Sixty Years of Nepal Rastra Bank

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Nepal Rastra Bank

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Foreword

Nepal Rastra Bank (NRB) was established as the central bank of the country on April 26, 1956. During its six-decade long journey, NRB has made a significant progress in monetary, foreign exchange, and financial sectors. This publication 'Sixty Years of Nepal Rastra Bank' has been commissioned to commemorate NRB's reaching its sixty-year milestone by taking a walk down the memory lane of the major course of actions taken, progression of institutional development and evolution of its major functions.

During the span of six decades, besides responsibly carrying out the traditional central banking roles and responsibilities, NRB has remained a firm anchor, constantly providing the solid foundation for ensuring monetary and financial stability. Over the years, monetary management has been streamlined and strengthened while the financial sector has been expanded and consolidated. For undertaking such responsibilities, NRB has transformed its organizational structure and management process for catalyzing the opportunities and proactively mitigating the challenges.

Nepal Rastra Bank has sought to devise and implement appropriate and timely policy measures to promote financial sector development, orient monetary management towards improving price, balance of payments, financial sector and exchange rate stability, as well as facilitating the overall development of the economy. In order to carry out effective regulation and supervision (especially with the enactment of the new NRB Act and Banks and Financial Institutions Act), NRB has been issuing and refining the unified directives comprising regulatory measures of international standard. Likewise, the financial sector reform was carried out by restructuring of Nepal Bank Ltd. and Rastriya Banijya Bank, re-engineering NRB and building capacity in financial sector, comprising reforms in financial sector legislation, assisting debt recovery tribunal, improving credit information center and providing training for upgrading financial journalism. Further, through its oversight tools, NRB has been able to ensure stable and efficient payment system. To enhance the access of all citizens to the whole range of financial services, financial literacy and financial education have been prominently focused by NRB. On the whole, NRB has been successful to foster the confidence and credibility on several fronts including country's monetary management, exchange rate system and financial sector, thereby laying a solid foundation for promoting overall economic stability of the nation.

In the sixtieth year of the NRB's existence, I would like to take this occasion to offer my deepest gratitude to my predecessors, the respected fellow Governors of NRB, whose drive to relentlessly pursue the central banking vision into reality has shaped NRB to its present form. I would also like to commend their invaluable contributions to "Reflection of Former Governors", a separate supplement of this publication.

This publication would not have come out in its present shape and form without the dedication of a number of key individuals and entire departments at NRB. First of all, the Editorial Team led by Mr. Nara Bahadur Thapa, Executive Director, Research Department & Coordinator of the Central Editorial Board, deserves special recognition for his role of leadership and coordination which he professionally discharged in bringing out this historic publication in the present form. My appreciation also goes to all the related departments and offices of NRB for their role and contribution in writing and finalizing the respective chapters. I appreciate Dr. Nephil Matangi Maskay, Executive Director, Office of the Governor, for his dedication in supervising the work during the final stages of the publication. I would like to extend my special thanks to Dr. Bhubanesh Pant, Executive Director and Dr. Prakash Kumar Shrestha, Director, for initiating this publication.

I deeply appreciate the amount of hard work put by Mr. Tula Raj Basyal, former Executive Director of NRB, for meticulously editing the entire manuscript.

I am confident that this work will help in crystallizing the understanding of evolutionary developments during the sixty years of central banking practice in Nepal.

Going forward, NRB shall endeavor in maintaining macroeconomic and financial stability conducive for inclusive and broad-based economic growth, employment and overall prosperity of the country.

(Dr. Chiranjibi Nepal)
Governor
Nepal Rastra Bank

Acknowledgements

On the historic occasion of the completion of six decades of Nepal Rastra Bank's establishment, I am honored to have led the preparation of this introspective publication 'Sixty Years of NRB'. This publication is the continuation of earlier publications of similar nature such as NRB in 25 years (in Nepali), 40 years of NRB, and NRB in 50 years. It attempts to highlight, document and reflect on policies and programs undertaken and achievements made in Nepal's central banking functions over the period.

This publication is the outcome of a team effort starting with designing table of content of the publication, then drafting the chapters from the respective departments and synthesizing them. In my capacity as coordinator of the Central Editorial Board, I would like to acknowledge the contributions made by all the Departments of the Bank in bringing out this publication.

First, I would like to acknowledge the contribution of the members of the Central Editorial Board for their sincere efforts towards overseeing the manuscripts and ensuring their authenticity. I appreciate the untiring efforts put by Dr. Bhubanesh Pant, Dr. Gunakar Bhatta and Dr. Prakash Kumar Shrestha in editing the manuscripts.

I would like to convey that this activity was in the annual program of the Office of the Governor and thus they made a special effort in this regard. In addition to those recognized above by the Governor, I would like to further highlight efforts of Deputy Director Bibhu Prasad Aryal and Assistant Director Sarthak Karki. I would also like to acknowledge the contribution made by Deputy Director Mr. Pitambar Sapkota for organizing the meetings of Central Editorial Board and to extend my thanks to Deputy Director Mr. Ganesh Man Maharjan and Assistant

Director Mr. Sanu Bhai Maharjan for their significant role in proof reading, formatting and designing this publication.

Last but not the least, I would again like to express my sincere thanks to all those who helped directly or indirectly to produce this important document in its present form.

(Nara Bahadur Thapa)
Executive Director
Research Department
and
Coordinator of Central Editorial Board

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List of Abbreviation

ACCSYS	Accounting System
ACU	Asian Clearing Union
ADB	Asian Development Bank
ADB/N	Agricultural Development Bank, Nepal
ADSL	Asymmetric Digital Subscriber Line
AEC	Agro Enterprise Centre
AFI	Alliance for Financial Inclusion
AGF	Agribusiness Grant Facility
ALM	Asset Liability Management
ALPA	Assets (Money) Laundering Prevention Act
AMC	Asset Management Company
AML	Anti Money Laundering
AMU	Asian Monetary Unit
APG	Asia Pacific Group on Money Laundering
APRACA	Asia-Pacific Rural and Agricultural Credit Association
ASB	Accounting Standards Board
A2F	Access to Finance Project
ATM	Automated Teller Machine
BAFIA	Bank and Financial Institution Act
BAFIO	Bank and Financial Institution Ordinance
BANKSYS	Banking System
BCBS	Basel Committee on Banking Supervision
BFI	Bank and Financial Institution
BFIRD	Bank and Financial Institution Regulation Department
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Corporation
BIS	Bank for International Settlement
BOD	Board of Directors
BOP	Balance of Payments
BPO	Business Process Outsourcing
BSD	Bank Supervision Department
BTC	Bankers' Training Centre
CAR	Capital Adequacy Ratio
CBS	Central Bureau of Statistics
CBSL	Central Bank of Sri Lanka
CCD	Credit to Core Capital and Deposit
CDD	Customer Due Diligence
CDS	Central Depository System
CEO	Chief Executive Officer

CFT	Combating Financing of Terrorism
CGWISP	Community Ground Water Irrigation Sector Project
CIAA	Commission for the Investigation of Abuse of Authority
CIB	Credit Information Bureau
CICL	Credit Information Centre Limited
CIT	Citizen Investment Trust
CL-PIU	Central Level Project Implementation Unit
CMD	Currency Management Department
CPD	Corporate Planning Department
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
CSB	Citizen Saving Bond
CSI	Cottage & Small Scale Industries
CYFI	Child and Youth Finance International
DAA	Documents Against Acceptance
DAP	Documents Against Payment
DB	Development Bond
DBAN	Development Bankers Association Nepal
DBIR	Data Breach Investigations Report
DC	Data Centre
DBSD	Development Bank Supervision Department
DCGC	Deposit and Credit Guarantee Corporation
DCGF	Deposit and Credit Guarantee Fund
DFID	Department for International Development, UK
DOA	Department of Agriculture
DOS	Denial of Service (Attack)
DPC	Development Policy Credit
DR	Disaster Recovery
DRS	Disaster Recovery Site
DRT	Debt Recovery Tribunal
DSIFI	Domestic Systemically Important Financial Institutions
DSL	Deprived Sector Lending
EAFS	Enhancing Access to Finance Services
EBA	Everything but Aims
ECC	Electronic Cheque Clearing
EDR	Eastern Development Region
ELF	Emergency Liquidity Facility
EPF	Employees Provident Fund
ERDB	Eastern Rural Development Bank
ESAF	Enhanced Structural Adjustment Facility

ESCAP	Economic and Social Commission for Asia and the Pacific
ESW	Egmont Secure Web
EUR	Euro
EWS	Early Warning System
EXCO	Executive Committee
FAO	Food and Agriculture Organization
FATF	Financial Action Task Force
FCGO	Financial Comptroller General Office
FCSD	Finance Company Supervision Department
FEDAN	Foreign Exchange Dealers' Association of Nepal
FEMD	Foreign Exchange Management Department
FESB	Foreign Employment Saving Bond
FI	Financial Institution
FINGO	Financial Intermediary Non-Government Organization
FIU	Financial Information Unit
FIUISS	Financial Information Unit Intelligence System Software
FNCCI	Federation of Nepalese Chambers of Commerce and Industry
FSAP	Financial Sector Assessment Programme
GATT	General Agreement on Tariffs and Trade
GBP	Great British Pounds
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GHC	Grievance Hearing Cell
GL	General Ledger
GoAML	Web application used by FIU to collect and analyze information relating to AML
GON	Government of Nepal
GSD	General Service Department
GVA	Gross Value Added
HBS	Household Budget Survey
HR	Human Resource
HRMD	Human Resource Management Department
HRMISS	Human Resource Management Information System
HVC	High Value Agricultural Commodities
IAD	Internal Audit Department
IBP	Intensive Banking Programme
IC	Investment Committee
ICAAP	Internal Capital Adequacy Assessment Process
ICAN	Institute of Chartered Accountants of Nepal
ICT	Information and Communication Technology

IDA	International Development Association
IGETC	Inter-Governmental Economic and Trade Committee
IIP	International Investment Position
ILRS	Insured Loan Record System
IMF	International Monetary Fund
IMS	Inventory Management System
IOM	International Organization of Migration
IPO	Initial Public Offering
IPS	Inter-bank Payment System
IRs	Indian Rupees
IRC	Interest Rate Corridor
IRD	International Relations Division
IRMF	Integrated Risk Management Framework
ISIC	International Standard Industrial Classification
ISP	Internet Service Provider
IT	Information Technology
ITD	Information Technology Department
KPMG	Klynveld Peat Marwick Goerdeler
KYC	Know Your Customer
LAN	Local Area Network
LC	Letter of Credit
LEA	Law Enforcement Agency
LED	Light Emitting Diode
LIBOR	London Interbank Offered Rate
LMFF	Liquidity Monitoring and Forecasting Framework
LTV	Loan-to-Value
LVP	Large Value Payments
MAP	Making Access Possible
MC	Management Committee
MCPW	Micro Credit Project for Women
MEDP	Micro Enterprise Development Programme
MFPSD	Micro Finance Promotion and Supervision Department
MICR	Magnetic Ink Character Recognition
MIGA	Multilateral Investment Guarantee Agency
ML	Money Laundering
MM4P	Mobile Money for the Poor
MOAD	Ministry of Agricultural Development
MOF	Ministry of Finance
MOLD	Ministry of Local Development
MOU	Memorandum of Understanding

NBL	Nepal Bank Ltd.
NCHL	Nepal Clearing House Limited
NEPS	Nepal Electronic Payments System
NEPSE	Nepal Stock Exchange
NSA	Nepal Standards of Auditing
NIDC	Nepal Industrial Development Corporation
NPA	Non Performing Assets
NPL	Non Performing Loan
NPS	National Payments System
NRA	National Risk Assessment
NRs	Nepalese Rupees
NPSDS	Nepal Payment System Development Strategy
NRA	Nepal Remitters Association
NRB	Nepal Rastra Bank
NSB	National Saving Bond
OAG	Office of the Auditor General
OBS	Online Bidding System
OBSS	Online Bidding System Software
OGL	Open General License
OMO	Open Market Operation
OMOC	Open Market Operation Committee
OMOTC	Open Market Operation Transactions Committee
OVO	Outside Valley Office
PAPWT	Poverty Alleviation Project in Western Terai
PBRD	Problem Bank Resolution Division
PBRF	Problem Bank Resolution Framework
PCA	Prompt Correcting Action
PDMD	Public Debt Management Department
PEP	Politically Exposed Person
POT	Point of Transaction
PPI	Producer Price Index
PRD	Public Relations Division
PRGF	Poverty Reduction and Growth Facility
PRS	Personnel Record System
PRSP	Poverty Reduction Strategy Paper
PSB	Payment and Settlement Bylaw
PSD	Payment Systems Department
PSO	Payment System Operation
PSP	Payment Service Provider
RBA	Risk Based Approach

RBB	Rastriya Banijya Bank
RBI	Reserve Bank of India
RBIA	Risk Based Internal Audit
RBS	Risk Based Supervision
RCF	Rapid Credit Facility
RDB	Rural Development Bank
RE	Reporting Entity
RISMFP	Raising Income of Small and Medium Farmers Project
RMC	Risk Management Committee
RMDC	Rural Microfinance Development Centre
RMFP	Rural Micro Finance Project
RMU	Risk Management Unit
Rs	Rupees
RSRF	Rural Self Reliance Fund
RTGS	Real Time Gross Settlement
SAARC	South Asian Association for Regional Corporation
SAF	Structural Adjustment Facility
SAFTA	South Asian Free Trade Agreement
SARTTAC	South Asia Regional Training and Technical Assistance Centre
SCT	Smart Choice Technology
SDR	Special Drawing Rights
SEACEN	South East Asian Central Banks
SEANZA	South East Asia, New Zealand and Australia
SEAVG	South East Asian Voting Group
SREP	Supervisory Review and Evaluation Process
SFCs	Small Farmers' Cooperatives
SHS	Solar Home System
SIFI	Systemically Important Financially Institutions
SIS	Supervisory Information System
SLF	Standing Liquidity Facility
SLR	Statutory Liquidity Ratio
SME	Small and Medium Enterprise
SOL	Single Obligors Limit
SPC	SAARC Payment Council
SPFC	Strategic Plan Formulation Committee
SREP	Supervision Review and Evaluation Process
SSA	Simplified Standardized Approach
SSR	Secure Sockets Layer
STI	Second Tier Institution

STR	Suspicious Transaction Report
STRO	Secured Transaction Registry Office
STW	Shallow Tube Well
SWRI	Salary and Wage Rate Index
TBs	Treasury Bills
TLDP	Third Livestock Development Project
TOR	Terms of Reference
TRTA	Trade-Related Technical Assistance
TT	Telegraphic Transfer
TSA	Technical Service Agreement
TTR	Threshold Transaction Report
UK	United Kingdom
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
UNODC	United Nations Office on Drugs and Crime
US	United States
US$	United States Dollar
VAPT	Vulnerability Assessment and Penetration Testing
VRS	Voluntary Retirement Scheme
VSAT	Very Small Aperture Terminal
WAF	Web Application Firewall
WAN	Wide Area Network
WB	World Bank
WPI	Wholesale Price Index
WRDB	Western Rural Development Bank
WTO	World Trade Organization
XMPI	Export and Import Price Index

Summary

This publication gives a series of historical snapshots on the activities discharged by Nepal Rastra Bank to fulfill its mandate and portrays the dynamism of the Bank in responding to the major challenges. This description is deliberated in 15 chapters broadly divided into five parts, namely: (i) Institutional Development; (ii) Monetary Policy; (iii) Financial Stability; (iv) Financial Sector Development; and (v) International Relations.

The first part, "Institutional Development", includes two chapters. The first chapter, Organizational Development, discusses the inception of NRB, the Bank's past and present organizational structure, its evolution including present status of various departments and offices, the development of corporate governance and internal control along with risk management. The current process of decision making, strategic planning, transparency and infrastructure development and planning are also reviewed. The second chapter deals with human resource management and commences with the structure of human resources in the Bank, its policies and practices, covering all aspects of employment starting from recruitment to ending with retirement, human resource development and planning as well as employee relations.

The second part, "Monetary Policy", spans over five chapters, starting from the third chapter which highlights Nepal's macroeconomic performance over the last six decades. This includes economic growth, patterns of consumption, savings, investment, development plans and budgetary development. This chapter also discusses inflation and developments of the monetary and external sector. The fourth chapter covers formulation and implementation of monetary policy. The fifth chapter deals with public debt management and explains the process of issuance of public debt, composition of public debt as well as institutional and domestic procedural changes. The sixth chapter covers foreign exchange management by elaborating its legal framework, evolution, institutions as well as principles of foreign exchange reserve management. This chapter also covers exchange rate policy and foreign exchange intervention. The seventh chapter deals with currency management and includes planning and forecasting of currency, process of currency design, issuance of both bank notes and coins, circulation of currency and note destruction.

The third part, “Financial Stability” includes three chapters starting from chapter eight which discusses financial sector reforms, particularly focusing on legal architecture and licensing policy. The ninth chapter highlights the evolution of regulatory framework and covers micro prudential, macro prudential and other regulations and continues with discussion on merger and acquisition as well as AML/CFT/KYC related measures. The tenth chapter elaborates supervisory practices adopted by NRB and includes evolution of supervision functions; onsite examination; off site surveillance; early warning system; stress testing; enforcement; prompt corrective actions along with problem banks resolution.

The fourth part, "Financial Sector Development" starts from chapter eleven which captures the development of banking services through discussion on development of banking institutions and banking services by NRB. The twelfth chapter on financial inclusion and literacy includes discussion on state of financial access and inclusion and relevant policies and programs (such as priority sector lending etc.) along with financial literacy. The thirteenth chapter on payment systems development includes discussion on large value payment systems, retail value payment systems, payment system oversight and auxiliary institutions (such as Nepal Clearing House Ltd. etc.). The fourteenth chapter on Information Technology includes discussion on IT infrastructure in NRB, IT infrastructure and electronic banking service in the banking sector and cyber threat and security measures.

The fifth part, “International Relations” is limited to one chapter. The fifteenth chapter discusses NRB's relations with various international organizations and covers International Monetary Fund; The World Bank; Asian Development Bank; World Trade Organization; The South East Asian Central Banks Research and Training Centre; South East Asia, New Zealand, Australia; Alliance for Financial Inclusion; Asian Clearing Union; Asia Pacific Rural and Agricultural Credit Association; Centre for International Cooperation and Training in Agricultural Banking; SAARCFINANCE, SAARC Payments Council; South Asia Regional Training and Technical Assistance Centre and Bank for International Settlements.

Part 1
Institutional Development

1 Organizational Development

1.1 Inception of Nepal Rastra Bank

Political revolution ended the 104-year old autocratic Rana regime in 1951. The regime was replaced by transitory multiparty democratic system. The Nepalese economy remained static as the country was virtually isolated from the rest of the world until then. Nepal, for the first time, formulated and presented annual budget in February 1951[1] and started maintaining Government accounts separately. At that time, the Nepalese economy was very primitive and traditional, heavily dominated by subsistence agriculture, low level of infrastructure and financial development, and very limited industrial activities. Within a few years, Nepal took initiative in building relations with the foreign countries and international institutions, joined the United Nations and started receiving financial assistance.

At that time, Nepal Bank Limited (NBL), the first and only one commercial bank which was established in 1937, was in operation and there was widespread circulation of Indian rupees (IRs) as a legal tender. With the political change, Nepal embarked on planned development path to expedite economic development, which required large-scale resource mobilization along with effective institutions to facilitate the process. It was realized that for the expansion of economic activities, especially industrialization and modernization of the agriculture, development of the financial sector was necessary. To monetize the barter economy and replace the use of IRs, the widespread circulation of Nepalese Rupee (NRs) was essential. Against this background, the Government of Nepal (GON) realized the importance of establishment of a central bank to issue currency and expand its circulation, regulate financial sector, manage foreign currency reserve and mobilize saving for economic development. Accordingly, the Nepal Rastra Bank (NRB) Act,

[1] The first budget was for the period of March 1951 to February 1952. From then onwards, budgets have been prepared for the Nepalese fiscal year, i.e. from mid-July to mid-July (Pant, 1956).

1955 was enacted and NRB was founded as Nepal's Central Bank on 26 April 1956, with Late King Mahendra Bir Bikram Shah Dev inaugurating it.

The NRB Bill 1955 was drafted with the active involvement of then Principal Royal Adviser Sardar Gunjjaman Singh. The Bill was granted the royal seal on 4 November 1955, which provided the legal basis for the establishment of the NRB. Mr. Himalaya S. Rana, who was assigned the responsibility of carrying out the work for the establishment of the NRB, was appointed later as its first Governor. The NRB started its operation in the beginning with three central departments -Banking, Issue and Research. At the time of NRB's inception, there were 23 staff comprising 5 officers and 16 non-officers in addition to the Chief Accountant and the Governor.

Considering the evolving stage of the Nepalese economy at that time, the then NRB Act, 1955 entrusted the NRB with both the traditional central banking as well as the development functions. In the beginning, the major task of the NRB was not simply to formulate monetary policy but to develop the financial sector and, more importantly, to both increase the circulation of NRs in the economy and to stabilize the volatility in exchange rate with IRs. Prior to the establishment of the NRB, Central Public Treasury *(Sadar Muluki Khana)* used to manage government accounts and issue NRs starting since 1945, but had no assigned role for the development and oversight of the Nepalese financial sector. Nepal's foreign exchange reserves were managed by Reserve Bank of India (RBI), which was established in April 1935, more than twenty years prior to the establishment of NRB.

1.2 Organization Structure

At the time of establishment, the Bank's organization structure was simple, having only the Central Office, Banking Section and the Issue Division for achieving the objectives as laid by the Act. The Central Office had further sub-sections, namely, Accounts, Administration, Foreign and Research Sections. In the course of evolution, the scope and coverage of NRB's tasks kept on expanding. In the first decade (1956-66) of its establishment, NRB focused on eliminating the dual currency system and stabilizing the exchange rate between the NRs and IRs. In the second decade (1966-76), the Bank shifted its focus towards formulating and executing appropriate monetary and credit policies, apart from initiating the development of the banking system in the country.

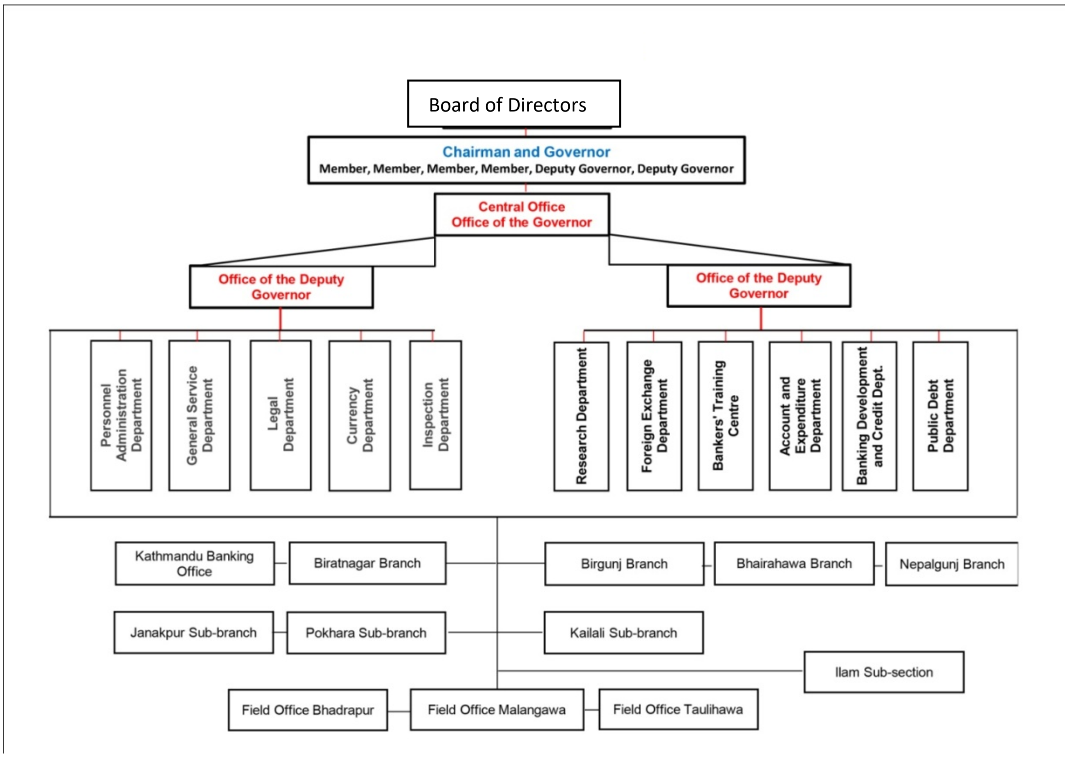
As the scope and sphere of the Bank's activities increased, the number of departments kept on increasing and the Bank's organization structure broadened. The Inspection and Check Department was established in 1956 for the inspection of various offices within the Bank. The Department was also entrusted with the function of internal audit. Likewise, the Administrative Department and the Accounts Department came into existence in 1957. While the Administrative Department was entrusted with the responsibility of efficient and effective management of the ever-increasing administrative functions, the Accounts Department took the onus of accounting the Bank's incomes and expenditures. The Supervision and Inspection Department also came into existence as a new department within two years of the establishment of the Bank. The year 1959 marked the birth of Foreign Agency, Exchange and Investment Department. The organization structure was expanded further with the establishment of Public Debt Department in 1962.

At that time NRB felt the necessity of encouraging and fostering banking practices among Nepalese citizens. Accordingly, NRB created Banking Operation and Development Department in 1966. The Legal Unit that was established initially under the Administrative Department had come into existence as a full-fledged department in 1968. In 1970, Bankers Training Centre was established with the objective of enhancing the knowledge and capacity of NRB's employees as well as that of other banks and financial institutions. The year also witnessed the institutionalization of Governor's Office albeit it had been in operation ever since the beginning of the Bank.

To assist the development of agricultural sector through studies and research, Agricultural Credit Department was established in 1972. The functions of budget release and infrastructure maintenance were segregated from the Administrative Department in 1977, which were carried out by the newly formed General Service Department (GSD). The same year also witnessed the birth of Budget Control Division which was entrusted with the primary responsibilities of formulating annual budget and ensuring transparency in expenditure mechanism within the Bank. The Bank Management Division, Bank Inspection Division and Industrial Credit Unit came into existence to effectively carry out the tasks like banking promotion, credit control, data refinement, commercial banks' inspection and so on.

The organization structure of the Bank in 25th year of its establishment (1956-1981) was as shown in Chart 1.1:

Chart 1.1: Organization Structure of NRB in 25th Year



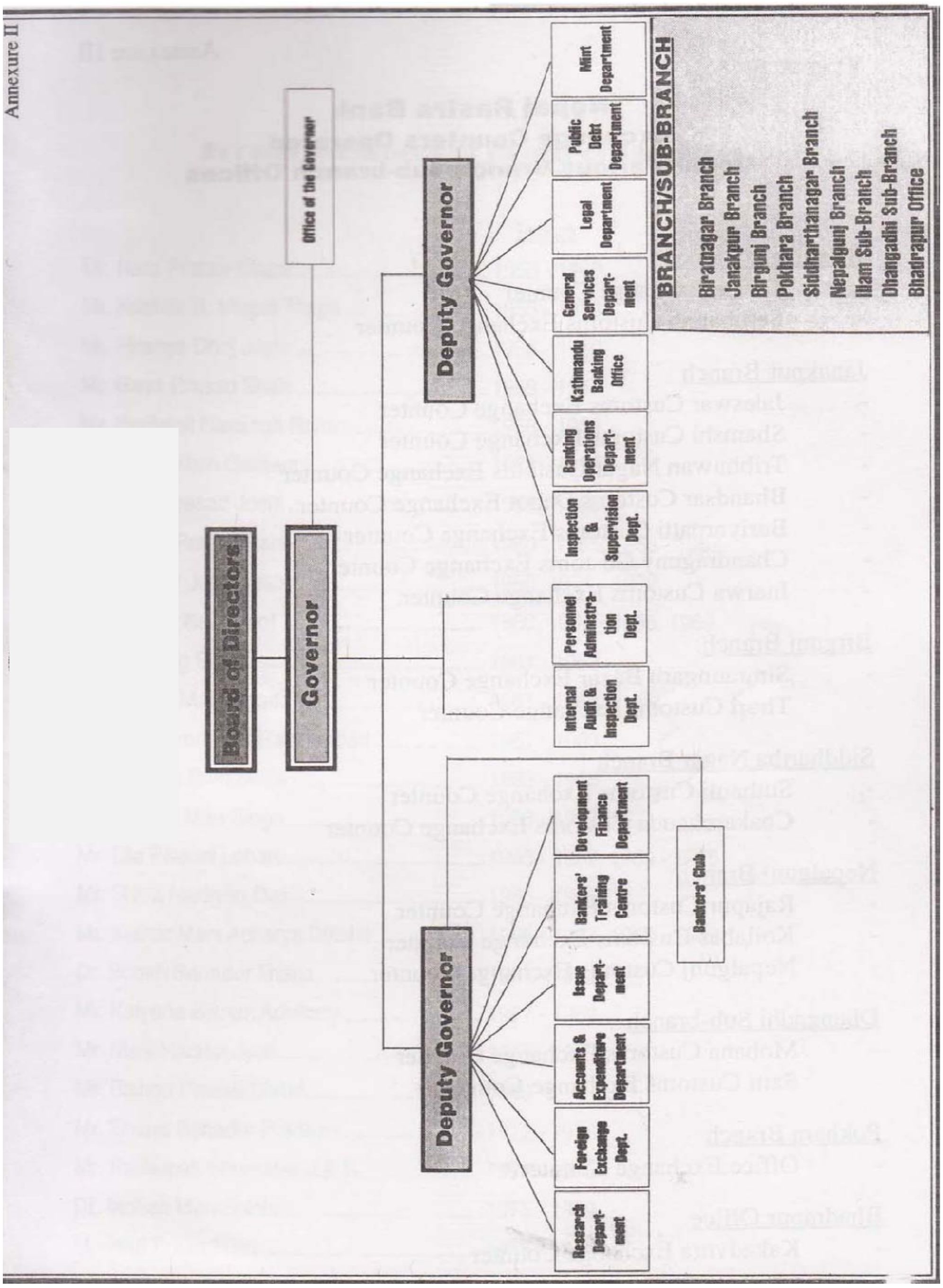
Source: NRB (1981)

The third decade (1976-86) witnessed the Bank playing an active role in development financing as the financial system kept on expanding. The fourth decade (1986-96) proved to be a turning point in redefining and readjusting the Bank's role as it had to adapt with and adopt the process of financial liberalization. Restructuring the organogram and formulating the policies and processes to assist in the economic stabilization were added to the Bank's core functions. The ever changing domestic economic dynamics and the necessity to converge with the waves of globalization were reflected in the organization's organogram.

The departmental structure and operational features of the Bank by the end of the fourth decade comprised the Office of the Governor, Kathmandu Banking Office (KBO), Issue Department, Personnel Administration Department, Banking Operation Department, Development Finance Department, Inspection and Supervision Department, Foreign Exchange

Department, Research Department, Public Debt Department, Mint Department, Internal Audit and Inspection Department, General Service Department, Accounts and Expenditure Department and Legal Department.

Chart 1.2: Organization Structure of NRB in 40th Year



Source: NRB (1996)

The beginning of the fifth decade (1996-2006) marked the initiation of financial sector reform where the Bank was heavily involved and engaged. Further departmental expansion took place in 2000. Corporate Planning Department was established in December 2001. Banking Operation Department was renamed as Regulation Department; and Regulation Department and Supervision Department were bifurcated into Bank and Non-Bank Regulation and Supervision Departments. However, after two years of operation, the Bank and Non-Bank Regulation Departments were merged resulting in the creation of Banks and Financial Institutions Regulation Department on 22 November 2002.

With the carrying out of the NRB reengineering process under the financial sector reform programme during the 2000s, the organization structure of the NRB was classified into four functional areas and the nomenclature of the departments was also changed on 25 November 2002. These four functional areas were: Monetary and Foreign Exchange Group, Regulation and Supervision Group, Banking Management Group and Support Services Group. Accordingly, by mid-July 2003, the list of departments was follows:

(1) Currency Management Department
(2) Human Resource Management Department
(3) Financial Management Department
(4) Foreign Exchange Management Department
(5) Bank Supervision Department
(6) Non-Bank Supervision Department
(7) Banking Office
(8) Microfinance Department
(9) Information Technology Department
(10) Internal Audit Department
(11) Research Department
(12) Mint Division
(13) Bank and Financial Institution Regulation Department
(14) General Service Department
(15) Public Debt Management Department
(16) Office of the Governor

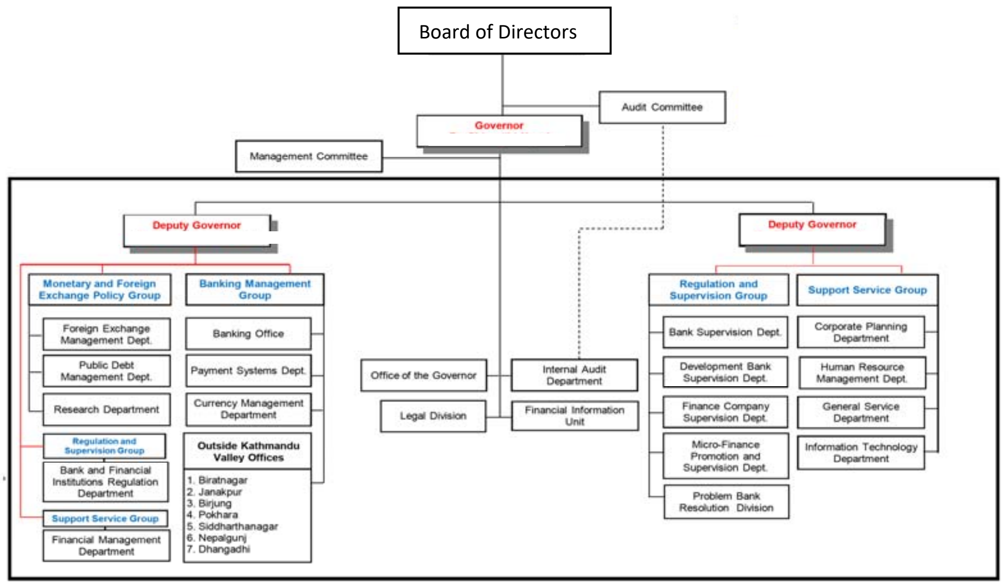
(17) Bankers Training Centre and

(18) Corporate Planning Department

In 2004/05, Banker's Club, established on 20 August 1971, was closed. On 11 July 2006, Mint Department was merged with Currency Management Department (CMD) as a Division. As a latest development, Payment System Department was established in July 2015. In the same year, BTC was downgraded as a division of HRMD. Thus, the number of departments now stands at 17.

By the end of 60th year, the Bank's organogram depicts the following structure as in mid-July 2016 (Chart 1.3).

Chart 1.3: Organization Structure of NRB in 60th Year



1.3 Departments and Offices of Nepal Rastra Bank

NRB is organized into a number of departments to carry out specific functions. Various departments and offices have been created in response to the need of the time. As of mid-December 2016 there are 17 departments, which are headed by Executive Directors (EDs) and remaining twelve offices and divisions are headed by Directors. A brief description of existing departments and offices is presented below.

Research Department

Research Department (RD) is one of the three departments established in the very beginning as Research and Statistics Department for compilation of statistics and carrying out economic research. The Department dedicates itself to compile macroeconomic statistics. RD plays a vital role in discharging the Bank's responsibility as an economic advisor to the Government. The Department is responsible for analyzing the overall macroeconomic situation of the country besides conducting research and analytical work in different economic issues. RD prepares analytical work for Pre-Budget Review Report and Annual Report, which are submitted to the Ministry of Finance (MOF). The Department also engages in preparing annual Monetary Policy draft together with conducting its periodic reviews. The Department is responsible for publications like the Monetary Policy and its reviews, annual report, quarterly economic bulletin, monthly macroeconomic and financial situation, economic review and other special research reports.

RD has been actively involved in compiling monetary, prices (consumer, wholesale and salary and wage rate index) and BOP statistics. Since 2002/03, the Department started compiling monetary statistics as per IMF's Monetary and Financial Statistics Manual 2000. Likewise, since May 2003, BOP statistics have been published as per the IMF's Balance of Payments Statistics (Fifth) Manual. More importantly, the Department has been conducting household budget survey starting in 1975 to prepare the National Urban Consumer Price Index. In 2015/16, the Department conducted the Fifth Household Budget Survey. The Department has also been publishing wholesale price index since 2000/01 and the Salary and Wage Rate Index since 2004/05.

RD is currently composed of 7 divisions, namely, Price Division, Monetary Division, Government Finance Division, Economic Development Division, Economic Analysis Division, Publication Division, BOP and International Finance Division. Separate Trade Division and BOP Division were combined together as BOP and International Finance Division in 2013. Some activities carried out by then International Finance Division were shifted to the Office of the Governor by creating International Relations Division (IRD), effective 12 June 2013.

Foreign Exchange Management Department

The Foreign Exchange Management Department (FEMD) is responsible for monitoring foreign exchange transactions and managing country's international reserves. The Department is also entrusted with the responsibility of facilitating external trade and payments and promoting orderly development of foreign exchange market in Nepal. The Department is also responsible for prudent management of the country's foreign exchange reserves. It is also involved in regulating money changers and other institutions engaged in foreign currency transactions.

Initially, Foreign Agency and Investment Department was formed on 21 September 1959, which evolved to the Foreign Exchange Department on 20 November 1969. During NRB reengineering process, it was renamed as Foreign Exchange Management Department, with restructuring of Investment Division into front office, middle office and back office. Presently, this Department is composed of seven divisions: Licensing, Policy Planning, Import and Export, Foreign Direct Investment (FDI) and Internal Administration and Inspection. This Department also coordinates with the Asian Clearing Unit (ACU), a regional institution with nine member countries, of which NRB is a founding member.

Bank and Financial Institution Regulation Department

Banking Operation and Development Department, the predecessor of the present Department, was established in 1966 for effective regulation of the banking sector. This Department was established after a year of issuing Credit Control Regulations for directing commercial banks in the matters of monetary and credit policies. The Department was renamed as Banking Operation and Credit Department on 2 December 1974 by merging the Agricultural Credit Department (which was formed on 21 April 1973) and the Industrial Credit Division. Until 1984, this Department also carried out supervisory function by establishing Inspection Division on 17 November 1974. Later, on 4 April 1986, the Department was renamed as Banking Operation Department by taking out Agricultural Credit Division, Industrial Credit Division and Priority Sector Credit Unit. This Department was again renamed as Regulation Department in 2000, and spilt into two departments: Bank Regulation Department and Non-Bank Regulation Department. After two years, they were merged together, to form Bank and Financial Institution Regulation Department (BFIRD) in the current form.

BFIRD exercises its regulatory powers in respect of licensing, branch expansion and management and modalities of operations of commercial banks (A-class financial institutions), development banks (B-class financial institutions), finance companies (C-class financial institutions) and Microfinance Development Institutions (D-class financial institutions). The Department is also responsible for promoting and fostering a sound, multi-faceted and competitive financial system by laying down norms and regulatory standards for prudential regulation for BFIs - the standards that are at par with the international best practices which are also tailored to suit the national requirements. Additionally, the Department facilitates mergers and acquisitions of financial institutions for which Merger and Acquisition Section was established in 2011. Altogether, there are nine Sections/Units in this Department as of mid-July 2016, namely, Bank Regulation (divided into Bank Regulation 1 and Bank Regulation 2), Development Bank Regulation, Finance Company Regulation, Microfinance Regulation, Statistics, Financial Stability, Merger and Acquisition, Policy Planning and Internal Administration.

Bank Supervision Department

In 1984, Supervision and Inspection Department was established as a predecessor of the Bank Supervision Department (BSD). Prior to that, the supervisory task was performed by the Inspection Division, which was set up on November 17, 1974 under the then Banking Operation and Development Department. In 2000, the then Supervision Department was divided into Bank Supervision and Non-Bank Supervision Department. The BSD is responsible for ensuring that the operations and conduct of commercial banks, i.e., the A-class financial institutions, are in line with the Bank and Financial Institution Act and prudential directives issued by the Bank. The BSD examines whether the supervised bank follows regulatory prescriptions and internal risk management practices and that those are aligned with regulatory expectations. It also collects, monitors and analyzes the data pertaining to banking indicators through its Off-site Monitoring Unit. The Special Inspection Unit carries out special inspection of commercial banks as and when necessary rather than as a pre-determined routine. Another area that BSD focuses is that of enforcement. The enforcement and follow up unit within the BSD ensures that the commercial banks comply with the directions given by the Bank in the course of on-site inspection, off-site monitoring as well as special inspection. The BSD consists of six Sections/Units: Policy Planning and Forward Looking Analysis, On-site Inspection, Enforcement and Follow up, Special Inspection, Off-site Supervision and Compliance, and Internal Administration.

Development Bank Supervision Department

In 2000, the then Supervision Department was divided into Bank Supervision and Non-Bank Supervision Departments. In November 2002, Non-Bank Supervision Department was renamed as Financial Institution Supervision Department. This Department in its present form was established in November 2011 by separating the Financial Institution Supervision Department into two departments, namely, Development Bank Supervision Department (DBSD) and Finance Company Supervision Department (FCSD).

The DBSD supervises the operations of development banks and ensures the implementation of prudential directives issued by the Bank. The DBSD consists of five Desks, namely, On-site Report Review Desk, Off-site Supervision Desk, Policy Planning and Forward Looking Analysis Desk, Internal Administration and On-site Report Enforcement Desk.

Finance Company Supervision Department

Considering the growing number of finance companies in the Nepalese financial system, the FCSD was established, together with DBSD, by splitting the then Non-Bank Supervision Department in November 2011. The FCSD is responsible for supervising finance companies. The FCSD ensures that the institutions within its purview comply with the prevalent laws and prudential regulations governing them. The FCSD consists of five Sections: On-site, Off-site, Enforcement, Policy Planning and Internal Administration.

Microfinance Promotion and Supervision Department

Until 2002, this Department was called Development Finance Department, which was established in April 1986 by merging Agriculture Credit Division, Industrial Credit Division and Priority Sector Credit Unit of the then Banking Operation and Development Department. In the past, the Development Finance Department used to channelize refinance facilities to the Agricultural Development Bank (ADB/N), Nepal Industrial Development Corporation (NIDC) and rural development banks as well as conduct Industrial Credit Surveys and Rural Credit Surveys besides executing the cottage and small-scale industries (CSI) project. This Department also managed the flow of credit to the priority sector of the economy.

Development Finance Department was renamed as Microfinance Department in November 2002. In 2010/11, Microfinance Department was reorganized into the present structure, discharging the responsibility of supervision of microfinance institutions in addition to promotion of these institutions. Supervision of microfinance institutions falls under the responsibility of this Department. However, unlike other supervisory departments, this Department is also responsible for the promotion of microfinance institutions throughout the country as an attempt to expand the access to finance under financial inclusion programmes. The Department consists of six Sections/Desks, namely, Internal Administration and Policy Planning, Off-site, Rural Self-Reliance Fund (Front Desk and Back Desk), Enforcement (Microfinance Institutions, FINGOs, Cooperatives), Phase-out Projects and Foreign Agency Projects, and Financial Literacy.

Internal Audit Department

The Internal Audit Department (IAD) was established in 1957 as Inspection and Check Department. At that time, this Department also undertook the inspection of commercial banks. IAD is now tasked with the mandate of providing an independent and objective assurance and feedback on the operations and working of different departments and units of the Bank. The Department examines, evaluates and reports on the adequacy and reliability of the Bank's policies, internal controls and governance processes through off-site as well as on-site auditing whenever necessary. The Department follows up on the audit observations to ensure that prompt corrective actions are taken up or risk mitigating counter-measures are being initiated. The Department reports straight away to the Audit Committee, which is constituted as per the provision of NRB Act, 2002. The Committee, which remains under Board of Directors of NRB, is formed under the Chairmanship of one of the non-executive Board of Directors. The Department consists of six Desks, i.e. Desk 1-6.

The Department is placed directly under the Governor of the Bank, and it is accountable to the Audit Committee for its operations. The main objectives of the Department are to control, check, provide recommendations for improvement on internal control and corporate governance and maintain balance in functioning of NRB.

General Service Department

General Service Department (GSD) was set up in August 1977. Prior to that, it was a section under the then Administration Department. The Department is responsible to provide timely and adequate supply of logistics necessary to ensure the smooth functioning of day-to-day activities of the Bank. The Department is entrusted with the task of maintaining, augmenting and conserving the existing physical facilities and structures as well as constructing new physical infrastructure as and when necessary. It also frames policies and guidelines on physical infrastructure, acquisition, maintenance, consolidation and disposal of office and residential space. In order to undertake its functions, the Department follows procedures that, at a minimum, provide for purchase/procurement of equipment, supplies and materials while abiding by existing procurement rules, budgetary provision and construction standards. GSD is also responsible for managing cafeteria for NRB staff and press for publication of NRB's materials. Currently, the Department consists of eight Sections/Units, which are: (i) Construction, Repair and Maintenance and Software, (ii) Policy Planning, Budget, Risk Management, Asset Management, (iii) Automobiles, (iv) Pharmacy, (v) Electrical, (vi) Press, (vii) Telephone Exchange and (viii) Central Receipt/Dispatch of Mails.

Human Resource Management Department

Human Resource Management Department (HRMD) essentially facilitates the central banking functions by undertaking a number of activities related to human resource of the Bank. The Department is responsible for evolving and implementing time-ordained policies of recruitment, placement, promotion and career progression, performance evaluation, training and development, transfers, pay structure and other facilities, among others. By undertaking the aforementioned activities, the Department aims at increasing the organizational efficiency by drawing the best from the staff apart from looking after their wellbeing and personal aspirations. The HRMD consists of four Sections, namely, Personnel, Recruitment, Policy Planning and Internal Administration. Since July 2015, Bankers Training Centre has also been operating under this Department.

The HRMD was named as Personnel Administration Department since 23 August 1977 until 2002. The Department was initially set up as the Administration Department in 1958. In the early days, this Department used to discharge functions relating to general services and legal matter. The Department uses Personnel Record Software (PRS) to manage the data like number of staff, salary, grade, leave, educational qualification, family members and retirement time. New system called Human Resource Management Information System (HRMIS) has been under implementation for effective and efficient record keeping of employees. Attendance module of HRMIS for biometric attendance was started since2015.

Payment Systems Department

Payment Systems Department (PSD) is a recent addition to the Bank's organogram. It came into existence as per the decision made on 2 July 2015 by NRB's Board of Directors (BOD). The Department is responsible for formulating various policies with respect to establishment of an effective and safe domestic payment systems. PSD prescribes policies relating to licensing, regulation and supervisiovn of all types of payments. Its functions include issuing license to institutions/ mechanisms operating related activities, their regulation as well as supervision apart from laying down standards for the same. Designing, developing and integrating payment system projects of national importance and facilitating such implementation are other focus of the Department. The Department consists of five Sections, namely, Policy Planning, Licensing, Oversight, Internal Administration, National/International Coordination and Cooperation.

Public Debt Management Department

In 1962, the Public Debt Department was established for internal debt mobilization of the government. Before that, Research Department carried out operations related to public debt. The Department was renamed as Public Debt Management Department (PDMD) in 2002. The main objectives of the Department are to manage the Government's debt in a risk efficient and cost effective manner and to provide innovative and practical solutions for government's debt management. The primary function of the Department involves choosing the instrument and tenure to manage the market borrowing programmes of the Government of Nepal (GON). It also monitors movement of yields of Government securities, among others. PDMD develops an issue and auction calendar in coordination with the Ministry of Finance (MOF) for raising necessary resources through internal borrowing. It also undertakes other public debt management functions relating to operation and management of secondary market of government securities, payment of interest on outstanding securities, payment of principal of matured securities and settlement with government agency.

Since the mid-1980s and more vigorously, since the 1990s, the Department has been involved in carrying out the open market operations as part of monetary policy operation conducted by the NRB in addition to public debt management of the government. For managing liquidity in the banking system, PDMD issues the NRB bond and term deposit auction in addition to other open market operations such as repo, reverse repo, outright sale and outright purchase. The Department consists of four Sections, namely, (i) Treasury, Policy Planning and Internal Administration, (ii) Monetary, (iii) Accounts and Reimbursement, and (iv) Issue and Management.

Corporate Planning Department

The Corporate Planning Department (CPD) was established in December 2001 under the name Policy Planning Department by upgrading the then Organization and Methodology (O and M) Division under Personnel Administration Department (currently called HRMD). The Organization and Method unit used to formulate policy regarding human resource and organizational restructuring. In December 2003, the job of formulating human resource policy was transferred to HRMD. Similarly, the job of formulating budget was transferred to the Policy Planning Department from the Financial Management Department

CPD undertakes a variety of functions in an effort to achieve the Bank's goals, long-term vision and mission. The primary responsibility of the Department is to formulate strategic and business plans to assist the Bank in achieving its goals apart from periodically reviewing and assessing the effectiveness of strategic and annual plans. CPD also prepares and allocates the budget for all the departments and units as well as the regional offices of the Bank. Besides, it is entrusted with the work of identifying, monitoring and managing the corporate risks that arise in the Bank from its policy implementation and business operations. The Department consists of four Sections, namely, Planning and Technical Cooperation, Internal Administration, Budget Management, and Risk Management.

Financial Management Department

The Financial Management Department (FMD), renamed so in November 2002, was previously called the Accounts and Expenditure Department, which was established in 1958 by upgrading the then Accounts Section. The prime responsibility of the Department is the management of the Bank's cash flow to ensure that there are enough funds available to meet the day-to-day payments as well as conduct the accounting function of the Bank. FMD, as the prime budget centre in NRB, is responsible for reporting the assets and liabilities as well as profits and losses of the Bank. It also prepares the periodic financial statements including the balance sheet of the Bank. For this matter, the Department also functions as the data consolidation centre for various budget centres, which report their financial activities to the Department for collection, compilation and consolidated reporting of the Bank's overall financial status. Financial expenses that are incurred in the course of carrying out the functions and duties of the Bank get released only upon the scrutiny and approval of the Department. In this regard, FMD acts as an accounting centre of Bank's financial activities which also ensures a level of check and balance between incurring of expenses and their final payment. Since 18 October 2006, welfare unit of HRMD was transferred to this Department. FMD consists of eight Sections, namely, Staff Expenses, Travel Bills, Purchase Bills, Balance Sheet, Reconciliation, Staff Retirement Fund, Pension and Welfare, and Internal Administration.

Currency Management Department

The Currency Management Department (CMD), earlier called the Issue Department, was established on 28 September 1956, five months after the establishment of NRB. To ensure wider circulation and expansion of NRs and to facilitate increased monetization of the economy, the Circulation of Nepalese Currency Act was enacted on 13 April 1960, which facilitated the then Issue Department to perform its functions more effectively. Since 19 February 1960, the NRB started issuing the currency notes after taking over all the unissued currency notes printed by 'Sadar Muluki Khana' (Central Treasury Office).

The Issue Department was renamed as CMD while changing the nomenclature of departments during the reengineering process. The Department has the responsibility of ensuring uninterrupted supply of notes and coins all over the country. It essentially entails the issue of notes and coins and retrieval of soiled notes from circulation. As such, the Department is entrusted with the responsibilities of forecasting the long-term requirements of the currency and its allocation taking into account the demand pattern, storage facilities and so on. In pursuit of currency management role, it also undertakes the functions like designing the banknotes, forecasting denomination wise demand for notes and coins, ensuring the integrity of banknotes and dissemination of information on currency-related matters to the general public, among others. As minting operation started getting outsourced due to cost-effectiveness, the Mint Department* limited itself to minting commemorative coins. Hence, once as a full-fledged Department, it was later downsized to Mint Division and transferred to CMD on 11 July 2006. The Department consists of nine Sections, namely, Note Printing and Fund Transfer, Note Chest, Note Stock, Exchange, Note Claim, Note Ledger, Ledger Account, Store, Internal and Administration/Purchase.

* The Mint Department was transferred to the NRB from the Government on 1 December 1983.

Information Technology Department

The Information Technology Department (ITD) was established in June 1999 by upgrading the then Computer Division under then Personnel Administration Department. Prior to that, Computer Section created in 1985 under the RD was upgraded and was placed under the Personnel Administration Department. This Department has the responsibility of facilitating smooth communication and maintaining a sound Information Management System in the Bank. The Department also develops software necessary for smooth functioning of various departments' activities as well as manages the customization process of the purchased software according to the Bank's requirements. ITD is also entrusted with the responsibility of maintaining hardware, protecting servers and network infrastructure, and safeguarding internal communication and information from internal and external threats. It also maintains data repository and the back-up centre for the Bank's data. In this realm, safeguarding and safe-keeping of data for a required time also come within the functions of the Department. It also assists other departments in IT related areas. The Department consists of five Sections, namely, Server Administration, Research Policy and Planning, Internal Administration, IT Infrastructure Support and Help Desk, and Software Implementation.

Banking Office

The Banking Office was established very early, immediately after the inception of NRB at Thapathali, Kathmandu. As the name suggests, the Banking Office undertakes the task of the banking for the Government and the BFIs. It is entrusted with the responsibility of discharging the banking functions for the GON such as making payments and collecting the revenues on its behalf. Banking Office is also responsible for providing exchange facilities to the GON, other licensed financial institutions or money changers as well as the general public. The Office is also entrusted with the end of the period payments and settlements among its licensed financial institutions operating in the economy by acting as the clearing house. The Office is also involved in providing IRs to the public and exchanges of foreign currencies with BFIs and Government institutions. The Office has 13 Sections, namely, Government Accounts, Electronic Cheque Clearing, Accounts Management, Remittance, Bills, Indian Currency, Letter of Credit (LC), Transfer, Deposit (*Dakhila*), Cash, Store, and SWIFT and Internal Administration.

Office of the Governor

The setting up of the Office of the Governor (OFG) dates back to the establishment of the Bank. Later, it was re-organized and expanded in 1970. The OFG is the department-level office that acts as the executive representation of the functions that would assist the Governor for discharging the day-to-day activities and also that demand the presence of the Governor. For this matter, the Office acts as the Secretariat of the Board and undertakes various functions for its internal and external stakeholders. For the external stakeholders like the general public, the OFG acts as the Bank's outlet of public relations. It also keeps close contact with line agencies of the Government. Internally, the Office facilitates BOD meetings, records the minutes of such meetings and disseminates such minutes to relevant departments and offices for necessary implementation. The directives and related policy matters on behalf of the BOD and Governor are channelized to the stakeholders through this office. Facilitating, conducting and record keeping of high profile meetings with other entities including various ministries and other international agencies also come within the purview of OFG. The Office also maintains close linkages with the international agencies.

Effective 6 January 2013, IRD has been established to maintain and enhance relations with international organizations and agencies. The OFG is also responsible for maintaining relations with the public and the media. For this purpose, the Public Relations Unit was set up in 1983, which was later upgraded to a Division in 1986. Public Relations Division publishes NRB Newsletter on a monthly basis and one Special Issue on the occasion of anniversary of the Bank. After the closure of Bankers' Club which used to publish "Mirmire" magazine, since July 2005, this division continued its publication. Since 2011/12, it has started knowledge sharing programme.

Legal Division

The Legal Division assists the Bank with the task of formulation, review and amendment of the prevalent laws and policies that govern the activities of the Bank. Providing legal advice to the top management, departments, units and regional offices of the Bank is another area that falls within the sphere of the Division's responsibilities. It also manages litigation on behalf of NRB against other organizations or entities and appears before various courts, judicial forums and other authorities on behalf of the Bank. Earlier, Legal Division used to be a department established in 1968, which was upgraded from a unit of the then Administration Department.

Financial Information Unit

Established on 21 April 2008 under section 9 of the Assets (Money) Laundering Prevention Act, 2008, the Financial Information Unit (FIU) is responsible for receiving, processing and analyzing financial information on suspected money laundering and terrorist financing activities as well as disseminating it to relevant law enforcement agencies and foreign FIUs. The primary responsibilities of FIU are to collect and receive reports from government agencies, financial institutions and non-financial institutions on suspicious and prescribed financial transactions and other information relevant to money laundering and financing of terrorist activities. It is also entrusted with the duty of ensuring compliance by reporting entities with their obligations on Suspicious Transaction Reporting (STR) and Threshold Transaction Reporting (TTR) under the Act, rules and regulations. The Unit is also mandated to develop information exchange mechanism with other FIUs or related international institution by entering into Memorandum of Understanding or by obtaining membership. It is also the national focal point of AML/CFT regime.

Bankers Training Centre

Bankers Training Centre (BTC) was established in 1970 for developing and upgrading the Bank's and the banking system's human resource through the means of training and development activities. Earlier, it was equivalent to a department, but downgraded as division on 22 July 2015 under the HRMD. BTC is engaged in providing internal trainings on different areas of banking. However, the Centre has also extended its training on the subjects pertaining to management, economics and other issues. It relies on the resources and expertise within the Bank and from outside.

Problem Bank Resolution Division

The Problem Bank Resolution Division is a new addition to NRB's organogram. It was established on 27 December 2013 and commenced its operation since 17 March 2014. The Problematic Banks and Financial Institutions By-laws 2014 approved on 10 July 2014 provided this Division with the guideline for resolving problematic institutions. The primary motivation behind the inception of this Division was to explore various resolution options for problematic financial institutions apart from expediting the resolution promptly. As mandated, the Division looks into the problems of troubled financial institutions and diagnoses the reasons for the occurrence of such problems. Once the problems are identified, the Division prescribes measure or series of measures for rescuing such institution. The Division provides approval to the appointment of the CEO and auditor besides selling the non-banking assets of problematic institutions. The Division obtains the information and statistics of problematic financial institutions as required.

NRB Offices Outside the Kathmandu Valley

At the backdrop of replacing the circulation of IRs by NRs, different branch offices were established all over Nepal at different points of time. For the purpose, these branches began unlimited exchange of IRs through setting up various counters in their region. These branches also undertook functions like operating government accounts in these regions, facilitating revenue collection for Government and issuing draft/TT for facilitating transactions, among others. At present, there are seven offices of NRB outside the Kathmandu Valley operating in Biratnagar, Janakpur, Birgunj, Pokhara, Siddharthanagar, Nepalgunj and Dhangadhi.

The first branch office was established in 1956 in Biratnagar. Till 1965, NRB continuously expanded its office network outside the Kathmandu Valley reaching as high as 24. The number of exchange counters reached a maximum of 83 in 1967/68. After the establishment of Rastriya Banijya Bank (RBB) in 1966, NRB handed over a number of its exchange counters, depots, sub-branches and co-branches to RBB. In 1967/68, about 14 centres were closed down which reduced the total number of counters to 66. The process of closing down of centres accelerated after starting to give license to money changers. By 2003, all NRB's counters were closed down and Ilam sub-office was merged with Biratnagar office in 2004. Branch office in Biratnagar, Birgunj and Siddharthanagar (Bhairahawa) were upgraded in 1988, with the special class officer heading these branches. However, with the centralization of Research and Supervisory functions, these branch offices were brought back again to be led by first class officer.

Further, increasing the circulation and access of NRs still remains as one of the focal objectives of branch offices. Although they still undertake their initial functions, there has been a gradual expansion in the duties and functions of these offices over the period of time. At present, these offices deploy the employees for economic research, price collection from the border areas and also undertake programmes to increase financial access and literacy in the regions that they are operating. General organization structure in these offices mostly comprises Internal Administration, Store, Research, Deposit, Bills, Clearing, Sorting and Cash Sections.

1.4 Corporate Governance and Internal Control System

The Bank develops policies and procedures on its own for its internal control and better self-governance. It believes that good governance in the Bank is key to achieve the objectives set out in NRB Act, 2002. There are different actors inside and outside the Bank to ensure good corporate governance and internal control. The major provisions of internal control system of NRB to maintain sound corporate governance could be described as follows:

Board of Directors and Management Committee

The primary responsibility of maintenance of good internal control and corporate governance within NRB lies with the BOD. It is the supreme authority of the Bank, which is headed by the Governor. The NRB Act, 2002 has also prescribed the formation of Management Committee (MC) which is responsible for implementing the decision of Board and ensuring that the functions of the Bank are performed to achieve the objectives mandated by NRB Act, 2002. It is also the duty of the Committee to ascertain that the day to day activities of the Bank are performed as per the prescribed Acts, rules, manuals and directives to assure that they are conducted in a smooth and transparent manner. The MC is also responsible for implementing various policies, plans and guidelines for internal strengthening and efficiency of the Bank.

Audit Committee

To ensure that the internal control system of the Bank, the NRB Act, 2002 has envisaged the formation of Audit Committee under the Chairmanship of non-Executive Director of the Board. Earlier, the Committee comprised the Chief of the IAD and one Senior Officer appointed by the Bank's BOD. Later, it was felt that involvement of senior officer of the Bank could possibly bring the conflict of interest and could compromise the independence of the Committee. Hence, to make the Committee more independent, transparent and objective, an external expert in related field as the member of Audit Committee in place of Senior Officer of the Bank has been provided in the NRB Act, 2002, as per the second amendment to the Act that was effected on 14 November 2016.

The primary roles and functions of Audit Committee are to provide oversight (i) on the accounts, budget and audit process, (ii) on the system of internal controls, (iii) on the appropriateness and adequacy of the financial reporting process and (iv) on the compliance with rules and regulations through regular conduct of management and performance audit. The Committee is also responsible for supervising the implementation of appropriate risk mitigation measures adopted by the Bank. It also oversees whether the segregation of duties among staff are proper and adequate, and whether activities are being conducted as per the approved work plan and budget to ensure better corporate governance.

Internal and External Audit

For internal control and corporate governance, IAD regularly audits the operations of departments and offices of NRB, in order to ensure that the day-to-day operations of the Bank run as per the prevailing rules and regulations and make necessary recommendation in this regard. Auditing is conducted based on various directives, manuals, guidelines, procedures and charter. These documents elucidate process, coverage areas and lines of authority of internal audit function; depict the planning, executing, programming and reporting method of the audit and provide authority to the personnel at the IAD to have unrestricted access to all the documents of the departments, divisions, units and offices while conducting audit. These documents include Internal Audit and Inspection Work Directives, 2003, Policy Paper regarding the Role of Management, Internal Audit and Audit Committee, 2002, Audit Committee (Work Procedure) Directives, 2002, Internal Audit and Inspection Bylaw, 2003 and Internal Audit Charter.

Regular audit of Banking Office, CMD, FMD, GSD, and seven offices outside the Kathmandu Valley are conducted. NRB intends to move towards implementing the risk-based internal auditing system (RBIA) soon from current compliance based system, for which IAD has already started to provide oversight on the Bank's risk management system.

Office of Auditor General (OAG) conducts the external audit of NRB, which is the supreme auditing authority of Nepal. OAG conducts audit of the financial statements and associated activities relating to the Bank. It conducts audit by giving due regard to considerations like the regularity, economy, efficiency, effectiveness and propriety as per the Audit Act, 1991. It also looks to ensure that the financial transactions comply with the existing laws, bylaws, regulations and financial reporting standards. It conducts audit to ascertain that the inventory of assets is accurate and up to date and arrangements for internal audit and internal control are made. The OAG conducts the audit of all the departments, offices and units to ascertain that the management and job allocation of the office are sufficient and proper. The IAD is also audited by the OAG on regular basis to check whether the Department is conducting the assigned task and submits its report based on the findings of audit.

Besides the emphasis on the adoption of measures for internal control for sound corporate governance, the NRB makes the rule-based decisions by formulating various by-laws and guidelines and disseminates reports pertaining to its performance to the government and the public on a regular basis. NRB publishes Annual Report on a yearly basis by including all activities carried out and financial statement of the respective fiscal year.

1.5 Risk Management

While carrying out its diverse functions and activities, it is inevitable to the Bank to confront with multiple risks emerging from the internal and the external environment. With the objective of integrating risks recognized across different departments and offices, and developing strategies to manage them cost effectively, NRB has initiated a systematic risk management approach since 2007 by formulating Risk Management Guideline. Several initiations have been followed to develop sound risk management practices in NRB. Until recently, NRB was following Integrated Risk Management Framework (IRMF), 2015 and Risk Management Directive, 2010, which has been recently replaced by Risk Management Directive, 2017. This framework has laid the foundation for creating a strong and consistent risk management culture in NRB.

Adoption of a sound risk management system has been given the high priority in accordance with the provisions made in different legal documents of NRB. NRB Act, 2002, section 35 (a), necessitates the NRB management to design and implement sound risk management practices throughout the Bank and ensure that all possible risks are identified and monitored on a timely basis. It also binds Audit Committee to supervise the risk management practices in the Bank. NRB has adopted the organizational set-up for risk management as given in Chart 1.4.

The BOD is the apex body in formulating the risk management policies, practices and other control mechanisms to manage risk. It plays an influential role in developing a strong risk management culture, approving a risk management framework consistent with the Bank's strategies and risk appetite, delegating authority to the Risk Management Committee and other departments and reviewing the quarterly integrated risk report submitted by CPD to ensure that the risk management has been undertaken adequately and effectively.

Chart 1.4: Organizational Set-up for Risk Management

Audit Committee along with IAD is responsible for ensuring that the Bank's risk management system, policies, programmes and safeguard measures are adequately implemented and complied for risk management. They also require all responsible departments and offices to identify potential risks relevant to their work periphery, to assess impacts of those risks, and to suggest suitable measures to mitigate them. The BOD has formulated Audit Committee Directives to review risk management processes all over the Bank regularly.

The BOD has formed the Risk Management Committee (RMC) under the Chairmanship of a Board member, which formulates necessary guidelines and procedures relevant to risk management. It is mainly responsible for reviewing and evaluating the consolidated risk management report submitted by the CPD; monitoring and evaluating the plans, policies and programmes undertaken to minimize the risks; establishing a coordination among the BOD, Audit Committee, senior management and Internal and External Auditor through CPD; submitting the half-yearly and yearly evaluation report to the BOD; and implementing the instructions given by the BOD, among others.

