

**NEPAL RASTRA BANK UNIFIED DIRECTIVES ON  
CAPITAL ADEQUACY 2067 BS  
A Case Study of Siddhartha Bank Limited**

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## **RECOMMENDATION**

This is to Certify that the thesis

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**"NRB Unified Directives on Capital Adequacy 2067 BS – A Case Study of Siddhartha Bank Limited"**

has been prepared as approved by this Campus in the prescribed format of the Faculty of Management, Tribhuvan University. This thesis is forwarded for examination.

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and found that the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirements for the Degree of Master of Business Studies (M.B.S).

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## DECLARATION

I hereby declare that the work reported in this thesis entitled, "**NRB Unified Directives on Capital Adequacy – A Case Study of Siddhartha Bank Limited.**" submitted to the Office of Dean, Faculty of Management, Tribhuvan University, is my original work. It is done in the form of partial fulfillment of the requirement for the Degree of Master of Business Studies (M.B.S.) under the supervision and guidance of **Mrs. Rita Maskey** and **Mr. Sharad Sigdel** of Shanker Dev Campus, Putalisadak, Kathmandu.

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## TABLE OF CONTENTS

Recommendation	
Viva-voce sheet	
Acknowledgement	
Declaration	
Table of contents	
List of tables	
List of figure	
List of abbreviation	
	<b>Page No.</b>
<b>CHAPTER I: INTRODUCTION</b>	<b>1-9</b>
1.1 Background of study	1-3
1.2 Introduction to Nepal Rastra Bank (NRB)	3-5
1.3 Introduction of Siddhartha Bank Limited	5-6
1.4 Statement of Problem	6-7
1.5 Objectives of the Study	7
1.6 Significance and focus of the study	7-8
1.7 Limitation of the Study	8
1.7 Organization of the study	9
<b>CHAPTER II: REVIEW OF LITERATURE</b>	<b>10-27</b>
2.1 Conceptual Review	10-18
2.1.1 Meaning of Central Bank	10-11
2.1.2 Importance and Functions of Central Bank	11-12
2.1.3 Meaning of Commercial Bank	12-13
2.1.4 Overview: Capital and Capital Adequacy	14-18
2.2 Legal Provision of capital adequacy from central bank	18-20
2.3 Review of related studies	20-27
2.3.1 Review of Articles and Reports	20-22
2.3.2 Review of Thesis Works	22-27
2.4 Research Gap	27

<b>CHAPTER III: RESEARCH METHODOLOGY</b>	<b>28-32</b>
3.1 Research Design	28
3.2 Population and Sample	28-29
3.3 Nature & scope	29
3.4 Data Collection Procedure	29-30
3.5 Data Analysis Tools	30-32
3.5.1 Financial Analysis	30-31
3.5.2 Statistical Tools	31-32
<b>CHAPTER IV: DATA PRESENTATION AND ANALYSIS</b>	<b>33-52</b>
4.1 Financial Performance Analysis	33-35
4.1.1 Capital Fund	33
4.1.1.1 Data presentation and analysis of secondary data	33-35
4.1.2 Risk Weighted Assets	35-37
4.1.3 Capital Adequacy Ratio of Siddhartha Bank	37-39
4.1.4 Deposit, Loan and Advances of Siddhartha Bank	40-42
4.2 Statistical Analysis	43
4.2.1 Correlation Co-efficient	43
4.2.2 Test of significance of correlation coefficient	43
4.3 Changes in Capital Adequacy Norms on Siddhartha Bank	44
4.3.1 Study of Changes in Capital Fund	44-45
4.3.2 Study of Changes in Paid Up Capital	45-46
4.4 Data presentation and analysis of primary data	46-49
4.5 Major Findings of secondary data	50-52
4.6 Major Findings of primary data	52
<b>CHAPTER V: SUMMARY, CONCLUSION AND RECOMMENDATION</b>	<b>53-55</b>
5.1 Summary	53-54
5.2 Conclusion	54-55
5.3 Recommendation	55
<b>Bibliography</b>	
<b>Appendices</b>	

## LIST OF TABLES

<b>Table No.</b>	<b>Page No:</b>
4.1 Capital Fund of Siddhartha Bank	34
4.2 Risk Weighted Assets of Siddhartha Bank limited	36
4.3 Risk weighted Assets of Siddhartha Bank limited	36
4.4 Capital Fund used by The Bank	38
4.5 Deposit, Loan and Advances of Siddhartha Bank	41
4.6 Changes in Capital Fund of Siddhartha Bank	44
4.7 Changes in Paid up Capital of Siddhartha Bank	45
4.8 Response of Officials on necessity of Capital Adequacy Norms	46
4.9 Justification of present Capital Adequacy Ratio	47
4.10 Most Safeguarded Interest	48
4.11 Necessity of Revision in Capital Adequacy Ratio	48
4.12 Weightage Prescribed by NRB	49
4.13 Appropriate Steps to follow	49

## LIST OF FIGURE

<b>Figure No.</b>	<b>Page No:</b>
4.1 Capital Fund of Siddhartha Bank	35
4.2 Risk Weighted Assets of Siddhartha Bank	37
4.3 Capital Fund Used by the Bank	39
4.4 Deposit, Loan and Advances of Siddhartha Bank	42
4.5 Response of Officials on Present Capital Adequacy Ratio	47

## ABBREVIATIONS

BCBS	:	Basel Committee On Banking Supervision
BOK	:	Bank Of Kathmandu Limited
CAR	:	Capital Adequacy Ratio
C/D Ratio	:	Credit/Deposit Ratio
CS	:	Capital Structure
CV	:	Coefficient of Variance
DPS	:	Dividend Per Share
EBL	:	Everest Bank Limited
EPS	:	Earning Per Share
Fig	:	Figure
FY	:	Fiscal Year
HBL	:	Himalayan Bank Limited
i.e.	:	That is
JVS	:	Joint Venture Banks
NABIL	:	Nabil Bank Limited
NIC	:	Nepal Industrial and Commercial Bank Limited
NRB	:	Nepal Rastra Bank
r	:	Correlation Co-efficient
SBL	:	Siddhartha Bank Limited
SCBNL	:	Standard Chartered Bank Nepal Limited
TRWA	:	Total Risk Weighted Assets

# CHAPTER: I

## INTRODUCTION

### 1.1 Background Of The Study

Banks and other financial sector as the backbones of country's economy are related with monetary and capital market. The main objective of the commercial banks is to mobilize the resources by investing the same in profitable manner. The resources include capital funds consisting of shareholder's equity, money deposited by the people, borrowing and profit capitalization. The competency of any commercial banks is referred as to utilization of the resources on most profitable manner. The profit should be adequate to meet its cost of funds as well as there should be some margin left over as the reward for risk bearing. The financial institutions are supposed to have contribution for the overall economic reforms in the country.

Capital is one of the most important components for every organization including the banks. Actually, no organization can exist without capital. Without capital, it is not possible to set up any type of business whether it is general store or a big business house. Every organization is started with a zero position and only come into existence when the promoters, owners or shareholders finance on it as capital. Every organization should have enough capital to run business.

Although the businesses are the major sources of capital, they also have to raise capital to run business. Especially, the bank are the major sources for those capital, which the bank provides in terms of loan in a way that it does not affect the interest of the shareholder's; who are the owner of the banks, and the depositors towards whom the banks are obliged to. Bank can distribute the collected money in terms of loan, may invest in some projects. They can also obtain the required fund by issuing bonds, debenture etc. All of before mentioned activities involve risk, so the bank personnel need to decide about them rationally. But the bank cannot use the entire collected fund. Instead, every bank needs to maintain capital which is adequate considering all the risks. But it is too difficult to determine how much capital is adequate for that purpose.

Capital Adequacy has become one of the most significant factors for assessing the soundness of banking sector. Raising and utilization of funds are the primary functions of commercial banks. As such, commercial bank collects a large amount of deposits from general public. The depositors think that depositing their money in bank is safe and relaxing. But, what does happen if the bank doesn't have enough capital funds to provide a buffer against future, unexpected losses? Therefore, capital must be sufficient to protect a bank's depositors and counterparties from the risks like, credit and market risks. Otherwise, the banks will use all the money of depositors in their own interest and depositors will have to suffer loss.

After the restoration of multiparty democracy, several commercial banks made a way to business in Nepal. At present, commercial bank holds a large share of economic activities of the country. Stock market has been dominated by commercial banks since a decade. Every day, we can see trading of large amount of stocks of commercial banks. Not only in the stock market, but commercial banks have also been major contributors to the revenue of the country. They have been paying a large amount of tax every year. Banking sector has become a backbone of the economy of the country.

Establishment of commercial banks is governed by Bank and Financial Institutions Act and Company Act. However, Nepal Rastra Bank (NRB), as a regulatory body for banks and financial institutions, has right to specify the capital requirements, and other requirements. Being the central bank of Nepal, NRB has the responsibility to give special attention to the interest of depositors.

Capital is the cash or goods used to generate income either by investing in a business or a different income property. Whereas the capital adequacy ratio is percentage ratio of a financial institution's primary capital to its assets (loans and investments), used as a measure of its financial strength and stability.

NRB issued Directives to be complied by all financial institutions of the country. The Directives consist of 21 volumes. The NRB Directive no. 1 states about the Capital Adequacy Norms for financial institutions indicating the requirements of maintaining the Capital Fund to the prescribed ratios. The directives are said to be based on the internationally accepted norms of Basel Committee. The Basel Committee on banking supervision is a committee of banking supervisory authorities which was established by the central bank governors of the group of ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, The Netherlands, Sweden,

Switzerland and the United Kingdom and the United States. It usually meets at the bank for international settlements in Basel, Switzerland, where its permanent secretariat is located.

## **1.2 Introduction To Nepal Rastra Bank [NRB]**

Nepal Rastra Bank (NRB), the central bank of the Government of Nepal, was established in 1956 to discharge the central banking responsibilities including guiding the development of the embryo domestic financial sector. Since then, there has been a huge growth in both the number and the activities of the domestic financial institutions.

To reflect this dynamic environment, the functions and objectives of the bank have been recast by the new NRB Act of 2002, the preamble of which lays down the primary functions of the Bank as: to formulate necessary monetary and foreign exchange policies to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of the Kingdom of Nepal; to develop a secure, healthy and efficient system of payments; to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development; and to further enhance the public confidence in Nepal's entire banking and financial system.

The Bank is eminently aware that, for the achievement of the above objectives in the present dynamic environment, sustained progress and continued reform of the financial sector is of utmost importance. Continuously aware of this great responsibility, NRB is seriously pursuing various policies, strategies and actions, all of which are conveyed in the annual report on monetary policy which provides a comprehensive review and evaluation of the previous monetary policy and justification and the analysis of the following year's monetary policy. The re-engineering of the NRB itself is one of the critical components of the reform agenda. To improve the financial sector legislative framework, some new Acts have already come out and there have been amendments to some existing Acts. Enactments of the draft legislations on bank and financial institutions, secured transactions, insolvency, assets Management of Company and anti-money laundering are expected to be soon materialized, all with the goal of

strengthening the financial sector through its healthy development and improved stability.

These activities convey the commitment of the NRB for addressing the present and future challenges of the financial system more competently. This dynamic and proactive approach to the financial system, especially with its increasing openness and competitive process in the context of growing global financial environment, should ensure a sustained progress and stability of the financial system under NRB's guidance and leadership, for contributing substantially to the sustained development of the economy of Nepal.

Being the central bank of the country, the ownership of NRB is with the Government of Nepal but, the management of NRB is not controlled by it. NRB has 12 branches throughout the kingdom of Nepal including the head office at Baluwatar and the main banking office at Thapathali in Kathmandu.

As per the Nepal Rastra Bank Act, 2058, the objectives of NRB are stated as follows:

- a) To formulate and maintain appropriate monetary and foreign exchange policy for stable price and balance of payments situation required for sustainable economic development.
- b) To manage the required liquidity and stability of banking and financial sectors.
- c) To develop secure, healthy and efficient payment system.
- d) To monitor, supervise and evaluate banking and financial system within the country.

As well as, Nepal Rastra Bank Act., 2058 has prescribed the rights, duties and functions of NRB as follows:

- a) To issue currency notes and coins in the market.
- b) To formulate and implement necessary monetary policy for price stability.
- c) To formulate and implement foreign exchange policy.
- d) To determine the foreign exchange rate adjustment regime.
- e) To operate and manage foreign exchange reserves.
- f) To issue license to commercial banks and financial institutions for carrying out financial transactions and regulate, inspect, supervise and monitor such transactions.
- g) To function as the banker, advisor and financial agent of Nepal Government.
- h) To function as a bank of commercial banks and financial institutions, and as a lender of last resort.
- i) To establish, promote and regulate the systems of payments, clearing and settlements: and

- j) To carry out other important functions as necessary towards realizing the objectives enjoyed by the Act.

### **1.3 Introduction of Siddhartha Bank Limited**

Siddhartha Bank Limited (SBL), established in 2002 and promoted by prominent personalities of Nepal, today stands as one of the consistently growing banks in Nepal. While the promoters come from a wide range of sectors, they possess immense business acumen and share their valuable experiences towards the betterment of the Bank.

Within a short span of time, Siddhartha Bank has been able come up with a wide range of products and services that best suits its clientele. Siddhartha Bank has been posting growth in its portfolio size and profitability consistently since the beginning of its operations. It has its head office in Hattisar, Kathmandu and 43 branches all over the Nepal in very short period of time. The management of the Bank has been thoroughly professional.

