FINANCIAL STABILITY REPORT
FISCAL YEAR 2018/19

(Issue No. 11)

Nepal Rastra Bank

DISCLAIMER

This *Eleventh issue* of the Financial Stability Report is based on the provisional data of Bank and Financial Institutions (BFIs) and other financial institutions as of mid-July 2019. Data used in its analysis may thus differ from the most recent statistics or audited financials published by BFIs. The colors, boundaries, denominations or any other signs and symbols used in the report do not imply any metamorphic judgments. This report, unless or otherwise stated elsewhere, covers the financial performance and phenomena observed during the fiscal year ended mid-July 2019. All the data and information in this report are retrieved from NRB depository, unless stated.

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

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List of Abbreviation

ADBL	Agriculture Development Bank Limited
AE	Advanced Economies
ANNA	Association of National Numbering Agencies
ASBA	Application Supported by Blocked Amount
ATM	Automated Teller Machine
BAFIA	Bank and Financial Institution Act
BFIs	Bank and Financial Institutions
BoD	Board of Director
CAR	Capital Adequacy Ratio
CB	Commercial Banks
CBS	Central Bureau of Statistics
CCB	Capital Conservation Buffer
CDatio	Credit to Deposit Ratio
CEO	Chief Executive Officer
CIT	Citizen Investment Trust
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
CSR	Corporate Social Responsibility
DBSD	Development Bank Supervision Department
DCGF	Deposit and Credit Guarantee Fund
DoC	Department of Cooperatives
ECB	European Central Bank
FI	Financial Institution
EMDE	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EPF	Employee Provident Fund
FINGO	Financial Non-government Organization
FEMD	Foreign Exchange Management Department
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness Indicators
GBBs	Grameen Bikash Banks
GDP	Gross Domestic Product
GFSR	Global Financial Stability Review
GON	Government of Nepal
IMF	International Monetary Fund
INR	Indian Rupees
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
IRC	Interest Rate Corridor
ISIN	International Securities Identification Number
LCR	Liquidity Coverage Ratio
LCY	Local Currency
LLP	Loan Loss Provision
LMFF	Liquidity Monitoring and Forecasting Framework
LoLR	Lender of Last Resort
LTV	Loan to Value Ratio
MFIs	Microfinance Financial Institutions
NBA	Non-Banking Assets
NBL	Nepal Bank Limited
NEPSE	Nepal Stock Exchange Limited
NSFR	Net Stable Funding Ratio
NGO	Non-Government Organization
NIDC	Nepal Industrial and Development Corporation
NPA	Non-Performing Assets
NPLs	Non-Performing Loans
NPR	Nepalese Rupees
NRB	Nepal Rastra Bank
PCA	Prompt Corrective Action
PIRD	Problem Institution Resolution Division
RBB	Rastriya Banijya Bank
ROA	Return on Assets
ROE	Return on Equity
RSRF	Rural Self Reliance Fund
RWA	Risk Weighted Assets
SOBs	State Owned Banks
SEBON	Security Board of Nepal
SLF	Standing Liquidity Facility
SLR	Statutory Liquidity Ratio
SOL	Single Obligor Limit
US	United States
WEO	World Economic Outlook

FOREWORD

Nepal Rastra Bank (NRB), the central bank of Nepal, has a mandate of maintaining and safeguarding stability of the domestic financial sector, among others. This responsibility is being discharged through disclosure of financial information in a transparent manner, to help manage market expectations. In this regard, the Bank has been publishing the Financial Stability Report since 2012 to meet this objective with focus on the risks and vulnerabilities of the domestic financial system.

Nepalese financial sector has recorded continuous robust growth in the size of total assets and liabilities of banks and financial institutions. Further, the implementation of prudential regulation has avoided excessive build-ups of exposures in a particular sector or industry on the one hand and bolstered the macroeconomic stability on the other hand. In this regard this eleventh issue of the financial stability report, undergoes an analytical review of the domestic banking and financial system and the achievements accomplished through the implementation of key regulations/ policies.

I believe that this will prove to be extremely useful to the concerned stakeholders. Besides helping for the better understanding of the trends and developments across the financial sector, it will contribute towards communicating key stances taken by the NRB in terms of policies and efforts for maintaining stability as mandated by the Nepal Rastra Bank Act, 2058.

Lastly, I appreciate Financial Stability Oversight Committee Chaired by Deputy Governor and also Executive Director of this Bank's Banks and Financial Institutions Department for coordinating with all departments and officials for bringing out this invaluable publication.

Thank You,

Maha Prasad Adhikari
Governor

Executive Summary

The world economy grew at 3.6 percent in 2018. It is expected to slow down to 3.0 percent in 2019 and improve modestly by 3.4 percent in 2020, according to the World Economic Outlook (WEO) published by the IMF in October 2019. Advanced economies grew by 2.3 percent in 2018 and are projected to slow down to 1.7 percent both in 2019 and 2020. Emerging market and developing economies grew by 4.5 percent in 2018 and are projected to experience to grow at a slower rate of 3.9 percent in 2019 and rebound to 4.6 percent in 2020.

The Global Financial Stability Report (GFSR) of IMF, October 2019, highlights the impact of regional tensions and how they have caused global growth to decline to the lowest level since the global financial crisis during 2007-09. Although the growth is expected to improve slightly, the availability of funds at lower interest rates have caused investors to seek a low interest-high yield investment, which is generally a phenomenon associated with high risk. These tendencies have given rise to new set of vulnerabilities which could jeopardize the stability of developed as well as developing economies. As a result, the GFSR advised policy makers to improve transparency, with a greater disclosure norm, for non-bank financial institutions. The GFSR also advised to adopt an improved and stringent sectoral supervisory, macro-prudential as well as regulatory norms for safeguarding the economy and maintaining the stability.

In Nepal, the annual average consumer price inflation increased to 4.6 percent in FY2018/19 from 4.2 percent in FY2017/18. The inflation rate of 4.6 percent has been lower than target of 6.5 percent set for FY2018/19. The Central Bureau of Statistics (CBS) estimated the real Gross Domestic Product (GDP) growth at producers' price for FY 2018/19 at 7.05 percent. This is higher than the revised estimate of 6.66 percent of FY2017/18. Similarly, the real GDP at basic price is estimated to grow by 6.81 percent compared to the revised growth of 6.30 percent in the previous year. Merchandise trade deficit widened 13.5 percent to NPR 1,321.42 billion in FY2018/19 compared to the growth of 26.9 percent in FY2017/18. The export-import ratio increased from 6.5 percent in 2017/18 to 6.8 percent in the review year. Total merchandise trade deficit, as percentage of GDP slightly improved from 38.4 percent in 2017/18 to 38.1 percent in the current year 2018/19.

Net services of the BoP worsened from a surplus of NPR 2.27 billion in 2017/18 to a wider deficit of NPR 16.52 billion in the review year. The workers' remittances increased 16.5 percent to NPR 879.27 billion, in the review year, compared to a growth of 8.6 percent in the previous year. The ratio of workers' remittances to GDP increased to 25.4 percent in FY2018/19 from 24.9 percent in FY2017/18. The net transfer receipts increased by 15 percent to NPR 994.78 billion, in the review year. Such receipts had increased at a much slower rate of 1.5 percent in the previous year.

The Nepalese banking system has been undergoing restructuring and consolidation, particularly through the merger/acquisition and increased paid-up capital requirements. Consequently, as of mid-July 2019, the total number of banks and financial institutions have shrunk to 168 comprising of 28 commercial banks, 28 development banks, 22 finance companies, and 90 microfinance development banks. Besides, 39 insurance companies, 1 reinsurance company and several non-bank financial institutions such as Employees Provident Fund (EPF), Citizens Investment Trust (CIT), Social Security Fund (SSF) and a postal saving bank are also in operation.

The share of banks and financial institutions in total assets and liabilities of the financial system stood at 76.99 percent in mid-July 2019. In terms of assets, commercial banks remained the key player in the financial system followed by development banks. In case of contractual saving institutions, EPF is a dominant institution followed by insurance companies.

The non-performing loans (NPL) of bank and financial institutions (BFIs) increased to NPR 44.18 billion in mid-July, 2019 compared to NPR 38.51 billion in mid-July 2018. Nevertheless, there was an improvement in ratio of NPL to total loans. The banking sector also improved its assets quality. This was a reflection of sufficient provisions made in the years 2012-2019, indicating the banking sector's resilience at large. The NPL to total loans of banking industry stood at 1.52 percent, comprising 1.40 percent in commercial banks, 0.92 percent in development banks and 8.80 percent in finance companies.

The pace of credit flows from BFIs slowed down from 21.47 percent in 2017/18 to 20.18 percent in 2018/19. Credit of commercial banks, development banks, and finance companies expanded by 18.25 percent, 36.29 percent and 19.86 percent, respectively, in mid-July 2019. Deposits of BFIs increased by 18.24 percent in mid-July 2019. The deposit growth of commercial banks, development banks and finance companies registered a growth of 16.53 percent, 31.96 percent and 19.56 percent, respectively, in mid-July 2019. The overall profitability of banking sector has increased by 21.01 percent to NPR 74. 23 billion in mid– July 2019. The growth rate of profitability of banking sector in the last year was 12.20 percent. The commercial banks posted the highest share of profitability of the banking sector, accounting for 87.85 percent of the total in mid-July 2019.

Following the issuance of the "Bank and Financial Institutions Merger By-laws, 2011"; as a result of mergers, as of mid-July 2019, the number of BFIs have come down from 171 to 43. As of mid-July, 2019, the branch network of commercial banks reached 3,585 followed by development banks (1,267), finance companies (205) and micro finance financial institutions (3,629). On an average, a BFI branch, excluding the branches of 'D' class financial institutions, has been serving around 5,776 people. The population served by the BFIs comes down to 3,363 people per branch, if the branches of "D" class financial institutions are also included.

As of mid-July 2019, deposits of cooperatives totaled NPR 345.58 billion while their total credit stood at NPR 332.71 billion. There are altogether 40 insurance companies (20 non-life, 19 life and 1 re-insurance) as of mid-July 2019. The data received from Insurance Board of Nepal reveals that in FY 2018/19, total assets/liabilities of insurance companies rose by 33.36 percent to NPR 347.15 billion. According to unaudited figures of mid-July 2018, the total assets/liabilities of EPF had increased by 18.64 percent to NPR 346.64 billion, in FY2018/19. Likewise, the funds collected by the EPF in FY 2018/19 grew by 11.15 percent to NPR 309.85 billion. Similarly, net fund collections of CIT stood at NPR 148.90 billion in FY2018/19. CIT's net fund collection in 2018/19 represents a growth rate of 30.54 percent over such collection of NPR114.06 billion in mid-July 2018

Short-term and long-term interest rates in the financial market remained relatively high in FY2018/19 in comparison to that of FY2017/18. In FY 2018/19 NPR depreciated by 0.76 percent against US dollar compared to a sharper depreciation of 6.30 percent in the previous year. To be specific, the exchange rate of one US dollar stood at NPR 113.48 in mid-July 2019 compared to NPR 109.34 in mid-July 2018. The NEPSE index rose by 3.8 percent, to 1,259.02 points, in mid-July 2019 compared to 1212.36 points in mid-July 2018. The float index, which was 87.15 points in mid-July 2018, increased by 6.1 percent to 92.43 points in mid-July 2019.

During the review period, NRB issued license to eleven development banks, one finance company and five non-BFIs to work as payments system operators (PSO) / payments services providers (PSP). Among five non-BFIs, two are licensed as PSOs and three as PSPs. Similarly, letter of intent (LOI) for 17 institutions have been issued during the review period to operate as PSOs and PSPs. With this, all the commercial banks, 15 development banks, and five finance companies are operating as PSO/PSP. Apart from this, there are a total 16 institutions, licensed by NRB, operating as payment institutions. Among them six are PSOs and 10 are PSPs.

Chapter - I
Macroeconomic Development

1.1 Global Economic Growth

The world economy which grew by 3.6 percent in 2018 is expected to slow down to 3.0 percent in 2019 and improve modestly by 3.4 percent in 2020 according to World Economic Outlook (WEO) published by IMF in October 2019.The report attributes such slowdown to factors such as rising trade barriers, elevated uncertainty surrounding trade, and structural factors.

According to WEO advanced economy grew 2.3 percent in 2018 and is projected to slowdown at the same rate of 1.7 percent in 2019 and 2020. The slowdown in economic growth of major advanced countries such as US, Euro area, UK, Canada and others caused the lower growth in 2019 compared to 2018. Emerging market and developing economies grew 4.5 percent in 2018. The growth rate in this group of countries is projected to slow down to 3.9 percent in 2019 and then pick up to 4.6 percent in 2020.

Among the advanced economies, the US economy, as a response to fiscal stimulus, is expected to be expand by 2.4 percent in 2019 and by 2.1 percent in 2020. Owing mainly to sluggish export performance, the Euro Area is expected to grow by a smaller magnitude of 1.2 percent in 2019 and 1.4 percent in 2020. The growth rate is expected to scale up in the United Kingdom, Germany, Italy, Canada and France and other advanced economies and scale down in Spain and Japan from 2019 to 2020.

Among the Emerging and Developing Economies, the growth rate of China is expected to remain at 6.1 percent in 2019, and 5.8 percent in 2020 on account of trade frictions. Like China, India is expected to grow by 6.1 percent in 2019, and is projected to accelerate to 7.0 percent in 2020.

Emerging market economies particularly, Argentina, Iran, Turkey, Venezuela, Libya and Yemen have been experiencing severe macroeconomic distress. Other large emerging market economies-Brazil, Mexico, Russia, and Saudi Arabia, among others, are projected to grow considerably below their historical averages. In India, corporate and environmental regulatory uncertainty, together with concerns about the health of the nonbank financial sector, has softened growth in 2019. These economies have driven part of the projected decline in growth in 2019.The growth rates of some emerging economies such as Brazil, Russia, South Africa, and Mexico are expected to scale up in 2020 compared to 2019 (IMF, 2019).

Table: 1.1 Overview of the World Economic Outlook Projection

	Year over Year			
	Estimate		Projections	
	2017	2018	2019	2020
World Output	**3.8**	**3.6**	**3.0**	**3.4**
Advanced economies	**2.5**	**2.3**	**1.7**	**1.7**
United States	2.4	2.9	2.4	2.1
Euro Area	2.5	1.9	1.2	1.4
Germany	2.5	1.5	0.5	1.2
France	2.3	1.7	1.2	1.3
Italy	1.7	0.9	0.0	0.5
Spain	3.0	2.6	2.2	1.8
Japan	1.9	0.8	0.9	0.5
United Kingdom	1.8	1.4	1.2	1.4
Canada	3.0	1.9	1.5	1.8
Other Advanced Economies[1]	2.9	2.6	1.6	2.0
Emerging Markets and Developing Economies	**4.8**	**4.5**	**3.9**	**4.6**
Russia	1.6	2.3	1.1	1.9
Emerging and Developing Asia	6.6	6.4	5.9	6.0
China	6.8	6.6	6.1	5.8
India	7.2	6.8	6.1	7.0
ASEAN-5[2]	5.3	5.2	4.8	4.9
Emerging and Developing Europe	3.9	3.1	1.8	2.5
Latin America and the Caribbean	1.2	1.0	0.2	1.8
Brazil	1.1	1.1	0.9	2.0
Mexico	2.1	2.0	0.4	1.3
Saudi Arabia	-0.7	2.4	0.2	2.2
Sub-Saharan Africa	3.0	3.2	3.2	3.6
Nigeria	0.8	1.9	2.3	2.5
South Africa	1.4	0.8	0.7	1.1

Memorandum				
Low-Income Developing countries	4.7	5.0	5.0	5.1
World Growth Based on Market Exchange Rates	3.2	3.1	2.5	2.7
Consumer Prices				
Advanced Economies	1.7	2.0	1.5	1.8
Emerging Market and Developing Economies[3]	4.3	4.8	4.7	4.8

Source: World Economic Outlook Update, October 2019.

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

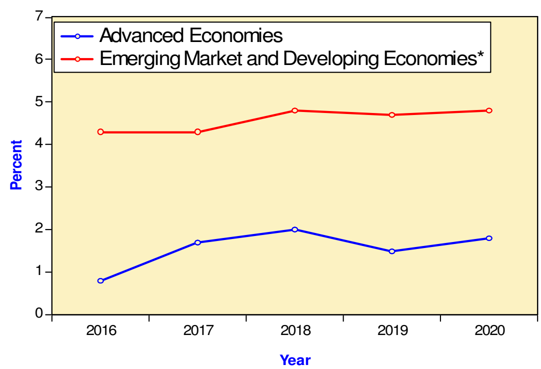
2/ Indonesia, Malaysia, Philippines, Thailand, Vietnam.

3/ Excludes Venezuela

1.1.1 Inflation

According to WEO (October 2019), advanced economies experienced a 2 percent rate of inflation in 2018. In the same year, emerging and developing economies had a rate of inflation of 4.8 percent. In 2019, In 2019 and 2020 inflation forecast for advanced economies is subdued at 1.5 percent and 1.8 percent respectively. The inflation forecast for emerging and developing economies is 4.7 percent for 2019 and 4.8 percent for 2020. However, core inflation remained different across the advanced countries.

Figure 1.1: Consumer Price

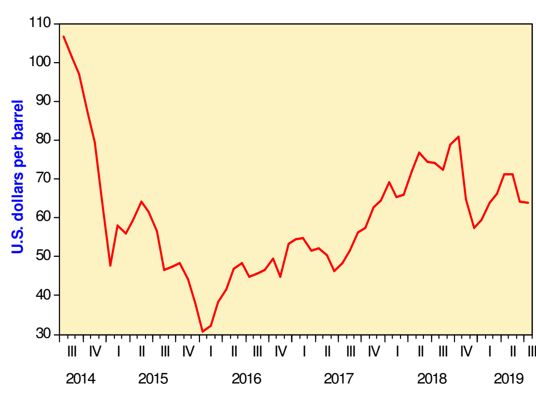


**Excludes Argentina and Venezuela*
Source: World Economic Outlook, Oct. 2019

1.1.2 Crude Oil

According to WEO (October 2019), the price of Brent crude oil increased by 29.4 percent in mid-Oct 2018 which is expected to decline by 9.6 percent in 2019 and by 6.2 percent in

Figure 1.2: Europe Brent Spot Price FOB



Source: U.S. Energy Information Administration

2020. Compared to 2017, Brent Crude Oil prices had risen by 23.3 percent in the corresponding period of 2018.

During 2018, the price of a barrel of Brent crude fluctuated, in US dollar terms, between 50.57 and 86.07 averaging U. S. $ 71.33 during.

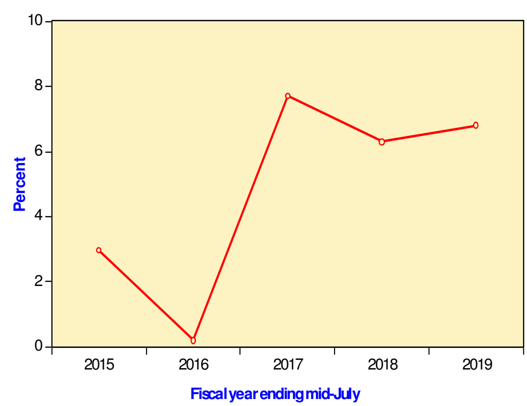
1.2 Domestic Macroeconomic Development

The Nepali economy continued its higher growth momentum in the FY2018/19. Increase in agricultural production, ease in energy supply, acceleration in construction activities, expansion in industrial production and an uptick in tourist arrival have contributed to higher economic growth. Consumer price inflation remained within control. Nevertheless, the balance of payments (BOP) and current account recorded deficit posing risk to external sector stability. The surge in current account deficit was due to the elevated level of import of petroleum products, transport equipment and parts, and industrial goods. Actual budget expenditure remained at 81.18 percent of total estimate in FY2018/19.

1.2.1 Economic Growth

Central Bureau of Statistics (CBS) estimated the growth of real GDP (at producers' price) at 7.05 percent in FY2018/19 compared to 6.66 percent in FY2017/18. Similarly, the real GDP, at basic price, is estimated to grow by 6.81 percent compared to a growth of 6.30 percent in the previous year. GDP grew at a healthy rate due to expansion of electricity, power and gas sector, pick up in construction activities, improved output of industrial sector and increased tourist arrivals among others.

Graph 1.3: GDP Growth Rate at Basic Prices



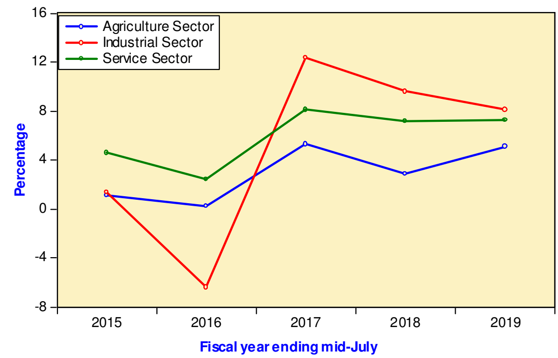
Source: CBS

In the review year, the agriculture sector exhibited an increased growth of 5.0 percent mainly due to favorable weather condition. Non-agricultural sector grew by 7.5 percent, which is compared to the growth of 7.7 percent in FY2017/18.

The industrial sector grew by 8.1 percent in the review year basically on account of the regular power supply and improved investment climate. Such growth was 9.6 percent in FY 2017/18.

In the review year, the service sector grew by 7.3 percent mainly due to increased tourists' inflow, expansion of trade and communication sector and the performance of social sectors such as health and education. Such growth was 7.2 percent in the previous year (CBS, 2019).

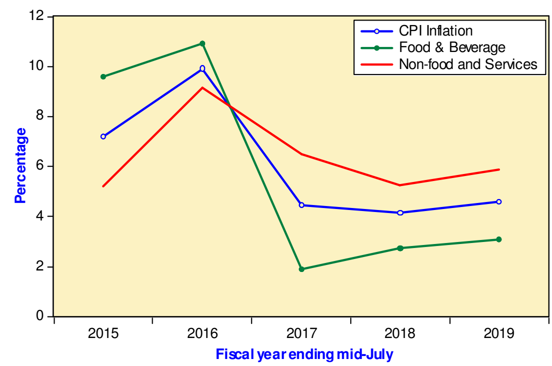
Graph 1.4: Sectoral GDP Growth



Source: CBS

1.2.2 Inflation

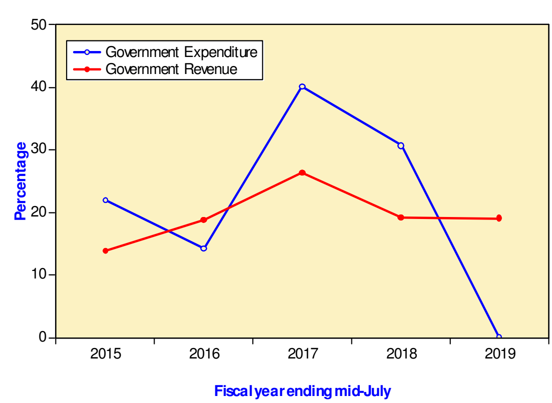
Figure 1.5: Changes in Consumer Price Index



Annual average consumer price inflation increased to 4.6 percent in FY2018/19 from 4.2 percent in the previous year. Yet, it was lower than the targeted 6.5 percent. The normal supply situation and lower global prices, including that of India, contributed to the moderation of consumer inflation in the review year. While the average food inflation increased to 3.1 percent in FY2018/19 from 2.7 percent a year ago, the nonfood inflation increased to 5.9 percent in the review year from 5.3 percent a year ago (NRB, 2019).

1.2.3 Government Finance

Figure 1.6: Growth Rate of Government Expenditure and Revenue



In 2018/19, the government revenue at NPR 865.55 billion recorded a growth of 19.1 percent, on top of a 19.3 percent growth in 2017/18. The 2018/19 revenue represented 91.54 percent of its budgeted target (i.e. NPR 945.55 billion). Revenue-to-GDP ratio in 2018/19 increased by a percentage over last year to 25.0 percent. Of the total revenue, the share of tax revenue and non-tax revenue stood at 88.3 percent and 11.7 percent, respectively, in the review year. In the previous year, the shares of tax and nontax revenue in the total revenue were 90.1 percent and 9.9 percent, respectively.

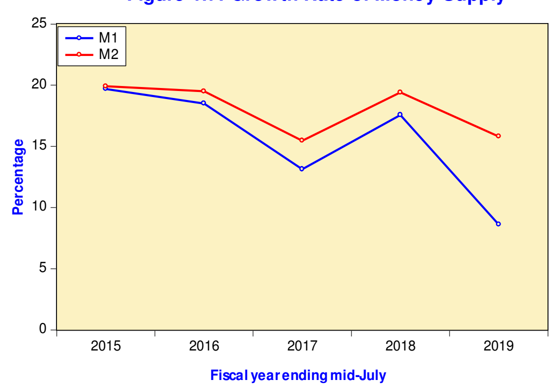
Government expenditure, based on banking transaction, increased marginally by 0.1 percent to NPR 1067.67 billion in FY2018/19. In 2017/18, such expenditure had risen substantially by 30.7 percent. During the review year, recurrent expenditure increased by 2.7 percent to NPR 712.31 billion compared to a growth of 35 percent in the preceding year. Such expenditure outturn stood at 84.25percent of the initial budget estimate.

The capital expenditure in 2018/19 decreased absolutely by11.8 percent to NPR 232.42 billion in contrast to an encouraging growth of 32.3 percent in the previous year. The capital expenditure in the review year accounted for 74.02 of allocation. Expenditure under 'Financing' increased by 12.6 percent to NPR 122.94 billion, amounting to 78.95 percent of its allocated budget.

1.2.4 Monetary Sector

Growth rate of broad money (M2) moderated to 15.8 percent in the review year compared to expansion of 19.4 percent in the previous year. Trends in narrow money (M1) also shadows M2 Pattern, as it increased by 8.6 percent in review year which was much lower than 17.6 percent in the previous year.

