

CHAPTER - ONE

INTRODUCTION

1.1 Background of the Study

Since FY 1987/88 a significant step towards financial liberalization has been undertaken by Nepal Government with the view to accelerate the pace of economic development under structural adjustment program. This gave birth to the liberalization in interest rate, strengthening of banking operation and shift to direct monetary control instruments (Dahal, 2056:25).

As a result of liberalization policy of Nepal Government, foreign investors were attracted to invest in Nepal in joint venture especially in banking business. This initiated the establishment of Nepal Arab Bank Limited (NABIL) in 1984 A.D. as joint venture with Dubai Bank Limited. Following this, other banks in the same year were established.

The increase in opening of the joint venture banks caught a dramatic way after the liberalization and market oriented economic policy. Though, JVBs are enjoying liberalization, Nepal Rastra Bank (NRB) has managed check and balance through its directives.

Since the JVBs basically hold upon management, they enjoy competitive advantageous factors like highly skilled personnel, modern and advanced banking technology, customer oriented modern banking services management skill, and global banking network. Hence in comparisons to domestic commercial banks JVBs have come far better regarding the liquidity and profitability management, investment and recovery of loans, and almost in each and every aspect.

How much capital does a bank need? It is a very difficult question to answer and one of the major functions of capital to absorb loss and to assure the society that the bank can run even at the time of adversity. If the bank has

risk free assets, bank management is efficient and bank has put in place proper internal control mechanism, even lower capital to total assets can be enough to sustain the organization. Else, even higher capital to assets may not keep the bank alive. View of the regulator and management always contradict in the issue of how much is adequate capital.

Banks hold capital in excess of reserve requirements to provide a buffer against future, unexpected losses. Such losses are brought about by the credit, market, and operational risks inherent in the business of lending money. Problems created by an insolvent bank are important enough that bank regulators enforce minimum capital standards on banks in an effort to safeguard depositors and ensure the ongoing viability of the financial system. However, from a bank's perspective holding idle capital is an expensive safeguard against risk because the bank's shareholders demand a return on their investment and idle capital provides no such return. For this reason, bankers and regulators can have divergent opinions about the amount of capital a bank should hold making the problem of determining a bank's risk-based capital a complex and important-question.

Numerous approaches exist for determining how much risk-based capital a bank should hold. In the simplest case, banks provide some basic information about the probability of default for loans in their portfolio and using this information, the bank's regulator suggests a capital ratio commensurate with the bank's risk exposure. Most small banks use this sort of procedure. Large banks have been increasingly encouraged to develop their own internal models or systems for determining the appropriate level of risk-based capital. Most often, these systems consist of some rather complex characterizations of the probability of default and some type of simulation model for determining the bank's capital-ratio. Capital is an extremely vague term whose specific definition depends on the context in which it is used. In general, it refers to financial resources available for use.

1. Financial assets or the financial value of assets such as cash.
2. The factories, machinery and equipment owned by a business.

In the past, regulators used to fix minimum capital to total assets ratio, minimum capital to risk assets (total assets-cash and bank balance) ratio etc. However, such criteria could not set capital requirement based on risk undertaken by the banks. Hence, concept of risk adjusted capital came into force in 1988 when developed countries adopted “Basle Agreement” on capital management developed by BIS (Bank for International Settlement), Basle Switzerland.

Banks employ their fund in different assets. These assets can be categorized into risky, semi-risky and risk free. Likewise, banks carryout various off balance sheet items and are prone to contingent liabilities.

On the basis of risk inherent in assets and contingent liabilities, there is a practice of assigning risk weight to them. Once we multiply assets and off balance sheet items by respective risk weights, we find risk-weighted assets. Underlying purpose of capital adequacy system is to protect the interest of depositors and creditors by making bank keep more risk free assets and by increasing their capital base. Adequate capital keeps the bank healthy and robust against all the contingencies and enhances the image of the financial market.

Banks are such financial institutions, which play an important role, to collect scattered insufficient saving and use them into predictive channels. “Most people like to save little money when they have a chance. They may save because they have no urgent need for the money later time. When they do need the money, they may not have saved enough. Many people who save money deposit it in some kind of bank. The borrowers pay interest (price for the use of the money) to the bank and the bank pays interest to the people, who have deposited their savings. The banks make a profit by charging more

for lending money than that it pays for holding money. Thus banking is the business of receiving, safeguarding and lending money.

Banks play a pioneering role in the enhancement of economy of the country and hence, it is the life-blood of the modern commerce and can be said that modern commerce is so much dependent upon banking that any cessation of banking activities, even for a couple of day will completely paralyze the modern business and economic life of a nature. Modern bank has gained paramount trust in the public.

There are several banks, which are of different types. In this study, we are only considering about the commercial banks and central bank. In context of Nepal, NRB (Nepal Rastra Bank) is the central bank. The bank plays a vital role for the development of the country. It monitors the deposits, interest rates, other bank rates and mandatory spread of finances to be maintained by the commercial bank, the proposition of the bank portfolio, establishment of branches and many more aspects of financial institutions NRB act as the bank of all other banks with a view to monitor and supervise the monetary situation. It lays down various rules and regulation for the banks and the banks have to obey such rules and regulation. At the same time, it protects and maintains of national fund, foreign currencies and valuable goods. Thus central bank is the bank as the lender of the last resort for commercial banks. On the other hand, central bank works or acts as clearing house control over credit etc.

At the time when the banks are concerned only with their financial viability, the role of central bank becomes crucial. The central bank plays an important role to develop banking, such as development and promotional role, regulatory role and supervisory role. A central bank makes rules and regulations for the growth and to promote banking sector in the country. Nepal Rastra Bank has been paying an important role by creating suitable environment to establish commercial banks, development role by creating

suitable environment to establish commercial banks, developmental banks, finance companies and co-operatives. Up to now registered all together there are 26 commercial banks 33 developments banks, 5 rural development banks 78 finance companies and 54 co-operative institutions. NRB acts 1955 have given regulatory authority to it. Thus, NRB issues different guidelines/policies/directives to different financial institution to operate such institutions effectively (NRB, 2009:2).

According to the NRB Act 1955 Section 23, the central bank has legal provision to regulate, supervise and direct. The tools that NRB uses to control and monitor the financial institutions of the country are circular popularly known as NRB directives. The commercial banks have to obey directives issued by NRB from time to time regarding banking operations, currency and credit. While trying to follow such directives of NRB, there may be impact on the various aspects of commercial banks functions. Sometimes they may light the reporting system and sometimes made to study the impact of NRBs guidelines or directives on commercial banks. This research is to find out whether the commercial banks follow the directives of NRB in the same way NRB expects them to do so.

1.1.1 An Introduction of Sample Banks

a) Nepal Bank Limited

Nepal Bank Ltd. is the first commercial bank in Nepal. It was established in 1994 under the industrial council and Nepal Bank Act 1993. This establishment had started the modern banking system in Nepal. In the initial stage, its main function was to perform the responsibility of Tejarath Adda. Apart from this its other functions were to provide the commercial service and to play the role of central bank of Nepal. But now, this bank is operating fully commercial bank. At the same time, NBL is surviving in the tough competitive environment of banking sector. 41percentage of the total capital

is owned by the Nepal government and the rest 59 percent of which is owned by Public and Private Shareholders.

b) Rastriya Banijya Bank

To develop the banking sector in Nepal and to make the financial system more competent, competitive and strong Rastriya Banijya Bank was established in 2022 B.S. (1966A.D) under the government ownership. At initial stage it had 212 branches in 14 zones and 68 districts. But because of the deteriorating security situation, steep competition from the joint venture banks and poor performance most of the rural branches were merged with its nearest branches. At this time 117 branches are providing banking services to the people. Rastriya Banijya Bank has 21 and 25 percent share in the total deposit and total loan in the banking sector which was 31 and 25 percent in 2051B.S.

c) Nepal Bangladesh Bank Ltd. (NBBL)

Nepal Bangladesh Bank Ltd. was established in June 1994 with an authorized capital of Rs. 240 million and Paid up capital of Rs. 60 million as a Joint Venture Bank with IFIC Bank Ltd. of Bangladesh. Its Head Office is situated at New Baneshwore, Bijuli Bazar, Kathmandu.

The prime objective of this Bank is to render banking services to the different sectors like industries, traders, businessmen, priority sector, small entrepreneurs and weaker section of the society and every other people who need Banking Services. During the period of 10 years of its operation, it has accommodated a large number of clients and has been able to provide excellent services to its clients.

With a network of 17 branches and a corporate office, the Bank commands the largest network amongst the joint venture banks in Nepal.

As the title of our study is to evaluate impact and implementation of NRB directives on commercial banks, it is relevant to present briefly about the central bank and concerned institution performing the related functions.

d) The Central Bank

It is very difficult to give a brief and accurate definition of a central bank. For easy understanding we can define the central bank on the basis of functions it performs. We may say that central bank is one which act as the bankers to the government and the commercial banks, enjoying the monopoly of issue and operation of the currency and credit system of the country and does not perform the ordinary commercial banking functions. The function of the central bank varies from country to country. With the passage of time, its functions have grown considerable. Central bank is the central arch (Principle) of the monetary and fiscal frame work in every country of the world and its functions are indispensable for proper functioning of the economy and fiscal operations of the government.

So many authors have given different definition of central bank according to situation and need. Which reflect that the term central bank is a board defines it's in a single sentence. Most of the authors define central bank by laying emphasis on one or more functions it performs.

“A central bank is a bank which constitutes the apex of the monetary and banking structure of its country and which performs, as best as it can in the national interest” (Vaidya, 2001: 50).

“The essential function of a central bank is the maintained of the stability of the monitory standard which involves the control of the stability of the monetary standard which involves the control of the monetary circulation” (Vaidya, 2001: 50).