Siddhartha Bank has been able to gain significant trust of the customers and all other stakeholders to become one of the most promising commercial banks in the country in less than 10 years of its operation. The Bank is fully committed towards customer satisfaction. The range and scope of modern banking products and services the Bank has been providing is an example to its commitment towards customer satisfaction. It is this commitment that has helped the Bank register quantum growth every year. And the Bank is confident and hopeful that it will be able to retain this trust and move even further towards its mission of becoming one of the leading banks of the industry.

#### **Vision**

Siddhartha Bank runs with a vision to be financially sound, operationally efficient and keep abreast with technological developments.

#### **Mission**

The Bank desires to be one of the leading banks of the industry by fulfilling the interest of the stakeholders and also aims to provide total customer satisfaction by way of offering innovative products and by developing and retaining highly motivated and committed staff. It directs all its efforts to move ahead with increased profits. The following mission statement is a guide to meet the Vision of the Bank:

Be one of the leading banks of the industry in terms of profitability, productivity and innovation.

Aim at total customer satisfaction by rendering efficient and diversified financial services through improved technology.

Build a highly motivated and committed team of staff by nurturing a good work culture to achieve superior individual performance aiming to enhance organizational effectiveness.

Be the place of pride to all its stakeholders.

#### **1.4 Statement of problem**

Bank plays a significant role in the economic development of the country by extending credit to the people. Although banking industry in Nepal is making remarkable progress and growth, it's not without the problems. At the present context, the main problem faced by the business sector as well as bank is the unstable political and economic condition of the country. And without the directives of the NRB capital adequacy for financial institutions would have been another great problem.

Capital Adequacy has become one of the most significant factors for assessing the soundness of banking sector. Raising and utilization of funds are the primary functions of commercial banks. As such, commercial bank collects a large amount of deposits from general public. The depositors think that depositing their money in bank is safe and relaxing. But, what does happen if the bank doesn't have enough capital funds to provide a buffer against future, unexpected losses? Therefore, capital must be sufficient to protect a bank's depositors and counterparties from the risks like, credit and market risks. Otherwise, the banks will use all the money of depositors in their own interest and depositors will have to suffer loss. If the banks go bankrupted, what will happen to the depositors of such money? Thus, an adequate Capital Fund is required to safeguard the money of depositors. The adequacy of Capital Fund is the most important aspect of the bank. The study has main focus on the Capital Fund of the Siddhartha Bank Ltd. This study tries to find out the answer of the following questions:

- What is the position of Siddhartha Bank Ltd in respect to its Capital Structure?

- What is the effect of change in Capital Adequacy Norms on Siddhartha Bank?
- Is Capital Fund of Siddhartha Bank adequate to safeguard the money of the depositors?

The Capital Adequacy ratio is derived on the basis of Total Risk Weighted Assets. The Capital Adequacy Ratios to be maintained by commercial banks are as follows since the FY 2064/65:

**Core Capital Fund** : **6%** of the Total Risk Weighted Assets

**Total Capital Fund** : **10%** of the Total Risk Weighted Assets

But before the FY 2062/63, this requirement had been minimum requirement of 4.5% in the form of Core Capital Fund and 9% in the form of Total Capital Fund by issuing a notification by NRB and it was 6% and 11% respectively since 2062/63. Since year 2064/65 the ratio is prescribed to be 10% for total capital and 6% for core capital.

### **1.5 Objective of the study**

The basic objective of the study is to study the NRB unified directives on capital adequacy of Siddhartha Bank Limited. The specific objectives of this study are listed below:

1. To examine the Capital Adequacy status of Siddhartha Bank Ltd.
2. To analyze the significance and impact of NRB Capital Adequacy Norms on Siddhartha bank Ltd.
3. To examine the relation of capital fund to the deposit, loan and advances of Siddhartha bank limited..

### **1.6 Significance of the study**

The study will have a significant importance in the present context of banking business in Nepal. Commercial banks have collected billions of Deposit. Such deposits are invested in different sectors or are mobilized as loan. In such a situation, these Deposits have to be protected by the adequate Capital Fund of respective commercial banks. In fact, the banks should have adequate Capital Fund apart from the deposits of public to make investments.

Presently, raising capital is a tough task and meeting the Capital Adequacy is tougher, though it is not impossible.

This thesis may not be new study in the field of banking sector but the thesis shall of course present some results which will reflect the capital structure and position of commercial banks in Nepal.

The study is based on the Capital Funds of the commercial banks which are supposed to be adequate as the NRB Directive no. 1 which is related with Capital Adequacy Norms for commercial banks. The norms basically emphasize on the basic requirement of the Capital Fund that a commercial bank should possess. The fundamental objective of the norm is to safeguard the interest of the depositors. As per the norm, Capital Fund has been divided into two categories i.e. Core Capital Fund and Supplementary Capital Fund.

At present, there are total 32 commercial banks in Nepal and few of them are still on the pipeline. Keeping in view of the striving commercial banks, the thesis report, as case study, analyzes the matters, issues and problems related to capital funds of Siddhartha Bank Limited. The thesis report is mainly focused on accordance of the Capital Adequacy Norms of Nepal Rastra Bank (NRB) by Siddhartha Bank Ltd.

### **1.7 Limitation Of The Study**

- The study is limited to the Capital Fund and Capital Adequacy Norms for commercial banks only.
- Since, it is not possible to take all commercial banks as sample, the thesis analyses the data and information of Siddhartha Bank Ltd.
- The data and information over the period of only 8 fiscal years commencing from FY 2062/63 to FY 2069/70 is used in the study.
- Though, Balance Sheets, Profit and Loss Accounts and other Financial Statements are considered as basic source of data. The study will be mainly based on the secondary data collected from various sources. However, some primary data will also be derived from the analysis of questionnaire prepared for the research study.
- For the literature review, various newspapers, journals, unpublished thesis works and nevertheless, the internet will be adequately referred. However, the literature review was limited to very few articles and research works due to unavailability of sufficient subject matters and adequate time.

## **1.8 Organization Of The Study**

The entire study is carried out to different stages and procedures as it is needed. The study is organized in the following 5 chapters in order to make the study easy to understand.

**Chapter 1:** This is an introductory chapter which contains brief background about bank and its importance, Introduction to Nepal Rastra Bank, Introduction to Siddhartha Bank, Statement of Problem, Objectives of the Study, Significance of the Study, Limitation of the Study and Organization of the Study. This chapter has been targeted to help the reader to understand get the rhythm of the subject matter of the thesis report.

**Chapter 2:** This chapter, 'Review of Literature' includes conceptual review, review of NRB Capital Adequacy Norms and review of empirical works. For this purpose, various books, journals and periodicals as well as internet have been adequately utilized.

**Chapter 3:** The third chapter is one of the most important chapters of the study. It deals with the research methodology, which is applied to collect the data and analyze them in the study. It contains Research Design, Population and Sampling, Methods of Data Collection and Methods of Data Analysis.

**Chapter 4:** Presentation and Analysis of Data illustrates the collected data into a systematic format. The collected are presented in tabular as well as graphical form so that it will be easy to understand and make a sense out of it. The analysis of those data is also included in this chapter. As well as, interpretation of analysis has also been done in this chapter. This chapter further describes the major findings of the thesis.

**Chapter 5:** The fifth chapter is the last part of the study, which provides summary, conclusion, suggestions and recommendations for improving the future performance of the sample bank.

Finally, bibliography and appendices are also presented at the end of the thesis work.

## **CHAPTER: II**

### **REVIEW OF LITERATURE**

Review of literature is the chapter where a researcher reviews the books, journal, magazines or any other types of studies, which are related to his/her field of study. Research is a continuous process it never ends. The procedures and the findings may change but research continues. It is believed that the review of literature is helpful to show the needs of the research work and to justify the work. It gives more information and description of the related theoretic aspects. This chapter deals with review of books, reports articles and unpublished publications.

#### **2.1 Conceptual Framework**

##### **2.1.1 Meaning Of Central Bank**

A central bank is fundamentally a chief bank of a given nation. The essential responsibilities of the central bank include issuing and maintaining a stable influx of currency, ensuring optimal employment, and keeping inflation under control. Other tasks of the central bank consist of holding deposits on the reserves of other banks, as well as overseeing lending and exchange practices of commercial lenders. The central bank also plays a vital role of reserving the nation's emergency funds. It is the national institution that monitors all financial and monetary procedures and policies.

Glenlake Publishing Co. Ltd and AMACOM American Management Association has expressed the central bank as bank that often carries out government economic policy, influences interest and exchange rates and monitors the activities of commercial and merchant banks. In this way it functions as the government's banker and is the lender of the last resort to the banking system. (Clark, 1999, International Dictionary of Banking and Finance)

Central Bank is an institution that is charged with regulating the size of a nation's money supply, the availability and cost of credit, and the foreign-exchange value of its currency. Regulation of the availability and cost of credit may be non selective or

may be designed to influence the distribution of credit among competing uses. The principal objectives of a modern central in carrying out these functions are to maintain monetary and credit conditions conducive to a high level of employment and production, a reasonably stable level of domestic prices, and an adequate level of international reserves. (Encyclopaedia Britannica, 2002)

Central bank is a banker's bank and a bank holding the main body of bank reserves of a nation and the prime reservoir of credit. (e.g. Bank of England, Bank of France) (Rosenberg,1982, Dictionary of banking and finance, New York: John Wiley and Sons )

Central bank is an institution which is charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare. It is also a banker's bank and holding reserves of the country and ultimate reservoir of credit. Hence, central bank is the regulating authority for commercial banks, and other banks and financial institutions.

### **2.1.2 Importance And Functions Of Central Bank**

It is difficult to lay down any hard and fast rule regarding the functions of a central bank. The powers and the range of functions of central banks vary from country to country.

The most important and the earliest functions to be discharged by a central bank is that of acting as a bank of issue. As well as it is a banker's bank. The central bank also acts as a lender of the last resort. In case of any problems and emergency to any of the banks operating under it, central bank comes forward to rescue them temporarily from such problems. It also plays the role of an agent, an advisor and banker to the Government. Central bank is a custodian of the nation's metallic reserves and controller of currency.

A central bank has sole right to issue national currency notes. It controls money flow in the market by imposing monetary policy. It issues notes after full analysis of unemployment, inflation, economic growth, etc. of the country. Central bank is the holder of all the Government balances. It is the holder of all the reserves of the other banks and financial institutions in the country.

Objectives between a central bank and other commercial banks are different. The main objective of a central bank is to assist the government to implement economic policies without any profit motive, whereas the main objectives of other banks is to earn profit by mobilizing funds collected from the general public. As well as the central bank plays the role of guardian and parents to other commercial banks.( Shekhar and Shekhar, 1998),

As a regulatory body of all other banks and financial institutions, a central bank is the origin of all banking policies under which all the banks are suppose to operate. Therefore, a central bank guides and assists in operating banking system as a whole. A central bank has full authority to interfere in the banking market i.e. to all banks in terms of implementing its policies. It can penalize the banks in case they go out of the central bank's policy or the termination of the license and also can restrict their working dimensions to a large extent.

A central bank is also important in the context to co-ordinate with different international institutions such as International Monetary Fund (IMF) etc. It works under the supervision and guidance of such institution to develop the monetary system of a country.

### **2.1.3 Meaning of Commercial Bank**

A commercial bank is a financial intermediary which collects credit from lenders in the form of deposits and lends in the form of loans. A commercial bank holds deposits for individuals and businesses in the form of checking and savings accounts and certificates of deposit of varying maturities while a commercial bank issues loans in the form of personal and business loans as well as mortgages. The term commercial bank came about as a way to distinguish it from an "investment bank." The primary difference between a commercial bank and its counterpart is that a commercial bank earns revenue by issuing primary loans from its pool of deposits while an investment bank brings debt and equity offerings to market for a fee. Among its assets, including loans, a commercial bank holds a portfolio of other securities to generate proprietary income.

Rosenberg (1982) has stated commercial bank as an organization chartered either by the Controller of the Currency and known as a national bank or chartered by the state

in which it will conduct the business of banking. A commercial bank generally specializes in demand deposits and commercial loans.

Clark (1999) has defined commercial bank as bank that concentrates on cash deposit and transfer services to the general public, often to be found on the High Street. It may be joint-venture bank or a private bank.

"Bank is an institution that deals in money and substitutes and provides other financial services. Banks accept deposits and make loans and derive a profit from the difference in the interest rates paid and charged, respectively. Some banks also have the power to create money. Commercial bank is a bank with the power to make loans that, at least in part, eventually become new demand deposits. Because a commercial bank is required to hold only a fraction of its deposits as reserves, it can use some of the money on deposit to extend loans. When a borrower receives a loan, his checking account is credited with the amount of the loan; total demand deposits are thus increased until the loan is repaid. As a group, then, commercial banks are able to expand or contract the money supply by creating new demand deposits."(Encyclopaedia Britannica, 2010)

"Banking, the business of providing financial services to consumers and businesses. The basic services a bank provides are checking accounts, which can be used like money to make payments and purchase goods and services; savings accounts and time deposits that can be used to save money for future use; loans that consumers and businesses can use to purchase goods and services; and basic cash management services such as check cashing and foreign currency exchange. Commercial banks specialize in loans to commercial and industrial businesses. Commercial banks are owned by private investors, called stockholders, or by companies called bank holding companies." (Microsoft Encarta Reference Library, 2010)

The main objective of a commercial bank is to earn profit by collecting the fund scattered around the general public, and mobilizing it. So, the main functions of commercial banks happen to be collecting deposits from general public and lending loans to various economic sectors that require financing. Commercial banks make profit by charging a bit higher interest rate in loans than they pay to depositors. So the main source of income of commercial banks is interest income.