Figure 1.7: Growth Rate of Money Supply



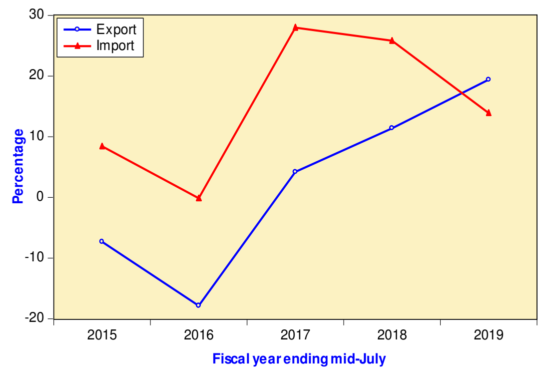
The developments in money supply aggregates was a reflection of movements in Net foreign assets (NFA after adjusting foreign exchange valuation gain/loss). The 2018/19 NFA decreased by NPR 67,400.5 million (6.4 percent) in the review year in contrast to an increase of NPR 960.2 (0.1 percent) million in the previous year. Reserve money decreased by 1.5 percent in the review year compared to a rise of 8.1 percent in the previous year.

Domestic credit expanded by 21.24 percent in the review year compared to a growth of 26.5 percent in the previous year. Claims of monetary sector on the private sector also decelerated to 19.1 percent in the review year compared to a growth of 22.3 percent in the previous year.

Deposits at banks and financial institutions (BFIs) increased by 18.24 percent in the review year compared to an increase of 18.96 percent in the previous year. Of the total deposits at BFIs, share of demand, saving and fixed deposits remained 9.29 percent, 31.62 percent and 45.51 percent, respectively, in mid-July 2019. Such a share was 9.3 percent, 34.5 percent and 44.8 percent, respectively, in mid-July 2018.

1.2.5 External Sector

Figure 1.8: Growth Rate of Export and Import



In 2018/19, merchandise exports grew by 19.4 percent to reach NPR 97.11 billion. This growth rate was higher than the last year's growth rate of 11.4 percent. In the review year, exports to India increased by 34.3 percent, exports to China decreased by 13.5 percent and export to other countries increased marginally by 0.2 percent. Total merchandise exports, 26.9as percentage of GDP, remained 2.8 percent in the review year compared to 2.7 percent in the previous year.

Merchandise imports increased by 13.9 percent to NPR 1418.54 billion, in the review year as against a growth of 26.9 percent in the previous year. In the review year, imports from India, China and Other countries increased by 12.8 percent, 28.5 percent and 8.9 percent, respectively. Total import-to-GDP ratio decreased to 40.94 percent in the review year from 41.1 percent of the previous year.

Merchandise trade deficit widened by 13.5 percent to NPR 1321.43 billion, in FY2018/19. The export-import ratio increased to 6.8 percent in the review year from 6.5 percent in the previous year. Total merchandise trade deficit as percentage of GDP slightly fell from 38. 4 percent in 2017/18 to 38.1 percent in the review year.

In the review year, the total services receipts increased by 5.3 percent and expenses rose at a much faster pace of 16.1 percent. As a result, the amount of net services deficit increased massively by 7.28 folds over last year to NPR 16.52 billion.

Workers' remittances accelerated by 16.5 percent to NPR 879.27 billion, compared to a growth of 8.6 percent in the previous year. The ratio of workers' remittances to GDP increased to 25.4 percent in FY2018/19 from 24.9 percent in 2017/18. The net transfer receipts increased by 15 percent to NPR 994.79 billion, in the review year. Such receipts had increased by 1.5 percent in the previous year.

The inflows under capital transfer of NPR 15.46 billion and foreign direct investment (FDI) of NPR 13.07 billion were both lower than in the previous year. In the previous year, capital transfer and FDI inflows were NPR 17.72 billion and NPR 17.51 billion, respectively.

Gross foreign exchange reserves decreased by 5.8 percent to NPR 1038.92 billion as at mid-July 2019 from NPR 1102.59 billion in the same date of last year. The share of Indian currency in total reserves stood at 23.6 percent as at mid-July 2019.

Foreign assets and liabilities of the country stood at NPR 1080.10 billion and NPR 921.94 billion respectively, as at mid-July 2019. Accordingly, the net IIP remained in surplus of NPR 158.16 billion as at mid-July 2019. Such surplus was NPR 282.12 billion as at mid-July 2018.

1.2.6 Liquidity Situation

In the review year, NPR 322.49 billion liquidity was injected through open market operations. BFIs used NPR 154.33 billion standing liquidity facility (SLF) in FY2018/19. Similarly, NRB injected net liquidity of NPR 360.91 billion through net purchase of USD 3.19 billion from foreign exchange market. NRB mopped up NPR 100.35 billion through open market operations.

NRB purchased Indian Currency (INR) equivalent to NPR 516.97 billion through the sale of 4.24 billion USD and other convertible currencies in the review year. INR equivalent to NPR 522.03 billion was purchased through the sale of USD 4.76 billion in the previous year.

Chapter - II
Financial System Performance and Stability

2.1 Global Financial Stability Overview

Global Financial Development Report 2019/2020, published by the World Bank, focuses on the decade succeeding the global financial crisis and the developments in financial sector following this crisis. Years prior to the global financial crisis were characterized by deregulation, mostly in advanced economies, but the global financial crisis brought about greater supervisory intrusions, greater regulatory concerns and increased regulatory capital. The report highlights that the set of policies for advanced economies could be too sophisticated for emerging and developing economies and hence softer stance on its adoption is required. The report further highlights that hike in regulatory reserves has appeared to reduce the access to credit, but only in short run (WB, 2020).

Global Financial Stability Report (GFSR) of October, 2019 published by International Monetary Fund, highlights on the impact of regional tensions and how they have caused global growth to decline and reach to its lowest level since the Global Financial Crisis (IMF, 2019 a).Global markets have been subject to twist and turns of trade tensions and these have been kept off balance by continuing trade uncertainty. Continuous economic expansion after the GFC seems to have taken a downturn as global growth is slowing. Global growth rate has been downgraded to 2.3 percent which is 0.3 percent below previous forecast. This has been primarily attributed to regional uncertainties in areas such as Brexit and USA – China trade frictions. In response to these, central banks have adopted an easier and accommodative stance on monetary policy resulting in a lower interest rate. As a result, lower rates have given rise to easier access to finance for investors and in a lower interest rates scenario, investors are trying to generate higher yields but, in turn, there is a tendency to invest in risky assets to achieve their targets. These have given rise to vulnerabilities, putting growth, in medium term, at risk. In the aftermath of GFC, banking sector, in general, is under greater regulations and supervision which are more adapt to absorbing uncertain scenarios and are more resilient to unfavorable situations. Thus, the vulnerabilities are greater in non-banking financial institutions, assets managers and finance companies which are vying for greater return on their investment without adequate risk management tools, as non-banking financial institutions, in particular, are more involved in riskier and less liquid assets. Similar instances were visible during the height of the global financial crisis of 2007.

There is a trend of growing corporate debts and possible corporate defaults could trigger losses in the entire sector and economic downturn by creating unemployment. These exposures may trigger and act as an amplifier to the shocks. Even though vulnerabilities in the banking sector continue to be modest, their lending to other sector with risky features has generated new vulnerabilities.

Lower rates in developed economies have given rise to different sets of vulnerabilities to the emerging economies which are obtaining those debts from developed economies. In an event of unfavorable scenarios such as slowdown in the economies, trade tensions and uncertainties will cause distress to the developed economies as a result of tightening in funding conditions. As a result, those economies receiving dollar source of funding could face distress situation which can trickle down to the developing economies receiving cross border dollar funding, putting global financial stability at risk.

As a result, GFSR sets out certain policy recommendations to mitigate the risks. Additional easing up on monetary policy would increase the vulnerability hence data driven, data dependent monetary policy and clear and transparent communication of policy is advised to avoid uncertainty. There is need for comprehensive assessment of risk for non-banking financial institutions, hence GFSR advised that a greater disclosure and transparency in non-banking financial institutions. Regarding corporate debts and cross border currency relations, GFSR recommends a more prudent debt management practices and a holistic view on overall debt and related risks to mitigate the effects of any downside on the economy.

The GFSR has also highlighted on environmental, social, and governance (ESG) principle of borrowing and investing as they become more significant. The report highlights on sustainable finance and focus on developing strategies for ESG and standards and promoting consistent ESG reporting (IMF, 2019a).

The Asian development outlook published by Asian development bank forecasts South Asian growth to decline from 6.7 to 6.1 which can be attributed to the slowdown in Indian economy. The report also outlines the decline in private consumption and investment brought about by lesser than expected harvest and slow job growth in south Asian countries. The report also points out that the political stability and improved business environment in Nepal has caused increase in foreign investment while remittance inflow has decreased (ADB, 2019)

2.2 Overview of Nepalese Financial System

2.2.1 Size of the Overall Financial System

Nepalese financial system has been regulated by different regulators in the sectors of banking, insurance, securities markets, contractual saving institutions and other service sectors. NRB, as the central bank, regulates commercial banks, development banks, finance companies, micro finance financial institutions and infrastructure development bank. Contractual saving institutions comprises of EPF and CIT. The Securities Board of Nepal (SEBON) regulates securities market which comprises of stock exchange, listed companies, central securities depository, stockbrokers, merchant bankers, credit rating agencies, mutual funds, Application Supported by Blocked Amount (ASBA) members and depository participants. Likewise, insurance companies are under the purview of Insurance Board and cooperatives fall under the jurisdiction of Department of Cooperatives, Government of Nepal (GON).

Following the financial liberalization policy adopted since the mid-1980s, there has been proliferation of the number of BFIs in the last few decades. The growth in the number of BFIs has moderated after NRB introduced moratorium on licensing. For the last three years, the banking system has been undergoing restructuring and consolidation, particularly through the merger and acquisition. As of mid-July 2013, the Nepalese financial system constituted of 31 licensed commercial banks ("A" class institutions), 86 development banks ("B" class institutions), 59 finance companies ("C" class institutions), 31 micro-finance financial institutions ("D" class institutions), 18 NRB permitted cooperatives undertaking limited banking transactions, 31 NRB permitted NGOs for limited banking transactions, 25 insurance companies and one each of the Employees Provident Fund, Citizen Investment Trust and Postal Saving Bank.

As of mid-July 2019, the total number of BFIs stood at 168 comprising 28 commercial banks, 28 development banks, 22 finance companies and 90 microfinance institutions. Besides, 39 insurance companies and non-bank financial institutions in the form of EPF, CIT, DCGF, Social Security Fund (SSF) and a Postal Saving Bank are also in operation. License provided by NRB to some cooperatives for conducting limited banking transactions were revoked. Similarly, NRB licensed FINGOs were converted into microfinance institutions.

Table 2.1: Number of BFIs and Other Institutions

Banks and Financial Institutions	Mid-July 2016	Mid-July 2017	Mid-July 2018	Mid-July 2019
Commercial Banks	28	28	28	28
Development Banks+	67	40	33	29
Finance Companies++	42	28	25	23
Microfinance Financial Institutions	42	53	65	90
Sub-Total	**179**	**149**	**151**	**170**
NRB Licensed Cooperatives	15	15	14	*
NRB Licensed FINGOs (with limited banking activities)	25	25	24	**
Insurance Companies	26	26	38	39
Reinsurance Company	1	1	1	1
Sub Total	**67**	**67**	**77**	**40**
Securities Market Institutions				
Stock Exchange	1	1	1	1
Central Depository Company	1	1	1	1
Stockbrokers	50	50	50	50
Merchant Bankers	17	24	25	30
Mutual Funds	6	9	9	9
Credit Rating Agencies	1	1	2	2
Depository Participants$	66	65	70	72
ASBA BFIs$	0	0	65	52
Sub-Total	**76**	**86**	**88**	**98**
Employees Provident Fund (EPF)	1	1	1	1
Citizen Investment Trust (CIT)	1	1	1	1
Postal Saving Bank	1	1	1	1
Deposit and Credit Guarantee Fund	1	1	1	1
Credit Information Center Limited(CICL)	1	1	1	1
Total	**327**	**307**	**321**	**313**

* *NRB Licensed cooperatives: Dismissed from August 2018.*

** *NRB Licensed FINGOs (with limited banking activities): Licensed under Microfinance*

$ *BFIs repeated as ASBA BFIs and Depository Participants not included in Total.*

\+ *including 1 problematic*

++ *including 4 problematic*

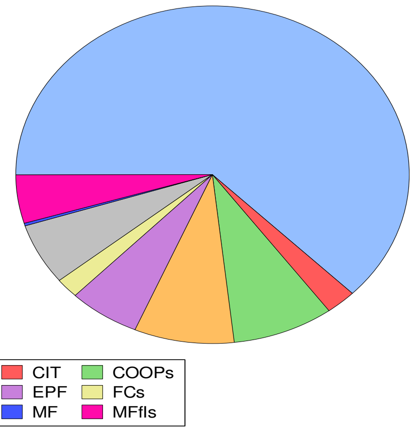
Table 2.2: Structure of the Nepalese Financial Sector (Assets/ Liabilities or Sources/Uses)

Financial Institutions	Mid-July			*(Amount In Billion Rupees)*	
	2015	2016	2017	2018	2019
Commercial Banks	1,774.50	2,184.81	2,621.23	3,104.27	3687.33
Development Banks	300.64	350.84	305.07	374.70	486.31
Finance Companies	108.00	103.44	82.60	96.01	112.54
MFIs	70.88	100.77	133.91	175.61	273.02
Cooperatives	265.55	385.72	396.53	388.13	491.93*
Contractual Saving Institutions					
Employees Provident Fund	195.90	224.85	251.28	292.16	346.64
Citizen Investment Trust	67.67	83.01	99.10	114.06	148.90
Insurance Companies	129.45	158.24	185.89	260.31	347.15
Reinsurance Company	6.15	6.26	6.85	10.04	12.14
Mutual Fund	-	-	9.75	12.95	15.64
Total	**2,918.77**	**3,597.96**	**4,092.10**	**4,828.25**	**5921.59**
Market capitalization (NEPSE)	989.40	1,889.45	1,856.82	1,435.13	1567.5
Total (incl. market capitalization)	**2,918.77**	**5,487.40**	**5,952.09**	**6,263.39**	**7488.95**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Commercial Banks	60.80	60.72	64.00	64.29	62.26
Development Banks	10.30	9.75	7.45	7.76	8.21
Finance Companies	3.70	2.88	2.02	1.99	1.90
MFIs	2.43	2.80	3.27	3.64	4.61
Cooperatives	9.10	10.72	9.68	8.04	8.30
Contractual Saving Institutions					
Employees Provident Fund	6.71	6.25	6.14	6.05	5.85
Citizen Investment Trust	2.32	2.31	2.42	2.36	2.51
Insurance Companies	4.44	4.40	4.54	5.39	5.86
Reinsurance Company	0.21	0.17	0.24	0.21	0.20
Mutual Fund	-	-	0.24	0.27	0.26
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100**

**Based on first 8 Month's data of FY 2018/19*

The share of BFIs in total assets and liabilities of the financial system stood at 79.06 percent in mid-July 2019 compared to 77.68 percent in the previous fiscal year. The

Figure 2.1: Structure of Assets Holding in Financial System



commercial banks remained the key player in the financial system occupying 62.26 percent of the system's total assets followed by development banks (8.21 percent), finance companies (1.90 percent) and microfinance financial institutions (4.61 percent). These figure stood at 64.29 percent, 7.76 percent, 1.99 percent 3.64 respectively.

In case of contractual saving institutions, insurance companies are a dominant institution having 5.86 percent share, followed by EPF (5.85 percent), CIT (2.51 percent), and Reinsurance Company (0.20 percent) as of mid-July 2019. The share of cooperatives in total financial system stood at 8.30 percent in mid- July 2019 compared to 8.04 in mid-July 2018. These figure stood at 6.05 percent, 5.39 percent, 2.36 percent and 0.21 percent.

Figure 2.2: Total Assets and Assets to GDP Ratio

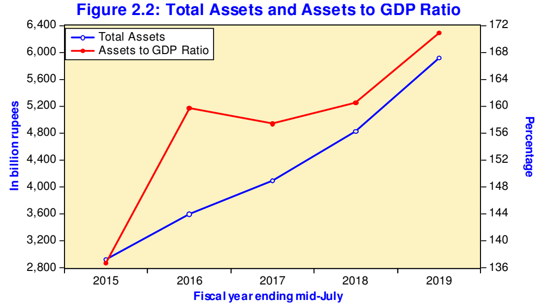
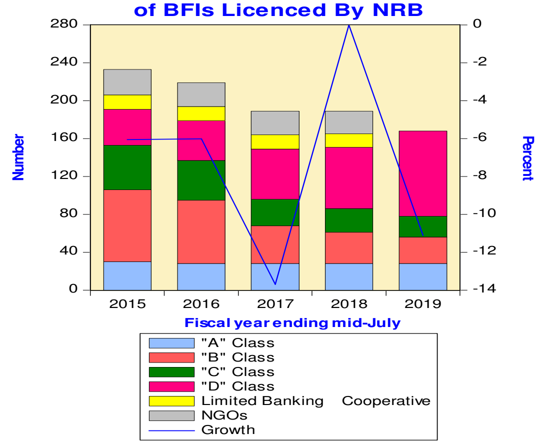


Figure 2.2 depicts the size of Nepalese financial system. The ratio of total assets of the financial system to GDP, which has been continually rising, reached 170.93 percent in mid-July 2019. Total assets and liabilities of commercial banks remained at 106.43 percent of GDP followed by development banks (14.03 percent), finance companies (3.24 percent), MFIs (7.88 percent) and Cooperatives (14.19 percent). Further, such ratio for contractual saving institutions stood at 25.12 percent comprising 10.06 percent of EPF, 4.29 percent of CIT, 10.02 percent of insurance companies, 0.34 percent of Reinsurance Company and 0.45 percent of mutual fund in mid-July 2019.

2.2.2 Structure and Performance of Banks and Financial Institutions

The Nepalese banking system has changed significantly, both in terms of number and structure, since 1985. Along with the financial liberalization, the number of BFIs peaked in 2011 to 218 from only 3 in 1985. While the global financial system was ridden with a crisis, new financial institutions were rapidly emerging in Nepal which underlined that Nepalese economy is less exposed to international financial markets. Nonetheless, efforts were made to consolidate so that the banking sector can be more resilient to any unfavorable changes and hence the number for BFIs has been decreasing. The decreasing trend is primarily attributed to the mergers and acquisitions. The growth of "D"- class institutions in the FY2018/19 is the result of transforming NRB licensed FINGOs to "D" class institutions.

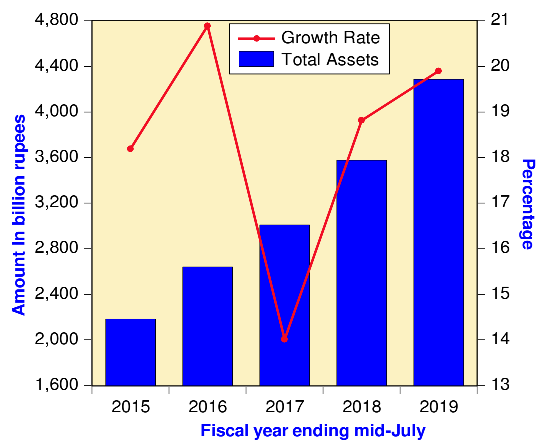
Figure 2.3: Number and Growth of BFIs Licenced By NRB



2.2.3 Growth of Assets in the Banking System

Total assets and liabilities of BFIs have continued to increase. As of mid-July 2019, total assets of BFIs increased by 19.89 percent to NPR 4,286.19 billion, compared to NPR 3,574.90 billion a year ago. Though restrictions have been placed on the licensing of new BFIs, there has been significant expansion of the balance sheet of BFIs mainly due to the increase in deposits and credits. Increase in deposits is mainly driven by increase in banking habits, expansion in banking outreach, supported by the wider adoption of information technology, and remittance inflows. The liabilities side of the balance sheet has grown on account of the increase in paid up capital and reserves through issuance of right shares, bonus share and increase in profit. Similarly, the government has injected a significant capital in the state-owned banks.

Figure 2.4
Total Assets in Banking System



As of mid-July 2019, the five large commercial banks namely RBB, NICA, NIBL, NABIL and EBL collectively accounted for 24.73 percent of total banking system assets and 28.74 percent of total commercial banks' assets. As of mid-July 2019, the five large commercial banks i.e RBB, NICA, NIBL, NABIL and EBL had total assets size of NPR 260.96 billion, NPR 222.86 billion, NPR 202.99 billion, NPR 194.98 billion, and NPR 178.19 billion respectively. This implies a concentration of banking assets to few banks in Nepal. The failure of any of these large banks is, therefore, likely to have a significant impact on the financial stability of Nepal.

2.2.4 Sectoral Credit Distribution by the Banking Sector

A large part of BFIs lending is concentrated in eight key areas of economic activities. Of the total credit outstanding, as of mid-July 2019, trade (wholesaler & retailer) accounted for 21.13 percent, followed by agriculture, forestry and beverage production related (17.52 percent), other services (13.96 percent), construction (10.63 per cent), finance, insurance and real estate (8.03 percent), consumption (5.63 percent), agricultural and forest related (5.42 percent), and Electricity, Gas and Water (4.35 percent).

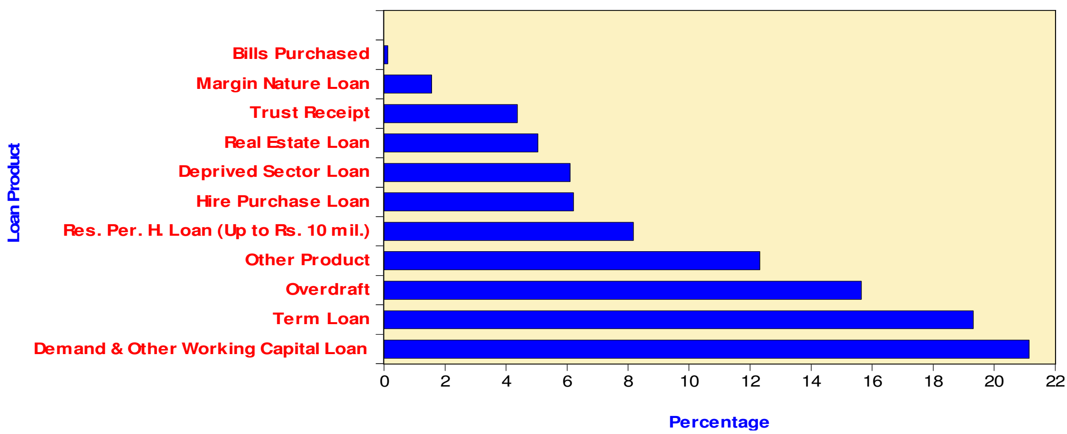
Table 2.3: Credit Distribution in the Banking System(as of mid-July, 2019)

Sector	Percent
Agricultural and Forest Related	5.42
Fishery Related	0.14
Mining Related	0.25
Agriculture, Forestry & Bevarage Production Related	17.52
Construction	10.63
Electricity, Gas and Water	4.35
Metal Products, Machinary & Electronic Equipment & Assemblage	1.27
Transport, Communication and Public Utilities	3.2
Wholesaler & Retailer	21.13
Finance, Insurance and Real Estate	8.03
Hotel or Restaurant	4.19
Other Services	4.22
Consumption Loans	5.63
Local Government	0.05
Others	13.96
TOTAL	**100**

Concentration of lending to a few sectors would expose banks to credit concentration risk. Though NRB has made mandatory provision of lending to priority sector to support economy ,BFIs have not been able to lend to the priority sector as per expectations.

As per the product-wise portfolio, BFIs have made highest lending in demand and working capital loan (21.15 percent) followed by term loan (19.32 percent) and overdraft (15.65 percent). The real estate loan has come below the regulatory requirement of 10 percent, standing at 5.05 percent in mid- July, 2019. Figure 2.5 depicts the product-wise lending of BFIs as of mid-July 2019.

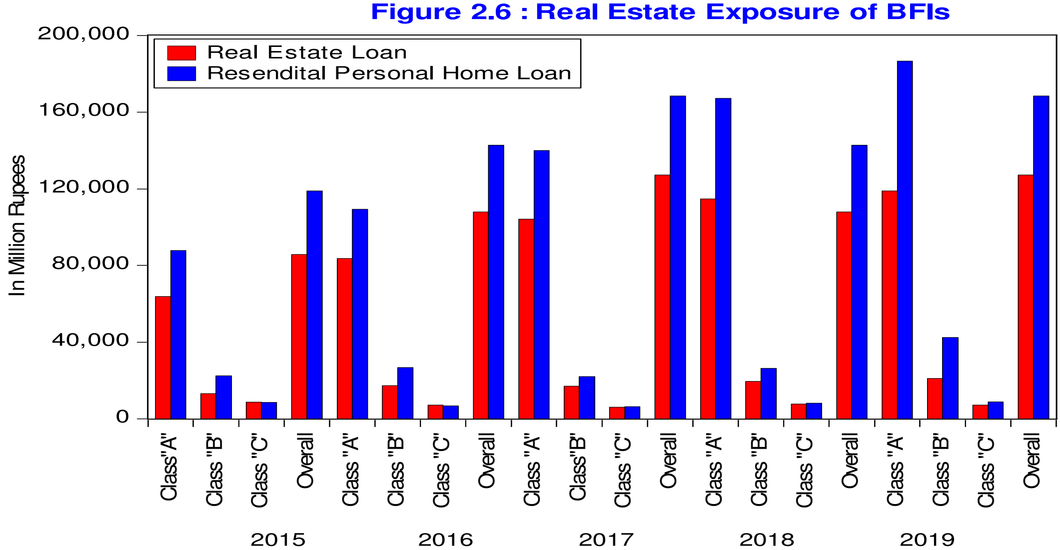
Figure 2.5: Product wise lending of BFIs



2.2.5 Real Estate Lending

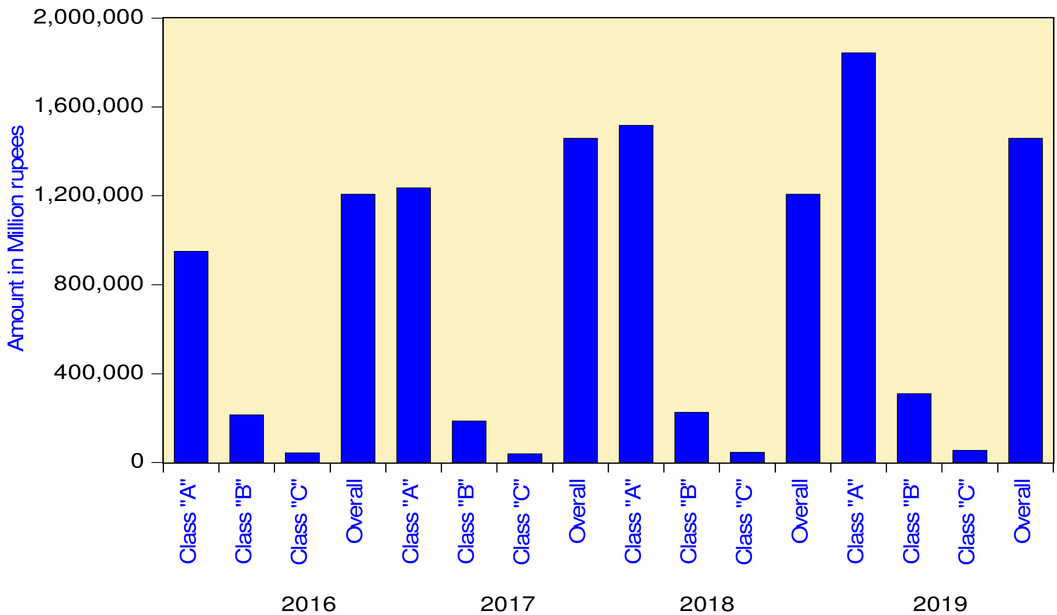
NRB has deployed some macro prudential measures to address real estate lending such as caps on real estate loans, loan-to-value ratio, and sectoral capital requirements. NRB has directed BFIs to limit their real estate and housing loan exposure to 25 percent of their total loans. The BFIs are also required not to issue loans exceeding 50 percent of fair market value of the collateral/project outside Kathmandu valley and 40 percent inside Kathmandu valley. The maximum loan-to-value (LTV) ratio for residential housing loan is 50 percent for Kathmandu valley and 60 percent for places

Figure 2.6 : Real Estate Exposure of BFIs



outside Kathmandu valley. As for the real estate sector (which does not include the housing sector), BFIs are to reduce their respective exposure to 10 percent. However, NRB has granted some relaxation on residential home loan whereby BFIs can lend up to NPR 15 million for personal residential home loan.

