meet the minimum paid-up capital requirement set by NRB. Therefore, those institutions can maintain their paid-up capital requirement within mid-July, 2019.

**6.3.2.** The BFIs which are problematic and are in process of resolution if they can maintain 25 percent of minimum capital and get rid of the problematic status they can maintain the minimum regulatory paid up capital within two years of getting revived.

**6.3**.3 NRB also provisioned, if necessary, to give waiver to maintain CCD ratio, priority sector lending and deprived sector lending to problem banks.

## 6.4 Domestic Regulatory Reforms

### Recent Regulatory Reforms

6.4.1 NRB has barred the local and provincial representatives from joining the board of banks and financial institutions during their tenure. The presence of elected representatives on board of the BFIs could weaken the governance of the BFIs, as elected representatives are very likely to indulge in power play.

6.4.2 Nepal Rastra Bank has tightened the credit limit against the collateral of stocks. BFIs are limited to 40 percent of core capital towards margin sector loans. Further, the margin for keeping shares of a single listed company as collateral will account for a maximum of 10 percent of BFIs' core capital. In addition, BFIs can lend against the collateral of promoters' shares only up to 50 percent of the average closing price of ordinary shares for the last 180 days or the prevailing market value of the promoters' shares, whichever is less.

6.4.3 Banks has been directed to open branches in 744 local levels, which are designed on the basis of the federal structure. Banks will be responsible to follow such directive and any defiance will be penalized as per the provision in the Nepal Rastra Bank Act. However, interest free loan of Rs. 10 million per branch for one year will be provided to those establishing branches in designated local levels in order to facilitate government transactions.

6.4.4 NRB has directed BFIs to fix the borrowing rate against the collateral of fixed deposit receipt at the time of opening the fixed deposit account and will not be allowed to charge interest more than the predetermined rate.

6.4.5 Commercial banks are required to bring down the ratio of institutional deposit to 45 percent of total deposit from the existing 50 percent by mid-July 2018.

6.4.6 NRB has made a provision to designate at least the senior manager or higher level official at the 'Information and Grievance Hearing Desk' of the BFIs. In addition, BFIs are required to publish the number of grievances handled and hearings in their annual reports, along with submitting such information to this Bank

6.4.7 NRB made mandatory to depositors to show their identification card if they are depositing cash in other's bank account. BFIs may not accept cash if depositors fail to show identification documents.NRB introduced this policy as part of its efforts to prevent money laundering and terrorism financing. This policy will prevent financial system getting abused by the ill-gotten money.

6.4.8 BFIs, required to raise stipulated minimum paid up capital by mid-July 2017, have been encouragingly working towards it. These institutions should meet the target for the minimum paid up capital and clearly show it on the 'Notes to Account' by the time the external audit report and financial statement of 2016/17 are made public as per the Banks and Financial Institutions Act, 2016. In the case of noncompliance, several actions will be taken including restricting the distribution of cash and bonus shares and branch expansion, limiting deposit collection and credit disbursement, and enforcing merger.

## 6.5 Recent Efforts of NRB for Financial Access

6.5.1 The provision has been made to provide an interest free one year loan of Rs. 10 million to BFIs, which open branches in Village Councils deprived of banking service and open at least 2500 accounts of those Nepali citizens not having bank account. This will facilitate the GoN's campaign of opening bank account of all citizens and provide social security allowance through banks. This provision will terminate after 2017/18.

6.5.2 NRB has issued circular to BFIs to make an arrangement to provide banking service to the senior citizens, differently-abled people and illiterate individuals through specified counters of BFIs. Furthermore, if possible BFIs should make necessary arrangement to provide ATM services friendly to differently-abled individuals.

## 6.6 Recent Provisions to promote Agriculture and Tourism Sector

6.6.1 Commercial banks are required to allocate minimum 25 percent of total credit to priority sector, which include minimum of 10 percent to agriculture, 5 percent to hydropower, and 5 percent to tourism and remaining to other priority sectors. However, the existing provision for development banks and finance companies to extend minimum 15 percent and 10 percent of their total credit to the priority sector is kept unchanged.

Hydropower, agriculture, tourism, exports, small and cottage industries, pharmaceuticals, cement and garment will be defined as priority sector. NRB has increased investment in priority sector to minimize widening trade deficit. In this context, monetary policy has given top priority to encourage banks and financial institutions for funneling credit towards agriculture, energy, tourism, small and medium scale enterprises as well as to other productive enterprises.

## 6.7 Deprived Sector Lending

6.7.1 NRB has kept the ratio of loan to be extended by the commercial banks, development banks and finance companies to the deprived sector unchanged. Under this provision, commercial banks are required to extend 5 percent, development banks 4.5 percent and finance companies 4 percent to the deprived sector. However, the provision requiring commercial banks to invest minimum 2 percent of the deprived sector credit directly has been made optional. A provision has been made to include the loan extended to purchase, own and operate electronic rickshaw as well as normal rickshaw by 'A', 'B' and 'C' class institutions under the deprived sector loan category. Previously, such loan to normal rickshaw pullers was counted as deprived sector lending. Furthermore, the provision to include project loan up to Rs. one million extended by the BFIs against the collateral of commercial agriculture project under deprived sector lending has been continued

## 6.8 Real Estate Policies

6.8.1 NRB has limited real estate lending inside Kathmandu valley. In the past, the limit of the loan was 50 percent of the value of collateral. NRB has reduced the limit to 40 percent inside Kathmandu valley and the limit outside the valley has been kept unchanged at the existing 50 percent. NRB expected that this provision will promote decentralized development in the process of implementing federalism. The maximum loan to value (LTV) ratio for residential housing loan is lowered to 50 percent for Kathmandu valley and such ratio has been kept unchanged at 60 percent for other places.

