Legal, Regulatory and Supervisory Provisions
for
Foreign Bank Branches in Nepal

A report by Nepal Rastra Bank Task Force on
Foreign Bank Branches and the Health and Stability of Nepal's Financial System

2006

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Foreword

On April 23, 2004, Nepal became the 147th member of the World Trade Organization (WTO). WTO covers international trade in goods and services. At the same time WTO also includes intellectual property rights within its domain. During the accession process, Nepal had made commitment in the Financial Services sector of the General Agreements on Trade in Services for allowing the operation of foreign bank branches in wholesale bank branching beginning from January 1, 2010.

Nepal Rastra Bank – the central bank of Nepal - is aware that this multilateral commitment will have a significant impact on the health and stability of the domestic financial system. In this context, the high level committee on WTO matters at the Bank has taken this commitment very seriously. The members of this committee are the Deputy Governor, and heads of concerned departments, with the member-secretary being the Director in Research Department looking after the Special Studies Division. In order to collect information on regulating foreign bank branches and to ensure domestic financial stability, the high level committee established an interdepartmental taskforce named as – "Foreign Bank Branches and the Health and Stability of Nepal's Financial System". The objective of the taskforce was to conduct a comparative study examining the experiences of selected countries in regard to rules and regulations for foreign bank branching and make recommendations keeping in mind the context of the Nepalese situation. In fulfilling this objective, the taskforce has produced this report entitled *Legal, Regulatory and Supervisory Provisions for Foreign Bank Branches in Nepal*, which provides comparative analysis of selected countries and important recommendations, in this regard.

I am certain that this publication, which I believe is a first step in reflecting a proactive attitude by the Bank in regard to addressing this commitment to the domestic financial services sector, will be very useful to general readers and the government authorities as well as private sectors. I am also confident that this publication will serve the purpose of enriching knowledge on rules and regulation for foreign bank branches that operate in the domestic financial system.

Before concluding this foreword, I would like to thank my predecessors for initiating and providing continuity to this process, and would like to acknowledge all the members and observers of the task force for their untiring efforts to bring the report in its present form.

Krishna Bahadur Manandhar
Coordinator, High Level Committee
&
Deputy Governor

Preface

Nepal Rastra Bank (NRB), the Central Bank of Nepal, is eminently aware that the country's membership into the World Trade Organization (WTO) has an impact on the health and stability of the domestic financial system. During the membership accession process, Nepal had made commitment to allow foreign bank branches in the context of wholesale banking. This commitment will have an effect on the sustainable health and stability of the domestic financial system. In this regard, the Bank has shown intense interest on this commitment since NRB has been given the responsibility of ensuring domestic financial stability by the NRB Act 2002.

To address this question, the High Level Committee on WTO related matters decided on December 9, 2003 to establish an interdepartmental taskforce entitled "Foreign Bank branches and the health and stability of Nepal's financial system" whose primary objective was to provide recommendation of necessary legal, regulatory and supervisory aspects with regard to foreign bank branches. It was further decided that a Director of Bank and Financial Institution Regulations Department would coordinate the taskforce.

In that capacity, I have had the privilege of coordinating this inter-departmental taskforce which has produced the report entitled "Legal, Regulatory and Supervisory Provisions for Foreign Bank Branches in Nepal". This inter-departmental taskforce was composed of a Deputy Director from Legal Division; Special Studies Division of the Research Department; and Bank and Financial Institution Regulations Department respectively and an Assistant Director from Bank Supervision Department with the member-secretary being an Assistant Director from Special Studies Division of the Research Department. Although the composition of the task force members was determined by the post, I would like to acknowledge the individuals behind the posts who were namely: Deputy Director Mr. Bhimananda Dhungana; Deputy Director Dr. Nephil Matangi Maskay; Deputy Director Mr. Chiranjibi Chapagain; Assistant Director Ms. Meena Pandey; Assistant Director Mr. Rajan Krishna Panta; and Assistant Director Mr. Satyendra Raj Subedi. I would also like to acknowledge the past coordinators of this taskforce namely: Acting Executive Director Mr. Ashwini Kumar Thakur and Acting Executive Director Mr. Gopal Prasad Kaphle. I feel that the synergy of the taskforce members enriched the final output which had met the above-mentioned objectives and pointed the way for further exploration in the due course of time. Furthermore in my view, this study reflects a first and proactive step for ensuring that the Bank will be best prepared for having foreign bank branches in the country. However, this report would be expanded incorporating the additional information in due course of time.

Finally, I would like to take this opportunity to express gratitude to members of the High Level Committee on WTO related matters for providing their invaluable advice and guidance during the course of this study. I would like to acknowledge the many helpful suggestions from the participants provided at an interaction program held at the Nepal Rastra Bank on March 12, 2006. I would also like to thank all the above-mentioned members of this task force for their contributions despite paucity of time from their official duties and limited resources, as well as to the task force secretariat at the Special Studies Division of the Research Department for providing necessary support in a timely manner.

Bhisma Raj Dhungana
Coordinator, Taskforce
& Director
Bank and Financial Institutions Regulation Department

Executive Summary

- On April 23, 2004 Nepal became the 147th member of World Trade Organization (WTO). During the accession process, Nepal had made commitment under the General Agreement on Trade in Services (GATS) to allow the foreign wholesale banks to open their branches by January 1, 2010. This commitment is of immense interest to the Nepal Rastra Bank (NRB) since it touches on the health and stability of the domestic financial system.
- Realizing the legal responsibility of different commitments related to financial system of Nepal, NRB has established a "High Level Committee on WTO related matters" (HLC) to observe, analyze and recommend the appropriate policies, rules, regulations and directives in this regard. The coordinator of the committee is the senior Deputy Governor and the other members of the committee are: the other Deputy Governor; the Executive Directors from Research Department, Bank and Financial Institutions Regulation Department (BFIRD), Foreign Exchange Management Department and Bank Supervision Department (BSD); and the Director from Legal Division (LD). The member-secretary of the committee is the Director from Research Department heading the Special Studies division (SSD).
- The HLC, cognizant of the potential impact that this WTO commitment would have on the domestic financial system, established an interdepartmental taskforce under the co-ordinatorship of a director of BFIRD, with members - a Deputy Director from BFIRD, LD and Research Department (SSD); the member-secretary being the Assistant Director from Research Department (SSD). The objective of the taskforce was to provide recommendation on necessary legal, regulatory, and supervisory provisions with regard to Foreign Bank Branches.
- This report provides a detailed and comparative study highlighting the necessary rules and regulations for foreign branch banking, keeping in mind the context of the Nepalese situation. Four countries - namely India and Sri Lanka from SAARC and Indonesia and Thailand from SEACEN - were selected by the taskforce on the basis of similar level of financial sector development, to comparatively analyze their regulatory and supervisory regimes.
- The environment of the Nepalese banking sector is first overviewed with respect to legal, regulatory and supervisory framework. His Majesty's Government of Nepal has been emphasizing the active role of private sectors for the investment in financial sector, especially with the adoption of liberalization policy since 1980s. The existing acts, rules, regulations etc. have been drastically modified to provide a greater role of the private sector, which is consistent with the liberalized policies. As a result, there has been a rapid growth and development in the domestic financial system - both in quantity and in quality. At present, there are six foreign joint venture commercial banks as a consequence of the adoption of the liberalized financial policy.
- The review of the above-mentioned four countries suggests, in general, that the branches of foreign banks are subject to the same prudential norms in regard to asset classification, income recognition and provisioning as the domestic banks. Similarly the branches of the foreign banks have to comply with the instructions issued by the host central bank or monetary authority from time to time. In all the selected countries the foreign bank are allowed either

through branch route or through subsidiary route, though there are some restrictions on the number of branches or sub branches. Foreign banks are generally allowed to open the branches after obtaining the license by the central bank or by the monetary board. All the countries have made legal provisions clearly specifying the documents or information to be submitted prior to the approval of the license including but not limited to the following: International Rating of the commercial bank such as Moody's Standard and Poor, a copy of Memorandum and Article of Association, copy of the operating license of the bank issued by the home banking authority, a no objection letter from the parent bank, consolidated financial statement for the last three years - audited by an international reputed auditor, other certified and necessary documents of concerning bank rating, Structure of business group, comparing parent company, Subsidiaries and affiliated companies, Details of organizational structure including job description of staff - responsible in managing the branch and Qualifications and experiences of its key personnel.

- The minimum capital requirement of a foreign bank intending to open its branch office varied in all selected countries. In India, the minimum capital requirement of the first branch is US $ 10 million, with capital requirements of the second and third branch being stepped up to US $ 20 and US $ 25 million respectively. In Sri Lanka, a branch of foreign bank shall have an assigned capital of not less than Rs 500 million and the head office is required to remit to Sri Lanka, dependent on domestic banking business and of off-shore banking activities. But when only the off shore banking, the necessary minimum capital requirement is US $ 0.75 million. In Indonesia, the minimum-operating fund is equivalent to not less than three trillion rupiahs. Likewise, in Thailand, the minimum capital is 3000 million baht.
- The case of supervision was more difficult to assess partly due to lack of information and its more complex nature as it involves the coordination between the two different supervisory authorities. These include the division of responsibilities of the host and home authorities, system of onsite and off site surveillance of foreign branch operations, arrangements for the enforcement of supervisory actions against foreign branches, mechanism to settle disputes between host and home authorities, if any etc. Despite the dearth of identified countries' supervisory provisions in this regard, general guidelines are put forward from International best practice. These follow the recommendations by the Basel Committee on Supervision especially the Principles for the Supervision of Banks Foreign Establishments (May 1983) and Authorization Procedures For Bank's Foreign Establishments (March 1983) and International Convergence of Capital Measurement and Capital Standards etc.
- After the comparative analysis of the provisions relating to the foreign bank branches, the study puts forward some policy and activity recommendations. The major recommendations are: (1) the need to incorporate and suggest some of the provisions in the BAFIO[1]; (2) commencement on developing a more elaborate licensing and approval procedures based on the tentative format suggested by the task force; (3) a more in depth study for the supervisory aspects of the foreign bank branches; and (4) lastly to adequately prepare ourselves for the future negotiations on matters relating to financial services sector in WTO.

[1] Though the present Bank and Financial Institutions Ordinance (BAFIO) 2062, has made special provisions concerning opening of offices by foreign banks or financial institutions (see especially the Articles 34 and 53). However, detailed provisions regarding the licensing, regulation, supervision of the foreign banks and the differential treatment vis-à-vis domestic banks, if any, need to be formulated.

List of Abbreviations

Annex	Annexure
BAFIO	Bank and Financial Institutions Ordinance
BFIRD	Bank and Financial Institutions Regulation Department
BFS	Board for Financial Supervision
BIS	Bank for International Settlement
BSD	Bank Supervision Department
CEO	Chief Executive Officer
COR	CAELS Offsite Rating
CPG	Credit Policy Guidelines
CRAR	Capital Reserve Adequacy Requirements
FBO	Foreign Banking Organization
FBSEA	Foreign Banks Supervision Enhancement Act, 1991
FY	Financial Year
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
HLC	High Level Committee
HMG/N	His Majesty's Government of Nepal
JV	Joint Venture
LAB	Local Advisory Board
MOU	Memorandum of Understanding
N.A.	Not Available
NRB	Nepal Rastra Bank
PCA	Prompt Correct Action
RBB	Rastriya Banijya Bank
RBI	Reserve Bank of India
SAARC	South Asian Association for Regional Cooperation
SEACEN	South East Asian Central Banks' Research and Training Centre
SSD	Special Studies Division
TOR	Terms of Reference
TSA	Technical Service Agreement
WTO	World Trade Organization

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Chapter I : Introduction

1.1 Background:

The fifth Ministerial Conference at Cancun, Mexico which took place on 10 – 14 September 2003 approved the membership of the Kingdom of Nepal into the World Trade Organization (WTO) on 11 September 2003 (WTO, 2003), with Nepal subsequently becoming the 147th member of the organization on April 23, 2004 (WTO, 2004). Membership in the WTO entails a whole range of commitments along with their implementation time frames. The focus of this taskforce study report[1] is regarding the commitment in financial services, especially foreign bank branches under the General Agreement on Trade in Services (GATS).

Financial services are the backbone of the modern economy. Financial services are crucial for savings and efficient resource allocation which facilitate economic growth. Internationalization can help countries build more robust and efficient financial systems by introducing international practices and standards; by improving quality, efficiency, and breadth of financial services; and by allowing more stable sources of funds. Realizing the enormous potential benefits that could be derived from the liberalization of financial services, countries have committed multilaterally under the GATS (Maskay et al forthcoming).

Presently, Nepal has not yet allowed foreign bank branches in the country and only permits commercial presence by a foreign financial institution – presently this is limited to a maximum equity of 75% (seventy five percent). However, during the course of accession negotiation for membership in WTO and at the request of some WTO members, Nepal has committed to allow foreign bank branches in the context of wholesale banking, only after 1 January 2010 (i.e. the transition period). In the mean time, the new Bank and Financial Institution Ordinance has been enforced from 2004, which has also incorporated a provision under section 4(3) that allows to incorporate a bank and financial institution in Nepal, fully owned as a subsidiary of a Foreign Bank or a Financial Institution.

The commitment on WTO for foreign bank branches in Nepal is of particular interest to the Nepal Rastra Bank (NRB) – the central bank of the country -- since it touches on the health and stability of the domestic financial system (NRB, 2002). That is, foreign bank branches have a direct impact on the health and stability of the domestic financial system through greater domestic competition in the financial sector from different corners like: financial intermediation in the domestic economy, technological transfer, greater level of service-choices to the consumers, higher levels of financial flows through the access to foreign capital, interlink of domestic financial system with global financial intermediation etc. Further, stability of the domestic financial system is important since it facilitates capital formation and assists in domestic economic growth and development. Given the above description and necessity, it is essential to forward necessary rules and regulations to maximize the benefits from the commitment of allowing the presence of foreign bank branches in the country.

This chapter, therefore, attempts to lay out the roadmap for this study by: having an overview of definition and concept of foreign bank branches at first, followed by the commitments to allow the

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[1] Formed by the decision of the 8th Meeting of the High Level committee on WTO matters at NRB held on 9th December 2003 (23rd of Mangsir 2060) and based on the concept paper of the same name which had been approved by the decision of the 6th Meeting of the High Level committee on WTO matters at NRB held on 5th July 2003 (20th of Srawan 2060).

foreign bank branches in Nepal in the context of WTO membership; the rationale and objectives as well as the methodology used in the study; and then finally ending with the limitations of the study.

1.2 Definition and Concept of Bank Branches:

The general definition for bank branches is "a system of banking in which a banking institution conducts branches or offices at locations other than that of the main or head office" (Woelfel, 1994, p.150). This is elaborated further, as stated in Woelfel (1994, p.150), by the Board of Governors of the Federal Reserve System defines bank branching as "a type of multiple-office banking under which a bank as a single entity operates more than one bank office." That is, a bank branch will not have a separate entity from the foreign bank implying there is no equity participating with the board of directors of the foreign bank who may not necessarily reside in the country of the bank branch[2]; this is also consistent with the definition put forward in the Basle Concordat which classifies a bank branch as "operating entities which do not have a separate legal status and are thus integral parts of the foreign parent bank." However the bank branch can fulfill many functions of the head office; for example, in the January 1998 information pamphlet for establishment of a foreign commercial bank's branch in Lebanon, it states that "the main activity of a foreign commercial bank branch is to carry out, on its behalf, credit operations from funds received from the public. Its main activity can be fiduciary operations and portfolio management on behalf of other parties. The branch can carry out brokerage activities and can perform all operations related or complementing its main activities".[3] Likewise, the branch may have access to the financial strength of the parent bank as well as access to the capital of the parent bank – it is important to note that this function will touch on the capital account.

In Nepal, a similar definition applies which is set forth in the existing framework for bank branches as conveyed in the Banking and Financial Institutions Ordinance 2062 (BAFIO 2062), whose relevant portions are discussed later and provided in a annex (technical) 1.1. In that Act, the terms and conditions of bank branches will be determined by the Nepal Rastra Bank after taking into consideration a number of factors (Article 34, BAFIO 2062). Nonetheless, it has clearly stated that foreign "offices", such as branches, must be established according to the terms and conditions prescribed by the NRB (Article 34, BAFIO 2062).

However, limitations in the activities of bank branches are prevalent, especially at the operational level. For example in Canada, full-service bank branches are not allowed to take retail deposits, but will be able to take deposits above $150,000 while a lending branch will not be permitted to take deposits, large or small, or borrow from the Canadian public; the primary business is to make loans (Canada, 1999). Similarly, Nepal has committed only to wholesale banking[4] reflected in the negotiations in the accession for WTO membership (WTO, 2004). Further, in USA, state authorization of branch banking varies according to a determined broad range of categories, as put forward in Woefel (1994, pp. 150 – 151). Likewise, Indonesia has limited to opening based on

[2] A subsidiary will have a separate legal entity from the parent company with 100% equity contribution (and thus board of director representation) from the parent company.

