FINANCIAL STABILITY

REPORT

Nepal Rastra Bank

Central Office

Baluwatar, Kathmandu

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FINANCIAL STABILITY REPORT

(Issue No. 7)

Nepal Rastra Bank
Baluwatar, Kathmandu

Disclaimer

This *seventh* issue of the Financial Stability Report is based on the provisional data of Bank & Financial Institutions (BFIs) and other financial institutions as of mid-July 2015. Data used in its analysis may thus differ from the most recent statistics or audited final data published by BFIs. All the findings, interpretation and conclusions expressed in this report do not necessarily reflect the views of Nepal Rastra Bank or its Board of Directors. The colors, boundaries, denominations or any other signs and symbols used in the report do not imply any metamorphic judgments. This report, unless or otherwise stated elsewhere, covers the developments and risks during the year to mid-July 2015. All the data and information in this report are retrieved from NRB depository, unless stated.

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

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Contents

Statistical Annex

List of Boxes

List of Figures

List of Tables

GOVERNOR

Foreword

Achieving financial stability through the prudent regulatory framework and effective supervision is one of the key challenges. NRB has been promoting financial stability by formulating required laws and regulations as well as amending current laws and policies so that they remain vigilant.

Nepalese Financial Sector remains sound and stable aftermath of April 2015 earthquake. Even after the catastrophe, public confidence towards the banking system has been still and profound thanks to prompt response from NRB to provide uninterrupted banking services during crisis. NRB came with necessary provisions to ensure smooth functioning of BFIs by way of relaxation in opening branches and service locations, simplifying account opening procedure for the earthquake victims, allow BFIs to restructure/reschedule loans provided to earthquake affected people among others. However, the earthquake exacerbated prevailing challenges in maintaining macroeconomic and financial stability. Thus with the hindsight, Monetary Policy for 2015/16 took bold step by quadrupling minimum capital requirements for BFIs to make them more stable and resilient to face future crises. The capital enhancement policy of NRB is directed toward strengthening regulated financial institutions in terms of capital so that they remain capable to support the overall economic development of the country.

The seventh Financial Stability report is equipped with analytical review of the banking and financial system and the achievements accomplished through the implementation of key regulations/policies. This Report, seventh in the series of such publication, is prepared by Financial Stability Unit (FSU) and Financial Stability Sub-committee (FSS) under the guidance of the Financial Stability Oversight Committee (FSOC), which is chaired by senior Deputy Governor of this bank. This publication has come out with the hard work of our staff and senior officials. In this context, I would like to thank the FSOC, FSS and the Bank and Financial Institutions Regulation Department (BFIRD) of this bank, particularly the FSU for preparing this report. Moreover, I offer my special thanks to Executive

Director of BFIRD Mr. Shivanath Pandy, Director Mr. Raman Nepal, Deputy Director Ms. Pushpa Adhikary and Assistant Director Nabin Timilsina for their untiring efforts in bringing out this report to this form.

I hope this report will facilitate the path of our financial stability effort and help to formulate, implement and communicate monetary and financial sector policies in the days to come. I am also confident that this Stability Report would serve as a useful source of reference for those who are interested in and have concerns with the financial system of the country.

Dr. Chiranjibi Nepal

Acronyms

ADBL	Agriculture Development Bank Limited
AE	Advanced Economies
ATM	Automatic Teller Machine
BAFIA	Bank and Financial Institution Act
BFIs	Bank and Financial Institutions
CAR	Capital Adequacy Ratio
CB	Commercial Banks
CBS	Central Bureau of Statistics
CD Ratio	Credit to Deposit Ratio
CEO	Chief Executive Officer
CIT	Citizens Investment Trust
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DBSD	Development Bank Supervision Department
DOC	Department of Cooperatives
ECB	European Central Bank
FI	Financial Institution
EMDE	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EPF	Employee Provident Fund
FINGO	Financial Non-government Organization
FEMD	Foreign Exchange Management Department
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness Indicators
GBBs	Grameen Bikash Banks
GDP	Gross Domestic Product
GFSR	Global Financial Stability Review
GoN	Government of Nepal
IC	Insurance Companies
IMF	International Monetary Fund
INR	Indian Rupees
IPO	Initial Public Offering
LCY	Local Currency
LS	Left Scale

LLP	Loan Loss Provision
LMFF	Liquidity Monitoring and Forecasting Framework
LoLR	Lender of Last Resort
MFDB	Microfinance Development Bank
NBA	Non-Banking Assets
NBL	Nepal Bank Limited
NEPSE	Nepal Stock Exchange
NGO	Non-Government Organization
NIDC	Nepal Industrial and Development Corporation
NPA	Non-Performing Assets
NPLs	Non-Performing Loans
NRB	Nepal Rastra Bank
PCA	Prompt Corrective Action
RBB	Rastriya Banijya Bank
RS	Right Scale
ROA	Return on Assets
ROE	Return on Equity
RSRF	Rural Self Reliance Fund
RWA	Risk Weighted Assets
SOBs	State Owned Banks
SEBON	Security Board of Nepal
SLR	Statutory Liquidity Ratio
SOL	Single Obligor Limit
US	United States
WEO	World Economic Outlook

Executive Summary

Global growth in the first half of 2015 was 2.9 percent, about 0.3 percentage point weaker than predicted in April of this year, states *World Economic Outlook 2015*. Growth was below forecast for both advanced economies and emerging markets. Specifically Growth in the United States was weaker than expected, despite a strong second quarter. Despite weaker growth, the unemployment rate declined to 5.1 percent at the end of August, 0.4 percentage point below its February level (and 1 percentage point below the level a year ago). Lower capital expenditures in the oil sector were also a major contributor to the slowdown in Canada, where economic activity contracted modestly during the first two quarters of 2015.

Growth in China was broadly in line with previous forecasts. Investment growth slowed compared with last year and imports contracted, but consumption growth remained steady. Economic activity in some advanced and emerging market economies in east Asia—such as Korea, Taiwan Province of China, and economies of Association of Southeast Asian Nations (ASEAN) members—was also a bit weaker than expected, reflecting lower exports but also a slowdown in domestic demand.

Headline inflation has declined in advanced economies, mostly reflecting the decline in the prices of oil and other commodities. Core inflation has remained more stable, but generally is below central banks' inflation objectives, as are nominal unit labor costs. After remaining broadly stable during the second quarter of 2015, oil prices declined through much of the third quarter. Recent developments suggest that oil markets will take longer to adjust to current conditions of excess flow supply, and oil prices through 2020 are now forecast to remain below the levels projected a few months ago.

Nepalese economy witnessed lower than expected growth in FY 2014/15 due mainly to devastating earthquake of April 25, 2015. The earthquake and the subsequent aftershocks disrupted the supply of agricultural inputs, machinery equipments and affected technical extension services essential for the major crops such as maize, paddy, millet and barley. Less favorable monsoon in the first half of the review year had already posed some production downturn of those major crops. On the non-agricultural side, the sluggish demand for the production after the earthquake resulted in deceleration of the industrial sector. The hotels and restaurants have been badly affected due to the earthquake since very few number of tourists made their visit to Nepal. According to the preliminary estimates of Central Bureau of Statistics (CBS), the real GDP at basic price is estimated to grow by 3.0 percent in fiscal year 2014/15.

According to the Post Disaster Needs Assessment (PDNA) report published by the National Planning Commission, the earthquake has caused the stock loss of Rs.707 billion in the economy. The stock loss from the earthquake is estimated to be 57.8 percent in the social sector, 25.2 percent in the manufacturing sector, 9.5 percent in the infrastructure sector and 7.5 percent in the remaining other sectors. The total stock loss from the earthquake stood at one third of the real GDP of 2014/15. The flow loss was Rs.36.0 billion resulting in 1.54 percent shrinkage in GDP of 2014/15.

Overall financial stability has improved in advanced economies since April 2015. It further states that the progress reflects a strengthening macro-financial environment in advanced economies as the recovery has broadened, confidence in monetary policies has firmed, and deflation risks have abated somewhat in the euro area. However, there are broad policy challenges in evidence over the past several months: emerging market vulnerabilities, legacy issues from the crisis in advanced economies and weak systemic market liquidity.

Nepalese banking system is in consolidation process through the merger and acquisition. As of mid-July 2015, the total number of financial institutions stood at 262 comprising of Commercial Bank 30, Development Bank 76, Finance Companies 47 and Microfinance Development Banks 38. Moreover, 42 other financial intermediaries licensed by NRB, 26 insurance companies and one each of EPF, CIT and Postal Saving Bank. Total number of "A", "B", "C" and "D" class financial institutions reduced to 191 in mid-July 2015 from 204 in mid-July 2014 due to merger and acquisition policy adopted by the NRB.

In terms of total assets and liabilities, banks and financial institutions shared 82.0 percent of total financial system of Nepal in mid-July 2015. Total assets of BFIs increased by 18.19 percent and reached to Rs. 2183. As on mid-July 2015, the commercial banks had provided 22.5 percent of their total loan on productive sector which includes 9.2% in agriculture, 5.2% in energy sector and 4.2% in tourism sector and 3.9% in cottage and small industries respectively. The capital fund of BFIs increased by 11.7 percent to Rs.163 billion from 145.8 billion in mid –July 2014. The overall CAR of BFIs in mid-July 2015 stood at 12.9 percent which was 12.7 percent in previous year.

NPL of BFIs rose by Rs.7.1 billion to Rs.49.6 billion in mid-July, 2015 which was Rs.42.5 billion in mid-July 2014. However, in terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2015 indicating the banking sector's resilience in large. NPL to total loans of commercial banks was decreased by 0.13 percentage point on y-o-y basis and recorded the ratio of 2.6 percent on mid-July, 2015.

Credit flows from BFIs grew significantly by 20.5 percentage in mid-July, 2015 such increment was 18.2 percent in mid-July, 2014. Commercial Banks grew by 21.9 percent in mid-July 2015, such increment was 19 percent in mid-July 2014. The overall profitability of banking sector increased significantly by 26.4 percent and reached to Rs. 37 billion in mid-July 2015 from 29.3 billion in mid-July 2014. The commercial banks posted a higher share of profitability of the banking sector accounting 76.5 percent of the total in mid-July 2015.

After the issuance of the "Bank and Financial Institutions Merger By-laws, 2011", 78 BFIs have merged with each other forming 30 BFIs as of mid-July 2015. During the the review period, 15 BFIs went for merger to form 6 BFIs. As of mid-July 2015, the branch network of commercial banks reached 1672 followed by development banks (808), Finance companies (242) and Micro Finance Development Banks (1116). In mid-July 2015, on an average, a BFI branch has been serving approximately to 10,160 people; excluding the branches of “D” class financial institutions.

The state owned commercial banks have 19 percent share in total deposit of commercial banks. Their market share in terms of total assets of all BFIs stood at 16.5 percent, whereas in total deposit and loan & advances, the ratio reached to 15.7 and 14.8 percent respectively in mid-July 2015. Ccapital fund of all three state owned banks are Rs. 3.3 billion, Rs. 2.3 billion and Rs. 12.9 billion respectively for NBL, RBB and ADBL.

As in mid-July 2015, share of commercial banks in total assets and liabilities of NRB regulated BFIs rose to 81.3 percent from 78.1 in mid-July 2014. Similarly, share of total assets and liabilities of commercial banks on total GDP decreased to 68.85 percent from 76.1 percent in mid-July 2014. Total deposit and credit of commercial banks stood at 68.8 and 51.9 of GDP in mid-July 2015 which was 62.5 and 46.8 percent of GDP in mid-July 2014 respectively. Total deposits grew by 21.4 percent to Rs.1462.9 billion during the period of mid-July 2015, surpassing previous growth of 18 percent growth during mid-July 2014.

Barring some instances, overall performances of the Development Banks were improving in an encouraging pace. Deposits at these banks grew by 18.6 percent to Rs.237 billion while credits grew by 19.6 percent to Rs.193 billion. The ratio of credit to domestic deposit and core capital barely changed from the level in mid-July 2014 to stand at 70.8 percent in mid-July 2015.

As of mid-July 2015, deposits of cooperatives totaled Rs.202.4 billion and total credit stood at Rs.187.8 billion. There are altogether 26 (17 non-life and 9 life) insurance companies. The data received from Insurance Board of Nepal, reveals that total assets/liabilities of insurance companies rose by 22.1 percent to Rs.124.3 billion during fiscal year 2014-15. Total assets of life insurance companies' and non-life companies' expanded by 23.0 percent and 22.6 percent respectively. According to unaudited figures of mid-July 2015, Employee Provident Fund (EPF) has provident fund amounting to Rs.189.7 billion, while total assets/liabilities of EPF stood at Rs.195.9 billion.

Short term and long term interest rates in the financial market remained relatively higher in FY 2014/15. Nepalese currency depreciated by 5.2 percent against US dollar during end of 2014/15 compared to a depreciation by 1.1 percent in the same period of the previous year. The NEPSE index declined by 7.2 percent to 961.2 points in mid-July 2015 on y-o-y basis. This was particularly due to the devastating earthquake that struck on April 23rd. This index had increased by 99.9 percent to 1036.1 points a year ago. The NEPSE sensitive index stood at 204.7 point in mid-July 2015, as against 222.5 in mid-July 2014.

Nepal Rastra Bank raised the level of minimum paid up capital for licensed A, B and C class Financial Institutions through annual monetary policy FY 2014/15. The new provision of paid up capital requires BFIs to increase their capital at least by four-fold from existing level within the two-year period ending mid-July 2017. Capital increment is expected to provide additional capacity for credit creation to the BFIs through infused capital. In a bid to increase resilience in licensed financial institutions, NRB has added a layer to its prevailing credit classifications. It issued directive on maintaining “watch list” of loans. NRB has set up the Payment and Settlement Department headed by Executive Director which has the responsibility for development of Payment and Settlement Systems (PSS). Furthermore, as stated in the 9th pillar of Nepal National Payment Development Strategy the NRB will form National Payments Council (NPC),

CHAPTER - ONE
MACROECONOMIC DEVELOPMENT

Global Economic Development

Recent Developments and Outlook

As the World Economic Outlook (WEO October 2015) states, growth in advanced economies in the first half of 2015 remained modest. For most emerging market economies, external conditions are becoming more difficult. Financial market volatility rose sharply during the summer, with declining commodity prices and downward pressure on many emerging market currencies.

Preliminary data suggest that global growth in the first half of 2015 was 2.9 percent, about 0.3 percentage point weaker than predicted in April of this year. Growth was below forecast for both advanced economies and emerging markets. Specifically Growth in the United States was weaker than expected, despite a strong second quarter. This reflected setbacks to activity in the first quarter, caused by one-off factors, notably harsh winter weather and port closures, as well as much lower capital spending in the oil sector. Despite weaker growth, the unemployment rate declined to 5.1 percent at the end of August, 0.4 percentage point below its February level (and 1 percentage point below the level a year ago). Lower capital expenditures in the oil sector were also a major contributor to the slowdown in Canada, where economic activity contracted modestly during the first two quarters of 2015.

The recovery was broadly in line with the April forecast in the euro area, with stronger-than-expected growth in Italy and especially in Ireland and Spain (sustained by recovering domestic demand) offsetting weaker-than-expected growth in Germany.

In the United Kingdom, GDP expanded at an annualized rate of 2.25 percent in the first half of 2015, with the unemployment rate now back near its pre-crisis average of about 5.5 percent. In Japan, a strong rebound in the first quarter was followed by a drop in activity in the second quarter. Over the first half of the year, consumption fell short of expectations and so did net exports. Exports declined substantially in the second quarter.

Growth in China was broadly in line with previous forecasts. Investment growth slowed compared with last year and imports contracted, but consumption growth remained steady. While exports were also weaker than expected, they declined less than imports, and net exports contributed positively to growth. Equity prices have dropped sharply since July after a one-year bull run. While the authorities intervened to restore orderly market conditions, market volatility remained elevated through August.

Table 1.1. Overview of the *World Economic Outlook* Projections *(Percentage change)*

	2014	2015	2016	2015	2016	2015	2016
World Output	**3.4**	**3.1**	**3.6**	**–0.2**	**–0.2**	**–0.4**	**–0.2**
Advanced Economies	**1.8**	**2.0**	**2.2**	**–0.1**	**–0.2**	**–0.4**	**–0.2**
United States	2.4	2.6	2.8	0.1	–0.2	–0.5	–0.3
Euro Area	0.9	1.5	1.6	0.0	–0.1	0.0	0.0
Germany	1.6	1.5	1.6	–0.1	–0.1	–0.1	–0.1
France	0.2	1.2	1.5	0.0	0.0	0.0	0.0
Italy	–0.4	0.8	1.3	0.1	0.1	0.3	0.2
Spain	1.4	3.1	2.5	0.0	0.0	0.6	0.5
Japan	–0.1	0.6	1.0	–0.2	–0.2	–0.4	–0.2
United Kingdom	3.0	2.5	2.2	0.1	0.0	–0.2	–0.1
Canada	2.4	1.0	1.7	–0.5	–0.4	–1.2	–0.3
Other Advanced Economies[2]	2.8	2.3	2.7	–0.4	–0.4	–0.5	–0.4
Emerging Market and Developing Economies	**4.6**	**4.0**	**4.5**	**–0.2**	**–0.2**	**–0.3**	**–0.2**
Commonwealth of Independent States	1.0	–2.7	0.5	–0.5	–0.7	–0.1	0.2
Russia	0.6	–3.8	–0.6	–0.4	–0.8	0.0	0.5
Excluding Russia	1.9	–0.1	2.8	–0.8	–0.5	–0.5	–0.4
Emerging and Developing Asia	6.8	6.5	6.4	–0.1	0.0	–0.1	0.0
China	7.3	6.8	6.3	0.0	0.0	0.0	0.0
India[3]	7.3	7.3	7.5	–0.2	0.0	–0.2	0.0
ASEAN-5[4]	4.6	4.6	4.9	–0.1	–0.2	–0.6	–0.4
Emerging and Developing Europe	2.8	3.0	3.0	0.1	0.1	0.1	–0.2
Latin America and the Caribbean	1.3	–0.3	0.8	–0.8	–0.9	–1.2	–1.2
Brazil	0.1	–3.0	–1.0	–1.5	–1.7	–2.0	–2.0
Mexico	2.1	2.3	2.8	–0.1	–0.2	–0.7	–0.5
Middle East, North Africa, Afghanistan, and Pakistan	2.7	2.5	3.9	–0.1	0.1	–0.4	0.1
Saudi Arabia	3.5	3.4	2.2	0.6	–0.2	0.4	–0.5
Sub-Saharan Africa	5.0	3.8	4.3	–0.6	–0.8	–0.7	–0.8
Nigeria	6.3	4.0	4.3	–0.5	–0.7	–0.8	–0.7
South Africa	1.5	1.4	1.3	–0.6	–0.8	–0.6	–0.8

[1]Difference based on rounded figures for both the current, July 2015 *WEO Update*, and April 2015 *World Economic Outlook* forecasts.
[2]Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.
[3]For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with FY2011/12 as a base year.

Source: World Economic Outlook 2015 October

Economic activity in some advanced and emerging market economies in east Asia—such as Korea, Taiwan Province of China, and economies of Association of Southeast Asian Nations (ASEAN) members—was also a bit weaker than expected, reflecting lower exports but also a slowdown in domestic demand.

In Latin America, the downturn in Brazil was deeper than expected, and with declining commodity prices, momentum continues to weaken in other countries in the region. Growth was also lower than expected in Mexico, reflecting slower U.S. growth and a drop in oil production.

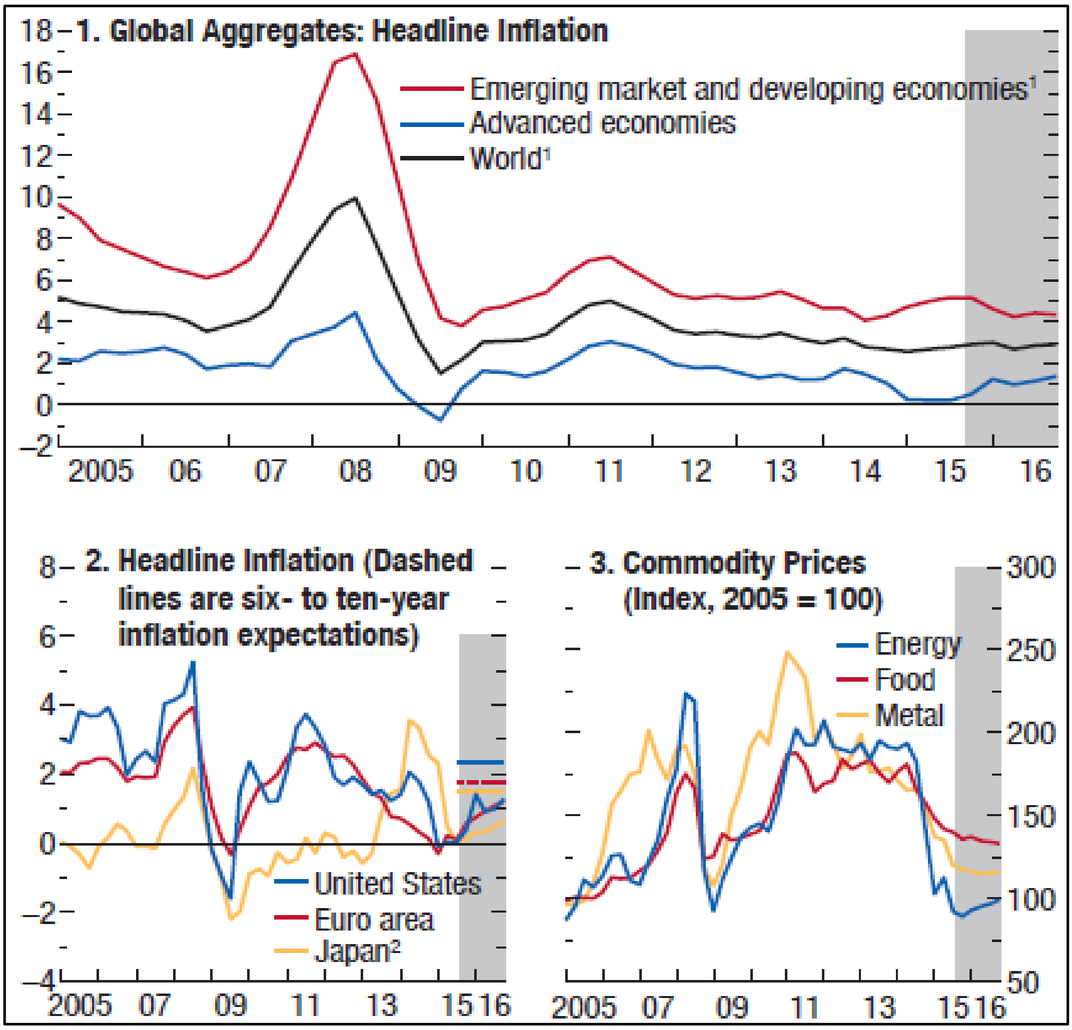
The decline in GDP in Russia over the first half of 2015 was somewhat larger than forecast, and the recession in Ukraine was deeper than previously forecast, reflecting the ongoing conflict in the region.

Macroeconomic indicators suggest that economic activity in sub-Saharan Africa and the Middle East—for which quarterly GDP series are not broadly available—also fell short of expectations, affected by the drop in oil prices, declines in other commodity prices, and geopolitical and domestic strife in a few countries.

Inflation

Headline inflation has declined in advanced economies, mostly reflecting the decline in the prices of oil and other commodities. Core inflation has remained more stable, but generally is below central banks' inflation objectives, as are nominal unit labor costs. In emerging market economies, lower commodity prices have also contributed to lowering headline inflation, but sizable currency depreciation has led to offsets on the upside in some economies.

Figure: 1.1 Global Inflation

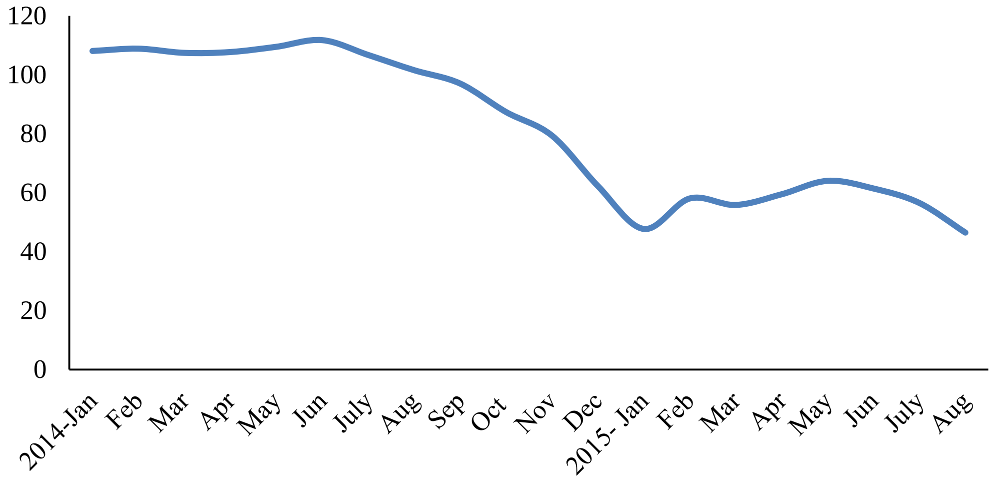


Source: World Economic Outlook 2015 October

Crude Oil

After remaining broadly stable during the second quarter of 2015, oil prices declined through much of the third quarter. Weaker-than-expected global activity coupled with higher supply due to strong production in members of the Organization of the Petroleum Exporting Countries (OPEC) as well as in the United States and Russia. Furthermore, a future boost to supply is expected, coming from the Islamic Republic of Iran after the recent nuclear agreement with the P5+1 nations.

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



Souce: www.eia.gov

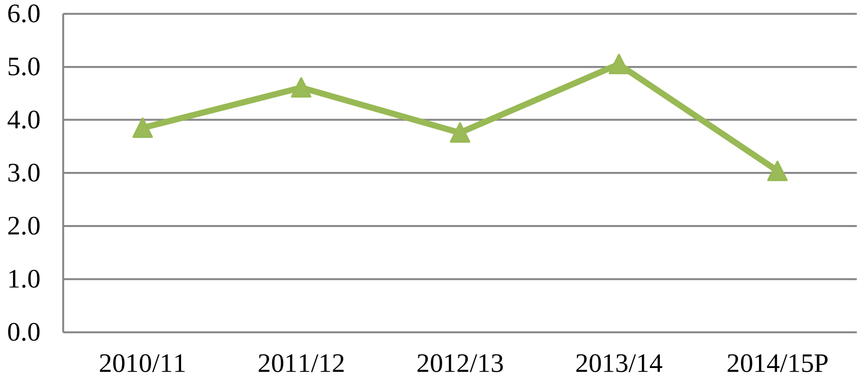
Recent developments suggest that oil markets will take longer to adjust to current conditions of excess flow supply, and oil prices through 2020 are now forecast to remain below the levels projected a few months ago. Supply has remained more resilient than expected, and global activity has been weaker. While lower oil prices have supported demand in importers, other shocks have partly offset the effects and so far prevented a broad-based pickup in activity, which in turn would have supported oil market rebalancing. The income windfall gains from lower oil prices have supported a pickup in private consumption in advanced economies, broadly as expected, except in the United States, where harsh winter weather and other temporary factors weakened the consumption response somewhat, and Japan, where the consumption response has been dampened by delayed pass-through and wage moderation. But investment has not responded, partly reflecting a greater contraction in oil sector investment, but also lackluster investment more broadly. And in emerging markets, economic activity has been weaker than expected, particularly in oil exporters.

DOMESTIC MACROECONOMIC DEVELOPMENT

The economy witnessed lower than expected growth in 2014/15 due mainly to devastating earthquake of April 25, 2015. The earthquake and the subsequent aftershocks disrupted the supply of agricultural inputs, machinery equipments and affected technical extension services essential for the major crops such as maize, paddy, millet and barley. Less favorable monsoon in the first half of the review year had already posed some production downturn of those major crops. On the non-agricultural side, the sluggish demand for the production after the earthquake resulted in deceleration of the industrial sector. The hotels and restaurants have been badly affected due to the earthquake since very few number of tourists made their visit to Nepal.

Economic Growth

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

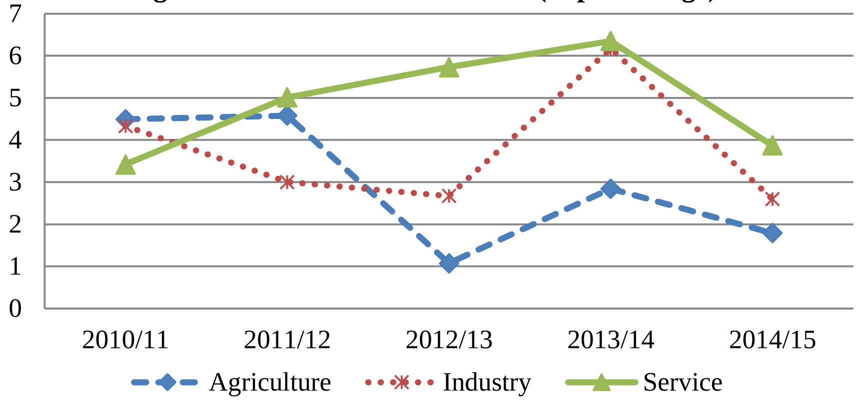


According to the preliminary estimates of Central Bureau of Statistics (CBS), the real GDP at basic price is estimated to grow by 3.0 percent in fiscal year 2014/15 compared to a growth of 5.1 percent in the previous year. Similarly, the real GDP at producers' price is expected to grow by 3.4 percent in the review year compared to a growth of 5.4 percent in the previous year. In the review year, the delay in monsoon, the devastating earthquake of April 25, 2015 and the subsequent aftershocks have significant negative impact in overall sectors of the economy resulting into a lower growth rate.

According to the Post Disaster Needs Assessment (PDNA) report published by the National Planning Commission, the earthquake has caused the stock loss of Rs.707 billion in the economy. The stock loss from the earthquake is estimated to be 57.8 percent in the social sector, 25.2 percent in the manufacturing sector, 9.5 percent in the infrastructure sector and 7.5 percent in the remaining other sectors. The total stock loss from the earthquake stood at one third of the real GDP of 2014/15. The flow loss was Rs.36.0 billion resulting in 1.54 percent shrinkage in GDP of 2014/15.

Agriculture sector, which was adversely affected by the earthquake has been further affected by the late monsoon. This sector is estimated to grow merely by 1.9 percent in 2014/15 compared to a growth of 2.9 percent in the previous year. Considering the adverse effects of power-shortage, earthquake and political uncertainties, growth in industrial sector is estimated to decline to 2.6 percent in the review year. Last year, the industrial sector had grown by 6.2 percent. The real estate and tourism sector have been hit hard by the earthquake. Likewise, wholesale and retail trade; transport, storage and communication; and financial intermediation were adversely affected. Services sector, therefore, is estimated to grow by 3.9 percent in 2014/15 compared to a growth of 6.4 percent in the previous year.

Figure 1.4: Sectoral GDP Growth (in percentage)



In the review period, the decline in the production of principal cereal crops; paddy and maize due to the delay in monsoon and losses in livestock and some agro-products from the earthquake has constrained the growth rate of the agriculture sector. The agriculture, beekeeping, fishery, poultry and irrigation are estimated to suffer a loss of total Rs.28.4 billion due to the earthquake. The destruction has resulted into 0.38 percent contraction in the growth of agriculture sector.

In the review year, the industrial sector is estimated to grow by 2.6 percent compared to a growth of 6.2 percent in the previous year. The power and labor shortage and some physical damages in the wake of devastating earthquake constrained industrial sector production during the review period. The industrial sector witnessed a sluggish progress due to the damage of the earthquake amounting approximately to Rs.19.0 billion in the fixed assets followed by the damage in 20.0 percent strategically important road networks and about 25.0 percent reduction in the power production. The earthquake and the subsequent aftershocks have enormously damaged the Araniko Highway and Pasang Lhamu Highway resulting obstruction in the import and export between Nepal and China. The construction process of Upper Tamakoshi and Rasuwagadhi Hydropower Projects has not been re-started by the end of 2014/15.

In the review year, the service sector is estimated to grow by 3.9 percent compared to a growth of 6.4 percent in the previous year. Despite the improvement in labor relation, security situation and other structural bottlenecks, adverse impact of the devastating earthquake of April 25 especially on hotel and restaurants, real estate, renting and business activities and wholesale and retail trade have impeded the growth rate of service sector in the review year.

The PDNA report has revealed that in 2014/15, poverty is estimated to increase by at least 2.5 percent to 3.0 percent resulting into an additional 0.7 million people lying below the poverty line due to the effects of the earthquake. Out of which 50.0 percent to 60.0 percent of recently defined poor people are believed to live in the central parts of hills and mountainous regions. In addition to this, the devastation of earthquake is believed to disrupt the water supply and sanitation, disturb the health services and schools and increase the food shortage which will further impact the poverty situation.