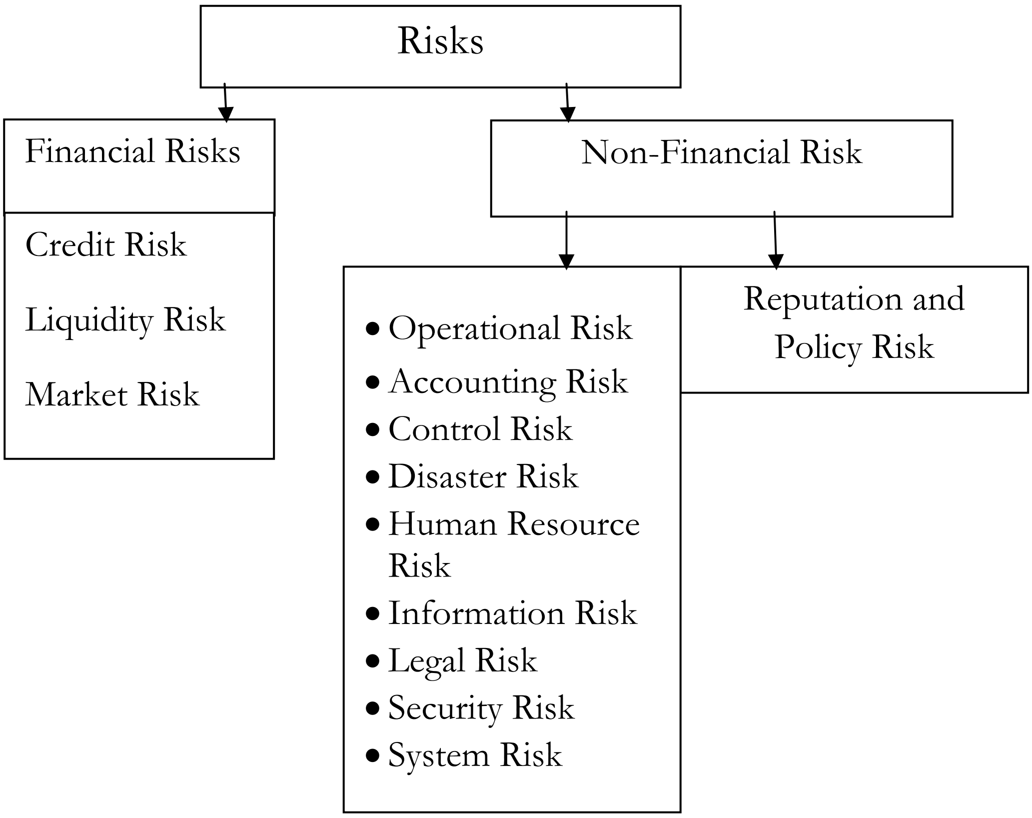
CPD functions as a secretariat of RMC. The Directive directs Risk Management Unit (RMU) established in CPD to look after the overall risk management activities of the Bank and appointment of a Chief Risk Management Officer in CPD. The Director of CPD is appointed as a Chief Risk Management Officer. The Department is responsible for submitting the risk management report to the RMC and submitting the same to the Board and establishing coordination among different departments. Risk management officers are to be appointed in each department

The RMU in CPD receives the risk registers from all the departments/offices quarterly. Then, by consolidating and assessing the recorded risks, and evaluating what actions needed to be taken, RMU prepares and submits the integrated half-yearly and yearly report to the RMC and quarterly report to the BOD upon the recommendation of the RMC. RMU then communicates the decisions to the concerned departments.

Risk Management Directive, 2017 mandates all the departments and offices to prepare the risk register as specified by the directive and also requires each of them to report the register to the CPD within seven working days from the end of each quarter**.** Departments, divisions and offices act as the first line of defence in risk management, whereby a Risk Management Officer identifies, assesses and categorizes the relevant risk in terms of the likelihood of occurrence and severity of impact along with the control measures undertaken to minimize the related risks. The departments, divisions and offices are responsible for submitting their risk registers to CPD on a quarterly basis. They are equally responsible for providing continuous feedback to RMU on the risk management practice.

Currently, there are 14 risk categories identified for NRB that may bring negative consequences, if not managed properly, as shown in Chart 1.5. These risks are assessed in terms of likelihood of occurrence and severity of impact from these risks. Likelihood of occurrence has been classified into five categories such as 'certain', 'likely', 'moderate', 'unlikely' and 'remote' by number as 5, 4, 3, 2, and 1 respectively. The severity of impact is also classified into five categories as 'extremely high', 'significant', 'considerable', 'minimum' and 'insignificant' which are numbered as 5, 4, 3, 2, and 1 respectively. Multiplication of numbers assigned to likelihood of occurrence and severity of impact gives the measurement of that risk. Number exceeding 16 indicates high risk, number ranging from 9 to 16 indicates medium risk and less than 9 shows less risky. Measurement of risks is shown in Box 1.1.

Chart 1.5: List of Risks Identified for NRB



Box 1.1: Risk Measurement Matrix

		Severity of Impact				
		1	2	3	4	5
Likelihood of Occurrence	5	Low	Medium	Medium	High	High
	4	Low	Low	Medium	Medium	High
	3	Low	Low	Medium	Medium	Medium
	2	Low	Low	Low	Low	Medium
	1	Low	Low	Low	Low	Low

1.6 Decision Making Process

Being at the forefront of the financial system, each and every decision made by the Bank could have serious economic impact on general public as well as the Nepalese economy. In this context, NRB Act, 2002 provides the legal set-up for decision making. The BOD is the highest decision making body. In previous NRB Act, 1955 too, the BOD was the apex decision-making body. However, the NRB Act 2002 has made NRB more independent for decision making and conducting monetary policy. This Act has made clear demarcation of functions, duties and powers of both the BOD and the Governor for decision making .

As per the NRB Act, 2002, the BOD comprises seven members. Apart from the Governor, as its ex-officio Chairman, the BOD includes the Finance Secretary and two Deputy Governors as ex-officio Board members[2] as well as three persons renowned in the fields of Economics, Monetary, Banking, Finance and Commercial Laws, appointed as members by the Government.

Decision of majority members is considered the decision of the BOD. In case of equality of votes for and against a resolution, the Chairman can cast the decisive vote. However, in practice, the Board normally makes decision unanimously. To facilitate the function of the Board, MC is formed as per section 33 of NRB Act, 2002 under the Chairmanship of the Governor which also comprises two Deputy Governors as members and one Senior Officer as Member Secretary.

As in earlier Act, NRB Act, 2002 has also incorporated the provision that the Governor can delegate authority assigned to him/her to Deputy Governor or other staff of the Bank. Accordingly, the delegation of decision making power has been made to different levels by enacting various rules and bylaws. As per the bylaw related to Board of Directors' Meeting 2006 introduced on 17 September 2006, the Board makes decisions on (i) monetary and foreign exchange rate policy, (ii) formulation of policy related to currency and coins, regulations and supervision, human resource management, licensing provisions, and investment of Bank's resources, (iii) approval of annual

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[2]As per the earlier NRB Act 1955, the Government used to appoint four directors for NRB Board, with Deputy Governors not included as members.

programmes and budget, and annual report of the Bank, (iv) limit of credit granted to the Government of Nepal from the Bank, (v) amount, limit and conditions for loans and refinance facility provided by the Bank to banks and financial institution (BFIs), (vi) Bank's membership with international institutions, (vii) proposal on amendment of NRB Act if necessary to forward to the Government and (viii) any matters that do not fall under the jurisdiction of the Governor as per the NRB Act, 2002.

The BOD has made the NRB Authority Delegation Bylaw, 2009 which has delegated the authority assigned to it by the Act to the Governor and from the Governor to Deputy Governors and officials of the departments. Accordingly, the Board delegated to the Governor the authority to (1) issue license to financial institutions except A-class and national level B-class financial institutions, (2) issue directive to licensed BFIs to deposit CRR as a ratio of deposits, borrowed fund and other liabilities, (3) penalize the licensed BFIs for not maintaining required CRR and not lending to designated areas, and working against the existing Acts and rules and regulations, (4) determine discount rate, bank rate and refinance rate, (5) issue order, directive, circular or notice for making the conduct of foreign exchange transactions by licensed institutions, (6) purchase or sell foreign exchange, gold and valuable metals, (7) issue regular and systematic directives to licensed BFIs on regulatory matters, (8) permit BFIs to issue debenture and other financial instruments, (9) decide and act on the corporate inspection and supervision reports of BFIs except class–A and national level class–B financial institution, (10) carrying out branch-level inspection and supervision and deciding on the necessary actions to be adopted, and (11) matters related to opening or closing of bank account and its operation in BFIs of Nepal and abroad.

As per the Authority Delegation Bylaw, 2009, depending on the amount of transactions and issues, decision making authority has been delegated up to Assistant Director on the matter related to foreign exchange transactions. Similarly, in case of regulation-related matters, decision making authority has been delegated up to the position of Director level. On the financial management-related issues, expense on small amount can be approved even at the level of Assistant Director. NRB's Purchase Bylaw 2014[3] (amended in 2015) has made necessary provision for the decision regarding purchasing goods and services by NRB.

For decisions to be made by the BOD, related departments submit the proposal in the prescribed format and present the issues in the BOD. Once the Board makes the decision on the proposed issues, the Board Secretary makes the minutes of the meeting, and decisions are sent to the respective departments for necessary implementation. In case of other decisions to be made at Governor's level, memo incorporating detailed description of the issues with related budget, if applicable, and proposed decisions should be forwarded to the Governor through different hierarchical authorities. Depending on the delegation of authority, the proposed decisions are accepted by different levels up to the level of the Governor.

Outside the Board, there are many other decisions made by committees such as (i) Recruitment Committee – headed by Deputy Governor to make decision on recruitment and promotion, (ii) Open Market Operation Committee – headed by Deputy Governor to make decision on open market operation and domestic debt management, (iii) Investment Committee – headed by Deputy Governor which makes decisions on investment of foreign reserves guided by the instrument guidelines approved by the Board, and (iv) Regulation Committee headed by Deputy Governor to make decisions on regulatory matters.

1.7 Strategic Planning

NRB has a very short history of strategic planning exercise. The first Strategic Plan was introduced in 2006 for five-year period of 2006-2010 and the second one covered the period of 2012-2016 on the English calendar basis. There was no strategic plan for one year period between these two plans. Second Strategic Plan was in effect until the end of December 2016.. The third Strategic Plan is in implementation starting from 2017/18 so that it corresponds to annual plan of the Bank.

Formulation of strategic plan is a subject of formal process that begins with formation of a high-level committee under the leadership of non-

[3] Enacted on 15 May 2014 (First amendment 23 June 2014).

executive Board member of the NRB. The Strategic Plan Formulation Committee (SPFC) normally consists of two deputy governors as well as executive director of CPD as members and director of CPD as member-secretary. Strategic plan is normally formulated covering a period of five years and a complete matrix of tasks (strategic actions and activities that are to be carried out by each of the departments and offices in NRB) is developed for each year and evaluated and monitored on a half-yearly basis as per the NRB Plan Formulation and Evaluation Guideline, 2015. In this guideline, there is a provision of one committee called Strategic Plan Review and Monitoring Committee (PRMC) under the lead of non-executive Board member of NRB.

First Strategic Plan (2006-2010) was developed for (a) determining priorities and defining core objectives for the NRB, (b) maximizing resource use, (c) optimizing performance and setting organizational/corporate culture, (d) strengthening internal communication, (e) applying international best practices, (f) devising defined programmes, implementing them and monitoring and measuring performance, and (g) building credibility to the public through having transparent and active systems of public accountability and external reporting.

The first Strategic Plan had helped to orient the various activities of the Bank towards the achievement of its long-term mission and vision set in it. By clearly outlining the objectives and actions with timeline matrix, the Plan had provided strategic direction for using human capital and other financial and physical resources of the NRB efficiently and effectively. In totality, the first Strategic Plan had paved the way for fostering work culture through planned way which was strategically important for the Bank.

The second Strategic Plan (2012-2016) was developed with a view of addressing the emerging challenges posed by the forces of globalization, financial liberalization and integration, and advancement in information and communications technology in the financial markets. While this Plan had not explicitly mentioned its objectives in the text, the objectives of the Strategic Plan were implicit under the pillars and strategic priorities. The strategic framework was built on seven key pillars and pillar-wide several strategic priorities. The seven pillars were: (a) macroeconomic stability, (b) financial sector stability, (c) foreign exchange management, (d) payment systems and mechanism, (e) human resource management and capacity development, (f) infrastructure development, corporate governance and customer services and (g) information and communications technology (ICT). A total of 201 tasks were prioritized to be accomplished in the second Strategic Plan; out of this, 27 tasks had been aborted from the Plan including 10 tasks deferred to the third Strategic Plan based on relevance and necessity.

The formulation and implementation of periodic strategic plans in NRB has given strategic directions to the Bank in accomplishing the actions. In addition, strategic planning process has helped reinforce the organization values, planned work culture, timeliness and proactive measures, and self-discipline towards improving organization excellence and maintaining reputation.

1.8 Transparency: Communication and Publication

Effectiveness of monetary policy decision and other decisions taken by the central bank depends on its credibility which is enhanced by transparent decisions and effective implementation. Transparency is also essential for maintaining good governance. An institution can increase transparency through effective communication. Various publications and feedback receiving system help increase the communication process. Through communication, a central bank guides expectations of economic agents in the economy. As it is believed that informed people can make rational decisions, right expectations, guided by rational decisions, help to maintain monetary and financial stability in the economy.

Since the beginning, NRB has been according due attention to transparency through communication with the public. While mode of communication has changed with change in technology, the NRB is committed to ensure transparency in discharging its responsibilities. NRB Act, 1955 contained the provision that required NRB prepare report on economic, banking and monetary situation of the country for submission to the Government and to publish it for the general public. Likewise, the Act also required the NRB to collect data and information of the economy following which the NRB could publish reports. The NRB Act, 2002 has continued these provisions and enhanced the scope of communication for increasing transparency; for example, as per section 93(2), which requires NRB to publish its monthly balance sheet within 15 days after the end of the month. Section (12) of the NRB Act, 2002 requires the NRB to publish and disseminate information on macroeconomy, financial market, money supply, inflation, bank credit, BOP and foreign exchanges on regular basis. NRB publishes Current Macroeconomic and Financial Situation of the country on a monthly basis. Likewise, as per the provision of Section (94) of the Act, NRB makes public announcement of its Annual Monetary Policy.

In addition, NRB conducts economic research and publishes the research report for public information. Since 2012, NRB has also started publishing "Financial Stability Report" by assessing the situation of financial sector. In line with the Right to Information Act, 2007, the Bank also uploads its quarterly report on its website. The list of publications of NRB is provided at its website - www.nrb.org.np.

Since April 2004, NRB has made provision of a Spokesperson, by assigning an Executive Director to release information of NRB through one window. As per the provision of Right to Information Act, 2007, Information Officer is assigned to provide information to general public. The spokesperson acts as an information officer for NRB.

NRB regularly issues circular and direction to BFIs and concerned parties relating to regulation and foreign exchange matters. These circulars and directives are also uploaded on the NRB website for public information. Other information like Governor's speech, matters related to public debt open market operations and activities of departments are also uploaded on the website. Some important notices are published in national newspapers.

Since April 2013, NRB has started disseminating information related to financial literacy through its website and different news media. In the recent years, the NRB has introduced *NRB with Student* programme to disseminate financial knowledge to students in the various parts of the country.

1.9 Infrastructure Development and Planning

1.9.1 Buildings

NRB was housed in a rented building at New Road, then called Juddha Sadak, before moving to 'Lalita Niwas' at Baluwatar in 1965. The Banking Office was initially housed in the premises of 'Sadar Muluki Khana', and was later shifted to Bahadur Bhawan and then to Singha Mahal after its acquisition by NRB in 1965. Both 'Lalita Niwas' and 'Singha Mahal, historical buildings constructed during Rana regime, were severely damaged by the earthquake of 25 April and 12 May 2015. In addition, the devastating earthquake also damaged the Mint Office at Sundhara to the extent that these buildings could no longer be used. Fortunately, two buildings (Block A and B) located at Baluwatar, which were being built during the years 1995-97, survived the earthquake and the Bank's central office has been running through these buildings since the earthquake.

Buildings were constructed for NRB's offices outside the Valley in different dates: Birgunj and Siddharthanagar in 1973, Pokhara in 1976 and Nepalgunj in 1977, Janakpur in 1981, Biratnagar in 1989 and Dhangadhi in 1993. The operations commenced in Biratnagar office in 1956, in Siddhathanagar office in 1957 and in Nepalgunj office in 1965. The Dhangadhi office was established as Depot in 1957 which was upgraded to sub-branch in 1960 and branch office in 1977. Built 24-44 years ago, these buildings lack modern facilities and spacious workplace, reflecting severe dearth of physical infrastructure for these offices.

1.9.2 Other Infrastructure and Facilities

NRB has been operating printing press for some of its regular publications. Printing of other special publications is outsourced. In the past, NRB had run employee canteen offering many food items at subsidized rate. Later, the service was outsourced and the Bank employees received tiffin allowance. NRB provides medical and clinic facilities for the employees by the outsourced specialist doctors in Baluwatar and Thapathali premises. For offices outside the Kathmandu

Valley, doctors are hired on part time basis to provide the medical facility. A dispensary facility is provided at the Baluwatar as well as Thapathali premises.

1.9.3 Infrastructure Development in Strategic Plans

Strategic plans of NRB gave due focus on the infrastructure development. The First Strategic plan (2006-2011) mentioned the following strategies with respect to infrastructure development: (i) provide qualitative goods and services through efficient procurement and distribution system, (ii) implement efficient physical assets management system, and (iii) outsource identified support services. The Second Strategic plan (2012-2016) included infrastructure development in its sixth pillar. This pillar set the strategic priority of creating conducive work environment for the delivery of quality services through modernizing the office premises, enhancing functional operation and providing quality services. However, progress towards this is less than satisfactory mainly because of low level of capital expenditure (Table 1.1).

Table 1.1: Budgeted and Actual Expenditure on Construction

(Rs. in million)

Fiscal Year	Approved Budget	Actual Expenditure	% of Actual Expenditure to Budget
2006/07	61.44	25.36	41.28
2007/08	25.43	12.65	49.76
2008/09	19.52	2.56	13.10
2009/10	40.94	4.67	11.42
2010/11	66.60	6.62	9.93
2011/12	163.36	4.30	2.63
2012/13	712.70	35.82	5.03
2013/14	571.97	196.18	34.30
2014/15	362.80	11.23	3.09
2015/16	873.58	103.46	11.84

1.9.4 Investment in Fixed Assets

Fixed assets such as land, building, computer & accessories, vehicles, machinery and equipment, office equipment, furniture and fixture, etc., have been the major headings of investments of the Bank. Table 1.2 depicts the book value of investments in fixed assets.

Table 1.2: Original Cost of Property, Plant and Equipment

(Rs. in million, mid-July)

Heading/Date	2011	2012	2013	2014	2015	2016
Land	31.35	31.35	31.33	193.83	193.83	193.83
Building	561.45	567.33	570.27	599.15	612.43	667.43
Computer & Accessories	141.99	156.13	181.84	182.11	202.14	192.03
Vehicles	174.1	208.32	190.69	188.95	245.00	240.64
Machinery Equipment	70.82	109.91	109.36	111.68	110.35	107.89
Office Equipment	85.93	98.81	102.40	102.54	114.86	123.34
Furniture & Fixture	53.43	20.51	21.56	22.13	23.00	22.97
Other Assets	4.73	4.71	4.64	4.65	4.74	4.86
Capital Work in Progress	3.49	0.03	15.57	14.02	15.15	42.13
Total Assets	1,127.29	1,197.10	1,227.66	1,419.06	1,521.50	1,595.12

The figures reveal that the share of buildings constitutes the highest investment in assets compared to other items. Based on the average original cost during the last six years, vehicles and computer and accessories rank second and third positions respectively.

1.9.5 Reconstruction of Buildings in Baluwatar and Thapathali

A memorandum of understanding (MOU) was signed between the GON, Ministry of Urban Development, Central level Projects Implementation Unit (CL-PIU) and NRB on 13 July 2016, authorizing all reconstruction works and physical infrastructure development works in Baluwatar and Thapathali premises to be performed by CL-PIU with necessary budget support from NRB. For the monitoring, coordination and follow-up of the construction works, one coordination and monitoring team has been constituted led by Executive Director of GSD, where Chief Divisional Engineer from CL-PIU is the member-secretary. Representatives from National Reconstruction Authority, Ministry of Urban Development and Department of Urban Development and Building Construction are members of the team. This team can invite experts in related fields as and when required.

Likewise, a higher level Reconstruction Committee was constituted under the chairmanship of senior Deputy Governor, experts from GON and NRB EDs as the members of the Committee. Following the clauses of MOU between NRB and CL-PIU, CI-PIU has completed the consultant selection process and also assigned the responsibility of Drawing, Designing, Master Plan and Demolition Plan to the consultants. Similarly, demolition of damaged structures of NRB within the premises of Baluwatar and Thapathali has started. The time estimated for the construction of the buildings is by the end of the fiscal year 2019/20. The newly constructed two-storied building in the premises of Baluwatar is undergoing the final stage of interior decoration. Moreover, the process of consultant selection for detailed drawing and design of Sanothimi project has been completed; this includes official residence for Governor and Deputy Governors, residential training centre, recreation, swimming pool, etc.

2 Human Resource Management

The Chapter highlights the change in Bank's human resource structure, policies and provisions from recruitment to retirement, work carried out for human resource planning and development and employee relations over time.

2.1 Human Resource Structure

The NRB staff strength at the time of its establishment was just 23. The Governor was assisted by the Chief Accountant, who also headed the then Personnel Unit, which comprised 5 officers and 16 non-officer-level staff; the officer/non-officer ratio at that time was 1:3.2. After 13 years of establishment, the number of staff reached 924, with 117 in officer level and 807 in non-officer level. The staff number over the years changed as follows (Table 2.1):

Table 2.1: Number of Staff

Year	Officer	Non-Officer	Total
1956	6	16	22
1968	117	807	924
1978	212	1823	2035
1988	407	2901	3308
1998	429	2764	3193
2008	539	978	1517
2017*	707	491	1198

* February 2017

Till 1988, there was continuous expansion of number of employees, both officers and non-officers. In 1988 the Bank recorded the highest number of staff at 3308 which included 407 officers and 2901 non-officers. The number of staff started declining in the following years, with the decline in the number of non-officers. As shown in Table 2.1, from the year 1998, the number of officers kept on increasing as NRB took fresh graduates from the market through open competition regularly while the number of non-officers declined as intake in the non-officers slowed down.

Significant decrease in the number of employees occurred during the period between 1998 and 2008 due to the implementation of financial sector reform programme starting in 2000 with the support of the World Bank and the International Monetary Fund (IMF). Re-engineering process of NRB was carried out with main objective of making the Bank lean and modern. In this perspective, NRB introduced first voluntary retirement scheme (VRS) in 2001. A total of 180 employees took part in the programme and retired from the Bank. The scheme was further extended to 2002; as a result, additional 101 staff were laid off from the job. The Second and Third VRS system was introduced in 2003 and 2004 with additional benefit package, which resulted in the retirement of 371 and 102 employees respectively from their job.

The above-stated facts demonstrate that the human resource policy is guided by the principle of 'optimum productivity by minimum possible number of staff. The number of officer-level staff has increased and reached 707 in 2017 whereas the number of non-officer level staff has decreased and reached 491 in that year. Decline in the non-officer level staff and increase in the officer-level indicates that the Bank is heading toward officer-oriented staff composition.

Table 2.2 : Post-wise Staff Composition
(as in February 2017)

Post	No of Staff	Percentage
Executive Director	17	1.42
Director	47	3.92
Deputy Director	139	11.60
Assistant Director	504	42.07
Senior Assistant	61	5.09
Assistant	213	17.78
Deputy Assistant	69	5.76
Office Subordinates	148	12.36
Total	1,198	100.00

As on 23 January 2017, the post-wise staff composition is shown in Table 2.2. The distribution of staff by qualification, as in February 2017, is shown in Table 2.3. Staff with Master's degree constituted the highest proportion. There were 14 staff with PhD degree and 35 Chartered Accounts (CA).

Table 2.3 : Distribution of Staff by Qualification (as in February 2017)

Level/Qualification	PhD	CA	Master	Diploma	Other	Total
Officer	14	35	411	154	93	707
Non-Officer	-	-	72	77	342	491
Total	14	35	483	231	435	1198

Distribution of staff on the basis of their age as in February 2017 is presented in Table 2.4. Altogether, 333 staff (27.79 percent of total staff) aged more than 50 years, 531 staff (44.32 percent) aged between 40 and 50, 241 staff (20.11 percent) were between 30 to 40 and 93 staff (7.76 percent) were between 20 and 30. From this analysis, the highest number of staff is in their middle age, which is the productive age of life.

Table 2.4 : Age-wise Distribution of Staff (as in February 2017)

Age	50 to 58	40 to 50	30 to 40	20 to 30	Total
No of Staff	333	531	241	93	1,198
Percentage	27.80	44.32	20.12	7.76	100.00

Analysis of staff's diversity on the basis of service period is captured in Table 2.5. From the description provided below, the highest number of staff has had service period exceeding 25 years. As 286 staff has had service period of less than 6 years, there is a significant number of fresh staff in the organization.

Table 2.5 : Distribution of Staff based on Service Period

Service Period (Years)	Above 25	21 to 25	16 to 21	11 to 16	6 to 11	Less than 6	Total
No of Staff	417	33	244	143	75	286	1,198
Percentage	34.81	2.75	20.37	11.94	6.26	23.87	100.00

2.2 Policies and Practices: Recruitment to Retirement

To hire, recruit and retain the best-qualified employees in the organization, NRB has regularly evolved human resource management policies, concerning recruitment to retirement. Some of the important policies adopted currently and in application are reviewed here.

2.2.1 Recruitment and Selection Policy

Central bank being the service-related organization, its performance solely depends upon the performance of its employees. Hence, competent employees are the essential conditions for the success of the organization. From regulation and supervision of banking industry to economic research, its employees play a vital role. As human resource management is associated with the recruitment and retention of high quality people who are best fitted to fulfil the organization's goal, human resource management policy of NRB is directed towards recruiting and inducting high quality manpower and deploying them effectively.

HRMD has a separate recruitment division for the recruitment of new employees and performance evaluation and promotion of the existing employees. For promotion through internal competition and the recruitment of new employees, the candidate has to go through rigorous process of written examination as well as the interview.

The policy of inducting university toppers in management and economics was first introduced and exercised in 1997, which continued till 2004. A total of 7 university toppers joined the Bank under this policy. Likewise, the policy of recruiting staff having qualification of PhD as a second-class officer was introduced in 1998, which continued till 2001. A total of three PhD holders joined the Bank under this policy. During the early eighties, CAs were recruited as first class officer. This policy was later amended and CAs were recruited in second-class level. NRB continued to follow this policy up to 2001. The policy was reviewed in 2001 and since 2002 onward, CAs have been recruited in Assistant Director level. Since 2001, NRB started to recruit legal officer as a third class officer and this policy is in existence till date. Since 2002, there was only two-entry level for career at NRB, the one at Assistant Director level and the other at Assistant level. This policy was amended in 2014 and the entry level of Assistant was changed to Deputy Assistant level. No employee at Deputy Assistant level, however, has been appointed after this amendment. As per the provision of Article 243 of the new Constitution, Public Service Commission has started conducting the written examination of NRB for open competition and internal competition since the promulgation of the Constitution in 2015.

NRB regularly appoints employees from open competition to acquire the new talent from the market. Recruitment trend of NRB in last ten years is presented in Table 2.6. Assistants were recruited for offices outside the Kathmandu Valley and retained there for at least five years.

Table 2.6 : Recruitment Trend

Post/Year	2006	2007	2009	2010	2011	2012	2013	2014	2015	2016
Officer III	17	19	6	15	18	29	-	17	-	23
Assistants	-			25		45	17	32	41	-

Note: Based on appointment date

Right now there are four subjects for the written examination of the Assistant Director. Among the four subjects, the first one is for pre-test, which was introduced in 2008. Candidates who are successful in the pre-test can only take part in the other subjects. Twenty-five percent of the marks obtained in the pre-test is carried forward to the next level. Before 2015, marks of pre-test were not carried forward for the final marks but candidate had to outperform other candidates in pre-test for participation in the next level of examination.

NRB periodically updates the syllabus for the open competition of Assistant Director so as to recruit the fresh candidates having knowledge and innovative ideas. Syllabus of Assistant Director was also reviewed and changed in 2009 and 2015 to make it more effective and updated. Periodic change in syllabus helps to cover the contemporary developments in the banking, finance and economic sectors. After the second People's Movement of 2005/06, in order to recognize and promote the principles of inclusiveness, new Interim Constitution was promulgated with the provision of reservation for women, disabled and marginalized community and people from backward region. Accordingly, NRB amended its staff service bylaws and introduced the provision of reservation in open competition from 2008 onwards. Fifty five percent of the total vacant positions are allocated for open competition and forty five percent are allocated for the reservation purpose. Forty five percent reserved positions are allocated among the marginalized group with thirty-three percent for women, twenty seven percent for ethnic groups, twenty-two percent for Madhesi, nine percent for dalit, five percent for disabled and four percent for the people from the backward region.

2.2.2 Promotion Policy

There are two types of promotion system for existing employees, viz., performance evaluation-based and internal competition. Proportion of performance evaluation-based promotion and internal competition-based promotion has changed over time. According to Staff Service Bylaw 2015, there is a provision of recruiting 50 percent from internal promotion and 50 percent from open competition for all levels. Staff service bylaw was amended several times over the years. The proportional distribution for internal competition, performance evaluation-based promotion and the recruitment from open competition over the time is given in Table 2.7. From 1992 onwards, there has been no significant change in the proportional distribution of Director and Deputy Director, but the proportion of Assistant Director has changed very often.

Table 2.7 : Composition for Promotion

Post	Open (%)			Internal Competition (%)			Performance Evaluation (%)		
	1992	2005	2015	1992	2005	2015	1992	2005	2015
Executive Director	–	–	–	–	–	–	100	100	100
Director	–	–	–	30	30	30	70	70	70
Deputy Director	–	–	–	30	30	30	70	70	70
Assistant Director	50	60	50	40	20	15	10	20	35
Assistant First			–	70	40	40	30	60	60
Assistant	100	90		–	10	60	–	–	40
Deputy Assistant	25	25	100	–	–	–	75	75	–
Office Subordinates iv	–	–	100	–	–	–	–	–	100
Office Subordinates (i-iii)	–	–	–	–	–	–	–	–	100

Currently, there are four criteria for the performance evaluation-based promotion, i.e., performance evaluation, seniority, academic qualification and geographical work experience. Eligible candidates need to outperform their competitors on total marks of 200. Criteria for performance evaluation-based promotion have also changed over time as shown in Table 2.8. Before 2005, there was a provision of awarding certain marks for research paper written by employees. This provision was removed in 2005. Similarly, the practice of allocating different marks for divisions of academic qualification was in place up to 2014. This provision was removed with the amendment to Staff Service Bylaws, 2011 in 2014 and marks for academic qualification have been assigned on the basis of academic level.

Table 2.8 : Criteria for Performance Evaluation-based Promotion

Criteria	1992	1995	2001	2005	2006	2015
Performance Evaluation	120	120	110	130	110	100
Seniority Based on Year	46	60	60	40	60	70
Academic Qualification	20	16	21	20	20	20
Geographical Work Experience	8	–	5	10	10	10
Research Paper	6	4	4	–	–	–
Total	200	200	200	200	200	200

NRB regularly conducts promotion of its employees for their career development. Certainty in career development helps for the higher motivation of the employees and employee can roughly forecast his/her promotion time as per schedule which helps to eliminate the uncertainty regarding the promotion. Table 2.9 shows the trend of promotion at NRB during the last ten years.

There is a provision of recruitment on contract basis in Staff Service Bylaws for the jobs such as Security Personnel, Driver, Sweeper and Mechanics. This practice helps to reduce the long-term financial burden, like pension, on the organization. Similarly, support services such as cleaning, gardening, and cafeteria have been gradually outsourced.

Table 2.9 : Promotions in Last Ten Years

Year/Post		Executive Director	Director	Deputy Director	Assistant Director	Assistant First	Assistant	Deputy Assistant
2007	P.E.	4	6	13	60	–	8	5
	I.C.	–	2	6	22	–	7	16
2008	P.E.	3	3	17	62	–	9	9
	I.C.	–	1	8	23	–	11	26
2009	P.E.	4	4	20	63	–	3	6
	I.C.	–	2	8	23	–	17	17
2010	P.E.	1	4	8	56	9	–	18
	I.C.	–	2	3	21	–	–	–
2011	P.E.	4	6	15	54	–	–	–
	I.C.	–	3	7	17	–	–	–
2012	P.E.	–	3	14	54	9	3	2
	I.C.	–	1	6	17	6	4	7
2013	P.E.	4	4	11	15	4	6	4
	I.C.	–	2	5	5	2	9	6
2014	P.E.	3	5	13	20	6	4	4
	I.C.	–	2	6	8	4	6	–
2015	P.E.	6	6	13	7	8	6	–
	I.C.	–	3	6	3	6	8	–
2016	P.E.	4	6	15	7	4	–	–
	I.C.	–	2	6	3	2	–	–

*P.E. = Performance Evaluation, I.C. = Internal Competition

2.2.3 Placement Policy

The guiding principles for placement of newly recruited and promoted employees are academic qualification and work experience. The newly recruited officers are normally placed at offices outside the Kathmandu Valley and retained there for two years. If newly recruited officers are not placed at offices outside the Kathmandu Valley, they are placed at different departments on the basis of merit. The candidates who appear in upper merit list are normally placed in core function departments. Employees promoted to officer level through evaluation system or through internal competition are most likely to be placed at offices outside the Kathmandu Valley for two years. Employees at Assistant level (Assistant II) are recruited to work for specified offices outside the Kathmandu Valley at least for five years.

2.2.4 Transfer Policy

Recently, the Bank has amended its erstwhile Transfer Policy. As per the Transfer Policy 2014, employees once transferred to departments with core function are normally retained there for at least five years and those transferred to other departments are retained for at least two years. The Policy clearly provides that normally transfers are to be made from core to non-core and vice versa. Similarly, employees once transferred to offices outside the Kathmandu Valley are normally retained there for two years. The Transfer Policy also provides for transfer of employees from one to another office outside the Kathmandu Valley. However, this provision has not been practiced as regular phenomenon and such transfer is done only if there is request from the employee side.

2.2.5 Retirement Policy

NRB has practiced different retirement policies over time. The Policy introduced in 1958 and implemented in 1959 provided for 60 years' age limit for retirement. With the amendment to then prevailing policy in 1967, the Governor was empowered to extend age limit up to 63 years, if necessary. Later, in 1992, the erstwhile Staff Service Bylaws were amended to introduce dual retirement window for the first time. As per the provision of amended bylaws, the retirement criteria was set as 30 years of service or attaining 58 years of age, whichever earlier. This criteria was introduced primarily to go in line with the retirement criteria of civil servants introduced by the then democratic government formed after the People's Movement of 1990. In 1993, the 30-year service period criterion was amended to make it 32 years. Later, in 1999, Staff Service Bylaws were amended again to follow single window retirement system by removing the service period retirement criteria. This single window (58 years of age) retirement system was continually followed up to mid-July 2005. Since then, dual window retirement criteria (30 years of service period or 58 years of age, whichever earlier) was reintroduced which has been followed till date.

2.2.6 Post Retirement Policy

NRB is a knowledge-based organization. Retirees of the Bank are equally capable and productive to contribute to the process of economic development of the country. The Bank needs to care about the livelihood and development of the retired staff. There is a provision of pension for those retiring after servicing of at least 20 years. There is also a provision of gratuity for those who retire or resign from the job after serving for at least five years, but before being eligible for pension. The sum of gratuity is different on the basis of service period. Ex-employees having longer service period get higher amount of gratuity whereas ex-employees having shorter service period get lower amount of gratuity. NRB has the provisions of financial benefit as well as non-financial benefit for the retired staff. The Bank provides medical allowance and *Dashain* allowance once in a year for the retired staff.

NRB has the policy of utilizing its retired staff as consultants and experts in various committees and programmes to tap their knowledge and experience. Some retired staff with technical knowhow are being recruited on contract basis as drivers, mechanics, electricians, and plumbers, among others. There is an Association of Ex-employees where retired staff regularly meet and share their ideas, experience, happiness and pain with each other. Ex-employees Association is a platform that raises the voice of ex-employees for their mutual benefits. The Bank is providing the logistic facilities like office room, furniture, electricity and water for their use.

2.3 Human Resource Planning and Development

2.3.1 Human Resource Planning

NRB prepared human resource planning in 2008 for the period of 2008 to 2014. The First Strategic Plan has underlined the significance of human resource development along with recognizing the emerging trend, and stated "enhancing the Bank's productivity and efficiency through proper development and effective utilization of human resource". Similarly, the Bank's Second Strategic Plan emphasized human resource management and capacity development as one of the strategic pillars. Currently, the Bank is also in the process of developing the Human Resource Development Plan for which a Board member headed Committee has been formed. The Committee is working as per its TOR and is expected to come up with a comprehensive HR plan very shortly.

2.3.2 Human Resource Development

Training and development have become an integral part of HR management in the Bank. The BTC and HRMD periodically conduct training need assessment surveys to determine the training needs of each Department and Office. On that basis, the Training Division of the HRMD endeavours to match the requirements and the provision of training. The BTC determines its internal training calendar based on the assessment survey. The BTC has been conducting various core-function related contemporary training. NRB has been adopting the policy of sending its employees abroad for training and development programmes. It recently formulated *Foreign Training Procedure* for the systematic management of foreign training. It has acted as an instrument useful both for personnel development as well as motivational package for the employees. Keeping increased environmental complexity and official responsibility in view, behavioural courses are organized to refresh the human values and to create an atmosphere of ideal organizational environment. To strengthen the domestic training, HRMD had planned to build infrastructure for the Management Development Centre (MDC) in 2009/10 and to restructure the BTC to build the best possible mechanism for internal training.

Growing complexities and challenges in domestic and international financial markets have created both opportunities and threats for the Bank in discharging legally entrusted duties and responsibilities. The Bank, therefore, has come up with the policy to equip its employees with best knowledge and international exposures. After developing a generous relationship with international and regional financial organizations, a greater number of staff is being able to grab international exposures. IMF has been providing a significant contribution through organizing training and seminars in several relevant issues and inviting eligible candidates on the basis of which NRB has been able to develop its efficient and professional employees' cadre. Likewise, SEACEN, APRACA, BIS, SEANZA, and CICTAB are other institutions, which are contributing tremendously on the human resource development front. Central banks of many countries like India, China, Sri Lanka, Philippines, Japan, Canada, Australia, Sweden, Norway, South Korea, and Malaysia are some of the major partners offering the opportunities of exchanging international experiences through organizing seminars, symposium, training and other interaction programmes for the senior officials of the Bank. Number of employees who have been nominated for international training during the last 10 years is presented in Table 2.10. A total of 3,630 employees attended the short-term courses in foreign countries in the last one decade (2007-2016), with the number of employees nominated for foreign training and exposure increasing every year during the period.

Table 2.10 : Trend of Foreign Training and Exposure

Year	No. of Staff	Year	No. of Staff
2007/08	155	2012/13	464
2008/09	178	2013/14	404
2009/10	219	2014/15	440
2010/11	278	2015/16	535
2011/12	357	2016/17	585

* Mid-January 2017

2.3.3 Motivation

NRB has been revising pay scale and other employee benefits time to time to motivate staff. Monthly salary, central bank allowance, Internet allowance and outstation allowance are regular monthly financial benefits. Apart from these, facilities such as medical allowance, mourning allowance, paternity allowance, forced leave allowance, house loan, vehicle and technology procurement and development *(prabidhi kharid tatha bikas)* loan, and telephone loan are important ones that have played their part to motivate staff. On the social security front, pension, gratuity, provident fund, welfare fund and staff insurance have been considered as the valuable motivators for the staff. Casual leave, sick leave, home leave, forced leave, special leave, unusual leave, study leave, study deputation, maternity leave and paternity leave add further leverage to the incentives of the employees.

2.4 Employee Relation

Effective communication system, equity, fairness and recognition foster the good relationship among employees, and between management and employees. NRB has arranged intranet facility for effective communication of circulars and notices to its employees. Staff Service Bylaws provide disciplinary issues of its staff. As per Staff Service Bylaw 2011, employees up to officer third level can be member of employee union and conduct union activities. One-fourth employees can file the application for the formation as well as renewal of the employee union at Labour Office. As in mid-July 2016, four employee unions have been in operation in the Bank.

There is a cordial relationship between the management and employee unions at NRB. NRB always believes that management and employee unions are the two sides of the same coin. Unions not only act as a watchdog to ensure impartiality, transparency and effectiveness in managerial activities but also provide constructive suggestions regarding staff's right and overall institutional reforms. Economic benefits, career development, institutional reform and other issues have been raised by the unions from time to time and such issues have been addressed by the management to the extent possible. Union desk under HRMD functions as communication channel with unions, delivers necessary facilities and coordinates between unions and management.

Part 2
Monetary Policy

3 Macroeconomic Performance

The macroeconomic performance of the Nepalese economy over the past six decades has remained mixed. The country has been implementing a series of five-year and three-year plans for moving forward in the economic development process. Despite some progress made, a number of challenges remain on the economic front. Further, the Nepalese economy witnessed several political changes ranging from party-less Panchayat era to multiparty system with constitutional monarchy to federal republic in the span of last six decades. Being an apex financial institution having the responsibility of conducting monetary policy and regulating the financial system, the role and contribution of NRB in shaping the structure, direction and performance of the macroeconomy has remained crucial. The statistics will slightly touch the period prior to 2006/2007, as those have been covered in detail in the publications commemorating the 50 years, 40 years and 25 years of NRB.

3.1. Economic Growth

The trajectory of economic growth in Nepal has been very sluggish and erratic during the last five and half decades. During the period[1], the economy grew by 3.6 percent on average.

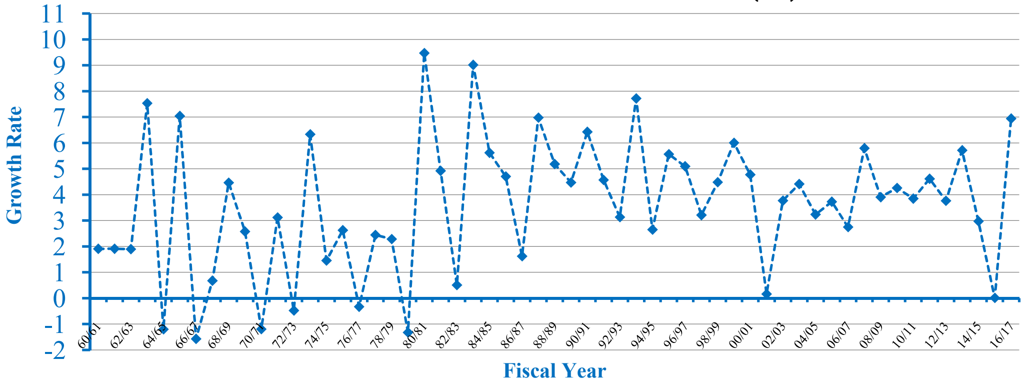
Table 3.1 : Growth Rate of Real GDP (%)

	Agriculture	Industry	Services	GDP
1960/61-64/65*	-	-	-	2.4
1965/66-69/70*	-	-	-	2.6
1970/71-74/75*	-	-	-	1.8
1975/76-79/80#	-1.0	5.4	6.8	1.1
1980/81-89/90#	4.6	8.0	5.6	5.2
1990/91-99-2000#	2.4	7.9	6.6	4.9
2000/01-09/10#	3.4	2.5	4.7	3.7
2010/11-16/17#	3.0	3.3	4.9	4.0

**Based on the World Bank Data*
- Refers to non-availability of data.
 # Central Bureau of Statistics, Government of Nepal.

[1] Average growth rate during 57 years from 1961 to 2017

Chart 3.1
Growth Rate of Real GDP (%)



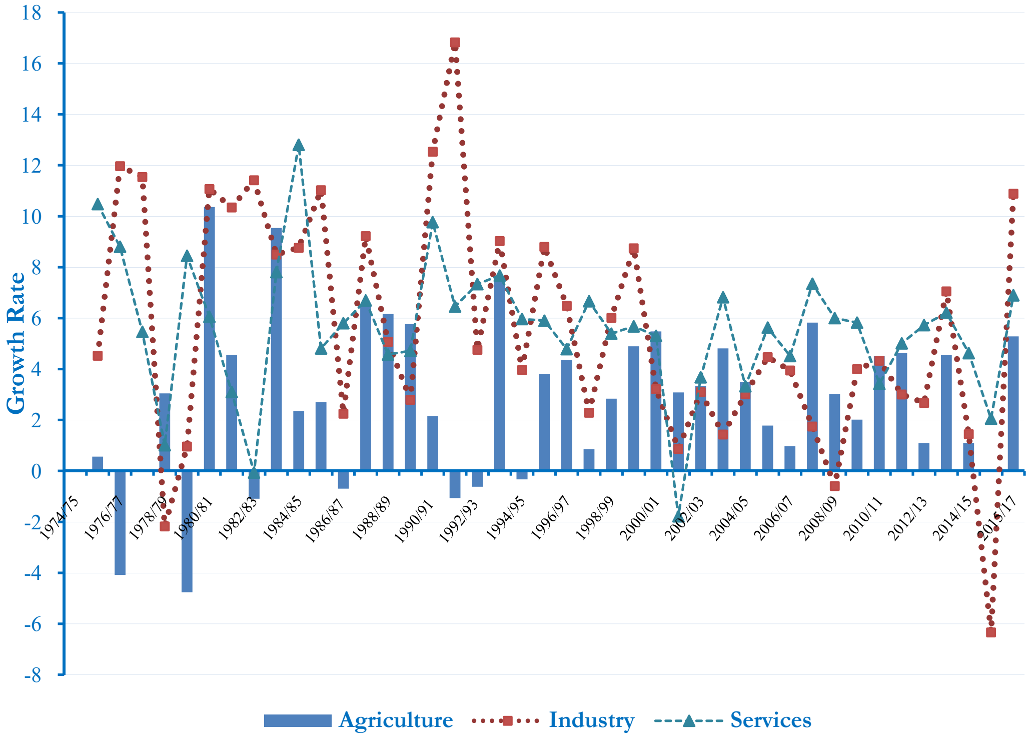
Note: Growth rate from 1961to1975was taken from World Bank database available atdata.worldbank.org.
Source: World Bank and Central Bureau of Statistics, Government of Nepal.

The performance of the economy was satisfactory during the 1980s when the economy grew by 5.2 percent on average (Table 3.1). The country could have performed better, had the economy not been stroked by drought in 1982/83 and 1986/87 when agriculture sector shrank by 1.1 and 0.7 percent respectively. During the first half of the 1990s, the economy performed relatively well due to improved performance in manufacturing and trade along with the expansion in transport and other services following the economic liberalization policy adopted by the Government. The overall growth rate was 4.9 percent during the 1990s.

The growth rate in 2001/02 fell to 0.1 percent, the worst performance of the economy after the negative growth rate of 1.3 percent in 1979/80 (Chart 3.1), due to heightened internal conflict that shifted the attention of the Government from developmental activities to maintaining security and minimizing the adverse impact of the conflict. The political uncertainty following thereafter reduced the performance of the economy and, consequently, the growth performance did not improve. During the last 15 years (2002/03 - 2016/17), the growth rate has been consistently below five percent except for the years 2007/08, 2013/14 and 2016/17. During 2015/16, the growth performance of the economy was affected due to the devastating earthquake of April 2015, and the supply disruptions caused by disturbances along the border following the promulgation of the Constitution of Nepal. However, in 2016/17, the economy recovered; it has been estimated to have grown by 6.9 percent underpinned by favourable monsoon, improvement in energy supply and the on-going post-earthquake reconstruction works.

Agriculture and industrial sector growth rates remained quite volatile due to the monsoon-based agriculture, internal conflict and industrial relation problems. From 1974/75 to 2016/17, the growth of agricultural output has been negative in seven years due to unfavourable monsoon whereas the industrial sector growth has been negative in three years during the period (Chart 3.2). Service sector performed relatively well, except for the years 1982/83 and 2001/02 when the growth rate of value added by this sector turned into negative.

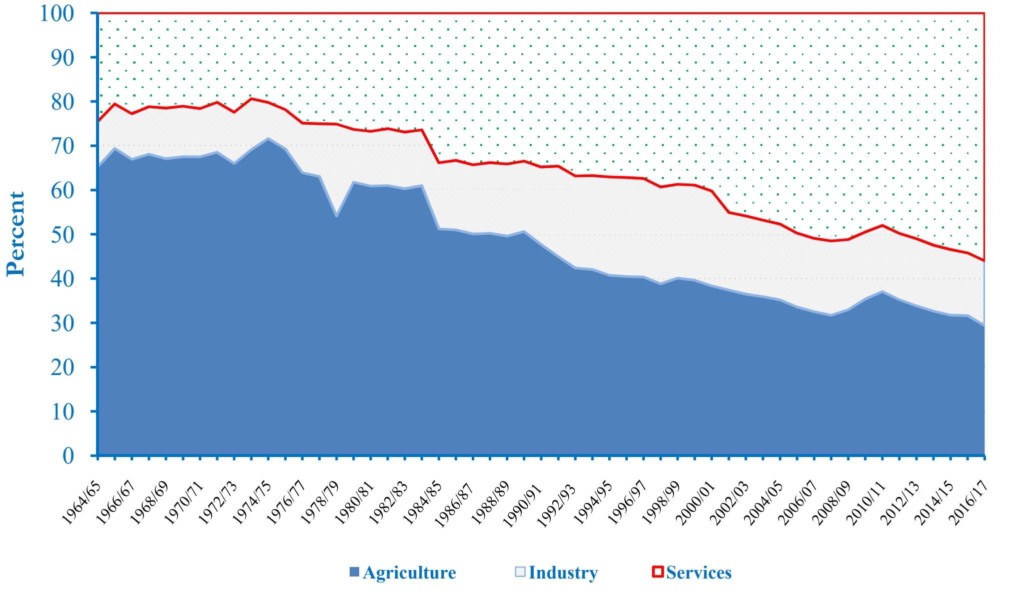
Chart 3.2
Growth Performance of Different Sectors (%)



Source: Central Bureau of Statistics, Government of Nepal.

Due to high growth of population and low growth performance of the economy, the growth rate of real GDP per capita staggered around 1.8 percent during the last five and half decades. As the population growth rate decelerated during the later decades, and the performance of the economy improved through the adoption of liberalization policy, growth rate of per capita GDP improved: it increased by 2.4 percent on average during 1980s, 2.5 percent during 1990s and 2.6 percent during 2000s. The output further increased by 3.2 percent during 2011-17 (World Bank and Central Bureau of Statistics, 2017). In nominal terms, per capita GDP increased by 10.3 percent on average over the 57 years in Nepalese Rupees term, while in US Dollar terms, such output increased by 5.6 percent per annum. The gradual depreciation of NRs against US dollar has lowered the growth of GDP per capita in US dollar terms.

Chart 3.3
Contribution of Different Sectors in Gross Value Added



Source: Central Bureau of Statistics, Government of Nepal

There has been a gradual shift of the economic activities from agriculture to service sector over the past five decades (Chart 3.3, Table 3.2). The relative contribution of agriculture sector to gross value added (GVA) has been falling over time and that of service sector is rising while industrial sector has not experienced a significant rise in terms of GVA. In 1964/65, the share of agriculture sector in GVA was 65.2 percent, which increased to 71.6 percent in 1974/75. Such share has gradually fallen over time and reached 29.4 percent in 2016/17. On the other hand, the share of non-agricultural sector has increased from 34.8 percent in 1964/65 to 70.6 percent in 2016/17. Under non-agricultural sector, service sector has grown substantially in terms of its contribution to GVA; the share of this sector in GVA was 24.5 percent in 1964/65 that gradually rose to 56.0 percent in 2016/17. The relative contribution of industrial sector has been declining in recent years (Chart 3.3., Table 3.2).

Table 3.2 : Share of Different Sectors in GDP

Sector	1965-70	1971-80	1981-90	1991-2000	2001-10	2011-17
Agriculture	67.4	65.5	54.6	41.7	35.0	33.1
Industry	10.7	11.8	14.5	21.1	17.2	14.8
Services	21.9	22.7	30.9	37.1	47.8	52.1

Source: Central Bureau of Statistics, Government of Nepal

3.2 Consumption, Saving and Capital Formation

In Nepal, consumption expenditure compared to domestic production is very high: around nine-tenth of the output produced in the country goes to consumption, which leaves a little room for utilizing the resources for capital formation (Table 3.3).

As a consequence of high consumption expenditure coupled with the slow increase in productive capacity, the domestic saving ratio of the economy has been persistently low for the last four decades, averaging 11.2 percent on the average (Table 3.3). However, the gross national saving ratio of the economy is higher than the domestic saving due to remittance inflows and transfer earnings. Such a ratio reached 41.5 percent on average during 2010/11 - 2016/17 (Table 3.3).

The gross fixed capital formation (GFCF) of the economy includes investment in plant, equipment and machinery, construction of roads, schools, hospitals, private residential and commercial buildings and others, which reflect the potential productive capacity of the economy. The fixed capital formation ratio for Nepal increased to 25.6 percent on average during 2010/11-2016/17 compared to just 14.9 percent during 1975/76 - 1979/80.

Table 3.3 : Consumption, Saving and Capital Formation as Percent of GDP

	1975/76-79/80	80/81-89/90	91/92-99/2000	00/01-09/10	10/11-16/17
Consumption/GDP	88.2	89.6	86.6	89.7	89.9
Gross Domestic Saving/GDP	11.8	10.4	13.4	10.3	10.1
Gross National Saving /GDP	16.0	13.8	15.8	29.3	41.5
Gross Fixed Capital Formation/GDP	14.9	17.8	20.8	20.6	25.6

Source: Central Bureau of Statistics

3.3 Plans and Budgetary Development

It was the onset of democracy in 1951 and opening to the outside world that prompted the then Government to pursue planned development in the country. Royal proclamation for a Five Year Plan for Nepal was announced by Late King Mahendra on 10 October 1955, with the formation of a seven-man Central Planning Commission. Prior to this, on 26 September 1948, the then Rana Prime Minister *Shri Mohan Shumshere Rana* had formed National Economic Planning Committee which was given the responsibility of preparing a 15-year plan (comprising three five-year plans) of economic development for making Nepal completely self-sufficient in all respects which however, could not be materialized. The first Five Year Plan finally came into effect in 1956/57, beginning the planned development era in Nepal. The country has so far completed implementation of eight five-year plans and five three-year plans since the process of planned economic development started in 1956.

3.3.1 Overview of Planned Development

The first Five Year Plan was implemented for the period of 1956/57 to 1960/61 by assessing then prevailing situation of Nepalese economy. Accordingly, emphasis was accorded to the development of transport and communication in the context of the geographical requirements of the country. The other areas of priority included agriculture, social services and other development programmes. Although very little progress took place in road, power and industrial development, considerable progress was made in the education and health sector. Although just 64 percent of total planned expenditure of Rs. 330 million was spent, major achievements included the establishment of telecommunication services in all district headquarters and construction of ropeway from Kathmandu to Hetauda. After a gap of one year, the Second Plan was implemented for the period from 1962/63 to 1964/65, following the introduction of the party-less Panchayat regime. During the Second Plan, the estimated expenditure was almost doubled in comparison to the First Plan with the actual spending at 99 percent of the planned outlay. Priority sectors of the Plan were transportation, communication and regional balance. Emphasis was also given to the collection of data on economic conditions as well as to organizational reform and improvement and the development of the economic infrastructure.

The **Third Plan** (1965/66-1969/70), **Fourth Plan** (1970/71 - 1974/75), **Fifth Plan** (1975/76-1979/80), **Sixth Plan** (1980/81-1984/85) and **Seventh Plan** (1985/86-1989/90) were formulated under the Panchyat regime and comprised the general objectives of increasing economic output and employment and improving the living condition of people by fulfilling their basic needs. Actual expenditure in these plans remained less than the planned outlays (Table 3.4).

After the political change in 1990 with the re-establishment of the multi-party democratic system, the new Government formulated the **Eight Plan** (1991/92 - 1996/97) after a gap of two years focusing on broad based growth. The three broad objectives of the Plan were attaining sustainable development, alleviating poverty and balancing regional development. In the context of achieving these objectives, the private sector's role was considered instrumental. Actual expenditure in this plan exceeded the planned amount (Table 3.4).

Table 3.4 : Estimated and Actual Expenditure During Plan Periods

Periodic Plan	Expenditure *(Rs in billions)*		
	Estimated	Actual	Actual as Percent of Estimated
First Plan (1956/57-1960/61)	0.33	0.21	63.6
Second Plan (1962/63 - 1964/65)	0.60	0.60	99.5
Third Plan(1965/66-1969/70)	2.50	1.78	71.2
Fourth Plan(1970/71 -1974/75)	3.54	3.47	98.0
Fifth Plan(1975/76-1979/80)	11.4	7.75	68.0
Sixth Plan (1980/81-1984/85)	33.9	22.04	65.0
Seventh Plan (1985/86-1989/90)	50.4	48.38	96.0
Eighth Plan (1991/92 - 1996/97)	167.24	180.16	107.7
Ninth Plan(1997/98-2001/02)	337.29	278.47	82.6
Tenth Plan (2002/03-2006/07)	456.30	443.50	97.2
Eleventh Plan (2007/08-2009/10)	511.38	476.33	93.1
Twelfth Plan (2010/11-2012/13)	1020.00	828.00	81.2
Thirteenth Plan(2013/14-2015/16)	1616.00	1358.00	84.0

Source: NPC's All Plan Reports

Considering the emergence of internal conflict mainly attributed to poverty and unemployment, the broad objective of the **Ninth Plan** (1997/98-2001/02) was to alleviate poverty and improve the standard of living of the people. The Plan also envisaged a concept of long term perspective plan of 20 years. The sole goal of the **Tenth Plan** (2002/03-2006/07) was poverty alleviation. The Plan formulated a poverty reduction strategy based on these four pillars: a) broad based high and sustainable growth, b) social sector development with emphasis on human development, c) targeted programmes with emphasis on social inclusion and (d) improved governance. The Plan also estimated to bring down the share of people living below the poverty line from then prevailing 38 percent to 30 percent by the end of the Tenth Plan. The **Eleventh Plan** (2007/08-2009/10) was the first three year interim plan after the People's Movement II and signing of Comprehensive Peace Agreement with the agitating party. The Plan incorporated goals of reducing poverty, increasing employment opportunities and building damaged infrastructure. Given the political transition taking a long time to settle as manifested in the delay in the promulgation of new Constitution by the Constituent Assembly, the practice of preparing plans for a period of three years has continued. The **Twelfth Plan** (2010/11-2012/13) set the objectives as improving the living standards of all people, reducing poverty ratio to 21 percent and achieving Millennium Development Goals (MDGs) by 2015 through fostering sustainable economic growth, generating dignified and gainful employment opportunities, reducing economic inequalities, achieving regional balances and eliminating social exclusion.

The **Thirteenth Plan** (2013/14-2015/16) set a long-term vision of upgrading Nepal's status from the least developed country to a developing country by 2022. The objective was to bring about a direct positive change in the living standards of the general public by reducing the economic and human poverty.

3.3.2 Government Budgetary Developments

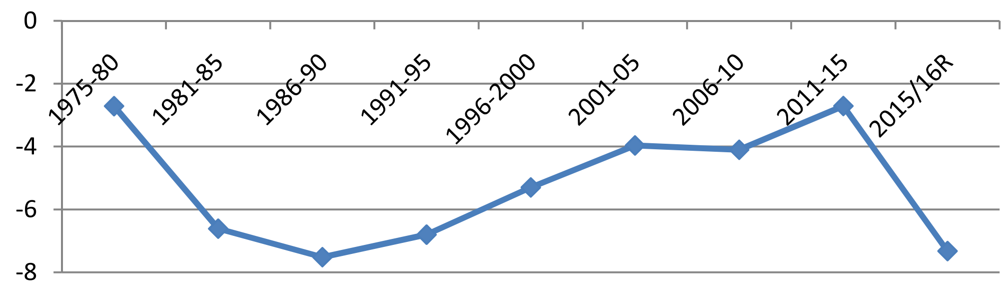
Prior to 1951, there was no formal budgetary system in Nepal. It was only after the political change in 1951 that the Government started to publically present the Budget every fiscal year. The Government announced the periodic budget in the parliament only after the formulation of First Five Year Plan. New tax collection Act (Tax Collection Act, 1955) authorized the Government to fix tax rates. Over time, the Government introduced many policies and programmes to strengthen the revenue base, increase capital expenditure and control budget deficit for ensuring macroeconomic stability.

In the evolutionary process of budgeting, implementation of Government Income/Expenditure Operation Procedures Bylaws, 1981 paved the way for the establishment of Financial Comptroller General's Office in 1982. This facilitated the process of budget release, payment and internal audit system in the country. Treasury single account was introduced in all the 75 districts by 2013/14, while system of annual and mid-term budget review has been in practice. The Government introduced pro-poor budget including the provision of early budget with specified date for its presentation in the new Constitution. This section briefly sketches the development of government budget operations over time.

Fiscal Deficit

Till the early sixties, the fiscal sector was characterized by a surplus budget. The budgetary operation started experiencing deficit after the introduction of Double Entry Accounting System in 1962/63. It was then that the Government started to accumulate debt on account of deficit financing. Government introduced Programme Budget System in 1969/70. The average fiscal deficit was just 2.7 percent of GDP during 2010/11 to 2014/15. However, the revised estimate for 2015/16 indicates that the government spending has surged ahead raising the deficit to 7.3 percent of GDP. The trend is shown in Chart 3.4.

Chart 3.4
Average Fiscal Deficit
(As Percent of GDP)



Source: NRB (2017)

Government Expenditure

Earlier, the government expenditure was categorized as regular spending and development spending until 2002/03; principal repayments used to be one of the components of regular expenditure. Since 2003/04, government expenditure was reclassified as recurrent expenditure, capital expenditure and principal repayments. Since 2011/12, it was again reclassified as recurrent, capital and financing expenditure complying with IMF's Government Finance Statistics Manual, 2001.

During 1974/7 - 1979/80, the government expenditure averaged 12.3 percent of GDP, which increased to 18.0 percent of GDP during 1980/81 - 1984/85 (Table 3.5). Government expenditure to GDP ratio remained almost stable at that level until 2000/01- 2004/05 because of fiscal consolidation in line with a series of IMF's supported programmes and adoption of economic liberalization policy. Then, it increased to 19.8 percent of GDP during 2005/06 - 2009/10, and to 22.4 percent during 2010/11 - 2014/15. The increase in government expenditure reflects its growing role for social security, maintenance of law and order, formulation of new Constitution and construction of infrastructure in recent years.

Table 3.5: Government Expenditure (As Percent of GDP)

	Total Expenditure	Recurrent	Capital	Financial*
1975-80	12.3	4.0	8.0	0.2
1980-85	18.0	5.3	12.3	0.3
1986-90	18.6	5.7	12.3	0.6
1991-95	18.0	6.0	11.1	0.9
1996-2000	18.1	8.3	8.5	1.3
2001-05	17.3	10.5	5.1	1.8
2006-10	19.8	12.1	5.5	2.2
2011-15	22.4	15.5	3.5	3.4
2015/16R	31.2	19.3	7.1	4.8

Source: NRB (2017)

During 1975-80, the regular expenditure (including principal repayment) was 4.0 percent of GDP whereas the development expenditure (recently called capital expenditure)[2]was 8.0 percent of GDP. Recurrent expenditure continuously increased over time and reached 15.5 percent of GDP (excluding principal repayment which was 3.4 percent of GDP) during 2010/11-2014/15. However, downward trend was recorded for the capital expenditure, with capital expenditure as percent of GDP declining to its lowest ratio at 3.5 during 2010/11-2014/15 (Table 3.5).

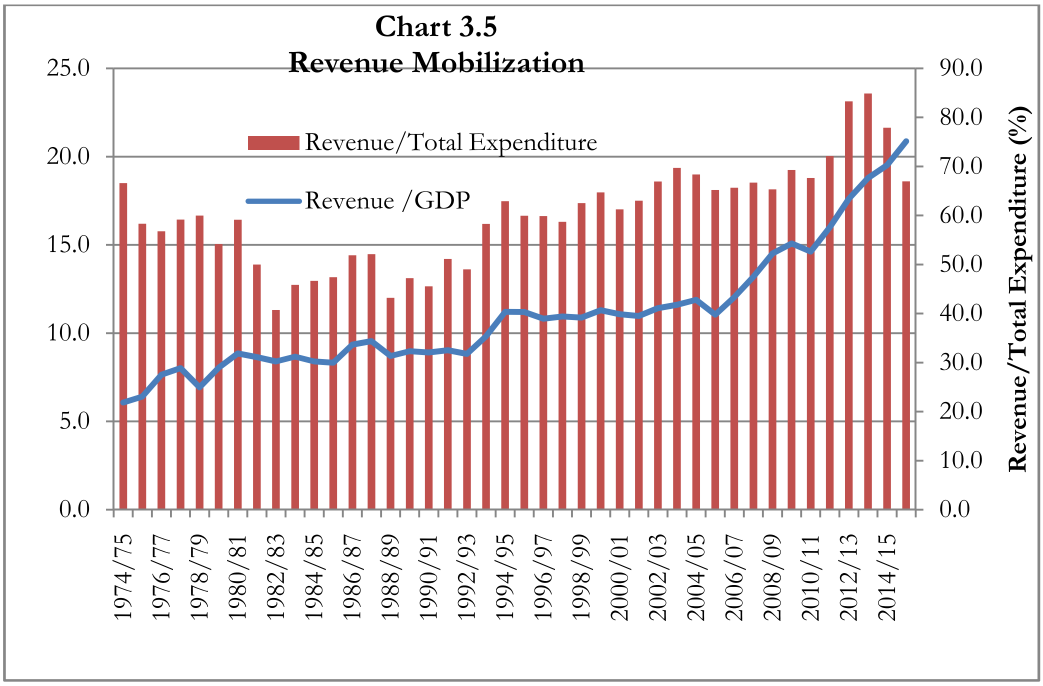
Government Revenue

Revenue collection has always been a vital source for financing the budgetary expenditure. Its share in GDP has consistently increased, because of various reforms such as introduction of Value Added Tax in 1997, new Income Tax Act in 2002, revision of Customs Act in 2001 and application of ICT in tax collection. As a result, the ratio of revenue mobilization to GDP went on increasing over the years and reached 20.9 percent in 2015/16 (Chart 3.5).

In 1974/75, revenue collection contributed to two-thirds of total government expenditure, which declined in the next few years and reaching as low as 40.7 percent in 1982/83. Because of continued improvement in

[2]The classification in terms of capital expenditure after 2003/04 and development expenditure before 2003/04 may not be directly comparable but some trend could be sketched.

revenue mobilization, this ratio rose to 84.9 percent in 2013/14 before some marginal deceleration in recent years.



Government Borrowing

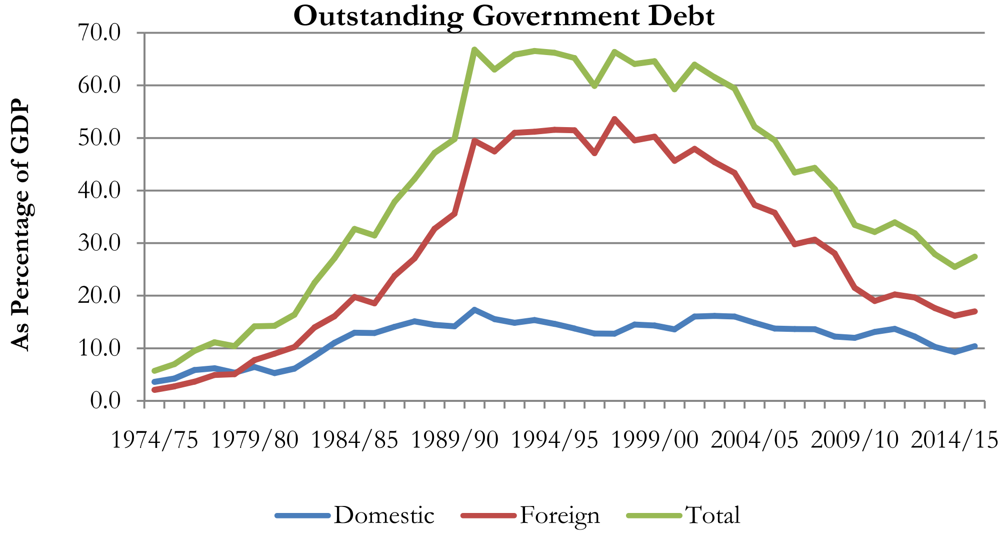
The Government has been utilizing both external as well as internal borrowing to finance the budget deficit from the early days. The average share of external borrowing during 1974/75-1979/80 was 1.4 percent of GDP. Such financing continued to increase till 1988/89 reaching almost 6.3 percent of GDP. However, the reliance on this source of financing started declining after that year. The share of external borrowing in GDP declined to just 0.7 percent in 2012/13. Recently, the dependence on external borrowing to cover the budget deficit has increased as the share of external borrowing in terms of GDP was 2.6 percent in 2015/16. On the other hand, the component of internal borrowing over the period of time has been in the range of about 1 to 2 percent. However, the ratio of internal borrowing to GDP surged to 3.9 percent in 2014/15 again.