Figure 2.7: Loan Against Collateral of Fixed Assets



The banking system has reduced its high exposures in real estate after the introduction of some additional macro prudential measures. The direct real estate exposure amounted to NPR 146.99 billion which accounts for 5.86 percent of total loan outstanding in mid-July 2019. Such exposure was about NPR 142.01 billion (5.86 percent of the total outstanding loan) in mid-July 2018.

Commercial banks' direct exposure to real estate and housing loan has declined from 19.40 percent in mid-July 2010 to 12.23 percent in mid-July 2019. Development banks and finance companies have lent 18.37 percent and 23.31 percent, respectively of their total loan portfolios to real estate and housing in mid-July 2019.

BFIs have lent 50.13 percent of their total loan against collateral of fixed assets. Commercial banks have lent 73.78 percent and development banks and finance companies have lent respectively 89.82 percent and 77.96 percent of their total loan portfolio against collateral.

2.3 Directed Lending

2.3.1 Productive Sector Lending

In order to facilitate the sustainable economic growth of the economy, NRB has directed BFIs to lend certain percent of their loan portfolio to the designated productive sector of the economy. Class "A" banks are required to lend at least 25 percent of their total loan to productive sector like agriculture, energy, and tourism among which they are required to flow at least 10 percent of their credit to the agriculture sector, 15 percent to hydropower and tourism sector. Likewise, class "B" and class "C" BFIs are required to lend at least 15 percent and 10 percent, respectively, of their total lending to productive sectors. The objective of this policy is to ensure the availability of adequate funding for sectors like agriculture, hydropower and tourism which are the key drivers of economic growth.

Figure 2.8: Productive Sector Lending of Commercial Banks

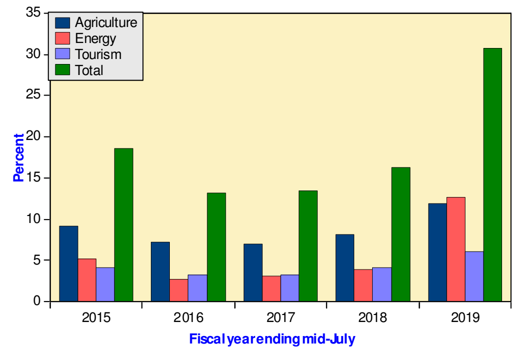
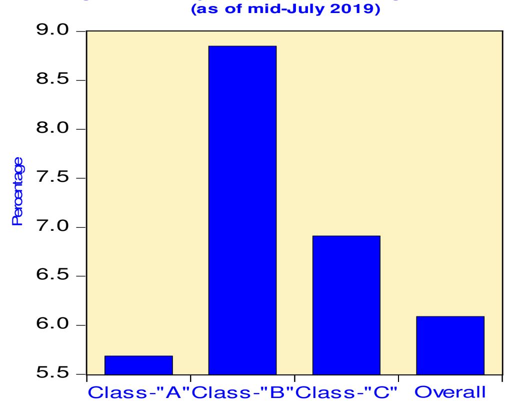


Figure: 2.9: Deprived Sector Lending of BFIs (as of mid-July 2019)



The monetary stance of NRB is designed to ensure the adequate credit for productive investments to support the attainment of the government's GDP growth target. As on mid-July 2019, commercial banks had provided 30.25 percent of their total loan to priority sector which comprises 11.89 percent in agriculture, 12.73 percent in hydropower and energy sector and 6.14 percent in tourism sector. Commercial banks have maintained the regulatory provision of a minimum 10 percent to the agriculture sector and 15 percent for energy and tourism sector.

2.3.2 Deprived Sector Lending

BFIs are required to disburse certain percent of their total loan portfolio to the deprived sector as stipulated by NRB. With the objective of gradual expansion of financial access to the deprived sectors of the economy, NRB has fixed such lending requirement rate at 5 percent for class “A”,“B” and “C”. The overall deprived sector lending by BFIs as of mid-July 2019 remained 6.09 percent whereas commercial banks, development banks and finance companies have lent 5.69 percent, 8.85 percent and 6.91 percent, respectively.

2.4 Liability Structure of the Banking Sector

Deposits are the largest source of external funds in the banking sector. The share of total deposits is 78.26 percent of the total liabilities, as of mid-July 2019. As of mid-July 2019, total deposit increased by 18.0 percent compared to 19.2 percent in mid-July 2018. Likewise, capital fund increased by 20.64 percent, mainly due to capital increment plan of NRB, borrowings increased by 155.91 percent, whereas other liabilities increased by 19.89 percent in mid-July 2019.

Figure 2.10: Liability Structure of BFIs

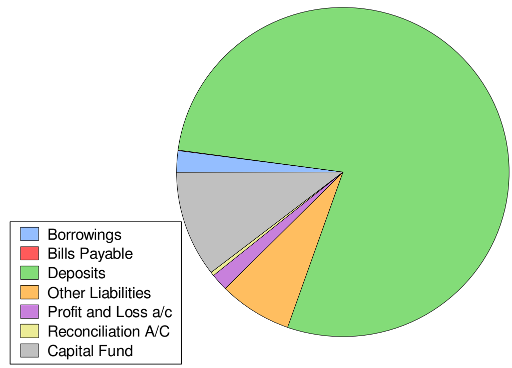
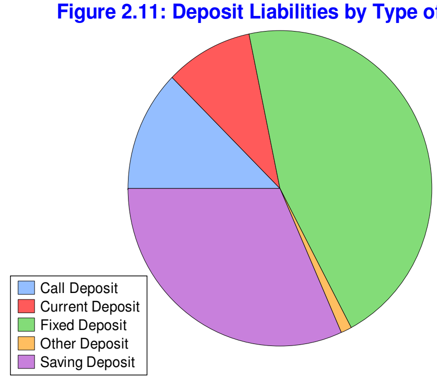


Figure 2.11: Deposit Liabilities by Type of Account



The share of saving deposits, fixed deposits, call deposits, current deposit and other deposit in mid-July 2019 stood at31.62 percent, 45.51 percent, 12.44 percent, 9.29 percent and 1.15 percent, respectively. The relative proportions of such deposits in mid- July 2018 were 33.38 percent, 43.35 percent, 12.96 percent, 9.05 percent and 1.26 percent respectively. The slight change in deposit structure is mainly driven by the increase in deposit rates following the liquidity tightness in the financial sector during the review period.

The total deposits of BFIs increased to NPR 3,354.42 billion in mid-July 2019 from NPR 2,836.90 billion a year ago. The share of top five BFIs stands at 28.42 percent of the total deposits, of the banking system, depicting a significant concentration of deposits in these institutions. Such a concentration ratio of deposit was 25.08 percent in the previous year. Among top five banks, one is state owned bank.

2.5 Financial Soundness Indicators

2.5.1 Capital Adequacy

In mid–July 2019, the capital fund of BFIs increased by 20.64 percent, to NPR 446.40 billion from NPR 370.01 billion in mid–July 2018. Such increment was 19.88 percent in the previous year. The capital fund is composed of paid-up capital (NPR 305.88 billion), statutory reserves (NPR 76.17 billion), retained earnings (NPR 4.53 billion) and other reserves (NPR 59.80 billion). In mid-July 2019, the CAR of commercial banks was be 13.95 percent; while such CAR of development banks and finance companies were 15.95 percent 20.42 percent respectively. The overall CAR of BFIs in mid-July 2019 stood at 14.29 percent, little lower than 15.15 percent in the previous year. The excess of capital adequacy ratio over the minimum requirement of banking system was mainly due to the consolidation among development banks and finance companies through merger and acquisition as well as the capital increment decision of NRB. The overall CAR of BFIs remained well above the standard requirements set by NRB which indicates that the banking system's capital soundness is in strong position.

Figure 2.12: Capital Adequacy Ratios of BFIs

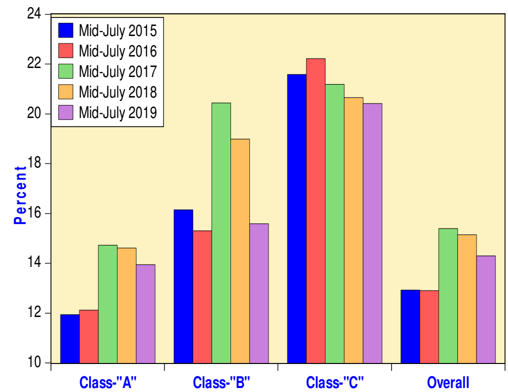
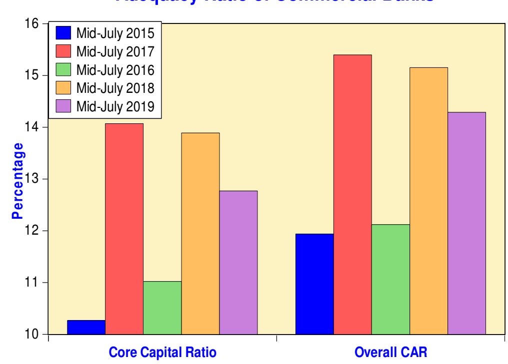


Figure 2.13: Core Capital and Overall Capital Adequacy Ratio of Commercial Banks



In mid-July 2019, commercial banks' compliance with the minimum Capital Adequacy Ratio (CAR) remained 100 percent. As evident from Figure 2.12, all banks have complied with the minimum CAR in mid-July 2019. During the period of 2011-2014, only two state owned banks (SOBs), Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) were non-compliant to regulatory CAR. With the injection of capital, RBB met capital adequacy ratio in mid-July 2015 with Tier1 capital of 9.9 percent and CAR ratio of 10.3 percent.

The analysis so far suggest that, over the period of mid-July of 2014-2019 the capital adequacy ratios of commercial banks are higher than regulatory standard. For instance, overall CAR of the commercial banks in mid-July 2019 is 13.95 percent compared to 10.6 percent in mid-July 2011.

2.5.2 Assets Quality

NPL of BFIs increased from NPR 38.51 million in mid-July 2018 to NPR 44.18 billion in mid-July 2019. In terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2019 indicating the banking sector's resilience toward vulnerable risk assets. NPL to total loans of BFIs decreased by 0.08 percentage points to 1.52 percent in mid-July 2019; compared to1.60 percent a year ago. NPL to total loans of commercial banks increased by 0.01 percentage point on y-o-y basis to stand at 1.40 percent in mid-July 2019.

None of the commercial banks have NPL above 5.00 percent in mid-July 2019. Likewise, NPL ratio of development banks decreased by 0.17 percentage points to 0.92 percent in mid-July 2019 as compared to 1.09 percent in mid-July 2018. The NPL ratio of finance companies have come down to 8.80 percent in mid-July 2019 which was in double digits at 10.83 percent in mid-July 2018. In mid- July 2019, BFIs watchlist provision to total loan remains at 0.06 percent. As of mid-July 2019, loan loss provision (LLP) of banking system amounting NPR 63.21 billion is sufficient to cover the outstanding NPL.

Figure 2.14: Non Performing Loans of BFIs

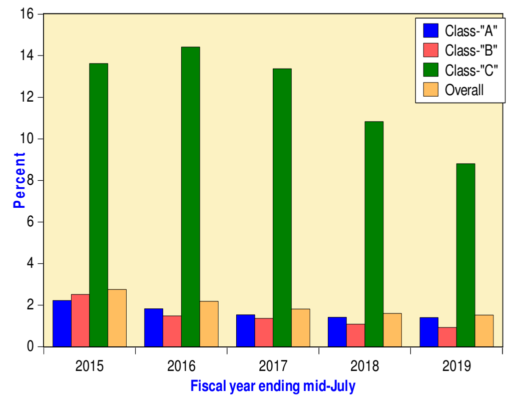


Figure 2.15: Provision Versus Actual Loan Loss

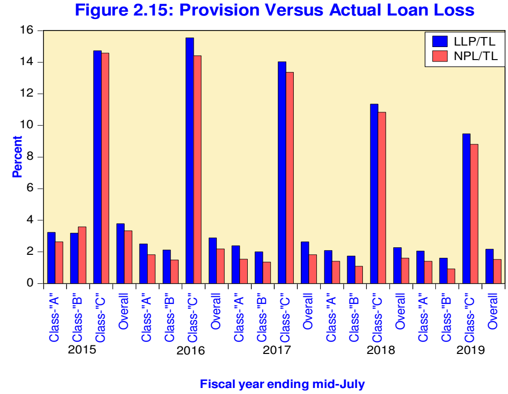
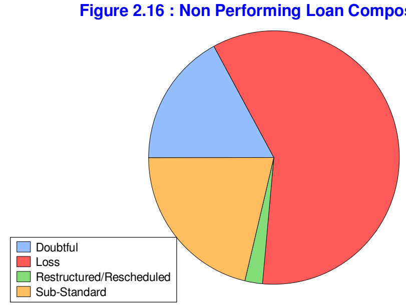
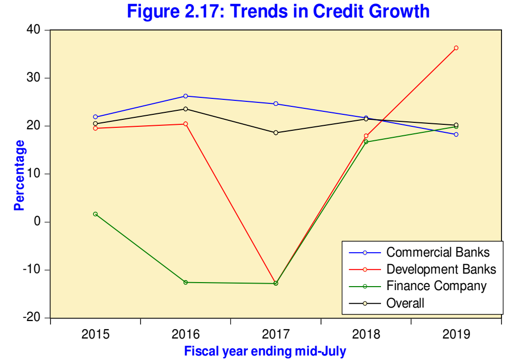


Figure 2.16 : Non Performing Loan Composition of BFIs



In the banking system, the bad loan, in loss category amounted NPR 26.25 billion in mid-July 2019 compared to NPR 23.04 billion in mid-July 2018. The ratio of such loans to NPL increased to 69.88 percent in mid-July 2019 from 59.83 percent a year ago. This reflects the deterioration in assets quality of the banking system. However, it is a matter of concern that a bulk of NPL is in loss category.

Figure 2.17: Trends in Credit Growth

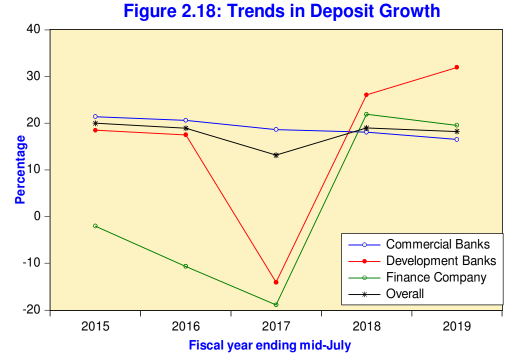


The NPL under sub-standard and doubtful categories constituted 21.25 percent and 17.06 percent respectively in mid-July 2019. The ratio of restructured/rescheduled loans to total NPL remained around 2.27 percent in FY 2018/19.

2.5.3 Leverage Ratio

Basel Committee on Banking Supervision has introduced leverage ratio which is complementary to the risk-based capital framework and aims to restrict the build-up of excessive leverage in the banking sector. Basel III has set a minimum leverage ratio of 3.0 percent at all times whereas NRB has set a minimum leverage ratio of 4.0 percent at all times.

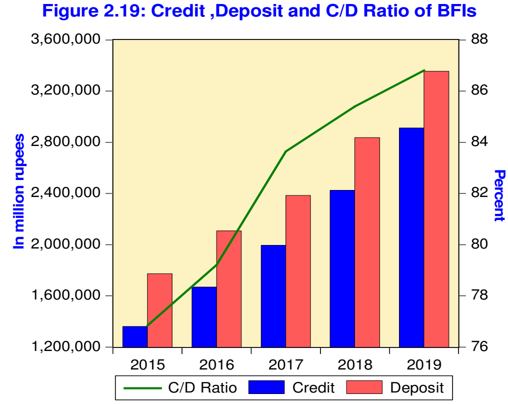
Figure 2.18: Trends in Deposit Growth



2.5.4 Credit and Deposit Growth

Credit flows from BFIs increased by 20.18 percent in mid-July, 2019 compared to 21.47 percent credit growth a year ago. The increase in credit growth rate was mainly due to increase in source of funds of BFIs on the one hand and increase in credit demand as a result of improvements in investment climate, on the other.

Figure 2.19: Credit ,Deposit and C/D Ratio of BFIs



The trend of credit growth and deposit growth of "A", "B" and "C" class financial institutions is presented in Figure 2.17 and Figure 2.18, respectively. The figure shows sharp decline in credit and deposit growth rate in Mid-July 2017 for development banks and finance companies, whereas the credit and deposit growth in commercial banks and overall system shows only slight decline. This is due to merger and acquisition of development banks and finance companies into commercial banks. Credit of commercial banks, development banks, and finance companies grew by18.25 percent, 36.29 percent and 19.86 percent, respectively, in mid- July, 2019.

Deposits of BFIs increased by 18.24 percent in mid-July 2019 as compared to 18.96 percent in mid-July 2018. The deposit growth of commercial banks, development banks and finance companies registered 16.53 percent, 31.96 percent and 19.56 percent respectively, in mid-July 2019.

There has been increment in overall credit to deposit ratio to 86.81 percent in mid-July 2019 from 85.41 in mid-July 2018. Such ratio was 90.45 percent for of finance companies, 86.65 percent for development banks, and 86.73 percent for commercial banks.

As of mid-July 2019, the ratio of total deposit to GDP reached 96.83 percent. The share of commercial banks, development banks and finance companies in total deposits stood at 85.85 percent, 11.87 percent and 2.26 percent respectively. Likewise, the ratio of total credit to GDP

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

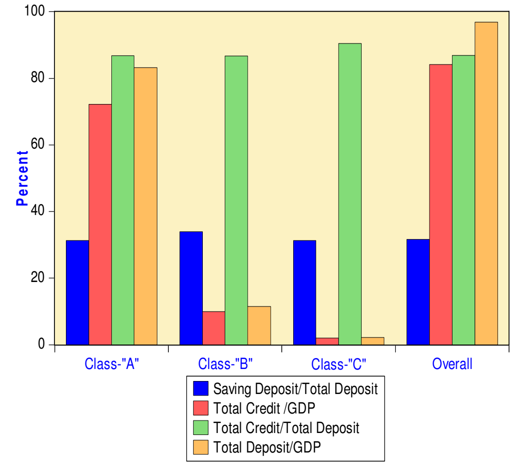


Figure 2.21: Class wise Profitability of BFIs

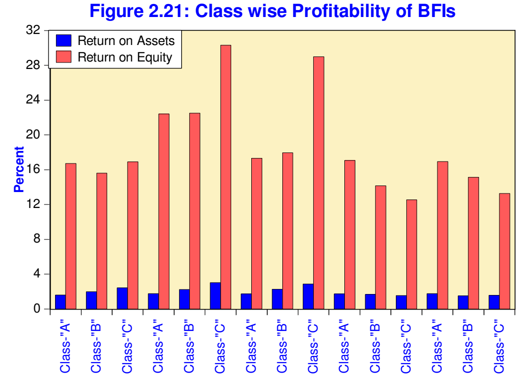
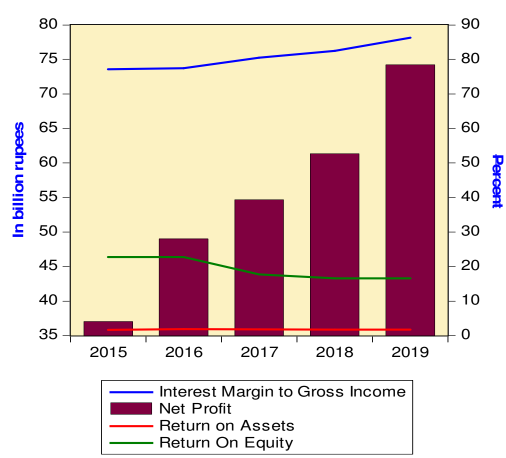


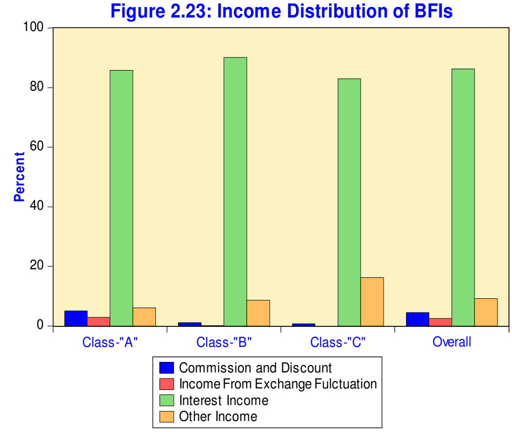
Figure 2.22: Net Profit (in Billion), ROE, ROA and interest Margin to Gross Income (In Percent)



reached 84.11 percent. The share of commercial banks, development banks and finance companies in total credit stood at 85.78 percent, 11.85 percent and 2.36 percent, respectively.

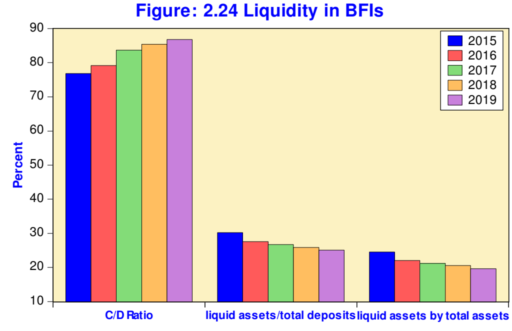
2.5.5 Profitability

Figure 2.23: Income Distribution of BFIs



The overall growth rate of profitability of banking sector has increased in the review period. The overall profitability of banking sector has increased appreciably by 21.01 percent in mid–July 2019 and reached NPR 74.23 billion from NPR 61.34 billion in mid-July 2018.The growth rate of profitability of banking sector in the last year was 12.20 percent. The commercial banks posted the highest share of profitability of the banking sector accounting 87.85 percent of the total in mid-July 2019.The Return on Equity (ROE) of commercial banks have fallen in FY 2018/19 mainly due to increase in capital. The ROE of commercial banks stood at 16.92 percent whereas those of development banks and finance companies stood at 15.14 percent and 13.27 percent respectively. Such ratio was 17.07 percent, 14.14 percent and 12.54 percent, respectively in the previous year.

Figure: 2.24 Liquidity in BFIs



The interest margin to gross income stood at 86.25 percent in mid-July 2019 which was 82.49 percent in mid-July 2018. The net profit of BFIs grew by 24.23 percent in mid-July 2019 from the growth of 12.20 percent in mid-July 2018. ROA increased slightly to 1.73 percent from 1.72 percent; whereas ROE decreased to 16.62 percent in mid-July 2019, from 17.58 percent in mid-July 2018. Interest income comprised the biggest share, 86.26 percent, in total income of BFIs in FY2018/19. Of the total interest income, interest on loan and advance constituted 93.26 percent and interest on call accounts constituted 5.92 percent. Commission based income contributed only 4.48 percent to the total income. The banking sector, thus, is still highly dependent on traditional activities of lending and deposit mobilization. The gain from exchange fluctuation was 2.52 percent and other income was 9.26 percent of the total income of BFIs in FY2018/19.

2.5.6 Liquidity

Fluctuations in the amount of liquidity have been a frequent occurrence in Nepali financial sector due mainly to mismatch in the growth rate of credit relative to deposit mobilization. With an increase in the paid-up capital, banks have been aggressively lending to maintain their profitability. However, they have not been able to generate adequate loanable fund following the sluggish growth of remittances and weak expenditure capacity of the government. NRB has been using credit to deposit (CD) ratio, net liquid assets to total deposits, and liquid assets to total assets as gross measures to monitor the liquidity condition in the banking system.

Total liquid asset to deposit ratio of BFIs stood at 25.06 percent in mid-July 2019 compared to 25.91 percent in mid-July 2018. The total liquid asset to deposit ratios for “A”, “B” and “C” class institutions was 24.41 percent, 27.57 percent and 36.27 percent, respectively, in mid-July 2019.Such ratios were 24.85 percent, 32.35 percent and 36.74 percent respectively in mid-July 2018. Hence, the ratios for all BFIs stood above the regulatory requirements thereby increasing the cost of fund for BFIs.