The Government of Nepal has organized an International Conference on Nepal's Reconstruction after earthquake on 25th June 2015. Multilateral and bilateral development partners such as India, China, Japan, USA, UK, Asian Development Bank, World Bank etc. among others have participated in the conference. The Government of Nepal produced details of loss caused by the earthquake amounting to Rs.706 billion to the participating donors. The donor agencies on the occasion made commitments of aid worth over Rs.440 billion to help with the reconstruction of Nepal. Out of the total amount, Rs.220 billion is grant assistance while remaining Rs.220 billion is soft loan.

The Government of Nepal has allocated Rs.94 billion in the budget of fiscal year 2015/16 for the reconstruction of the affected houses, heritages and infrastructures. The Government has also proposed to organize a high level National Reconstruction Authority (NRA) to expedite and implement the reconstruction.

Table 1.2: Summary of Earthquake Disaster Effects

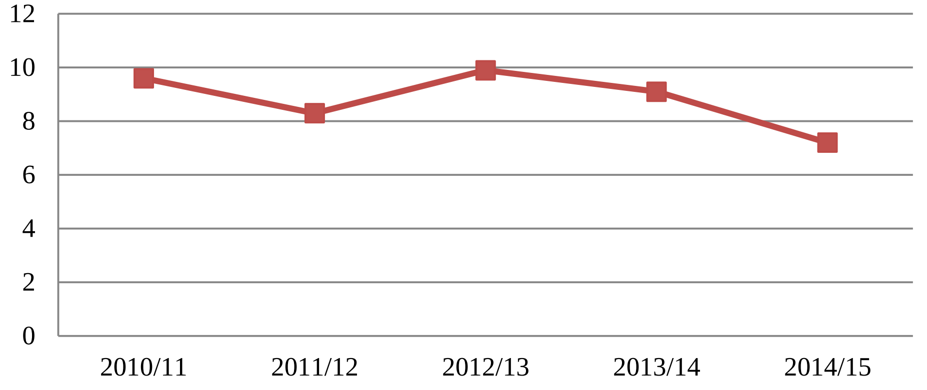
Sectors	Disaster Effects (Rs. In million)		
	Damages	Losses	Total
Social Sectors	**355028**	**53597**	**408625**
Housing and Human Settlements	303632	46908	350540
Health	6422	1122	7544
Education	28064	3254	31318
Cultural Heritage	16910	2313	19223
Productive Sectors	**58074**	**120046**	**178121**
Agriculture	16405	11962	28366
Irrigation	383	0	383
Commerce	9015	7938	16953
Industry	8394	10877	19271
Tourism	18863	62379	81242
Finance	5015	26890	31905
Infrastructure Sectors	**52460**	**14323**	**66783**
Electricity	17807	3435	21242
Communications	3610	5085	8695
Community Infrastructure	3349	0	3349
Transport	17188	4930	22118
Water and Sanitation	10506	873	11379
Cross-Cutting Issues	**51872**	**1061**	**52933**
Governance	18757	0	18757
Disaster Risk Reduction	155	0	155
Environment and Forestry	32960	1061	34021
Total	**517,434**	**189,027**	**706,462**

Source: Post Disaster Needs Assessment Report, National Planning Commission.

Inflation

The annual average consumer price inflation increased by 7.2 percent in 2014/15 compared to an increase of 9.1 percent in the previous year. The price index of food and beverages group increased by 9.6 percent whereas the index of non-food and services group increased by 5.2 percent in 2014/15. The indices of food and beverages, and non-food and services had increased by 11.6 percent and 6.8 percent respectively in 2013/14. Rise in food and beverages group prices was mainly due to the increase in prices of vegetables, tobacco products, meat and fish, hard drinks and fruits.

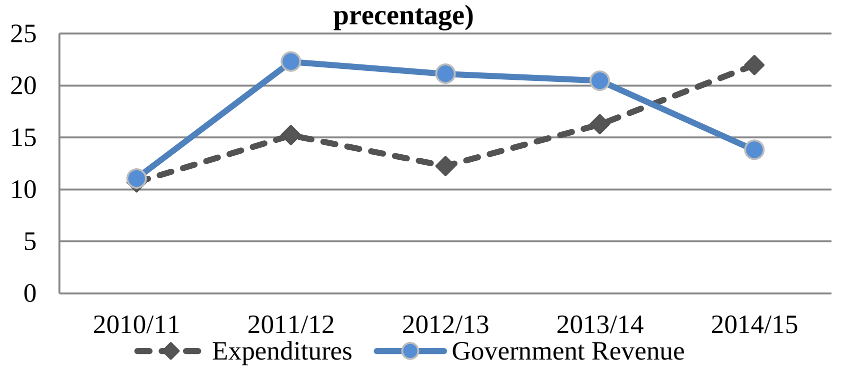
Figure 1.5: Changes in Consumer Price Index (in percentage)



Government Finance

The government expenditure, on cash basis, increased by 22.0 percent to Rs.509.21 billion in the review year compared to a growth of 16.3 percent in the last year. In the total expenditure, the share of recurrent, capital and financial expenditures stood at 65.8 percent, 15.9 percent and 18.3 percent, respectively in the review year compared to 71.0 percent, 14.7 percent and 14.2 percent, respectively a year ago. The capital expenditure, which increased by 32.1 percent to Rs.81.03 billion is 69.4 percent of the annual budget estimate for 2014/15. The low execution of capital expenditure reflects the entrenched structural problems in the public expenditure system of Nepal.

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



The slackening of economic activities following the devastating earthquake of April 25, 2015 and its aftershocks adversely affected the revenue collection in the last quarter of the review year. The government revenue collection increased by 13.8 percent to Rs.405.85 billion (96 percent of annual budget estimate) in 2014/15 compared to 20.5 percent rise in the previous year. The revenue-to-GDP ratio, however, increased to 19.1 percent in 2014/15 from 18.4 percent in the previous year.

Because of low growth in resource mobilization relative to government expenditure, the government budget on cash basis remained at a deficit of Rs.45.88 billion in 2014/15. The budget deficit was Rs.13.75 billion in 2013/14.

In the review year, the government repaid Rs.47.45 billion as principal of domestic borrowings and made new domestic borrowing of Rs.42.42 billion in 2014/15. The cash balance of the GoN held at NRB stood at Rs.33.81 billion (including the previous year's balance of Rs.23.50 billion) at the end of 2014/15.

The outstanding public debt of the GoN stood at Rs.539.75 billion in mid-July 2015. Of this, the share of foreign loans was 63.5 percent. The total public debt-to-GDP ratio of the GoN, which has been declining in the last few years, further declined to 25.4 percent in 2014/15. This shows the improvement in the debt sustainability of the nation and ample fiscal space for building necessary infrastructure for economic development.

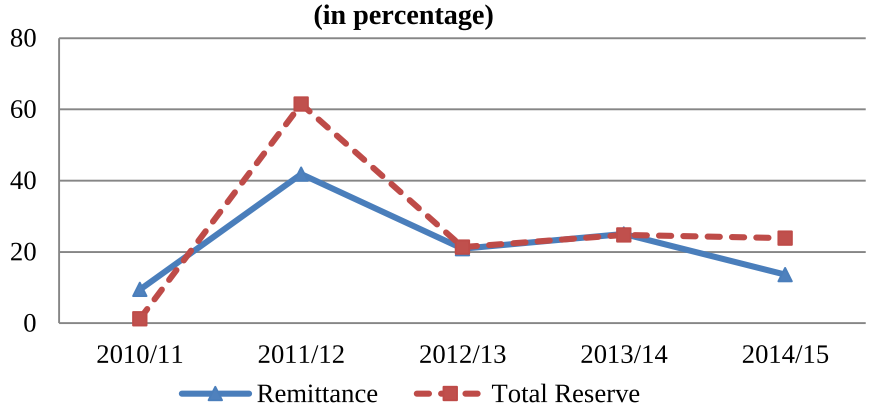
External Sector

Merchandise exports decreased by 7.3 percent to Rs.85.32 billion in 2014/15 in contrast to its growth of 19.6 percent in the previous year. Likewise, merchandise imports increased by 8.4 percent to Rs.774.68 billion in the review year. Such imports had risen by 28.3 percent in the previous year. Consequently, total trade deficit went up by 10.8 percent to Rs.689.37 billion in the review year. The ratio of export to import declined to 11.0 percent during 2014/15. Such ratio stood at 12.9 percent in the previous year. The share of India in total foreign trade stood at 63.7 percent during in 2014/15.

The overall BOP recorded a surplus of Rs.144.85 billion in 2014/15 compared to a surplus of Rs.127.13 billion in the previous year. Existing foreign exchange reserve is sufficient for financing merchandise imports of 13.0 months and merchandise and service imports of 11.2 months as at mid-July 2015.The BOP surplus is mainly driven by the payments for imports and inflow of remittances. Workers' remittances grew by 13.6 percent to Rs.617.28 billion in 2014/15 compared to 25.0 percent in the previous year.

The foreign exchange reserve of the banking system rose by 23.8 percent to Rs.823.87 billion in 2014/15 compared to its growth of 24.8 percent in the previous year. The growth rate of reserve is closely linked with growth of remittances. Remittance inflow is also contributing to the expansion of financial sector and deposit mobilization; hence remittance inflow is correlated with the liquidity situation of the banking sector. The widening base and regular flows of the Nepalese workers visiting abroad for work, external sector is expected to remain resilient in the future.

Figure 1.7: Growth in Remittance Inflow and Total Reserve (in percentage)

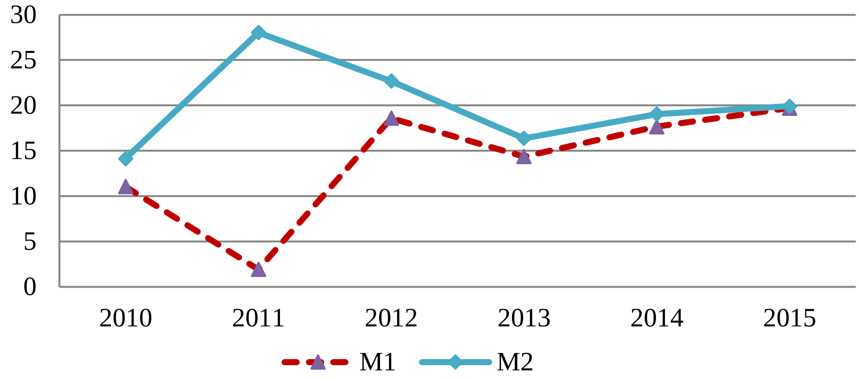


The International Investment Position (IIP) shows that the foreign assets of Nepal are Rs.847.66 billion and the liabilities are Rs.487.32 billion as at mid-July 2015. Accordingly, the net IIP remained in surplus by Rs.360.35 billon as at July 2015 which was in surplus by Rs.204.03 billion as of mid-July 2014.

Monetary Situation

Monetary aggregates were kept at the desired level in 2014/15. Despite high growth in net foreign assets, this was possible mainly due to liquidity absorption through open market operations such as the deposit collection auction. In 2014/15, broad money supply (M2) increased by 19.9 percent compared to an increase of 19.1 percent in the previous year. Likewise, narrow money supply (M1) grew by 19.7 percent in the review year compared to a growth of 17.7 percent in the previous year. Net foreign assets (after adjusting foreign exchange valuation gain/loss) increased by Rs.145.04 billion (24.2 percent) during the review year compared to an increase of Rs.127.13 billion (27.2 percent) in the previous year. A higher inflow of remittances along with a decelerated growth of imports resulted in an expansion of net foreign assets in the review year.

Figure 1.8: Money Supply Growth (in percentage)



Domestic credit increased by 16.2 percent in the review year compared to a growth of 12.7 percent in the previous year. Increase in claims on the private sector as well as financial institutions resulted in a higher growth of domestic credit in the review year. Likewise, claims on the private sector increased by 19.4 percent in the review year compared to a growth of 18.3 percent in the previous year.

Reserve money increased by 19.8 percent in the review year compared to an increase of 23.3 percent in the previous year. The absorption of liquidity through deposit collection auction accounted for a slower growth in reserve money.

Deposits at banks and financial institutions (BFIs) increased by 20.1 percent (Rs.282.06 billion) in the review year compared to an increase of 18.4 percent (Rs.218.68 billion) in the previous year. Deposits at commercial banks and development banks increased by 21.4 percent and 15.2 percent respectively while that of finance companies decreased by 0.6 percent in the review year compared to the respective increase of 17.8 percent, 29.1 percent and 5.7 percent in the previous year.

Loans and advances of BFIs increased by 17.5 percent (Rs.229.30 billion) in the review year compared to a growth of 14.4 percent (Rs.165.48 billion) in the previous year. In the review period, loans and advances of commercial banks, development banks and finance companies increased by 18.8 percent, 13.5 percent and 0.3 percent respectively. Likewise, credit to the private sector from BFIs increased by 19.8 percent (Rs.221.61 billion) in the review year compared to an increase of 18.7 percent (Rs.176.14 billion) in the previous year. In the review year, private sector credit from commercial banks, development banks and finance companies increased by 22.0 percent, 16.0 percent and 0.4 percent respectively.

BFIs' credit exposure to the production, construction, wholesale and retail trade sectors shows a remarkable growth in the review year. Credit to production sector increased by Rs.32.89 billion (14.8 percent) in the review year compared to an increase of Rs.32.10 billion (16.8 percent) in the previous year. Likewise, credit to the construction sector increased by Rs.33.31 billion (27.9 percent), the wholesale and retail trade sector by Rs.53.23 billion (21.8 percent) and the transportation, communication and public service sector by Rs.12.75 billion (27.0 percent) during the review year. The credit to the construction sector, wholesale and retail trade sector and transportation, communication and public service sector had increased by Rs.23.49 billion (24.5 percent), Rs.45.94 billion (23.2 percent) and Rs.3.45 billion (7.9 percent) respectively in the previous year. In the review year, credit to the agriculture sector increased by Rs.14.25 billion (28.0 percent) compared to an increase of Rs.11.13 billion (28.0 percent) in the previous year.

Liquidity Situation

In 2014/15, the NRB mopped up liquidity of Rs.155.0 billion through deposit auctions, Rs.315.80 billion through reverse repo auction and Rs.6.0 billion through outright sale auction on a cumulative basis. In the previous year, Rs.602.50 billion was mopped up through reverse repo and Rs.8.50 billion through outright sale auction.

In the review year, the NRB injected net liquidity of Rs.396.72 billion through the net purchase of USD 4.03 billion from foreign exchange market (commercial banks). Net liquidity of Rs.343.46 billion was injected through the net purchase of USD 3.52 billion in the previous year.

The NRB purchased Indian currency (INR) equivalent to Rs.348.09 billion through the sale of USD 3.50 billion in the review year. INR equivalent to Rs.307.98 billion was purchased through the sale of USD 3.14 billion in the previous year.

CHAPTER - TWO
FINANCIAL SYSTEM PERFORMANCE AND STABILITY

Global Financial Stability Overview

Overall Financial Stability Outlook

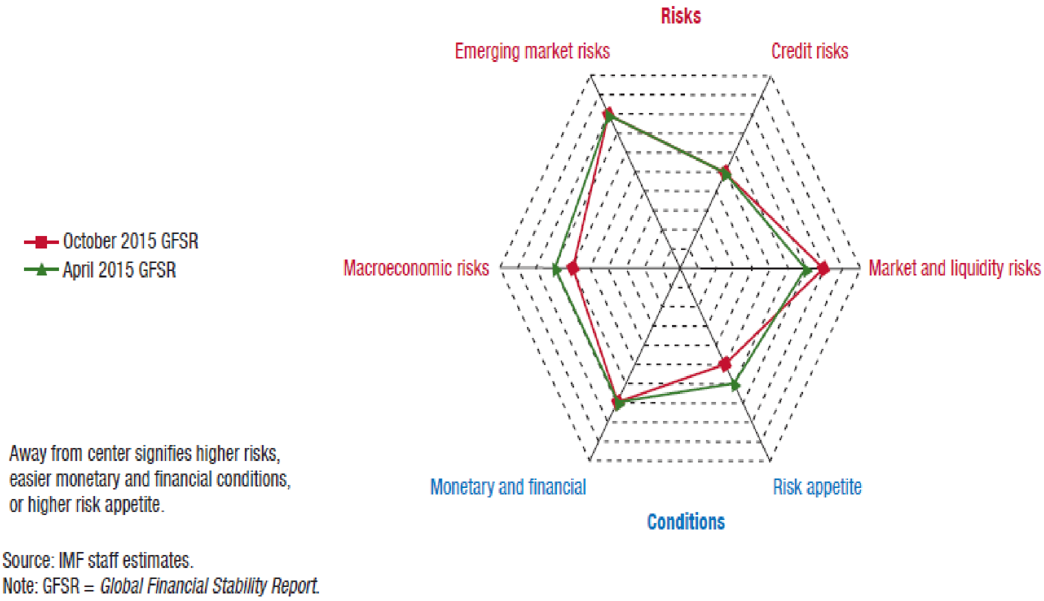
Global Financial Stability Report October 2015 concludes that overall financial stability has improved in advanced economies since April 2015. It further states that the progress reflects a strengthening macro-financial environment in advanced economies as the recovery has broadened, confidence in monetary policies has firmed, and deflation risks have abated somewhat in the euro area.

Meanwhile, the Federal Reserve's consideration about raising benchmark interest rates should help slow the further buildup of excesses in financial risk taking. In Europe, credit conditions are improving and credit demand is picking up, partly due to confidence in the European Central Bank’s (ECB’s) policies. Corporate sectors are showing tentative signs of improvement that could spawn increased investment and economic risk taking, including in the United States and Japan, albeit from low levels.

The FSR has also underscored challenges posed to the financial stability despite these improvements in advanced economies. Its assessment, emerging market vulnerabilities remain elevated, risk appetite has fallen, and market liquidity risks are higher. Although many emerging market economies have enhanced their policy frameworks and resilience to external shocks, several key economies face substantial domestic imbalances and lower growth. Many emerging market economies relied on rapid credit creation to sidestep the worst impacts of the global crisis. This increased borrowing has resulted in sharply higher leverage of the private sector in many economies, particularly in cyclical sectors, accompanied by rising foreign currency exposures increasingly driven by global factors. This confluence of borrowing and foreign currency exposure has increased the sensitivity of these economies to a tightening of global financial conditions.

The report has warned about increment in non-performing loans in emerging market as corporate earnings and asset quality deteriorate because these countries are approaching to the late stage of the credit cycle. It has also shown concern about thinner capital cushions in emerging market banks.

Figure 2.1: Global Financial Stabiliy Map: Risks and Conditons



Concerns for Instability

The report has analyzed the prospects for normalization according to three scenarios: the baseline, an upside scenario of successful normalization, and a downside scenario characterized by disruptions in global asset markets. It has identified a triad of broad policy challenges in evidence over the past several months:

Emerging market vulnerabilities— growth in emerging markets and developing economies is projected to decline for the fifth year in a row. Many emerging markets have increased their resilience to external shocks with increased exchange rate flexibility, higher foreign exchange reserves, increased reliance on FDI flows and domestic currency external financing, and generally stronger policy frameworks. But balance sheets have become stretched thinner in many emerging market companies and banks. These firms have become more susceptible to financial stress, economic downturn, and capital outflows. Deteriorating corporate health runs the risk of deepening the sovereign-corporate and the corporate-bank nexus in some key emerging markets. China in particular faces a delicate balance of transitioning to more consumption-driven growth without activity slowing too much, while reducing financial vulnerabilities and moving toward a more market-based system—a challenging set of objectives. Recent market developments, including slumping commodity prices, China's bursting equity and margin-lending bubble, falling emerging market equities, and pressure on exchange rates, underscore these challenges.

***Legacy issues from the crisis in advanced economies*—** high public and private debt in advanced economies and remaining gaps in the euro area architecture need to be addressed to consolidate financial stability, and avoid political tensions and headwinds to confidence and growth. In the euro area, addressing remaining sovereign and banking vulnerabilities is still a challenge.

***Weak systemic market liquidity*—** this poses a challenge in adjusting to new equilibrium in markets and the wider economy. Extraordinarily accommodative policies have contributed to a compression of risk premiums across a range of markets including sovereign bonds and corporate credit, as well as a compression of liquidity and equity risk premiums. While recent market developments have unwound some of this compression, risk premiums could still rise further.

Now that the Federal Reserve looks set to begin the gradual process of tightening monetary policy, the global financial system faces an unprecedented adjustment as risk premiums "normalize" from historically low levels alongside rising policy rates and a modest cyclical recovery.

Way Ahead

According to *FSR* October 2015, ensuring successful normalization of financial and monetary conditions and a smooth handover to higher growth requires further policy efforts to tackle pressing challenges are must to tackle such vulnerabilities. This can be done by successful normalization of financial and monetary conditions would bring macro-financial benefits and considerably reduce downside risks. These should include the following:

- Continued effort by the Federal Reserve to provide clear and consistent communication, enabling the smooth absorption of rising U.S. rates, which is essential for global financial health.
- In the euro area, more progress in strengthening the financial architecture of the common currency to bolster market and business confidence. Addressing the overhang of private debt and bank nonperforming loans in the euro area would support bank finance and corporate health, and boost investment.

- Rebalancing and gradual deleveraging in China, which will require great care and strong commitments to market-based reforms and further strengthening of the financial system.
- More broadly, addressing both cyclical and structural challenges in emerging markets, which will be critical to underpin improved prospects and resilience. Authorities in emerging markets should regularly monitor corporate foreign currency exposures, including derivatives positions, and use micro- and macro-prudential tools to discourage the buildup of excessive leverage and foreign indebtedness.
- Safeguarding against market illiquidity and strengthening market structures, which are priorities, especially in advanced economies' markets.
- Ensuring the soundness and health of banks and the long-term savings complex (for example, insurers and pension funds), which is critical, as highlighted in the April 2015 GFSR.

The report recommends that these vulnerabilities could be addressed by bold and upgraded financial policy actions. Policymakers can help deliver a stronger path for growth and financial stability, while avoiding downside risks. Such an upside scenario would benefit the world economy and raise global output 0.4 percent above the baseline by 2018. Further growth-enhancing structural reforms could bring additional support to growth and stability.

Overview of Nepalese Financial System

Size of the Overall Financial System

Nepalese financial system has been regulated by different independent regulators in the sectors of banking, insurance, securities markets, contractual saving institutions and other service sectors. In the system, NRB, as the central bank, regulates commercial banks, development banks, finance companies, micro finance financial institutions, FINGOs and cooperatives carrying limited banking activities. Besides this, NRB has made provisions to allow companies to work as hire purchase companies with pre-approval from NRB. The contractual saving institutions comprises of Employee Provident Fund (EPF) and Citizen Investment Trust (CIT) operating under the regulatory jurisdiction of Ministry of Finance. Similarly, Security Board of Nepal (SEBON) is acting as the regulator of the securities market which comprises of NEPSE, CDS &Nepal Clearing House Limited (NCHL) and merchant banks. ICRA Nepal is the only credit rating agency operating in Nepal under the purview of SEBON. The financial system also embraces insurance companies under the purview of Insurance Board and cooperatives established under Cooperative Act which falls under the purview of Department of Cooperatives.

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

Due to financial liberalization policy adopted after the mid of 1980s, Nepal observed the proliferation in number of BFIs in the last couple of decades and the growth has moderated as NRB has imposed moratorium on licensing on BFIs except micro credit development banks (D-class financial Institutions). For the last two years, banking system of Nepal is experiencing an encouraging restructuring and consolidation, particularly through the merger and acquisition. As of mid-July 2015, the total number of financial institutions stood at 262 comprising of Commercial Bank 30, Development Bank 76, Finance Companies 47, Microfinance Development Banks 38. Moreover, 42 other financial intermediaries licensed by NRB, 26 insurance companies and one each of EPF, CIT and Postal Saving Bank. Total number of "A", "B", "C" and "D" class financial institutions reduced to 191 in mid-July 2015 from 204 in mid-July 2014 due to merger and acquisition policy adopted by the NRB. However, the number of "D" class financial institutions is in increasing trend due to the provisions of mandatory conversion of FINGOs to Class "D" by mid-January 2016.

Table 2.1: Number of BFIs and Other Institutions

Banks and Financial Institutions	Mid-July 2013	Mid-July 2014	Mid-July 2015
Commercial Banks	31	30	30
Development Banks	86	84	76
Finance Companies	58	53	47
Microfinance Finance Development Banks (MFDBs)	31	37	38
Sub-Total	**206**	**204**	**191**
NRB Licensed Cooperatives (with limited banking activities)	16	15	15
NRB Licensed FINGOs (with limited banking activities)	31	29	27
Insurance Companies	25	25	26
Contractual Saving Institutions			
Employees Provident Fund (EPF)	1	1	1
Citizen Investment Trust (CIT)	1	1	1
Postal Saving Bank	1	1	1
Total	**281**	**276**	**262**

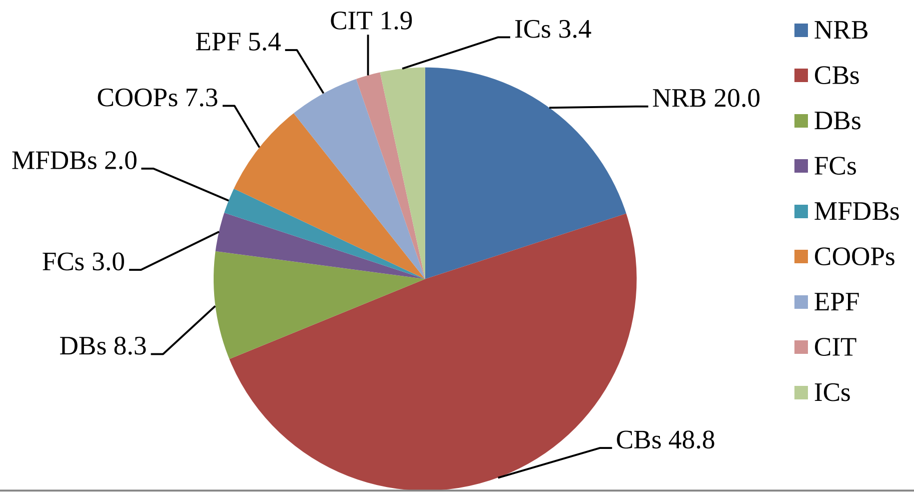
Table 2.2: Structure of the Nepalese Financial Sector (Assets/ Liabilities or Sources/Uses)

(In million Rupees)

Financial Institutions	**Mid-July 2011**	**Mid-July 2012**	**Mid-July 2013**	**Mid-July 2014**	**Mid-July 2015**
Nepal Rastra Bank	319,692.60	455,826.50	534,897.90	655,280.60	726,499.60
Commercial Banks	853,490.70	1,052,450.70	1,242,881.40	1,467,151.90	1,774,504.80
Development Banks	129,617.40	160,360.20	199,954.80	255,373.40	300,641.80
Finance Companies	118,578.20	109,687.50	100,856.70	110,342.30	108,007.40
MFDBs	20,862.90	29,815.50	35,774.90	49,395.80	70,880.40
Cooperatives (Capital and Savings)	137,520.37	166,634.86	191,614.00	233,715.55	265,551.90
Contractual Saving Institutions					
Employees Provident Fund	106,584.50	125,752.80	145,283.40	170,638.60	195,903.00
Citizen Investment Trust (Capital and Net Fund Balance)	26,905.40	38,068.50	42,753.60	54,621.30	67,675.00
Insurance Companies	61,213.40	73,825.00	84,650.40	101,097.20	124,300.00
Total	**1,651,185.70**	**2,062,975.50**	**2,409,425.40**	**2,886,881.40**	**3,633,963.90**
Market capitalization (NEPSE)	323,484.30	368,262.10	514,492.10	1,057,165.80	9,89,403.96
Total (incl. market capitalization)	**1,974,670.00**	**2,431,237.60**	**2,923,917.50**	**3,944,047.20**	**4,623,367.86**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Nepal Rastra Bank	19.36	22.10	22.20	22.70	19.99
Commercial Banks	51.69	51.02	51.58	50.82	48.83
Development Banks	7.85	7.77	8.30	8.85	8.27
Finance Companies	7.18	5.32	4.19	3.82	2.97
Microfinance Development Banks	1.26	1.45	1.48	1.71	1.95
Cooperatives (Capital and Savings)	8.33	8.08	7.95	8.10	7.31
Contractual Saving Institutions					
Employees Provident Fund	6.46	6.10	6.03	5.91	5.39
Citizen Investment Trust (Capital and Net Fund Balance)	1.63	1.85	1.77	1.89	1.86
Insurance Companies	3.71	3.58	3.51	3.50	3.42
Total	100	100	100	100	100

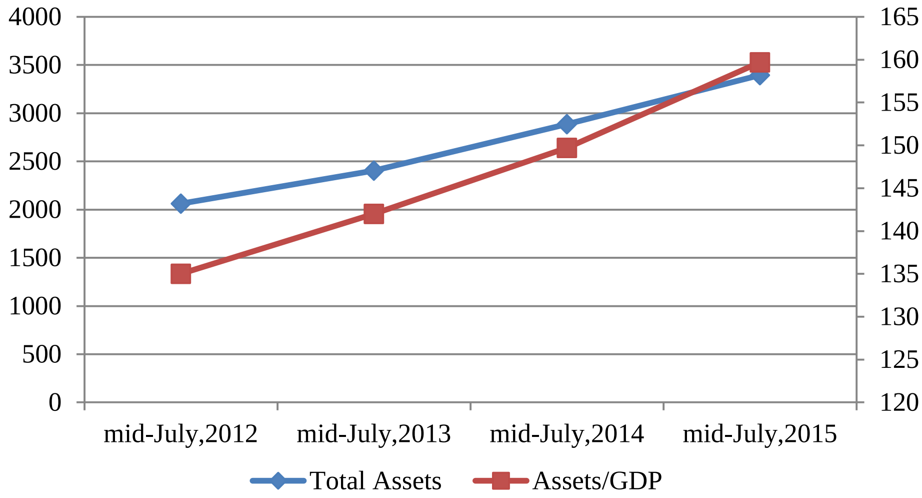
In terms of total assets and liabilities, banks and financial institutions shared 82.0 percent of total financial system of Nepal in mid-July 2015. The commercial banks remained the key player in the financial system occupying 48.8 percent of the system's total assets followed by NRB (20.0 percent), development banks (8.3 percent), finance companies (3.0 percent) and micro credit development banks (2.0 percent). In case of contractual saving institutions, EPF is a dominant institution having 5.4 percent of shares, followed by insurance companies (3.4 percent) CIT (1.9 percent) as of mid-July 2015.

Figure 2.2: Structure of Assets Holding in Financial System



In the Nepalese financial system, BFIs have the prominent share of assets among which commercial banks have the highest share in total assets. As evident from the figure 2.3, the assets size of financial system is increasing over the years. The total share of banking and non-banking financial institutions in GDP continued to expand in the mid-July 2015. The ratio of total assets & liabilities of Nepalese financial system reached 159.7 percent of GDP in mid-July 2015.

Figure 2.3: Total Assets (in Rs. billion) and Assets to GDP Ratio Growth (right scale)



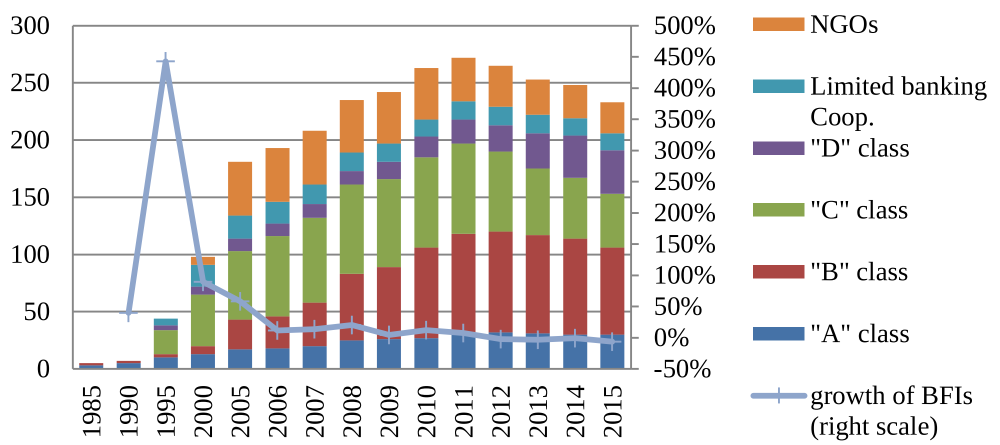
Total assets and liabilities of commercial banks remained at 83.5 percent of GDP followed by the NRB (37 percent), development banks (14.2 percent), finance companies (5.1 percent), MFDBs (3.3) percent. Further, such ratio for contractual saving institutions stood at 15.4 percent comprising 8.0 percent of EPF, 2.6 percent of CIT, 4,8 percent of insurance companies in mid-July 2015.