The functions of central bank are as follows:

- a. As the country's central bank, this bank has sole right to issue currency notes and coins and is responsible to manage the country foreign exchange reserves.
- b. The control of credit in accordance with the needs of business and with a view to carrying out the broad monetary policy.
- c. Central bank performs solutions of clearance balances between the banks and financial institutions.
- d. To perform the general banking and agency services for the state.
- e. The custody of the cash reserves of the commercial banks.
- f. The custody of management of the nations reserves of international currency.
- g. Lender of the last resort to other banks and government.
- h. The granting of accommodation in the form of rediscounts or collateral advances to commercial banks, bill brokers and dealers or other financial institutions.

“The primary definition of central banking is a banking system in which a single bank has either a complete or a residuary monopoly in the note issue” (Vaidya, 2001: 50).

Central banking is of recent origin. Prior to the commencement of the twentieth century, there had been no clearly defined concept of central banking. But today there is no country in the world, which does not have a central bank. Due to its various functions and fundamental rights, it has become an essence for the proper functioning of the economy. Before the commencement of the twentieth century, some banks in England, Europe Sweden etc were assuming more powers and enjoying the right of note issue and were acting as the government's banker and agent. They were not originally called the central banks but were generally known as the bank of issue or the national banks.

The oldest central bank is the Riksbank of Sweden, established in 1656 then after Bank of England came into being in 1694. Which was assumed, to be a first central bank, to develop, what are now, generally recognized as the fundamentals of the art of central Banking. The fundamentals, principles and tools and instruments developed, by Bank of England was universally accepted by the entire Bank over the country. The successful working of Bank of England, stimulate the development of central banking in the world. As a result, the bank of France was established in 1800 with the assistance of state funds and private capital. Similarly, the bank of Russia was established in 1860, as a state bank, with the declared object of consolidating the monetary circulation and the floating debt of the Russian Empire. The Bank of Netherlands was founded in 1814 on the ruins of old Bank of Amsterdam. The National bank of Austria, is the result of the reorganization of Bank of Austria-Hungary in 1877, was established in 1817 to manage the deteriorated situation of over issue of paper currency. In 19th century, the Bank of Norway, the national Bank of Denmark and bank of Spain were also established in 1817 A.D. 1818 A.D. and 1856 A.D. respectively. Bank of Japan was established in 1882, to manage the currency. Establishment of Federal Reserve System of U.S.A in 1914, International Financial Conference held in Brussels in 1920 and establishment of the International Monetary Fund, the highest body in the world to control monetary system, in 1944 are considered as milestones in the history of central bank. Today the number of central banks stands over 150.

Previously, central banks were privately owned and in a form of Joint Stock Banks. They were managed by shareholders with the objectives to finance the government from the private sector. Gradually the trend towards nationalization of central banks gathered momentum and now become important organs of the government. They actually support the policy of the government in the economic field. The dynamism of economic raised the status of the central banks to the position of the leader of the entire banking

system. Today's position of central bank is attained in past three centuries and yet it is in the growing stage.

“Central Bank have developed their own code of rules and practices, which can be described as the art of central banking but which, in a changing world, is still in the process of evolution and subject to periodical readjustment” (Vaidya, 2001:51).

Nepal Rastra Bank

In the context of Nepal, Nepal Rastra Bank is the central bank and was established in 1956 AD (2013 BS) as per NRB Act 2012. It is non-profit organization fully subscribed by the government. It was established to discharge the central banking roles and responsibilities including guiding the development of the embryonic domestic financial sector, since then, there has been huge growth in both the number and the activities of the domestic financial institutions NRB as the central bank of the country is entrusted with responsibility of management and supervision of the monetary and credit system of the country. In order to exercise adequate control and supervision over the banking and credit system of the country, the NRB has a key role in the country's economic system in which no other organization is likely to substitute it. As the highest monetary authority of the country, the bank's activities are directed towards the economic up ward of the country. NRB has been given wide regulatory responsibility under the various provisions of the following legislations.

- Nepal Rastrya Bank Act 2012 BS (1955 A D.) New Act 2058 BS
- Commercial Bank Act 2031 BS (1974 A.D.)
- Foreign Exchange Act 2019 BS (1962 A.D.)
- Bank and Financial Institutions Act 2063 BS

1.2 Focus of the Study

This study entitled “Implementation and Impact of NRB Directives” (A Study on selected Commercial Banks in Nepal) with respect to single borrower limit, capital adequacy ratio and loan classification and loan loss provision as well as mainly focused on directives issued by central bank to commercial banks. This study tries to find out the implementation and impact of NRB directives on commercial banks with special reference to the directive considered on this study is single borrower limit, capital adequacy norms and loan classification and loan loss provision.

1.3 Statement of Problem

In 21st century, the increasing trend of banking sector in the country, there is a mushrooming growth of commercial banks in private sector as well as in joint venture. A large number of banking, serving in the small sector will obviously increase the top competition for survival which might lead to keen rivalry among them to occupy the bigger part. So there may be offering of uneconomic rate of interest, including in risky enterprises, unhealthy competition etc. Such situations may endanger the deposits of general public. In order to safeguard the public deposits and ensure the economic stability in the country, NRB issues directives from time to time to commercial banks. The directives are related to various performances of the banks and the banks are required to follow the directives. There are sixteen (16) directives related to the banking supervision and regulations.

In the beginning, due to lack of proper regulations, Nepalese Commercial Banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problems of bad debts, over due loans, accrued interest, accumulations of non-banking assets and excess liquidity in the banking system. Viewing the need of structural reform amidst of these

adverse implications, NRB must issue suitable directives to run commercial banks in a healthy competitive manner to ensure the sustainable developments of the over all banking system.

In the year 2001, NRB issued a set of directives to commercial banks consisting of nine parts: claiming that these directives are based on internationally accepted banking norms of Basel Committee. NRB ordered the commercial banks to increase its authorized capital to Rs. 1 billion by 2010 which was almost impossible for Nepalese commercial banks.

We know that, directives are only tools of NRB to supervise, monitor and control the financial institutions; it must be formulated taking into consideration the positive as well as negative impact on the commercial banks. Issue of wrong or unsuitable directives, may ruin the conditions of commercial banks instead of enhancing its situations. NRB should take necessary actions to ensure that its recent directives have compelled all commercial banks equally. However, commercial banks should not be forced to comply with the norms.

1.4 Objectives of the Study

Nepal Rastra Bank has under taken various activities for the banking and financial development since its establishment. NRB has issued various regulation and directives to commercial banks to make the banking sector effective. The main objectives of the study are to review directives of the NRB related to commercial banks. This study conducted with the broad objectives of examining the state of NRB functions in the commercial banks in Nepal. The specific objectives of this study are given below.

- a. To review and analyze the selected directives of NRB to the banks under study.
- b. To examine the implementation and impact of NRB Directives to the concern commercial banks.

- c. To analyze the steps taken by commercial banks to fulfill the requirements of NRB directives.
- d. To provide necessary suggestions and recommendations on the basis of findings.

1.5 Significance of the Study

NRB is the main figure of this research study. NRB directives being only the tools of NRB to supervise, monitor and control the financial institutions, it obviously plays important role in the development of commercial banks of Nepal. NRB issues directives to the commercial banks from time to time in order to maintain stability in the financial market. The directives are issued on the basis of monetary policies and the success of the country depends on the directives of the central bank and its central role.

- a. In the process of economic development it has become necessary to develop NRB directives to meet the objectives.
- b. This research will help commercial banks to reassess their strategies and policies to cope with the development created by the recent changes made in the directives by NRB.
- c. It helps NRB to find out their shortcoming and take necessary actions.
- d. This study will have importance on various groups but it is particularity dedicated to:
 - i. Nepal Rastra Bank
 - ii. Nepal Bank Limited
 - iii. Rastriya Banijya Bank Limited
 - iv. Nepal Bangladesh Bank Limited
 - v. Other research on similar studies

1.6 Limitations of the Study

The effort has made to present and analyze the fact clearly, truly and within the boundary. But reliability of tools, lack of research experiences and lack of data are the primary limitation of this report. Other limitations are:

- a. This study is focused on only three directives among sixteen directives issued by NRB for commercial banks namely single borrower limit, capital adequacy ratio and provision of loan classification and loan loss provisioning on the credit.
- b. The study is based on questionnaire direct interview and secondary data received form NRB and other commercial banks. As well as primary data were also used to support the secondary date.
- c. The commercial banks formulate their own policies after properly studying the directives of the central banks. They have close relationship between NRB directives and commercial banks policies and always acting as a bridge between the NRB and commercial bank.
- d. In some situation independent assumption has been made, therefore the accuracy of results can be question.

1.7 Organization of the Study

This study has been divided into five different parts, which are as follows:

i. Introduction

This chapter includes background of study statement of problems, objectives of the study, importance of the study and limitation of the study.

ii. Review of Literature

The second chapter consists of the conceptual framework about assets utilization of assets and also of the review of available literatures from books and other related study.

iii. Research Methodology

The third chapter deals with introduction research design, nature and sources of data analysis, tools and techniques used for the study.

iv. Presentation and Analyses of Data

This fourth chapter deals with organizing tabulating and assessing financial and statistical results.

v. Summary, Conclusions and Recommendations

Ultimately fifth chapter comprised summary of main finding prevailing. Issued and of the company and some workable suggestion to the compares that help to improve thesis situation to some extent.

CHAPTER – TWO

REVIEW OF LITERATURE

In this chapter, the researcher has presented the conceptual framework or regulatory system of NRB directives (guidelines) of commercial bank and financial institutions. All the directives are directly related to the commercial bank's activities and it's affected by the bank rules and regulations. The reviews are done regarding the directives relating to capital adequacy ratio, single borrower limit and loan loss classification and provisioning. In this connection, the researcher has reviewed books and articles published in different journals and newspapers as well as browsing materials from the concerned web sites previous dissertations in the relevant subject matters etc.