[3] Another example is the branching policy of the African export-import bank; it states that a branch so designated by the Board of the Bank may perform "marketing, relationship development, loan structuring, loan monitoring and agency functions for the bank in its area of coverage", although it is limited to lending.

[4] Wholesale banking is defined by Woelfel (1994, p.1203) as providing "bank services, loan security and loans to large corporate customers or non-profit institutions" or implying that lending for projects and trade finance which does not include retail lending or consumer finance whereas funding for the lending is to be met out of wholesale deposits (limits of which is to be defined) and inter bank borrowings.

geographical locations while in India and Pakistan, there are limitations to access of parent bank capital, which may be due to implications on financial flows and consistency with their respective policy on the capital account.[5] The list, of course, goes on.

The important aspect for bank branches and financial stability is in regard to their monitoring and supervision. In most countries, these institutions would be subject to the same prudential regulation as regard to domestic financial institutions. For example, in the Indian "Foreign Bank Branch/Subsidiary Policy", foreign financial institutions have to undergo on-site as well as off-site inspection, which is equal to that of domestic financial institutions.[6] Interestingly, for Canada, foreign bank branches face "lighter Canadian regulatory requirements" since they do not take foreign deposits; further it is stated "in addition, satisfactory regulation by the home country regulator will be one of the conditions of allowing individual foreign banks to set up branches in Canada" suggesting that part of the monitoring will also be done by the home country. Likewise in the Nepal case, in the above-mentioned Act, the regulation stipulates that such "offices" would come under the supervision of the NRB (Article 52, BAFIO 2062) although supervision from the home country parent bank is also allowed with approval from NRB (Article 53, BAFIO 2062). An important issue concerning the supervision of foreign bank's branches is the coordinated roles of parent authority, parent bank and host authority. Adequate supervision of banks' foreign establishments calls not only for an appropriate allocation of responsibilities between parent and host supervisory authorities but also for contact and cooperation between them (Principles for the Supervision of Banks Foreign Establishments, May 1983).[7]

1.3 Commitments to allow the foreign bank branches in Nepal in the context of WTO membership:

During the course of negotiating for accession to WTO, Nepal made commitments for bank branches. However, three aspects are worth mentioning. First, there is a transition period where foreign bank branches are only allowed as of January 1, 2010. Second, entry of financial institutions are limited to a rating of at least "B" by Credit Rating Agency e.g. MOODI, Standard & Poor etc. Lastly, establishment of foreign bank branches are subject to the domestic laws, rules and regulations and terms and conditions of the Nepal Rastra Bank.

1.4 Rationale and objective of the study:

The rationale for this study is based on the premise that the impact of Nepal's commitments for foreign bank branches is largely determined by the preparedness of the Nepalese monetary authority to meet this new challenge. In this regard the primary objective is to produce a detailed and comparative study highlighting, among other matters, the necessary rules and regulations for foreign branch banking, keeping in mind the context of Nepalese situation and the framework for foreign branch banking in BAFIO, 2062. The English version (unofficial) of terms of reference(TOR), as decided by the 9th meeting of the "high level committee on WTO related matters" on 2 January 2003 (18 Pous 2060), are as follows:

- To study the legal provisions regarding the nature and working procedures of foreign bank branches of different countries;
- To study the regulation and supervisory system of foreign bank branches;

[5] See Maskay (2002) for a discussion of this.
[6] This also applies to USA with the Foreign Bank Supervision Enhancement Act of 1991 (Woefel, p. 435).
[7] While this is not explicitly touched on in BAFIO 2062, this is elaborated in NRB Act 2002, Article 85.

- To study the comparative and detailed analysis of the experiences on the operation of foreign bank branches in SAARC, SEACEN and other countries and the policy adopted by these countries regarding the foreign bank branches;
- To recommend the appropriate policy, directives and rules regarding the opening of foreign bank braches in Nepal;
- To study the contribution and the role of foreign bank branches in the enhancement of financial intermediation and to meet the productive investment of Nepal; and
- To study on other related matters on foreign bank branches, as necessary.

1.5 Methodology, Outline and Limitations:

To achieve the above mentioned objectives a task force was established by the high level committee to examine the impact of foreign bank branches[8]; this task force works under the coordinatorship of Director, Bank and Financial Institution Regulation Department (BFIRD) with participation of Deputy Director, Legal Division; Deputy Director, BFIRD; Deputy Director, Research Department (Special Studies Division); Assistant Director, Bank Supervision Department (BSD); and Assistant Director, Research Department (SSD) who will act as Member Secretary. Each of the above mentioned departmental representatives were chosen to participate in this study to contribute in enriching the final study report with SSD of the Research Department acting as secretariat.

The study is divided into five chapters. The first chapter provides the background, rationale and the scope of the present study. The second chapter presents the stylized facts of Nepalese Banking sector with the brief historical background focusing on the foreign participation in this sector. The third chapter summarizes and synthesizes the operation of foreign bank branches of the relevant countries identified above for south Asia and East Asia. The fourth chapter puts forward comparative experience from other countries and also the policy recommendations of regulation and supervision for foreign bank branches. Finally, the last chapter concludes and summarizes the report.

The major limitation of the study is mainly based on information obtained from secondary sources only. However, owing to time constraint and limited resources some issues may have been left out. Also, a great deal of reliance has to be place on the accuracy of the information provided from various sources. The present study does not focus on the specific issues of regulation, supervision etc. of foreign bank branches. Rather, a broad analysis and possible impact of foreign bank branches on Nepalese financial system is done. This report, it is hoped, will provide a basis for further research and analysis on specific issues involved.

[8] Formed by the decision of the 8th Meeting of the High Level committee on WTO matters at NRB held on 9th December 2003 (23rd of Mangsir 2060) and based on the concept paper of the same name which had been approved by the decision of the 6th Meeting of the High Level committee on WTO matters at NRB held on 5th July 2003 (20th of Srawan 2060). This will be explained in greater detail further on.

Chapter II : Stylized Facts of Nepalese Banking Sector Environment

This section presents some stylized fact on the environment of the Nepalese banking sector by answering three questions: what is the history of the Nepalese banking system?; what is its current status?; and what is the current legal provision regarding this sector?

2.1 History of Nepalese Banking System:

The initiation of formal banking system in Nepal commenced with the establishment in 1937 of Nepal Bank Limited (NBL), the first Nepalese commercial bank.[9] The country's central bank, Nepal Rastra Bank (NRB) was established in 1956 by Act of 1955, after nearly two decades of NBL having been in existence. A decade after the establishment of NRB, Rastriya Banijya Bank (RBB), a commercial bank under the ownership of His Majesty's Government of Nepal (HMG/N) was established. Thereafter, HMG/N adopted open and liberalized policies in the mid 1980s reflected by the structural adjustment process, which included privatization, tariff adjustments, liberalization of industrial licensing, easing of terms of foreign investment and more liberal trade and foreign exchange regime was initiated.

With the adoption of liberalization policy, there has been rapid development of the domestic financial system both in terms of number of financial institutions and as ratio of financial assets to the GDP. As of July 2005, the number of commercial banks has reached 17 and their branches numbered 375. A total of 60 finance companies and other Development Banks and numerous credit cooperatives have also been established. Total financial assets in 2004/2005 reached around 54.09 percent of GDP and the M2/GDP ratio, which shows the financial sector development or financial deepening increased from in 12.4 percent in 1975 to 50.9 percent in 2000.

In the context of banking development, the 1980s saw a major structural change in financial sector policies, regulations and institutional developments. HMG/N emphasized the role of the private sector for the investment in the financial sector. The financial sector liberalization, started already in the early eighties with the liberalization of the interest rates, encompassed further deregulation of interest rates, relaxation of entry barriers for domestic and foreign banks, restructuring of public sector commercial banks and withdrawal of central bank control over their portfolio management (Acharya et al, 2003). These policies opened the doors for foreigners to enter into banking sector under joint venture. Consequently, the third commercial bank in Nepal, or the first foreign joint venture bank, was set up as Nepal Arab Bank Ltd(now called as NABIL Bank Ltd). in 1984. There after, two foreign joint venture banks, Nepal Indosuez Bank Ltd. (now called as Nepal Investment Bank) and Nepal Grindlays Bank Ltd (now called as Standard Chartered Bank Nepal Ltd.) was established in 1986 and 1987 respectively. There after, another 12 commercial banks have been established within the period of 12 years. Nepalese banking system has now a wide geographic reach and institutional diversification.

Although, Nepalese financial sector is dynamic, a lot of scope for development of this sector exists. This is because the banking and non-banking sectors have not been able to capture all the potentialities of business till this time. It is evident from the Rural Credit Survey Report that the majority of rural credit is supplied by the unorganized sector at a very high cost – perhaps being at two or three time of the formal sector - suggesting that the financial sector is still in the path of gradual development. Overdue loans and inefficiency of the older and the larger of commercial

[9] The rudimentary banking system can be traced back to 1877 with the existence of the *Tejarath Adda.* The system was initiated by the then Prime Minister Ranoddip Singh for providing credit facilities (NRB, 1996).

banks have aggravated and have been made to compete with the new trim banks with no rural operations. Also, the commercial banks, domestic or joint venture have shown little innovation and positive attitude in identifying new areas of saving and investment opportunities.

Following table reflects the present development of commercial banking institutions in Nepal.

Table-1: Establishment of Commercial Banks

SN	Name of Commercial Banks	Head Office	Operation Date	No. of offices
1.	Nepal Bank Ltd	Kathmandu	1937	106
2.	Rastriya Banijya Bank	Kathmandu	1966	114
3.	Nabil Bank Ltd.	Kathmandu	1984	17
4.	Nepal Investment Bank Ltd.	Kathmandu	1986	12
5.	Standard Chartered Bank Nepal Ltd	Kathmandu	1987	8
6.	Himalayan Bank Ltd.	Kathmandu	1991	15
7.	Nepal SBI Bank Ltd	Kathmandu	1993	13
8.	Nepal Bangladesh Bank Ltd.	Kathmandu	1994	17
9.	Everest Bank Ltd	Kathmandu	1994	16
10.	Bank of Kathmandu Ltd.	Kathmandu	1995	9
11.	Nepal Credit & Commerce Bank Ltd	Siddharthanager	1996	17
12.	Nepal Industrial & Commercial Bank Ltd.	Biratnager	1998	8
13.	Lumbini Bank Ltd.	Narayanghat	1998	4
14.	Machhapuchere Bank Ltd.	Pokhara	2000	9
15.	Kumari Bank Ltd	Kathmandu	2001	4
16.	Laxmi Bank Ltd.	Birgunj	2002	3
17	Siddhartha Bank Ltd.	Kathmandu	2002	3

Source: Banking and Financial Statistics vol.-45, NRB.

2.2. Existing Scenario of Banking Sector:

As mentioned in the previous section, there are 17 commercial banks presently in operation. Among these banks some are established under joint venture with foreign banks while some are fully domestic bank. Out of total commercial banks, 6 commercial banks are with foreign joint venture and 11 are fully domestic banks. Table-2 below exhibits the position of capital structure and foreign participation towards these banks.

Table-2: Establishment of Commercial Banks

SN	Name of Commercial Banks	Paid-up Capital Rs.in million	Pattern of ownership	Participating foreign bank and fin. Institutions
1.	Nepal Bank Ltd	380.4	Government-49% Nepalese-51%	
2.	Rastriya Banijya Bank	1172.3	Government –100%	
3.	Nabil Bank Ltd.	491.7	Nepalese-50% Foreign Joint venture-50%	NB International, Ireland
4.	Nepal Investment Bank Ltd.	587.7	Nepalese-100%	
5.	Standard Chartered Bank Nepal Ltd	374.6	Nepalese-25% Foreign Joint venture-75%	Standard chartered Group.
6.	Himalayan Bank Ltd.	643.5	Nepalese-80% Foreign Joint venture-20%	Habib Bank Ltd, Pakistan
7.	Nepal SBI Bank Ltd	431.9	Nepalese-50% Foreign Joint venture 50%	State Bank of India, India
8.	Nepal Bangladesh Bank Ltd.	719.9	Nepalese- 75% Foreign Joint venture-25%	IFIC, Bangladesh
9.	Everest Bank Ltd	455.0	Nepalese-80% Foreign Joint venture-20%	Punjab National Bank, India
10.	Bank of Kathmandu Ltd.	463.6	Nepalese-100%	
11.	Nepal Credit & Commerce Bank Ltd	693.6	Nepalese-100%	
12.	Nepal Industrial & Commercial Bank Ltd.	500.0	Nepalese-100%	
13.	Lumbani Bank Ltd.	500.0	Nepalese-100%	
14.	Machhapuchere Bank Ltd.	550.0	Nepalese-100%	
15.	Kumari Bank Ltd	500.0	Nepalese-100%	
16.	Laxmi Bank Ltd.	610.0	Nepalese-100%	
17	Siddratha Bank Ltd.	350.0	Nepalese-100%	
	Total	9423.2		

Source: Bank and Financial Institution Department, NRB.

Capital Structure of Banks: The current regulation of NRB prescribes that all the new commercial banks are to be established in Kathmandu at national level should have minimum paid up capital Rs. 1 billion; the existing banks in operation are required to enhance the capital level to Rs. 1 billion by the end of FY 2065/66 BS. For this purpose and objective all the commercial banks have furnished their plans to enhance the level of capital accordingly. In the mean time, there are separate provisions on capital requirements for the national level banks to be operated outside the Kathmandu. Banks to be established out side the Kathmandu valley are required to have a minimum paid up capital of Rs. 250 million.[10] The total paid up capital of 17 banks as at July 2005 has reached at Rs 9.423million. The paid up capital of commercial banks operating in Nepal is on an average of Rs. 554 million

Banks Under Foreign Participation: All together nine banks were established under foreign participation in Nepal but three of these have divested their stake to Nepalese promoters. Six banks still have foreign joint ventures. The banks operating under foreign participation are NABIL Bank Ltd, Standard Chartered Bank Nepal Ltd, Himalayan Bank Limited, Nepal SBI Bank Ltd, Everest Bank Limited and Nepal Bangladesh Bank Ltd. Initially, Bank of Kathmandu, Nepal Credit and Commerce Bank and Nepal Investment Bank were also established under foreign joint venture.

Assets of Banks Under Foreign Participation: The banking asset with the foreign joint venture banks is gradually increasing. As of July 2005, the commercial banks under foreign participation hold 37.54 percent of total banking assets. The deposits and credits are still of greater proportion. Foreign joint venture banks possess 39.65 percent of total deposits and 38.45 percent of total credit of the banking system. The total assets, deposits and credit of domestic banks and foreign joint venture banks are exhibited below:

Table-3: Total assets, deposit and credit in the banking system [Mid-July2005]

(Rs. in Million)

SN	Name of Commercial Banks	Total Assets	Deposits	Credit
A	**Domestic Banks**			
1.	Nepal Bank Ltd	47045.15	35934.16	16866.55
2.	Rastriya Banijya Bank	56822.01	43016.06	26702.11
3.	Nepal Investment Bank Ltd	16274.06	14254.57	10453.16
4.	Bank of Kathmandu Ltd.	9857.13	8942.75	6182.04
5.	Nepal Industrial & Commercial Bank Ltd.	7508.06	6241.38	4909.35
6.	Nepal Credit & Commerce Bank Ltd	7485.28	6630.94	6011.90
7.	Lumbini Bank Ltd.	4494.90	4031.22	3685.13
8.	Machhapuchere Bank Ltd.	6456.46	5586.80	5130.22
9.	Kumari Bank Ltd	7437.89	6268.95	5681.01
10.	Laxmi Bank Ltd.	3820.77	3051.75	2726.14
11.	Siddratha Bank Ltd.	3098.99	2461.92	2634.93
	Total of domestic Banks	170300.70 (62.46)	136420.50 (60.35)	90982.54 (64.45)
B	**Foreign Joint - Venture Banks**			

[10] As all the commercial banks have already revised their capital base the paid up capital is now below than that of the new standards prescribed in the Nepalese Banking system.

1.	NABIL Bank Ltd.	17186.32	14586.61	10946.74
2.	Himalayan Bank Ltd.	27862.88	24814.01	13451.16
3.	Standard Chartered Bank Nepal Ltd	21893.57	19335.09	8420.87
4.	Nepal SBI Bank Ltd	10345.37	8654.77	6739.34
5.	Nepal Bangladesh Bank Ltd.	13277.15	12125.58	9626.91
6.	Everest Bank Ltd	11792.12	10097.69	7900.09
	Total of Joint venture banks	102357.41 (37.54)	89613.75 (39.65)	57085.11 (38.55)
	Total of Banking System	272658.11	226034.25	**148067.65**

Source: Bank and Financial Institution Department, NRB.