Structure and Performance of Banks and Financial Institutions

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

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

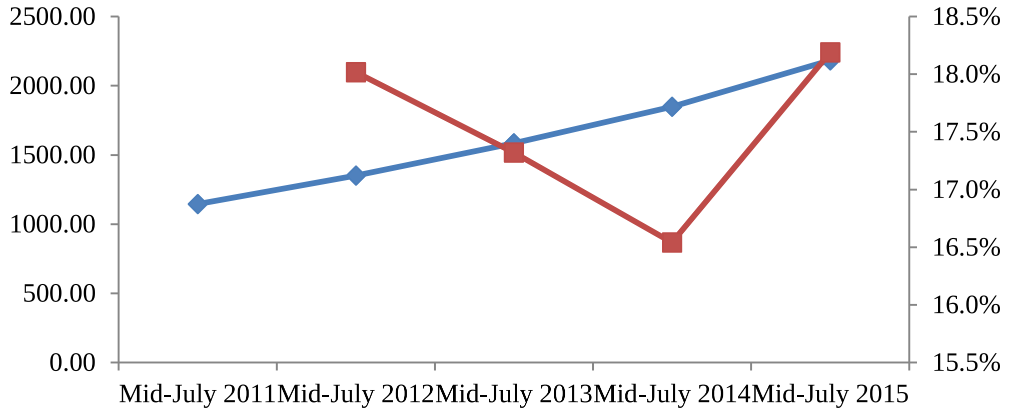
Figure 2.4: Number and growth of BFIs licensed by NRB



Assets Growth in Nepalese Banking System

The total assets and liabilities size of BFIs have continued to increase. As of mid-July 2015, total assets of BFIs increased by 18.19 percent and reached to Rs. 2183 billion in comparison to Rs.1847 billion in the same period of last year. Though the licensing policy of BFIs is kept in moratorium, there is significant expansion on the balance sheet of BFIs mainly due to the increase in deposits and credits. Increase in deposits is mainly driven by ever increasing remittance inflows. The liabilities side of the balance sheet may also inflated on account of the increasing paid up capital and reserves through issuance of right shares, bonus share and increasing profit. Similarly, government has injected a large chunk of capital in state owned banks.

Figure 2.5: Total Assets of Banking System (Left Side) (in billion Rs.) and Assets Growth Rate (in percent)

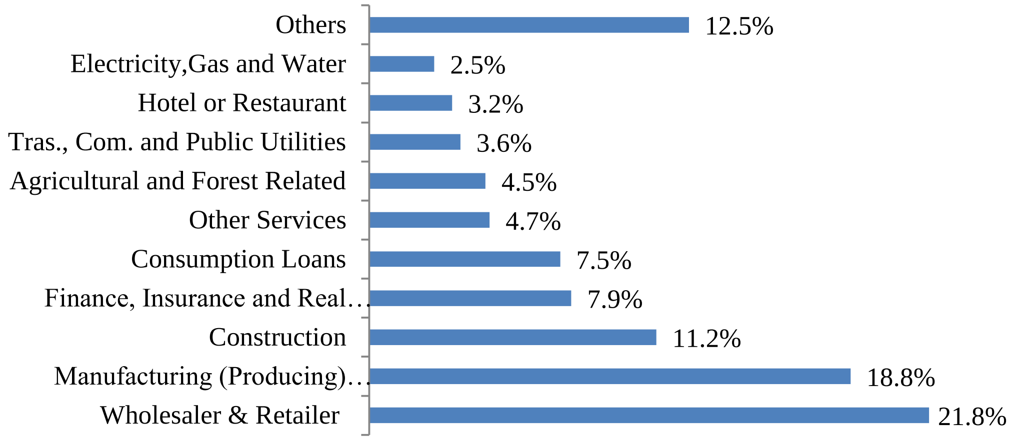


As on mid-July 2015, the five large commercial banks (LCBs) collectively accounted for 27.3 percent of total banking system assets and 33.6 percent of total commercial bank assets. As of mid-July 2015, the five large commercial banks, RBB, NABIL, ADBNL, NIBL and EBL had total assets size of Rs.150.5 billion, Rs. 124.8 billion, Rs.119.6 billion, Rs.111.0 billion and Rs.100.0 billion respectively. This implies a high concentration of banking assets to few banks in Nepal. So any events of bank failure of large banks may have greater impact to financial stability of Nepal.

Credit Distribution in Banking Sector

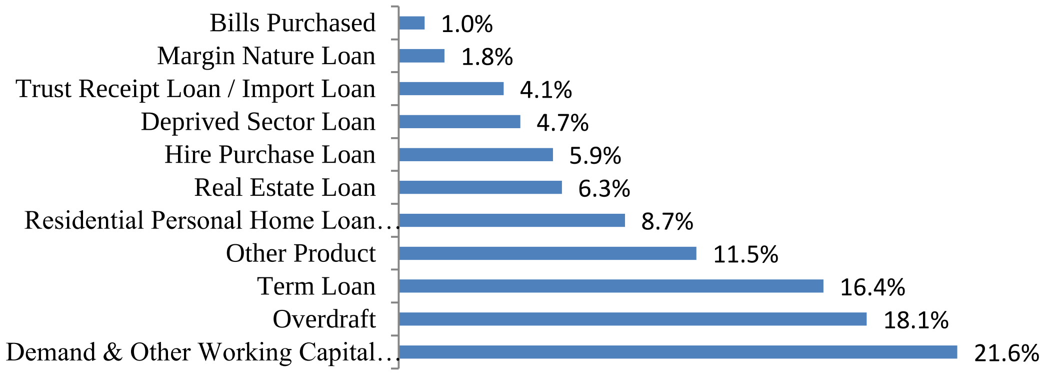
A large part of BFIs lending is concentrated in eight key areas of economic activities. As on mid-July 2015 trade (wholesaler & retailer) accounted for 21.8 percent, followed by manufacturing (18.8 percent), construction (11.2 per cent), finance, insurance and real estate (7.9 percent), consumption (7.5 percent), other services (4.7 percent) agriculture and forestry (4.5 percent) and transportation and communication (3.6 percent). Concentration of lending to a few sectors would expose bank to credit risk. Though NRB has made mandatory provision of lending in agriculture and productive sector to support economy, BFIS are still behind as expected to lend on productive sector. The deficiency of Capital in those sectors is one of the main reasons for low productivity and sluggish growth.

Figure 2.6: Major areas of Credit distribution of BFIs



Analyzing the type of loan products, BFIs has made highest lending in total in demand and working capital loan (21.6) percent followed by overdraft (18.1) percent and term loan (16.4) percent. The real estate loan has come below the regulatory requirement of 10 percent, the lending percentage of BFIs in real estate stood in 6.3 in mid- July, 2015. Figure 2.7 depicts the picture of the lending of BFIs in different products.

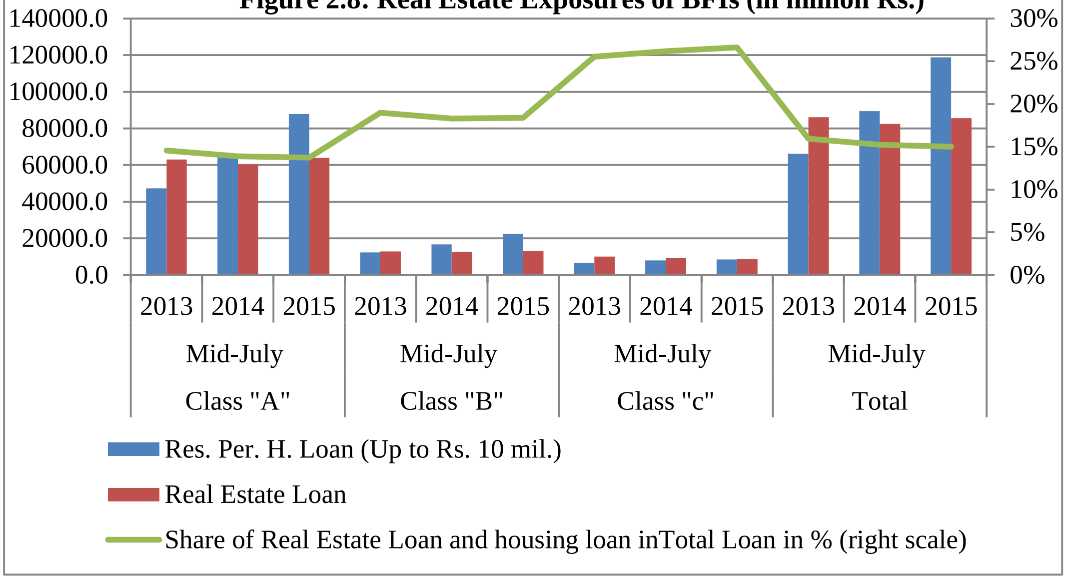
Figure 2.7: Product wise lending of BFIs



Real Estate Lending

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

Figure 2.8: Real Estate Exposures of BFIs (in million Rs.)

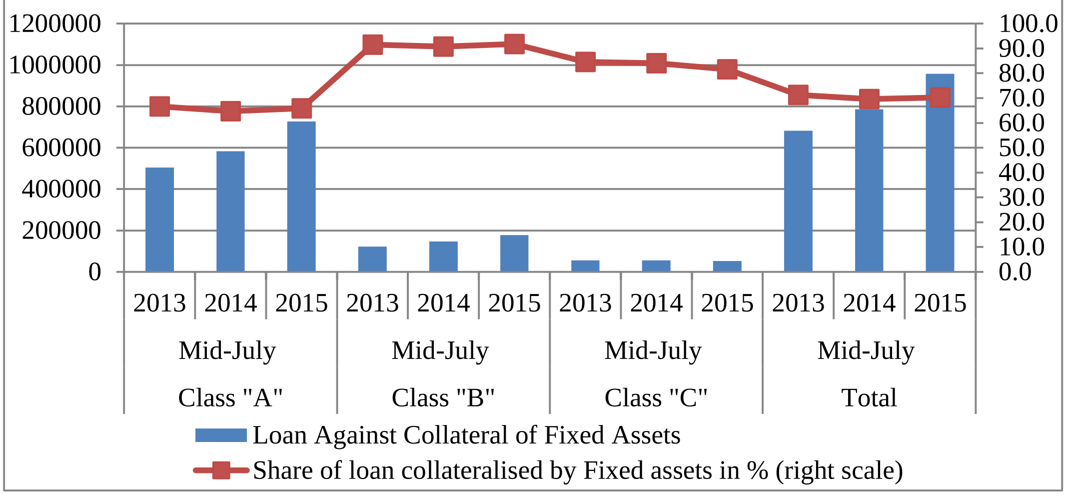


The banking system has reduced their high exposures in real estate after the introduction of some macro prudential measures. The direct real estate exposure amounted to Rs.85 billion which accounts for 6.3 percent of total loan in mid-July 2015 which was about Rs.92 billion (11.7 percent of the total outstanding) in mid-July 2013.

Commercial bank's direct exposure to real estate and housing has declined from 19.4 percent in Mid-July 2010 to 5.8 percent in mid-July 2015. Indirect exposures through collateral of land and buildings have slightly inclined from 64.7 percent to 65.9 percent over the same period. The development banks and finance companies have higher exposures in real estate and housing in comparison to the commercial banks. The developments banks and finance companies have lent 6.8 and 13.4 percentage of total loan portfolios in real estate and housing in mid-July, 2015.

In mid-July 2015, only one Commercial Bank had exposures to real estate in excess of 20 percent against 3 in mid-July 2014. The situation was even worse in mid-July, 2013 as 6 commercial banks had real estate exposure of more than 20 percent of their total loan portfolio. The total real-estate-loan-to-GDP ratio has declined to 4.0 in mid-July, 2015 from that of 8.9 percent in mid-July 2014.

Figure 2.9: Loan against collateral of Fixed Assets



Directed Lending: Productive Sector Lending & Deprived Sector Lending

In order to achieve the sustainable economic growth of the country, NRB has directed BFIs to lend in some priority sector of the economy. Currently, such directed lending is focused on productive sector and deprived sector. NRB has made the mandatory requirement for BFIs to lend in those sectors, where class "A" commercial banks are required to lend 20 percent of their total loan on defined productive sector like agriculture, energy, tourism, cottage and small industry among which they are required to flow at least 12 percent of their credit in agriculture and energy sector by mid-July, 2015. Likewise, class "B" and "C" BFIs are required to lend 15 percent and 10 percent respectively on productive sectors. The main objective of this policy is to encourage the BFIs to diversify the loan in productive sector and discourage lending in unproductive sector to ensure economic dynamism and stability.

The monetary stance of NRB is designed to ensure the adequate credit for productive investments to support the attainment of the government's GDP growth target. As on mid-July 2015, the commercial banks had provided 22.5 percent of their total loan on productive sector which includes 9.2% in agriculture, 5.2% in energy sector and 4.2% in tourism sector and 3.9% in cottage and small industries respectively. Table 2.3 gives the detailed figure in commercial bank lending in productive sector. Commercial banks have lent 14.4% in combined agriculture and energy sector which is above the regulatory limit of 12 %. The productive sector lending of commercial banks in mid-July 2014 was 13.8%. Such figure clearly depicts that the policy introduced by NRB has been able to boost the lending in productive sector.

Figure 2.10: Productive Sector lending of commercial banks

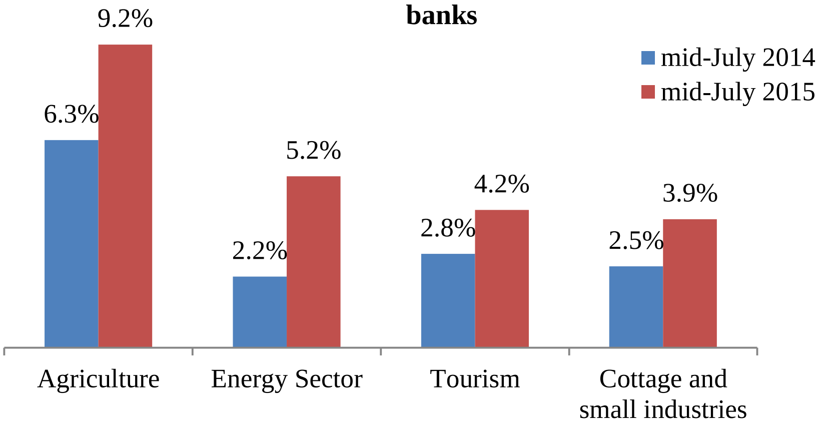


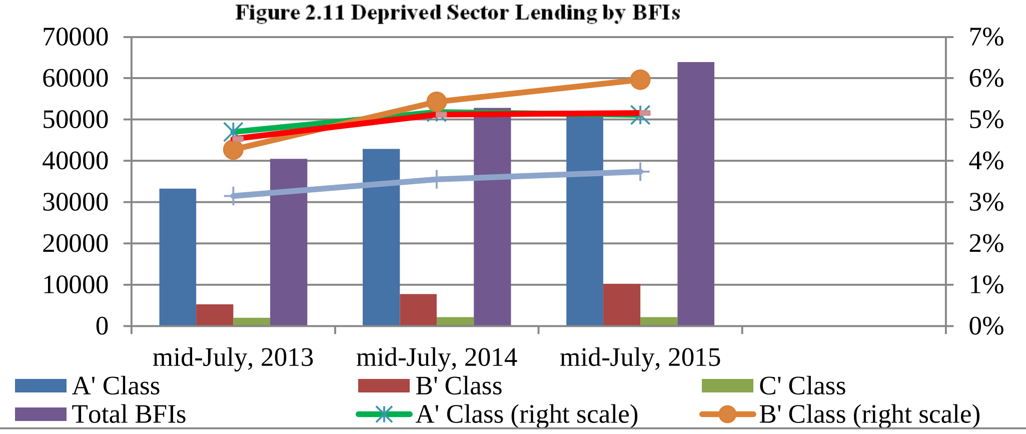
Table 2.3 Productive Sector Lending (*Rs. in million)*

S. No.	Industry/Sector	Mid- July	Mid- July
1	Agriculture	101607	56871
1.1	Agricultural and Forest Related	57076	37055
1.2	Fishery Related	3080	2491
1.3	Agriculture Related Machinery/Tools	1932	821
1.4	Fertilizers (not included in 1.1)	1209	13
1.5	Seeds	777	72
1.6	Animal and Poultry Feeds	5805	2033
1.7	Agro Product Storage	1711	1707
1.8	Processing of Tea, Coffee, Ginger and Fruits and	30018	12679
2	Energy	57422	19467
2.1	Hydropower	55913	18172
2.2	Renewal Energy	1509	1295
3	Tourism	46131	25666
3.1	Trekking, travel agency, mountaineering, resort,	12682	6829
3.2	Hotel (including other services)	30572	16853
3.3	Entertainment, recreation, films	2877	1984
4	Cottage and Small Industries	43066	22235
4.1	Cottage Industries	7990	4463
4.2	Small Industries	35076	17773
	Total of Agriculture and Energy Sector (1+2)	159029	76338
	TOTAL (1+2+3+4)	248226	124239
	Total Loans and Advances of Commercial Banks	1103153	902138
	Lending in Agriculture and Energy Sector	14.4 %	8.5%
	Lending in Productive Sector	22.5%	13.8%

Deprived Sector Lending

BFIs are required to disburse certain percent of their total loan portfolio in the deprived sector as stipulated by NRB. With the objective of gradual increment in the size of deprived sectors of the economy, NRB has fixed such lending requirement rate 5.0 for class “A”, 4.5 for class ”B” and 4.0 for class ‘C’. The overall deprive sector lending by BFIs as on mid-July 2015 remained 5.1 percent where commercial banks, development banks and finance companies lend 5.1 percent, 5.9 percent and 3.7 percent respectively. Finance companies are still below the regulatory requirement in deprived sector lending..

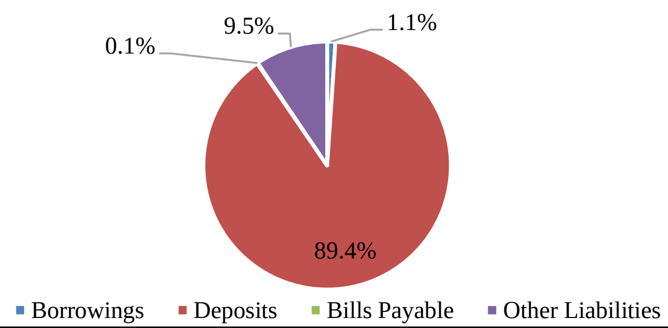
Figure 2.11 Deprived Sector Lending by BFIs



Liability structure of the banking sector

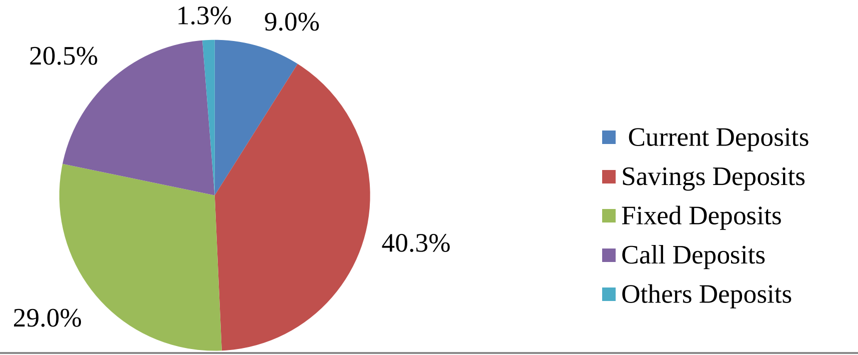
Deposits are the largest source of external funds in the banking sector. The share of total deposits is 89.4 percent of the total liabilities as of mid-July 2015. As of mid-July 2015, total deposit increased by 19.9 percent against 18.2 percent in mid-July 2014. Likewise, borrowings from NRB increased by 17.3 percent which was decreased by 32.6 percent in mid-July, 2014, whereas other liabilities increased by 11.1 percent in mid-July 2015.

Figure 2.12: Liability Structure of BFIs



The share of saving deposits, fixed deposits, call deposits, current deposit and other deposits stood at 40.3 percent, 29.0 percent, 20.5 percent, 9.0 percent and 1.3 percent respectively at mid- July 2015. The relative proportions of deposits remain similar as in previous year. The deposit structure shows a greater reliance on saving deposits and fixed deposits which are regarded as more stable.

Figure 2.13: Deposit Liabilities by types of Account



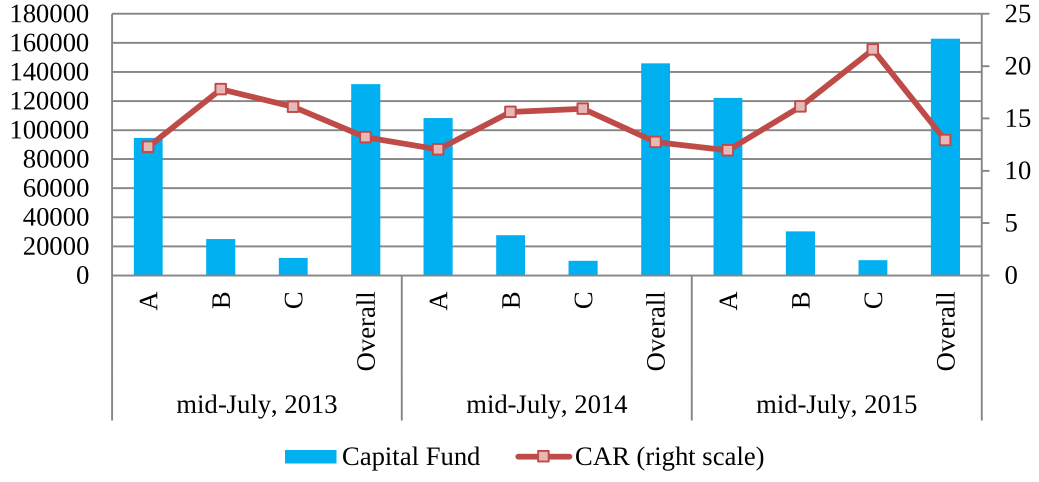
The total deposits of BFIs reached Rs.1772 billion in mid-July 2015 from that of 1477 billion in mid-July 2014. The share of top five BFIs depicts 27.0 percent of the total deposits which shows a significant concentration of top 5 BFIs in the total system in terms of deposit. The concentration ratio was similar in previous year as well. Among top five banks, there are two state owned commercial banks and remaining 3 other commercial banks.

Financial Soundness Indicators

Capital Adequacy

In mid –July 2015, the capital fund of BFIs increased by 11.7 percent to Rs.163 billion from 145.8 billion in mid –July 2014. Such increment was 10.7 percent in the previous year. The capital fund is composed of paid-up capital (Rs.140.7 billion), statutory reserves (Rs.37.1 billion), and retained earnings (Rs.27.8 billion in negative figure) and other reserves (Rs.12.8 billion). In mid-July 2015, the CAR of commercial banks registered 11.9 percent, with a y-o-y decrease of 0.7 percent point. In the same period, the CAR of development banks recorded 16.1 percent, with a y-o-y increase of 3.4 percentage points and the CAR of finance companies stood at 21.5 percent, which was increased by 35 percent point y-o-y. The overall CAR of BFIs in mid-July 2015 stood at 12.9 percent which was 12.7 percent in previous year. The increment in capital adequacy ratio of banking system was mainly due to the consolidation among development banks and finance companies through merger and acquisition. The overall CAR of BFIs remained well above the standard requirements set by NRB which indicates that the banking system's capital soundness is general.

Figure 2.14: Capital Fund (in Million Rs.) and CAR (in percent) of BFIs

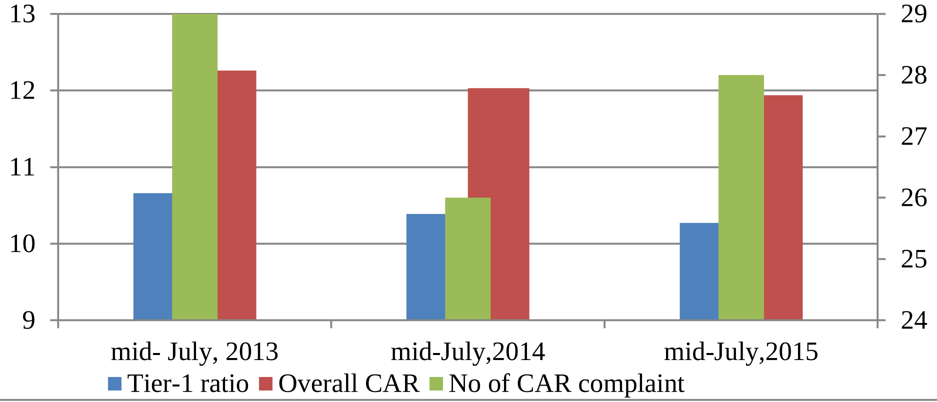


In mid-July 2015, commercial bank's compliance with the minimum Capital Adequacy Ratio (CAR) is 93 percent in comparison 87 percent as on mid-July 2014. As evident from figure 2.15, Only 2 banks Nepal Bank and Grand Bank are non-compliant with the minimum CAR out of 30 commercial banks in mid-July 2015. During the period of 2011-2014, state owned banks (SOBs), Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) are the only two commercial banks which were non-compliant with required CAR. With the injection of capital, RBB in mid-July 2015 met capital adequacy ratio with Tier1 capital 9.9 percent and CAR ratio 10.3 percent. Nepal Bank was also able to meet the core capital requirement with 6.6 percent, but it still fails to maintain the CAR ratio as per regulatory requirements. The bank has maintained CAR ratio 7.8 percent in mid-July 2015. Grand Bank is the only private commercial bank, which could not meet minimum capital requirement in mid-July 2015.

The aforementioned analysis highlights that the Capital adequacy ratios of commercial banks are higher than regulatory standard over the period of mid-July 2011 to mid-July 2015. For instance, overall CAR of the commercial banks in mid-

July 2015 is 11.9 percent which was 10.6 percent in mid-July 2011. In addition, Tier-1 ratios were 10.0 percent, 10.7 percent, 10.4 percent and 10.2 in mid-July 2012, 2013, 2014 and 2015 respectively.

Figure 2.15 : Capital toTier-1 ratio and overall CAR (in percentage) and number of compliant BFIs (right scale)



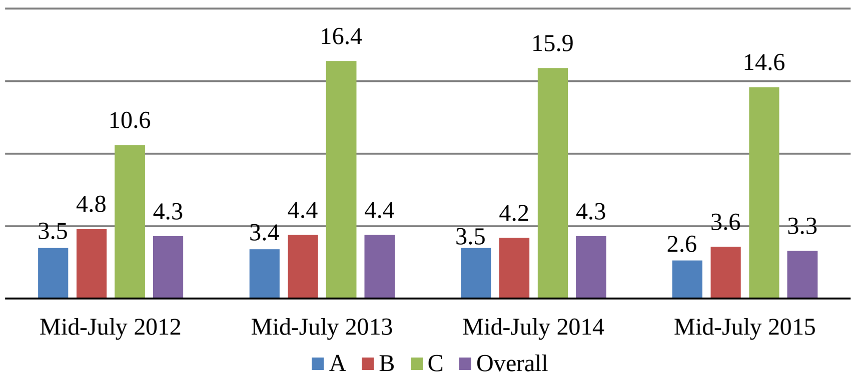
Assets Quality

Non-performing loans (NPL)[1] emanated from the deterioration in the quality of the loan portfolios which was expected to emerge due to the rapid growth of credit in recent years. Indeed, NPL of BFIs was slightly increased by Rs.7.1 billion to Rs.49.6 billion in mid-July, 2015 which was Rs.42.5 billion in mid-July 2014. However, in terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2015 indicating the banking sector's resilience in large. NPL to total loans of commercial banks was decreased by 0.13 percentage point on y-o-y basis and recorded the ratio of 2.6 percent on mid-July, 2015.

Only two private sector commercial banks Grand Bank and Prabhu Bank have the NPL above 5 percent in mid-July, 2015. State owned banks are able to bring down the NPL below 5 in mid-July 2015. Likewise, NPL ratio of development banks was decreased by 0.16 percentage to 3.6 in mid-July, 2015 as compared to 4.2 in mid-July 2014. The NPL ratio of finance companies is still in double digit which stands at 14.6 percent in the same period.

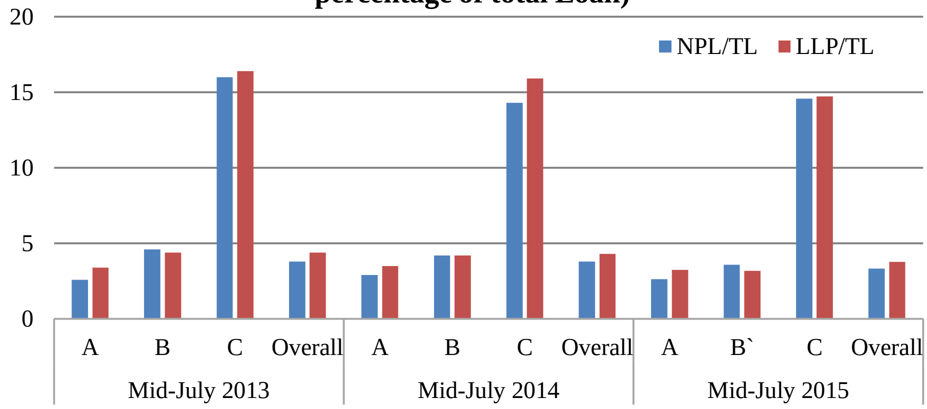
[1]Non-performing loans are those loans which are classified as ‘watch list’, ‘restructured/rescheduled’, ‘sub-standard’, ‘doubtful’ and ‘loss’ as per NRB unified directive, directive no. 2.

Figure 2.16: NPL of BFIs (percentage of total loans and advances)



NRB has introduced "watch list" as the new category of loan provision to discourage growing practice of borrowers not utilizing the loans in projects where they were supposed to go. According to this directive, any loan that has crossed the repayment deadline by a month will come under the "watch list". Also, short-term loans and operating loans whose deadline has been extended temporarily without renewal should be categorized under "watch list". Likewise, BFIs have to categorize the loans extended to a borrower whose loans from another bank have turned non-performing, and loans provided to a firm whose net worth and cash flow have remained negative for the past two years despite regular payment of principal and interest, under the "watch list". In mid- July 2015, BFIs watch list provision to total loan remains 0.06 percentage.

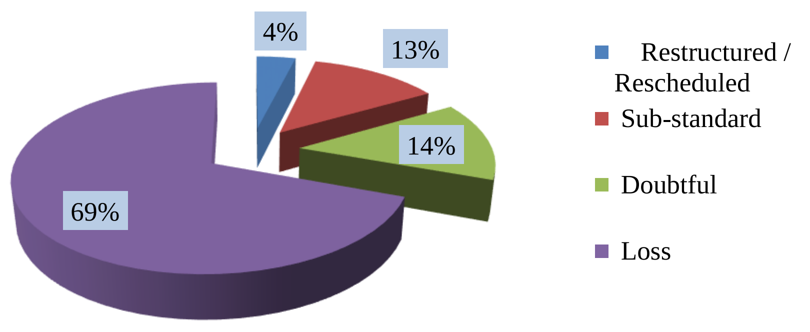
Figure 2.17: Provision Versus Actual Loan Loss (as a percentage of total Loan)



The provisions for NPL stood at Rs.49.6 billion in mid-July 2015, which is Rs.1.7 billion more than of mid-July 2014. As of mid-July 2014, LLP of banking system is sufficient to cover NPL of the same period.

In the banking system, the loss loan is Rs.28.5 billion in mid-July 2015. In total NPL, loss loan accounts for 69 percent in mid-July 2015. It is alarming that a bulk of NPL are loss loan. There is slight increment in ratio of loss loans to NPL to 69 percent in mid-July 2015 from 67 percent in mid-July 2014, which shows deterioration in the assets quality in banking system. NRB introduced the watch list category in loan loss provision. The NPL under sub-standard and doubtful categories, on the other hand, constituted 13 percent and 14 percent respectively. The ratio of restructured/rescheduled loans to total NPL remained around 4 percent in the current year.