6.8.2 NRB has eased the cap on home loan. Previously, the BFIs could offer housing loans to up to NPR 10 million, this has now been increased to NPR 15 million.

## 6.9 Qualifications requirement for BOD members and CEO

NRB has set the basic qualification criteria for Chief Executive officers and board of directors of BFIs in line with the provision of the BAFIA. On dated 2017/12/05, NRB issued the "Qualification and work experience for CEOs and BODs of BFIs Bylaw, 2017" which set the new qualification requirements. According to the new provision, to be eligible to be the CEO of a commercial bank, development bank or financial institution, a candidate needs to have completed Masters Degree in either management, banking, finance, economics, commerce, accounting, statistics, mathematics, trade administration or law. However, if a candidate has ten years of experience or more in an international organization, government office, university or any BFI as an officer or has held a higher position, they could also qualify for the CEO's post of BFIs even if he/she only has a Bachelor's degree in the aforementioned subjects or a degree in chartered accountancy. While the educational qualification requirements have been kept same for micro-finance institutions, any candidate who has three years of working experience in the above mentioned organizations could qualify as CEO. To qualify to be appointed to board of BFIs, NRB has set different criteria. Firstly, the candidate should either have worked for at least five years in public service or international organization. Other Otherwise, the candidate should have a Bachelor's degree and three years of working experience as a government officer or officer at any bank and financial institution. The third option is that the candidate should have a Masters degree in one of the subjects — management, banking, economics, commerce, accounting, statistics, mathematics, trade administration or law — to become the board member of BFIs. As per new provision, any person having completed 10-plus-two and with two years of work experience in government service or banking sector in the post of officer or higher position could be deemed eligible to be appointed to board of microfinance company. Likewise, anyone having a Bachelor's degree on management, banking, finance, economics, commerce, accounting, statistics, mathematics, trade administration or law could also be the board member a microfinance company. The Banks and Financial Institutions Act was endorsed by the Legislature-Parliament on January 10. The act has given right to the central bank to set the qualification requirements for CEOs and board members of BFIs.

**New requirements**

**CEO of class 'A', 'B' and 'C' institutions:** Completed Masters degree in either management, banking, finance, economics, commerce, accounting, statistics, mathematics, trade administration or law or Bachelor's degree in the aforementioned subjects or a degree in chartered accountancy along with 10 years of experience or more in an international organization, government office, university or any banking or financial institution as an officer or a higher position

**CEO of class 'D' institutions:** Educational qualification requirements same as in class 'A', 'B' and 'C' institutions, but require only three years of working experience in the above mentioned organizations

**BoD of class 'A', 'B' and 'C' institutions:** Worked for at least five years in public service or international organization or a Bachelor's degree and three years of working experience as a government officer or officer at any BFI or a Masters degree in one of the subjects — management, banking, economics, commerce, accounting, statistics, mathematics, trade administration or law

**BoD for class 'D' institutions:** Completed 10-plus-two and two years of work experience in government service or banking sector in the post of officer or higher position or having a Bachelor's degree on management, banking, finance, economics, commerce, accounting, statistics, mathematics, trade administration or law

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

*In million Rupees*

| **Financial Institutions** | **Mid-July 2013** | **Mid-July 2014** | **Mid-July 2015** | **Mid-July 2016** | **Mid-July 2017** |
|---|---|---|---|---|---|
| Commercial Banks | 1,242,881.40 | 1,467,151.90 | 1,774,504.80 | 2,184,811.57 | 2,621,230.38 |
| Development Banks | 199,954.80 | 255,373.40 | 300,641.80 | 350,844.75 | 305,079.44 |
| Finance Companies | 100,856.70 | 110,342.30 | 108,007.40 | 103,443.22 | 82,609.84 |
| MFFIs | 35,774.90 | 49,395.80 | 70,880.40 | 100,770.60 | 133,765.0 |
| Cooperatives (Capital, Fund and Savings) | 191,614.00 | 233,715.55 | 265,551.90 | 385,721.81 | 396,534.8 |
| Contractual Saving Institutions | | | | | |
| Employees Provident Fund | 145,283.40 | 170,638.60 | 195,903.00 | 224,854.80 | 251,283.35 |
| Citizen Investment Trust (Capital and Net Fund Balance) | 42,753.60 | 54,621.30 | 67,675.00 | 83,013.40 | 99,101.60 |
| Insurance Companies | 84,650.40 | 101,097.20 | 129,450.00 | 158,241.60 | 185,890.00 |
| Reinsurance Company | - | - | 6,157.57 | 6,254.38 | 10,020.89 |
| **Total** | **2,043,769.20** | **2,442,336.05** | **2,918,771.87** | **3,597,956.13** | 4,095,265.30 |
| Market capitalization (NEPSE) | 514,492.10 | 1,057,165.80 | 9,89,403.96 | 1,889,451.74 | 1,856,829.39 |
| Total (incl. market capitalization) | **2,558,261.30** | **3,499,501.85** | **2,918,771.87** | **5,487,407.87** | 5,952,094.69 |
| Percentage Share (Excluding NEPSE Market Capitalization) | | | | | |
| Financial Institutions | | | | | |
| Commercial Banks | 60.81 | 60.07 | 60.80 | 60.72 | 64.00 |
| Development Banks | 9.78 | 10.46 | 10.30 | 9.75 | 7.45 |
| Finance Companies | 4.93 | 4.52 | 3.70 | 2.88 | 2.02 |
| Microfinance Development Banks | 1.75 | 2.02 | 2.43 | 2.80 | 3.27 |
| Cooperatives (Capital Fund and Savings) | 9.38 | 9.57 | 9.10 | 10.72 | 9.68 |
| Contractual Saving Institutions | | | | | |
| Employees Provident Fund | 7.11 | 6.99 | 6.71 | 6.25 | 6.14 |
| Citizen Investment Trust (Capital and Net Fund Balance) | 2.09 | 2.24 | 2.32 | 2.31 | 2.42 |
| Insurance Companies | 4.14 | 4.14 | 4.44 | 4.40 | 4.54 |
| Reinsurance Company | - | - | 0.21 | 0.17 | 0.24 |
| Mutual Fund | - | - | - | - | 0.24 |
| **Total** | **100** | **100** | **100** | **100** | **100** |

