Capital Adequacy Framework

2007

Nepal Rastra Bank

Accord Implementation Group

FOREWORD

Risk-taking is a necessary element of a dynamic market-based economy. As banking by nature is a risk taking business, optimal failure rate in this sector can hardly be zero. Banks, in order to increase their market share and revenue base, willingly or unwillingly endure some risks. The nature and extent of these risks could potentially bring a bank down on its knees. Thus, the onus today is truly on the risk management function in banks.

Though the primary responsibility for the safe and sound operation of banking lies with the individual banking organization, supervisory authority of the banks should not lag behind in playing key role in critically reviewing bank operations and encouraging the development of the necessary risk management and control mechanisms. With this broad objective, the Basel Committee on Bank Supervision has released the "International Convergence of Capital Measurements and Capital Standards: Revised Framework", popularly known as Basel II, on June 26, 2004. This framework was updated in November 2005 and a comprehensive version of the framework was issued in June 2006.

Basel II aims to build on a solid foundation of prudent capital regulation, supervision, and market discipline, and rewards better risk management in banks. It is fundamentally about better risk management and corporate governance on the part of banks, as well as improved banking supervision and greater transparency. It is also about increasing the stability of the global financial system, to the benefit not only of banks, but also consumers and businesses. The new capital framework attempts to achieve these objectives with three mutually reinforcing pillars; minimum capital requirements; supervisory processes and market discipline.

Nepal Rastra Bank (NRB) is committed to adopt the best supervisory methods and practices. In line with this commitment, NRB has decided to move ahead with the implementation of capital accord in Nepal. However, as the Nepalese banking sector is yet to gain the maturity the advance approaches prescribed for the sophisticated banks in international markets are largely impractical in our context. Thus, the prescribed approaches have been customized and thereby simplified to suit the need of our market condition.

Consistent with the International convergence of capital measurements and capital standards, this framework also builds around three mutually reinforcing pillars, viz. minimum capital requirements for credit risk; operational risk and market risk, review process and disclosure requirements. This framework has been prepared after thorough discussion with the stakeholders as well evaluation and assessment of impact studies conducted at various phases. In order to further smoothen the transition to this framework a parallel run has been contemplated during the whole year in 2007/08.

I would like to take this opportunity to express my gratitude to the members of the "Core Committee for Basel II implementation in Nepal" for their guidance and direction. I would also like to thank all the past and present members of the Accord Implementation Group (AIG) for their invaluable contribution in drafting this framework. Last; but not the least; I would like to thank Nepal Bankers Association, The Institute of Chartered Accountants of Nepal, banks and their representative and all other persons for their valuable effort.

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1. INTRODUCTION

1.1 BACKGROUND:

Prior to 1988, there was no uniform international regulatory standard for setting bank capital requirements. In 1988, the Basel Committee on Banking Supervision (BCBS)[1] developed the Capital Accord, which is known as Basel I, to align the capital adequacy requirements applicable especially to banks in G-10 countries. Basel I introduced two key concepts. First, it defined what banks could hold as capital, as well as designating capital as Tier 1 or Tier 2 according to its loss-absorbing or creditor-protecting characteristics. The second key concept introduced in Basel I was that capital should be held by banks in relation to the risks that they face. The major risks faced by banks relate to the assets held on balance sheet. Thus, Basel I calculated banks' minimum capital requirements as a percentage of assets, which are adjusted in accordance to their riskiness and assigning risk weights to assets. Higher weights are assigned to riskier assets such as corporate loans, and lower weights are assigned to less risky assets, such as exposures to government.

The BCBS released the "International Convergence of Capital Measurements and Capital Standards: Revised Framework", popularly known as Basel II, on June 26, 2004. This framework was updated in November 2005 and a comprehensive version of the framework was issued in June 2006. Basel II builds significantly on Basel I by increasing the sensitivity of capital to key bank risks. In addition, Basel II recognizes that banks can face a multitude of risks, ranging from the traditional risks associated with financial intermediation to the day-to-day risks of operating a business as well as the risks associated with the ups and downs of the local and international economies. As a result, the new framework more explicitly associates capital requirements with the particular categories of major risks that banks face.

The new capital framework also recognizes that large, usually internationally active banks have already put in place sophisticated approaches to risk measurement and management based on statistical inference rather than judgement alone. Thus, the framework allows banks, under certain conditions, to use their own 'internal' models and techniques to measure the key risks that they face, the probability of loss, and the capital required to meet that loss. In developing the new framework, the Basel Committee wanted to incorporate many elements that help promote a sound and

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[1] The Basel Committee on Banking Supervision is a committee of banking supervisory authorities that was established by the central bank governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. It usually meets at the Bank for International Settlements in Basel, Switzerland where its permanent Secretariat is located.

efficient financial system over and above the setting of minimum capital requirements. With this in mind, the Basel II framework incorporates three complementary ‘pillars’ that draw on the range of approaches to help ensure that banks are adequately capitalised in commensurate with their risk profile.

The Basel Committees on Banking Supervision's (BCBS) recommendations on capital accord are important guiding framework for the regulatory capital requirement to the banking industry all over the world and Nepal is no exception. Realizing the significance of capital for ensuring the safety and soundness of the banks and the banking system, at large, Nepal Rastra Bank (NRB) has developed and enforced capital adequacy requirement based on international practices with appropriate level of customization based on domestic state of market developments. The existing regulatory capital is largely based on the Basel committee's 1988 recommendations.

With a view of adopting the international best practices, NRB has already expressed its intention to adopt the Basel II framework, albeit in a simplified form. In line with the international development and thorough discussion with the stakeholders, evaluation and assessment of impact studies at various phases, this framework has been drafted. This framework provides the guidelines for the implementation of Basel II framework in Nepal. Reminiscent of the International convergence of capital measurements and capital standards, this framework also builds around three mutually reinforcing pillars, viz. minimum capital requirements, supervisory review process and disclosure requirements.

1.2 OBJECTIVE:

The main objective of this framework is to develop safe and sound financial system by way of sufficient amount of qualitative capital and risk management practices. This framework is intended to ensure that each commercial banks maintain a level of capital which,

(i) Is adequate to protect its depositors and creditors.

(ii) Is commensurate with the risk associated activities and profile of the commercial bank.

(iii) Promotes public confidence in the banking system.

1.3 PRE-REQUISITES:

The effective implementation of this framework is dependent on various factors. Some such pre-requisites are:

(i) Implementation of Basel Core Principles for effective Banking Supervision

(ii) Adoption of the sound practices for the management of Operational Risk

(iii) Formulation and adoption of comprehensive risk management policy

(iv) Adherence to high degree of corporate governance

1.4 RESPONSIBILITY:

The board of directors of each bank shall be responsible for establishing and maintaining, at all times, an adequate level of capital. The capital standards herein are the minimum that is acceptable for banks that are fundamentally sound, well managed, and which have no material financial or operational weaknesses. Thus, the banks are generally expected to operate above the limits prescribed by this framework.

1.5 SCOPE OF APPLICATION:

This framework shall be applicable to all "A" Class and National level "B" Class financial institutions (hereinafter jointly referred to as banks), licensed to conduct banking business in Nepal under the Bank and Financial Institution Act, 2063.

This capital adequacy framework shall be applicable uniformly to all "A" class financial institutions and national level "B" class financial institutions on a stand-alone basis and as well as on a consolidated basis, where the bank is member of a consolidated banking group. For the purpose of capital adequacy, the consolidated bank means a group of financial entities, parent or holding company of which a bank is a subsidiary. All banking and other relevant financial activities (both regulated and unregulated) conducted within a group including a bank shall be captured through consolidation. Thus, majority owned or controlled financial entities should be fully consolidated. If any majority owned subsidiaries institutions are not consolidated for capital purposes, all equity and other regulatory capital investments in those entities attributable to the group will be deducted and the assets and liabilities, as well as third party capital investments in the subsidiary will be removed from the bank’s balance sheet for capital adequacy purposes.

1.6 APPROACHES TO IMPLEMENTATION:

"International Convergence for Capital Measurements and Capital Standards: Revised Framework" alias Basel II under Pillar 1, provides three distinct approaches for computing capital requirements for credit risk and three other approaches for computing capital requirements for operational risk. These approaches for credit and operational risks are based on increasing risk sensitivity and allow banks to select an approach that is most appropriate to the stage of development of bank's operations.

The product and services offered by the Nepalese Banks are still largely primitive and conventional, in comparison to other economies. This coupled with the various inherent limitations of our system like the absence of credit rating agencies makes the advanced approaches like Internal Ratings Based Approach or even

Standardized Approach impractical and unfeasible. Thus, at this juncture, this framework prescribes Simplified Standardized Approach (SSA) to measure credit risk while Basic Indicator Approach and an indigenous Net Open Position Approach for measurement of Operational Risk and Market Risk respectively.

1.7 EFFECTIVE DATE:

All banks within the scope of this framework should adopt the prescribed approaches by Mid July 2008 (Fiscal Year 2065/066).

1.8 PARALLEL RUN:

In order to ensure a smooth transition to new approach prescribed by this framework, a parallel run for the whole year from Mid July 2007 (Fiscal Year 2064/065) has been envisioned. During this period, besides fulfilling the responsibilities under the prevailing directives, banks shall be required to compute their capital adequacy requirements, based on this framework, on a quarterly basis. The so arrived result should be reported to their respective board of directors as well as to the Nepal Rastra Bank in the prescribed formats. Any shortfall in the capital adequacy requirement in accordance with this framework shall not constitute a default during this review period. However, the failure to submit the returns stipulated in this framework shall constitute non-compliance.