Some Indicators of Domestic and Foreign Joint Venture Banks: The performance of foreign joint venture banks is better than the domestic banks reflected in profitability position, NPA levels and capital adequacy positions. The shares of interest income to total income are lower in the joint venture banks which indicate that the service business is better in those banks. The practice of introducing new products and business in joint venture banks is consistently maintained – e.g. credit cards, debit cards, e-banking facilities. Gradually private domestic banks are also entering into other the innovative sectors with Nepal Investment Banks, Bank of Kathmandu, and Kumari Bank are leading other domestic banks in introducing new business in the economy.

Table-4: A Comparison of Important Indicators of Domestic banks and foreign JV Banks

July2005

(Rs. in Million)

SN	Name of Commercial Banks	Net profit	NPA/ Total Loan %	Net worth	Capital Adequacy %	Mgmt. exp*	Int. spread %
A	**Domestic Banks**						
1.	Nepal Bank Ltd	1730.13	49.64	(7548.66)	(19.54)	**1687.9**	4.38
2.	Rastriya Banijya Bank	1322.89	52.99	(20199.44)	(40.54)	**1044.9**	4.67
3.	Nepal Investment Bank Ltd	232.1	2.69	1180.17	11.58	**279.9**	3.74
4.	Bank of Kathmandu Ltd.	139.53	4.99	720.74	11.22	**153.0**	4.21
5.	Nepal Industrial & Commercial Bank Ltd.	113.76	3.78	684.19	13.29	**90.6**	3.68
6.	Nepal Credit & Commerce Bank Ltd	(5.16)	8.64	239.46	5.51	**115.8**	3.69
7.	Lumbani Bank Ltd.	(196.77)	15.23	245.01	6.35	**87.4**	4.31
8.	Machhapuchere Bank Ltd.	84.87	0.39	589.29	11.36	**89.5**	3.56

9.	Kumari Bank Ltd	87.88	0.95	645.44	11.15	**114.2**	3.68
10.	Laxmi Bank Ltd.	26.46	1.63	603.09	20.72	**67.0**	2.97
11.	Siddratha Bank Ltd.	70.28	2.58	382.39	13.93	**51.2**	3.32
	Total of domestic Banks	3605.97		(22458.32)		3781.4	
B	**Foreign Joint - Venture Banks**						
1.	NABIL Bank Ltd.	518.64	1.32	1657.64	12.44	**389.8**	5.36
2.	Himalayan Bank Ltd.	325.22	7.44	1493.25	11.10%	**455.9**	3.53
3.	Standard Chartered Bank Nepal Ltd	539.20	2.69	1574.10	16.36%	**405.2**	4.53
4.	Nepal SBI Bank Ltd	57.38	6.54	689.01	9.47%	**128.2**	3.36
5.	Nepal Bangladesh Bank Ltd.	(749.54)	19.04	222.73	3.02%	**257.2**	2.76
6.	Everest Bank Ltd	170.80	1.63	629.62	13.57%	**189.6**	4..29
		861.71		6266.35		1825.9	
	Total of Banking System	4467.68		(16191.97)		5607.3	

Source: Bank and Financial Institution Department, NRB.

*Management expenses is sum of employee and office operating expenses

In sum, the banking sector of the economy is still dominated by the domestic banks. However, the performance of some domestic banks is poor with those banks not competitive strength even in the national level.

2.3 Domestic Legal Provisions Regarding Banking Sector

Nepal Rastra Bank Act, 2002 has given full authority to the Nepal Rastra Bank regarding regulation, inspection and supervision of the banks and financial institutions. Bank and Financial Institution Ordinance, 2060, which is popularly known as Umbrella Act, has recently been enacted in unified form. Agricultural Development Bank Act, 1967, Commercial Bank Act, 1974, Finance Company Act, 1986, Nepal Industrial Development Corporation Act, 1990 and Development Bank Act 1996 have been repealed with the promulgation of this ordinance. The ordinance governs the functional aspect of banks and financial institutions. Some of the important provisions in the ordinance regarding the banking sector have been analyzed in this chapter as follows:

Any person wishing to incorporate a bank or financial institution to carry on financial transactions should incorporate a bank or financial institution as a registered public limited company under the prevailing law of Nepal with prior approval of NRB by fulfilling the conditions prescribed in section 4 of the ordinance. The individual desiring for the incorporation of such entity is required to submit an application to NRB for prior approval with the prescribed documents. The NRB is required to conduct necessary investigation and grant permission to establish a bank or financial institution with or without terms or conditions if all the criteria are met and information of disapproval with reason is also to be given to the concerned person in case the application is denied. Similarly, any foreign bank or financial institution wishing to establish a bank or financial institution by making joint venture investment with a corporate body incorporated in Nepal or with a Nepali citizen or as a subsidiary company with 100% share is eligible to furnish the application to establish a bank or financial institution. However, the ordinance is silent about the percentage of equity investment in joint venture, such foreign corporate body can invest. It has been regulated by regulation till now as 75%.

The ordinance prohibits anybody to conduct financial transaction except an established bank or financial institution and no bank or financial institution can use the proposed name for the purpose of carrying financial transaction without obtaining license from NRB. The bank or financial institution desiring to conduct financial transaction must submit an application for license to the NRB in the prescribed form including the prescribed fees, documents and description. NRB will grant license if it is satisfied with the basic physical infrastructure of the bank or financial institution; if the issuance of license for operating financial transaction will promote healthy and competitive financial intermediary and protect the interest of the depositors, the applicant is competent to operate financial transaction in accordance with the provision of this ordinance and its regulation, directives, order or provisions of Memorandum and Article of Association and there are sufficient grounds to believe that the entity is competent to operate financial transaction.

The NRB will classify the institutions into "A" "B" "C" "D" groups on the basis of the minimum paid-up capital and provide the suitable license to the bank or financial institution.. The authorized, issued and paid up capital of a license holder institution will be as prescribed by NRB from time to time. The NRB can issue directives to the license holder entity to increase its authorized, issued and paid-up capital if it deems necessary. Similarly, the license holder entity must maintain a capital fund according to ratio prescribed by NRB based on the basis of its total asset or risk weighted assets, and other transactions. At the same time, the license holder entity must maintain a risk fund according to ratio prescribed by NRB based on the basis of liability relating to its total asset and the other risk to be borne from off balance sheet transaction. The license holder entity must maintain general reserve fund regularly every year till the amount becomes double of the paid up capital of such entity.

The bank or financial institution can be upgraded if the authorized capital is enough for upper class, the institution has been able to make profit for last five years and the non-performing asset is within the prescribed limit. Similarly, the bank or financial institution can be degraded if it fails to meet prescribed capital within the time period, it has been making loss for last five years, it has violated the directives of Rastra Bank time and again and it fails to maintain Risk Management Fund as prescribed by it. The NRB will make necessary investigation and avail opportunity to clarify before taking such decisions.

The NRB is in full power to deny license for financial transaction if the conditions stipulated in ordinance are not met and it is also authorized to impose necessary conditions taking into account the existing financial position of the bank or financial institution, the interest of depositors and healthy operation of financial transaction. Similarly, it may increase, decrease or modify the terms and conditions time to time. The NRB can suspend the license of the license holder for a specific period of time issued for the purpose of carrying financial activities or it may order the bank or financial institution to close the operation of their office partially or fully if such a license holder acts against the provisions of the Nepal Rastra Bank Act, 2002, or the regulation made there under or fails to act in accordance with the order or directives issued by it or fails to act for the welfare and in the interest of the depositors. The NRB may cancel the license issued under this ordinance to carry on the financial transactions of the license holder under the certain circumstances as stipulated in the ordinance.

A foreign bank or financial institution desiring to open its office within the Kingdom of Nepal must submit an application to NRB in the form as prescribed along with the fees and particulars as prescribed. The NRB may issue a license to foreign bank or financial institution to carry on financial transaction by allowing them to open a office within the Kingdom of Nepal taking into account the situation of competition existing in the banking sector, the contribution that could be rendered in the Nepalese banking sector and the reputation of such foreign bank or financial institution. The NRB may specify necessary terms and conditions in the course of granting transaction license and it shall be the duty of the foreign bank or financial institution to comply with such terms and conditions. The section 34(4) of the ordinance reiterates that the provisions of the ordinance are to be complied by such foreign bank or financial institution. The foreign bank or financial institution, which has been issued license to operate financial transaction by opening its office within the Kingdom of Nepal, can not open another bank or financial institution in joint venture within the Kingdom of Nepal. However, the provision for the contact or representative office of any foreign bank or financial institution will be as prescribed by NRB. Some of the important issues such as relationship with parent bank in case of liquidation and supervisory role of the different institutions (parent bank and parent bank's supervisory authority) have not been adequately addressed in this ordinance. Provisions relating to capital requirement are also silent in ordinance. However, it can be fixed by regulation.

The section 47 of the ordinance prescribes functions of the bank or financial institutions. The entities functioning under sub-section (1) only can keep their name as bank of class "A" category. The functions of such bank are incorporated in subsection (1) (A) – (AF) which are in very detail. As per Nepal's commitments foreign bank branches are only allowed for wholesale banking functions. So all of the provisions stipulated in subsection (1) will not be relevant to the foreign bank branches. According to the ordinance, NRB has authority to make necessary regulation in this aspect. See Attached annex (technical) 1.1 for details

2.4 Existing Rules and Regulations Relating to the Banking Sector:

Followings are the requirements for establishing a new commercial bank in Nepal[11].

2.4.1 Regarding Paid up capital Requirements

2.4.1.1 To establish a new commercial bank of national level, the paid up capital of such bank must be at Rs. 1000 million.

2.4.1.2 To have an office in Kathmandu, the bank is required to have either joint venture with foreign banks and financial institutions or a technical service agreement (TSA) at least for three years with such institutions.

2.4.1.3 In general, the share capital of commercial banks will be available for the promoters up to 70 percent and 30 percent to general public. The foreign banks and financial institutions could have a maximum of 75 percent share investment on the commercial banks of national level. In order to provide adequate opportunity for investment to Nepali promoters in National level banks, only 20 percent of total share

[11] For recent details, see the website of Nepal Rastra Bank at www.nrb.org.np

capital will be made available to general public on the condition that the foreign bank and financial institution are going to acquire 50 percent of total share.

2.4.1.4 Banks that are already in operation and those who have already obtained letter of intent before the enforcement of these provisions have to bring their capital level within seven years, i.e., by 16 July 2009 as per this recently declared provision. In order to increase in the capital such increase should be at a rate of 10 percent per annum at the minimum.

2.4.1.5 Banks to be established with foreign promoters' participation have also to be registered fulfilling all the legal processes prescribed by the prevalent Nepal laws.

2.4.1.6 To establish the commercial banks in all the places in the kingdom other than in the Kathmandu valley, the paid up capital must be Rs. 250 million. In this case, the commercial banks to be established outside Kathmandu Valley, share investment of promoters and general public should stand at 70 percent and 30 percent respectively.

2.4.1.7 Banks to be established outside Kathmandu Valley could be allowed to operate throughout the kingdom including Kathmandu Valley only on the condition that they have operated satisfactorily at least for a period of three years and they have brought their paid up capital level up to Rs. 1000 million and also fulfilled other prescribed conditions. Unless and until such banks do not get licence to operate throughout the kingdom, they will not be allowed to open any office in Kathmandu Valley.

2.4.1.8 Of the total committed share capital, the promoters has to deposit in NRB an amount equal to 20 percent along with the application and another 30 percent at the time of receiving the letter of intent on the interest free basis. The bank should put into operation within one year of receiving the letter of intent. The promoters have to pay fully the remaining balance of committed total share capital before the banks comes into operation. Normally, within 4 months from the date of filing of the application, NRB should give its decision on the establishment of the bank whether it is in favor or against it. If it declines to issue license, it has to inform in writing with reasons to the concern body.

2.4.2 Regarding Promoters Qualification

2.4.2.1 Action on the promoters' application will not be initiated by the Nepal Rasta Bank if it is proved that their collateral has been put on auction by the bank and financial institution as a result of non-payment of loans in the past, who have not cleared such loans or those in the black list of the Credit Information Bureau and five years have not elapsed from the date of removal of their name from such list. The application will be deemed automatically cancelled irrespective of it being on any stage of process of license issuance if the above events are proved.

2.4.2.2 Of the total promoters, one-third should be its Chartered accountants or at least a graduate of Tribhuvan University or recognized institutions with major in economics or accountancy, finance, law, banking or statistics. Likewise, at least 25 percent of promoters group should have the work experience of the bank or financial institution or similar professional experience.

2.4.2.3 An individual, who is already serving as a director in one of the bank and financial institutions licensed by Nepal Rastra Bank, cannot be considered eligible to become the director in other banks or financial institutions.

2.4.2.4 Stockbrokers, market makers, or any individual/institution - involved as an auditor of the bank and institution carrying on financial transactions - cannot be a director.

2.4.3 Regarding the Sale of Promoters' Share

2.4.3.1 Promoter group's share can be disposed or transferred only on the condition that the bank has been brought in operation, the share allotted to the general public has been floated in the market and after completion of three year from the date it has been registered in the Stock Exchange. Prior to the disposal of such shares, it is mandatory to get approval from the Nepal Rastra Bank.

2.4.3.2 The share allotted to the general public has to be issued and sold within three years from the date the bank has come into operation. Failing to fulfill such provisions, the bank cannot issue bonus share or declare and distribute dividends.

2.4.3.3 Shareholders of the promoters group and their family members cannot have access to loans or facilities from the same institution. For this purpose, the meaning of the family members will comprise of husband, wife, son, daughter, adopted-son, adopted-daughter, father, mother, step-mother and depended brother and sister.

2.4.4 Regarding Branch Expansion Policy

The Commercial banks established with a head office in Kathmandu will initially be authorized to open a main branch office in the Valley and thereafter, they will be authorised to open one more branch in Kathmandu Valley only after they have opened two branches outside Kathmandu Valley.

Procedural Aspects for Establishing a Commercial Bank: The following documents should be submitted sequentially while applying for the establishment of a Commercial Bank.

1. Following documents are required to be submitted along with the application to establish a commercial bank: -

    1.1. Application

    1.2. Bio-data of promoters

    1.3. Feasibility Study Report on the proposed commercial bank in the format prescribed by the Nepal Rasta Bank.

    1.4. Attested photocopies of the minutes within the promoters to organize the bank.

    1.5. Promoters agreement relating to operation of the bank

    1.6. Copies of Articles of Association and Memorandum in the prescribed format in the Company Act, 1996. The memorandum should compulsorily include, inter alia, the provision that no person, firm, company and related group of company will be allowed to hold beyond the 10 percent stake on the issued capital in one bank and altogether 15 percent stake in all the commercial banks.

2. Requirements in the case of participation of the firm established in Nepal:

    2.1. Photocopy of firm registration certificate

    2.2. Broad resolution stating the amount to be invested in the proposed bank

2.3. Certified photocopies of Articles of Association and Memorandum of the investing firm.

2.4. List of Directors and proportion of their share ownership

2.5. Tax clearance Certificate of the firm and its directors

3. Certified documents on prescribed amount deposited in the Nepal Rastra Bank

4. Commitment document of the collaborating foreign bank and financial institutions providing Technical Service Agreement in the case of proposed national level commercial bank to be established in the Kathmandu valley.

5. Additional requirements in the case of joint venture of foreign banks:

   5.1 Certified minute of the board of directors of the foreign bank with a commitment of the amount to invest on the proposed bank establishing in Nepal.

   5.2 Clearance letter from the regulatory authority or the central bank of the collaborating foreign bank.

   5.3 Last three year's audited balance sheet, profit and loss statement and cash flow statements.

   5.4 Certified copies of joint venture agreement with Nepalese promoters to invest in the proposed bank

   5.5 A statement, in the case of the joint venture foreign bank has a holding bank and financial institution or a branch office or a representative office or liaison office in Nepal.

   5.6 A justification, in the case of the joint venture foreign bank already has a joint venture in any bank or financial institution in Nepal.

Nepal Rasta bank will provide the letter of intent to the applicants to establish a bank within the four months of period the promoters of the proposed commercial banks have had submitted all the necessary documents and after the study and analysis of such documents only if it would be appropriate to incorporate the bank.