#### **2.1.4 Overview: Capital And Capital Adequacy**

"Capital is a stock of resources that may be employed in the production of goods and services and the price paid for the use of credit or money, respectively." (Microsoft Encarta Reference Library, 2010)

Rosenberg (1982) has defined capital in relation with banking as a long-term debt plus owners' equity. The efficient functioning of markets requires participants to have confidence in each other's stability and ability to transact business. Capital-rules help foster this confidence because they require each member of the financial community to have, among other things, adequate capital. This capital must be sufficient to protect a financial organization's depositors and counterparties from the risks of the institution's on-balance sheet and off-balance sheet risks. Top of the list are credit and market risks; not surprisingly, banks are required to set aside capital to cover these two main risks. Capital standards should be designed to allow a firm to absorb its losses, and in the worst case, to allow a firm to wind down its business without loss to consumers, counterparties and without disrupting the orderly functioning of financial markets.

Minimum capital fund standards are thus a vital tool to reducing systematic risk. They also play a central role in how regulators supervise financial institutions. But capital requirements have so far tended to be simple mechanical rules rather than applications of sophisticated risk-adjusted models. Such capital standard is widely known as capital adequacy.

Patheja (1994) Financial management of commercial banks, Delhi has defined banks capital as common stock plus surplus plus undivided profits plus reserves for contingencies and other capital reserves. In addition since a bank's loan-loss reserves also serves as a buffer for absorbing losses, a broader definition of bank capital include this account.

Verma and Malhotra (1993) have indicated that the general public is interested in the higher profitability and safety of the funds of a bank, because the public expects the shareholders to assume all the risks. Lower profitability of a bank fills the faith of the prospective depositors and all their incentive for investing in the various deposit schemes.

The Basel Committee sets a standard for all the banking norms, which will be accepted by central banks of all big industrialist countries. Regarding the capital funds

the committee has issued the Basel Capital Accord. The first Basel Capital Accord was issued in 1988 and was implemented by 1992. The committee had issued New Basel Capital Accord which should have been implemented by 2006 to overcome the drawbacks of the present capital accord.

NRB had issued new set of Capital Adequacy Framework 2010(Revised with the inclusion of unified directives, 2009) applicable to all 'A' class financial institutions licensed to conduct banking business in Nepal under the Bank and Financial Institutions Act, 2063, which should have been implemented by Mid July 2010.

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

1. Is adequate to protect its depositors and creditors.
2. Is commensurate with the risk associated activities and profile of the commercial bank.
3. Promotes public confidence in the banking system.

Central banks of developing and underdeveloped countries follow these standards. NRB also follow these standards and accordingly sets standard for commercial banks in Nepal.

According to the Directive issued by NRB, the bank capital has been categorized into two parts: **Core Capital** and **Supplementary Capital**.

**A. Core Capital:** The key element of capital on which the main emphasis should be placed is the Core Capital, which comprises of equity capital and disclosed reserves. This key element of capital is the basis on which most market judgements of capital adequacy are made; and it has a crucial bearing on profit margins and a bank's ability to compete.

The BCBS (Basel Committees on Banking Supervision's) has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way, which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings. In order to rank as core capital, capital must be fully paid up, have no fixed

servicing and be freely available to absorb losses ahead of general creditors. Capital also needs to have a very high degree of permanence if it is to be treated as core capital.

**B. Supplementary Capital:** The supplementary capital includes reserves which, though unpublished, have been passed through the profit and loss Account and all other capital instruments eligible and acceptable for capital purposes. It will be reckoned as capital funds up to a maximum 100% of a core capital arrived at, after making adjustment referred in deduction from core capital. In case where the core capital of a bank is negative, the supplementary capital for regulatory purpose shall be considered as zero and hence the capital fund, in such case, shall be equal to core capital.

The Core Capital consists of the following components of capital:

1. Paid Up Capital
2. Share Premium
3. Irredeemable Preference Shares
4. Proposed Bonus Equity Shares
5. General Reserve Fund
6. Retained Earnings
7. Accumulated Profit / Loss
8. Capital Redemption Reserve
9. Capital Adjustment Fund
10. Calls in advances
11. Other Free Reserves

Following items should be deducted while determining Core Capital

- a. Goodwill
- b. Amount invested in shares and securities of corporate bodies exceeding the limit imposed by this Bank.
- c. All amount of investment made in shares and securities of the corporate bodies having own financial interests.
- d. Fictitious assets

For this purpose, fictitious assets mean the fictitious expenses other than the expenses in research, development and computer software.

e. Credit and facilities made available to persons and groups prohibited by the prevailing laws.

Provided that in case the prevailing law has not prohibited to providing loan and facilities to such person or groups at the time of making available loans and facilities, this provision shall not be applicable until one year of such prohibition or expiry of the date of repayment of the loan, whichever is earlier.

f. The amount of purchasing of land and houses for self purposes not abiding by Directives of this Bank. 3

g. The amount invested in residence, buildings construction and land development exceeding the limit.

h. The share underwriting not could be sold within the prescribed time-limit.

The Supplementary Capital consists of the following components of capital:

1. Redeemable Preference Share
2. General Loan Loss Provision
3. Assets Revaluation Reserve
4. Hybrid Capital Instruments
5. Unsecured Subordinated Term Debt
6. Exchange Equalization Fund
7. Investment Equalization Fund
8. Other Reserves

The total of Core Capital and Supplementary Capital is considered for calculating Capital Adequacy Ratio. The Capital Adequacy Ratio is based on total Risk-Weighted Assets.

**Maisel (2038)**, "*Risk and capital adequacy in commercial banks, Chicago*" Capital is adequate either when it reduces the chances of future insolvency of an institution to some predetermine level of alternately when the premium paid by the banks to an insurer is "fair", that is, when it fully covers the risks borne by the insurer. Such risks, in turn, depend upon the risk in the portfolio selected by the bank, on its capital and on terms of the insurance with reference to when insolvency will be determined and what loss will be paid".

**Besis (2056)** "*Risk management in banking*", .has claimed that capital adequacy aims at setting minimum level of capital as a function of risks. Thus, capital should be risk based.

**Clark (2057)** has defined capital adequacy as legal requirement that a financial institution (such as bank) should have enough capital to meet all its obligations and fund the services it offers.

The Capital Adequacy Ratio is yielded by the following formula:

$$\text{Capital Adequacy Ratio} = \frac{\text{Total Capital fund}}{\text{Total Risk Weighted Assets}} \times 100\%$$

## **2.2 Legal Provisions Of Capital Adequacy For Commercial Banks**

With an objective to develop a healthy, competent and secured banking system for economic prosperity of the country and to safeguard the interest of depositors, NRB issued the directive no.1 regarding minimum capital fund to be maintained by commercial banks. NRB issued these capital adequacy norms by using the power given by Bank and Financial Institutions Act (BAFIA). These norms were issued under the Provision 79 of Nepal Rastra Bank Act, 2059 for developing and regulating banking system.

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

1. Core Capital of not less than 6% of total risk weighted exposures.
2. Total Capital Fund of not less than 10% of total risk weighted exposures.

Capital Adequacy Ratio is calculated by dividing eligible regulatory capital by total risk weighted exposure. The total risk exposure shall comprise of risks weights calculated in respect of bank's credit, operational and market risks.

Requirements have not been prescribed for Supplementary Capital and focus has been made for Core Capital. So, it is required to fulfil the requirement for Core Capital and excess of Core Capital over the requirement can be utilized to meet the overall requirement of Total Capital Fund.

As stated earlier, for the purpose of calculation of Capital Fund, the capital of the banks is divided into two components Core Capital and Supplementary Capital. Core Capital consists of paid up capital, share premium, Irredeemable preference shares, proposed bonus equity shares, general reserve fund, accumulated profit/loss., retained earnings, capital redemption reserve, capital adjustment fund, dividend equalization reserves and other free reserves. Supplementary capital consists of redeemable preference share, general loan loss provision, exchange revaluation reserve, assets revaluation reserve, hybrid capital instruments, unsecured subordinated term debt, investment adjustment reserve and other reserves. The sum of these two components is considered to be total capital fund.

For the purpose of calculation of capital fund, the risk-weighted assets have been classified into two parts – On-Balance Sheet Risk-Weighted Assets and Off-Balance Sheet Risk-Weighted Items. The amount of risk-weighted assets calculated by multiplying the amount of the asset with the weightage assigned to them and the total of which will be extracted for the purpose of calculation of capital adequacy ratios.

As per the norms, the capital fund ratio would measure the total capital fund on the basis of total risk-weighted assets. The capital fund ratio shall be determined as follows:

$$\text{Capital Fund Ratio} = \frac{\text{Core Capital} + \text{supplementary Capital}}{\text{Sum of risk weighted assets}} \times 100\%$$

The sum of risk-weighted assets is the sum of total on-balance sheet risk-weighted assets and total off-balance sheet risk-weighted items.

The banks shall, at the end of Ashoj (mid October), Poush (mid January), Chaitra (mid April) and Ashad (mid July) of each fiscal year, prepare the Statements of Capital Fund and other relevant statements on the basis of the financial statements as per the prescribed Form No. 1 and Form No. 2 and submit to the Banking Operations Department and Inspection and Supervision Department of this bank within one month from the end of each quarter.

Through a review process, NRB has prescribed a separate Form applicable to all 'A' class financial institutions from the year 2065/66.

In the event of non-fulfilment of Capital Adequacy Ratio by any bank, the Board of

Directors of the bank shall submit the adequate reasons for not being able to maintain the required capital fund and capital plan or program prepared to fulfil the capital fund requirements within 35 days. NRB shall direct the bank to fulfil the requirements as per submitted capital plan or program and within the time limit prescribed. The bank is not allowed to distribute dividends and bonus shares in such context.

If any bank does not fulfil the minimum Capital Fund within the specified period, NRB may initiate any of the following actions:

- a) Suspension of opening new branch.
- b) Suspension of access to refinancing facilities of Nepal Rastra Bank
- c) Restriction on lending activities of the bank.
- d) Restriction on accepting new deposits.
- e) Initiation of any other actions by exercising the authority under Section 100 of Nepal Rastra Bank Act, 2058.

## **2.3 Review Of Related Studies**

### **2.3.1 Review of Journals and Articles**

**Prof. Howell (2067)**, published an article on "*Capital adequacy and liquidity after financial crisis*", which have summarised that Basel Accord focuses on the definition of capital and the market shift to common equity as the strongest loss absorber constitutes a much needed important quality of capital. The leverage ratio, which has long been a central tenet of the regulation of depository institution, is clear, transparent, and comparatively easy to monitor. The new liquidity requirements addresses one of the key drivers of the financial crisis- arguably, it was liquidity rather than a capital crisis, not withstanding that it was ultimately caused by fundamentally bad lending decision. The capital conservation buffer provides an antidote to the pro-cyclical effects of Basel-II to smoothen the exposure of banks to the volatility of the credit cycle.

**Onalapo (2068)**, an article on "*A Qualitative Analysis of the Impact of Capital Adequacy on Managerial Effectiveness*" have summarised that financial capital is an essential tool in any sustainable business. There are countless challenges in the undertaking and successfully execution of feasible business due to inadequate capital required to exploit the various opportunity in the environment. Capital is an essential

tool in business formation and continuity which prompts the realization of business objectives while its insufficiency can preempt organisation goal realization. Hence, it is recommended that in order to attract and enjoy the potential opportunities offered by the provision of adequate capital in the insurance industry, operators must come to terms on the overall size of capital requirement as a basis for creating a supportive and enabling business support system that fosters management culture, performance and practice.

**John (2069)**, has published an article on "*Capital adequacy standards, BASEL Accord and bank performance*". A capital adequacy standard for banks that operates internationally is of major concern for bank regulators worldwide. In consequence, the Bank for International Settlements, (BIS) established a framework for measuring capital adequacy for banks in the group of ten (G10), industrialized nations of the world. The adoption of the standards in the city of Basel came to be referred as the Basel Capital Accord on Capital Adequacy Standard. The Capital adequacy Standard under the Basel accord has been widely accepted worldwide by bank regulators. Capital adequacy standards, exert a major influence on bank performance. And so does the efficient and effective bank supervision and risk management.

**Abba (2069)**, has published an article on "*Capital Adequacy Ratio and Banking Risks*", Capital adequacy ratio is an important measure of "safety and soundness" for banks and depository institutions because it serves as a buffer or cushion for absorbing losses. Capital adequacy ratio is one of the important concepts in banking which measures the amount of a bank's capital in relation to the amount of its risk weighted credit exposures. The Basel Capital Accord is an international standard for the calculation of capital adequacy ratios. The Accord recommends minimum capital adequacy ratios that banks should meet. Applying minimum capital adequacy ratios serves to promote the stability and efficiency of the financial system by reducing the likelihood of banks becoming insolvent. When a bank becomes insolvent, this may lead to loss of confidence in the financial system, causing financial problems for other banks and perhaps threatening the smooth functioning of financial markets. In the aftermath of the financial crisis, there have been efforts by regulatory authorities to make banks stronger. To accomplish this, governments across the developed world are compelling banks to raise fresh capital and strengthen their balance sheets, and if banks cannot raise more capital, they are told to shrink the amount of risk assets (loans) on their books.

### 2.3.2 Review of Thesis

**Pandit, (2067)** has conducted thesis on the title “*The directives of NRB In Maintaining capital Adequacy Ratio and Its Impact on NIC Bank*”

#### **Objectives:**

The main objectives of study are as follows:

- To study and analyze the significance and impact of NRB capital adequacy norms on NIC bank.
- To examine the deposit trend of NIC Bank and its performance.
- To analyze the activities of NIC bank to fulfil the requirements as per the norms and
- To provide necessary suggestions on the basis of study.