1.9 IMPLEMENTATION OF ADVANCED APPROACHES:

This framework prescribes the most simplest of the available approaches at the initial phase with a vision to move onto more complex and risk sensitive approaches as the market gradually gains maturity. However, banks willing to adopt advanced approaches, even for internal purposes, should obtain prior written approval from Nepal Rastra Bank on providing evidences that they have the resource and the capability to adopt the proposed approaches.

A bank will not be allowed to choose to revert to a simpler approach once it has been approved for a more advanced approach without supervisory approval. However, if a supervisor determines that a bank using a more advanced approach no longer meets the qualifying criteria for advanced approach, it may allow the bank to revert to a simpler approach for some or all of its operations, until it meets the conditions specified by the supervisor for returning to a more advanced approach.

2. ELIGIBLE CAPITAL FUNDS

2.1 DEFINITION OF CAPITAL:

Qualifying capital consists of Tier 1 (core) capital and Tier 2 (supplementary) capital elements, net of required deductions from capital. Thus, for the purpose of calculation of regulatory capital, banks are required to classify their capital into two parts as follows;

a. Core Capital (Tier 1)

The key element of capital on which the main emphasis should be placed is the Tier 1 (core) capital, which comprises of equity capital and disclosed reserves. This key element of capital is the basis on which most market judgments of capital adequacy are made; and it has a crucial bearing on profit margins and a bank's ability to compete.

The BCBS has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings.

In order to rank as Tier 1, capital must be fully paid up, have no fixed servicing or dividend costs attached to it and be freely available to absorb losses ahead of general creditors. Capital also needs to have a very high degree of permanence if it is to be treated as Tier 1.

b. Supplementary Capital (Tier 2)

The Supplementary (Tier 2) Capital includes reserves which, though unpublished, have been passed through the profit and loss account and all other capital instruments eligible and acceptable for capital purposes. Elements of the Tier 2 capital will be reckoned as capital funds up to a maximum of 100 percent of Tier 1 capital arrived at, after making adjustments referred to in 2.4. In case, where the Tier 1 capital of a bank is negative, the Tier 2 capital for regulatory purposes shall be considered as zero and hence the capital fund, in such cases, shall be equal to the core capital.

2.2 ELEMENTS OF TIER 1 CAPITAL:

a. Paid up Equity Capital.

b. Irredeemable non-cumulative preference shares which are fully paid-up and with the capacity to absorb unexpected losses. These instruments should not contain any clauses, which permit redemption by the holder or issuer upon fulfillment of certain condition. Banks should obtain prior approval of NRB for this kind of instruments to qualify as a component of core capital.

c. Share Premium
d. Proposed Bonus Equity Share
e. Statutory General Reserve.
f. Retained Earnings available for distribution to shareholders.
g. Un-audited current year cumulative profit, after all provisions including staff bonus and taxes. Where provisions are not made, this amount shall not qualify as Tier 1 capital.
h. Capital Redemption Reserves created in lieu of redeemable instruments.
i. Capital Adjustment reserves created in respect of increasing the capital base of the bank.
j. Dividend Equalization Reserves.
k. Other free reserves
l. Any other type of reserves notified by NRB from time to time for inclusion in Tier 1 capital

2.3 ELEMENTS OF TIER 2 CAPITAL:

a. Cumulative and/or redeemable preference shares with maturity of five years and above.
b. Subordinated term debt fully paid up with a maturity of more than 5 years; unsecured and subordinated to the claim of other creditors, free of restrictive clauses and not redeemable before maturity. Since, subordinated term debt is not normally available to participate in the losses; the amount eligible for inclusion in the capital adequacy calculations is limited to 50% of core capital. Moreover, to reflect the diminishing value of these instruments as a continuing source of strength, a cumulative discount (amortization) factor of 20% per annum shall be applied for capital adequacy computations, during the last 5 years to maturity. The banks should obtain written approval of NRB for including any subordinated debt instruments (like Debenture/Bonds) in supplementary (Tier-2) capital.
c. Hybrid capital instruments. Those instruments which combine certain characteristics of debt and certain characteristics of equity. Each such instrument has a particular feature, which can be considered to affect its quality as capital. Where these instruments have close similarities to equity, in particular when they are able to support losses on an ongoing basis without triggering liquidation, they may be included in Tier 2 capital.
d. General loan loss provision limited to a maximum of 1.25% or total Risk Weighted Exposures. The loan loss provision in respect of the rescheduled/restructured loans and specific loan loss provision in respect of Non Performing Assets shall not be included under this category. However,

provisions created in excess of the regulatory requirements or provisions which is not attributable to identifiable losses in any specific loans shall be allowed to be included in the General Loan Loss Provision and shall be eligible for Tier II capital subject to a maximum of 1.25% of total risk weighted exposures. Banks shall be required to disclose the cases where additional provisions have been made.

e. Investment adjustment reserves created as a cushion for adverse price movements in bank's investments.

f. Revaluation reserves often serve as a cushion against unexpected losses but may not be fully available to absorb unexpected losses due to the subsequent deterioration in market values and tax consequences of revaluation. Therefore, revaluation reserves will be eligible up to 50% for treatment as Tier 2 capital and limited to a maximum of 2% of total Tier 2 capital subject to the condition that the reasonableness of the revalued amount is duly certified by the internal auditor of the bank.

g. Exchange equalization reserves created by banks as a cushion for unexpected losses arising out of adverse movements in foreign currencies.

h. Other reserves

i. Any other type of reserves notified by NRB from time to time for inclusion in Tier 2 capital

2.4 DEDUCTIONS FROM CORE (TIER 1) CAPITAL:

Banks shall be required to deduct the following from the Tier 1 capital for capital adequacy purposes. The claims that have been deducted from core capital shall be exempt from risk weights for the measurement of credit risk.

a. Losses suffered in the current period as well as those brought forward from previous periods,

b. Book value of goodwill.

c. Fictitious assets[2] to the extent not written off. (e.g. VRS expense, preliminary expense, share issue expense, deferred revenue expenditure, etc.)

d. Investment in equity of financial institutions licensed by Nepal Rastra Bank[3].

e. All Investments in equity of institutions with financial interest.

f. Investments in equity of institutions in excess of the prescribed limits.

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2 Software expenditure or software development expenditure, research and development expenditure, patents, copyrights, trademarks and lease hold developments booked as deferred revenue expenditure are subject to 100% risk weight and shall not be deducted from Tier 1 capital.

3 Investment in shares of Rural Development Banks and other institutions, where the waiver has been explicitly provided by NRB are subject to risk weight of 100% and shall not be deducted from Tier 1 capital.

g. Investments arising out of underwriting commitments that have not been disposed within a year from the date of commitment.

h. Reciprocal crossholdings of bank capital artificially designed to inflate the capital position of the bank.

i. Any other items as stipulated by Nepal Rastra Bank, from time to time.

2.5 CAPITAL FUNDS:

The capital fund is the summation of Tier 1 and Tier 2 capital. The sum total of the different components of the tier 2 capitals will be limited to the sum total of the various components of the Tier 1 capital net of deductions as specified in 2.4. In case the Tier 1 capital is negative, Tier 2 capital shall be considered to be "Nil" for regulatory capital adequacy purposes and hence, in such a situation, the capital fund shall be equal to the Tier 1 capital.

2.6 MINIMUM CAPITAL REQUIREMENTS:

Unless a higher minimum ratio has been set by Nepal Rastra Bank for an individual bank through a review process, every bank shall maintain at all times, the capital requirement set out below:

a. A Tier 1 (core) capital of not less than 6 per cent of total risk weighted exposure;

b. A total capital fund of not less than 10 per cent of its total risk weighted exposure.

The Capital Adequacy Ratio (CAR) is calculated by dividing eligible regulatory capital by total risk weighted exposure. The total risk weighted exposure shall comprise of risk weights calculated in respect of bank's credit, operational and market risks. The methodologies to calculate RWE for each of these risk categories are described in detail in subsequent chapters.

3. CREDIT RISK

3.1 GENERAL:

Credit risk is the major risk that banks are exposed to during the normal course of lending and credit underwriting. Within Basel II, there are two approaches for credit risk measurement: the standardized approach and the internal ratings based (IRB) approach. Due to various inherent constraints of the Nepalese banking system, the standardized approach in its simplified form, Simplified Standardized Approach (SSA), has been prescribed in the initial phase.

3.2 SIMPLIFIED STANDARDIZED APPROACH (SSA):

In comparison to Basel I, SSA aligns regulatory capital requirements more closely with the key elements of banking risk by introducing a wider differentiation of risk weights and a wider recognition of credit risk mitigation techniques. The advantage of implementing this approach is twofold. This approach allows transitional advantage for countries like us by avoiding excessive complexities associated with the advanced approaches of Basel II while at the same time it will produce capital ratios more in line with the actual economic risks that banks are facing, compared to the present Accord.

Under this approach commercial banks are required to assign a risk weight to their balance sheet and off-balance sheet exposures. These risk weights are based on a fixed weight that is broadly aligned with the likelihood of a counterparty default.

All claims including loans & advances as well as investments shall be risk weighed net of specific provisions. Generally provision related to any receivable or investment is not defined as general or specific. In such situation, the total provision against any claim/exposure (other than the loans and advances) shall be considered as specific provision. However, provisions eligible for the supplementary capital shall not be allowed for netting while calculating risk weighted exposures.