For this, to obtain a the Letter of Intent form the Nepal Rasta Bank, the certified document stating that the prescribed amount has been deposited, should be produced. If the bank is not appropriate to establish, the applicant will be notified by such information. The Nepal Rastra Bank will also provide the required period to make the bank operation while granting the letter of Intent. If the bank will not come into the operation within such time period, it can cancel the letter of intent provided to such bank.

Providing of letter of intent shall not be regarded as the approval to conduct the banking transactions.

After obtaining the letter of intent, following additional documents should be produced to the Nepal Rastra Bank seeking the approval to conduct banking transactions:

1. An Application
2. Technical service agreement in case of foreign joint venture

3. Certified documents stating that the committed amount by promoters has been deposited fully in the Nepal Rastra Bank.
4. The agreement document, if the bank premises are in rent, and the site plan of the bank building along with necessary layout required for bank operation.
5. Information on recruitments of Staffs
6. Statements on Software Application
7. Credit Policy Guidelines (CPG) of the Bank
8. Employees by-laws
9. Information on all the physical infrastructure that are required to operate a bank

The operating license will be provided only after the conformation that all the statements and documents are complete and on the basis of physical infrastructure inspection report submitted by physical inspection team comprising of members from Bank Operations Department, Inspection and supervision Department and Information Technology Department of this Bank.

2.5 Existing Supervision relating to the Banking Sector:

Promotion of financial stability, development of safe and efficient payment systems, regulation and supervision of banking and financial system and the promotion of healthy and competitive financial system are some of the objectives of functioning of Nepal Rastra Bank.

To attain the above objectives Section 84 of the Nepal Rastra Bank Act 2002 has entrusted Nepal Rastra Bank with the necessary powers to perform inspection and examination of any commercial banks or obtain necessary information for the purpose of supervision of the commercial banks.

Currently the Bank Supervision Department in Nepal Rastra Bank carries out the function of supervision of all commercial banks in Nepal. Since foreign banks have their presence only in the form of Joint Venture establishments – that is in collaboration with the local entrepreneurs - Nepal Rastra Bank supervises foreign establishes in the same manner as it supervises other local banks. For the purpose of supervision, the department is required to prepare annual supervision plan for onsite examinations as well off site surveillance of the commercial banks. The same is to be approved by the Governor of the Bank.

The Bank Supervision Department carries out both onsite examinations as well as off site surveillance of the commercial banks as per its annual supervision plan.

On site Examination

The Bank Supervision Department can carry out onsite examination of commercial banks in Nepal by sending examination team to the commercial banks. Onsite examination can be corporate level inspection covering all aspects of functioning of commercial banks or can be targeted branch level inspection.

The Department also performs follow up of the earlier examination reports by visiting the branches to ensure necessary compliance of the NRB instructions. If information as to functioning of commercial banks against the interest of depositors' or some serious irregularity is received, the Department can perform special on site examination in such cases. The Bank Supervision Department is required to carry out corporate level examination of all commercial banks at least once in a year as per its annual plan but the gap between two inspections at any time should not exceed two years. As per current policy of the Department, corporate examination of all commercial banks is carried out once in a year. For the guidance of the onsite examination, an "On site inspection manual" is in force. On completion of the onsite examination examiners perform CAMELS rating of the bank which is exclusively used for the supervisory purpose and is not revealed to general public.

Off site supervision

Off site supervision is a supplement to the onsite examination and is designed to act as an early warning system to identify banks with potential problems so that appropriate policies and action can be determined. Off site division of the Bank Supervision Department is carried out in a quarterly frequency as well as annual off site review based on the reports and returns submitted by the commercial banks

Quarterly offsite review

Off site division reviews performance of all commercial banks on quarterly basis which is submitted to the Governor of Nepal Rastra Bank. Such review involves assessment of the financial information as well as compliance of applicable rules regulations and legal provisions including NRB directives. Based on the review internal rating which is called CAELS Offsite Rating (COR) is also assigned to the banks.

Annual Balance sheet review

The Department's off site division reviews the balance sheet of the commercial banks at the end of each financial year and issues necessary instructions based on such review; this is then published in their annual report. In the course of such review the auditor's report, audited financial statements, long form audit report preliminary, audit report and banks reply thereon are studied. Based on the review of above report consisting of the review of financial performance, compliance with Nepal Rastra Banks directives and applicable legal provisions, adverse observations of the auditors and other significant findings is prepared and necessary instructions are issued to the bank thereon.

For the guidance of the offsite surveillance off site supervision manual is in force.

Till now there is no difference in the supervision methods used for the banks with foreign investment and other commercial banks

Chapter III: Review

3.1 Background:

Nepal Rastra Bank has established a task force to produce a detailed and comparative study highlighting, among other matters, the necessary rules and regulations for foreign branch banking, keeping in mind the context the Nepalese situation. In this regard, the structure of the chapter is as follows: the next section discusses the formal development as well as sources of data; the third section discusses the above identified analysis country by country (e.g. the vertical analysis) while the last section provides a functional analysis (e.g. the horizontal analysis).

3.2 Format development and sources of data:

The task force, faced with the above objective, proceeded for parallel development of a format as well as obtaining the required data.

3.2.1 Format Development:

As mentioned earlier, the primary objective of the task force is for highlighting the necessary rules and regulations with regard to foreign bank branching in Nepal. To facilitate attaining this objective, a standard format has been developed in coordination and discussion with the team members of the task force. The final version of this is presented below.

No.	Description
1	Country description with respect to the banking sector
2	In country legal provisions regarding the foreign bank branches. Are there provisions regarding establishment of the foreign branches, the host supervisory authority of the branches, onsite inspections by the parent authorities etc.?
3	In country licensing policies and procedures regarding foreign bank branches: What are the required documents to be submitted with application? Is there a minimum rating requirements of the parent bank? What are the condition as to approval of home supervisor before granting license etc.
4	In country regulation and directives regarding foreign bank branches additional to domestic financial institutions such as minimum capital requirements. Is there understanding and coordination between host authorities regarding level of support that will be available in case of crisis from parent bank/supervisory authorities including study of an example for effect of failure of bank and crisis management by the host countries?
5	In country monitoring and supervision regarding foreign bank branches. Is there clear division and coordination of responsibility of supervision foreign branches between home authorities and host authorities etc.
6	Experiences [in Supervision] on Central Banks/Monetary Authorities in regard to foreign bank branches

Source: TF1 decision (Meeting No 6 dated July 19, 2004)

With this above version, the below obtained data was classified.

3.2.2 Source of Data: The data have been provided from official sources. The data for the SAARC countries have been requested through SAARCFINANCE, a regional network of

Central Bank Governors and Finance Secretaries. Similarly, the then chairman of the high level committee, Senior Deputy Governor Mr. RB Pant, had consented to issue a request letter to Dr. Subarjo of SEACEN to facilitate in the collection of the information from SEACEN member countries.[12]

3.2.3 Limitation: The broad and groundbreaking nature of this study in Nepal needs some limitations. The first is that the study is only as good as the data obtained. The second is that the paper focuses on representative sample of SAARC and SEACEN countries which are: SAARC (India and Sri Lanka) and SEACEN (Indonesia and Thailand)[13].

3.3 Country Analysis:

The country analysis proceeds along the lines of the format described above with a matrix for vertical comparison given at the end. The two SAARC countries (India and Sri Lanka) are first given followed by two SEACEN countries (Indonesia and Thailand). These are:

3.3.1. India

3.3.1. A Brief Introduction of India: Until recently, foreign banks were permitted to have commercial presence in India only through branch operations. However, the Government of India has announced, in the Union Budget (2002-03), that foreign banks will be allowed commercial presence either through the branch route or subsidiary route. Existing banks will be given the option to convert their branches in case so desire. Presently there are 36 foreign banks in India with 206 branches (as of July 4, 2003). Foreign banks have also set up Representative Offices in India. Thus, 62 banks have presence in India either through branches or Representative Offices.

3.3.1.B. In country legal provisions regarding the foreign bank branches: The branches of foreign banks are subject to the **same** prudential norms in regard to asset classification, income recognition and provisioning as Indian banks and the banks have to comply with the instructions issued by the RBI from time to time. The regulations governing commercial banking in India are equally applicable to both foreign and domestic banks. However, foreign banks have business presence mostly in urban centers where the client profile and the service needs are different from those in semi-urban/ rural etc. centers. Thus, the nature of service provided by foreign banks, to some extent, differs from Indian banks.[14] In lieu of agricultural finance, the foreign banks are required to extend export credit as part of priority sector stipulation. Further the stipulation of minimum 25% of branch presence in rural areas is not applicable to foreign banks as most of the foreign banks been allowed to operate with very few branches in India, confined to metropolitan and urban centers.

There are also provisions regarding onsite inspection by parent supervisory authorities: A foreign bank operating in India, either having a solitary branch or number or branches under an Indian Head Office, is treated as an independent bank, and supervision and monitoring of such bank is done by the Reserve Bank of India (RBI) through (i) on-site inspection and (ii) off-site surveillance.

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[12] It should be mentioned that there had been hope that information regarding supervision as well as experiences, would be gathered in Kathmandu during the 5th SEACEN/Fed/World Bank Seminar for Senior bank Supervisors from Asia-Pacific countries and the 6th SEACEN Conference of Directors of Supervision of APEC Economies and 17th Meeting of SEACEN Director of Supervision scheduled to be held on 16 – 21 August 2004 and 23 – 25 August 2004. Unfortunately, those events for Kathmandu were cancelled and moved to Malaysia.

[13] Information in this regard was available at the relevant countries' central bank websites.

[14] For example, the stipulation for priority sector lending for foreign banks has been prescribed at a minimum 32% of net bank credit as against 40% for domestic banks.

On-site inspection is conducted by RBI in its Annual Financial Inspection of banks. It is inspected as a banking company and all the supervisory prescriptions of RBI for foreign banks are applicable to them. The on-site inspection of a foreign bank is done following the CALCS model.[15] The performance of a bank in each individual area under CALCS is assessed during the inspection and accordingly supervisory rating is awarded, which is a scale of 'A' through 'D' according to descending order of performance. The findings of the inspection are communicated to the bank's Head Office in India with an instruction to place the same before the Local Advisory Board (LAB) and its Head Office in within stipulated time frame, with the approval of its Local Advisory Board (LAB). Subsequently, the Chairman/CEO of the concerned bank in India is called for a supervisory discussion in RBI and finally, a memorandum, containing the RBI observations and CEO's comments, is placed before the Board for Financial Supervision (BFS) for further directions. Apart from the inspection findings, if there is any other serious supervisory concern, viz. penalty imposed on the bank by RBI, a letter of displeasure is issued to the bank by RBI with the same is conveyed to the home supervisor as well as the Head of the concerned bank.

Apart from the on-site inspection, monitoring of foreign banks/branches is also done through off-site surveillance system. Under the system, the banks are under obligation to submit prescribed returns (DSB returns - tranche I & II) at quarterly (in certain cases monthly) intervals to RBI. There are five returns in the first tranche, containing capital, assets, liabilities, capital market exposure, etc.; and four returns under the second tranche, containing data on position of structural liquidity and interest rate sensitivity. The returns are used as a tool for supervising the performance of a bank on a continuing basis, since the on-site inspection is concluded once in a year. Moreover, the credibility of the date submitted by a bank through the DSB returns is verified during the on-site inspection.

Additional information pertaining to definition of foreign bank; provisions regarding licensing and registration authorities; Provision regarding host supervisory authorities; and Qualifications for the management staff of foreign branch were, unfortunately, not available.

<u>3.3.1.C. In country licensing policies and procedures regarding foreign bank branches:</u> There are a number of required documents to be submitted by a foreign bank for opening a foreign bank branch. RBI scrutinizes the applications with reference to the following: 1) Financial soundness of the parent foreign bank; 2) International and home country ranking of the parent foreign bank; 3) Rating of the foreign bank by international rating agencies; 4) Quality and spread of its international presence; 5) Economic and political relations between India and the home country of the foreign bank; 6) The foreign bank should be under consolidated supervision of the home country regulators and RBI should be satisfied with the standards of supervision of the home country regulator; 7) The country of incorporation of the foreign bank should not be discriminated against by Indian banks; and 8) The foreign bank must obtain the home country regulator's approval for opening the branch.

Though no minimum rating requirements have been prescribed for the applicant foreign bank but the applicant is required to specify ranking in home country and global ranking and credit ratings by international credit rating agencies. Further, the applicant is required to submit: (i) the certificate from supervisory authority that the applicant bank is duly authorized as a bank is of good standing and it is under consolidated supervision; and a copy of the approval/authorization given by the home country supervisor/regulator permitting to open a branch in India. Further, the

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[15] CALCS is an acronym for: capital adequacy (C), Assets quality (A), Liquidity position (L), Compliance to RBI guidelines/instructions (C) and Systems obtaining in the bank (S)

procedures for assessing capacity for and performance of consolidated supervision by home country supervisor

There is no specific information regarding the procedures followed by RBI to assess capacity and performance of consolidated supervision by the host authority, however the applicant is required to submit the certificate from supervisory authority that the applicant bank is duly authorized as a bank, is of good standing and it is under consolidated supervision. This is essential to understand the structure of corporate group to ensure adequacy of consolidated supervision. Additionally, applicant is required to submit the Financial Position including: Highlights of financial position of the bank based on last three years financial statements; Capital adequacy ratio as per BIS standards indicating Tier-I and Tier II capital separately; Ranking in home country and global ranking; and Credit ratings by international credit rating agencies.

3.3.1.D The main regulation is regarding *capital requirement;* since 1993, a foreign bank opening the first branch in India is required to bring in US $10 million as an assigned capital. The capital requirement is stepped up to US $ 20 million when the second branch is opened and further to US $ 25 million when the third branch is opened. Permission to open second and subsequent branch is granted taking into account, *inter alia*, the policy prevailing at that time. Second branch is allowed after watching performance of the first branch. It is ensured that the required capital has been brought before commencement of business in India. The unimpaired capital has to be maintained on an ongoing basis.

Additional information pertaining to Single Obligor limits; Loan classification provisioning and income recognition; Lending and deposit concentration; and Prudential regulations regarding good corporate governance, are awaited.

3.3.1.E Monitoring and supervision system regarding foreign branches: foreign bank operating in India, either having a solitary branch or number or branches under an Indian Head Office, is treated as an independent bank, and supervision and monitoring of such bank is done by the Reserve Bank of India (RBI) through (i) on-site inspection and (ii) off-site surveillance.

On-site inspection - RBI conducts on-site Annual Financial Inspection of banks and is inspected as a banking company and all the supervisory prescriptions of RBI for foreign banks are applicable to them. The on-site inspection of a foreign bank is done following the CALCS model, under which mainly the areas, viz. capital adequacy(C), Assets quality (A), Liquidity position (L), Compliance to RBI guidelines/instructions (C) and Systems obtaining in the bank (S) are examined. The performance of a bank in each individual area under CALCS is assessed during the inspection and accordingly supervisory rating is awarded, which is a scale of 'A' through 'D' according to descending order of performance. The findings of the inspection are communicated to the bank's Head Office in India with an instruction to place the same before the Local Advisory Board (LAB) and its Head Office in within stipulated time frame, with the approval of its Local Advisory Board (LAB). Subsequently, Chairman/CEO of the concerned bank in India is called for a supervisory discussion in RBI and finally, a memorandum, containing the RBI observations and CEO's comments, is placed before the Board for Financial Supervision (BFS) for further directions. Apart from the inspection findings, if there is any other serious supervisory concern, viz. penalty imposed on the bank by RBI, letter of displeasure issued to the bank by RBI, any infringement of legal provisions, bank coming under Prompt Correct Action (PCA) in terms of low CRAR or low Return on Assets or high NPAs, liquidity crisis, major fraud perpetrated, etc., the same is conveyed to the home supervisor as well as the Head of the concerned bank.

Off-site surveillance: Apart from the on-site inspection, monitoring of foreign banks/branches is done through off-site surveillance system. Under the system, the banks are under obligation to submit prescribed returns (DSB returns- tranche I & II) at quarterly (in certain cases monthly) intervals to RBI. There are five returns in Tranche I, containing capital, assets, liabilities, capital market exposure, etc. and four returns under Tranche II, containing data on position of structural liquidity and interest rate sensitivity. The returns are used as a tool for supervising the performance of a bank on a continuing basis, since the on-site inspection is concluded once in a year. Moreover, the credibility of the date submitted by a bank through the DSB returns is verified during the on-site inspection.