Figure 2.18: NPL composition of BFIs (Mid-July 2015)

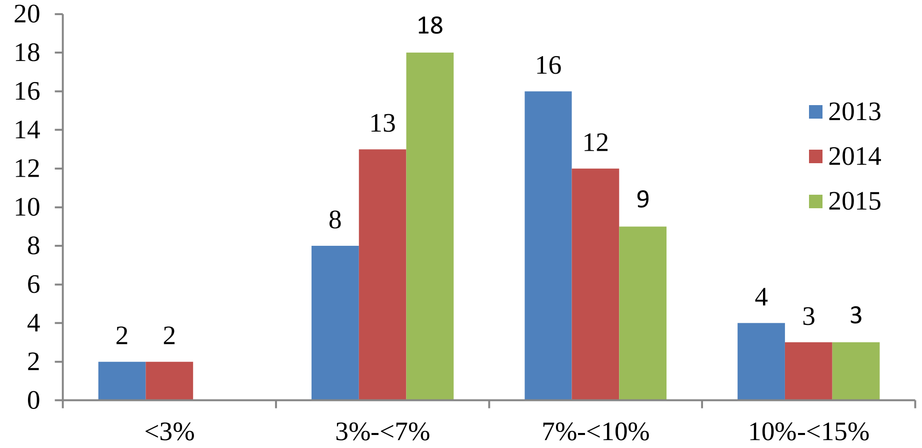


The adverse effect on bank balance sheets arising out of high classified loans is a major concern for the central bank. NRB's directives to the banks to take precautions while extending loans to high risk sectors, keeping single obligor limit, and prioritize loans to productive sectors, and also blacklisting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

Leverage Ratio

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

Figure 2.19: Leverage ratio of Commercial Banks

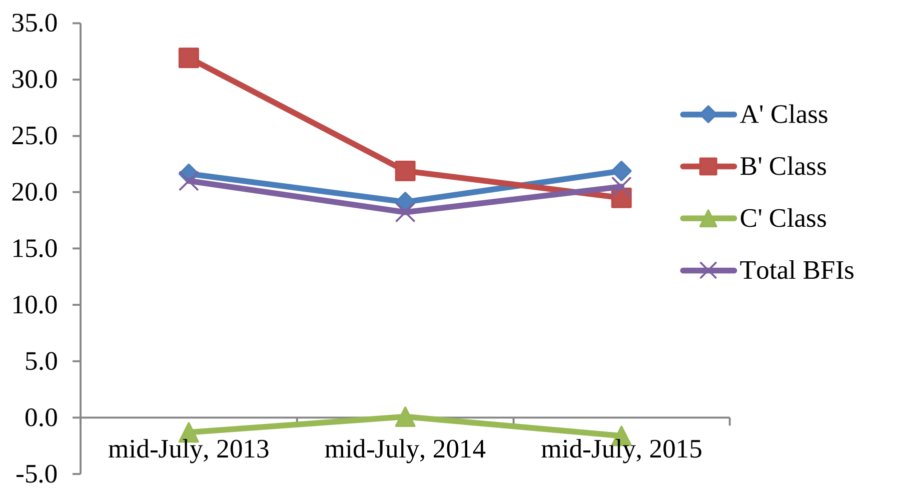


In Nepalese context, practice of regulatory monitoring of the leverage ratio is not yet implemented. As evident from the figure 2.19, Nepalese commercial banks are better than the minimum proposed limit by Basel III. In mid-July 2015 all banks are able to maintain the minimum limit of leverage ratio (Tier 1 capital/ (Assets + off B/S Items) higher than 3 percent. In year 2013 and 2014, only two state owned banks NBL and RBB had leverage ratio below 3 percent. The gradual improvement in the performance of NBL and RBB also reflects in leverage ratio, they also met the requirement with 4.3 percent and 4.8 percent respectively. In mid-July 2015, 18 banks had a leverage ratio higher than 3 percent but less than 7 percent; 9 banks had leverage ratios greater than 7 percent and less than 10 percent, similarly 3 banks able to maintain the ratio above 10 percent.

Credit and Deposit Growth

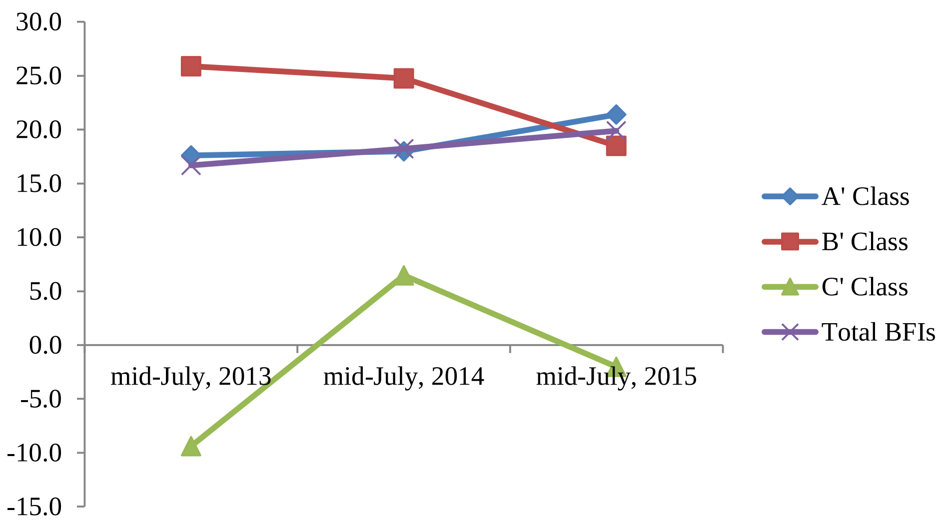
Credit flows from BFIs grew significantly by 20.5 percentage in mid-July, 2015 such increment was 18.2 percent in mid-July, 2014. Commercial Banks grew by 21.9 percent in mid-July 2015, such increment was 19 percent in mid-July 2014. Development banks credit expanded by 19.5 percent, whereas finance companies credit dropped by 1.7 percentage in mid-July 2015.

Figure 2.20: Trends in Credit Growth (in percent)



Deposits of BFIs increased by 20 percent in mid-July, 2015 which went up by 18.2 percent in mid-July 2014. The deposit growth of commercial banks registered 21.5 percent followed by development banks 18.6 percent in mid-July 2015. However, there has been negative growth of deposits by 2 percent in finance companies mainly due to the merger and up-gradation of some of the companies to development bank.

Figure 2.21: Trends in Deposit Growth (in percent)



There has been slight increment in overall credit to deposit (C/D) ratio to 76.8 percent in mid-July 2015 from 76.5 in mid-July 2014. The C/D ratio of finance companies stood (90 percent), development banks (81.6 percent) and commercial banks (75.4 percent). As of mid-July the share of total deposit to GDP reached to 83.4 percent comprising 68.8 percent share of commercial banks whereas the share of development banks remained 11.1 percent and finance companies 3.4 percent only.

Figure 2.22: Credit ,Deposit (in million Rs.) and C/D Ratio (in percent) of BFIs

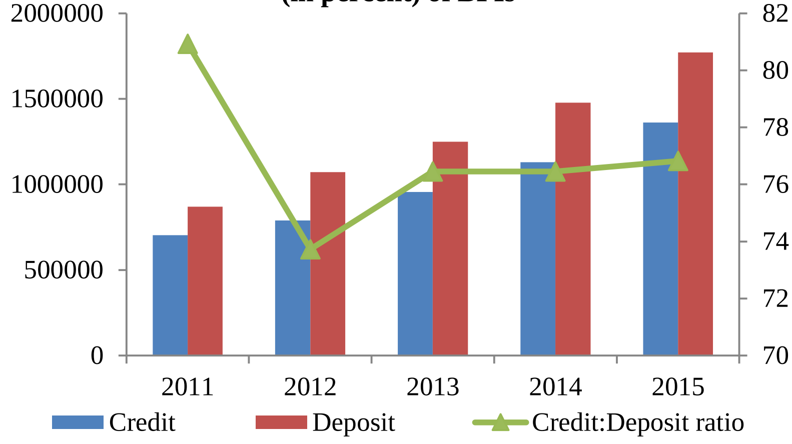
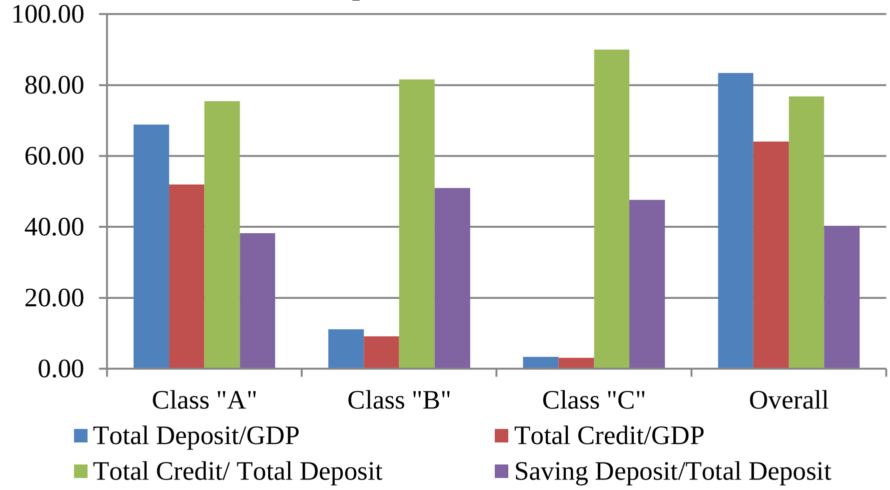


Figure 2.23: Credit, Deposit with GDP ratio and saving deposit ratio of BFIs



Profitability

The overall profitability of banking sector increased significantly by 26.4 percent and reached to Rs. 37 billion in mid-July 2015 from 29.3 billion in mid-July 2014. The commercial banks posted a higher share of profitability of the banking sector accounting 76.5 percent of the total in mid-July 2015. Credit growth of 20.5 percent mainly lead to increment in interest income significantly thereby contributing to more profitability in the review period.

Figure 2.24: Class wise Profitability of BFIs (in percent)

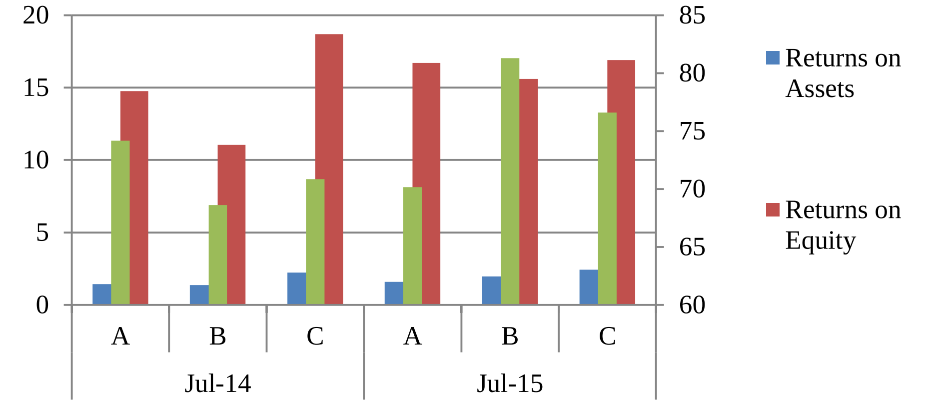
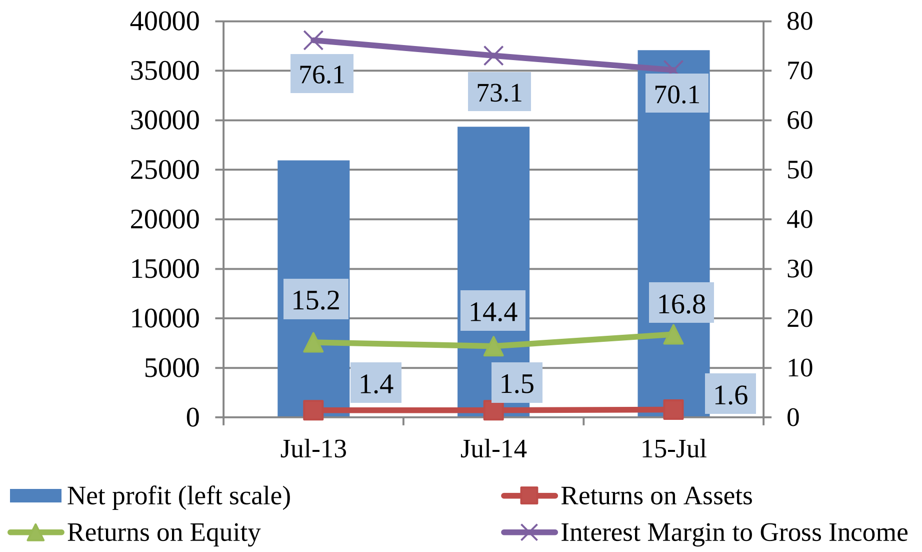


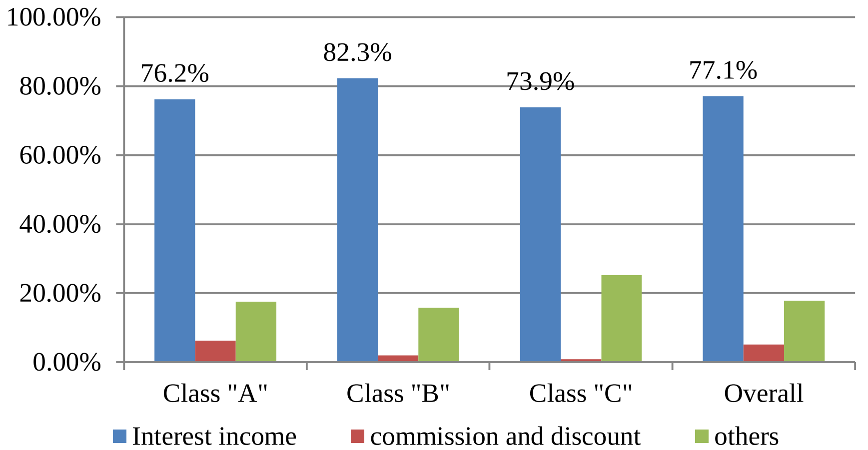
Figure 2.25: Net Profit (in millions), ROE, ROA and Interest Margin to Gross Income (In percent)



The interest rate spreads have, on average, decreased slightly from 6.3 percent in mid-July 2014 to 5.6 percent in mid-July 2015, thus contributed to the decline in net interest margin. The interest margin to gross income stood at 70.1 percent in mid-July 2015 which was 73.1 percentages in mid-July 2014. The net profit of BFIs grew by 26 percent in mid-July 2015 from the growth of 13 percent mid-July 2013. ROA increased to 1.5 percent by 0.1 percentage points. Similarly, ROE also increased slightly to 16.9 percent from 14.4 percent in mid-July 2014.

Interest income has the biggest share in total income of BFIs which accounted for 77.1 percent in mid-July 2015, on which; interest income on loan and advance consists of 94.8 percent where as 1.7 percent of the total income is from investment on bonds and debentures. Commission based income contributed only 5.1 percent of total income which shows that banking sector has been concentrating in traditional activities of lending and deposit mobilization only. The gain from exchange fluctuation is 2.7 percent of total income of BFIs in mid-July 2015.

Figure 2.26: Income distribution of BFIs



Liquidity

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

Total liquid asset to deposit ratio of BFIs stood at 30.2 percent in mid-July 2015 compared to 32.1 percent in mid-July 2014. The liquid asset to deposit ratios for "A", "B" and "C" class institutions are recorded at 29.1, 35.0 and 35.8 in mid-July 2015. Such ratios were 31.2 percent, 35.7 percent and 36.7 percent respectively in mid-July 2014. Hence, the ratios for all BFIs stood above the regulatory requirements but it has been increasing the cost of fund for BFIs, which is also creating some stress in liquidity management function to the central banks.

As at mid-July 2015, the credit to deposit ratio of BFIs stood at 76.8 percent. The credit to deposit ratios for "A", "B" and "C" class institutions stood at 75.4 percent, 81.6 percent and 90 percent respectively. Such ratios were 74.9 percent, 80.9 percent and 89.7 percent respectively in mid-July 2014. Despite the liquidity pressure being moderated at present, liquidity risk is likely to hit banks at any time, the ratios indicate finance companies are operating on very high risk, as they are operating under growing competition, poor asset/liability management practices, poor corporate governance and high dependence on corporate deposits. Likewise, large inflows of remittances as well as excessive surplus of government deposit with NRB since mid-July 2012 has been posing more pressure to liquidity management.

Figure 2.27: Liquidity in BFIs (in percent)

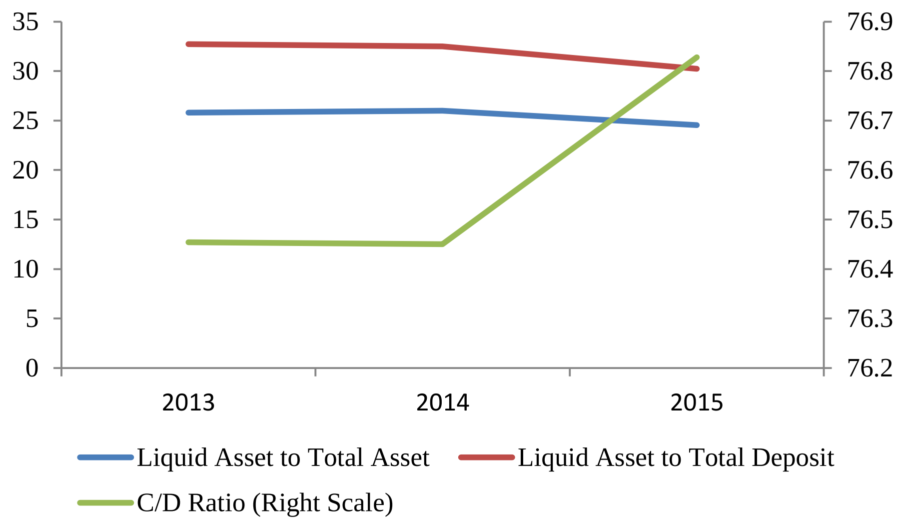


Table 2.4: Financial Soundness Indicators of BFIs (in percent)

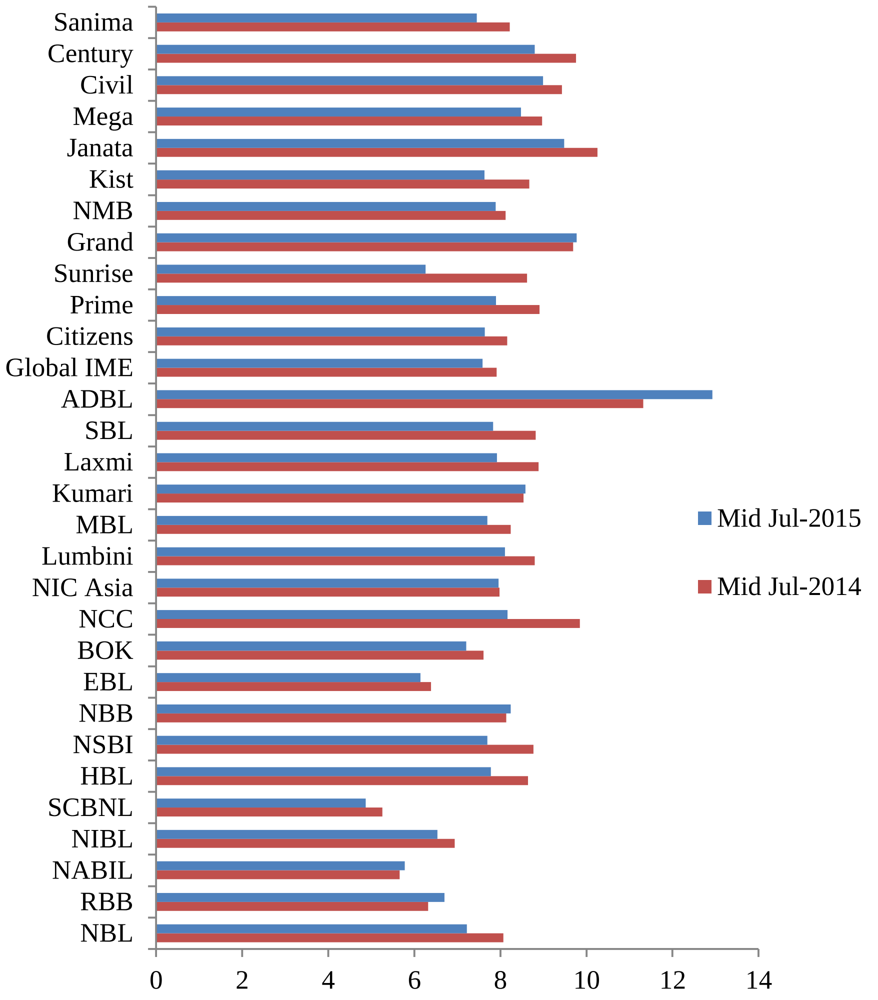
Indicators	Class "A"		Class "B"		Class "C"		Overall	
	mid-July 2014	mid-July 2015	mid-July 2014	mid-July 2015	mid-July 2014	mid-July 2015	mid-July 2014	mid-July 2015
Credit and deposit related indicators								
Total deposit/GDP	62.5	68.8	10.4	11.1	3.8	3.3	76.6	83.4
Total credit/GDP	46.8	51.9	8.4	9.1	3.4	3.0	58.6	64.0
Total credit/ Total deposit	74.9	75.4	80.9	81.6	89.7	89.6	76.5	76.8
LCY credit/LCY deposit and core Capital	71.6	72.0	71.0	70.8	76.6	73.2	71.8	71.8
Fixed deposit/Total deposit	30.3	28.7	27.0	26.2	46.8	43.3	30.7	28.9
Saving deposit/Total deposit	37.4	38.2	52.6	50.9	43.5	47.6	39.8	40.3
Current deposit/Total deposit	10.4	10.5	2.0	2.1	0.1	0.1	8.7	8.9
Assets quality related indicators								
NPL/ Total loan	2.9	2.6	4.2	3.5	14.3	14.5	3.8	3.3
Total LLP/Total loan	3.5	3.2	4.2	3.1	15.9	14.7	4.3	3.7
Res. Per. H. Loan (Up to Rs. 10 mil.)/Total Loan	10.4	7.9	10.4	11.6	12.3	13.1	7.9	8.7
Real estate exposure/Total loan	9.7	5.8	7.8	6.8	14	13.4	7.3	6.2
Deprived sector loan/Total loan	5.2	5.1	5.4	5.9	3.5	3.7	5.1	5.1
Liquidity related indicators								
Cash and bank balance/Total deposit	17.6	15.7	17.0	16.9	22.4	22.9	17.8	16.1
Investment in Gov. security/Total deposit	12.9	12.0	1.6	1.4	3.3	3.5	10.9	10.2
Liquid assets/Total assets	25.9	25.3	27.9	27.6	23.9	23.8	26.1	25.6

Indicators	Class "A"		Class "B"		Class "C"		Overall	
	mid-July 2014	mid-July 2015	mid-July 2014	mid-July 2015	mid-July 2014	mid-July 2015	mid-July 2014	mid-July 2015
Total liquid assets/Total deposit	31.7	29.1	36.1	35.0	35.8	35.8	32.5	30.2
Capital adequacy related indicators								
Core capital/RWA (percent)	10.4	10.2	14.8	15.2	15.2	20.6	11.3	11.3
Total capital/RWA (percent)	12.0	11.9	15.6	16.1	15.9	21.5	12.7	12.9
Wt. Avg. interest rate on deposit	4.2	3.9						
Wt. Avg. interest rate on credit	10.5	9.5						

Base Rate of BFIs

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

Figure 2.28: Base Rates of Commercial Banks



The base rates of majority of commercial banks are in declining trend in mid-July 2015 from that of mid-July 2014. Agriculture Development Bank Limited has posted a maximum base rate in mid-July 2015 with 12.8 percent followed by Grand Bank 9.7 percent and Janata Bank 9.4 percent where as Standard Chartered Bank (SCBNL) registered a minimum base rate was 4.8 percent. Among state owned banks, NBL, RBB and ADBL have set base rate of 7.2 percent, 6.7 percent and 12.8 percent respectively in mid-July 2015. Their base rates were 8.1 percent, 6.3 percent and 11.3 percent respectively in mid-July 2014.

Interest Rate Spread

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

With the objective to control randomness in fixing interest spread, NRB has directed BFIs to bring their interest spread rate at 5.0 percent and monitoring of interest spread was begun since mid-July 2014. BFIs are also directed to publish their spread in a monthly basis. As evident from the figure 2.29, the overall interest spread of the commercial banks stood at 4.4 percent whereas the interest spread of the state owned banks remained at 5.1 percent as of mid-July 2014. Grand Bank has registered the highest interest rate spread of 6.7 percent among commercial banks followed by Siddhartha Bank Ltd 5.8 percent. Nepal Bangladesh bank has the lowest interest rate spread of 2.4 percent in the same period. Interest rate spread of state owned banks NBL and RBB are below the regulatory requirement, whereas ADBL has the spread of 5.7 in mid- July 2015 .

Figure 2.29: Net interest spread of CBs in percentage point

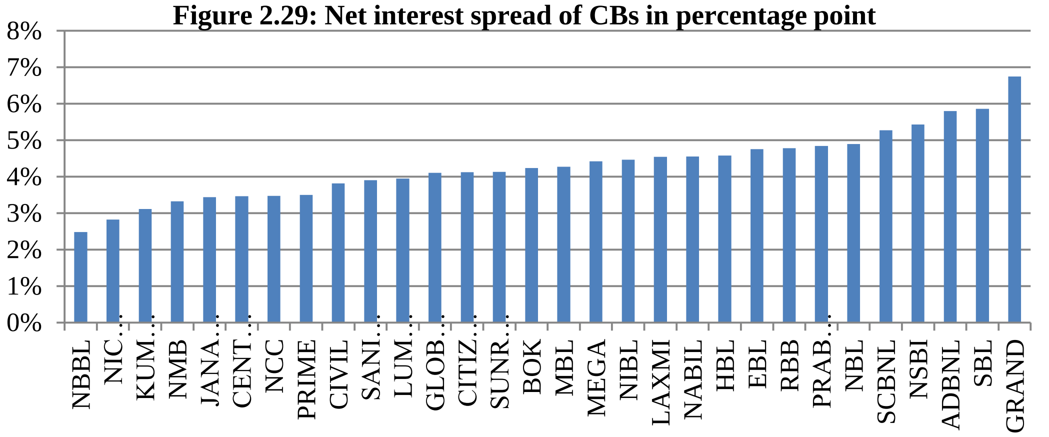
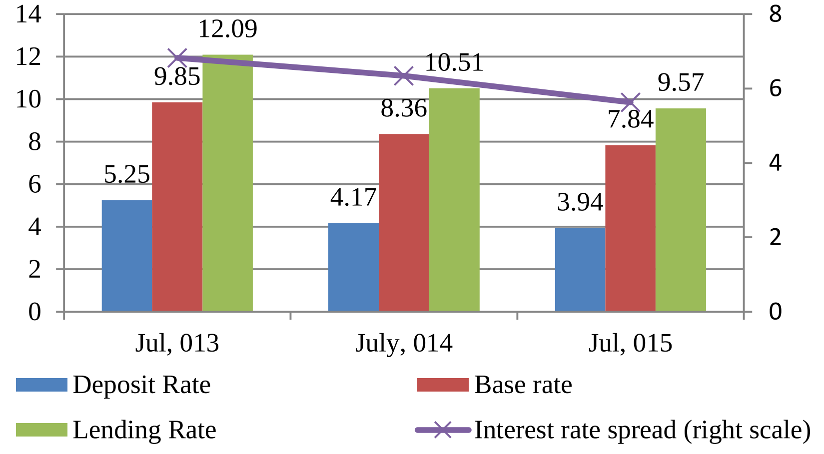


Figure 2.30: Deposit Rate, Lending Rate, Spread Rate & Base Rate



Banking Sector Consolidation: Merger & Acquisition

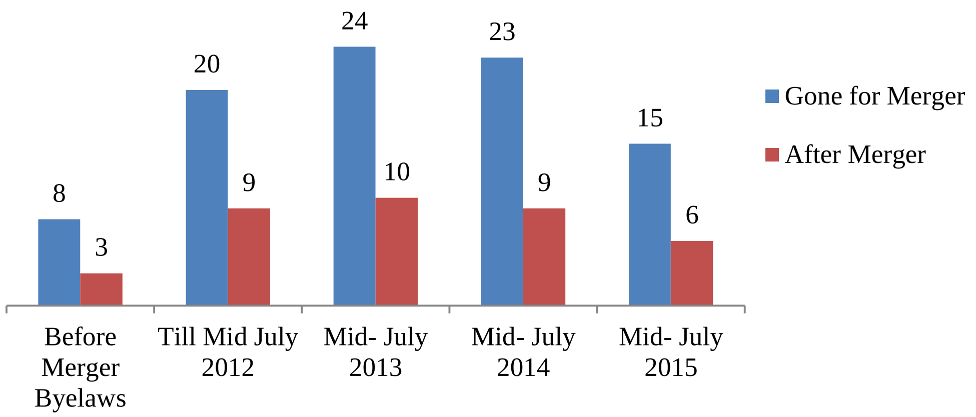
Consolidation is taken as one of the tools to enhance the capital base, achieve operational efficiency and strengthen the resilience of BFIs. Merger and acquisitions are considered one of the effective measure of financial consolidation. Increasing capital and asset bases through consolidation would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

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

Merger and Acquisition

The number of BFIs opting for merger has been increasing after the introduction of merger policy. After the issuance of the "Bank and Financial Institutions Merger By-laws, 2011", 78 BFIs have merged with each other forming 30 BFIs as of mid-July 2015. In the review period, 15 BFIs have merged to form 6 BFIs. Last year 23 BFIs were merged to 9 BFIs. Likewise, during the review period, as per the provision of Acquisition Bylaw, 2070, 2 finance companies Nepal Housing & Merchant Finance and Peoples' Finance Ltd were acquired by Citizens' Bank International Ltd. Similarly, Muktinath Bikas Bank Ltd. acquired Civic Development Bank Ltd.

Figure 2.31: Status of BFIs Merger



Financial Access and Inclusion

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

Financial Inclusion and Efforts of NRB

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

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

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

Table 2.5: Branches of BFIs

Financial Institutions	Number of Branches		Share (in percent)	
	Mid-July 2014	Mid-July 2015	Mid-July 2014	Mid-July 2015
Commercial Banks	1547	1672	44.8	43.5
Development Banks	818	808	23.7	21.0
Finance Companies	239	242	6.9	6.3
Micro Finance Development Banks	852	1116	24.7	29.1
Total	**3456**	**3838**		

Financial access has been increasing with the expansion of network of financial institutions. As of mid-July 2015, the branch network of commercial banks reached 1672 followed by development banks (808), Finance companies (242) and Micro Finance Development Banks (1116). The number of branches of the respective categories of BFIs accounted to 1547, 818, 239 and 852 respectively as of mid-July 2014. Due to the merger policy adopted by NRB, the number of branches of Development Banks (B Category) reduced by 10 to 808 after the merger of 5 Development Banks. However, the total number of bank branches of BFIs increased by 382 (11.1 percent) and reached to 3838 in mid-July 2015 from that of 3456 in mid-July 2014.

In mid-July 2015, on an average, a BFI branch has been serving approximately to 10,160 people; excluding the branches of “D” class financial institutions. The banking service served population comes down to 7206 people per branch when branches of "D" class also included.

Figure 2.32: Branches of BFIs

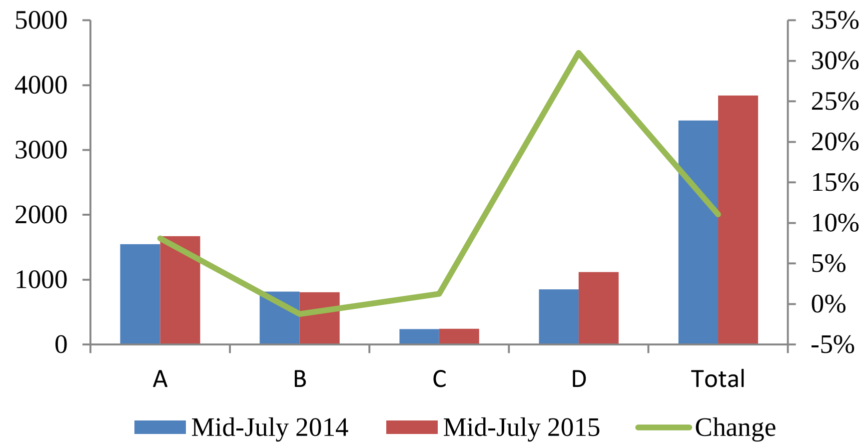
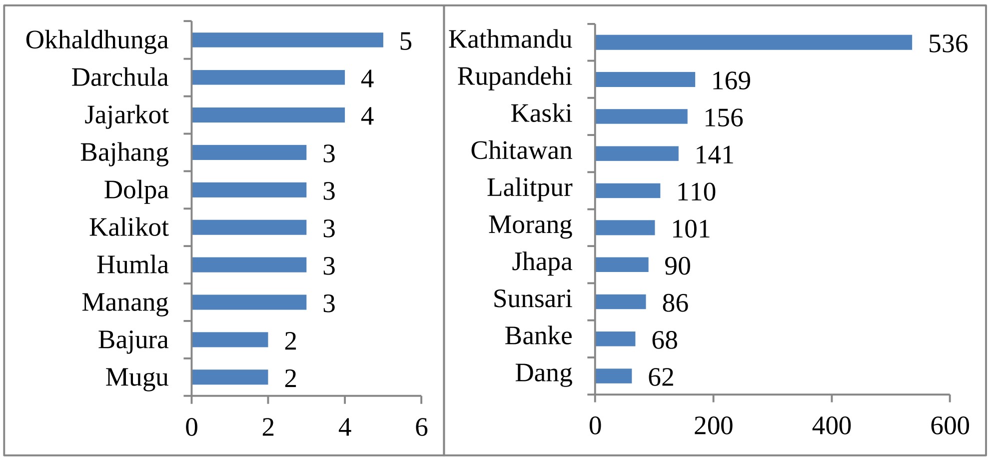


Table 2.6: Regional Allocation of BFI Branches

Region	BFIs			Total	Share (in percent)	Population (per branch)
	A	B	C			
Eastern	308	103	26	437	16.0	13724
Central	827	291	137	1255	46.1	8119
Western	292	312	68	672	24.6	7542
Mid-western	152	74	9	235	8.6	15851
Far-western	93	28	2	123	4.5	21769
Total	**1672**	**808**	**242**	**2722**	**100.00**	**10160**

Increase in number of branches indicates the increase in financial outreach or financial access, which is also considered as one of the indicators of financial inclusion. Banking industry occupies a bigger chunk in the financial system; despite the growth in number of BFIs and their branches; financial service providers are still mainly concentrated in urban or semi- urban areas where geographical access is relatively easy. Looking upon the region wise distribution, the majority branches of BFIs are situated in the central development region totaling of 1255 (46.1 percent), followed by western development region 672 (24.6 percent) and eastern development region 437 (16.0 percent). Kathmandu is highly concentrated district in terms of number of BFIs presence, followed by Rupendehi and Kaski. Despite continuous efforts from the NRB in increasing the outreach of financial services in remote areas, the result is still not satisfactory in terms of branch expansion in Far western region. Bajura and Mugu have still 2 bank branches only. Manang, Humla, Kalikot, Dolpa and Bajhang have only 3 branches, similarly Darchula and Jajarkot have 4 branches and Okhalghunga has 5 branches.