In order to be consistent with the Basel-II framework, the credit risk for the regulatory capital purpose shall be computed by segregating the exposure in the following 11 categories.

a) Claims on government & central bank
b) Claims on other official entities
c) Claims on banks
d) Claims on corporate & securities firms
e) Claims on regulatory retail portfolio
f) Claims secured by residential properties
g) Claims secured by commercial real state
h) Past due claims

i) High risk claims

j) Other assets

k) Off balance sheet items

3.3 RISK MEASUREMENT AND RISK WEIGHTS:

a. Claims on government & central bank

1. All claims on Government of Nepal and Nepal Rastra Bank shall be risk weighed at 0 %.

2. Claims on foreign government and their central banks shall be risk-weighted on the basis of the consensus country risk scores of export credit agencies (ECA)[4]. As detailed below, each ECA risk scores will correspond to a specific risk weight category:

ECA risk scores	0-1	2	3	4 to 6	7
Risk weights	0%	20%	50%	100%	150%

b. Claims on other official entities

3. Claims on the Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community will receive a 0% risk weight.

4. Following Multilateral Development Banks (MDBs) will be eligible for a 0% risk weight.

   - World Bank Group, comprised of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC),
   - Asian Development Bank (ADB),
   - African Development Bank (AfDB),
   - European Bank for Reconstruction and Development (EBRD),
   - Inter-American Development Bank (IADB),
   - European Investment Bank (EIB),
   - European Investment Fund (EIF),
   - Nordic Investment Bank (NIB),
   - Caribbean Development Bank (CDB),
   - Islamic Development Bank (IDB), and
   - Council of Europe Development Bank (CEDB).

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4 The consensus country risk classification is available on the OECD's website (http://www.oecd.org) in the Export Credit Arrangement web page of the Trade Directorate. Each bank while computing the risk weight in any claim should use the updated risk score.

5. The standard risk weight for claims on other Multilateral Development Banks will be 100%.

6. Claims on public sector entities (PSEs)[5] will be risk-weighed as per the ECA country risk scores.

ECA risk scores	0-1	2	3 to 6	7
Risk weights	20%	50%	100%	150%

c. Claims on banks

7. All claims, irrespective of currency, on domestic banks/financial institutions that fulfill Capital Adequacy Requirements will be risk weighed at 20% while for the rest, it will be 100%.

8. Other claims on a bank shall be risk weighed as per the ECA Country risk score subject to the floor of 20% as follows:

ECA risk scores	0-1	2	3 to 6	7
Risk weights	20%	50%	100%	150%

d. Claims on corporate[6] & securities firms

9. The risk weight for claims on domestic corporates, including claims on insurance companies and securities firm will be 100%.

10. The claims on foreign corporates shall be risk weighed as per the ECA Country risk score subject to the floor of 20% as follows:

ECA risk scores	0-1	2	3	4 to 6	7
Risk weights	20%	50%	100%	100%	150%

e. Claims on regulatory retail portfolio

11. Claims that qualify all criteria listed below and approved by management under product policy[7] may be considered as regulatory retail portfolio. Exposures included in such a portfolio may be risk-weighed at 75%, except for past due loans**.** However, all credit products to qualify under regulatory retail portfolio category must be approved by Nepal Rastra Bank.

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[5] Public sector entity (PSE) is one, which is owned or controlled by government or any other entity categorized as PSE by NRB.

[6] "Corporate" shall include all exposures other than those which qualify for inclusion under "sovereign", "bank", "regulatory retail", "residential mortgage", "commercial real estate", "past due claims" or other specified category addressed separately under this guideline. For capital adequacy purposes, the term also includes insurance companies

[7] Lending against securities (such as equities and bonds), whether listed or not, are specifically excluded from this category. Likewise, personal loans and credit card receivables are excluded from this category.

<u>Criteria:</u>

- *Orientation criteria* :- exposure is to an individual person or persons or to a small business
- *Product Criteria* :- The exposure takes the form of any of the following:
  - Revolving credits and lines of credit, (including overdraft, hypothecation etc.)
  - Term loans and leases (e.g. hire purchase, auto loans and leases, student and educational loans[8]) and,
  - Small business facilities and commitments,
- *Granularity criteria* :- NRB must be satisfied that the regulatory retail portfolio is sufficiently diversified to a degree that reduces the risks in the portfolio, warranting the 75% risk weight. No aggregate exposure[9] to one counterpart can exceed 0.5 % of the overall regulatory retail portfolio.
- *Low value individual criteria* :- The maximum aggregated retail exposure to one counterpart cannot exceed an absolute threshold of Rs.5 million (Nepalese Rupees Fifty Lakhs)

f. <u>Claims secured by residential properties</u>

12. Lending fully secured by mortgages on residential property, that is or will be occupied by the borrower or that is rented, will be risk-weighed at 50% subject to the fulfillment of all the following criteria. Banks should apply to NRB for approval of product paper relating to this type of lending.
    1. Existence of substantial margin (minimum 40% of Distress Value) of security over the amount of the loan.
    2. Valuation is done by an Expert Valuator empanelled by the bank, stating the basis of valuation and standards followed. Mortgaged land must be revalued once every two years. Revaluation of building on depreciation basis shall be accepted.
    3. Documentation is complete with the witness/guarantee from all undivided family members.
13. Where, above mentioned criteria are not met, qualifying[10] residential mortgage

[8] Personal finance includes overseas employment loan, home loan (to the extent they do not qualify for treatment as claims secured by residential property), direct deprived sector loan.

[9] Aggregated exposure means gross amount (i.e. not taking any credit risk mitigation into account) of all forms of credit exposures (e.g. loans or commitments) that individually satisfy the three other criteria. In addition, “on one counterpart” refers to one or several entities that may be considered as a single group.

[10] Qualifying residential mortgage mean lending fully secured by mortgages on residential property, that is or will be occupied by the borrower, or that is rented.

loan shall be risk-weighed at 75%.

14. The unsecured portion of any residential mortgage loan shall be risk weighed at 150%.
15. When claims secured by residential properties are or have been past due[11] at any point of time during the last two years, they shall be risk-weighed at 100**%,** net of specific provisions.

g. Claims secured by commercial real estate

16. Claims secured by mortgages on commercial real estate[12], except past due, shall be risk-weighed at 100%.

h. Past due claims

17. Any loan, except for claim secured by residential property, which is past due for more than 90 days, will be risk-weighed at 150% net of specific provision.

i. High risk claims

18. 150% risk weight shall be applied for venture capital and private equity investments.
19. Exposures on Personal loan and credit card receivables shall attract a risk weight of 150%.
20. Investments in the paid-up equity of institutions, which are not listed in the stock exchange and have not been deducted from Tier 1 capital, shall be risk weighed at 150% net of provisions.
21. Investments in the paid-up equity of institutions, which are listed in the stock exchange and have not been deducted from Tier 1 capital, shall be risk weighed at 100% net of provisions.
22. Where loan cannot be segregated/or identified as regulatory retail portfolio or qualifying residential mortgage loan or under other categories, it shall be risk weighed at 150%.

j. Other assets

23. With regard to other assets, following provisions have been made;
    - Interest receivable/claim on government securities will be risk-weighed at 0%.

[11] An exposure is past due if interest or principal is overdue by 90 days or more from the due date.

[12] Claims secured by mortgage of Office buildings, retail space, multi-purpose commercial premises, multi-family residential buildings, multi-tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction etc.

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- Investments in equity or regulatory capital instruments issued by securities firms will be risk-weighed at 100%.
- Cash in transit shall attract risk weight of 20%.
- Cash items in the process of collection will be risk-weighed at 20%. For this purpose, cash items shall include Cheque, Draft, and Travellers Cheques.
- Fictitious assets that have not been deducted from Tier 1 capital shall be risk weighed at 150%.
- Other assets will be risk-weighed at 100% net of provision.

k. <u>Off balance sheet items</u>

24. Off-balance sheet items under the simplified standardized approach will be converted into equivalent risk weight exposure using risk weight as follows:

Off Balance Sheet Exposure	Risk Weight
Any commitments those are unconditionally cancelable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness (for example bills under collection)	0%
Forward exchange contracts.	10%
Short Term Trade-related contingencies Contingent liabilities arising from trade-related obligations, which are secured against an underlying shipment of goods for both issuing and confirming bank and are short term in nature. This includes documentary letters of credit, acceptances on trade bills, shipping guarantees issued and any other trade-related contingencies with an original maturity up to six months.	20%
Undertaking to provide a commitment on an off-balance sheet items	20%
Unsettled[13] securities and foreign exchange transactions between bank to bank and between bank and customer	20%
Long Term Trade-related contingencies Contingent liabilities arising from trade-related obligations, which are secured against an underlying shipment of goods for both issuing and confirming bank and are long term in nature. This includes documentary letters of credit, acceptances on trade bills, shipping guarantees issued and any other trade-related contingencies with an original maturity of over six months	50%
Performance-related contingencies	50%

[13] An unsettled transaction is one where delivery of the instrument is due to take place against receipt of cash, but which remain unsettled five business days after the due settlement date.

Contingent liabilities, which involve an irrevocable obligation to pay a third party in the event that counterparty fails to fulfill or perform a contractual non-monetary obligation, such as delivery of goods by a specified date etc. This includes issue of performance bonds, bid bonds, warranties, indemnities, underwriting commitments and standby letters of credit in relation to a non-monetary obligation of counterparty under a particular transaction.	
Irrevocable Credit Commitments Any un-drawn portion of committed credit lines. This shall include all unutilized limits in respect of Working Capital Finance of revolving nature e.g. Overdraft, Hypothecation, Trust Receipt Loan etc.	Upto 50%
Repurchase agreements, securities lending, securities borrowing, reverse repurchase agreements and equivalent transactions This includes repo/reverse repo, sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the purchasing bank.	100%
Direct credit substitutes Any irrevocable off-balance sheet obligations which carry the same credit risk as a direct extension of credit, such as an undertaking to make a payment to a third party in the event that a counterparty fails to meet a financial obligation or an undertaking to a counterparty to acquire a potential claim on another party in the event of default by that party, constitutes a direct credit substitute. This includes potential credit exposures arising from the issue of financial guarantees and credit derivatives, confirmation of letters of credit (acceptances and endorsements), issue of standby letters of credit serving as financial guarantees for loans, securities and any other financial liabilities, and bills endorsed under bill endorsement lines (but which are not accepted by, or have the prior endorsement of, another bank).	100%
Unpaid portion of partly paid shares and securities	100%
Other Contingent Liabilities	100%

3.4 CREDIT RISK MITIGATION:

Banks may use a number of techniques to mitigate the risks to which they are exposed. The prime objective of this provision is to encourage the banks to manage credit risk in a prudent and effective manner. As such, credit risks exposures may be collateralized[14] in whole or in part with cash or securities, or a loan exposure may be guaranteed by a third party. Where these various techniques meet the minimum conditions mentioned below, banks which take eligible financial collateral

[14] A collateralized transaction is one in which: a) banks have a credit exposure or potential credit exposure; and b) that credit exposures or potential credit exposure is hedged in whole or in part by collateral posted by the counter party or by a third party on behalf of the counter party.

are allowed to reduce their credit exposure to counterparty when calculating their capital requirements to take account of the risk mitigating effect of the collateral. However, credit risk mitigation is allowed only on an account by account basis, even within regulatory retail portfolio.