3.3.1 F Information experience's of RBI in regard to foreign bank branches, are likewise awaited

3.3.2. Sri Lanka

3.3.2.A. Brief Introduction of Sri Lanka –

Sri Lanka is a small island in the Indian Ocean with a land area of 25,000 square miles and a population of 18.3 million. Topographically the island consists of a south central mountainous region which rises to an elevation of 2,502m and is surrounded by broad lowland plains at an elevation of 0-75 m above sea level. Despite abundant natural resources, Sri Lanka remains a poor country with a per capita gross national income of about $1010 in 2004. Since 1977, Sri Lanka has been trying to open up its economy and aid the development of the private sector. But the process of reform has been undermined by the civil war that began in the early 1980s and continues to the present day. The financial sector reforms in Sri Lanka have been implemented gradually over the last two and half decades. During late 1970s and early 1980s, the pace of reforms were rapid but after 1983 some slowdown was evident as civil unrest. The most comprehensive financial sector reform that have been introduced since the latter part of 1977 have been to open up more economic activities to the private sector, the freeing of interest rate from administrative controls, relaxation of exchange controls , implementation of industrial reforms including authorization of new financial institutions, placing greater emphasis on market orientation in monetary management and credit allocation, and strengthening of the legal, accounting and regulatory framework of financial institutions.

3.3.2.B. While there is no definition of a foreign bank branch in Sri Lanka, there is the requirement that it should be a body incorporated outside Sri Lanka or formed in pursuance of any statute of a foreign country, royal charter or letters patent. There primary provisions regarding licensing and registration authorities is that a branch of foreign bank can carry on the banking business in Sri Lanka only with a license issued by the issued by the Monetary Board with the approval of the Minister of Finance. While there is not provision found regarding reference to the host supervisory authorities, it is required that license be obtained from the Bank Supervision Department of the Central Bank of Sri Lanka

Additional information pertaining to onsite inspection by parent supervisory authorities and qualifications for the management staff of foreign, are not available.

3.3.2.C No information was obtained regarding licensing policies and procedures with regard to foreign bank branches. However, the application has to be obtained from the Bank Supervision Department of the Central Bank of Sri Lanka. The application has to be accompanied by the following: A certified copy of the Certificate of Incorporation; A certified copy of the Memorandum and Articles of Association of the Company; A copy of the latest audited balance sheet and profit and loss account of the company with annual reports for the preceding 3 years; A feasibility study to the establishment of a branch in Sri Lanka stating the objectives of establishing a branch in Sri Lanka and the manner in which it would benefit Sri Lanka; A certified copy of resolution passed b the Board of Directors of the bank authorizing the establishment of a branch in Sri Lanka; A certificate from the Monetary Authority of the country where the Head Office of the bank is located stating that permission has been granted for the bank to establish a branch in Sri Lanka; A written undertaking supported by a resolution passed by the Board of Directors, stating that the company or body corporate shall, on demand by the Central Bank of Sri Lanka, provide such funds as may necessary to cover all obligations and liabilities incurred by the branch in carrying on banking business in Sri Lanka; any other particulars or documents that may be required by the monetary Board. Although there is no minimum-rating requirement of the parent bank, the applicant is required to specify the Bank's ranking in terms of capital, deposits and total assets in home country.

Applicant is required to submit a certificate issued by the relevant monetary authority of the country stating that permission has been granted to establish of a branch in Sri Lanka. However, the procedure for assessing capacity for and performance of consolidated supervision by home country supervisor is not available. Likewise, there is no specific pre condition as to the signing of an MOU with the host supervision authority for establishment of foreign branch. However, understanding structure of corporate group is essential to ensure adequacy of consolidated supervision. Application format requires the submission of list of shareholders of holding more than 10% of the issued shares of the Bank. Further, no information as to the structure of corporate group as a whole is found to have been obtained.

Applicant is required to submit its detailed business plan including projections of Deposits, Lendings and Profit/Loss or the first three years and also stating the objectives of establishing a branch in Sri Lanka and the manner in which it would benefit Sri Lanka. Likewise, an amount of Rs 250,000/- per annum fee will be charged to foreign bank branched and off-shore banking business with an amount of Rs 150,000/- per annum fee will be charged to those who receive license for performing off-shore banking business only.

3.3.2.D In country regulation and directives regarding foreign bank branches and difference if any from the regulations applicable to locally established banks. A difference relates to *capital requirements* namely: A branch of the foreign bank shall have an assigned capital of not less than Rs. 500 million; the head office of the foreign bank shall also remit to Sri Lanka a sum of US $ 2 million as determined by ht Monetary Board in respect of branches carrying on domestic banking or both domestic and off-shore banking business; for off-shore banking business only, a sum of US $ 0.75 million shall be remitted to Sri Lanka as determined by the Monetary Board. Additional information pertaining to Single Obligor limits; Loan classification provisioning and income recognition; Lending and deposit concentration; Prudential regulations regarding good corporate governance were not available

3.3.2. E and F Information regarding country monitoring and supervision system regarding foreign branches as well as the experience's of CBSL in regard to foreign bank branches, are likewise awaited

3.3.3 Indonesia

3.3.3 A Brief Introduction of Indonesia **-** Indonesia is a Southeastern Asia, archipelago between the Indian Ocean and the Pacific Ocean with an area of 1,919,440 sq km and GDP per capita of $3,419.38. The Dutch began to colonize Indonesia in the early 17th century; the islands were occupied by Japan from 1942 to 1945. Indonesia declared its independence after Japan's surrender. Indonesia, a vast polyglot nation, has restored financial stability and pursued sober fiscal policies since the Asian financial crisis, but many economic development problems remain, including high unemployment, a fragile banking sector, endemic corruption, inadequate infrastructure, a poor investment climate, and unequal resource distribution among regions. Several significant developments have taken place, including privatization of banks, move towards establishing a financial safety net, and amendments to the related Laws, providing for greater oversight of its functions. However, various key issues remain to be addressed, including (i) improving governance of state banks and financial institutions; (ii) enhancing financial intermediation, to support real sector growth besides just consumer lending; (iii) strengthening capital markets to encourage financing of long-term corporate growth; (iv) formulating a sound implementation plan for the Indonesian banking architecture; and (v) consolidating financial sector supervision and strengthening the governance of oversight institutions.

3.3.3 B In country legal provisions regarding the foreign bank branches: The Republic of Indonesia has issued decree (number 24 of 1999) concerning provisions and procedure for the establishment of branch offices, sub-branch offices and representative offices of foreign banks. It has defined foreign bank, branch office, sub-branch office, and representative office categorically. Foreign banks may only establish branch office, sub-branch office and representative office with the approval of the Board of Managing Directors of Bank Indonesia (Central Bank). A representative office is not allowed to conduct banking operations. Any foreign bank that is intending to open branch banking should have a sound rating and reputation. Bank Indonesia may also consider other matters like the bank rating, level of fair competition among the banks, saturation level of number of banks and equitable distribution of national economic development. The form of legal entity of a branch office or a representative office of a foreign bank shall be in accordance with the form of legal entity of its head office. Thus, it is clear that any branch of foreign bank conducting banking business has not to be locally incorporated as legal subsidiary or joint venture. Such foreign bank branches should comply with all prevailing laws and regulations of host country. They shall have to comply with capital requirement as determined by Bank Indonesia. Office of such branch may only be closed with the approval of Central Bank.

Additional information pertaining to: provisions regarding licensing and registration authorities; Provision regarding host supervisory authorities; and provision regarding onsite inspection by parent supervisory authorities are not available.

3.3.3. C In Indonesia, the general conditions for a Branch Office to conduct business in Indonesia is that it comply with all prevailing laws and regulations in the country. Further a foreign bank may only establish a Branch Office pursuant to approval of the Board of Managing Directors of Bank Indonesia. With regard to the issuing of a license for establishment of offices by a foreign bank, Bank Indonesia shall consider, among others: the bank rating, level of fair competition among banks, saturation level of number of banks, and equitable distribution of national economic development. The granting of a license shall take in two stages: approval in principle and operating license.

Foreign bank intending to open foreign bank branch shall submit an application to Bank Indonesia; Documents required to be submitted along with the application form are: copy of deed of incorporation of the Bank legal entity, including Articles of Association validated by the competent authority in the country of origin of the Bank head office; operating license of the Bank issued by the banking authority in the country of origin of the Bank head office; rating and reputation of the Bank and ranking among banks in the world by total assets; statement of no objection to the establishment of a Branch Office in Indonesia, issued by the banking authority in the country of the head office; latest financial statement; consolidated financial statement for the last three years, audited by an independent international public accountant; copy of documents concerning bank rating for the last 2 (two) years; list of nominees to the Branch Office Management, with required documents attached; planned organizational structure; branch Office work plan for the first year, containing feasibility study, business plan, planned personnel requirements, monthly cash flow and balance sheet projections; list of customers/prospective customers domiciled in Indonesia; list of correspondent banks in Indonesia; proof of initial deposit of Operating Funds amounting not to less than 30% (thirty percent) of the Operating Funds.

In addition for the application for operating license for a Branch of a Foreign Bank following documents are required: organizational structure and working systems and procedures, including composition of personnel; proof of operational readiness including list of fixed assets and inventory, proof of ownership, control, or leasing agreements for office premises etc.; copy of deposit slip to the Board of Managing Directors of Bank Indonesia and as proof of payment in full of the required Operating Funds. Further**,** a foreign bank intending to open a branch office should have sound rating and reputation according to the rating issued by leading international rating agency such as Mood'y, Standard and Poor's or other international rating agency of similar standing of not less than “A” or the equivalent. Also the bank should rank among the 200 (two hundred) largest banks in the world by total assets.

The branch is required to provide a feasibility study of the branch operations which include review of the financial standing and operating performance of foreign bank on individual as well as consolidated basis is made. Applicant is required to submit its detailed business plan includes business operation plan, detailed organizational structure to establish feasibility of the project including the cash flow and balance sheet projections for one year. Further, the employment of an expatriate at a Branch Office or Representative Office shall comply with the prevailing manpower regulations in Indonesia.

Additional information pertaining to approval of the home supervisor before granting license; procedures for assessing capacity for and performance of consolidated supervision by home country supervisor; Assessment as to the management capacity, risk management system etc.; and MOU with the home supervisor regarding scope and conditions of sharing information, are not available.

3.3.3 D Information on regulation and directives regarding foreign bank branches and difference if any from the regulations applicable to locally established banks, such as Single Obligor limits; Loan classification provisioning and income recognition; Lending and deposit concentration; and prudential regulations regarding good corporate governance, is being awaited.

3.3.3. E and F Information regarding country monitoring and supervision system regarding foreign branches as well as the experience's of Indonesia in regard to foreign bank branches, are likewise awaited

3.3.4 Thailand

3.3.4 Brief Introduction of Thailand: Thailand is located in southeastern Asia, bordering the Andaman Sea and the Gulf of Thailand, southeast of Burma with an area of 513,120 sq. km and population of 64,865,523 (2003). The estimated GDP was 475.7 billion dollars in 2003.

3.3.4 B In country legal provisions regarding the foreign bank branches: In Thailand, the Ministry of Finance has published notification in the Gazette regarding foreign bank branches. This notification is issued under Commercial Banking Act. It has categorically defined foreign bank, branch of foreign bank and subsidiary of foreign bank. A foreign bank may create a subsidiary as a public limited company with equity participation not less than 95 percent under the Thai law. A foreign bank may establish its Branch Office or Subsidiary pursuant to the approval of Ministry of Finance after reviewing the application by the Committee appointed in accordance with the Financial Sector Plan by the Minister. A foreign bank intending to open its branch office in Thailand should be a large and reputable with sound and strong operating performance. It shall have engagement in international banking with a good world ranking, good credit rating as evaluated by the competent authority, a sound financial structure and the net capital to risk-weighted assets ratio complying with the standards prescribed by the competent authority. A foreign bank intending to open its branch office shall have extensive experience and expertise in international financial business and whose central bank and supervisory authorities have good relations with the Bank of Thailand for fetching up the information of that bank in times of need. A commercial bank that is a subsidiary of foreign bank shall fulfill the conditions that it has established a branch in Thailand or has established an office of the international banking facility in Thailand and has a plan for merger, or acquisition or acceptance of the transfer of all or most of the assets and liabilities with at least one financial institution in accordance with the rules, procedures, and conditions prescribed by the Bank of Thailand for the purpose of establishing a subsidiary.

Additional information pertaining to provisions regarding licensing and registration authorities; provision regarding host supervisory authorities; and provision regarding onsite inspection by parent supervisory authorities, were not available.

<u>3.3.4 C The licensing policies and procedures regarding foreign bank branches in Thailand start with the application process.</u> Foreign bank intending to open foreign bank branch shall submit an application to Bank of Thailand; Documents required to be submitted along with the application form namely consent letter of supervisory authority of home country of foreign bank, confirmation letter from foreign bank to guarantee[16], Confirmation that Home supervisory authority has applied prudential regulations to foreign banks as per international standards, information as to consolidated supervision regulations of the home country, information as to the existing international business facilities and credit flow in Thailand over last three years, two years annual reports with equity structure and financial statement, documents showing cooperation in economic development and financial knowledge (Technical services agreement etc.,), detailed business plan and detailed Work plan.

Though no minimum rating requirements have been prescribed for the applicant foreign bank but the applicant is required to specify ratings of the bank by the Moody s, standard and poor and others in the application format and it is reviewed for decision making. Likewise, Applicant is required to submit the consent letter of the home supervisory authority along with application form.

There is no specific information is available as to the procedures followed by Bank of Thailand to assess capacity and performance of consolidated supervision by the host authority however it is observed that while approving the application, information as to the consolidated supervision regulations of home country is reviewed by the approving authority. Confirmation letter from home country supervisor as to it applies prudential regulations of international standards to its banks is obtained. MOU with the home supervisor regarding scope and conditions of sharing

[16] Such as Oversee/ instruct bank branch to comply with Thai rules and regulations; financial and liquidity support; and provide necessary information to home supervisory authority.

information: No specific pre-condition as to the signing of MOU with the host supervision authority is there for establishment of foreign branch. However, regulation do require that home Supervisory authority of the foreign bank should have good business relation with supervisory authority to request required information flow as a essential precondition for establishment of foreign branch. It is felt that an understanding of the structure for the corporate group is essential to ensure adequacy of consolidated supervision. Further, an application format requires the submission of list of the 10 largest shareholders of the foreign bank and assets of subsidiaries, branches network and representative offices. However no information as to the structure of corporate group as a whole has been obtained.

An applicant is required to submit detailed work plan to ensure which shall ensure compliances with the following conditions: having risk management system that can measure, monitor and control the level of various risks namely credit risk, market risk, liquidity risk, strategic risk, and operational risk including legal and reputation risk; having clear policy on lending to business group or businesses that are related to the foreign bank branch, including information systems to monitor the outstanding loans and contingent liabilities and reason for difference if any to general lending; having concrete internal control system in line of segregation of duties approval of credit lines, investment or various expenses; have assets valuation system that covers customers interest payment principal payment, collateral valuation as per notification of Bank of Thailand; having personnel with knowledge in banking and finance.

3.3.4 D There are limited regulation and directives in Thailand regarding foreign bank branches and difference if any from the regulations applicable to locally established banks. For example, while information as to capital requirements as in relation to assets and contingent liabilities is awaited, branches are required to maintain assets in Thailand not less than 3000m baht.

3.3.4. E and F Information regarding country monitoring and supervision system regarding foreign branches as well as the experience's of Bank of Thailand in regard to foreign bank branches, are likewise awaited

3.4. Comparative Analysis:

The prior vertical analysis is provided in compact form in the below table, which is attached. Now the analysis proceeds on a horizontal analysis across thematic areas, namely: legal, licensing, regulation and directives, and supervision.

Legal perspective: Comparative analysis of the four above mentioned countries.

Box: Legal perspective – example of Philippines

In Philippines, An Act Liberalizing the Entry and Scope of Operation of Foreign Banks (Act no. 7721) has been promulgated in this regards. In pursuant to the provision of this Act, foreign banks with the approval of monetary board of Philippines, can conduct banking business through i) by investing majority of voting stock of an existing domestic bank, or ii) by establishing branches with full banking authority, or iii) by establishing its subsidiary. A foreign bank seeking to establish a new banking subsidiary or to establish branches with full banking authority must be widely-owned and publicly-listed (listed in any stock exchange authorized by the government of the country of origin), unless more than fifty percent of the capital stock of said foreign bank applicant is owned by the government of its country of origin. A foreign bank seeking to establish its branch office should be among the top 150 banks in the world or the top five in its country of origin. A foreign bank seeking to establish its branch office or a new subsidiary may subject to requirement of total asset as criterion by the Monetary Board. The minimum capital requirement fixed by Monetary Board is another important criteria. A foreign bank may avail itself of only one mode of entry but a foreign bank that comes in via the establishment of branches may still invest in the equity of a domestic bank subject to the initial provisions amended.