Table 2.4: Financial Soundness Indicators of BFIs (in percent)

Indicators	Class “A”		Class “B”		Class “C”		Overall	
	Mid-July		Mid-July		Mid-July		Mid-July	
	2018	2019	2018	2019	2018	2019	2018	2019
Credit and deposit related indicators								
Total deposit/GDP	82.19	83.14	10.04	11.50	2.11	2.19	94.34	96.83
Total credit/GDP	70.24	72.17	8.42	9.96	1.91	1.98	80.57	84.11
Total credit/ Total deposit	85.47	86.81	83.9	86.94	90.22	90.45	85.41	86.87
LCY credit/LCY deposit and core Capital	77.07	76.77	72.78	76.92	77.88	72.73	76.81	76.68
Fixed deposit/Total deposit	43.33	45.42	41.36	44.91	53.63	51.78	43.35	45.51
Saving deposit/Total deposit	32.84	31.30	38.05	33.98	32.27	31.31	33.38	31.62
Current deposit/Total deposit	10.08	10.47	2.41	2.37	0.44	0.70	9.05	9.29
Call Deposit /Total Deposit	12.48	11.69	18.08	18.67	7.02	8.20	12.96	12.44
Other Deposit/Total Deposit	1.26	1.11	0.09	0.07	6.65	8.01	1.26	1.14

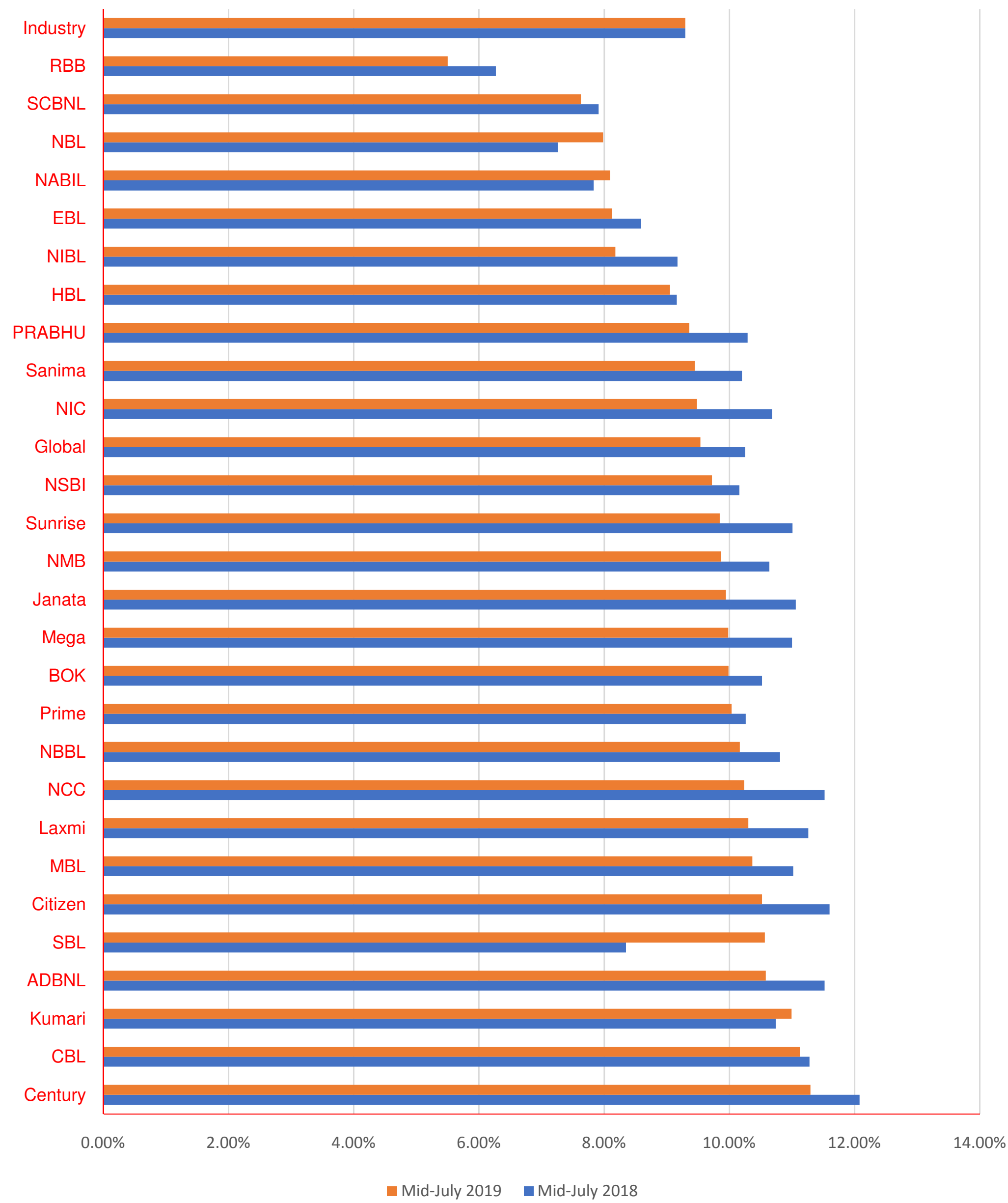
Assets quality related indicators								
NPL/ Total loan	1.41	1.40	1.09	0.92	10.83	8.80	1.6	1.52
Total LLP/Total loan	2.09	2.05	1.73	1.59	11.35	9.49	2.27	2.17
Res. Per. H. Loan (Up to NPR 15 mil.)/Total Loan	7.92	7.47	10.43	12.29	14.05	12.89	8.32	8.17
Real estate exposure/Total loan	5.43	4,76	7.73	6.07	13.36	10.42	5.86	5.04
Deprived sector loan/Total loan	5.94	6.07	9.47	10.14	5.46	7.81	6.28	6.56
Cash and bank balance/Total deposit	12.57	11.30	16.53	12.30	19.49	18.47	13.15	11.58
Investment in Gov. security/ Total deposit	11.57	12.33	2.54	3.83	3.7	5.08	10.43	11.16
Liquid assets/Total assets	19.78	17.19	26.06	22.61	24.32	24.49	20.56	19.61
Total liquid assets/Total deposit	24.85	24.41	32.35	27.60	36.74	36.27	25.91	25.06
Net liquid assets/Total Deposit	23.49	27.47	32.1	26.30	34.9	31.46	24.66	22.35

Capital adequacy related indicators								
Core capital/RWA (percent)	13.32	12.38	17.93	14.86	19.78	19.50	13.89	11.58
Total capital/RWA (percent)	14.61	13.95	18.99	15.59	20.65	20.42	15.15	14.29
Wt. Avg. interest rate on deposit	6.49	6.60	4.69	4.93	-		-	
Wt. Avg. interest rate on credit	12.29	12.16	9.04	8.62	-		-	

2.5.7 Base Rate of BFIs

NRB introduced base rate for commercial banks in 2013 and for development banks and finance companies in 2014 advising the BFIs not to lend, below the base rate. The base rate system will also facilitate BFIs in setting their adjustable interest rate as the cost of funds can act as an effective reference rate. BFIs are required to publish their base rate monthly in their website and quarterly in national daily newspaper for public knowledge. The introduction of base rate is believed to enhance transparency in interest rate setting for different products; protect the clients' interest; promote the healthy competition and sustainability of BFIs; and strengthen the monetary transmission mechanism. Industry average base rate stood at 9.30 percent in the review period.

Figure 2.25: Base Rate of Commercial banks

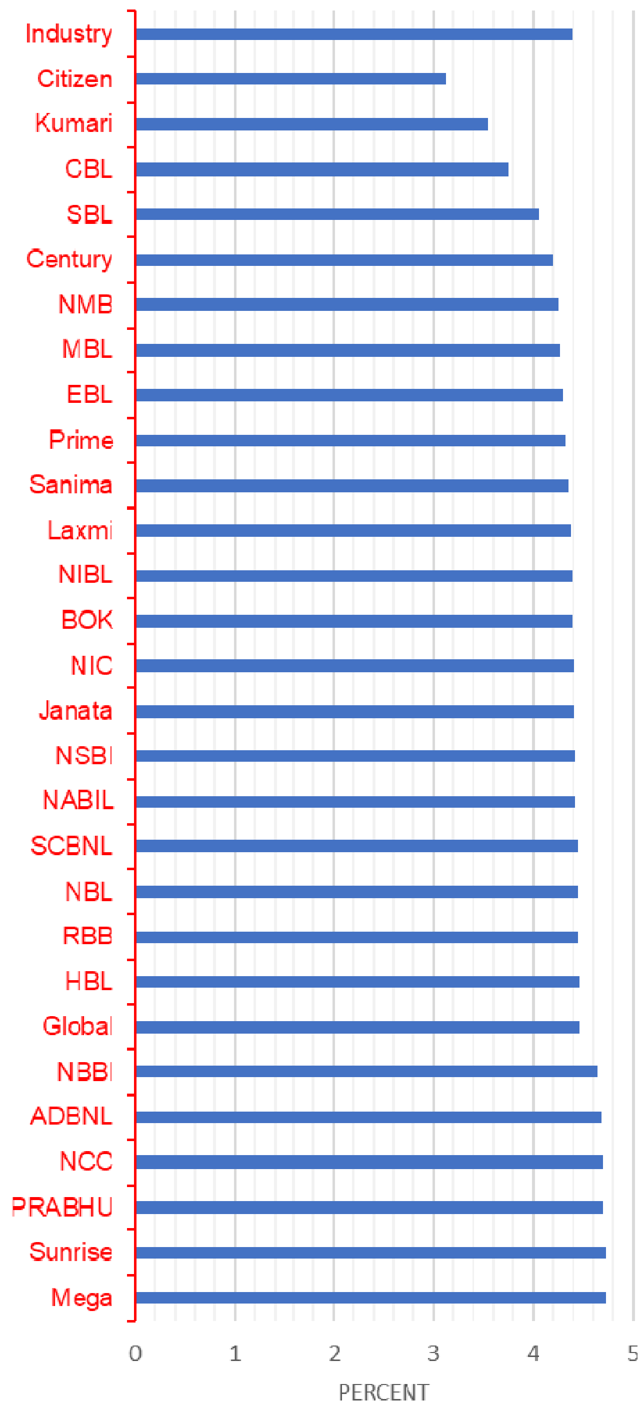


2.5.8 Interest Rate Spread

Interest rate spread is one of the major indicators of reflecting the cost of financial intermediation. The spread, at any given time, is generally a function of many factors such as, expenses on deposits, the general level of competition in the banking sector, the extent of credit risk, and the managerial efficiency of the concerned banks. NRB had directed "A" class banks to bring down their interest spread rate within 4.5 percent and "B" and "C" class financial institutions within 5.00 percent by mid-July 2019. BFIs have also been directed to publish their interest spread on a monthly basis. As evident from the figure 2.26, the overall interest spread of the commercial banks stood at 4.39 percent whereas, the interest spread of the state-owned banks remained higher at 4.53 percent as of mid-July 2019. Mega Bank Ltd. has registered the highest interest rate spread of 4.73 percent among commercial banks followed by Sunrise Bank with interest rate spread of 4.72 percent. Citizen Bank Ltd has the lowest interest rate spread of 3.13 percent in the same period (Figure 2.26).

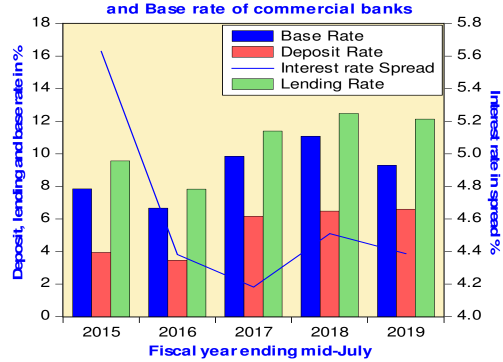
All the state-owned banks have the spread below 5.00 percent in mid-July 2019.

Figure 2.26: Net Interest Spread of Commercial Banks



2.6 Banking Sector Consolidation: Merger & Acquisition

Figure 2.27: Deposit Rate, Lending Rate, Spread Rate and Base rate of commercial banks



Consolidation is taken as one of the tools to enhance the capital base, achieve operational efficiency and strengthen the resilience of BFIs. Merger and acquisitions are considered one of the effective means of financial consolidation. NRB believes, the synergies generated through consolidation will enable BFIs to offer a wider array of products to customers. Diversifying the products offered, in turn, will offer opportunities for customer to diversify risks, thereby helping them to become more resilient.

To strengthen the health and competency of BFIs, NRB has given high priority to merger between licensed financial institutions. It includes specific process of merger with several incentives, regulatory relaxations and encouragement for further consolidations. NRB, through consolidation among BFIs, has expected to yield the benefits of becoming larger institutions, enhancing their capacity for providing modern financial products, enhance strong corporate governance culture, strengthen capital base, ability to introduce new products, maximize the adoption of enhanced IT platforms, enhance economies of scale, lower the cost of funds and ultimately build resilience to domestic and external shocks.

The number of BFIs opting for merger has been increasing after the introduction of merger policy. As of mid-July 2019, total number of BFIs has shrunk from 171 to a total of 43.

2.7 Financial Access and Inclusion

Access to finance is expected to enable the poor and low- income people to be self-reliant and break away from the vicious cycle of poverty. Increasing financial access and inclusion has been a focal point for all regulatory institutions in Nepal. They have been operating through various programs aimed to increase financial access and inclusion in the country. Nepal Financial Inclusion Portal was launched on 30 September 2018. This portal provides information on the status and progress of financial access and inclusion in Nepal.

2.7.1 Efforts of NRB in Expanding Financial Inclusion

Recognizing the need and importance of inclusive growth, NRB in coordination with the government of Nepal, has taken a number of policy measures to ensure reliable and affordable financial services to the poor people in the country. NRB has been endeavoring to extend financial access and inclusion through various incentives directed towards banks and financial institutions. Financial policy of establishing a branch of commercial banks in every local bodies, expanding the size of deprived sector lending requirement for licensed BFIs, mandatory requirements for them to invest certain percentage of their total credit in the priority sectors, liberal branch opening policy in local municipality (except their center), special refinance facility to cottage and small industries, interest free loan to extend bank branches in all local levels, establishment of Rural Self Reliance Fund for subsidized credit to the poor and marginalized population, directives on consumer protection, simplified provision to extend financial services through branchless banking and mobile banking services, and policy regarding financial literacy are some of the policy measures adopted by NRB towards ensuring financial inclusion and inclusive growth in the country. In this connection, Government of Nepal has also announced a policy aiming at a bank account for every citizen.

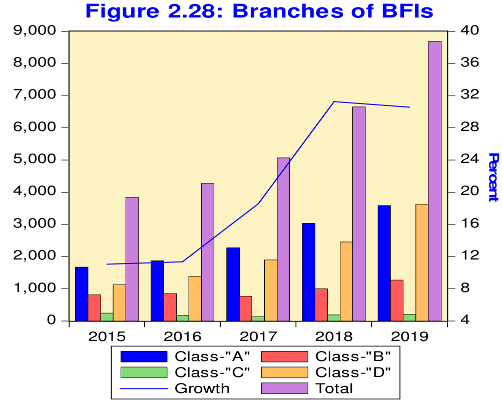
In addition to these, NRB has also been taking initiatives on extending the reach of financial literacy programs and financial consumer protection which is expected to enhance the banking habits of the people.

Table 2.5: Number of Branches of BFIs

Financial Institutions	Number of Branches		Share (in percent)	
	Mid-July 2018	Mid-July 2019	Mid-July 2018	Mid-July 2019
Commercial Banks	3,023	3,585	45.44	41.27
Development Banks	993	1,267	14.93	14.58
Finance Companies	186	205	2.80	2.36
MFIs	2,450	3,629	36.83	41.77
Total	**6,652**	**8,686**	**100**	**100**

Financial access has been increasing with the expansion of branch network of financial institutions. As of mid-July 2019, the branch network of commercial banks has reached 3585. This was followed by development banks (1267), Finance companies (205) and Micro Finance Financial Institutions (3629). In mid-July 2018, the number of such branches of the respective categories of BFIs stood at 3,023, 993, 186 and 2,450, respectively. . With the direction of NRB to open at least one commercial bank branch in the Municipal Government level, along with the increase in branches of other BFIs, the total number of BFIs branches increased by 2,034 (30.57 percent) to 8,686 in mid-July 2019. Consequently, the number of people per BFI branch (excluding MFIs) came down from 6,652 in mid-July 2018 to 5, 776 in mid-July 2019. Including MFIs (Class D FIs) per branch population comes further down to 3363.

Figure 2.28: Branches of BFIs



Increase in number of branches indicates the increase in financial outreach or financial access, which is also considered as one of the indicators of financial inclusion. Despite the growth in number of BFIs and their branches, financial service providers are still mainly concentrated in urban or semi- urban areas where geographical access is relatively easy.

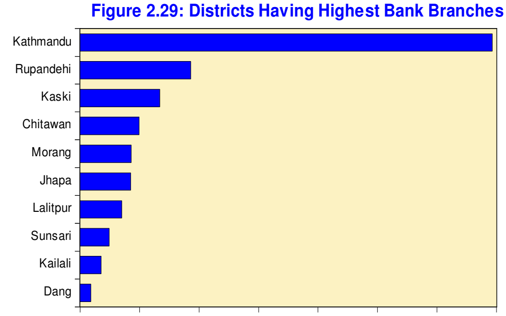
Table 2.6: Provincial Distribution of BFI Branches

Province	A	B	C	D	Total (A+B+C)	Total (A+B+C+D)	Share (in %)	Population (per branch)*
1	585	183	39	624	807	1,431	16.47	6,015
2	421	94	23	660	538	1,198	13.79	11,269
Bagmati	1,238	335	78	554	1,651	2,205	25.39	3,775
Gandaki	396	253	28	497	677	1,174	13.52	3,685
5	530	317	30	814	877	1,691	19.47	5,661
Karnali	159	20	4	168	183	351	4.04	9,593
Sudur Paschim	256	65	3	312	324	636	7.32	8,783
Total	**3,585**	**1,267**	**205**	**3,629**	**5,057**	**8,686**		**5,776**

*Excluding D- class financial institutions

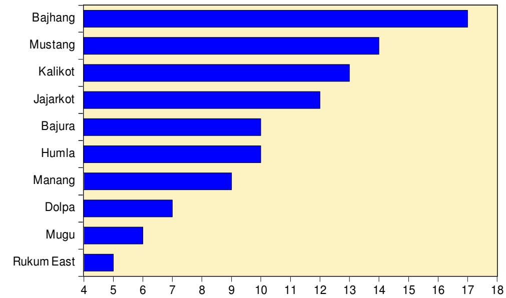
Looking upon the province-wise distribution, the majority of BFIs branches of BFIs are situated in is concentrated in Bagmati Province, totaling 1,651 (25.39 percent). The second biggest BFI branch density is in Province No 5 with total of 877 (19.47 percent).

Figure 2.29: Districts Having Highest Bank Branches



Kathmandu is highly concentrated district in terms of number of BFIs presence, followed by Rupandehi and Kaski. Despite continuous efforts from the NRB in increasing the outreach of financial services in remote areas, the result is still not satisfactory in terms of branch expansion in Karnali Province. Rukum East has only 5 BFIs branches while Mugu has only 6 BFIs branches.

Figure 2.30: Districts Having Least Bank Branches



Investment in information technology (IT) based systems is vital to improve banking efficiency and service delivery in this competitive age. The resulting greater efficiency and outreach will help promote financial inclusion, reduce intermediation costs thereby improving the bottom line of the financial services. Table 2.7 demonstrates the status of electronic banking such as numbers of ATM terminals, number of debit cards, credit cards along with the increase in number of internet banking and mobile banking customers.

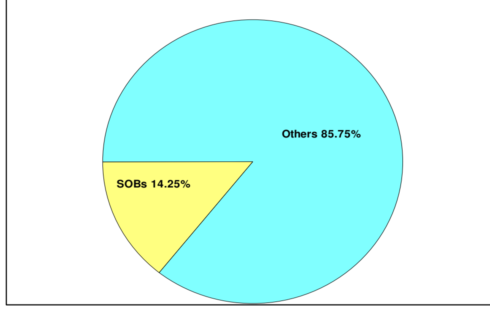
Table 2.7: Use of Financial Services

Particulars	Class "A"	Class "B"	Class "C"	Total
No. of Deposit Accounts	22,927,898	4,375,814	562793	27,866,505
No.of Loan Accounts	1,047,537	349,126	42985	1,439,648
No. of Branchless Banking Centers	1,529	1	0	1,530
No. of Branchless Banking Customers	168,164	143	0	168,307
No. of Mobile Banking Customers	7,406,802	909,512	30873	8,347,187
No. of Internet Banking Customers	888,268	24,124	4952	917,344
No. of ATMs	2,951	318	47	3,316
No. of Debit Cards	6,454,285	216,991	37245	6,708,521
No. of Credit Cards	123,146	0	0	123,146
No. of Prepaid Cards	67,386	0	0	67,386

Branchless banking has been developed to address the payment needs of people who do not have access to the financial system. Branchless banking is a cheaper means of banking system which can be operated in the remote districts whilst phone- based payment systems have been introduced to enhance convenience in making payments at merchandise outlets. In mid-July 2019, branchless banking centers numbered 1,530. BFIs are encouraged to serve through branchless banking in remote areas

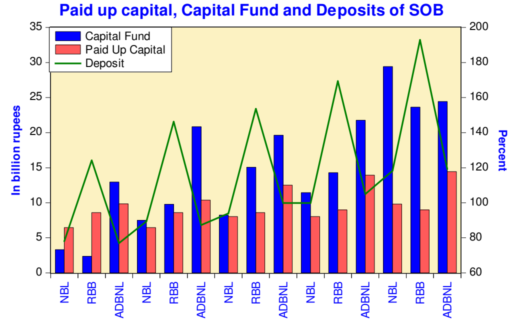
2.8 Performance and Reform of State Owned Banks (SOBs)

Figure 2.31
Share of SOBs in Total Assets of Commercial Banks



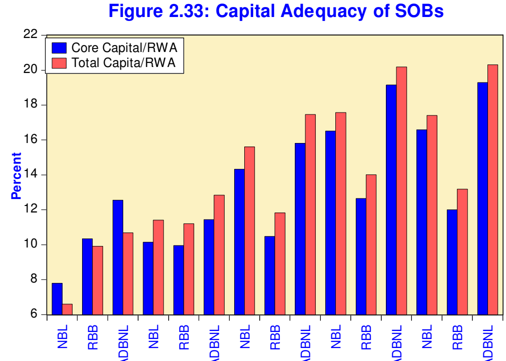
Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBB) and Agriculture Development Bank Limited (ADBL) are the three state-owned commercial banks, whose total assets and liabilities in mid-July 2019 was equivalent to 17.63 percent of that year's GDP. The share of total assets & liabilities of BFIs to GDP reached to 123.724 percent in mid-July 2019. This reflects the progress achieved in Nepal's financial deepening. The total assets of state- owned banks (SOB) increased from NPR 475.29 billion in mid-July 2018 to NPR 610.80 billion in mid-July 2019. The total share of SOBs in total assets of commercial bank is 14.25 percent in mid-July 2019.

Figure 2.32
Paid up capital, Capital Fund and Deposits of SOB



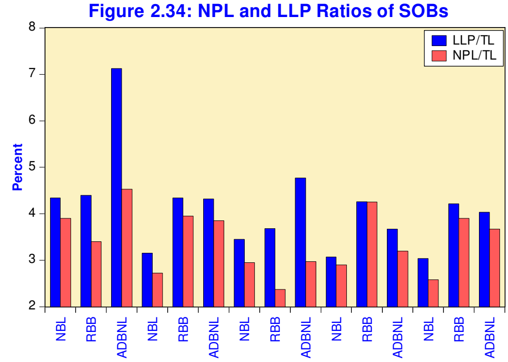
The state-owned commercial banks represent 12.82 percent share in total deposit of commercial banks. Their market share in terms of total assets, total deposit and loan & advances of all BFIs stood at 14.25 percent, 12.82 percent and 12.21 percent, respectively, in mid-July 2019. Among these banks, financial and regulatory position of ADBL, especially in terms of capital base and capital adequacy remains at satisfactory level. The asset quality of NBL and RBB has been gradually improving in the review period.

Figure 2.33: Capital Adequacy of SOBs



As of mid-July 2019, capital fund of NBL stood at NPR 23.43 billion, while that of RBB and ADBL stood ats NPR 23.65 billion and NPR 24.46 billion respectively. The corresponding capital funds of these SOBs in mid-July 2018 were NPR 11.45 billion, 14.30 billion and 21.78 billion, respectively. This shows a significant improvement in the capital base of these SOBs.

Figure 2.34: NPL and LLP Ratios of SOBs



The core capital-to-risk weighted assets and total capital-to-risk weighted assets of ADBL stood at 19.29 percent and 20.31 percent in mid-July 2019. Such capital was 19.16 percent and 20.18 percent, respectively, in mid-July 2018. Likewise, reform of two SOBs led the improvement in core capital and total capital. Both RBB and NBL have already met the minimum capital requirement. The core capital and total capital-to-risk weighted assets of NBL stood at 16.59 percent and 17.41 percent, respectively. Similarly, core capital and total capital-to-risk weighted assets of RBB stood at 12.01 percent and 13.19 percent respectively in mid-July 2019. Improvement in capital adequacy ratio of SOBs indicates improved resilience (Figure 2.33).

The NPL ratio of state-owned banks has improved from 3.54 percent in mid-July 2018 to 3.38 percent in mid-July 2019. As on mid- July 2019, the NPL ratio of ADBL was 3.67 percent, while RBB and NBL had NPL ratios of 3.90 percent and 2.58 percent respectively. This implies improvements in their asset quality. Such ratios were 3.20 percent, 4.25 percent and 2.90 percent in mid-July 2018 (Figure 2.34). The NPL ratio of all state-owned banks are found improving gradually. Though there has been decrease in NPL of SOBs, NPL of majority of other commercial banks have been increasing. Consequently, overall NPL of commercial banks has worsened from 1.39 percent in 2018 mid-July to 2019 mid-July.

2.9 Infrastructure Development Bank

In the review period, Nepal Infrastructure Bank Limited (NIFRA) came into operation with a paid up capital of NPR 12 billion, authorized capital of NPR 40 billion and issued capital of NPR 20 billion. Similarly, in the review period the bank managed to collect fixed deposit of NPR 200 million from institutional depositors, net profit was NPR 669.2 million while the Bank's total assets stood at NPR 13.15 billion.