As a general rule, no secured claim should receive a higher capital requirement than an otherwise identical claim on which there is no collateral. Similarly, the effects of the CRM shall not be double counted and capital requirement will be applied to banks on either side of the collateralized transaction: for example, both repos and reverse repos will be subject to capital requirements.

Those portions of claims collateralized by the market value of recognized collateral receive the risk weight applicable to the collateral instrument. The remainder of the claim should be assigned the risk weight appropriate to the counter party.

Where the same security has been pledged for both the funded and non funded facilities, banks should clearly demarcate the value of security held for funded and non funded facility.

a. <u>Minimum conditions for eligibility</u>:

In order to obtain capital relief towards credit risk mitigation, there are certain basic condition that needs to be fulfilled. Supervisors will monitor the extent to which banks satisfy these conditions, both at the outset of a collateralized transaction and on an on-going basis.

1. *Legal certainty:-* Collateral is effective only if the legal mechanism by which collateral is given is robust and ensures that the lender has clear rights over the collateral to liquidate or retain it in the event of default. Thus, banks must take all necessary steps to fulfill local contractual requirements in respect of the enforceability of security interest. The collateral arrangements must be properly documented, with a clear and robust procedure for the timely liquidation of collateral. A bank's procedures should ensure that any legal conditions required for declaring the default of the customer and liquidating the collateral are observed. Where the collateral is held by a custodian, the bank must seek to ensure that the custodian ensures adequate segregation of the collateral instruments and the custodian's own assets. Besides that, banks must obtain legal opinions confirming the enforceability of the collateral arrangements in all relevant jurisdictions.

2. *Low correlation with exposure:-* In order for collateral to provide protection, the credit quality of the obligor and the value of the collateral must not have a material positive correlation. For example, securities issued by the collateral provider - or by any related group entity - would provide little protection and so would be ineligible.

3. *Maturity Mismatch:-* The maturity of the underlying exposure and the maturity of the hedge should both be defined conservatively. The effective maturity of the underlying should be gauged as the longest possible remaining time before the obligor is scheduled to fulfill its obligation. The collateral must be pledged for at least the life of the exposure. In case of mismatches in the maturity of the underlying exposure and the collateral, it shall not be eligible for CRM benefits.

4. *Currency Mismatch:-* Ideally the currency of the underlying exposure and the collateral should be the same. Where the credit exposure is denominated in a currency that differs from that in which the underlying exposure is denominated, there is a currency mismatch. Where mismatches occur, it shall be subject to supervisory haircut of 10%.

5. *Risk Management:-* While CRM reduces credit risk, it simultaneously may increase other risks to which a bank is exposed, such as legal, operational, liquidity and market risks. Therefore, it is imperative that banks employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the bank's use of CRM techniques and its effect with the bank's overall credit profile. In case where these requirements are not fulfilled, NRB may not recognize the benefit of CRM techniques.

6. *Qualifying criteria for guarantee:-* A guarantee (counter guarantee) to be eligible must represent a direct claim on the protection provider and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and irrefutable. Other than non-payment by a protection purchaser of money due in respect of the credit protection contract it must be irrevocable in that there must be no clause in the contract that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure. It must also be unconditional in that there should be no clause in the protection contract outside the control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counter party fails to make the payments due.

   On the qualifying default or non-payment of the counter party, the bank may in a timely manner pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counter party covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counter party payment.

b. <u>Eligible Collaterals:</u>

1. Cash deposit (as well as certificates of deposit or fixed deposits or other deposits) with the bank.
2. Fixed Deposit Receipts/Certificates of deposits/other deposits of other Banks, who fulfill the capital adequacy requirements, subject to a 20% supervisory haircut.
3. Gold.
4. Securities issued by the Government of Nepal and Nepal Rastra Bank.
5. Guarantee of the Government of Nepal
6. Financial guarantee/counter guarantee of domestic banks who meet the minimum capital adequacy requirements subject to a haircut of 20%.
7. Securities/Financial guarantee/Counter guarantee issued by sovereigns.
8. Securities/Financial guarantee/Counter guarantee issued by MDBs in the list specified in 3.3 b (3 & 4)
9. Securities/Financial guarantee/Counter guarantee issued by banks with ECA rating 2 or better. The supervisory haircut shall be 20% and 50% for the banks with ECA rating of 0-1 and 2 respectively.

c. <u>Methodology for using CRM</u>:

1. Step 1: Identification of accounts eligible for capital relief under credit risk mitigation.
2. Step 2: Assess the value of the exposure and the eligible collateral.
3. Step 3: Adjust the value of the eligible collateral in respect of the supervisory haircut in terms of currency mismatch and other eligibility requirements.
4. Step 4: Compare the adjusted value of the collateral with the outstanding exposure.
5. Step 5: The value of the eligible CRM is the lower of the adjusted value of the collateral and the outstanding exposure.
6. Step 6: Plot the eligible CRM in the appropriate category of credit risk.

4. OPERATIONAL RISK

4.1 GENERAL:

Operational risk is the risk of loss resulting from inadequate internal processes, people, and systems, or from external events. Operational risk itself is not a new concept, and well run banks have been addressing it in their internal controls and corporate governance structures. However, applying an explicit regulatory capital charge against operational risk is a relatively new and evolving idea. Basel II requires banks to hold capital against the risk of unexpected loss that could arise from the failure of operational systems.

The most important types of operational risk involve breakdowns in internal controls and corporate governance. Such breakdowns can lead to financial losses through error, fraud, or failure to perform in a timely manner or cause the interests of the bank to be compromised in some other way, for example, by its dealers, lending officers or other staff exceeding their authority or conducting business in an unethical or risky manner. Other aspects of operational risk include major failure of information technology systems or events such as major fires or other disasters.

4.2 BASIC INDICATOR APPROACH:

Under the basic indicator approach, banks must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted alpha) of positive annual gross income.

NRB shall review the capital requirement produced by this approach for general credibility, especially in relation to a bank's peers and in the event that credibility is lacking, appropriate supervisory action under Review Process shall be considered.

Figures for the year, in which annual gross income is negative or zero, should be excluded from both the numerator and denominator, when calculating the average. In case where the gross income for all of the last three years is negative, 5% of total credit and investments net of specific provisions shall be considered as the measurement for operational risk under the review process.

The capital charge for operational risk may be expressed as follows:

$$K_{BIA} = [\sum(GI_{1..n} \times \alpha)]/N$$

where:

K_{BIA} = capital charge under the Basic Indicator Approach

GI = annual gross income, where positive, over the previous three years

N = number of the previous three years for which gross income is positive

α = 15 percent.

4.3 GROSS INCOME:

Gross income is defined as "net Interest Income" plus "non interest income". It is intended that this measure should:

a. be gross of any provisions (e.g. for unpaid interest) and write-offs made during the year;
b. be gross of operating expenses, exclude reversal during the year in respect of provisions and write-offs made during the previous year(s);
c. exclude income recognized from the disposal of items of movable and immovable property;
d. exclude realized profits/losses from the sale of securities in the *"held to maturity" category*;
e. exclude other extraordinary or irregular items of income and expenditure

Thus, for the purpose of capital adequacy requirements, gross income shall be summation of:

a. Total operating income as disclosed in Profit and Loss account prepared as per NRB directive no.4. The total operating income comprises of:
   1. Net Interest Income
   2. Commission and Discount Income
   3. Other Operating Income
   4. Exchange Fluctuation Income
b. Addition to the Interest Suspense during the period.

4.4 COMPUTATION OF RISK WEIGHT:

Operational risk-weighted assets are determined by multiplying the operational risk capital charge by 10 (i.e., the reciprocal of the minimum capital ratio of 10%) and adding together with the risk weighted exposures for credit risk.

5. MARKET RISK

5.1 DEFINITION OF MARKET RISK:

Market risk is defined as the risk of losses in on-balance sheet and off-balance sheet positions arising from adverse movements in market prices. The major constituents of market risks are:

a. The risks pertaining to interest rate related instruments;

b. Foreign exchange risk (including gold positions) throughout the bank; and

c. The risks pertaining to investment in equities and commodities.

5.2 SEGREGATION OF INVESTMENT PORTFOLIO:

Banks will have to segregate their investment portfolio into any of following three categories:

a. Held for Trading:

An investment that is made for the purpose of generating a profit from short term fluctuations in price should be classified under this category. An asset should be classified as held for trading even if it is a part of a portfolio of similar assets for which there is a pattern of trading for the purpose of generating a profit from short term fluctuations in price. These investments should be marked to market on a daily basis and differences reflected in the profit and loss account.

b. Held to Maturity:

The investments made with positive intent and ability of the bank to hold till maturity should be classified as held to maturity investments. The bank does not have the positive intent to hold an investment to maturity, if any of the following conditions are met:

1. Bank has the intent and the ability to hold the asset for only an undefined period; or
2. Bank stands ready to sell the asset (other than if a situation arises that is non-recurring and could not have been reasonably anticipated) in response to changes in market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources and terms, or changes in foreign currency risk.