Figure 2.33: Highest and Lowest Concentration of BFIs (no. of Branches)



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

Table 2.7: Use of Financial Services

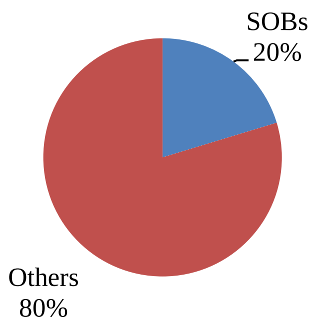
Services	Class "A"	Class "B"	Class "C"
No. of ATM, Outlet	1483	213	25
No. of Debit Cards	4146237	355460	30090
No. of Credit Cards	43895	0	0
No. of Deposits Accounts	11343425	3042484	548709

Branchless banking has been developed to address the payment needs of people who do not have access to the financial system. Branchless banking is cheaper means of banking system which can be operated in the remote districts whilst mobile phone based payment systems have been introduced to enhance convenience in making payments at merchandise outlets using technologies and other banking transactions. In mid-July 2015, such branchless banking center accounted to 504. BFIs are encouraged to serve through branchless banking in remote areas where the branch operation is not viable due to high cost of financial intermediation.

Performance and Reform of State Owned Banks

Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBB) and Agriculture Development Bank Limited (ADBL) are the three state owned commercial banks, which occupied 17.0 percent share in GDP in terms of total assets & liabilities. The share of total assets & liabilities of BFIs to GDP reached to 102.7 percent in mid-July 2015 shows the increment in financial deepening. The total assets of state owned banks (SOBs) reached to Rs. 360 billion in mid-July 2015 from Rs.312 billion in mid-July 2014. The total share of SOBs on total assets of commercial bank is 20.0 percent in mid-July 2015.

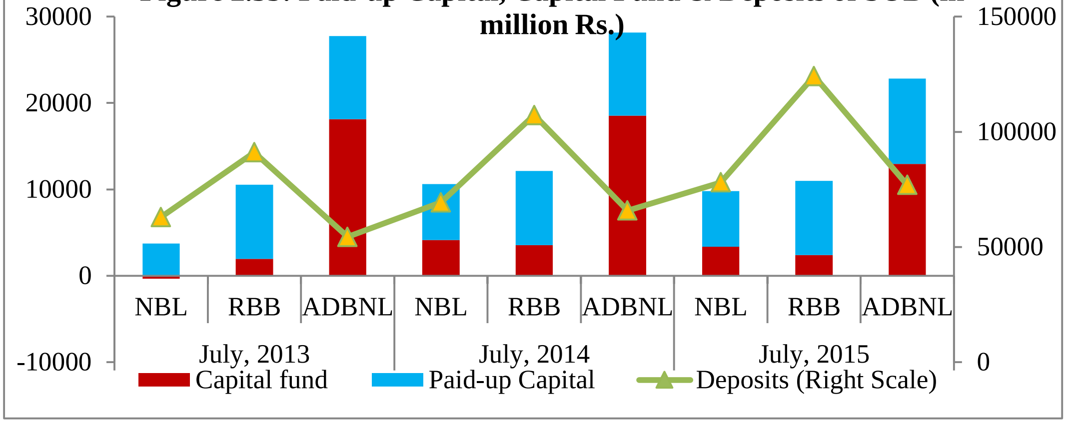
Figure 2.34: Share of SOBs in Total Assets of CBs



The state owned commercial banks have 19 percent share in total deposit of commercial banks. Their market share in terms of total assets of all BFIs stood at 16.5 percent, whereas in total deposit and loan & advances, the ratio reached to 15.7 and 14.8 percent respectively in mid-July 2015. Among these banks, financial and regulatory position of ADBL, especially in terms of capital base and capital adequacy remains in satisfactory level. The asset quality of NBL and RBB has been gradually improving in the review period.

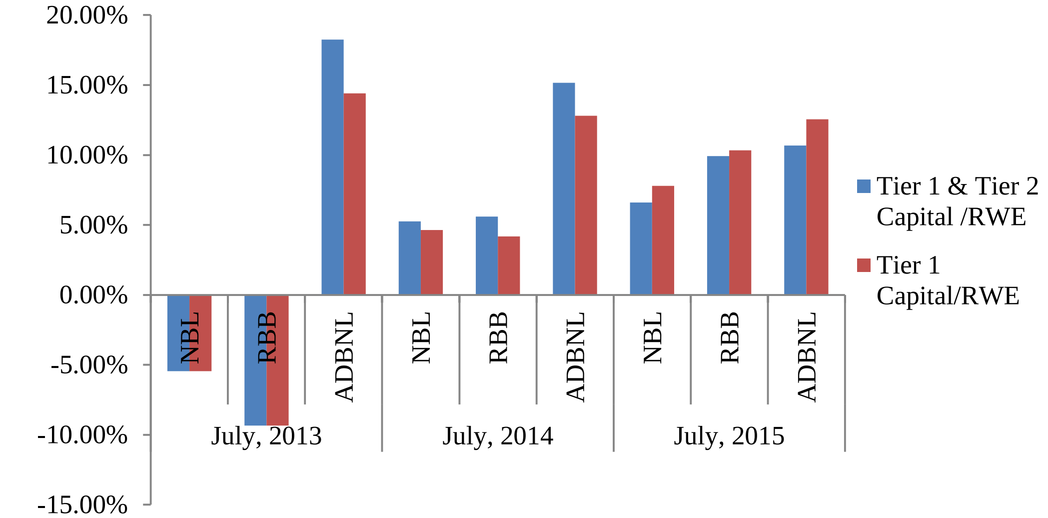
As of mid-July 2015, capital fund of all three state owned banks are Rs. 3.3 billion, Rs. 2.3 billion and Rs. 12.9 billion respectively for NBL, RBB and ADBL. The figure was Rs.2.6 billion, 1.2 billion and 14.2 billion respectively for NBL, RBB and ADBL in mid-July 2014, showing a slight improvement in the capital base of SOBs. This calls for a regulators efforts and actions for the SOBs to improve the resilience.

Figure 2.35: Paid-up Capital, Capital Fund & Deposits of SOB (in million Rs.)



The Tier1 and Tier2 capital of ADBNL stood at 10.7 percent and 12.5 percent in mid-July 2015. Such capital was 12.8 percent and 15.2 percent respectively in mid-July 2014. Likewise, reform of two SOBs lead the improvement in tier 1 and tier 2 capitals. RBB met the minimum capital requirement by maintaining Tier1 capital 9.9 percent and Tier2 capital 10.3 percent. NBL's capital adequacy ratio is also in improving trend and hence met the Tier1 capital ratio with 6.6 percent in mid-July 2015, the Tier 2 ratio of NBL also reached 7.8 percent. Improvement in capital adequacy ratio of SOB indicates improved resilience.

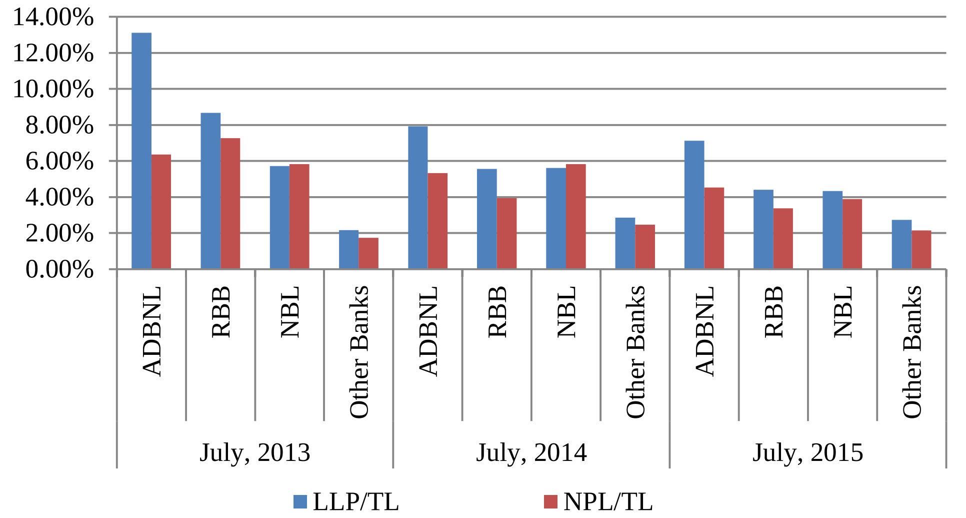
Figure 2.36: Capital Adequacy in SOBs (in percent)



The NPL ratio of state owned banks is being improved from 4.9 percent in mid-July 2014 to 3.9 percent in mid-July 2015. As on mid- July 2015 the NPL ratio of

ADBNL, RBB and NBL stands on 4.5 percent, 3.4 percent and 3.9 percent respectively implying a gradual improvement in the assets quality towards international standard. Such ratios were 5.3 percent, 4.0 percent and 5.8 percent in mid-July 2014. The NPL ratio of ADBNL & NBL has also come down to the regulatory limit in the review period. With the better performance of SOB's in managing the loan portfolio, the overall NPL ratio of banking industry has come down to 2.6 percent from 2.9 percent last year.

Figure 2.37: NPL and LLP Ratios of SOBs



State owned banks are the major investors in deprived sector lending among BFIs. Aggregate deprived sector lending of commercial banks is 5.1 percent of the total loan. In total deprived sector lending of commercial banks, state owned banks share 23 percent in mid-July 2015. The deprived sector lending of NBL is 4.5 percent, RBB (4.8 percent) and ADBNL (8.0 percent) which are above the regulatory requirements of NRB in mid-July 2015.

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

Impact of Earthquake 2015 on Financial Stability

The April 25 earthquake, occurred at a time when the major macroeconomic indicators were in positive note, has posed challenges in maintaining macroeconomic stability. It is estimated that the total value of disaster effects (damages and losses) caused by the earthquakes is NPR 706 billion or its equivalent of US$ 7 billion (PDNA, 2015). The financial stability became one of the major challenges after this devastating earthquake. The total disaster effects in the financial sector was estimated to NPR 31.9 billion (including damages of NPR 5.0 billion and losses of NPR 26.9 billion).

Besides damages and losses in this sector, the financial sector stability became a major challenge due to massive destruction of owner occupied dwellings and public assets worth over NPR 300 billion. Partly because of their exposure to residential finance and real estate. The banking and financial institutions (BFIs) are likely to see modest deterioration in the quality of loan portfolios, impacting the solvency of institutions, micro and large, and the overall flow of credit. The credit growth rate of BFIs after earthquake became sluggish due to shortages of construction materials and labor along with psychological effects of aftershocks in people.

CHAPTER - THREE

PERFORMACE OF FINANCIAL INSTITUTIONS

Performance of Commercial Banks

In the Nepalese financial system, BFIs have prominent share of assets and in which commercial banks have the dominant share in total assets. As in mid-July 2015, share of commercial banks in total assets and liabilities of NRB regulated BFIs rose to 81.3 percent from 78.1 in mid-July 2014. Similarly, share of total assets and liabilities of commercial banks on total GDP decreased to 68.85 percent from 76.1 percent in mid-July 2014. The dominance of commercial banks in total banking sector in terms of assets and liabilities as well as in terms of balance sheet component has been broadly remained stable. The total assets and liabilities of commercial banks increased by 20.0 percent to Rs.1774.5 in mid-July 2015 from Rs.1477.8 billion in mid-July 2014.

Deposits and Credits

Total deposit and credit of commercial banks stood at 68.8 and 51.9 of GDP in mid-July 2015 which was 62.5 and 46.8 percent of GDP in mid-July 2014 respectively. Total deposits grew by 21.4 percent to Rs.1462.9 billion during the period of mid-July 2015, surpassing previous growth of 18 percent growth during mid-July 2014. Total credit flows grew by 21.9 percent and reached to Rs.1087.5 in mid-July 2015.

After loan and advances, investment in government securities has emerged as a second best option for the commercial banks to utilize the excess liquidity. Investment in government securities increased by 21.0 percent to Rs.176.2 billion in mid-July 2015. In the context where major balance sheet indicators such as capital, deposits, lending, investments, liquid funds, borrowings etc. have all shown a positive growth in mid-July 2015 as compared to that of mid-July 2014.

Capital

The capital fund of commercial banks rose by 12.9 percent to Rs.122.1 billion in mid-July 2015 from Rs.108.2 billion in mid-July 2014. Of which, paid up capital rose by 11.9 percent, whereas statutory reserves and other reserves rose by 12.1 percent and 8.7 percent respectively during mid-July 2015. However, retained earnings remained in negative.

Assets

The aggregate NPL to total loan ratio of commercial banks decreased to 2.6 percent on mid-July 2015 in comparison to the ratio of 2.9 percent in mid-July 2014. The three states owned banks in total have NPL ratio of 3.9 percent where as that of private commercial banks is only 2.4 percent in mid-July 2015. As in mid-July 2014, average NPL ratio of three state owned commercial banks was 4.9 percent, whereas such ratio for private commercial banks was 2.5 percent. Credit quality of commercial banks has slightly improved and NPL ratio is below the regulatory standard of 5.0 percent, which does not warrant financial stability risk while measuring in terms of assets quality.

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

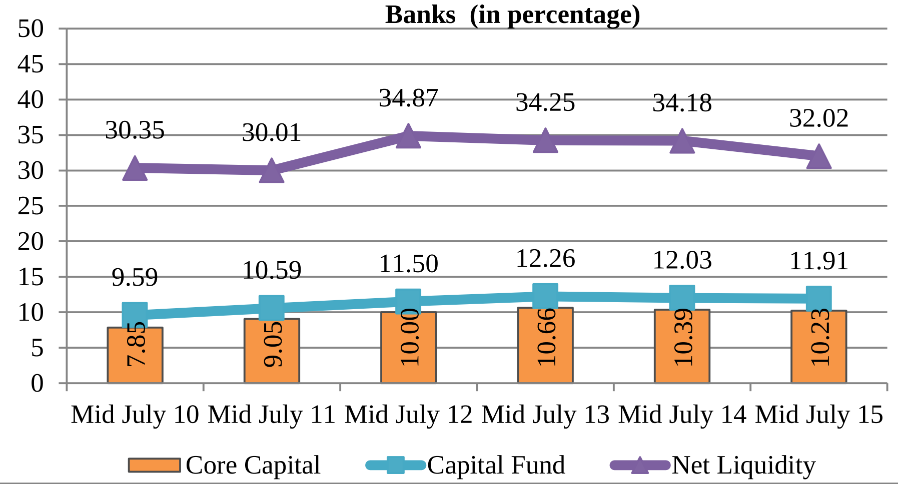


Table 3.1: Major Financial Indicators of Commercial Banks (in percentage)

Indicators	Commercial Banks	Private-Sector Banks	SOBs
Tier 1 & Tier 2 Capital /RWE	11.94	12.18	10.93
Tier 1 Capital/RWE	10.27	10.40	9.72
NPL/Total Loan	2.63	2.4	3.9
Return on Equity	28.67	27.95	30.77
Net Interest Spread	3.91	3.66	4.98
Total Credit to Total Deposit	75.41	76.18	72.16
Liquid Assets/Total Deposit	30.62	29.42	35.69
Base Rate	7.85	7.73	8.95

Despite the directive of NRB to BFIs to invest at least 12.0 percent of total loan in agriculture and electricity sector, only 4.33 percent of total loans of commercial banks had been disbursed in agriculture sector and 2.7 percent in electricity, gas and water. Manufacturing (production) related sector availed 21.7 percent of total loan and retailer and wholesaler sector utilized 23.2 percent of total loan. Likewise, out of total loan 7.3 percent was disbursed to consumption sector and 7.3 percent was disbursed to real estate sector.

Comparing the product-wise loan with the previous year, commercial banks were less motivated to invest in real estate lending as such lending has declined to 5.8 percent in mid-July 2015. Investment in business purpose loans such as term loan, overdraft loan, demand and other working capital loan were 16.4 percent, 18.1 percent and 21.6 percent respectively in mid-July 2015, which were 27.1 percent, 13.7 percent and 16.5 percent in mid-July 2014. There was remarkable growth in residential and hire purchase loan, which shows that banking sector; especially the CBs have still attracted in such loans (retail lending) for their short term profitability and performance. Similarly, commercial banks have made 5.1 percent of total loan in deprived sector in the review period. Loan against real estate as collateral has shown increasing trend in the review period. Out of total loan, 83.1 percent are backed by real estate collateral which was 81.3 percent in mid-July 2014.

Profitability

Net Profit of the commercial banks posted a growth of 33.3 percent to Rs. 28.4 billion in mid-July 2015 compared to the growth of 19.5 percent as of mid-July 2014. All commercial bank except Grand Bank registered a positive profit during the review period. Total assets of the banks rose by 20.0 percent in mid-July 2015 compared to the growth of 18.0 percent during mid-July 2014. Contribution of interest income was 76.2 percent of the total income in the review period, such contribution slightly decreased from 82 percent of total income as of mid-July 2014.

Stress Testing of Commercial Banks

Credit Shock

Stress test results show that there is growing risk in credit among commercial banks. Stress testing results based on data of mid-July 2015 obtained from 30 commercial bank revealed that a combined credit shock of 15 percent of performing loans degraded to substandard, 15 percent of substandard loans deteriorated to doubtful loans, 25 percent of doubtful loans degraded to loss loans and 5 percent of performing loans deteriorated to loss loans categories which would push the capital adequacy ratio of 21 commercial banks below the minimum regulatory requirements of 10.0 percent. The numbers of such banks were 29 in mid-July 2014.

Stress testing results under the scenario of all non-performing loans under substandard category downgraded to doubtful and all non-performing loans under doubtful category downgraded to loss underscores a pessimistic scenario as the number of banks capable of withstanding such shock without deteriorating capital adequacy to below 10 percent came to two, down from previous reading of four in mid-July 2014. Similarly, stress testing results under the scenario of 25.0 percent of performing loans of real estate and housing sector directly downgraded to substandard showed same result: deteriorating capital adequacy of two banks to below minimum requirement of 10 percent. However, another scenario of 25.0 percent of performing loans of real estate and housing sector directly downgraded to loss loans showed some respite. Under this scenario, capital adequacy ratio of 7 commercial banks will come below the required level of 10 percent, which was 9 as on mid-July 2014. The result showed that majority of commercial banks maintained their resilience towards realty sector during the fiscal year.

In an another credit shock test, under the scenario of top two large exposures (loans) were downgraded from performing to substandard category, the capital adequacy ratio of 5 commercial banks would fall below the required level whereas the number of such commercial banks was 6 in mid-July 2014. Decrease in number of such banks shows they are strengthening their position by decreasing dependency on such exposures.

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

Liquidity Shock

Results from stress tests under liquidity shock show encouraging improvements in liquidity resilience among commercial banks. The stress test under scenario of withdrawal of customer deposits by 2, 5, 10, 10 and 10 percent for five consecutive days' results showed that 16 of 30 commercial banks are vulnerable towards liquidity crisis.

Three banks were prone to liquidity shock of withdrawal of 5 percent of deposits in a single day, while twelve banks' liquidity ratio would drop below 20 percent after withdrawal of 10 percent deposit in a single day. The number of banks seeing their liquidity ratio drop below 20 percent would grew to 22 if the single day deposit withdrawal increased to 15 percent. The numbers of banks prone to liquidity shock under single day deposit withdrawal of 5, 10 or 15 percent were Nil, 7 and 17 respectively on mid-July 2014.

With the shock of withdrawal of deposits by top 2, 3 or 5 institutional depositors, liquid assets to deposit ratio of 9, 19 and 22 commercial banks would be below 20.0 percent in mid-July 2015. The numbers were 8, 11 and 18 in mid-July 2014. However, only one commercial bank was vulnerable among all commercial banks in case of deposit withdrawals from top 2, 3 or 5 individual depositors. This situation was Nil in mid-July 2014.

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 0.5 to 2.0 percent.

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

When going through market shock, 28 out of 30 commercial banks (excluding two state owned banks) could maintain their capital adequacy ratio above the regulatory requirement of 10.0 percent.

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

The combined credit and market shocks based on a scenario of 25.0 percent of performing loan of real estate and housing sector directly downgraded to substandard category of NPLs and fall of the equity prices by 50.0 percent showed that CAR of 2 banks would fall below 10 percent. However, under a more adverse scenario of 15.0 percent of performing loans deteriorated to substandard, 15.0 percent of substandard loans deteriorated to doubtful loans, 25.0 percent of doubtful loans deteriorated to loss loans and the equity prices fall by 50.0 percent, the CAR of just 9 banks would remain above the regulatory minimum level.

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

Performance of Development Banks

FY 2014-15 was a good year for Development Banks. Barring some instances, overall performances of the Development Banks were improving in an encouraging pace. In the financial front they have been able to expand their balance sheets, register profit growth and reduce non-performing loans. On the other hand, they have seen major consolidation with the encouraging numbers of merged and acquired institutions.

Deposits and Credits

Development banks have been able to record robust growth in deposit collection as well as credit disbursement during FY 2014-15. Deposits at these banks grew by 18.6 percent to Rs.237 billion while credits grew by 19.6 percent to Rs.193 billion. The ratio of credit to domestic deposit and core capital barely changed from the level in mid-July 2014 to stand at 70.8 percent in mid-July 2015. The ratio of credit to domestic deposit and core capital was 70.40 in mid-July 2014.

Assets

Total assets of development banks (B class institutions) has crossed the mark of Rs.300 billion for the first time, registering growth of 16.1 percent from Rs.259 billion in mid-July 2014. The surge in credit flow has resulted in increase in the volume of bad loans at the banks which accounted bad loans of Rs.6.93 billion as of mid-July 2015. Non-performing loans accounted for Rs.6.74 billion in mid-July 2014. However, in percentage term these loans have declined from previous level of 4.2 percent in mid-July 2014 to 3.6 percent in mid-July 2015.

Capital

Development banks have been able to maintain sufficient capital adequacy to meet the regulatory requirement. Indeed, they have significant cushion in capital adequacy after fulfilling regulatory requirement. As of mid-July 2015, development banks have capital adequacy ratio of 16.1 percent. The ratio was 15.8 percent in mid-July 2014. Current regulatory requirement demands 11 percent capital adequacy ratio from development banks. Capital Funds of development banks saw an appreciation in value during last fiscal year by 9.4 percent to Rs.30.3 billion at mid-July 2015. The increase was mainly propelled by increase in paid-up capital due to right issuance and dividend distribution of banks. Pad-up capital of development bank at mid-July 2015 amounted for Rs.27.5 billion.

Profitability

Development banks have recorded sound profit growth during FY 2014-15. The impressive growth of 26.3 percent is amongst the highest in recent years. Profit of the development banks totaled Rs.5.9 billion in mid-July, while the figure was Rs.4.7 billion in mid-July 2014. The growth in profit was result of surge in interest income by 12.4 percent coupled with write back from possible losses amounting Rs.2.6 billion. Increased profit has also improved ROE and ROA of development banks during the fiscal year. Return on Equities of development banks improved by 1.6 percentage points to 15.6 percent while Return on Assets were improved by 57 basis points to 1.97.

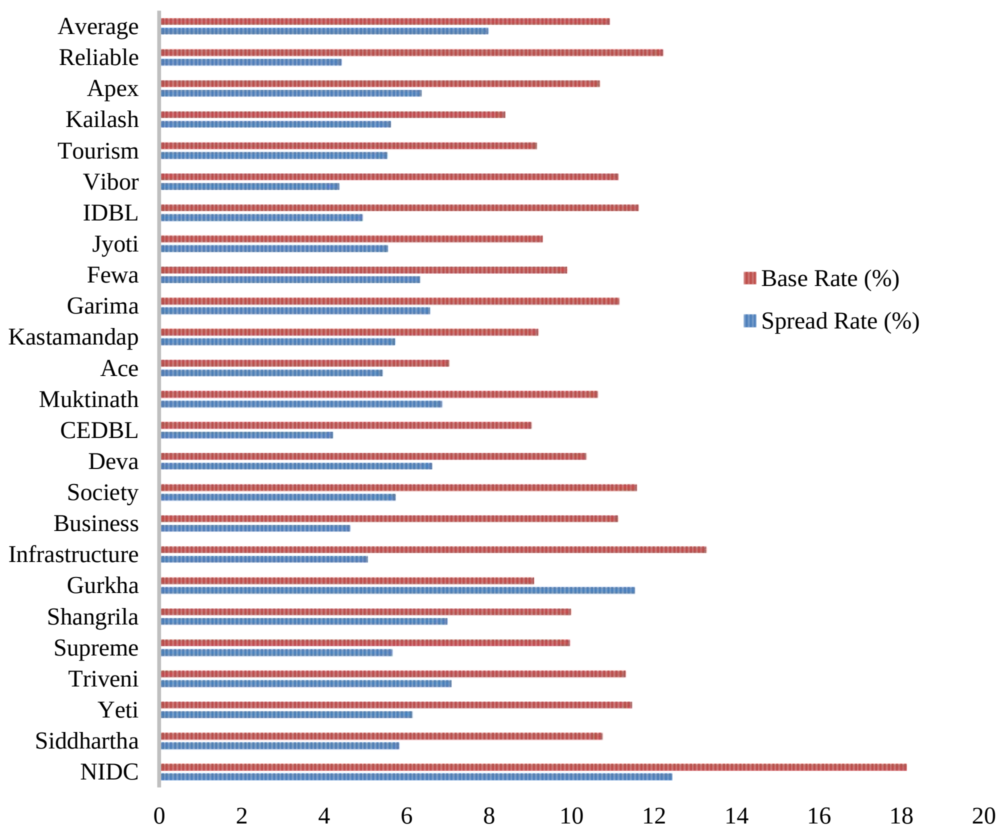
Table 3.2: Major Indicator of Development Banks (as of mid-July 2015)

Particulars	Ratios (in percent)
Core Capital to RWA	14.65
Capital Fund to RWA	15.40
Credit to Deposit (LCY) Ratio	81.84
Credit to Deposit (LCY) & Core Capital	71.13
Non-Performing Loan to Total Loan	2.76
Net Liquid Asset /Total Deposit	34.03
Liquid Assets to Total Deposits	35.06
Weighted Average Interest on Credit	14.61
Weighted Average Interest on Deposit	6.61
Weighted Average Interest on Govt. Sec.	3.00

Base Rates and Spread Rates

The average base rate of national level development banks stood at 10.9 percent in mid-July 2015, whereas it was 11.5 percent in mid-July 2014. Improvement in base rates shows declining interest rates aftermath of earthquake that heaped pressure in excessive liquidity. Furthermore, lower base rate is the result of operating efficiency among Development Banks. As of mid-July 2015, Out of 24 national level Development Banks, base rates of 12 Developments Banks are below average and 12 Development Banks base rates are higher than the average rate. Government-owned NIDC Development Bank has the highest base rate of 18.1 percent followed by Infrastructure Development Bank with 13.3 percent. Similarly, Ace Development Bank has the lowest base rate among national level development banks, which stood at 7.0 percent.

Figure 3.2 : Base Rate and Spread Rates of National Level Development Banks (In Percent)



Average spread rate of national level developments banks rose by 70 basis points during the FY 2014-15 to 7.98 percent. The increase is believed to be the effect of relatively slower decline in lending rates compared with deposit rates. data shows that only two banks have higher spread rates than the average rates. Government owned NIDC development Bank has the highest spread of 12.4 percent, while crisis-ridden Gurkha Development Bank is under control of NRB after it was declared problematic, has the second highest spread of 11.5 percent. Amongst the national level development banks, Clean Energy Development Bank has the lowest spread rate of 4.2 percent.

Stress Testing of Development Banks

National level development banks have emerged as strong institutions in the recent stress testing scenarios defined by NRB. Based on the data as of mid-July 2015, it was revealed that the banks have adequate buffer capital to absorb the perceived shocks. Stress testing results of 20 national level development banks on various shocks have been observed as follows.

Credit Shock

The stress testing results of national level development banks as of mid- July 2015 revealed that a standard credit shock would push the capital adequacy ratio of as much as 5 banks out of total 20 national level development banks below the regulatory minimum benchmark of 10 percent. However, the result for different criteria was zero in most scenarios. Five banks would fail to maintain minimum capital adequacy if 5 percent of performing loans detreated to loss loans. Similarly, the banks would not comply the requirement if 15 percent of performing loans downgraded to substandard category.

Liquidity Shock

The stress test results found that just four banks would see their capital adequacy dip below minimum level if withdrawal of deposit by 2, 5, 10, 10 and 10 percent for five consecutive days. There has been no change in this result from mid-July 2014.

Similarly, if there is a withdrawal of deposit by 5.0 percent, 10.0 percent and 15.0 percent the number of bank's whose liquid assets to deposit ratio below the regulatory minimum of 20.0 percent stood at 0, 4 and 8 in mid-July 2015. However, the number will reach 12 if 20 percent of the deposits were withdrawn. With the shock on withdrawal of deposits by top 2, 3 and 5 institutional depositors, liquid assets to deposit ratio of 1, 2 and 4 banks respectively will be below 20 percent. These liquidity shock shows that very few banks are reliant on institutional depositors. Furthermore, no banks would face liquidity problem if up to 5 top individual depositors opt to withdraw their deposits.

Other Shocks

The stress testing results revealed that 18 out of the 20 national level development banks' CAR was above the regulatory requirement when calibrating through interest rate, exchange rate and equity price shocks. Similarly, since development banks are not allowed to make equity investments except in their subsidiaries, the impact of fluctuation in equity price is also low. The banks do not bear interest rate risks as they pass it directly to their clients, so that they are found to be less affected by interest rate shocks as well.

The resilience of national level development bank towards key stress tests analysis showed an improved, sound and strong financial condition through all three kinds of credit, liquidity and market shocks in stress testing analysis. The overall vulnerability test in aggregate of all 20 national level development banks found less vulnerable position except the Gurkha Development Bank which is still controlled by Nepal Rastra Bank.

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

Shocks		Mid-Jan 2014	Mid-July 2014	Mid-Jan 2015	Mid-Jul 2015
Capital Adequacy <10					
A. Before Shocks			1	0	0
B. After Credit Shock					
C1	15 Percent of Performing loans deteriorated to substandard	3	3	2	3
	15 Percent of Substandard loans deteriorated to doubtful loans	0	1	0	0
	25 Percent of Doubtful loans deteriorated to loss loans	0	1	0	0
	5 Percent of Performing loans deteriorated to loss loans	5	5	4	5
C2	All NPLs under substandard category downgraded to doubtful.	0	1	0	0

Shocks		Mid-Jan 2014	Mid-July 2014	Mid-Jan 2015	Mid-Jul 2015
	All NPLs under doubtful category downgraded to loss.	1	1	0	0
C3	25 Percent of performing loan of Real Estate & Hosing sector	0	2	0	0
	loan directly downgraded to substandard category of NPLs.				
C4	25 Percent of performing loan of Real Estate & Hosing sector	2	1	1	0
	loan directly downgraded to Loss category of NPLs.				
C5	Top 5 Large exposures downgraded: Performing to Substandard	2	2	0	1
C. After Liquidity Shocks		*Liquidity Ratio <20*			
L-1a	Withdrawal of deposits by 2%, 5%, 10%, 10%, 10%, for five consecutive days respectively.		4	2	4
L-2a	Withdrawal of deposits by 5%	0	1	0	0
L-2b	Withdrawal of deposits by 10%	1	1	2	4
L-2c	Withdrawal of deposits by 15%	5	7	10	8
L-2d	Withdrawal of deposits by 20%	12	11	13	12
L-3b	Withdrawal of deposits by top 2 institutional depositors.	0	1	1	1
L-3c	Withdrawal of deposits by top 3 institutional depositors.	0	1	2	2
L-3e	Withdrawal of deposits by top 5 institutional depositors.	1	1	2	4
L-4b	Withdrawal of deposits by top 2 individual depositors.	0	0	0	0
L-4c	Withdrawal of deposits by top 3 individual depositors.	0	0	0	0
L-4e	Withdrawal of deposits by top 5 individual depositors.	0	0	0	0

Performance of Finance companies

Share of Finance companies in the overall economic activity is smaller in comparison to A and B class FIs, as shown by small deposit to GDP ratio. Such ratio is 3.4 percent in mid-July 2015, which was 3.8 percent of GDP in mid July 2014. The total assets and liabilities of finance companies decreased in mid-July 2015 by 2.12 percent to Rs.108 billion compared to mid-July 2014. Finance companies mobilized aggregate deposit of Rs.72 billion in mid July 2015 which is a decrease of 2.02 percent compared to mid-July 2014.