Comparative Analysis Between Countries

S. No.		SAARC		SEACEN	
		India	Sri Lanka	Indonesia	Thailand
1	Licensing policies and procedures regarding foreign bank branches:	The foreign banks will be allowed presence either through the branch route or through subsidiary route.	In terms of the banking act, a branch of a foreign bank could carry on banking business with a license by the monitory board with the approval of the MOF	The foreign banks will be allowed presence either through the branch route or through subsidiary route.	A foreign bank can apply to establish a branch of foreign bank in accordance with the rules, procedure and condition specified notification.
2	Application required/ documents to be submitted.	As per prescribed format	As per prescribed format	As per prescribed format	As per prescribed format
3	Minimum rating requirements of the parent bank/organization	International & home country rating & ranking	N.A.	Rating issued by a lending international rating agency, such as Moody's, standard and Poor's or international rating agency of similar standing, of not less than A or the equivalent.	Need to specify rating by international credit agency Consent letter of the home supervisory authority Info' regarding the consolidated supervision regulations of home country is reviewed
4	Feasibility study of branch operations with the objectives and expected benefit to the country	Highlights of financial position of proposed foreign bank branch	Necessary the feasibility study relating to the establishment of a branch in Sri lanka.	Detailed business plan to be submitted including projection of cash flow	submit detailed *work plan* including risk mgmt system etc (details elsewhere).Detailed business plan including financial projection of 3 yrs etc

5	Clear understanding as to the structure of the corporate group of the bank types of banking and non-banking activities etc.	N.A.	N.A.	Operations as regulated by article 6 and article 7 of act number 7 of 1992 concerning banking as amended by act number 10 of 1998.	Foreign bank branch can undertake the business of commercial banking in Thailand by establishing a full branch of commercial bank.
6	Conditions as to the management personnel of the foreign branches		Necessary the name of CEO, other chief officer and staffing of the proposed branch.	Organizational structure etc. The employment of an expatriate at a branch office or representative office shall comply with the prevailing manpower regulations in Indonesia.	details of organizational structure, including job description of staff responsible for management of the subsidiary to be established in Thailand, including the qualifications and experiences of key personnel.
7	Regulation and directives regarding foreign bank branches (additional to domestic financial institutions such as minimum capital requirements.)	Assigned capital US $10m, second branch US $20m and US $ 25 m for third branch.	Assigned capital not less than Rs 500 million. Also HO to remit US $2 m for both domestic and offshore banking.	Place operating fund in either rupiahs or foreign currency equivalent to not less than RP. 3000,000,000,000.00(three trillion rupiahs)	Maintain assets in Thailand not less than 3000m baht.
	Applicable Regulations	Equally applicable to both foreign and domestic banks. The stipulated for priority sector lending for foreign banks has been prescribed at a minimum 32% of net bank credit as against 40% for domestic bank.	N.A.	A branch office, sub-branch office, office below sub-branch, or representative office shall comply with banking regulations and other prevailing laws and regulations in Indonesia.	Details of organizational structure, including job description of staff responsible for management of the subsidiary to be established in Thailand, including the qualifications and experiences of key personnel.

	Provision of Opening of a Representative office	Representative office can open in but that office cannot undertake any banking business or any commercial activity. It can undertake activities such as correspondent banking, loan syndication or risk management for companies.	N.A.	Representative office can do only liaison between the bank and its customers.	
	Branch open Policy/ Expansion Policy	There no necessary to open bank branch in rural areas for foreign bank.	Details plans for branch expansion in the first three years.	N.A.	N.A.
11	Is there understanding and coordination between host authorities regarding level of support that will be available in case of crisis from parent bank/supervisory authorities including study of an example for effect of failure of bank and crisis management by the host countries.	N.A.	N.A.	N.A.	N.A.

Comparative Analysis

Similarities

There are some similarities in licensing policies and procedures regarding opening of foreign bank branches within India, Srilanka Indonesia and Thailand. These similarities are pointed as follows:

(a) Entry Modes

In India, Srilanka, Indonesia and Thailand, the foreign bank will be allowed either through branch route or through subsidiary route. Similarly, foreign bank branch can be established with a license by the central bank or by the monitory board with the approval of the ministry of finance.

(b) Required Documents

All nations have developed and identified the required level of documents for licensing of foreign bank branch to open a representative office in their country. Those required documents are presented in country wise separately. Some similar documents are as follows.

- Copy of Memorandum and Article of Association.
- Copy of the operating license of the bank issued by the banking authority in the country of origin of the bank (head office)
- No objection letter of the parent bank and the central bank
- Consolidate financial statement for the last 3 years, audited by an international reputed auditor.
- Certified documents of concerning bank rating.
- Structure of business group, comparing parent company, subsidiaries and affiliated companies.
- Details of organizational structure, including job description of staff responsible in managing the branch and qualifications and experiences of its key personnel.

(c) Minimum Rating Requirement of the Parent Bank

All the nations have similar requirement for rating of the parent bank. Thailand use Moddy's standard and Poor's method, whether Indonesia use any one international rating system. The rating system of Srilanka is not found.

(d) Feasibility Study

Feasibility study is essential for establishment of foreign bank branch in all countries. Some countries say Business Plan also.

(e) Country Regulation

All countries have their own country regulation and directives for regulating foreign bank branch. In India, the banking regulation is equally applicable to both foreign and domestic banks whether other countries have their separate regulations and directives for foreign bank and domestic banks.

- *Licensing perspective:*

Suggested Application Procedures for establishing Foreign Bank Branches In Nepal

Application procedures

It will be desirable either to follow branch route or subsidiary route to open a Foreign Bank Branch. To establish either branch or subsidiary in the Nepal, a foreign bank must apply for and obtain prior approval of Nepal Rastra Bank. A foreign bank intending to open a branch office shall placed operating fund in equivalent to not less than Rs.1000 million. The Minimum Rating grade should be as specified in the negotiation meeting of WTO. World class top 200 banks are allowed to apply.

Applications typically require the following documents or information:

- Formal documents such as:

  -Certified copies of the applicant's articles of association in Nepalese language or (and translation into English language)

  - Certified copy of the operating license of the bank issued by banking authority of the country of origin of the Bank head office;

  -An approval or statement of no objection from home country Regulator;

  -A corporate resolution authorising the application; and

  -Necessary legal opinions.

- Information about the parent foreign bank, including;

  - Certified copy of rating and reputation issued by an international rating agency;

  -The most recent bank financial statement prior to the date of application for approval in principal;

  -Bank consolidated financial statement for the last three years, audited by an independent international public accountant;

- A list of nominees for the branch office management;

  -Information concerning the applicant's ownership;

  -Curriculum vitae of chief executive officer and other key executives;

  - Documents specifying operation system

  - Organisation chart and description of its existing offices and affiliates.

- Information about the proposed branch or agency, including;

  -Its business plan;

  -Feasibility study on market opportunities and economic potential minimum three years projection;

  -Monthly cash flow projection for 1 year from the date that the branch office commence operations and balance sheet and income statement projection;

- Others as prescribed by the NRB

- Proof of initial deposit of 20 percent of the required operating funds.
- Expected competition; and

Evaluation of applications

In evaluating applications, the applicant foreign bank is engaged in banking business abroad and is subject to comprehensive, consolidated supervision or regulation in its home country. NRB must also determine whether applicant has furnished sufficient information and whether will continue to submit information about its activities that will sufficient to allow regulatory requirements and compliance. Other factors considered are as under:

- The financial and managerial resources and future prospects of the applicant foreign bank and its proposed branch expansion strategy;
- Whether bank has furnished adequate information to assess the application and has provided adequate assurances that information will be made available to determine and enforce compliance with applicable Nepalese Banking and other laws;
- whether foreign bank and its Nepalese affiliates are in compliance with branching requirements
- Controls or directed to control money laundering
- whether foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor; and
- whether the home country supervisor has consented to the proposed establishment of the branch or agency
- At least two month before scheduled opening supervisory agency will conduct a review to verify that foreign bank has met all requirements of commencing banking business in Nepal

Application is not approved unless following is determined:-

- Foreign bank is subject to comprehensive supervision on a consolidated basis by appropriate authorities in home country
- Foreign bank engages directly in the business of banking outside
- Foreign bank has furnished adequate and true informations to consider application

Additional standards that may consider:

- Financial and managerial resources of bank including its internal methods of monitoring worldwide operations and compliance with law;
- Bank and its affiliates are in compliance with all applicable Nepalese laws;
- Whether banks home country supervisors shares material supervisory information with other regulatory authorities
- Whether foreign bank has received approval from home country authorities to establish branch or agency; and
- Whether bank has adopted procedures to combat anti money laundering

- *Regulation and directives perspective*:

Prescribed Prudential Norms and Regulations for FBB

Capital Adequacy

For the foreign bank to establish branch or agency foreign bank's capital ratio to be equivalent, but not identical to the minimum ratio of Nepalese Bank. Notional required capital will be as specified in the licensing policy.

Loan loss Reserves

The foreign bank branches have to comply and maintain loan classification and provisioning equally to Nepalese bank.

Single Obligor Limits

Foreign branches and agencies must comply with the same lending limits to customers as Nepalese banks. The limits are calculated on the basis of the capital of parent foreign bank

Reserve Requirements

Bank branches and agencies of foreign banks are required to maintain same reserves as domestic banks, cash in vault; balances with Nepal Rastra Bank

Reporting requirements

Foreign bank branches have to submit final annual report to Nepal Rastra Bank within 90 days after fiscal year end. Unless and until specified, other requirements are to submit reports similar to that of domestic bank.

Systems and Policy Documents

Transparent systems, credit policy guidelines, borrowing guidelines, operational guidelines, risk management guidelines and other appropriate policies and guidelines need to be prepared, approved and implemented

Assure Good Corporate Governance

As per the international best practices.

Technology and Technical Service

Modern technology and technical services as approved by NRB

Employees Regulations and limitations on expatriates to executives

Bank Supervision Perspective: Foreign branches unlike bank subsidiaries are not separate legal entity, rather they are legal and operational extension of a foreign bank. Hence, such branches shall require specific supervision mechanism than mechanism currently in use for joint venture banks in Nepal. For this purpose information was sought from the countries under study unfortunately information was not received from most countries. The sole exception was that of the supervision mechanism existing in India which has a similar banking environment as Nepal. Despite this scarcity, it is felt that certain guidelines issued by Basel Committee regarding supervision of Bank's foreign establishments can be adopted as universal rules of supervision. For effective supervision of foreign bank establishments, it should be ensured that none of foreign establishments escapes supervision and also supervision should be adequate.(Principles for supervision of Bank's foreign establishments, BIS, May 1983). It is also important to note that in a situation where it is felt that the host authority considers home authority supervision is not adequate, the host authority should either reject the application for licensing or should impose restrictions on the operations of such branches. Further before establishment of foreign branch, mutual consent of host and home supervisory authorities should be obtained. (Minimum standards for supervision of International Banking groups and their cross border establishments, BIS, July 1992).

While giving consent for expansion host country and home country authorities should, at a minimum, give weight to (a) the strength of the bank's and banking group's capital and (b) the appropriateness of the bank's and banking group's organization and operating procedures for the effective management of risks, on a local and consolidated basis respectively. In judging these two criteria, a host country authority should be particularly concerned with the level of support that the parent is capable of providing to the proposed establishment.

To avoid gaps in supervision there has to be mutual cooperation and flow of information amongst the home and host authorities. Host authorities should ensure that parent authorities are informed immediately of any serious problems that arise in a parent bank's foreign establishment. Similarly, parent authorities should inform host authorities when problems arise in a parent bank which is likely to affect the parent bank's foreign establishment. Such information includes information as to local office under host authority as to supervisory framework of the parent's banking group as a whole and any significant problems in head office or group as a whole (Supervision of cross border banking, BIS, October1996). *Legal constraint if any on passing such information should be removed*. Memorandum of understanding may also be entered into with foreign supervisory authority in the format suggested by Basel committee at the time of registration in order to facilitate free flow of information among supervisory authorities.(Essential elements of a statement of cooperation between banking supervisors, BIS, May 2001).

Survival of foreign bank branch shall be dependent entirely on survival of foreign bank, effective comprehensive and consolidated supervision of foreign bank operations by home supervisory authority is prerequisite for supervision of such establishments. Basel's 25 core principles for bank supervision also stresses the need for consolidated supervision. Accordingly, Host supervisory authorities are required to conduct global consolidated supervision over their internationally active banking organizations. For this purpose they are required to establish contacts and make arrangements of sharing of information with other supervisory agencies to facilitate consolidated supervision. Host country supervisor is required to apply same high standards for conduct of local operations of the banks as is required of the domestic financial institutions. Host authority must have powers to share information needed by the home authority for supervision and should be able to determine adequacy of the consolidated supervision by the home supervisory authority. In India RBI considers adequacy of supervisory and regulatory systems in home country and system of exchange of information is in place while issuing license to the foreign bank. Foreign banking organizations are subject to same legislation and regulatory requirements as applicable to foreign banks. RBI has powers to share information with the overseas supervisors

Thus, at the time of granting the license, the host supervisory authority should be able to evaluate capability of home supervisory authority to perform effective consolidated supervision. There has to be in place some mechanism to evaluate ability of home supervisory authority. For this purpose information was sought from the countries under study, but unfortunately it was not available. However Basel committee has recommended some guidelines (enclosed in annex 3.1), which can be used for purpose of such evaluation. (Supervision of Cross Border Banking, BIS, October 1996)There has to be clear understanding about division of supervisory responsibilities among the host and home supervisory authorities. Division of the supervisory responsibilities is guided by the Principles for the Supervision of Banks Foreign Establishments (May 1983). Accordingly, Host authorities are responsible for the foreign bank establishments operating in their territories as individual institutions while parent authorities are responsible for them as parts of larger banking groups, where a general supervisory responsibility exists in respect of their worldwide consolidated activities. The supervision of banks' foreign establishments is considered in this report from three different aspects: solvency, liquidity, and foreign exchange operations and positions:

Solvency: For branches, their solvency is indistinguishable from that of the parent bank as a whole. So, while there is a general responsibility on the host authority to monitor the financial soundness of foreign branches, supervision of solvency is primarily a matter for the parent authority. The "dotation de capital" requirements imposed by certain host authorities on foreign branches operating in their countries do not negate this principle. They exist firstly to oblige foreign branches that set up in business in those countries to make and to sustain a certain minimum investment in them, and secondly, to help equalize competitive conditions between foreign branches and domestic banks.

Liquidity: The host authority has responsibility for monitoring the liquidity of the foreign bank's establishments in its country; the parent authority has responsibility for monitoring the liquidity of the banking group as a whole. For branches, the initial presumption should be that primary responsibility for supervising liquidity rests with the host authority. Host authorities will often be best equipped to supervise liquidity as it relates to local practices and regulations and the functioning of their domestic money markets. At the same time, the liquidity of all foreign branches will always be a matter of concern to the parent authorities, since a branch's liquidity is frequently controlled directly by the parent bank and cannot be viewed in isolation from that of the whole bank of which it is a part. Parent authorities need to be aware of parent banks' control systems and need to take account of calls that may be made on the resources of parent banks by their foreign branches. Host authorities have a duty to ensure that the parent authority is immediately informed of any serious liquidity inadequacy in a parent bank's foreign establishment. Host and parent authorities should always consult each other if there are any doubts in particular cases about where responsibilities for supervising the liquidity of foreign branches should lie.

Foreign Exchange Operations: As regards the supervision of banks' foreign exchange operations and positions, there should be a joint responsibility of parent and host authorities. It is particularly important for parent banks to have in place systems for monitoring their group's overall foreign exchange exposure and for parent authorities to monitor those systems. Host authorities should be in a position to monitor the foreign exchange exposure of foreign establishments in their territories and should inform themselves of the nature and extent of the supervision of these establishments being undertaken by the parent authorities. If, as a result of the establishment's proposed activities or the location and structure of the bank's or the banking group's management, either authority concludes that the division of supervisory responsibilities suggested above is not appropriate, then that authority has the responsibility to initiate consultations with the other authority so that they reach an explicit understanding on which authority is in the best position to take primary responsibility, either generally or in respect of specific activities.

In addition to the regular review of the Risk management systems, operational controls, Compliance and Assets quality of the foreign branches, home supervisory authority should also be able to assess the ability of the FBO to support its foreign branch in case of need arises . For this purpose the supervisory authority should be able to review and evaluate on continuous basis financial profile of FBO on consolidated basis, adequacy of the home country banking supervisory system, ability of home authority to deal with supervisory problems, and degree of transfer risks due to exchange controls and other restrictions.