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

In Million Rupees

| | Particulars | Mid-July | | | Mid-June | Mid-July |
|---|---|---|---|---|---|---|
| | | 2014 | 2015 | 2016 | 2017 | 2017 |
| **Liabilities** | | 1 | 2 | 3 | 4 | 5 |
| 1 | **CAPITAL FUND** | 145861.43 | 162992.51 | 214892.48 | 285705.61 | 308651.74 |
| | a. Paid-up Capital | 128985.27 | 140794.10 | 163370.74 | 209939.14 | 225313.64 |
| | b. Statutory Reserves | 32722.08 | 37149.85 | 43680.58 | 52906.60 | 53665.23 |
| | c. Retained Earning | -27214.24 | -27802.05 | -11166.95 | -12201.79 | -3005.23 |
| | d. Others Reserves | 11368.33 | 12850.60 | 19008.11 | 35061.67 | 32678.11 |
| 2 | **BORROWINGS** | 18202.84 | 21355.96 | 42822.19 | 40876.33 | 31800.16 |
| | a. NRB | 2010.04 | 3291.48 | 6855.13 | 8725.35 | 7094.37 |
| | b. "A"Class Licensed Institution | 5182.01 | 5504.53 | 20083.07 | 15764.73 | 9094.04 |
| | c. Foreign Banks and Fin. Ins. | 4.12 | 0.00 | 0.00 | 0.00 | 0.00 |
| | d. Other Financial Ins. | 1306.53 | 1119.81 | 5111.62 | 6073.68 | 5299.38 |
| | e. Bonds and Securities | 9700.14 | 11440.14 | 10772.37 | 10312.57 | 10312.37 |
| 3 | **DEPOSITS** | 1477832.61 | 1771946.15 | 2107502.69 | 2292956.70 | 2384806.95 |
| | a. Current | 129108.41 | 158746.16 | 185135.30 | 180138.10 | 204360.95 |
| | b. Savings | 587593.46 | 714466.16 | 875419.91 | 794735.71 | 816572.17 |
| | c. Fixed | 453408.61 | 513283.02 | 617634.95 | 964730.50 | 998258.72 |
| | d. Call Deposits | 285024.29 | 363041.66 | 401829.34 | 323959.72 | 333350.39 |
| | e. Others | 22697.85 | 22409.16 | 27483.20 | 29392.67 | 32264.72 |
| 4 | **Bills Payable** | 1553.13 | 1729.91 | 3927.13 | 2554.41 | 2219.17 |
| 5 | **Other Liabilities** | 169227.44 | 188093.19 | 206694.45 | 249231.33 | 224201.08 |
| | 1. Loan Loss Provision | 48932.49 | 51482.56 | 48593.77 | 53626.55 | 52553.17 |
| | 2. Interest Suspense a/c | 30453.76 | 31256.97 | 32000.69 | 49049.37 | 34891.97 |
| | 3. Others | 89841.19 | 105353.66 | 126099.99 | 146555.42 | 136755.94 |
| 6 | **Reconciliation A/c** | 2869.47 | 280.36 | 13817.41 | 18971.93 | 2358.50 |
| 7 | **Profit & Loss A/c** | 31566.75 | 36755.88 | 49443.18 | 42237.72 | 54882.04 |
| | **TOTAL** | **1847113.68** | **2183153.96** | **2639099.54** | **2932534.04** | **3008919.66** |
| | **Assets** | | | | | |
| 1 | **LIQUID FUNDS** | 319196.62 | 353397.28 | 385746.01 | 348877.89 | 423242.12 |
| | a. Cash Balance | 41862.07 | 48642.45 | 56937.25 | 54563.53 | 64372.60 |
| | Nepalese Notes & Coins | 41073.72 | 47305.51 | 55937.33 | 53245.58 | 63282.78 |
| | Foreign Currency | 788.35 | 1336.94 | 999.92 | 1317.95 | 1089.82 |
| | b. Bank Balance | 220546.60 | 237957.23 | 262419.81 | 244274.69 | 305795.05 |
| | 1. In Nepal Rastra Bank | 162286.93 | 165070.53 | 180498.18 | 173386.40 | 233256.83 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | 2. "A" Class Licensed Institution | 34656.48 | 37838.00 | 41730.30 | 32677.31 | 38882.05 |
| | 3. Other Financial Ins. | 5302.85 | 6882.80 | 8437.01 | 6982.40 | 6368.76 |
| | 4. In Foreign banks | 18300.33 | 28165.90 | 31754.32 | 31228.58 | 27287.42 |
| | c. Money at Call | 56787.95 | 66797.60 | 66388.94 | 50039.67 | 53074.46 |
| **2** | **INVESTMENTS** | 162544.89 | 206160.48 | 238675.86 | 219911.76 | 232706.63 |
| | a. Government Securities | 160867.12 | 182112.29 | 196070.31 | 196615.13 | 214380.95 |
| | b Others | 1677.78 | 24048.18 | 42605.55 | 23296.62 | 18325.68 |
| **3** | **SHARE & OTHER INVESTMENT** | 72656.22 | 85675.60 | 131777.67 | 135760.43 | 129938.39 |
| **4** | **LOANS & ADVANCES** | 1119260.81 | 1345671.32 | 1669203.04 | 1948238.58 | 1976879.74 |
| | a. Private Sector | 1084965.27 | 1230999.56 | 1542024.97 | 1897432.57 | 1923942.40 |
| | b. Financial Institutions | 26247.72 | 30678.62 | 121291.82 | 42711.45 | 44543.48 |
| | c. Government Organizations | 8047.82 | 83993.14 | 5886.25 | 8094.56 | 8393.85 |
| **5** | **BILLS PURCHASED** | 9805.60 | 14548.03 | 11601.52 | 17713.13 | 17198.72 |
| **6** | **LOANS AGT. COLLECTED BILLS** | 737.25 | 1132.63 | 1075.28 | 764.01 | 570.71 |
| **7** | **FIXED ASSETS** | 30477.72 | 31732.63 | 35044.21 | 39730.12 | 40633.93 |
| **8** | **OTHER ASSETS** | 123962.34 | 135346.49 | 144135.22 | 193203.43 | 166139.11 |
| | a. Accrued Interests | 32041.34 | 32792.14 | 34038.25 | 57886.81 | 37665.70 |
| | b. Others | 91920.99 | 102554.35 | 110096.97 | 135316.61 | 128473.40 |
| **9** | **Expenses not Written off** | 491.99 | 392.16 | 319.21 | 281.32 | 279.01 |
| **10** | **Non Banking Assets** | 4756.96 | 5250.92 | 4797.21 | 4594.73 | 4465.45 |
| **11** | **Reconciliation Account** | -1032.54 | 2947.32 | 16089.93 | 22184.19 | 16631.18 |
| **12** | **Profit & Loss A/c** | 4255.78 | 899.11 | 634.40 | 1274.45 | 234.67 |
| **TOTAL** | | **1847113.65** | **2183153.98** | **2639099.55** | **2932534.04** | **3008919.66** |