Loan and advances of finance companies stood at Rs.64.7 billion accounted for 3.5 percent of total GDP. It decreased marginally in mid-July 2015 from mid July 2014. Of the total loan and advances, private sector accounted for more than 97.6 percent, followed by financial institutions, with 2.3 percent. The investment of finance companies accounted to Rs.2.5 billion in mid-July 2015 which was Rs.2.4 billion in mid-July 2014. Almost all of such investment is in government securities.

Capital fund of finance companies stood at Rs.10.5 billion in mid-July 2015 which is 21.6 percent of risk weighted exposure of the same period. In mid-July 2014 such ratio was 15.9 percent amounting to Rs.10 billion.

The credit to deposit and core capital ratio of finance companies registered 73.2 percent in mid-July 2015, which is below the prescribed limit of 80 percent. Such ratio was 76.5 percent in mid-July 2014. Total non-performing loan of finance companies was very high with 14.6 percent of total loan and advances in mid July 2015 which was 14.3 percent in mid-July 2014. Non-banking assets of finance company have decreased by 31.5 percent to Rs.800 million in mid July 2015 from Rs.1.2 billion in mid-July 2014. Loan loss provision reached to Rs.9.5 billion in mid-July 2015 from that of Rs.10.5 billion in mid-July 2014.

Finance companies, as a whole, are in profit as exemplified by positive ROA (2.23 percent) and ROE (2.23 percent), despite some of them being declared problematic and few others are under prompt corrective actions.

Total liquid assets to total deposit of finance companies stood at 35.8 percent in the review period which implies that finance companies are in comfortable position in terms of liquidity. Out of total loan and advances construction sectors has highest share accounting to 16.6 percent followed by wholesale and retail with 13.1 percent. Share of agriculture is minimal with 2.9 percent of the total, while 27.3 percent of the loan is provided to unclassified sectors, which clearly depicts that the major chunk of finance companies credit is availed to unproductive sectors. Likewise, demand and working capital loan and term loan has 19.7 and 12.1 percent share in total loan portfolio. Deprived sector loan has 3.4 percent share which is lower than prescribed limit of 3.5 percent in aggregate. Real estate sector received 13.4 percent of loan in total portfolio. In mid-July 2014 real estate loan had 14 percent share in total loan and advances.

Number of finance companies has decreased to 48 in mid-July 2015 from 54 in mid-July 2014. During the review period, two more finance companies have been declared problematic, totaling to 10 finance companies as problematic.

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

Stress Testing of Finance Companies

NRB has mandated all the national-level finance companies to conduct stress tests and to report it to NRB on a quarterly basis. Among 48 finance companies 42 finance companies are national level. Among national level finance companies 10 are declared problematic and 1 is under liquidation process. Stress testing result of rest of the 31 national-level finance companies found that finance companies remained less vulnerable to individual credit shocks and liquidity shocks in aggregate. However, for 10 finance companies Capital adequacy ratio decreased to less than 10 percent after combined credit shocks. Similarly after combined credit shocks none performing loan increased to 20 percent in minimum to 71 percent in maximum in different finance companies. Position of finance companies after stress testing scenarios is shown in the following table.

Table 3.4: Summary Result of Stress Testing of Finance Companies

Criteria	**Number**
No. of Finance Companies with CAR below 10 percent before shocks	**1**
A. Credit Shock	
	No. of BFIs having CAR<10 percent
15 Percent of Performing loans deteriorated to substandard	0
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 & Hosing 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	7
Withdrawal of deposits by 15 percent	9
Withdrawal of deposits by 20 percent	17
Withdrawal of deposits by top 2 institutional depositors.	5
Withdrawal of deposits by top 3 institutional depositors.	5
Withdrawal of deposits by top 5 institutional depositors.	7
Withdrawal of deposits by top 2 individual depositors.	2
Withdrawal of deposits by top 3 individual depositors.	2
Withdrawal of deposits by top 5 individual depositors.	2

Performance of Microfinance Development Banks

As of mid-July 2015, there were altogether 36 micro finance development banks (MFDBs) operating as "D" class financial institutions. They consisted of one Nepal Grameen Bikas Bank Ltd., 31 private sector micro finance development banks replicating the 'Grameen Banking Model' and 4 wholesale lending microfinance development banks (MFDB). The number of branches of MFDBs reached to 1124, creating employment for 5749 persons as of mid-July 2015. Out of these, the wholesale MFDBs are operating 11 branches with 107 employees. As compared to previous year, the total members of MFDBs slightly decreased by 4.2 percent to 15,48,987 in mid-July 2015. The total loan disbursed by the MFDBs as of mid-July 2015 rose by 39.8 percent to Rs.271.8 billion as compared to the previous year. Out of the total loan, wholesale MFDBs shared percent to Rs.44.9 billion.

Table 3.5: Key performance Indicators of MFDBs

S.N.	Particulars	(Rs. '000)	
		Mid-July 2014	**Mid-July 2015**
1.	No. of MFDBs	37	36
1.2	*No. of Wholesale MFDBs*	*4*	*4*
2.	No. of Branches of MFDBs	851	1124
2.1	*No. of Wholesale MFDBs*	*10*	*11*
2.2	*No. of Branches of NGBB*	*170*	*186*
3.	Total Members of MFDBs	1616367	1548987
3.1	*Members of NGBB*	*191781*	*191787*
4.	Total Capital of MFDBs (Rs.)	5,723,281	6,203,539
4.1	*Capital of Wholesale MFDBs (Rs.)*	*2,309,778*	*2,722,692*
4.2	*Capital of NGBB (Rs.)*	*596,915*	*73,053*
5.	Total Paid-up Capital of MFDBs (Rs.)	2,903,491	3,987,256
5.1	*Paid-up Capital of Wholesale MFDBs (Rs.)*	*910,682*	*1,062,682*
5.2	*Paid-up Capital of NGBB (Rs.)*	*408,567*	*557,500*
6.	Total Assets of MFDBs (Rs.)	49,092,50	70,832,902
6.1	*Assets of Wholesale MFDBs (Rs.)*	*13,721,26*	*17,828,531*
6.2	*Assets of NGBB (Rs.)*	*6,404,077*	*5,957,759*
7.	Total Loan and Advances of MFDBs (Rs.)	35,429,66	55,327,268
7.1	*Loans and Advances of Wholesale MFDBs (Rs.)*	*9,593,829*	*14,731,256*
7.2	*Loan and Advances of NGBB (Rs.)*	*3,879,739*	*5,222,439*
8.	Total Deposit in MFDBs (Rs.)	11,041,95	16,057,983
8.1	*Deposit in NGBB (Rs.)*	*1,196,561*	*1,410,210*
9.	Total Overdue (Loan & Interest) of MFDBs (Rs.)	908,074	1,048,804
9.1	*Overdue (Loan & Interest) of Wholesale MFDBs (Rs.)*	*8,233*	*10,154*
9.1	*Overdue (Loan+ Interest) of NGBB (Rs.)*	*718,781*	*752,353*

As of mid-July 2015, total capital of MFDBs increased by 8.4 percent to Rs.6.2 billion compared to the same period of the last year. Out of total capital fund, capital fund of wholesale MFDBs stood at Rs.2.7 billion and NGBBL's capital fund stood at Rs. 7.3 million. The paid-up capital of MFDBs increased by 37.3 percent to Rs.4.0 billion. The ratio of paid-up capital to total capital stood at 64.3 percent. The paid-up capital of wholesale MFDBs stood at Rs.1062.7 million and NGBBL's paid-up capital stood at Rs.557.5 million. Based on risk-weighted asset, MFDBs are required to maintain at least 4.0 percent as core capital and 8.0 percent as the capital fund.

Total asset of MFDBs in the review period increased by 44.3 percent to Rs.70.83 billion. In this category, the share of wholesale MFDBs stood at 25.2 percent and share of NGBBL's asset stood at 8.4 percent. Out of the total assets, loan and advances registered a growth rate of 56.6 percent to Rs.44.17 billion. Out of the total loans and advances; the wholesale loan shared 26.8 percent while individual loans shared remaining part. NGBBL's share in this category stood at 9.9 percent. The ratio of loan and advances to the total assets stood at 56.2 percent. MFDBs have not booked any asset as non-banking assets during the review period. Likewise, investment of these banks during the review period reduced by 1.2 percent to Rs.2.5 billion. Out of total investment, the ratio of investment in government securities stood at 4.7 percent.

Total deposit mobilization by MFDBs from their member clients increased by 45.4 percent to Rs.16.1 billion in the review period. Out of the total deposits, NGBBL mobilized Rs.1.41 billion sharing 8.8 percent. As compared to total liabilities of these institutions, the share of deposit mobilization remained at 22.7 percent. Out of total deposits, compulsory deposits shared 37.8 percent. Total borrowing of these banks during the review period increased by 38.9 percent to Rs.38.5 billion. NGBB borrowed Rs.3.5 billion sharing 9.1 percent in total borrowing. As compared to total liabilities of MFDBs, the share of borrowed amount remained at 54.4 percent.

The total amount of overdue loan, including interest, of these institutions increased by 15.5 percent to Rs.1.1 billion as compared to the same period of the last year. The overdue of wholesale MFDBs stood at Rs.10.1 million. NGBBL's overdue loan amounted to Rs.752.3 million with a significant share of 71.7 percent of total overdue of MFDBs. The number of borrowers with overdue loan in MFDBs has increased significantly by 118.8 percent to 66,916 persons during the review period. Out of this, NGBBL alone has 70 percent of borrowers with overdue loan. Likewise, the amount of loan loss provision of these institutions increased by 20.1 percent to Rs.981.9 million during the review period. NGBBL had loan loss provision of Rs.303.4 million which is of 30.9 percent share of the total loan loss provision of MFDBs.

Due to the adverse effect of April 25, 2015 earthquake and its aftershocks, total loan of Rs.2.8 billion from 363 branches of 28 MFDBs was fallen into risk categories. This amount constituted 6.4 percent of the total outstanding loan of

Rs.44.3 billion from all 28 MFDBs. It does not include the data related to four of the wholesale lending MFDBs. Among the total members (14,12,665) of these 28 MFDBs, 473 persons lost their lives and 1,40,151 houses were severely damaged. Overall, the ratio of earthquake affected members was 11.1 percent of the total members.

Financial Literacy, Financial Inclusion, Access to Finance

NRB has been involved in different activities to promote financial literacy in the country. Different financial literacy materials were disseminated in 2015. As NRB is affiliated with different international organizations like Alliance for Financial Inclusion (AFI), Child and Youth Finance International (CYFI) etc., to promote financial inclusion and financial literacy in the country; various financial literacy-programs were conducted in 2015. As a member of AFI, NRB has made some commitments towards financial inclusion under the 'Maya Declaration 2013' and most of the commitments in this concern has been fulfilled.

With regard to financial literacy, NRB celebrated the global financial literacy week called 'Global Money Week' announced by the CYFI in March 2015. In this connection, NRB organized a grand financial literacy rally in Kathmandu on March 14th gathering some 4000 people comprising students, teachers, BFIs, Cooperatives, NGOs, donor agencies, etc. Intensive one-day interaction program on financial literacy focusing child and youths was also organized in Kathmandu on March 17th. During the program, a comprehensive presentation was made on on-going financial literacy activities in Nepal. Ministry of Education also made a presentation on its activities on financial literacy. Many participants from school, students, teachers, BFIs, cooperatives, NGOs, donor agencies, journalists, etc., actively participated in the interaction. Different financial literacy materials, like hand-book entitled 'NRB with Students', story-book called 'Paisako Bot', musical CD comprising financial literacy songs, etc. were distributed during the rally and interaction program. Moreover, upon the request of NRB; BFIs, NGOs, Cooperatives, Bankers Training Institutes, etc. also carried out different financial literacy activities during the week. Different Radio and TV programs on 'Global Money Week' were also broadcasted during the week. NRB has been regularly organizing such programs since 2013.

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

Issues and Challenges

Although the rapid expansion of micro finance sector has been widely accepted as an effective tool of enhancing access to finance, reducing poverty, empowering women and uplifting the living standards of the poor people; their concentration are mostly in urban and accessible areas accompanied with multiple financing and duplication in some cases, duplication is even observant among the donors in other cases, comparatively higher interest rates being charged with the poorest section of the society, deviation from the social responsibility in many cases and more concentration of the loans on the middle and upper middle classes rather than the deprived sector are some of the major weaknesses witnessed in this sector, which need to be addressed. Arrangements should be made to accommodate the credit information of MFIs by the Credit Information Bureau so that problem of multiple financing and duplication is addressed properly. Even though the licensing of new MFIs is still open; however it is the right time to think about the appropriate size and number of the MFIs in Nepal.

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

Financial viability is necessary for the sustainability of MFIs. They are generally resource deficient. The capital base of most of the MFIs is comparatively small as compared to other BFIs. As MFIs generally borrow fund from BFIs, the price they charge for their financial services is relatively high. At the same time MFIs mostly engage in small-sized business transactions with relatively higher overhead cost. As the interest rate in conventional banking system increases, it further pushes up the interest rate of MFIs, making micro finance services more costly to the poor and needy people. This is another major challenging issue of this sector which needs to be addressed by an effective policy response.

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

On the policy front, legal framework regarding the establishment of *National Micro Finance Fund* is still under-way. A separate unified directive for 'D' class MFIs has been already put in place. Revision of directives issued to cooperatives licensed by the NRB is under consideration. FINGOs have already been asked to convert themselves into Micro Finance Development Banks within a stipulated time frame. Formulation of *National Financial Literacy Policy* is underway. Establishment of a separate credit information agency for the MFIs is at the final stage. All these initiatives are expected to promote financial discipline and corporate governance, increase financial soundness and magnification of financial inclusion process that ultimately contribute on the financial stability.

CHAPTER - FOUR

COOPERATIVES AND OTHER FINANCIAL INSTITUTIONS

Performance of Cooperatives

NRB Licensed Cooperatives

The number of cooperatives allowed for conducting limited-banking activities by the NRB stood at 16 as of mid-July 2015. Out of these cooperatives, National Cooperative Development Bank (NCDB) is involved with the wholesale lending activities while remaining are involved in retail business. The total asset of these 16 institutions increased by 18.8 percent to Rs.25.0 billion during the review period. Total capital of these institutions increased by 30.9 percent to Rs.2.7 billion during the period. Out of the total capital fund, the share capital covers 61.8 percent. Similarly, total deposit of these 16 cooperatives increased by 17.9 percent to Rs.18.7 billion during the review period. Likewise, their loans and advances rose by 21.8 percent to Rs.14.4 billion. Similarly, the total commercial investment of these cooperatives increased by 94.8 percent to Rs.1.9 billion during the review period.

Government Registered Cooperatives

According to statistics from Department of Cooperative, 32,663 cooperatives are operating throughout the country as on mid-July 2015. Amongst the different types of cooperatives, savings and credit cooperatives are dominant accounting 41.2 percent of the total number.

The regional distribution of cooperatives shows a remarkable presence of those entities around Mid Development Region while they are yet to make significant presence in Mid-west and Far-west Development Region.

Table 4.1: Regional Distribution of Cooperative

Development Region	No. of Cooperatives	Members	Deposits
Eastern	6053	1034737	15426
Mid	15585	2303259	147018
Western	5216	990574	26986
Mid-west	3621	414461	6603
Far-west	2188	357703	6388
Total	**32663**	**5100734**	**202421**

Financial Highlights of Cooperatives

As of mid-July 2015, deposits of cooperatives totaled Rs.202.4 billion and total credit stood at Rs.187.8 billion. Deposits of cooperatives grew by 17.3 percent during review period while credits grew by 21.4 percent. Cooperatives have total capital of Rs.63.1 billion and total funds amounted to Rs.6.8 billion.

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

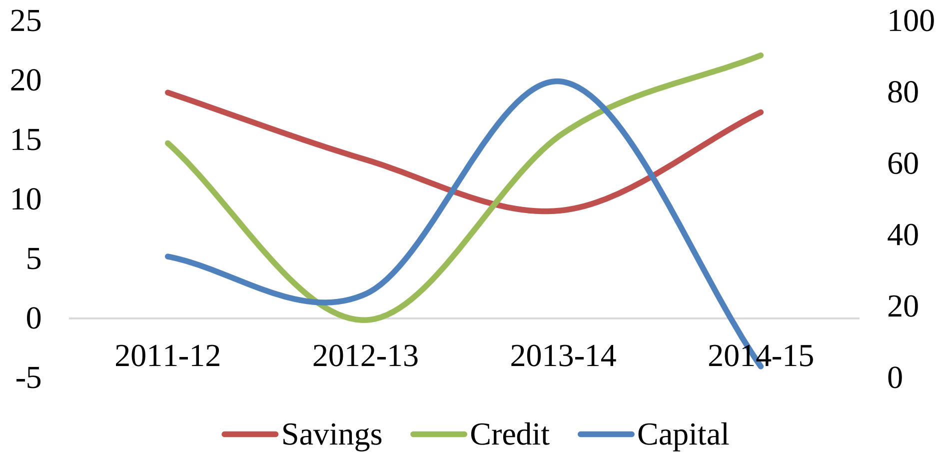


Table 4.2: Key Figures of Cooperatives (As of Mid-July 2015)

Indicators	Figures
No. of Cooperatives	32,663
Members (Nos.)	5,100,370
Male (Nos.)	*2,281,935*
Female (Nos.)	*267,988*
Total Staff (Nos.)	57,854
Total Capital (in Rs.)	63,059,914,000
Total Fund (in Rs.)	6,779,243,000
Deposit (in Rs.)	202,420,535,000
Credit (in Rs.)	187,756,583,000
Credit to Deposit Ratio	92.8%
Credit to Capital and Deposit Ratio	70.9%

Source: Department of Cooperatives

Despite the increase in number of cooperatives, the growth rate has been very slow in recent year. This is particularly due to strict policy adopted by Government of Nepal for new cooperative registration in the recent years. Department of Cooperatives has been adopting stringent policies for registration of new cooperatives, particularly for savings and credit cooperatives, as most of the cooperatives involved in saving and credit operation were found to be operating without following the Cooperative Standard issued by the department. Similarly, the department has been cautious over registration of new multipurpose cooperatives.

Table 4.3: Growth of Cooperatives over the years

Fiscal Year	Number	Growth (Number)	Growth Rate
2001-02	4349	-	-
2002-03	4860	511	10.51%
2003-04	5671	811	14.30%
2004-05	6484	813	12.54%
2005-06	7074	590	8.34%
2006-07	7445	371	4.98%
2007-08	7598	153	2.01%
2008-09	8045	447	5.56%
2009-10	8530	485	5.69%
2010-11	9720	1190	12.24%
2011-12	11302	1582	14.00%
2012-13	15813	4511	28.53%
2013-14	20102	4289	21.34%
2067-68	23301	3199	13.73%
2068-69	26500	3199	12.07%
2069-70	29526	3026	10.25%
2070-71	31177	1651	5.30%
2071-72	32663	1486	4.77%

Source: Department of Cooperatives

Financial Non-Government Organizations

As of mid-July 2015, there are altogether 26 Financial NGOs (FINGOs) with their 306 branches operating throughout the country. In the previous year, there were 27 FINGOs operating with their 279 branches. Since NRB has directed all the FINGOs to be transformed themselves into 'D' class MFDBs within a stipulated time frame, their number is gradually decreasing over the time. The FINGOs registered under the Institutions Registration Act, 1977 at the office of the chief district officer and are carrying out microfinance activities with the permission of NRB as per the provision of the Financial Intermediary Act, 1999. The members of such institutions as of mid-July 2015 have been increased by 5.2 percent to Rs.5,09,040. As of the review period, the outstanding loan of these institutions increased by 6.8 percent to Rs.9.7 billion while total deposit of the members in these institutions decreased by 11.9 percent to Rs.4.5 billion.

Rural Self-Reliance Fund (RSRF)

The Rural Self Reliance Fund (RSRF) was instituted in 1991 with the joint efforts of NRB and the Government of Nepal. The objective of the Fund is to work for gradual poverty reduction by providing wholesale credit to those cooperatives/NGOs which are involved in providing concessional loans to the poor people for conducting income generating activities. The total capital of the Fund as of mid-July 2015 reached Rs. 793.4 million with Rs.540.0 million contributed by the government and Rs. 253.4 million by the NRB. The loan-limit per individual borrower has been set at Rs.90 thousand. As of mid-July 2015, total loan of Rs.1.7 billion has been disbursed through this Fund to 1024 institutions throughout 68 districts of Nepal, benefitting some 49 thousand low income-households. The recovery rate of the fund was nearly 95 percent during the review period.

OTHER FINANCIAL INSTITUTIONS

Insurance Companies

There are altogether 26 (17 non-life and 9 life) insurance companies. The data received from Insurance Board of Nepal, reveals that total assets/liabilities of insurance companies rose by 22.1 percent to Rs.124.3 billion during fiscal year 2014-15. Total assets of life insurance companies' and non-life companies' expanded by 23.0 percent and 22.6 percent respectively.

Table 4.4: Sources and Uses of Funds of Insurance Companies (in billion Rs.)

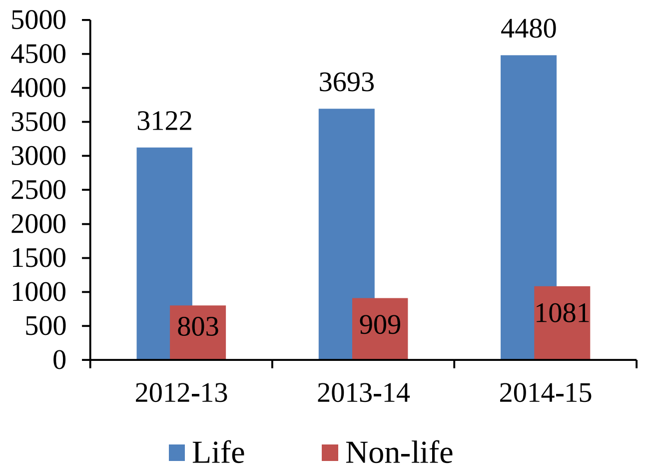
Sources	Life			Non-Life		
	2012/13	**2013/14**	**2014/15**	**2012/13**	**2013/14**	**2014/15**
Paid-up Capital	2.79	4.66	4.70	1.80	3.17	3.60
Reserve Funds	57.07	71.08	88.40	8.85	8.23	10.90
Other Liabilities	4.99	6.26	7.80	5.67	7.69	8.90
Total	**64.85**	**82.00**	**100.90**	**16.33**	**19.08**	**23.40**
Uses						
Cash and Bank	1.77	2.78	3.50	1.45	1.33	1.60
Investment	57.11	70.97	86.60	9.89	12.11	15.10
Fixed Assets	1.44	1.42	1.90	1.11	1.06	1.40
Other Assets	4.50	6.83	8.90	3.88	4.59	5.30
Total	**64.85**	**82.00**	**100.9**	**16.33**	**19.09**	**23.40**

Source: Beema Samiti (Insurance Board)

While the coverage of insurance penetration is very low in comparison to other financial services in Nepal, there have been some signs of significant growth in recent years. Number of policy holders in both life and non-life sectors grew by 20.84 percent in 2014-15 beating previous figure of 17.26 percent in 2013-14. Significant growth have been seed in individual sectors too. The number of life insurance policy holders went up by 21.31 percent in 2014-15 to reach 4.5 million from 3.7 million in 2013-14.

Similarly, non-life insurance coverage grew by 18.9 percent totaling to 1.1 million in 2014-15, surpassing last year's growth of 13.2 percent. Significant growth in non-life policy issuance coverage can be mainly attributed to the devastating earthquake. Policy issuance in non-life as well as life insurance sector is expected to register healthy growth rate in subsequent periods due to the devastating effects of earthquake.

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



Source: Beema Samiti (Insurance Board)

Employees Provident Fund (EPF)

According to unaudited figures of mid-July 2015, Employee Provident Fund (EPF) has provident fund amounting to Rs.189.7 billion, while total assets/liabilities of EPF stood at Rs.195.9 billion. The funds at EPF grew by 116 percent during last fiscal year. The savings (funds) in EPF shares 10.6 percent of total deposits of NRB regulated BFIs. Similarly, it has reserve worth of Rs.4.9 billion.

As of mid-July 2015, loan and investment portfolio of EPF comprised of share investment, project loans, lending to contributors, fixed deposits at financial institutions and government bonds and debentures. Within these, contributors lending accounts to 54.5 percentage of total and fixed deposits ranked second with 18.9 percentage share in the portfolio. The fund has been utilizing almost its total fund with loan and investment to total fund ratio at 96 percent and maintaining cash and bank balance of Rs.5 billion.

Table 4.6: Key Indicators of EPF Mid- July, 2015

Indicators	Amount (Million Rs.)
Sources of Fund	**195,903**
Provident Fund	189698
General Reserve and Funds	3993
Liabilities	842
Provisions	1370
Uses of Fund	**195903**
Cash and bank	5518
Bonds and Debentures	15110
Fixed Deposits	37020
Share Investments	2229
Project Loan	26209
Lending to Contributors	106747
Investment in Fixed Assets	790
Fixed Assets	300
Assets under construction	2.5
Miscellaneous Assets	1978
Loan and Investment to Total Fund Ratio	**96%**
Loan and Investment to Provident Fund Ratio	**99.2%**
Liquidity Ratio (Cash and bank to Total Fund)	**2.82%**

Source: Karmachari Sanchay Kosh (Employee Provident Fund)

Citizen Investment Trust (CIT)

Citizen Investment Trust (CIT) is another institutional fund mobilizer with mentionable market share. As of mid-July 2015, net fund collections of CIT stood at Rs.67.2 billion, recording a growth of 30.2 percent from the figures of Rs.51.6 billion in mid-July 2014. Apart from its capital of Rs.450 million, regular contributions from members are the only and major source of fund for CIT. Investments of the Trust, which are diversified in five broad categories, stood at Rs.59.1 billion.

CIT has been heavily dependent on BFIs for its fund mobilization. Out of total funds, 37.7 percent has been put on BFIs and fixed deposits, while the fixed deposit accounts 42.9 percent of total investment of CIT. Considering the nature of the funds, which have longer term prospect, it can be utilized for long term projects with high return.

Table 4.7: Key Figures of CIT Mid- July, 2015

Indicators	Figures (millions)
Share Capital (Rs.)	450
Net Fund Balance (Rs.)	67,225
Investment (Rs.)	59,097
Government Bond (Rs.)	2,592
Fixed Deposit (Rs.)	25,340
Term Loan (Rs.)	8,404
Investment in Shares (Rs.)	3,791
Home Loan and Landings to Participant (Rs.)	8,970
Fund to Investment Ratio	87.90%
Average Return on Investment (percent)	0.3

Source: Nagarik Lagaani Kosh (Citizen Investment Trust)

CHAPTER - FIVE

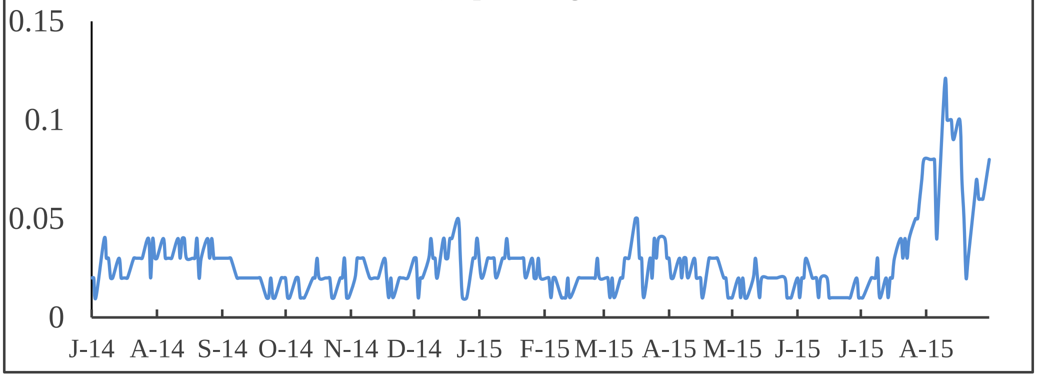
FINANCIAL MARKETS

Global Financial and Money Market Perspectives

3-month US Government Treasuries

The yields on 3-months US treasuries did not see much changes in the yield curves until the markets scented a hint about normalization of US monetary policy. The idea that the Fed may pass on an interest rate hike in September meeting helped to push the higher in the end of October. Subsequently, investors sold low-yielding government treasuries in favor of other investment opportunities that offer higher return after rate hike, which in turn, have positive impact of treasury yields.

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



Source: Federal Reserve Bank, USA

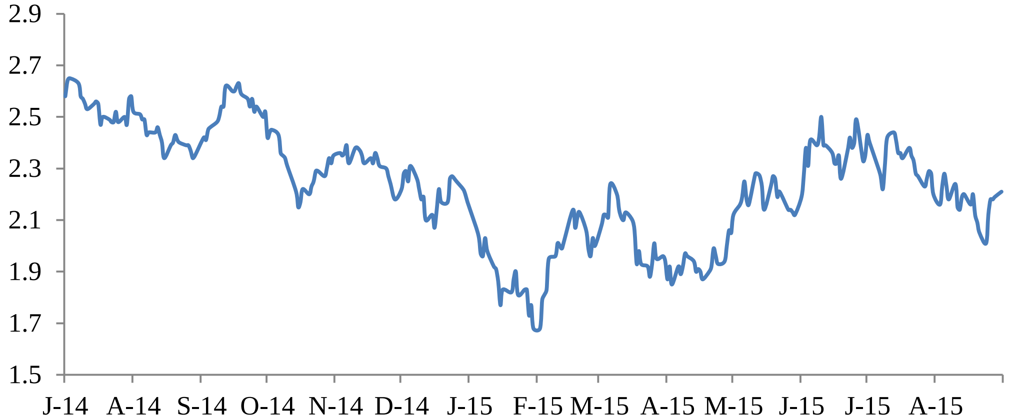
The sentiment for an increase in federal fund rates have been at high level owing to healthy economic data since the begging of the year. But despite those healthy indicators, interest rates are at emergency levels. Between September 2007 and December 2008 the benchmark Federal Funds rates fell from 5.25% to between zero and 0.25% in an effort to stave off recession. Economists argue it is high time rates started to head higher, to prevent excessive consumer borrowing and prevent bubbles emerging in the housing market and other types of assets. However, there is some concern over companies that have borrowed too much. Rising interest rates could make it more expensive or impossible for them to refinance their debts.

10-Year US Government Bond

The yield on the 10-year U.S. government debt fell below the 2% mark in August. However, it managed to rise after falling below five-month low in mid-August. The decline was due to fresh signs of tepid consumer spending and boosted demand for haven assets like treasuries in the context of low inflation.

Similarly, the market perception that the Federal Reserve may need to wait until 2016 to start raising interest rates also weighed high on long-term government bonds. Higher interest rates from the central bank make newly issued bonds more attractive and shrink the value of outstanding bonds. Investors expecting the Fed to remain patient in shifting into a tightening policy scooped up Treasury bonds, which offer higher yields compared with sovereign debt sold by Germany, Japan, the U.K., France and Switzerland in a low-yield world.

Figure 5.2: Daily US TreausaryYield Curve Rates of 10-Year t-bill (in percenage)



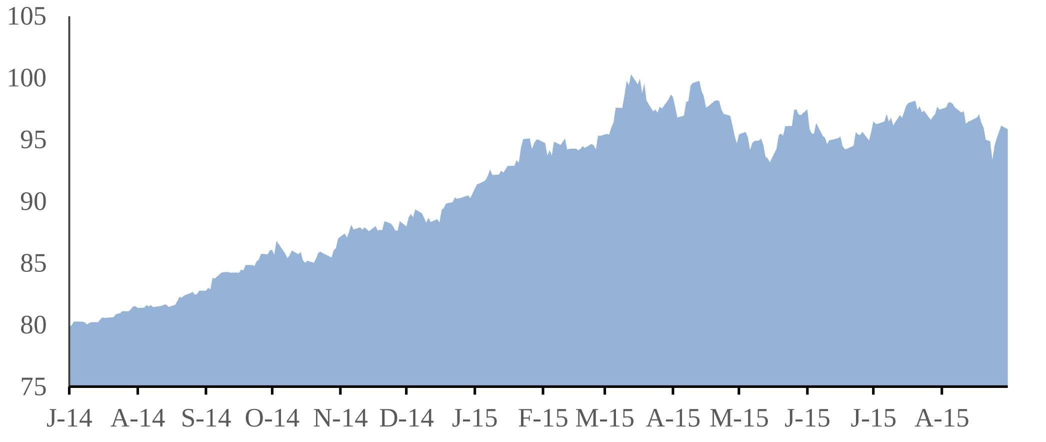
Source: Federal Reserve Bank, USA

The 10-year Treasury yield has dropped from eight-month peak of 2.5% reached in June as worries over the global economy boosted the appeal of preserving capital in highly liquid U.S. government debt instruments. Among the key worries have been the economic slowdown in China, the world's second-largest economy, and its global ramifications.