Chapter – III
Performance of Financial Institutions

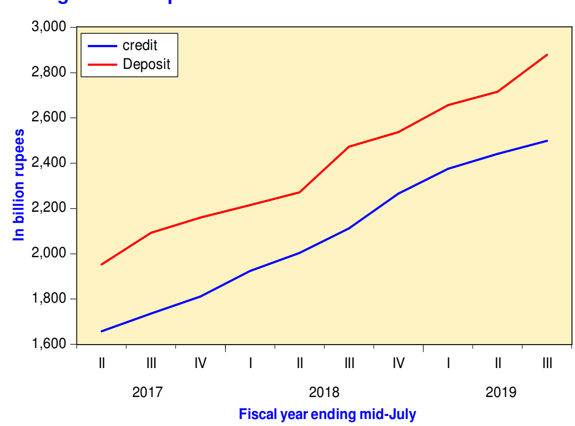
3.1 Performance of Commercial Banks

Nepalese financial system comprises dominant share of BFIs. Moreover, among the BFIs, commercial bank holds significant share in total assets (NPR 3687.33 billion as of mid-July 2019). In mid-July 2019, share of commercial banks in total assets and liabilities of NRB regulated BFIs decreased to 80.87 percent from 83.42 percent in mid-July 2018. Similarly, ratio of total assets and liabilities of commercial banks to GDP increased to 106.43 percent in mid-July 2019 from 103.23 percent a year ago. The dominance of commercial banks in total banking sector in terms of assets and liabilities as well as in terms of balance sheet component has broadly remained stable. The total assets (or liabilities) of commercial banks increased by 18.78 percent to NPR 3687.33 billion in mid-July 2019 from NPR 3104.27 billion in mid-July 2018.

3.1.1 Deposits and Credits

Total deposit and credit of commercial banks stood at 83.14 percent and 72.17 percent of GDP, respectively, in mid-July 2019 compared to 82.20 percent and 70.24 percent of GDP, respectively, in mid-July 2018. Total deposits grew by 16.53 percent to NPR 2880.09 billion in FY2018/19 compared to a growth of 18.07 percent in the previous year. Total credit flow grew by 18.36 percent and reached to NPR 2496.60 in mid-July 2019.

Figure 3.1: Deposit and credit trends of commercial banks



Besides loans and advances, investment in government securities has emerged as the second best option for commercial banks to utilize their excess liquidity. Investment in government securities increased by 24.27 percent, on y-o-y basis, to NPR 355.20 billion in mid-July 2019.

3.1.2 Capital

The capital fund of commercial banks rose by 22.61 percent to NPR 385.24 billion in mid-July 2019 from NPR 314.19 billion a year ago. Of the total capital fund, paid up capital was NPR 252.26 billion and general reserves were 67.35 billion. Moreover, in mid-July 2019, all the commercial banks have maintained the mandatory Capital Adequacy Ratio. Total Capital fund to risk weighted exposure of commercial banks has decreased to 13.96 percent in mid- July 2019 from 14.61 percent in mid-July 2018 (Table 3.1).

3.1.3 Assets

The aggregate NPL to total loan ratio of commercial banks decreased to 1.43 percent in mid-July 2019 from 1.39 percent in mid-July 2018. The three state-owned banks in total have a combined NPL ratio of 3.47 percent whereas that of private commercial banks is 1.09 percent in mid-July 2019. As of mid-July 2018, average NPL ratio of three state owned commercial banks was 3.54 percent, whereas such a ratio for private commercial banks was 1.03 percent. Credit quality of both state-owned commercial banks and private commercial banks on aggregate has slightly improved.

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

Indicators	mid-July 2018	mid-July 2019
Tier 1 & Tier 2 Capital /RWE	14.61	13.96
Tier 1 Capital/RWE	13.32	12.39
NPL/Total Loan	1.39	1.43
Return on Equity	17.07	17.18
Net Interest Spread	3.85	4.09
Total Credit to Total Deposit	85.47	86.77
Total Liquid Assets/Total Deposit	26.2	24.31
Base Rate	9.77	8.93

The existing regulatory provision requires commercial banks to invest at least 25 percent of total loan and advances in agriculture, hydropower/energy and tourism sector. The total loans of commercial banks in agriculture and hydropower/energy and tourism sector accounts for 11.89 percent and 18.36 percent, respectively.

The regulatory requirement for agriculture sector is 10 percent while for energy (hydropower) and tourism sector is 15 percent which has been fully complied.

Product-wise loan comparison with the previous year reveals that commercial banks were less motivated to invest in real estate lending and margin nature loan as they represented 4.7 6percent and 1.72 percent, respectively, of the total loan in mid-July 2019. Similarly, product wise loans in terms of term loan, overdraft loan, demand and other working capital loan and hire purchase loan represent 19.08 percent, 15 percent, 23.96 percent and 5.68 percent respectively, of the total loan in mid-July 2019. Such ratios were 17.46 percent, 16.53 percent, 22.74 percent and 6.50 percent, respectively, in mid-July 2018. There was noticeable growth in term, demand and working capital loan and slight dip in hire purchase loan, which shows that banking sector, especially CBs, still prefer such loans (retail lending) as lucrative for short term profitability and performance. As of mid-July 2019, commercial banks have disbursed 5.69 percent of their total loan in the deprived sector. Loan against properties have shown increasing trend in the review period. Out of total loan, a significantly higher proportion of 89.53 percent are backed by collateral of properties in mid-July 2019 compared to 61.70 percent a year ago.

3.1.4 Profitability

Compared to a modest growth of 16.26 percent in the previous year, net profit of the commercial banks increased significantly by 22.47 percent to NPR 64.45 billion in FY 2018/19. All commercial banks registered positive profit during the review period. Contribution of interest income was 85.76 percent of the total income in the review period, a decent increase from 83.82 percent in the previous year.

3.2 Stress Testing of Commercial Banks

3.2.1 Credit Shock

Stress testing results based on data of mid-July 2019 obtained from 28 commercial banks revealed that a combined credit shock of 15 percent of performing loans degraded to substandard, 15 percent of substandard loans deteriorated to doubtful loans, 25 percent of doubtful loans degraded to loss loans, and 5 percent of performing loans deteriorated to loss loans categories would push down the aftershock capital adequacy ratio of 24 commercial banks below the minimum regulatory requirements (including conservation buffer) of 11 percent. The numbers of such banks were 24 in mid-July 2018 also. Four commercial banks have complied with the regulatory requirement of CAR after shock i.e. 11 percent.

However, another scenario of 25 percent of performing loans of real estate and housing sector directly downgraded to loss loans showed some respite. Under this scenario, capital adequacy ratio of 3 commercial banks will come below the required level of 11 percent. In mid-July 2018 only 2 banks belonged to this category. The result showed that majority of commercial banks maintained their resilience towards real estate sector during the fiscal year.

In another credit shock test, under the scenario of top two large exposures (loans) downgraded from performing to substandard category, the capital adequacy ratio of 1 commercial bank would fall below the required level whereas the number of such commercial banks was 3 in mid-July 2018. This scenario shows that there is slight improvement in the performance due to loan diversification and less dependency on top two borrower's exposure. The overall credit shock scenario revealed that banks' credit quality has been improving as per the expectation due to various measures taken during the review period.

3.2.2 Liquidity Shock

The stress test under scenario of withdrawal of deposits by customers by 2, 5, 10, 10 and 10 percent for five consecutive days showed that 24 out of 28 commercial banks are vulnerable towards liquidity crisis. Eight banks were prone to liquidity shock of withdrawal of 5 percent of deposits in a single day, while 17 banks' liquidity ratio would drop below 20.00 percent after withdrawal of 10 percent deposit in a single day. The number of banks seeing their liquidity ratio drop below 20 percent would grow to 26 if the single day deposit withdrawal increased to 15 percent. In mid-July 2018, the numbers of banks prone to liquidity shock under single day deposit withdrawal of 5, 10 or 15 percent were 8, 21 and 24, respectively.

With the shock of withdrawal of deposits by top 2, 3 or 5 institutional depositors, liquid assets to deposit ratio of 13, 19 and 23 commercial banks would be below 20 percent in mid-July 2019. The numbers were 18, 22 and 22 in mid-July 2018. However, 11 of the commercial banks were vulnerable in case of deposit withdrawals from top 2, 3 individual depositors, respectively, and 1 commercials bank was vulnerable among all commercial banks in case of deposit withdrawals from top 5 individual depositors. Four commercial banks were vulnerable in case of deposit withdrawals from top 5 individual depositors in mid-July 2018.

3.2.3 Market and Combined Credit and Market Shock

The stress testing result under market shock revealed that 28 commercial banks have maintained enough CAR to absorb the interest rate shock and maintain it above the regulatory requirement. The interest rates were calibrated by changes in deposit and credit interest rates from 1 percent to 2 percent. Similarly, commercial banks were found to be safe from exchange rate risks as the net open position to foreign currency was lower for all 28 of them. Furthermore, since commercial banks have nominal equity investments, the impact of fluctuation in equity price is near to zero. However, 2 commercial banks had fall in equity prices by 50 percent.

When going through market shock, all commercial banks could maintain their capital adequacy ratio above the regulatory requirement of 11 percent. The banks did not bear interest rate risks as they pass it directly to their clients; so, they are found to be less affected by interest rate shock as well.

The combined credit and market shocks based on a scenario of 25 percent of performing loan of real estate and housing sector directly downgraded to substandard category of NPLs and fall of the equity prices by 50 percent showed that CAR of 2 banks would fall below 11 percent. However, under a more adverse scenario of 15 percent of performing loans deteriorated to substandard, 15 percent of substandard loans deteriorated to doubtful loans, 25 percent of doubtful loans deteriorated to loss loans and the equity prices fall by 50 percent, the CAR of 10 banks would remain above the regulatory minimum level and CAR of 18 banks would fall below regulatory minimum of 11 percent.

3.3 Performance of Development Banks

Development banks have maintained buffers of capital and liquidity over current regulatory requirements. They have also remained profitable and largely able to withstand various shocks. There has been a significant increase in their deposits and lending during FY2018/19. Increment in business volumes of the development banks has led to increase in profit. Even though, the development banks have enough capital and liquidity to withstand any unfavorable changes in economy, there still seems to be a need for greater resilience among development banks to withstand possible liquidity shocks.

There has been slight decrease in base rate and interest rate spread as compared to the previous FY. Such decline was a reflection of the regulatory requirements and the prevailing market conditions.

Mergers and acquisitions continued during this fiscal year as well such that the number of development banks has decreased from 33 a year ago to 29 in 2018/19.

3.3.1 Deposit and Credit

Total deposits increased by 31.91 percent to NPR 398.33 billion from NPR 301.97 billion during FY 2018/19 while gross loans increased by 36.30 percent to NPR 345.17 billion, from NPR 253.24 billion in 2017/18. However, these figures have to be understood in the context of merger and acquisitions that took place during FY 2018/19.

Credit to deposit ratio stood at 86.94 percent during FY 2018/19 while credit to deposit and core capital ratio was76.68 percent during this period. Growth in credit was more pronounced than the increase in deposits during the period which contributed to the rise in credit to deposit ratio as well as credit to deposit and core capital ratio. As of mid-July 2019, credit to deposit and core capital ratio of national level and other development banks stood at 77.87 percent and 73.12 percent, respectively.

3.3.2 Assets

In 2018/19 total assets of development banks increased by 29.78 percent to NPR 486.31 billion from NPR 374.70 billion in 2017/18. The non-performing loans which stood at NPR 3.16 billion as on mid-July 2019, accounted for 0.92 percent of total loans. This means that non- performing loans as a percentage of total loans decreased by 13 basis points during FY 2018/19. As of mid-July 2019, non-performing loan percentage of national level and other development banks stood at 0.96 percent and 0.71 percent, respectively.

3.3.3 Capital

Core capital to risk weighted assets (RWA) figure declined from 22.73 percent as on mid-July 2018 to 14.86 percent on mid-July 2019 while Capital fund to RWA figure declined from 18.99 percent to 15.96 percent.

The regulatory requirement for FY2018/79 requires a minimum of 6 percent of tier 1 capital to RWE and a minimum 10 percent total capital fund to RWE for national level development banks. Similarly, they require minimum 5.5 percent core capital to RWA and minimum 11 percent capital fund to RWA for other development banks. Therefore, development banks seem to be in a comfortable position with respect to capital adequacy requirement.

The decrease in capital adequacy was largely driven by an increase in business volume via credit growth. As on mid-July 2019, core capital to risk weighted exposure (RWE) and risk weighted assets (RWA) ratio of national level and other development banks stood at 14.47 percent and 16.29 percent respectively; while capital fund to RWE and RWA ratio stood at 15.62 percent and 17.16 percent, respectively.

3.3.4 Profitability

Total net profit of development banks increased by 17.69 percentage during FY 2018/19. However, these figures have to be understood in the context of M&As which occurred during FY2018/19 during which 4 development banks were merged.

Table 3.2: Major Indicators of Development Banks

Particulars	Ratios (in percent)
Core Capital to RWA (RWE in case of National Level)	14.47%
Capital Fund to RWA (RWE in case of National Level)	15.62%
Credit to Deposit (LCY) Ratio	86.94%
Credit to Deposit (LCY) & Core Capital	76.92%
Non-Performing Loan to Total Loan	0.92%
Liquid Assets to Total Deposits	27.60%
Weighted Average Interest on Credit	14.07%
Weighted Average Interest on Deposit	8.62%
Weighted Average Interest on Govt. Sec.	4.93%

Similarly, as on mid-July 2019, ROE and ROA of development banks stood at 13.27 percent and 1.51 percent, respectively. Of this, ROE of national level and other development banks stood at 13.57 percent and 12.31 percent respectively while their ROA stood at 1.46 percent and 1.72 percent, respectively.

3.3.5 Base Rates and Spread Rates

The average base rate of development banks decreased by 1.20 percentage points to 11.22 percent during FY2018/19. Similarly, interest rate spread decreased from

5.30 percent to 5.08 percent. This decrease in base rate is largely attributable to the changes in regulatory requirements. As on mid-July 2019, average base rate of national level and other development banks stood at 11.25 percent and 11.34 percent respectively, while the interest rate spread stood at 4.89 percent and 5.90 percent respectively.

3.4 Stress Testing of Development Banks

Stress test results indicate that national level development banks remain sound and quite resilient to various kinds of shocks though greater resilience seems necessary for liquidity shocks. Results indicate that national level development banks have adequate buffer capital to absorb various shocks as detailed below (Table 3.3):

3.4.1 Credit Shock

Standard credit shock test results indicated that all national level development banks would be able to withstand all except three among nine standard credit shocks to which they were subjected in stress testing scenario. Only one out of eleven national level development banks would not comply with the minimum capital adequacy ratio requirement if 15 percent of performing loans deteriorated to substandard loans,

3.4.2 Liquidity Shock

Standard liquidity shock test results suggested that few national level development banks would fall below mandatory liquidity ratio in stress scenarios. Stress test results indicate that seven national development banks would see its capital adequacy dip below minimum level if there were a withdrawal of deposits by 2 percent, 5 percent, 10 percent, 10 percent and 10 percent per day for five consecutive days.

Similarly, none of the national level development banks were found to have their liquid assets to deposit ratio fall below the regulatory minimum of 20 percent if top individual depositors withdrew their deposits.

3.4.3 Other Shocks

All national level development banks were found to be resilient to standard interest rate, exchange rate and equity price shocks such that none of the national level development banks would have their capital adequacy ratio fall below the regulatory minimum of 10 percent following these shocks.

Table 3.3: Summary Results of Stress Testing of National Level Development Banks

As of Asar end, 2076

Events		Number of Banks with CAR		
		< 0%	0% - <10%	>=10 %
	Pre Shock	0	0	11
A. After Credit Shock		**Post Shocks**		
		< 0%	**0% - <10%**	**>=10 %**
C1	15 Percent of Performing loans deteriorated to substandard	0	1	10
	15 Percent of Substandard loans deteriorated to doubtful loans	0	0	11
	25 Percent of Doubtful loans deteriorated to loss Loans	0	0	11
	5 Percent of Performing loans deteriorated to loss Loans	0	2	9
C2	All NPLs under substandard category downgraded to doubtful.	0	0	11
	All NPLs under doubtful category downgraded to loss.	0	0	11
C3	25 Percent of performing loan of Real Estate & Hosing sector loan directly downgraded to substandard category of NPLs.	0	0	11
C4	25 Percent of performing loan of Real Estate & Hosing sector loan directly downgraded to Loss category of NPLs.	0	1	10
C5	Top 5 Large exposures downgraded: Performing to Substandard	0	0	11
B. After Market Shocks				
(a) Interest Rate Shocks		**< 0%**	**0% - <10%**	**>=10 %**
IR-1a	Deposits interest rate changed by 1.0 percent point on an average.	0	0	11
IR-1b	Deposits interest rate changed by 1.5 percent point on an average.	0	0	11
IR-1c	Deposits interest rate changed by 2.0 percent point on an average.	0	0	11
IR-2a	Loan interest rate changed by -1.0 percent point on an average.	0	0	11
IR-2b	Loan interest rate changed by -1.5 percent point on an average.	0	0	11
IR-2c	Loan interest rate changed by -2.0 percent point on an average.	0	0	11
IR-3	Combine Shocks (IR-1a & IR-2a)	0	0	11
(b) Exchange Rate Shocks				
E R - 1a	Depreciation of currency exchange rate by20%	0	0	11

E R - 1b	Appreciation of currency exchange rate by25%	0	0	11
(c) Equity Price Shocks				
EQ-1	Fall in the equity prices by 50%	0	0	11
C. After Liquidity Shocks				
	Events			
L-1a	Number of BFIs illiquid after on 1st day while withdrawal of deposits by 2%		0	
	Number of BFIs illiquid after on 2nd day while withdrawal of deposits by 5%		0	
	Number of BFIs illiquid after on 3rd day while withdrawal of deposits by 10%		0	
	Number of BFIs illiquid after on 4th day while withdrawal of deposits by 10%		0	
	Number of BFIs illiquid after on 5th day while withdrawal of deposits by 10%		7	
Number of Banks with Liquid Assets to Deposit Ratio		**< 0%**	**0% - <20%**	**>=20 %**
	Pre-shocks	0	0	11
		After Shocks		
L-2a	Withdrawal of deposits by 5%	0	4	7
L-2b	Withdrawal of deposits by 10%	0	10	1
L-2c	Withdrawal of deposits by 15%	0	11	0
L-2d	Withdrawal of deposits by 20%	0	11	0
L-3a	Withdrawal of deposits by top 1 institutional depositors.	0	0	11
L-3b	Withdrawal of deposits by top 2 institutional depositors.	0	2	9
L-3c	Withdrawal of deposits by top 3 institutional depositors.	0	3	8
L-3d	Withdrawal of deposits by top 4 institutional depositors.	0	5	6
L-3e	Withdrawal of deposits by top 5 institutional depositors.	0	5	6
L-4a	Withdrawal of deposits by top 1 individual depositors.	0	0	11
L-4b	Withdrawal of deposits by top 2 individual depositors.	0	0	11
L-4c	Withdrawal of deposits by top 3 individual depositors.	0	0	11
L-4d	Withdrawal of deposits by top 4 individual depositors.	0	0	11
L-4e	Withdrawal of deposits by top 5 individual depositors.	0	0	11

3.5 Performance of Finance companies[1]

Share of finance companies in the overall economic activity is smaller in comparison to A and B class FIs, as shown by their low deposit to GDP ratio which stood at 2.19 percent in mid-July 2019. Such a ratio was 2.11 percent in mid-July 2018.The total assets (or liabilities) of finance companies increased by 17.21 percent to NPR 112.54 billion in mid-July 2019 compared to mid-July 2018. Finance companies mobilized aggregate deposit of NPR 75.99 billion in mid-July 2019, an increment of 19.56 percent compared to mid-July 2018.

Loan and advances of finance companies stood at NPR 68.73 billion in mid-July 2019,which was 1.86 percent of GDP compared to 1.91 percent of GDP in mid-July 2018.The investment of finance companies increased to NPR 3.88 billion in mid-July 2019 from NPR 2.35 billion a year ago. Investment in government securities accounted for 63.18 percent whereas 33.50 percent of total investment was on share investment. The rest was on other investment.

Capital fund of finance companies stood at NPR 13.22 billion in mid-July 2019 which is 19.45 percent of their risk weighted exposure. In mid-July 2018 such ratio was 21.44 percent amounting to NPR 14.02 billion.

The credit to deposit and core capital ratio of finance companies registered 72.73 percent in mid-July 2019, which is below the prescribed limit of 80 percent. Such a ratio was 77.80 percent in mid-July 2018.Total non-performing loan of finance companies was 2.41 percent of total loan and advances in mid-July 2019 compared to 2.91 percent in mid-July 2018. Non-banking assets of finance company has decreased by 6.21 percent to NPR 0.36 billion in mid-July 2019 from NPR 0.38 billion in mid-July 2018. Loan loss provision reached to NPR 1.9 billion in mid-July 2019 from NPR 1.8 billion in mid-July 2018. Finance companies, as a whole, are in profit as reflected by their positive ROA (1.50 percent) and ROE (9.87 percent).

Net liquid assets to total deposit of finance companies stood at 31.46 percent in mid-July 2019 which implies that finance companies are in comfortable position in terms of liquidity. Out of total loan and advances, construction comprises the highest share 14.50 percent, followed by wholesale and retail sectors (13.81 percent, and agriculture and forest related sector (6.90 percent) in mid-July 2019. Share of fishery is minimal with 0.10 percent of the total, while 25.45 percent of

[1] excluding five problematic finance companies which are under resolution process.

the loan was provided to unclassified sectors. Likewise, the share of demand & other working capital loan and term loan were 8.12 percent and 18.48 percent, respectively. The share of deprived sector loan stood at 8.34 percent, higher than the minimum requirement of 5 percent. In mid-July 2019 real estate loan had 7.53 percent share in total loan and advances.

Total number of finance companies which stood 25 in mid-July 2018 decreased to 23 in mid-July 2019 as 2 finance companies got merged with other BFIs in the review period. As of mid-July 2019, four finance companies are in problematic status and under resolution process. In mid-July 2018, five finance companies were in problematic status.

3.6 Stress Testing of Finance Companies

NRB has mandated all the national-level finance companies to conduct stress tests and to report it to NRB on a quarterly basis. Stress testing result of 17 national-level finance companies found that finance companies remained less vulnerable to individual credit shocks and liquidity shocks in aggregate. However, for 1 finance company, capital adequacy ratio decreased to less than 10 percent after combined credit shocks. In the same way, for 10 finance companies, liquidity ratio decreased to less than 20 percent after withdrawal of deposits by 20 percent. Position of finance companies after stress testing scenarios is shown in the following table (Table 3.4).

Table 3.4: Summary Result of Stress Testing of Finance Companies

Criteria	**Number**
No. of Finance Companies with CAR below 10 percent before shocks	**0**
A. Credit Shock	
	No. of FCs having CAR<10 percent
15 Percent of Performing loans deteriorated to substandard	1
15 Percent of Substandard loans deteriorated to doubtful loans	0
25 Percent of Doubtful loans deteriorated to loss loans	0
5 Percent of Performing loans deteriorated to loss loans	1
All NPLs under substandard category downgraded to doubtful.	0
All NPLs under doubtful category downgraded to loss.	0
25 Percent of performing loan of Real Estate & Housing sector loan directly downgraded to Loss category of NPLs.	0
Top 5 Large exposures downgraded: Performing to Substandard	0

B. Liquidity Shock

	No. of Finance Companies having Liquidity Ratio<20 percent
Withdrawal of deposits by 5 percent	2
Withdrawal of deposits by 10 percent	5
Withdrawal of deposits by 15 percent	9
Withdrawal of deposits by 20 percent	10
Withdrawal of deposits by top 1 institutional depositors.	1
Withdrawal of deposits by top 2 institutional depositors.	1
Withdrawal of deposits by top 3 institutional depositors.	2
Withdrawal of deposits by top 4 institutional depositors.	2
Withdrawal of deposits by top 5 institutional depositors.	2
Withdrawal of deposits by top 1 individual depositors.	1
Withdrawal of deposits by top 2 individual depositors.	2
Withdrawal of deposits by top 3 individual depositors.	2
Withdrawal of deposits by top 4 individual depositors.	3
Withdrawal of deposits by top 5 individual depositors.	3

Note: Above mentioned data does not include data regarding 5 Problematic Finance Companies which are under resolution process.

Table 3.5: Major Indicators of Finance Companies (as of mid-July 2019)

Particulars	Ratios (in percent)
Core Capital to RWA (RWE in case of National Level)	18.54%
Capital Fund to RWA (RWE in case of National Level)	19.45%
Credit to Deposit (LCY) Ratio	86.27%
Credit to Deposit (LCY) & Core Capital	72.73%
Non-Performing Loan to Total Loan	2.41%
Liquid Assets to Total Deposits	36.16%
Weighted Average Interest on Credit	14.72%
Weighted Average Interest on Deposit	9.59%
Weighted Average Interest on Govt. Sec.	3.88%

3.7 Performance of Microfinance Financial Institutions

As of mid-July 2019, there were altogether 90 microfinance financial institutions (MFIs) operating as "D" class financial institutions. Among them, 4 are wholesale lending MFIs, viz, RMDC, RSDC, Sana Kisan MFI and First Microfinance Financial Institution.