Requirements of Core Principles for Effective Banking Supervision

In 1997 Basel Committee has prescribed 25 core principles for effective banking supervision which were in nature of minimum requirements intended to guide supervisory authorities to strengthen their current supervisory regime. In respect of the Cross border banking Core principles has laid guidelines as to responsibilities of the home and host supervisory authorities in respect of supervision of Foreign Banking organizations given as under.

" *…Obligations of Home country supervisors*

Principle 23 : Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all respects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries

Principle 24: A key component of consolidated supervision is establishing contact and information exchange with various other supervisors involved, primarily host country supervisory authorities."

. In addition to monitoring activities and applying prudential norms of banking orgnanisations on consolidated basis parent supervisory authorities should ensure that parent bank is having adequate oversight over its branches as to compliance of internal controls, adequate information flows and periodical verification of information. Supervisors should ensure that bank has all needed expertise to conduct business at cross border establishments in safe and sound manner

Key component of consolidated supervision is establishing contact and information sharing with other supervisors especially host supervisory authorities. Contact is to be established at time of licensing and information sharing arrangements needs to be made. If arrangements for sharing of information cannot be agreed supervisors should prohibit expansion of operations which prevent information flow for adequate consolidated supervision.

Home supervisory authorities should allow expansion only when supervision by host authorities is adequate. If it is not adequate special additional measures like onsite examinations or additional information may be required to mitigate risks. If such steps are not adequate to give comfort closure of foreign establishment may be required.

"*..Obligations of Host country supervisors*

Principle 25: Banking Supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision."

Foreign bank operations should be subject to similar prudential, inspection and reporting requirements as domestic banks (recognizing, of course, obvious differences such as branches not being separately capitalized). As host supervisory authority only supervises limited part of overall operations it should determine that home country supervisor practices adequate consolidated supervision. Host supervisor should share information as to operations of foreign banks and give access to local offices and subsidiaries to the home supervisory authorities for consolidated supervision.

Supervision system of USA

Most of foreign banks in the USA, which are operating in wholesale markets, have virtually no presence in the retail banking. Through Offsite supervision and regular on site examinations, Federal and State regulators closely monitors the operations of each depository institution to evaluate both its financial soundness and it compliance with applicable statutes and regulations. FBSEA requires that each branch be examined on an annual basis by either a federal or state regulatory authority. Regulators employ a risk-focused examination and supervisory program for foreign bank operations in the United States called FBO supervision Program which focuses on an organizations principal risk and its internal systems, and processes for managing and controlling these risks

Each branch is inspected once in an 18 month period and is assigned ROCA rating assessing its "Risk Management, Operational Controls, Compliance, and Assets Quality. Rating is done 1 to 5 while 1 and 2 requires normal supervision. Foreign bank receives Strength of Support Ratings (SOSA) which considers overall financial viability of foreign bank as well as several external factors such as strength of management oversight and degree of supervision it receives from the home country supervisor, foreign banks financial condition, system of home country supervision, record of home country government support of banking system or other support and transfer of risk concern internal controls and compliance procedures of US operations. Ranking is from 1 to 3 where 1 is lowest supervisory concern while 3 is the highest. For subsidiaries, the US uses CAMELS ratings, with ratings from 1 to 5. The US considers information technology to develop risk assessment program. Banks critical systems i.e., that support major business activities and degree of reliance of those systems on information technology. If there are operational risks it can affect other risks.

Box: Foreign Bank Supervision and Challenges to Emerging Market Supervisors

The increased presence of foreign banks in a country's domestic banking system necessitates the development of effective cross-border prudential supervision where the consolidated supervision is the essential element. This paper presents foreign bank supervision in terms of division of responsibilities between the home and host countries, consolidated supervision, quality of home-country supervision, memoranda of understanding (MOUs), and "ringfencing" of banks. A number of challenges which foreign banks bring to emerging market banking supervisors are also discussed. The paper also provides surveys of country cases.

The paper concludes that as the presence of foreign-owned banks grows, the complexity of the tasks facing supervisory authorities increases. The challenges for emerging market supervisors include: (i) choosing of licensing policy and fitness and propriety test for management and owners of a complex holding company or investment funds; (ii) effectively monitoring the local establishment of large international banks or complex financial institutions; (iii) upgrading their supervisory capacity to oversee complicated financial products of foreign banks; (iv) dealing with the issue of the parent bank support in case of difficulties of a branch or subsidiary in normal as well as systemic crisis situations; (v) handling consolidated supervision in the event the market is heavily dependent on foreign banks; (vi) effectively exchanging information with the home supervisors in the case of bank holding companies or other complex financial institutions; (vii) dealing with increasing concentration in the banking system by foreign banks; and (viii) improving the governance structure of complex international banking groups while, among other things enhancing the integrity standards in the financial markets. These challenges should be resolved through more enhanced cooperation between home-and host-country supervisory authorities, as well as development of additional international best practices.

Reference: Song, Inwon (2004) Foreign Bank Supervision and Challenges to Emerging Market Supervisors, International Monetary Fund Working Paper WP/04/82, IMF.

Chapter IV: Recommendation

Based on the study a number of recommendations fall out:

Table 4.1: Recommendations

<table>
<tr><th></th><th>Description</th><th>Recommended Objectives</th><th>Remarks</th></tr>
<tr><td>1.</td><td>Legal</td><td>Ensure that there are adequate legal provisions to capture the activity of foreign bank braches.

Clearly differentiate wholesale activities of foreign bank branches.</td><td>Despite existence of special provision in the present Bank and Financial Institutions Ordinance (BAFIO) 2062 concerning opening of braches by foreign banks or financial institutions[17], it is recommended that LD explore further on this matter along with clearly differentiation activities of wholesale bank branches. Wholesale activities for collecting deposit and lending amount will be specified in directives.</td></tr>
<tr><td>2.</td><td>Application process</td><td>Produce an appropriate application form for foreign bank branches which should necessarily include the following information:
• Proposed Memorandum of Association, its Articles of Association and any other documents associated with its formation
• The proposed locations of the business and the branch offices of the applicant
• Essential specifications such as the amount of proposed capital; the amount of capital of the applicant to be subscribed by that owner, his substantial interests on other enterprises, and for each corporate owner the substantial interests of other persons in that owner.
• A business plan and strategy of the bank;
• The list of directors and chief executive of the legal entity and, for each of them should submit necessary documents;
• Documents such as audited balance sheets and profit and loss accounts showing the financial position of the parent bank.
• Written permission from the host central bank certifying that the bank is allowed to open up the branches as authorized by the Law verifying that the foreign bank has the valid license to operate banking business in Nepal.
• Develop a clear evaluation procedure, in this regard.</td><td>Development of appropriate application form and evaluation process by BFIRD in regard to foreign bank branches.

(Note: Draft of application form, profile and sample business plan provided in Annex 4.1 to 4.4) These forms are considered as bases and will be finalized while preparing policies in this regard.</td></tr>
</table>

[17] see especially the Articles 34 and 53

3	Regulation and directives	Produce appropriate regulation and directives for foreign bank branches which should ensure consistency with domestic financial institutions, and include information such as: • Any employee of a foreign bank branch, who knowingly approves, authorizes, executes or facilitates any act resulting in the transfer or export of any asset of a foreign bank branch from Nepal to any other country should be regarded as guilty of an offence by the Law. • Clearly specify aspects of wholesale branch banking such as minimum deposit; minimum lending; minimum capital etc. • Prioritize areas for lending such as to large projects in hydropower, infrastructure etc. • Ensure that fund transfer for interest rate should be consistent with NRB guidelines. • Specify single obligator limit, tied in with parent bank capital, and ensure that adequate safeguards are explored. • Tax implication and calculation method has to be explored. • Labor issues such as appointment of management ad local employees, will have to be clarified. • Expansion policy with regard to foreign bank branches will have to be developed. • Domestic financial sector saturation levels will have to be determined.	With considerations of objectives, it is required to develop of appropriate regulation and directives by BFIRD in regard to foreign bank branches.
4	Monitoring and supervision	Formats for quarterly information about operations of foreign bank branches as per country regulations and offsite quarterly review to be performed. Review of record of home country support in case of internationally active Banking organizations, level of transfer risks, adequacy of home country supervision framework and mechanism should be done at east annually on basis of data accumulated on discussions with management of FBO and supervisory authorities and other sources. Annual consolidated and audited financial statements to be reviewed by offsite to ensure stability of foreign bank including its capital adequacy by offsite supervision division. Commercial banks are inspected once in a financial year. This policy can be extended to the foreign branches also. Currently CAMELS rating is used for onsite, which is adopted from Federal Reserve Inspection Manual. Federal Reserve has also developed manual for inspection of foreign branches named "Examination manual for US Branches and	Formation of a taskforce in Bank Supervision Department coordinated with the BFIRD and HLC secretariat, to provide recommendations for an appropriate monitoring and supervision framework with regard to foreign bank branches.

		agencies of foreign banking organizations" which needs to be further studied to develop suitable supervision mechanism in Nepal after necessary amendments. Findings of offsite and onsite surveillance shall be informed to • foreign banks branches with instructions to place it before their head office • Home supervisory authority in case of very serious observations.	

Chapter V: Summary and Conclusion

Financial institutions play an important role in financial intermediation to efficiently allocate scarce funds – this will spurt economic growth and development. That is why the multilateral commitment by the Kingdom of Nepal for allowing foreign (wholesale) bank branches "as of" 1 January 2010 is of great interest to the Nepal Rastra Bank since it will facilitate sustainable economic development of the country. To ensure that the Bank is fully prepared to provide appropriate rules and regulations in this regard, the Bank's High Level Committee of WTO matters established the interdepartmental taskforce entitled - “Foreign Bank Branches and the Health and Stability of Nepal's Financial System".

This report by the taskforce is broken down into three parts: first, the taskforce collected information and examined the existing legal, regulatory and supervisory provisions in Nepal. Second, the taskforce made comparative analysis in this regard, for identified countries: two in south Asia (India and Sri Lanka) and two in East Asia (Indonesia and Philippines). Third, from this comparative analysis, the gaps were highlighted and recommendations were provided in terms of to legal, application process, regulation and directives and monitoring and supervision. While these are significant recommendations, it important to point out that this report should be considered simply as a first step in this essential process to provide those essential information to the Bank.

By ending, the taskforce would like to highlight the necessity for greater study on the aspect of supervisory provisions with regard to foreign bank branches. It goes without saying that adequate supervision of the financial system can mitigate and prevent financial crisis. However, the taskforce was unable to fully gather in the supervisory experiences of the identified countries, due to various constraints. Given the importance of having effective supervisory provisions, it is essential that this aspect be examined seriously.

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Annexes

Annex (Technical) 1.1:

Domestic Legal Provision Regarding Banking Sector [A Critical Analysis of what does or what does not allow]

Nepal Rastra Bank Act 2002 replaced Nepal Rastra Bank Act 1955. In the new enacted law, objectives of the NRB are clearly incorporated which are as follows:

To formulate necessary monetary and foreign exchange policies in order to maintain the stability of price and balance of payment for sustainable development of economy, and manage it;

(b) To promote stability and liquidity required in banking and financial sector;

(c) To develop a secure, healthy and efficient system of payment;

(d) To regulate, inspect, supervise and monitor the banking and financial system; and

(e) To promote entire banking and financial system of the Kingdom of Nepal and to enhance its public credibility.

NRB shall have powers to regulate the functions and activities of commercial banks and financial institutions and it may inspect and supervise them.

Bank and Financial Institution Ordinance, 2062, which is popularly known as Umbrella Act, has recently been enacted in unified form. The ordinance governs the functional aspect of Banks and Financial Institutions. Some of the important provisions in the ordinance regarding the banking sector have been analyzed in this chapter as follows:

a. <u>Incorporation of Bank or Financial Institution</u>: Any person wishing to incorporate a Bank or Financial Institution to carry on financial transactions should incorporate a Bank or Financial Institution as a registered public limited company under the prevailing law of Nepal with prior approval of Nepal Rastra Bank by fulfilling the conditions prescribed in section 4 of the ordinance.

b. <u>Permission to establish Bank or Financial Institution (section 4)</u>: The individual desiring for the incorporation is required to submit an application to NRB for prior approval with the following documents:

- Memorandum of Association of proposed Bank or Financial Institution,
- Article of Association of proposed Bank or Financial Institution,
- Report of the Feasibility study conducted by the form prescribed by NRB,
- Biographic information of promoters in the form prescribed by NRB,
- A certified copy of an agreement, if any, which has been concluded among the promoters before the establishment of such Bank or Financial Institution,
- Proof of payment of tax of previous fiscal years, and
- Any other document or condition prescribed by NRB.

The NRB is required to conduct necessary investigation and grant permission to establish a Bank or Financial Institution within 120 days with or without terms or conditions if all the criteria are met and information of disapproval with reason is also to be given to the concerned person in case the application is denied. Similarly, any Foreign Bank or Financial Institution wishing to establish a Bank or Financial Institution by making joint venture investment with a corporate body incorporated in Nepal or with a Nepali citizen or as a subsidiary company with 100% share is eligible to furnish the application to establish a bank or financial institution. However, the ordinance is silent about the percentage of equity investment, such foreign corporate body can invest. It has been regulated by bank regulation till now up to 75%.

c. Financial transaction limited to Bank or Financial Institution: The ordinance prohibits anybody to conduct financial transaction except an established Bank or Financial Institution and no Bank or financial Institution can use the proposed name for the purpose of carrying financial transaction without obtaining license from NRB.

d. Application for license to conduct financial transaction: The Bank or Financial Institution desiring to conduct financial transaction must submit an application for license to the NRB in the prescribed form including the prescribed fees and the following documents and description:

- Memorandum of Association, Article of Association, Certificate of Incorporation as a company,
- Description of all necessary infrastructures,
- Biographic information of the Chief Executive and other Administrators,
- Bye-laws relating to employees, Financial and administrative regulation,
- Credit policy,
- Proof of full payment promised by the promoters,
- Any other documents and description as prescribed by NRB from time to time.

The Bank or Financial Institution wishing to get the license from the NRB to conduct financial transactions should mention the following things in the application:

- During the operation of financial transaction, maintaining of minimum capital as prescribed by NRB from time to time,
- The fact that the proposed Bank or Financial Institution has to show to the full satisfaction of the NRB that it has the necessary infrastructure developed in order to operate financial transactions and to provide service and facilities,
- The proposal relating to provision of operation modalities and transaction methods submitted by Bank or Financial Institution pertaining to their financial transaction will ensure protection of right and interests of depositors through the operation of such financial transaction on regular basis,
- The agreement to abide by the rules set by the NRB regarding conducting financial transaction.

e. License for operating financial transaction: Nepal Rastra Bank will grant license if it is satisfied with the basic physical infrastructure of the bank or financial institution; if:

- The issuance of license for operating financial transaction will promote healthy and competitive financial intermediary and protect the interest of the depositors,
- The applicant is competent to operate financial transaction in accordance with the provision of this ordinance and its regulation, directives, order or provisions of Memorandum and Article of association,
- There are sufficient grounds to believe that the entity is competent to operate financial transaction.

f. Classification of the licensed institutions: The NRB will classify the institutions into "A" "B" "C" "D" groups on the basis of the minimum paid-up capital and provide the suitable license to the Bank or Financial Institution. The NRB is authorized to determine minimum paid-up capital of the licensed Bank or Financial Institution time to time.

g. NRB's authority to deny license and impose conditions: The NRB is in full power to deny license for financial transaction if the conditions stipulated in section 32 are not met and it is also authorized to impose necessary conditions taking into account the existing financial position of the Bank or Financial Institution, the interest of depositors and healthy operation of financial transaction. Similarly, the NRB may increase, decrease or modify the terms and conditions time to time.

h. Special provision for Foreign Bank or Financial Institution to open their office: A foreign Bank or Financial Institution desiring to open its office within the Kingdom of Nepal must submit an application to NRB in the form as prescribed along with the fees and particulars as prescribed. The NRB may issue a license to foreign Bank or Financial Institution to carry on financial transaction by allowing them to open a office within the Kingdom of Nepal taking into account the situation of competition existing in the banking sector, the contribution that could be rendered in the Nepalese banking sector and the reputation of such foreign Bank or Financial Institution.

The NRB may specify necessary terms and conditions in the course of granting transaction license and it shall be the duty of the Foreign Bank or Financial Institution to comply with such terms and conditions. The section 34(4) of the ordinance reiterates that the provisions of the ordinance are to be complied by such foreign Bank or Financial Institution. The foreign Bank or Financial Institution, which has been issued license to operate financial transaction by opening its office within the Kingdom of Nepal, can not open another Bank or Financial Institution in Joint Venture within the Kingdom of Nepal. However, the provision for the contact or representative office of any foreign Bank or Financial Institution will be as prescribed by Nepal Rastra Bank.

i. Provision for canceling or suspending license: The NRB can suspend the license of the license holder for a specific period of time issued for the purpose of carrying financial activities or it may order the Bank or Financial institution to close the operation of their office partially or fully if such a license holder acts against the provisions of the Nepal Rastra Bank Act, 2002, or the regulation made there under or fails to act in accordance with the order or directives issued by it or fails to act for the welfare and in the interest of the depositors.