Outstanding Government Debt

During 1974/75, the outstanding government debt stood at 5.7 percent of GDP. Of this, the outstanding domestic debt was 3.6 percent of GDP while the outstanding foreign debt was 2.1 percent of GDP (Chart 3.6). The outstanding government debt started rising rapidly during the successive years. By the end of 1979/80, as percent of GDP, the outstanding government debt almost tripled to 14.2 percent of GDP, which further increased to 32.7 percent of GDP by the end of 1984/85.

By 1990/91, the outstanding government debt further increased to 66.8 percent of GDP. Of this, the outstanding foreign debt and the domestic debt constituted as high as 49.4 and 17.3 percent of GDP respectively. Subsequently, the Government began to cut down both the internal and external borrowing which led to the falling ratio of outstanding government debt to GDP. In 2005/06, the outstanding government debt dropped to 49.5 percent of GDP. With the rapid mobilization of government revenue and the slower growth of capital expenditure in recent years, the necessity of using public borrowing in order to finance the fiscal deficit declined. Consequently, in 2015/16, the outstanding government debt fell to 27.4 percent of GDP, with the foreign and domestic debt standing 17 and 10.4 percent of GDP respectively.

Chart 3.6
Outstanding Government Debt



Source: NRB (2017)

3.4 Inflation

NRB, since its inception, has been collecting prices of essential consumer goods and services, processing them in a systematic way and publishing the price statistics at a regular interval. As the economic advisor of the Government and monetary authority of the country, NRB has given utmost priority for enhancing the quality, appropriateness and reliability of the price statistics. Presently, NRB has been publishing CPI, WPI and Salary and Wage Rate Index (SWRI) on a monthly basis. Among them, CPI has been taken as an official measurement of inflation

3.4.1 History of Price Collection and Household Budget Surveys

The history of price collection in Nepal can be traced back to 1902 when "*Gorkhapatra*" had begun to collect and publish retail prices of a few commodities (NRB, 1981). Since 1956, the Kathmandu Municipality Office started publishing retail prices of consumer goods in its monthly magazine "*Jana Chetana*". However, these attempts could not last for a long period. Since 1962, the Central Bureau of Statistics (CBS) began collecting prices of selected consumer goods in the Kathmandu Valley.

Realizing the importance of price statistics in Nepal, NRB had begun to collect prices of essential consumer goods in a systematic way since its establishment in 1956 starting from 15 different types of consumer goods. The number of consumer goods for collecting prices was gradually increased to 31 in 1960 and then to 46 in 1965. In 1957, NRB had started constructing the un-weighted price index for Kathmandu and published it on a regular basis. Later, in 1962, NRB started to construct and publish the un-weighted price index for the Terai region and, a year later in 1963, it was extended to the Hilly region as well. In the mean time, CBS had started to construct and publish the weighted CPI for Kathmandu since 1962/63.

The weighted CPI of Kathmandu was not enough to trace the price movement at national level. Therefore, to arrive at the weighted price index for the national level as well, NRB launched the first nationwide Household Budget Survey (HBS) in 1972/73. The second, third, fourth and the latest fifth surveys were conducted in approximately a gap of ten years in 1983/84, 1995/96, 2005/06 and 2014/15 respectively. Thus, NRB conducted series of five Household Budget Surveys so far with the main objective of updating the consumption basket and revising the weightage factors for the construction of

CPI so that it more reliably and realistically represented the change in consumption behaviour of people. Table 3.6 provides the glimpse of all the five household budget surveys conducted by NRB.

The updated consumption basket for current CPI comprises 496 different types of items of goods and services distinguished between Food and Beverages group with 43.91 percent weight, and Non-food and Services group with 56.09 percent weight. The Food and Beverages group includes 192 items while Non-food and Services group includes 304 items. The total consumption basket is composed of 402 Goods items and 94 Services items. While computing the CPI, the Laspeyres' Weighted Geometric Average indexing method has been used. In addition to Consumer Price Index, NRB has been constructing and publishing WPI since 2000/01, with base year as 1999/00.

Table 3.6 : Household Budget Surveys in Nepal

Household Budget Survey			First	Second	Third	Fourth	Fifth
1.	Survey Period		1973-75	1984/1985	1995/1996	2005/2006	2014/2015
2.	Sector Coverage		Urban	Rural and Urban	Urban	Rural and Urban	Rural and Urban
3.	Coverage of Market Centres	Urban	18	12	21	23	37
		Rural	–	23	–	25	47
		Total	**18**	**35**	**21**	**48**	**84**
4.	***Covered by Survey***						
	Total no. of Municipalities		16	12	21	23	36
	Total no. of Households ('000)		20,84	25,85	33,29	42,53	54,27
	Sample Households		6,625	5,323	2,500	5,095	8,028
	Nepal's Population ('000)		11,556	15,023	18,491	23,151	26,495
5.	***Weightage in CPI (%)***		**100.00**	**100.00**	**100.00**	**100.00**	**100.00**
	Food and Beverages group		66.78	62.63	53.20	46.82	43.91
	Non-food and Services group		33.22	37.37	46.80	53.18	56.09

3.4.2 Inflation Trend in Nepal : 1960s to the Present

The trend of price movements during the sixties shows that an overall inflation measured in terms of CPI averaged 5.8 percent where food inflation and non-food inflation recorded an average of 8.2 percent and 3.4 percent respectively (Table 3.7). During the period, three of the fiscal years, i.e., 1964/65, 1965/66 and 1969/70, witnessed double digit inflation at 11.7 percent, 14.2 percent and 10.7 percent respectively while there was a negative inflation, i.e., a deflation, at 1.0 percent in 1967/68. The price of food articles showed a substantial upward movement leading to double digit inflation throughout these years. This unprecedented rise in the price, particularly of the food articles, was attributed to the adverse weather situation causing a drastic fall in the production of food grains. The year 1966/67 witnessed only a marginal rise in the price level at 1.8 percent and a year later in 1967/68 there was a negative growth in price at 1.0 percent. The contributory factor for the fall in the prices was the appreciation of the NRs vis-à-vis the IRs in 1966. Both the customs and excise duties were increased heavily, together with monetary expansion contributing to an upward movement in inflation at 10.7 percent in the final year of the sixties.

The inflation during 1970s averaged 7.9 percent, higher than 5.8 percent in the sixties (Table 3.7). The food inflation stood at 8.0 percent while the non-food inflation stood at 7.8 percent during the period. In the early years of the seventies, most of the countries had experienced a high inflationary pressure due to the world oil crises. Nepal had also been affected by such international shocks resulting in rise in the domestic prices of petroleum products. During the period, the consecutive three fiscal years from 1972/73 to 1974/75 and 1977/78 witnessed double digits inflation at 11.2 percent, 18.5 percent, 16.7 percent and 11.2 percent respectively while the fiscal year 1975/76 witnessed a marginal negative inflation at 0.7 percent. In order to control the increasing domestic price level, GON revised customs and excise duty downwards, thereby containing the inflation at a single digit in 1978/79. However, the shortfall in the production of food grains and an upward revision in the prices of petroleum products in 1979/80 contributed to an upsurge in the price level by 9.8 percent.

Table 3.7 : Price Dynamics in Last Six Decades (Average Percent Change)

Period	Overall	Food and Beverages Group	Non-food and Services Group
1960s	5.8	8.2	3.4
1970s	7.9	8.0	7.8
1980s	10.6	11.0	10.2
1990s	9.6	9.9	9.1
2000s	6.1	7.0	5.6
2010/11-2015/16	9.0	10.7	7.6

The 1980s witnessed an alarming price movements with an average inflation at 10.6 percent, higher than that of the seventies at 7.9 percent (Table 3.7). During the period, the food inflation averaged 11.0 percent whereas non-food inflation averaged 10.2 percent. The higher rate of inflation during the period could be attributed to the rise in prices of food articles due to a decline in the production of food grains owing to a severe drought experienced both in Nepal and the bordering areas of India together with the spillover of inflation in India. In addition, the lagged impact of the rise in the price of petroleum products, successive devaluation of the Nepalese rupee vis-à-vis the US dollar and expansionary fiscal policy of the Government contributed significantly to such upsurge in the price movement in Nepal.

The 1990s observed the speed-up in economic liberalization process in Nepal. This decade also experienced a higher level of inflation but was limited to a single average digit due mainly to the structural changes in the economy. The average inflation for the period stood at 9.6 percent followed by food inflation at 9.9 percent and non-food inflation at 9.1 percent. Although the amicable resolution of the 15-month long trade and transit dispute with India in 1990 eased the supply situation, the outbreak of the Gulf War in 1990 combined with a relatively higher growth of Indian inflation induced an upward pressure on CPI in Nepal.

During the 1990s, the average change in the National Urban CPI remained below 10 percent in most of the years, except in two fiscal years 1991/92 and 1998/99. The fiscal year 1991/92 witnessed an inflation of 21.1 percent, the highest ever recorded in the history of Nepal. The contributory factor for such a high inflationary pressure was the high price increment in food articles rather than non-food articles. The inflation of food articles shot up by a whopping 24.5 percent while the inflation of non-food articles went up by 14.8 percent only. The higher rise in food articles was mainly due to the steep rise in the prices of rice and spices that were imported from India. The other factors responsible for such unprecedented rise in the rate of inflation in 1991/92 were the devaluation of the Nepalese rupee vis-à-vis the US dollar and other convertible currencies by 20.9 percent in conjunction with the policy of the convertibility of the NRs in the current account which pushed up the import prices of raw materials, fuels, fertilizers, construction materials, daily consumer goods, etc. Along with the devaluation, the government also adjusted the administered prices of goods and services upwards. Moreover, the perpetually long expansionary fiscal policy of the Government in the past continued to put pressure on the monetary liquidity that fuelled the inflation from the demand side as well.

From the very beginning of the twenty-first century, many countries around the world experienced low level of inflation. Nepal also witnessed relatively low level of inflation during this period. During the 2000s, the average inflation stood at 6.1 percent, comprising food inflation at 7.0 percent and non-food inflation at 5.6 percent. A smooth supply situation in domestic market and a favourable price situation in India in conjunction with a good harvest both in Nepal and neighbouring India as a result of a favourable weather condition for both the cereal and cash crops as well as seasonal production were the main attributing factors for containing inflation at a lower level.

Inflation remained at a higher level 2010 onwards. The average inflation stood at 9.0 percent, with food inflation at 10.7 percent and non-food inflation at 7.6 percent. The year 2015/16 witnessed the inflation of 9.9 percent on account of disruptions in supply due to disturbances in the southern border of the country.

3.5 Monetary Sector Development

NRB started compiling monetary statistics since mid-July 1960 focusing on "A" class financial institutions. Monetary statistics have been compiled in accordance with IMF's Monetary and Financial Statistics Manual 2000 since mid-July 2003. Since mid-January 2011, monetary aggregates started to be compiled by including balance sheets of "B" class and "C" class financial institutions. Currently, monetary sector statistics include the monetary survey, central bank survey and other depository corporation survey as well as balance sheets of the commercial banks and other financial institutions. In this way, coverage of monetary statistics has increased significantly over time.

Broad money showed a high and volatile growth pattern in the past. The annual growth of broad money supply ranged from 4.4 percent to 33.3 percent during 1960-2016 (Chart 3.16). The average growth during 2005-2016 was 19.2 percent. The growth of narrow money and currency in circulation was also high in the past. The average growth of narrow money during 1960-2016 was 15.5 percent. During the period, the growth ranged from 1.9 percent in 2011 to 38.1 percent in 1964. Likewise, the average growth of currency in circulation was 15.6 percent during 1960-2016.

Chart 3.7
Growth of Currency, Narrow Money and Broad Money
(in percent, 1960-2016)

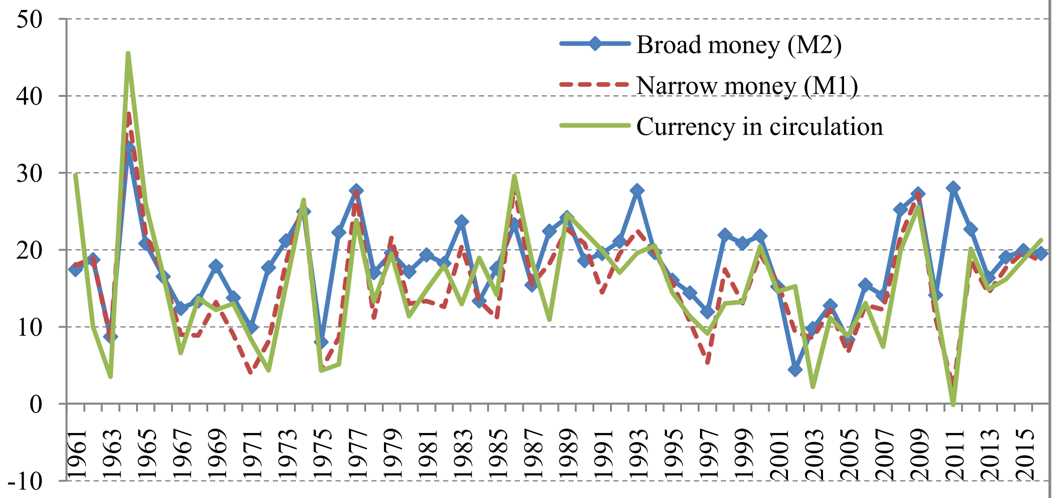
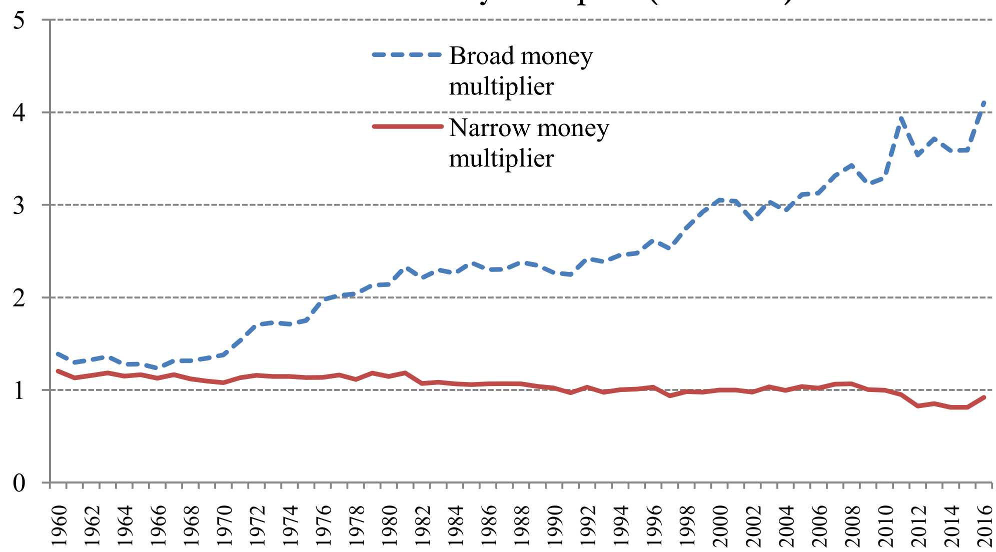
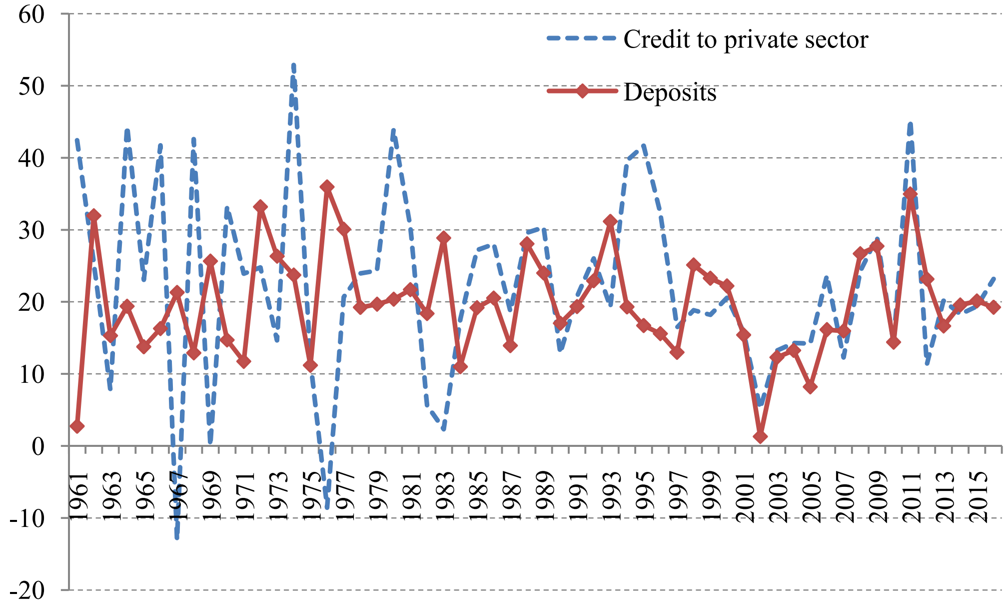


Chart 3.8
Movement of Money Multiplier (1960-2016)



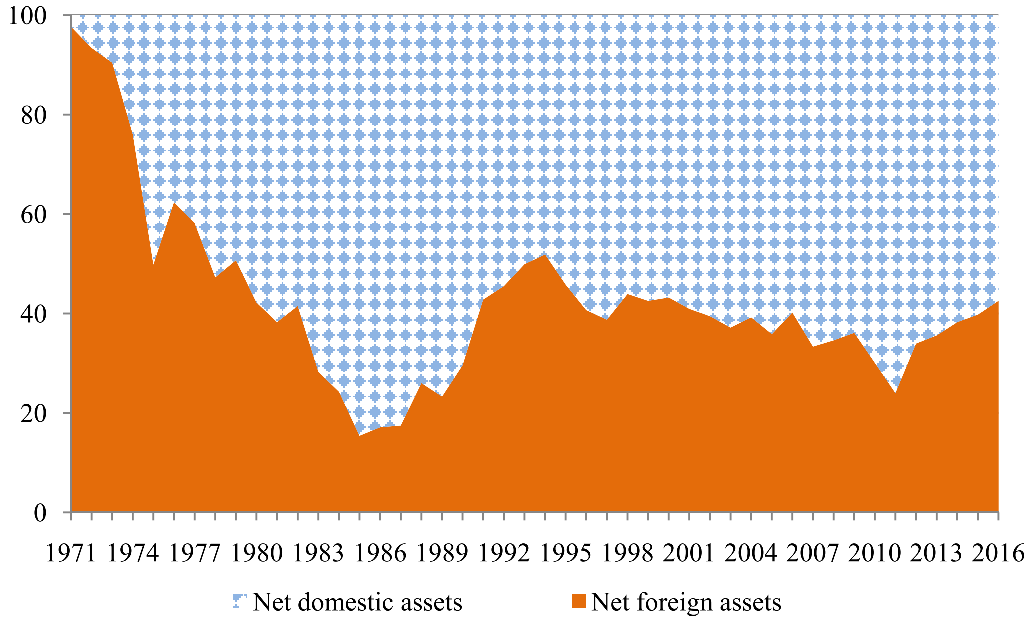
Broad money multiplier depicts an increasing trend in the past and the narrow money multiplier is almost stable (Chart 3.8). During the period 1960-2016, the average value of broad money multiplier and narrow money multiplier was 2.4 and 1.1 respectively. Such value was 3.7 and 0.9 in the period 2011-2016. The growth of deposits as well as the credit to the private sector was high and also volatile (Chart 3.9). The average growth of deposits and private sector credit during 1960-2016 was 19.7 percent and 22.1 percent respectively. Such a growth during the period 2011-2016 was 22.3 percent and 22.9 percent respectively.

Chart 3.9
Growth of Deposits and Private Sector Credit
(in percent, 1960-2016)



The composition of broad money has significantly changed during the period 1970-2016. In the 1970s, the share of net foreign assets (NFA) was higher than the net domestic assets (Chart 3.19). The share of NFA significantly declined during the period of BOP deficits in the mid-1980s. Later, after the implementation of liberalization measures in 1990s, the share of NFA increased again. After 2000, the growth of NFA has been continuously supported by the surge in remittance inflows.

Chart 3.10
Composition of Broad Money
(in percent, 1971-2016)



3.6 External Sector Development

This section examines trade relation with Republic of India and People's Republic of China followed by discussion on institutional arrangements made for trade promotion. The section then overviews the developments in external sector over the last six decades.

3.6.1 Trade Relation with India

Nepal's trade with India could be traced back to time immemorial. Nepal and India have entered into various agreements for promoting trade between them. Both countries signed the Treaty of Perpetual Peace and Friendship in December 1923, which provided Nepal the facility for importing from and through India. The 1950 Treaty was called Trade and Commerce Treaty. Article 5 of the Treaty mentioned that Nepal is free to import, from or through the territory of India.

Nepal again signed the Treaty of Trade and Transit with India in 1960, which provided unrestricted transit facilities for goods shipping from Nepal to third countries via India. In the Trade and Transit Treaty of 1971, the Government of India provided access to the Indian market free of basic customs duty and quantitative restrictions generally for all manufactured articles which contained not less than ninety percent of Nepalese materials or Nepalese and Indian materials. In 1978, Nepal signed separate Trade and Transit Treaties with India. Trade Treaty was renewed for another five years in 1983 and Transit Treaty was for seven years. The Trade Treaty was to be renewed in March 1988, but could not be renewed due to Nepal's refusal to Indian request to have single unified trade and transit treaty along with agreement on unauthorized trade as before 1978. As a result, after two extensions, in March 1989, India declared end of validity of these treaties and closed transit points except two.

After restoration of democracy, Treaty of Trade 1991 was signed for five years on 6 December 1991. Along with the Trade Treaty, Transit Treaty was signed for seven years while Cooperation to Control Unauthorized Trade was also signed. The Trade Treaty provided duty free/quota free access into India for the product containing 55 percent (earlier it was 65 percent) of Nepalese or Nepalese and Indian material. There were some revisions to Trade Treaty during the Indian Prime Minister's visit to Nepal in October 1992. With the signing of letter of exchange in February 1993, the new provision provided the duty free/quota free access to Nepalese article in Indian market if the percentage of Nepalese labour, Nepalese and Indian materials contained more than 50 percent in the ex-factory value of Nepalese manufactured products.

The Trade Treaty of 1996, signed in December 1996, gave a new direction and improvement in bilateral trade relations between Nepal and India as articles manufactured in Nepal got access to the Indian market free of customs duties and quotas, except (a) alcoholic liquors/beverages and their concentrates except industrial spirits, b) perfumes and cosmetics with non-Nepalese/ non-Indian brand names, and (c) cigarettes and tobacco.

The Trade Treaty of 1996 was renewed with some revisions for a period of five years with effect from 6 March 2002, which introduced fixed quota on exports of certain items from Nepal such as vegetable fats (Vanaspati ghee) with quota of 100,000 metric tons, Acrylic Yarn with quota of 10,000 metric tons, Copper products with quota of 7,500 metric tons and Zinc Oxide with quota of 2,500 metric tons.

The most recent treaty between Nepal and India was signed in October 2009. The Treaty remained in force for a period of seven years with a provision of automatic extension for the next seven years at a time. This Treaty, which granted the facility to use 27 trade routes,[3] has been renewed again in 2016.

Table: 3.8
Some Major Trade Agreements with India

1	Nepal-India Treaty of 1923
2	India-Nepal Treaty of Trade and Commerce 1950
3	Treaty of Trade and Transit 1960
4	Treaty of Trade and Transit 1971
5	Treaty of Trade, Treaty of Transit and Agreement of Co-operation to Control Unauthorized Trade 1978
6	Treaty of Trade and Treaty of Transit 1991
7	Trade Treaty of 1996
8	Trade Treaty of 2002
9	Treaty of Trade 2009

Source:
1) https://nrb.org.np/red/publications/golden_jubilee/Golden_Jubilee_Publications--Nepal_Rastra_Bank_in_Fifty_Years__Part%20II-Macroeconomy.pdf.
2) http://www.tepc.gov.np/pages/trade-agreement

3.6.2 Trade Relation with China

Nepal's foreign trade with China can be traced back to the pre-historical period. The trend of bilateral agreements is provided in Table 3.9. Nepal and China established Inter-Governmental Economic and Trade Committee (IGETC), which is a forum for discussion on Nepal-China bilateral economic and technical cooperation, in October 1982.

Table: 3.9
Some Major Trade Agreements with PR China

1	The First Agreement of Kuti 1615-20.
2	The Second Agreement of Kuti 1661-80
3	The Trade Agreement of 1814 and 1837
4	The Trade Agreement of 1956 and 1960
5	Trade and Payments Agreement 1974
6	Trade and Payments Agreement 1981
7	Agreement on Transit Transport2016

Source:
1) http://journals.sagepub.com/doi/abs/10.1177/000944558802400304
2) http://www.fmprc.gov.cn/mfa_eng/wjb_663304/zzjg_663340/yzs_663350/gjlb_663354/2752_663508/2753_663510/t16095.shtml
3) http://www.tepc.gov.np/pages/trade-agreement
4) https://www.mofa.gov.np/wp-content/uploads/2016/07/MOFA_REPORT_Nepal-Foreign-Affairs_2016.pdf

Recently, the Agreement on Trade and other related issues between

[3] http://tepc.gov.np/pages/treaty-of-trade-india, 22 March 2017

Nepal and Tibet Autonomous Region of China of 2002, with automatic renewal provision for ten years, dealt with the trade and travel of diplomatic personnel, civil servants, pilgrims and inhabitants of the border districts across the border. In 2010, PR China provided special preferential tariff treatment to the imports from developing countries including Nepal. In 2016, Nepal and PR China signed an Agreement for providing Nepal the facility to use China's sea port for trade with third countries. Similarly, Ministry of Commerce of Nepal and Ministry of Commerce of the People's Republic of China agreed to launch the Joint Feasibility Study of China-Nepal Free Trade Agreement. Instead of the previous practice of classifying trade transactions with India and other countries, NRB started to separately classify trade transactions with China since 2012/13 due to the growing volume of trade with China in recent years.

3.6.3 Domestic, Bilateral and Multilateral Arrangement for Trade Promotion

The GON established Trade and Export Promotion Centre in November 2006 merging three organizations, namely, Trade Promotion Centre, Export Promotion Board, and Carpet and Wool Development Board to work as a national trade promotion organization of the country. The major objectives were to (a) advise the GON in formulating policies for the development and expansion of trade and export, (b) support in fostering internal and external market for domestic products, (c) cooperate to implement appropriate programmes to attract investment, both domestic and foreign, for assisting export-oriented and import management ventures, and (d) simplify the procedures related to quality control, insurance and transport.

Nepal Trade and Competitiveness Study was a diagnostic trade study conducted to analyse Nepal's trade regime and performance which identified products with comparative and competitive advantage. This study showed a) inadequate mechanisms and incentives for firms to acquire new technology, b) weak infrastructure, and c) an unfavourable business climate as the key factors contributing to low competitiveness and productivity in Nepal's economy (World Bank, 2003).

Likewise, Nepal Trade Integration Strategy was developed in 2010 in the context of change in international trade regimes and changes in international trade. It had identified five objectives to respond to capacity development as a) strengthen trade negotiations (especially bilateral), b) strengthen the technical capacity of domestic non-tariff barrier (NTB) and other business environment supportive institutions, c) strengthen the export capacity of 'Inclusive' export potential goods and services, d) strengthen the GON's capacity to coordinate and manage Trade-Related Technical Assistance (TRTA) and Aid for Trade (AfT) and (e) implement the recommendations of NTIS. The supply side constraints along with inadequate infrastructure and low investment led to the poor performance of Nepal's trade, resulting in continuous trade deficits (Ministry of Commerce and Supply, 2016).

In order to address the rising trade and competitiveness challenges faced by Nepalese exports, another Nepal Trade Integration Strategy has been formulated in 2016. The strategy has aimed to (a) strengthen trade and exports, (b) focus on product development and strengthen supply capacity of priority products, (c) bolster institutional capacity on trade negotiation and inter-agency coordination and (d) build and enhance trade-related infrastructure. The goods consisted of 1) four agro-based products namely (a) cardamom, (b) ginger, (c) tea and (d) medicinal and aromatic plants, 2) five craft and manufacturing products namely (a) all fabrics, textile, yarn and rope, (b) leather, (c) footwear, (d) Pashmina and (e) carpets. Similarly, three service sectors covered are (a) skilled and semi-skilled professionals at various categories (remittance generating services), (b) IT and BPO as well as IT engineering and (c) tourism (including leisure, business, education and medical) (Ministry of Commerce and Supply, 2016).

Trade Policy 2015 was issued in August 2015 replacing the Trade Policy 2009 to (a) address the coordination of Trade Policy and Trade Integration Strategy, (b) strengthen supply capacity, (c) enhance production and productivity, (d) address the service trade and intellectual property rights with the view to reduce trade deficit and increase the access of Nepalese products, services and intellectual property in the world market.

Besides the Trade Policy 2015 and Nepal Trade Integration Strategy 2016, Nepal has issued laws and regulations for trade promotion such as Export Import Control Act 1957, Excise Duty Act 2002, Industrial

Enterprises Act 2016, Foreign Investment and Technology Transfer Act 1992 and Industrial Policy 2010, among others.

Further, Nepalese products have obtained duty free access to US market till 2025. Nepal has been getting duty-free, quota-free access to European market under its 'Everything but Arms' (EBA) initiative. Under EBA, products except arms and ammunition can have access to the EU market duty free. Nepal became the member of South Asian Free Trade Agreement (SAFTA), Bay of Bengal Initiatives for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) and World Trade Organization (WTO) in 2004 in order to strengthen and enhance trade.

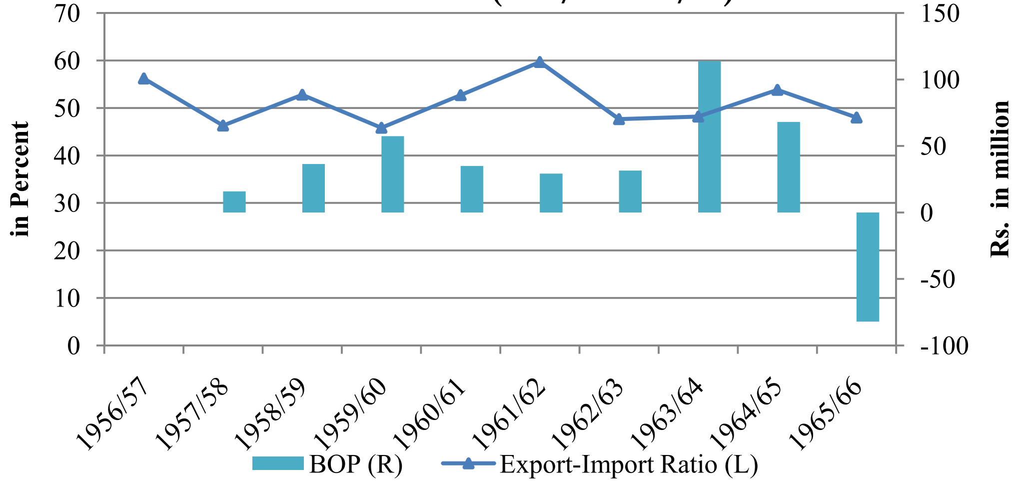
3.6.4 Performance of External Sector

Nepal's trade and payments transactions with the rest of the world have been institutionally recorded since 1950s though the trade transactions of Nepal with its neighbours like India and China have had a long history. Recording of foreign trade statistics was made since 1956/57, detailed BOP statistics since 1974/75, and Export-Import Price Index (XMPI) and International Investment Position (IIP) since 2012/13. NRB made public for the first time the XMPI and IIP in 2014/15.

Though aggregate BOP figures are available since 1956/57, the Central Balance of Payments Division (renamed Balance of Payments Division on 29 June 1978) of NRB started compiling BOP statistics using IMF's BOP manual since 1974/75. Since May 2003, Nepal has been compiling BOP statistics as per IMF's fifth edition of BOP manual. The external sector trends are being depicted in the following Chart 3.11-3.15.

During the 60 years, exports at nominal prices rose from Rs. 95.5 million in 1996/97 to Rs. 70,117.1 million in 2015/16, recording an annual average growth of 11.6 percent. Imports rose from Rs. 169.9 million in 1956/57 to Rs. 77,359.91 million in 2015/16, registering an annual average growth of 15.1 percent. The first decade (1956/57-1965/66) witnessed exports averaging one-third of the total trade during the decade. In 1956/57, exports-imports ratio was 56.2 percent which rose to 59.7 percent in 1961/62 before declining to 48.0 percent in 1965/66 (Chart 3.11, NRB 1981). Since 1963/64, NRB started publishing exports and imports data under two classification, namely, with India and with countries other than India. In 1963/64, 97.7 percent of total exports and 98.5 percent of total imports were carried out with India. As far as BOP was concerned, in the first nine years, BOP recorded a surplus, which, however, turned into deficit amounting to Rs. 82.1 million in 1965/66 (Chart 3.11).

Chart 3.11
External Sector (1956/57-1965/66)

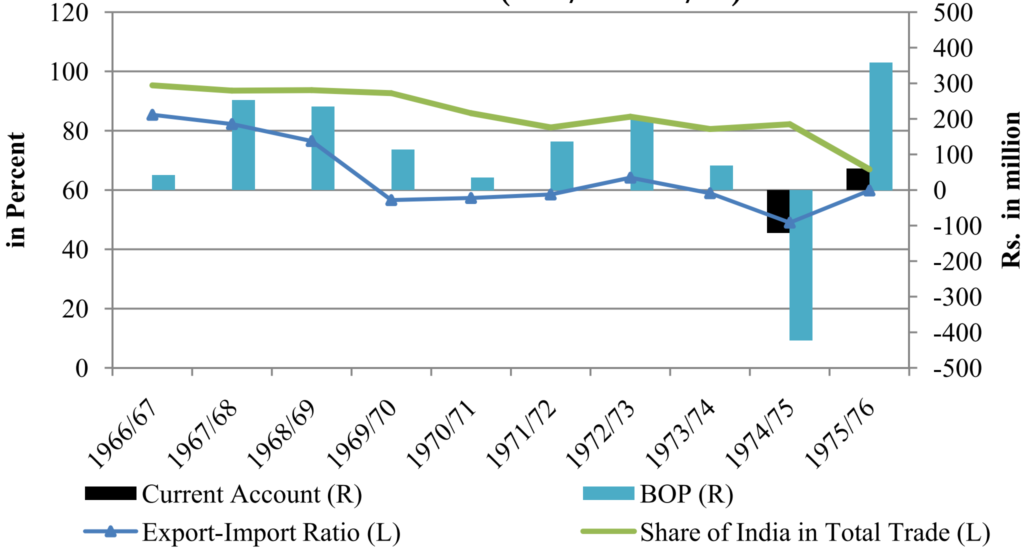


Since 1966, foreign exchange reserve data of the banking system (NRB and banks) had been included in NRB publications. The share of foreign exchange reserves then held by banks except NRB was 1.3 percent of the total reserves. During this decade, foreign exchange reserve level was sufficient to cover goods imports (cif) equivalent to 4.7 months on average[4].

The first year of the second decade (1966/67-1975/76) witnessed a tremendous improvement in export-import ratio which recorded 85.4 percent because of suppressed imports but rise in exports. The ratio declined to 59.8 percent in 1975/76. Overall, total exports increased 3.2 times and total imports increased 2.5 times during this decade. The growth of exports remained lower than that of imports resulting in widening gap between them (Chart 3.12).

[4]Based on average of annual import capacity of 10 years.

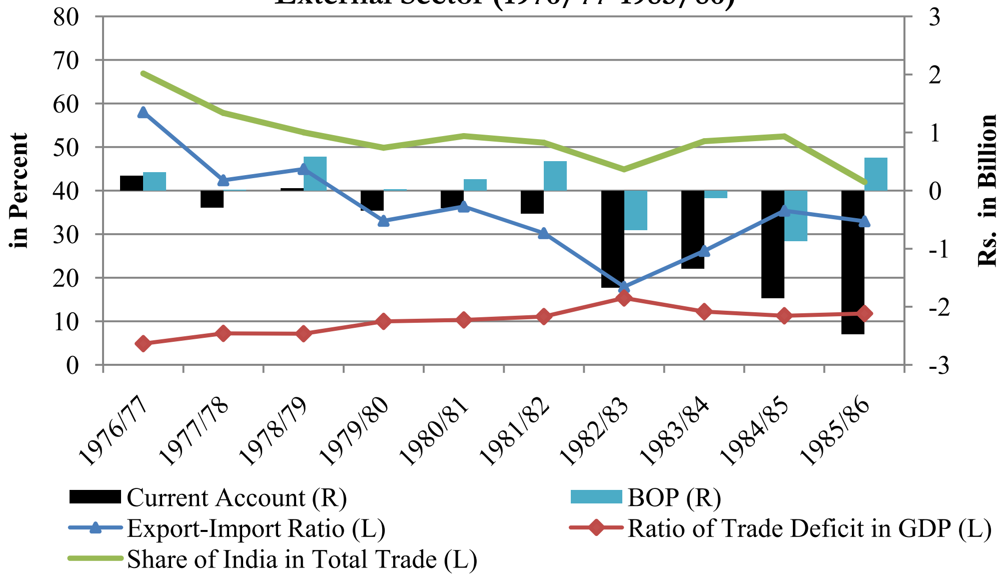
Chart 3.12
External Sector (1966/67-1975/76)



Regarding trade diversification, some progress was observed in the period as exports to and imports from India declined to 75.3 percent and 61.9 percent of total exports and imports respectively by 1975/76. This shows growing trade integration of Nepal with countries other than India in line with trade diversification policy. Regarding the BOP situation, the decade started with surplus in BOP which continued until first eight years before turning into BOP deficit at Rs. 422.4 million in 1974/75, the year since the NRB started presentation of detailed BOP statistics including net service income and net transfer income. The foreign exchange reserves increased 5.3 times between 1967 and 1976. On average, existing foreign exchange reserves was enough to cover the goods imports (cif) equivalent to 13.2 months.

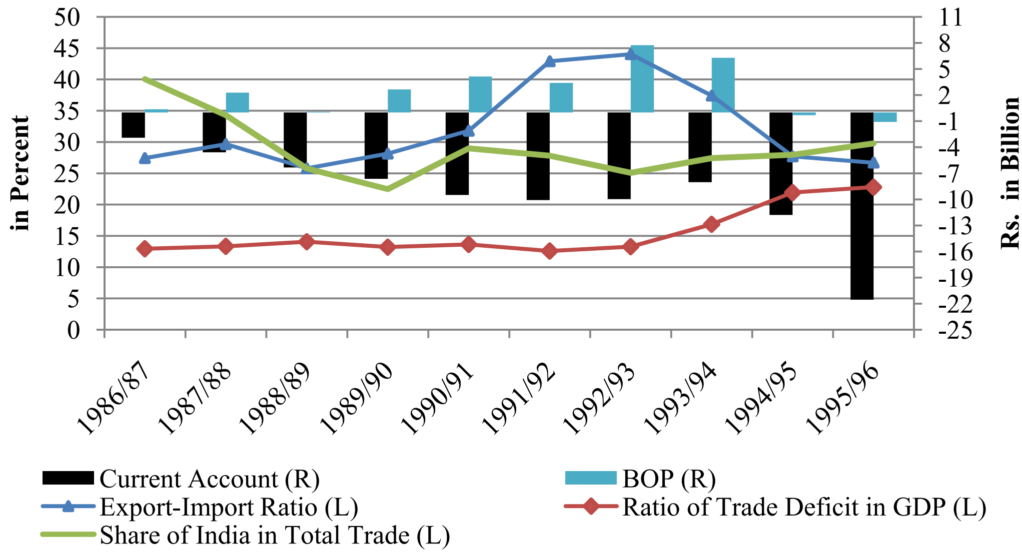
The third decade (1976/77-1985/86) observed the weak performance of exports relative to imports, resulting in further decline in export-import ratio to 33 percent in 1985/86. Likewise, the share of exports in total trade declined from 36.7 percent in 1976/77 to 24.8 percent in 1985/86. On average, exports had increased by 13.3 percent while imports increased by 17.1 percent during this period, further widening the trade deficit to 11.8 percent of GDP in 1985/86 from 4.9 percent in 1976/77 (Chart 3.13). Export-GDP and import-GDP ratio were 5.8 percent and 17.6 percent in 1985/86 compared to 6.7 percent and 11.6 percent in 1976/77 respectively. Diversification of trade was further continued as the share of trade with India declined from 66.9 percent in 1976/77 to 42.0 percent in 1985/86.

Chart 3.13
External Sector (1976/77-1985/86)



During this decade, current account remained in deficit in almost all years, except in 1976/77 and 1978/79. During initial years, BOP also remained in surplus, but turned into deficit later because of increasing budget deficit for three consecutive years of 1982/83 to 1984/85, resulting in the decline of foreign exchange reserves to cover just three months of imports of goods and services in 1984/85. To address the continuous BOP deficit, Nepal entered into the agreement with IMF for implementing the Structural Adjustment Programme. However, the average number of equivalent months of imports covered by the foreign exchange reserves remained 6.5 months during this period.

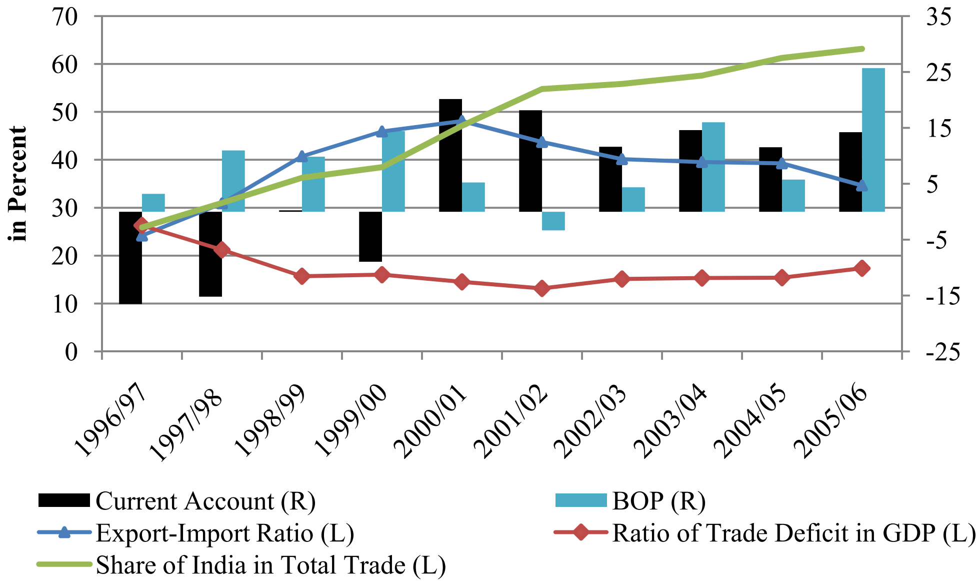
Chart 3.14
External Sector (1986/87-1995/96)



Since mid-1980s, the GON implemented economic liberalization policy which got further boost in the early 1990s with the introduction of the current account convertibility in 1993. As a result, during the fourth decade (1986/87 - 1995/96), exports grew by 23 percent and imports grew by 23.3 percent on average. Total trade to GDP ratio increased from 22.7 percent in 1986/87 to 39.4 percent in 1995/96. Despite the improvement in export performance, export-import ratio further dropped in this period to 26.7 percent in 1995/96 (Chart 3.14). Trade deficit continued widening to the extent that the trade deficit to GDP ratio stood at 22.8 percent in 1995/96 compared to 12.9 percent in 1986/87. As in the earlier decade, the focus continued on trade diversification, with the share of trade with India declining from 40 percent in 1986/87 to 29.8 percent in 1995/96 (Chart 3.14).

The current account registered a deficit in all the years in this period, but surplus was recorded in BOP because of inflows of foreign aid, except for 1994/95 and 1995/96, attributed to escalating imports. Further, the foreign exchange reserves increased 10.6 times between 1987 and 1996. As a result, foreign exchange reserves was sufficient to cover the imports for 6.4 months.

Chart 3.15
External Sector (1996/97-2005/06)



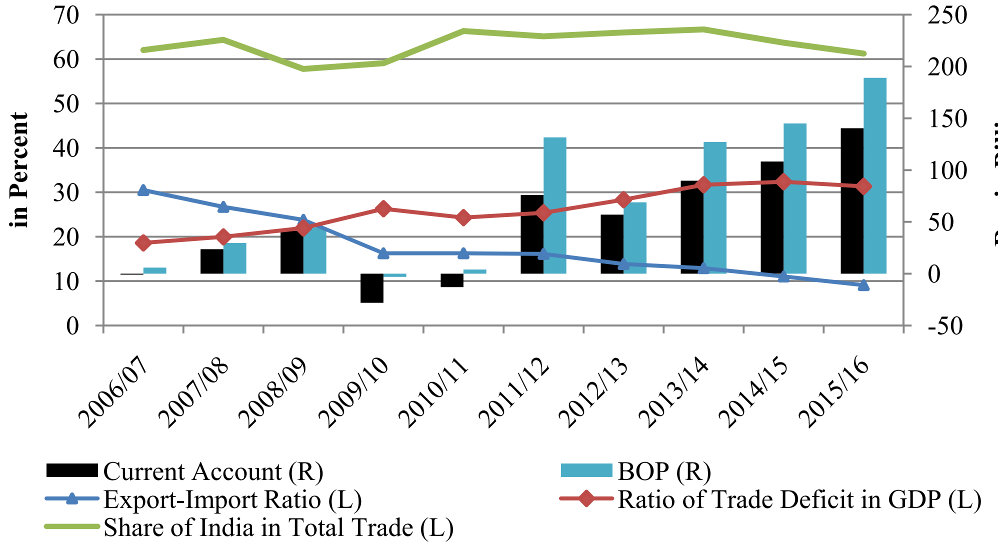
After renewal of trade treaty with India in 1996, trade with India further improved, especially exports to India increased until 2002. As a result, export-import ratio rose substantially from 24.2 percent in 1996/97 to 48.1 percent in 2000/01. Export-GDP ratio improved from 8.4 percent in 1996/97 to as high as 13.6 percent in 1999/2000 in contrast to import-GDP ratio which declined from 34.7 percent to 29.6 percent during the same period. Accordingly, trade deficit-GDP ratio declined from 26.3 percent in 1996/97 to a minimum of 13.2 percent in 2001/02 (Chart 3.15). However, growth of exports started decelerating and even declined in 2001/02 by 15.6 percent with the escalation of internal conflict in the country.

Revision of Trade Treaty with India in 2002 with the provision of quota restriction on exports of some items such as vegetable fats (*Vanaspati Ghee*), Acrylic Yarn, some Copper products, and Zinc Oxide led to further deterioration of exports. Trade deficit-GDP ratio again started to take an upward trend and reached 17.5 percent in 2005/06 (Chart 3.15). Total trade to GDP ratio, however, declined from 43.1 percent in 1996/97 to 35.8 percent in 2005/06. Trade dependence with India continued to increase as the share of trade with India surged from 25.9 percent in 1996/97 to 63.2 percent in 2005/06. Since 2002/03, Nepal started to import petroleum products directly from India by paying IR which also contributed to rising share of trade with India. The complete phase out of Multi-Fibre Agreement at the end of 2004 also put downward pressure on Nepal's export performance. As measure of further economic integration, Nepal became a member of WTO and joined BIMSTEC in 2004, but export performance did not improve.

Increasing remittance inflows, however, helped maintain external stability with surplus in current account and BOP despite deteriorating exports in the later part of this period. As a result, the period from 1997 to 2006 witnessed further increase in foreign exchange reserves by 3.4 times. Existing foreign exchange reserves was enough to finance imports equivalent to 8.7 months on average during this period.

The sixth decade (2006/07-2015/16) witnessed further the deterioration of export performance since exports grew only by an annual average of 2.2 percent. Compared to export growth, imports grew by a very higher rate of 16.5 percent on average, resulting in ever increasing trade deficit, which reached 31.3 percent of GDP in 2015/16 from 18.6 percent in 2006/07 (Chart 3.16). Export-GDP ratio continuously declined to 3.1 percent in 2015/16 from 8.2 percent in 2006/07. In contrast, import-GDP ratio jumped up to 34.4 percent from 26.8 percent during that period. Further, export-import ratio fell sharply to 9.1 percent in 2015/16 from 30.5 percent in 2006/07. India comprised two-thirds of Nepal's total trade in this period. Given Nepal's growing trade with China, NRB started reporting trade data with China separately since 2012/13. The share of China in Nepal's total exports and imports was 2.7 percent and 11.2 percent respectively in 2012/13. Such a share of exports to China declined to 2.4 percent while the share of imports from China increased to 14.9 percent in 2015/16.

Chart 3.16
External Sector (2006/07-2015/16)



Despite widening trade deficit arising from weak performance of exports and elevated level of imports, current account and BOP remained in surplus during most of the years primarily because of higher level of remittance inflows. Current account recorded deficit in 2006/07 and consecutively in 2009/10 and 2010/11. BOP was also in deficit in 2009/10, attributed to deceleration in remittance inflows arising from the impact of the global financial crisis of 2007/08. However, resumption of the growth of inflows of remittance in later years resulted in the record level of BOP surplus of Rs. 131. 63 billion in 2011/12, Rs. 127.13 billion in 2013/14, Rs. 145.04 billion in 2014/15, and Rs. 188.95 billion in 2015/16. With growing number of people going for foreign employment, remittance inflows, which was 13.8 percent of GDP in 2006/07, increased to 29.6 percent in 2015/16. Foreign exchange reserves was adequate to cover imports equivalent to 14.1 months in 2015/16.

In a nutshell, Table 3.10 shows the performance of Nepalese external sector over the last six decades based on a few selected indicators. Trade deficit as percent of GDP increased continuously from 10.1 percent during the third decade to 26.0 during the sixth decade. Export-import ratio, which rose and reached 64.9 percent during the second decade, declined to 35.7 percent in the third decade and 32.2 percent in the fourth decade. Though some improvement in export-import ratio was registered during the fifth decade, it fell sharply to 17.6 percent in the sixth decade. Concentration of Nepal's foreign trade with India was almost hundred percent in the first decade, but declined thereafter continuously until the fourth decade. The share of trade with India again started taking an upward trend from the fifth decade standing at 47.1 percent on average during that period, and further rising to 63.2 percent in the sixth decade (Table 3.10). Despite weak performance of exports resulting in ever increasing trade deficit and declining export-import ratio, import covering capacity of foreign exchange reserves remained at satisfactory level.

Table 3.10 : Selected Indicators of External Sector

(decade-wise average)

Fiscal Year/Variables	Trade Deficit/GDP (%)	Export-Import Ratio (%)	Trade with India as % of Total Trade	Import Capacity in Months
1956/57-1965/66		51.1	98.0 (last 3 yrs)	4.7
1967/68-1975/76		64.9	85.7	13.2
1976/77-1985/86	10.1	35.7	52.2	6.5
1986/87- 1995/96	15.5	32.2	29.0	6.4
1996/97-2005/06	17.0	38.7	47.1	8.7
2006/07-2015/16	26.0	17.6	63.2	9.8

Source: NRB (1981), NRB's Various Quarterly Economic Bulletins and MOF's various Economic Surveys

4 Monetary Policy

Formulation and implementation of monetary policy is the major function of NRB. The Bank's priority during the first decade of its establishment was placed on the development of banking system and payment system in the country. Only in 1966, NRB introduced monetary policy instruments through circulars and directives. NRB relied more on direct approach of monetary policy implementation in the decades of 1960s, 1970s and 1980s. Since late 1980s, NRB gave emphasis on the indirect monetary instruments by deregulating interest rate determination and brought about reforms in monetary strategy, instruments and operating procedure, among others.

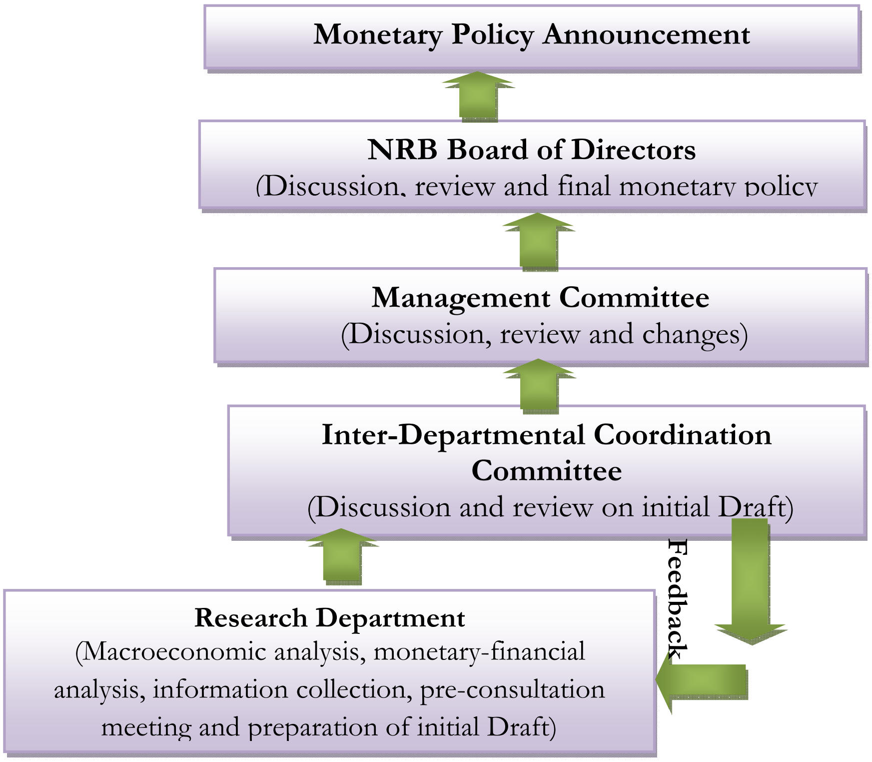
The first decade of the twenty first century heralded a major breakthrough in the Nepalese monetary policy. NRB Act, 2002 provided a clear legal and institutional framework for monetary policy. The monetary policy operating procedure was changed in response to the evolving needs of time. This Chapter aims to outline the evolution of Nepal's monetary policy in recent decades. More specifically, it covers four areas: (i) formulation of monetary policy, (ii) monetary policy strategy, (iii) monetary policy implementation, and (iv) monetary policy instruments.

4.1 Formulation of Monetary Policy

Formulating monetary policy in Nepal formally received its institutional, legal and more transparent framework in recent decades despite its history of five decades. NRB Act, 2002 broadly provides the guidelines and institutional set-up for monetary policy decision. It mandated the annual announcement of monetary policy by incorporating the review of past policy, programmes for the following year and rationale for such programmes. After the promulgation of the Act, NRB began the practice of formally announcing and publishing monetary policy statement starting from fiscal year 2002/03 which was a breakthrough in modernizing monetary policy through more transparent framework with public dissemination. Besides, the tradition has also been to incorporate financial and foreign exchange policies in monetary policy document. The summary of monetary policy formulation process is presented in Chart 4.1.

As regards the formulation process, Research Department (RD) first prepares an initial draft of monetary policy. While preparing this draft, it collects information from other Departments of the Bank and related stakeholders. There is also a practice of organizing pre-monetary policy consultation meetings with the stakeholders. Then, initial draft is presented in the Inter-Departmental Coordination Committee, which is headed by Executive Director of RD. By incorporating the changes recommended by the Committee, the RD submits the Draft to the Management Committee (MC) which reviews and makes possible changes in the draft.

Chart 4.1: Monetary Policy Formulation Process



By incorporating the recommendations of the MC, the draft of monetary policy is forwarded to the BOD for approval.. After the approval, the Governor formally announces the policy through press conference and the document is published electronically and also made available in hard copy.

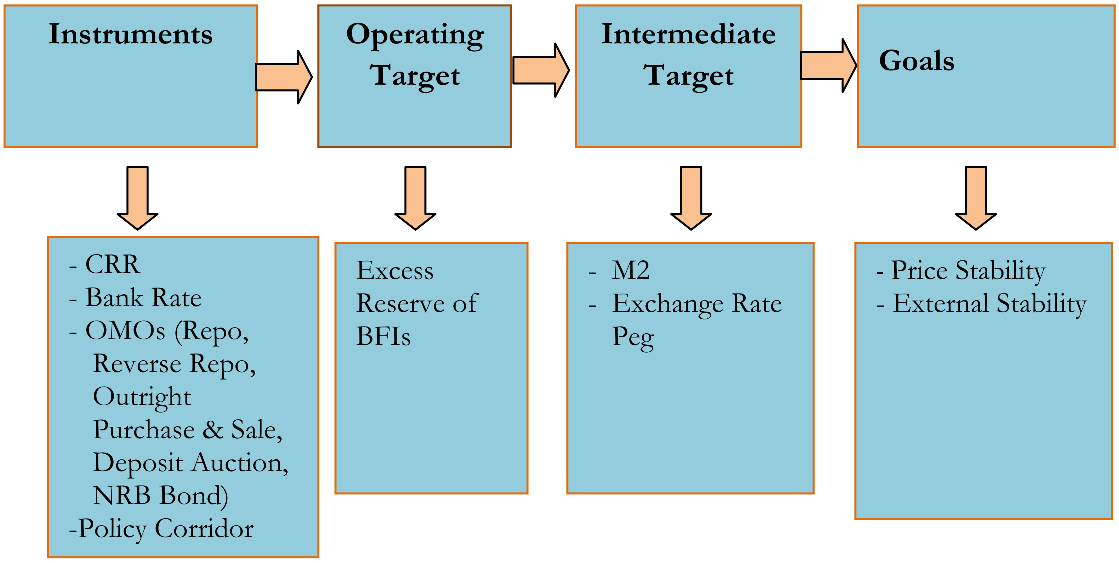
NRB follows the same procedure for Mid-term Review and Quarterly Review of the monetary policy, which has been started since 2016/17.

4.2 Monetary Policy Strategy

In order to implement monetary policy, it is important to have an operational plan or path that links the monetary policy instruments with the intermediate and final targets of the policy. Such a plan or strategy is a key for a successful operation of monetary policy. Under this backdrop, NRB has also adopted an explicit monetary policy strategy considering the level of financial development, trade openness, monetary transmission channels, inflation dynamics and behavior of monetary aggregates. The current framework including strategy was largely formalized in the early 2000s as part of the monetary policy operational reform. Historically, the peg with the IRs was adopted as a nominal anchor in most of the time period because of high trade integration, long open border and cross-border labor movement with India.

Currently, the monetary policy has explicit goals, intermediate strategy and operational targets. As per the NRB Act, 2002, NRB has the goals of monetary stability, external sector stability, financial stability and supporting growth through adequate provision of liquidity. The goals of monetary stability and external sector stability are operationalized respectively in terms of containing inflation at a level stipulated by the Government's budget statement and maintaining foreign exchange reserve to cover certain months of imports of goods and services. Broad money (M2) growth is considered as intermediate target of the policy, which is set on the basis of projected economic growth and inflation target as per the Government's budget for the forthcoming year. The exchange rate peg with the IR presently serves as a nominal anchor of the monetary policy. NRB has been adopting quantity based operational target of monetary policy, that is, the excess reserves of the banks and financial institutions, the chosen counterparties (Chart 4.2).

Chart 4.2: Monetary Policy Framework of Nepal



4.3 Monetary Policy Implementation

In the initial years following its establishment, NRB primarily concentrated on exchange rate system, especially on the expansion in the circulation of NRs in the economy. NRB introduced monetary policy instruments such as cash reserve ratio (CRR) and interest rate regulation only in 1966. Until 1980s, there was emphasis on direct monetary policy implementation, which included the interest rate regulation and credit ceilings, among others (see Appendix A). The reform in monetary policy implementation took place in late 1980s and 1990s. Then, the NRB shifted to indirect methods of monetary control. For example, the liberalization of interest rate was initiated in 1984 and the complete deregulation took place in 1989. The credit ceilings were also repealed in 1991/92. Likewise, new monetary policy instruments such as NRB bond and open market operation were also introduced in this period. However, there was no explicit monetary policy implementation framework announced until 2000s.

As mentioned before, the formal monetary policy implementation framework was announced explicitly in first monetary policy document released in 2002. The institutional framework was also established for the implementation. For example, NRB Act, 2002 made a provision of Open

Market Operation (OMO) to control excess/under-liquidity in the financial system, to ensure monetary stability and to provide confidence in the monetary operations. The framework explicitly connected the policy instruments to the intermediate and final monetary policy goals. Monetary policy instruments were also modernized in this period (see Appendix A). For example, OMO was modernized by operating OMO at the initiative of the NRB rather than on the basis of request by the BFIs. Moreover, the Liquidity Monitoring and Forecasting Framework (LMFF) has also been in use since 2004/05 at the RD for assessing the excess liquidity and forecasting which served as the basis for OMO. Likewise, new instruments such as NRB Bond and deposit collection auction (introduced in 2014/15) are also in operation.

PDMD acts as the secretariat of OMOC for short-term monetary operation. The Open Market Operation Transactions Committee (OMOTC), headed by the Deputy Governor and meets once a week or more frequently if needed. It is responsible to conduct all open market related operations such as repo, reverse repo, outright sale, outright purchase, deposit collection auction and NRB bond. Moreover, the PDMD also collects information on liquidity development from the RD and facilitates OMOTC for taking the decision on monetary operation.

4.4 Monetary Policy Instruments

Cash Reserve Ratio (CRR)

The cash reserve regulation was introduced in 1966. Initially, the ratio was 8 percent of the total deposit liabilities of commercial banks. Currently, the CRR is differentiated by types of institutions–6 percent for 'A' class (commercial banks), 5 percent for 'B' class (development banks) and 4 percent for 'C' class (finance companies). Foreign currency deposits are excluded from CRR. The CRR is unremunerated, and there is a penalty for the BFIs in the case of shortfall. The computation of required reserves averaging over one-week was introduced in 1999 in order to provide buffer against day-to-day autonomous liquidity shocks and assist OMO. Such averaging period has been increased to two weeks in 2016. There is a lagged reserve accounting in practice. Thus, the BFIs are certain of the required reserves at the beginning of the period, which allows managing the unexpected payment shocks more effectively. Since August 2016, the BFIs are required to maintain at least 70 percent of the required reserves daily. Details of the historical evolution of the CRR have been provided in Appendix 4.1.

Bank Rate

The bank rate is the rate at which the NRB provides the lender of the last resort facility. It also serves as a penalty rate on the BFIs in case of shortfall of the CRR. The changes in the bank rate also signal the monetary policy stance. Currently, the bank rate is 7 percent.

Statutory Liquidity Ratio (SLR)

NRB introduced SLR in 1974 with a view to mobilize savings, channelize credit into more productive areas, and check money supply growth. The SLR at 32 percent of total deposit liabilities was introduced for commercial banks in October 1974. The SLR consisted of 5 percent compulsory investment in Government bonds and 5 percent compulsory reserves maintained at NRB. The SLR was in practice during 1974-1986 and 1991-1993 which, however, was discontinued in 1993 on the assumption that it distorted the markets. In view of the global financial crisis in 2008-09, it was reintroduced in 2009. Currently, SLR ratio also differs by type of institutions, vis., 12 percent for 'A' class, 9 percent for 'B' class and 8 percent for 'C' class institutions, with only 6 percent for the 'B' and 'C' class institutions which collect only current and call deposits. The assets for the calculation of the SLR include the investment in Government securities, CRR maintained at the NRB and cash in vault of the BFIs. The investment in deposit auction can be included for the computation of SLR and liquidity ratio (detail in Appendix 4.1).

Standing Liquidity Facility (SLF)

NRB introduced the SLF in 2004 for the first time in order to provide fully collateralized liquidity facility for commercial banks. The initial provision included the liquidity facility to commercial banks up to five days by paying two percent penal rate over the 91-day TB rate against the collateral of Government bonds. Currently, SLF is provided to the BFIs in order to assist them meet short-term liquidity requirements for a period of maximum five days during normal times. The amount of loan provided is up to 90 percent of the face value of the collateral. The bank rate has served as the SLF rate since 2012/13.

NRB Bond

NRB bond was issued for the first time in 1993. NRB recently issued NRB bond in 2016 for absorbing excess liquidity. The procedure for NRB bond has been guided by NRB Bond Issuance Manual, 2015. The bond can be issued for the period of six months or one year. It is issued on interest rate auction basis, which could be done at multiple rates. The minimum amount of auction is Rs. 10 million and, above that, the amount must be divisible by Rs. 10 million.

Deposit Collection Auction

The auction-based interest paying deposit collection with maximum maturity of 90 days was introduced in 2015. The multiple rate auction procedure is adopted for the issuance of deposits. It has emerged as an effective tool of monetary policy operations. The minimum auctioned amount for 3 months deposit collection auction is Rs. 50 million and, above that, the amount must be divisible by Rs. 50 million. For the deposit collection with two-week maturity, the minimum auctioned amount must be Rs. 10 million and, above that, the amount must be divisible by Rs. 10 million. The investment in deposit collection can be included for the computation of SLR or liquidity ratio.

Refinance Facilities

Refinance facilities are provided by the NRB for the deprived sector lending, productive sector lending and the programme for earthquake victims. These programmes are designed to meet the social objective of channeling financial resources for the deprived and productive sector and thus promote growth and employment through increased investment in these productive sectors. Currently, the refinance facilities include (i) general refinance facility at which the refinance rate is 4 percent and the BFIs are allowed to charge maximum rate of 9 percent, (ii) special refinance facility with refinance rate of 1 percent where the BFIs are allowed to charge maximum 4.5 percent interest, and (iii) refinance facility for earthquake victims in which the refinance rate is zero percent and the BFIs are allowed to charge maximum interest of 2 percent.

4.5 Liquidity Monitoring and Forecasting Framework (LMFF)

One of the major elements of the monetary policy implementation is managing liquidity through its proper assessment and forecasting. In order to monitor and forecast the liquidity position of the banking system, NRB has been using LMFF since 2004/05. The output from LMFF is a key input for the OMOTC in taking decision over monetary operations. The LMFF is prepared on the basis of NRB balance sheet, information on foreign exchange intervention and government treasury position, among others. Currently, the RD prepares liquidity assessment and forecasting using the LMFF. Liquidity monitoring is done on daily basis and forecasting of liquidity is carried out on a weekly basis.

The key to liquidity management framework is a forward-looking assessment of system-level liquidity demand and supply. The LMFF is used to forecast liquidity over short-horizon on the basis of projections of autonomous drivers of liquidity. Currently, the focus of liquidity forecast is on one week ahead with four weeks rolling time horizon. Liquidity development over longer-horizon is also made in consideration with the target of broad money growth, projection of deposits, and private sector credit.