Table 3.6: Key Performance Indicators of MFIs

Amount in NPR Thousand

S.N.	Particulars	Mid-July 2018	Mid-July 2019	Change %
1	No. of MFIs	65	90	38.46
1.1	*No. of Retail MFIs*	*61*	*86*	*40.98*
1.2	*No. of Wholesale MFIs*	*4*	*4*	*0.00*
2	No. of Branches of MFIs	2,450	3,547	44.78
2.1	*No. of Branches of Retail MFIs*	*2,439*	*3,533*	*44.85*
2.2	*No. of Branches of Wholesale MFIs*	*11*	*14*	*27.27*
3	Total Members of MFIs	2,856,859	4,330,586	51.59
3.1	*No. of Members of Retail MFIs*	*2,856,179*	*4,329,836*	*51.60*
3.2	*No. of Members of Wholesale MFIs*	*680*	*750*	*10.29*
4	Total Capital Fund of MFIs (NPR)	21,263,633	32,228,856	51.57
4.1	*Capital Fund of Retail MFIs (NPR)*	*16,094,478*	*25,997,107*	*61.53*
4.2	*Capital Fund of Wholesale MFIs (NPR)*	*5,169,155*	*6,231,749.5*	*20.56*
5	Total Paid-up Capital of MFIs (NPR)	11,182,470	17,077,797	52.72
5.1	*Paid-up Capital of Retail MFIs (NPR)*	*8,782,573*	*14,174,458*	*61.39*
5.2	*Paid-up Capital of Wholesale MFIs (NPR)*	*2,399,897*	*2,903,339*	*20.98*
6	Total Assets of MFIs (NPR)	175,610,062	273,062,387	55.49
6.1	*Assets of Retail MFIs (NPR)*	*141,232,053*	*232,326,349*	*64.50*
6.2	*Assets of Wholesale MFIs (NPR)*	*34,378,009*	*40,736,038*	*18.49*
7	Total Loan and Advances of MFIs (NPR)	145,951,477	235,153,361	61.12
7.1	*Loans and Advances of Retail MFIs (NPR)*	*116,516,477*	*198,380,266*	*70.26*
7.2	*Loans and Advances of Wholesale MFIs (NPR)*	*29,435,000*	*36,773,095*	*24.93*

8	Total Savings in MFIs (NPR)	49,548,794	85,631,899	72.82
9	Total Borrowings of MFIs (NPR)	87,683,689	126,482,161	44.25
9.1	*Borrowings of Retail MFIs (NPR)*	*61,259,102*	*95,247,701*	*55.48*
9.2	*Borrowings of Wholesale MFIs (NPR)*	*26424587*	*31234460*	*18.20*
10	Total Overdue (Loan &Interest) of MFIs (NPR)	2,371,253	4,204,690	77.32
10.1	*Overdue (Loan & Interest) of Retail MFIs (NPR)*	*2,358,540*	*4,188,854*	*77.60*
10.2	*Overdue (Loan & Interest) of Wholesale MFIs (NPR)*	*12,713*	*15,836*	*24.57*
11	Total Loan Loss Provision of MFIs (NPR)	2,391,710	4,011,640	67.73
11.1	*Loan Loss Provisions of Retail MFIs (NPR)*	*2,008,068*	*3,540,415*	*76.31*
11.2	*Loan Loss Provisions of Wholesale MFIs (NPR)*	*3,83,642*	*4,71,225*	*22.83*
12	*Public deposit*	*2,070,849*	*2,126,084*	*2.67*
13	*No. of Total Staff*	*11,557*	*17,362*	*50.23*

Out of 86 Retail MFIs, 2 are public deposit takers, namely, Nirdhan Utthan Microfinance Institution and Chhimek Microfinance Institution. As of mid_July 2019, the number of branches of all MFIs reached to 3,547; creating employment for 17,362 employees. In comparison to previous year, the total members of MFIs increased by 51.59 percent to 4,330,586 in mid-July 2019.

The total outstanding loan of MFIs as of mid-July 2019 increased by 61.12 percent to NPR 235.15 billion as compared to NPR 145.95 billion in previous year. Out of the total loans and advances; the wholesale loan shared only 15.64 percent, while retail loans shared the rest 84.36 percent. The ratio of loan and advances to the total assets stood at 86.12 percent. MFIs booked only 1.34 million as non-banking assets during the review period.

Compared to mid-July 2018, as of mid-July 2019, total capital fund of MFIs increased by 51.57 percent to NPR 32.23 billion. Out of total capital fund, capital fund of wholesale and retail MFIs comprise NPR 6.23 billion and NPR 25.99 billion respectively. The total paid-up capital of MFIs increased by 52.72 percent to reach NPR 17.08 billion. The ratio of paid-up capital to total capital stood at 52.99 percent. The paid-up capital of wholesale MFIs stood at NPR 2.90 billion. Based on risk-weighted assets, MFIs are required to maintain at least 4.0 percent as core capital and 8.0 percent as the capital fund.

In the review period, total asset of MFIs increased by 55.49 percent and reached NPR 273.06 billion. In this category, the share of wholesale MFIs' assets stood at 14.92 percent only.

Total savings mobilized by the MFIs increased by 72.82 percent and reached NPR 85.63 billion in the review period. As compared to the total liabilities of these institutions, the share of savings remained at 31.36 percent. Out of total savings, the share of public deposits is only 2.48 percent which was collected by two microfinance institutions, viz. Chhimek Laghubitta Bittiya Sanstha Limited and Nirdhan Utthan Laghubitta Sanstha Limited., and the rest being collected from the members of 84 retail microfinance institutions. Total borrowings of these MFIs during the review period increased by 44.25 percent and reached NPR 126.48 billion. Out of the total borrowings, wholesale MFIs borrowed 31.23 billion, which comprises only 24.69 percent of total borrowing. As compared to total liabilities of MFIs, the share of borrowed amount remained at 46.32 percent.

The total amount of overdue loan, including interest, of these institutions increased by 77.32 percent to NPR 4.21 billion as compared to the same period of the last year. The overdue of wholesale MFIs stood at NPR 15.84 million. Likewise, the amount of loan loss provision of these MFIs increased by 67.73 percent to 4.01 billion during the review period.

At last, most of the key performance indicators of MFIs improved encouragingly due largely to the increase in the number of MFIs by 38.46 percent in review period. Due to, regulatory requirement, 24 financial intermediary non-governmental organizations (FINGO) were upgraded to MFIs during the review year. This is the primary cause of a sharp increase in the number of MFIs in the review period.

3.8 Financial Literacy

Realizing the importance of financial literacy to improve the demand side of financial access, NRB is being involved in various activities to promote financial literacy in the country. FY 2018/19 was a step forward in the continuous effort of NRB. As NRB is affiliated with different international organizations like Alliance for Financial Inclusion (AFI), and Child and Youth Finance International (CYFI) which are dedicated to promote financial inclusion and financial literacy in the country; various financial literacy- programs were conducted in FY 2018/19 as well. As a member of AFI, NRB has made some commitments towards financial inclusion under the 'Maya Declaration 2013' and most of the commitments in this regard have been fulfilled. The monetary policy of FY 2018/19 envisioned bank account for every citizen and a campaign was announced (NRB, 2018). Similarly, banks were allocated and mandated to open bank branches in local bodies to improve the access. As a result, the accessibility of banking increased to 735 of the 753 local bodies in the review period.

A special school-visit program, entitled 'NRB with Students' has been initiated by the NRB on financial literacy since FY 2013/14. During this on-going program, a team of NRB visits different schools to organize a brief presentation on financial literacy and distributes the financial literacy materials to the students. NRB has already organized several of such programs in different schools throughout the country. Most of these programs were chaired by the high-level authorities of NRB, including Governor himself in many occasions. NRB has also been working closely with the Ministry of Education to incorporate the issues of financial literacy in formal educational curriculum. To promote financial literacy, a separate window has been dedicated within the NRB web-site. SEBON as well as the FNCCI also help educate people including investors, entrepreneurs and businesspersons, students and academicians through various programs.

Similarly, SEBON has been conducting investors awareness programs continuously and it has so far conducted such programs in more than 50 districts. SEBON has published different educational materials for investors of securities market such as "Capital Market Literacy", FAQ on securities market, and Investment tips for investors.

Chapter - IV
Non Banking Financial Institutions

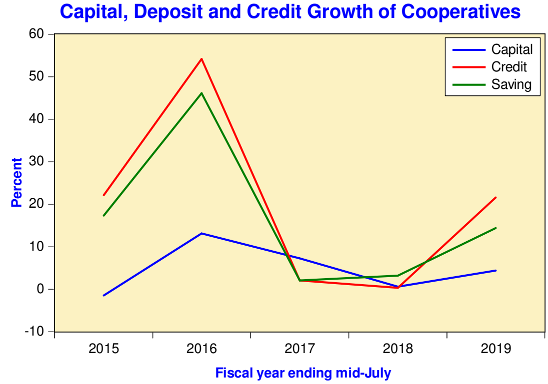
4.1 Performance of Cooperatives

All NRB licensed cooperatives for undertaking limited banking activities have been removed from regulatory and supervisory ambit of NRB from FY2018/19 onwards. These cooperatives are now within the regulatory jurisdiction of Department of Cooperatives. Thus, there is no NRB licensed cooperatives from 17 July 2018.

4.1.1 Government Registered Cooperatives

According to statistics from Department of Cooperatives, 34,763 cooperatives comprising 6.51 million membership are operating throughout the country as of mid-July 2019.

Figure 4.1
Capital, Deposit and Credit Growth of Cooperatives



4.1.2 Financial Highlights of Cooperatives

As of mid-July 2019, deposits of cooperatives totaled NPR 345.58 billion while their total credit stood at NPR 332.71 billion. Cooperatives have total capital of NPR 76.342 billion.

Table 4.1: Key Figures of Cooperatives (As of Mid-July 2019)

Indicators	Figures
No. of Cooperatives	34,737
Members (Nos.)	6.51 Million
Total Staff (Nos.)	63,500
Total Capital (in NPR)	76.34 Billion
Deposit (in NPR)	345.58 Billion
Credit (in NPR)	332.71 Billion
Credit to Deposit Ratio	96.27%
Credit to Capital and Deposit Ratio	78.85%

Source: Department of Cooperatives

The number of cooperatives has increased in FY2018/19. The Department of Cooperatives has been adopting stringent policies for registration of new cooperatives, particularly for savings and credit cooperatives, as most of the cooperatives involved in saving and credit operation were found to be operating without following the Cooperative Standard issued by the Department. Similarly, the Department has been cautious over registration of new multipurpose cooperatives.

Table 4.2: Growth of Cooperatives over the Years

Fiscal Year	Number	Growth (Number)	Growth Rate
1997-98	4349	-	-
1998-99	4860	511	10.51%
1999-00	5671	811	14.30%
2000-01	6484	813	12.54%
2001-02	7074	590	8.34%
2002-03	7445	371	4.98%
2003-04	7598	153	2.01%
2004-05	8045	447	5.56%
2005-06	8530	485	5.69%
2006-07	9720	1190	12.24%
2007-08	11302	1582	14.00%
2008-09	15813	4511	28.53%
2009-10	20102	4289	21.34%
2010-11	23301	3199	13.73%
2011-12	26500	3199	12.07%
2012-13	29526	3026	10.25%
2013-14	31177	1651	5.30%
2014-15	32663	1486	4.77%
2015-16	33599	936	2.87%
2016-17	34646	1047	3.12%
2017-18	34512	-134	-0.39%
2018-19	34763	251	0.72%

Source: Department of Cooperatives

4.2 Other Financial Institutions

4.2.1 Insurance Companies

There are altogether 40 (20 non-life and 19 life and 1 Reinsurance) insurance companies as of mid-July 2019. Total assets/liabilities of insurance companies rose by 33.36 percent to NPR 347.15 billion in FY2018/19. Total assets of life insurance companies' and non-life companies expanded by 34.91 percent and 25.69 percent respectively.

Table 4.3: Sources and Uses of Funds of Insurance Companies

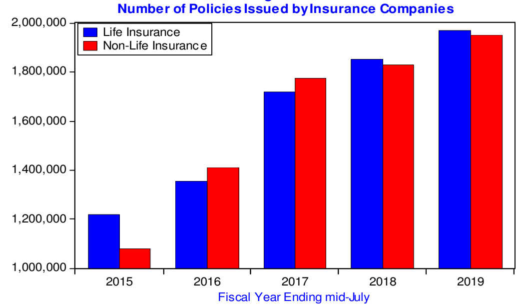
In Billion NPR

Sources	Life				Non-Life			
	2015/16	**2016/17**	**2017/18**	**2018/19**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
Paid-up Capital	6.24	8.30	25.56	30.84	4.75	6.22	10.41	13.91
Reserve Funds	115.69	138.41	180.12	248.75	21.07	24.41	23.62	35.15
Other Liabilities	7.95	4.35	10.92	12.63	4.23	4.2	9.67	5.86
Total	**129.88**	**151.06**	**216.60**	**292.22**	**30.05**	**34.83**	**43.70**	**54.93**
Uses	**Life**				**Non-Life**			
Cash and Bank	2.36	2.25	3.75	6.69	3.18	2.37	3.15	2.63
Investment	117.98	138.83	196.23	263.88	16.82	22.42	31.54	38.05
Fixed Assets	1.66	1.64	2.20	2.47	1.1	1.36	1.42	1.79
Other Assets	7.89	8.34	14.42	19.19	8.96	8.67	7.59	12.46
Total	**129.88**	**151.06**	**216.60**	**292.22**	**30.05**	**34.83**	**43.70**	**54.93**

Source: Beema Samiti (Insurance Regulatory Authority of Nepal)

While the coverage of insurance penetration is very low in comparison to other financial services in Nepal, there have been some sign of significant growth in recent years. Number of policies issued have risen steadily over the years and reached 3.9 million (1.94 million non-life and 1.96 million life) in the review period.

Figure 4.2
Number of Policies Issued by Insurance Companies



Source: Beema Samiti (Insurance Regulatory Authority of Nepal)

4.2.2 Reinsurance Companies

There is only one reinsurance company in Nepal which was formally established in November 7, 2014. Before its establishment, there was an institution called Insurance Pool Nepal to make arrangement of reinsurance for bearing the claims of risk emanating from riot, strike, malicious damage & terrorism (RMSDT).The reinsurance company, presently, has been carrying out various reinsurance portfolios mostly in non-life part. The total assets/liabilities of reinsurance company rose by 20.91 percent to NPR 12.14 billion during FY2018/19.

4.2.3 Employees Provident Fund (EPF)

The total assets of EPF increased by 18.64 percent to NPR 346.64 billion in FY2018/19. Likewise, the funds collected by the EPF grew by 11.15 percent to NPR 309.85 billion in the review period. Similarly, it has reserve created from the profit worth of NPR 33.42 billion.

On utilization side, 52.15 percent of the fund is used in lending to contributors, whereas, 22.59 percent is used in investment in fixed deposits. EPF has been utilizing almost all of its total resources. The loan and investment to total fund ratio stands at 97.60 percent. Its cash and bank balance stood at NPR 4.15 billion. Though cash and bank balance seem to be on lower side, EPF has investment in equity shares, which are highly liquid and can be used to support its liquidity requirements.

Table 4.4: Key Indicators of EPF mid- July, 2019 (unaudited)

Indicators	Amount (Billion NPR)
Sources of Fund	
Provident Fund	309.85
General Reserve and Funds	33.42
Liabilities	1.32
Provisions	2.05
Uses of Fund	
Cash and bank	4.15
Investment in Government Saving Bonds	0.53
Investment in Fixed Deposits	78.32
Investment in Equity Shares	25.43
Project Loan	52.28
Lending to Contributors	180.79
Investment Properties (Investment in Fixed Assets)	0.97
Property, Plant and Equipment (Fixed Assets)	0.26
Assets under construction	0.02
Miscellaneous Assets	3.89
Loan and Investment to Total Fund Ratio	97.60
Loan and Investment to Provident Fund Ratio	109.19

Source: Employee Provident Fund

4.2.4 Citizen Investment Trust (CIT)

CIT is another institutional fund mobilizer with a significant market share. As of mid-July 2019, net fund collections of CIT stood at NPR 148.90 billion, recording a growth of 30.54 percent from NPR 114.06 billion in mid-July 2018. Apart from its capital, reserve and other liabilities of NPR 22.90 billion, regular contributions from members are the only and major source of fund for CIT. Uses of fund of the Trust, which are diversified in three broad categories, stood at NPR 84.22 billion.

CIT has been heavily dependent on BFIs for its fund mobilization. Out of total funds, 51.50 percent has been placed on fixed deposits at BFIs. While fixed deposit accounts 91.05 percent of total investment of CIT, loan and advances to participants accounts 27.29 percent. Considering the nature of the funds, which have longer term prospect, it can be utilized for long term projects with high return.

Table 4.5: Key Figures of CIT mid- July, 2019

Indicators	Figures (Billion NPR)*
Sources of Funds	
Paid up Capital	1.10
Reserve Fund	4.22
Fund Collection	126.00
Other Liabilities	17.57
Total	**148.90**
Uses of Fund	
Cash and Bank Balances	6.03
Investments	**84.22**
a) Fixed Deposits	76.70
b) Governments Bonds	0.60
c) Shares	6.93
d) Debentures	0.97
Loan and Advances	40.65
Fixed Assets& Assets in WIP	0.97
Other Assets	17.02
Total	**148.90**

**Provisional*

Source: Citizen Investment Trust

4.2.5 Social Security Fund (SSF)

The Social Security Fund (SSF) is a type of pension fund scheme which is based on individual workers' contribution. This fund provides various benefits such as assistance for medical treatment, health and maternity protection, accident and disability protection, dependent family protection, and elderly protection of employee from the day of joining to the retirement. Organizations registered under the scheme will only be eligible to enjoy the benefits offered by the fund.

CHAPTER - V
FINANCIAL MARKETS

5.1 Global Financial Market Perspectives

5.1.1 US Government Treasuries

Yields on US government treasuries continued its gradual increasing trend in FY 2018/19. This is mostly attributable to the continuation of hike in US Federal Funds Rate by Federal Reserve. There were two rate hikes of 25 basis points each in the review year (September 2018 and December 2018), which raised the rate to 2.50 percent. The yield on three months T-bills that averaged 1.46 in the last review period spiked to and sustained at 2.25 percent throughout the FY 2018/19. The three months T-bill yield curve showed the lowest yield of 1.95 percent on 20 July 2018 and the highest return of 2.43 percent on 21 March 2019.

Figure 5.1
Daily Yield Curve Rates for 3 Months T-Bills

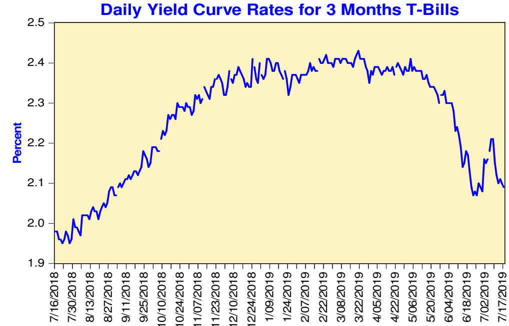
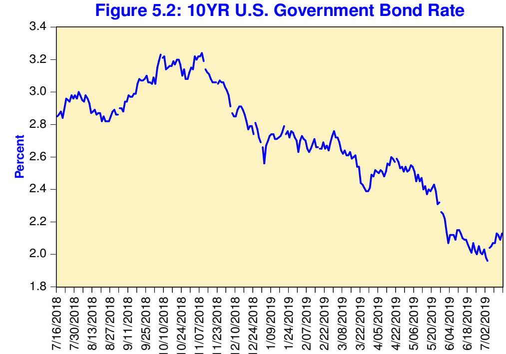


Figure 5.2: 10YR U.S. Government Bond Rate



Contrary to the yield on short term security, the yields on long term securities exhibited a slightly declining trend in the review year. The yield remained broadly stable at around 2.70 percent throughout the review period. The yield reached a peak of 3.24 percent on 8 November 2018 but continuously declined to reach to the lowest of 1.96 percent on 3 July, 2019.

5.1.2 Crude Oil

Brent crude oil, the international benchmark, was trading between US dollars 48 to 79 per barrel during the review period. The crude oil prices reached the highest level of US dollar 79.8 per barrel on 23 May 2018 with the lowest point being US dollar 48.06 on 21 July 2017. The crude oil price, though fluctuating in the short term, was broadly on a rising trend in the review year. Generally, oil prices fluctuate because of changes in supply and demand, but there are multiple factors at play like weather events, supply interruptions, broader demand trends such as the emergence of renewable energy, OPEC decisions, or other events that can have an immediate effect on supplies that can affect those fundamentals. The disruption in oil supply across the world as a result of terrorism, strikes, sabotage or lack of maintenance were the reasons for price fluctuations in the review year.

5.1.3 Dollar Index

The U.S. Dollar Index is an index measure of the value of the United States dollar relative to a basket of foreign currencies including Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish Krona and Swiss Franc. The US dollar index swung between gains and losses in the review year due to lack of clear clue. The index went as low as 88.59 on 15 February 2018 to the highest of 95.312 on 28 June 2018. The dollar saw a high level of volatility with the Fed's rate hikes as well, Besides geo-political tensions in Middle-East, Russia and North Korea and trade war with China also played role.

5.1.4 Dollar-Rupee Exchange Rate

Nepalese currency depreciated by 0.76 percent against US dollar during the end of FY 2018/19 compared to a sharp depreciation by 6.30 percent in the same period of the previous year. The exchange rate of one US dollar stood at NPR 113.48 in mid-July 2019 compared to NPR 109.34 in mid-July 2018.

Figure 5.3
Europe Brent Crude Oil Price (USD per barrel)

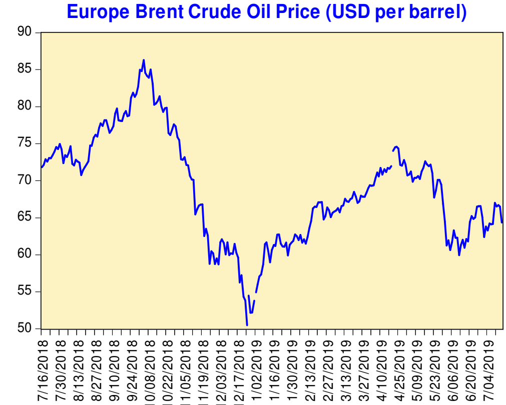


Figure 5.4
Movement of U.S. Dollar Index

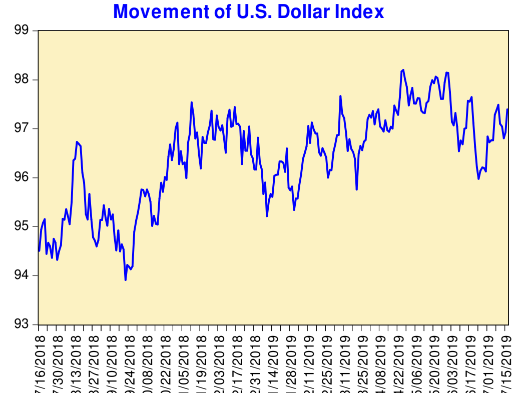
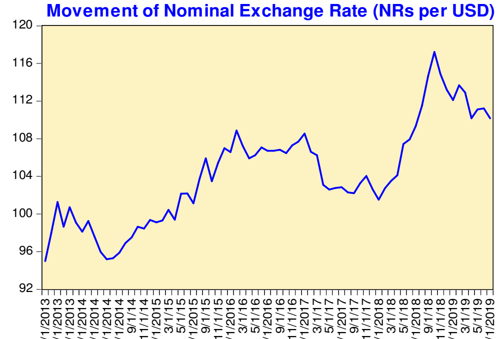


Figure 5.5
Movement of Nominal Exchange Rate (NRs per USD)



5.2 Domestic Financial Market

5.2.1 Securities Market

In recent years, SEBON has been implementing various structural reform programmes and policies to develop and modernize the securities markets. Primary market services have been expanded to all districts through the channels of more than 3,500 BFI branches. SEBON has also expanded services of merchant banking and securities broking business outside the Kathmandu valley as well. SEBON has introduced alternative investment vehicle regulations to promote the use of alternative investment instruments such as private equity, venture capital, hedge funds. During the period, one open ended mutual fund also entered into the market. SEBON also provisioned the margin trading facility to increase the liquidity of securities. Similarly, NEPSE has begun to calculate mutual fund sub-index to trace the price of mutual fund industry.

IN FY 2018/19 Securities market scenario remained mixed. Most of the secondary market indicators such as NEPSE index, market capitalization, number of listed companies and turnover increased compared to the last year. During the period, total fund mobilised through primary market decreased slightly. In the review year, debentures were issued significantly. Likewise, the number of securities market participants also increased in FY 2018/19. The list of securities market participants is presented in Table 5.1.

Table 5.1: Securities Market Participants

SN	Participants	Mid-July 2015	Mid-July 2016	Mid-July 2017	Mid July 2018	Mid July 2019
1	Stock Exchange	1	1	1	1	1
2	Central Depository Company	1	1	1	1	1
3	Stockbroker	50	50	50	50	50
4	Merchant Banker	16	17	24	25	30
5	Fund Manager and Depository	5	6	9	9	9
6	Credit Rating Agency	1	1	1	2	2
7	Listed Companies	232	229	208	196	215
8	Depository Participant	53	66	65	70	72
9	ASBA BFIs	-	-		65	52
	Total	**357**	**371**	**426**	**419**	**432**

5.2.2 Primary Market

During last three fiscal years, corporate sectors have mobilized fund through IPOs, FPOs, right offerings, stock dividends, debentures and mutual fund schemes. In FY 2018/19, funds amounting to NPR 7.35 billion were mobilized through IPOs, Rs 5.88 billion through right shares, NPR 29.98 billion through debentures and NPR 6.55 billion through mutual fund schemes. Thus, a total of NPR 49.76 billion funds were mobilized in the FY2018/19 which is less by 6.6 as compared to the total fund mobilization of NPR 53.3 billion in the last fiscal year. Decrease in right offerings and absence of FPOs attributed to the decline of fund mobilization in primary market. During this period, one open ended mutual fund entered in the market. Primary market data of three fiscal years is presented in Table 5.2.

Table 5.2: Primary Market(Amount in Rs billion)

SN	Particulars	2016/17		2017/18		2018/19		Percentage Change			
								In Number		In Amount	
		Number	Amount	Number	Amount	Number	Amount	2017/18	2018/19	2017/18	2018/19
1	IPOs	17	1.51	21	8.3	28	7.35	23.5	33.3	449.7	-11.4
2	Right Offerings	76	45.64	55	25.7	19	5.88	-27.6	-65.5	-43.7	-77.1
3	FPOs	4	7.99	6	11.5	-	-	50.0	-	43.9	-
4	Debenture	-	-	1	3	12	29.98	-	1100.0	-	899.3
5	Mutual Fund	4	4.25	4	4.8	6	6.55	0.0	50.0	12.9	36.5
	Total	**101**	**59.39**	**87**	**53.3**	**65**	**49.76**	**-13.9**	**-25.3**	**-10.3**	**-6.6**

The primary market has been expanded to 2500 places (77 districts) of the country through Applications Supported by Blocked Amount (ASBA) System. After the introduction of CASBA System, people can participate in IPO through online system throughout the country. SEBON introduced inclusive securities allotment system which helped to increase the number of securities investors.

5.2.3 Secondary Market

In FY 2018/19, major indicator of the secondary market remained positive. The number of listed companies increased to 215 from 196 in the last fiscal year. In FY 2018/19, total traded value of the listed securities remained NPR 110.07 billion, a decrease of 9.3 percent as compared to NPR 121.4 billion of FY 2017/18. Average daily turnover was NPR 0.52 billion, a decrease of 41.6 percent as compared to NPR 0.89 billion of FY 2017/18.