# Annex-3

## Profit and Loss Statement of Bank and Financial Institutions

In Million Rupees

| Particulars | Mid-July | | | Mid-June | Mid-July |
|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2017 |
| **1 Interest Expenses** | 68151.35 | 67271.02 | 64943.04 | 88485.49 | 97850.70 |
| 1.1 Deposit Liabilities | 66485.63 | 65418.33 | 63252.25 | 86312.80 | 95608.58 |
| 1.1.1 Saving A/c | 21763.14 | 22494.48 | 21234.79 | 21472.29 | 23525.99 |
| 1.1.2 Fixed A/c | 34583.20 | 31594.10 | 31710.65 | 49093.46 | 55650.88 |
| 1.1.2.1 Up to 3 Months Fixed A/c | 2866.37 | 1995.01 | 1914.75 | 2245.99 | 2495.80 |
| 1.1.2.2 3 to 6 Months fixed A/c | 1065.31 | 1043.26 | 1240.54 | 2322.42 | 2672.64 |
| 1.1.2.3 6 Months to 1 Year Fixed A/c | 15136.29 | 14308.11 | 15369.26 | 26303.98 | 29697.33 |
| 1.1.2.4 Above 1 Year | 15515.23 | 14247.72 | 13186.09 | 18221.08 | 20785.12 |
| 1.1.3 Call Deposit | 10108.65 | 11302.25 | 10301.47 | 15745.29 | 16429.74 |
| 1.1.4 Certificate of Deposits | 30.64 | 27.50 | 5.34 | 1.76 | 1.97 |
| 1.2 Others | 1665.72 | 1852.69 | 1690.79 | 2172.70 | 2242.12 |
| **2 Commission/Fee Expense** | 448.04 | 509.46 | 546.23 | 529.14 | 600.94 |
| **3 Employees Expenses** | 18747.82 | 21218.85 | 22715.53 | 23183.91 | 26627.48 |
| **4 Office Operating Expenses** | 15067.83 | 17624.25 | 18123.58 | 17839.10 | 20754.59 |
| **5 Exchange Fluctuation Loss** | 30.99 | 64.81 | 197.03 | 101.78 | 108.69 |
| 5.1 Due to Change in Exchange Rates | 16.21 | 64.83 | 182.01 | 88.83 | 88.16 |
| 5.2 Due to Foreign Currency Transactions | 14.77 | -0.01 | 15.02 | 12.95 | 20.54 |
| **6 Non-Operating Expenses** | 143.87 | 89.80 | 106.14 | 17.99 | 33.54 |
| **7. Provision for Risk** | 14274.84 | 12781.47 | 9649.95 | 11537.00 | 12762.76 |
| 7.1 Loan loss Provision | 12362.41 | 11018.41 | 8451.80 | 10386.35 | 11477.45 |
| 7.1.1 General Loan loss Provision | 2835.44 | 4071.38 | 5107.97 | 6082.19 | 7035.80 |
| 7.1.1.1 Pass Loan Loss Provision | 0.00 | 3210.53 | 4530.40 | 5101.35 | 6256.87 |
| 7.1.1.2 Watch List Provision | 0.00 | 860.85 | 577.57 | 980.84 | 778.93 |
| 7.1.2 Special Loan Loss Provision | 9424.45 | 6627.48 | 3028.49 | 4080.43 | 4375.25 |
| 7.1.3 Additional Loan Loss Provision | 102.52 | 319.54 | 315.34 | 223.74 | 66.40 |
| 7.2. Provision for Non-Banking Assets | 1498.26 | 1429.51 | 1012.22 | 1023.15 | 1053.41 |