The NRB may cancel the license issued under this ordinance to carry on the financial transactions of the license holder under the following circumstances, if:

- The license holder itself submits an application for the cancellation of its license.
- Fails to conduct the business of financial transaction even after 6 months of issuance of license.

- If it stops financial transaction for more than one month continuously,
- Operates financial transaction against the welfare and interest of the depositors.
- Acts in contravention of NRB Act 2002 or the regulation or byelaws made there under.
- Violates the terms and conditions prescribed by the NRB.
- Fails to act in accordance with the order or directives issued by the NRB.
- Has been declared insolvent.
- The applicant Bank or Financial institution is found to have obtained license by providing false particulars.
- If a bank or financial institution is merged with the other Bank or Financial institution.
- Application is submitted by Bank or Financial institution to Rastra Bank for the cancellation of its license, the NRB must decide on such application within 45 days of receiving the application.

j. Provision for upgrading or degrading the class of licensed institution: The bank or financial institution can be upgraded if:

- the authorized capital is enough for upper class
- the institution has been able to make profit for last five years,
- the non-performing asset is within the prescribed limit.

The bank or financial institution can be degraded if:

- it fails to meet prescribed capital within the time period
- it has been making loss for last five years
- it has violated the directives of Rastra Bank time and again
- it failed to maintain Risk Management Fund as prescribed by the Rastra Bank.

The NRB will make necessary investigation and avail opportunity to clarify before taking such decisions.

k. Provision about capital: The authorized, issued and paid up capital of a license holder institution will be as prescribed by NRB from time to time. The NRB can issue directives to the license holder entity to increase its authorized, issued and paid-up capital if it deems necessary. Similarly, the license holder entity must maintain a capital fund according to ratio prescribed by NRB based on the basis of its total asset or risk weighted assets, and other transactions.

At the same time, the license holder entity must maintain a risk fund according to ratio prescribed by NRB based on the basis of liability relating to its total asset and the other risk to be borne from off balance sheet transaction. The license holder entity must maintain general reserve fund regularly every year till the amount becomes double of the paid up capital of such entity.

l. Financial transaction by license holding entity: The section 47 of the ordinance prescribes functions of the bank or financial institutions. The entities functioning under sub-section (1) only can keep their name as bank of class "A" category. The function of such bank are as follows:

- To accept deposit with or without interest and make payment of such deposit amount
- To provide loan as prescribed by NRB only
- To operate transactions in foreign exchange, subject to prevailing laws of Nepal
- To operate loan for hire purchase, hypothecation, leasing, housing and service oriented business.
- Subject to the directives of Nepal Rastra Bank, to carry on Merchant Banking Transaction
- To provide loans on the basis of co-financing according to the agreement concluded among the license holding entity so as to divide the collateral on paripassu.
- To issue Bank guarantees on behalf of its customers, have such customers execute necessary bonds in consideration thereof, obtain security, and acquire their movable or immovable assets as collateral or on mortgage, or the assets of third individuals as collateral
- To provide loans against the guarantee provided by any local or foreign bank or financial institution
- To issue, accept, redeem, endorse discount, purchase or deal in letter of credit, bill of exchange, promissory notes, cheques, drafts, traveler's cheques or any other financial instrument.
- Subject to the directives of NRB, to accept, make payment or transfer deposit through telephone, telex, fax, computer or magnetic tape or any other types of electronic devices or instrument.
- Subject to the directives of NRB, to issue and accept credit card, debit card, charge card including other financial instruments and to appoint an agent to perform such activities
- To accept, make payment or provide loan by using automated teller machine or cash dispensing machine.
- To grant overdraft to the person trusted by it
- To provide a fresh loan in the lump sum or in installments against the security of the same movable or immovable assets which have already been pledged with itself or other license holding entity, to the extent of the total value of such security.
- Subject to condition specified by NRB, to work as an agent of the NRB to perform government transaction and similar other transactions on behalf of His Majesty's Government.
- To remit or transmit amount to different places within or outside of the Kingdom of Nepal through bill of exchange, cheques, or hundis through other electronic device or arrange for the sale or purchase of bullion, shares, debenture and bond etc.. and collect dividends accruing on the shares and interest on promissory notes, debentures, bonds etc.
- To accept and arrange for the sale or purchase of shares, debentures, securities and collect interest, dividends of securities of limited company in the capacity of a commission agent on behalf of customers, and remit or transmit such interests, dividends to places within or outside of the Kingdom of Nepal

- To purchase, sale or accept the securities issued by His Majesty's government or Rastra bank.
- To arrange for safe deposit vaults
- To undertake off balance sheet operations subject to the conditions specified by the NRB
- To provide loans not exceeding the amount specified by the NRB to low-income families, poor class, and natural disaster-affected people with the provision of individual or collective responsibilities.
- To exchange between the NRB and license holding entity the particulars, information or notices regarding debtors or customers who have obtained loans or any other facilities from the license holding entity.
- To provide bank guarantee for loans to be made available by other license holding entity to its clients.
- Subject to the limitation set by NRB, to mobilize capital through shares, debentures, loan bond, saving bond or any other financial instrument.
- To obtain refinance loans from NRB, or supply loan to other license holding entity or obtain loan from them, according to need.
- To conduct or make arrangements for conducting studies, research, and surveys in respect to the establishment, operation and evaluation of projects, and provide training or consultancy service and other information.
- To distribute in the form of loans, fund received from His Majesty's government or any other domestic or international agency for the purpose of promoting project.
- To prescribe conditions and conclude agreement according to need so as to protect its interest while conducting transaction with or advancing loans to any entity or transacting with any individual
- To obtain loans against the security of its movable or immovable assets
- Subject to bylaws made by the committee, to underwrite the loan
- To make proper arrangements of its assets or to sell them.
- To perform any other functions as prescribed by NRB.

m. Function which license holding entity can not perform: No License Holding Entity shall perform any of the following functions:

- To purchase or sell goods with commercial motives or make investment in immovable property unless required holding for such property for its own use. However, license holding entity of class "B" and "C" may purchase or sell immovable asset or managing such property for the purpose of performing their business.
- To provide loans against the security of its own shares.
- To provide loans of facilities of any kind to the Promoter, Director, person holding more than 1 percent of shares, Executive chief or any member of undivided family of such person or any firm, company or corporate body which is entitled to nominate Director.
- To provide loans of facilities of any kind to any firm, company or corporate body in which the Promoter, Director or any member of his undivided family or the Executive

Chief functioning as Director or Managing Agent, or person holding more than 1 percent of shares or in which any such person or form, company, corporate body or individual who is entitled to nominate Director, has financial interest.

- To provide loan, guarantee or facilities for an amount exceeding the percentage of its capital fund specified by the Rastra Bank to a single customer, company or companies belongs to one group, partnership firm except as permitted by the Rastra Bank.
- To provide loan against the personal guarantee of promoter, director or chief executive officer.
- To invest against the security of shares of any entity who has obtained license from Rastra Bank to perform financial transaction.
- To invest money on the share of other license holding entity exceeding the limit imposed by Rastra Bank.
- To carry on those functions in collaboration among or between the license holding entities for the purpose of creating their monopoly and business under their control.
- To engage in manipulative devices or practices to create artificial paucity in the competitive environment of financial sector for unfair advantage for them.
- To work against the business prohibited by the NRB.
- To work anyway for saving or in favor of the person/institution earning money illegally so that he could be saved from punishment or blame.

Annex 3.1

Basel Committee Guidelines

Sharing of Information

In connection with the authorization process, and in accordance with the core principles:

(a) The host supervisors should notify the home supervisors, without delay of applications for approval to establish offices or make acquisitions in the host jurisdiction.

(b) Upon request, the home supervisor should notify the host supervisor whether the applicant bank is in compliance with banking laws and regulations and whether the bank may be given its administrative structure and internal controls to manage the cross border establishment in an orderly manner. The home supervisor should also, upon request, assist the host supervisor by verifying or supplementing any information submitted by the applicant bank.

(c) The home supervisor should inform the host supervisor about the nature of the regulatory system and consolidated supervision over the applicant bank. Similarly, the host supervisor should indicate the scope of its supervision and indicate any specific features that might give rise to the need for special arrangements.

(d) To the extent permitted by law, home and host supervisors should share information on the fitness and properness of prospective directors, managers, relevant shareholders of the cross border establishment.

In case of on going supervision of cross border establishments supervisors from home and host countries should do the following:

(a) provide relevant information to their counterpart regarding material developments or supervisory concerns in respect of operations of a cross border establishments.

(b) Provide information on their respective regulatory systems and major changes, in particular, those which have significant bearing on the activities of cross border establishments.

(c) Inform their counter part of penalties imposed or enforcement actions taken, against a cross-border establishment.

(d) Facilitate transmission of any other relevant information that might be required to assist with the supervisory process.

Onsite Inspections

The statement should recognize that cooperation is particularly useful to the supervisors in assisting each other in carrying out on-site inspections of cross border establishments in the host country. The home supervisor should notify the host supervisor of plans to examine a cross-border establishment and to indicate the purpose and scope of the visit. The host supervisor should allow the home supervisor or its delegated agent to conduct onsite inspections. As may be mutually agreed between the parties, examinations may be carried out by the home supervisor alone or accompanied by the host supervisor. Following the inspection, an exchange of views should take place between the examination team and host supervisor.

Protection of Information

The statement should recognize that mutual trust between supervisory authorities can only be achieved if exchanges of information can flow with confidence in both directions. The supervisor receiving the information must provide the assurance that all possible steps will be taken to preserve the confidentiality of the information received.

Ongoing coordination

The statement should recognize that visits for information purposes and exchanges of staff may promote cooperation between supervisors.

Annex 4.1

Application by a foreign bank to Nepal Rastra Bank for grant of license to open its branch in Nepal (Proposed)

I. General Information

1. Name of the applicant bank:
2. Place and date of incorporation;
3. Address of Head Office:

II. Ownership & Management

1. List of names and addresses of directors and their qualifications and principal business

Name & address	Qualifications	Principal Business

2. Details of shareholders holding 10 per cent or more of voting stock and their principal business
3. Name of the Chief Executive Officer
4. Name & designation of senior official at Head quarters that will be responsible for the bank's operations in Nepal

III. Structure

1. Organizational chart showing subsidiaries and associated companies
2. Countries in which the bank and its subsidiaries operate
3. No. of domestic and overseas branches

IV. Financial Position

1. Highlights of financial position of the bank based on last three years financial statements
2. Capital adequacy ratio as per BIS standards indicating Tier -1 and Tier - II capital separately
3. Ranking in home country and global ranking
4. Credit ratings by international credit rating agencies

V. Supervisory Arrangements

1. Details of supervisory arrangements to which the bank is subject in its country of origin.
2. Home country regulations on entry of foreign banks.

VI. Details of existing relationship with Nepal

1. Details of correspondent banking relationships with Nepalese banks and the aggregate amount of lines of creditor other limits extended to them.
2. Details of foreign currency loans extended to Nepalese companies and other types of business transacted.
3. Other (if any)

VII. Details of proposed branch operations in Nepal

1 Location of branch:

2. Details of proposed initial capitalization:

3. Number of expatriate officials proposed to be posted in Nepal
4.Purpose of opening the branch in Nepal the benefits to the different sectors in the Nepalese community and activities proposed to be undertaken

VIII. Documents to be enclosed

1.Copies of Memorandum Articles of Association or similar documents
2.Last three years financial statements
3. A brief business plan/feasibility study

Annex 4.2

Personal Profile of the person to hold the top management position of a branch of foreign bank to be established

1. Same/Family Same (1) Name (in Nepali) ....(Maiden Name__....
   (2) Name (in English) ....
   (3) Name (in other language...

2.Year of Birth..................Age.............Years..........
3.Natoinality...
4. Contact Address Number.....................Street.... District

5. Marital Status
   (1) Spouse Name...(Maiden Name...............;.......................)
   (2) Number of Children....................... (If a child becoms Work, specify place of work):
      2.1 Name: _______________ Year of Birth:
      Place of Work
      Position
      2.2 Name: _______________ YearoFBirth:

      2.3 Name: _______________ Year of Birth:
      Place of Work
      Position

6. Education Background

Institution	***Degree and Subject***	***Year of Graduation***
_______________	_______________	_______________
_______________	_______________	_______________
_______________	_______________	_______________

7. Work Experience

8. Major Responsibilities taking the past.

Organization	Position	From-To (years)	Reason for leaving
_______________	_______________	_______________	_______________
_______________	_______________	_______________	_______________
_______________	_______________	_______________	_______________
_______________	_______________	_______________	_______________

9. Current Positions in other Businesses or Sodal Activities

Company/ Institution, ,	Location	Position
_______________	_______________	_______________
_______________	_______________	_______________
_______________	_______________	_______________
_______________	_______________	_______________
_______________	_______________	_______________
_______________	_______________	_______________

10. Specify equity holding in other financial institutions where the holding is at least 10 percent of total shares as of the application date, or information on senior management positions held in other financial institutions
....
....
....

11. 1 do certify that I have all the qualifications and none of the forbidden characteristics as specified in the Bank and Financial Institution ordinance,2062 and prevailing law of Nepal of the Notification of Nepal Rastra Bank Rules, Procedures, and Conditions for Establishing a Branch of Foreign Bank.
Enclosed herewith are a photocopy of personal identification card (or a photocopy of a passport for foreigners) and certificates of academic qualifications.
I certify that the information provided above is true and the supporting documents submitted herewith are authentic.

Signature...(Owner of the Record)

Date. ..../...................../ year.................

Signature.....................................(Director with the Company's Power of Attorney)

(..........................,,...)

Company Seal (if any)

Date. ...._J............./ year.................

Annex 4.3

Sample: Business plan of the branch of foreign bank

1. Business strategy
    1.1 Vision, direction, and objective of the business
    1.2 Business base and main products
    1.3 Target customer base
    1.4 Competition strategy
2. Overall target and expansion of commercial bank that is a branch of foreign bank
3. Business plan
    3.1 Credit extension
    3.2 Other investments
    3.3 Target and expansion
    3.4 Provisioning policy
4. Competitiveness analysis
    4.1 Analysis of overall economic conditions and each industry sector
    4.2 Analysis of strength, weakness, opportunity, and threat (SWOT)
5. financial data and key assumptions in the formulation of the financial plan e.g. GDP (%), inflation rate (%), range of lending rates (%), range of deposit rates (%)

Annex 4.4

Application for Operating License for a Branch Office of a Foreign Bank

.... Bank Limited

Nepal Rastra Bank
Central Office

Banks and Financial Institution Regulation Department

Subject: Application for Operating License for a Branch Office of a Foreign Bank

In reference to the approval in principle of Nepal Rastra Bank number....................... dated .... we the undersigned,

Name of bank
Address of Branch Office

Herewith submit an application for an operating license for a Branch Office for our Bank.

To complete the requirements for this application, we enclose the following documents:

1. List of composition of Branch Office Management, with the required documents attached.
2. Organizational structure and working systems and procedures, including composition of personnel.
3. Photocopy of deposit slip equivalent to Rs. .... (..................) to Nepal Rastra Bank, as proof of payment in full of the required Operating Funds.
4. Proof of operational readiness, including the following:
    a. list of fixed assets and inventory;
    b. proof of ownership, control, or leasing agreements for office premises;
    c. photograph of office building and layout of office space;
    d. specimen forms/nuts/slips etc.
    e. Taxpayer Identification Number (PAN) and Corporate Registration;

5. Personal statements by the Branch Office Management, that they do not hold concurrent positions.

We express our gratitude for your approval.

Signature

....

(Director with the Company's Power of Attorney)

(____________)
Company Seal (if any)

Members of Nepal Rastra Bank Task Force on Foreign Bank Branches and the Health and Stability of Nepal's Financial System

Coordinator:	Director *Mr. Bhisma Raj Dhungana*, Bank and Financial Institutions Regulation Department
Member	Deputy Director *Mr. Bhimananda Dhungana*, Legal Division
Member	Deputy Director *Dr. Nephil Matangi Maskay*, Research Department (Special Studies Division)
Member	Deputy Director *Mr. Chiranjibi Chapagain*, Bank and Financial Institutions Regulation Department
Member	Assistant Director *Ms. Meena Pandey*, Bank Supervision Department
Member-Secretary	Assistant Director *Mr. Satyendra Raj Subedi*, Research Department (Special Studies Division)