The market capitalization reached Rs 1,567.5 billion, an increase of 9.2 percent as compared to last fiscal year. Similarly, float market capitalization also increased by 15.4 percent over last year to NPR 558.25 billion. The 2018/19 NEPSE Index also plunged by 3.8 percent over last year to 1,259.02 points. Float Index which was at 87.15 points in the FY 2017/18, increased by 6.1 percent to 92.43 points in FY 2018/19. The trends in secondary market during last three fiscal years is presented in Table 5.3.

Table 5.3: Secondary Market

SN	Indicators	Unit	Fiscal Year			Percentage Change	
			2016/17	2017/18	2018/19	2017/18	2018/19
1	Listed Companies	Number	208	196	215	-5.8	9.7
2	Annual turnover	Rs in billion	205.02	121.4	110.07	-40.8	-9.3
3	Average daily turnover	Rs in 10 million	89.14	52.1	44.75	-41.6	-14.1
4	Traded Securities	No. in 10 million	39.29	29.4	38.75	-25.2	31.8
5	No of Transaction	No in 10 million	1.36	1.31	1.42	-3.7	8.4
6	Number of Listed Securities	No in 10 million	296.59	359.87	420.66	21.3	16.9
7	Market Capitalization	Rs billion	1856.82	1435.14	1567.5	-22.7	9.2
8	Float Market Capitalization	Rs billion	641.69	483.9	558.25	-24.6	15.4
9	Turnover/Market Capitalization	Percentage	11.04	8.5	7	-23.0	-17.6
10	Market Capitalization/ GDP	Percentage	71.44	47.7	45.25	-33.2	-5.1
11	Float Market Capitulation/ GDP	Percentage	24.69	16.1	16.11	-34.8	0.1
12	NEPSE Index	Unit	1582.67	1212.36	1259.02	-23.4	3.8
13	NEPSE Float Index	Unit	116.14	87.15	92.43	-25.0	6.1

Source: Nepal Stock Exchange Ltd .

Secondary market services have been expanded to 95 Places. There are around 1.5 million investors participating through their own DEMAT accounts. Online trading system has been introduced and more than 24000 investors are using the system. On a regulatory perspective, SEBON introduced the Corporate Governance codes for listed companies while legal framework and regulatory mechanism for venture capital and private equity fund were also implemented. Similarly, Anti-money Laundering Guidelines and KYC requirements for securities businesspersons have been implemented subject to legal actions in case of noncompliance.

Chapter - VI
Payment System

6.1 Evolution of Payment System

Secure, affordable and accessible payment systems and services help expand financial inclusion, foster development and support financial stability. NRB has been entrusted with the responsibility of establishing and promoting the system of payment, clearing and settlement and to regulate these activities in order to develop *secure, healthy and efficient system of payment* in the country. Payment systems have been considered to be an important element of the financial stability and is evolving as a core central banking function around the world. It is believed that a well-developed payment system ultimately contributes to strengthen the domestic financial system.

Payment System modernization effort in Nepal was started with the formulation of Nepal Payment System Development Strategy, 2014. Since then, NRB has initiated number of reforms in the payment systems. Currently, Payment Systems Department (PSD) of NRB has been performing regulatory, catalytic, operator, and overseer role in the payment systems. Payment and Settlement Act, 2019, Payment and Settlement Bylaw, 2015 and Licensing Policy for Payment Related Institutions 2016 provide a strong legal basis for the development of national payment system. Increasing number of card users, IPS users, digital banking users and e-Commerce users show that Nepalese payment system has been developing rapidly. As an overseer of the National Payment System, NRB is committed to ensure safety and efficiency of the payment system. Payment Systems Department of NRB oversees all licensed Payment Service Providers and Payment System Operators as per the approved annual work plan based on the Principles of Financial Market Infrastructures (PFMIs).

6.2 Legal Framework

6.2.1 Payment and Settlement Act, 2019 is one of the most important legal frameworks that came into existence during the review period. The Act has the following salient features:

- Licensing responsibility: NRB has been tasked with the responsibility of issuance, withdrawal or refusal of license to an entity to work as a payment service provider or provide any service under the Act.

- Oversight: NRB is empowered to monitor and conduct inspection of the licensed institutions and the services they provide on a regular basis.
- Dispute Settlement Committee: In the event of any dispute arising between the institutions regarding any work to be performed under this Act, the same will be handled by the Dispute Resolution Committee.
- Powers to give direction: NRB has the powers to give directions to its licensed entities.
- Powers to frame regulations: Under the Act, NRB has powers to frame by-laws for administration of the Act.
- National Payment Board: The Act has made the provision of National Payment Board to make payment system safe, sound and efficient for financial stability, to minimize the risk inherent in payment systems and to regulate, monitor and oversee the activities regarding payment system.
- Secretariat to the Board: A department of NRB as prescribed provides secretariat support to the Board.
- Institution responsibility: The Act has clearly defined the responsibilities of PSPs and PSOs.
- RTGS: NRB has launched the RTGS system for large value and critical payment.
- Punishment, fine and penalties: Provisions for punishment, fine, and penalties has been mentioned in the act for the licensed entity in case of breach of act, bylaws or directions made under this act .

6.2.2 Payment and Settlement Bylaw, 2015 has been formulated for the development of the secure, healthy and competent payment system. It is further required for the fulfillment of the objective of NRB Act that specify the functions related to regulation, supervision and oversight over the services and instruments issued by the institutions which operate payment and settlement services.

6.2.3 Directives are issued to regulate the institutions.

- Directive No. 1: It regulates the Electronic Payment Cards in terms of the issue and operation and regulatory compliance of electronic cards as well as the settlement of transactions. It also sets timelines for all electronic payment instruments like electronic payment cards, POS/POT Terminals, and ATMs to be chip-based that ensures these instruments are safe and secure enough.
- Directive No. 2: It is about Conducting Financial Service Operation in domestic currency through Telecommunication Networks.
- Directive No. 3: It specifies on Adoption of Security Measures while providing electronic payment services. It seeks needful arrangements from the service provider to make the transactions secure.
- Directive No. 4: It mandates the provision of Settlement Bank. The directive regulates all non-bank PSPs must have a settlement account in class A Bank.
- Directive No. 5: It defines transaction limit for different electronic payment instruments like credit card, debit card, prepaid card, mobile banking, internet banking, e-wallets, etc.
- Directive No. 6: It defines the timeline for submitting the Annual Financial Report.
- Directive No. 7: It defines the prerequisites, procedures, infrastructures required to obtain license for payment system function by Micro-Finance Institutions.

6.3 Licensing

NRB is issuing license to operate as a PSOs and PSPs. With the objective of promoting innovation in digital financial services, PSD is also giving permission to add additional services to licensed PSOs and PSPs.

During the review period, NRB has issued license to eleven development banks, one finance company and five non-BFIs to work as PSO/PSP. Among five non-BFIs, two are licensed as PSOs and three as PSPs. Similarly, LOI for seventeen institutions have been issued during the review period to operate as PSOs and PSPs.

With this, all the commercial banks, fifteen development banks, and five finance companies are operating as PSO/PSP. Apart from this, there are a total of sixteen institutions licensed by NRB that are operating as payment institutions. Among them six are PSOs and ten are PSPs.

Table 6.1: Licensed Institution to Perform Electronic Payment

S.N.	Category	Number
1	Commercial Bank ("A" Class)	28
2	Development Bank ("B" Class)	15
3	Finance Company ("C" Class)	5
4	Payment System Operator (PSO)	6
5	Payment System Provider (PSP)	10

6.4 Large Value Payment Systems

As an operator of the payment system and based on the mandate given by Payment and Settlement Act and Bylaw, NRB has installed and implemented Real-Time Gross Settlement (RTGS) System for large value and critical payment. RTGS System is an electronic fund transfer system in which the transfer of funds between one bank to another takes place in "real-time" and on a "gross" - transaction by transaction basis, without bundling or netting with any other transaction.

RTGS System formally started from 12th September 2019. PSD has issued RTGS System Rule, 2019 which regulates the membership criteria, members' responsibilities, settlement rules, operating procedures in the RTGS system. Similarly, NRB has issued a separate directive for the operation of RTGS. Transactions can be settled in five different currencies i.e. Nepalese Rupees (NPR), US Dollar (USD), Euro (EUR), Pound Sterling (GBP), and Japanese Yen (JPY). Minimum limit for value of credit transfers in RTGS is NPR 200,000 and threshold for mandatory transaction has been set at NPR 2 Million or above. Currently, all Commercial Banks are operating as direct participants of the RTGS System.

RTGS implementation has eased the large value payment process which was earlier based on manual clearing in NRB's general ledger (Olympic) system. Further, it is expected that the RTGS System will enhance the trust and confidence towards the payment system as it significantly reduces liquidity risk and eliminates credit risk in payment mechanism. NRB's liquidity management is also expected to be more efficient with this system.

6.5 Retail Payment System (RPS)

The retail payment systems in Nepal have been experiencing significant developments. Banks continue to be the major providers of retail payment services to consumers, businesses and Government. NRB has licensed 51 banks and financial institutions as PSPs to operate retail payment activities. Seven non-bank institutions have been licensed as PSOs while another ten have been licensed as PSPs.

Banks provide their customers with account-based services, cheque facility, debit and credit cards, e-money, remittance services, and online banking facilities (internet/mobile). Non-bank PSPs provide e-money services to their customers. NRB has initiated the process to give permission to domestic payment institutions to acquire international wallets through settlement arrangement in Nepal. NRB has also taken initiation to establish national payment switch to allow interoperability in the retail payment systems.

As an effort for payment system modernization, NRB formulated and published a Retail Payment Strategy (RPS), 2019. RPS, amongst others, focuses on key pillars of (i) strengthening the legal and regulatory framework, (ii) deepening digital retail payment systems, (iii) government and remittances payment to transaction account, (iv) settlement in central bank money, (v) financial awareness, (vi) oversight-covering endpoint security, and (vii) coordination with authorities.

6.6 Payment System Development and Financial Stability

Payment systems and financial market infrastructures (FMIs) are the mechanisms established to facilitate the clearing and settlement of monetary and other financial transactions. Safe, reliable and efficient payment systems and FMIs perform the following:

- Support financial stability by mitigating risks related to financial transactions and facilitating the smooth flow of payments and efficient functioning of financial markets.
- Promote efficiency in the economy by facilitating the smooth flow of payments that magnifies economic activity and promote financial sector development through fostering consumers' confidence in the use of money and payment services.

- Enable access to transaction accounts as a means to safely store value, and make and receive payments, and foster financial inclusion.
- Foster transparency and efficiency in the national and international remittances markets.
- Support the digitization of government payments as part of cross-cutting work in areas like consumer protection, e-Governance and public financial management reforms. The work spans across the revenue collection and expenditure side, including large scale programs like tax collection, public sector salary payments, public procurement and other government to person (G2P) payments.

Chapter - VII

FINANCIAL SECTOR POLICIES AND INFRASTRUCTURES

7.1 Domestic Policy Developments

To ensure stability and foster development, NRB has taken and maintained an accommodative stance to facilitate the growth rate set by GON. In these regards, status of the policies and updates in regulatory measures that were made in the FY 2018/19 are outlined below.

7.1.1 Implementation of Basel III

Realizing the importance of stringent measures for banking sectors, the Basel Committee on Banking Supervision (BCBS) issued "Basel III: A global regulatory framework for more resilient banks and banking systems" in December 2010.

In order to enhance the financial stability, NRB has implemented regulatory provisions of Basel III. Commercial banks were required to meet minimum capital adequacy based on Basel III with effect from mid-August 2016. As a result, banks have started to calculate their capital funds according to Capital Adequacy framework, 2015 published by NRB which is based on Basel-III. Basel III will be implemented at national level development banks and national level finance companies gradually.

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

In order to enhance the risk absorption capacity of banks by strengthening the capital base, a provision is made for commercial banks to maintain capital conservation buffer (CCB) equal to 2.5 percent of total risk weighted assets. Instruments under common equity tier 1 capital will be used for such calculation. The framework of capital conservation buffer is expected to strengthen the ability of banks to withstand adverse economic environment conditions, will help increase banking sector resilience both going into downturn, and provide the mechanism for rebuilding capital during the early stages of economic recovery. The CCB, introduced in 2016, has been in implementation from mid-July 2019.

NRB has introduced counter cyclical buffer in "Capital Adequacy Framework, 2015" to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its aim is to protect the banking sector from periods of excess aggregate credit growth that have often been associated with the buildup of system wide risk. Therefore, to minimize the adverse impact of pro-cyclicality and fluctuations in macroeconomic variables on financial sector, this provision has been made for banks to maintain an additional counter cyclical buffer up to a maximum of 2.5 percentage point of total risk weighted assets by mid-July 2020.

Commercial banks are required to maintain minimum Tier 1 leverage ratio of 4 percent. The banks are required to maintain the leverage ratio on a quarterly basis. Non-risk-based leverage ratio that includes off-balance sheet exposures will serve as a backstop to the risk-based capital requirement. It also helps contain system wide buildup of leverage.

7.1.2 Basel III Liquidity Framework

During the time of Global financial crisis, many banks with adequate capital levels also experienced difficulties because of their weak liquidity management. In response to this, BCBS issued guidelines, "Basel III: International framework for liquidity risk measurement, standards and monitoring (December 2010)". BCBS has established some principles for Sound Liquidity Risk Management and Supervision. In addition to the principles, Basel III introduced two ratios for liquidity monitoring and management in banks; (i) liquidity coverage ratio (LCR) &, (ii) net stable funding ratio (NFSR).

LCR is introduced to promote short-term resilience by requiring sufficient high-quality liquid assets to survive acute stress lasting for 30 calendar days. NRB has developed its own liquidity monitoring framework for the short-term liquidity monitoring of the banks.

Similarly, NSFR is aimed at promoting resilience over longer term through incentives for banks to fund activities with more stable sources of funding. The ratio is developed to address the maturity mismatch between liabilities and assets in the financial sector and to make sure that banks have sufficient stable funding to withstand a yearlong liquidity crisis. NRB is currently in line to implement LCR and NSFR related guidelines by end of FY 2019/20.

7.1.3 Nepal Infrastructure Development Bank

Infrastructure has always been a backbone for economic growth. With the aim of addressing the infrastructure funding gap, Nepal Infrastructure Development Bank (NIFRA) was given operating license in FY 2018/19. NIFRA was conceptualized as a vehicle for investment and improvements in infrastructures of energy, transportation, agriculture, tourism, healthcare, education among others. NIFRA has a joint investment from government and private sector and has an authorized capital of NPR 40 billion of which paid up is NPR 12 billion. The bank is expected to boost up the infrastructure needs as it is required to invest only in projects of NPR 300 million or above.

7.1.4 Reporting Standards and NFRS for B and C Class FIs

In accordance with accounting principles of transparency, reliability, consistency and comparability of financial statements, measures were undertaken to improve the disclosures of BFIs. Effective from FY 2018/19, development banks and finance companies are required to furnish their financial information based on Nepal financial reporting standard (NFRS).

7.1.5 Risk Management Guidelines, 2018

In recent years, following the global financial crisis, risk management issues have received increasing attention of international supervisory bodies. Following the global financial crisis of 2007, risk management in financial institutions moved from a compliance driven function toward a top-level comprehensive activity relevant at the highest levels of decision making and strategy setting. While the extent of risk management function performed and structure kept in place depend on the size and complexity of individual financial institution, risk management is most effective when basic principles and elements of risk management are applied consistently throughout the financial institution.

Along with the objective of maintaining soundness and stability of financial institution, some of the other objectives of NRB in publishing these guidelines are:

- To promote better risk culture at all levels of the financial institution.
- To provide minimum standards for risk management practices.

- To improve financial soundness of individual financial institutions and there from the stability of the overall financial sector.
- To encourage financial institutions to adopt and implement a sound risk management framework. To introduce important risk management tools and techniques for assessment and necessary treatment of various risks.

7.1.6 Strengthening anti-money laundering measures

To combat money laundering and financing of terrorism, GON and NRB have put forward some provisions relating to reporting and monitoring. Anti-money laundering measures are primarily guided by Money Laundering Prevention Act, 2008, and anti-money laundering prevention rules of 2073. Apart from these, NRB issues circulars and directives from time to time to discourage such activities. The policy provision made by NRB mandates on BFIs to put in place a AML/CFT related policy covering procedures and guidelines relating to identification, verification of suspicious and threshold transactions and monitoring and tracing concerned transactions. Similarly, it also guides on issues such as politically exposed person (PEP) and beneficial owner (BO), guides on enhanced customer due diligence (ECDD) and other transaction related provisions.

Moving forward, NRB has mandated commercial banks to start reporting via. go-aml-production live environment effective from 3rd quarter of FY 2019/20. Development banks and finance companies have to start reporting on such system from the start of FY 2077/78.

7.1.7 Access to Finance

To improve the general public's access to finance, NRB has adopted policy measures to improve the supply side of financial services. A campaign was announced in the monetary policy of FY 2018/19 of opening a bank account for every citizen. To improve the access in the local body, NRB allotted A class banks to open branches in all local bodies. The accessibility of banking hence increased and reached 735 local bodies in the review period.

7.1.8 Corporate Social Responsibility

There is a mandatory provision requiring banks to create a corporate social responsibility fund and set aside one percent of profit for corporate social responsibility (CSR). Some of the areas where money collected in CSR fund could be utilized are: education, health, natural disaster management, environmental conservation, cultural promotion, rural infrastructure upgradation, capacity enhancement for income generation of people belonging to socially backward communities, enhancing financial literacy and consumer protection. The money could also be extended to cover education and healthcare expenses of the poor or build infrastructure of organizations working to promote interests of the poor. The money could also be used to build child day care centers at banks and financial institutions or extend direct or indirect financial support to help Nepal achieve 17 Sustainable Development Goals. As directed by NRB, the money collected in the CSR fund, however, should not be spent on activities aimed at promoting the brand of banks and financial institutions, or to serve individual and political interests of board directors. In FY 2018/19 NRB directed banks to allocate at least10 percent of the total CSR fund in each province.

7.2 Measures undertaken by NRB to maintain financial stability

Since the publication of last stability report, a number of stability measures have been undertaken by NRB. Some of them are outlined below:

- Human resource development is seen as key to improve the performance and resilience of banks. Hence, banks were mandated to provide training to the staffs (assistant to officer level) compulsorily. New entrants must be given the training within 2 years of their joining date.
- With the rapid increase in use of information technology in payments and settlements, there have been concerns regarding the security of banking system. Hence, Banks are required to conduct system audit.
- From FY 2018/19, banks are required to obtain tax clearance certificate/ e-statement before approving or renewing loan to any firms/companies.
- Statutory liquidity ratio was decreased from 12 percent to 10 percent for commercial banks. Such ratio was reduced to 8 and 7 percent for development banks and finance company from 9 and 8 percent, respectively.
- Interest spread for commercial banks have to be limited below 4.5 percent effective from the beginning of FY 2019/20. For development banks and finance company, Interest rate spread is to be maintained at 5 percent from the beginning of FY 2019/20

- Banks have to limit their exposure of deposit of a single entity to 15 percent of total deposit. Such ceiling was 20 percent previously.
- Priority sector lending by banks have been set at 25,15 and 10 percent for class A, B and C, respectively, but commercial banks now have to lend at least 10 percent to agriculture sector and 15 percent to energy and tourism sector.
- Banks have to get accredited from an international or national credit rating agency from FY 2018/19.
- Banks were allowed to issue debentures up to the limit of 100 percent of their core capital. Earlier banks were allowed to issue debentures worth 50% of their core capital.
- Loan-to-value ceiling for margin lending was increased to 65 per cent from 50 per cent. In conjunction to this, the risk weights for such kind of loan were assigned 100 percent from 150. The ceiling of margin lending for Banks and financial institutions is fixed at 25% of core capital, which was 40 percent previously. Similarly, banks were allowed to establish subsidiary brokerage firm, provided they have at least 51 percent stake in them.

Annex-I

Statement of Assets and Liabilities of Banks & Financial Institutions (Aggregate)

(In Million Rs.)

	Liabilities	Mid-July 2016	2017	2018	2019	% Change 2/1	3/2	4/3
		1	2	3	4	2/1	3/2	4/3
1	CAPITAL FUND	214,892.48	308,651.74	370,014.44	446,402.47	43.63	19.88	20.64
	a. Paid-up Capital	163,370.74	225,313.64	282,196.04	305,884.91	37.92	25.25	8.39
	b. Statutory Reserves	43,680.58	53,665.23	63,755.69	76,174.07	22.86	18.80	19.48
	c. Retained Earning	(11,166.95)	(3,005.23)	(1,931.93)	4,538.02	(73.09)	(35.71)	(334.90)
	d. Others Reserves	19,008.11	32,678.11	25,994.64	59,805.48	71.92	(20.45)	130.07
2	BORROWINGS	42,822.19	31,800.16	35,452.57	90,729.26	(25.74)	11.49	155.92
	a. NRB	6,855.13	7,094.37	12,121.92	22,927.12	3.49	70.87	89.14
	b. "A"Class Licensed Institution	20,083.07	9,094.04	8,582.53	34,285.55	(54.72)	(5.62)	299.48
	c. Foreign Banks and Fin. Ins.	-	-	-	3,298.50	-	-	-
	d. Other Financial Ins.	5,111.62	5,299.38	2,435.75	3,283.23	3.67	(54.04)	34.79
	e. Bonds and Securities	10,772.37	10,312.37	12,312.37	26,934.86	(4.27)	19.39	118.76
3	DEPOSITS	2,107,502.69	2,384,806.95	2,836,930.01	3,354,427.87	13.16	18.96	18.24
	a. Current	185,135.30	204,360.95	256,808.59	311,505.36	10.38	25.66	21.30
	b. Savings	875,419.91	816,572.17	947,024.22	1,060,515.82	(6.72)	15.98	11.98
	c. Fixed	617,634.95	998,258.72	1,229,730.70	1,526,497.38	61.63	23.19	24.13
	d. Call Deposits	401,829.34	333,350.39	367,596.88	417,390.12	(17.04)	10.27	13.55
	e. Others	27,483.20	32,264.72	35,769.62	38,519.20	17.40	10.86	7.69
4	Bills Payable	3,927.13	2,219.17	3,108.92	2,309.25	(43.49)	40.09	(25.72)
5	Other Liabilities	206,694.45	224,201.08	263,876.38	303,249.45	8.47	17.70	14.92
	1. Loan Loss Provision	48,593.77	52,553.17	55,008.99	54,893.33	8.15	4.67	(0.21)
	2. Interest Suspense a/c	32,000.69	34,891.97	37,704.55	20,271.09	9.04	8.06	(46.24)
	3. Others	126,099.99	136,755.94	171,162.84	228,085.03	8.45	25.16	33.26
6	Reconcillation A/c	13,817.41	2,358.50	4,265.20	15,556.11	(82.93)	80.84	264.72
7	Profit & Loss A/c	49,443.18	54,882.04	61,337.97	73,518.78	11.00	11.76	19.86
	TOTAL	2,639,099.54	3,008,919.66	3,574,985.48	4,286,193.20	14.01	18.81	19.89
	Assets							
1	LIQUID FUNDS	385,746.01	423,242.12	439,298.52	466,278.56	9.72	3.79	6.14
	a. Cash Balance	56,937.25	64,372.60	74,892.95	92,563.12	13.06	16.34	23.59
	Nepalese Notes & Coins	55,937.33	63,282.78	72,207.99	84,640.15	13.13	14.10	17.22
	Foreign Currency	999.92	1,089.82	2,684.96	7,922.98	8.99	146.37	195.09
	b. Bank Balance	262,419.81	305,795.05	298,098.38	295,862.06	16.53	(2.52)	(0.75)
	1. In Nepal Rastra Bank	180,498.18	233,256.83	218,135.41	215,138.12	29.23	(6.48)	(1.37)
	2. "A"Class Licensed Institution	41,730.30	38,882.05	41,054.74	29,035.70	(6.83)	5.59	(29.28)
	3. Other Financial Ins.	8,437.01	6,368.76	7,556.64	13,009.76	(24.51)	18.65	72.16
	4. In Foreign banks	31,754.32	27,287.42	31,351.59	38,678.47	(14.07)	14.89	23.37
	c. Money at Call	66,388.94	53,074.46	66,307.19	77,853.38	(20.06)	24.93	17.41
2	INVESTMENTS	238,675.86	232,706.63	331,231.04	375,402.17	(2.50)	42.34	13.34
	a. Govt.Securities	196,070.31	214,380.95	295,853.80	374,262.09	9.34	38.00	26.50
	b Others	42,605.55	18,325.68	35,377.25	1,140.08	(56.99)	93.05	(96.78)
3	SHARE & OTHER INVESTMENT	131,777.67	129,938.39	109,664.75	186,189.49	(1.40)	(15.60)	69.78
4	LOANS & ADVANCES	1,669,203.04	1,976,879.74	2,419,841.87	2,910,510.65	18.43	22.41	20.28
	a. Private Sector	1,542,024.97	1,923,942.40	2,355,915.45	2,819,278.66	24.77	22.45	19.67
	b. Financial Institutions	121,291.82	44,543.48	58,055.79	86,055.92	(63.28)	30.34	48.23
	c. Government Organizations	5,886.25	8,393.85	5,870.64	5,176.07	42.60	(30.06)	(11.83)
5	BILLS PURCHASED	11,601.52	17,198.72	2,955.87	3,459.14	48.25	(82.81)	17.03
6	LOANS AGT. COLLECTED BILLS	1,075.28	570.71	128.63	-	(46.92)	(77.46)	(100.00)
7	FIXED ASSETS	35,044.21	40,633.93	47,763.06	71,419.84	15.95	17.54	49.53
8	OTHER ASSETS	144,135.22	166,139.11	206,833.99	253,948.55	15.27	24.49	22.78
	a. Accrued Interests	34,038.25	37,665.70	43,308.52	46,171.39	10.66	14.98	6.61
	b. Others	110,096.97	128,473.40	163,525.47	207,777.17	16.69	27.28	27.06
9	Expenses not Written off	319.21	279.01	264.06	26.42	(12.59)	(5.36)	(89.99)
10	Non Banking Assets	4,797.21	4,465.45	4,614.27	5,715.65	(6.92)	3.33	23.87
11	Reconcillation Account	16,089.93	16,631.18	12,388.71	13,167.24	3.36	(25.51)	6.28
12	Profit & Loss A/c	634.40	234.67	0.72	75.47	(63.01)	(99.69)	10,417.22
	TOTAL	2,639,099.55	3,008,919.66	3,574,985.49	4,286,193.19	14.01	18.81	19.89

Annex-II

Profit and Loss Statement of Banks & Financial Institutions (Aggregate)

(In Million Rs.)