Dollar Index

The US dollar has been rising since final quarter of 2014 in anticipation of higher interest rates. By nature, currency markets are extremely sensitive to moves in interest rates. Dollar has seen an unprecedented strength against a basket of other currencies in recent month amid near-stagnant Eurozone economy and expectation of Federal Reserve rate increment have been stimulating the value of the greenback.

Figure 5.3: Movement of Daily Dollar Index



Source: investing.com

During the period of July 2014 to August 2015, the index surged to 100.38 in March before settling at 98.85 at the end of August. During the course, the index rose by 20 percent from the level of 79.84 at the beginning of July 2014.

An era of rising US interest rates, which is likely to happen in near future, is expected to strengthen the dollar in future. That could cause pain for companies and countries that have raised debt in dollars. If they earn much of their income in a local currency, then servicing a debt in dollars will become more expensive as the dollar rises. Economists are not sure how much further the dollar will strengthen and much depends on the Fed's actions over the coming months.

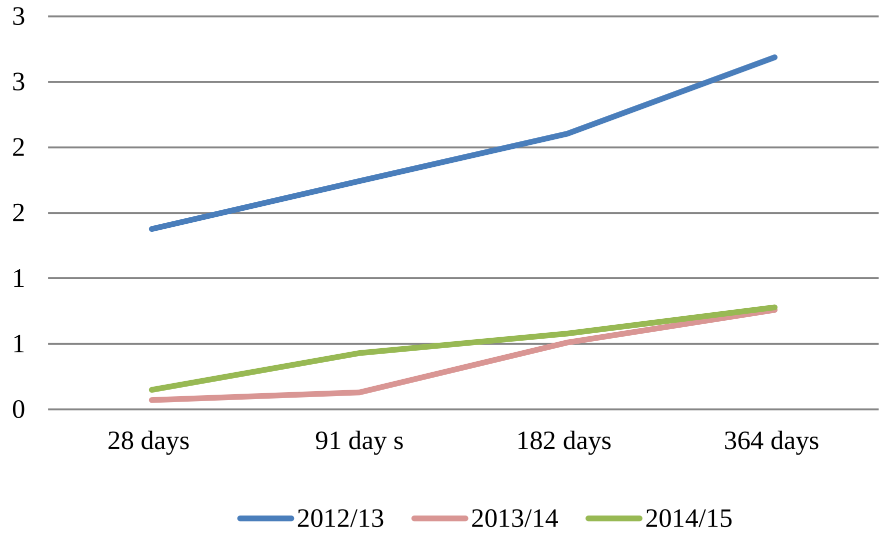
The effects of the stronger dollar can already be seen in the earnings reports of US companies. Many have blamed weaker profits on the strength of the dollar, which erodes the value of sales made overseas. It also makes their exports less competitive on the international markets.

Domestic Financial Market

Money Market

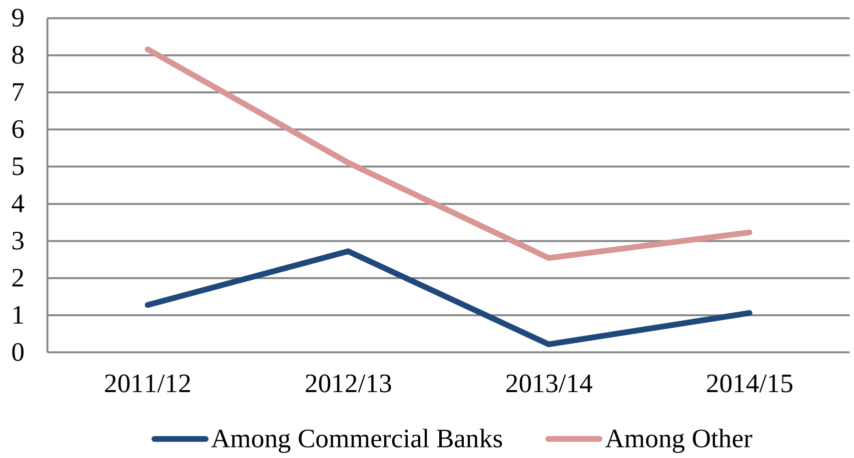
Short term and long term interest rates in the financial market remained relatively higher in FY 2014/15. Both the weighted average of 91-day Treasury Bill rate and inter-bank transaction rates increased in the last month of 2014/15 compared to a year ago. The weighted average 91-day Treasury Bill rate increased to 0.1739 percent in the review month from 0.02 percent a year ago. The weighted average inter-bank transaction rate among commercial banks that was 0.16 percent a year ago reached 1.01 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions increased to 3.89 percent from 2.40 percent a year ago.

Figure 5.4: Weighted Average Treasury Bill Rate (in percent)



Weighted average interest rate spread of commercial banks decelerated to 4.6 percent in the review period from 5.2 percent a year ago and the average base rate came down to 7.8 percent from 8.3 percent a year ago.

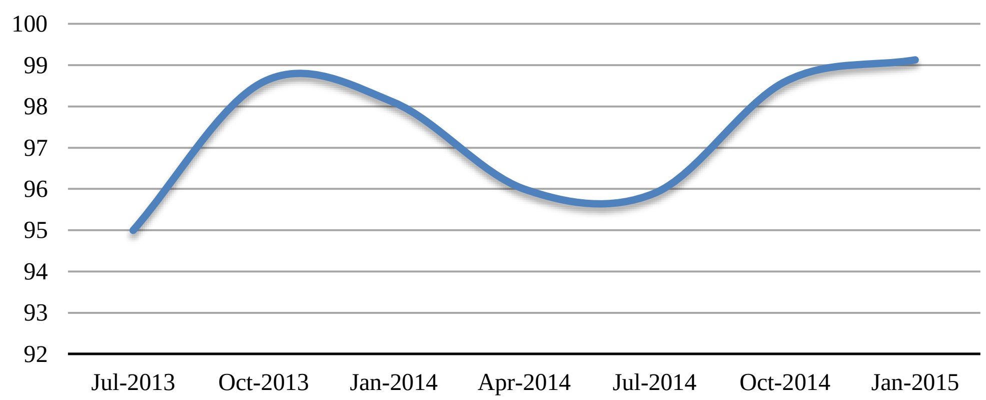
Figure 5.5: Weighted Average Inter-bank Rate



Dollar-Rupee Exchange Rate

Nepalese currency depreciated by 5.2 percent against US dollar during end of 2014/15 compared to a depreciation by 1.1 percent in the same period of the previous year. The depreciation of Nepalese rupee against US dollar accounted for improving export competitiveness as well as stimulated remittance inflows. It increased the foreign debt liability of the government also. The exchange rate of one US dollar stood at Rs.101.1 in mid-July 2015 compared to Rs.95.9 in mid-July 2014.

Figure 5.6 : Movement of Nominal Exchange Rate (NRs/US$)

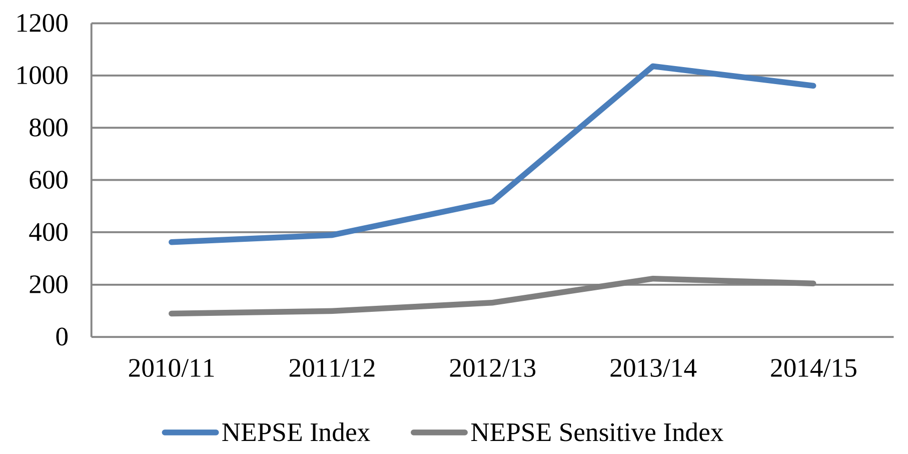


Securities Market

The NEPSE index decreased by 7.2 percent to 961.2 points in mid-July 2015 on y-o-y basis. This was particularly due to the devastating earthquake that struck on April 23rd. This index had increased by 99.9 percent to 1036.1 points a year ago. The NEPSE sensitive index stood at 204.7 point in mid-July 2015, as against 222.5 in mid-July 2014.

The y-o-y stock market capitalization decreased by 6.4 percent to Rs. 989.40 billion in mid-July 2015. The ratio of market capitalization-to-GDP stood at 46.6 percent in mid-July 2015 compared to 54.4 percent a year ago. Of the total market capitalization as of mid-July 2015, the share of banks and financial institutions (including insurance companies) stood at 77.7 percent. Hydropower, manufacturing and processing companies, hotels, trading and others recorded a share of 7.0 percent, 3.0 percent, 2.5 percent, 0.1 percent and 9.6 percent respectively.

Figure 5.7: NEPSE and Sensitive Index



The total number of companies listed at the NEPSE decreased from 237 in mid-July 2014 to 232 in mid-July 2015. Merger of some banks and financial institutions during this period resulted in a decline in the number of listed companies. Of the total listed companies, the number of banks and financial institutions (including insurance companies) stood at 198 followed by production and processing industries (18), hotels (4), business entities (4), hydropower (6) and other companies (2).

CHAPTER - SIX

FINANCIAL SECTOR POLICIES AND INFRASTRUCTURES

Financial Sector Policies

Capital Enhancement of BFIs

Nepal Rastra Bank raised the level of minimum paid up capital for licensed A, B and C class Financial Institutions. The new provision of paid up capital requires BFIs to increase their capital at least by four-fold from existing level within the two-year period ending mid-July 2017. The new capital requirement of the central bank aims to strengthen financial soundness of BFIs there by establishing highly capitalized bank with wider capital base to absorb external shocks. Similarly, it also helps avail adequate financial resources for mega projects to support economic growth.

Table 6.1: New Capital Framework for A, B, and C Class institution (in Rs.)

Class/ Level	National		4-10 districts		1-3 districts	
	Old	New	Old	New	Old	New
A	2bn	8bn	-	-	-	-
B	640mn	2.5bn	200-300mn	1.2bn	100-300mn	500mn
C	200 - 300mn	800mn	-	800mn	100-300mn	400mn

According to the estimation of NRB, commercial banks need to raise additional capital of Rs.143 billion to meet the new capital requirement by mid-July 2017, if they don't opt to be reduced by mergers and acquisition. However, only 12 banks can be operated within the existing paid-up capital arrangements under new regulation.

Perceived implication of Capital increment

Capital increment is expected to provide additional credit creation capacity to the BFIs through infused capital. Similarly, BFIs have enough strength to withstand internal threats such as credit loose due to bad loans as well as domestic and international economic meltdown. In addition, it will help to promote financial stability.

However, there are surmounting challenges to the BFIs to meet the new capital requirements. The most formidable is to persuade investor to inject extra capital for minimal return compared to the previous years. Considering the current year's GDP growth projection, it will be challenging for BFIs to accumulate returns according to the increased capital. In addition, there would be challenges for the central bank to regulate the possible credit expansion in unproductive sectors and haphazard lending to boost the profitability.

Financial Sector Regulations

Regulation to promote agriculture sector

Nepal Rastra bank issued a circular to promote credit in agriculture sector. The circular comprehends government strategy to promote agriculture as a business among youth. In order to attract rural youths towards agriculture, the government in its budget had announced a subsidy of four percent on interests charged by BFIs for agriculture credit. NRB issued working procedure for agricultural credits which was prepared by Ministry of Finance and endorsed by cabinet.

According to the working procedure, an individual can avail the facility on loans up to Rs10 million from BFIs. The working procedure has identified 12 priority areas eligible for the facilities. The areas include vegetable production, processing and storage; seed production, processing and storage; floriculture; livestock; fruits production, processing and storage; and dairy production, processing and sales. Fishery, production and sales; mushroom production, processing and storage; animal slaughter house and meat business; herbal production, processing and storage; sugarcane, cardamom and ginger farming, storage and processing and agriculture businesses.

The interest subsidy facility can be availed only in investment made in areas outside the Kathmandu metropolitan city and other sub-metropolitan cities. The procedure has restricted BFIs to charge more than 6 percent as interest from the borrowers. However, they can charge for insurance premium and credit information as other services charges. The BFIs would receive subsidized interest payment from government while the remaining will be paid by borrower themselves. The repayment period for such loans will range from a minimum of three months to a maximum of five years. Maximum lending limit for any BFIs has been set at one billion rupees for BFIs but that can be extended with NRB's approval.

Additional Provisions Regarding Possible Loan Losses

In a bid to increase resilience in licensed financial institutions, NRB has added a layer to its prevailing credit classifications. It issued directive on maintaining “watch list” of loans. Furthermore, BFIs are required to make extra provisioning for loans under watch list. BFIs have to make provisioning of 1.5 percent in mid-April and 2 percent in mid-July 2015, and increase the provisioning by 50 basis points in every quarter until mid-January 2017 to increase the provisioning up to five percent for such loans after mid-January 2017.

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

BOX 6.1: Provisions for Classification of Loans/Advances

And Loan Losses

Entire loans and advances extended by a licensed institution have to be classified as follows based on aging of the overdue of the principal and interest of such loans/advances:

Classification of Loans/ Advances

Pass Loans: Loans/advances which have not overdue and which are overdue by a period up to three months. Such loans require provisioning of one per cent of the total loan amount.

Watch list Loans: If the borrower's cash flow cannot support the repayments of the loan, then the loan acquired by the firm should be classified as 'watch list'. Also, loans acquired by firms whose working capital, cash flow or net worth have remained negative for two consecutive years have to be classified as 'watch list', even if the firm is making timely principal and interest payments. In addition, Loans should also be categorized as 'watch list' if the credit obtained by the same borrower from another financial institution turns into non-performing asset. Among others, credit obtained by borrowers, who have missed monthly, quarterly or half-yearly installment payment deadlines, should also be categorized as 'watch list', adds the directive. Five per cent of the total loan amount must be provisioned for such credit.

Sub-standard: Loans/advances which are overdue by a period from three months to a maximum period of six months. Such loans require provisioning of 25 per cent of the total loan amount.

Doubtful: Loans/advances which are overdue by a period from six-months to a maximum period of one year. Such loans require provisioning of 50 percent.

Loss: Loans/advances which are overdue by a period of more than one year. Such loans require provisioning of 100 percent.

Additional Regulations on Corporate governance

Most of the problems that the Nepalese banking industry has been witnessing so far are related to the governance. Furthermore, most of the financial institutions which are being declared problematic were mainly due to the lack of good governance and flaws in ethical standards. Insider lending, related party lending and connectivity, unethical relations etc. have created most of the problems rather than credit risks and the business risks. NRB has always encouraged banks to have a professional board with high moral and ethical background and expects the board to retain the oversight of the operations and risk management of the bank[2]. Additional regulations made on the governance sector of the BFIs are as follows:-

i) *Chief executive officers and directors cannot serve the organization for more than two consecutive terms:* NRB issued directives for BFIs which prohibits directors and chief executive officers from serving more than two consecutive terms. The central bank is mulling adopting a provision, under which the existing terms of the BFI executives will be considered first. The policy was introduced as an attempt to 'ensure corporate governance in the BFIs, as corporate governance has been found weak among BFIs where a single person remained in the post of chairman, director, CEO, and managing director for a long time.

ii) *Credit to managerial level:* NRB bars BFIs from extending loans to firms, companies or institutions where CEO or higher level manager of other BFIs holds more than fifty percent of shares in order to ensure corporate governance in BFIs.

iii) *Limit on Equity of CEO and other staff:* NRB has also barred an individual, holding shares worth one percent of the paid-up capital of commercial banks and two percent of the paid-up capital of development banks, from assuming any post in that bank. Such ceiling for finance companies and microfinance financial institutions is 5 percent of paid up capital. These measures will help maintaining corporate discipline in the banking industry.

[2] For details see: Directive No. 6 of Unified Directive, 2015. http://www.nrb.org.np/bfr/directives/Directives--Unified%20Directives%202072-new.pdf

BOX: 6.2: BCBS Principles for enhancing corporate governance

BCBS published a consultative document in October 2014, which revised the Committee's 2010 document *Principles for enhancing corporate governance*. The committee's revised principles provide a framework within which supervisors and banks operate to achieve strong and transparent risk management. The revised principles are:

- Strengthen the guidance on risk governance; including the risk management roles played by business units, risk management teams, and internal audit and control functions (the three lines of defense) and the importance of a sound risk culture to drive risk management within a bank.
- Expand the guidance on the role of the board of directors in overseeing the implementation of effective risk management systems.
- Emphasize the importance of the board's collective competence as well as the obligation on individual board members to dedicate sufficient time to their mandates and to remain current on developments in banking.
- Provide guidance for bank supervisors in evaluating the processes used by banks to select board members and senior management, and
- Recognize that compensation systems form a key component of the governance and incentive structure through which the board and senior management of a bank convey acceptable risk-taking behavior and reinforce the bank's operating and risk culture.

iv) Prohibition on classification of promoter shareholders of BFIs

NRB had issued circular where BFIs need to end classification of promoter shareholders of BFIs, requiring them to end the provision under which a shareholder gets elected to the BoD from the same group. However, it has allowed banks and financial institutions (BFIs) with institutional and foreign investment to fix the number of their board members in proportion to their holdings. This means though there will be no separate groups, BFIs with foreign and institutional investors can ensure proportional representation in their respective boards. BFIs will have to scrap provisions related to classification of shareholders amending their Memorandum of Association or Article of Association through their upcoming annual general meetings according to the circular. Ending classification of promoter shares was intended to ensure corporate governance in the BFIs as some promoters remain in the bank´s board of directors for a long period of time by getting elected from his/her class of shareholders where shareholders of other classes are not allowed to cast their vote.

v) *NRB prohibits to keep the post of CEO and other top management to vacant for more than three months*

NRB made mandatory for BFIs to appoint a chief executive officer (CEO) within three months of the post being vacant. Likewise, BFIs should also fill all other managerial position allocated by them within three months and should mention this provision in their staff service bylaw.

Regulations on Anti-Money Laundering (AML)/Combating the Financing of Terrorism (CFT)

i) AML CFT Regulation and Supervision

NRB has issued directives[3] on "Anti Money Laundering and Combating Financial Terrorism" to licensed BFIs utilizing the prerogative power conferred by section 7 (o) & 7 (p) and section 79 of the Nepal Rastra Bank Act, 2002. This directive has mandated BFIs to comply with policies on AML/CFT wherein BFIs are required to carry Risk based Customer due Diligence (CDD), enhanced customer Due Diligence (ECDD) for high risk customer and Simplified Customer Due Diligence for low risk customer. NRB conducts both on-site and offsite AML/CFT supervision. NRB to assess the adequacy of policies and internal controls of BFIs for deterring, detecting and reporting suspected money laundering and terrorist financing activities developed and published "AML/CFT Questionnaire for Banks and Financial Institutions". Financial Intelligence Unit of Nepal is a central, national agency responsible for receiving, processing, analyzing and disseminating financial information and intelligence on suspected money laundering and terrorist financing activities to the Investigation Department and other relevant law enforcement agencies and foreign FIUs. BFIs and other entities are required to report their STR and TTR on to FIU as per Section 7S of ALPA (Second Amendment), 2008.

[3] Directive No. 19 in Unified Directive 2013, http://bfr.nrb.org.np/directives/Directives--Unified%20Directives%202071-NEW.pdf

ii) *National Risk Assessment*

The National Risk Assessment (NRA) is an assessment of the country's exposure to prevailing crimes (domestic and foreign) and vulnerabilities of various sectors to money laundering and terrorism financing risks. It is an initiative undertaken under the ambit of the National Coordination Committee to Counter Money Laundering (NCC). The assessment is based on sources such as statistics and reports from various agencies, surveys conducted among law enforcement agencies and reporting institutions and credible external report.

World Bank has attached high importance to money laundering and terrorist financing risk assessment from the early years of the recognition of risk based approach in AML/CFT area and has actively helped client countries to assess these risks. In doing so, the World Bank developed two national risk assessment tools (First Generation and Second Generation National Risk Assessment tools) as well as national risk assessment process, with a view to facilitate the risk assessment even in the countries where the data and statistics are limited. The World Bank tools are essentially, although not limited to, self-assessment tools in order to help the countries develop their capacity to collect and analyze the useful data, statistics and information and introduce a risk based approach.

The first generation NRA tool utilizes a matrix approach in assessing the ML and TF risks. The risk assessment template focuses on the assessment of threat and vulnerabilities as the main components of the ML/TF risk. SIP NRA Template is an Excel file with 5 assessment areas (ML Prevailing Crime Type/TF Threat Analysis, Legal/Judicial/Institutional Framework, Economic and Geographical Environment, Financial Institutions and DNFBPs), accompanied by summary findings. Each of the assessment areas contains carefully selected indicators to assess threats and vulnerabilities.

The Second Generation NRA Tool has been developed by the World Bank with a view to enable more rigorous and sophisticated risk assessment. This NRA tool was modeled on the Bayesian Network which utilizes the laws of probability at its core of the modeling and analyses the sources and causes of risk. Strong logical sequence of events and causal relations between variables affecting risk is carefully modeled. This enables capturing main drivers of the money laundering risk, formularizing the complex environment of money laundering taking into account the interactions among various components of risk and vulnerability and generating a final measure of the risk/vulnerability level. In order to make the tool user friendly and easily accessible, this Second Generation tool has been remodeled based on excel and using weighted averages instead of probabilities, while keeping the logic and concept of ML risk assessment built from the initial Bayesian Network approach.

iii) National Risk Assessment and Nepal

The key aim of the NRA is to help authorities maintain an effective risk-based regime to combat money laundering and terrorism financing, as well as to prioritize and allocate public sector resources efficiently. The NRA is also meant to help private sector stakeholders to better understand the money laundering and terrorism financing risks in their own and related industries, assess the adequacy of their controls, and strengthen them where necessary. The public will also benefit from greater awareness of the money laundering and terrorism financing risks in Singapore and the measures in place to mitigate them

Recommendation 1 of revised FATF introduced in February 2012, requires all jurisdictions to assess their ML/TF risks and use the risk assessment results for effective implementation of AML/CFT measures to help mitigate the identified risks. The World Bank has developed a tool that countries can use to conduct this risk assessment. The Nepal NRA was launched during the Initial NRA Workshop that was held in Kathmandu from July 8-10, 2013.

There are eight sub-groups working on different modules, namely: proceeds of crime; national vulnerability; banking sector; securities sector; insurance sector; other financial institutions; non-financial businesses such as real estate, lawyers and others; and financial inclusion products. The authorities involved in coming up with this report include:

- Ministry of Finance
- Ministry of Law and Justice and Parliamentary Affairs
- Ministry of Home Affairs
- Ministry of Tourism and Civil Aviation
- Special Court
- Judgment Enforcement Directorate
- Office of the Attorney General
- Commission for the Investigation of Abuse of Authority

- Department of Money Laundering Investigation
- Financial Intelligence Unit
- Department of Revenue Investigation
- Department of Customs
- Department of Commerce
- Department of Land Reform and Management
- Department of Cooperatives
- National Investigation Department
- Nepal Police
- Armed Police Force
- Nepal Rastra Bank
- Securities Board of Nepal
- Insurance Board
- Social Welfare Council
- Nepal Bar Council
- Institute of Chartered Accountants of Nepal

The NRA work remains to be done by all the sub-groups in completing the assessment to incorporate the comments provided by the World Bank. The major objectives of the NRA were:

a) Identifying the level of proceeds of crime generated in or coming into Nepal and the threat posed by terrorist financing (TF);
b) Determining the vulnerabilities of financial sectors as well as designated non-financial and business professions (DNFBPs) to ML and TF;
c) Identifying the gaps in the existing legal framework, by considering the criminal and administrative justice system, and existing preventative systems;
d) Analyzing the adequacy of powers, resources and skills available with the agencies tasked with the anti-money laundering and combating the financing of terrorism (AML/CFT) responsibilities, including the Financial Intelligence Unit (FIU), the Department of Money Laundering Investigation regulators, courts and prosecution authority;
e) Analyzing the existing ML typologies; and
f) Determining the best manner to allocate resources for the prevention, investigation and prosecution of ML and TF.

NFRS Implementation Guidelines to BFIs

In line with the recommendation of Accounting Standards Board (ASB), the Institute of Chartered Accountants of Nepal (ICAN) in its Council meeting held on 13 September 2013 decided to announce the roadmap for implementation of Nepal Financial Reporting Standards (NFRS) including its interpretations. As per the said announcement, Commercial Banks, including State Owned Commercial Banks (Class 'A') are required to fully implement NFRS from 2015- 16. All the other financial institutions (Class 'B', 'C' and 'D') are mandated to implement NFRS from 2016-17 onwards.[4]

The Monetary policy of 2014-15 announced implementation of NFRS in financial sector by 2017. Furthermore, NRB on dated December 14, 2014 issued "NFRS Migration Guidelines to Banks & Financial Institutions". NRB hereby states that all Class 'A' Banks and Class 'B', 'C' and 'D' financial institutions are required to comply with NFRS migration guidelines as issued by ICAN subject to NRB regulation. As announced by ICAN, fully NFRS compliant financial statements is to be prepared by 2016-17 for Class 'A' Banks and from 2016-17 for Class 'B', 'C' and 'D' financial institutions.

Financial Market Infrastructure

Payment and Settlement

The Principles for Financial Market Infrastructures (PFMI) released by the Bank for International Settlements (BIS) and the IOSCO has been widely acknowledged. Nepal has been making efforts to align its regulatory framework in accordance with the global standards. Nepal National Payment System covers all the pillars of a comprehensive payments system strategy, and is in the process of being adopted by the NRB (Box: 6.2). NRB in its National Payment Development Strategy has listed following broad objectives:-

- To provide effective mechanisms for the exchange of money between transacting parties;
- To enable the management, reduction and containment of systemic and other payments system-related risks; and
- To promote systems that effectively contributes to the country's financial stability, economic growth and financial inclusion.

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[4] See details at : http://www.ican.org.np/nfrs.php

Box 6.3: Nine Strategic pillars of Nepal National Payment Development Strategy

Pillar I: Legal Framework. Payment systems in Nepal work in a sound and robust legal environment.

Pillar II: Settlement mechanisms for Large-Value and Time-Critical Payments in Nepal are safe and efficient and comply fully with the *Principles for Financial Market Infrastructures*

Pillar III: Retail Payment Systems in Nepal are efficient, sound and interoperable and support a wide range of payment instrument and services

Pillar IV: Government Transactions. Government collection and disbursement are fully and efficiently integrated with the National Payments system in Nepal

Pillar V: Securities Depository, Clearing and Settlement. Securities Depository, Clearing and Settlement are safe and efficient, fully comply with international standards, and support the development of capital markets.

Pillar VI: Money Markets. Interbank money markets are fully developed and closely integrated with settlement systems

Pillar VII: International Remittances. International remittances and other cross-border payments are distributed rapidly and conveniently in Nepal, and are cost efficient from the perspective of end users

Pillar VII: International Remittances. International remittances and other cross-border payments are distributed rapidly and conveniently in Nepal, and are cost efficient from the perspective of end users

Pillar IX: Co-operation. Effective, structured and fruitful co-operation is in place within the NPS.

Establishment of Payment and Settlement Department

A number of initiatives have been taken for creating an enabling environment for furthering the reach and use of safe and efficient payment systems. Nepal Rastra Bank (NRB) has explicitly stated policy goals of payment services in NRB Act 2002, article 4. wherein one of the major objectives of NRB is to develop a secure, healthy and efficient system of payment. In addition, NRB in its 2nd Strategic Plan 2012-2016, it has stated “Payment System & Mechanism” as 4th strategic pillar which has the sole focus to enhance and strengthen the national payment and settlement system.

NRB has set up the Payment and Settlement Department headed by Executive Director which has the responsibility for development of Payment and Settlement Systems (PSS). Furthermore, as stated in the 9th pillar of Nepal National Payment Development Strategy the NRB will form National Payments Council (NPC), which will play the role of a permanent body for a high-level co-operation among market participants, between regulators and market participants for the development of a sound and efficient payments system. The major stakeholders of PSS are Banks and Financial Institutions, Nepal Stock Exchange, Central Depository System, Security Exchange Board of Nepal, commodity market, government, Nepal Clearing House Limited, Telecommunications, etc.

NRB is in process to implement RTGS which will help for settling large value interbank transfers, bulk payment clearing operations, securities transactions, etc.in real time basis. To develop retail payment system in the country, NRB will form and lead retail Payments Working Group with membership drawn from all parties involved in retail payment system and this group will develop a strategy and action plan in this regard.

Electronic banking is the automated delivery of new and traditional banking products and services directly to customers through electronic, interactive communication channels. It provides customers convenient access to banking facilities from the comfort of their home or office. Electronic banking includes systems that enable customers to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the Internet. Electronic banking can help the standardization of banking products and lead to substantial reduction in costs. Enhancing efficiency of banking services is a major objective of electronic banking by creating opportunities for penetrating new markets, and expanding banking across borders. Electronic banking increases transparency and competition in services but also increases risks.

Recent developments in cash and non-cash payment are stated as follows, almost of which are interoperable between FIs, customers, and merchant and other payment processors:

- Banks are taking various initiatives for retail electronic payments in the spheres of internet/ mobile banking, cross-border inward remittances and cards. The initiatives pertain to creation of networks of clusters of banks for card-based payment services (ATM and EFTPOS through SCT and two other providers), different product offerings in mobile banking (e.g. Hello Paisa) and remittance products.

- Mobile payment services have started to be offered through agreements between mobile network operators and BFIs. Some of the popular and innovative mobile payments services are MNepal, E-sewa, Fonepay etc.
- NRB has issued directive to BFIs to issue MICR encoded cheques.
- SWIFT are used for all interbank payments.
- POS and POT machines are also gaining popularity in the medium of payment.

Implementation of MICR

Magnetic Ink Character Recognition (MICR) is a component of Cheque Truncation, an online image-based clearing system that discourages the flow of physical cheques from one branch to the other for clearance. The system automatically reads data like bank code, branch code, bank number and account number after scanning them. The system can automatically read the figures and amounts only if any specific bank adds that feature. NRB has directed all A, B, and C class financial institutions to issue machine-readable cheque books encoded with MICR, a system that enables banks to reduce operational errors and provide faster service, to all their account holders. This provision will fasten the processing time by reducing the chances of wrong data entry. The system will mainly help reduce risk and operational errors through automation. MICR makes it possible to have cheques deposited on the same day of request, unlike in case of non-MICR cheques that often take several days. The central bank has also mentioned that non-MICR cheques, that any customer might have, will be valid only until mid-April, 2015 — around six months after the October 18th deadline. It has asked all the banks and financial institutions to inform their customers that non-MICR cheques will be invalid after the stated period.

Monetary Policy 2015/16

The monetary policy for 2015/16 is directed at maintaining macroeconomic stability and supporting the revival of the earthquake devastated economy. The monetary policy stance is designed considering the effect of possible excess demand on price, external and financial sector stability arising from reconstruction driven private investment and the implementation of fiscal policy. The situation warrants that accommodative monetary policy will have difficulty in attaining its primary objectives and the tighter one will not be able to contribute to reconstruction and growth. Thus, the monetary policy takes cautious and balanced stance.

The price situation has improved compared to the previous years. This is attributed to the decline in the price of the petroleum products, improvement in the neighboring country's price level, and the efforts of this bank to keep the monetary aggregates at the desired level. However, there is a challenge in containing inflation due to the likely pressure on aggregate demand and other supply side constraints. Therefore, monetary policy will focus on maintaining monetary aggregates at a desired level to arrest the inflationary pressure arising from the demand side.

The external sector remained robust for the last couple of years mainly due to the significant inflow of remittance. However, there is a possibility of further widening trade deficit due to higher imports for reconstruction works more specifically on the earthquake affected areas.

Stabilizing interest rate has been a challenging task due to volatility in the inflow of remittance as well as weak monetary transmission. In order to support economic growth by encouraging saving mobilization and credit expansion, the interest rate should be maintained at an appropriate level. Therefore, the monetary policy is oriented towards maintaining interest rate stability by effectively utilizing appropriate monetary instruments.

Excess liquidity, lower interest rate and interest rate differential with the neighboring economy are some challenges facing the economy. If this situation prevails for long, there is a risk of informal capital flight, dominance of imports along with luxurious consumption and increasing speculative businesses. Considering the likely impact of such situation on financial stability, monetary policy will focus on managing liquidity and interest rate at appropriate level and channeling the financial resources towards productive sector.