From above it is clear that the purpose of literature review is to be final out. What research has been conducted in one's chosen field of study and what remarks to be done;

Thus this chapter is broadly discussed under three sections.

- a. Conceptual framework
- b. Review of Journals and Articles.
- c. Review of related studies

2.1 Conceptual Framework

In this section we are discussing briefly about the theoretical and conceptual framework, which are closely related to the NRB directives on commercial bank

2.1.1 Supervision and Regulation of NRB

The NRB has the responsibility for the supervision and control over commercial banks, financial institutions, and development banks and co-operatives organizations. The bank's inspection and supervision department

carry out this responsibility. In order to ensure the sound, healthy and efficient operation of the financial system, the inspection and supervision department is mandated to carry out both off-site and on-site supervision of banks and other institutions. Under off-site examination, the department is responsible for carrying out regular monitoring of the portfolio structure of the banks and financial institutions to ensure strict adherence to prudential guidelines and various sectoral targets set by the NRB. The department also issues permission to conduct limited banking activities to the ADB/N, co-operatives societies and NGO's and monitor their activities (Annual Report; 2002/03). The bank is generally regarded as having sought under-developed supervisory and regulatory capability. One of the key reasons for this appears to be the inability to retain trained staff who are attracted by considerable higher salaries offered by the private sector, financial institutions. This is particularly the case at senior levels, where staff has often had the benefit of foreign training and experience. Despite having available the necessary financial resources, the NRB is unable to effectively de-link the salary scale of its staff from the civil service pay scale. A study of the pay arrangements of the regional central banks made various recommendations in this area, but the government has apparently not yet allowed an independent pay policy for the NRB. Another area of weakness lies in the investment in technology, where the private banks have considerably superior information system and supervision them effectively in difficult. As a consequence they operate in a prudentially sound manner. The worst manifestation of this is demonstrated by the very poor financial health (and lack of proper accounting data) for the RBB.

The World Bank believes developing appropriate regulation which meets internationally acceptable norms with respect to exposure limits, provisioning policies, and capital adequacy and so on, is an urgent issue for the NRB. The subsequent development of both an on-site and off-site supervisory capacity is also extremely important. It is not only the development of these

capacities, but also the authority that the NRB subsequently has to deal with non-compliance with the central bank directives, which will be critical according to World Bank (Financial Sector Nepal, World Bank, 1999).

Central bank has power and full authority to supervise and regulate the banking sector. A central bank makes rules, issues instructions from time to time. For this NRB established banking operations and development department in 1966 AD to effectively mobilize the capital for promoting industry and the banking system. In December 1974 AD, agriculture loans department and industrials loans department were merged and the department was renamed as a banking operation and loan department. Again in 1986 AD it was divided into two different departments namely bank operation and development finance department. In 2002 AD, it came in its present form of Bank and Financial Institutions Regulation Department (BFIRD).

The main functions of the BFIRD include steering the financial sector reform, providing license to banks and financial institutions, issuing regulations and directives to the banks and financial institution re-financing the commercial banks to rehabilitate and sick industries, devising laws relating to banks and financial institutions and make timely amendments compiling, processing and publishing the data on banking and financial sector.

Finally, NRB's ongoing re-engineering to update its inspection supervision and regulation capacity at par with the international standard is another important part of the reform process.

2.1.2 Review of NRB Directives

NRB is authorized bank to regulate, control and develop the banking system; it gives permission for the setting up of new commercial bank and financial institutions and lastly, serves as a lender of last resort to commercial banks and financial institutions. The NRB's mandate incorporates the supervision,

regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing pioneer role by issuing directives to commercial bank is an attempt to maintain their level at par to the international standard. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

1. The provision of minimum capital fund to be maintained by the commercial bank.
2. The provision of loan classifications and loan loss provisioning on the credit.
3. The provision relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
4. The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.
5. Regulation relating to minimization of risk inherent in the activities of commercial banks.
6. The provision of institutional good governance to be followed by commercial banks.
7. Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of commercial banks.
8. Regulation relating to investment in shares and securities by commercial banks.

9. The provision of submission of statistical data to the NRB. Banking management division and inspection and supervision division.
10. Regulation relating to sale and ownership transfer of promoters shares.
11. Regulation relating to, stringent blacklisting procedure for loan defaulters.
12. The provision relating to compulsory deposited amount of NRB.
13. Regulation relating to developing the branch office of commercial banks.
14. Provision relating to interest rates.
15. Provision relating to collection of financial sources.
16. Provision relating to consortium financing (www.nrb.org.np)

The world was witnessed many financial crises and devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and their, magnitude of losses was much larger than expected. If we go back to the history, then on 3rd march 1997; the Asian crisis began in the form of liquidity problem of two finance companies which, later on spread over to other financial intuition within the Thai financial system. Simultaneously, crisis began to cover Malaysian, Indonesian and South Korean financial statement and loomed in the form of Asian crisis. So this Asian crisis appealed the whole world for regular and timely supervision and assessment of financial system, its soundness and vulnerabilities. This event forced the regulatory authorities for the enforcement of prudential measures in order to avoid further crisis review and revision in prudential regulations such as capital adequacy ratio, asset classification. Provisioning for impaired assets, exposures limit and enforcement of international accounting standard etc have now become common issue all over the world since the late 1990s.

Similarly, in our country too commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problem

of bad debts, overdue loans, accrued interest, accumulation of non-banking assets and excess liquidity in the banking system. In addition to these expected happenings new challenger were added to the Nepalese banking sector due to the adverse development in the domestic economy resulting from deteriorating peace and security situation and continuous persistence of natural calamities inside the country on one hand and the global recession primarily caused by international terrorism on the other. Viewing the need of structural reformation of these adverse implications, NRB issued directives to run commercial banks in a healthy competitive manner to ensure the sustainable development of the overall banking system (NRB Annual Report, 2002:15-20).

Capital Adequacy Ratio

Capital can be defined as the money invested in the business. It is required to conduct the business activities and is the primary requirement for initial period of business. Capital refers to those funds contributed by the bank's owners, consisting mainly of stock, reserve and earnings that are retained in the bank rather than paid out to the stockholders. Capital is required for conducting several important functions like supplying resources to get operates a new bank. Further expansion and defend against risk as well as it also assists in maintaining public confidence in the bank's management and shareholders (www.nrb.org.np).

Capital is envisaged as a provision or buffer to meet potential losses and to act as a motivational factor to the owners of the business to manage it prudently. Capital helps to absorb loss and to assure the society that the bank can play active role even at the time of adversity. 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.

No one can say how much capital is adequate for the bank. It is really a difficult question to answer. It is not right to think that having high capital to

asset ratio can keep bank alive, in fact, if the bank has risk free assets and bank management is efficient than even lower capital to total assets can sustain bank life. In the past, regulators used to fix minimum capital to total assets ratio, minimum capital to risk assets (total assets-cash and bank balance) ratio etc. However, such criteria could not set capital requirement based on risks undertaken by the banks. Hence, concept of risk-adjusted capital came into force from 1988, when development countries adopted, "Basel agreement" on capital management development by bank for international settlement (BIS), Basel Switzerland.

Accordingly, effective from 16th July 2001 (1st Shrawan 2058 B.S.) capital of the bank has been categorized into two parts by NRB as follows (www.nrb.org.np).

1. Tier-1 Capital/core capital in which includes following components are:

1. Share capital
2. Share premium
3. Non-redeemable preference shares
4. General reserve fund
5. Cumulative profit/loss (up to previous FN)
6. Cumulative year profit/loss as per balance sheet.
7. Capital adjustment fund (www.nrb.org.np)

2. Tier-2 Capital/supplementary capital in which includes following components are:

1. Loan loss provision for good or pass loan.
2. Assets revaluation reserve
3. Exchange equalization reserve
4. Hybrid capital instruments
5. Unsecured subordinated term debt

6. Interest rate fluctuation fund and
7. Other free reserves (investment adjustment reserve etc) not allocated for specific reserves (www.nrb.org.np).

Notes:

-) Under supplementary capital exchange equalization reserve is deleted through the amendment unified directive 2062
-) Loan loss provision up to 1.25% of total risk weighted assets is consider as supplementary capital
-) Gain from revolution of assets is transferred to Asset revolution reserve but fund in asset Revolution reserve up to 2% is treated as supplementary capital
-) If the average interest spread between deposit and loan exceeds 5%, the excess interest is to be deposited in Interest spread Reserve / Interest fluctuation fund

Tier-1-Capital/core capital is capital, which is permanently and freely available to absorb losses without the bank being obliged to cease trading. N example of tier one capital is the ordinary share capital of the bank. Tier-one capital is important because it safeguards both the survival of the bank and the stability system.

Tier-2-Capital/supplementary is capital which is generally absorbs losses only in the event of a winding up of a bank, and so provides a lower level of protection for depositors and other creditors. It comes into play is absorbing losses after tier one capital has been lost by the bank. An example of tier-two capital is subordinated debt. This is debt which ranks is priority behind all creditors except shareholders. In the events of a winding-up, subordinated debt holders will only be repaid if all other creditors (including depositors) have already been repaid.

The sum of core capital and supplementary capital is called total capital fund. Capital adequacy ratio is calculated on the basis of core capital,

supplementary capital and risk weighted assets. Capital adequacy as a legal requirement that a financial institution should have enough capital to meet all its obligations and fund the services it offers. The provision of minimum capital fund to be maintained by the commercial banks as per directed by NRB since fiscal year 2059/60 is as follows.