LMFF takes into consideration several factors in forecasting liquidity. The autonomous factors in the LMFF include currency in circulation, government balances with NRB, net foreign exchange intervention, net changes in claims on non-banks, demand for reserves and changes in other items. Actual budgetary information is available on daily basis and forecast is made on the basis of trend and other information. Likewise, currency is forecast on the basis of seasonality and the development in the economy. Foreign exchange intervention is forecast on the basis of flow of remittances and other external sector developments. Likewise, time series evolution of the determinants of liquidity is also taken into account for the forecasting purposes. Any other information related to monetary operations is also used for the forecasting.

4.6 Open Market Operations (OMOs)

It is a key instrument of monetary policy operations, introduced by the NRB in 1988. Open Market Operation Committee (OMOC) was established for OMO. However, the process of modernizing OMO was initiated only in 2003. OMO was conducted at the initiative of NRB and LMFF was introduced in order to support the OMO. Likewise, procedure of OMO and related infrastructure was also established (details in Appendix 4.1).

OMO is divided into repo, reverse repo, outright purchase and outright sale. Reverse repo and outright sale are used to absorb liquidity whereas repo and outright purchase are used to inject liquidity. On the basis of nature, the OMO Bylaw, 2014 divides the OMOs into regular, fine tuning and structural OMOs. Regular OMOs are conducted Wednesday with a maximum maturity of seven days in order to manage the general type of shortage/excess liquidity in the system. Fine-tuning OMOs can be conducted for a maximum maturity period of three months using repo/reverse repo in case of substantial liquidity fluctuation with high volatility in short-term interest rates. Finally, the operation of structural OMOs is for the maximum period of six months for the purpose of long-term liquidity management. The collateral in OMOs includes government securities (such as T-bills, development bonds), NRB bond (if it exists) and other specified securities. The cap for individual auction is limited to the maximum of two percent of overall domestic deposit liabilities of the BFIs. Currently, the counterparties in OMOs are 'A' class, 'B' class and 'C' class financial institutions.

OMOTC is headed by the Deputy Governor, consisting of Executive Directors from RD and PDMD as well as Joint-Secretary of Ministry of Finance as members, and a Director from PDMD serving as member-secretary. The role of OMOTC is to take decision on OMOs and other monetary operations on the basis of related trend and features of the financial market, monetary policy stance and the overall real sector developments in the economy.

RD plays an active role in the process of monetary policy implementation by providing relevant information about liquidity situation and other developments in the economy. The Department assesses the daily liquidity based on the deposits of the BFIs, balances at the NRB and required reserves using the NRB balance sheet. The Department uses LMFF to forecast the supply and demand for reserves balances. While forecasting liquidity, the relevant information used includes the balance sheet of NRB, government treasury position and foreign exchange intervention, among others. The OMOTC primarily uses the forecast of excess liquidity situation computed using the LMFF and thus takes decision on supplying or withdrawing reserves through monetary operations.

The NRB Open Market Operation Bylaw, 2014 clearly spells out the implementation procedure of monetary policy. In order to simplify operation, there are manuals related to different instruments such as NRB Bond Issuance Manual 2015, Two Weeks Deposit Collection and Repo Related Manual 2016, Deposit Collection Manual 2014 and Online Bidding Related Manual 2015. These manuals specify the process related to issue, auction, interest rate determination, allotment and settlements, among others.

Table 4.1 presents the glimpse of OMO carried out for monetary management during the last one decade. There has been addition of instruments to carry out the open market operations.

Table 4.1: Summary of Monetary Policy Operations during the Last Decade (Rs. in million)

Year	Repo	Reverse Repo	Outright Sale	Outright Purchase	Deposit Collection	NRB Bond	Net Foreign Exchange Purchase
2005	6,680	5,270	10,500	1,312			34,275
2006	450	6,500	13,510	830			55,223
2007	2,000	14,340	18,400	-			64,455
2008	9,000	6,570	14,850	-			102,410
2009	11,000	13,260	7,460	-			142,499
2010	131,677	1,000	7,440	3,382			118,660
2011	92,386	19,000	2,000				174,298
2012	744	-	8,400				258,277
2013	-	-	8,500				285,028
2014	-	602,500	8,500				343,462
2015	-	315,800	6,000		155,000		396,716
2016	-	235,950	9,100		297,500	49,080	471,350

Source: NRB (2016), Quarterly Economic Bulletin

4.7 Interest Rate Corridor System

With a view to steer the short-term rate to a desired path, NRB introduced interest rate corridor (IRC) system in 2016. The corridor was introduced through the Monetary Policy of 2016/17. To begin, NRB adopted a floating interest rate corridor hanging with the fixed ceiling rate with an objective of guiding the market for the short-term interest rate determination.

The SLF rate is the upper bound of the corridor. The interest rate on the deposit collection auction with two-week maturity is the lower limit of the operating band. For 2016/17, the lower limit rate was determined by subtracting 10 basis points from the weighted interbank rate prevailing before two working days. There is also a window of providing liquidity through repo with two-week maturity. The rate on this type of repo was set by adding 200 basis points to the weighted interbank rate prevailing before two working days.

4.8 Interest Rate Spread and Base Rate

In line with the financial sector liberalization, NRB completely deregulated the interest rate determination in the market in August 1989 with an objective of creating competitive environment in the financial sector. However, some anomalies appeared in the market on determining interest rates on deposits and lending by BFIs leading to a higher interest rate spread harming both depositors and borrowers. Hence, NRB introduced the interest rate spread of six percent to be maintained by BFIs in August, 1993, which was lowered further to five percent in July 1998. Interest rate spread was computed as a difference between weighted lending rate and weighted deposit rate. To help reduce the interest rate spread, NRB gradually reduced the CRR to be maintained by BFIs and made availability of government securities by converting non-marketable government securities and government overdraft into marketable treasury bills.

Because of criticism that interest rate spread does not suit with financial liberalization policy and some success on reducing the spread, NRB withdrew the provision of maintaining interest rate spread in July 2002. However, realizing the increasing gap between deposit and lending rates, NRB again directed commercial banks to maintain the average interest rate spread of 5 percent by the end of 2013/14 by issuing directive on 10 October 2013 and to publish the interest rate spread on a monthly basis from January 2014 onwards. Methodology for computing interest rate spread was designed as [(monthly interest income/monthly average loans and advances)x12 -(monthly interest expenses /monthly average domestic deposits)x12]x100. The methodology for computing interest rate spread was however revised on 10 July 2014 which incorporated interest income from investment in government bonds[1].

In 2012/13, NRB introduced the concept of computing base rate, which helps to set interest rate on lending, by issuing the methodology to compute the base rate. Accordingly, NRB directed all commercial banks to compute and publish the base rate on a monthly basis. Base rate is the minimum rate below which it is not viable for banks and financial institutions to lend in the market. It is computed as the sum of cost of fund, cost of maintaining CRR and SLR, operating cost and minimum rate of return on assets (0.75 percent)[2]. In 2013/14, with the view to making the determination of interest rate on loans more transparent and competitive, the concept of the base rate was extended from commercial banks to "B" and "C" class financial institutions as well.

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[1] Interest rate spread =- $\left[\frac{\frac{Ic*365}{d1}+\frac{Is*365}{d2}}{C+I}\right] - \left[\frac{\frac{Id*365}{d1}}{D}\right]$, where Ic = interest income from loans and advances, Is = interest income from government bonds. d1 = number of days in that month, d2= number of days having investment in government bonds, C = monthly average domestic deposits and I = monthly average investment on government bonds.

[2] Cost of fund (%) = weighted average interest rate on domestic deposits and borrowings; Cost of maintaining CRR = (Average amount of CRR x cost of fund)/ average amount of loanable fund; Cost of maintaining SLR = [net SLR amount *(cost of fund - weighted average interest rate on government bonds)]/ average amount of loanable fund; Operating cost = (Total operating expenses x 85)/ average amount of loanable fund. Here, average amount of loanable fund is sum of average domestic deposits and average domestic borrowing less SLR amount; and net SLR amount is total SLR amount less CRR amount.

Appendix 4.1:
Historical Evolution of Monetary Policy Instruments

Instruments	Description
Cash Reserve Ratio	▪ **December 1966:** The CRR was introduced for the commercial banks. The banks were required to maintain cash reserves with the NRB at a minimum of 8 percent of their total deposit liabilities. ▪ **October 1974**: The cash reserves that banks were required to maintain with the NRB was reduced from 8 percent to 5 percent. But, the CRR remained at 8 percent by including the cash reserves with the NRB and cash in vault with the banks. ▪ **March 1978:** The CRR was lowered to 7 percent in order to ease liquidity situation. ▪ **July 1981:** The CRR was increased to 9 percent which included 4 percent cash in vaults and 5 percent cash reserves maintained with the NRB. ▪ **August 1989:** Separate ratio of cash in vault and cash reserve with the NRB was abolished. The cash reserve ratio of 9 percent whether in the form of cash in vault or the balance with NRB or both was applied. ▪ **September 1989:** The CRR was revised upwards from 9 to 12 percent. ▪ **July 1991:** The separate ratio of cash in vault of the BFIs and the cash reserves with the NRB was reintroduced. The BFIs were required to maintain with the NRB minimum cash reserves of 8 percent of total deposit liabilities out of 12 percent of CRR. ▪ **April 1998:** The commercial banks were required to maintain 3 percent in cash in vault, 8 percent of their total domestic current and savings deposits with the NRB and 6 percent of their total domestic fixed deposits with the NRB. ▪ **August 1999:** The computation of cash reserves was started on the weekly average deposit liabilities of four weeks earlier. The weekly average was determined by dividing the daily balance of total deposit liabilities, cash in vault and balance with NRB from Monday through Friday

	▪ **December 2001**: The required balance of BFIs with NRB was reduced to 7 percent in case of current and savings deposits and 4.5 percent in case of fixed deposits. ▪ **August 2002**: The cash in vault to be kept by the BFIs was reduced to 2 percent. ▪ **August 2003:** The provision for the cash in vault to be maintained by the commercial banks was withdrawn. The single ratio of 6 percent of the total domestic deposit liabilities was introduced in order to maintain uniformity and simplicity in place of differentiated ratios. ▪ **August 2004:** The CRR for commercial banks was slashed down to 5 percent. ▪ **August 2008:** The CRR was increased to 5.5 percent as a tight stance of monetary policy. ▪ **August 2010:** The finance companies which were not allowed to operate current accounts were required to maintain 2 percent CRR and 'D' class institutions mobilizing public deposits were required to maintain 2 percent CRR. ▪ **August 2011:** The CRR was reduced to 5 percent in order to channelize resources to productive sectors and support growth through accommodative monetary stance. ▪ **August 2012:** The CRR was differentiated for class of institutions. The CRR was fixed 6 percent for commercial banks, 5.5 percent of development banks and 5 percent for finance companies. ▪ **August 2013:** The CRR was reduced to 5 percent for commercial banks, 4.5 percent for development banks and 4.0 percent for finance companies. ▪ **August 2014:** The CRR was increased to 6 percent for commercial banks, 5 percent for development banks and 4 percent for finance companies.
Statutory Liquidity Ratio (SLR)	▪ **October 1974**: The SLR of 32 percent of total deposit liabilities was introduced for commercial banks. It included 5 percent compulsory investment in government bonds and 5 percent compulsory reserves with the NRB. ▪ **March 1975**: The SLR was reduced to 27 percent

	because of the pressure on the liquidity position of the banks. Moreover, mandatory requirement of 5 percent in government bonds was abolished. ▪ **April 1975**: The SLR was further reduced to 25 percent. However, the CRR of 5 percent with the NRB was continued. ▪ **March 1992**: NRB increased SLR to 36 percent in order to check the credit demand that increased with the surges in imports due to partial convertibility of Nepalese Rupee. It included 4 percent in cash in vault, 8 percent mandatory cash reserves with the NRB and 24 percent in government securities or in the NRB bond. ▪ **December 1992:** The SLR was reduced to 34 percent. It included 4 percent cash in vault, 8 percent cash reserves with the NRB and 22 percent investment in government securities. ▪ **July 1993:** The SLR was abolished completely. The rationale behind such abolishment included: (i) suppression of the proper development of securities market, (ii) crowding out of the private sector credit with high SLR, (iii) incompatibility with the liberalized policy, and (iv) tax on financial intermediation due to obstacles for the commercial banks in maximizing portfolio. ▪ **August 2009**: In order to enhance financial soundness of the banks, the SLR was introduced. In this provision, the commercial banks, development banks and finance companies were required to maintain SLR at least 6.0 percent, 2.0 percent and 1.0 percent respectively by mid-January 2010. These institutions were required to raise such ratios to 8.0 percent, 3.0 percent and 2.0 percent respectively by mid-July 2010. ▪ **August 2010**: The SLR was increased to 15 percent for commercial banks, 11 percent for development banks, 10 percent for finance companies and 6 percent for finance companies not authorized to operate current account. The 'D' class institutions authorized for public deposit mobilization and those that already started deposit mobilization from public were required to maintain SLR at 4 percent. The computation of SLR included the

	investment in government securities, cash in vault and deposits held with the NRB. ▪ **August 2013**: The SLR was fixed at 12 percent for commercial banks, 9 percent for development banks and 8 percent for the finance companies which operated current and call accounts.
Bank Rate	▪ **1991:** The basic rate was used for rediscounting/refinancing facilities against the treasury bills maturing within 45 days or less. ▪ **July 1993:** The rediscounting rate on treasury bills, government bonds and NRB bonds was fixed at 3 percent over and above the maximum interest rates quoted on latest treasury bills auction. ▪ **December 1997:** The system of basic rate, selective rate, and lender of the last resort rate on refinancing/rediscounting were adjusted to a uniform rate of 9 percent. Additional 5 percent interest rate was charged in case of the failure to repay loans under refinance facility. ▪ **April 2000:** The bank rate was revised downwards to 7 percent. ▪ **August 2003:** The bank rate was used to signal monetary policy stance. The bank rate was fixed at 5.5 percent. ▪ **August 2005:** The bank rate was increased to 6 percent in order to signal tight stance and anchor inflationary expectations. The rate was further increased to 6.25 percent in mid-term review of monetary policy. ▪ **August 2008:** The bank rate was increased to 6.5 percent. ▪ **August 2010:** The bank rate was increased to 7 percent in order to signal the tight stance of monetary policy. ▪ **August 2012:** The bank rate was increased to 8 percent. ▪ **August 2015:** The bank rate was reduced to 7 percent, considering the situation after the earthquake.
Standing Liquidity Facility (SLF)	▪ **August 2004:** The practice of providing SLF to commercial banks for 1 to 7 days through repo was abolished. Instead, the completely collateral based SLF was introduced. Under this facility, the BFIs were allowed to borrow from the NRB at a penal rate against the

	collateral of the government securities. The penal rate of interest was determined by adding 1.5 percentage points to the latest weighted average discount rate of 91-day T-bills. The SLF could be used for 1 day to a maximum of 5 days. ▪ **August 2005:** The maximum maturity period for SLF was reduced from 5 days to 3 days. ▪ **July 2006:** The SLF maturity period was increased from 3 days to 5 days. The practice of providing SLF up to 50 percent of the face value of the government securities was continued. ▪ **August 2007**: The maximum amount of SLF against the value of government securities was increased from 50 percent to 75 percent. The SLF penal rate was increased to 2 percentage points in order to discourage the commercial banks from using excessive loan under SLF. ▪ **August 2008**: The maximum amount of loan that the BFIs could take under SLF was increased to 90 percent of the value of the collateral. The penal rate of the facility was increased from 2 percentage points to 3 percentage points. ▪ **August 2009**: The bank rate was introduced as a factor for determining interest rate on SLF. ▪ **August 2010**: The interest rate on SLF was computed by adding 3 percentage points penal rate on the latest weighted average 91-day treasury bills rate or prevailing bank rate, whichever was higher. ▪ **August 2012**: The provision of determining rate by adding 3 percentage points penal rate on weighted average of 91-day treasury bills rate or prevailing bank rate, whichever was higher, was repealed. Only the bank rate was applicable for the SLF.
Refinancing Rates	▪ **January 1967:** NRB introduced refinance facilities for export and industrial credit. The refinance rate for such credit to commercial banks was 6 percent against fully secured export and industrial credit and bills of exchange related to exports. Maximum limit for such credit was 80 percent of the amount of credit provided by the commercial banks in those areas.

	▪ **May 1969:** The refinance rate on the credit by the commercial banks against export bills was fixed at 6 percent and the maximum rate the bank could charge on such credit was 7.5 percent. The refinance rate for industrial establishments was 7 percent and that to be charged by the commercial banks was 8.5 percent. ▪ **April 1971:** The refinance rates for commercial banks varied ranging from 4 percent to 6 percent for different sectors. Likewise, the refinance rates to agriculture sector financial institutions ranged from 2.5 to 6 percent and to Nepal Industrial Development Corporation at 5 percent, the rates for Small Scale Industries Development Corporation varied from 2.5 percent to 5 percent. ▪ **May 1973:** The refinance rate on loans against export bills was fixed at 9 percent, loans against textiles at 13 percent and loans to Agricultural Marketing Corporation at 6.5 percent. ▪ **April 1978:** The refinance rate to commercial banks on irrigation loans was reduced from 10 percent to 7 percent. ▪ **May 1986:** The refinance rate to commercial banks increased to 11 percent. The maximum loan amount that the commercial banks could take under such facility was 80 percent of total credit extended in such specified sectors. ▪ **August 1989:** The refinancing was categorized into basic refinancing, selective refinancing and lender of the last resort. The basic rate was fixed at 11 percent, the selective rate at par with the basic rate, and the lender of the last resort rate not less than the maximum lending rate charged by the banks in their credit. ▪ **May 1991:** The basic rate was increased from 11 percent to 13 percent with a view to mop up excess liquidity in the economy. ▪ **July 1993**: The refinance rate was reduced to 11 percent from 13 percent. ▪ **December 1999:** The refinance on export credit was fixed at 7 percent, with the interest rate to be charged by

	the commercial banks on such credit at 10 percent. ▪ **April 2000:** The refinance rates of 9 percent for deprived sector and 7 percent for export credit was unified to 6.5 percent. The penal of 5 percentage points was applied in the case of overdue refinance facility. ▪ **August 2003**: The refinance rates were fixed at 2 percent for export credit in foreign currencies, 2 percent for sick industries and 4.5 percent for rural development banks and export credit in domestic currency. ▪ **August 2004:** The refinance rate for RDBs and export credit in domestic currency including agricultural credit was reduced to 3 percent. The refinance rate for sick industries was reduced to 1.5 percent. ▪ **May 2005:** The refinance rate for export credit and agriculture credit was revised upwards to 3.5 percent. ▪ **August 2006:** The refinance rate for small and medium enterprises (SMEs) was fixed at 3.5 percent with a view to revive these enterprises from the crisis-stricken situation. ▪ **August 2007:** The refinance rate for export credit in local currency was reduced to 2.5 percent. The rate for sick industries was fixed at 1.5 percent. Likewise, the refinance rate for SMEs was reduced to 2.5 percent. ▪ **August 2008**: The refinance rate for local currency export credit was reduced to 2 percent for encouraging export. Likewise, the refinance rate on foreign currency export credit was fixed at prevailing LIBOR plus 0.25 percent. ▪ **August 2010:** The refinance rate was unified to a single rate except for the rate on export credit in foreign currency. The refinance rate for export industry, sick industry, small and cottage industry and the foreign employment of specified section was fixed at 1.5 percent. The BFIs were not allowed to charge more than 4.5 percent under such facility. The rate on export credit in foreign currency was fixed at 0.25 percentage point plus the LIBOR.

	▪ **August 2011:** In order to avoid shortfall of credit for export oriented and import substituting industries, energy and tourism sector, the refinance rate for these sectors was reduced from 7.5 percent to 7 percent. The BFIs were not allowed to charge more than 10 percent interest to the borrowers on such loans. The refinance rates on export, sick industry, small and cottage industry and foreign employment were unified to a single rate of 1.5 percent. The BFIs were not allowed to charge more than 4.5 percent on such loans. ▪ **August 2012:** In order to channelize credit to the productive sectors, the rate for general refinance in agriculture and hydropower extended for the maximum period of 6 months was fixed at 6 percent and for other specified sectors 7 percent. The BFIs were not allowed to charge more than 9 percent on such facility. ▪ **August 2013:** The general refinance rate was reduced to 5 percent for agriculture, hydropower, livestock and fishery and other specified sectors, with the BFIs not allowed to charge more than 9 percent. Special refinance rate for sick industry, cottage and small industries, export oriented enterprises, enterprises operated by women, foreign employment of specified class of people and small enterprises operated by specified communities was reduced to 1 percent. The BFIs were not allowed to charge more than 4.5 percent on such loans. ▪ **August 2014:** The refinance rate for agriculture, hydropower, livestock, fishery and other specified productive sectors was reduced to 4 percent. Likewise, the refinance rate for concessional credit for livestock, herbs, horticulture, dairy, fishery, mushroom farming, agriculture storage, cold storage, animal slaughterhouse and meat-related business was reduced to 6 percent. ▪ **August 2015:** A special refinance for earthquake victims was introduced. Under this facility, the BFIs could get refinance of such loans at zero percent interest from NRB, in which the maximum rate that the BFIs could charge was 2 percent.

Open Market Operations	▪ **1989/90:** NRB started to place emphasis on indirect monetary instruments over direct instruments. Thus, treasury bills auction was introduced in November 1988. OMOC was constituted. A Monetary Programming Cell was established to provide the feedback to OMOC by evaluating liquidity situation. ▪ **August 2003:** Auction system was introduced for other short-term treasury bills in addition to the existing 91-day and 364-day treasury bills. The practice of conducting OMOs at the initiative of the NRB was initiated. Moreover, the OMO was supported by the liquidity monitoring and forecasting framework (LMFF). Also, the outright sale and purchase of TBs in secondary market was introduced. ▪ **August 2005:** There was an initiation of modernizing OMOs. The practice was initiated for primary issuance of treasury bills every Monday and OMOs every Wednesday. A system of buying and selling of treasury bills based on endorsement was started. The practice of implementing OMOs in treasury bills in coordination with foreign exchange intervention was initiated. OMOs included repo, reverse repo, outright purchase and sale auction. ▪ **August 2008:** The counterparties for OMO were broadened by including development banks and finance companies. ▪ **August 2009:** The maximum maturity period for repo and reverse repo auctions under OMO was extended from 28 days to 45 days in order to address the situation of liquidity contraction. ▪ **August 2012:** The maximum period of repo and reverse repo auction was reduced to 28 days from 45 days. ▪ **August 2013:** The maximum period of repo and reverse repo auctions under OMOs was reduced to 21 days. ▪ **August 2014:** Open Market Operations Bylaw, 2014 was brought in implementation. As per the provision, the OMO has been categorized into regular OMO, fine tuning OMO and structural OMO. The Bylaw explains

	the detailed procedure for monetary operations.
NRB Bond	▪ **December 1991:** In order to mop up excess liquidity, NRB issued bond on 31 December 1991. Initial amount of issued Bond was Rs. 575.4 million, maturing within 91 days. In 1992/93, NRB Bond amounting to Rs. 4,290 million was issued. The amount of issuance reached Rs. 5,989 million in 1993/94. At the end of 1994/95, the stock of NRB Bond amounted to Rs. 1,882 million. NRB Bond was also used as a sterilization tool to mop up excess liquidity from the impact of net foreign assets on money supply. ▪ **July 2016:** NRB Bond was introduced as a tool to absorb excess liquidity in the banking system. The NRB Bond Issuance Manual, 2015 specifies the issuance procedure related to NRB Bond. The Bond can be issued for the maturity period of 6 months to 1 year.

5 Public Debt Management

Managing domestic public debt falls under the function of NRB, being the fiscal agent of the GON, with the legal mandate to manage the domestic debt of the GON. NRB involves from issue to redemption of government bonds, which are issued as a part of deficit financing of the Government. This Chapter presents the evolution of domestic public debt management, giving special focus on current practice of issuing different types of bonds, changing composition of the outstanding debt over time, and institutional and procedural changes.

Public debt in Nepal was raised for the first time after 11 years of initiation of budgetary practice. The enactment of first Public Debt Act, 1961 paved the way for raising domestic debt as part of deficit financing of the budget. Since 1961, NRB has been involved in domestic public debt management as the Government's agent and banker. The Bank created a separate department in 1962 to carry out management of the Government's domestic debt in accordance with the provision of Public Debt Act,1961. The focus of domestic public debt management is to achieve the objective of budgetary deficit management with the instruments proving handy in connection also with monetary management. In addition to meeting the debt financing requirement for the GON, debt management decisions and practices based on the trade-off between cost and risk support the development of the domestic market for government securities. At present, NRB is involved in raising and managing the domestic debt for the GON in accordance with the mandate under section 5 of the Public Debt Act, 2002.

NRB acts as the issuer and manager of domestic debt on behalf of the GON, while MOF provides policy guidelines with respect to domestic debt and coordinates as well as manages the external debt. NRB through its PDMD has been involved in issuing domestic debt securities in the form of Treasury Bills (TB) and longer term bonds. The back office function like accounting and record keeping of the government's domestic and external debt is managed by MOF through the Financial Comptroller General Office (FCGO).

Legal framework for domestic debt management is provided by NRB Act, 2002 as well as Public Debt Act, 2002. In addition, GON has issued Public Debt Rules, 2003 (second amendment on 21 March 2011), and Primary and Secondary Market Management of Public Debt Rules, 2005. To facilitate the smooth functioning of the departmental roles and responsibilities, Public Debt Management Guideline 2003 is in place.

The OMOC, formed as per Public Debt Rules 2002 is responsible for taking decisions on auction, issue and management of government securities. Deputy Governor of NRB chairs the Committee while Executive Directors of NRB from RD, PDMD, BFIRD, Banking Office and Joint Secretary from MOF constitute the members. Director of NRB from PDMD acts as the Member Secretary of the Committee. The OMOC has the right to invite other officials and experts as and when found necessary. This Committee is responsible for the preparation and implementation of the issue and auction calendar of domestic borrowing for the GON.

GON's domestic debt comprises five types of debt instruments, namely, TB, Development Bond (DB), Citizen Saving Bond (CSB), National Saving Bond (NSB) and Foreign Employment Saving Bond (FESB), the latter three instruments being saving instruments issued for individuals. Among these, TB is a short term instrument with maturity period up to one year while other debt instruments have maturities ranging above one year up to 15 years.

Though TBs and DBs are mostly purchased by BFIs, individuals can also subscribe these instruments. While CSB is targeted to individuals only and institutions cannot buy them, the NSB could also be bought by approved retirement funds in addition to the Nepalese citizens in the past; however, this practice is now discontinued. No fresh issue of NSB is made at present, with CSB remaining as the sole instrument for mobilizing medium to long-term saving from individuals. In the past, the Government issued special bonds for some special purposes. However, no such special bonds exist at present. The DB, CSB, NSB and FESB are issued either in stock or promissory notes type, as institutions and individuals demand, whereas TBs are only issued as promissory notes.

FESB, which was issued for the first time on 16 July 2010, is sold with the intention of providing opportunity to the Nepalese residents working abroad or NRNs to invest in domestic bonds as well as facilitate the inflow of foreign currency through formal channel. However, the FESB has been under-subscribed by the target group.

5.1 Process of Issuance of Domestic Debt

In order to carry out the public debt management function, a number of entities are involved in Nepal. Resource Committee at the National Planning Commission (NPC) sets the limit of domestic borrowing for the fiscal year in accordance with the projected amount stated in the periodic plan, and government budget indicates the amount of domestic borrowing for the particular fiscal year. After the Parliament passes domestic borrowing bill, MOF correspondents with NRB to carry out borrowing operations. Based on this, OMOC prepares the issue and auction calendars for domestic borrowing. These incorporate the types, amount, interest rate, schedule and modalities of borrowing. Factors such as cost of debt, maturity structure, requirements in response to appropriate period of debt amortization, state of development of financial market, situation of the economy and other factors such as liquidity position and market interest rate are considered while developing the issue calendar. The targeted domestic borrowing for primary issue in each quarter of each fiscal year is projected on the basis of the trends of government income and expenditure, revenue collection level and cash position projection for the periods. The proposed issue and auction calendar is sent to MOF for the necessary approval. After approval, NRB publishes in its website. OMOC then starts issuing government bonds on the basis of the calendar for collecting domestic debt.

5.1.1 Issuance of Treasury Bills

The first ever domestic debt raised by the GON was through the issuance of 91-day TB amounting to Rs. 7 million in 1962. The TB was issued on face value at 1 percent annual coupon rate. Auction system for TB was introduced in November 1988 and TBs have been issued every week since January 1992. The secondary market facility for TB was started in 1994, and tap sale window for TB was opened in 1996. TB of 182-day was first time issued in 1988/89, 364-day in 1996/97 and 28-day in 2004/05. In this way, GON issues TB of four different maturity periods. Online Bidding System for TB and DB was started on 29 June 2015. The process of issuing TB is described in Appendix 5.1

5.1.2 Issuance of DB

DB amounting to Rs.13.1 million was issued for the first time in 1964 with annual coupon rate of 6 percent as an initiative to raise longer-term debt for supporting development activities of GON. The process of issuing DB is described in Appendix 5.2.

With the purpose of diversifying the maturities of the bonds, the GON introduced DB of 10-year maturity in 2005/06, 12-year maturity in 2006/07, 8-year maturity in 2007/08, 6-year and 7-year maturity in 2008/09, 3-year maturity in 2009/10 and 2-year maturity in 2010/11. Further, in 2014/15, GON issued DBs of 9-year and 15-year maturity and in 2015/16, DBs of 11-year and 13-year maturity were issued for the first time. Issued DBs have been listed in Nepal Stock Exchange Ltd. since 15 December 2006.

5.1.3 Issuance of CSB, NSB and FESB

NSB, CSB and FESB were for the first time issued in 1983, 2001 and 2010 respectively. CSB, NSB and FESB are issued with the intention of raising medium term debt for GON especially by focusing on individuals as per the approved issue and auction calendars for the respective fiscal year. The notice for sale of each type of bonds is published in NRB website, online media and newspapers incorporating salient features of the instruments such as opening and closing date of sale, maturity date, coupon rate, interest payment frequency, offered amount, applying procedures, eligibility of applicants and other related information along with the application forms to be submitted to PDMD. The process of issuing CSB, NSB and FESB is described in Appendix 5.3.

FESB has been issued with the maturity of 5-year period. Maturity of CSB and NSB are also of normally 5-year period. However, CSB of 12-year maturity was issued on 17 January 2007 for the first time.

5.1.4 Interest Rate Determination Mechanism

The mechanism of determining interest rate is different for short and long terms bonds. For TBs which are issued through auction held every Monday, the discount rate is determined by the market. Competitive bidders (A, B, C class financial institutions) can bid in multiple prices while contractual saving institutions like the EPF, CIT and insurance companies and public at large can bid as non-competitive bidders who can purchase the TBs and DBs at the weighted average rate applicable for competitive bidders. The non-competitive bidders also have the option to participate in competition. T-Bills discount rate is calculated by using the formula,

$$\text{Discount rate} = \frac{100 - \text{bid price}}{\text{bid price}} \times \frac{364}{\text{No.of days}} \times 100\%$$

OMOC has the right to fix the cut-off rate if bid price is unexpected or if some incongruities are suspected in the bidding procedures. In case of under-subscription, NRB purchases the remaining amount at the weighted average rate determined at the auction. However, in case of fresh issue the remaining amount could either be purchased by NRB or could be offered for next issue as per the decision of the OMOC.

5.1.5 Secondary Transactions of TBs and Bonds

No organized market for secondary trading of TBs exists. If the Government is not repaying the holders of the TBs when they matured, NRB arranges for renewing the TBs in secondary market through auctions where the amount is raised by new holders and the old holders are repaid. DBs once issued are listed in stock exchange for secondary transaction. However, secondary transactions of DBs are very negligible. TBs and DBs could be used for Repo, SLF and inter-bank transactions by the BFIs while individuals could use them as collateral to obtain loan from BFIs. The secondary transaction of CSB, NSB and FESB is conducted through licensed market makers and NRB offices outside the Kathmandu Valley. Individuals can buy and sell these securities in secondary market through the market makers.

5.2 Composition of Outstanding Domestic Public Debt

The composition of outstanding domestic public debt has changed over time. As mentioned above, the five different types of government securities are being issued in recent years: TB, DB, CSB, NSB, and FSEB. The composition structure and trend of outstanding public debt is portrayed for TB, DB, CSB, NSB, and FSEB as in mid-July 1996, mid-July 2006 and mid-July 2016 (Table 5.1).

Table 5.1 : Composition of Outstanding Domestic Public Debt (Rs. in billion, percentage share in parenthesis)

Instrument-wise	Mid-July 1996	Mid-July 2006	Mid-July 2016
Treasury Bills	7.14 (20.85)	62.97 (70.00)	116.06 (49.56)
Development Bonds	3.67 (10.72)	17.96 (19.96)	108.90 (46.51)
National Saving Bonds	7.38 (21.55)	3.88 (4.31)	0.91 (0.39)
Citizen Saving Bonds		1.68 (1.87)	7.81 (3.33)
Special Bonds	16.05 (46.88)	3.47 (3.86)	0.0
Foreign Employment Saving Bonds		0.0	0.49 (0.21)
Total	**34.24 (100.0)**	**89.95 (100.0)**	**234.16 (100.0)**
Ownership-wise			
NRB	17.54 (51.23)	11.05 (12.28)	16.41 (7.01)
BFIs	7.54 (22.02)	58.86 (65.44)	176.96 (75.57)
Individuals and Other Institutions	9.16 (26.75)	20.04 (22.28)	40.79 (17.42)

Source: NRB (2016), Quarterly Economic Bulletin, 50 (4)

As portrayed above, the composition of domestic public debt in terms of ownership has also undergone changes among NRB, BFIs and individuals and other institutions – especially moving away from NRB to the BFIs (Table 5.1).

5.3 Institutional and Domestic Procedural Changes

5.3.1 Accounting of Government Securities

Accounting of government securities has undergone drastic transformation after the adoption of GL System by NRB with the processes becoming clearer and more simplified. The general procedure for transaction of government bills and bonds is outlined in Appendix 5.4.

5.3.2 Interest Payments of Bonds

The holders of DB, CSB, NSB and FESB receive interest payments on regular basis at the pre-specified dates. The interest amounts for the bonds received from the Government are credited into the Coupon Transit Account prior to the date of interest payment. On the date of interest payment, interest amount is transferred to individual portfolio after verifying the amount for each individual security holder. At the date of maturity, owners of the securities are paid interest and principal amount by debiting their individual portfolios.

5.3.3 Market Makers and Sales Agents

The market makers and sales agents are a group of intermediaries appointed by Bank to deal exclusively with government securities. These institutions act as a channel between the debt manager and investors in primary market and facilitate the development of both primary and secondary market for government securities. NRB is providing license to such agencies with the view to simplifying the buying/selling procedure of government securities and providing prompt and reliable service to security holders. Since 1994/95, BFIs were licensed to function as market makers to provide an active primary and secondary market for the transactions in government securities. Similarly, PDMD has been providing license to commercial banks, money transfer companies and remittance companies as sales agents since 2009/10 to undertake primary transactions in FSEB.

Market makers involve in primary issue and secondary transactions of CSB while sales agents involve in sales of FSEB at the time of issue, the secondary transaction of which can be done through market makers. A, B, C class BFIs and some other institutions can apply to the Bank for obtaining license of market maker, but they need to fulfil certain criteria. These institutions accomplish the tasks assigned to them as per Market Maker Working Procedure, 2014 (first amendment, 2016). Sales Agents, on the other hand, are those institutions licensed by NRB to carry out primary transactions in FESB, but not any secondary transactions in such bonds. These institutions work as per Foreign Employment Saving Bond Working Procedure, 2012. As in mid-July 2016, there were 51 market makers and 13 sales agents.

During primary issue of bonds, market makers and sales agents are involved in distributing application forms to eligible individuals, collecting essential documents and verifying the forms along with the applied amount to be subscribed and sending them to PDMD. They also provide certificates of securities along with interest for broken period after receiving the same from PDMD.

Appendix 5.1: Process of issuing TB

TBs are issued on the basis of multiple price bidding auction (American Auction System) through Online Bidding System and are sold at discounted rate. Any institution or individual could participate in the bidding auction. NRB licensed A, B, C class BFIs comprise the competitive bidders while other bidders are classified as non-competitive. Out of total offered amount, at least 15 percent is reserved for non-competitive bidders at a weighted average price.

Generally, TBs are issued every Tuesday and bidding occurs on Monday. The notice concerning TBs to be issued is published on NRB website as well as Online Bidding System (https://obss.nrb.org.np/pd). It consists of details such as series No., issue and maturity date, offered amount, whether fresh or renewal, bidding date and time. The notice also includes some information regarding previous auction results, such as offered, issued and allocated amount, and highest, lowest and weighted average discount rates.

Online Bidding System (OBS) replaced the conventional manual bidding system on 29 June 2015. Interested individuals and institutions submit their bids through OBS within specified date and time. Before submission of bid, every detail has to be verified such as series No., bid amount and bid price. The bid price for demanded amount has to be mentioned on the basis of Rs. 100. Multiple price bidding is permitted, but one institution can bid only once for each issue. After the bid has been submitted, there is no option for editing; so bidders have to be very careful. Non-competitive bidders need not mention the discount price, but have to quote only the demanded amount. The same bidder cannot participate in both competitive and non-competitive categories. Bid amount should be minimum at Rs. 50,000 and, thereafter, any amount that is perfectly divisible by Rs. 50,000 up to the called amount in maximum.

Individuals and institutions that do not have an account at NRB have to deposit earnest money (2.5% of the bid amount) in specified account at Banking Office or any district offices of NRB. Such deposit vouchers have to be presented at PDMD within the specified time. Those who are not able to receive the TB will get refund of their earnest money on the issue date without any interest payments.

After closing of bid time, auctions are allocated through the OBS system. The bids are arranged in descending order of the bid price or in ascending order of the discount rate by the system itself. The computer generated result sheets are presented to the OMOC along with the draft minute for final authorization of bid award. The OMOC makes decision on the bid award. Usually the amounts are awarded on the basis of discount rates. However, OMOC has the right to fix the cut-off price and the authority not to award the bidders if the Committee feels some sort of unnatural responses from the bidders.

The bid amount is settled on the issue date, usually Tuesday, one day after the bidding. For those institutions who have an account at NRB, the settlement is done by debiting their account with the net paid amount while for those not having such account, the difference between amount accepted and deposited earnest money has to be deposited in non-operative account. This amount is then transferred to the government debt account. On the maturity date, the bidders get the full amount. The system-generated certificates are printed and distributed to owners of the bills after authentication.

Appendix 5.2 : Process of Issuing DB

The issuance and award procedure for DB is now similar to that of TB. Since 2013/14, interest rate on DB has been determined by auctions. Prior to that, coupon rate was specified, but issued through bidding process, which was started in 2004/05. 'Primary Issue and Management of Secondary Market Transaction Rules, 2004' gave a legal infrastructure for the sale of the DBs through primary market on auction basis, which was issued by the Government on 30 March 2005. Issuance of DBs of through auction was started in May 2004.

The notice for DB to be issued as per the auction calendar for respective fiscal year is published at NRB website as well as OBS prior to the bid date. Competitive bidders submit their bids by bidding on single or multiple rates. However, the DBs are issued at the cut-off rate which clears the market. The auction system followed for the issuance of DBs is the Dutch Auction System. Thus, DBs are issued with coupon rates. The provision of competitive and non-competitive bidders and earnest money is similar to that for TB auction. The settlement is done on the issue date by debiting the operative account for competitive bidders and non-operative account for non-competitive bidders. The interest for DB is paid semi-annually and owners of bonds can claim interest from market makers or any other banks and financial institutions. NRB reimburses such payments on claim from such institutions.

Appendix 5.3: Process of Issuing CSB, NSB and FESB

The sale of the bonds starts on the announced date. Interested and eligible buyers can collect application forms from market makers (for CSB and NSB) and sales agents (for FESB) free of cost or download from the central bank website. Such forms have to be filled up as prescribed in the notice of sale. The types of certificates (stock or promissory note, joint or sole ownership) have to be clearly mentioned along with other details in the application form. Illiterate individuals are provided with stock certificates only. There is also provision of buying bonds in the name of infants by their guardians. The application forms have to be submitted to PDMD through market makers, sales agents or NRB district offices along with self-verified citizenship certificate, and birth certificate in case of infants. For subscribing FESB, essential documents include photocopy of passport, valid visa, identity card, citizenship certificate along with two passport size photos and foreign currency receipt vouchers through formal channel or bank statement, among others. Generally, the sale of securities closes at the announced date and time. However, if the securities are over-subscribed before the notified closing date, selling may close at the oversubscribed date. These bonds are issued at a pre-determined coupon rate.

The duly filled demand applications along with amount and other required documents are received from market makers, sale agents and district offices on daily basis. After the offer for sale of securities is closed, the demand list is prepared and demand allocation is done as per the decision of the OMOC. If the amount demanded is less than or equal to the offered amount, the applicants receive full of the demand amount. However, in case of over-subscription, OMOC allocates the amount on pro-rata basis among the applicants. If applicants get less than the demanded amount, excess of the deposited amount will be refunded within seven days of the decision taken by the OMOC for allocation without any interest payments.

On the basis of the allocated amount, certificates are prepared in the applicant's name. Separate certificates are prepared for principal and interest amount. These certificates are signed and stamped by concerned authorities. The certificate on principal amount has all the details regarding the security such as portfolio number, bond name and series number, applicant's name, face value of bond, maturity date, and interest rate, among others. The amount and date of interest payments and number of payments are mentioned on the interest certificate.

After the certificates have been prepared, they are distributed to owners of the securities from the same institutions from where the applicants submitted their application form along with interest payments for the broken period. Utmost care is taken during the delivery of the certificates for safety reasons.

Appendix 5.4 : General Procedure for Transaction of Government Bills and Bonds.

The first step in accounting of bills and bonds is the creation of security master file. The security master file contains all the information regarding the debt instrument such as name of the security, currency in which the security is transacted, minimum amount to be subscribed by each client, total amount of bills/bonds, date of issue and maturity, calculation base, interest payment frequency and coupon rate. Each security has a unique security code which is a 10-digit numeric symbols that represent 3 digits for category, 4 digit for bills/bonds series number, 1 digit for suffix of serial number and 2 digits for the period (total number of years for bonds and 01, 02, 03 and 04 for 28 days, 91 days 182 days and 364 days TB respectively). This step is common in the accounting of all types of government securities. The subsequent procedures after the creation of master file for accounting of government securities are briefly discussed below.

On the issue date, purchase of T-bill and DB is done by debiting the account of successful bidders by net paid amount for TB and accepted bond amount for DB and crediting the amount into TB issue transit account and DB issue transit account respectively. For non-competitive bidders, before actual sale is done, earnest money needs to be collected and the amount needs to be credited into TB application account or bond application account. If there is no account, at first it should be created for every successful bidder and the amount should be transferred to the individual's non-operative account or portfolio. Then, the total net paid amount and bond amount is transferred from respective transit accounts onto the government internal debt account. This completes the accounting procedure for issue of TB and DB.

At the time of maturity, the Government refunds the TB and DB amount by cheque, cash or instruction to debit vostro account at NRB. This amount is credited into TB/DB redemption transit account. Then, by running redemption function from the GL system, the TB and DB amounts are paid to the holders of TB and DB. If Government does not refund the net paid amount for TB, the amount is to be rolled over.

In case of issue of CSB, NSB and FESB, as the eligible buyers of such bonds do not have an operating account at NRB, the amount collected from the applicants is deposited in Bond Application Account. Then, for each applicant, Public Debt Payable Account or portfolio is created and the allocated amount is transferred to individual payable account. On the issue date, by debiting all the individual portfolios the amount is transferred to Bond Issue Transit Account. This amount is then transferred to Government's internal debt account.

In case of redemption of CSB, NSB and FESB, the principal amount of such bonds received from the Government is credited into Bond Redemption Transit Account. On maturity date, such amount is automatically transferred to individual portfolios by running redemption function on the system. The last coupon amount also has to be transferred to the respective portfolios before redemption. The individual bond holders are paid the principal amount along with the remaining coupon interest by debiting their respective portfolios.

6 Foreign Exchange Management

NRB is the custodian of foreign currency reserves of Nepal. Foreign currencies that enter into the country finally reach NRB, which not only collects foreign currencies but also manages it effectively so that there is smooth functioning of international payments. This Chapter starts with legal framework for foreign exchange management and discusses the various aspects of foreign exchange management including the evolution of exchange rate system and mechanism of foreign exchange intervention over time.

6.1 Legal Framework for Foreign Exchange Management

The legal framework for foreign exchange management in Nepal is covered in various Acts including NRB Act, 2002, Foreign Exchange (Regulation) Act, 1962, and Act Restricting Investment Abroad, 1964. Apart from these Acts, there are Foreign Exchange License and Inspection Bylaw 2010, Remittance Bylaw 2010, Money Changer Bylaw 2010 and Notices, Circulars and Directives issued by NRB.

The NRB Act, 2002 has provided the Bank a sole authority to formulate, implement and cause to implement foreign exchange policy of Nepal, to specify the system of foreign exchange rate determination and to manage and operate foreign exchange reserves of the country. Likewise, the Act has given NRB powers to (a) issue license under the Act or any other prevailing laws to the persons willing to deal in foreign exchange transaction, (b) frame rules and bylaws and to issue necessary order, directives or circulars in order to regulate dealings in the foreign exchange transaction by the foreign exchange dealer, (c) inspect, supervise and monitor the foreign exchange dealer, (d) set the bases, limitations and terms and conditions for the transaction of the foreign exchange dealer and (e) prescribe the system of determining the foreign exchange rate of the Nepalese currency. Further, NRB can prescribe details of foreign exchange transactions to be submitted to NRB in prescribed formats.

NRB can purchase and sell foreign exchange, gold and precious metals effected through the spot, advance exchange rate, swap, option or similar types of other instruments, cash or negotiable instrument. The Bank shall deal in foreign exchange after fixing its buying and selling rates. The basis, limitations and conditions of such dealing shall be as prescribed by the Bank. Section 66 of NRB Act, 2002 has given powers for mobilization and management of foreign exchange reserves and assets. While selecting the assets, due consideration should be given to the Bank's capital and liquidity to maximize earnings. The Bank shall maintain international reserve at a level which shall be adequate for the execution of monetary and exchange rate policies and for the prompt settlement of the international transactions. If international reserves have depleted or, in the opinion of Bank, are in danger of depleting to such an extent as to jeopardize the execution of the monetary or exchange rate policies in the prompt settlement of the country's international transactions, the Bank shall submit to the GON a report on the international reserves position and the causes which have led or may have led to such a decline, together with such recommendations as it considers necessary to remedy the situation. Until such time as the situation referred to above has been rectified, the Bank shall further make such report and recommendations to the GON.

The Bank may, having obtained approval from GON, issue one or more types of bond denominated in gold or foreign currency for certain purpose. The terms and conditions of such bonds shall be as prescribed by the Bank. Under Section 68, the Bank, either for its own account or by the order of the GON for the Government's account, can enter into clearing and payment agreements with public or private central clearing institutions domiciled abroad. The Bank may, in order to implement the objectives of such agreement, enter into other necessary agreements.

The Foreign Exchange (Regulation) Act, 1962 has clearly laid down detailed provisions related to regulation of the foreign exchange transactions in Nepal. This Act has given NRB power to regulate foreign exchange transactions. NRB issues license for foreign exchange business, can issue directive and circulars to licensed institutions and can take action against licensed institutions, if they fail to abide by NRB directives. The Act has clearly laid down procedural requirements for foreign exchange business, liabilities and duties of importers, exporters and foreign currency earners, FDI investments, borrowings/lending in foreign currency, transfer and return of FDI investment. On violation of the provision of the Act, strict arrangement for investigation and punishment has been made.

6.2 Evolution of Foreign Exchange Management

The evolution of foreign exchange management in Nepal could be analyzed on the basis of three broad time frames: (a) prior to establishment of NRB, (b) after establishment of the NRB but before liberalization, and (c) in the post-liberalization period. The foreign exchange management system in these periods can be studied in terms of three broad policy parameters: (a) exchange rate regime adopted in the country, (b) policies pursued for exchange control, i.e., policy in terms of current account convertibility including trade control and intervention policies and (c) management of foreign exchange reserves.

6.2.1 Prior to Establishment of NRB

Before establishment of NRB, there was widespread circulation of IRs throughout Nepal. Due to poor physical infrastructure in the country, it was not possible to move to different parts of Nepal without going via Indian territory. Besides, there was lack of legal provisions regarding currency circulation. In such circumstances, it was difficult to circulate NRs in all parts of Nepal. At that time, IRs had served dual purposes of medium of exchange and store of value need of Nepalese people and IRs was almost legal tender in Nepal.

Exchange business in IRs was in the hands of traditional family-based money traders called Sharafs (money changers) at that time. Price of IRs was determined by these Sharafs based on demand and supply conditions in the market. There used to be widespread fluctuation in exchange rates of IRs *vis-a-vis* NRs due to which people preferred holding IRs. The Government used to intervene in foreign exchange market by fixing exchange rate from time to time, but this was not very effective. Since 18 April 1955 until 30 June 1956, provision was made to sell IRs through NBL by fixing the exchange rate to import specified goods from India, but the exchange rate changed quite frequently.

Prior to the execution of the First Trade and Transit Treaty between Nepal and India in 1960, the RBI was the custodian of Nepal's convertible foreign currency holdings. The convertible foreign currency holdings used to be deposited with the banks in India and permission from RBI was required for use of these currencies. As a result, the exchange rate for the convertible currencies was not required to be determined. Foreign exchange market existed only for Indian currency. Since the date of execution of above treaty, convertible foreign currency of Nepal was started to be deposited in the NRB's account. Since then, NRB has been responsible for managing Nepal's foreign exchange reserves.

6.2.2 After the Establishment of NRB until 1993

With the establishment, NRB assumed the IRs transaction task of NBL and started selling IRs from the Government's account at the rate fixed by the Government. However, the rate changed quite frequently given the demand pressure in the market. At the time of establishment of NRB, there was urgent need to remove dual currency system in Nepal, establish NRs as widely accepted legal tender of money, bring stability in exchange rate vis-a-vis IRs, regulating foreign exchange transactions and managing foreign currency reserves of the country. Due to geographical, social and economic proximity, transactional demand for IRs was very high. There was also need to bring gradual change in the mindset of people towards the use of NRs.

Effective 13 April 1960, exchange rate with IRs was fixed at NRs. 160 for IRs 100 with the provision of unlimited convertibility, for which NRB established exchange counters to facilitate the exchange facility. At the same date, Increase in the Circulation of Nepalese Currency Act, 1957 was first time implemented in the Kathmandu Valley and almost all Hilly Districts; later, it was extended to the whole country. Further, on 2 June 1960, the GON enacted Control of the Foreign Exchange Transaction Act, 1960, which made the requirement of permission of NRB to carry out any transactions in foreign currency and besides requiring that such a transaction should only be made at the rate prescribed by NRB. With the increasing monetization and the business activities in the economy, the prior Act of 1960 was felt inadequate, hence, it was replaced by enacting Foreign Exchange Regulation Act, 1962, which has up to now been amended five times. On 28 August 1964, Nepal enacted Act Restricting Investment Abroad, 1964, which has prohibited the Nepalese citizens residing in Nepal or outside, and institutions established in Nepal from investing in any form of foreign investment. Thus, all the transactions of the nature of capital account unless specially exempted by GON through notification in the Nepal Gazette have been prohibited.

On 6 June 1966, IRs was devalued by 36.5 percent. At that time, Nepalese authorities decided not to devalue NRs vis-à-vis the IRs. This decision was taken in view of favourable trade balance and existence of significant IRs reserve with NRB. As a result, there was automatic appreciation of NRs vis-à-vis IRs with the exchange rate fixed at NRs. 101.55 per IRs.100. Due to devaluation of Indian currency, people holding Indian currency suffered significant exchange loss and showed hesitance towards holding IRs. Thus, adoption of above measures and devaluation of IRs both led to a gradual decline in the practice of dual currency in Nepal.

On 18 November 1967, the Sterling Pound went through a bout of devaluation. At that time, that currency constituted significant portion of the foreign exchange reserves of the country. Likewise, Nepal's reserve of IRs was also declining. These conditions forced authorities to devalue Nepalese Rupee and a new exchange rate was fixed at Rs. 135 per IRs 100 on 6 December 1967. Since then, the Government revised the parity three times up to 30 November 1985: (a) from Rs. 135 to Rs. 139 on 17 December 1971, (b) from Rs. 139 to Rs. 145 on 23 March 1978, and (c) from Rs. 145 to Rs. 170 on 30 November 1985.

On 31 May 1986, it was decided to include IRs in foreign currency basket, and NRB started to quote the buying and selling rates on a daily basis like other currencies. Theoretically, exchange rate of the IRs could change on a daily basis. However, in practice, all changes were made on the basis of Government's decision to devalue or revalue the currency (Table 6.1).

Table 6.1: Change in the Exchange Rate of the Nepalese Rupee via-a-vis Indian Rupee

Date	NRs per unit of IRs	Remarks
13 April 1960	1.60	Fixation of the new rate after establishment of NRB with the introduction of unlimited convertibility of IRs
6 June 1966	1.01	A marked appreciation of about 37 percent of rupee due to the decision of the Government not to follow the Indian path of sharp devaluation of its currency
8 Nov. 1967	1.35	Devaluation of the rupee
22 Dec. 1971	1.39	Following the realignment of currency on 17 Dec. 1971, the exchange rate of NRs./IRs. was also revised along with Pound Sterling, Deutsche Mark and Japanese Yen, effective from 22 Dec 1971.
22 Mar. 1978	1.45	NRs was devalued by 4.1 percent against the IRs.
30 Nov. 1985	1.70	14.7 percent devaluation of Nepalese rupee against the foreign currencies
31 May 1986	1.68	It was decided to also include IR in the currency basket, effective from 1 June 1983. The previous practice of setting the buying and the selling rate of IRs on the basis of parity fixed by the Government was done away with. NRB started to quote the buying and the selling rate of IRs on a daily basis.
1 July 1991	1.65	-
12 Feb. 1993	1.60	-

Source: NRB (1996) and Quarterly Economic Bulletin

The basket system failed to capture the magnitude of change of exchange rate of IRs with US Dollar. From its introduction in 1983 to formal burial of this system in 1992, exchange rate with US Dollar increased from NRs 14.20 to NRs 43.10 per US Dollar. Out of the total increase of Rs 28.90 during the period, an increase of Rs 10.40 was due to devaluation of currency by Government for three times and Rs 18.50 was due to gradual adjustment under the basket system (NRB, 1996, 101).

In the early 1990s, Indian economy went through major crisis. Its foreign exchange reserve level was at the record low and Indian currency was devalued twice within two days. As macroeconomic indicators in Nepal were not unfavourable as that in India, there was not much justification for revaluation of NRs vis-à-vis IRs as well as devaluation with other currencies. However, due to compulsion of avoiding broken cross rates and possibility of arbitrage in the prevailing situation of huge trade gap between the two countries with the consequence of depletion of IRs balances with the banking system, it was decided to go for revaluation against IRs and devaluation against other currencies. Accordingly, with effect from 1 July 1991, the exchange rate with IRs was revised from Rs 168 to Rs. 165 per 100 IRs and the exchange rate with US Dollar was revised from NRs 38.00 to NRs 42.70 per US Dollar.

Since 4 March 1992, the Government decided to go for partial convertibility of the NRs. Under this system, two tiers of exchange rates came into existence. One was NRB rate and the other was open market rate fixed by commercial banks based on demand and supply factors. All government transactions were to be undertaken at the NRB rate. All private sector import except industrial machinery; petroleum products and fertilizers had to be undertaken at the open market rates. With a view to building reserve for the purchase of these items, commercial banks were required to surrender 35 percent of their foreign currency earning to NRB. Hence, the rate offered by commercial banks was composite rate where 65 percent represented market component and 35 percent represented NRB rate. Subsequently, the ratio was amended to reduce NRB component to 25 percent and market component to 75 percent on 12 July 1992.

Finally on adoption of full convertibility in the current account since 12 February 1993, this practice of ratios came to an end with all transactions being undertaken at open market rate. The exchange rate with IRs was re-valued from Rs. 165 to Rs. 160 per 100 IRs. In the new regime, commercial banks could quote their own exchange rates without requirement to surrender to NRB any amount of their purchase from customers. All foreign currency required for their transactions had to be acquired by the banks themselves either through purchase from customers or through interbank transactions. The BFIs could use NRB's intervention window to settle their excess or deficit US Dollar after settling in interbank market.

6.2.3 During the Post Liberalization Period (after 1993)

Major changes in foreign exchange front were initiated as a part of domestic economic liberalization policy. Need for paying premium for import license was removed as the Open General License (OGL) system was introduced. There were structural changes in the overall economic policy framework of the country. Restrictive policies and procedures in the foreign exchange sector were gradually relaxed.

NRB Act, 2002 gave NRB more power and autonomy to formulate and implement effective foreign exchange policy. Foreign Exchange (Regulation) Act, 1962 was also amended to incorporate provisions required for effective implementation of foreign exchange policy on 7 August 2002.

The introduction of partial convertibility of Nepalese rupee in March 1992 and subsequent full convertibility in February 1993 brought about substantial change with respect to the nature and dynamics of current account of the external sector along with the exchange rate system of Nepal. Except for the IRs, the market forces of demand and supply could determine the exchange rate of convertible currency. Commercial banks could determine their own buying and selling rates in the market. NRB also published exchange rates for its own purposes. Commercial banks became free to manage their own foreign currency reserves and were themselves responsible for the foreign exchange obligations and risks.

Now, the spread between buying and selling rates of Nepalese rupees with US Dollar has been fixed at 60 paisa while there is no such specified spread with respect to other currencies. NRB is responsible for foreign exchange management of the country and, hence focused on maintaining exchange rate stability by intervening in the market.

However, NRB can adopt indirect means of intervention like moral suasion, signalling its view on prevailing exchange rate and buying or selling dollar from/to commercial banks at the exchange rate fixed by it.

Besides commercial banks, post liberalization era has witnessed opening of foreign exchange licenses to the moneychangers and money remitting companies in addition to hotels and travel agencies. This has facilitated increased inflow of remittances through formal channels.

Following provisions have been adopted in the post-liberalization period.

1. After introduction of OGL system, any firm or company registered in Nepal can import any quantity of eligible goods by opening Letter of Credit (L/C). For the smaller value of imports, other mechanism of Draft/TT, DAP, or DAA can also be availed easily from the commercial banks.

Regarding imports from India, although normal mode of payment is in Indian Rupee, some products can also be imported on payments of convertible currencies. This system was introduced in 1992/93 to facilitate easy availability of industrial raw materials by opening L/C to import raw materials directly from the manufacturing companies in India. The number of items imported under this scheme reached 66 in 2004/05, which has risen to 161 in 2013/14.

2. With first amendment of Foreign Exchange (Regulation) Act, 1962 in 1987, foreign exchange earners were allowed to open their own foreign currency account in commercial banks. Initially, foreign currency account could be opened for only 30 percent of earnings; presently, foreign currency earners can deposit 100 percent in their accounts. Initially, only foreign nationals and institutions could open account in foreign currency; now, Nepalese citizens and institutions can also open such accounts upon presentation of relevant documents on source of earnings. For foreign nationals and institutions as well as Nepalese nationals, rules of withdrawal and deposits have been made fairly easy.

3. During controlled regime, no one was allowed to obtain foreign exchange without prior approval of NRB. The situation has changed remarkably in recent years. Now, the eligible recipients can obtain foreign exchange directly from BFIs. Present arrangements can be divided as follows:

   a. <u>Exchange facilities not requiring permission for unspecified amount of foreign exchange</u>

      Unlimited amount of foreign exchange is provided for payment of import of goods under the OGL through L/C by any firm or company or industry registered in Nepal under existing rules and regulations. Similarly, foreign exchange required for payment to foreign education institutions abroad does not require permission from NRB, provided prescribed documents are presented to commercial banks.

   b. <u>Exchange facilities not requiring permission up to a specified limit</u>

      For payment of services, foreign exchange up to US$ 10,000 can be availed from commercial banks on presentation of necessary documents. Import of services from India can be made for value up to IRs 100,000 from commercial banks without approval from NRB. Goods up to the value of US$ 50,000 can be imported using Draft/TT instruments from the commercial banks. Nepalese citizens can avail foreign exchange up to US$ 2,500 for visiting foreign countries directly from commercial banks against their passports.

   c. <u>Exchange facilities that can be acquired only on permission of NRB</u>

      Permission of foreign exchange facility for almost all current account transactions are granted if applicant furnishes relevant documents. Foreign exchange permissions for meetings, conventions and medical expenses abroad are granted on the basis of the documentary evidence. NRB readily issues exchange permission for some items such as payment of principal and interest on loans, dividend, technical services fee, management fee and royalty as per existing legal system.

6.3 Institutions Involved in Foreign Exchange Transaction

Prior to the first half of the 1990s, only banking system was allowed to carry out foreign exchange transactions in Nepal. Some of the entities like hotel and travel agencies were allowed to make specific foreign exchange transactions, i.e., only accepting foreign currencies from their customers. Confining the foreign exchange transactions to a limited sector was not suitable in the liberalized context. Considering the difficulties faced by foreign tourists, the NRB started to issue license to the private sector since 1995. As a result, the new institutions in the form of money changers and remittance companies were established to conduct specified foreign exchange transactions. Besides, licenses were issued to a number of other institutions like hotels, travel agencies, trekking agencies, airline companies, cargo and curios to operate limited foreign exchange transactions.

Till mid-February 2017, the number of institutions involved in foreign exchange transactions reached 2,888. Money changer companies are now regulated by NRB Money Changer Bylaw, 2010, and money transfer companies by NRB Remittance Bylaw, 2010. Other licensed institutions are regulated by Foreign Exchange License and Inspection Bylaw, 2010. Institutions involved in foreign exchange transactions as mid-February 2017 are given in Table 6.2.

Table 6.2 : Institutions Licensed for Foreign Exchange Transactions (as in mid-Feb 2017)

S.N.	Particulars	No. of Licenses Issued	No. of Institutions of which License has been Cancelled	Existing No. of Licensed Institutions
1	**Licensed Banks and Remittance Companies for Inward Remittance**			**81**
	Commercial and Developments Bank	32		32
	Other Remittance Companies	69	20	49
2	**Money Changers**			**402**
	Inside Valley	241	77	164
	Outside Valley	250	12	238
3	**Other Licensed Institutions**			**2,405**
	Hotel	371	210	161
	Trekking	1,889	605	1,284
	Travel Agency	1,869	1,025	844
	GSA & PSA of Foreign Airlines	60	28	32
	Cargo & Couriers	306	255	51
	Other Institutions	90	57	33
Total				2,888

6.4 Foreign Exchange Reserve Management

Foreign exchange reserve is an important component of national assets that has to be managed effectively and productively taking in view the key elements such as safety, liquidity and return[1]. NRB Act, 2002 provides the overarching legal framework for management of foreign exchange reserves. One of the Bank's functions as per the Act is to hold the country's foreign exchange reserves and to manage them. The NRB is the sole legal custodian of Nepal's foreign exchange reserves. The Bank is also required to maintain international reserve at a level which is adequate for the execution of monetary and exchange rate policies and for the settlement of the international transactions.

[1] Nepal Rastra Bank, Strategic Plan 2012-2016

As per the NRB Act, 2002, foreign exchange reserves consist of gold and other precious metals, foreign currencies, Special Drawing Rights (SDR), bill of exchange, promissory note, certificate of deposit, bonds, and other debt instrument payable in convertible foreign currencies, any forward purchase or repurchase agreements of the Bank concluded with or guaranteed by foreign central banks or public international financial institutions, and any futures and option contracts of the Bank providing for payment in freely convertible foreign currency.

NRB has devised appropriate decision making and governance structures to manage its foreign exchange reserves. The prevailing institutional framework of the Bank for foreign reserve management consists of four-tier hierarchical arrangement: NRB BOD at the apex, then Governor, Investment Committee and FEMD respectively. The NRB Board assumes the primary responsibility of management of reserves whose responsibilities include approving policy guidelines. The Investment Committee headed by Deputy Governor ensures the sound management of the reserves and advises the Board in foreign reserves investment matters while the FEMD is responsible for dealing in financial markets and the execution of decisions taken by the Board and Investment Committee.

NRB formulated Foreign Exchange Investment Directive 2009, and amended twelve times so far (last amendment on 8 December 2015), which provides an operational framework for reserve management. The Directive defines the broad parameters of currencies, instruments, issuers and counterparties. The middle office, established in 2009, in Investment Division monitors those parameters on a continuous basis and reports to Investment Committee in case of discrepancies.

The Investment Directive permits the investment only in those instruments which are of low risk and high liquidity. The Investment Committee continuously reviews the list of eligible instruments or counterparties and makes recommendation to NRB's BOD for amendment, if deemed necessary. NRB prioritizes investments in currencies or instruments of G-7 and OECD countries. As per this Directive, foreign exchange reserves are invested in highly rated sovereigns and financial institutions, with average credit quality of invested reserves maintained at A- or better, while no investment is made below investment grade. The eligible instruments include sovereign treasury bills, notes and bonds, call and current account of central banks and BIS, instruments issued by BIS, repo and reverse repo, time deposits of some approved foreign banks and gold and silver.

A risk management framework has been devised for managing the investment of foreign exchange reserves, which includes decision making hierarchy, eligibility criteria for the selection of counterparties, counterparty and issuer exposure limits, list of eligible instruments and currencies, portfolio duration, liquidity requirement, currency exposure, among others. The risks associated with the deployment of reserves, viz., credit risk, market risk, liquidity risk and operational risk, are also being managed. Credit risk is managed within a ratings-based limit framework. This framework includes strategies such as making investments in bonds/treasury bills of highly rated sovereigns and supranational entities, placing deposits with central banks, BIS and select foreign banks having A- or above credit ratings, assigning exposure limit based on long-term credit ratings and constantly monitoring the changes in credit worthiness of counterparties.

Currency risk under market risk arises due to uncertainty in exchange rates. Decisions are taken regarding the long-term exposure to different currencies depending on the likely movements in exchange rate and other considerations in the medium and long-term such as usage or need of currencies (for intervention or trade financing) or benefits of diversification. NRB's strategies to minimize currency risk include keeping 40 to 60 percent of total reserves in US Dollar (an intervention currency), up to 25 percent of total exposure in IRs (trade financing) and the rest for setting up of exchange equalization fund as a permanent tool to absorb exchange losses.

To minimize interest rate risk, NRB has undertaken a number of strategies including focusing investment on instruments of diversified tenure (up to 10 years with average tenure of all reserve investment not exceeding 6 months), investment in 91-day Indian treasury bills, placement of the fund by taking interest rate quotation from a number of counterparties and investment in foreign branches of Indian banks. The focus of the investment strategy revolves around the need to keep the interest rate risk of the portfolio reasonably low with a view to minimizing losses arising out of adverse interest rate movements, if any.

For managing liquidity risk, NRB is required to invest 40 percent of its reserves in liquid instruments. It closely monitors the portion of the reserves that could be converted into cash at a very short notice to meet any unforeseen/emergent needs.