The held to maturity investments should be valued at amortised cost i.e. the cost price less any impairments (if applicable). The impairments should be included in the profit and loss accounts for the period.

c. Available for Sale:

All other investments that are neither "held for trading" nor "held to maturity" should be classified under this category. These investments should be marked to market on a regular basis and the difference to be adjusted through reserves. Banks are required to maintain Investment Fluctuation Reserve (eligible as Tier 2 capital) to the extent of 2% of available for sale portfolio.

5.3 NET OPEN POSITION APPROACH:

Out of the various forms of market risk, foreign exchange risk is the predominant one in our country. The effects of other forms of market risk are negligible. Thus, a net open position approach has devised to measure the capital requirement for market risk. As evidenced by its name, this approach only addresses the risk of loss arising out of adverse movements in exchange rates. This approach will be consolidated over time to incorporate other forms of market risks as they start to gain prominence.

The designated Net Open Position approach requires banks to allocate a fixed proportion of capital in terms of its net open position. The banks should allocate 5 percentage of their net open positions as capital charge for market risk.

5.4 NET OPEN POSITION:

Net open position is the difference between the assets and the liability in a currency. In other words, it is the uncovered volume of asset or liability which is exposed to the changes in the exchange rates of currencies. For capital adequacy requirements the net open position includes both net spot positions as well as net forward positions.

For capital adequacy purposes, banks should calculate their net open position in the following manner:

a. Calculate the net open position in each of the foreign currencies.

b. Convert the net open positions in each currency to NPR as per prevalent exchange rates.

c. Aggregate the converted net open positions of all currencies, without paying attention to long or short positions.

d. This aggregate shall be the net open position of the bank.

5.5 COMPUTATION OF RISK WEIGHT:

Risk-weighted assets in respect of market risk are determined by multiplying the capital charges by 10 (i.e., the reciprocal of the minimum capital ratio of 10%) and adding together with the risk weighted exposures for credit risk.

6. REVIEW PROCESS

6.1 GENERAL:

The supervisory review process of the framework is intended not only to ensure that banks have adequate capital to support all the risks in their business, but also to encourage banks to develop and use better risk management techniques in monitoring and managing their risks. It is the responsibility of the bank management in developing an internal capital assessment process and setting capital targets that are commensurate with the bank's risk profile and control environment beyond the core minimum requirements.

Nepal Rastra Bank recognizes the significance of the relationship between the amount of capital held by the bank against its risks and the strength and effectiveness of the bank's risk management and internal control processes. However, increased capital should not be viewed as the only option for addressing increased risks confronting the bank. Other means for addressing risk, such as strengthening risk management, applying internal limits, strengthening the level of provisions and reserves, and improving internal controls, must also be considered. Furthermore, capital should not be regarded as a substitute for addressing fundamentally inadequate control or risk management processes.

There are three main areas that is particularly suited to treatment under this process: risks considered under minimum capital requirements which are not fully captured it (e.g. credit concentration risk); those factors not taken into account by the minimum capital requirements (e.g. business and strategic risk); and factors external to the bank (e.g. business cycle effects).

In order to achieve the objectives of the supervisory review process, this process has been broadly divided into three parts:

a. Internal Capital Adequacy Assessment Process (ICAAP)

b. Supervisory Review

c. Supervisory Response

6.2 INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS:

The internal capital adequacy assessment process (ICAAP) is a comprehensive process which requires board and senior management oversight, monitoring, reporting and internal control reviews at regular intervals to ensure the alignment of regulatory capital requirement with the true risk profile of the bank and thus ensure long-term safety and soundness of the bank. The key components of an effective ICAAP are discussed below.

a. **Board and senior management oversight**

Bank management is responsible for understanding the nature and level of risk being taken by the bank and how this risk relates to adequate capital levels. It is also responsible for ensuring that the formality and sophistication of the risk management processes is commensurate with the complexity of its operations. A sound risk management process, thus, is the foundation for an effective assessment of the adequacy of a bank's capital position.

The board of directors of the bank are responsible for setting the bank's tolerance for risks. The board should also ensure that management establishes a mechanism for assessing various risks; develops a system to relate these risks to the bank's capital level and sets up a method for monitoring compliance with internal policies. It is equally important that the board instills strong internal controls and thereby an effective control environment through adoption of written policies and procedures and ensures that the policies and procedures are effectively communicated throughout the bank.

The analysis of a bank's current and future capital requirements in relation to its strategic objectives is a vital element of the strategic planning process. The strategic plan should clearly outline the bank's capital needs, anticipated capital expenditures, desirable capital level, and external capital sources. Senior management and the board should view capital planning as a crucial element in being able to achieve its desired strategic objectives.

b. **Sound capital assessment**

Another crucial component of an effective ICAAP is the assessment of capital. In order to be able to make a sound capital assessment the bank should, at minimum, have the following:

- Policies and procedures designed to ensure that the bank identifies, measures, and reports all material risks;
- A process that relates capital to the level of risk;
- A process that states capital adequacy goals with respect to risk, taking account of the bank's strategic focus and business plan; and
- A process of internal control, reviews and audit to ensure the integrity of the overall management process.

c. **Comprehensive assessment of risks**

All material risks faced by the bank should be addressed in the capital assessment process. Nepal Rastra Bank recognizes that not all risks can be measured precisely. However, bank should develop a process to estimate risks with reasonable certainties. In order to make a comprehensive assessment of risks, the process should, at minimum, address the following forms of risk.

1. Credit risk: Banks should have methodologies that enable them to assess the credit risk involved in exposures to individual borrowers or counterparties as well as at the portfolio level. The credit review assessment of capital adequacy, at a minimum, should cover risk rating systems, portfolio analysis/aggregation, large exposures and risk concentrations.

Internal risk ratings are an important tool in monitoring credit risk. Internal risk ratings should be adequate to support the identification and measurement of risk from all credit exposures, and should be integrated into an institution's overall analysis of credit risk and capital adequacy. The ratings system should provide detailed ratings for all assets, not only for problem assets.

2. Credit concentration risk: Risk concentrations are arguably the single most important cause of major problems in banks. A risk concentration is any single exposure or group of exposures with the potential to produce losses large enough (relative to a bank's capital, total assets, or overall risk level) to threaten a bank's health or ability to maintain its core operations.

Lending being the primary activity of most banks, credit risk concentrations are often the most material risk concentrations within a bank. However, risk concentrations can arise in a bank's assets, liabilities, or off-balance sheet items, through the execution or processing of transactions (either product or service), or through a combination of exposures across these broad categories. Credit risk concentrations are based on common or correlated risk factors, which, in times of stress, have an adverse effect on the creditworthiness of each of the individual counterparties making up the concentration.

Such credit concentrations are not addressed in the minimum capital requirements for credit risk. Thus, Banks should have in place effective internal policies, systems and controls to identify, measure, monitor, and control their credit risk concentrations. Banks should explicitly consider the extent of their credit risk concentrations in their assessment of capital adequacy under review process. These policies should cover the different forms of credit risk concentrations to which a bank may be exposed to. Such concentrations include but are not limited to:

- Significant exposures to an individual counterparty or group of related counterparty. Banks might also establish an aggregate limit for the management and control of all of its large exposures as a group;
- Credit exposures to counterparties in the same economic sector or geographic region;
- Credit exposures to counterparties whose financial performance is dependent on the same activity or commodity; and

- Indirect credit exposures arising from a bank's CRM activities (e.g. exposure to a similar type of collateral or credit protection provided by a single counterparty or same collateral in cases of multiple banking).

A bank's framework for managing credit risk concentrations should be clearly documented and should include a definition of the credit risk concentrations relevant to the bank and how these concentrations and their corresponding limits are calculated. Limits should be defined in relation to a bank's capital, total assets or, where adequate measures exist, its overall risk level. A bank's management should conduct periodic stress tests of its major credit risk concentrations and review the results of those tests to identify and respond to potential changes in market conditions that could adversely impact the bank's performance.

3. Operational risk: The failure to properly manage operational risk can result in a misstatement of an institution's risk/return profile and expose the institution to significant losses. Gross income, used in the Basic Indicator Approach is only a proxy for the scale of operational risk exposure of a bank and can in some cases underestimate the need for capital. Thus, Banks should develop a framework for managing operational risk and evaluate the adequacy of capital as prescribed by this framework. The framework should cover the bank's appetite and tolerance for operational risk, as specified through the policies for managing this risk, including the extent and manner in which operational risk is transferred outside the bank. It should also include policies outlining the bank's approach to identifying, assessing, monitoring and controlling/mitigating the risk.

4. Market risk: The prescribed approach for the computation of capital charge for market risk is very simple and thus may not be directly aligned with the magnitude of risk. Likewise, the approach only incorporates risks arising out of adverse movements in exchange rates while ignoring other forms of risks like interest rate risk and equity risks. Thus, banks should develop a framework that addresses these various forms of risk and at the same time perform stress tests to evaluate the adequacy of capital.

The use of internal models by the bank for the measurement of market risk is highly encouraged. Wherever bank's make use of internal models for computation of capital charge for market risks, the bank management should ensure the adequacy and completeness of the system regardless of the type and level of complexity of the measurement system as the quality and reliability of the measurement system is largely dependent on the quality of the data and various assumptions used in the model.