Table 2.1
Capital Fund to be Maintained

Time Period	Capital Fund in % on the Basis of Total Risk Weighted Assets		
	Core Capital	Supplementary Capital	Total Capital Fund
2059/60	4.5	4.5	9
2060/61	5	5	10
2061/62 to onward	5.5	5.5	11

Source: www.nrb.org.np

Banks are required to submit the report of capital adequacy along with other required data related with it, on a quarterly basis with in one month from the end of each quarter starting from Aswin, Poush, Chaitra and Ashad of every year. In case capital adequacy ratio is found shortfall banks are required to cover the short-fall with in next six months by the way of re-allocating assets or by issuing new share or by appropriating from the next profit while increasing its paid-up capital, it should increase its paid-up capital at least by 10% per year. Action against not fulfilling the requirement of capital adequacy ratio:

-) Prohibition on declaration and distribution of dividend.
-) Prohibition on opening of new branch.
-) Prohibition on loan distribution.
-) Prohibition on accepting new deposits.
-) Refinancing facility form NRB is not provided

$$\text{Capital Adequacy Ratio} = \frac{\text{Core Capital} + \text{Supplementary Capital}}{\text{Risk Weighted Assets}}, \text{ Or,}$$

$$\text{CAR} = \frac{\text{Tier - 1 Capital} + \text{Tier - 2 Capital}}{\text{Risk Weighted Assets}} \text{ (Rose, 1997:95).}$$

For the calculation of capital fund or CAR:

The risk weighted assets has been classified in following two components:

-) On- balance sheet risk-weighted assets
-) Off-balance sheet risk-weighted assets.

On-balance sheet assets of banks are group into three categories with assignment of separate risk-weighted. The assets categories and their corresponding risk-weights are given in the following table. To determine the risk weighted on-balance sheet assets, the national value of the various balance sheet assets are multiplied by their respective risk weights and then added together.

Table 2.2
Risk-Weighted on-Balance Sheet Assets

On balance Sheet Assets Risk Weights	Risk weighted %
) Cash balance- gold tradable- balance of NRB	0%
) Investment on HMG bonds/ securities	0%
) Investment on NRB bonds/ securities	0%
) Fully secured loan against own FDR	0%
) Balance at local banks & financial institutions	20%
) Fully secured loan against other banks FDR	20%
) Balance at foreign banks- loan against guarantee of	20%
) A+ rated Int'l banks	20%
) Money at call- other investment on A+ rated Int'l banks	20%
) Investment on share, debt and bond	100%
) Other Investment	100%
) Other loan, advance and bills purchased	100%
) Fixed assets	100%
) Other Assets	100%

(Source: www.nrb.org.np)

In order to determine the value of risk-weighted assets of balance sheets items of a bank the items are grouped in to four categories and accordingly risk weight age of 10%, 20%, 50% and 100% have been assigned .The risk-weight age assigned for off-balance sheets items, the value of the off-balance sheets items shall be multiplied by their respective risk-weights and then added together.

Table 2.3
Risk-Weighted off-Balance Sheets Items

Particular off-Balance Sheets Items	Risk Weighted %
) Bills collection	0%
) Forward foreign exchange contact.	10%
) L/C with maturity of more than 6 months (full value)	20%
) Guarantee provided against counter guarantee of internationals rated foreign bank	20%
) L/C with maturity of more than 6months (full value)	50%
) Bid bond	50%
) Performance bond	50%
) Advance payment guarantee	100%
) Financial guarantee	100%
) Other guarantee	100%
) Contingent Tax Liability	100%
) Irrevocable loan commitment	100%
) Other contingent liabilities	100%

(Source: www.nrb.org.np)

regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and

healthy development of banking and financial system and towards enhancing the public creditability toward it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing pioneer role by issuing directives to commercial bank is an attempt to maintain their level at par to the international standard. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

bank healthy and robust against all the contingencies and enhances the image of the bank in the financial market. Higher the capital adequacy ratio the more sound the bank is.

Regarding the capital adequacy ratio, there is always been conflict between management and regulatory authorities. Regulatory authorities always focus in increasing capital adequacy ratio in order to stabilize the financial system while management wishes to reduce the ratio so as to increase shareholders rate of return on investment. Thus, capital management has been most important and most controversial issues in the financial institutions.

Loan Classification and Loan Loss Provision

The International Accounting Standards Board (IASB) has issued standard on assets valuation and disclosure, it has not yet provided detailed guidance on loan provisioning. As a result, countries that implement the international accounting standards still have different loan loss provisioning regulatory home works.

In such loan means money lent at interest. In commerce and finance term is used as the transfer of money or other property on promise of repayment along with interest, usually at a fixed future date. Loan loss provision is an arrangement made in order to safeguard from bankruptcy if loaned amount is

not recovered or if the debtors default on repayment of loan. It provides buffer against future unexpected losses.

Loan and advances are the most profitable of all the assets of a commercial bank. This is the primary source of income and the most profitable of all the assets of the bank. Loan and advances account for the largest part of the revenue of the bank. But bank need to be careful about the safety of such loan and advances because bank may be influences by bad debts and since loan and advances are least liquid of the entire banker's assets. So may feel difficult to realize them on short notice.

There are different types of loan and advances such as secured and unsecured loans. These loans, which were granted against the personal security of the borrower, is secured loan i.e. against the promissory notes while unsecured loan means that are not backed by tangible assets or securities.

With an objective to minimize the possible loss of credits extended by commercial banks, as provided under section 23(1) of Nepal Rastra Bank Act 2012 (with amendment) relating to development and regulation of banking system, this directives in respect of loan classification and provisioning has been issued in exercise of authority under section 14 (a) of commercial banking act 2031.

Clause - 1: Classification of outstanding loan and advances on the basis of aging:

Effective from FY 2059/60 (2001/02) banks shall classify outstanding principal amount of loan and advances on the basis of aging.

Clause - 2: Classification of loan and advances:

As per the directives issued by NRB, all loans and advances shall be classified into the following four categories:

- a) **Pass Loan:** Loans and advances whose principal amounts are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing loans.
- b) **Sub-Standard Loan:** All loans and advances that are past due for a period of 3 months to 6 months shall be included in this category.
- c) **Doubtful Loan:** All loans and advances, which are past due for a period of 6 months to 1 year shall be included in this category.
- d) **Loss:** All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

Loans and advances falling in this category of sub-standard, Doubtful and loss are classified and defined as Non-performing loan.

Clause - 3: Relating to Collateral

Loan Loss Provisioning

The loan loss provisioning on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as follows:

Table 2.4
Provision for Loan Loss

Classification of Loan	Loan Loss Provision
Pass	1%
Sub-standard	25%
Doubtful	50%
Loss	100%

(Source: www.nrb.org.np)

Loan loss provision set aside for performing loan is defined as general loan loss provision and loan loss provision set for non-performing loan is defined as "Specific loan loss provision". Banks shall as of the end of Ashoj, Poush, regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

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on the basis of following timetable into four parts.

For fiscal year 2003/2004 A.D. (2060/2061 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 1 year.
Doubtful loan	Loans and advances past due for a period over 1 year to 3 year.
Loss	Loans and advances past due for a period of over 3 Year.

For fiscal year 2004/2005 A.D. (2061/2062 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 1 year.
Doubtful loan	Loans and advances past due for a period over 1 year to 3 year.
Loss	Loans and advances past due for a period of over 3 Year.

For fiscal year 2005/ 2006A.D. (2062/2063 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 9 months.
Doubtful loan	Loans and advances past due for a period over 9 months to 2 years.
Loss	Loans and advances past due for a period of over 2 Years.

For fiscal year 2006/2007A.D. (2063/2064 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 6 months.
Doubtful loan	Loans and advances past due for a period over 6 months to 1 year.
Loss	Loans and advances past due for a period of over 1 Year.

Even if the loan is not past due, loans having any or all of the following discrepancies shall be classified as loss.

-) No security at all or security that is not in accordance with the borrower's agreement with the bank.
-) Borrower has been declared bankruptcy.
-) Borrower was lost or cannot be found.
-) Discounted bills not repayable within 90 days from due date.
-) Loan and advances amount not used for the actual purposes.
-) Blacklisted borrowers.

Single Borrower Limit

Commercial banks were not allowed to disburse fund-based loans and advances exceeding 25% of their core capital and non-fund based facilities relating to the off balance sheet items like letter of credit (L/C), guarantee approval letter and commitments exceeding 50% of their core capital to a client, firm, company or group of related customers. A commercial bank should limit both fund-based and non-fund based loans and advances and

facilities given prior to this direction. In this regard, such fund-based loans and advances and facilities were to be brought to the level of 40% and 25% of the core capital by the end of FY 2001/02 and FY 2002/03 respectively.

However, these limitations would not pretrial for the following loans, advances and facilities:

-) Loans and advances against fixed deposit receipt, bank deposit, securities of Government, NRB bonds and against the guarantee of a bank, which was rated as A+ by the world bank (WB), Asian development bank/ Manila (ADB), International finance corporation (IFC) and by the renowned rating agency or classified as first class bank by NRB.
-) Loans and advances given to Nepal oil corporation, Agriculture input corporation and Nepal food corporation to input petrol, diesel, kerosene, liquefied petroleum gas' fertilizers and seeds and food products.

Basel - II

Reform of the Capital Adequacy Standard

In the 2004, the world's top central bankers put their seal of approval on Basel II, a new capital adequacy framework for banks. Basel II aims to build on a solid foundation of prudent capital regulation, supervision and market discipline and to enhance further risk management and financial stability. It is fundamentally about better risk management and corporate governance on the part of banks as well as improved banking supervision and greater transparency. It is also about increasing the stability of the global financial system to the benefit not only of banks but also consumers and business. The new capital framework attempts to achieve these objectives with three mutually reinforcing pillars.