| | | | | | |
|---|---|---|---|---|---|
| 7.3. Provision for Loss on Investment | 40.12 | 101.98 | 14.53 | 119.08 | 185.90 |
| 7.4. Provision for Loss of Other Assets | 374.06 | 231.58 | 171.40 | 8.41 | 46.00 |
| **8 Loan Written Off** | 623.54 | 439.90 | 355.03 | 935.59 | 996.12 |
| **9 Provision for Staff Bonus** | 3452.11 | 4053.16 | 5851.53 | 5034.18 | 6656.78 |
| **10 Provision for Income Tax** | 10677.75 | 12158.39 | 17591.64 | 15198.17 | 20370.63 |
| **11 Others** | 45.06 | 495.79 | 61.16 | 40.16 | 55.62 |
| **12 Net Profit** | 29331.59 | 37039.32 | 49004.93 | 41214.57 | 54665.43 |
| ***TOTAL EXPENSES*** | **160994.78** | **173746.23** | **189145.80** | **204117.09** | **241483.28** |
| **Income** | | | | | |
| **1. Interest Income** | 127191.89 | 134011.48 | 146483.09 | 164726.41 | 194358.11 |
| 1.1. On Loans and Advance | 119484.79 | 127175.43 | 138782.71 | 153320.77 | 181923.38 |
| 1.2. On Investment | 3502.98 | 2309.29 | 3487.02 | 5291.76 | 5875.27 |
| 1.2.1 Government Bonds | 3049.44 | 1982.25 | 3005.11 | 4370.81 | 4830.38 |
| 1.2.2 Foreign Bonds | 28.74 | 76.54 | 136.72 | 129.96 | 153.35 |
| 1.2.3 NRB Bonds | 234.04 | 160.24 | 199.66 | 698.43 | 776.75 |
| 1.2.4 Debenture & Bonds | 190.76 | 90.26 | 145.54 | 92.55 | 114.78 |
| 1.3 Agency Balance | 962.10 | 716.42 | 589.35 | 736.66 | 1021.51 |
| 1.4 On Call Deposit | 2108.65 | 2633.89 | 2513.39 | 3917.76 | 3475.05 |
| 1.5 Others | 1133.37 | 1176.47 | 1110.61 | 1459.46 | 2062.91 |
| **2. Commission & Discount** | 8051.43 | 8935.14 | 9828.97 | 10846.64 | 11806.85 |
| 2.1 Bills Purchase & Discount | 231.80 | 248.42 | 300.48 | 218.18 | 239.80 |
| 2.2 Commission | 6517.57 | 7494.65 | 8074.48 | 9299.58 | 9864.84 |
| 2.3 Others | 1302.07 | 1192.07 | 1454.01 | 1328.88 | 1702.22 |
| **3 Income From Exchange Fluctuation** | 4168.69 | 4761.74 | 5708.82 | 5581.66 | 6248.97 |
| 3.1 Due to Change in Exchange Rate | 220.18 | 983.31 | 1342.09 | 698.51 | 706.74 |
| 3.2 Due to Foreign Currency Trans. | 3948.52 | 3778.43 | 4366.73 | 4883.15 | 5542.23 |
| **4 Other Operating Income** | 5508.69 | 7326.73 | 9123.21 | 9113.45 | 10772.31 |
| **5 Non Operating Income** | 4041.44 | 4743.47 | 4775.86 | 3071.24 | 3783.15 |
| **6 Provision Written Back** | 8679.68 | 11842.55 | 11550.65 | 9420.66 | 12883.40 |
| **7 Recovery from Written off Loan** | 806.02 | 1508.63 | 1276.09 | 996.17 | **1504.14** |
| **8 Income from Extra Ordinary Expenses** | 526.32 | 157.81 | 231.44 | 109.59 | 108.16 |
| **9 Net Loss** | 2020.61 | 458.66 | 167.67 | 251.30 | 18.20 |
| ***TOTAL INCOME*** | **160994.77** | **173746.22** | **189145.79** | **204117.11** | **241483.29** |