	Mid-July				% Change		
	2016	2017	2018	2019			
	1	2	3	4	2/1	3/2	4/3
1 Interest Expenses	64,943.04	97,850.70	167,966.94	212,129.40	50.67	71.66	26.29
1.1 Deposit Liabilities	63,252.25	95,608.58	165,253.99	208,274.00	51.15	72.84	26.03
1.1.1 Saving A/c	21,234.79	23,525.99	39,005.05	48,101.58	10.79	65.80	23.32
1.1.2 Fixed A/c	31,710.65	55,650.88	112,317.02	143,530.33	75.50	101.82	27.79
1.1.2.1 Upto 3 Months Fixed A/c	1,914.75	2,495.80	8,397.90	8,211.49	30.35	236.48	(2.22)
1.1.2.2 3 to 6 Months fixed A/c	1,240.54	2,672.64	6,798.97	10,805.65	115.44	154.39	58.93
1.1.2.3 6 Months to 1 Year Fixed A/c	15,369.26	29,697.33	57,784.49	72,244.36	93.23	94.58	25.02
1.1.2.4 Above 1 Year	13,186.09	20,785.12	39,335.65	52,268.83	57.63	89.25	32.88
1.1.3 Call Deposit	10,301.47	16,429.74	13,817.98	16,374.37	59.49	(15.90)	18.50
1.1.4 Certificate of Deposits	5.34	1.97	113.93	267.72	(63.14)	5,683.67	134.99
1.2 Others	1,690.79	2,242.12	2,712.96	3,855.40	32.61	21.00	42.11
2 Commission/Fee Expense	546.23	600.94	612.76	1,668.49	10.02	1.97	172.29
3 Employees Expenses	22,715.53	26,627.48	31,472.44	39,311.85	17.22	18.20	24.91
4 Office Operating Expenses	18,123.58	20,754.59	25,516.90	29,456.13	14.52	22.95	15.44
5 Exchange Fluctuation Loss	197.03	108.69	125.33	35.14	(44.83)	15.31	(71.96)
5.1 Due to Change in Exchange Rates	182.01	88.16	102.33	26.26	(51.56)	16.08	(74.34)
5.2 Due to Foreign Currency Transactions	15.02	20.54	23.00	8.88	36.73	12.00	(61.39)
6 Non-Operatiing Expenses	106.14	33.54	58.45	163.71	(68.40)	74.28	180.08
7. Provision for Risk	9,649.95	12,762.76	15,147.02	19,851.73	32.26	18.68	31.06
7.1 Loan loss Provision	8,451.80	11,477.45	12,874.70	19,032.37	35.80	12.17	47.83
7.1.1 General Loan loss Provision	5,107.97	7,035.80	6,484.42	8,358.44	37.74	(7.84)	28.90
7.1.1.1 Pass Loan Loss Provision	4,530.40	6,256.87	5,678.68	6,457.38	38.11	(9.24)	13.71
7.1.1.2 Watch List Provision	577.57	778.93	805.74	1,901.07	34.86	3.44	135.94
7.1.2 Special Loan Loss Provision	3,028.49	4,375.25	6,216.13	9,622.67	44.47	42.07	54.80
7.1.3 Additional Loan Loss Provision	315.34	66.40	174.15	1,051.26	(78.94)	162.29	503.65
7.2. Provision for Non-Banking Assets	1,012.22	1,053.41	1,255.16	481.16	4.07	19.15	(61.67)
7.3. Provision for Loss on Investment	14.53	185.90	715.51	146.75	1,179.20	284.90	(79.49)
7.4. Provision for Loss of Other Assets	171.40	46.00	301.66	191.45	-	-	(36.53)
8 Loan Written Off	355.03	996.12	971.19	917.47	180.57	(2.50)	(5.53)
9 Provision for Staff Bonus	5,851.53	6,656.78	7,981.80	8,856.79	13.76	19.90	10.96
10 Provision for Income Tax	17,591.64	20,370.63	24,582.73	30,504.93	15.80	20.68	24.09
11 Others	61.16	55.62	28.87	20.50	(9.06)	(48.09)	(28.98)
12 Net Profit	49,004.93	54,665.43	61,337.25	74,229.60	11.55	12.20	21.02
TOTAL EXPENSES	189,145.80	241,483.28	335,801.69	417,145.74	27.67	39.06	24.22
Income							
1. Interest Income	146,483.09	194,358.11	283,227.23	359,819.98	32.68	45.72	27.04
1.1. On Loans and Advance	138,782.71	181,923.38	265,445.85	335,598.08	31.09	45.91	26.43
1.2. On Investment	3,487.02	5,875.27	10,903.10	13,247.48	68.49	85.58	21.50
1.2.1 Government Bonds	3,005.11	4,830.38	9,359.75	11,868.28	60.74	93.77	26.80
1.2.2 Foreign Bonds	136.72	153.35	186.01	194.68	12.17	21.29	4.66
1.2.3 NRB Bonds	199.66	776.75	1,030.65	620.00	289.04	32.69	(39.84)
1.2.4 Deventure & Bonds	145.54	114.78	326.70	564.52	(21.14)	184.63	72.80
1.3 Agency Balance	589.35	1,021.51	987.51	1,063.54	73.33	(3.33)	7.70
1.4 On Call Deposit	2,513.39	3,475.05	3,927.59	6,393.62	38.26	13.02	62.79
1.5 Others	1,110.61	2,062.91	1,963.17	3,517.26	85.75	(4.83)	79.16
2. Comission & Discount	9,828.97	11,806.85	13,569.38	18,693.73	20.12	14.93	37.76
2.1 Bills Purchase & Discount	300.48	239.80	117.08	217.80	(20.20)	(51.18)	86.03
2.2 Comission	8,074.48	9,864.84	11,380.96	15,684.71	22.17	15.37	37.82
2.3 Others	1,454.01	1,702.22	2,071.34	2,791.22	17.07	21.69	34.75
3 Income From Exchange Fluctuation	5,708.82	6,248.97	7,849.70	10,506.14	9.46	25.62	33.84
3.1 Due to Change in Exchange Rate	1,342.09	706.74	1,536.71	1,181.65	(47.34)	117.44	(23.10)
3.2 Due to Foreign Currency Trans.	4,366.73	5,542.23	6,312.99	9,324.49	26.92	13.91	47.70
4 Other Operating Income	9,123.21	10,772.31	13,392.38	15,375.80	18.08	24.32	14.81
5 Non Operating Income	4,775.86	3,783.15	2,491.29	792.37	(20.79)	(34.15)	(68.19)
6 Provision Written Back	11,550.65	12,883.40	14,545.42	10,302.46	11.54	12.90	(29.17)
7 Recovery from Written off Loan	1,276.09	1,504.14	672.99	994.82	17.87	(55.26)	47.82
8 Income from Extra Ordinary Expenses	231.44	108.16	53.31	634.55	(53.27)	(50.71)	1,090.25
9 Net Loss	167.67	18.20	-	25.89	(89.14)	(100.00)	-
TOTAL INCOME	189,145.79	241,483.29	335,801.70	417,145.73	27.67	39.06	24.22

Annex-III

Major Financial Indicators of Microfinance Financial Institutions

(In Million Rs.)

		Mid-July						
		2016	2017	2018	2019	% change		
	Liabilities	1	2	3	4	2/1	3/2	4/3
1	CAPITAL FUND	8,684.93	12,592.83	17,420.21	25,503.40	45.00	38.33	46.40
	a. Paid-up Capital	5,436.50	7,721.29	11,159.07	17,077.80	82.78	42.03	53.04
	b. Statutory Reserves	1,214.82	1,747.60	2,450.93	3,531.26	132.25	43.86	44.08
	c. Retained Earning	363.62	1,179.47	1,378.95	1,750.02	64.85	224.37	26.91
	d. Others Reserves	1,669.98	1,944.47	2,431.26	3,144.31	35.47	16.44	29.33
2	BORROWINGS	52,434.42	66,772.73	87,706.95	126,378.12	87.95	27.35	44.09
	a. NRB	91.14	554.80	2,069.52	1,701.16	(82.69)	508.74	(17.80)
	f. Others	52,343.28	66,217.93	85,637.43	124,676.96	91.24	26.51	45.59
3	DEPOSITS	24,095.33	34,344.13	49,548.56	85,606.23	119.02	42.53	72.77
4	BILLS PAYABLE	0.76	1.99	1.32	75.28	-	163.52	5,591.09
5	OTHER LIABILITIES	7,205.02	10,366.32	13,551.50	23,664.48	90.74	43.88	74.63
	a. Loan Loss Provision	1,345.57	1,716.06	2,390.75	4,013.07	62.23	27.53	67.86
	b. Interest Suspense a/c	652.70	938.51	1,121.40	1,800.17	37.42	43.79	60.53
	c. Others	5,206.75	7,711.75	10,039.35	17,851.24	110.54	48.11	77.81
6	RECONCILIATION A/c	5,031.93	5,779.85	3,480.31	5,192.15	362.41	14.86	49.19
7	PROFIT & LOSS A/c	3,318.19	3,907.17	4,038.70	6,608.23	125.15	17.75	63.62
	Total	100,770.57	133,765.01	175,747.57	273,027.90	100.78	32.74	55.35
	Assets							
1	LIQUID FUNDS	11,096.17	12,497.71	16,314.24	19,246.27	54.05	12.63	17.97
	a. Cash Balance	75.50	93.88	147.32	214.46	92.39	24.35	45.57
	b. Bank Balance	6,327.04	6,243.28	9,189.76	13,398.03	70.51	(1.32)	45.79
	c. Money at Call	4,693.64	6,160.55	6,977.16	5,633.79	35.93	31.25	(19.25)
2	INVESTMENT IN SECURITIES EXCEPT SHARES	38.73	42.73	42.73	311.89	(66.67)	10.33	629.98
3	SHARE & OTHER INVESTMENT	2,809.82	2,658.12	2,564.66	2,261.72	(2.92)	(5.40)	(11.81)
4	LOANS & ADVANCES	77,232.89	106,540.87	145,943.77	235,101.47	116.40	37.95	61.09
	Institutional	19,194.27	24,131.09	30,596.92	38,954.85	94.60	25.72	27.32
	Individual	58,038.62	82,409.78	115,346.85	196,146.62	124.73	41.99	70.05
5	FIXED ASSETS	961.14	1,219.24	1,471.88	2,106.88	53.92	26.85	43.14
6	OTHER ASSETS	3,598.17	4,766.06	5,735.32	8,552.06	44.77	32.46	49.11
7	EXPENSES NOT WRITTEN OFF	4.47	11.17	7.10	10.88	(52.58)	149.58	53.11
8	NON BANKING ASSETS	-	-	-	1.34	-	-	-
9	RECONCILIATION A/c	5,017.27	5,959.49	3,608.95	5,390.65	362.34	18.78	49.37
10	PROFIT & LOSS A/c	11.91	69.64	56.58	44.73	(85.45)	484.89	(20.95)
	Total	**100,770.57**	**133,765.01**	**175,745.23**	**273,027.90**	**100.78**	**32.74**	**55.35**
	Profit & Loss A/c Expenses							
	1 INTEREST EXPENSES	3,494.31	5,937.76	11,759.20	17,021.80	77.57	69.93	44.75
	2 COMMISSION/FEE EXPENSES	0.01	0.21	3.12	6.69	(99.98)	2,474.30	114.61
	3 EMPLOYEE EXPENSES	2,671.95	3,619.07	4,735.39	6,299.32	82.46	35.45	33.03
	4 OFFICE OPERATING EXPENSES	1,505.00	1,231.78	1,594.42	2,358.20	206.23	(18.15)	47.90
	5 NON OPERATING EXPENSES	4.81	0.80	9.27	62.89	-	(83.33)	578.43
	6 PROVISION FOR RISK	560.23	641.44	1,048.32	1,920.61	197.73	14.50	83.21
	7 LOAN WRITTEN OFF	-	2.97	0.82	4.64	(100.00)	-	464.16
	8 EXTRAORDINORY EXPENSES	-	0.01	-	1.30	-	-	-
	9 PROVISION FOR STAFF BONUS	314.96	518.61	546.76	861.36	207.19	64.66	57.54
	10 PROVISION FOR INCOME TAX	946.11	1,561.02	1,663.47	2,544.76	212.89	64.99	52.98
	11 NET PROFIT	3,374.46	3,901.54	4,013.38	6,248.96	135.06	15.62	55.70
	TOTAL EXPENSES	12,871.83	17,415.23	25,374.17	37,330.52	114.55	35.30	47.12
	Income							
	1. INTEREST INCOME	11,628.63	15,659.24	22,236.28	31,647.10	115.76	34.66	42.32
	2. COMMISSION & DISCOUNT	286.71	409.62	546.27	804.88	119.13	42.87	47.34
	3 OTHER OPERATING INCOME	684.42	1,000.22	2,048.87	3,738.78	124.52	46.14	82.48
	4 NON OPERATING INCOME	34.47	50.76	142.21	176.22	(14.15)	47.24	23.91
	5 PROVISION FOR WRITTEN BACK	222.11	241.31	364.35	935.81	151.48	8.65	156.84
	6 RECOVERY FOR WRITE BACK	4.63	2.99	5.18	2.08	134.91	(35.39)	(59.94)
	7 INCOME FOR EXTRA ORDINARY EXPENSES	0.01	-	0.00	0.03	(88.62)	(100.00)	712.18
	8 NET LOSS	10.85	51.08	31.00	25.63	(75.15)	370.64	(17.32)
	TOTAL INCOME	12,871.83	17,415.23	25,374.17	37,330.52	114.55	35.30	47.12
	Miscellaneous Information							
	No. of Total Staffs	7,132.00	8,903.00	11,552.00	17,361.00	61.91	24.83	50.29
	No. of Total Branches	1,378.00	1,895.00	2,448.00	3,629.00	60.05	37.52	48.24
	No. of Total Centers	100,794.20	132,355.20	172,788.20	274,186.20	69.74	31.31	58.68
	No. of Total Groups	366,540.40	455,206.20	562,425.20	926,624.60	25.43	24.19	64.76
	No. of Total Passive Groups	4,601.00	4,942.00	5,762.00	9,565.00	(49.65)	7.41	66.00
	No. of Total Members	1,898,891.00	2,338,046.00	2,856,380.00	4,327,991.00	17.77	23.13	51.52
	No. of Total Passive Members	32,378.00	37,050.00	51,516.00	118,044.00	(51.27)	14.43	129.14
	No. of Total Borrowers	1,296,303.00	1,576,155.00	1,853,417.00	2,679,016.00	17.62	21.59	44.54
	No. of Total Overdue Borrowers	44,861.00	44,281.00	56,823.80	165,984.00	46.33	(1.29)	192.10
	No. of Total Saving Members	1,873,431.80	2,368,499.80	3,010,165.93	4,323,956.80	56.32	26.43	43.65
	Total Saving Amount (Rs million)	24,111.28	34,583.36	49,548.56	101,910.06	119.18	43.43	105.68

Annex-IV

Sector wise, Product wise and Security wise Credit Flow from BFIs

(In Million Rs.)

	Mid-July				% Change		
	2016	2017	2018	2019			
Sectorwise	1	2	3	4	2/1	3/2	4/3
Agricultural and Forest Related	76,816.32	87,899.16	115,385.84	157,905.31	14.43	31.27	36.85
Fishery Related	1,980.46	2,328.51	2,725.01	4,215.51	17.57	17.03	54.70
Mining Related	3,404.03	3,950.19	5,033.27	7,313.23	16.04	27.42	45.30
Agriculture, Forestry & Bevarage Production Related	296,097.02	329,835.00	415,538.69	510,037.65	11.39	25.98	22.74
Construction	182,851.94	213,028.75	253,186.93	309,417.48	16.50	18.85	22.21
Electricity,Gas and Water	46,417.77	63,520.59	86,863.05	126,593.91	36.85	36.75	45.74
Metal Products, Machinary & Electronic Equipment & Assemblage	19,473.46	25,044.82	33,148.29	37,075.90	28.61	32.36	11.85
Transport, Communication and Public Utilities	67,489.25	76,264.31	83,254.65	93,129.08	13.00	9.17	11.86
Wholesaler & Retailer	374,322.54	436,442.74	532,010.61	615,309.45	16.60	21.90	15.66
Finance, Insurance and Real Estate	135,000.17	166,374.23	203,050.35	233,846.71	23.24	22.04	15.17
Hotel or Restaurant	54,426.26	66,900.15	91,145.89	122,122.50	22.92	36.24	33.99
Other Services	72,146.41	90,250.94	105,969.22	122,900.06	25.09	17.42	15.98
Consumption Loans	120,843.49	158,359.29	166,318.73	163,819.04	31.04	5.03	(1.50)
Local Government	1,654.98	1,568.65	1,553.54	1,569.10	(5.22)	(0.96)	1.00
Others	228,955.74	272,881.84	327,742.30	406,641.86	19.19	20.10	24.07
TOTAL	1,681,879.83	1,994,649.17	2,422,926.38	2,911,896.78	18.60	21.47	20.18
Productwise							
Term Loan	272,694.42	320,735.49	423,647.60	562,526.81	17.62	32.09	32.78
Overdraft	294,326.89	361,906.83	410,910.51	455,716.09	22.96	13.54	10.90
Trust Receipt Loan / Import Loan	72,678.07	64,530.02	113,868.62	127,215.69	(11.21)	76.46	11.72
Demand & Other Working Capital Loan	365,785.23	404,195.22	498,115.75	615,755.45	10.50	23.24	23.62
Residential Personal Home Loan (Up to Rs. 1.5 Crore)	142,815.41	168,383.92	201,681.80	237,959.11	17.90	19.77	17.99
Real Estate Loan	108,071.88	127,318.70	142,005.39	146,990.82	17.81	11.54	3.51
Margin Nature Loan	37,681.04	41,170.06	41,128.86	45,416.72	9.26	(0.10)	10.43
Hire Purchase Loan	110,094.35	150,400.06	171,054.03	180,956.55	36.61	13.73	5.79
Deprived Sector Loan	81,239.19	111,984.61	137,728.27	177,390.02	37.85	22.99	28.80
Bills Purchased	12,530.80	17,354.17	2,858.75	3,341.84	38.49	(83.53)	16.90
Other Product	183,962.55	226,670.09	279,926.81	358,627.69	23.22	23.50	28.11
TOTAL	1,681,879.83	1,994,649.17	2,422,926.38	2,911,896.79	18.60	21.47	20.18
Collateral wise							
Gold and Silver	30,642.25	37,466.92	38,070.33	38,246.38	22.27	1.61	0.46
Government Securities	1,014.67	997.94	470.42	336.21	(1.65)	(52.86)	(28.53)
Non Governmental Securities	29,668.70	34,634.94	37,124.14	35,873.09	16.74	7.19	(3.37)
Fixed Deposit Receipts	10,553.39	22,175.52	18,557.51	24,098.87	110.13	(16.32)	29.86
Own	9,577.14	20,780.98	17,907.40	23,569.08	116.99	(13.83)	31.62
Other Licences Institutions	976.25	1,394.55	650.11	529.80	42.85	(53.38)	(18.51)
Collateral of Properties	1,463,645.87	1,734,997.03	2,136,643.17	2,600,224.91	18.54	23.15	21.70
Fixed Assets	1,207,217.80	1,459,790.48	1,788,776.33	2,206,624.04	20.92	22.54	23.36
Current Assets	256,428.07	275,206.55	347,866.84	393,600.86	7.32	26.40	13.15
Against security of Bill	15,710.45	15,873.63	18,166.44	23,280.71	1.04	14.44	28.15
Domestic Bills	3,525.87	798.38	826.25	2,381.60	(77.36)	3.49	188.24
Foreign Bills	12,184.58	15,075.25	17,340.19	20,899.12	23.72	15.02	20.52
Against Guarantee	52,993.07	63,293.16	78,284.15	100,600.99	19.44	23.69	28.51
Government Guarantee	2,364.19	2,560.01	2,348.23	2,365.22	8.28	(8.27)	0.72
Institutional Guarantee	33,209.50	42,758.93	55,644.51	77,217.25	28.76	30.14	38.77
Personal Guarantee	4,054.12	5,340.32	6,080.54	5,845.79	31.73	13.86	(3.86)
Collective Guarantee	4,855.55	5,828.86	7,085.62	7,398.46	20.05	21.56	4.42
International Rated Foreign Bank's Guarantee	4,226.93	1,469.32	1,681.66	1,662.22	(65.24)	14.45	(1.16)
Other Guarantee	4,282.79	5,335.71	5,443.59	6,112.04	24.59	2.02	12.28
Credit Card	416.03	905.78	1,257.07	1,670.37	117.72	38.78	32.88
Others	77,235.40	84,304.25	94,353.16	87,565.25	9.15	11.92	(7.19)
TOTAL	1,681,879.83	1,994,649.17	2,422,926.38	2,911,896.78	18.60	21.47	20.18

Annex-V

Major Financial Indicators

as on Asar End, 2076 (Mid-July, 2019)

		Class "A"	Class "B"	Class "C"	Overall
A. Credit, Deposit Ratios (%)					
1	Total Deposit/GDP	83.14	11.50	2.19	96.83
2	Total Credit/GDP	72.17	9.96	1.98	84.11
3	Total Credit/ Total Deposit	86.81	86.65	90.45	86.87
4	CCD Ratio#	75.36	76.42	74.01	75.22
5	Fixed Deposit/Total Deposit	45.42	44.91	51.78	45.51
6	Saving Deposit/Total Deposit	31.30	33.98	31.31	31.62
7	Current Deposit/Total Deposit	10.47	2.37	0.70	9.29
8	Call Deposit/Total Deposit	11.69	18.67	8.20	12.44
9	NPL/ Total Loan	1.40	0.92	8.80	1.52
10	Total LLP/Total Loan	2.05	1.59	9.49	2.17
11	Deprived SectorLoan/Total Loan $	6.07	10.14	7.81	6.56
B. Liquidity Ratios (%)					
1	Cash & Bank Balance/Total Deposit	11.30	12.30	18.47	11.58
2	Investment in Gov. Security/Total Deposit	12.33	3.83	5.08	11.16
3	Total Liquid Assets/Total Deposit	24.41	27.57	36.27	25.06
C. Capital Adequacy Ratios (%)					
1	Core Capital/RWA	12.38	14.86	19.50	12.77
2	Total Capital/RWA	13.95	15.95	20.42	14.29
D. Financial Access					
1	No. of institutions	28	29	23	80
2	No. of Branches	3,585	1,267	205	5,057
3	No. of Deposit Accounts	22,927,898	4,375,814	562,793	27,866,505
4	No.of Loan Accounts	1,047,537	349,126	42,985	1,439,648
5	No. of Branchless Banking Centers	1,529	1	-	1,530
6	No. of Branchless Banking Customers	168,164	143	-	168,307
7	No. of Mobile Banking Customers	7,406,802	909,512	30,873	8,347,187
8	No. of Internet Banking Customers	888,268	24,124	4,952	917,344
9	No. of ATMs	2,951	318	47	3,316
10	No. of Debit Cards	6,454,285	216,991	37,245	6,708,521
11	No. of Credit Cards	123,146	-	-	123,146
12	No. of Prepaid Cards	67,386	-	-	67,386

E. Interest Rate(%)

1	**Wt. Avg Interest on Deposit**	**6.60**
	(a) Saving	4.96
	(b) Fixed	9.95
	(c) Call	4.40
2	**Wt. Avg Interest on Credit**	**12.16**

Note:

Bank balance includes money at call

Nominal GDP(At Producer's Price) for 2018/19 Rs. 34,64,319 million(Preliminary)

Negative core capital has been excluded in calculation of Capital Adequacy Ratios

$ 6 months prior Total Loan is taken to calculate Deprived Sector Lending

Asar month end (last day) CCD ratio

Annex-VI

Composition of Financial Stability Oversight Committee	
Name and Designation	**Status**
Mr. Chinta Mani Siwakoti, Deputy Governor	Chairperson
Mr. Dev Kumar Dhakal, Executive Director, Banks and Financial Institution Regulation Department	Member
Mr. Mukunda Kumar Chettri, Executive Director, Bank Supervision Department	Member
Mr. Rishikesh Bhatta, Executive Director, Development Bank Supervision Department	Member
Dr. Gunakar Bhatta, Executive Director, Research Department	Member
Dr. Prakash Kumar Shrestha, Executive Director, Micro-Finance Promotion and Supervision Department	Member
Mr. Bam Bahadur Mishra, Executive Director, Foreign Exchange Management Department	Member
Mr. Ramu Poudel, Acting Executive Director, Finance Company Supervision Department	Member
Mr. Revati Prasad Nepal, Executive Director, Payment Systems Department	Member
Mr. Kiran Pandit, Director, Banks and Financial Institutions Regulation Department	Member Secretary
Registrar, Department of Cooperative	Invitee Member
Chairman, Insurance Board	Invitee Member
Chairman, Security Board of Nepal	Invitee Member
Administrator, Employee Provident Fund	Invitee Member
Executive Director, Citizen Investment Trust	Invitee Member
Related Sectors Experts (maximum 2)	Invitee Member

Composition of Financial Stability Sub-Committee	
Name and Designation	**Status**
Mr.Kiran Pandit, Director, Banks and Financial Institutions Regulation Department	Coordinator
Mr Sharan Kumar Adhikari, Deputy Director, Bank Supervision Department	Member
Ms. Sajana Silpakar , Deputy Director, Finance Company Supervision Department	Member
Mr. Nanda Kumar Dhakal, Deputy Director, Research Department	Member
Mr. Krishna Sharan Phuyal, Deputy Director, Foreign Exchange Management Department	Member
Mr. Rajan Prasad Adhikari, Deputy Director, Microfinance Promotion and Supervision Department	Member
Mr. Rakesh Prajapati, Deputy Director, Development Bank Bank Supervision Department	Member
Mr. Kriti Bikram Dahal, Deputy Director, Payment Systems Department	Member
Dr. Deepak Adhikari, Deputy Director, Banks and Financial Institutions Regulation Department	Member Secretary
Mr. Prithu Sharma Binadi, Assistant Director, Banks and Financial Institutions Regulation Department	FSU

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