1. Minimum capital Requirement

2. Supervisory review process
3. Market discipline

The first pillar of the accord is related to the minimum capital requirement. It is the bank that has to measure its true risks profile and volume of unexpected losses and the level of required capital. The minimum capital is to be computed to cover not only the credit risk but also market and operational risk as well for the minimum capital requirement another important development of the new accord is risk. Under the framework the operation risk is defined as “the risk of loss resulting from inadequate or failed internal process, people and systems or from external events”. This definition includes legal risk but excludes strategic and reputation risk. Quantification of operational risk is not a possible even though its measurement essential for capital purpose. Therefore the Basel-II framework has prescribed some workable methodologies for the measurement of operational risk. The framework has prescribed three different approaches for the operational risk.

- Basic indicator approach
- Standardized approach
- Advance measurement approach.

The 2nd pillar of the framework is related to the "Supervisory Review Process" (SRP). The objective of this second pillar is to add values to the regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing pioneer role by issuing directives to commercial bank is an attempt to maintain their level at par to the international standard. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

right duty and responsibility to evaluate how well the banks are assessing their capital need relative to their risks and to intervene where appropriate. The third principle is related to buffer capital supervisors always expect a bank to operate above the minimum regulatory capital. The fourth principle is related to early remedial action if the capital is not maintained or the capital is deteriorating. The pillar-II of the new framework demands for the supervisory capacity building. Unless and until the conceptual understanding and operating modalities of the framework are not clear to the supervisor, its effective implementation is not possible.

The third pillar of the framework is related to "Market discipline". Market discipline refers to the market disclosure. The main objective of the 3rd pillar is to reward the banks that have efficient and sound practice and to penalize those banks that have poor management and inefficient operation. In response to the disclosure made by the bank, the market will reward or punish the bank depending on the information so published. It encourages transparency and governance in financial services. Where the disclosure is poor the supervisory review process may apply and the enforcement action shall be taken through the second pillar. The disclosure is required in a number of items related to components of capital, risk weighted assets, risk weight on credit risk, operational risk, market risk and the different disclosure requirement under different approaches and different complex situations. Such disclosure should be in quantitative as well as qualitative term (The Nepal Chartered Accountant- September 2005; Vol.3, no.4).

"Although, the adoption of Basel-II is the long run destination of our industry, which we are going to put forward in this seminar, we should adopt rather a simple way of managing capital according to our available resources and expertise. The accessions of our country into WTO and other globalization initiative have recommended us to adopt this new capital accord despite the fact that Basel Committee does not make it mandatory for all the country to implement it" (Speech of Bijay Nath Bhattarai, Ex. Governor of Nepal Rastra Bank.)

2.2 Review of Related Studies

2.2.1 Review of the Article and Journal

NRB took action against some commercial banks under its supervisory function as per the provision of NRB act 2002 on the basis of their financial statement and reports for fiscal year 2001/02. As some bank couldn't maintain required minimum level of capital of Rs 500 million but mid-July 2001 as directed by NRB, so distribution of any kind of dividend or bonus share was restricted for those banks which couldn't fulfill their minimum capital requirement (NRB Annual Report; 2001/02).

Some banks were penalized for not maintaining a compulsory cash reserve and for not disbursing the loan to the deprived sector under the priority sectors loan, as per the directive of NRB during the year 2001/02.

Nepal Rastra Bank is committed to strength and ensures the stability and soundness of the banking system. In this process, NRB has continued to review the relevant legislations and regulations in 2004/05 in order to place up to date regulatory framework that meets international standards and resolves the issues of the banking industry.

A number of changes took place in the banking legislation and directives during the year 2004/05. The year saw revisions being made in the bank and

financial institution ordinance (BAFIO) as well as in the NRB act, 2058, two of the most binding documents of the banking industry. The substitute for the commercial bank act, BAFIO could not be enacted as an act, in the absence of the legislative body, thus requiring the document to be re-approved every six months. In this process some of the lapses that were felt in the earlier document were duly addressed.

Under the existing structure of Nepal Rastra bank, the directives applicable to the commercial banks are primarily issued from two departments, Banks & financial institutions regulation department and foreign exchange management department. The foreign exchange management department regulates the foreign currency transactions of the bank while the bank and financial institutions regulation department covers the rest. The essence of the various circulars issued by these departments in the year 2004/05 (Banking Supervision Annual Report, 2005).

The journal of business age has focused on the take over of Lumbini bank by NRB because of violation of NRB's directives and regulations. NRB has dissolved the existing board of director and brought the management under its own control as considering the interests of depositors as well as investors. Recently, NRB's has take over the Nepal Bangladesh bank and dissolved the regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

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international standard. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

bank.

Similarly, NRB's has merged the non-banking operations departments and the banking operations department. Recently, NRB has established a new Research department in order to expedite the supervision of the functioning of all financial institutions in the country. The research department is expected to be responsible for the regulation and monitoring of all those institution that are operating in Nepal.

Everest bank ltd. has been awarded the prestigious "Bank of the year 2006" by the London-based financial time groups the bank. Everest bank ltd has thus become the fist time with the award. It is the joint venture bank, which is related to Punjab national bank. This award is given to the basis of the growth and performance in terms of capital assets, return on equity and management quality. States a press release issued by Everest bank.

NRB has implied that the further established of commercial bank in Nepal, where has withdraw the seven-year restriction. Under new directives, commercial bans must maintain paid up capital equivalent to Rs 2 billion and Rs. 25 million at the national and regional levels respectively. This proviso stipulates one compulsory requires the joint investment of foreign commercial bank or financial institutions and Nepali firm company etc. for the operation of such commercial banks. These new NRB banking policy has affected the royal army's long-standing plan to established a separate commercial bank. Its management ownership also, there may be negative effect on foreign investment because of no registration of new banks starting form the year 1995 due to express of competition aroused by massive investment following the adoption of liberal policy.

In accordance with the directives of NRB dated 2060-5-31. Nepal bank limited recently published the list of willful defaulters, who are making no effort to repay their debt and honor their obligation. Nepal bank blamed them for loading their debt to the hapless citizens of Nepal and they are in effect economic renegades engaging in commercial terrorism to the detriment of the people of Nepal. The total debt including un-paid interest, of the defaulters stands at Rs. 2074 crore. This amount to a loss to each shareholder of Nepal bank of Rs. 5453 for each share held for each citizen of Nepal its amount to Rs. 896. After commencement of restructuring project Nepal bank is successful in collecting Rs. 517 crore in cash form defaulters. Nepal bank committed to continue its endeavors to actively pursue these uncooperative defaulters until their debts are repaid (New Business Age January, 2006:13).

The senior charter accountant of the country in his interview with business age magazine regarding black listing borrowers comments that the blacklisting law is quite draconian and does not appear to be logical. There is no doubt that the time was ripe for NRB to act sternly in this direction but in the process they missed out to distinguish between a bad and good lender as they did for he borrowers. The delinquent borrower needs to be punished but if the delinquency was the result of economic depression or business failure he/she should be given opportunity for expanding or diversifying the business instead of clamping down access to resources. He further stated that the recommended provision is quite relevant and timely in respect of willful defaulter and person miss-utilizing the loan (New Business Age, 2006:23).

2.2.2 Reviews of the Previous Studies

Karmacharya (2002), study entitled “Study on Capital Structure of Joint Venture Commercial Bank and NRB Directives Issued in Regards” concluded the following finding and recommendation. He has started that financial soundness and strength of the company is largely depending upon the composition of he capital structure and assets. The proportion of debt and

equity capital should be decided keeping mind the effort of tax advantages and financial distress. Maintaining the improved capital structure by increasing equity base by issuing more equity capital, expanding general reserve and retaining more earnings are the advantages. As mandated by NRB for the operation in all over Nepal, a commercial bank should have paid up capital base of Rs. 500 million hence, the banks should raise its paid up capital to Rs. 500 million as soon as possible.

Pandey (2002), in his study entitled '*Nepal Rastra Bank directives, their implementation and impact on the commercial banks- A case study of HBL*' has set conclusion on the subject of the capital adequacy of HBL during his study periods, i.e., as of poush 2058 as the capital fund of HBL stands at Rs.1070 million comprising of Rs.756 million core capital and Rs.314 million of supplementary capital. For this, the bank has to try to increase its supplementary capital because the supplementary capital falls short by Rs.73 million even after contribution from the excess core capital. The total risk weighted assets of HBL is equal to Rs.12690.6 million. AS a result, the capital adequacy of the bank stands at 8.43% of total risk weighted assets. Core capital is 5.9% and the supplementary capital is 2.47% of total risk weighted assets. Core capital is 5.96% and supplementary capital is 2.47% of total risk weighted assets. Pandey has suggested that HBL should increase the capital base from Ts. 1070 million by least Rs.115 million to meet the capital adequacy ratio. For this, the bank should try to increase its supplementary capital as falls short by Rs.73 million. The bank should increase its core capital in order to expose itself to more credit risk. Supplementary capital can be fulfilled by the surplus in core capital.

Shrestha (2003), entitled "NRB capital Adequacy Norms for the Commercial Banks and its Impacts Case study of Bank of Kathmandu and Himalayan Ltd." concluded the following finding and recommendation. In this thesis he started that raising and utilization of funds are the primary functions of commercial banks. Commercial banks collect a large amount of

deposits from general public so in order to protect such deposit. Capital must be sufficient otherwise the banks will use all the money of deposits in their regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing pioneer role by issuing directives to commercial bank is an attempt to maintain their level at par to the international standard. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

safely to their money. Therefore, NRB should initiate awareness programs to make the depositors aware of such fact and think before depositing money in any commercial banks.

He further stated that NRB should consult to the various bank officials before setting or resetting standards on capital adequacy norms. The complaints and criticism of bank officials should be considered accordingly; consequently an optimal standard will ensure which will satisfy almost everyone.

Shrestha (2003), in her studies "Impact and Implementation of NRB's Guidelines on Commercial Banks A study of NABIL Bank Ltd. and Nepal SBI Bank Ltd" has tried to find out the impact of NRB directives on commercial banks. She has also made effort to find out whether the directives are actually implemented and are being monitored by NRB or not. She has stated that both NABIL and SBI bank are implementing the NRB directives.