5. Liquidity risk: Liquidity is crucial to the ongoing viability of any financial institution. The capital positions can have a telling effect on institution's ability to obtain liquidity, especially in a crisis. Each bank must have adequate systems for measuring, monitoring and controlling liquidity risk. Banks should evaluate the adequacy of capital given their own liquidity profile and the liquidity of the markets in which they operate. Banks are also encouraged to make use of stress testing to determine their liquidity needs and the adequacy of capital.

6. Other risks: Although the 'other' risks, such as reputational and strategic risk, are not easily measurable, banks are expected to take these into consideration as well while deciding on the level of capital.

d. Monitoring and reporting

The bank should establish an adequate system for monitoring and reporting risk exposures and assessing how the bank's changing risk profile affects the need for capital. The bank's senior management or board of directors should, on a regular basis, receive reports on the bank's risk profile and capital needs. These reports should allow senior management to:

- Evaluate the level and trend of material risks and their effect on capital levels;
- Evaluate the sensitivity and reasonableness of key assumptions used in the capital assessment measurement system;
- Determine that the bank holds sufficient capital against the various risks and is in compliance with established capital adequacy goals; and
- Assess its future capital requirements based on the bank's reported risk profile and make necessary adjustments to the bank's strategic plan accordingly.

e. Internal control review

The bank's internal control structure is essential to a sound capital assessment process. Effective control of the capital assessment process includes an independent review and, where appropriate, the involvement of internal or external audits. The bank's board of directors has a responsibility to ensure that management establishes a system for assessing the various risks, develops a system to relate risk to the bank's capital level, and establishes a method for monitoring compliance with internal policies. The board should regularly verify whether its system of internal controls is adequate to ensure well-ordered and prudent conduct of business.

The bank should conduct periodic reviews of its risk management process to ensure its integrity, accuracy, and reasonableness. Key areas that should be reviewed include:

- Appropriateness of the bank's capital assessment process given the nature, scope and complexity of its activities;
- Identification of large exposures and risk concentrations;

- Accuracy and completeness of data inputs into the bank's assessment process;
- Reasonableness and validity of scenarios used in the assessment process; and
- Stress testing and analysis of assumptions and inputs.

6.3 SUPERVISORY REVIEW:

Nepal Rastra Bank shall regularly review the process by which a bank assesses its capital adequacy, risk positions, resulting capital levels, and quality of capital held by a bank. Supervisors shall also evaluate the degree to which a bank has in place a sound internal process to assess capital adequacy. The emphasis of the review should be on the quality of the bank's risk management and controls and should not result in supervisors functioning as bank management. The periodic review can involve any or a combination of:

- On-site examinations or inspections;
- Off-site review;
- Discussions with bank management;
- Review of work done by external auditors (provided it is adequately focused on the necessary capital issues); and
- Periodic reporting.

Some of the key areas which will be reviewed during the supervisory review process are discussed hereunder

a. Review of adequacy of risk assessment

NRB shall assess the degree to which internal targets and processes incorporate the full range of material risks faced by the bank. Supervisors shall also review the adequacy of risk measures used in assessing internal capital adequacy and the extent to which these risk measures are also used operationally in setting limits, evaluating business line performance, and evaluating and controlling risks more generally. Supervisors shall consider the results of sensitivity analyses and stress tests conducted by the institution and how these results relate to capital plans.

b. Assessment of capital adequacy

NRB shall review the bank's processes to determine that:

- Target levels of capital chosen are comprehensive and relevant to the current operating environment;
- These levels are properly monitored and reviewed by senior management; and

- The composition of capital is appropriate for the nature and scale of the bank's business.

NRB shall also consider the extent to which the bank has provided for unexpected events in setting its capital levels. This analysis should cover a wide range of external conditions and scenarios, and the sophistication of techniques and stress tests used should be commensurate with the bank's activities.

c. Assessment of the control environment

NRB shall consider the quality of the bank's management information reporting and systems, the manner in which business risks and activities are aggregated, and management's record in responding to emerging or changing risks. In all instances, the capital level at an individual bank should be determined according to the bank's risk profile and adequacy of its risk management process and internal controls. External factors such as business cycle effects and the macroeconomic environment should also be considered.

d. Supervisory review of compliance with minimum standards

In order to obtain relief as per this framework banks are required to observe number of requirements, including risk management standards and disclosures. In particular, banks will be required to disclose features of their internal methodologies used in calculating minimum capital requirements. As part of the supervisory review process, supervisors must ensure that these conditions are being met on an ongoing basis. Likewise, the supervisors must ensure that qualifying criteria as specified in the framework are continuously being met as these criteria are developed as benchmarks that are aligned with bank management expectations for effective risk management and capital allocation.

e. Significance of risk transfer

Securitization or credit sale agreements with recourse may be carried out for purposes other than credit risk transfer (e.g. funding). Where this is the case, there might still be a limited transfer of credit risk. However, for an originating bank to achieve reductions in capital requirements, the risk transfer arising from a securitization or credit sale has to be deemed significant by the NRB. If the risk transfer is considered to be insufficient or non existent, NRB can require the application of a higher capital requirement or, alternatively, may deny a bank from obtaining any capital relief from the securitization or transfer agreements. Therefore, the capital relief that can be achieved will correspond to the amount of credit risk that is effectively transferred.

f. Credit Risk Mitigants

In case when the eligibility requirements are not fulfilled, NRB will not consider Credit Risk Mitigants in allocating capital. Similarly, CRM may give rise to residual risks, which may render the overall risk reduction less effective. Where, these risks are not adequately controlled by the bank, NRB may impose additional capital charges or take other appropriate supervisory actions.

g. Operational risk and Market Risk

The framework prescribes simple approaches for allocating capital for operational and market risk which may not be directly aligned with the volume and complexity of risk. Thus, the supervisor shall consider whether the capital requirements generated by the prescribed approaches gives a consistent picture of the individual bank's risk exposure in comparison with the peer group and the banking industry at large. Where NRB is convinced such is not the case, appropriate supervisory response is warranted.

6.4 SUPERVISORY RESPONSE:

Nepal Rastra Bank expects banks to operate above the minimum regulatory capital ratios. Wherever, NRB is not convinced about the risk management practices and the control environment, NRB has the authority to require banks to hold capital in excess of the minimum.

a. Supervisory adjustments in risk weighted assets and capital

Having carried out the review process as described above, supervisors should take appropriate action if they are not satisfied with the results of the bank's own risk assessment and capital allocation. In such a scenario, NRB shall be empowered to undertake any or combination of the following adjustments in the banks risk weighted assets and regulatory capital computations.

1. Shortfall in provisions made by the bank against adversely classified assets shall be deducted from the Tier 1 capital.
2. The loans extended to DOSRI or related parties as well as loans and advances restricted by the prevailing rules and regulations shall be deducted from Tier 1 capital.
3. In case the bank has provided facilities in excess of its Single Obligor Limits, 10% of all such excess exposures shall be added to the risk weighted exposure for credit risk.
4. Where the bank has been involved in the sale of credit with recourse facility, 1% of the contract (sale) value shall be added to the risk weight for credit risk.
5. Where the banks do not have satisfactory Assets Liability Management policies and practices to effectively manage the market risks, an additional risk weight of 1% of Net Interest Income shall be added to the risk weight for credit risk.

6. Where the bank's liquid asset (inclusive of investment in government securities) to total deposit ratio is less than 20%, a risk weight of 0.5% of total deposit is added to total of the Risk Weighted Exposures.
7. Where the banks do not adopt sound practices for the management of operational risk, an additional capital charge of 2% of Gross Income shall be levied for operational risks.
8. Where the Gross Income determined for computation of capital charge of Operational Risk for all of the last three years is negative, 5% of the total credit and investments net of specific provisions shall be the capital charge for operational risk.
9. During the course of review, where the supervisor is not satisfied with the overall risk management policies and procedures of the bank, the total risk weighted exposures of the bank shall be increased up to 5%.
10. In case the bank has not achieved the desired level of disclosure requirements, the total risk weighted exposures of the bank shall be increased up to 3%.
11. Banks that do not meet the eligibility requirements to claim the benefit under credit risk mitigation techniques shall not be allowed the benefit of CRM.

b. <u>Corrective Actions for Non-Compliances</u>

The failure on part of the banks to meet the provisions of this framework shall be considered as a violation of the NRB directives and shall attract stipulated actions. The nature of the enforcement action largely depends on degree of the capital adequacy of the bank. The trigger points and the prescribed action have been determined as follows:

1. CAR below 10% and equal or above 9%
   - Prohibition from establishing new branches.
   - Prohibition from declaring dividends.
   - Submit a capital plan for recapitalization of the bank.
   - Interaction with the senior management on corrective course of action.
2. CAR below 9% and equal or above 6%
   - Action required under category 1.
   - Suspension of lending, investment, and credit extension activities
   - Prior approval of NRB for acquiring, through purchase or lease, additional fixed assets;
   - Prior approval of NRB for establishing new business lines
   - Other actions under Nepal Rastra Bank Act 2058.
   - Other actions under Bank and Financial Institution Act 2063.

3. CAR below 6% and equal or above 3%
    - Action required under category 2.
    - Restriction on deposit mobilization
    - Prohibition from acquiring, through purchase or lease, additional fixed assets;
    - Restrictions on paying incentives, severance packages, management fees or other discretionary compensation to directors or officers without prior approval of NRB.
    - Restriction on SLF.
    - Other actions under Nepal Rastra Bank Act 2058.
    - Other actions under Bank and Financial Institution Act 2063.
4. CAR below 3% and equal or above 1%
    - Action required under category 3.
    - Restrictions on salary increments, recruitments and promotions.
    - Action to directors and chief executive if capital position doesn't improve in 6 months after initiating action under this category.
    - Other actions under Nepal Rastra Bank Act 2058.
    - Other actions under Bank and Financial Institution Act 2063.
5. CAR below 1%
    - Action required under category 4.
    - Declare the bank as problem bank and initiate actions under Section 86 of NRB Act.
    - Suspend existing board of directors and chief executive of the bank and bring in new board and management.
    - Initiate steps to dilute the ownership of the existing shareholders.
    - Other actions under Nepal Rastra Bank Act 2058.
    - Other actions under Bank and Financial Institution Act 2063.