**Research Methodology:** The necessary data for the purpose of the study was collected from the secondary sources such as Unified Directives of NRB, annual reports of NIC bank, different magazines and journals.

**Major Finding Of The Study:** It was found that,

- Bank was quite successful in maintaining capital adequacy ratio as prescribed by NRB.
- The bank had capital adequacy ratio of 20.90% against the requirement of 9% in FY 2059/60 . During FY 2060/61, the bank had the capital adequacy ratio of 18.87% against the requirement of 10%. In the followed year, the bank had capital adequacy ratio of 13.75%, 13.29%,and 13.57% against the requirement of 11%.
- Capital fund of NIC bank has grown consistently over the study period of 2059/60 to FY 2063/64 and it has reached 1036.84 millions.

**Karki, (2068)** has conducted thesis on the tittle "*Capital Adequacy Ratio analysis (Comparative study Of BOK and HBL)*"

#### **Objectives:**

The general objectives of this disseration are to evaluate and compare the capital adequacy analysis and risk measurement of Nepalese commercial bank. and other objectives are:

- To analyze the capital adequacy ratio i.e. minimum capital requirement against its risk of selected commercial banks.

- To examine the relation of capital fund to the other stakes of bank (credit/deposit).
- To Find out whether the selected commercial banks achieving the NEB guidelines of minimum percent of capital adequacy or not.
- To make necessary Suggestions and recommendations.

**Research Methodology:** The necessary data for the purpose of the study was collected from the secondary sources such as Unified Directives of NRB, annual reports of Bank of Kathmandu and Himalayan Bank Limited, different magazines and journals.

**Major Findings Of The Study:** It was found that,

- Capital Fund of both BOK and HBL has grown consistently over research period from FY 2061/62 to 2066/67. The Capital of BOK has reached 2336.07 millions from 777.45 millions. Whereas the capital of HBL has reached 1525.77 millions till 2066/67.
- BOK has not successfully maintained capital adequacy ratio in 2064/65 against the requirements of 11%; otherwise both the bank has meet the requirements.
- The Capital to deposit ratio of sample banks are satisfactory. The Capital deposit ratio of HBL changed to 85% to 50% which is the case of overutilization. Whereas the same of the HBL ranged from 66.12% to 82.03% over the study period.

**Sedhai, (2069),** *“A Study On Capital Adequacy Of Nepalese Commercial Banks (Based on Basel-II and Implementation in Nepal- Case Study of NABIL, BOK and SBL.”*

**Objectives:**

The basic objective of the study is to explore the overall framework of the capital regulation that are presently followed by international as well as national financial institutions, basically the commercial banks .Other objectives are

- To analyze the risk associated with the capital adequacy of the selected banks.
- To indentify the difference in maintaining the minimum capital standard of commercial bank in context of Nepal.

- To explore the relevancy of Basel Accord in Nepalese perspective.
- To disclosure the NRB regulation and directives related to capital standard of Nepalese commercial banks.

**Research Methodology:** The required data for the purpose of the study was collected both primary as well as secondary data. The primary data was collected through the field survey where the bank officials of NABIL, BOK and SBL are asked to fill the questionnaire. And the secondary data was collected through the annual reports of the respective banks and other magazines, NRB directives etc.

**Major Findings Of The Study:** It was found that,

- Total Capital of the commercial banks has significantly increased during the past years by 273.50% and reached 25778.0 million till mid july 2011.
- The commercial banks have the share of 85.7% of deposits from 508905.7 millions.
- Among the sample Banks NABIL bank has not been able to maintain its core and total capital. Whereas other two banks, BOK and SBL has maintained both core and total capital.

**Sharma, (2069),** *“A Study Of Capital Adequacy Of Selected Commercial Banks of Nepal With Reference To NABIL, BOK, EBL, and SCBNL”*

**Objectives:**

The main objectives of the study were as follows:

- To ensure that every commercial banks maintains a level of capital that is required to protect its depositors and creditors.
- To ensure that every commercial bank maintain a level of capital that promotes public confidence in banking system.
- To disclose the NRB regulations and directives related to capital standard of Nepalese commercial banks.

**Research Methodology:** The required data for the purpose of the study was collected both primary as well as secondary data. The primary data was collected through the field survey where the bank officials of NABIL, BOK, EBL and SCBNL are asked to fill the questionnaire. And the secondary data was collected through the annual

reports of the respective banks and other magazines, NRB directives etc.

**Major Findings Of The Study:** It was found that,

- Capital maintained by the sample banks is sufficient to protect its depositors.
- Bank capital regulation framework has helped in developing suitable prudential norms to save the banks and financial institutions from financial crisis and signals of failure.
- The risk management system of all sample banks has improved.
- All sample banks have maintained the required capital adequacy ratio. The total deposit of the financial institution has reached 508095.7 million, among which the commercial banks have the share of 83.7%.

**Shrestha, (2069)** *"NRB Directives on Capital Adequacy – A Case Study of Nepal Industrial and Commercial Bank Limited."*

**Objectives:** The main objectives of the study were as follows:

- To examine the Capital Adequacy status of NIC Bank Limited.
- To analyze the significance and impact of NRB Capital Adequacy Norms on NIC Bank Limited.
- To examine the relation of capital fund to the deposit, loan and advances of the bank.
- To provide conclusion, findings and recommendations based on the analysis of data.

**Research Methodology:** The required data for the purpose of the study was collected both primary as well as secondary data. The primary data was collected through the field survey where the bank officials of NIC Bank Limited were asked to fill the questionnaire. And the secondary data was collected through the annual reports of the respective banks and other magazines, NRB directives etc.

**Major Findings Of the Study:** It was found that,

- Capital Fund of NIC has seen steady growth. The Core Capital of the bank has seen consistent growth except FY 2065/66, where a sharp increment has been observed, whereas fluctuation has been seen in the Supplementary Capital. The Capital Fund of NIC consisted of Core Capital of Rs. 911.80 million and Supplementary Capital of Rs. 296.80 million totalling Rs. 1208.60 million at the end of the FY 2063/64. The Capital Fund has increased

approximately to double Rs. 1956.13 million consisting of Core Capital and Rs. 267.65 million of Supplementary Capital totalling Rs. 2223.77 million by the end of the FY 2067/68.

- The bank had capital adequacy ratio of 12.20% during FY 2063/64 against the NRB requirement of 11%. In the years followed, the bank had capital adequacy ratios of 13.10%, 12.42%, 12.92% and 12.89% against the NRB requirement of 10%.
- The bank under study, NIC Bank is found to be successful to comply with requirement of capital adequacy norms. Anyhow the bank is meeting the capital adequacy requirements. However, some bank officials are not satisfied with the provisions.

**Sapkota, (2070),** “*Capital Adequacy Of Commercial Banks In Nepal ( A Comparative Study of Laxmi Bank limited And Himalayam Bank Limited)*”

**Objectives:** The main objectives of the study were as follow:

- To disclose the NRB regulation and directives related to capital standard of the Nepalese commercial banks.
- To analyze the risk associated with the capital adequacy of the selected commercial banks.
- To explore the relevancy of Basel Accord in Nepalese perspective.
- To identify the difficulties in maintaining the minimum capital standard of commercial bank in context of Nepal.

**Research Methodology:** The required data for the purpose of the data were collected through the secondary sources such as annual reports of sample banks, NRB directives, and others magazines published by the sample banks.

**Major Findings Of The Study:** It was found that,

- The core capital and the supplementary capital of the sample banks has increased in research period. Both sample banks has maintained the required capital adequacy ratio.
- All sample banks have maintained the required capital adequacy ratio. The total deposit of the financial institution has reached 508095.7 million, among which the commercial banks have the share of 83.7%.

- The risk management system of all sample banks has improved.
- Bank capital regulation framework has helped in developing suitable prudential norms to save the banks and financial institutions from financial crisis and signals of failure.

## **2.4 Research Gap**

Earlier studies dealt about NRB Directives as a whole and generalized the matter about the objectives, purpose and impact of the directives to the commercial banks and financial institutions. Very few of them have gone specific about capital adequacy norms but none of them have written over two phases of the capital adequacy norms taking Siddhartha Bank in specific. So, this study is conducted to make a specific review of capital adequacy norms with a specific case of Siddhartha Bank. It may be the case that the bank is not very old, so, many studies regarding this bank have not been made compared to other elder commercial banks. As such, this study might be a novel one with reference to the study of the capital adequacy norms of Siddhartha Bank.

Directives for Financial Institutions has been issued as applicable from FY 2063/64, so, it can be said that this study should be new one incorporating the capital adequacy norms of such new directives. The study is focused on capital adequacy norms fulfilled by the bank and its impact upon it. The study has also reviewed few important items like Capital Fund, Deposit and Credit, which have important role to play in the capital adequacy requirements. Moreover, the study has incorporated the views and opinions of the bank officials with the help of questionnaires regarding capital adequacy requirements set by NRB. The study certainly gives clear picture of the compliance of the capital adequacy norms by Siddhartha Bank limited and its impact on the bank with reference to the analytical study of Capital Fund, Deposit and credit.

# **CHAPTER: III**

## **RESEARCH METHODOLOGY**

Research is search or study about phenomena. The research methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view. Research Methodology can be understood as a science of studying how research has been done.

This chapter looks into the Research Design, Nature and Sources of Data, Data Collection Procedure and Tools and Technique of Analysis. For the purpose of achieving the objectives of the study, the applied methodologies are used. The research methodology used in the present study is briefly mentioned below.

### **3.1 Research Design**

Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research question. Selection of appropriate research design is necessary to meet the objectives of the study. This study research attempted to analyze the Capital Funds of commercial banks taking the data and information of Siddhartha Bank Ltd. The research design was basically focused on analytical study. Ratio Analysis, Correlation Analysis and Comparative Analysis of the ratios have been done for analyzing the research. The research examined the relationship of Capital Fund to various other stakes, like Deposits, Credits, etc.

### **3.2 Population And Sample**

The process of selecting one or some elements with the intention of finding out something about the population from which they are taken is called sampling and that particular element or the group of elements is called sample. The method of selecting a sample is of great importance. The sampling procedures, which are commonly used, are probability sampling (random sampling) and non-probability sampling (or non-random sampling).

Non- probability sampling is the method of selecting samples, in which the choice of selection of sampling units depend entirely on the discretion or judgement of the sampler. This type of sampling method is further classified into judgement sampling, convenience sampling, accidental sampling, quota sampling, and sequential sampling.

There are total 30 commercial banks presently operating in Nepal. Collecting the data of these entire commercial banks is not possible. Hence, Siddhartha Bank Ltd. has been selected as the sample population for the study using judgement sampling method due to the following reasons.

1. No evidences of the research study about this bank on the concerned topic has been found, so, this research work will found out whether or not the Siddhartha bank adhere to the norms of NRB Directives.
2. Siddhartha Bank is one of the emerging successful banks, so it would beneficial for the bank and its stakeholders if this study is conducted.

5 bank officials of Siddhartha Bank were selected as the respondents out of the officials by using judgement sampling. A research questionnaire was designed for interviewing.

(Appendix- B)

### **3.3 Nature and sources of data:**

The data and information used in this study are both primary and secondary in nature. Questionnaire is asked to fill to the officials of SBL for the primary data. 5 officials of Siddhartha Bank has answered the questionnaire. Unified Directives of Nepal Rastra Bank, Annual Reports of Siddhartha Bank, various publications of Nepal Rastra Bank, magazines, the other publications and the internet (website [www.nrb.org.np](http://www.nrb.org.np)) have been used for the secondary data. Also, for other related information, various books and periodicals have been referred from library.

### **3.4 Data Collection Procedure**

The data and information are collected from both the primary and secondary sources. For the primary information, questionnaire was used. The research interview, questionnaire was set for bank officials.

For the collection of secondary data and information, Unified Directives of Nepal Rastra Bank, Annual Reports of Siddhartha Bank, various publications of Nepal Rastra Bank, magazines, the other publications and the internet (website [www.nrb.org.np](http://www.nrb.org.np)) have been used. Also, for other related information, various books and periodicals have been referred from library and some that the researcher self has.

Before analyzing the data, the data and information have been presented systematically in the formats of Tables, Graphs and Charts which will explain a lot about the data and information collected. For the analysis of the research study, the following financials tools and statistical tools are used.

### **3.5 Tools of Analysis**

#### **3.5.1 Financial Tools**

Financial tools basically help to analyze the financial strength and weakness of the banks. In this study, financial tools like ratio analysis have been used.

##### **3.5.1.1 Ratio Analysis**

Ratio Analysis is the main tools of financial analysis. Ratios can be taken as expression of relationships between two items or group of items and therefore may be calculated in any number and ways so far meaningful co-relationship is obtainable.

In general, the Ratio Analysis is used as a benchmark for evaluating the financial position and performance of a firm.

The following ratios related to the banks are used to analyze the data:

##### **a. Capital Adequacy Ratio**

Capital Adequacy Ratio is the foremost tool to analyze the Capital Fund of a bank. Actually, the fundamental objective of this study is to examine Capital Adequacy of Siddhartha Bank.