In her study, she found out that all the changes in NRB directives made both positives and negative impacts on the commercial bank. Even though the study is limited to only two samples, it is cleared that new directives issued by NRB make good impact more than bad impact on the various aspects of the banks. It can be seen that the provision has been changed and the increased provisioning amount has decreased the profitability of commercial banks. Apart from, loan exposure has been cut down to customers due to the borrowers limits have been brought down by NRB. Therefore reductions in loan amount result to decrease the interest income from loans. This will decrease the profit of the banks shareholders and lesser bonus to employees. Not only negative sides but also there are positive sides of new directives. Recently the problems of banks are increasing operating cost and decreasing loan amount resulting decrease in profit of the banks. But it shows it in only for short term because the directives are more effective to protect the banks from bad loans, which protect the banks from bankruptcy as well as protections of deposits of general public. Increase in capital adequacy ratio strength the banks financial position. Loan related provision will make safety of loans except the risk reducing provision will protect the bank from liquidation.

Shrestha (2004), entitled “NRB Guidelines on Investment Policy of Commercial Bank in Nepal A Case Study of Nepal Investment Bank.” concluded the following finding and recommendation. In this study conclude that NRB has to play active or vital role to enhance the operation of commercial banks, development banks, financial institutions, co-operatives banks as well as insurance companies. Strengthening and institutionalization of the commercial banks is very important to have a meaningful relationship between commercial banks and national development through shift of credit to the productive industrial sectors. At the same time the series of reforms such as consolidation of commercial bank directing attention to venture capital financing, appropriate risk return trade off by linking credit to timely

repayment schedules avoiding imperfections, allowing flexibility in lending. One window service from NRB need of a strong supervision and monitoring from NRB, diversity scope of activities of commercial banks, professional culture within commercial banks etc. all these are necessary to ensure better future performance of commercial banks that have already been established and growing in Nepal.

Dhakal (2006), in his study entitled “A comparative study of Capital Adequacy of Joint Venture Banks in Nepal especially of Nepal Arab Bank Ltd. and Nepal Investment Bank Ltd.” concludes that the liquidity position of both the banks is below the normal standard of 2:1. Comparatively this ratio of NIBL is better on an average. Both the banks are found to be efficient in utilizing most of their total assets. Capital structure is highly leveraged, capital adequacy ratio of NIBL is better than that of NABIL and the profitability position of both the banks is not recorded as satisfactory. Based on the findings of analysis, the research suggests finding out the root cause of weak liquidity position to improve the liquidity of both banks. Similarly, both the banks are suggested to maintain improve capital structure by increasing equity base, to extend loan and advances

to utilize more of the total deposits, to minimize operational expenses or to mobilize resources more efficiently and to extend their banking facilities even in the rural areas.

Kandel (2007), in his study entitled “Capital Adequacy of Commercial Banks in Nepal especially of Nepal Bank Limited, Himalayan Bank Limited and Nepal Investment Bank Limited.” concludes that After detail analysis of capital adequacy directives issued by Nepal Rastra Bank based on Capital Accord 1988, International practices on capital adequacy, the compliance status on capital adequacy by selected commercial banks and their management effort to built strong capital base, following conclusions are drawn:

During regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

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Since, there are the provisions for supervisory/regulatory authorities and the banks themselves would be granted more discretionary power on the application of the provisions. When the changes are implemented, it is therefore of great importance that uniform application of the provisions should be ensured for all banks subject to the new Basel II issued on November, 2005 (latest revision). For this, Nepal Rastra Bank should be serious to develop new capital adequacy framework timely in order to implement it timely.

About 25% commercial banks (4 numbers) out of total numbers commercial banks (17 numbers) are unable to fulfill capital adequacy norms based on core capital to risk weighted assets. Out of which Nepal Bank Limited is also unable to maintain adequate core capital based on RWA based on average data of last three years. Himalayan Bank Limited and Nepal Investment Bank Limited are successful in this regard. 9 commercial banks had not complied

regulatory requirement in the maintenance of capital fund out of 17 commercial banks.

Again, Nepal Bank Limited is not able to fulfill the regulatory requirement on capital fund to risk weighted assets based on average data of last three years. Himalayan Bank Limited and Nepal Investment Bank Limited are successful in this regard.

There is continuous growth in core capital, capital fund. The risk-weighted asset was fluctuating in HBL. Average growth rate of capital fund, core capital, RWA, % of capital fund to RWA, % of core capital to RWA were 6.79%, 7.84%, 5.95%, 18.24%, 17.31% respectively in HBL. There is continuous growth in core capital, capital fund and risk weighted assets of NIBL. Average growth rate of capital fund, core capital, RWA, % of capital fund to RWA, % of core capital to RWA were 34.93%, 28.13%, 37.29%, 15.93%, 13.32% respectively in NIBL. There is continuous decrement in core capital, capital fund and risk-weighted assets of NIBL. But, risk weighted assets was begun to increase in FY 2004/5. Average growth rate of capital fund, core capital, RWA, % of capital fund, % of core capital to RWA were -72.25%, -16.64%, 3.39%, -27.94%, -35.63% respectively.

HBL has surplus core and supplementary capital by Rs 772.83 million and Rs 489.64 million in FY 2004/5 and in all the years the bank is successful to maintain capital adequacy requirement. In NIBL, there was surplus core and supplementary capital by Rs 421.66 million and Rs 78.14 million in FY 2004/5 and in all the years the bank is successful to maintain capital adequacy requirement except FY 2002/3. In NBL, there is deficit core capital and capital fund by Rs -24559.02 million and Rs -27614.92 million in FY 2004/5 and in all the years, the bank was failed to maintain capital adequacy requirement.

Timsina (2008), in his study entitled “A study on capital adequacy of commercial banks in Nepal,” and following conclusions were drawn on the basis of quantitative and qualitative analysis on the selected commercial banks (Standard Chartered Bank Nepal Limited, Nepal Investment Bank Limited and Rastriya Banijya Bank Limited)

Average total risk weighted assets of SCBNL was Rs 9608 million. RWA in SCBNL is more or less consistent. The bank had Rs 7839 million (81.5%) of on balance sheet risk assets and Rs 1769 million (18.5%) of off balance sheet risk assets in average. Majority of risk weighed asset is composed by loan and advance and bills and purchase (54%) in total risk weighted assets. Average total risk weighted assets of NIBL was Rs 7670 million. RWA in NIBL is increasing trend. The bank had Rs 6640 million (86.5%) of on balance sheet risk assets and Rs 1030 million (13.5%) of off balance sheet risk assets in average. Majority of risk weighed asset in NIBL is composed by loan and advance and bills and purchase (72%) in total risk weighted assets. Risk weighted assets of both on balance sheet and off balance sheet assets of Rastriya Banijya Bank Limited was fluctuating. The bank had Rs 51508 million (98%) of on balance sheet risk assets and Rs 796 million (2%) of off balance sheet risk assets in average. majority of risk weighed asset is composed by loan and advance and bills and purchase (22%) and by other assets (46%) in total risk weighted assets.

Rastriya Banijya Bank Limited has not focused on off balance sheet transactions (2% of total risk weighted assets) in its business to increase profitability in comparison to Standard Chartered Bank Nepal Limited (18.5%) and Nepal Investment Bank Limited (13.5%) of off balance sheet risk weighted assets based on total RWA. Net profit and capital fund of SCBNL and NIBL are in increasing in each year in comparison to last year. But, in case of RBB, capital fund of RBB is continuously decreasing up to FY 2004/05 and began to improve slightly from FY 2005/06. RBB has been incurring loss from FY 2001/02 to 2003/04 but then, the loss RBB is able to

regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing pioneer role by issuing directives to commercial bank is an attempt to maintain their level at par to the international standard. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

where as capital fund is in increasing trend. Percentage of non-performing loan to capital fund of SCBNL is in decreasing trend. In case of NIBL, non-performing loan was fluctuating. The growth of capital fund of NIBL is higher than SCBNL. NIBL's percentage of non-performing was fluctuating. Percentage of non-performing loan was also fluctuating in RBB. Capital Fund of the RBB was continuously deteriorating till FY 2003/4 and began to improve from FY 2005/06 but the fund is still negative.

2.3 Research Gap

From above literature it can be concluded that newly issued directives are more effective than previous one although it has brought some problems towards banks. To decrease the decreasing profits of the banks, they should research the alternative such like more investments in other business, banks, should adopt new technology according to the demand of time and must not depend on only interest income for profits. Previous researchers analyzed financial performance by using secondary source of information in terms of financial ratio. But actually speaking, country's environment and fiscal policy in terms NRB directives and adequate fund may be the strong

determinant for capital adequacy management in the commercial banks. Present study tries to define different accord and directives of central bank in Nepal by applying those various facts in the context of Nepalese commercial banks. It can be very useful or important in capital adequacy management. Thus, present study will be fruitful to those interested person, parties, scholars, professor, students, businessman and government for academically as well as policy perspective. Hope this study will help to others in future in the related field.

CHAPTER - THREE

RESEARCH METHODOLOGY

The main objectives of this study are to evaluate or description of the assessment of NRB directives on commercial banks and compare one another assuming they represent almost all of the entire banking industry. Research methodology is the way to solve systematically about the research problem. Research is essentially inquiry seeking facts through objectives verifiable methods in order to discover the relationship among them and to deduce from them broad principles or laws. It is really a method of critical thinking by defining and redefining problems, formulating hypothesis or suggested solution, collecting organizing and evaluating data making deductions and making conclusion to determine whether they fit the formulated hypothesis. To sum up research is the process of a systematic and in-depth study or search of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data (Wolf and Pant, 2003:25).