# Annex-4
## Major Financial Indicators of Microfinance Financial Institutions

*In Million Rupee*

| | Liabilities | Mid-July | | | Mid-Jun | Mid-July |
|---|---|---|---|---|---|---|
| | | 2014 | 2015 | 2016 | 2017 | 2017 |
| 1 | **CAPITAL FUND** | 4950.7 | 6147.3 | 8684.9 | 12255.2 | 12592.8 |
| | a. Paid-up Capital | 2974.3 | 3987.3 | 5436.5 | 7529.4 | 7721.3 |
| | b. Statutory Reserves | 523.1 | 750.3 | 1214.8 | 1752.7 | 1747.6 |
| | c. Retained Earning | 220.6 | 8.9 | 363.6 | 1055.6 | 1179.5 |
| | d. Others Reserves | 1232.7 | 1400.8 | 1670.0 | 1917.5 | 1944.5 |
| 2 | **BORROWINGS** | 27897.3 | 38244.9 | 52434.4 | 63407.5 | 66772.7 |
| | a. NRB | 526.4 | 306.6 | 91.1 | 320.6 | 554.8 |
| | f. Others | 27371.0 | 37938.3 | 52343.3 | 63087.0 | 66217.9 |
| 3 | **DEPOSITS** | 11001.2 | 15775.5 | 24095.3 | 32642.6 | 34344.1 |
| 4 | **BILLS PAYABLE** | 0.0 | 0.0 | 0.8 | 0.1 | 2.0 |
| 5 | **OTHER LIABILITIES** | 3777.5 | 5205.7 | 7205.0 | 11542.6 | 10366.3 |
| | a. Loan Loss Provision | 829.4 | 986.0 | 1345.6 | 1713.0 | 1716.1 |
| | b. Interest Suspense a/c | 475.0 | 575.3 | 652.7 | 905.1 | 938.5 |
| | c. Others | 2473.1 | 3644.3 | 5206.8 | 8924.5 | 7711.8 |
| 6 | **RECONCILIATION A/c** | 1088.2 | 2330.2 | 5031.9 | 5943.4 | 5779.8 |
| 7 | **PROFIT & LOSS A/c** | 1473.7 | 2524.8 | 3318.2 | 3808.7 | 3907.2 |
| | **Total** | **50188.7** | **70228.2** | **100770.6** | **129600.1** | **133765.0** |
| | **Assets** | | | | | |
| 1 | **LIQUID FUNDS** | 7202.8 | 6597.2 | 11096.2 | 9589.1 | 12497.7 |
| | a. Cash Balance | 39.2 | 62.2 | 75.5 | 152.2 | 93.9 |
| | b. Bank Balance | 3710.6 | 3900.5 | 6327.0 | 5501.2 | 6243.3 |
| | c. Money at Call | 3452.9 | 2634.4 | 4693.6 | 3935.6 | 6160.5 |
| 2 | INVESTMENT IN SECURITIES EXCEPT SHARES | 116.2 | 116.2 | 38.7 | 42.7 | 42.7 |
| 3 | **SHARE & OTHER INVESTMENT** | 2894.2 | 2350.1 | 2809.8 | 2659.8 | 2658.1 |
| 4 | **LOANS & ADVANCES** | 35689.3 | 54915.5 | 77232.9 | 105198.3 | 106540.9 |
| | Institutional | 9863.5 | 14853.5 | 19194.3 | 23880.5 | 24131.1 |
| | Individual | 25825.8 | 40062.0 | 58038.6 | 81317.9 | 82409.8 |
| 5 | **FIXED ASSETS** | 624.4 | 775.2 | 961.1 | 1239.1 | 1219.2 |
| 6 | **OTHER ASSETS** | 2485.4 | 3205.4 | 3598.2 | 5022.9 | 4766.1 |
| 7 | **EXPENSES NOT WRITTEN OFF** | 9.4 | 7.2 | 4.5 | 8.6 | 11.2 |
| 8 | **NON BANKING ASSETS** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 9 | **RECONCILIATION A/c** | 1085.2 | 2215.3 | 5017.3 | 5795.6 | 5959.5 |
| 10 | **PROFIT & LOSS A/c** | 81.8 | 46.2 | 11.9 | 44.0 | 69.6 |
| | **Total** | **50188.7** | **70228.2** | **100770.6** | **129600.1** | **133765.0** |