The Capital Adequacy Ratio is based on Total Risk-Weighted Assets (TRWA) of the bank. Capital Adequacy Ratios are a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposures. This ratio is used to examine adequacy of Total Capital Fund and Core Capital, which is yielded by the following formulas:

To measure the adequacy of Total Capital Fund:

$$\frac{\text{Total Capital Fund}}{\text{TRWA}} \times 100\%$$

To measure the adequacy of Core Capital:  $\frac{\text{Core Capital}}{\text{TRWA}} \times 100\%$

### **b. Credit / Deposit Ratio:**

The Credit / Deposit Ratio (CD Ratio) is a major tool to examine the liquidity of a bank. CD Ratio measures the ratio of fund that a bank has utilized in credit out of the total deposit collected. More the CD Ratio more the effectiveness of the bank to utilize the fund it collected.

The CD Ratio is derived by the following formula:

$$\frac{\text{Total Credit}}{\text{Total Deposit collected}} \times 100\%$$

Further, comparative analysis of the ratios of the bank with average industry ratios were also made to check the significance of the ratios of the bank in the industry as a whole.

## **3.5.2 Statisticals Tools**

The following statistical tool is used to analyze the data:

### **a) Karl Pearson Correlation Analysis:**

The relation between two variables is correlated by Karl Pearson's Correlation Coefficient. The following is the formula proposed by Karl Pearson for calculation of correlation coefficient.

$$r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{N\sum X^2 - (\sum X)^2} \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

Where,

N = Number of pairs in observation

X = First variable

Y = Second variable

To ease the calculation, a shortcut formula has been proposed which has been used to calculate correlation coefficients in this thesis report. The shortcut formula is as follows:

$$r = \frac{\sum xy}{\sqrt{\sum x^2} (\sqrt{\sum y^2})}$$

Where,

$$x = X - \bar{X}$$

$$y = Y - \bar{Y}$$

$\bar{X}$  = Mean of deposits

$\bar{Y}$  = Mean of loan and advances.

$$\bar{X} = \frac{\sum X}{N}$$

$$\bar{Y} = \frac{\sum Y}{N}$$

**b) Test of significance of correlation:**

$$P.E = \frac{1 - r^2}{\sqrt{n}} \times 0.6754$$

Where,

P.E= Probable Error.

r= coefficient of correlation between deposits and loans and advances.

n= no of sample.

$\bar{X}$  = Mean of deposits

$\bar{Y}$  = Mean of loan and advances.

## **CHAPTER: IV**

### **DATA PRESENTATION AND ANALYSIS**

This chapter deals with the presentation, analysis and interpretation of relevant data and information of Siddhartha Bank. Also, the analysis and interpretation of the information and data produced from questionnaire is also contained in this chapter. To obtain best result, the data and information have been analyzed according to the research methodology as mentioned in Chapter 3. The main purpose of analyzing the data is to change it from an unprocessed form to an understandable presentation. The analysis of data consists of organizing, tabulating and performing statistical analysis.

This chapter is partitioned into three sections as Presentation of Data and Ratio Analysis, Statistical Analysis, Study of response of Officials of Siddhartha Bank.

#### **4.1 Financial Performance Analysis:**

The collected data related to the capital fund, TRWA, deposits, loan and advances, paid up capital etc of SBL were used to calculate different ratios to view the financial performance of the bank and the result were analyzed to reach to a conclusion under this section. The ratios like capital adequacy ratio, credit - deposit ratio were calculated.

##### **4.1.1 Capital Fund**

Capital Fund of a bank consists of two types of components viz. Core and Supplementary Capital. Hence, the Total Capital Fund of a bank is derived by adding these two components of capital. The Capital Fund of Siddhartha Bank has been illustrated hereinafter.

###### **4.1.1.1 Data Presentation And Analysis Of Secondary Data**

The capital funds of Siddhartha Bank have been tabulated in Table 4.1 which shows the capital fund of the bank over the period of eight fiscal years, i.e., from FY 2062/63 to FY 2069/70.

**Table 4.1****Capital Fund of Siddhartha bank**

(Rs. in millions)

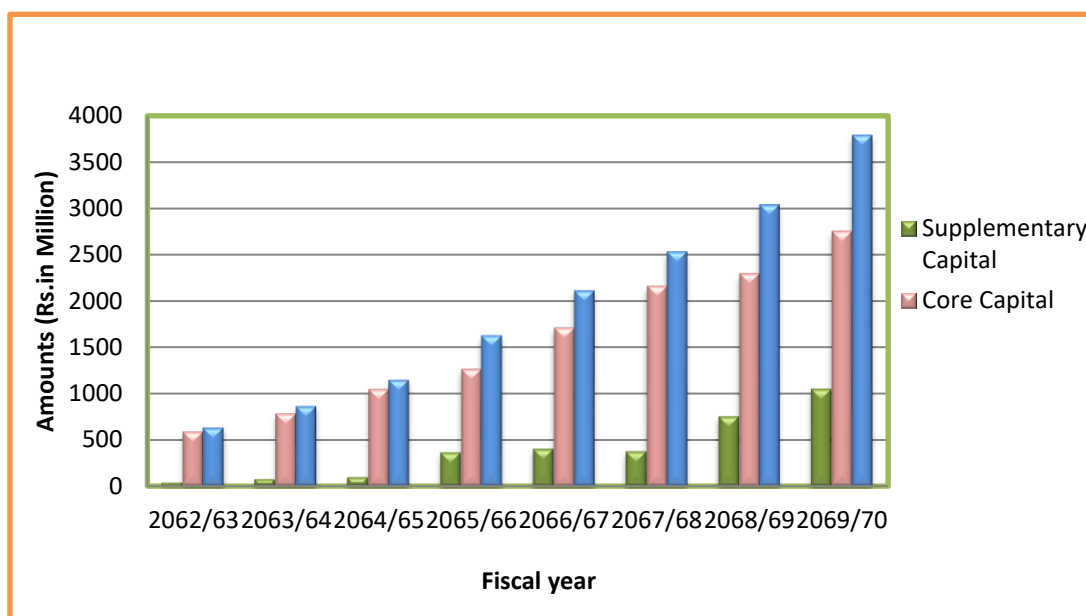
Fiscal Year	Core capital	Supplementary capital	Total Capital fund
2062/63	593.244	39.035	632.279
2063/64	786.859	76.962	863.820
2064/65	1049.679	98.055	1147.734
2065/66	1265.281	365.377	1630.658
2066/67	1710.719	402.122	2112.841
2067/68	2160.596	374.511	2535.107
2068/69	2296.991	747.432	3044.423
2069/70	2751.764	1041.856	3793.620

(Source: Annual Reports of Siddhartha Bank ltd)

In the previous last eight years period, the Capital Fund of Siddhartha bank has increased unevenly. The growth of the capital fund is in diminishing rate except in the year 2065/66; 2068/69 and 2069/70. The Core Capital of the bank has been increasing but that too in an uneven rate. In the year 2066/67 and 2069/70 a sharp increment has been observed whereas only a small increment was there in the year 2068/69. The supplementary capital has shown the fluctuation where it has been increasing gradually till the year 2066/67 and then it decreased up to the extent of 374.511 million in year 2067/68 which later increased dramatically up to 1041.856 millions in the year 2069/70. The Capital Fund of Siddhartha bank consisted of Core Capital of Rs. 593.244 million and Supplementary Capital of Rs. 39.065 million totalling Rs.632.279 million at the end of the FY 2062/63. The Capital Fund has increased nearly 6 times reaching to Rs. 3793.620 million consisting of Core Capital of Rs. 2751.764 million and Supplementary Capital totalling Rs. 1041.856 million by the end of the FY 2069/70. The same information can be depicted in the chart below.

**Figure 4.1**

**Capital Fund of Siddhartha bank limited**



(source: Table 4.1)

The Table 4.1 and Figure 4.1 shows the growing trend of Capital Fund of the bank during the eight fiscal years. The trend shows that Core Capital is in increasing trend but Supplementary Capital is in increasing order till FY 2066/67 and then after it decreased in the year 2068/69 and again increased thereafter. The total capital of the bank though increased to the great extent coming up to the year 2069/70.

The increment in the Capital Fund shows that Siddhartha Bank has been increasing its capital base to comply with the requirements of NRB as prescribed in Capital Adequacy Norms for commercial banks.

#### **4.1.2 Risk Weighted Assets**

The Risk-Weighted Assets are derived by calculating the amount from the respective balance sheet and off-balance sheet items with the prescribed weightage. The assets are categorized into five types while assigning weightage to them. NRB has assigned weightage of 0%, 10%, 20%, 50% and 100% according to their nature of risk bearing, which is based on the standard of Basel Committee. Total risk weighted assets are calculated by multiplying the assets with their as prescribed by NRB.

The Risk-Weighted Assets of Siddhartha Bank has been illustrated in Table 4.2. and 4.3. The tables shows Risk-Weighted Assets of the bank over the period of previous seven years starting from 2062/63 to 2068/69.

**Table 4.2****Risk weighted assets of Siddhartha Bank Limited**

(In millions)

<b>Fiscal years</b>	<b>Risk weighted Assets</b>
2062/63	4465.021
2063/64	7297.687
2064/65	10299.852
2065/66	15608.914

**(Source: Annual Report of Siddhartha Bank Limited)****Table 4.3****Risk-Weighted Assets of Siddhartha Bank limited**

(Rs. in Millions)

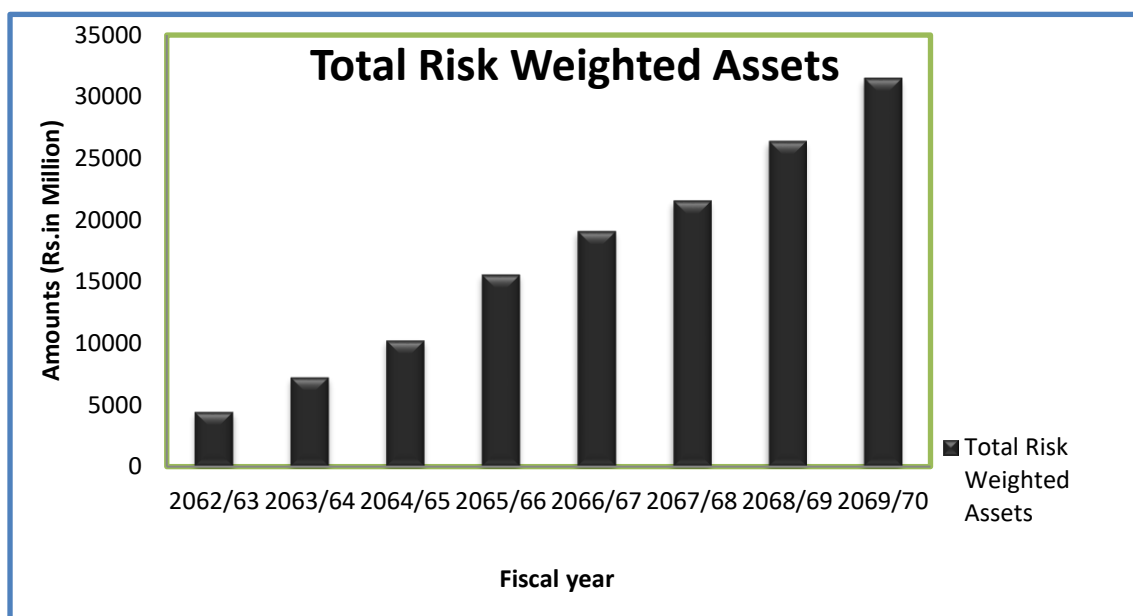
<b>Particulars</b>	<b>2066/67</b>	<b>2067/68</b>	<b>2068/69</b>	<b>2069/70</b>
A) Risk Weighted Exposure for Credit Risk	18193.830	20279.188	24498.995	28482.932
B) Risk Weighted Exposure for Operational Risk	852.473	852.440	1349.783	1913.886
C) Risk Weighted Exposure for Market Risk	71.626	28.468	24.233	130.756
<u>Adjustment under pillar II</u> Add: 2% of TRWE due to supervisor is not satisfied with overall risk mgmt policies & proceeds of balance		423.202	517.460	610.557
<u>Add:</u> 2 % of gross income of last FY due to supervisor not satisfied with sound practice of management of operational risk				334.587
<b>Total Risk Weighted Exposure (A+B+C) After adjustment</b>	<b>19117.929</b>	<b>21583.297</b>	<b>26390.474</b>	<b>31472.713</b>

**(Source: Annual Reports of Siddhartha Bank Limited)**

The TRWA of the bank has been increasing gradually from the fiscal year 2062/63 to 2069/70. The TRWA of the bank was Rs. 4465.021 million during FY 2062/63 including both Balance Sheet Items and Off-Balance Sheet Items which amounted to Rs. 31472.713 million in the year 2069/70. The same information can be depicted in the chart below:

**Figure 4.2**

**Risk Weighted Assets of Siddhartha Bank**



(source: Table 4.2 and 4.3)

The Figure 4.2 shows the increasing trend of TRWA in the last five years starting from 2064/65 to 2068/69 though in the different rate.

**4.1.3 Capital Adequacy Ratio of Siddhartha Bank Limited**

Capital Adequacy Ratio shows the strength of a bank. The calculated Capital Adequacy Ratio is shown in the Table 4.4 for the FY 2062/63 to FY 2069/70.

**Table 4.4****Capital Fund used by the Bank**

<b>Fiscal Year</b>	<b>Percentage of Core Capital</b>	<b>Percentage of Supplementary Capital</b>	<b>Percentage of Total Capital</b>	<b>CAR of NRB Total Capital Fund</b>	<b>CAR of NRB Core capital</b>
2062/63	13.29%	0.87%	14.16%	11%	6%
2063/64	10.68%	1.05%	11.84%	11%	6%
2064/65	10.19%	0.95%	11.14%	10%	6%
2065/66	8.11%	2.34%	10.45%	10%	6%
2066/67	8.95%	2.1%	11.05%	10%	6 %
2067/68	10.01%	1.74%	11.75%	10%	6 %
2068/69	8.70%	2.84%	11.54%	10%	6%
2069/70	8.74%	3.31%	12.05%	10%	6%

(Source: annual report Siddhartha Bank Limited)

The Capital Adequacy Ratios show that the bank has been able to comply with the requirements of NRB consistently.