3.1 Research Design

A Research design is purely and simple the framework or plan for a study that guides the collection and analysis of data "Research design is the plan structure and strategy of investigation conceived so as to obtain answer to research questions and control variance". This study is based on descriptive source research design. This study is an examination and evaluation of NRB directives on commercial banks. It helps the researcher in the right direction in order to achieve the goal.

3.2 Population and Sample

Population means the whole industry and for this study twenty six commercial banks operating in the kingdom are the total population. Listed commercial banks are twenty-six in numbers. We were selecting three

commercial banks, out of commercial banks as a sample of the study. These three banks were selected taking is to consideration the availability of data. So rather than random selection, the selected three commercial banks as the sample of this study are as follows:

1. Nepal Bank Ltd.
2. Rastriya Banijya Bank Ltd.
3. Nepal Bangladesh Bank Ltd.

3.3 Source of Data

This research study is mainly based on the secondary data that are available in the published form and as well as primary data are also referred. The required data for the study has been collected from the concerned organizations. Following are the secondary sources of data used in the study.

-) Annual reports, newsletters, broacher etc. of the selected banks.
-) Textbooks, articles published in newspapers, journals magazines etc.
-) Laws, NRB guidelines, NRB acts etc.
-) Banks websites and other relative websites.
-) Questionnaire to bank officials depositors and academicians

3.4 Data Collection Techniques

In order to make the study more reliable and authentic different tools and techniques are used through out the study. Primary data has been obtained through questionnaire, direct interviews, field visits and telephone inquires. For secondary data annual reports, brochures etc has been collected from different department of concerned banks and as well as websites were also used for down loading the necessary information. Various related publications of NRB were collected from concerned departments of NRB Baluwatar. Similarly reports of credit information bureau (CIB) have been collected from office of CIB, Thapathali.

3.5 Data Analysis Tools

The data collected from different sources are recorded systematically as necessary. Only useful and related data are grouped as per need of the research work. Data are presented in appropriate forms of tables; graphs and Figures for analysis of appropriate mathematical, financial as well as statistical tools are used. Some of them are:

-) Ratio Analysis: Capital adequacy ratio, Loan loss provision
-) Statistical Analysis: Correlation analysis, Probable error, Coefficient of Determination etc.

a. Financial Tools

For proper financial analysis of data ratio analysis is the best tool. It is very simple analyzing tools under which ratios are taken to express the relation between two or more data. Through ratio analysis we can establish the relationship among the data and research into conclusion. Under ratio analysis following ratio related to bank are analyzed.

1. Capital Adequacy Ratio

This ratio is used to protect depositors and promote the stability and efficiency of financial system around the world and to examine adequacy of the total capital fund and core capital, which is yielded by the following formulas:

To measure the adequacy of capital fund

$$\text{CAR} = \frac{\text{Total Capital Fund}}{\text{Risk Weighted Assets.}} | 100\%$$

Where,

Total capital fund = Core capital + Supplementary capital

2. Dividend to Net Profit

This ratio is used to calculate the portion of dividend distributed to shareholders from the net profit earned by the bank. High ratio shows the large portion of net profit is distributed to shareholders. Due to certain norms of NRB, commercial banks are required to keep some reserves for different purpose, which is obviously deducted from net profit. Hence, dividend is distributed, if large portion of net profit is kept for certain reserves, retained earning etc. through this ratio we can know what portion is separated for dividend and reserves and can also find out the impact of maintaining reserves earning etc. from net profit. It is calculated as follows:

$$\text{Dividend to net profit} = \frac{\text{Dividend}}{\text{Net Profit}} \times 100\%$$

3. Non-Performing Loan to Total Loans and Advances Ratio

This ratio is used for find out the portion of non-performing loan is the portfolio of total loan and advances. Higher ratio shows that bank has bad quality of assets in the form of loan and advances. Hence, lower ratio is preferred. There is no fixed ratio to be maintained but as per international standard only 5% is allowed. It is calculated as follows:

$$\text{NPL to total loan and advances} = \frac{\text{Non Performing Loan}}{\text{Total Loan and Advances}} \times 100\%$$

4. Provision Held to NPL

This ratio is used to find out the provision held for non-performing loan. This ratio measures up to what extent of risk interest in NPL is covered by loan loss provision held for NPL. Since higher ratio safe guard against future contingencies that may create due to non performing loan, higher ratio is

preferred by bank or in other words banks have cushion of provision to cope the problem that may he cause due to NPL. It is calculated as follows:

$$\text{Provision held for NPL to NPL} = \frac{\text{Provision Held for NPL}}{\text{Non Performing Loan}} | 100\%$$

5. Loan Loss Provision to Total Loan and Advances

Loan loss provision signifies the cushion against future contingencies created by the default of the borrowers in the payment of loans and ensures the continued solvency of the banks. Since low ratio reflects the good quality of assets in the volume of total loan and advances, low ratio is preferred. It indicates how efficiently it manages loan and advances and makes efforts to cope with probable loan loss, since, high provision has to be made for non-performing loans, higher ratio implies, higher portion of NPL in the total loan portfolio. It is calculated as follows:

$$\text{Loan loss provision to total loan and advances} = \frac{\text{Loan Loss Provision}}{\text{Total Loan \& Advances}} | 100\%$$

b. Statistical Tools

1. Correlation Coefficient

Correlation analysis is the statistical tool that can be use to describe the degree to which one variable is linearly related to other variable. Two or more variables are said to be correlated if change in the value of one variable appears to be related or linked with the change in the other variables. Correlation is an analysis of the co-variance between two or more variables and correlation analysis deals to determine the degree of relationship between two or more variables. It refers the closeness of the relationship between two or more variables. The correlation between two variables X and Y is calculated as follows:

Karl parson's correlation coefficient $(r_{xy}) = \frac{\sum xy}{\sqrt{\sum x^2 \sum y^2}}$

Where,

$$\sum x = \sum X$$

$$\sum y = \sum Y$$

N= numbers of observations

x & y = variables.

2. Coefficient of Determination

The square of the correlation coefficient is called the coefficient of determination. It is used to interpret the value of the correlation coefficient. The main significance of the coefficient of determination is to represent the proportion of total variations in the dependent variable, which is explained, by the variations in the independent variables. It is calculated as follows:

$$\text{Coefficient of Determination } (r_{xy})^2 = (\text{Correlation of coefficient})^2$$

3. Probable Error

Probable error is an old measure of ascertaining the reliability of the value of coefficient of correlation. It is used to test whether the calculated value of sample correlation coefficient is significant or not and also it is used to determine the limits within which the population correlation coefficient may be expected to lie. The probable error may lead to fallacious conclusions particularly when the number of observations is small. It is calculated as follows:

$$PE (r) = 0.6745 \sqrt{SE (r)}$$

Where,

r = Correlation Coefficient

$$SE = \text{Standard Error} = \frac{\sum Zr^2A}{\sqrt{n}}$$

Limits for Population Correlation Coefficient = $r \pm PE(r)$

c. Analysis of Primary Data

Data generated through questionnaires and personal interviews of commercial banks, bank officials, academicians, and Depositors are analyzed using descriptive methods and are presented in tables wherever necessary.

regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. NRB has the effective functioning of commercial banks; they should be issued some guidelines of commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing a pioneer role by issuing directives to commercial banks. An attempt to maintain their level at par to the international standard. At present the number of guidelines issued by NRB to commercial banks reaches sixteen, which are as follows.

the NRB directives. Since data of the study is of non-experimental type; chance of observation errors may take place. Similarly, primary data are based on survey of personal interviews and questionnaires; there can be selective bias because of non-response error.

CHAPTER – FOUR

DATA PRESENTATION AND ANALYSIS

In this chapter, we analyze the impact assessment of NRB regulatory system on commercial bank. The main important or crucial tool to evaluate the true and actual position of any organization is its past information and data. The strength and weakness of the organization can be appraised from the proper analysis of data. This part of the report focuses on presentation and analysis of data related to the NRB norms to obtain the objectives of the study.

4.1 Capital Fund Analysis

Table 4.1
Capital Fund of Rastriya Banijya Bank Ltd.

(Amount in Rs.in million)

Fiscal Year	2060/61	2061/62	2062/63	2063/64	2064/65
Core capital	1767.2	1594.4	1802.5	2441.8	2445.9
Supplementary	-25607	-23032.3	-22085	-20826.9	-19641.3
Total capital fund	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
TRWA	8519.81	7896.16	9836.7	13632.91	17586.8

NRB Requirement (%)

Core Capital to RWA	4.5	5	5.5	5.5	5.5
CAR	9	10	11	11	11

Actual Maintained (%)

Core capital to RWA	20.74	20.19	18.32	17.91	13.90
CAR	2.79	2.71	2.06	1.34	0.97

Excess or short fall in (%) of Core Capital to RWA

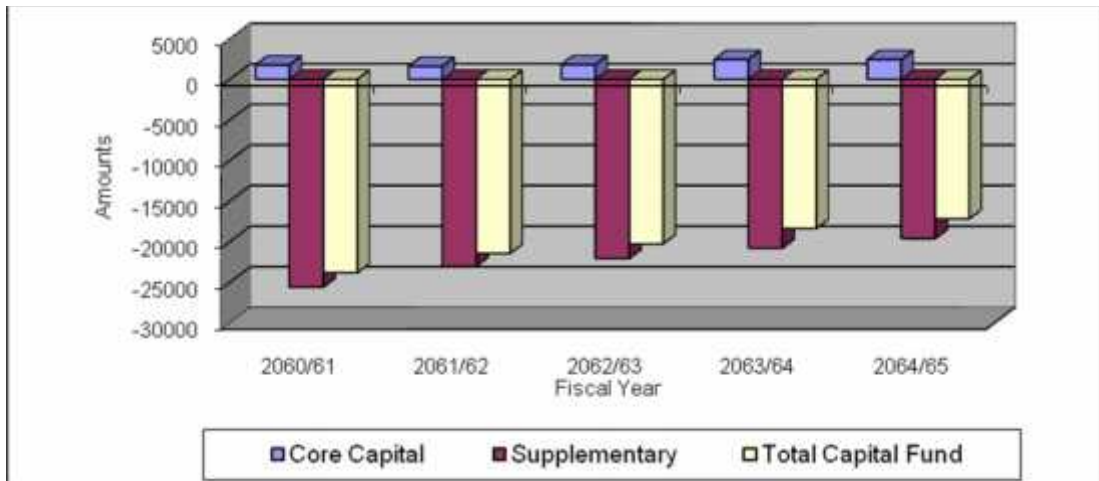
Percentage	16.24	15.19	12.82	12.41	8.40
RWA (Rs)	6752.61	6301.76	8034.2	11191.1	15140.9