In the context of lower level of financial inclusion, limited access to financial services, and low level of financial literacy among the general public in remote rural and high poverty areas; utmost priority will be given to address these concerns

Though the economic growth contracted due to the earthquake effects, the price, financial sector and the external sector situation remained satisfactory in 2014/15. The existing excess liquidity in the banking sector has not only posed the challenge, but also offers opportunities by availing resources required for economic resurrection and investment expansion. Thus, the monetary policy instruments are chosen by considering both opportunities and challenges of expected economic expansion.

Despite the significant mop-up drive through open market operations, the liquidity remained higher than expected in 2014/15. Considering the adverse effects from prevailing excess liquidity and higher demand arising from post-disaster reconstruction efforts, the existing provision of mandatory cash reserve ratio of 6 percent for "A" class, 5 percent for "B" class and 4 percent for "C " class, is kept unchanged.

The bank rate, the policy rate for the purpose of the lender of last resort as well as for the discount of securities, is reduced by 1 percentage point to 7 percent. This is in consideration of the monetary policy stance adopted to achieve the specified objectives and the special situation of the country in the aftermath of the earthquake. In addition, the provision of providing SLF at the bank rate is continued.

BFIs will be required to increase the minimum paid up capital in order to promote the financial stability and mobilize the resources needed for the long-term development. Commercial banks will be required to increase paid-up capital to Rs.8 billion, national level development banks Rs.2.5 billion, development banks operating in 4 to 10 districts Rs.1.20 billion and the development banks operating in 1 to 3 districts Rs.0.50 billion. Similarly, national level finance companies and finance companies operating in 4 to 10 districts will require Rs.0.80 billion paid-up capital and those operating in 1 to 3 districts Rs.0.40 billion paid up capital. BFIs are required to meet this provision by mid-July 2017. In addition, BFIs will be further encouraged for merger and acquisition.

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

(In million Rupees)

Financial Institutions	**Mid-July 2011**	**Mid-July 2012**	**Mid-July 2013**	**Mid-July 2014**	**Mid-July 2015**
Nepal Rastra Bank	319,692.60	455,826.50	534,897.90	655,280.60	726,499.60
Commercial Banks	853,490.70	1,052,450.70	1,242,881.40	1,467,151.90	1,774,504.80
Development Banks	129,617.40	160,360.20	199,954.80	255,373.40	300,641.80
Finance Companies	118,578.20	109,687.50	100,856.70	110,342.30	108,007.40
MFFIs	20,862.90	29,815.50	35,774.90	49,395.80	70,880.40
Cooperatives (Capital and Savings)	137,520.37	166,634.86	191,614.00	233,715.55	265,551.90
Contractual Saving Institutions					
Employees Provident Fund	106,584.50	125,752.80	145,283.40	170,638.60	195,903.00
Citizen Investment Trust (Capital and Net Fund Balance)	26,905.40	38,068.50	42,753.60	54,621.30	67,675.00
Insurance Companies	61,213.40	73,825.00	84,650.40	101,097.20	124,300.00
Total	**1,651,185.70**	**2,062,975.50**	**2,409,425.40**	**2,886,881.40**	**3,633,963.90**
Market capitalization (NEPSE)	323,484.30	368,262.10	514,492.10	1,057,165.80	989,403.96
Total (incl. market capitalization)	**1,974,670.00**	**2,431,237.60**	**2,923,917.50**	**3,944,047.20**	**4,623,367.86**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Nepal Rastra Bank	19.36%	22.10%	22.20%	22.70%	19.99%
Commercial Banks	51.69%	51.02%	51.58%	50.82%	48.83%
Development Banks	7.85%	7.77%	8.30%	8.85%	8.27%
Finance Companies	7.18%	5.32%	4.19%	3.82%	2.97%
Microfinance Development Banks	1.26%	1.45%	1.48%	1.71%	1.95%
Cooperatives (Capital and Savings)	8.33%	8.08%	7.95%	8.10%	7.31%
Contractual Saving Institutions					
Employees Provident Fund	6.46%	6.10%	6.03%	5.91%	5.39%
Citizen Investment Trust (Capital and Net Fund Balance)	1.63%	1.85%	1.77%	1.89%	1.86%
Insurance Companies	3.71%	3.58%	3.51%	3.50%	3.42%
Total	100%	100%	100%	100%	100%

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

(In million Rupees)

	Particulars	Mid-July 2012	Mid-July 2013	Mid-July 2014	Mid-July 2015
LIABILITIES					
1.	**CAPITAL FUND**	**115163**	**131724.3**	**145861.4**	162992.51
	a. Paid-up Capital	104303.8	119506.9	128985.3	140794.10
	b. Statutory Reserves	22068.1	26038.2	32722.1	37149.85
	c. Retained Earning	-24321.8	-22344.2	-27214.2	-27802.05
	d. Others Reserves	13112.8	8523.4	11368.3	12850.60
2.	**BORROWINGS**	**17805.9**	**26999.3**	**18202.8**	21355.96
	a. NRB	4286.7	2884.3	2010	3291.48
	b. "A” Class Licensed Institution	3297	10466.6	5182	5504.53
	c. Foreign Banks and Fin. Ins.	2507.9	2954.3	4.1	0.00
	d. Other Financial Ins.	781.1	2438.3	1306.5	1119.81
	e. Bonds and Securities	6933.2	8255.9	9700.1	11440.14
3.	**DEPOSITS**	**1071394.1**	**1250062**	**1477832.6**	1771946.15
	a. Current	95993.1	111686.5	129108.4	158746.16
	b. Savings	400723.1	471215.4	587593.5	714466.16
	c. Fixed	372137.6	423478.4	453408.6	513283.02
	d. Call Deposits	187998.5	225704.8	285024.3	363041.66
	e. Others	14541.8	17976.8	22697.8	22409.16
4.	**Bills Payable**	**1626.4**	**1561.6**	**1553.1**	1729.91
5.	**Other Liabilities**	**123660.2**	**140770.3**	**169227.4**	188093.19
	1. Loan Loss Provision	33874	42223.8	48932.5	51482.56
	2. Interest Suspense a/c	26056.2	27920.7	30453.8	31256.97
	3. Others	63730.1	70625.8	89841.2	105353.66
6.	**Reconciliation A/c**	**1537.8**	**7290**	**2869.5**	280.36
7.	**Profit & Loss A/c**	**19776.5**	**26544.7**	**31566.8**	36755.88
TOTAL LIABILITIES		**1350964**	**1584952**	**1847114**	**2183154**

Particulars		Mid-July 2012	Mid-July 2013	Mid-July 2014	Mid-July 2015
ASSETS					
1.	LIQUID FUNDS	**236056.9**	**259224.9**	**319196.6**	353397.28
	a. Cash Balance	31020.1	35728.2	41862.1	48642.45
	Nepalese Notes & Coins	30353.3	34876.1	41073.7	47305.51
	Foreign Currency	666.8	852.1	788.3	1336.94
	b. Bank Balance	164605.2	173856.7	220546.6	237957.23
	1. Nepal Rastra Bank	120457.3	130802.8	162286.9	165070.53
	2. "A" Class Licensed Institution	26284.3	23269.1	34656.5	37838.00
	3. Other Financial Ins.	7649.8	5673.4	5302.9	6882.80
	4. In Foreign banks	10213.8	14111.4	18300.39	28165.90
	c. Money at Call	40431.6	49640.1	56788	66797.60
2.	**INVESTMENTS**	**137304.4**	**151340**	**162544.9**	206160.48
	a. Govt. Securities	133251.1	149700.8	160867.1	182112.29
	b Others	4053.3	1639.2	1677.78	24048.18
3.	**SHARE & OTHER INVESTMENT**	**52851.1**	**66725.5**	**72656.2**	85675.60
4.	**LOANS & ADVANCES**	**779560.9**	**945698.4**	**1119260.8**	1345671.32
	a. Private Sector	741145	915010	1084965.3	1230999.56
	b. Financial Institutions	31389.3	21910.2	26247.7	30678.62
	c. Government Organizations	7026.6	8778.2	8047.8	83993.14
5.	**BILL PURCHED**	**9634.2**	**9007.9**	**9805.6**	14548.03
6.	**LOANS AGT. COLLECTED BILLS**	**645.9**	**1015.5**	**737.3**	1132.63
7.	**FIXED ASSETS**	**27146.4**	**28916.8**	**30477.7**	31732.63
8.	**OTHER ASSETS**	**93318.3**	**104448.2**	**123962.3**	135346.49
	a. Accrued Interests	27621.8	30638.6	32041.3	32792.14
	b. Others	65696.6	73809.6	91921	102554.35
9.	**Expenses not Written off**	**586.9**	**622**	**492**	392.16
10.	**Non-Banking Assets**	**2225.1**	**3731.3**	**4757**	5250.92
11.	**Reconciliation Account**	**8638.9**	**10394.1**	**-1032.5**	2947.32
12.	**Profit & Loss A/c**	**2994.9**	**3827.7**	**4255.8**	899.11
TOTAL ASSETS		**1350964**	**1584952**	**1847114**	**2183154**

Annex - 3

Statement of Assets and Liabilities of BFIs

(Mid-July 2015)

(In million Rupees)

	Particulars	Class "A"	Class "B"	Class "C"	Total
LIABILITIES					
1.	**Capital Fund**	**122167.9**	**30296.8**	**10527.7**	**162992.5**
	a. Paid-up Capital	97921.41	27448.46	15424.23	140794.10
	b. Statutory Reserves	31063.03	3608.10	2478.72	37149.85
	c. Retained Earning	-17279.67	-1907.59	-8614.79	27850.60
	d. Others Reserves	10463.18	1147.88	1239.54	12850.60
2.	**Borrowings**	**18419.8**	**2454.3**	**482**	**21356**
	a. NRB	3291.48	0.00	0.00	3291.48
	b. Interbank Borrowing	2762.58	2260.00	481.95	5504.53
	c. Foreign Banks and FIs	0.00	0.00	0.00	0.00
	d. Other Financial Ins.	925.56	194.26	0.00	1119.81
	e. Bonds and Securities	11440.14	0.00	0.00	11440.14
3.	**Deposits**	**1462896.1**	**237096.1**	**71953.84**	**1771946.1**
	a. Current	153598.94	5056.01	91.21	158746.16
	b. Savings	559391.64	120779.9	34294.58	714466.16
	c. Fixed	419883.01	62203.55	31196.45	513283.02
	d. Call Deposits	313955.92	48166.94	918.79	363041.66
	e. Others	16066.61	889.75	5452.80	22409.16
4.	**Bills Payable**	**1698.3**	**27.2**	**4.4**	**1729.9**
5.	**Other Liabilities**	**146984.0**	**20670.2**	**20439**	**188093.2**
	1. Loan Loss Provision	35779.54	6171.65	9531.38	51482.56
	2. Interest Suspense a/c	21287.89	3322.76	6646.32	31256.97
	3. Others	89916.59	11175.78	4261.29	105353.66
6.	**Reconciliation A/c**	**-5325.8**	**3800.8**	**1805.3**	**280.4**
	Profit & Loss A/c	**27664.4**	**6296.3**	**2795.2**	**36755.9**
TOTAL LIABILITIES		**1774504.8**	**300641.8**	**108007.4**	**2183154**

	Particulars	Class "A"	Class "B"	Class "C"	Total
ASSETS					
1.	**Liquid Funds**	**250377.11**	**79794.81**	**23225.37**	**353397.28**
	a. Cash Balance	40636.96	6979.21	1026.28	48642.45
	Nepalese Notes & Coins	39384.90	6894.72	1025.89	47305.51
	Foreign Currency	1252.06	84.49	0.39	1336.94
	b. Bank Balance	189230.03	33250.96	15476.25	237957.23
	1. Nepal Rastra Bank	147933.67	14008.99	3127.86	165070.53
	2. "A" Class Licensed Institution	13172.91	15817.63	8847.46	37838.00
	3. Other Financial Ins.	125.88	3255.99	3500.93	6882.80
	4. In Foreign banks	27997.56	168.34	0.00	28165.90
	c. Money at Call	20510.12	39564.65	6722.84	66797.60
2.	**Investments**	200262.57	3338.45	2559.46	206160.48
	a. Govt. Securities	176214.77	3338.33	2559.20	182112.29
	b Others	24047.80	0.12	0.26	24048.18
3.	**Share & Other Investment**	81897.82	2037.17	1740.61	85675.60
4.	**Loans & Advances**	1087486.6	193462.9	64721.71	1345671.3
	a. Private Sector	976374.75	191447.8	63176.98	1230999.5
	b. Financial Institutions	27231.05	1981.58	1465.98	30678.62
	c. Government Organizations	83880.89	33.50	78.74	83993.14
5.	**Bill Purchased**	14533.93	7.70	6.40	14548.03
6.	**Loans Against Collected Bills**	1132.63	0.00	0.00	1132.63
7.	**Fixed Assets**	24479.96	4925.03	2327.65	31732.63
8.	**Other Assets**	113748.89	10992.49	10605.10	135346.49
	a. Accrued Interests	22293.32	3803.85	6694.97	32792.14
	b. Others	91455.57	7188.64	3910.13	102554.35
9.	**Expenses not Written off**	318.55	35.13	38.48	392.16
10.	**Non-Banking Assets**	2608.84	1840.38	801.69	5250.92
11.	**Reconciliation Account**	-2675.08	3820.15	1802.25	2947.32
12.	**Profit & Loss A/c**	332.89	387.56	178.66	899.11
	TOTAL ASSETS	**1774504.7**	**300641.7**	**108007.39**	**2183153.9**

Annex - 4

Aggregate Balance Sheet of MFFIs ('D' Class Financial Institutions) (Mid-July 2015)

(In million Rupees)

	Particulars	Mid-July 2012	Mid-July 2013	Mid-July 2014	Mid-July 2015
LIABILITIES					
1	**CAPITAL FUND**	**2816.6**	**3801.3**	**4950.7**	**6142.7**
	a. Paid-up Capital	1717.2	2234.0	2974.3	3987.3
	b. Statutory Reserves	288.3	383.5	523.1	750.3
	c. Retained Earning	107.6	208.2	220.6	8.9
	d. Others Reserves	703.6	975.6	1232.7	1396.2
2	**BORROWINGS**	**16586.4**	**20216.3**	**27897.3**	**38648.4**
	a. NRB	198.4	210.3	526.4	306.3
	f. Others	16388.0	20006.0	27371.0	38342.1
3	**DEPOSITS**	**5235.2**	**7221.6**	**11001.2**	**16013.1**
4	**Other Liabilities**	**2502.9**	**3009.7**	**3777.5**	**5170.5**
	a. Loan Loss Provision	505.5	694.0	829.4	986.7
	b. Interest Suspense a/c	410.0	446.9	475.0	600.6
	c. Others	1587.5	1868.8	2473.1	3583.2
5	**Reconciliation A/c**	**2236.6**	**688.6**	**1088.2**	**2330.2**
6	**Profit & Loss A/c**	**629.8**	**837.9**	**1473.7**	**2575.6**
	Total	**30007.5**	**35775.3**	**50188.7**	**70880.4**
ASSETS					
1	**LIQUID FUNDS**	**5843.5**	**6322.8**	**7202.8**	**6954.0**
	a. Cash Balance	44.2	42.8	39.2	59.0
	b. Bank Balance	3253.9	3561.6	3710.6	3908.7
	c. Money at Call	2545.4	2718.5	3452.9	2986.3
2	**INVESTMENT IN SECURITIES**	**128.7**	**116.2**	**116.2**	**116.2**
3	**SHARE & OTHER INVESTMENT**	**2040.6**	**2963.6**	**2894.2**	**2350.1**
4	**LOANS & ADVANCES**	**17738.3**	**23401.7**	**35689.3**	**55126.4**
	Institutional	6194.1	6740.3	9863.5	14863.0
	Individual	11544.2	16661.4	25825.8	40263.4
5	**FIXED ASSETS**	**340.2**	**444.6**	**624.4**	**803.5**
6	**OTHER ASSETS**	**1594.9**	**1685.8**	**2485.4**	**3274.6**
7	**Expenses not Written off**	**0.7**	**9.8**	**9.4**	**7.2**
8	**Reconciliation Account**	**2234.8**	**699.6**	**1085.2**	**2202.2**
9	**Profit & Loss A/c**	**85.8**	**131.2**	**81.8**	**46.2**
	Total	**30007.5**	**35775.4**	**50188.7**	**70880.4**

Annex 5

Sector wise, Product wise and Security wise Credit flow from BFIs (Mid-July 2015)

(Rs. in million Rupees)

SECTOR WISE		Class "A"	Class "B"	Class "C"	Total
1.	Agricultural and Forest Related	47818.18	12002.65	1963.05	61783.87
2.	Fishery Related	2888.07	404.87	62.64	3355.59
3.	Mining Related	3064.11	390.09	71.55	3525.74
4.	Manufacturing (Producing) Related	239722.81	12179.35	3632.41	255534.57
5.	Construction	115175.72	26554.42	10750.27	152480.40
6.	Electricity, Gas and Water	29412.29	4933.46	194.69	34540.43
7.	Metal Products, Mach. & Ele. Eqp.	12402.24	2976.90	829.16	16208.31
8.	Tras., Com. and Public Utilities	26254.45	15099.18	7098.04	48451.67
9.	Wholesaler & Retailer	256252.52	32542.18	8491.89	297286.58
10.	Finance, Insurance and Real Estate	89220.30	13368.46	4704.90	107293.66
11.	Hotel or Restaurant	35337.97	7231.42	1459.52	44028.90
12.	Other Services	53099.98	8661.91	2195.70	63957.60
13.	Consumption Loans	80339.71	15563.89	5546.54	101450.14
14.	Local Government	1621.81	32.34	59.99	1714.14
15.	Others	110543.10	41529.50	17667.77	169740.36
	Total sector wise Loan	**1103153.25**	**193470.61**	**64728.11**	**1361351.97**
PRODUCT WISE		**Class "A"**	**Class "B"**	**Class "C"**	**Total**
1.	Term Loan	187297.61	27992.73	7859.26	223149.61
2.	Overdraft	200106.73	45887.99	0.00	245994.73
3.	Trust Receipt Loan / Import Loan	55141.88	0.00	0.00	55141.88
4.	Demand & Other Working Capital Loan	260320.80	20503.15	12779.18	293603.14
5.	Res. Per. H. Loan (Up to Rs. 10 mil.)	87842.96	22476.27	8542.32	118861.54
6.	Real Estate Loan	63879.59	13116.83	8681.64	85678.07
7.	Margin Nature Loan	16360.29	3831.26	3893.22	24084.77
8.	Hire Purchase Loan	54406.77	18970.95	7589.24	80966.96
9.	Deprived Sector Loan	51515.94	10198.29	2175.58	63889.82
10.	Bills Purchased	13497.19	7.70	6.40	13511.29
11.	Other Product	112783.49	30485.43	13201.26	156470.18
Total Product wise Loan		**1103153.26**	**193470.61**	**64728.11**	**1361351.98**

COLLATERAL WISE		Class "A"	Class "B"	Class "C"	Total
1.	Gold and Silver	26813.12	4111.82	449.73	31374.67
2.	Government Securities	751.68	12.34	20.72	784.73
3.	Non-Governmental Securities	13183.16	3330.32	2263.45	18776.93
4.	Fixed Deposit Receipts	6561.88	2014.24	1248.78	9824.90
	Own	5662.90	2014.20	1248.78	8925.88
	Other Licensed Institutions	898.97	0.05	0.00	899.02
5.	Collateral of Properties	900985.02	177855.55	52989.91	1131830.49
	Fixed Assets	726933.32	177513.72	52784.94	957231.98
	Current Assets	174051.71	341.83	204.97	174598.50
6.	Against security of Bill	13672.66	15.30	281.05	13969.01
	Domestic Bills	3236.45	15.30	281.05	3532.80
	Foreign Bills	10436.21	0.00	0.00	10436.21
7.	Against Guarantee	34298.71	5424.35	755.99	40479.05
	Government Guarantee	2208.28	112.07	64.90	2385.24
	Institutional Guarantee	24969.73	2552.54	311.04	27833.31
	Personal Guarantee	2069.26	155.40	126.05	2350.72
	Collective Guarantee	951.02	2602.75	27.25	3581.03
	Int. Rtd. Foreign Bank's Guarantee	93.08	0.00	0.00	93.08
	Other Guarantee	4007.34	1.59	226.74	4235.68
8.	Credit Card	427.58	0.00	0.00	427.58
9.	Others	106459.44	706.70	6718.39	113884.53
Total Collateral wise Loan		**1103153.26**	**193470.61**	**64728.01**	**1361351.89**

Annex - 6

Profit & Loss Account of BFIs

(As of Mid-July 2015)

(In million Rupees)

EXPENSES	Class "A"	Class "B"	Class "C"	Total
1 Interest Expenses	49191.03	13561.44	5065.25	67817.71
1.1 Deposit Liabilities	47732.95	13208.83	5023.09	65964.87
1.1.1 Saving A/c	14740.74	6063.26	2031.92	22835.91
1.1.2 Fixed A/c	23632.62	5231.89	2934.69	31799.20
1.1.2.1 Up to 3 Months Fixed A/c	1909.08	60.21	27.16	1996.44
1.1.2.2 3 to 6 Months fixed A/c	890.25	118.19	39.81	1048.25
1.1.2.3 6 Months to 1 Year Fixed A/c	10151.63	2811.21	1483.36	14446.21
1.1.2.4 Above 1 Year	10681.65	2242.29	1384.35	14308.30
1.1.3 Call Deposit	9332.14	1913.68	56.44	11302.25
1.1.4 Certificate of Deposits	27.45	0.00	0.05	27.50
1.2 Others	1458.08	352.61	42.16	1852.85
2. Commission/Fee Expense	505.07	3.26	1.13	509.46
3. Employees Expenses	17776.14	2701.19	823.62	21300.95
4. Office Operating Expenses	13613.82	3100.54	1009.86	17724.22
5. Exchange Fluctuation Loss	63.27	1.55	0.00	64.81
5.1 Due to Change in Exchange Rates	63.27	1.56	0.00	64.83
5.2 Due to Foreign Currency Transactions	0.00	-0.01	0.00	-0.01
6. Non-Operating Expenses	13.39	41.67	34.74	89.80
7. Provision for Risk	9962.24	1892.95	996.35	12851.54
7.1 Loan loss Provision	9070.71	1363.38	617.09	11051.18
7.1.1 General Loan loss Provision	3891.06	156.42	26.31	4073.79
7.1.1.1 Pass Loan Loss Provision	3163.99	30.08	18.68	3212.75
7.1.1.2 Watch List Provision	727.07	126.34	7.63	861.04
7.1.2 Special Loan Loss Provision	5176.73	1116.06	365.05	6657.85
7.1.3 Additional Loan Loss Provision	2.92	90.90	225.73	319.54
7.2. Provision for Non-Banking Assets	679.65	510.27	254.78	1444.70
7.3. Provision for Loss on Investment	40.37	11.46	72.24	**124.08**
7.4. Provision for Loss of Other Assets	171.51	7.84	52.23	231.58
8. Loan Written Off	**103.45**	**231.17**	**110.96**	**445.58**
9. Provision for Staff Bonus	**3139.60**	**704.19**	**215.38**	**4059.17**

EXPENSES	Class "A"	Class "B"	Class "C"	Total
10. Provision for Income Tax	**9521.99**	**2043.98**	**610.43**	**12176.41**
11. Others	**465.47**	**41.02**	**11.60**	**518.08**
12. Net Profit	**28386.05**	**5925.13**	**2770.19**	**37081.37**
TOTAL EXPENSES	**132741.51**	**30248.09**	**11649.50**	**174639.11**
INCOME				
1. Interest Income	**101174.86**	**24883.86**	**8605.76**	**134664.48**
1.1. On Loans and Advance	97566.06	22515.25	7710.19	127791.49
1.2. On Investment	2065.62	139.83	110.25	2315.69
1.2.1 Government Bonds	1774.19	127.22	87.24	1988.65
1.2.2 Foreign Bonds	76.54	0.00	0.00	76.54
1.2.3 NRB Bonds	132.56	10.90	16.78	160.24
1.2.4 Debenture & Bonds	82.33	1.71	6.23	90.26
1.3 Agency Balance	491.44	137.10	87.87	716.42
1.4 On Call Deposit	399.14	1709.58	546.09	2654.81
1.5 Others	652.61	382.10	151.36	1186.08
2. Commission & Discount	**8247.23**	**592.04**	**102.93**	**8942.20**
2.1 Bills Purchase & Discount	247.40	1.02	0.00	248.42
2.2 Commission	7055.01	396.58	50.12	7501.71
2.3 Others	944.82	194.44	52.81	1192.07
3. Income From Exchange Fluctuation	**4712.88**	**48.86**	**0.00**	**4761.74**
3.1 Due to Change in Exchange Rate	980.69	2.62	0.00	983.31
3.2 Due to Foreign Currency Trans.	3732.18	46.25	0.00	3778.43
4. Other Operating Income	**5281.25**	**1584.33**	**509.79**	**7375.37**
5. Non-Operating Income	**3880.23**	**402.44**	**462.98**	**4745.66**
6. Provision Written Back	**7604.21**	**2647.78**	**1751.62**	**12003.61**
7. Recovery from Written off Loan	**1445.40**	**21.45**	**41.78**	**1508.63**
8. Income from Extra Ordinary Expenses	**64.77**	**37.22**	**63.05**	**165.0425**
9. Net Loss	**330.67**	**30.11**	**111.60**	**472.37**
TOTAL INCOME	**132741.51**	**30248.09**	**11649.50**	**174639.11**

** Cumulative figure adjusted for percentage calculation*

Annex - 7

Financial Soundness Indicators (Mid-July, 2015)

Indicators	A	B	C	Total
Capital Adequacy Ratios				
Regulatory capital to risk-weighted assets	11.9	16.1	21.5	12.92
Regulatory Tier - 1 capital to risk-weighted assets	10.2	15.2	20.6	11.39
Non-performing loan to total gross loan	2.63	3.58	14.5	3.33
Non-performing loan net of provisions to capital	3.56	4.57	2.79	3.68
Share of Sector Wise Loans in Total Loan (percentage)				
Agricultural and Forest Related	4.33	6.20	3.03	4.54
Fishery Related	0.26	0.21	0.10	0.25
Mining Related	0.28	0.20	0.11	0.26
Agricultural, Forestry and beverage Production Related	21.7	6.30	5.61	18.77
Non-food Production Related				
Construction	10.4	13.7	16.6	11.20
Electricity, Gas and Water	2.67	2.55	0.30	2.54
Metal Products, Machinery & Electronic Equipment &	1.12	1.54	1.28	1.19
Transport, Communication and Public Utilities	2.38	7.80	10.9	3.56
Wholesaler & Retailer	23.2	16.8	13.1	21.84
Finance, Insurance and Real Estate	8.09	6.91	7.27	7.88
Hotel or Restaurant	3.20	3.74	2.25	3.23
Other Services	4.81	4.48	3.39	4.70
Consumption Loans	7.28	8.04	8.57	7.45
Local Government	0.15	0.02	0.09	0.13
Others	10.0	21.4	27.3	12.47
Total	**100**	**100**	**100**	**100**
Returns on Assets	1.58	1.97	2.42	1.68
Returns on Equity	16.7	15.6	16.9	16.58
Interest Margin to Gross Income (percent)	70.1	81.3	76.6	72.15
Non-interest Expenses to Gross Income (percent)	43.7	41.2	40.7	43.24
Liquid Assets to total Assets	25.2	27.6	23.8	25.51
Liquid Assets to total Deposits	30.6	35.0	35.8	31.42
Credit to Deposit Ratio	75.4	81.6	89.9	76.83

Annex - 8

Stress Testing Results for Commercial Banks

<table>
<tr><th rowspan="2">Criteria</th><th>Mid-Jul 2015</th><th>Mid-Jul 2014</th><th>Mid-Jan 2014</th><th>Mid-Jul 2013</th></tr>
<tr><th colspan="4">No. of banks with CAR < 10%</th></tr>
<tr><td colspan="5">Credit shocks</td></tr>
<tr><td>15 Percent of Performing loans deteriorated to substandard.</td><td>22</td><td>16</td><td>20</td><td rowspan="4">27</td></tr>
<tr><td>15 Percent of Substandard loans deteriorated to doubtful loans.</td><td>2</td><td>4</td><td>3</td></tr>
<tr><td>25 Percent of Doubtful loans deteriorated to loss loans.</td><td>2</td><td>4</td><td>3</td></tr>
<tr><td>5 Percent of Performing loans deteriorated to loss loans.</td><td>26</td><td>22</td><td>24</td></tr>
<tr><td>All NPLs under substandard category downgraded to doubtful.</td><td>2</td><td>4</td><td>3</td><td rowspan="2">2</td></tr>
<tr><td>All NPLs under doubtful category downgraded to loss.</td><td>3</td><td>4</td><td>3</td></tr>
<tr><td>25 Percent of performing loan of Real Estate loan directly downgraded to substandard category of NPLs.</td><td>3</td><td>4</td><td>3</td><td>2</td></tr>
<tr><td>25 Percent of performing loan of Real Estate loan directly downgraded to Loss category of NPLs.</td><td>14</td><td>9</td><td>9</td><td>5</td></tr>
<tr><td>Top 2 Large exposures downgraded: Performing to Substandard</td><td>6</td><td>6</td><td>3</td><td>2</td></tr>
<tr><td colspan="5">Liquidity shocks</td></tr>
<tr><td>Withdrawal of customer deposits by 2% 5% 10% 10% and 10% for five consecutive days respectively.</td><td>23</td><td>10</td><td>16</td><td>5</td></tr>
<tr><td>Withdrawal of deposits by 5%</td><td>10</td><td>0</td><td>2</td><td>1</td></tr>
<tr><td>Withdrawal of deposits by 10%</td><td>18</td><td>7</td><td>12</td><td>4</td></tr>
<tr><td>Withdrawal of deposits by 15%</td><td>26</td><td>17</td><td>22</td><td>16</td></tr>
<tr><td>Withdrawal of deposits by top 2 institutional depositors.</td><td>16</td><td>8</td><td>11</td><td>10</td></tr>
<tr><td>Withdrawal of deposits by top 3 institutional depositors.</td><td>20</td><td>11</td><td>15</td><td>14</td></tr>
<tr><td>Withdrawal of deposits by top 5 institutional depositors.</td><td>20</td><td>18</td><td>20</td><td>21</td></tr>
<tr><td>Withdrawal of deposits by top 2 individual depositors.</td><td>1</td><td>0</td><td>0</td><td>1</td></tr>
<tr><td>Withdrawal of deposits by top 3 individual depositors.</td><td>1</td><td>0</td><td>0</td><td>1</td></tr>
<tr><td>Withdrawal of deposits by top 5 individual depositors.</td><td>1</td><td>0</td><td>0</td><td>1</td></tr>
</table>

Annex - 9

Composition of Financial Stability Oversight Committee

Name and Designation	Status
Mr. Chintamani Siwakoti, Deputy Governor	Chairperson
Mr. Shiba Raj Shrestha, Deputy Governor	Member
Mr. Narayan Prasad Paudel, Executive Director, Bank Supervision Department	Member
Mr. Nara Bahadur Thapa, Executive Director Research Department	Member
Dr. Binod Atreya, Executive Director, Micro Finance Promotion and Supervision Department	Member
Mr. Janak Bahadur Adhikari, Executive Director, Finance Company Supervision Department	Member
Mr. Bhishma Raj Dhungana, Executive Director, Foreign Exchange Management Department	Member
Mr. Laxmi Prapanna Niraula, Executive Director, Development Bank Supervision Department	Member
Mr. Shiva Nath Pandey, Executive Director, Bank and Financial Institutions Regulation Department	Member
Mr. Raman Nepal, Director, Bank and Financial Institutions Regulation Department	Member Secretary
Registrar, Department of Cooperative	Invitee Member
Chief Executive, Insurance Board	Invitee Member
Chief Executive, Security Board of Nepal	Invitee Member
Administrator, Employee Provident Fund	Invitee Member
Chief Executive Officer, Citizen Investment Trust	Invitee Member
Related Sectors Experts (maximum 2)	Invitee Member

Annex - 10

Composition of Financial Stability Sub-Committee

Name and Designation	Status
Mr. Raman Nepal, Director, Bank and Financial Institutions Regulation Department	Coordinator
Mr. Kamal Acharya, Deputy Director, Development Bank Supervision Department	Member
Mr. Devendra Gautam, Deputy Director	Member
Mr. Ram Hari Dahal, Deputy Director, Micro Finance Promotion and Supervision Department	Member
Mr. Bigyan Raj Subedi, Deputy Director, Research Department	Member
Mr. Nishchal Adhikari, Deputy Director, Finance Company Supervision Department	Member
Ms. Subash Aacharya, Deputy Director, Foreign Exchange Management Department	Member
Ms. Pushpa Adhikary, Deputy Director Bank and Financial Institutions Regulation Department	Member Secretary