For operational risk management, there is a total separation of the front, middle and back office functions. The internal control systems ensure several checks at the stages of deal capture, deal processing and settlement. The middle office is responsible for risk measurement and monitoring. The deal processing and settlement system is also subject to internal control framework.

Further, reconciliation of accounts is done regularly. In addition to annual inspection by the IAD, a statutory audit of accounts by external auditors is also carried out. There is a comprehensive reporting mechanism covering significant areas of activity/operations relating to reserves management. These are being provided to the senior management periodically, viz., on a daily, weekly, monthly, half-yearly and yearly interval, depending on the type and sensitivity of information. NRB uses financial software such as Reuters and Bloomberg as the messaging platform to execute deals and SWIFT for confirmation and settlement of deal with its counterparties.

NRB has also been managing gold reserves since its establishment in 1956. In order to effectively manage its gold reserves, NRB has formulated 'Gold Reserve Management Policy, 2013'. The policy has taken gold as a part of foreign exchange reserves and set a target of maintaining 5 to 10 percent of its reserves in the form of gold.

6.5 Exchange Rate Policy

As mentioned earlier, since the time of establishment of NRB, following two separate policies for exchange rate determination, one for IRs and another one for convertible currencies (NRB, 1996) have been followed. The exchange rate trend of NRs vis-à-vis IRs is described in section 6.2.

At the beginning, the Government used to fix the exchange rates against convertible currencies in terms of IRs. With the fixation of exchange rate with IR, exchange rates with convertible currencies were started to be quoted in NRs. With a view of increasing international transactions in relation with foreign currencies, NRB started to make exchange of foreign currencies by quoting exchange rate for Sterling Pound, US Dollar and Swiss Franc at first on 14 May 1960. Various currencies were added in this list over time. Since 10 August 2016, NRB quoted exchange rates for 20 convertible currencies for both buying and selling including five additional currencies such as Swedish Kroner, Danish Kroner, Hong Kong Dollar, Kuwaiti Dinar and Bahrain Dinar.

Prior to the collapse of the Bretton Woods system, Nepal was following the system of fixed parity in line with the international practice, India then also adopted fixed exchange rate system. In addition to IR, exchange rate with US Dollar was also fixed. In the beginning of 1980s, India delinked its currency from fixed parity with Sterling Pound and floated its currency. As a result, exchange rate of IRs vis-a-vis US Dollar started to change almost on a daily basis. NRs was having fixed parity both with IRs as well as US Dollar. This led to emergence of broken cross rates demanding correction of exchange rates in the form of devaluation or revaluation by the Government. However, such process took its own time so that, it was felt more expedient to leave matter of determination of exchange rate to NRB through adoption of new system called currency basket system.

With the adoption of currency basket system on 1 June 1983 until 4 March 1992, US Dollar was assigned the status of intervention currency. All the other currencies' exchange rates were dependent on international cross rates with US Dollar. First, rate of US Dollar needed to be determined. Once US Dollar exchange rate was fixed, rates of other currencies were determined. For determining the rate of US Dollar, a basket was fixed. All important currencies, including IRs, which were significant for the economy were included in the basket. The movement of exchange rate of these currencies in the international market influenced the basket rate. NRB never published the composition of currencies in the basket and the weights assigned to them. Exchange rate with IRs did not change on a daily basis as expected theoretically in the basket system though exchange rate with other convertible currencies used to change.

With a view to maintaining exchange rate stability, Nepal has been adopting mixed exchange rate system since 12 February 1993, mixed in the sense, on one side, NRs is pegged with IRs and, on the other side, it floats with other convertible currencies. Nepalese currency became fully convertible in current account in February 1993, after partial convertibility in March 1992.

NRB publishes the foreign exchange rates for various currencies on a daily basis as indicative rates. Commercial and development banks are free to determine their own exchange rate for convertible currencies. The exchange rate of NRs-US Dollar is computed on the basis of cross rate between IRs and US Dollar in the international market on a daily basis. The exchange rates for other 20 currencies are determined on the basis of individual currencies' cross rate with US Dollar and NRs - US Dollar exchange rate. As the currency is pegged with IRs, the exchange rate between NRs and all other currencies is also similarly affected.

6.6 Foreign Exchange Intervention

In Nepal, foreign exchange market intervention is conducted with the objective of injecting/moping-up liquidity in the domestic foreign exchange market, avoiding undesired fluctuations in the exchange rate of convertible foreign currencies and defending the existing pegged exchange rate with the IRs.

NRB intervenes in the local foreign exchange market on a daily basis, provided there is a request from BFIs. The process of foreign exchange market intervention was first introduced in 1991/92 on the basis of need of the market participants, in conjunction with the adoption of partial convertibility of the NRs. Later on, the intervention frequency was increased twice a week. Similarly, effective from September 2009, the frequency was increased to three times a week on alternate days, i.e., Monday, Wednesday and Friday. Finally, effective from October 2013, the intervention process has been conducted every working day. Presently, intervention has been a mostly used window for all BFIs to dispose of (or get) their excess (deficit) foreign currency.

Currently, the Foreign Exchange Purchase, Sale and Intervention Directive 2010, issued on 15 July 2010, serves as an operational framework for intervention in Nepal. The Directive describes two types of interventions; (i) regular buying and selling of the foreign exchange at the request of market participants and (ii) discretionary intervention. The first is a regular purchase/sale of foreign currency from and to BFIs, and purchase from remittance companies. This is a regular and scheduled window where the commercial banks/national-level development banks can buy/sell their foreign currencies as per their short or long position. This regular purchase/sale from/to BFIs is executed at the request of market participants (BFIs). The determination of intervention rate and other procedures are executed as specified in the Directive. The second type, which is discretionary, is executed only when the NRB observes misalignment in the exchange rate and feels necessary for correcting it. The FEDAN, which consists of representative from all commercial banks, works as a bridge between the commercial banks and the NRB in foreign exchange related matters. Likewise, Development Bankers Association Nepal (DBAN) and Nepal Remitters Association (NRA) also serve as a bridge between their respective members and the NRB.

NRB generally intervenes in the local foreign exchange market to mop up the excess supply of US Dollar that arises mainly from the remittances sent by Nepalese workers abroad. The intervention ensures adequate level of foreign currency in the domestic market sufficient to meet the demand of the market. The NRB's interventions are spot, scheduled, based on request from the market participants, and non-sterilized type.

The foreign exchange intervention is undertaken five days a week (Monday through Friday) subject to exception of public holidays. US dollar, the most liquid and freely convertible currency, is used for intervention. Most of the intervention in Nepal is purchase intervention with sale intervention occurring only a few times a year. All the BFIs are first required to settle their short or long dollar position in the interbank market. The FEDAN extends coordination for all the BFIs to settle the requirements of individual banks in the interbank market. The BFIs approach the NRB's window if they are not able to settle in the interbank market. However, the NRB executes one-way intervention only, i.e., either purchase or sale intervention in a day. The NRB encourages BFIs to settle their requirements through interbank market before approaching NRB's intervention window.

The commercial banks and national-level development banks are major counterparties for intervention. They can participate in both purchase and sale interventions. Further, the remittance companies, in coordination with the NRA, can only participate in the purchase intervention.

The BFIs that are in long or short position approach the FEDAN few minutes before 11:00 in the morning. The net amount obtained from matching the total demand and supply determines the type of request to be sent to NRB. If the total requirement is US$ 2 million or more, FEDAN requests individual BFIs to furnish their request directly to NRB's intervention platform, i.e. FX ALL. Each participating bank needs to put the value date (usually the next working day) for which the intervention is done, along with the precise amount. Further, the participating BFIs are required to disclose their latest foreign exchange position to the NRB before the intervention procedure begins.

In NRB, the authority with regard to purchase intervention has been delegated as follows: up to US$ 30 million to the Executive Director, above US$ 30 million and up to US$ 50 million to Deputy Governor and above US$ 50 million to Governor. However, only the Governor has the authority to execute the sale intervention.

The intervention transactions are generally settled on 'T+1' basis, i.e. next working day is considered as the 'value date'. On the value date, BFIs deposit the sold US Dollar amount in NRB’s specific account abroad and NRB deposits the corresponding NPR in the accounts of the concerned BFIs maintained with NRB's Banking Office, Thapathali, Kathmandu. SWIFT transfers are made by the BFIs to transfer fund in NRB's account. In case of default in depositing the foreign currency on the specified value date in the NRB’s account, the BFIs need to pay a penalty of flat US$ 100 plus interest at federal funds rate for the number of days delayed.

The cross mid-rate of US Dollar-IRs at 12:15 p.m. serves as the basis for intervention rate. NRB derives the buying intervention rate by deducting 3 paisa from the cross mid-rate and selling intervention rate by adding 4 paisa in the cross mid-rate. NRB communicates the intervention rate through FX ALL platform and allows the banks to come up with their stance within 10 minutes of communication. It is to be noted that the banks must sell minimum 75 percent to maximum 100 percent of their request amount.

The purchase and sale interventions are treated separately to meet the policy objectives. The sale intervention is considered solely to address the genuine need of the commercial banks. The commercial banks are not allowed to purchase US Dollar with intention of selling in the next intervention to NRB itself. Attempting such trade is considered violating the NRB’s prudential norms as per the provision made under section 3, paragraph 17, of the Intervention Guidelines.

The major volume of intervention transactions consists of purchases from BFIs while sales to BFIs are comparatively very low. Following Table 6.3 provides the frequency and volume of intervention transactions that took place over the years since 1991/92 to 2015/16:

Table 6.3: Frequency and Volume of Interventions by NRB (Volume in Millions of US Dollar)

Fiscal Year	Purchase		Sale		Net Purchase Volume
	Frequency	Volume	Frequency	Volume	
1991/92	1	8.7	0	0.0	8.7
1992/93	8	110.5	0	0.0	110.5
1993/94	5	69.6	4	22.1	47.5
1994/95	0	0.0	10	163.6	-163.6
1995/96	7	41.8	8	164.8	-123.0
1996/97	7	44.7	5	35.1	9.6
1997/98	8	65.6	6	59.6	6.0
1998/99	15	161.0	0	0.0	161.0
1999/00	7	70.3	4	28.2	42.1
2000/01	5	94.8	15	162.1	-67.3
2001/02	9	107.5	7	102.4	5.1
2002/03	24	323.1	2	7.8	315.3
2003/04	30	408.7	3	27.6	381.1
2004/05	41	527.0	4	50.1	476.9
2005/06	64	769.9	2	9.2	760.7
2006/07	77	923.0	1	7.2	915.8
2007/08	90	1,589.2	3	17.7	1,571.5
2008/09	100	1,919.0	3	21.5	1,897.6
2009/10	134	1,606.7	1	6.0	1,600.7
2010/11	134	2,419.9	2	9.5	2,410.4
2011/12	135	3,186.1	0	0.0	3,186.1
2012/13	130	3,235.3	2	11.3	3,224.0
2013/14	192	3,546.7	4	25.9	3,520.9
2014/15	208	4,043.8	4	11.4	4,032.5
2015/16	214	4,355.7			4,355.7
Total	**1,645**	**29,628.3**	**90**	**942.9**	**28,685.4**

7 Currency Management

NRB has the sole legal right to issue Nepalese banknotes and coins. NRB started issuing banknotes since 1960 after a few years of its establishment. Currency management is an important responsibility of NRB to facilitate payment systems and operation of financial system. Currency management process starts with planning and forecasting and, ultimately, ends with destruction of notes. This Chapter highlights the evolution of currency management practices adopted by NRB over time.

7.1 Planning and Forecasting of Currency

It is the responsibility of Currency Management Department (CMD) of NRB to forecast the amount of currency to be printed in a cycle. The forecasting is done usually for two years, which is considered as the time it takes to complete one cycle for currency printing. However, it usually takes 1.25 years to complete the procurement process from tender to actual delivery of the currency. Thus, the Department forecasts the currency requirement for 3.25 years. The forecasting is strictly done denomination-wise. The planning of the currency has to be on time. Just because there is adequate stock for the next couple of years does not mean that we do not have to plan it as evident by the 'lead time' it takes.

Special attention is given to Dashain and Tihar festivals in Nepal as people have special sentiment and huge demand for new currency during the time. Nepalese also have the culture to offer coins in temples; for this, necessity of adequate supply of coin is realized and the management has been done accordingly. The currency implications of budget expenditure plan of the Government, and mode and mechanism for welfare payments have to be carefully incorporated while forecasting the currency.

Work on forecasting of currency is performed by the Note Procurement Section of CMD. The section analyses the historical data of quantity of currency printed in the past, stock note consumption, currency in circulation and disposal of soiled notes. These data are available in the section. The relevant macroeconomic indicators are taken from RD or economic publications, as required. RD also provides the forecasting for currency demand as per the request of CMD considering the factors such as economic growth, inflation, income elasticity of currency, financial development and other relevant changes in the economy.

Three mechanisms are used to forecast the currency requirement which are described below.

7.1.1 Stock Note Position Analysis

The currency that is printed by NRB is kept in the stock note vault. Periodically, the stock notes are supplied in the market. The consumption of stock notes, i.e., the currency that is issued in the market is analyzed and a time series trend analysis is conducted. The stock position analysis provides an indication as to which denomination among all the denominations has to be printed first in the current cycle of currency printing. The following relationship is estimated for arriving at the actual quantity to be printed.

$$N_y = \frac{(SN_{Y-1} + SN_{Y-2} + SN_{Y-3})}{3} - SN_{Y0} - I$$

Where,

N_Y = Quantity of currency to be printed this cycle

SN_{Y-1} = Stock note out last year

SN_{Y-2} = Stock note out two years back

SN_{Y-3} = Stock note out three years back

SN_{Y0} = Current stock position

I = Pending incoming stock currency from previous cycle

7.1.2 Currency in Circulation and Disposal Growth

Another mechanism to forecast currency requirement is by analyzing the currency in circulation and the amount of disposal. Currently, NRB has its ongoing plan for Clean Note Policy, which has significance in maintaining neat and clean banknote and destroying the soiled ones. Initiation and implementation of such policy also has huge impact on accuracy of forecasting of currency as there would be more disposal as compared to recent past. The model that is used to forecast currency through circulation and disposal is :

$$T_R = G_D + R_N = C^{Req} - C^{Exist} + R_N$$

Where,

T_R	=	Total requirement of currency notes
G_D	=	Additional currency demand (due to demand – supply mismatch)
C^{Req}	=	Currency required according to prevalent demand – supply scenario
C^{Exist}	=	Currency already in circulation
R_N	=	Currency to be replaced/ disposed

7.1.3 Denomination Composition Analysis

Compared to the other two, this analysis is less scientific as it expects the market to have same compositional ratio of denomination as in the past. Though this analysis fails to forecast the transition in denomination, it is useful for providing additional vantage point to forecast the currency printing. Under this analysis, the market composition of all the denominations is analysed and their weighted contribution in the market computed.

Under the existing practice, there has been no serious issue on forecasting of currency in Nepal. There is adequate provision in the bylaws and directives for the currency management to print the currency faster by appointing the bidder selected for printing the notes under special circumstances within the previous cost. With changing time and standardization and consideration of additional variables, the forecasting needs to be made as scientific and practicable as possible. Certain concepts of 'reorder level' and 'safety stock' have to be incorporated over time so that there will not be any problem of inadequacy of currency in the market.

7.2 Process of Currency Design

In NRB, various committees and steps are arranged for finalizing note and coin design related activities. It usually starts with recommendation from the CMD to the Governor after discussion with Work Management Committee (*Karya Byabastha Samiti)* to have new printing of banknotes and coins. The matter is then forwarded to the 'Design Committee' with the approval of the Governor. After requisite discussion, the 'Design Committee' recommends the proposed design to the Board, which then takes decision over the design either by itself if authorized or sends it to the GON if it needs to be, as per the NRB Act, 2002.

The NRB Act, 2002 Section 52 (1) explicitly provides monopolistic authority to the Bank to issue banknotes and coins in the country. It also states that such notes and coins shall be legal tender throughout the country. Similarly, as per Section 52 (4), the Bank can issue the banknotes of various denominations as necessary. While designing and printing new banknotes, it is to be noted that the pictures appearing in the note, size and denomination shall be as approved by GON and the latent pictures, security features, printing substance and other materials shall be as decided by the NRB Board.

Table 7.1 : Composition of Design Committee

Governor	Chairman
Deputy Governors	Member
Representative (Linguist), Nepal Academy	Member
Gazetted 1st Class or equivalent representative (Archaeologist), Department of Archaeology, GON	Member
Gazetted 1st Class or equivalent representative (wildlife expert), Department of Wildlife Conservation, GON	Member
Representative (Historian), at least Professor, Tribhuvan University	Member
Nepalese note and coin specialist, as selected by NRB	Member
Chief, CMD	Member Secretary

According to NRB Note and Coin Rules 2003, Rule 10, the Design Committee is made up as in Table 7.1. However, the Committee can invite banknote and coin specialist as an observer. NRB Note and Coin Rules 2003, Rule 12, has mentioned functions and duties of the Design Committee. In addition, as mentioned in Rule 13 of NRB Note and Coin Rules 2003, a committee called Work Management Committee (*Karya Byabastha Samiti)* is constituted (Table 7.2) for the work related to note printing and coin minting. One major roles and responsibility of this Committee is to prepare the master plan, with quantity and time line, for printing and minting of banknotes and coins, as necessitated by circulation demand. The master plan is then submitted to the Deputy Governor and then to the Governor. As stated above, once it is decided that the new banknotes and coins need to be printed or minted, it is referred by the CMD to the Design Sub-committee.

Table 7.2 : Work Management Committee (*Karya Byabastha Samiti)*

Chief, Currency Management Department	Coordinator
Chief, Financial Management Department	Member
Chief, General Service Department	Member
Chief, Corporate Planning Department	Member
Chief, Banking Office	Member
Chief, Legal Division	Member
Deputy Chief of Currency Management Department or Chief of Mint Division	Member Secretary

At present, the Bank has been using the pictures and some features on the banknotes as recommended by the Note and Coin Design Sub-committee formed on 12 July 2013. The Committee included previous Deputy Governor, learned scholar, Director General of Department of Archaeology, and Director General of Department of National Wildlife. The Sub-committee recommended the specific pictures of animals to be printed in respective denomination of the banknotes as mentioned in Table 7.3 below. The Committee also recommended changing the security thread used in Rs. 500 and Rs. 1000 banknotes to colour shift pattern and to use optical variable ink in at least one part of these higher denominated banknotes.

Table 7.3 : Prescribed Designs of Notes

(Recommended by Note and Coin Design Sub-committee)

Rs. 1000	In place of picture of an elephant as currently seen on the banknote, the picture of twin elephants, called Ram Laxman, certified as born in Chitawan National Park, elephant breeding camp
Rs. 500	In place of pictures of tigers as currently seen on the banknote, the picture of Royal Bengal tiger, certified as found in Chitawan National Park
Rs. 100	In place of picture of rhino as currently seen on the banknote, the picture of one-horned she-rhino and its calf, certified as found in Chitawan National Park
Rs. 50	In place of picture of wild goat as currently seen on the banknote, the picture of snow leopard, certified as found in Nepalese Himalayan region at the altitude of 3000 to 4500 meters

Rs. 20	In place of picture of sambar deer as currently seen on the banknote, the picture of swamp deer, certified as found in Shukla Phanta National Park
Rs. 10	In place of picture of black buck as currently seen on the banknote, the picture of black buck, certified as found in Black Buck Conservation area, Khairapur, Bardia
Rs. 5	In place of pictures of yaks as currently seen on the banknote, the picture of yaks, certified as found in Nepalese Himalayan region

7.3 Issuance of Banknotes

Banknote issuance in Nepal can be categorized into two eras, one issued by GON and another issued by NRB. The first evidence of banknote issuance in Nepal dates back to 1945 A.D., issued by the GON. Later, after establishment of NRB and since 1960, banknotes have been issued by NRB. The banknotes issued by GON were signed by Treasurer (*Khajanchees)*. In the past, there have been three *Khajanchees* who signed the respective Nepalese banknotes issued by GON. After this, the banknotes issued by the NRB are signed by the Governors. Till now, 17 Governors (including one Acting Governor) have signed the banknotes issued by the NRB. In Nepal, banknotes of 11 different denominations have been issued, namely, denomination of Rupees 1, 2, 5, 10, 20, 25, 50, 100, 250, 500, and 1000. Though there has not been any demonetization moves in Nepal, only 7 denominations of banknotes, namely, 5, 10, 20, 50, 100, 500, and 1000 are issued at present. GON had introduced denomination of Rupees 1, 5, 10 and 100 while NRB introduced the other denominations. Banknotes of Rupees 25 and 250 denominations were special banknote issuance. These were issued to commemorate the Silver Jubilee of King Birendra's accession to the throne. Table 7.4 presents the date of first issue of different denominations of Nepalese banknote.


नेपाल राष्ट्र बैंक
RUPEES TWO
SPECIMEN
RUPEES FIVE
NEPAL RASTRA BANK
RUPEES TEN
रुपैयाँ बीस
RUPEES TWENTY

Front **Back**


नेपाल राष्ट्र बैंक
SPECIMEN
रुपैयाँ पचास
RUPEES FIFTY
रुपैयाँ एक सय
LUMBINI THE BIRTH PLACE OF LORD BUDDHA
NEPAL RASTRA BANK
RUPEES ONE HUNDRED
रुपैयाँ पाँच सय
RUPEES FIVE HUNDRED
RUPEES ONE THOUSAND

Front **Back**

Table 7.4: Introduction of Banknotes (Denomination-wise)

Denominations	Year of First Issue
1	1953
2	1981
5	1945
10	1945
20	1982
25	1997
50	1977
100	1945
250	1997
500	1971
1000	1969

As mentioned in the section on planning and forecasting of currency, banknote issuance starts with identification of needs, i.e., banknote demand forecasting. Demand forecasting/projection of banknotes basically deals with the quantity and timing of banknotes needed. The demand for banknotes depends on the country's macroeconomic indicators, existing circulation of the banknotes, and destruction cycle of the banknotes, among others. Table 7.5 presents the circulation of Nepalese banknotes during the last four fiscal years.

Table7.5 : Circulation of Banknotes in Nepal

(in million)

Fiscal Year	Denomination of Banknotes										
	1	2	5	10	20	25	50	100	250	500	1,000
2012/13	161.8	94.1	302.2	220.5	124.8	2.4	79.9	96.6	351	127.2	149.5
2013/14	161.5	93.6	336.8	252.7	149.9	2.3	95.0	110.6	351	155.5	171.9
2014/15	161.4	93.3	371.8	279.4	170.9	2.3	113.9	115.5	350	176.9	204.8
2015/16	161.2	93.1	400.7	302.5	187.8	2.3	132.4	117.3	350	183.8	266.6

As presented in Table 7.5, circulation of all banknotes except denominations 1, 2, 25, and 250 has been growing in recent years. Circulation of banknotes with denominations 1, 2, 25, and 250 has not witnessed growth because these denominations have not been issued during the reported years. Inference on total monetary value of circulation of banknotes (summation of quantities in circulation of each denomination multiplied by its denomination value) can also be made from Table 7.5. Monetary value of banknote circulation has been consistently increasing over the four-year period. As of end 2015/16, total monetary value of banknote in circulation stood at Rs. 386.16 billion. Higher denomination banknotes constituted the majority of the monetary value of banknote in circulation. In 2015/16, Rs. 1000 denomination banknote contributed 69 percent of total circulation of banknotes followed by Rs. 500 with 24 percent, Rs. 100 with 3 percent, and Rs. 50 with 2 percent. The remaining denominations contributed for a total of less than 3 percent with none of them contributing for more than 1 percent in total monetary value of circulation.

Another factor affecting the demand for banknote issuance is the pace and volume of destruction of banknotes. Banknotes are destructed when they are deemed unfit for circulation, namely, soiled, old, mutilated, rotten, caught by fire and having graffiti. Higher rate of destruction of banknotes calls for greater need for banknote issuance. Table 7.6 presents the banknote destruction as per the denomination over the last four fiscal years. As presented in Table 7.6, very few quantities of denomination 1, 2, 25 and 250 have been destroyed in line with their lower quantities in circulation while denominations having higher destruction quantities, namely, 5 and 10, are also the banknotes having higher volumes of circulation.

Table7.6 : Destruction of Banknotes in Nepal

(in '000)

Fiscal Year	Denomination of Banknotes										
	1	2	5	10	20	25	50	100	250	500	1,000	Total
2012/13	565	1,047	38,355	32,682	32,252	101	24,832	25,792	11	14,403	14,763	184,804
2013/14	392	765	37,064	34,272	31,758	70	26,269	28,218	1	10,296	8,929	178,034
2014/15	206	267	40,873	40,150	34,701	37	26,710	37,563	2	23,430	22,440	226,377
2015/16	194	364	40,088	39,178	29,453	33	24,573	41,273	0	12,844	13,317	201,319

Banknotes are issued considering the demand for banknotes, stock position of banknotes, and future stock-ins of the banknotes. Table 7.7 presents the banknote issuance or stock out position of banknotes over the last four fiscal years.

Table 7.7 : Issuance of Banknotes in Nepal

(in '000)

Fiscal Year	Denomination of Banknotes									
	1	2	5	10	20	50	100	500	1,000	Total
2012/13	-	3,150	113,700	27,150	16,200	8,150	27,950	22,100	83,950	302,350
2013/14	-	-	79,050	75,900	65,050	49,800	49,850	38,250	28,150	386,050
2014/15	-	-	75,600	73,950	63,600	7,900	38,200	43,400	60,500	403,150
2015/16	-	-	56,750	49,550	38,200	34,850	48,900	25,700	77,650	331,600

As presented in Table 7.7, issuance of Rupees 5 denomination banknote has consistently decreased over the last four-year period. Rupees 2 denomination banknote has not been issued since 2013/14. Issuance for other denominations does not show any consistent increasing or decreasing trend. Observance of such erratic trend in banknote issuance for most of the denominations is attributed to various factors, like banknote printing of different denominations done at different points of time (within a cycle), delivery of different denominations of the banknotes in the vaults of NRB at different points of time, and demand for a particular denomination banknote could be substituted by banknotes of other denominations. In terms of the total monetary value of the banknote issuance (summation of quantity issued of each denomination multiplied by each denomination), it has been consistently increasing except for 2013/14.

7.4 Printing of Banknotes

Banknote printing is not the same as banknote issuance. Banknote printing is only a part of overall banknote issuance. All the printed banknotes are not issued at once. After approval of design, a notice for international tender is floated inviting the prequalified banknote printers. Prequalification of security printers (for both banknote printing and coin minting) is compulsory. Generally, a prequalification list is valid for 2 years or for completion of a cycle of banknote printing. Printing of notes and minting of coins are done as per the provisions made in Note Printing and Coin Minting Directives, 2009.

In the past, Nepalese banknotes have been printed by several international printers. Till date, 13 banknote printers have printed the banknotes, as listed in Table 7.8. Printers from 11 different countries have printed the Nepalese banknotes; these are from Asia, Australia, Europe, and North America. Moreover, UK has been the only country from where more than one printing company has printed Nepalese banknotes.

Table 7.8: List of Nepalese Banknote Printers

S.N.	Banknote Printer	Country
1	Security Printing and Minting Corporation of India Limited	India
2	De La Rue International Limited	UK
3	Bradbury Wilkinson & Co.	UK
4	Orell Fussli Security Printing	Switzerland
5	B A Banknote International	Canada
6	Harrison & Sons Ltd.	UK
7	Giesecke & Devrient GMBH	Germany
8	Oberthur Fiduciaire	France
9	Note Printing Australia Ltd.	Australia
10	Canadian Banknote Co. Ltd.	Canada
11	Joh Enschede Security Print	Netherlands
12	Perum Peruri	Indonesia
13	China Banknote Printing and Minting Corporation	China

See Appendix 7.1 for the process of selecting banknote printers

The banknote printers which have been awarded the contract for designing, printing and supplying different denomination Nepalese banknotes over the three banknote printing cycle is presented in Table 7.9 below.

Table 7.9 : Nepalese Banknote Printing over Three Cycles

Denominations	5	10	20	50	100	500	1,000
Panel A: Two Cycles Ago							
Quantity (in million)	250	230	130	90	120	100	100
Cost per quantity (in Rs.)	1.76	1.83	1.59	1.73	1.77	2.99	2.32
Banknote Printer	DLR	SPMC	PP	PP	SPMC	PP	PP
Panel B: Last Cycle							
Quantity (in million)	200	270	180	140	110	140	160
Cost per quantity (in Rs.)	1.53	1.61	2.11	2.06	2.59	3.13	3.92
Banknote Printer	DLR	DLR	GD	GD	PP	DLR	PP
Panel C: Present Cycle							
Quantity (in million)	260	240	210	240	200	180	200
Cost per quantity (in Rs.)	1.39	1.46	1.11	1.48	2.15	2.92	1.94
Banknote Printer	CBPM	OF	PP	PP	CBPM	PP	CBPM

Note. DLR = De La Rue International Limited, UK. SPMC = Security Printing and Minting Corporation of India Limited, India. PP = Perum Peruri, Indonesia. GD = Giesecke & Devrient GMBH, Germany. CBPM = China Banknote Printing and Minting Corporation, China. OF = Oberthur Fiduciaire, France

With regard to the cost of banknote printing, cost per quantity of banknote (in NRs.) has declined in the current cycle vis-a-vis last cycle for all the denominations of banknotes. This indicates that banknote printing industry has become more competitive in recent years. Another notable thing is that for a particular banknote denomination, Asian printers have printed the Nepalese banknotes at the lowest cost over the three banknote printing cycles, except for Rupees 10 denomination. This is probably because of lower manufacturing costs in Asian countries.

7.5 Issuance of Coins

Mint Department was established on 2 December 1932 for minting and issuing coins in Nepal. Since then, the Department has been minting and issuing circulation coins, commemorative coins and coins of valuable metals *(Asarfis)*. It has also been preparing special medals and medallions for GON and various corporations on request.

The Mint Department was then transferred to NRB on 1 December 1983. The transfer, however, did not impact the scope of work it had been performing. It is still responsible to mint and issue circulation coins, commemorative coins and *Asarfis*. In the beginning, the Department used to mint coins of following denominations: 1, 2, 5, 10, 25 and 50 *paisa* as well as Re. 1. However, due to receding importance and demand of lower denominations, minting and issuing of small denomination coins has been stopped. The last time 50 paisa was minted and issued by the Mint Department was in 2001. Since then, Re. 1 and Rs 2 coins have been issued on a regular basis though the Department ceased to mint them.

Around 80 percent of the work in the Department is of technical nature. However, due to various reasons, the machineries that are used have not been modernized and repaired with changing times. This is the prime reason for not minting the coins in the Department since one and half decades. Currently, the Department only stores and issues the coins that are minted in foreign countries. Other work such as minting *Asarfi*, silver coins, commemorative coins and medals are also being done on limited basis.

On 11 August 2005, the Department was converted to a Division under CMD. The Division has been distributing circulation coins, commemorative coins and *Asarfis* to offices of NRB. While converting the Department to Division, direction was given to Mint Division as "to continue production and issuance of commemorative coins and *Asarfis*, to carry on production of medals and medallions as requested by the Government as well as to keep on providing services to the exporters of gold jewelleries".

7.6 Circulation of Currency

7.6.1 Supply of Currency

In the history of Nepalese currency note, for the first time, Rana Prime Minister Juddha Shamsher issued an ordinance on 17 September 1945 to issue and circulate the currency notes from Central Treasury Office (*Sadar Muluki Khana)*. As a consequence, for the first time in Nepal, the *Sadar Muluki Khana* issued Nepalese currency notes with the denominations of Rs. 5, Rs. 10 and Rs. 100. However, these notes were circulated only in Kathmandu Valley and in very selected hilly regions of the country. Most of the revenue and government transactions used to be carried out in IRs. Also, coins comprised more than 50 percent share of total circulated currency (NRB, 1981). Individuals' bank accounts used to be maintained in IRs. Due to these reasons, demand for NRs was very low. One of the objectives for NRB's establishment was to ensure proper management of NRs notes and to make proper arrangement for the circulation of NRs throughout the country.

After the establishment of the NRB, the Bank took over all the liabilities and obligations of the notes issued by *Sadar Muluki Khana*. The NRB, for the first time, issued notes in denominations of Rs. 1, Rs. 5, Rs. 10 and Rs. 100 on 19 February 1960. This step further helped to promote the circulation of NRs across the country and also to increase people's faith in Nepalese notes. Likewise, as per the advice of NRB, GON enacted an Act in 1957 to promote the use of Nepalese currency (Increasing the Use of Nepalese Currency Act, 1957) in order to increase the circulation and trust in NRs.

On 14 May 1960 GON decided to use only NRs for all the transactions in the country. This was a major shift to enhance the circulation of NRs. While implementing this decision, the circulation of NRs across the country increased significantly. The NRB had established various branches, sub-branches and exchange counters to increase the supply of NRs and withdraw the IRs from circulation.

Following Table 7.11 shows the denomination-wise circulation balance of Nepalese currency in the last seven years. Total currency in circulation, which was Rs. 161,300 million in 2009/10 increased every consecutive year and stood at Rs. 386,160 million in 2015/16.

Table 7.10 : Denomination-wise Circulation Balance of NRs

(Rs. in million)

Deno	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
1	165.4	163.2	162.3	0.0	161.5	161.4	161.2
2	199.9	193.7	190.3	188.2	187.1	186.6	186.1
5	1,038.8	1141.4	1316.2	1511.1	1683.9	1859.0	2003.7
10	1,307.3	1537.6	1883.2	2205.0	2526.8	2794.4	3025.0
20	2,044.9	1922.8	2294.2	2495.8	2999.0	3418.6	3756.2
25	73.8	64.7	61.0	59.5	58.6	58.2	57.7
50	3179.3	3000.9	3761.2	3999.6	4752.3	5693.2	6622.3
100	8717.6	8675.1	8909.3	9657.2	11064.4	11554.3	11734.6
250	93.3	88.8	88.0	87.8	87.6	87.5	87.5
500	47134.8	52589.0	61467.2	63628.2	77757.7	88489.6	91896.8
1000	97344.9	98242.6	121117.1	149465.8	171971.0	204777.2	266628.9
Total	**161,300.0**	**167,620.0**	**201,250.0**	**233,298.2**	**273,250.0**	**319,080.0**	**386,160.0**

Supply of currency to the market is a key action comprising the currency management. Demand for domestic consumption of goods and services largely determines the supply of currency. As the economic activities increase and growth accelerates, the demand for domestic currency increases, so the supply of currency increases too. However, with the effect of inflation, the purchasing power of NRs has been weakening. As a result, the NRB has stopped printing notes of Re. 1 and Rs. 2 denomination. Instead, coins of Re. 1 and Rs. 2 are in circulation. This is the reason for having a negative growth of circulation of Re. 1 and Rs. 2 in recent years.

7.6.2 Points of Currency Issuance (Currency Chests)

As per the NRB Act, NRB has the sole responsibility for circulating the notes and coins across the nation. In order to carry out this responsibility given by the then NRB Act, 1955 (now NRB Act, 2002), NRB established currency chest at the then Issue Department, Thapathali, as well as at its entire offices outside the Kathmandu Valley. Later, RBB, as the second commercial bank, was established in 1966 at the initiation of the GON. Thereafter, NRB encouraged NBL and RBB to establish their branches across the country to support the GON to mobilize government revenue as well as utilize public expenditure. NRB, then, handed over its many offices including Exchange Counters to the NBL and RBB.

At present, the NRB has seven offices outside Kathmandu Valley. Each office has a Note Chest to manage the circulation of the NRs (both the notes and coins) in the region. At central level, CMD has its own Note Chest at Thapathali. Note chests are also at various branch offices of NBL and RBB in different parts of the country. Presently, there are altogether 75 note chests in Nepal (Table 7.12). Kailali, Dang and Solukhumbu districts have two note chests each whereas note chest has not been established in Lalitpur, Bhaktapur and Parbat districts. Every year, based on the currency demand, CMD reviews the total insurance amount of the note chests.

Table 7.11 : Number of Note Chests

S. N.	Name of the Bank	Number of Chests
1	Nepal Rastra Bank	8
2	Nepal Bank Limited	24
3	Rastriya Banijya Bank	43
	Total	75

7.7 Note Destruction

After the circulation of new banknotes, the lifetime of the banknotes gradually decreases as a result of wear and tear in the process of handling and hand-to-hand transfer. Banknotes, which are soiled, mutilated or torn are treated as unfit for circulation. NRB collects the unfit banknotes from commercial banks, financial institutions and public, and destroys the same by incineration.

7.7.1 Legal Framework for Destructing the Banknotes

NRB Note Destruction Rules, 2003 prescribes the legal framework for destructing the unfit banknotes. As per the rule, 'Note Destruction' means to destruct the notes by incineration in the furnace or cutting them into small pieces (shredding). As per Rule 4, a Note Destruction Committee with the following members is formed for the purpose of destructing notes in the CMD:

i) Department Head of CMD - Coordinator

ii) Representative, Ministry of Finance, GON - Member

iii) Representative, Legal Division, NRB - Member

iv) Official appointed by Department Head of CMD - Member

v) Related Official of CMD - Secretary

In the offices outside Kathmandu Valley, following Committee has been formed to destruct the unfit notes:

i) Head of the Office - Coordinator

ii) Representative from Regional Office of Comptroller General's Office - Member

iii) In-charge of Currency Section of Office - Member

iv) Related Official of Currency Section - Secretary

As per Rule 3, the following banknotes are destroyed by the CMD and NRB Offices outside the Kathmandu Valley.

i) Unfit notes exchanged and received in the Bank under NRB Note Reimbursement Rules, 2003

ii) Banknotes treated as unfit for circulation by the CMD and NRB offices outside the Kathmandu Valley

iii) Banknotes determined as unfit for circulation by the Board of Directors of the Bank

iv) Soiled and mutilated banknotes (unfit notes to re-circulate) deposited by the BFIs

v) Notes which are forfeited by NRB as counterfeit notes.

7.7.2 Process of Note Destruction

As per Rule 5, the following process has been followed for destructing the notes.

i) The banknotes to be destructed are segregated and counted.

ii) A separate record is maintained both in GL and Register for the notes to be destructed.

iii) The notes below Rs.50 denomination are punched with two holes and Rs.50 and above are punched with four holes.

iv) Before incineration, 5 percent of the punched notes are verified on the random sampling basis in the presence of the members of Note Destruction Committee.

A report of the note destruction is to be presented to the Office of the Governor daily after the completion of the destruction work.

Appendix 7.1: Process of Selecting Bank Note Printers

From among the prequalified banknote printers, a global sealed tender is called for printing, designing, and supplying of banknotes giving at least 45 days' time from the date of publication of notice. A single notice may be published for single denomination or multiple denominations (but with separate tender reference numbers). After publication of notice, the interested prequalified security printers purchase the tender document. For the current cycle of banknote printing (starting from 2015), the list of prequalified banknote printers has been presented in Table 7.9. There is no rule of ordering for printing a particular denomination, rather it is done on the need basis.

List of Prequalified Banknote Printers in Nepal for Current Cycle

S.No	Name of Banknote Printer	Country
1	China Banknote Printing and Minting Corporation	China
2	Giesecke & Devrient GMBH	Germany
3	CRANE AB	Sweden
4	De La Rue International Ltd.	UK
5	Canadian Bank Note Co. Ltd.	Canada
6	Bundes Druckerei GMBH	Germany
7	Oberthur Fiduciaire	France
8	Joint Stock Company GOZNAK	Russia
9	Perum Peruri, Perum Percetakan Uang Republik Indonesia	Indonesia

A pre-bid meeting is held for the participated security printers, at least 15 days prior to bid submission deadline with the purpose of clarifying the queries, if any, of the security printers on the tender document. The bids collected till the submission deadline are opened and evaluated. The bidders having met all the commercial, technical, and economic criteria are selected and a letter of intent provided to all participated security printers stating the Bank's intention to award the contract to the selected banknote printer. If no claim is lodged on the Bank's intention to award the contract to the selected banknote printer, within the claim period of 7 days, a notification of award is issued to the selected banknote printer to enter the contract with the Bank, within 15 days of such notice. Then, a contract is signed between NRB and the banknote printer. Among several milestones that constitute the banknote printing contract, the banknote printer is required to submit the digital proof print (durer) of the banknote, get its approval from the Bank, submit real proof print of the banknote, and get its approval from the Bank, in stepwise progression, within the time frame stipulated in the contract. After approval of the real proof print, the Bank is required to open a Letter of Credit favouring the banknote printer. The printer is then required to dispatch the specified quantities of banknotes within the time frame specified in the contract, and the Bank is required to make payments thereof.

Part 3
Financial Stability

8 Financial Sector Reforms: Legal and Policy Framework

The Nepalese financial sector has expanded in terms of the number, type, operations, geographical spread and other features since the mid-1980s. The growth of the financial sector accelerated during the 1990s and 2000s. This was possible with the adoption of economic liberalization policy in general and financial liberalization policy in particular. Consequently, a large number of financial institutions came into existence in the private sector. The financial sector reform programme implemented by the Government was successful in bringing about operational efficiency turning around the delivery of services and improving the financial strength of financial institutions owned by the Government. Adoption of proactive policy, laws, regulations and processes enlarged the capacity of financial sector, both quantitatively and qualitatively. NRB as the regulator played a pivotal role in bringing about and sustaining the favourable outcomes in the financial sector.

Capacity building of the financial sector remained as an important pillar of financial sector reform, which has increasingly been attained through enacting new laws, amending existing laws and establishing supportive financial institutions like Debt Recovery Tribunal and Credit Rating Agency. In the process of financial sector reform, NRB also changed the regulatory policy and provisions including licensing policy with the inherent motive of safeguarding financial stability by making financial sector stronger and more efficient. In this context, this Chapter mainly covers development of legal architecture of financial sector and evolution of licensing policy for BFIs.

8.1 Legal Architectures of Banking in Nepal

Available legal architecture, including laws as well as rules and regulations enacted in different times for governing Nepalese financial system, can be grouped into three broad areas. First, those Acts related to governing the functions of NRB, second, those Acts related to the whole banking system under the regulation of NRB and third, rules and bylaws as well as guidelines issued by NRB for operation and regulation of the banking system including its own activities.

8.1.1 Acts Governing NRB

As mentioned earlier, NRB was established in 1956 as per the NRB Act, 1955. In the context of financial sector reform process, new NRB Act, 2002 was enacted in 2002 by replacing the NRB Act, 1955 and Currency Act, 1983, with a view to changing financial landscape and refining the role of the central bank in the economy. The NRB Act was further amended on 14 November 2016 to make the NRB more efficient and effective in the changing context of focus being given to financial consolidation rather than financial expansion with priority accorded to financial access.

According to Section 4 of NRB Act, 2002 with second amendment 2016, the objectives of NRB have been revised as below.

- To formulate necessary monetary and foreign exchange policies and manage them in order to maintain the stability of price and balance of payments for the sustainable development of economy and economic stability,
- To promote public confidence in the banking and financial system by increasing access to financial services and maintaining stability in the banking and financial sector,
- To develop a secure, healthy and efficient system of payments.

Section 3 of NRB Act, 2002 provides reasons for the establishment of NRB as to perform the functions of central bank. It is an autonomous corporate body, as per Section 3 (3) of NRB Act. Section 4 (2) provides that the Bank shall, without any prejudice to its objectives, extend cooperation in the implementation of the economic policies of the GON. The NRB is governed by this Act as well as the Foreign Exchange (Regulation) Act, 1962. The major features of the amended NRB Act are provided in the attached appendix 8.1.

The BOD of NRB has to discharge the functions as listed in section 29 of NRB Act. Once appointed, all members of the BOD remain in office for a tenure of five years. Government cannot remove the member of the BOD prior to the expiry of their tenure in office unless there is cause for removal as specified in Section 22 (5) of the NRB Act. The cause for removal of the member of the BOD has to be established by an inquiry carried out by the Inquiry Committee instituted under the chairmanship of retired justice of Supreme Court.

8.1.2 Other Banking and Financial Acts

Prior to the establishment of NRB, NBL was providing banking services to the Government and general public as per the mandate conferred by Nepal Bank Limited Act, 1937. Until 2004, banking institutions were governed and regulated under scattered legislations; there were separate Acts for separate category of institutions, even separate Acts for institutions such as ADB/N, Cooperative Bank Act, NIDC and RBB.

The Bank and Financial Institution Ordinance, 2004 was the first umbrella legislation to regulate and supervise all BFIs under single legislation. Provision was made to classify BFIs as A, B, C and D as per the minimum paid-up capital requirement, which was also based on the geographical areas to be covered. The Ordinance enlisted overall functions of each category of BFIs and ensured reliable and quality banking and financial services through healthy competition among BFIs together with protecting the interest of depositors. This made provision to ensure good corporate governance and financial discipline in the BFIs and also ensured professionalism in their boards and management teams. Besides, it also entrusted NRB with enough supervisory and enforcement powers. This Ordinance was later formalized as an Act - Banks and Financial Institutions Act (BAFIA), 2006. This legislation first repealed the provisions of previous scattered legislations and unified them so as to harmonize the banking practices.

BAFIA has been replaced by BAFIA 2017, which was enacted on 23 April 2017. The newly amended BAFIA has expanded the role and functions of NRB. It has continued the classification of BFIs into 'A', 'B', 'C', and 'D' classes. However, only the class 'A' and class 'B' institutions are entitled to use the word 'bank' in their names. Other major provisions of this newly enacted BAFIA 2017 are provided in attached appendix 8.2.

There are some old Acts still in operation. In 1957, Act Enhancing the Circulation of the Nepalese Currency was enacted to "enhance the circulation of the Nepalese currency throughout Nepal for the purpose of consolidating and balancing the economy of the country on the basis of a single currency". Foreign Exchange (Regulation) Act was enacted in 1962 to regulate foreign exchange transactions, which made the use of foreign currencies illegal inside the domestic economy. Likewise, some other Acts like Negotiable Instruments Act, 1977, which was enacted to "define negotiable instrument and make other arrangements relating to it in order to systematize the banking transaction", is in application. Negotiable Instruments Act, 1977 controls and regulates the issues of Cheques, Drafts, Promissory Notes, Bills of Exchange, etc and its conditions. Through appropriate directives and order, NRB prescribes for the required conditions of these instruments with a view to ensure more secured transactions for BFIs licensed by it.

In addition to NRB Act, 2002 and BAFIA, 2006 (now 2017), legal architecture of Nepalese banking consists of a number of legislations relating to incorporation and operation of the banking institutions. As Nepalese legal system follows the norms of a common law system, the precedents laid down by the Supreme Court also form part of the legal architecture. Box 8.1 presents the list of banking laws, which govern the financial institutions.

Besides NRB Act and BAFIA, there are other new Acts related to financial activities enacted in the course of financial sector reform programme like Banking Offence and Punishment Act 2008, Banks and Financial Institutions Debt Recovery Act, 2002, Insolvency Act, 2006, Secured Transaction Act, 2006, Money (Asset) Laundering Prevention Act, 2008, and Money (Asset) Laundering Prevention Rules, 2016 as shown in Box 8.2.

Box 8.1 : Acts Governing Banking Sector

Banks and Financial Institutions Act, 2006 (Recently new BAFIA 2017)

Banking Offence and Punishment Act, 2008

Banks and Financial Institutions Debt Recovery Act, 2002

Act Relating to Institutions Acting as Financial Intermediary, 1999

Financial Intermediaries Rules, 1999

Negotiable Instruments Act, 1977

Act Enhancing the Circulation of the Nepalese Currency, 1957

Companies Act, 2006

Insolvency Act, 2006

Secured Transaction Act, 2006

Public Procurement Act, 2007

Foreign Investment and Technology Transfer Act, 1992

Industrial Enterprises Act, 2016

The Banking Offence and Punishment Act, 2008 following its first amendment in 2016 has expanded the scope of banking offences to cooperatives and 'Dhukuti' (a practice of unauthorized informal group deposit and lending). Under this law, NRB files First Information Report to the Nepal Police for investigation and prosecution of the offence. Based on the investigation report of Nepal Police, Government Attorney prosecutes the banking offence case before the High Court. Commercial Bench of the High Court hears the cases of Banking Offence. Other salient features of this Act are included in Appendix 8.3.

Banks and Financial Institutions Debt Recovery Act, 2002 is applicable to recover loan by BFIs for the amount exceeding Rs. 500,000 if BFIs could not recover loan under normal procedures of recovery. Based on this Act, Debt Recovery Tribunal and Appellate Debt Recovery Tribunal have been established to facilitate debt recovery of BFIs.

Box 8.2: AML/CFT Laws

Money (Asset) Laundering Prevention Act, 2008 (second amendment, 2015)
Money (Asset) Laundering Prevention Rules, 2009, new 2016
Money (Asset) Laundering Prevention (Freezing of Properties and Funds of Designated Person, Group and Organization) Rules, 2013
Proceeds of Crime and Instruments (Freezing, Seizing and Confiscation) Act, 2014
Extradition Act, 2013
Mutual Legal Assistance Act, 2014
Mutual Legal Assistance Rules, 2013
Organized Crime Prevention Act, 2013

In recent years, to comply with Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) requirement, various new Acts such as Organized Crime Prevention Act, 2013; Mutual Legal Assistance Act, 2014; Proceeds of Crime and Instruments (Freezing, Seizing and Confiscation) Act, 2014 have come into implementation. BFIs are required to put in place AML/CFT measures as per the provision of Asset (Money) Laundering Prevention Act, 2008. Second amendment of NRB Act has included the provision of AML/CFT issues. International Anti-Money Laundering Standards set by Financial Action Task Force (FATF) have been incorporated in the Act. FIU as envisaged in international legal instruments and FATF standards was established on 21 April 2008 within NRB as per the provision of Asset (Money) Laundering Prevention Act, 2008.

All BFIs are established under Company Act, 2006 as public limited companies. In case of dissolution, companies will wind up based on the provision of Companies Act, 2006 and Insolvency Act, 2006. However, NRB Act, 2002 (Second Amendment) has provided more power to NRB regarding liquidation of the banking institutions. The decisions of NRB on financial matters are final whereas the liquidation of banks as a company should be allowed by designated court.

The NRB should also follow Public Procurement Act, 2007. However it can formulate its own byelaws without violating the provision of this Act. Foreign Investment and Technology Transfer Act, 1992 and

Industrial Enterprises Act, 2016 are also relevant to NRB to the extent that the final authority of foreign investment amount in foreign currency should be approved by it.

8.1.3 Rules and Bylaws

Apart from the parliamentary enactments, the banking sector is regulated by a number of delegated legislations issued by NRB as per the power conferred to it by NRB Act and BAFIA. NRB issues the prudential guidelines in the form of Directives to BFIs. Depending on the subject matter concerned, guidelines and policies have also been issued to regulate banking business. NRB has issued a number of bylaws to organize its own day-to-day operation to perform the legal mandate. As shown in the list in Box 8.3 to 8.6, there are a number of rules, by-laws, policies, guidelines and manuals, which have now clearly governed and guided the activities of financial institutions including NRB. In addition, Unified Directives issued by NRB also direct and regulate the activities of BFIs to maintain financial stability in the economy and enhance public confidence in the financial system.

Box 8.3 : List of Rules

Primary and Secondary Market Management of Public Debt Rules, 2004

NRB Note Exchange Rules, 2003

NRB Note and Coins Rules, 2003

NRB Note Destruction Rules, 2003

Public Debt Rules, 2003

NRB has been issuing directives, as per necessity, to effectively regulate the banking system. It issues unified directives as per Section 79 of NRB Act. The NRB Directives have received judicial recognition as binding legal instruments. Separate Directives are issued for Class D microfinance institutions since 2013/14. Currently, Unified Directives of NRB, 2016 (For Class 'A' and Class 'B' Bank, and Class 'C' financial institutions) and Unified Directives of NRB, 2016 (for Class 'D' financial institutions) are in place.

Box 8.4 : List of Bylaws

Merger and Acquisition of Banks and Financial Institution Bylaw, 2016

Payment and Settlement Bylaw, 2015

Prompt Corrective Actions for Banks and Financial Institutions Bylaw, 2008 (new 2017)

NRB Staff Service Bylaw, 2011

NRB Procurement Bylaw, 2014

Resolution of Problem Institutions Bylaw, 2014

Open Market Operation Bylaw, 2014

NRB Publication Directives, 2011

Note Printing and Coin Minting Directives, 2009

NRB Authority Delegation Bylaw, 2008

NRB Auction Directives, 2008

NRB Function Management Bylaw, 2003

NRB Blacklisting Bylaw, 2003

NRB Inspection and Supervision Bylaw, 2013

NRB Board of Directors Meeting and Seal Bylaw, 2006

NRB Cash Bylaw, 2006

NRB Documents Shredding Bylaw, 2007

NRB Foreign Exchange License and Inspection Bylaw, 2011

NRB Money Changer Bylaw, 2010

NRB Remittance Bylaw, 2010

Section 110 of NRB Act, 2002 has granted the power to issue rules and bylaws on different matters. Under Section 110 (1), NRB has issued NRB Note Exchange Rules, 2003, NRB Note and Coin Rules, 2003 and NRB Note Destruction Rules, 2003. NRB has issued following bylaws under Section 110 (2) to concretize the functions of NRB and its various departments and offices as shown in Boxes 8.4 to 8.7. These rules, bylaws as well as manuals and guidelines provide the clear direction for executing functions of NRB.

Box 8.5 : List of Procedural Manuals and Guidelines

Procedural Manual of Interbank Payment System, 2016
Procedure of the Formulation of Monetary Policy, 2016
Procedure for Nepal Rastra Bank Higher Education, 2007
Risk Management Guideline, 2010
Balance of Payments (BOP) Manual, 2004
Rural Self Reliance Fund (RSRF) Credit Manual, 2012
Consumer Price Collection and Inspection Guideline, 2016
Public Debt Management Guideline, 2003
Banking Service Fee Guideline, 2010
Chief Executive's Remuneration Guideline, 2010
CEO's Remuneration for B,C and D Class Institutions Guideline, 2011
Stress Testing Guideline, 2012
IT Guideline, 2012
Cheque Standards and Specifications Guideline, 2012
Currency Chest Operation Guideline, 2013

Box 8.6: List of NRB Directives

Unified Directives, 2016 (For Class A, B, and C banks and financial institutions)
Unified Directives, 2016 (For D Class financial institutions)
Foreign Exchange Directives and Circulars on different dates

8.2 Licensing Policy

In line with the policy of deregulation and liberal economic policies, the financial sector was opened to the private sector. With the enactment of Bank and Financial Institution Ordinance 2004, NRB started to grant operating license to BFIs to carry out banking business by classifying the BFIs into four categories based on their capital, functions and geographical dimensions, viz., A (Commercial Banks), B (Development Banks), C (Finance Companies) and D (Micro-finance Development Banks, now called Micro-Finance Financial Institutions). The licensing policy stipulates formal procedures for granting license to establish banking institutions. Without obtaining license from NRB, banking activities are not allowed to be conducted as per Section 76 (1) of the NRB Act, 2002. However, Saving and Credit Cooperatives engaged in limited banking transactions could operate in accordance with Cooperative Act, 1992, first amendment effected on 6 December 2000.

8.2.1 Licensing Policy for BFIs

In 1992/93, NRB introduced the policy for opening finance companies by including the requirement of paid-up capital ranging from Rs. 2.5 million to Rs. 30 million depending on their nature of work and geographical working area. That policy also required the submission of projected transactions for three years including the possibility of opening of finance companies in joint venture with foreign bank or financial institutions. As per the policy, there should at least be two promoters with at least five years of experience in bank, insurance, industry and business for opening the company.

Effective 1 May 1994, NRB for the first time introduced policy provisions for opening new commercial bank outside the Kathmandu Valley. According to this policy, the minimum paid-up capital needed to open a commercial bank with central office in the Kathmandu Valley with countrywide coverage was Rs. 250 million; with central office in any municipality outside the Kathmandu Valley Rs. 120 million and with central office in any districts outside the Kathmandu Valley covering five districts other than the Valley Rs. 50 million. This policy also made the requirement of selling at least 30 percent equity share to the general public while imposing the limit on share holding in such a way that a single individual, firm, company or companies of same group could not buy more than 10 percent of issued capital of the bank and more than 15 percent of issued capital of all banks.

On 31 August 1995, NRB renewed the existing policy provision of paid-up capital and share limit for opening new commercial banks. This renewed policy increased the paid-up capital requirement to Rs. 500 million for national level commercial bank with central office in the Kathmandu Valley. The renewed policy added the provision of requiring paid-up capital of Rs. 300 million to open a commercial bank for operating in rural areas outside the Kathmandu Valley and other municipalities. Moreover, as per this policy arrangement, foreign investors could take equity capital in the range of 40 to 50 percent in a commercial bank. Regarding educational qualification, the Chief Executive Officer (CEO) and at least 40 percent members of the Board of a commercial bank needed to have bachelor's degree. Similarly, relatives of CEO and Chairman of the Board could not become eligible for membership of the Board. More importantly, this policy made the provision of accepting applications for new banks only during the time period specified by the NRB.

In 1996/97, NRB directed the existing commercial banks with their central office located in the Kathmandu Valley to increase the capital to Rs. 500 million within five years. Minimum capital was computed as paid-up capital and general reserves with deduction of net loss. In the same year, as per the newly enacted Development Bank Act, 1996, NRB specified the minimum paid-up capital required for opening new development banks at Rs. 160 million for national level development bank having central office in the Kathmandu Valley, Rs. 120 million for operating and having central office outside the Kathmandu Valley, Rs. 80 million for operating in the respective Eastern, Central and Western Development regions, Rs. 50 million for operating in the respective Mid-Western and Far-Western Development regions, and Rs. 10 million for operating in 4 to 10 districts, Rs. 5 million for operating in three districts and just Rs. 2.5 million for operating in one district outside the Kathmandu Valley. Moreover, NRB specified that a minimum of 50 percent to a maximum of 70 percent of the shares should be held by promoters. In case of foreign participation, it should fall within the limit of promoters' share but should not exceed 50 percent. Single individual, firm, company, institution and company of the same group could buy shares to the maximum of 15 percent of the capital of a single development bank and, on overall basis, 20 percent of all development banks. Paid-up capital requirement for development banks was revised in 2004/05, according to which paid-up capital for national level development banks increased to Rs. 320 million. Likewise, the paid-up capital for development banks operating in 4 to 10 adjacent districts outside the Kathmandu Valley was raised to Rs. 50 million. Likewise, the paid-up capital for development banks operating in 1 to 3 districts was raised to Rs. 20 million.

In 1997/98, NRB set the minimum paid-up capital requirement for opening finance company as per the Finance Company Act, 1985. Effective 16 July 1997, paid-up capital for finance companies undertaking all financial operations including leasing was raised from Rs. 30 million to Rs. 60 million, and for those not undertaking leasing activities was increased to Rs. 20 million from Rs. 10 million. Finance companies in operation then were directed to maintain the new paid-up capital within five years.

However, providing new license for opening commercial banks was put in moratorium between 1994/95 and 2001/02. On 16 May 2002, NRB introduced new policy for establishing commercial banks, according to which paid-up capital of Rs. 1 billion was required for opening national level commercial bank. Further, to set up an office in Kathmandu, a commercial bank was required to have either joint venture with foreign bank and financial institutions or a technical service agreement with such institution at least for three years. As per this new policy, foreign banks could hold maximum of 67 percent of total share of the proposed bank. In the case of foreign banks holding at least 50 percent of share capital, the proportion of shares to be issued to the general public could be lowered to 20 percent. Commercial banks which were already in operation or had already obtained the consent letter for operation were required to fulfil the new capital requirement by mid-July 2009.

On 23 January 2003, NRB hiked the paid-up capital requirement to open a new development bank, according to which Rs. 320 million was required for opening national level development bank, Rs. 50 million for development banks operating in 4 to 10 districts and Rs. 20 million for development banks operating in 1 to 3 districts outside the Kathmandu Valley. Those development banks already in operation were required to hike the paid-up capital accordingly by mid-July 2009. In 2003, NRB also increased paid-up capital requirement to establish national level finance company undertaking leasing activities to Rs. 150

million from Rs. 60 million and for those not undertaking leasing activities to Rs. 50 million from Rs. 20 million. The paid-up capital required for those finance companies opening in the respective Eastern, Central and Western Development regions outside the Kathmandu Valley was Rs. 20 million.

In 2003/04, NRB revised the policy provision for establishing commercial banks according to which commercial banks were allowed to operate nationwide including the Kathmandu Valley after operating outside for three years and increasing paid-up capital to Rs. 1 billion. However, regional commercial banks having Rs. 1 billion paid-up capital and entering into technical agreement with foreign bank for at least for three years were allowed to open office in the Kathmandu Valley even before three years of operation.

After bringing the Bank and Financial Institutions Ordinance, 2004 (first time in February 2004), NRB issued on 13 July 2006 the consolidated new licensing policy with clear process and documentary requirements for opening new BFIs. After the enactment of BAFIA, 2006 on 5 November 2006, the NRB amended the then existing licensing policy for the establishment of BFIs on 26 March 2007, which has still been in operation with some amendments. The existing policy framework called *Policy and Procedural Provisions regarding BFI Establishment and Licensing to Conduct Financial Operations, 2006* (updated until 2011) has introduced some key elements in the changing context. Requirements of tax clearance certificate and verifiable source of income for promoters as well as certain criteria for fit and proper tests were the new requirements added to prevent money laundering in the banking sector. The policy is applicable for all 'A', 'B', 'C' and 'D' class institutions. Some major provisions stipulated in the policy document are summarized below.

- Minimum paid-up capital requirement by category and geographical coverage of the concerned BFIs as shown in Table 8.1

Table 8.1 : Minimum Paid-Up Capital Requirement for BFIs

BFIs	National Level	Regional Level (within development region)	4-10 Districts	1-3 Districts
Commercial Bank	Rs. 8.00 billion			
Development Bank	Rs. 2.5 billion		Rs. 1.2 billion	0.50 billion
Finance Company	Rs. 800 million		Rs. 800 million	Rs.400 million
Micro-Finance Institution	Rs. 100 million	Rs. 60 million	Rs. 20 million	Rs. 10 million

- Promoters can own minimum of 51 percent to a maximum of 70 percent of the equity capital and the remaining 30 percent to be allocated to the general public
- A foreign BFI can own in the range of 20 to 85 percent of the equity capital in case of joint venture arrangement
- Mandatory requirement for disclosure of source of income as well as tax clearance while not allowing borrowed fund in equity investment for establishing BFIs
- Fit and proper test criteria for promoters as well as directors representing promoters and public
- Grounds for license refusal are stated
- Limitation that a person, firm, company and related group of companies cannot hold more than 10 percent of issued capital in one bank and altogether 15 percent stake in all the NRB licensed BFIs
- Specific requirements for academic qualification, managerial skill and competence and moral qualities for Chief Executive Officer (CEO) of proposed BFI
- Limit on preliminary/incorporation expenses for each category of institutions is placed, viz., 0.5 percent of paid up capital for 'A' class, 1.0 percent of paid up capital for 'B' class, 1.5 percent of paid up capital for 'C' class and 2.0 percent of paid up capital for 'D' class.

Moratorium on Licensing

Despite having clear procedure for licensing, NRB has put moratorium on licensing of new 'A', 'B' and 'C' Class BFIs since 2009. Likewise, NRB recently put partial moratorium on licensing of 'D' Class institutions through its Monetary Policy for 2016/17. Accordingly, 10 districts categorized as those having minimal access to finance are open for 'D' class institutions while their licensing to conduct business on other districts is put on hold.

8.2.2 Licensing Policy for Foreign Banks or Financial Institutions

Nepalese domestic financial sector has been open to all members of the WTO since 2010. In a move to open up domestic market for foreign BFIs, NRB issued a policy document with regard to setting up branch offices of foreign BFIs in Nepal. The policy called *Policy Provision for Opening Branch Office by Foreign Banks or Financial Institutions in Nepal, 2010*, states that foreign BFIs can operate in Nepal through opening their branch offices. However, they are not allowed to incorporate fully owned subsidiary. Furthermore, the branch office of foreign BFIs will have to be limited to conduct wholesale banking operations only.

The foreign bank willing to open branch office in Nepal must produce no objection letter and a letter indicating of conducting regulation and supervision in an integrated manner from the central bank or licensing authority of its home country. Moreover, the bank or financial institution must produce a letter indicating that its company has been rated at least BBB or Baa or equivalent by the international rating agencies for three consecutive years.

A foreign bank or financial institution desiring to open its office in Nepal must submit an application to NRB with the specified registration fee. NRB after reviewing documents may issue letter of intent to respective foreign BFI to open a branch office in Nepal subject to specific terms and conditions. After obtaining the letter of intent, the BFI must submit an application to the NRB along with required documents within six months for approval of commencement of banking operations.

The assigned capital must be equivalent to minimum capital for 'A' Class banks in US Dollar term in minimum to operate branch office in Nepal by the foreign bank. Moreover, the capital of the foreign branch shall also be increased in a similar proportion while increasing the capital level of the existing domestic banks. If the bank intends to extend the number of its branch office, then the bank must increase its assigned capital accordingly for each such branch.

As mentioned before, the foreign bank or financial institution may only carry out wholesale banking transactions relating to deposit, loan, credit, other service and facilities through the branch office in Nepal. The policy has clearly defined transactions that come under wholesale category, namely, fixed deposit amounting to a minimum of Rs.100 million from corporate body/association registered in Nepal, issuance of Certificate of Deposits worth Rs.100 million or more for more than one year, and loans more than Rs. 200 million for more than one year.

8.2.3 Licensing Policy for Others

In 1993/94, with a view to increasing financial access, NRB started giving license to cooperatives for undertaking limited banking activities. The first such cooperative was Nawajiwan Cooperative, Dhangadhi, which began operation on 15 November 1993. By the end 2000/01, the number of cooperatives obtaining license for limited banking activities reached 34. After the first amendment of Cooperative Act, 1992 in 2000/01, cooperatives which obtained license for financial transactions from NRB had to return the deposits collected from non-members within a year from 6 November 2000. After April 2000, NRB has not granted license to cooperatives.

In 2002/03, NRB adopted the policy of not granting license to cooperatives and introduced regulatory provisions for existing cooperatives which included the paid-up capital requirement, minimum capital adequacy ratio, limit on mobilization of financial resources, cash reserve ratio and liquid asset provision, single obligor limit, loan classification and loan loss provisioning, and provision on investment, corporate governance and interest rate determination. NRB also adopted the policy of handing over the cooperatives, which were operating by obtaining license from the Bank to Small Farmers Development Bank (SFDB) and National Cooperative Development Bank for their effective supervision. Hence, the number of cooperatives operating under NRB fell to 20 in 2004/05, and further to 19 in 2005/06, 17 in 2006/07, 16 in 2007/08, and 15 in 2009/10. However, with the incorporation of National Cooperative Development Bank in 2010/11, such a number again increased to 16.