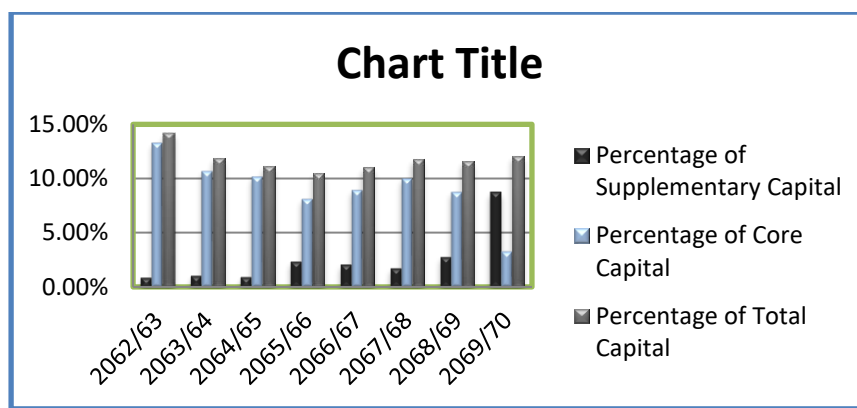
In the FY 2062/63 and 2063/64 the bank has total capital fund at 14.16% and 11.84% of TRWA against the requirements of 11%. Whereas in year 2064/65, the bank has Total Capital Fund at 11.14% of Risk Weighted Assets with the NRB requirement of 10% and this has decreased to 10.45% in FY 2065/66. The Total Capital Fund of the bank was 11.05%, 11.75%, 11.54% and 12.05% during the FY 2066/67, 2067/68, 2068/69 and 2069/70 respectively. And the core capital ratio was in between the range of 8.11% - 13.29% as shown in the table. The NRB requirement of 6% for Core Capital and 11% for total capital of total Risk Weighted Assets have been complied with till year 2063/64 and the requirements of 6% for core capital and 10% for total capital were met afterwards till 2069/70.

The Capital Adequacy Ratio of the bank decreased till 2065/66 and it is in increasing trend thereafter except it decreased to some extent in year 2068/69. It is obvious, as

transactions of the bank increases; the Risk Weighted Assets also increases in the same manner. But this creates bank difficulty to maintain capital fund as required by the NRB as capital do not increase often and the performance of the bank (i.e. earning of profit) has major role to play to comply with the NRB requirements. As such, it is evident that Siddhartha Bank has been performing well enough to comply with the NRB requirement without failure at any point of time. The same information can be depicted in the chart below.

**Figure 4.3**

**Capital Fund used by the Siddhartha Bank limited**



(source: Table 4.4)

The Table 4.4 and Figure 4.3 displays Total Capital Fund at 14.16% of Risk Weighted Assets in FY 2062/63 and 12.05% in FY 69/70. Percentage of Total Capital Fund is in decreasing trend till year 2065/66 and in increasing trend afterwards over the study period except for the year 2068/69. But Percentage of Supplementary Capital has been fluctuating where it as increased in year 2063/64, 2064/65 and 2068/69 and then gradually decreased over the remaining four years and. Similarly, core Capital ratio kept on fluctuating throughout.

**4.1.4 Deposit, Loan and Advances Analysis of Siddhartha Bank Limited**

Being the main function of a commercial bank, every commercial bank collects deposits from general public and distributes the collected deposits in terms of loan. Verma and Malhotra (1993) have mentioned that a commercial bank has usually access to three sources of fund: capital fund, deposits and borrowings.

It is clear that Siddhartha Bank could not remain in the business without collecting deposits. The bank has its own policies to lure deposits from general public. In this matter, Siddhartha Bank has few successful schemes of saving deposits like Siddhartha sarvottam bachat, jetha nagarik bachat, siddhartha mega saving, nari bachat, bal bachat; fixed deposits and current deposits. These products have really played important role in the swift collection of deposit for the bank. The main source of income of a bank is interest income from extending credit facility to its clients. Most of the funds available in the bank either in the form of capital or deposit is utilized for providing credit facility. The commercial banks are inspired with the motive of gaining profit and to fulfill this objective, they should widely manage and improve credit facility they provide. Much attention should be paid to the extension of the quality of the credit facility although quantity of the facility should also be considered. Being a commercial bank, one of the prime functions of the Siddhartha bank is to provide credit facility. The deposit, loan and advances for last eight fiscal years can be viewed in the Table 4.5.

**Table 4.5**

**Deposit, Loan and Advances of Siddhartha Bank Ltd**

(Rs. In Millions)

<b>Fiscal Year</b>	<b>Deposit Collection</b>	<b>Loan and Advances</b>	<b>Credit/Deposit Ratio</b>
2062/63	3918	3789	96.70%
2063/64	6625	6320	95.39%
2064/65	10191.0	9481.0	93.03%
2065/66	15854.80	13504.8	85.17%
2066/67	20197.0	16895.4	83.65%
2067/68	21575.6	18647.0	86.42%
2068/69	25948.5	20607.3	79.41%
2069/70	28392.822	23721.6	83.54%

(Source: Annual Reports of Siddhartha Bank)

The table shows that Siddhartha Bank has been increasing the deposit collection over the years though in inconsistent rate. Over the last eight years the deposit amount has increased more than 7 times, which was Rs.3918 millions in year 2062/63 and Rs.28392.822 millions in year 2069/70.

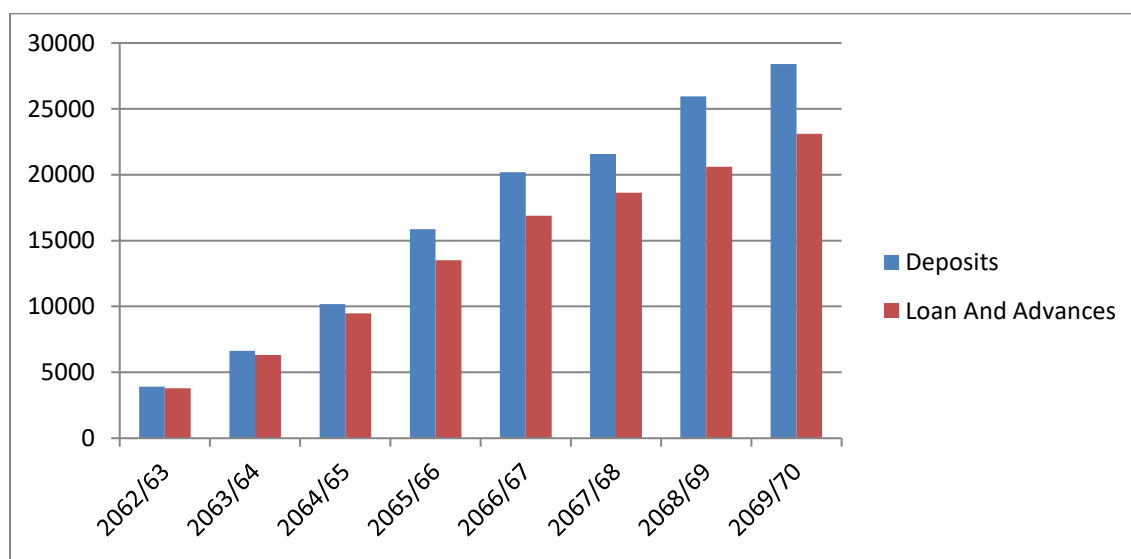
The Table 4.5 also shows the increment in the flow of credit by Siddhartha bank during past eight years. The bank was able to flow Rs. 3789 million of loans during the year 2062/63, which has increased up to Rs.23721.604 millions in the end of FY 2069/70.

The deposit, loan and advances made by Siddhartha Bank have been illustrated in the figure below.

**Figure 4.4**

**Deposit, Loan and Advances of Siddhartha Bank**

(In millions)



The Credit/Deposit (CD) Ratio is a major tool to examine the liquidity of the bank. It also measures the performance of the bank in terms of resources utilization irrespective of the quality of utilization. Higher the CD Ratio better is the performance regarding deposit utilization whereas such high ratio may not be favored by the depositors as in case of improper investment, the depositor's fund may be on risk.

**Ratio of Credit to Deposit as:**

$$\frac{\text{Total Credit}}{\text{Total Deposit}} \times 100$$

The Table 4.5 shows a fluctuating CD Ratios of the bank in the past eight years, beginning from FY 2062/63 to FY 2069/70. The ratio has been ranging from 96.70% to about 79.41% with fluctuations in between years. The ratio was 96.07% during FY 2062/63 then fell continuously for four years reaching 83.65% during FY 2066/67 after which increased to 86.42% in FY 2067/68 and again decreased to 79.41% in year 2068/69. It was 81.13% in year 2069/70.

## 4.2 Statistical Analysis

Statistical Analysis is carried out for better understanding of the collected data and information. The result of the statistical analysis is enumerated in the following section.

### 4.2.1 Correlation- Coefficient

To test the relationship between deposit, loan and advances the correlation coefficients have been calculated by using Karl Pearson's correlation co-efficient.

∴ Correlation co-efficient of Deposit on loan and advances,  $r = 0.9979$ . (Appendix-B)

The calculated correlation co-efficient between Deposit, Loan and Advances is strongly positive. Therefore, it can be said that Deposit and Credit components of a bank are positively correlated with each others. Here, we can see that co-efficient is near to 1 which indicates that the correlations seem to be nearly perfectly positive. We can say that the increase in deposit causes the increase in loan and advances.

### 4.2.2 Test of significance of Coefficient of Correlation:

$$P.E = \frac{1 - r^2}{\sqrt{n}} \times 0.6754$$

$$= \frac{1 - 0.9979^2}{\sqrt{8}} \times 0.6754$$

$$= 0.00148$$

Now,

$$6 \times P.E = 6 \times 0.00148 = 0.0089$$

Since,  $(6 \times P.E) < r$ , i.e.  $(0.0089 < 0.9979)$ , the correlation is highly significant. It means the bank was successful to keep loan and advances according to collection of deposits.

where,

P.E= Probable Error.

r= coefficient of correlation between deposits and loans and advances.

n= no of sample.

### **4.3 Changes In Capital Adequacy Norms On Siddhartha Bank**

#### **4.3.1 Study Of Changes In Capital Fund**

The Capital Adequacy Norms have greater impact on changes in capital fund of commercial banks. Table 4.1 has already presented the components of capital that are included in capital fund of Siddhartha Bank.

The Table 4.7 shows the increment in the capital funds of the bank in the form of amount and percentage both.

**Table 4.6****Changes in Capital Fund of Siddhartha Bank**

(Rs. in millions)

<b>Fiscal Year</b>	<b>Total Capital Fund</b>	<b>Amount Increased</b>	<b>Percentage Increment</b>
2062/63	632.279	-	-
2063/64	863.820	231.541	36.62%
2064/65	1147.734	283.914	32.86%
2065/66	1630.658	482.924	42.07%
2066/67	2112.841	482.183	29.56%
2067/68	2535.107	422.266	19.98%
2068/69	3044.423	509.316	20.09%
2069/70	3793.620	749.197	24.60%

(Source: Annual Reports of Siddhartha Bank)

At the beginning of the study period, the bank had total capital fund of Rs. 632.279 million which has been increased up to Rs. 3793.620 million by the end of the FY 2069/70. Both the increment in percentage and amount are seen fluctuating. The rate of increments in amount is variable as the increment during year 2063/64 and 2064/65 was 231.541 and 283.914 million respectively. The increment in year 2065/66 was Rs. 482.924.03 million followed by somewhat consistent increment of Rs. 482.183 million in the following year. An increment of lesser amount was seen in the year 2067/68; again it increased by 509.316 million in FY 2068/69 and increased by 749.197 in FY 2069/70. Similarly, the increment rate in percentage during FY 2063/64 was 36.62% which decreased to 32.86% in FY 2064/65 and increased to 42.07% in FY 2065/66 which decreased to 29.56% & 19.98% in FY 2066/67 & 2067/68 respectively. And again increased by 20.09% and 24.60% in year 2068/69 and 2069/70 respectively.

### 4.3.2 Study Of Changes In Paid Up Capital

It has been observed in Table 4.7 that the capital base has been increased to meet the NRB requirements. Since, the capital adequacy norms require that the core capital should at least be 50% of the capital base; the bank has been trying to increase its core capital. The major portion of the core capital is paid up capital, so, the table 4.8 shows the changes in the paid up capital of the bank in the five years period beginning from 2062/63 to 2068/69.

**Table 4.7**

#### **Changes in Paid Up Capital of Siddhartha Bank**

(Rs. in millions)

<b>Fiscal Year</b>	<b>Paid Up Capital</b>	<b>Amount Increased</b>	<b>Percentage Increment</b>
2062/63	500.00	-	-
2063/64	600.00	100.00	20%
2064/65	828.00	228.00	38%
2065/66	952.200	124.2	15.0%
2066/67	1310.436	358.236	37.62%
2067/68	1571.130	260.694	19.89%
2068/69	1619.244	48.114	3.06%
2069/70	1813.55	194.306	12%

(Source: Annual Reports of Siddhartha Bank Ltd)

Table 4.8 shows the paid up capital and the increment in it over the years. Being the main element of the core capital paid up capital is most essential element that helps to fulfill the capital adequacy requirements of NRB. So, major changes in Paid up Capital have been observed in every year. It has always been a major disadvantage that the bank has not been established with strong capital base and thus, has to always increase it to meet the NRB requirements. Thus, the impact of the norms caused the increment in paid-up capital of the bank. During FY 2063/64, 2064/65, 2065/66, 2066/67, 2067/68 paid up capital was increased by 20%, 38%, 15%, 37.62% and

19.89% respectively. During FY 2068/69 paid up capital changed only by a smaller percentage (3.06%) and again it increased by 12% in FY 2069/70.