The trigger points and stipulated action are applicable uniformly to all banks within the scope of this framework. However, NRB may allow certain exceptions in the following cases:

1. Branch expansion is targeted in the rural parts of the country where the banking facility is not available in a competitive manner.
2. Banks that are already under the restructuring process.
3. Banks whose management and operation is taken under the direct control of Nepal Rastra Bank.
4. Banks that are too big to fail in the national context.

7. DISCLOSURE

7.1 GENERAL:

The purpose of disclosure requirements is to complement the minimum capital requirements and the review process by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the bank. It is believed that providing disclosures that are based on a common framework is an effective means of informing the market about a bank's exposure to those risks and provides a consistent and comprehensive disclosure framework that enhances comparability. The importance of disclosure is more pronounced in cases of bank that rely on internal methodologies in assessing capital requirements.

7.2 DISCLOSURE PRINCIPLES:

Banks should have a formal disclosure policy approved by the Board of directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency. While deciding on the disclosure policy, the board should pay due attention to strike a balance between materiality and proprietary and confidential information.

a. Materiality

Besides the minimum prescribed disclosure requirements, a bank should decide which additional disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

b. Proprietary and confidential information

Proprietary information encompasses information (for example on products or systems), that if shared with competitors would render a bank's investment in these products/systems less valuable, and hence would undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship. This has an impact on what banks should reveal in terms of information about their customer base, as well as details on their internal arrangements, for instance methodologies used, parameter estimates, data etc. The disclosure requirements set out below by NRB aims to strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.

7.3 VALIDATION:

The disclosures of the bank should be subjected to adequate validation. In addition, supplementary material (such as Management's Discussion and Analysis) that is published should also be subjected to sufficient scrutiny (e.g. internal control assessments, etc.) to satisfy the validation issue. If material is not published under a validation regime, for instance in a stand alone report or as a section on a website, then management should ensure that appropriate verification of the information takes place, in accordance with the general disclosure principles.

7.4 DISCLOSURE REQUIREMENTS:

Banks should at minimum, disclose the following information at the stipulated time intervals. At the same time, banks shall be free to disclose any other information they consider important for its stakeholders as and when they consider necessary, beyond the prescribed requirements.

a. Banks should provide the following disclosures as at end of each financial year along with the annual financial statements.

1. Capital structure and capital adequacy

- Tier 1 capital and a breakdown of its components;
- Tier 2 capital and a breakdown of its components;
- Detailed information about the Subordinated Term Debts with information on the outstanding amount, maturity, amount raised during the year and amount eligible to be reckoned as capital funds.
- Deductions from capital;
- Total qualifying capital;
- Capital adequacy ratio;
- Summary of the bank's internal approach to assess the adequacy of its capital to support current and future activities, if applicable; and
- Summary of the terms, conditions and main features of all capital instruments, especially in case of subordinated term debts including hybrid capital instruments.

2. Risk exposures

- Risk weighted exposures for Credit Risk, Market Risk and Operational Risk;
- Risk Weighted Exposures under each of 11 categories of Credit Risk;
- Total risk weighted exposure calculation table;
- Amount of NPAs (both Gross and Net)
  - Restructure/Reschedule Loan
  - Substandard Loan

  - Doubtful Loan
  - Loss Loan
- NPA ratios
  - Gross NPA to gross advances
  - Net NPA to net advances
- Movement of Non Performing Assets
- Write off of Loans and Interest Suspense
- Movements in Loan Loss Provisions and Interest Suspense
- Details of additional Loan Loss Provisions

3. Risk Management Function

- For each separate risk area (Credit, Market and Operational risk), banks must describe their risk management objectives and policies, including:
  - Strategies and processes;
  - The structure and organization of the relevant risk management function;
  - The scope and nature of risk reporting and/or measurement systems; and
  - Policies for hedging and/or mitigating risk and strategies, and processes for monitoring the continuing effectiveness of hedges/mitigants.
- Types of eligible credit risk mitigants used and the benefits availed under CRM.

b. All commercial banks should make following disclosures on a quarterly basis on their respective websites.

- Tier 1 capital and a breakdown of its components;
- Tier 2 capital and a breakdown of its components;
- Detailed information about the Subordinated Term Debts with information on the outstanding amount, maturity, amount raised during the year and amount eligible to be reckoned as capital funds.
- Deductions from capital;
- Total qualifying capital;
- Capital adequacy ratio;
- Risk weighted exposures for Credit Risk, Market Risk and Operational Risk;
- Risk Weighted Exposures under each of 11 categories of Credit Risk;
- Total risk weighted exposure calculation table;
- Amount of NPAs (both Gross and Net)
  - Restructure/Reschedule Loan
  - Substandard Loan
  - Doubtful Loan

        - Loss Loan
    - NPA ratios
        - Gross NPA to gross advances
        - Net NPA to net advances
    - Movement of Non Performing Assets
    - Write off of Loans and Interest Suspense
    - Movements in Loan Loss Provisions and Interest Suspense
    - Details of Additional Loan Loss Provisions
    - Summary of the bank's internal approach to assess the adequacy of its capital to support current and future activities, if applicable; and
    - Summary of the terms, conditions and main features of all capital instruments, especially in case of subordinated term debts including hybrid capital instruments.

c. Banks within the scope of the framework that do not host a website are required to make the necessary arrangements to host a website by Poush end 2064.

d. Banks are required to report to NRB their capital adequacy computations, according to the format as specified in Annexure of this framework on a quarterly basis, within 30 days after the end of the quarter. All such returns has to be certified by the internal auditor of the bank.

   Besides the returns specified above, a bank must inform NRB within 30 days of:

   1. Any breach of the minimum capital adequacy requirements set out in this framework together with an explanation of the reasons for the breach and the remedial measures it has taken to address those breaches.
   2. Any concerns it has about its capital adequacy, along with proposed measures to address these concerns.

e. Full compliance of these disclosure requirements is a pre-requisite before banks can obtain any capital relief (i.e., adjustments in the risk weights of collateralized or guaranteed exposures) in respect of any credit risk mitigation techniques.

ANNEXURE : REPORTING FORMS

FORM NO.1 CAPITAL ADEQUACY TABLE

1. 1 RISK WEIGHTED EXPOSURES		Current Period	Previous Period
a	Risk Weighted Exposure for Credit Risk		
b	Risk Weighted Exposure for Operational Risk		
c	Risk Weighted Exposure for Market Risk		
Total Risk Weighted Exposures (a+b+c)			

1.2 CAPITAL		Current Period	Previous Period
	Core Capital (Tier 1)		
a	Paid up Equity Share Capital		
b	Proposed Bonus Equity Shares		
c	Irredeemable Non-cumulative preference shares		
d	Share Premium		
e	Statutory General Reserves		
f	Retained Earnings		
g	Un-audited current year cumulative profit		
h	Capital Redemption Reserve		
i	Capital Adjustment Reserve		
j	Dividend Equalization Reserves		
k	Other Free Reserve		
l	Less: Goodwill		
m	Less: Fictitious Assets		
n	Less: Shortfall in provisions		
0	Less: Loan to parties prohibited by Acts and directives		
p	Less: Investment in equity in licensed Financial Institutions		
q	Less: Investment in equity of institutions with vested interests		
r	Less: Investment in equity of institutions in excess of limits		
s	Less: Investments arising out of underwriting commitments		
t	Less: Reciprocal crossholdings		
u	Less: Other Deductions		
	Supplementary Capital (Tier 2)		
a	Cumulative and/or Redeemable Preference Share		
b	Subordinated Term Debt		
c	Hybrid Capital Instruments		
d	General loan loss provision		
e	Investment Adjustment Reserve		
f	Assets Revaluation Reserve		
g	Exchange Equalization Reserve		
h	Other Reserves		
Total Capital Fund (Tier I and Tier II)			

1.3 CAPITAL ADEQUACY RATIOS	Current Period	Previous Period
Tier 1 Capital to Total Risk Weighted Exposures		
Tier 1 and Tier 2 Capital to Total Risk Weighted Exposures		