Table 8.2 : Number of Cooperatives and NGOs Performing Limited Banking Operations

Fiscal Years	Cooperatives	NGOs
1993/94	1	
1994/95	6	
1995/96	11	18
1996/97	17	24
1997/98	25	30
1999/2000	25	7
2000/01	34	15
2001/02	34	25
2002/03	23	40
2003/04	23	44
2004/05	20	47
2005/06	19	47
2006/07	17	47
2007/08	16	46
2008/09	16	45
2009/10	15	45
2010/11	16	38
2011/12	16	35
2012/13	16	31
2013/14	16	29
2014/15	16	27
2014/16	16	25

Since 1994/95, NRB started providing temporary license to conduct limited banking activities to NGOs. The number of NGOs obtaining license for limited banking activities increased to 18 in 1995/96, 24 in 1996/97, and 30 in 1997/98. However, effective 23 April 1998, NRB cancelled the license of five NGOs because of violating the directives given by NRB. With the enactment of Financial Intermediaries Institutions Act, 1999 and Financial Intermediaries

Institutions Rules, 2000, existing NGOs conducting limited banking transactions as well as new NGOs interested in doing such transactions needed to apply with necessary documents for carrying out micro-credit activities. Accordingly, 7 NGOs in 1999/2000 and 8 NGOs in 2000/01 obtained license for carrying out micro-credit transactions. The number of NGOs performing limited banking activities increased since then. However, since 2007/08, their numbers started declining, with 25 NGOs as in mid-July 2016 (Table 8.2). In 2013/14, NRB introduced the policy of upgrading these NGOs performing limited banking activities to "D" Class micro-finance financial institutions.

A policy regarding licensing for hire purchase loan companies was formulated in 2014. The policy document called *Procedural Provisions Regarding Establishment of Hire Purchase Loan Companies, 2014* specified procedures as well as functions of such companies. To establish hire purchase loan company, it was required to have the minimum capital of Rs.10 million. Furthermore, the company was required for maintaining net worth of Rs.10 million while conducting the business. The policy barred such companies from accepting deposits besides not allowing them to borrow more than 10 times of their net worth. Furthermore, the spread rate between interest on borrowed fund and hire purchase loan has been capped at 3.5 percentage points. These companies are not allowed to extend other types of credit except the hire purchase loan.

Appendix 8.1: Major Features of the Amended NRB Act

- Preamble has been rearranged with an emphasis on maintaining price and balance of payments stability, and overall financial sector stability supporting sustainable development.
- Audit Committee will be established comprising one Board member nominated by the Board as the Coordinator, one expert of this discipline nominated by the Board as a Member and Chief of the Internal Audit Department of NRB as Member Secretary.
- The NRB paid-up capital has been increased to five billion rupees from one billion rupees.

- Profit and loss statement shall be prepared by using Nepal Accounting Standards. Anything not expressly addressed by Nepal Accounting Standards shall be covered in accordance with the International Accounting Standards.
- Provision for fund management has been included which requires allocation of amounts to different funds.
- The provision of open market operation for maintaining liquidity has been reformulated in the Act. Besides repo and reverse repo, NRB could use other appropriate instruments and other measures for the purpose of OMO.
- Under section 79, NRB can issue to BFIs directives on Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) covering areas like identification of clients as well as the classification of client risks and their management, fund transfer, furnishing of details on border or suspicious transactions including deposits to the FIU.
- The amendment has increased the power of NRB for remedial action in the resolution process of problem bank and financial institutions.
- A separate Chapter has been provided for the resolution process. Under this provision, Special Administration Group shall be formed for the settlement of the problem BFIs. The group shall operate BFI except collecting deposit and providing loan. There is also the provision of Bridge Institution or Unit for the operationalization of resolution of BFI. During the resolution process, the rights of all the staff shall be suspended. Special Administration Group shall prepare new balance sheet and shall recommend for the improvement of financial status of BFIs. All the actions and activities commenced prior to the resolution shall be suspended. Special Administration Group could also request for, and obtain, mutual assistance from concerned institutions in foreign countries, if so required, to support resolution process, with the prior approval of the NRB.
- NRB may inspect and supervise payment service provider and payment system operator licensed by it.

- Governor of NRB cannot be appointed in any designation of the BFIs after retirement. Deputy Governor and Executive Director cannot be appointed in any designation of BFIs for three years and other officers for two years after retirement. Even after this period, they should obtain prior approval from NRB for engaging in any such designation.

Appendix 8.2 : Major Provisions of BAFIA 2017:

- The provision for foreign bank branch has been incorporated in law. Previously, NRB directive had governed the issue.
- The provision for the restriction on the sale of promoters share and pledge of such share has been slightly liberalized.
- The maximum number of members of the BOD of BFI has been reduced from nine to seven. The qualification and experience for the independent Director shall be as specified by the NRB in place of the previous practice of appointing the independent director out of the list maintained by the NRB. More than one member in BOD cannot come from the same family.
- The responsibility of risk management has been vested in the BOD of BFIs.
- CEO of BFI cannot remain in office for more than two consecutive terms.
- The provision for Infrastructure Development Bank has been made.
- Provision for voluntary and involuntary dissolution/liquidation has been made.
- The issues of the customer rights and discloser of information have been expressly made.
- The subject of merger and acquisition has been incorporated in law.
- Besides issuing directives, NRB can impose fine.
- Staff of banking institution can buy 0.5 percent share of Initial Public Offering (IPO) other than the 30 percent share issued to the public.
- The promoters' share can be converted into general share after 10 years with the consent of NRB based on the effect on overall economic scenario.

Appendix 8.3: Salient Features of Banking Offence and Punishment Act, 2008 (First amendment in 2016)

- Special Investigation Team can be constituted for the investigation of banking offence.
- Investigation agency may request for any relevant information to any agency or person possessing such information and documents.
- The offence can be investigated by taking the suspect into custody. The suspect can be remanded for custody for 60 days at maximum, but for seven days at a time.
- The offence now carries up to 12 years of imprisonment depending on the gravity of the offence.
- *Dhukuti* transaction has been declared unlawful.
- Banking transaction cannot be done without approval of NRB.
- Improper valuation of property and preparation of financial statements have been criminalized.
- A person blacklisted for loan default is barred from opening or continuing the bank account. However, bank account can be used for the purpose of paying loan, with limited amount allowed to be withdrawn to meet the cost of living.
- The specified person having financial interest can misuse the resource and instrument of BFIs by borrowing or any other means, according to Section 9 of the Act.
- The same collateral cannot be used for more than one loan. If there is the issue of *pari-passu*, it can be accepted.
- Promoter and director of bank or financial institution or any other person deemed to have financial interest or their family members are barred from obtaining loan from concerned institution provided that this provision shall not bar them to obtain loan by pledging certificate of fixed deposit, gold and public debt, etc.

Appendix 8.4: Licensing Procedure

According to the existing policy, NRB provides Letter of Intent (LOI) to the applicants within four months of the receipt of application if it is satisfied with the proposal after studying, verifying and reviewing all the necessary documents. If the NRB finds that the proposed bank does not seem justifiable for the establishment, the applicant is notified accordingly. To obtain a LOI, the proposed BFI must deposit specified portion of the paid-up capital in an account maintained in NRB. The LOI specifies the time period within which the business is to commence. However, if the BFI is not able to commence its business within the given time period, NRB could revoke the LOI. Thus, LOI shall not be regarded as the final approval to conduct banking business. Proposed BFI will be required to submit the following additional documents to NRB for obtaining final approval or operating license as per the existing Licensing Policy.

- Formal Application in prescribed format for the operating license
- Technical service agreement in case of foreign joint venture
- Evidence of money deposited by promoters in NRB account
- Office layout plan, rental agreement for office building
- Staff recruitment
- Core banking system
- Credit Policy
- Employee Bylaw
- Financial Administration Bylaw
- Loan Write-off Bylaw
- Organizational structure and infrastructure required to operate the proposed BFI

Once the NRB is satisfied with all the documents submitted, a study on physical infrastructure of the proposed BFI is carried out by a team deputed by NRB. On the recommendation of the team, operating license is issued to the proposed BFI.

9 Regulatory Framework

The first directive issued by NRB as part of regulation was in 1961 when it fixed interest rate on deposit and credit. Moving further from interest rate fixation, NRB introduced different monetary instruments and guidelines related to credit control, namely, margin rate, refinance rate, cash reserve requirement, liquidity requirement and credit limit during the 1960s. It also introduced some directed lending programmes in this decade. In a bid to introduce the liberalization process 28 years after the establishment of NRB, the GON and NRB introduced private sector participation in banking in the mid-1980s. Since then, NRB not only liberalized its licensing policies for deposit taking financial institutions but also introduced the new regulatory provisions. New banks and financial institutions came into operation as there were fewer barriers to entry including the institutional autonomy that was provided for determination of interest rates.

In 2004, the Government repealed all laws related to BFIs and enacted an umbrella banking law known as Bank and Financial Institution Ordinance, 2004, which became an Act in 2006. This Act has been the major banking law governing all BFIs in the country. The NRB Act and the BAFIA established NRB as sole regulator of deposit-taking BFIs. Until then, NRB used to issue separate regulatory directives for commercial banks, development banks and finance companies. As mentioned in Chapter 8, the present regulatory framework adopted by the NRB is essentially based on and guided by this legal framework.

9.1 Micro-Prudential Regulations

Even though NRB used prudential regulatory measures since the mid-1960s, the formal practice of prudential regulations started since 2001 when it issued regulations in the form of directives. These regulations were based on the Basel Accord of 1988 (Basel I), which were drafted and issued with consultative assistance of the World Bank in line with the Core Principles of

Bank Supervision prescribed by Bank for International Settlements (BIS). NRB, at the first instance, issued directives under seven headings that were extended to 16 by 2006. Later, directives on Know Your Customer (KYC) and Credit Policy were added in 2007. With certain amendments and updates consistent with the changing context, these directives have been continued by NRB till date. The Unified Directives currently consist of 23 different headings; these are placed on the NRB webpage at www.nrb.org.np. Furthermore, it started publishing separate directives for 'D' class institutions since 2013. Prior to that, single unified directives had been serving as banking rulebook for all BFIs.

Some of the regulatory provisions that could be grouped under micro-prudential regulations are discussed below.

Capital Adequacy Framework

First time in 1974/75, NRB directed NBL and RBB to increase their capital base by Rs. 40 million and Rs. 20 million respectively. Later, a separate section on the capital fund ratio was enacted in the then Commercial Bank Act, 1974, but the NRB needed to specify it. Considering growing risks with expansion of commercial banks, NRB directed them in 1988/89 to maintain the capital fund ratio at 2.5 percent of their total deposits by mid-July 1989, 3.5 percent by mid-July 1990 and 5.5 percent by mid-July 1991. Commercial banks were directed to meet any shortfall in capital adequacy ratio (CAR) by transferring from profit or by increasing the paid-up capital. On 22 March 1991, NRB imposed the new CAR compatible with international standard. Accordingly, commercial banks were required to maintain capital fund on the basis of risk-adjusted assets and off-balance sheet transactions at a minimum of 8 percent including 4 percent core capital by mid-July 1992.

In 1998/99, NRB revised the CAR for finance companies upwards to 10 percent of total risk weighted assets, including core capital at 5 percent. Effective 16 July 2001, NRB increased the required minimum capital fund for commercial banks to 9 percent (core capital at 4.5 percent) for 2001/02, 10 percent (core capital at 5.0 percent) for 2002/03 and 12 percent (core capital at 6 percent) for 2003/04 onwards. In 2002/03, NRB introduced minimum capital fund requirement for development banks at 10 percent (core capital at 5 percent) of risk weighted assets for 2002/03 and at minimum 12 percent (core capital at 6 percent) from 2004/05 onwards.

In 2003/04, NRB amended the CAR for commercial banks so that 11 percent ratio was set for 2003/04 and 12 percent (core capital at 6 percent) for 2004/05 onwards. Similar CAR was also set for development banks. However, in 2004/05, NRB directed BFIs just to maintain 11 percent CAR rather than 12 percent considering the adverse situation prevailing at that time. Beginning from 2005/06, unified directives were issued for BFIs in line with BAFIA, which specified the risk weighted CAR at 12 percent (core capital at 6 percent) for BFIs (except micro-finance institutions). At the same time, CAR to be maintained by micro-finance institutions was lowered to 8 percent (core capital at 4 percent).

NRB issued New Capital Adequacy Framework in 2007 for class 'A' banks (commercial bank) in line with Basel II implemented since 2007/08. Under the new provision, minimum CAR was 10 percent, out of which at least 6 percent comprised the core capital, consisting of paid-up capital, statutory reserves and accumulated profits or losses. Core capital is also known as Tier-I capital. Similarly, Tier-II (supplementary) capital consists of general loan loss provision, revaluation reserve, exchange equalization reserve, investments adjustment reserve, other reserves, redeemable preference share and subordinated term debt. The new provision stated that Tier-II capital would not exceed the total Tier-I capital, with the sum of Tier-I and Tier-II capital constituting the total capital fund.

Under the new capital accord (Basel II), NRB adopted the Simplified Standardized Approach (SSA) for Credit Risk, Basic Indicator Approach for Operational Risk and Net Open Exchange Model for Market Risk to compute the risk weighted CAR. The framework was built around three mutually reinforcing pillars, viz., minimum capital requirements, supervisory review process and disclosure requirements. This framework became applicable to 'B' class BFIs since 2016. 'C' class BFIs have maintained capital and other disclosure related provisions parallel to existing provisions with effect from

2016. However, this framework would not be applicable for 'A' class BFIs from 2016; instead, a new capital adequacy framework based on Basel–III has been applied 2017 onwards. The new framework, called Capital Adequacy Framework 2015 which is based on reforms prescribed by Basel Committee on Banking Supervision (BCBS), has more provisions that strengthen the micro prudential regulation along with macro prudential focus. So, these reforms are aimed at addressing institution wide as well as system wide risks that could build up across the banking sector.

The new framework has given more emphasis on improving the quality of capital in banks. Macro prudential aspects of Basel III are reflected through capital buffers. The framework has introduced provision of buffer capital for the first time as capital conservation buffer and the counter-cyclical buffer. These buffers are intended to protect the banking sector from periods of excess credit growth. Just like the previous framework, the new framework has adopted SSA to measure Credit Risk, Basic Indicator Approach for measurement of Operational Risk and indigenous Net Open Position Approach for Market Risk. NRB has introduced the provision of leverage ratio through this framework in the Nepalese banking sector. As the new framework consists of some paradigm shifting elements, NRB has planned phase wise implementation of the framework. The module for implementing the framework is depicted in Table 9.1.

A guideline on Internal Capital Adequacy Assessment Process (ICAAP) for commercial banks under the Basel II framework was issued to commercial banks in 2012. The second pillar (Supervisory Review) of Basel II framework is comprised of Internal Capital Adequacy Assessment Process (ICAAP) followed by its Supervisory Review and Evaluation Process (SREP) of the same. The guideline has been assisting commercial banks to determine their capital adequacy in relation to all material and inherent business risks and other risks related to external economic environment. As per the guideline, commercial banks are required to set policies, methodologies and procedures for assessing the capital adequacy relative to their risk profile.

Table 9.1 : Basel-III Implementation Timeline in Nepal

	Mid July 2015	**Mid July** 2016	**Mid July** 2017	**Mid July**2018	**Mid July** 2019
Minimum Common Equity Capital Ratio	4.00%	4.50%	4.50%	4.50%	4.50%
Capital Conservation Buffer	1.00%	1.25%	1.50%	2.00%	2.50%
Minimum Common Equity plus Capital Conservation Buffer	5.00%	5.75%	6.00%	6.50%	7.00%
Minimum Tier 1 Capital (excluding conservation buffer)	6.00%	6.00%	6.00%	6.00%	6.00%
Minimum Total Capital (excluding conservation buffer)	10.00%	9.75%	9.50%	9.00%	8.50%
Minimum Total Capital (including conservation buffer)	11.00%	11.00%	11.00%	11.00%	11.00%
Counter Cyclical Buffers	Introduce minimum standard	0-2.5%	0-2.5%	0-2.5%	0-2.5%
Leverage Ratio	Introduce minimum standard	Offsite Monitoring 4.00%			Migration to Pillar 1
Liquidity Coverage Ratio	Review Existing Framework		LCR 100%	LCR 100%	LCR 100%
Net Stable Funding Ratio	Observation and Parallel Run		Introduce minimum standard	Implemented	
Systematically Important Financial Institution (SIFI) Measures	Yet to issue the regulatory directives in this regard.				

New Minimum Paid-up Capital Framework

NRB raised the level of minimum paid up capital for licensed A, B and C class financial institutions through its Monetary Policy for 2015/16. According to the new provision, BFIs are required to increase their minimum paid up capital by at least four-folds from the existing level within the two-year period ending in mid-July 2017. The new capital requirement aims at strengthening the financial soundness of BFIs by establishing highly capitalized BFIs with wider capital base so as to reduce vulnerabilities and absorb financial shocks. Similarly, the move contributes to avail adequate financial resources for mega projects to support economic growth. The current and new minimum paid-up capital framework for different BFIs is given in Table 8.1

Loan Loss Provision and Classification: NRB for the first time introduced the loan classification and loan loss provision in 1988/89. At that time, over-due loans and advances were to be classified into four categories based on the period: good (over-due up to six months), sub-standard (over-due between six months to one year), doubtful (one year to five years) and bad (already over-due, having negligible value of collateral, disappearance of borrowers, pending for decision in Court). In 1990/91, by replacing the prevailing provision, NRB directed the BFIs to classify loans and advances into six categories as good, acceptable, indication of sub-standard, sub-standard, doubtful, and bad, based on period of over-due, financial situation and management capacity of borrower, conditions of industry, and quality of collateral. Accordingly, commercial banks were directed to maintain loan loss provisioning of 1 percent for the first two categories, 5 percent for the third, 25 percent for the fourth, 50 percent for the fifth and 100 percent for the last one.

In 1991/92, small revision was made in loan loss provision for loans extended against the collateral of fixed deposit and government bonds to be classified as 'good' for which only 1 percent provisioning was required. Moreover, only 5 percent provisioning for loans against gold and silver and 25 percent provisioning for priority sector lending were required. In 1993/94, NRB directed ADB/N to classify loans into five categories, namely, good (overdue until 6 months), indication of sub-standard (overdue between 6 months and 1 year), sub-standard (1 to 2 years overdue), doubtful 2 to 5 years (overdue) and bad (more than 5 years overdue). The respective ratios of loan loss provisions were 0 percent, 5 percent, 25 percent, 50 percent and 100 percent. In 1995/96, ADB/N was directed to classify loans into six categories similar to commercial banks.

In 2000/01, four categories of loan classification were introduced, namely, good loans, overdue up to one year, overdue more than one year up to 3 years, and overdue more than 3 years, with required loan loss provisioning at 1 percent, 25 percent, 50 percent and 100 percent respectively. Further, in 2002/03, loan classification and loan loss provisioning was introduced for development banks in the same format. In 2011/12, some relaxation was given for loans flowing to hydropower, cable cars and other infrastructure related investment. With the introduction of the watch list provision on 13 March 2015, as in mid-July 2016, there have been five broad categories of loan classification, viz., pass, watch-list, sub-standard, doubtful, and bad debt with assigned loan loss provisioning ratios at 1, 5, 25, 50 and 100 percent respectively.

Liquidity-related Regulations: NRB has issued regulations regarding the minimum liquidity to be maintained by BFIs. Under the existing provision, BFIs must maintain liquidity ratio at 20 percent of their total deposits. In addition, provisions for CRR and SLR need to be complied with. The detailed evolution of CRR and SLR is presented in Chapter 4.

Investments of BFIs: NRB issued separate directive to regulate investments of commercial banks in 2001/02. The directive specified areas for equity investments by commercial banks in shares of those registered companies, or in the position of being registered within a year, in the Nepal Stock Exchange. However, the directive did not allow commercial banks to invest in shares, securities as well as hybrid capital instruments of BFIs licensed by NRB. The directive also specified the limit on investment according to which a commercial bank could make investment up to 10 percent of paid-up capital of the registered company and up to 20 percent of all companies in which the commercial bank has financial interest. However, aggregate investment should not exceed 30 percent of its own paid-up capital. With the introduction of Unified Directives starting from 2005/06, these directives on investment became applicable for all A, B, and C class BFIs. The directives also mandated all BFIs to formulate Investment Policy with approval from the Board and implement the same. In 2012/13, a provision was made that BFIs could invest 20 percent of their core capital in companies where they have financial interest.

Financial Resource Mobilization: There is no restriction applicable for 'A' class institution for resource mobilization. However, 'B', and 'C' class institutions are restricted to mobilize deposits in relation to core capital of individual BFI. For the first time, in 1998/99, ceiling on resource mobilization by finance company was fixed 10 times of its core capital. In the same way, in 2000/01, cap of 15 times the core capital was introduced on resource mobilization by development banks. Such a cap was revised upwards in

2005/06 to 20 times for development banks and 15 times for finance companies. In the same year, cap of 20 times its core capital was introduced for D-class financial institutions. Borrowing has been limited to 25 percent of total deposits for all BFIs. The prevailing regulation bars 'D' class institutions from taking deposits from non-member individuals. However, these institutions can collect deposits from non-members with prior approval of NRB.

Productive Sector Lending: In 1988/89, the floor for lending by commercial banks to the productive sector was fixed at 25 percent of outstanding credit, including priority sector lending at 8 percent. The mandatory ratio for productive sector lending was increased to 40 percent, including the priority sector-lending ratio at 12 percent, in 1990/91. Since then, the main focus was shifted to priority sector lending and, later, to the deprived sector lending. So, the mandated productive sector lending ratio was not given much attention. It was only in 2010/11 that NRB again directed commercial banks to lend at least 20 percent of their total lending to the productive sector identified as agriculture, energy, tourism and cottage and small industries. Further, in 2011/12, commercial banks were directed to lend to agriculture and energy sector minimum 10 percent of their total loans as part of 20 percent productive sector lending. The minimum ratio of lending towards agriculture and energy sector was further raised to 12 percent for commercial banks in 2013/14. In that fiscal year, development banks and finance companies were also directed to develop work plan to flow certain portion of total credit to the productive sector. Accordingly, in 2014/15, development banks and finance companies were directed to flow 15 percent and 12 percent of their loan portfolio to productive sector respectively. In 2016/17, the minimum share of lending to agriculture and energy was further raised to 15 percent of total loans for commercial banks.

Stress Testing: NRB has issued Stress Testing Guidelines in January 2012 for stress testing of licensed BFIs. Stress testing is aimed at testing resilience of individual BFIs through different scenarios. As per current regulations, 'A' class institutions as well as national level 'B' and 'C' class institutions are required to conduct stress testing on quarterly basis and submit the results to NRB for review.

9.2 Macro Prudential Regulations

NRB, just like other regulator and supervisor, adopted micro prudential policies before the global financial crisis of 2007-09. As the global financial crisis exposed cracks in the existing regulatory and supervisory framework, regulators worldwide rushed to adopt new toolkits called as macro-prudential. Following the global trend, the NRB issued several macro prudential measures to make the situation in BFIs more resilient. The major macro prudential policies implemented by NRB relate to strengthening the capital of BFIs, expanding access of general people to financial services, implementing RBS, making necessary arrangement for system audit, enhancing corporate governance in BFIs, and updating the banking rules and regulations in a timely manner.

The main elements of macro prudential regulation of the NRB relate to capital requirements, risk management guidelines for banks, stress testing guidelines, liquidity monitoring, and policies for real estate loan and deposit insurance. Similarly, fixation of credit to core capital and deposit (CCD) ratio, loan to value ratio, limit on loan against shares, single borrower limit and liquidity ratio could be included as macro- prudential policy measures. The regulatory provisions having some features of macro-prudential in nature are briefly discussed below.

Leverage Ratio and SIFI measures: NRB has, for the first time, introduced the concept of leverage ratio in the Nepalese financial sector, with effect from mid-July 2016, according to which commercial banks must maintain a leverage ratio of not less than four percent. The ratio will be reviewed based on the Basel Committee Guidelines beginning from mid-July 2018. Similarly, NRB is in the process of identifying Domestic Systemically Important Financial Institutions (DSIFIs) and formulating additional regulatory measures for those BFIs.

Credit to Core Capital and Deposit (CCD) Ratio: NRB fixed CCD ratio for BFIs at 80 percent in 2009/10. While issuing regulation at that time, NRB directed BFIs with the CCD ratio higher than 80 percent to bring down their limit to 95, 85 and 80 percent by mid-July 2010, mid-July 2011 and mid-January 2012 respectively. In 2016/17, 50 percent of credit flows to the deprived sector and productive sector was allowed to be deducted from total credit until mid-July 2017.

Deposit Guarantee: As a part of financial safety net mechanism, NRB made mandatory provisions for licensed BFIs to guarantee deposits up to Rs. 200,000 in saving and fixed deposit account of natural persons through the Deposit and Credit Guarantee Fund (DCGF) since 2010/11.

Single Obligor Limit: NRB, for the first time, issued provision of Single Obligor Limit (SOL) in 1988/89. Such a limit to single customer, firm, company or inter-connected group was 50 percent of capital funds for fund-based loans and advances and 100 percent of capital funds for non-fund based banking services such as letter of credit, guarantee, acceptance and commitment. At the same time, commercial banks were directed to lower the SOL gradually to 25 percent of capital fund for fund-based lending and 50 percent for non-fund based transactions by mid-July 1992. In 1992/93, accommodating the higher credit demand from the private sector following the adoption of economic liberalization policy, NRB increased the SOL on fund-based lending to 35 percent. Likewise, in 1995/96, NRB revised the method for calculation of SOL as the percentage of total capital fund instead of the core capital. SOL of 25 percent of core capital for fund-based lending and 50 percent of core capital for non-fund based was introduced for finance companies in 1998/99 and for development banks in 2000/01. With the beginning of 2001/02, commercial banks were also directed to maintain the same ratios of SOL.

Effective 15 January 2011, SOL for both fund-based and non-fund based lending has been set at 25 percent of core capital. However, such a provision for productive industries may be extended up to 30 percent of core capital. This ratio could go up to 50 percent of core capital for the construction projects relating to hydropower, electricity transmission lines and cable car.

Sectoral Credit Limit: In 1998/99, NRB introduced the provision of limiting the credit flow in a particular sector at 60 percent of total credit. The limit was revised in 2000/01 with reduction from 60 percent to 50 percent. NRB removed sectoral credit limit for 'B' and "C' class institutions in 2005/06. However, in 2010/11, the limit was reduced to 40 percent of total credit, with applicability to all A, B and C class institutions. In 2009/10, NRB introduced credit limit of 25 percent of the total credit for the lending to real estate and 40 percent of the total credit for the lending to real estate plus residential house loans. For BFIs having such loans already exceeding the ceiling, NRB directed to lower credit on real estate to 15 percent of total loans by mid-July 2011 and 10 percent by mid-July 2012. Likewise, NRB directed the BFIs to bring down the total loan for real estate and residential housing loan together to 30 percent and 25 percent by mid-July 2011 and 2012 respectively.

Loan Against Shares: NRB, for the first time, issued the directive to provide loan against (promoter) share in 2005/06. As per the directive, BFIs had to adopt necessary measures to minimize and manage risk while providing loan under the collateral of the promoter share. Such loans could be up to 50 percent of the market value of the shares. However, additional security was required to be arranged in case of the decline in market price of share. Such shares should not be counted as non-banking assets and the date of repayment should be specified, with such period not exceeding one year. This type of loans could not be restructured or rescheduled. In case of overdue of payment, 100 percent loan loss provisioning was required. In case of failure to repay the loan within the stipulated date, promoter/director shall be recommended for black listing within 21 days.

In 2006/07, a provision was made to bar BFIs from lending for share purchase during the first seven days of IPO. However, if the total issued shares are not subscribed within first seven working days of the issuance, BFIs could lend for share purchase after fulfilling prescribed criteria, namely, keeping at least 50 percent cash margin of total loan amount for investing in IPO for the period fixed for the allotment of share and making 100 percent provisioning in case of no repayment in time.

In 2007/08, NRB issued to BFIs the directive related to loans against the security of shares of the listed companies in the Nepal Stock Exchange Limited. As per the provisions in the directive, the amount of loans to be provided on the security of shares must be within the limit of 50 percent of the average price of closing share prices of last 180 working days or 50 percent of the current market price, whichever is lower. The amount of margin lending once accepted for the borrower could not be further increased through revaluation of the shares under security. If the amount of the loans accepted in the past exceeded the stipulated limit of 50 percent, the lending should have been brought to the limit of 50 percent by mid-July 2008 or the maturity period, whichever earlier. The maturity period of the margin lending should not exceed one year and such lending is not allowed for renewal, rescheduling and restructuring. The concerned BFIs needed to maintain 100 percent loan loss provision for such lending, except that the lending was in a status of good loan. The loans provided before the issuance of this directive must have been rescheduled as per the above provisions by mid-July 2008 along with complying with the limit fixed by the directive. Such loans could be provided to the limit of the core capital of BFIs. However, those BFIs already having such loans up to that limit are not allowed to issue this type of loans. Loans against share could not be made against the shares of those BFIs which have a capital fund below that fixed by the NRB, have negative net worth, are delisted by Nepal Stock Exchange Ltd, and are unable to complete final audit even after one year from the end of the fiscal year. However, lending against the security of listed shares of a single institution shall not exceed the limit of 25 percent of the core capital.

In 2009/10, revision was made to the directive on loans against shares whereby 75 percent of margin type lending could be renewed if 25 percent of principal and accrued interest due was paid on time. Further, shares held under collateral could not be purchased by BFIs to recover such lending; if it was done earlier, BFIs were required to sell the shares compulsorily. In 2011/12, provision on loan against share was further revised to allow BFIs to determine themselves the appropriate credit level based on average share price of last 180 days or the current market price of share, whichever is lower, considering the risk level of lending. However, additional lending could not be provided by re-evaluating the shares that remained as collateral. Effective August 2016, NRB again introduced the margin ratio of 50 percent as before while lending against collateral of share.

Loan-to-Value (LTV) Ratio: LTV ratio was fixed for the first time on lending against the collateral of land and housing as well as real estate in 2009/10. According to the directive related to housing and real estate lending, credit disbursement shall not exceed 60 percent of the fair market value of the housing and real estate asset. With the aim of not discouraging housing construction works and ensuring their access to finances, residential home loan up to Rs 6 million was removed from the list of real estate loans in 2010/11 and, at the same time, a provision was made so that loans equivalent to two-thirds of the fair market value of the collateral could be disbursed in the case of loans for residential real estate. In 2011/12, residential home loan up to Rs. 10 million was removed from classifying as a real estate loan. LTV ratio for real estate loans was revised to 50 percent, and residential real estate loans to 60 percent in 2015/16.

Limit on Deposit Concentration: This was introduced in 2009/10 with the provision that the deposits from single firm, company or organized entities must not exceed 20 percent of total deposits of concerned BFI. New provision for deposit concentration was put forth in 2013/14, limiting institutional deposits to 60 percent of total deposits. Deposits from government entities, government owned institutions and fund operated by such institutions and public limited companies are counted as institutional deposits. The limit imposed on institutional deposits was reduced to 50 percent in 2015/16, with the deposits from saving and credit cooperatives and funds operated under such cooperatives categorized as institutional deposits.

9.3 Other Prudential Regulations and Guidelines

NRB has issued several prudential regulatory measures to make financial sector more secure, stable and sound. To implement prudential measures, NRB issues circulars on a regular basis which are accumulated in Unified Directives at the end of each fiscal year. Other key prudential regulations contained in the Unified Directives, 2016 are discussed in Appendix 9.1.

In addition to directives, NRB has issued several guidelines to guide the operations of the BFIs. NRB issued Guidelines on Management Expenses and Salary of Executive Chief, Allowance and Other Financial Facilities in Licensed Banks/Financial Institutions in 2010/11. Furthermore, it issued Guideline on Bank/Financial Institutions' Services and Service Charges and Guidelines on Risk Management for BFIs in 2010. The guideline has laid out procedures for managing credit, market, liquidity and operational risks in class

'A' banks. The guideline served as a focal point of reference for all requirements of NRB for overall policy formulation and management regarding risks. The guideline provided minimum standard for the risk management practice to be exercised in BFIs.

Similarly, NRB issued Information Technology Guidelines in 2012 for class 'A' banks. IT Guidelines, 2012 aimed at promoting sound and robust technology-based risk management in the banks. Furthermore, it aimed to strengthen system security, reliability and business continuity in commercial banks of Nepal. The guideline necessitated all banks to have their own IT policy commensurate with their size and scale of business.

In the wake of global financial crisis of 2007-09, NRB, in order to test the strength of the major banks in the eventuality of financial distress, issued Guidelines for Stress Testing in 2012, as mentioned earlier. This guideline prescribes the analytical methods to assess and evaluate the financial position under different scenarios for testing credit, market and liquidity risks faced by concerned banks.

9.4 Mergers and Acquisitions in Nepal

Mergers and acquisitions (M&A) among BFIs have been in the limelight in recent years. NRB has been facilitating the process through policy provisions and concessions for M&A. Because of the deliberate effort made by NRB for the past six years (2010/11-2015/16), Nepalese financial sector saw the number of BFIs reduced by 91 with significant decrease in the number of 'C' class financial institutions by 46, followed by 'B' class institutions by 37 and 'A' class institutions by four (Table 9.2).

Table 9.2 : Mergers and Acquisitions among BFIs (as of mid-January 2017)

Merger-Acquisition (Final Approval Granted)	A	B	C	D	Total
Licensed Institutions Involved	19	58	52	5	134
Licensed Institutions Reduced	4	37	46	4	91
Licensed Institutions Remained	15	21	6	1	43

History of merger in Nepal dates back to 2004 with first merger between a commercial bank (Laxmi Bank Limited) and finance company (HISEF Finance Company Limited). However, after the first merger, very few mergers happened until 2011/12. Indeed, there was the favourable outcome of the newly issued Merger Bylaw in 2011, the process of mergers of ‘A’, ‘B’ and ‘C’ class institutions was adopted to consolidate the banking sector and enhance its trustworthiness among the general public. The Bylaw also opened frontier for mergers between ‘D’ and ‘D’ class institutions, too. The Bylaw stipulated process for registering the application for mergers, due diligence audit for swap determination and other related aspects of mergers. Similarly, NRB provided some concessions relating to adjustment of capital structure, branch expansion and other compliance related issues through the Bylaw. Furthermore, a separate desk has been established in BFIRD to facilitate the merger and acquisition process. After the enactment of the Bylaw, NRB took initiatives for motivating BFIs with common promoters to undergo merger.

In the beginning, the Merger Bylaw did not create immediate impact among BFIs. However, the process soon started gaining acceleration, starting with the merger between Himchuli Finance Limited and Birgunj Finance Limited to become H & B development bank in 2013. In the same year, a new milestone was achieved when two commercial banks, a well established Nepal Industrial and Commercial Bank and relatively new Bank of Asia Limited, were merged to create new commercial bank named NIC Asia Bank Limited. Fiscal year 2012/13 emerged as a successful year from the point of view of mergers, with 27 BFIs opting for the merger.

NRB introduced Acquisition Bylaw in 2013 in order to attract large BFIs into the consolidation process. Since the Merger Bylaw had envisaged coexistence of all merging entities, the Acquisition Bylaw was put forward with provision of acquiring one institution by the other. The policy framework for merger as well as acquisition was the same except the provision of cash payments to the shareholders of acquired entity. Under the provision made in the Bylaw, for the first time, Citizens' Bank International Limited acquired Nepal Housing and Merchant Finance Limited and People's Finance Limited.

Later, the Acquisition Bylaw was merged with Merger Bylaw in 2016 to consolidate provisions made in both the Bylaws. Since then, Merger and Acquisition Bylaw, 2016 has been in place for regulating mergers and acquisitions of BFIs.

Merger and acquisition activities accelerated in 2015, when NRB, through its annual Monetary Policy for 2015/16, hiked the minimum paid up capital requirements of 'A', 'B', 'C' class BFIs by four times. The major objective underlying the hike was to strengthen the capital base of BFIs to enhance their capacity for financing mega projects as well as further consolidating the banking sector. The year 2015/16 saw mergers between 28 institutions with involvement of eight commercial banks, 13 development banks and seven finance companies. During 2015/16, the merger between two established commercial banks, namely, Bank of Kathmandu Limited and Lumbini Bank Limited, was notable. Thus, merger between the BFIs could be considered as positive achievement of the year. The process has been further magnified in 2016/17 with the number of mergers reaching 33 till mid-January 2017.

9.5 Anti-Money Laundering/Combating the Financing of Terrorism/Know Your Customer (AML/CFT/KYC)

In 2008, Nepal showed its strong commitment towards AML/CFT by enacting Assets (Money) Laundering Prevention Act (ALPA). This is regarded as the milestone for Nepal in the fight against the risk of money laundering and terrorist financing. Foundation of the Act is based on the recommendation of Financial Action Task Force (FATF) and guidance of APG. Nepal's commitment to fight against money laundering and terrorist financing has been further strengthened by Money Laundering Prevention Rule, Freezing, Seizing and Confiscation of Proceeds and Instrumentalities of Criminal Offences Act, Mutual Legal Assistance Act, Extradition Act and Organized Crime Control Act. Along with these Acts, the legal framework has also been supported by the issuance of Unified Directive No. 19 on preventing money laundering and financing of terrorism (ML/FT), Directive by NRB's Foreign Exchange Management Department and Suspected

Transaction Report/Threshold Transaction Report (STR/TTR) Guideline by FIU-Nepal.

As per the methodology developed by FATF in 2013, Nepal's AML/CFT regime will be facing third round of mutual evaluation in 2020. The team of experts from APG assessed Nepal's AML/CFT system in 2005 and 2010. The primary focus of third round of mutual evaluation will be the evaluation of effectiveness of laws, rules and institutions instead of technical evaluation. Nepal has already shown its commitments by enacting many legislations and institutional set ups.

Financial Information Unit

Anti-money laundering and CFT regime has envisaged strong legal base as well as sound functioning organizational framework. The legal framework needs to be dynamic, hence, it has to be amended and improved as the financial and non-financial sector expands and new products emerge into the financial system. The organizational framework needs to be modern and dynamic, with dedicated and competent human resources.

Recommendation No. 29 of the FATF makes the provision for FIU. It is one of the organizational frameworks that need to be established within the AML/CFT regime to govern suspicious activities in the financial system. Recommendation No. 29 under country responsibilities mentions that, "Countries should establish an FIU with responsibility for acting as a national centre for receipt and analysis of suspicious transaction reports and other information relevant to money laundering, associated predicate offences and terrorist financing; and for the dissemination of the results of that analysis."

FIU-Nepal serves as a central national agency responsible for receiving, analyzing and disseminating information concerning suspected proceeds of crime, money laundering and/or terrorism financing and financing of proliferation. In addition, FIU-Nepal performs as the Secretariat of National Coordination Council, an apex body to oversee the national strategy and policy formation with regard to AML/CFT regime. As per the ALPA Act, FIU-Nepal serves as a national focal point of Anti-Money Laundering. Also, it is a focal institution for APG. It obtained the membership of Egmont Group of Financial Intelligence Unit in June 2015. As a member of the Egmont Group, it can receive from, and disseminate financial information to, 152 foreign counterparts around the world using Egmont Secure Web (ESW), a dedicated online information exchange server.

As globally accepted, Nepal's FIU is also concentrated on converting financial information into intelligence by adding value to financial information. Generally, it works like a bridge between Reporting Entities (REs) and Law Enforcement Agencies (LEAs). This includes receiving financial transaction reports from reporting entities, analyzing these reports and disseminating intelligence product to LEAs.

Money launderers use new and advanced technologies to deceive the financial system to legitimatize their illicit earnings. FIU-Nepal also realized the challenges of technological advancement and automation in reporting and analyzing. Accordingly, it has procured the goAML software that was developed by United Nations Office on Drugs and Crime (UNODC). It will help for online receipt of suspicious reports from reporting entities, especially financial institutions, and analysing such reports electronically. As per the experience of goAML users, it will increase the pace of receiving report quickly with increased accuracy. On the other hand, it will enhance the quality and speed of investigation. However, it is the foremost need of FIU-Nepal to develop and acquire skilful human resources compatible with the highly automated system.

Development of AML/CFT Regime : In Nepal, AML/CFT has been sensitized after enactment of ALPA in 2008. After a vigorous effort of all stakeholders, the legal structure governing AML/CFT regime was established. The AML/CFT regime of Nepal includes the AML/CFT National Strategy 2011-2016, a number of statutes and regulatory/supervisory guidelines, and conclusion of the first National Risk Assessment (NRA). First National Strategy and Action Plan for Combating Money Laundering and Financing of Terrorism 2011–2016 has come to the end and it has achieved almost all the targets. National Coordination Council has already instructed relevant agencies to prepare second National Strategy.

Assets Laundering Prevention Act, 2008, ALPA Rules, 2016, and NRB's Unified Directive No. 19 have been aligned with 40 recommendations issued by FATF. The recommendations have elaborately covered the role of reporting entities that are recognized by the Act. As per the Act, the reporting entities are BFIs, insurance companies, stockbrokers, cooperatives, real estate agents, dealers of gold and precious stones, and casinos. The backbone of the sound AML/CFT regime is the properly obtained KYC information and continuous Customer Due Diligence (CDD) by reporting entities. All reporting entities should develop AML/CFT policies and procedures to prevent and control the risk of ML/TF. As per the recommendation of the FATF, the reporting entities should have developed the risk profile of their customers in order to implement Risk Based Approach (RBA). It will enable reporting entities to manage their resources by focusing on high vulnerable areas.

National identification number or digital identification is very critical to prevent and control the risk of ML/TF. That is why, National Risk Assessment, 2016 has recommended relevant government institutions to set up the base to digitalize database of citizens. ALPA Rules, 2009 has made the provision of obtaining IDs other than citizenship card, such as, passport, voter's identification, and driver's license. In the rural areas, certification from local government would be accepted as simplified KYC to open bank account.

The ALPA Act and Unified Directive No. 19, issued by NRB, have given responsibility to reporting entities to prevent and control ML and TF. During the verification of identification documentation and conducting CDD, the BFI should determine the beneficiary or ultimate owner in the case of legal persons. The reporting entities should maintain and continuously monitor customer information, called ongoing CDD. Verification of all related parties' account and obtaining more information of the transactions for higher risk customer and Politically Exposed Person (PEP) is called the enhanced CDD.

Wire transfers and remittances, cross-border or domestic, comprise another sensitive area where ML/TF risks persist. Reporting entities need to have higher standard in monitoring such transactions. So, they need to prepare policies and procedures to monitor and maintain higher level of control mechanism on wire transfers. It is very important to obtain complete information of originator, such as, name, address, bank account number, identification documents and purpose of transaction.

Record keeping is another area that the BFIs need for maintaining complete database. As per the FATF recommendation, BFIs should maintain sufficient record of transactions for five years at least, which can be provided to competent authorities whenever required. The BFIs are obliged to report TTR and STR transactions to the FIU and maintain the records of these transactions. They are also prohibited by law on tipping off the information about the TTR and STR that are sent to FIU. As per the provision of law, the toughest penalties may be imposed to reporting entities on breaching of requirements of the Acts and the directives. Such penalties could be financial as well as range up to de-licensing.

With the technical assistance of IMF, NRB has prepared risk based supervision manual of AML/CFT. NRB had constituted an inter-departmental technical team, comprised of members from BFIRD, FEMD and all the Supervision Departments to prepare off-site manual, on-site risk-based supervision manual and other guidelines. NRB has already implemented 20 off-site and on-site supervisory manuals in compliance of the AML/CFT laws. Supervision departments have set high priority to develop risk profile of all BFIs, which would help further in implementing risk based approach to AML/CFT supervision.

The coordination among the regulators, supervisors and BFIs is essential in order to develop sound and safe financial system by mitigating ML/TF risk. Level of awareness among the stakeholders as well as public should be further raised to develop a sound AML regime. The regulation and supervision functions should be more stringent in order to minimize the risk of ML/TF. Though the FIU has been receiving STR and TTR from BFIs, in case of STR reporting, only the commercial banks have been reporting regularly, while the filing of STR from development banks and finance companies is not encouraging. So, supervision in these institutions should be more focused on implementing AML/CFT policies and procedures in order to mitigate risk of ML/TF.

Appendix 9.1 : Other Key Prudential Regulations in the Unified Directives, 2016

Accounting Policies and Formats of Financial Statements: NRB has defined accounting policies and prescribed formats for financial statements to be prepared and submitted as per the regulatory requirements. It has specified formats for balance sheet, profit and loss account, profit and loss appropriation account, cash flow statement as well as other accompanying schedules as part of the final accounts. Similarly, it has stipulated provision regarding treatment of specific account heads and items.

Statistical Information: NRB has issued directive to BFIs specifying formats and data requirements to be submitted to NRB through internet. This is a mandatory provision and the violation of this provision attracts punishable offence.

Promoter Share: NRB has issued separate directive to BFIs that stipulates provisions regarding sale/transfer of promoter share, conversion of promoter shares to ordinary share and restrictions imposed on promoter shareholders.

Consortium Financing: Unified Directive contains a directive with provision for consortium formation, operation and other matters regarding consortium. This Directive has made a compulsory provision for loan disbursement and payment through the lead bank.

Credit Information and Black-listing: This Directive has a provision regarding submission of credit information for loans in excess of one million rupees. Similarly, BFIs are required to avail credit information for extending loans exceeding one million rupees. This Directive has specified procedures and criteria for black listing as well as the classification of defaulters.

Branch Office: Under current provision, BFIs are required to obtain approval from NRB to open branches in Metropolis, Sub-metropolis and central parts of municipalities. However, they are free to expand branches in villages and other parts of Municipality apart from the centre. BFIs must submit feasibility report for each branch while seeking approval. Regarding transfer of branches, BFIs could transfer branches within same ward of Municipalities, Sub-metropolis, Metropolises, and Village Body whereas they must get approval from NRB for other transfers.

Upgradation and Area Expansion/Contraction: NRB's regulation provides for upgradation for 'B ' and 'C' class BFIs. It has defined certain criteria for BFIs wishing to upgrade into upper class. Similarly, it has also set criteria for working area expansion or contraction. Capital adequacy, profitability, NPA, supervisory action and maintenance of risk coverage fund have been the major determinants underlying these types of decisions.

Subsidiaries: NRB has not allowed BFIs to open subsidiaries haphazardly. BFIs could open subsidiary for micro-financing and merchant banking only, with some restrictions for merchant banking subsidiaries.

E-Banking: NRB has issued separate directive for BFIs in 2011/12 to regulate electronic banking transactions. Under this directive, there are provisions regarding branch-less banking services, mobile banking, internet banking and electronic cards.

Financial Consumer Protection and Financial Literacy: NRB has issued several directives to BFIs to maintain transparency and fair dealing with customers. These directives include provision regarding fees and charges, interest rates, cheque payments, privacy and data protection. Similarly, NRB has made mandatory for BFIs to include activities for financial literacy in annual programmes.

Corporate Governance: For maintaining good corporate governance in BFIs, NRB has made a number of provisions by issuing separate directive incorporating several provisions since 2001/02. The directive on corporate governance has limited the tenure of CEO and Chairperson to two consecutive terms. Furthermore, there exists a policy of discouraging a single person being the Chairman and CEO of BFI. There is a policy for declaring loan obtained by promoter along with family members from BFIs. NRB has barred 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. A regulation to bar an individual holding shares at one percent of the paid-up capital in commercial banks and two percent of the paid-up capital in development banks from assuming any post in that bank has been put in place. Such ceiling for finance companies and microfinance financial institutions is 5 percent of paid up capital. A policy provision to restrict credit facility to promoters, chief executive officers or managerial level officials of licensed institutions excepting education loan, home loan or home appliance loan has been made. To maintain good corporate governance, code of conduct has been specified for board of directors and employees of BFIs.

Implementation of Nepal Financial Reporting Standards (NFRS) : In line with the recommendation of Accounting Standards Board (ASB) and the Institute of Chartered Accountants of Nepal (ICAN), NRB directed commercial banks to implement NFRS on a parallel basis since 2015/16 with the aim of making it compulsory by 2017/18. After full implementation in class 'A' banks, it will be further extended to other BFIs.

Watch List Provision : On 13 March 2015, NRB issued to BFIs a new directive adding a new layer to the existing classification of loans and advances. The new layer, called 'watch-list', would require five percent provisioning for the following loans and advances which would fall under this category:

- The borrower's cash flow cannot support the repayments of the loan.
- Loans acquired by a firm which have working capital, cash flow or net worth negative for two consecutive years even if the firm is making timely principal and interest payments.
- Loans obtained by the same borrower from another financial institution turns into non-performing loans.

- Loans obtained by borrowers missing monthly, quarterly or half-yearly instalment payment deadlines.

Miscellaneous : NRB has also issued regulations on various aspects of banking business like SWIFT transfers, cheque clearing, refinancing from central bank, standing liquidity facility, safe deposit vaults and lockers, ATMs, technical services agreement and mutual fund operation, among others.

10 Supervisory Practices

The main aim of the supervisory function is to ensure the safety and soundness of the financial sector. Regulation and supervision of the financial system is a key tool for attaining the stability of the financial sector as envisaged by the NRB Act, 2002 which together with the BAFIA, 2006 (now 2017) have strengthened the supervisory authority of the NRB. The NRB Act, 2002 has made NRB an autonomous institution empowered to regulate and supervise the Nepalese banking industry. Section 79, subsection (1), of the NRB Act, 2002 states that 'the NRB may has full authority to regulate the activities of commercial banks and financial institutions'. Section 84, subsection (2) of the Act states: ‘the NRB shall have full powers to inspect and supervise any office of the licensed BFI at any time for which the Bank's Board of Directors shall formulate the same, as per subsection (1) of the Act. This Chapter presents the evolution of supervisory functions with focus on recent developments in this area.

10.1 Evolution of Supervision Function

Continuous off-site surveillance of BFIs and periodic on-site examinations are undertaken to ensure BFIs are complying with the regulatory provisions as mandated by related laws as well as NRB directives and running smoothly with properly managing all material risks inherent in their business and creating no vulnerabilities to possible systemic crisis in the near future. For this, NRB has been focusing on its duty of supervision since the pre-liberalization era.

Initially, the inspection and supervision function used to be carried out in such a manner as to cover 20 percent of all the commercial banking branches and 75 percent of their total credit portfolio. Similarly, inspection at the corporate level for all the BFIs was conducted in such a way as to cover all the BFIs once in three to five years.

With the implementation of FSR programme, NRB started to adopt the core principles for effective supervision developed by the Basel Committee on Banking Supervision (BCBS). Accordingly, the NRB focused on the issues of corporate governance, market discipline and management oversight. In this regard, NRB formulated Inspection and Supervision Bylaw in 2003 using the rights provided by Section 110, Subsection (2) of NRB Act, 2002. This Bylaw was later replaced by the Inspection and Supervision Bylaw, 2013. The main objectives of the Bylaw are:

- To conduct planned inspection and supervision functions every year with a fixed action plan,
- To mandate the use of inspection manuals,
- To have a structured process for on-site examination and off-site supervision, viz., team formation, credit file selection, branch inspection, discussion with management, CAMELS rating, off-site financial analysis, and off-site reports, among others,
- To uniformly organize the supervision functions with the structured units in the supervision departments,
- To clearly provide the code of conduct, responsibility, duty and security of inspector and supervisor, and
- To regularize the enforcement functions along with the establishment of Policy Direction Enforcement Committee.

10.2 On-site Examination

On-site examination is the most effective method of spotting the problems in banks though it is a costly and burdensome process. Not all aspects of the bank's functions can be assessed by the examination of bank returns only. Thus, no supervisor can ignore the importance of on-site examinations of BFIs.

10.2.1 Compliance Based Supervision

Before adopting the risk-based supervision (RBS) in 2013, especially for A-class institutions, NRB had been practicing compliance-based supervision. This is still applicable for B-class and C-class financial institutions. As a regulator, NRB issues prudential regulations for

BFIs, and the compliance status of these regulations is ensured by the supervision function.

In March 2002, NRB formalized its supervision manuals with the support of World Bank. The manuals were developed for both on-site and off-site functions and were very much detailed and elaborate documents. Manuals guide bank examiners in on-site inspection procedures on each area of inspection. Along with the development of manuals, a consultant from the World Bank provided training to the supervisors for their capacity development. Those manuals were updated in 2012 and were in practice until the formalization of RBS On-site Manuals in 2013.

For on-site examination, NRB used to assess the CAMELS (Capital adequacy, Asset quality, Management quality, Earnings record, Liquidity position and Sensitivity to market risk exposure). To be able to assess these six aspects, inspectors were required to review the BFI's portfolio's quality and performance, compliance with legal and regulatory requirements, the existence of policies, the practices and internal controls and the degree of managerial control. Each of the component factors was rated on a scale of 1 (best) to 5 (worst). A composite rating was assigned as a weighted average of the component ratings and was taken as the prime indicator of a bank's current financial condition. The composite rating also ranged between 1 (best) and 5 (worst), and also involved a certain amount of subjectivity based on the examiners' overall assessment of the institution in view of the individual component assessments. The inspections were carried out focusing mainly on the appraisal and verification of capital, asset quality, management, earnings and liquidity, sensitivity to risk and compliance with regulatory requirements. The examiners used to focus primarily on the breaches and non-compliances of the regulatory provisions.

10.2.2 Risk Based Supervision

RBS saves supervisory resources and helps to promote a safer and more sound financial system focusing supervisory resources on areas of highest risk and requiring lesser transaction testing. This method lets institutions to manage the root cause of risks as opposed to correcting just the symptoms of problems and focus more on the actions on correcting the root causes of problems.

The BCBS also updated its Core Principles of 2006 in 2012, emphasizing more on risk management and RBS. The number of core principles was increased from 25 to 29. Principle No. 8 clearly states the supervisory approach, which needs to be risk based. Likewise, Principle No. 9 emphasizes the need of risk-based utilization of supervisory resources. On the other hand, Principle Nos. 14, 15, 17, 19, 21, 22, 23 and 24 explicitly talk about the need of proper risk management practices in the BFIs which need to be commensurate with their size and complexity.

Considering the importance of RBS, NRB, while formulating its Strategic Plan for 2006-11, had emphasized the need of proactive stance in adopting international norms while developing supervisory process and mechanism. NRB furthered its activities in its Second Strategic Plan for the period of 2012-16, which also emphasized the need for RBS as one of its guiding principles and targets. For this, NRB formulated its strategic objective to move toward RBS by July 2015. It successfully achieved this objective and started RBS in commercial banks in 2013 and in national level development banks in 2017. To pave the way for RBS, NRB had issued Risk Management Guideline for the banks in 2010 providing a broad idea of what is being expected from the BFIs regarding the development of risk management practices. Besides, NRB is in the process of implementing Supervisory Information System to strengthen the off-site surveillance, which is expected to further increase the effectiveness of RBS.

10.2.3 Targeted and Special Inspection

The other modes of on-site inspection being made by NRB are Targeted and Special Inspection. Some special causes trigger such inspection. The complaints and grievances primarily received from various stakeholders, requests from other State agencies such as Commission for the Investigation of Abuse of Authority (CIAA), off-site surveillance, early warning signals and any other reason perceived by NRB prompt such inspection. These are of short-term nature in comparison to the full-scope on-site inspection and are conducted with very specific objectives.

Additionally, in 2013-15, as a part of the Development Policy Credit (DPC) initiated by the GON, NRB had conducted the Special Inspection of BFIs as a separate mission. The total number of BFIs subject to the special inspection programme reached 54 including 22 Class 'A', 20 Class 'B', and 12 Class 'C' BFIs. The Special Inspection Programme was carried out with the joint support from the World Bank, IMF and DFID and aimed at having a comprehensive assessment of the Nepalese financial sector. Experts from KPMG Portugal along with the practitioners from local partners TR Upadhya & Co. and CSC & Co. were deployed for this inspection.

Table 10.1 : No. of Special/Targeted Inspection

S. No.	Fiscal Year	No. of Special/Targeted Inspection
1	2005/06	19
2	2006/07	21
3	2007/08	18
4	2008/09	20
5	2009/10	39
6	2010/11	61
7	2011/12	36
8	2012/13	44
9	2013/14	70
10	2014/15	90

NRB Inspection and Supervision Bylaw, 2013 has laid down the provisions for special and targeted inspection. The number of such inspection in 'A' class institutions excluding those under DPC, as mentioned above, for the last ten years is as provided in Table 10.1.

Since these are not pre-planned and are of contingent nature, number of such inspection does not follow any order. However, the number is gradually rising due to the growing complexity in the banking business. This has compelled NRB to deploy supervisory resources significantly in such inspection.

10.3 Off-site Surveillance

Off-site surveillance is part of the supervisory framework that NRB has put in place to ensure that, under all reasonable circumstances; BFIs are able to honour their obligations to depositors. It provides supervisors with information about both the current and impending issues within BFIs that may not have been otherwise detected until the next on-site inspection. Off-site surveillance permits the NRB to study the BFIs' entire business holistically. It can help provide some early warnings for potential problem areas in BFIs, but it cannot, in itself, be a complete system for the effective supervision of BFIs.

In line with this Principle 10 of Basel Core Principles, NRB started performing off-site reviews since early 2000s as the Supervision Bylaw, 2003 made continuous off-site surveillance mandatory. This resulted in the operation of separate Off-site Supervision Division within all supervision departments. The Supervision and Inspection Bylaw was further amended/upgraded in 2013 with more specific provisions regarding the number of divisions in department and their respective duties with specific timeline. The core objective of this Division is to conduct periodic financial reviews of BFIs in order to identify potential risks and to assess compliance of prevailing regulatory provision. Besides, it also provides feedback and red flag areas that need to be focused during the on-site inspection.

The NRB has an Off-site Supervision Manual that guides the objectives and procedures of the inspection. The Off-Site Supervision Division reviews and analyses the financial performance of BFIs using prudential reports, statutory returns and other relevant information. It also monitors trends and developments of financial indicators of the banking sector as a whole and generates industry reports on a quarterly basis. The Division also checks compliance provisions related to CRR, SLR and Deprived Sector Lending (DSL) and recommends penalties in case of non-compliance. Full-fledged reviews, analysis, and assessment of the BFI's profile including CAELS and peer comparison are performed. Through off-site surveillance, the following reports are generated :

- The BFI Profile : a report that covers each BFI's detailed financial information, risk analysis and relevant trends in addition to each BFI's comparison to its peer group,
- The CAELS report : a report that is used to measure the strengths and weaknesses of a given BFI, based on both quantitative and qualitative factors,
- Stress Testing Reports : as part of the assessment process, standard as well as ad-hoc stress testing is conducted periodically to assess potential adverse scenarios related to perceived volatility of loss events that could negatively affect BFIs,
- Trend analysis to see if various key ratios show an improving or deteriorating trend over time and in peer group analysis, BFIs are compared with other BFIs with similar characteristics using various key ratios.

If any impending problems are detected and identified in any of the reports, the BFI is contacted for prompt rectification of these problems, and even special or targeted inspection may be conducted given the severity of the situation.

NRB has prepared templates and other tools for conducting off-site surveillance. Returns are required to be prepared and submitted by BFIs in specified formats on Weekly, Fortnightly, Monthly, Quarterly, Semi-Annually and Annually basis. If needed, the NRB requests special reports, with additional details to look at, for instance, on particular exposures, risks or off-balance sheet activities.

10.4 Early Warning System

Over the last few years, NRB has adopted new approaches and developed new systems for ongoing banking supervision in order to be better equipped to face many challenges presented by financial innovation and globalisation. An early warning system (EWS) is an off-site monitoring system to detect the possibility of crisis in advance and to alert policy makers to take preventive actions. NRB has been using off-site surveillance for EWS by analyzing systematically various data reported every quarter by BFIs. Early Warning System (EWS) assists in:

- Systematic assessment of BFIs within a formalised framework both at the time of on-site examination and in between examination through off-site monitoring,
- Identification of institutions and areas within institutions where problems exist or are likely to emerge,
- Prioritisation of BFI examination for optimal allocation of supervisory resources and pre-examination planning, and
- Initiation of warranted and timely action on the basis of supervision findings.

Financial ratio analysis for individual BFIs generates a warning if the ratio exceeds a predetermined critical level, or lies within a set interval, or is an outlier. Peer group analysis is undertaken on the basis of financial ratios for a group of BFIs taken together. It is used to ascertain whether an individual BFI is performing in a significantly different way from its peers and the reason for such significant difference, which may or may not imply supervisory concern.

NRB also uses set of questionnaire to evaluate the banks for Early Warning Signals. These questionnaires are broadly categorized into five categories:

(a) Financial Analysis and Interpretation

(b) Off site Review List

(c) Quarterly Performance (CAELS)

(d) Financial Ratios and Peer Group Analysis, and

(e) Compliance Status

The evaluation of these set of questionnaires results in six outcomes, which are, A=Seek Capital Restoration Plan immediately, B=Seek NPL Management Strategy, C= Follow-up in writings, D=Immediate on-site Inspection, E=A detailed review in forthcoming on-site inspection and F=Seek Asset Liability Management (ALM) strategy.

10.5 Stress Testing

Stress Testing Guideline was issued in 2012 requiring BFIs to undergo regular stress tests. As the first step in stress testing, these guidelines cover simple sensitivity tests in different areas of risk management. There are simple shocks, which provide the minimum standards for stress testing in Nepalese banking. All commercial banks are required to conduct stress test on a regular basis. As per the regulatory provision, board level committee for risk management of commercial banks should review the stress test results. Likewise, BFIs are encouraged to develop institution specific scenarios and shocks, along with more advanced techniques of stress testing to improve their own internal risk management practices. Based on the nature, size and complexities of the business activities, the techniques for stress testing could vary. The guideline aims to establish link between our current banking practices and the Basel principles and international best practices. BFIs are required to conduct stress test on a quarterly basis and the result should be reported to respective Supervision Departments.

NRB has developed various scenarios for stress testing related to three major risk categories such as credit, market and liquidity risk. The following are the what-if scenarios that are considered for stress testing related to credit risk:

- certain percentage of performing loans deteriorated to substandard,
- certain percentage of substandard loans deteriorated to doubtful loans,
- certain percentage of doubtful loans deteriorated to loss loans,
- all NPLs under substandard category downgraded to doubtful,
- all NPLs under doubtful category downgraded to loss,
- certain percentage of performing loan of real estate and housing sector loan directly downgraded to doubtful category of NPLs,
- certain percentage of performing loan of real estate and housing sector loan directly downgraded to loss category of NPLs,
- large exposures downgraded: from performing to substandard and from performing to loss.

Regarding the stress testing related to market risk**,** BFIs are directed to study, discuss and report on indirect rate shocks, though market risks also cover risks emanating from change in equity prices and exchange rates. Nepal has been following a mix of fixed and variable exchange rate and exposure to equity is still not significant.

Liquidity risk related stress test assesses the BFI's ability to discharge its liabilities during the stressed events. The BFI with sufficient liquid assets will have strong liquidity strength. BFIs are required to maintain minimum level of liquidity to meet their day-to-day obligations. BFIs are required to conduct stress test on what happens if deposits are withdrawn (a) in certain percentage for number of days and (b) by certain numbers of top depositors.

BSD has developed a spreadsheet for simple sensitivity tests. At minimum, the result of the spreadsheet should be reported to "Offsite Division, Bank Supervision Department" on a quarterly basis within 30 days of every quarter end. The reporting should be based on the standard assumptions made in the spreadsheet.

10.6 Enforcement

Compliance with prudential requirements and implementation of directions given to individual BFIs are the key factors in ensuring the safety, soundness and the stability of the financial system. Once the onsite supervision is completed and report is sent to BFIs, then the role of enforcement function starts. Enforcement Division of the respective Supervision Departments in NRB is responsible for the enforcement of all the directions and corrective measures provided to the BFIs. Through its continuous follow-up and monitoring mechanism, Enforcement Division ensures that directions given by NRB on the basis of on-site examination and off-site surveillance are followed by BFIs.

The Inspection and Supervision Bylaw, 2003 made a provision for setting up an Enforcement Unit separately or jointly with other units within each Supervision Department so as to facilitate regular monitoring on the status of enforcement of each and every instruction issued by the NRB through its Off-Site Surveillance as well as On-Site Inspection. Inspection and

Supervision Bylaw, 2013 also envisioned constituting Report Enforcement Unit separately or jointly with other units of the Department.

In 2016, a separate Enforcement Unit was set up for carrying out follow-up and enforcement activities in all Supervision Departments. The Enforcement Unit, as guided by the Inspection and Supervision Bylaw, 2013, has been discharging the following functions:

- Monitoring whether the direction given to BFIs based on the on-site inspection and off-site supervision reports is complied with and to initiate necessary proceedings in case of non-compliance of the direction,
- Assessing the adequacy of policy, plan and procedure received from the concerned BFI on the basis of the inspection and supervision report and issuing further direction as per the requirement after carrying out consultation with the BFIs,
- Preparing quarterly enforcement status report of BFIs under its purview to be submitted to higher authority, and
- Keeping records of inspection reports, maintenance of other database, status of compliance of directions given, BOD and management data.

10.7 Prompt Corrective Action (PCA)

It is essential that corrective action is taken well in time when the BFI still has adequate cushion of capital so as to minimize the cost of failure and its spillover effects on the real economy through financial system.

NRB issued bylaw for PCA based upon the capital adequacy as PCA Bylaw, 2008 (later updated in 2017). PCA is intended to resolve the problems of BFIs with inadequate capital at the least possible long-term cost by earlier intervention in the BFIs through mandatory dividend restriction, prohibition on acceptance of deposits and in several other ways, depending on the triggers. PCA is a regulatory provision mandating progressive penalties against BFIs that exhibit deteriorating capital ratios. At the lower extreme, a critically undercapitalized BFI (i.e., one with a ratio of total capital/risk weighted assets below 2 percent) is required to be declared as problematic in order to minimize long-term losses. NRB has put in place some trigger points to assess, monitor, control and take corrective actions on weak BFIs.

NRB had set five trigger points on the basis of CAR in PCA Bylaw, 2008. Based on each trigger point, the BFIs would have to follow certain corrective actions ranging from the submission of the action plans to the de-licensing. As part of its action plan, the BFI is required to develop a detailed capital and operating plan showing how the BFI's capital will be restored. The plan must show the BFI's projections for its income, dividends, assets, liabilities, capital, liquidity, NPA, and loan charge-offs, assessed in a conservative manner. A key factor in determining whether the action plan will be successful is the commitment of the Board of Directors and, ultimately, of the major shareholders of the BFI.

The Bylaw has been revised in 2017, with some refinements, after introduction of new capital adequacy framework. The new Bylaw, which has been in effect since 2 May 2017, has reduced existing levels of PCAs from five to four with introduction of some stringent measures. Unlike previous modality, which focused on shortfall in capital adequacy in percentage points, the new Bylaw has calculated the existing capital adequacy of BFIs as a percentage of total required capital adequacy. The first level of PCAs starts if the capital adequacy defined by NRB falls from minimum level to 25 percent of that level. The second level of actions triggers when capital adequacy falls from 25 percent to 50 percent of minimum level, third level from 50 percent to 75 percent of minimum level, while fourth level of PCAs is triggered when capital deficiency level crosses 75 percent of minimum requirement. The new Bylaw has delegated authority to take PCAs from department level to the BOD of the NRB.

10.8 Problem Banks Resolution

A financial institution could be problematic due to various reasons including poor management, inadequate financial resources, and absence of long-term sustainable business strategy, weak asset quality, poor internal control system, poor corporate governance and so forth. NRB Act, 2002 provides the legal mandate to the NRB to deal with problem BFIs and to initiate corrective and resolution actions on problem BFIs in a prudent manner. With increasing number of financial institutions declared problematic, the Monetary Policy of 2013/14 envisioned the formation of separate division to resolve these institutions and subsequently, on 20 May 2013, the Problem Bank Resolution

Framework (PBRF) was approved by the NRB Board. Before the Problem Bank Resolution Division (PBRD) was established, the Resolution Unit of concerned Department looked after this work.