#### 4.4 Data Presentation And Analysis Of Primary Data

Regarding the impact of capital adequacy norms, a simple questionnaire was developed. The questionnaire revealed the opinions that bank officials held towards the capital fund and capital adequacy. A total number of five officials participated in the queries.

**Table 4.8**

##### **Response of Officials on necessity of capital adequacy norms**

<b>Question No. 1</b>	<b>No. of Responses</b>	<b>Percentage</b>
a) Yes	5	100.00%
b) No	0	0.00%

(Source: Field survey, Appendix B)

In this question, all the officials unanimously agreed that the central bank should issue capital adequacy norms for commercial banks. All respondents answered that an adequate capital fund will always help to safeguard the interest of depositors.

**Table 4.9**

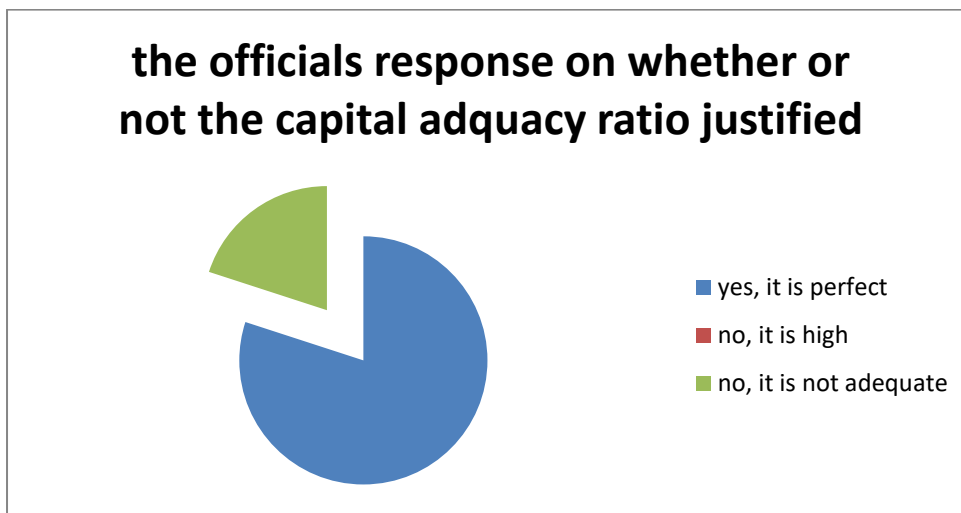
##### **Justification of Capital Adequacy Ratio**

<b>Question No. 2</b>	<b>No. of Responses</b>	<b>Percentage</b>
a) Yes, it is perfect	4	80%
b) No, it is high	0	0.00%
c) No, it is not adequate	1	20%

(Source: Field survey, Appendix B)

In this question, the officials found to be disagreeing. Out of five, four respondents answered that the capital adequacy ratio prescribed by NRB is perfect while remaining one answered that it is not adequate. It seemed that officials are satisfied with the prescribed capital adequacy ratio. It can be illustrated by pie-chart also, which is shown below:

**Figure 4.5**



(Source: Field survey, Appendix B)

Fig.4.5 demonstrates that 80% of respondents are in the view that the present capital adequacy prescribed by NRB is perfect whereas 20% opined that it is high.

**Table 4.10**

**Response of Officials on most safeguarded interest**

Question No. 3	No. of Responses	Percentage
a) Depositor's Interest	5	100.00%
b) Shareholder's Interest	0	0.00%
c) Employees' Interest	0	0.00%

(Source: Field survey, Appendix B)

All the respondents answered that the depositor's interest should be safeguarded most because without depositor no any banks can imagine its future.

**Table 4.11**

**Response of Officials on necessity of revision in CAR**

<b>Question No. 4</b>	<b>No. of Responses</b>	<b>Percentage</b>
a) Yes, it is necessary	5	100.00%
b) Not at all	0	0.00%

(Source: Field survey, Appendix B)

All the respondents said that it is necessary to bring changes in capital adequacy norms from time to time.

**Table 4.12**

**Response of Officials on weightage prescribed by NRB**

<b>Question No. 5</b>	<b>No. of Responses</b>	<b>Percentage</b>
a) Yes, it is perfect	2	40%
b) Just OK	3	60%
c) No, it needs revision	0	0.00%

(Source: Field survey, Appendix B)

Three respondents answered that the weightage on risk weighted assets prescribed by NRB are just OK while others said that it is perfect.

**Table 4.13**

**Response of Officials on appropriate steps to follow**

<b>Question No. 6</b>	<b>No. of Responses</b>	<b>Percentage</b>
a) We can increase core capital	1	20%
b) We can increase supplementary capital	0	0.00%
c) We can increase both components of capital hand in hand	4	80%

(Source: Field Survey, Appendix B)

Officials of the bank had unanimous thoughts that they can increase both components of capital subsequently to cope up with the NRB requirements.

#### **4.5 Major Findings Of Secondary Data**

The thesis has been concentrated on the capital and capital related items of Siddhartha Bank. The findings of the study are as follows:

**Capital Fund:** Capital Fund of Siddhartha bank has seen steady growth. The Core Capital of the bank has seen consistent growth except over the last 8 years, where a sharp increment has been observed in 2066/67, whereas fluctuation has been seen in the Supplementary Capital. The Capital Fund of Siddhartha Bank consisted of Core Capital of Rs. 593.244 million and Supplementary Capital of Rs. 39.035 million totaling Rs. 632.279 million at the end of the FY 2062/63. The Capital Fund has increased near to five times to Rs. 3044.423 million at the end of year 2068/69 of which Core Capital is Rs.2296.991 and Supplementary Capital is Rs. 747.432 million.

On review of the financial statements of the FY 2066/67, it was clearly seen that major reason for increment in capital fund was mainly due to issuance of huge portion

shares and general reserve fund. These are the components of core capital and thus, resulted into sudden increment in the capital fund.

**Capital Adequacy:** It is found that the bank has maintained the capital adequacy ratio as prescribed by NRB. The bank had capital adequacy ratio of 14.16% and 11.84% in FY 2062/63 and 2063/64 respectively against the requirements of 11%. Whereas the ratio was 11.14% during FY 2064/65. In the years followed, the bank had capital adequacy ratios of 10.45%, 11.05%, 11.75%, 11.54% and 12.28% respectively against the NRB requirement of 10%.

The Capital Adequacy Ratio of the bank shows that bank has properly maintained the required ratio. It is obvious, as transactions of the bank increases; the Risk Weighted Assets also increases in the same manner. But this creates bank difficulty to maintain capital fund as required by the NRB as capital do not increase often and the performance of the bank (i.e. earning of profit) has major role to play to comply with the NRB requirements. As such, it is evident that Siddhartha Bank has been performing well enough to comply with the NRB requirement without failure at any point of time.

**Risk Weighted Assets:** The risk weighted assets is the most significant component to be considered while studying the capital adequacy norms. The TRWA of the bank has been increasing gradually from FY 2062/63 to FY 2068/69, though in different rate. The TRWA of the bank was Rs. 4465.021 million during FY 2062/63 including both on Balance sheet and Off-Balance sheet items. In FY 2068/69, the TRWA is Rs.26390.47million.

It is really commendable performance of the bank to cope with the increasing risk weighted assets and maintain the prescribed capital fund as directed by NRB.

**Credit/Deposit (CD) Ratio:** CD ratio is one of the most important ratios for commercial banks. This ratio shows how effectively the bank has been able to utilize its available fund collected from depositors. The ratio has been ranging from 79.41% to about 96.70% with fluctuations in between years. In an average, the bank has been able to utilize 4/5 portion of the depositors fund in the form of Credit. The ratio was 96.70% during FY 2062/63 and after that the ratio has decreased to 95.39% in FY 2063/64 and 93.03% in FY 2064/65. After that it decreased suddenly to 85.18% in FY 2065/66 and 83.65% in FY 2066/67. After being increased to 86.42% in FY 2067/68 it again decreased sharply to 79.41% in FY 2068/69. A small improvement was seen in

year 2069/70 with the ratio being 81.4%. The ratios clearly tell that bank has not been able to properly utilize the collected funds. The bank should be able to utilize more funds in the form of credit to generate revenue for it. But the quality of the credit should also be well considered for better financial performance of the bank.

**In addition to this, some other findings of the study are as follows:**

- The average Core Capital, Supplementary Capital and capital fund of the bank are Rs.1409.05, 300.5 and Rs.1709.55 million respectively.
- The average Total Risk Weighted Assets is Rs.14966.17 million.
- The average Capital Adequacy Ratio for Core Capital and Total Capital Fund are 9.99% and 11.776% respectively.
- The average Deposit Collection, Loan and Advance are Rs.16587.84 and Rs.14044.388 million respectively.
- The average Credit/Deposit ratio of the bank is 87.64%.
- Correlation co-efficient of Deposit on loan and advances is 0.9979.
- The average Capital Fund Increment of the bank is 30.19%.
- The average paid up capital increment of the bank is 22.26%

**Statistical Analysis:** The correlation co-efficient between deposit and credit of the bank showed that it is correlated. The co-efficient is more than 0.9979 which is near to 1. The co-efficient nearest to 1 show the relationship to be more perfect.

**Impact Analysis:** It is observed that the bank has been complying with the requirement of the capital adequacy norms of NRB. The bank has been increasing its capital fund to meet the capital adequacy requirement.

#### **4.6 Major Findings Of Primary Data:**

- Based upon their response the officials of the bank feel that NRB, as a central bank, should set the capital adequacy norms.
- They all agree that these norms are required to safeguard the interest of depositors.
- Most of the officials are convinced with the prescribed ratios. Four of them said that the ratios are reasonable and one said that it is not adequate. However, the majority of them opined that these norms are acceptable.

- All officials think that the ratio should be revised time to time and they are satisfied with the weightage provided by NRB on all on and off-balance sheet items for the purpose of calculating total risk-weighted assets.
- And they suggested to increase both components of total capital to cope for the compliance of capital adequacy ratio. In addition, they provide some other way too for the compliance of capital adequacy such as, lending and borrowing in efficient portfolio; increasing low risk assets; and encouraging the capital with low capital charges etc.

## **CHAPTER: V**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

This chapter includes summary, conclusion and recommendation as a concluding part of the study. The study summarizes the background of the study, objectives, research methodology and the major findings of the study. The next part of the study is conclusion which indeed is the objectives answer. Finally, the recommendation of the study is made included with suggestion remark.

#### **5.1 SUMMARY**

This research is aimed at studying capital adequacy for commercial banks set by NRB with case study of Siddhartha Bank Limited. Raising and utilization of funds are the primary functions of commercial banks. As such, commercial banks collect a large amount of deposits from general public. They mobilize thus collected fund as loan and advances and other investments in securities. They have to pay interest on deposits and charges interest on loans. Interest charged on loans are higher than on interest paid for deposits, which result in the income of the banks. Besides these commercial banks provide other various services so they are also called financial departmental stores these days. It is obvious that banks earn profit from the difference in interest rate or interest spread but banks should be responsible towards their stakeholders before taking any decisions. They should always maintain a adequate capital with themselves. Capital must be sufficient to protect a bank's depositors and counterparties from the risks like credit and market risks. Otherwise, the banks will use all the money of depositors in their own interest and depositors will have to suffer loss. Banks have to make decision about the amount of capital they need to hold for the three reasons. First, bank capital helps prevents bank failure, a situation in which the bank cannot satisfy its obligations to pay its depositors and other creditors and so goes out of business. Secondly, the amount of capital affects the returns for the owners (equity holders) of the bank. And third, a minimum amount of bank capital is required by regulatory authorities.

Being the central bank of Nepal, NRB has the responsibility to give special attention to the interest of depositors. NRB has issued various directives to regulate commercial banks. The directive no. 1 has been issued for norms on capital adequacy to be followed by commercial banks. In this research study the capital adequacy of Siddhartha Bank limited is checked.

The main objective of the study was to find out whether or not the sample bank has adhered to the regulation as prescribed by NRB directives. Along with it the credit deposit ratio and the condition of paid up capital was overviewed. For the same purpose both primary and the secondary data were collected, studied and presented in the tabular and graphical format as well.

The thesis has been prepared with the study of capital funds of Siddhartha Bank. The study showed that the capital fund of Siddhartha Bank passably meet the requirement of capital adequacy norms. Capital Adequacy ratios have been calculated to check the adequacy as per the norms. CD Ratio, which is the key ratio of commercial banks, has also been checked. Analyses have been done to check the relationship of deposit with credit.

The thesis studies the responses of 5 bank officials received through research interview.