## Annex-5

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

*In Million Rupee*

| Particulars | Mid-July | | | Mid-June | Mid-July |
|---|---|---|---|---|---|
| **Sector wise** | **2014** | **2015** | **2016** | **2017** | **2017** |
| Agricultural and Forest Related | 48152.08 | 61783.87 | 76816.32 | 86410.21 | 87899.16 |
| Fishery Related | 2747.06 | 3355.59 | 1980.46 | 2320.99 | 2328.51 |
| Mining Related | 3580.05 | 3525.74 | 3404.03 | 3698.87 | 3950.19 |
| Agriculture, Forestry & Beverage Production Related | 222489.70 | 255534.57 | 296097.02 | 329112.59 | 329835.00 |
| Construction | 118632.87 | 152480.40 | 182851.94 | 219343.44 | 213028.75 |
| Electricity, Gas and Water | 25606.61 | 34540.43 | 46417.77 | 61501.15 | 63520.59 |
| Metal Products, Machinery & Electronic Equipment & Assemblage | 13994.97 | 16208.31 | 19473.46 | 24614.43 | 25044.82 |
| Transport, Communication and Public Utilities | 43707.55 | 48451.67 | 67489.25 | 79318.57 | 76264.31 |
| Wholesaler & Retailer | 243966.15 | 297286.58 | 374322.54 | 430291.27 | 436442.74 |
| Finance, Insurance and Real Estate | 90353.77 | 107293.66 | 135000.17 | 160108.84 | 166374.23 |
| Hotel or Restaurant | 32909.63 | 44028.90 | 54426.26 | 65591.10 | 66900.15 |
| Other Services | 54154.23 | 63957.60 | 72146.41 | 83232.68 | 90250.94 |
| Consumption Loans | 87003.21 | 101450.14 | 120843.49 | 150835.56 | 158359.29 |
| Local Government | 1182.73 | 1714.14 | 1654.98 | 1562.07 | 1568.65 |
| Others | 141309.64 | 169740.36 | 228955.74 | 268773.97 | 272881.84 |
| **TOTAL** | **1129803.67** | **1361351.97** | **1681879.83** | **1966715.74** | **1994649.17** |
| **Product wise** | | | | | |
| Term Loan | 211367.58 | 245994.73 | 294326.89 | 344403.47 | 361906.83 |
| Overdraft | 48161.32 | 55141.88 | 72678.07 | 72070.41 | 64530.02 |
| Trust Receipt Loan / Import Loan | 250607.47 | 293603.14 | 365785.23 | 409766.27 | 404195.22 |
| Demand & Other Working Capital Loan | 89484.87 | 118861.54 | 142815.41 | 168173.80 | 168383.92 |
| Residential Personal Home Loan (Up to Rs. 1 Crore) | 82482.16 | 85678.07 | 108071.88 | 127154.22 | 127318.70 |
| Real Estate Loan | 20031.63 | 24084.77 | 37681.04 | 39194.14 | 41170.06 |
| Margin Nature Loan | 63653.90 | 80966.96 | 110094.35 | 150734.68 | 150400.06 |
| Hire Purchase Loan | 50576.56 | 63889.82 | 81239.19 | 105365.04 | 111984.61 |
| Deprived Sector Loan | 10045.08 | 13511.29 | 12530.80 | 17779.56 | 17354.17 |
| Bills Purchased | 130323.28 | 156470.18 | 183962.55 | 221632.17 | 226670.09 |
| Other Product | **1129803.66** | **1361351.98** | **1681879.83** | **1966715.73** | **1994649.17** |
| **Total** | 211367.58 | 245994.73 | 294326.89 | 344403.47 | 361906.83 |

| Collateral wise | | | | | |
|---|---|---|---|---|---|
| Gold and Silver | 31102.67 | 31374.67 | 30642.25 | 36663.59 | 37466.92 |
| Government Securities | 992.12 | 784.73 | 1014.67 | 1023.14 | 997.94 |
| Non Governmental Securities | 14092.14 | 18776.93 | 29668.70 | 32922.11 | 34634.94 |
| Fixed Deposit Receipts | 10774.58 | 9824.90 | 10553.39 | 21433.77 | 22175.52 |
| Own | 9893.47 | 8925.88 | 9577.14 | 20138.91 | 20780.98 |
| Other Licences Institutions | 881.11 | 899.02 | 976.25 | 1294.86 | 1394.55 |
| Collateral of Properties | 936410.77 | 1131830.49 | 1463645.87 | 1714990.81 | 1734997.03 |
| Fixed Assets | 785804.82 | 957231.98 | 1207217.80 | 1442467.09 | 1459790.48 |
| Current Assets | 150605.95 | 174598.50 | 256428.07 | 272523.72 | 275206.55 |
| Against security of Bill | 11927.48 | 13969.01 | 15710.45 | 15927.66 | 15873.63 |
| Domestic Bills | 2817.51 | 3532.80 | 3525.87 | 893.89 | 798.38 |
| Foreign Bills | 9109.97 | 10436.21 | 12184.58 | 15033.77 | 15075.25 |
| Against Guarantee | 29975.14 | 40479.05 | 52993.07 | 60411.20 | 63293.16 |
| Government Guarantee | 2155.95 | 2385.24 | 2364.19 | 2542.29 | 2560.01 |
| Institutional Guarantee | 20737.62 | 27833.31 | 33209.50 | 39907.08 | 42758.93 |
| Personal Guarantee | 2001.69 | 2350.72 | 4054.12 | 5284.51 | 5340.32 |
| Collective Guarantee | 2167.66 | 3581.03 | 4855.55 | 6005.33 | 5828.86 |
| International Rated Foreign Bank's Guarantee | 192.25 | 93.08 | 4226.93 | 1482.98 | 1469.32 |
| Other Guarantee | 2706.26 | 4235.68 | 4282.79 | 5189.02 | 5335.71 |
| Credit Card | 410.98 | 427.58 | 416.03 | 876.48 | 905.78 |
| Others | 94117.78 | 113884.53 | 77235.40 | 82466.96 | 84304.25 |
| **Total** | **1129803.67** | **1361351.89** | **1681879.83** | **1966715.73** | **1994649.17** |