NRB Act, 2002 equipped NRB with the power to declare a BFI problematic and initiate reform measures as required. The Act required that in case a financial institution is unable to discharge its liabilities or there is no possibility to operate it in a healthy way, NRB may apply to the Appellate Court for the dissolution of such a BFI. Because of lengthy court procedures required for dissolution, this provision has been revised in the recently amended NRB Act (second amendment in 2016), empowering NRB to handle financial liquidation process by itself.

In this regard, PBRF outlines policies and procedures for efficient and effective resolution of problematic financial institutions within existing legal and regulatory framework. In addition to the PBRF, Problematic Bank and Financial Institution Regulation Bylaw, 2015 guides the functions of PBRD besides outlining the process in which problematic financial institutions are resolved.

As guided by Problematic Bank and Financial Institution Resolution Bylaw, 2015, a Problematic Institution Resolution Committee has been formed with concerned Deputy Governor as Chairman and the other Deputy Governor, Departmental Head of BFIRD and the Head of Legal Division as members, with the Head of the PBRD designated as the Member Secretary. The heads and representatives from other supervision departments, where necessary, are the invitee members in the Committee. The Committee discusses and makes recommendation on the important issues pertaining to the problematic institution resolution.

PBRD, established on 27 December 2013, is headed by a Director and comprises a pool of staff taken from various supervision departments. PBRD, as an independent division, reports directly to Deputy Governor. Among other functions, the Division supervises problematic institutions, collects and analyzes financial statements from these institutions on a periodic basis, prepares and discusses agenda related to problematic institution in the NRB Resolution Committee, engages with various stakeholders and discusses resolution issues, approves or extends the employment terms of employees of the problematic financial institutions and works to resolve financial institutions that have been declared problematic.

Status of Financial Institutions Declared Problematic

Out of the total of 16 financial institutions declared problematic, resolution has been completed in seven of the financial institutions so far through merger, liquidation, or capital investment from new investors. PBRD has been currently working for resolution in nine financial institutions out of which seven are finance companies and two are development banks. The total NPL of these financial institutions stood at 97 percent as in mid-October 2016.

Table 10.2 provides the status of problematic financial institutions as on 16 October 2016 while Table 10.3 gives a list of earlier declared problematic financial institutions where problems have been resolved now.

Table 10.2 : Status of Problematic Financial Institutions

Rs. in thousand

S.N	Name of Institution	Problematic Declared Date	Loan		Loan since Recovered	Deposit		Resolution Status as on 19 February 2017
			At time of declaration	Mid October 2016		At time of declaration	Mid October 2016	
	Development Banks							
1	Narayani Development Bank	10 April 2014	410,105	161,930	248,175	825,537	255,990	New Investors are interested to buy majority stake and increase capital. Past attempts to do so have not been successful so far.
2	Corporate Development Bank	19 December 2014	434,005	226,386	207,619	406,792	95,823	MOU done with new investors and share transfer is in process.
	Finance Companies							
1	Nepal Share Markets and Finance Limited	12 January 2012	5,186,378	2,353,737	2,832,641	3,094,513	502,331	A management team from NRB is working to measure issues faced by the institution. Attempt to increase capital and make share transfer has been halted due to litigation and stay order from the Court.
2	Capital Merchant Banking and Finance Limited	1 February 2013	3,683,916	1,711,792	1,972,124	2,798,380	851,412	MOU done with new investors. Management is preparing document for share transfer. There are several legal issues to be resolved.
3	Kuber Merchant Banking and Finance Limited	5 February 2013	808,551	100,183	708,368	710,198	203,306	MOU done with new investors and share transfer is in process.
4	World Merchant Banking and Finance Limted	18 April 2013	711,235	249,029	462,206	519,134	145,348	MOU done with new investors and share transfer is in process.
5	Nepal Finance Limited	3 December 1014	324,172	175,027	149,145	419,270	105,724	NRB takeover of Board, Resolution in process
6	Crystal Finance Limited	23 September 2012	763,962	380,723	383,239	566,109	278,597	The Court has decided for liquidation, but yet to appoint a liquidator.
7	Lalitpur Finance Limited	30 March 2015	1,023,857	540,647	483,210	1,293,726	252,266	MOU done with new investors and share transfer is in process.
		Total	**13,346,181**	**5,899,455**	**7,446,726**	**10,633,659**	**2,690,797**	

Table 10.3 : List of Problematic Financial Institutions resolved

S.N	Name of Institution	Problematic Declared Date	Resolution Status
1	General Finance Limited	26 May 2013	New Investors have bought majority equity in the institution and achieved capital adequacy as required by NRB regulation. The institution has been removed from category of problematic institution, vide NRB Board decision of 12 December 2016.
2	Samjhana Finance Limited	10 June 2010	The institution was decided for liquidation on 12 January 2012 and liquidator appointed on 22 April 2012. The institution is in the process of liquidation.
3	Himalaya Finance Limited	7 January 2013	The institution was decided for liquidation on 10 September 2015. Liquidator appointed on 13 October 2015. The institution is in the process of Liquidation.
4	Arun Finance Limited	26 January 2015	New Investors have bought majority equity in the institution and achieved capital adequacy as required by NRB regulation The institution has been removed from category of problematic institution, vide NRB Board decision of 25 January 2017.
5	Gorkha Development Bank	25 March 2011	Merger with Kathmandu Finance Limited on 10 April 2016 as 'C' class finance company and operating as Gurkhas Finance.
6	United Development Bank	13 February 2011	The institution was decided for liquidation on 3 November 2013. Institution has been liquidated. Remaining Assets and Liabilities is being managed by Citizens Bank International through MOU on 14 September 2016.
7	Nepal Development Bank	21 September 2007	Liquidated. Assets and Liabilities handed over to Prabhu Bank Limited on 18 March 2015.

Part 4
Financial Sector Development

11 Development of Banking Services

11.1 Development of Banking Institutions

Prior to the establishment of NRB, only one banking institution, namely, NBL was in existence. In 1957, one year after the NRB came into existence, Industrial Development Bank was established as the first development bank of the country to function as the specialized financial institution providing term credit for the industrial sector. Later on, Industrial Development Bank was converted into NIDC on 5 July 1959. Then, RBB, the second commercial bank, fully owned by the Government, was established on 23 January 1966 under RBB Act, 1965. Likewise, with the objective of providing long term and medium term credit facilities to the agricultural sector, Agricultural Development Bank Ltd. (ADBL) came into operation on 21 January 1968 as per Agricultural Development Bank Act, 1967 by incorporating the assets and liabilities of the then Cooperative Bank set up in 1963.

In 1967/68, NRB adopted the policy of opening branch office of commercial banks in all districts by formulating banking development plan and establishing banking development fund. Accordingly, NRB started providing compensation for financial loss to commercial banks up to five years for opening branch offices in remote districts. As a result, by July 1977, all districts of Nepal had at least one branch of commercial banks.

Prior to 1984, there were only two commercial banks and two development banks. Establishment of banks and financial institutions gained momentum since mid-1980s when the government initiated liberal economic policy. Government allowed the entry of commercial banks as joint venture undertaking with foreign banks as a step towards financial liberalization. The financial sector had thus started to grow in quantity and variety. The first foreign joint venture bank, Nepal Arab Bank (now Nabil Bank Ltd.), was established with co-ownership of Emirates Bank International Ltd. (Dubai), which commenced operations on 12 July 1984. The establishment of the joint venture bank was also a step towards modernization of banking services through the transfer of technology and managerial skills. Following the trend, Nepal Indosuez Bank (now Nepal Investment Bank Ltd.) and Nepal Grindlays Bank Ltd. (now Standard Chartered Bank Nepal Ltd.) were established in 1986 and 1987 respectively.

As only two categories of banks, commercial and development banks, were in existence until mid-1980s, the need for specialized institutions was felt to meet the consumer financing requirements. To address such requirement, Finance Company Act, 1985 was enacted, and Nepal Housing Development Finance Company Ltd. was established under this Act in 1992. Likewise, to specifically serve the people in rural areas, the concept of rural development banking model was introduced in 1993 with the establishment of region-based rural development banks – Eastern Rural Development Bank Ltd. and Far Western Rural Development Bank Ltd. By the end of 1995, three other rural development banks were established in each of the other development regions. Further, Development Bank Act, 1996 was formulated to encourage the private sector's involvement in development banking which accelerated the promotion of development banks through the participation of the private sector. With the enactment of the Development Bank Act, establishment of development banks were gathered momentum.

In 2002, the 46 years old NRB Act, 1955 was revamped and replaced with the NRB Act, 2002, which served as a breakthrough in the areas of role, responsibility and autonomy of the central banking in the country. To replace the fragmented banks and financial institution Acts, Banks and Financial Institutions Ordinance, 2004 came into force as an Umbrella Act with effect from February 2004. In 2006, the Ordinance was approved as BAFIA, 2006. This Act categorized all the banking institutions under the following four groups: Class 'A' – Commercial Banks; Class 'B' – Development Banks; Class 'C' – Finance Companies; and Class 'D' – Microfinance Development Banks.

Within a short time span, the country's banking sector witnessed a huge jump in terms of number of BFIs. As in mid-December 2016, there were altogether 176 banks and financial institutions (Class A, B, C & D) in operation. Moreover, in the past NRB also provided license to some Saving and Credit Cooperatives and NGOs to operate limited banking transactions, which numbered 15 and 29 respectively as in mid-December 2016. Such Cooperatives and NGOs are not governed by BAFIA, 2006 (now, BAFIA, 2017 with effect from 23 April 2017); rather they are regulated under specific acts, rules and directives. The names of banks and financial institutions in operation as in mid-December 2016 with the date of their commencement of operations is presented in Appendix 11.1 of this Chapter. As in mid-July 2016, there were 28 commercial banks, 67 development banks, 42 finance companies and 42 micro-finance financial institutions compared to just 2 commercial banks and 2 development banks as in mid-July 1980. Because of consolidation process due to merger and acquisition, the number of banking institutions has been declining in recent years. However, the number of branches of BFIs has been continuously increasing. NRB has been focusing on expanding branch of BFIs in unbanked areas of the country.

Table 11.1 : Expansion of Banking Institutions in Nepal
(in number)

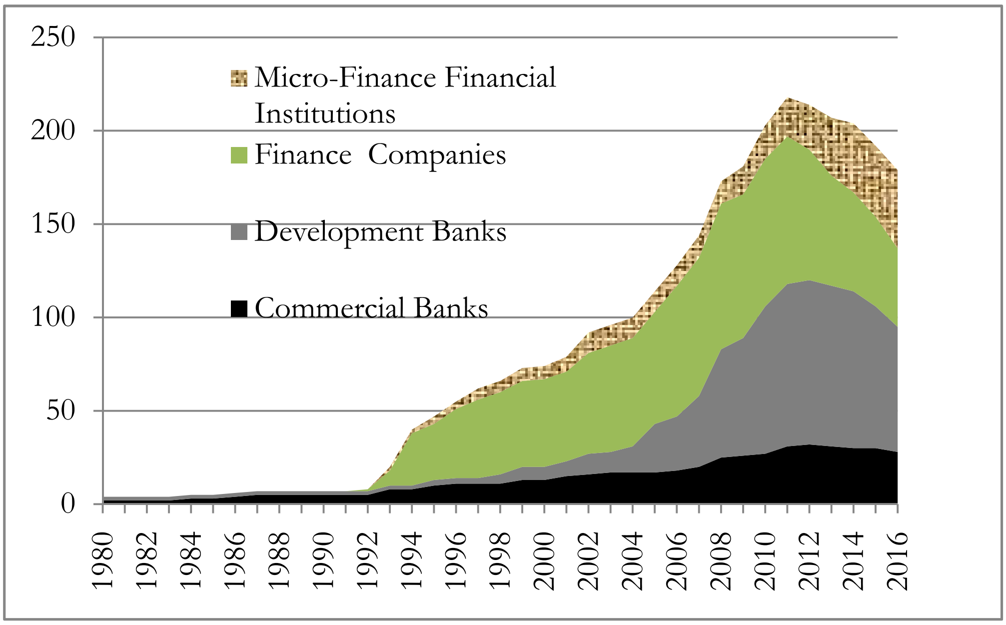
Year (mid-July)	Commercial Banks	Development Banks	Finance Companies	Micro-Finance Financial Institutions
1980	2	2	-	-
1990	5	2	-	-
2000	13	7	47	7
2010	27	79	79	18
2016	28	67	42	42

Source: NRB (2016)

With the increase in the number of BFIs, there has also been a growing competition for delivery of modern banking services to the customers. NABIL Bank Ltd. was the first bank to provide modern banking service by introducing credit cards in early 1990s. Likewise, Himalayan Bank Ltd. first introduced ATM and Nepali Credit Card for the domestic market in 1995. Himalayan Bank Ltd. was also the pioneer in introducing Tele-Banking (Telephone Banking) service. On 2002, Kumari Bank Ltd. introduced Internet banking for the first time in the country. In 2004, Laxmi Bank Ltd. became the first bank to introduce SMS-Banking (Mobile Banking) service. Likewise, various modern banking services like branchless banking, moving ATMs, utility bill payments and free ABBS, among others, are being provided by a number of banks and financial institutions in the country.

Chart 11.1

Development of Banking Institutions (in number)



Although there has been competition amongst BFIs to deliver modern banking services, majority population in the country has no access to such services. The reason for this is the concentration of BFIs in urban areas. So, modern banking services are available in urban areas only, with most people in rural areas being deprived of even the basic banking services. Table 11.2 depicts the uneven regional distribution of branches of BFIs as in mid-December 2016.

Table 11.2 : Distribution of Branches of BFIs in Different Development Regions (in number)

Region/BFI Class	A	B	C	Total No of Branches	Population	Population per Branch
Eastern	353	101	26	480	6,121,394	12,753
Central	901	337	87	1,325	10,543,221	7,957
Western	363	330	37	730	5,162,077	7,071
Mid-western	176	79	9	264	3,843,855	14,560
Far-western	114	34	2	150	2,760,947	18,406
Total	1,907	881	161	2,949	28,431,494	9,641

11.2 Banking Services by NRB

Being the central bank, NRB does not deal directly with the people like other BFIs. It regulates and supervises the financial intermediary institutions, which mobilize and provide necessary financial resources for the growth of overall economic activities in the country. Being the banker and financial agent of the GON, NRB provides entire banking services to the GON. For the purpose of carrying out such banking transactions, Banking Office had been set up on the very first day of the Bank's establishment.

There is a separate division in the Banking Office called the Government Accounts Division which handles and manages all the Government accounts. The Banking Office performs Government transactions like receiving collections, making payment and remittances and undertaking foreign exchange operations including conducting foreign debt transactions. The Bank has also appointed commercial banks as its agent to conduct Government transactions on its behalf in the areas where the Bank has no offices. As in mid-December 2016, the Government has appointed 159 branches of commercial banks to conduct Government transactions (Table 11.3).

Table 11.3 : Banks Conducting Government Transactions

Banks (Conducting Govt. Transactions)	No. of Bank Branches
Rastriya Banijya Bank Ltd.	69
Nepal Bank Ltd.	49
Everest Bank Ltd.	9
Nepal Bangladesh Bank Ltd.	1
NMB Bank Ltd.	1
Global IME Bank Ltd.	4
Bank of Kathmandu Lumbini Ltd.	1
Agriculture Development Bank Ltd.	24
Century Commercial Bank Ltd.	1
Total	**159**

Besides serving as the banker to the Government, the NRB also acts as the banker to the BFIs. The Banking Office, located at Thapathali, Kathmandu, is, therefore, the hub of BFIs' financial transactions. The Banking Office facilitates the clearance of cheques, pay orders and bank drafts for its member BFIs. It works as a clearing house for which it has separate Electronic Cheque Clearing (ECC) Division. The Division settles the transactions of BFIs on net basis by debiting or crediting their accounts maintained with the Banking Office. Nepal Clearing House Ltd. (NCHL) provides the service to electronically transfer cheque images through a secure medium, thus completely replacing the traditional routine of moving paper cheques between the banks and clearing house. The Bank has also implemented Inter-bank Payment System (IPS) from 17 August 2016, enabling funds transfer from one account to any other account held at any of the participating member BFIs, thereby directly supporting debit and credit-related transactions.

The Banking Office also operates Indian Currency Note Chest. NRB purchases IRs from Mumbai money market and deposits in RBI. Banking Office withdraws the IRs fund and brings physical cash from RBI, Kolkata Regional Office, in order to sell to the general public and BFIs for meeting their requirements. Transactions of the Bank are also conducted through seven district offices outside the Kathmandu Valley, i.e., Biratnagar, Janakpur, Birgunj, Pokhara, Siddharthanagar, Nepalgunj and Dhangadhi. The Banking Office also provides Letter of Credit (L/C) services to government offices, army and police organizations including other government organizations besides carrying out all the functions related to payment and settlement of the same.

Appendix 11.1

Banks and Financial Institutions Licensed by NRB

A. Class "A" (Commercial Banks) as in mid-December 2016 with Date of Commencement of Operation

S. No.	Name	Operation Date	S. No.	Name	Operation Date
1	Nepal Bank Ltd.	1937/11/15	15	Citizens Bank International Ltd.	2007/04/20
2	Rastriya Banijya Bank Ltd.	1966/01/23	16	Prime Commercial Bank Ltd.	2007/09/24
3	Agriculture Development Bank Ltd.	1968/01/21	17	Sunrise Bank Ltd.	2007/10/12
4	Nabil Bank Ltd.	1984/07/12	18	Janata Bank Nepal Ltd.	2010/04/05
5	Nepal Investment Bank Ltd.	1986/03/09	19	Mega Bank Nepal Ltd.	2010/07/23
6	Standard Chartered Bank Nepal Ltd.	1987/02/28	20	Century Commercial Bank Ltd.	2011/03/10
7	Himalayan Bank Ltd.	1993/01/18	21	Sanima Bank Ltd.	2012/02/15
8	Nepal SBI Bank Ltd.	1993/07/07	22	Machhapuchhre Bank Ltd.	2012/7/9*
9	Nepal Bangladesh Bank Ltd.	1994/06/06	23	NIC Asia Bank Ltd.	2013/6/30*
10	Everest Bank Ltd.	1994/10/18	24	Global IME Bank Ltd.	2014/4/9*
11	Nepal Credit and Commerce Bank Ltd.	1996/10/14	25	Civil Bank Ltd.	2014/4/14*
12	Kumari Bank Ltd.	2001/04/03	26	NMB Bank Ltd.	2015/10/18*
13	Laxmi Bank Ltd.	2002/04/03	27	Prabhu Bank Ltd.	2016/2/12*
14	Siddhartha Bank Ltd.	2002/12/24	28	Bank of Kathmandu Lumbini Ltd.	2016/7/14*

*Joint operation date after merger

B. Class "B" (Development Banks) as in mid-December 2016 with Date of Commencement of Operation

S.No.	Name	Operation Date	S.No.	Name	Operation Date
1	NIDC Development Bank Ltd.	1959/06/15	33	Mission Development Bank Ltd.	2010/06/15
2	Narayani Development Bank Ltd.	2001/10/17	34	Mount Makalu Development Bank Ltd.	2010/07/21
3	Sahayogi Vikas Bank Ltd.	2003/10/23	35	Sindhu Bikas Bank Ltd.	2010/09/09
4	Karnali Bikash Bank Ltd.	2004/02/18	36	Sahara Bikas Bank Ltd.	2010/10/27
5	Shubhechchha Bikas Bank Ltd.	2004/09/26	37	Nepal Community Development Bank Ltd.	2010/11/03
6	Gandaki Development Bank Ltd.	2005/01/25	38	Cosmos Development Bank Ltd.	2010/11/17

7	Excel Development Bank Ltd.	2005/07/21	39	Manasalu Bikash Bank Ltd.	2010/12/14
8	Western Development Bank Ltd.	2005/09/15	40	Kalinchowk Development Bank Ltd.	2011/11/21
90	Miteri Development Bank Ltd.	2006/10/13	41	Kasthamandap Development Bank Ltd.	2012/4/13*
10	Tinau Bikas Bank Ltd.	2006/11/01	42	Infrastructure Development Bank Ltd.	2012/7/10*
11	Muktinath Bikas Bank Ltd.	2007/01/03	43	Supreme Development Bank Ltd.	2012/7/13*
12	Sewa Bikas Bank Ltd.	2007/02/25	44	Salapa Bikash Bank Ltd.	2012/07/16
13	Kankai Bikas Bank Ltd.	2007/05/03	45	Vibor Bikas Bank Ltd.	2012/9/2*
14	Ace Development Bank Ltd.	2007/08/15	46	Saptakoshi Development Bank Ltd.	2012/10/02
15	Mahakali Bikas Bank Ltd.	2007/08/18	47	Sajha Bikash Bank Ltd.	2013/4/30
16	Bhargab Bikas Bank Ltd.	2007/08/30	48	Professional Diyalo Bikas Bank Ltd.	2013/6/30*
17	Country Development Bank Ltd.	2007/10/4	49	Arniko Development Bank Ltd.	2013/7/14*
18	Alpine Development Bank Ltd.	2007/10/05	50	Yeti Development Bank Ltd.	2013/7/15*
19	Corporate Development Bank Ltd.	2007/11/07	51	Apex Development Bank Ltd.	2013/7/15*
20	Kabeli BikasBankLtd.	2007/12/16	52	Green Development Bank Ltd.	2013/8/25
21	Purnima Bikas Bank Ltd.	2008/05/20	53	Reliable Development Bank Ltd.	2014/4/16*
22	Jyoti Bikas Bank Ltd.	2008/07/24	54	Biratlaxmi Bikas Bank Ltd.	2014/5/17*
23	Bagmati Development Bank Ltd.	2009/03/23	55	Sangrila Development Bank Ltd.	2014/7/13*
24	Hamro Bikas Bank Ltd.	2009/04/19	56	Triveni Bikas Bank Ltd.	2015/6/1*
25	Kakre Bihar Bikas Bank Ltd.	2009/05/15	57	Deva Development Bank Ltd.	2015/7/10*
26	Pacific Development Bank Ltd.	2009/07/26	58	Fewa Bikas Bank Ltd.	2015/7/13*
27	International Development Bank Ltd.	2009/09/04	59	Garima Bikas Bank Ltd.	2015/7/14*
28	Kanchan Development Bank Ltd.	2009/09/19	60	Om Development Bank Ltd.	2016/4/4*
29	Matribhumi Bikas Bank Ltd.	2009/10/09	61	Kailash Bikash Bank Ltd.	2016/4/4*
30	Innovative Development Bank Ltd.	2009/11/13	62	Siddhartha Development Bank Ltd.	2000/06/26
31	Raptibheri Bikas Bank Ltd.	2010/01/15	63	Shine Resunga Development Bank Ltd.	2013/3/17*
32	Tourism Development Bank Ltd.	2010/03/18	64	Kamana Bikas Bank Ltd.	2007/10/29

*Joint operation date after merger

C. Class "C" (Finance Companies) as in mid-December 2016 with Date of Commencement of Operation

S. No.	Name	Operation Date	S. No.	Name	Operation Date
1	Nepal Finance Ltd.	1993/01/06	19	Shrijana Finance Ltd.	1999/12/14
2	NIDC Capital Markets Ltd.	1993/03/11	20	World Merchant Banking & Finance Ltd.	2001/08/10
3	Nepal Share Markets and Finance Ltd.	1993/10/19	21	Capital Merchant Banking & Finance Co. Ltd.	2002/02/01
4	Union Finance Ltd.	1994/12/12	22	Crystal Finance Ltd.	2002/3/13
5	Paschhimanchal Finance Co.Ltd.	1995/04/09	23	Guheshwori Merchant Banking & Finance Ltd.	2002/06/13
6	Goodwill FinanceLtd.	1995/5/15	24	Everest Finance Ltd.	2003/07/02
7	Shree Investment& FinanceCo.Ltd.	1995/06/01	25	ICFC Finance Ltd.	2004/07/15
8	Lumbini Finance & Leasing Co.Ltd.	1995/06/26	26	Kuber Merchant Finance Ltd.	2006/03/24
90	International Leasing &Finance Co.Ltd.	1995/10/31	27	Seti Finance Ltd.	2006/05/18
10	Lalitpur Finance Co.Ltd.	1995/12/14	28	Hama Merchant & Finance Ltd.	2006/06/16
11	United Finance Co .Ltd.	1996/01/26	29	Namaste Bitiya Sanstha Ltd.	2007/07/09
12	General Finance Ltd.	1996/2/1	30	Unique Financial Institution Ltd.	2007/10/12
13	Progressive Finance Co. Ltd.	1996/02/26	31	Manjushree Financial Institution Ltd.	2007/10/17
14	Janaki Finance Co. Ltd.	1997/03/07	32	Jebil'sFinance Ltd.	2009/10/28
15	Pokhara Finance Ltd.	1997/03/16	33	Bhaktapur Finance Ltd.	2011/02/08
16	Central Finance Ltd.	1997/04/14	34	Synergy Finance Ltd.	2012/12/6*
17	Arun Finance Ltd.	1997/08/17	35	Sagarmatha Finance Ltd.	2015/7/16*
18	Multipurpose Finance Co. Ltd	1998/04/15	36	Gorkhas Finance Ltd.	2016/4/10*

*Joint operation date after merger

D. Class "D" (Microfinance Development Banks) as in mid-December 2016 with Date of Commencement of Operation

S. No.	Name	Operation Date	S. No.	Name	Operation Date
1	Nirdhan Utthan Bank Ltd.	1999/07/17	25	Reliable Microfinance Bittiya Sanstha Ltd.	2013/05/19
2	Rural Microfinance Development Centre Ltd.	1999/12/06	26	Mahuli Samudyik Laghubitta Bittiya Sanstha Ltd.	2013/06/15
3	Deprosc Microfinance Development Bank Ltd.	2001/07/03	27	Suryodaya Laghubitta Bitiya Sanstha Ltd.	2013/07/16

4	Chhimek Microfinance Development Bank Ltd.	2001/12/10	28	Mero Microfinance Bittiya Sanatha Ltd.	2013/07/18
5	Swawalamban Laghu BittaBikas Bank Ltd.	2002/02/22	29	Samata Microfinance Bittiya Sanatha Ltd.	2013/08/25
6	Sana Kisan Bikas Bank Ltd.	2002/03/11	30	RSDC Laghubitta Bitiya Sanstha Ltd.	2013/09/11
7	Nerude Laghu Bitta Bikas Bank Ltd.	2007/06/15	31	Samudayik Laghubitta Bitiya Sanstha Ltd	2014/04/13
8	Naya Nepal Laghu Bitta Bikas Bank Ltd.	2009/03/20	32	National Microfinance Bittiya Sanstha Ltd.	2014/07/02
9	Mithila Laghu Bitta Bikas Bank Ltd.	2009/04/29	33	Nepal Grameen Bikas Bank Ltd.	2014/08/15*
10	Summit Microfinance Development Bank Ltd.	2009/05/20	34	Nepal Sewa Laghubitta Bittiya Sanstha Ltd.	2014/10/26
11	Sworojagar Laghu Bitta Bikas Bank Ltd.	2009/12/16	35	Unnati Microfinance Bittiya Sanstha Ltd.	2014/11/07
12	First Microfinance Development Bank Ltd.	2009/12/28	36	Swadeshi Lagubitta Bittiya Sanstha Ltd.	2014/12/31
13	Nagbeli Microfinance Development Bank Ltd.	2010/02/04	37	NADEP Laghubitta Bittiya Sanstha Ltd.	2015/05/15
14	Kalika Microcredit Development BankLtd.	2010/07/21	38	Support Microfinance Bittiya Sanstha Ltd.	2015/07/12
15	Mirmire Microfinance Development Bank Ltd.	2010/09/23	39	Arambha Microfinance Bittiya Sanstha Ltd.	2015/07/23
16	Janautthan Samudayik Microfinance Dev. Bank Ltd.	2010/11/09	40	Janasewi Laghubitta Bittiya Sanstha Ltd.	2015/09/29
17	Womi Microfinance Bittiya Sanstha Ltd.	2012/03/08	41	Chautari Laghubitta Bittiya Sanstha Ltd.	2016/01/03
18	Laxmi Microfinance Bittiya Sanstha Ltd.	2012/06/04	42	Ghodighoda Laghubitta Bittiya Sanstha Ltd.	2016/06/12
19	ILFCO Microfinance Bittiya Sanstha Ltd.	2012/07/05	43	Asha Laghubitta Bittiya Sanstha Ltd.	2016
20	Mahila Sahayatra Microfinance Bittiya Sanstha Ltd.	2012/12/25	44	Nepal Agro Microfinance Bittiya Sanstha Ltd.	2016
21	Kisan Microfinance Bittiya Sanstha Ltd.	2013/01/16	45	Creative Laghubitta Bittiya Sastha Ltd.	2016
22	Vijaya Laghubitta Bittiya Sanstha Ltd.	2013/03/28	46	Ramaroshan Laghubitta Bittiya Sanstha Ltd.	2016
23	NMB Microfinance Bittiya Sanstha Ltd.	2013/03/31	47	Gurans Laghubitta Bittiya Sastha Ltd.	2016
24	FORWARD Community Microfinance Bittiya Sanstha Ltd.	2013/05/17	48	Ganapati Laghubitta Bittiya Sastha Ltd.	2016

12 Financial Inclusion and Literacy

Financial inclusion has been a major policy concern for central banks all around the world. Establishment of financial institutions may not be sufficient to make financial system inclusive. Mainstream financial institutions normally hesitate to go to the remote and far-flung villages to serve low-income people. Sometimes, conditionalities set by financial institutions exclude many people despite the presence of these institutions in the nearby areas. For inclusive growth and development, access to financial service should be also inclusive, giving enough attention to provide banking service to poor people and those living in rural areas. Financial literacy is also crucial for financial inclusion as it increases financial knowledge and encourages people to use financial services available in the market.

12.1 State of Financial Access and Inclusion

The Nepalese financial system has been effortful in delivering financial services and promoting financial inclusion through 28 licensed commercial banks (class 'A'), 67 development banks (class 'B'), 40 finance companies (class 'C') and 42 micro-finance development banks (class 'D') as in mid-July 2016. These BFIs are delivering financial services through their 4,274 branches in the country. The average population served by these BFI branches stands at 6,647 per branch. Besides, 25 financial NGOs (FINGOs) with their 352 branches, which are permitted by the NRB for undertaking micro-financing activities, are also operating in the country. As directed by the NRB, these FINGOs are in the process of transforming themselves into 'D' class MFDBs. Likewise, 49 remittance companies licensed by the NRB are also catering to enhance financial access through the payment channel. Table 12.1 highlights the progress with respect to financial access as in mid-July 2016.

Regarding the financial services rendered by the BFIs, A, B and C class BFIs together served 16,836,017 depositors and 1,096,570 borrowers as in mid-July 2016. Among them, 213,084 customers are receiving banking services through 812 branchless points of different commercial banks. Likewise, the D class FIs served their 1,898,997 members, while FINGOs served their 582,433 members. Almost all of these 2.5 million members of D class FIs and FINGOs are women. Regarding the financial products availed by the BFIs to promote the financial access, A, B and C class BFIs have provided mobile banking services and internet banking services to 1,754,566 and 515,465 customers respectively. These BFIs have installed a total of 1908 ATMs throughout the country for providing easy financial access. Similarly, also issued are 4,657,125 debit cards and 52,014 credit cards by A, B and C class BFIs as well as 82,797 prepaid cards by commercial banks for their customers for promoting deeper financial access.

Table 12.1 : Financial Access through the Banking Sector

(Mid-July 2016)

Number of	A	B	C	D	Total	FINGOs
1. BFIs	28	67	40	42	177	25
2. Branches	1,869	852	175	1,375	4,271	352
3. Deposit Accounts ('000)	13,010.2	3,302.2	52.40	-	16,364.8	-
4. Loans ('000)	753.6	303.9	39.0	-	1,096.6	-
5. Members ('000)	-	-	-	1,898.8	1,898.9	5,82.4
6. Branchless Banking Centres	812	-	-	-	812	-
7. Branchless Banking Customers	213,084	-	-	-	213,084	-
8. Mobile Banking Customers ('000)	1,604.6	133.6	16.4	-	1,754.6	-
9. ATMs	1661	230	17	-	1,908	-
10. Debit Cards ('000)	4,142.4	479.3	35.4	-	4,657.1	-
11. Credit Cards ('000)	52.0	-	-	-	52.0	-
12. Pre-paid Cards ('000)	82.8	-	-	-	82.8	-

Source: NRB (2016), Banking and Financial Statistics, Mid-July 2016

In case of cooperatives, there were altogether 32,633 cooperatives providing financial services to their 5,100,370 members in the country as in mid-July 2016. Out of the total members, nearly 45 percent are women. Among these cooperatives, 15 cooperatives have been permitted by the NRB for conducting limited banking transactions and one is permitted for wholesale banking activities. The latest figures of financial access provided by the cooperatives is presented in Table 12.2.

Table12.2 : Financial Access by Cooperatives
(Mid-July 2015)

	No. of Cooperatives	No. of Members	o/w Women Members	% of Women Members
Saving and Credit Cooperatives	13,460	27,29,485	13,18,825	48.3
Multipurpose Cooperatives	4,031	10,69,990	4,28,593	40.1
Other Cooperatives	15,172	13,00,895	534,517	41.1
Total Cooperatives	32,663	51,00,370	22,81,935	44.7

Source : Cooperative Data, July 2015, Department of Cooperatives, Government of Nepal

Besides, 25 insurance companies, 117 postal saving banks and one each of Employees' Provident Fund (EPF) and Citizen Investment Trust (CIT) are also working in the financial system for financial access/inclusion through insurance and saving/investment activities.

A large number of BFIs, including cooperatives, emerged in Nepal, especially after the country adopted liberal economic policy in the 1990s. This shift in policy paradigm significantly widened the financial access over the years. However, financial inclusion has not deepened much as the financial institutions are basically dispersed around the urban, semi-urban and accessible areas only. In contrast, cooperatives and MFIs have relatively more access in rural/remote areas as compared to other BFIs. Among the financially accessed groups, more men are assumed to be benefited as compared to women. Regarding the economic status, deprived/poor people are assumed to be less benefited as compared to middle, upper-middle and higher class people. Similarly, educated people are assumed to be more included financially as compared to illiterate groups.

However, formal studies carried out on financial inclusion have been limited. The Third Rural Credit Survey was carried out in 1991/92 by the NRB. After a long gap, a survey was conducted on financial inclusion by the United Nations Capital Development Fund (UNCDF) under UNNATI-Access to Finance Project (A2F) of NRB in 2014. Some of the key findings of this survey are highlighted in Table 12.3.

Table 12.3 : Findings of Nepal Financial Inclusion Survey

Headings	Banked (A, B, C, D)	Other Formal FIs (FINGOs, Co-op, Rmt Cos., Postal Banks, etc.)	Informal Only (also includes Users Groups)	Excluded (neither formal nor informal)
Overall	**40%**	**21%**	**21%**	**18%**
1.1 Male	45 %	19%	20%	16%
1.2 Female	36%	21%	23%	20%
2.1 Urban	56%	15%	11%	18%
2.2 Rural	36%	22%	24%	18%
3.1 Mountain	24%	34%	27%	15%
3.2 Hill	40%	21%	24%	15%
3.3 Terai	43%	18%	18%	21%
4.1 Eastern Region	38%	25%	20%	17%
4.2 Central Region	42%	20%	17%	21%
4.3 Western Region	48%	18%	21%	13%
4.4 Mid-Western Region	29%	19%	28%	24%
4.5 Far-Western Region	39%	18%	33%	10%

Source: FinScope Survey Highlights Nepal, 2014, UNCDF[1]

As per the survey, 22 percent people claim to belong to cooperatives, of which 11 percent are with cooperatives only. Likewise, 29 percent people claim to belong to saving groups. Of these, 66 percent are females and 34 percent are males. While 28 percent people claim to be aware of insurance, only 11 percent have done insurance. In case of remittance, 24 percent claimed that they received money from another country. Of these, 63 percent used money transfer agency, 23 percent received from bank transfer while 22 percent claimed to use informal channel. Regarding technological access, 78 percent claimed to have mobile phones and 14 percent internet. In case of access (distance) to banks, 28 percent claimed to have access within 30 minutes while 14 percent claimed to have access more than 2 hours, with 10 percent having access at a distance exceeding 5 hours.

1 The Survey was carried out by UNCDF under UNNATI-Access to Finance Project (A2F) of Nepal Rastra Bank. The survey was done by FinMark Trust, South Africa covering 4014 Nepalese 18+ adults within 669 Wards (Enumeration Areas--EAs) of 73 districts of Nepal. Nationally representative samples were drawn with the technical assistance of Central Bureau of Statistics (CBS) at 3 levels; national level, urban/rural level and ecological/development region level with data weighted to Census 2011. EAs were selected by using simple random method with approximately 6 interviews conducted in the field per EA.

12.2 Policies and Programmes

NRB has been adopting different policies and programmes that help promote financial access and inclusion. The major policy steps undertaken by NRB in this direction are discussed below:

12.2.1 Priority Sector Lending

NRB formulated a policy in May 1974 directing all commercial banks to lend at least 5 percent of their total deposits to the 'Small Sector', which was later renamed as 'supervised credit' in 1976, requiring to lend 7 percent of total deposits. It was further renamed as 'Intensive Banking Programme' (IBP) in 1981 by incorporating the provision of group lending under joint liability. This was the beginning of non-collateral based micro financing in Nepal. While introducing IBP, the NRB had also changed the deposit-based mandatory requirement for this sector into credit-based, requiring to invest 8 percent of the total credit outstanding which was later increased to 10 percent in 1985 and 12 percent in 1991 in the name of 'Priority Sector Lending'. Those banks that failed to meet the target set by the NRB were penalized.

Since the directed lending programmes were not considered to be consistent with the financial sector liberalization policy, NRB adopted a policy of gradually phasing out the priority sector lending programme since 2002/03. The priority sector lending requirement (12 percent) was reduced to 7 percent in 2002/03, 6 percent in 2003/04, 4 percent in 2004/05, 2 percent in 2005/06 and completely phased out in 2006/07.

12.2.2 Deprived Sector Lending

In order to increase the contribution of financial institutions in the income and employment generation activities of the poorest section of the society, BFIs were asked to disburse a certain portion of their total loan portfolio to the deprived sector since 1990. In the beginning, commercial banks were asked to lend from 0.25 percent (for newly established bank) to 3.00 percent (for those banks having more than 3 years of existence) of their total loan portfolio for the deprived sector. This was a mandatory provision, and if the banks failed to achieve the target, they were penalized for the shortfall. The ratio of 3 percent was kept unchanged for the commercial banks up to 2010/11. It was, then, increased to 3.5 percent in 2011/12, 4.0 percent in 2012/13, 4.5 percent in 2013/14 and 5.0 percent in 2015/16. Since 2008/09, development banks were also directed to extend 1.0 percent in this sector which was further increased to 2.0 percent in 2009/10, 2.5 percent in 2010/11, 3.0 percent in 2011/12, 3.5 percent in 2012/13, 4.0 percent in 2013/14 and 4.5 percent in 2015/16. Likewise, for finance companies, it was 1.5 percent in 2009/10, which was increased to 2.0 percent in 2010/11, 2.5 percent in 2011/12, 3.0 percent in 2012/13, 3.5 percent in 2013/14 and 4.0 percent in 2015/16. The ratio of loan to be extended by the commercial banks for the deprived sector was kept unchanged at 5 percent in 2016/17, but they were required to invest minimum 2 percent of the loan directly by themselves.

Various types of loans have been categorized and counted under deprived sector lending. Decision on this has been made in different times, as briefly sketched below in Box 12.1. The requirement to maintain an additional 20 percent loan loss provision has been waived for those loans disbursed for the deprived sector, with effect from 2007/08. In order to ensure credit flow to the targeted group, BFIs were restricted to deposit the deprived sector amount into other BFIs to earn interest since 2010/11.

Box 12.1 : Types of Loans under Deprived Sector

Description	Commencement Time
Equity financing by banks in Rural Micro Finance Development Centre (RMDC)	1998/99
BFIs' lending up to Rs. 30,000 to the poorest, weak and deprived people; lending for employment oriented and income generating projects up to Rs. 30 thousand; equity investment of banks in Grameen Bikas Banks; lending to Grameen Bikas Banks and other poverty alleviation related development banks and micro finance institutions (MFIs) for further lending under micro credit; and bank's lending to cooperatives, NGOs and Small Farmers' Cooperatives (SFCs) which were permitted by the NRB for limited banking operations	1999/2000

BFIs' lending up to Rs.100,000 for foreign employment	2001/02
Lending to MFDBs engaged in providing micro credit up to the limit of Rs. 30,000 per family	2001/02
MFDBs' lending in solar home system (SHS) and bio-gas credit ceiling up to Rs. 50,000	February 4, 2005
Credit advanced for the workers going abroad under Government's Youth Self-employment and Employment Training Programmes	2006/07
Wholesale credit provided by the commercial banks through financial institutions or cooperatives licensed by NRB	2006/07
Credit flow to the micro hydro projects	2008/09
Collateral loan up to Rs 150,000 per family eligible to get deprived sector loan for the purpose of sheep farming for wool production and setting up carpet knitting loom by individual/group on single or partnership basis	2009/10
Collateral loan up to Rs 150,000 provided to marginalized people and small farmers for fertilizer and seeds purchase, cold storage establishment, animal farming, small irrigation canal and installation of shallow tube well	2009/10
Loan up to Rs. 300,000 provided for micro-enterprises run by women	2010/11
Credit up to Rs. 10 million provided to hydropower project of up to 500 KW capacity with at least 50 percent investment participation by community users committee or private sector	2010/11
Loans provided through consumer group or cooperative for community irrigation in rural area	2010/11
Loans provided for buying tractor, thresher and other agricultural equipment	2010/11
Credit extended to low cost housing, electricity, hospitals that fulfill the requirement of deprived sector	2010/11
Loans up to Rs. 150,000 per household provided to establish a cold storage at collective ownership for preserving food grains	2010/11
Loans up to Rs. 250,000 per household provided for animal husbandry, fishery and bee keeping	2010/11
Loans up to Rs 200,000 provided without collateral to youths from deprived families for studying secondary and higher secondary level technical and vocational education	2010/11

Credit up to Rs. 10 million extended to rural community hospitals meeting specified standards	2011/12
Project credit up to Rs. 500,000 provided to micro-enterprises promoted by women	2013/14, limit was raised to Rs. 7,00,000 in 2014/15
Commercial agriculture lending	2015/16

12.2.3 Micro Finance Institutions

Microfinance sector, considered as an effective tool for poverty alleviation and means of raising financial access to the rural and the deprived sections of the society has developed steadily in Nepal since the early 1990s. Different setups of micro finance institutions are in operation under different rules and regulations. Many policy provisions were taken to facilitate the expansion of MFIs and their operations. Effective 18 August 2005, the individual/institutional share investment limitation in MFDBs has been increased from 15 percent to 25 percent (of paid-up capital). Further, since 2005/06, MFIs have been permitted to conduct their operations in 4 to 10 districts with the capital base of Rs. 20 million. Since 2006/07, they have been allowed to expand their coverage to 5 additional hilly districts with the same capital base. On 4 May 2008, National Micro Finance Policy, 2008 was formulated by the GON.

There has been regular increment of borrowing limit for individuals as well as micro-enterprises from MFIs, as shown in Table 12.4.

Table 12.4: Changes in Borrowing Limits from MFIs

Fiscal year	Individuals	Micro-enterprises
2010/11	Rs, 90,000 from Rs, 60,000	Rs. 200,000 from Rs. 150,000
2012/13	Rs. 100,000	Rs. 300,000
2013/14	Rs. 150,000	Rs. 400,000
2014/15	Rs. 200,000	Rs. 500,000
2015/16	Rs. 300,000	Rs. 700,000

Moreover, effective from 2016/17, the limit of micro credit to the deprived or low income individuals against group guarantee for operating micro business was increased from Rs. 100,000 to Rs. 300,000. Likewise, for group members classified as good borrowers for the last two years, such a limit was increased from Rs. 300,000 to Rs. 500,000. Similarly, credit limit for solar system and/or biogas under renewable energy technology was increased from Rs. 60,000 to Rs. 200,000 per family. Credit limit against acceptable collateral was raised from Rs. 700,000 to Rs. 1,000,000 for individuals, affiliated or not in groups, in village development committees where BFIs are not present. Finally, credit limit for the deprived and low income people not associated with any group was increased from Rs. 60,000 to Rs. 300,000.

Since July 2007, MFIs have been allowed to expand their operation area by one more additional adjoining district with an incremental paid up capital of Rs. 2.5 million, over and above the existing paid up capital as in mid-July 2007. Since 2009/10, upon fulfilling the requirements stipulated by the NRB, FINGOs were allowed to expand their financial intermediary services in other districts in addition to the district they were registered.

Commercial banks, since 2009/10, have been allowed to establish a "subsidiary company" under their ownership for arranging credit flow to the deprived sector. For this, the existing maximum limit of 25 percent equity investment of total paid-up capital that a household, firm, company or corporate can own in MFIs was also relaxed for commercial banks.

NRB, effective from 2011/12, announced to provide interest free loan up to Rs. 1.5 million for class 'D' financial institutions based on their capital strength if they opened a new branch in the nine specified remote districts with limited financial access (namely, Manang, Humla, Kalikot, Mugu, Dolpa, Jajarkot, Bajhang, Bajura and Darchula). The loan size was revised to Rs. 2.0 million effective from 2013/14 and Rs. 3.0 million effective from 2014/15. Given the dearth of financial institutions in the nine districts, “D” class FIs have been allowed to collect deposits from the general public up to five times their core capital, effective from 2012/13. NRB directed to penalize MFIs at the bank rate which were not lending the amount obtained from BFIs against deprived sector borrowing within stipulated time, effective from 2013/14.

MFIs were directed to exchange credit information among the micro-credit operators with each other while making micro-credit transactions of more than Rs. 50,000, effective from 2013/14. MFIs were required to be linked up with Credit Information Centre. The membership of Credit Information Centre has been made compulsory for all MFIs in 2016/17.

MFIs since 2015/16 have been required to establish a separate fund by allocating a certain percent of their profit for the common welfare of the borrowers and institutional development. Manual for Refinancing the Earthquake Affected Households for Residential House Reconstruction, 2015 was introduced in 2015/16 in order to provide refinance facility at zero percent interest rate even to MFIs for the loan extended to earthquake affected households for residential house reconstruction up to Rs. 300,000 against group guarantee.

As per the Monetary Policy for 2016/17, a moratorium has been imposed on establishing MFIs except in districts with low financial access, namely, Manang, Jumla, Dolpa, Kalikot, Mugu, Jajarkot, Bajhang, Bajura and Darchula until e-mapping is completed. MFIs have now been required to maintain maximum of 7 percent spread in excess of their cost of fund (except 4 percent of their administrative cost) while charging interest on loans. Similarly, minimum paid up capital has been raised for the national level MFIs providing wholesale lending from Rs. 100 million to Rs. 600 million by mid-July 2018.

Non-government organizations licensed by NRB for financial intermediation (FINGOs) have been asked to convert into "D" class MFIs within stipulated time-frame by fulfilling all necessary process. Letters regarding such provisions were given to related institutions in July/August 2013 and respective action plans were received from them by mid-July 2014. Considering the difficult situation after the earthquake, the deadline for converting into "D class" MFIs was extended until mid-July 2016. To encourage this conversion process, the provision of ceiling on promoter share ownership of these FINGOs in such 'D' class organization was changed from existing 25 percent to 51 percent on 18 December 2014. By mid-January 2017, all the remaining 25 FINGOs have already submitted to NRB their applications for conversion.

12.2.4 Rural Development Bank

In 1992, the GON established two regional level rural micro-finance development banks one each in the Eastern and Far-Western Development Regions closely based on the Grameen Banking model of Bangladesh with the major share participation of NRB at 66.75 percent and 58.5 percent respectively. By June 1996, three other RDBs, one each in the other three development regions were also set up. NRB altogether invested Rs.195.0 million as equity in these RDBs.

The main objective of the RDBs was to provide credit to the poorer households, mainly to women. The RDBs' credit was provided for micro-level income generating activities on group guarantee basis. Each group has to follow weekly repayment schedule. Client activities and their transactions are observed closely and loans are supervised regularly. Although the RDBs provided micro finance services to more than 270,000 deprived people, almost all women, during 12 years since they came into operation, only one RDB (WRDB) ran in profit while the remaining four incurred huge accumulated losses. So, the Government initiated structural reforms in these RDBs in October 2001, with the Government and NRB contributing a total of Rs. 163 million to compensate for the accumulated losses of the four RDBs.

After the reform, two RDBs, WRDB and ERDB, generated profit while some improvements were also noticed in the other three RDBs. Various prudential norms such as productivity measures, appointment of the executive directors through open competition, and cost reduction scheme like Voluntary Retirement Scheme (VRS) were implemented by the NRB to make these banks viable and self-sustained. However, the VRS did not work as per the expectation.

Then, the second phase of the VRS was introduced with the support of the NRB. As per the 15-point restructuring programme of the RDBs, the NRB started divestment of its equity from those RDBs which generated profit. Accordingly, with the objective of gradual privatization of the profitable RDBs, the NRB initiated to divest 51 percent share out of its total 61 percent in the WRDB. The first phase of the privatization programme of WRDB was completed, through which clients and staff acquired altogether 41 percent share. Under the second phase of the divestment programme, the Nirdhan Utthan Bank purchased the remaining 10.0 percent share. The WRDB declared a 10 percent dividend to its investors in 2003/04 for the first time after its privatization.

ERDB, another profitable institution, also announced its privatization programme in 2004 and the process of privatization started with the divestment of 56.75 percent share out of NRB's total share ownership of 66.75 percent. Out of the 56.75 percent share, 41.75 percent was allocated to the bank's clients, 5 percent to the staff and 10 percent to the public.

The NRB Act, 2002 categorically mentions that this Bank cannot invest in the share of any BFI, with the provision that the share investment not exceeding 10 percent of the paid up capital of such specified institutions which perform activities that assist NRB in carrying out its activities or fulfilling its liability may be invested. So, the NRB, as a token of commitment to the micro finance sector development, took a policy of keeping 10 percent of the equity with these RDBs.

Out of Rs. 190 million accumulated loss of the four RDBs (other than WRDB), NRB directed to set aside Rs. 150 million as loan loss provisioning in 2005/06. The Government was requested to bear the accumulated loss of these RDBs in order to improve their financial health. NRB handed over the management of WRDB to the board elected from shareholders through the competitive election in 2005/06. The Government initiated the process of divesting its 16.5 percent share ownership from the WRDB to 10 percent in 2005/06.

In order to raise their capital base and strengthen their capacity to extend their financial services to deprived sector, the Government initiated merger and acquisition of RDBs in 2011/12. All the 5 RDBs completed their due diligence audit and received a Letter of Intent for merger in 2012/13. Nepal Rural Development Bank Limited was formed in 2013/14 after merging all these 5 rural development banks. After the merger in 2014/15, restructuring of this Bank was initiated.

12.2.5 Productive Sector Credit

A provision was introduced in 2013/14 for commercial banks to maintain 20.0 percent of total credit to productive sectors, especially in agriculture, energy, tourism, small and medium enterprises by mid-July 2015. Under this, they were to maintain at least 12.0 percentage point credit flow to agriculture and energy sector. In addition, a similar provision was introduced in 2014/15 for the development banks and finance companies to lend 15 percent and 10 percent of their total credit respectively to the productive sectors by mid-July 2016.

In 2015/16, the coverage of productive sector loan was broadened to include the loans granted to the organized firms to operate public city transport services in the major cities including Biratnagar, Janakpur, Birgunj, Pokhara, Bhairahawa, Nepalgunj, Dhangadhi and the Kathmandu Valley. Circular for this purpose was issued by the NRB on 18 August 2015. By continuing the provision of extending 20 percent of total loan portfolio to productive sector in 2015/16, the minimum ratio for agriculture and hydropower sector together has been increased to 15 percent by mid-July 2017. Penalty at bank rate is imposed to BFIs on non-fulfillment of this provision.

With a circular issued on 18 August 2015, a provision of special refinance facility at 1 percent interest has been made to encourage the BFIs to extend loans to agriculture and small enterprises for income generating activities in poverty stricken districts including Bajura, Kalikot, Bajhang, Humla, Darchula, Jumla, Doti, Achham, Mugu and Baitadi. This facility also covers 114 Village Development Committees and 4 Municipalities of Parsa, Bara, Rautahat, Sarlahi, Mahottari, Dhanusha, Siraha and Saptari located in the southern border with relatively higher intensity of poverty.

12.2.6 Subsidized Agriculture Credit

As mentioned in the Government's budget statement for 2014/15, a circular was issued by the NRB on 27 October 2014 notifying the availability of agriculture credit from commercial banks at 6 percent interest rate especially for livestock, herbs, horticulture, dairy, fishery, mushroom farming, agriculture storage, animal slaughterhouse and meat-related businesses. A refinance facility was also announced, if resources were needed for such credit flows. The "Manual for Interest Subsidy on Commercial Agriculture Credit to Youths, 2014" was introduced in 2015/16 to provide interest subsidy on loans for the specified agricultural businesses. The budget statement of the Government for 2016/17 lowered the interest on such agriculture loan from 6 percent to 5 percent.

12.2.7 Policy Response to SMEs

A provision was made in 2012/13 for arranging separate desk in BFIs to increase credit for small and medium enterprises (SMEs) and to enhance financial access including for its effective monitoring. NRB announced to form an appropriate mechanism in 2012/13 for coordination among commercial banks, development banks and MFDBs to provide credit in excess of microcredit limit to entrepreneurs who had successfully run their business by obtaining credit from MFDBs and further desired to expand their businesses.

To assist SMEs, a provision of providing refinance at 5.0 percent from NRB has been made since 2013/14 for project lending up to Rs. 1 million provided to them by BFIs. While utilizing this facility, BFIs would only charge interest rate up to 10 percent to their clients.

An agreement was reached between Rural Self Reliance Fund (RSRF) managed by NRB and GON's Micro Enterprise Development Programme (MEDP) in 2013/14 for making a provision of extending loan for the promotion of productive micro enterprise/business by developing coordination and cooperation with each other. Further, to provide incentives to the cottage and small enterprises, a facility has been arranged by NRB, effective 25 August 2014, to provide credit up to Rs. 1 million to the existing enterprise based on the annual turnover and up to Rs. 500,000 to the new enterprise for starting a business against personal/institutional guarantee.

The other policies/directives adopted or issued for enhancing financial inclusion in recent years are provided in Appendix 12.1.

12.2.8 Rural Self Reliance Fund

Rural Self Reliance Fund (RSRF) was established in February 1991 by the GON with the objective of uplifting socio-economic status of deprived groups in rural areas by providing institutional wholesale credit to the financial intermediaries, i.e., Saving and Credit Cooperatives (SACCOPs) and Financial Non-Government Organizations (FINGOs). The BOD chaired by the Deputy Governor of the NRB and represented by the concerned Ministries is managing the operation of the RSRF.

Total capital of the RSRF as in mid-July 2016 stood at Rs. 793.40 million of which the Government contributed Rs. 540 million and NRB contributed Rs. 253.40 million. Initially, Rs. 20 million (Rs. 10 million in 1991 and Rs. 10 million in 1992) was allocated as a capital grant by the Government to the RSRF. In 2004, the Government again made available to the Fund additional Rs. 20 million as capital grant, increasing the Government's total contribution to Rs. 40 million. In addition, a decision was made in 2006/07 to transfer the assets and liabilities of various phased-out projects related to access to finance programmes to the RSRF from this Bank, with a view to expanding micro-credit in the rural areas. In this way, the Government's contribution to the RSRF was gradually raised to Rs. 190 million by 2012/13. The Government further contributed Rs. 350 million to the RSRF in 2013/14, making the Government's total contribution to Rs. 540 million. Likewise, the NRB also contributed Rs.100 million in 2001/02. It further provided Rs. 74.8 million in 2002/03 and Rs. 78.6 million in 2003/04, making its total contribution at Rs. 253.4 million.

New "Rural Self Reliance Fund (RSRF) Operational Directive, 2013" has been implemented since 2013/14 in order to expand the access of financial service in rural areas in more simplified way.

Acting as a trustee of the RSRF, the MFPSD of the NRB has been performing the secretariat role as per the mandate. The interest rate of the RSRF is 8 percent per annum, with the provision of returning 75 percent of it on timely re-payment of the instalments. As per the provision, the loan receiving financial institutions cannot charge more than 14 percent interest rate to their clients while disbursing the borrowed amount from the RSRF. The retail loan limit of the individual borrower is capped at Rs. 90,000 in case of the amount received from the RSRF. While disbursing this loan, the institution should contribute 20 percent of the total loan provided. The loan from the RSRF is provided to any institution only for the 3-year period and would be given for three times only, if it is timely repaid. The maximum institutional limit of such loan is Rs.2.5 million for the first loan, Rs.3.0 million for the second loan and Rs.3.5 million for the final loan. Collateral is not required for the institutions as Board of Directors is responsible jointly as well as individually for the re-payment of the loan received. As in mid-July 2016, the RSRF has disbursed a total loan of Rs. 2.06 billion through 1,104 financial institutions benefiting 55,304 families in 70 districts. The current repayment rate of the loan disbursed from the RSRF has averaged 95.3 percent. Other policies and activities of the RSRF are presented in Box 12.2.

Box 12.2 : Policies and Activities of RSRF

- The long-term credit of Rs. 92.2 million was provided to the ADB/N for tea cultivation and processing and Rs. 20.0 million provided to Eastern Rural Development Bank and Mid-Western Rural Development Bank for further lending to micro-credit clients.
- Provided wholesale credit for organic coffee production since 2008/09.
- Effective 2007/08, credit was provided for renewable energy, such as solar energy, bio-gas and micro hydro unit.
- Effective 2007/08, Line of Credit Facility was provided to the cooperatives which utilized loans for three times while working in remote areas.
- Since 2007/08, loans provided to install shallow tube-wells for extending irrigation facilities.
- An arrangement was made between RSRF and MEDEP in 2013/14 to avail RSRF credit to physically disabled people to run self-employment activities.
- Since November 2014, credit provided to cooperatives located in municipality areas outside the Kathmandu Valley.
- Since 2014/15, the requirement that the office of the cooperatives should be located in the rural areas for availing RSRF credit has been waived for those cooperatives that are operated by handicapped people.
- An agreement has been signed on 31 May 2016 between the RSRF and the UNNATI-Access to Finance Project (A2F) for mutual cooperation for extending technical support to the cooperatives receiving concessional credit from RSRF in the Eastern Development Region (EDR), especially for training on accounts and management.

12.2.9 Small Farmers' Cooperatives

Agriculture Development Bank's 'Small Farmers Development Programme' (SFDP) was introduced in Nepal in 1975 with the funding of the FAO. Financing on group guarantee in SFDP was regarded as a new practice of financing in the country. The ADB's 410 offices as in mid-July 2004 contributed to the benefit of rural poor, especially through rural and agricultural finance. To institutionalize and sustain the programme in the longer run, the SFDPs were converted into cooperatives known as 'Small Farmers Cooperative Limited' (SFCL). Starting from 1993/94, their number grew to 165 SFCLs which were in operation as in mid-January 2005.

To help cater for the wholesale credit need of these SFCLs including similar types of other cooperatives, a new wholesale financing institution called 'Sana Kisan Bikas Bank Ltd' (Small Farmers Development Bank Ltd.) was established as a wholesale micro finance development bank in 2001. The SFDBL is also responsible for strengthening and capacity building of its partner organizations.

12.2.10 Banking Promotion Committee

The NRB set up the Banking Promotion Committee in July 1968 comprising the representatives of the banks, the Government and the business communities. With the objective of promoting banking activities all over the country through creating awareness among general public about banking services, the Committee studied and analyzed the existing policies and programmes related to banking promotion and disseminated necessary information through its regular activities like radio programme, publication, workshops and other support services.

The Committee also set up a separate banking publicity sub-committee which broadcasted banking programme through the Radio Nepal regularly since its establishment. Presently, the Committee is under NBA where all the commercial banks including the NIDC and the ADB/N are the members. The Committee was transferred to NBA on 15 July 2009.

12.2.11 Project-led Model for Financial Access

During the past four decades of priority sector financing, a number of programmes supported by the donor agencies with regard to financial access were carried out in Nepal with the involvement of NRB. The major programmes carried out during the period include Production Credit for Rural Women (PCRW), Micro-Credit Project for Women (MCPW), Cottage and Small-Scale Industries (CSI) Project, Community Ground Water Irrigation Sector Project (CGWISP), Third Livestock Development Project (TLDP), Rural Micro-Finance Project (RMP), Poverty Alleviation Project in Western Terai (PAPWT), Enhancing Access to Financial Service (EAFS) Project, Raising Income of Small and Medium Farmers Project (RISMFP) and UNNATI-Access to Finance Project (A2F). Except last three, all other projects were completed in the past.

Regarding EAFS project, an agreement was signed with the NRB in 2008 to implement it with financial support from the UNDP and UNCDF. The Project ended in March 2013 and, by that time, total grant of US$ 1.3 million was distributed among nine strategic and eight innovative partners to enhance the capacity for inclusive finance component of the Project.

Likewise, RISMFP is a Project aimed at increasing the production of high-value agricultural commodities (HVC) by small and medium scale farmers in Mid-Western and Far-Western Development Regions of Nepal. The districts covered by the Project were Banke, Bardiya, Dang, Dailekh, Surkhet, Baitadi, Dadeldhura, Darchula, Doti and Kailali. A Grant Assistance Agreement was signed between GON's Ministry of Agriculture Development (MOAD) and ADB on 16 March 2011. The Project is expected to be completed in six years, by 31 December 2017, at an estimated cost of US$ 33.54 million, of which ADB's contribution has been US$ 20.10 million. The executing agency is MOAD and implementing agencies are Department of Agriculture (DOA), NRB and Agro Enterprise Centre (AEC) of FNCCI. Part of the Project was for 'Agribusiness Grant Facility (AGF) component with the grant proceeds agreement between NRB and ADB taking place on 16 March 2011. Under the AGF component, NRB is to provide subgrants to 'qualified enterprises' upon approval by DOA and entering into an AGF grant agreement. The subgrants should be applied for financing the expenditures on the Project under 'qualified subprojects' according to the provisions of this Grant Agreement and the NRB Project Agreement. The Project is expected to benefit some 17,800 farm households with some 7,500 ha. contracted production farm, with some 64,500 tons of estimated annual HVC production.

UNNATI-Access to Finance (A2F) has been in implementation with the help of the Government of Denmark and UNCDF since 2013/14 in Eastern Nepal under the 5-year "UNNATI-Inclusive Growth Programme". The A2F Project, being implemented by NRB, costs USD 9.4 million. The purpose of the A2F Project is to support financial service providers to more effectively serve the agriculture value chain actors with appropriate financial products, thereby enabling small farmers and micro-SMEs to invest into their value chain activities leading to sustained improvement in competitiveness of selected chains. This Project intervention will have national impact with a specific focus given to the seven mountainous districts of Eastern Development Region, namely, Ilam, Paanchthar, Terhathum, Bhojpur, Dhankuta, Taplejung and Sankhuwasabha. The Project is basically concentrated on four agricultural products including dairy, big cardamom, orthodox tea and ginger by focusing on five agricultural financial products including savings, credit, insurance, leasing and warehousing. The Project also incorporates Mobile Money for the Poor (MM4P) and Making Access Possible (MAP) programmes.

12.3 Financial Literacy

NRB has been focusing on financial literacy in recent years. The basic objective of such focus is to (a) motivate people for saving, (b) raise awareness of financial system among people including financial products, credit facilities, consumer rights, risk mitigation, etc., (c) motivate people towards formal financial channels, (d) increase awareness among the people for mobilizing resources towards productive sectors, and (e) enhance financial access and financial inclusion. Promoting financial literacy will have positive implications on production, consumption, investment and employment, ultimately helping in reducing poverty.

NRB has been working directly or indirectly on financial awareness programmes since its establishment. In this context, NRB has been publishing various publications, organizing different programmes and training activities as well as involving in media programmes on a regular as well as occasional basis. As mentioned earlier, in order to develop banking habits among the people and banking system in the country, Banking Promotion Board was set up by the NRB in July 1968 with the involvement of different stakeholders including BFIs, the Government and the private sector. The Board is currently running under Nepal Bankers' Association. The promotional role played by the Board in the past has definitely contributed to enhance the banking habit amongst the general people, especially in rural areas.

In recent years, NRB has been conducting different activities in promoting financial literacy in the country. Amongst them, NRB has initiated a financial literacy campaign targeting students, called 'NRB with Students' since 2014. In this on-going programme, NRB officials visit a school and make a presentation on financial literacy before the students, teachers, members of the school management, local education officials of the government agencies, representatives of local BFIs, cooperatives, NGOs and INGOs. NRB has conducted many programmes in different schools throughout the country.

On the international front, NRB has joined two major forums which are working on financial inclusion and financial literacy issues. It has joined Alliance for Financial Inclusion (AFI) in 2010 and Child and Youth Finance International (CYFI) in 2013. Being the member of AFI, NRB has also expressed different commitments in the Maya Declaration regarding financial access, financial inclusion and financial literacy. Likewise, as a member of CYFI, NRB has been organizing different promotional financial literacy programmes primarily focused on students and youth. Global Money Week is one of the major activities carried out in Nepal as requested by the CYFI. Since 2013, NRB has been celebrating such financial literacy week with the coordination of UNICEF in Nepal. Mass rally on financial literacy is held each year for a week with the participation of students of different schools as well as the BFIs, cooperatives, NGOs, scouts and donor agencies. BFIs and the cooperatives were also requested to celebrate the week by organizing different programmes focused on financial literacy, especially among the youth. Likewise, radio programmes and TV talks focusing on financial literacy took place during the week.

NRB has also developed different financial literacy materials for public distribution. A story-book, called 'Paisako Bot' (Money Tree) was published by the NRB with the help of UNDP and UNICEF in 2013 for teenaged school students focusing on financial literacy issues. It was re-printed in 2014 with the help of UNICEF and Save the Children. Another booklet, entitled 'NRB with Students' focusing on different subjects comprising financial literacy for higher class students was published (in Nepali) in 2014. Another booklet, namely, 'NRB: Then, Now and Ahead' was also published (in English) in 2014 as a reference material for financial literacy, providing a brief introduction of NRB and its functions since its establishment. All of these publications are being distributed to the students during the rally as well as the visit of NRB officials to different schools for the financial literacy campaign. In case of training materials, NRB, under its Enhancing Access to Financial Services (EAFS) Project, developed a 'Trainers Training Manual on Financial Literacy' (in Nepali) in 2013.

For public awareness, NRB has developed a separate window in its home page (www.nrb.org.np) regarding financial literacy issues since 2014. Likewise, the Bank has also initiated displaying different financial literacy slogans at the front wall of NRB website since 2015. As a part of public awareness, NRB, in 2014, released a 'Musical CD' comprising six financial literacy songs (in Nepali) composed/sung by well-known artists in Nepalese musical field. The CD has been provided to different radio stations and TV channels for public broadcasting. Two financial literacy awareness programmes were also broadcasted through national media in 2012/13 with a view to promote public awareness. The display of financial information and literacy-related materials was launched through the electronic LED display at the front premises of NRB central office since 2013/14.