## **5.2 CONCLUSION**

Commercial banks of Nepal are bound by the NRB Directives and are currently bound by Directives issued for all financial institutions. The directive no. 1 has set norms on capital adequacy for commercial banks. Every commercial bank has to meet the requirement of capital adequacy as stated by the directive. Capital adequacy is the portion of capital fund with regards to risk weighted assets that a commercial bank holds. Capital adequacy is required to safeguard the money of the depositors as the banks are playing with the money they collected from the depositors. Banks have to make decision about the amount of capital they need to hold for the three reasons. First, bank capital helps prevents bank failure, a situation in which the bank cannot satisfy its obligations to pay its depositors and other creditors and so goes out of business. Secondly, the amount of capital affects the returns for the owners (equity holders) of the bank. And third, a minimum amount of bank capital is required by regulatory authorities

The bank under study, Siddhartha Bank Limited is found to be successful to comply with requirement of capital adequacy norms. Anyhow the bank is meeting the capital adequacy requirements. Almost all bank officials are satisfied with the provisions.

The CD ratio of the bank is average and needs to be improved immediately. Although the bank is successful to meet the capital adequacy requirement, it seems to be ineffective to fulfil other capital and deposit ratios which are also very much

important in regard of safeguarding the money of the depositors. The bank should highly focus on optimum utilization of the deposits because underutilization of deposit means bearing additional cost as deposits do not come for free. Ignoring all other facts and being concerned on the topic of study the performance of the Bank should be considered satisfactory and there are many ways they can perform better.

### **5.3 RECOMMENDATION**

After thorough study of the research, the following recommendations have been proposed for consideration by the concerned persons:

- The capital fund of the bank under study is highly depending upon share capital. It is recommended to the commercial banks to follow optimal capital structure which maximizes the market value of the firm. The banks should be able to use some sort of debt financing depending upon its viability. It is notable that the bank has started the debt financing. But still debt financing is an unaccustomed source of financing for commercial banks in Nepal.
- CD ratio of the bank is average. This showed that the bank has not been effectively using the funds collected from depositors. It is recommended that the bank should concentrate more on credit and investment. The bank shall expand more branches in different places of the country and search investment opportunities there. More credit flow and investment are required to verge on the optimum CD ratio.
- The commercial banks should try to maintain appropriate CD ratios as state above. They can no way escape pointing on to the lack of the policy.
- While providing loans and advances, banks should keep in account that the fund they are going to lend is the fund of the depositors and as such, needs to focus on the quality of the investments they make.
- NRB should consult to the various bank officials before setting or resetting standards on such capital adequacy norms. The complaints and criticisms of bank officials should be considered accordingly. Consequently, an optimal standard will be ensured which will satisfy almost everyone.

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## **APPENDICES**

### **Appendix-A**

#### **Calculation of correlation between Deposit and Loan and Advances**

In millions

X	Y	x=(X- $\bar{X}$ )	y=(Y- $\bar{Y}$ )	x <sup>2</sup>	y <sup>2</sup>	xy
3918	3789	-12669.9	-10259.1	160527886.4	105249912.5	129982868.1
6625	6320	-9962.96	-7728.14	99260571.96	59724116.95	76995129.77
10192.0	9481.0	-6395.96	-4567.14	40908304.32	20858749.51	29211231.96
15854.8	13504.8	-733.16	-543.338	537523.586	295216.18	398353.69
20197.0	16895.4	3609.04	2847.26	13025169.72	8106900.9	10275882.45
21575.6	18677.0	4987.64	4628.86	24876552.77	21426363.42	23087097.27
25948.5	20607.3	9360.54	6559.16	87619709.09	43022606.14	61397298.27
28392.8	23110.6	11804.8	9062.47	139354766.8	8218290	106981160.5
$\Sigma X=132$ 703.722	$\Sigma Y=112$ 385.104			$\Sigma x^2=$ 566110484.6	$\Sigma y^2=$ 340812155.6	$\Sigma xy=$ 438329022

$$r = \frac{\Sigma xy}{\sqrt{\Sigma x^2} \sqrt{\Sigma y^2}}$$

$$= 0.9979$$

Where,

X= deposit ; Y= Loan and advances

$$x = (X - \bar{X})$$

$$y = (Y - \bar{Y})$$

### Appendix-B

**Study on Capital Adequacy Directives and its impact on Nepal Industrial and Commercial Bank Limited**

**INTERVIEW QUESTIONNAIRE FOR BANK OFFICIALS**

**1. Do you think it is necessary that a central bank should issue capital adequacy norms for commercial banks?**

- Yes  No

**2. Do you think the present capital adequacy ratio prescribed by NRB is justified?**

- Yes, it is perfect  No, it is high  No, it is not adequate

**3. Which stakeholders' interest will be safeguarded most by adequate capital fund?**

- Depositor's Interest  Shareholder's Interest  
 Employees' Interest  
 Others (Please Specify) .....

**4. Do you think the revision in capital adequacy ratio is necessary from time to time?**

- Yes, it is necessary  Not at all

**5. The capital adequacy ratio is based on risk-weighted assets. Do you think the weightage prescribed by NRB on the on and off-balance sheet items are appropriate?**

- Yes, it is perfect  Just OK  No, it needs revision

**6. In your opinion, which of the following steps is appropriate for your bank to follow to cope for the compliance of capital adequacy ratio?**

- We can increase core capital  
 We can increase supplementary capital  
 We can increase both components of capital hand in hand  
 Others (Please Specify)

.....

**Name of Interviewee**.....

**Designation**.....

## APPENDIX - C

### **Risk Weightage on On-Balance Sheet Assets**

<b>On-Balance Sheet Assets</b>	<b>Weightage (%)</b>
Cash Balance	0
Gold	0
Balance at NRB	0
Investment on Government Bonds	0
Investment on NRB Bonds	0
FD Loan provided against the collateral security of own FD	0
Loan provided against the collateral security of Government Bonds	0
Accrued Interest Amount on Saving Bonds	0
Balance with national banks and financial institutions	20
FD Loan provided against the collateral security of FD of other banks and financial institutions	20
Balance with Foreign Banks	20
Money at Call	20
Loan provided against the guarantee of *Rated licensed foreign institutions	20
Investment made in *Rated licensed foreign institutions	20
Investment in Shares, Debentures and Bonds	100
Other investments	100
Loans, Advances and Bills Purchase/Discount**	100
Fixed Assets	100
Net Interest Amount Receivable (Total Interest Receivable-Interest from Saving Bonds-Interest Suspense)	100
Other Assets (Other than Advance Tax Deposit)	100

(Sources: NRB unified Directives on Capital Adequacy Norms)

### **Notes:**

\* For the purpose, banks listed in **Top Thousand World Banks** published every year in July by '**The Banker**' from United Kingdom.

Banks that do not come under above listing should be provided the risk weightage of 100%

\*\* Loans other than those provided against FD, NRB Bonds, Government Bonds and Guarantee of Internationally Listed banks

## APPENDIX - D

### Risk Weightage on Off-Balance Sheet Items

<b>Off-Balance Sheet Assets</b>	<b>Weightage (%)</b>
Bills Collection	0
Forward Foreign Exchange Contract	10
Guarantee having maturity period less than 6 months (Full Amount)#	20
Guarantee issued against Counter Guarantee of Rated* Licensed Institutions	20
Guarantee having maturity period of more than 6 months#	50
Bid Bond, Performance Bond and Underwriting related liabilities	50
Advance Payment Guarantee	100
Financial and Other Guarantee	100
Irrevocable Loan Commitment	100
Contingent Liability related to Income Tax	100
All Other Contingent Liabilities including Acceptance	100

(Sources: NRB Unified Directives on Capital Adequacy Norms)

#### Notes:

\* For the purpose, banks listed in **Top Thousand World Banks** published every year in July by ‘**The Banker**’ from United Kingdom.

Banks that do not come under above listing should be provided the risk weightage of 100%

# To assess the maturity period of Guarantee, the date from which the Guarantee has been opened should be considered

## APPENDIX - E

**Table of Capital Fund (Directives Form No. 1)**

<b>Particulars</b>	<b>Previous Quarter</b>	<b>This Quarter</b>
<b>(A) Core Capital</b>  1) Paid Up Capital 2) Share Premium 3) Irredeemable Preference Shares 4) General Reserve Fund 5) Accumulated Profit/Loss (Up to PY) 6) Profit/Loss (Current Period) 7) Capital Redemption Reserve Fund 8) Capital Adjustment Reserve 9) Other Free Reserves  <b>Less:</b> - Goodwill - Investment over the prescribed limit - Fictitious Assets - Investment made in shares of company having financial interest		
<b>(B) Supplementary Capital</b>  1) General Loan Loss Provision 2) Assets Revaluation Reserve 3) Hybrid Capital Instruments 4) Unsecured Subordinated Term Debt 5) Exchange Revaluation Reserve 6) Additional Loan Loss Provision 7) Investment Adjustment Reserve		
<b>(C) Total Capital Fund (A+B)</b>		

<p><b>(D) Minimum Capital Fund to be maintained on the basis of Risk Weighted Assets</b></p> <p>Capital Fund (..... percentage)</p> <p>Core Capital (.....percentage)</p>		
<p>Capital Fund (Excess/Deficit) (by.....percentage)</p> <p>Core Capital (Excess/Deficit) (by.....percentage)</p>		

(Sources: NRB Unified Directives on Capital Adequacy Norms)

**APPENDIX - F**

**Table of Risk Weighted Assets (Directives Form No. 2)**

**(Rs. in thousands)**

On-Balance-Sheet Assets	Weight	Previous Quarter		This Quarter	
		Amount	Risk Weighted Asset	Amount	Risk Weighted Asset
Cash Balance	0				
Gold	0				
Balance at NRB	0				
Investment on Government Bonds	0				
Investment on NRB Bonds	0				
FD Loan provided against the collateral security of own FD	0				
Loan provided against the collateral security of Government Bonds	0				
Accrued Interest Amount on Saving Bonds	0				
Balance with national banks and financial institutions	20				
FD Loan provided against the collateral security of FD of other banks and financial institutions	20				
Balance with Foreign Banks	20				
Money at Call	20				
Loan provided against the guarantee of Rated licensed foreign institutions	20				
Investment made in Rated licensed foreign institutions	20				
Investment in Shares, Debentures and Bonds	100				
Other investments	100				

Loans, Advances and Bills Purchase/Discount	100				
Fixed Assets	100				
Net Interest Amount Receivable (Total Interest Receivable-Interest from Saving Bonds-Interest Suspense)	100				
Other Assets (Other than Advance Tax Deposit)	100				
<b>Total (A)</b>					
<b>Off-Balance-Sheet Items</b>					
Bills Collection	0				
Forward Foreign Exchange Contract	10				
Guarantee having maturity period less than 6 months (Full Amount)	20				
Guarantee issued against Counter Guarantee of Rated Licensed Institutions	20				
Guarantee having maturity period of more than 6 months	50				
Bid Bond, Performance Bond and Underwriting related liabilities	50				
Advance Payment Guarantee	100				
Financial and Other Guarantee	100				
Irrevocable Loan Commitment	100				
Contingent Liability related to Income Tax	100				
All Other Contingent Liabilities including Acceptance	100				
<b>Total (B)</b>					
<b>Total Risk Weighted Assets (A+B)</b>					

( Sources: NRB Unified Directives on Capital Adequacy Norms)

**APPENDIX - G**

**Form No. 1.1 Capital Adequacy Table**

(Rs. In .....)

1.1 Risk Weighted Exposures		Current Period	Previous Period
a	Risk Weighted Exposure for Credit Risk		
b	Risk Weighted Exposure for Operational Risk		
c	Risk Weighted Exposure for Market Risk		
<b><u>Adjustments under Pillar II</u></b>			
	Add: 3% of the total RWE due to non compliance to Disclosure Requirement (6.4 a 10)		
	Add: ....% of the total deposit due to insufficient Liquid Assets(6.4 a 6)		
<b>Total Risk Weighted Exposures (After Bank's adjustments of Pillar II)</b>			
1.2 CAPITAL		Current Period	Previous Period
<b>Core Capital (Tier 1)</b>			
a	Paid up Equity Share Capital		
b	Irredeemable Non-cumulative preference shares		
c	Share Premium		
d	Proposed Bonus Equity Shares		
e	Statutory General Reserves		
f	Retained Earnings		
g	Un-audited current year cumulative profit		
h	Capital Redemption Reserve		
i	Capital Adjustment Reserve		
j	Dividend Equalization Reserves		
k	Other Free Reserve		
l	Less: Goodwill		
m	Less: Fictitious Assets		

n	Less: Investment in equity in licensed Financial Institutions		
o	Less: Investment in equity of institutions with financial interests		
p	Less: Investment in equity of institutions in excess of limits		
q	Less: Investments arising out of underwriting commitments		
r	Less: Reciprocal crossholdings		
s	Less: Other Deductions		
<b>Adjustments under Pillar II</b>			
Less: Shortfall in Provision (6.4 a 1)			
Less: Loans and Facilities extended to Related Parties and Restricted lending (6.4 a 2)			
<b>Supplementary Capital (Tier 2)</b>		<b>0</b>	<b>0</b>
a	Cumulative and/or Redeemable Preference Share		
b	Subordinated Term Debt		
c	Hybrid Capital Instruments		
d	General loan loss provision		
e	Exchange Equalization Reserve		
f	Investment Adjustment Reserve		
g	Assets Revaluation Reserve		
h	Other Reserves		
<b>Total Capital Fund (Tier I and Tier II)</b>		<b>0</b>	<b>0</b>
<b>1.3 CAPITAL ADEQUACY RATIOS</b>		<b>Current Period</b>	<b>Previous Period</b>
Tier 1 Capital to Total Risk Weighted Exposures (After Bank's adjustments of Pillar II)			
Tier 1 and Tier 2 Capital to Total Risk Weighted Exposures (After Bank's adjustments of Pillar II)			

(Source: NRB Unified Directives on Capital Adequacy Norms)