# Annex-6
# Major Financial Indicators
# (Mid-July 2017)

| Indicators | Class "A" | | Class "B" | | Class "C" | | Overall | |
|---|---|---|---|---|---|---|---|---|
| | mid-July 2016 | Mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 |
| ***Credit and deposit related indicators*** | | | | | | | | |
| Total deposit/GDP | 78.47 | 80.53 | 12.39 | 9.21 | 2.86 | 2.01 | 93.72 | 91.75 |
| Total credit/GDP | 61.39 | 66.78 | 10.36 | 8.06 | 2.51 | 1.89 | 74.79 | 76.74 |
| Total credit/ Total deposit | 78.91 | 82.93 | 83.62 | 87.54 | 87.72 | 94.28 | 79.80 | 83.64 |
| LCY credit/LCY deposit and core Capital | 75.97 | 79.57 | 74.56 | 76.82 | 71.05 | 76.00 | 75.59 | 79.17 |
| Fixed deposit/Total deposit | 29.72 | 42.00 | 24.49 | 39.37 | 38.80 | 47.67 | 29.31 | 41.86 |
| Saving deposit/Total deposit | 39.60 | 33.59 | 51.56 | 39.69 | 51.43 | 35.51 | 41.54 | 34.24 |
| Current deposit/Total deposit | 10.10 | 9.52 | 2.42 | 2.05 | 0.2 | 0.17 | 8.78 | 8.57 |
| Call Deposit /Total Deposit | 19.32 | 13.63 | 21.26 | 18.42 | 2.68 | 7.23 | 19.07 | 13.98 |
| Other Deposit/Total Deposit | 1.26 | 1.26 | 0.27 | 0.39 | 6.88 | 9.05 | 1.30 | 1.35 |
| ***Assets quality related indicators*** | | | | | | | | |
| NPL/ Total loan | 1.82 | 1.54 | 1.48 | 1.36 | 14.42 | 13.37 | 2.19 | 1.89 |
| Total LLP/Total loan | 2.51 | 2.39 | 2.12 | 2.01 | 15.54 | 14.03 | 2.89 | 2.63 |
| Res. Per. H. Loan (Up to Rs. 10 mil.)/Total Loan | 7.85 | 8.07 | 11.5 | 10.51 | 11.94 | 12.84 | 8.49 | 8.44 |
| Real estate exposure/Total loan | 6.00 | 6.00 | 7.41 | 8.09 | 12.76 | 12.45 | 6.43 | 6.38 |
| Deprived sector loan/Total loan | 5.52 | 5.95 | 6.77 | 9.11 | 4.57 | 5.15 | 5.65 | 6.26 |
| | | | | | | | | |
| Cash and bank balance/Total deposit | 14.39 | 15.19 | 16.94 | 17.42 | 28.48 | 20.05 | 15.15 | 15.52 |
| Investment in Gov. security/Total deposit | 10.61 | 9.97 | 1.97 | 1.82 | 5.16 | 2.53 | 9.30 | 8.99 |

| Indicators | Class "A" | | Class "B" | | Class "C" | | Overall | |
|---|---|---|---|---|---|---|---|---|
| | mid-July 2016 | Mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 | mid-July 2016 | mid-July 2017 |
| Liquid assets/Total assets | 12.56 | 19.59 | 24.45 | 24.73 | 24.63 | 21.63 | 14.62 | 21.19 |
| Total liquid assets/Total deposit | 26.17 | 26.00 | 32.75 | 31.52 | 44.80 | 34.27 | 27.6 | 26.74 |
| Net liquid assets/Total Deposit | 24.06 | 24.59 | 31.68 | 31.15 | 40.82 | 31.84 | 25.58 | 25.40 |
| ***Capital adequacy related indicators*** | | | | | | | | |
| Core capital/RWA ( percent) | 10.62 | 13.35 | 14.41 | 19.43 | 21.28 | 20.21 | 11.52 | 14.07 |
| Total capital/RWA ( percent) | 12.12 | 14.72 | 15.31 | 20.44 | 22.22 | 21.19 | 12.91 | 15.40 |
| Wt. Avg. interest rate on deposit | 3.28 | 6.15 | | | | | | |
| Wt. Avg. interest rate on credit | 8.86 | 11.39 | | | | | | |

# 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,<br>Bank and Financial Institution Regulation Department | Member |
| Mr. Nara Bahadur Thapa, Executive Director<br>Research Department | Member |
| Mr. Janak bahadur Adhikari, Executive Director<br>Micro-Finance Promotion and Supervision Department | Member |
| Mr. Bhishma Raj Dhungana, Executive Director,<br>Foreign Exchange Management Department | Member |
| Mr. Maheshwor Lal Shrestha, Executive Director,<br>Bank Supervision Department | Member |
| Mr. Bhuban Kadel, Executive Director,<br>Development Bank Supervision Department | Member |
| Mr. Dev Kumar Dhakal, Executive Director,<br>Finance Company Supervision Department | Member |
| Mr. Bam Bahadur Mishra, Director,<br>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. Bam Bahadur Mishra, Director,<br>Bank and Financial Institutions Regulation Department | Coordinator |
| Mr. Narendra Singh Bista, Deputy Director,<br>Development Bank Supervision Department | Member |
| Dr. Dilli Ram Pokharel, Deputy Director,<br>Research Department | Member |
| Mr. Ishwori Prasad Bhattarai, Deputy Director,<br>Foreign Exchange Management Department | Member |
| Ms. Sunita Shrestha, Deputy Director,<br>Finance Company Supervision Department | Member |
| Mr. Chandra Kumar Shrestha, Deputy Director,<br>Micro Finance Promotion and Supervision Department | Member |
| Mr. Satyendra Raj Subedi, Deputy Director<br>Bank Supervision Department | Member |
| Ms. Samjhana Dhakal, Deputy Director<br>Bank and Financial Institutions Regulation Department | Member Secretary |