Appendix 12.1 : Policies for Increasing Financial Inclusion

Date	Policies/Directives
2007/08	• Refinance facility for commercial banks and development banks against the collateral of loan provided to *dalit*, women, indigenous, downtrodden, *Madhesi*, minorities and people of backward region for foreign employment at a refinance rate of 1.5 percent, for which BFIs are not allowed to charge more than 4.5 percent.
2010/11	• Waiver for the requirement of additional capital (Rs. 20 million for Kathmandu Valley and Rs. 5 million for other areas) for finance companies to open branches in municipalities or village development committees having two or less branches of BFIs. • Provision of interest free loan up to Rs. 5 million and Rs. 10 million respectively to those BFIs which open branches in district headquarters and outside the headquarters in 22 remote districts, specified by the Government. • BFIs were allowed to open a branch in Kathmandu Valley only after having operating a branch in one of the 30 specified districts where there has been limited presence of BFIs coupled with one more branch anywhere outside the Kathmandu Valley. • BFIs were allowed to operate branchless banking services by using smart card through the Point of Transaction (POT) with the help of their commercial representatives.
2012/13	• Refinance facility was announced for the loans provided to enterprises/businesses operated by youths who returned from foreign employment or returned after completing higher education from foreign countries.
2013/14	• Allowing credit to the agro-projects, basically coffee, orange, tea, livestock and dairy products against the collateral of project itself based on its viability.
2014/15	• For protecting consumers' right, BFIs were required to provide leaflet/booklet to their customers and general public incorporating the information regarding all the financial services, all kinds of accounts and credit, and financial instruments available in the concerned BFI.

2015/16	• The provision of obtaining prior approval by BFIs for opening branches in certain areas was waived. These areas include 114 Village Development Committees and 4 Municipalities of Parsa, Bara, Rautahat, Sarlahi, Mahottari, Dhanusha, Siraha and Saptari districts adjoining the southern border with India where there is relatively higher severity of poverty; 10 previously specified districts with higher level of poverty in the hilly region including Bajura, Kalikot, Bajhang, Humla, Darchula, Jumla, Doti, Achham, Mugu and Baitadi; and districts severely affected by the earthquake, except Kathmandu Valley. • Mapping of the financial access throughout the country was carried out. • A policy to extend concessional housing loan to earthquake victims was introduced immediately after the earthquake on 25 April 2015. Under this provision, a loan up to Rs. 2.5 million to the residents of Kathmandu Valley and up to Rs. 1.5 million to the residents outside the Valley may be arranged at 2 percent interest rate by the BFIs for which refinance facility could be provided by the NRB to the BFIs extending such loan at zero percent interest rate. This was further extended to include loans up to Rs. 300,000 per client by MFIs against group guarantee. BFIs could also get refinance for such loans from the NRB at zero percent interest rate. • To encourage the commercial farming and livestock, small and medium size enterprises and income generating activities in the earthquake affected areas, BFIs were allowed to extend loan up to Rs. 1 million against the collateral also of arable land not linked to roads.

13 Payment System Development

A National Payment System (NPS) covers all institutions and instruments, which are used for moving money safely, swiftly and efficiently between payers and payees. In other words, NPS encompasses the process of making a sound and credible financial transaction. In this regard, a healthy and efficient NPS becomes essential for exercising an effective monetary policy, attaining and maintaining financial credibility and stability and strengthening public confidence in the financial system.

While payment systems are an essential component of every economy including the Nepalese economy, the NRB Act, 2002, through Section 4, sub-section 1, clause c, conferred the responsibility of developing "a secure, healthy and efficient system of payment", to the NRB. The NRB Act, 2002, in a subsequent part (Section 5, sub-section 1, clause i) also provides authority to the central bank "to establish and promote the system of payment, clearing and settlement and to regulate these activities".

The systematic approach for the modernization of the national payments system was subsequently initiated by NRB in 2006 with the formulation of the Bank's First Strategic Plan (2006 – 2010). This had underlined "developing the payment and settlement systems as per the international norms and standards" as one of the strategies and activities under the financial sector management. The Strategic Plan stated, "NRB will take necessary initiatives to restructure the nation's payment system and establish the settlement system to minimize financial and systemic risks and promote efficiency. Modern payment system infrastructures, especially automated clearing house system, will be established. The Payment and Settlement Systems Master Plan will be formulated. The application of electronic payment system such as debit cards and credit cards will be promoted. The implementation process of the Real Time Gross Settlement (RTGS) system and Scripless Securities Settlement System will be established and operated. The existing Negotiable Instrument Act will get amended and other necessary laws related to the payment and settlement system such as the Payment and Settlement System Act will get enacted. It will allow commercial banks and financial institutions to undertake government transactions in a phased manner."

Box 13.1 : Status Background of Automated Clearing System in Nepal
The First Strategic Plan (2006–2010) had highlighted the need to develop system infrastructures for automated clearing house system in the country. In an effort to establish the automated clearing system, the NRB took the lead in establishing Nepal Clearing House Limited (NCHL) in 2008. The NCHL is now operating under the ownership of NRB, Nepalese BFIs and Smart Choice Technology (SCT), a private card switch operator. The establishment of NCHL can be regarded as one of the key milestones for the modernization of the payment system in the country (further details on NCHL are provided in following section of 13.4.1).

The NRB continued its priority for the development of payments system in its Second Strategic Plan (2012-2016). This Plan emphasized Payment System and Mechanism as one of the strategic pillars. Strategic Priority 4.1 of the Plan was to promote efficient and effective payment system. The Plan aimed to promote efficient and effective payment system, establish payment system unit, implement electronic cheque clearing, install RTGS system, formulate Electronic Payment and Fund Transfer Act and formulate regulations for e-payment, electronic funds transfers, internet banking and credit card operations.

In a bid to modernize the payment system in the country, NRB, with assistance from development partners issued Nepal Payment System Development Strategy (NPSDS) in 2014. This constituted as one of the key documents for guiding the development of a sound domestic payment and settlement system. NPSDS identified these nine key pillars: Legal Framework, Settlement Mechanisms for Large Value and Time Critical Payments Retail Systems, Government Payments, Securities Depository, Clearing and Settlement Mechanism, Interbank Money Market, International Remittance, Oversight of the National Payments System and Cooperative Framework for the Payments System.

With an aim to fill up the gap due to absence of National Payment and Settlement Systems Act in the smooth operation of payment system in the country, NRB developed and released Payment and Settlement Bylaw (PSB) on 7 July 2015. This Bylaw has required the institutions to obtain license from NRB to carry out payment related activities. BFIs and non-BFIs have to obtain appropriate license as per their payment instruments. The NRB set up new Payment Systems Department (PSD) on 2 July 2015 in line with the NPSDS and in the spirit of NRB Act, and entrusted the Department with the tasks of regulation, supervision and oversight of the entire domestic payment system.

PSD, in accordance with the provisions of the PSB, formulated the licensing policy for all institutions /mechanism carrying out the payment related activities on 12 July 2016. This policy brings non-BFIs under the regulatory domain of the central bank. The policy categorizes payment related institutions into two groups: Payment Service Provider (PSP) and Payment System Operator (PSO). PSPs are those institutions dealing with customers, while PSOs are those dealing with networks, switches and payment gateways. PSPs handle payment account, either electronic wallet-based or bank-based, and their operations can either be card based, telecom based or internet based.

13.1 Large Value Payment System

The prevailing payment system in Nepal is still dominated by physical cash as a payment instrument. The traditional instruments used in payment system are cash, cheque, telegraph transfer (TT), draft and internal remittance. While the intrabank payments are processed through Clearing House, the larger value payments (LVP) are still processed manually through cheques. The threshold for LVP for cheque clearing prior to mid-April 2017 stood at Rs 100 million. Large value cheques are cleared mutually by NRB and NCHL. While NCHL clears cheque denominating between Rs 100 million and Rs 200 million through ECC system, NRB clears cheque denominating more than Rs 200 million manually. Before 2014/15, all large value cheques were cleared manually by NRB through its Banking Office at Thapathali.

In 2015/16, a total of 730 large value cheques worth Rs. 109.10 billion were cleared. Of the LVP, 602 cheques worth Rs 90.3 billion were cleared by NCHL through ECC system and 128 cheques worth Rs 18.8 billion were cleared by NRB through manual clearing. There is no such clear demarcation on the threshold for LVP in Nepal. The above mentioned threshold is applicable only for the clearing of cheque and not for any other forms of payments.

LVPs are manually entered which delays the payment with diminishing efficiency. Since most of the central banks in the world have adopted RTGS system for critical and large value payment processing, NRB is also in a process to establish RTGS in order to enhance effectiveness and smoothness in payment systems.

13.2 Retail Payment System

Retail payment usually involves smaller value transactions between two consumers, between consumers and business, customers and the government, and sometimes between businesses. Retail payment system generally characterizes higher volume of transactions with lower value, comprising three mechanisms, namely, Systems, Channels and Instruments. Cheque clearing, Automated Teller Machine (ATM) networks, Direct Debits and Credits are components of this system. Internet banking, mobile banking and mobile payments are the channels and cheques, debit cards, credit cards, e-money are the instruments to execute the system using appropriate channels.

The existing retail payment systems of Nepal include NCHL, SCT, and NEPS. These are the existing systems that support retail channels and instruments. NCHL is electronic cheque clearing system, which supports ECC system. SCT and NEPS are shared ATM networks which facilitate the processing of card transactions. IPS is operated by NCHL which facilitates interbank payments, direct debits and credits.

Among the channels used for retail payment System, internet banking provides a convenient way of performing basic banking transactions like transferring funds from one account to another, utility payments, etc. For internet banking, one needs to be connected with internet and have a registered account being provided by the BFI through which a customer will be able to perform banking and payments from home, office or virtually anywhere. As in mid-December 2016, the number of internet-banking users in Nepal reached 515,465. Mobile banking facilitates common banking transactions as similar to internet banking where one needs mobile phone, registered account for mobile banking and telecommunication network coverage. As in mid-December 2016, there were 1,754,566 mobile banking customers in Nepal. Mobile payments help to make different payments to selected merchants using the mobile phones. Mobile banking facilitates mobile payments while non-bank mobile payment services are provided using an e-money account.

Retail based cheques are cleared by NCHL through a deferred net settlement process and submitted for final settlement to NRB's Banking Office at Thapathali, Kathmandu. The volume of cheques increased by 12 percent in 2015/16 as compared to the previous year. Such growth was 23 percent in 2014/15. The value of cheques rose by 31 percent in 2015/16, up from a growth of 30 percent in 2014/15. Comparison over the three year period suggests that the volume of cheques has increased between 2013/14 and 2015/16 by 38 percent and the value of cheques cleared has increased by 70 percent during the period. On the composition of cheques cleared in 2015/16, 74 percent of total cheques were valued at less than Rs 200,000. While cheques with value less than Rs. 1 million comprised 93 percent, cheques with value more than this amount stood at less than one percent.

13.3 Payment System Oversight

Payment system oversight is a central bank function where safety and efficiency are ensured by monitoring and assessing existing payment systems and inducing change, whenever necessary. Oversight differs from supervision in the sense that this uses a guideline and resolution based approach from a payment system viewpoint (and views this from a broad system wide perspective) whereas supervision uses a regulation and institution based approach from a prudential solvency and liquidity viewpoint (and views this on the basis of individual institutions). Thus, payments system oversight looks at systems, participants and instruments with its major role to ensure that systems are sufficiently protected against risk that may arise and also allowing funds to flow between individuals, business and financial markets efficiently and safety.

Before the establishment of PSD, NRB used to regulate payments system of BFIs through NRB's Banks and Financial Institutions Regulation Department. There was no such oversight of the payment system, but the NRB's Supervision Departments carried out the supervision of BFIs. Non-BFI payment institutions were outside the domain of the central bank's regulation and supervision. NRB has been working on the legal framework and has already published PSB, 2015. Licensing Policy for Institution/Mechanism Operating Payment Related Activities, 2016 has been published and the institutions providing payment systems are now required to be registered.

13.4 Auxiliary Institutions

13.4.1 Nepal Clearing House Limited

As discussed in Box 13.1 regarding the background to NCHL, it was established under the initiation of NRB to reduce the time and remove the cumbersome process of cheque clearing through NRB's own clearing house. Establishment of NCHL has enabled BFIs to adopt Electronic Cheque Clearing (ECC) system, which provides the means to electronically transfer cheque images through a secure medium, thus totally replacing the traditional physical routine of moving paper-cheques between the banks and clearing house. This has resulted in the significant reduction of tedious and time consuming manual process of cheque clearing, both for the banks and for the customers.

Electronic Cheque Clearing (NCHL-ECC) is an image-based, cost-effective, MICR (Magnetic Ink Character Recognition) cheque processing and settlement solution where an original paper cheque is converted into an image for electronic processing of the financial transactions between participating member Banks/FIs. The physical movement of the cheques are truncated or stopped at the level of the presenting bank in the NCHL-ECC system. The cheque does not physically travel to the clearing house or to the paying branch as it used to do in manual clearing process, resulting in a faster and easier processing of the cheque transactions. Only the MICR encoded cheques issued by the Banks/FIs are supported by NCHL-ECC system. NCHL-ECC currently supports cheque clearing of four currencies, namely, NPR, USD, GBP and EUR, with cut-off time for presentation at 14:00, cut-off time for paying bank response at 15:00 and final settlement at 15:30 for standard (MICR encoded) cheques. Express Clearing and High Value Clearing are also available, which are of shorter durations.

In addition, NCHL also operates interbank payment system (IPS). NCHL-IPS system provides safe and efficient means of funds transfer. It supports direct credit (payment) and direct debit (collection) related transactions of BFIs. Individual BFIs are enrolled in the NCHL as participating members and are responsible for their payment transactions and clearing operations. This system helps customers for payments or collections of fees, insurance premium, loan instalment, treasury, salary, pension, social security, dividend, Initial Public Offerings (IPO) refunds, government payments, etc. The service is available through any of the BFIs enrolled within the NCHL-IPS system. In IPS, transactions received before 1:00 pm are cleared by the system on the same day (T+0). The transactions presented after the cut-off time are cleared and settlement takes place the following day (T+1).

13.4.2 Credit Information Centre Limited

Credit Information Centre Limited (CICL) acts as the repository of credit information of the customers and commercial borrowers of all the BFIs. It collects, collates and disseminates credit information to assist BFIs. It disseminates credit information of borrowers to the BFIs upon request. NRB's regulation has made it mandatory for all BFIs to send credit records of all clients borrowing Rs. 1 million and above to CICL. They are also required to seek credit information of potential borrowers from CICL before they extend, renew, restructure or reschedule loans equal to or above Rs. 1 million. As per the NRB directives, BFIs will be liable for the punitive actions by NRB if they fail to submit and take credit information from CICL.

CICL was established by NRB in May 1989 in participation with commercial banks, with the sole objective of restraining the growth of the non-performing assets of the banking and financial sector.

Authorized share capital of CICL is Rs. 100 million and paid-up capital is Rs. 72 million. Initially, it was under Nepal Bankers' Association; later, in 2004, it got registered as a limited company under the Company Act and started its operation as an independent and autonomous entity since March 2005. It operates under the provisions made in NRB Act, 2002 (Second Amendment), Section 88. It is a public limited company with BFIs holding majority of equity (90 percent) while the rest (10 percent) is held by NRB.

The CICL issues both consumer (individual) and commercial (corporate) credit reports to its member BFIs. These reports contain information pertaining to creditworthiness of the members' clients which enables members to assess the credit risk more objectively, minimize the risk of bad debts and increase market penetration and volume of credit extended.

13.4.3 Deposit and Credit Guarantee Fund

Deposit and Credit Guarantee Fund (DCGF) is one of the major entities solely committed towards guaranteeing priority (deprived) sector loans including SME, agriculture and livestock loans as well as deposits amounting up to Rs. 200,000, thereby assisting in the promotion of financial system stability in the country. It was established on 20 September 1974 as Credit Guarantee Corporation with the objective of guaranteeing priority sector loan. The founding members of the DCGF are NRB, RBB and NBL.

In order to enhance the Corporation's effectiveness, the Government injected some capital in 1986 which made the Government as its major shareholder. Later, in 1997, deposit guarantee was added as its function. Hereafter, the Corporation was named as Deposit and Credit Guarantee Corporation Ltd. Recently, in 2016, the Corporation was converted into DCGF through a separate Act, named as Deposit and Credit Guaranteed Fund Act, 2016 which has overhauled legal as well as managerial features of the Fund.

The Act has limited its ownership to the GON and NRB to 90 percent and 10 percent respectively. Furthermore, it has made provisions regarding authorized and issued capital which are Rs. 10 billion and Rs. 5 billion respectively. Moreover, the Act has given DCGF the sole mandate to guarantee deposits collected by BFIs regulated by NRB. Apart from deposit guarantee, other major functions, duties and authorities of the Fund, according to the Act, are:

- To guarantee deposits of member institutions and reimburse to depositors,
- To guarantee loans floated by member institutions to small and medium industries, agriculture sector, service industry and others,
- To guarantee credit by member institutions to microfinance and livestock sector,
- To guarantee export loans provided by member institutions, and
- To perform other necessary activities to meet the objectives of DCGF.

Deposit Insurance in Nepal

Deposit insurance (guarantee) is a system that protects depositors against the loss of their guaranteed deposits placed with the bank in case of the failure of the bank. Nepal recognized the need of deposit guarantee in 1997 as evident by conversion of the name of erstwhile Credit Guarantee Corporation to Deposit and Credit Guarantee Corporation, but did not initiate the process of deposit guarantee immediately. However, after the financial crisis of 2007-09, the need for deposit insurance became vivid. Furthermore, the urgency to initiate the process was more intensified due to the shock faced by some financial institutions regulated by NRB during the real estate crisis in 2009/10. The Government, in its budget for FY 2010/11, announced the mandatory provision of deposit guarantee for the individual deposits up to Rs. 200,000 in the 'A' class Banks. Complying with the government decision, NRB issued a circular to 'D' class financial institutions (Microfinance Development Banks) to guarantee deposits up to Rs.200,000 of individual depositors. Later, NRB issued another circular to 'B' and 'C' class BFIs (Development Banks and Finance Companies) for the same purpose. Similarly, NRB through its annual Monetary Policy for 2011/12, made provision regarding the mandatory deposit guarantee for individual deposits up to Rs. 200,000. As per the figures from DCGF, Rs. 339 billion deposits from 13.9 million accounts were guaranteed by mid-October 2016.

Credit Guarantee in Nepal

DCGF was initially established for priority sector credit guarantee in 1974. However, after the phasing out of the priority sector credit by the Government, DCGF did not provide such guarantee for credits. However, it recently started providing guarantee for some kind of credits. Currently, DCGF provides guarantee for the following credits:

- Livestock Guarantee: Livestock purchased from the credit provided by the member institutions up to Rs. 100,000,
- Microfinance and Deprived Sector Credit: Loan provided by the member institutions to the group member up to Rs. 300,000 without collateral on a group guarantee basis and up to Rs. 7,00,000 with collateral. Similarly, loans provided by member institutions for micro-enterprises promoted by women entrepreneurs up to Rs. 500,000 per loan with personal or group guarantee basis in addition to project collateral,
- Small and Medium Enterprises Credit: Loan provided by the member institutions to small and medium enterprises in service sector as well as for industries up to Rs. 5 million per loan compulsorily and the investment up to Rs. 10 million per loan under DCGF's approval,
- Agriculture Credit : Loan provided by the member institutions to the agriculture sector up to Rs. 5 million per loan compulsorily and the investment up to Rs. 10 million per loan under DCGF's approval.

13.4.4 Debt Recovery Tribunal

Debt Recovery Tribunal (DRT) was established in 2003 to address the complex and lengthy legal processes in recovering the non-performing assets (NPAs) of BFIs. It was established under the provision made in Bank and Financial Institutions' Debt Recovery Act (BFIDRA), 2002. Initially, it operated with one Court, together with an Appellate Court, which was established with the motive of recovering huge bad debts piled in government-owned banks. Establishment of DRT has been one of the major outcomes of FSAP launched in association with the World Bank, International Monetary Fund, and DFID.

DRT is empowered with the legal authority to acquire the borrowers'/guarantors' additional assets which are not pledged in the concerned bank, and to dispose these acquired assets through auction in order to recover the bank's loan. Establishment of the DRT in the financial system has proved to be crucial in strengthening the legal framework with respect to loan recovery. According to the BFIDRA, BFIs with loans that have not been recovered by regular process could apply to DRT for loan recovery. However, they are required to apply for the recovery within four years of the loan becoming overdue. Initially, DRT[1] attempts to solve the case amicably through discussions between BFIs and borrowers. If the problem is not solved through discussions, then the case is forwarded to the courtroom.

The Act has given full authority to the loan recovery officer of DRT to seize all pledged or non-pledged fixed and movable properties of borrower or sell-off through auction, to siege all fixed and moveable

[1]DRT is comprised of three members, one each from law, banking and accounting group, with the provision of law group member holding Chairmanship. The members are appointed by the Government. The Act has specified certain criteria to qualify as members for the Tribunal. An incumbent or ex-Judge or individual qualified to become Judge of District Court would qualify to be a member of Tribunal. Similarly, to qualify as a member from banking group, a person must have at least master's degree in Economics or Commerce with at least ten years of working experience at least at Second Class officer level in BFIs established as per prevailing law. To qualify as a member from accounts group, a person must have master's degree in Commerce or Chartered Accountancy or equivalent degree following which (s)he should possess the license of 'B' Class auditor and then have at least 10 years of experience in auditing the BFIs.

properties of guarantor and to take concerned borrower or guarantor into custody in accordance with the prevailing law. Since its establishment DRT has recovered Rs. 13.29 billion bad debts. During 2015/16, it has recovered Rs. 2.27 billion while the amount was Rs. 3.32 billion in 2014/15. According to DRT, most of the registered cases are related with public sector banks.

13.4.5 Credit Rating Agencies

Practice of credit rating started in Nepal in 2011, after Securities Board of Nepal (SEBON) introduced Credit Rating Regulation, 2011. The Regulation necessitates credit ratings for the following offerings and issuance: Public or right issuance of more than Rs. 30 million. However, SEBON can publish public notice if it deems rating is necessary in the following cases: Issues even below the threshold of Rs. 30 million; Debentures and other debt instruments; Preference Shares; Initial, right, further and other offerings with premium prices; and Other securities or instruments specified by SEBON. According to the Regulation, results from ratings should be published in the prospectus/offer letter and other public documents. Furthermore, it has mandated rating agencies to rate individual borrowers who seek credit from BFIs.

Currently, there are two rating agencies in the country. ICRA Nepal Limited is the first rating agency which was granted license from SEBON on 3 October 2012. CARE Ratings Nepal Limited is the other credit rating company which was registered at the Company Registrar's Office on 3 May 2017. Apart from public issues, there has not been other provision regarding credit ratings.

13.4.6 Secured Transactions Registry

Secured transactions are loans or purchases that are secured by collateral. Credits or purchases for expensive items such as homes, vehicles or appliances are usually secured by the same item. For example, when a person buys a car on bank loan, s/he borrows money from the bank as car loan. In this transaction, this particular loan is a secured transaction where the bank is secured party and owns a security interest in the car which is the collateral for the loan.

Secured Transaction Registry is a database where all secured creditors (financial institutions, leasing companies and private lenders) can give notice of their security interests in movable goods of an entity or individual. Subsequently, it also enables all related parties to find out whether a particular movable good has interests from others or not. The provision of secured transaction registry was first introduced in Nepal through the Secured Transaction Act, 2006. The Act made provision about establishment of Secured Transaction Registry Office (STRO) for registration of secured transactions. However, it took a decade to implement the provision made through the Act. With the assistance from the International Finance Corporation, the Government has established STRO in partnership with CICL; the later was appointed as the private partner, responsible for the day-to-day operation of the Registry. The registry system, which became fully functional since 2015, is installed at CICL Data Centre in Kathmandu. One Under-Secretary from the MOF heads STR and it operates for 24/7 through web-based system. MOF is the sole regulator of the Registry.

The main objective of STR is to reduce risks associated with credit. It will significantly improve access to finance in the economy by the means of well-functioning secured transactions systems which enable businesses to use their assets as security to generate capital. The functions, duties and powers of STR Office include the following:

(a) Establishing, operating and maintaining an electronic registry for the filing of notices or amendments related with notices, continuation statements, termination statements, correction statements and notices of the interests of lien holders,

(b) Delivering to any person who so requests information from the records of the Registration Office as provided in the Act, and

(c) Publishing an annual report on the functions that it has performed within six months of the end of each fiscal year.

NRB has directed all BFIs to sign a *pari passu* agreement before extending or renewing working capital loans such as overdraft, cash credit, demand loan, trust receipt loan and short-term loan exceeding

Rs. 10 million for the same borrower. Such an agreement ensures proportional rights on collateral put up by the borrower with financing BFIs based on the size of loans. If such loans are not recovered, BFIs will have to recover the loans from the collateral based on the *pari passu* agreement. The registry has been helping BFIs to identify multiple borrowing incidents, thus reducing the risk associated with such borrowing.

To cite an example, businessperson, merchant, trader or entrepreneur (the debtor) goes to BFI (secured party) for a loan with his movable assets. BFI searches the records of the STRO via the internet to check whether the assets have been put for collateral or not. These assets can be searched by citizenship number of holder, registration number in case of registered assets like vehicles and other specified identity of these kinds of assets. If the asset is free from lien, then the BFI can file for its interest on that particular asset. Then the BFI can extend credit to the borrower taking that asset as collateral. Furthermore, if the BFI finds that another person has already filed the proposed collateral, it has several options. The BFI can contact the existing secured party to determine the size of existing obligation to find out whether there is enough space for the proposed loan and then file its own notice of security interest. In such a case, the second BFI would have secondary priority in the collateral. Or, the potential lender may try to make an agreement with existing secured party to subordinate its interest to the current secured party's security interest, and then file a notice. Or, the BFI may decide not to lend to the proposed borrower taking the asset as security.

14 Information Technology

Development of Information Technology (IT) has changed the banking operations drastically by fastening the banking services and helping to expand the outreach of financial services. However, the use of IT has also increased security threats in banking activities, demanding the effective security measures to prevent financial fraud that could occur in banking business. NRB has been giving due attention to modernize its own service as well as activities of BFIs through modern information and communication technology (ICT). This Chapter describes the IT adoption in NRB as well as in overall banking system, also highlighting emerging security threats with possible security measures.

14.1 IT Adoption in NRB

The first computer to enter Nepal was an IBM 1401 computer system installed at the Central Bureau of Statistics to process data of National Population Census, 1970. The resulting performance of census calculation prompted NRB to use the computer at the Bureau to process data of First Family Budget Survey (1973-75). In 1982, the Bank purchased its own computer – OHIO SCIENTIFIC, which allowed up to 16 people to work simultaneously. Initially, this computer was placed at the Bank's Research Department. In 1985, the Bank established Computer Section under the Research Department primarily for processing statistical data and the Second Family Budget Survey (March 1984 - February 1985) data. In September 1992, the Computer Section was upgraded to a Division under the Human Resource Management Department (then called the Personnel Administration Department), after which the computerization process in the Bank commenced in a systematic manner and PCs became more common. In June 1999, the Computer Division was upgraded to departmental level and named as the ITD. Since then, ITD has been actively involved in developing new software applications, supporting existing applications, maintaining and repairing computers and related equipment, managing Local Area Network (LAN), Wide Area Network

(WAN) and Internet/Intranet, designing and updating Bank's official website, reviewing and improving IT systems of the Bank, supervision of IT systems in BFIs and formulation of IT Policy and Guidelines.

The current IT adoption scenario could be categorized into three streams as discussed below:

14.1.1 Software System

The Bank has been actively investing in software system to automate or modernize its various operations. Some of the more prominent software systems that have been procured or developed in recent years are briefly described below.

Olympic Banking System: The most prominent of the software systems that have been procured is the Olympic Banking system which was introduced on 13 April 2013 by replacing the in-house developed banking and accounting systems including NRB Accounting System (ACCSYS), Banking System (BANKSYS), Public Debt Management System and Signature Verification System (SIGNAT). This system performs as GL as well as banking system.

Human Resource Management Information System Software (HRMISS): This software was introduced in August 2014, which is primarily used by HRMD and caters to various functions of HR management, ranging from personnel records, transfer and placement to attendance and leave management. It is expected to replace Personnel Record System (PRS), Insured Loan Record System (ILRS) and Payroll and Pension System.

Online Bidding System Software (OBSS): This software came into operation in July 2015 primarily to automate the OMO activities of PDMD, including bidding for Treasury bill, repo and reverse repo operations. Although this system is also designed for e-procurement for various offices of the Bank, this has not yet been used for the purpose.

Consumer Price Index (CPI): This is a web-based application designed to assist Price Division to calculate Consumer Price Index periodically which came into operation in July 2015. Primary data collected at various centres is uploaded via internet and is used by the Bank staff to produce CPI data. This system has been applied for data processing in connection with the Fifth Household Budget Survey.

Inventory Management System (IMS): This system, which was introduced in April 2013, is used by GSD to track inventory of the Bank and replaces Stock Inventory System as well as Depreciation System.

goAML: This system is being tested at the FIU for usage in its investigation of ML incidents.

The software indicated above are the more prominent ones and do not comprise an exclusive list of all the software being used. Altogether, there were 37 software systems, that were either developed or procured. Out of these, 23 are still in use, 10 replaced the other software and 4 are no longer in use.

14.1.2 Hardware System

NRB's current hardware infrastructure revolves around 17 servers. Four of the servers cater to Olympic GL system. Email, SWIFT and OBSS use one server each. Remaining servers are used in virtualized platform to host various other applications as well as services. On the desktop front, there are approximately 900 desktop computers and laptops. Similarly, there are about 500 printers, mostly laser printers.

Communication System

NRB has its own communications infrastructure leased from Worldlink Communications Pvt. Ltd. Currently, all offices outside the valley are connected to head office via fibre as well as radio link in redundant mode. Fibre links are the primary link while radio serves as fall-back link. Offices within the valley have redundant dual-fibre link to the head office. Lainchaur premises have only one fibre link due to temporary nature of the infrastructure.

Initiatives Underway

With financial and technical assistance of DFID, NRB has been working on establishment of its DR Site at NRB Biratnagar office. The construction work is under way, with civil works fully completed and non-IT infrastructure being installed. The DR site is expected to continue services in case some disasters occur in the primary site rendering it useless. The project will also encompass establishing a Bank-wide secondary communication link via different ISP.

NRB has committed to construct a modern and well-equipped Data Centre (DC) at its central office in Baluwatar premises. This infrastructure is expected to replace the existing data centre. On software front, goAML system, is expected to go live in the near future. Development of a Supervisory Information System is also in progress under the assistance of DFID that will assist BSD to collect and analyse supervisory information from the banking sector. Similarly, RTGS system is also in the pipeline, which will facilitate the real time transaction settlement of interbank payments.

14.2 IT Infrastructure and Electronic Banking Services in the Banking Sector

Technology, one of the critical resources in the banking sector, has changed the way and content of business operations. Evolution of IT has revolutionized the banking services and operations. Traditional brick and mortar banking has increasingly been substituted by the introduction of electronic delivery channel in the banking. In other words, the innovations in banking technology based on ICT are immediately and widely adopted by the Nepalese banks in the recent years. With the increase in penetration of mobile and internet users in Nepal, the adoption of banking based on such technology has also increased.

The use of ICT in the banking sector started with the ADB/N using stand-alone system for basic banking operations in 1984. Subsequently, other joint venture banks started using computer system in their back office operation. With the introduction of computer networking technology, stand-alone system was migrated to client server system. After innovation of web based technology and applications, web based systems have been widely used. Today, many of the client server based systems are migrated to web based system. In web based system, being thin client based system, client side does not need so much of processing power and applications can be used from web browsers. This has increased the popularity of web based banking applications. The recent status of implementation of information technology based products and services in Nepalese banking industry is discussed below.

CORE (Centralized Online Real-time Exchange) Banking Solution (CBS)

CORE banking applications have revolutionized the banking services. CBS allows customers to access the bank account and do the banking services from any branch of the bank regardless of which branch the account was opened. Most of the Nepalese banks have implemented CORE banking system. They are using CORE banking solutions from different vendors in different names, namely, Pumori, Finacle, Flexcube, Temenos 24, Professional Banking Software (PBS), etc.

Communication Infrastructure

There have been rapid technological changes in communication infrastructure globally towards high bandwidth communication link. After the introduction of optical fibre network, bandwidth of the network has increased tremendously and price has decreased in the same way. Optical fibre has become primary communication like in BFIs. In addition to Nepal Telecom, there are a number of private vendors providing networking solutions including optical fibre connectivity. Radio link and VSAT links are also in use for back up purpose and to connect to remote areas, where optical fibre links are not available. In addition to this, 3G networks, ADSL links, etc., are in use for back up purpose.

14.2.1 ICT-enabled Banking Delivery Channels

Initially, usage of ICT in financial sector was limited mainly to the back office operations. With the advancement of technology, the adoption of internet and mobile phone has become common. Customers can now use mobile devices and internet to do their banking operation without visiting bank branches. Following IT based delivery channels are provided by banks in Nepal.

Internet Banking

This service allows customers subscribing internet banking service to do banking by using internet from their PC, laptops and mobile, among others. Depending on the service offered by the bank, customers may be able to view their account information, transfer fund from one account to another, and pay bills. Subscribers may also communicate with the bank to request some banking operations. Internet banking service was first started in Nepal by Kumari Bank Limited in 2002 which at present, is offered by most of the commercial banks. There are 515,465 internet banking subscribers in Nepalese financial industry as in mid-December 2016.

Mobile Banking

This service allows customers to perform their banking operations by using mobile hand-held device. Message transfer is typically sent via SMS from mobile hand-held device to bank's system. Typical services offered by this service are fund transfer, account information view, communication with the bank, bill payment and mobile Top Up, among others. Laxmi Bank Limited first started this service in Nepal in 2004 and now most of the class "A" banks offer this service. As in mid-December 2016, there are 1,754,566 mobile banking customers in Nepal.

Plastic Cards

This is another widely used electronic banking channel. Plastic cards are available in the form of prepaid, debit and credit cards. Such cards can be used to withdraw money, pay bills by ATM and POS machine, and make payments for purchased goods online, among others. Plastic card holds data in magnetic stripe at the back of card but this technology is being replaced by chip based, more secured EMV card. Plastic card as a credit card was first introduced in Nepal by Nepal Arab Bank Limited (now NABIL bank) in 1990. There are 4,657,125 subscribers of debit cards, 52014 subscribers of credit cards and 82,797 subscribers of prepaid cards in Nepal as in mid-December 2016. Nepalese banks also issue plastic cards that can be used in international

ATM and POS machines. Currently, VISA, SCT and Master Card plastic cards are issued by Nepalese banks, which also acquire cards issued by international banks. Nepalese banks, which issued magnetic stripe-based cards initially, have now started issuing EMV cards.

Automated Teller Machine and Point of Sale Machine

ATM is a device used to withdraw cash; it can also be used to make payments of bill. In Nepal, Himalayan Bank Limited first introduced it in 1995. The number of ATMs installed is growing day by day, with the number of ATMs reaching 1,908 as in mid-December 2016. After the establishment of SCT 2001, an integrated shared network of ATMs was established. This network is allowing inter-operability of ATM Cards in ATMs and POS of different financial institutions by accepting multiple device type and acquiring standards[1]. Besides, there is a network of VISA that allows usage of card of one bank in ATM of another bank.

Mobile Wallets

This product is the latest and emerging e-banking product in Nepal. This allows customers without having bank account to hold money in their mobile number. This can be used for payment of goods and services. Subscribers of this product can load money from their bank accounts. This product has helped to provide banking services to customers who do not have bank account. As penetration of mobile device in Nepal is high and establishing banks and bank branches is difficult due to geographical terrain, this can be a great tool for financial inclusion.

Branchless Banking

This is a relatively new electronic banking product that helps to include the people who are staying in remote areas and do not have access to bank branches. Customers can access their bank account, transfer fund to other accounts, withdraw money from their account and make payments for purchasing goods and services at Point of Transaction (POT) machine maintained by bank or its branchless banking agent.

[1]SCT website http:/www.sct.com.np/about.us.php

The service can be accessed by using plastic branchless banking cards and their biometrics. Mostly, fingerprint is taken for biometric authentication. There are 914 branchless banking centres and 213,084 number of branchless banking customers as in mid-December 2016.

14.2.2 Disaster Recovery Capability

Disaster recovery capability constitutes one of the most important requirements for critical business like banking. Both man-made and natural disasters are likely to strike any technology infrastructure. Restoring operation promptly on any of such disasters is essential to continue the banking operations smoothly. There are many DCs and Disaster Recovery Centres available in Kathmandu and out of Kathmandu Valley run by private entities other than BFIs. Many Nepalese financial institutions have outsourced their Disaster Recovery Sites (DRS) to improve their disaster recovery capability. Some banks have maintained their own DC and DRS. Most of the banks have made arrangements to make real time replication of data in DC and DRS.

14.3 Cyber Threats and Security Measures

Threats and attacks from cyber criminals are increasing rapidly in the financial sector globally. They are continuously growing in scale and sophistication. None of the organizations is immune to such attack as even organizations with highest security measures have also become victim of cyber attacks. Financial sector, being primary holder of money, is becoming prime target of fraudsters. There are many examples of cyber frauds in financial industry that occurred in 2016, showing the magnitude of financial loss due to cyber attacks in the financial sector. Maintaining strong security measures has become very important for BFIs to mitigate the risks from cyber threats.

Arranging and managing security is very challenging as security is not a simple task, achievable just by installing latest security devices and software. Since the threat landscape is changing, security measures should also be changed accordingly. Implementing just one or two security measures is never sufficient for banking institutions which should implement layered approach to security design, filtering cyber threats in each layer.

NRB has been taking several measures to tackle possible cyber threats facing NRB IT infrastructure. Since security cannot be achieved just by upgrading hardware and software, layered approaches of security measures are applied by the ITD. Moreover, NRB has been directing and enforcing cyber security measures in the financial sector of Nepal. The following are some measures which have been undertaken by NRB for tackling increasing cyber security.

1. NRB has started to apply Secure Sockets Layer (SSL) encryption of its website since 27 October 2016. This SSL encryption digitally signed the website that makes the user easily find the genuine website of NRB. Along with the main domain of website, SSL has been implemented in its sub domain as well.

2. NRB has introduced IT Policy, IT Guidelines and IT Code of Conduct since 29 April 2011. IT Policy and IT Guidelines have enforced security measures to be followed by NRB and vendors accessing NRB's resources. Similarly, IT Code of Conduct provides prescriptions for dos and don'ts while accessing resources in NRB IT infrastructure.

3. With effect from 2016/17, NRB started implementing Active Directory system in all departments of NRB to centrally control security measures in all computers and laptops running Microsoft windows environment. NRB has started central controlling system on installation of unauthorized and illegal software and enforcing uniform system controlled security policies. Very soon, NRB is going to disable the access of external devices such as pen drives, CDs, etc. to prevent threats from external devices.

4. To minimize the attacks from external networks and external devices, NRB has been maintaining antivirus and firewall on its network, which are being regularly updated.

5. NRB has started migrating the existing email system to new and updated version, which is expected to be completed soon. With the migration to new system, NRB is expecting to reduce the impact of security threats on the email system.

6. Since user awareness is also a key layer of cyber security measures, NRB has been conducting user awareness programme each year in coordination with BTC. A security awareness programme is also being conducted by ITD in each of NRB offices outside the Kathmandu Valley.

Regulations related to IT Security Issued to BFIs

In addition to enhancing cyber security measures in NRB IT infrastructure, NRB has been regulating and supervising BFIs' IT system to enhance their cyber securing measures. Following are some of the initiatives from NRB to make cyber security measures more stringent and protect customer's data.

1. NRB issued IT Guidelines to BFIs on 16 August 2012. The IT Guidelines provide comprehensive guidelines that class 'A' banks must comply in their IT activities. This Guidelines is not mandatory for other classes of financial institutions yet but they are recommended to follow the Guidelines. Other classes of financial institutions will be required mandatorily to follow this Guidelines soon.

2. NRB has issued Directives related to e-banking on 21 June 2012, which provide directions on non-technical aspects of e-banking activities such as mobile banking, internet banking and branchless banking.

3. NRB has been conducting IT supervision annually in each commercial bank by including IT supervisor while conducting supervision by BSD. From 2016/17, supervision of development banks and finance companies also comprise IT supervisors.

Part 5
International Relations

15 Relations with International Organizations

As the central bank of the country, NRB also represents Nepal on the international front regarding national economic policies relating mostly to money, finance, banking, credit and BOP. NRB maintains relations with international financial institutions with a view to strengthening mutual cooperation and augmenting/exchanging skills and knowledge in diverse fields including research and capacity development. On these fronts, NRB represents the GON in various bilateral, regional and multilateral financial institutions.

NRB has been exhibiting its presence at the international level and maintaining sound relations with the relevant international agencies and institutions. Efforts are being made by NRB to broaden its presence and further improve its ties in the related field at the international level.

In this regard, NRB has maintained relations with various international organizations such as the International Monetary Fund (IMF), World Bank (WB), and Asian Development Bank (ADB). NRB also has a long history of its relation/involvement with the regional organizations such as the South East Asian Central Banks Research and Training Centre (The SEACEN centre), South East Asia, New Zealand and Australia (SEANZA) central banks group, Asian Clearing Union (ACU), the SAARCFINANCE (forum of the central banks of SAARC countries), Asia-Pacific Rural and Agricultural Credit Association (APRACA), SAARC Payments Council (SPC) and Alliance for Financial Inclusion (AFI), among others. As membership in most of the above organizations has been covered in the publications commemorating completion of 25, 40 and 50 years of NRB, they will only be briefly touched on, with the more recent memberships discussed in detail.

15.1 International Monetary Fund (IMF)

Nepal became the member of IMF on 6 September 1961 with initial quota of US$ 7.5 million, which increased to US$ 10.0 million in 1966, SDR

10.40 million in 1971, SDR 10.90 million in 1978, SDR 20.85 million in 1983, SDR 52.0 million in 1990 and SDR 71.3 million in 1998. After the Fourteenth General Review, Nepal's quota has increased to SDR 156.9 million in 2016, representing 0.03 percent of the total quota of IMF. Total votes allocated to Nepal amount to 3,033, which is 0.06 percent of the total votes.

Facilities used by Nepal

IMF makes its financial resources available to member countries through a variety of financial facilities. It levies charges on these drawings and requires that members repurchase (repay) their own currency from the IMF. Nepal has used the various facilities from IMF.

The first facility used by Nepal was First Reserve and Credit Tranches. The country had availed SDR 7.6 million under this facility in 1976. During 1976/77, Nepal faced a severe drought and agricultural production had declined by nearly 4 percent. To tackle this problem, Nepal had availed SDR 20.0 million under Compensatory Financing Facility and another SDR 13.7 million under Trust Fund Facility in 1978 (NRB, 1996). In the early 1980's Nepal had faced severe internal and external imbalances, reflected in low output growth, huge fiscal deficit, overvalued exchange rate, declining exports and BOP deficit for three consecutive years which totaled Rs 1.67 billion during the three years, 1983-1985. In 1985, the BOP deficit represented 1.45 percent of GDP with the decline in the foreign exchange reserve of the country to less than two months equivalent of merchandise imports. To overcome this situation, Nepal availed SDR 18.65 million from IMF in 1985/86 under the Stand-by Arrangements and implemented various policy measures including the devaluation of Nepalese currency by 14.7 percent in November 1985. Nepal availed this facility for the period covering December 1985 to April 1987.

Beginning in March 1986, Nepal availed the Structural Adjustment Facility (SAF) of 26.0 million during October 1987 to October 1990. In 1991/92, Nepal experienced inflation shoot up to 21 percent and current account deficit rising to 8 percent of GDP. To cope with the problems, Nepal entered into Enhanced Structural Adjustment Facility (ESAF) in October 1992. Under the ESAF, the IMF approved SDR 33.57 million to be utilized during the period of three years (May 1992 to April 1995). However, Nepal availed only SDR 16.79 million, leaving SDR 16.78 million undisbursed.

For implementing Poverty Reduction and Growth Facility (PRGF) in Nepal, the Government submitted to the IMF the Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding on 31 October 2003, requesting PRGF facilities for three years. The main elements of the PRGF-supported programmes included sound macroeconomic management, better expenditure prioritization and enhanced efficiency, structural reform in major economic sectors, improved governance for delivering conditions for sustained growth and enhanced pro-poor focus on budget spending.

On 20 October 2004, IMF gave the approval to Nepal to draw an amount equivalent to SDR 7.1 million (about US$ 10.6 million) which made the total disbursement (including the first instalment received at the time of PRGF acceptance) under the programme to SDR 14.3 million (US$ 21.2 million). The Poverty Reduction Strategy Paper (PRSP) policy measures targeted to increase GDP growth and reduce the poverty rate by 8-10 percentage points (from around 40 percent then) in five years. It also aimed at significant improvements in human development indicators. The PRSP strategy was composed of four pillars: broad based economic growth, social sector development, targeted programmes for the poor and deprived groups and good governance. Nepal's Tenth Plan was based on the PRSP of the Government.

Nepal has obtained Rapid Credit Facility (RCF) two times from IMF. In May 2010, IMF provided RCF equivalent to SDR 28.52 million (about US$ 42.05 million) to help address the economic impact of the global financial crisis. Again, on 31 July 2015 the Executive Board of the IMF approved a disbursement of SDR 35.6 million (US$49.7 million) for Nepal under the RCF. This financial support was expected to help the country address the urgent BOP and fiscal needs associated with the rehabilitation and reconstruction efforts in the aftermath of the powerful earthquake that occurred on 25 April 2015 causing widespread damage and devastation.

Technical Assistance and Training

The IMF provided a number of technical assistance to Nepal at its request on a number of issues (ranging from price, monetary, regulation, supervision, tax etc.) since the latter half of 1970s. In recent years, the list and the year of Technical Assistance (TA) provided by the IMF has been as shown in Box 15.1:

Box 15.1 : List of TAs provided by IMF

- Monetary Policy Operations and Enhancing Banking Supervision (2010)
- Bank Supervision and Crisis Management (2011)
- Bank Diagnostics (2012)
- Banking Supervision and Regulation (2012)
- Migration to GFSM 2001 (2012)
- Exchange Rate and Capital Account Liberalization (2013)
- Tax and Customs Administration Reforms / Modernization (2006-12)
- Public Financial Management (PFM) Stock Take (2010)
- Revenue Administration (2011-13)
- Public Financial Management (2014)
- Pension Reform (2014)
- Designing a Comprehensive Tax Reform Plan (2015)
- Enhanced General Data Dissemination System (2016)
- Monetary Policy/Operations (Continuous)

Liaison with IMF

The Governor of NRB acts as the Governor of Nepal to the Board of Governors of the IMF. The GON also nominates a senior official, usually a Joint Secretary, from the Ministry of Finance, as an alternate Governor to the IMF Board. Every year, in October, the IMF and the World Bank host the annual joint meetings in which Finance Minister heads Nepal's delegation comprising NRB Governor and Finance Secretary.

IMF had been placing a Senior Resident Representative in Nepal since 1985. Since 2010, the Resident Representative designated for India has been looking after Nepal. Resident Representative coordinates agenda for discussion between Nepal and IMF in regular Article IV consultation missions. (S)he is also responsible to facilitate the country in undertaking any IMF-supported programmes.

15.2 The World Bank

Nepal became the member of the World Bank on 6 September 1961, the same day of joining the IMF. The first partnership between Nepal and World Bank began when the first economic mission was assigned to Nepal in 1963. Since then, the World Bank has been supporting Nepal in a number of ways including lending in support of development projects and programmes, offering macroeconomic policy advice and assisting Nepal by financing development activities. Since the 1970s, the World Bank has funded several projects including development and maintenance of roadways and strengthening educational institutions at district and national level by financing basic and primary education projects.[1] Financial Sector Reform Programme was launched with the financial assistance of the IDA of the World Bank group and a grant of DFID in 2002, which was completed in 2011.

15.3 World Trade Organization

Nepal applied for the membership of the General Agreement on Tariffs and Trade (GATT) in May 1989 and was subsequently given an observer's status. The World Trade Organization (WTO) succeeded GATT since 1 January 1995.Nepal acceded to the WTO in 2004 as the 147th member of the multilateral trade body and as the first least-developed country to have joined the institution through the process of accession. As part of Nepal's commitments made under WTO accession, financial sector has been opened for foreign investment. Accordingly, NRB issued in 2010 a licensing policy for foreign bank branches to be established in Nepal.

15.4 Asian Development Bank (ADB)

Nepal is one of the founding members of Asian Development Bank (ADB), which was established in 1966 for fostering the economic growth and cooperation in the Asian region. The number of shares held by Nepal in ADB is 15,606, which is 0.147 percent of total shares. Total votes of Nepal are

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1http://www.worldbank.org/en/country/nepal/projects

55,213, which is 0.416 percent of total membership and 0.638 percent of total regional membership. Nepal's total capital subscription in ADB is US$ 209.8 million and paid up capital subscription is US$ 10.50 million.[2]

Although ADB mostly deals with the Government, NRB was also involved in some projects as a coordinating or implementing agency, especially microfinance related projects supported by ADB. Some of these projects and the year of their commencement are Microcredit Project for Women in 1993, Third Livestock Development Project in 1996, Community Ground Water Irrigation Sector Project (CGWISP) in 1999, Rural Micro-Finance Project (RMP) in 1999 and Raising Incomes of Small and Medium Farmers Project (RISMFP) in 2011.

15.5 The South East Asian Central Banks Research and Training Centre

The South East Asian Central Banks (SEACEN) Research and Training Centre was established as a legal entity in 1982 with eight member central banks/monetary authorities which increased to 20 members as in 2014. Since its inception in the early 1980s, the SEACEN Centre has established its unique regional position in serving its membership of central banks in the South-East Asian region through its learning programmes, research work, and networking and collaboration platforms for capability building in central banking.

NRB has been the founding member of the Centre. The former Governor Mr. Kalyan Bikram Adhikary was one of the signatories in the Memorandum establishing the SEACEN Centre on 3 February 1982 along with other six signatories comprising the Governors of the Central Banks and Managing Director of the Monetary Authority. Nepal has been taking part in all the training/activities conducted by the Centre. NRB has been participating in the various training activities conducted by the Centre by sending its officials.

Altogether, 4 BOG Meetings and Governors' Conferences, 9 SEACEN trainings, 11 seminars and 2 workshops have so far been held in Nepal. The latest event held in Nepal was the 49th Governors' Conference and

[2] https://www.adb.org/sites/default/files/publication/27783/nep-2015.pdf

33rd Meeting of the SEACEN Board of Governors (21-23 November 2013). Earlier, the 9th (March 4-6, 1974), the 13th (January 16-18, 1978) and the 22nd (January 20-21, 1987) SEACEN Governors' Conferences were held in Nepal. The list of training events and seminars that were held over the years in Nepal is given in Appendix 15.1. The research officials of the member banks also got opportunity to work at the Centre on occasional basis. So far, NRB has deputed seven research officers to the Centre. NRB has participated in many collaborative research studies organized by SEACEN as shown in Appendix 15.2 of this Chapter.

15.6 South East Asia, New Zealand and Australia

The South East Asia, New Zealand, Australia (SEANZA) was established by the meeting of central bank governors from the Asia-Oceanic region in 1956. The SEANZA is one of the oldest regional central bank groups, with its membership now growing to 20 countries from the original five countries. The SEANZA was formed to promote cooperation among central banks by providing intensive and elaborate training courses for central bank staff.[3]

NRB joined this Association in 1968. The Governor of NRB takes part at the meeting of the Council of Governors. NRB has been regularly participating in the SEANZA Central Banking Courses. NRB successfully conducted the Fifteenth Central Banking Course in Kathmandu in April-June 1985. It also hosted the 30th SEANZA Governors' Symposium and Central Banking Course in Kathmandu during 21-26 August 2016. This Symposium transferred the SEANZA Forum of Banking Supervisors' Chair from NRB to the Central Bank of Islamic Republic of Iran, with effect from January 2017. Prior to this, NRB had also organized SEANZA Advisors' Meeting in Kathmandu on 17 December 2015.

15.7 Alliance for Financial Inclusion

Alliance for Financial Inclusion (AFI) was established in 2008 to promote innovative financial inclusion policies to expand the financial access among the unbanked people. The AFI provides a platform to share and learn ideas for financial inclusion among members from more than 90 countries.

[3] https://aric.adb.org/initiative/south-east-asia-new-zealand-australia

NRB became a member of AFI in 2015. NRB has been regularly participating in programmes organized by AFI. As AFI member institution, NRB announced its Maya Declaration Commitment to increase financial inclusion in Nepal in August 2013. The Commitment acts in accordance with the central bank's stated objectives, strategic plan and policies. NRB had committed to increase financial literacy across the nation through the development of a national level Financial Literacy Strategy by mid-2014.

15.8 Asian Clearing Union

Asian Clearing Union (ACU) was established at the initiative of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP). The draft agreement establishing the ACU was finalized at a meeting of senior officials of the governments and central banks held at ESCAP, Bangkok, in December 1974, which was signed by five central banks (India, Iran, Nepal, Pakistan, and Sri Lanka). Bangladesh and Myanmar were the sixth and seventh signatories to this agreement. Bhutan and the Maldives signed the agreement in 1999 and 2009 respectively. The ACU started its operation in November 1975, with its headquarters in Teheran.

The ACU is a payment arrangement whereby the participants settle payments for intra-regional transactions among the participating central banks on a net multilateral basis. The main objectives of the clearing union are to facilitate payments among member countries for eligible transactions, thereby economizing on the use of foreign exchange reserves and transfer costs besides promoting trade and banking relations among the participating countries.[4]

15.9 Asia Pacific Rural and Agricultural Credit Association (APRACA)

The establishment of APRACA was first proposed at the regional seminar on "Agricultural Credit for Small Farmers", sponsored by the Food and Agriculture Organization (FAO) in October 1974 to enhance mutual cooperation and information sharing in rural finance. Under the auspices of FAO, rural finance and agricultural credit institutions in the region formally

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4 https://www.asianclearingunion.org/Home.aspx

established APRACA during its first general assembly meeting in New Delhi, India, on 14 October 1977. The general secretariat of APRACA was established at the FAO Regional Office for Asia and the Pacific premises in Bangkok, Thailand.

NRB is the founding member of APRACA. NRB, ADB/N, NBL and RBB are members from Nepal.

15.10 Centre for International Cooperation and Training in Agricultural Banking (CICTAB)

At the suggestion of FAO, CICTAB was set up by Ministry of Agriculture, Government of India, as an autonomous institution with its headquarters at Vaikunth Mehta National Institute of Cooperative Management, Pune, in January, 1983. The CICTAB became operational, initially for four countries of the region, viz., Bangladesh, Nepal, Sri Lanka and India. In 1991, the general council of CICTAB decided to revive the development of CICTAB activities.

CICTAB was conceived essentially as a sub-regional centre for Nepal, Bangladesh, Sri Lanka and India, as aforesaid, subsequently extending its scope to all the countries of the SAARC region. The countries of the region participating in CICTAB programmes possess more or less common features and comparable experiences and problems in their rural economy and in the various development programmes undertaken by them. NRB, NBL, RBB, ADB/N and National Cooperative Development Board are the members of this institution. Staff of these institutions have been benefiting from CICTAB's training programmes.

15.11 SAARCFINANCE

The 10th SAARC Summit of the Heads of the States of the SAARC region which was held in Colombo on 29 July 1998 agreed, in principle, to establish a "Network of Central Bank Governors and Finance Secretaries of the SAARC Region (SAARCFINANCE)" with a view to opening dialogues on macroeconomic policies of the region and sharing mutual experiences and ideas. Accordingly, the SAARCFINANCE was established on 9 September 1998 as a regional network of the SAARC Central Bank Governors and Finance Secretaries. It is a permanent body which obtained formal recognition from SAARC at the 11th SAARC Summit held in Kathmandu, Nepal, in January 2002. As per the decision of the Summit, Chairperson of SAARCFINANCE is invited to the sessions of the SAARC Council of Ministers to make a presentation on SAARCFINANCE activities.

SAARCFINANCE and NRB

Nepal is one of the founding members of SAARCFINANCE. As a member central bank, NRB has established a SAARCFINANCE Cell to coordinate the activities of SAARCFINANCE. The SAARCFINANCE Cell, which was previously under the then International Finance Division of the Research Department, was transferred to the International Relations Division under the Office of the Governor, with effective from 27 May 2015. NRB has also appointed the Coordinator and Alternate Coordinator of SAARCFINANCE.

As of mid-December 2016, 33 SAARCFINANCE Group Meetings of Central Bank Governors and the Secretaries of Ministry of Finance were held since its inception. The Meetings are held twice a year. NRB organized the 8th SAARCFINANCE Governors' Symposium and 24th SAARCFINANCE Group Meeting in Pokhara during 16-17 May 2012.

It was the 5th SAARCFINANCE Group Meeting that decided to organize SAARCFINANCE Coordinators Meeting. Accordingly, the first meeting of the SAARCFINANCE Coordinators was held in Colombo, Sri Lanka, on 7 January 2002. Five such meetings as below have been hosted by NRB to date:

Table 15.1: List of SAARCFINANCE Coordinators' Meetings held in Nepal

Date	Meeting
7 August 2002	2nd
11 August 2003	3rd
24 April 2013	17th
18-19 May 2014	19th
4-5 September 2014	20th

SAARCFINANCE has since undertaken various collaborative research studies. The first meeting of researchers under SAARCFINANCE collaborative arrangement was held during 17-18 August 2015 in Islamabad, Pakistan. The second meeting was held during 28-29 April 2016 in Colombo, Sri Lanka. The third meeting was held on 16 December 2016 in Dhaka, Bangladesh. The first collaborative research entitled "Managing Capital Flows and Remittances in the SAARC Region for Safeguarding Financial Stability" was led by the Reserve Bank of India and State Bank of Pakistan. The second collaborative research entitled "Promoting Financial Inclusion in the SAARC region" was led by Bangladesh Bank and Maldives Monetary Authority. The third collaborative research entitled "Comparative Analysis on Financial Stability led by Central Bank of Sri Lanka has now been ongoing. NRB has participated in all these collaborative research studies (These study reports are available in the website http://www. saarcfinance.org/). NRB also undertook a study on "The Feasibility of Using National Currencies in SAARC Trade" in 2000 as part of its annual programme.

Based on the decision of the 13th SAARCFINANCE Group Meeting to organize at least one seminar every year by each member central bank (except Bhutan and the Maldives), NRB has hosted eight SAARCFINANCE seminars. The details of the seminars are presented in Table 15.2.

Table 15.2 : Topics and Dates of SAARCFINANCE Seminars organized by NRB

S.N.	Topic	Date Held
1	Issues in Foreign Exchange Management	12-14 February 2001
2	Promoting Financial Stability- The Role of Central Banks	15-18 March 2004
3	Human Resources Management in Central Banks	21-23 August 2006
4	Management of Workers' Remittances in SAARC Countries	9-11 May 2007
5	Liquidity Management for Monetary Policy in SAARC Region	22-24 April 2009
6	Targeted Credit Programmes in SAARC Region	20-22 April 2011
7	Regulation and Supervision of Microfinance Institutions in SAARC Region	20-22 March 2013
8	Payment and Settlement Systems in SAARC Region	5 September 2014
9	Macro-Prudential Policies in SAARC countries	8-9 June 2017

Member countries also have mutually agreed for hosting staff exchange programme under the SAARCFINANCE umbrella. Under this programme, about 500 officials of the member countries have exchanged their knowledge on various issues by visiting the fellow central banks.

15.12 SAARC Payments Council

In order to enhance national Payment and Settlement Systems (PSS) of the member countries, it was decided to form a SAARC Payments Council (SPC) in 2008. SPC is engaged in enhancing cooperation among SAARC central banks on payments systems related issues. The SPC consists of senior officials at the level of Deputy Governor/Executive Director in charge of payment system development at the member central bank/ monetary authority. Chairperson of SPC presents the progress report of the SPC in the SAARCFINANCE Group Meetings. The inaugural meeting of SPC, hosted by the Central Bank of Sri Lanka (CBSL), was held on 28 March 2008 in Colombo, Sri Lanka.[5] NRB is one of the founding members of SPC with Deputy Governor representing in the SPC.

The 5th SPC meeting organized by the NRB was held on 29 March 2009 in Kathmandu, Nepal. NRB also hosted the 15th SPC meeting and the 1st SPC Seminar in Kathmandu during 9-10 May 2015.

15.13 South Asia Regional Training and Technical Assistance Centre

The South Asia Regional Training and Technical Assistance Centre (SARTTAC) at New Delhi, India, commenced its operations on 13 February 2017. The SARTTAC was established for planning, coordinating and implementing the IMF's capacity development activities in the South Asian region on a wide range of areas including macroeconomic and fiscal management, monetary operations, financial sector regulation and supervision, and macroeconomic statistics. The Centre aims to help address existing training needs and respond to the demand for IMF training in India, Bangladesh, Bhutan, Maldives, Nepal, and Sri Lanka, while bringing the region's training volume at par with those of other regions.

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[5] http://www.saarcfinance.org/innmspc.html

Funding for the SARTTAC comes from contributions by regional member countries and development partners. Australia, Republic of Korea and India have pledged financial support for the Centre. Nepal has also decided to contribute USD 2 million for the Centre. Nepal is represented by NRB Deputy Governor and Joint Secretary from Ministry of Finance as a member and alternate member respectively in the SARTTAC Steering Committee.

15.14 Bank for International Settlements

Established on 7 May 1930, Bank for International Settlements (BIS) is the world's oldest international financial organization which fosters international monetary and financial cooperation and serves as a bank for central banks. Currently, BIS has 60 member central banks or monetary authorities. All the members are entitled to representation and vote in the general meetings. The BIS works as a forum for promoting discussion and facilitating decision-making process among central banks and within the international financial community, including promoting economic and monetary research. BIS works as a prime counterparty for central banks in their financial transactions and as an agent or trustee in connection with international financial operations.

Appendix 15.1: SEACEN's Training, Seminars and Workshop held in Nepal

Training

- Inspection and Supervision of Financial Institutions (1983, 1990)
- Examination and Supervision of Financial Institutions (1993)
- Currency Operation Management (2001)
- Macroeconomic Management (2002)
- Balance of Payments Management (2007)
- Intermediate Course on Banking Supervision and Financial Stability (2008)
- Intermediate Course on Macroeconomic and Monetary Policy Management (2011)
- Risk Based Supervision (2012)
- Foundation Course for Bank Examiners (2016)

Seminars

- Role of Central Banks in Development Finance (1982)
- Country Risk and Treatment of Non- Performing Loans (1983)
- Current Problems and Issues in International Trade (1987)
- Domestic Resource Mobilization in the SEACEN Countries (1988)
- Bank Regulation of Off-Balance Activities in the SEACEN Countries (1993)
- Monetary Policy in a Liberalized Financial Environment (2000)
- WTO and Liberalization of the Financial Services Sector (2003)
- Seminar for Senior Bank Supervisors from Asia-Pacific Economies (2004)
- Comparative Experiences in Confronting Banking Sector Problems in the Asia-Pacific Region (2007)
- Leadership Seminar for Senior Bank Management of Central Banks on Financial System Oversight (2008)
- Regional Seminar for Bank Supervisors and Regulators: Liquidity Risk Management in Bank (2010)

Workshop

- Regulatory Responses to Derivatives Trading and other Financial Innovations (1997)
- Regional Workshop for Bank Supervisors and Regulators: Stress Testing Techniques (2009)

Appendix 15.2 : List of SEACEN's Collaborative Research Studies participated by NRB

Year	Research Title
1986	The Financial Structure and its Implications for Monetary Policy in the SEACEN Countries
1986	Selective Credit Policies in the SEACEN Countries
1987	Foreign Exchange Markets in the SEACEN Region
1989	Non-bank Financial Institutions: Their Impact on the Effectiveness of Monetary Policy in the SEACEN Countries
1989	Deregulation in the Financial System of the SEACEN Countries
1989	The Development of Capital Markets in the SEACEN Countries
1992	Public Sector and Monetary Policy in the SEACEN Countries
1993	Domestic Resource Mobilization in the SEACEN Countries
1993	Trade in Services in the SEACEN Countries
1994	Financing for Small and Medium-Scale Industries in the SEACEN Countries
1994	Long-term Financing for Manufacturing and Agricultural Sectors in the SEACEN Countries
1994	Foreign Direct Investment in the SEACEN Countries
1994	Export Promotion Strategies of the SEACEN Countries
1995	International Capital Movements in the SEACEN Countries
1996	Taxation of Financial Assets in the SEACEN Countries
1996	Inflation in the SEACEN Countries
1996	Taxation of Financial Assets in the SEACEN Countries
1998	Early Warning Indicators, Deposit Insurance and Methods for Resolving Failed Financial Institutions
1998	Financial System Soundness and Risk-Based Supervision
1999	Analysis of Economic Interdependence Among Asian Countries
1999	Securitization and its Impact on Banking Business
2001	Payment and Settlement Systems in the SEACEN Countries
2001	Analysis of Economic Interdependence Among Asian Countries
2003	Issues in External Debts: Concepts, Monitoring Procedures, Reporting and Crisis Prevention in the SEACEN Countries
2004	Central Bank Responses and Regulatory Framework of E-Money
2004	Managing and Monitoring Direct and Portfolio Investment Flows: A Comparative Study of the SEACEN Countries
2005	Role of Central Banks in Promoting Small and Medium Scale Enterprises
2005	Development of Domestic Bond Market and Implications for Central Bank: Countries Experiences

2006	Adequacy of Existing Level of Capital Implied by the Basel Standards Relative to the Credit Risk Exposures of Banks in the SEACEN Region
2007	Role of Non-Bank Financial Intermediation: Challenges for Central Banks in the SEACEN Countries
2007	Impact and Policy Responses to Oil Price Shock in the SEACEN Countries
2008	Macroeconomic Surveillance for Monetary Policy Management in the SEACEN Countries
2008	Comparison of Problem Bank Identification, Intervention and Resolution in the SEACEN Countries
2008	Understanding and Addressing the Pro-Cyclicality Impact of Basel II in the SEACEN Countries
2008	Development of E-payments and Challenges for Central Banks in the SEACEN Countries
2009	Capital Flows and Implication for Central Bank Policies in the SEACEN Countries
2009	Investment in the SEACEN Countries in the Post-Crisis Era: Issues and Challenges
2009	Supervisory Impact of Technology on SEACEN Financial Institutions: Issues and Challenges
2009	Comparative Strategies of Human Resource Management in Selected SEACEN Central Banks and Monetary Authorities
2010	Macro-Financial Links and Monetary Policy Management
2011	Relative Effectiveness of Policy Choices during the Global Financial Crisis in SEACEN Countries
2011	Addressing Risks in Promoting Financial Stability
2012	Framework for Macro-prudential Policies for Emerging Economies in a Globalized Environment
2012	New Financial Product and Challenges for Central Banks in the SEACEN Countries
2013	Role of Payment and Settlement Systems in Monetary Policy
2014	Analytical Framework in Assessing Systemic Financial Market Infrastructure: Interdependence of Financial Market Infrastructure and the Need For a Broader Risk Perspective
2014	Mortgage Finance and Consumer Credit: Implications on Financial Stability in SEACEN Economies
2015	Advancing Inclusive Financial System in the Next Decade

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