FORM NO.2 RISK WEIGHTED EXPOSURE FOR CREDIT RISK

A. Balance Sheet Exposures	**Book Value** **a**	**Specific Provision** **b**	**Eligible CRM** **c**	**Net Value** **d=a-b-c**	**Risk Weight** **e**	**Risk Weighted Exposures** **f=d*e**
Cash Balance				0	0%	0
Balance With Nepal Rastra Bank				0	0%	0
Investment in Nepalese Government Securities				0	0%	0
All other Claims on Government of Nepal				0	0%	0
Investment in Nepal Rastra Bank securities				0	0%	0
All other claims on Nepal Rastra Bank				0	0%	0
Investment in Foreign Government Securities (ECA Rating 0-1)				0	0%	0
Investment in Foreign Government Securities (ECA -2)			0	0	20%	0
Investment in Foreign Government Securities (ECA -3)			0	0	50%	0
Investment in Foreign Government Securities (ECA-4-6)			0	0	100%	0
Investment in Foreign Government Securities (ECA -7)			0	0	150%	0
Claims On BIS, IMF, ECB, EC				0	0%	0
Claims on Multilateral Development Banks (MDB's) recognized by the framework				0	0%	0
Claims on Other Multilateral Development Banks			0	0	100%	0
Claims on Public Sector Entity (ECA 0-1)			0	0	20%	0
Claims on Public Sector Entity (ECA 2)			0	0	50%	0
Claims on Public Sector Entity (ECA 3-6)			0	0	100%	0
Claims on Public Sector Entity (ECA 7)			0	0	150%	0
Claims on domestic banks that meet capital adequacy requirements			0	0	20%	0
Claims on domestic banks that do not meet capital adequacy requirements			0	0	100%	0
Claims on foreign bank (ECA Rating 0-1)			0	0	20%	0
Claims on foreign bank (ECA Rating 2)			0	0	50%	0
Claims on foreign bank (ECA Rating 3-6)			0	0	100%	0
Claims on foreign bank (ECA Rating 7)			0	0	150%	0
Claims on Domestic Corporates			0		100%	
Claims on Foreign Corporates (ECA 0-1)			0	0	20%	0
Claims on Foreign Corporates (ECA 2)			0	0	50%	0
Claims on Foreign Corporates (ECA 3-6)			0	0	100%	0
Claims on Foreign Corporates (ECA 7)			0	0	150%	0
Regulatory Retail Portfolio (Not Overdue)			0	0	75%	0
Regulatory Retail Portfolio (Overdue)			0	0	150%	0
Claims secured by residential properties (with condition)			0	0	50%	0
Claims secured by residential properties (without condition)			0	0	75%	0
Unsecured portion of claims secured by residential properties			0	0	150%	0
Claims secured by residential properties (Overdue)			0	0	100%	0
Claims secured by Commercial real estate			0	0	100%	0
Past due claims (except for claim secured by residential properties)			0	0	150%	0

High Risk claims (Venture capital, private equity investments, personal loans and credit card receivables)			0	0	150%	0
Investments in equity of institutions not listed in the stock exchange			0	0	150%	0
Investments in equity of institutions listed in the stock exchange			0	0	150%	0
Other Loans and Advances			0	0	150%	0
Cash and cash items in transit			0	0	20%	0
Fictitious Assets			0	0	150%	0
Other Assets (as per attachment)			0	0	100%	0
TOTAL	**0**	**0**	**0**	**0**		**0**
B. Off Balance Sheet Exposures	**Gross Book Value a**	**Specific Provision b**	**Eligible CRM c**	**Net Value d=a-b-c**	**Risk Weight e**	**Risk Weighted Exposures f=d*e**
Revocable Commitments					0%	0
Bills Under Collection					0%	0
LC Commitments With Original Maturity Up to 6 months (domestic)			0	0	20%	0
ECA Rating 0-1			0	0	20%	0
ECA Rating 2			0	0	50%	0
ECA Rating 3-6			0	0	100%	0
ECA Rating 7			0	0	150%	0
LC Commitments With Original Maturity Over 6 months (domestic)			0	0	50%	0
ECA Rating 0-1			0	0	20%	0
ECA Rating 2			0	0	50%	0
ECA Rating 3-6			0	0	100%	0
ECA Rating 7			0	0	150%	0
Bid Bond and Performance Bond (domestic)			0	0	50%	0
ECA Rating 0-1			0	0	20%	0
ECA Rating 2			0	0	50%	0
ECA Rating 3-6			0	0	100%	0
ECA Rating 7			0	0	150%	0
Underwriting commitments			0	0	50%	0
Lending of Bank's Securities or Posting of Securities as collateral			0	0	100%	0
Repurchase Agreements, Assets sale with recourse (including repo/ reverse repo)			0	0	100%	0
Advance Payment Guarantee			0	0	100%	0
Financial Guarantee			0	0	100%	0
Acceptances and Endorsements			0	0	100%	0
Unpaid portion of Partly paid shares and Securities			0	0	100%	0
Irrevocable Credit commitments			0	0	50%	0
Other Contingent Liabilities			0	0	100%	0
TOTAL	**0**	**0**	**0**	**0**		**0**
Total RWE for credit Risk (A) +(B)	**0**	**0**	**0**	**0**		**0**

FORM NO.3 ELIGIBLE CREDIT RISK MITIGANTS

Credit exposures	Deposits with Bank	Deposits with other banks/FI	Gold	Govt.& NRB Securities	G'tee of Govt. of Nepal	Sec/G'tee of Other Sovereigns	G'tee of domestic banks	G'tee of MDBs	Sec/G'tee of Foreign Banks	Total [15]
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
Balance Sheet Exposures										
Investment in Foreign Government Securities (ECA -2)										0
Investment in Foreign Government Securities (ECA -3)										0
Investment in Foreign Government Securities (ECA-4-6)										0
Investment in Foreign Government Securities (ECA -7)										0
Claims on Other Multilateral Development Banks										0
Claims on Public Sector Entity (ECA 0-1)										0
Claims on Public Sector Entity (ECA 2)										0
Claims on Public Sector Entity (ECA 3-6)										0
Claims on Public Sector Entity (ECA 7)										0
Claims on domestic banks that meet capital adequacy requirements										0
Claims on domestic banks that do not meet capital adequacy requirements										0
Claims on foreign bank (ECA Rating 0-1)										0
Claims on foreign bank (ECA Rating 2)										0
Claims on foreign bank (ECA Rating 3-6)										0
Claims on foreign bank (ECA Rating 7)										0
Claims on Domestic Corporates										0
Claims on Foreign Corporates (ECA 0-1)										0

[15] The total amount of Eligible CRM shall be adjusted for the supervisory haircuts and floors. In this regard banks should disclose the total value of eligible collateral in the respective column of type of CRM and while summing up the total value necessary adjustments have to be made.

Credit exposures	Deposits with Bank	Deposits with other banks/FI	Gold	Govt.& NRB Securities	G'tee of Govt. of Nepal	Sec/G'tee of Other Sovereigns	G'tee of domestic banks	G'tee of MDBs	Sec/G'tee of Foreign Banks	Total [15]
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
Claims on Foreign Corporates (ECA 2)										0
Claims on Foreign Corporates (ECA 3-6)										0
Claims on Foreign Corporates (ECA 7)										0
Regulatory Retail Portfolio (Not Overdue)										0
Regulatory Retail Portfolio (Overdue)										0
Claims secured by residential properties (with condition)										0
Claims secured by residential properties (without condition)										0
Unsecured portion of claims secured by residential properties										0
Claims secured by residential properties (Overdue)										0
Claims secured by Commercial real estate										0
Past due claims (except for claim secured by residential properties)										0
High Risk claims (Venture capital, private equity investments, personal loans and credit card receivables)										0
Investments in equity of institutions not listed in the stock exchange										0
Investments in equity of institutions listed in the stock exchange										0
Other Loans and Advances										0
Cash and cash items in transit										0
Fictitious Assets										0
Other Assets (as per attachment)										0
Off Balance Sheet Exposures										
LC Commitments With Original Maturity Up to 6 months (domestic)										0

Credit exposures	Deposits with Bank	Deposits with other banks/FI	Gold	Govt.& NRB Securities	G'tee of Govt. of Nepal	Sec/G'tee of Other Sovereigns	G'tee of domestic banks	G'tee of MDBs	Sec/G'tee of Foreign Banks	Total [15]
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
ECA Rating 0-1										0
ECA Rating 2										0
ECA Rating 3-6										0
ECA Rating 7										0
LC Commitments With Original Maturity Over 6 months (domestic)										0
ECA Rating 0-1										0
ECA Rating 2										0
ECA Rating 3-6										0
ECA Rating 7										0
Bid Bond and Performance Bond (domestic)										0
ECA Rating 0-1										0
ECA Rating 2										0
ECA Rating 3-6										0
ECA Rating 7										0
Underwriting commitments										0
Lending of Bank's Securities or Posting of Securities as collateral										0
Repurchase Agreements, Assets sale with recourse (including repo/ reverse repo)										0
Advance Payment Guarantee										0
Financial Guarantee										0
Acceptances and Endorsements										0
Unpaid portion of Partly paid shares and Securities										0
Irrevocable Credit commitments										0
Other Contingent Liabilities										0

FORM NO.4 OTHER ASSETS

S.No.	Assets	Gross Amount	Specific Provision	Net Balance
1	Fixed Assets			0
2	Interest Receivable on Other Investment			0
3	Interest Receivable on Loan			0
4	Non Banking Assets			0
5	Reconciliation Account			0
6	Draft Paid Without Notice			0
7	Sundry Debtors			0
8	Advance payment and Deposits			0
9	Staff Advance			0
10	Stationery			0
11	Other			0
TOTAL		**0**	**0**	**0**

FORM NO.5 RISK WEIGHTED EXPOSURE FOR OPERATIONAL RISK

Particulars	Year 1	Year 2	Year 3
Net Interest Income			
Commission and Discount Income			
Other Operating Income			
Exchange Fluctuation Income			
Additional Interest Suspense during the period			
Gross income (a)	**0**	**0**	**0**
Alfa (b)	**15%**	**15%**	**15%**
Fixed Percentage of Gross Income [c=(a×b)]			
Capital Requirement for operational risk (d) (average of c)			
Risk Weight (reciprocal of capital requirement of 10%) in times (e)	**10**		
Equivalent Risk Weight Exposure [f=(d×e)]			

FORM NO.6 RISK WEIGHTED EXPOSURE FOR MARKET RISK

S.No.	Currency	Open Position (FCY)	Open Position (NPR)	Relevant Open Position
1	INR			
2	USD			
3	GBP			
4	EURO			
5	GBP			
6	CHF			
7	......			
8	....			
9	....			
Total Open Position (a)				
Fixed Percentage (b)				5%
Capital Charge for Market Risk [c=(a×b)]				
Risk Weight (reciprocal of capital requirement of 10%) in times (d)				
Equivalent Risk Weight Exposure [e=(c×d)]				