Excess or Short fall in (%) Capital Adequacy Raito

Percentage	6.21	7.29	8.94	9.66	10.03
Amount	529.08	575.63	879.40	1316.93	1811.44

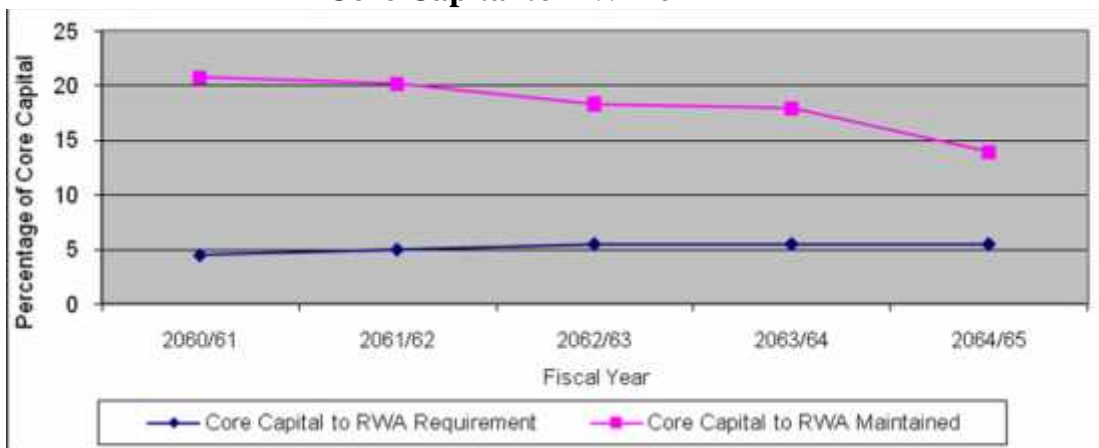
Source: Annual Report of RBB, 2060/61 to 2064/65.

Figure 4.1
Capital Fund of RBB

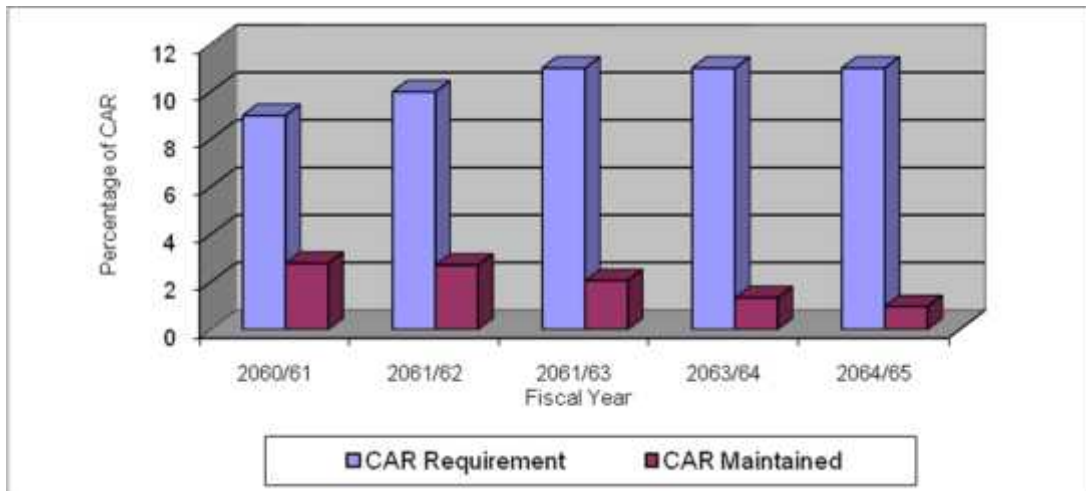


The given data shows that the capital fund, core capital and supplementary capital are in increasing trend. If we see the figures then Rastriya Banijya bank has subsequently lowered its negative total capital fund by increasing its core capital is in more growth of total capital fund. Core capital play important role in safeguarding both survive of the bank and stability of the financial system so commercial banks give more priority to core capital than that of supplementary capital.

Figure 4.2
Core Capital to RWA of RBB



**Figure 4.3
CAR to RWA of RBB**



The core capital to risk weighted assets and CAR of the Rastriya Banijya bank during the fiscal year 2060/61, 2061/62, 2062/63, 2063/64 and 2064/65 is within the shortfall by 16.24%, and 6.21, 15.19 and 7.29%, 12.82% and 8.94%, 12.41% and 9.66%, 8.40% and 10.03% respectively than NRB requirement. So during the year capital adequacy amount is short by Rs. 529.08 million in 2060/61 and 1811.44 million in 2064/65. Another side, we see the core capital is by 2.87%. In this fiscal year shortfall amount is due to the shortfall in supplementary than comparison of core capital, supplementary capital and total capital fund. Increase in risk weighted assets is due to heavy increase in on balance sheet items like loan fixes assets and similarly heavy increase in off balance sheet items like letter of credit, bid bond, performance bond, advance payment guarantee and other guarantee.

Similarly, in the every fiscal year, Rastriya Banijya bank cannot able to maintain its capital adequacy requirement as well as core capital to risk weighted assets. If we see the data, there is a huge shortfall in supplementary capital. In the fiscal year 2064/65, Rastriya Banijya Bank able to collect bad debt which is the main cause for decrease in negative supplementary capital similarly it has also able to earn profit and decrease general loan loss provision amount and able to accumulated profit which also increase the core capital.

So as to fulfill the requirements of NRB norms, Rastriya Banijya Bank is forced to increased its capital base for implementation of NRB norms, Rastriya Banijya Bank has taken various steps like it collect bad debt and decrease in NPA in the fiscal year 2064/65 and able to earn profit in the fiscal year 2062/63 to 2064/65.

To maintain the required capital adequacy norms, Rastriya Banijya Bank had allocated huge portion of profit into different reserve fund, which is ultimately, reduce the shareholders dividend.

Table 4.2
Capital Fund of Nepal Bank Ltd.

(Amount in Rs. in million)

Fiscal Year	2060/61	2061/62	2062/63	2063/64	2064/65
Core Capital	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Supplementary Capital	8519.81	7896.16	9836.7	13632.91	17586.8
Total Capital Fund	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
TRWA	8519.81	7896.16	9836.7	13632.91	17586.8

NRB Requirement %

Core Capital to RWA	4.5	5	5.5	5.5	5.5
CAR	9	10	11	11	11

Actual Maintained %

Core Capital to RWA	-69.0	-73.53	-95.94	-89.66	-90.24
CAR	-0.78	-7.046	-6.77	0.97	1.004

Excess/shortfall in (%) Core Capital to RWA

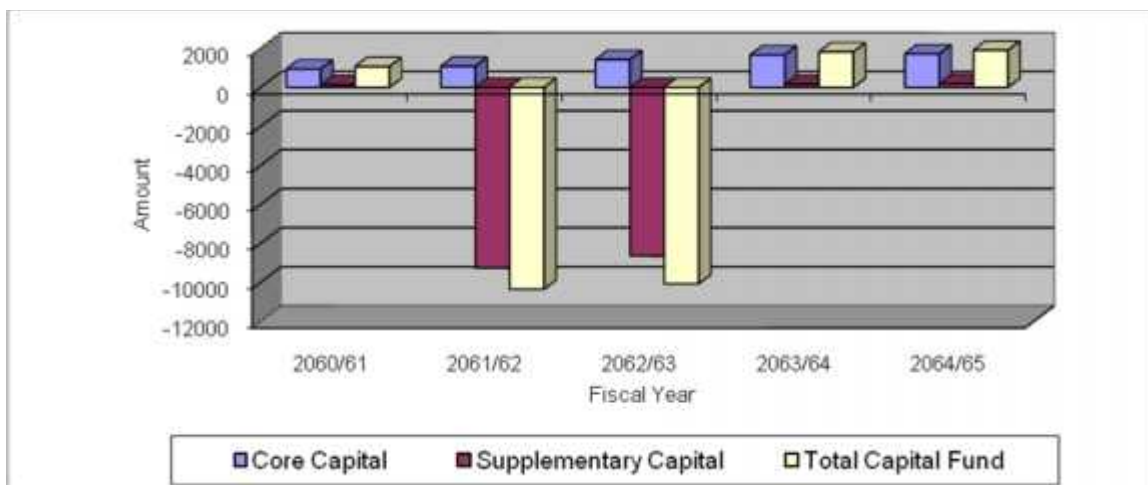
Percentage	-64.5	-68.53	-90.44	-84.16	84.74
RWA (Rs)	-872.13	-1006.28	-1338.51	-1654.85	-1608.04

Excess or Short fall in (%) Capital Adequacy Raito

Percentage	-9.78	-12.046	-17.77	10.03	9.99
Amount	-104.08	-1246.45	-1788.81	182.06	190.45

Source: Annual Report of NBL, 2060/61 to 2064/65.

Figure 4.4
Capital Fund of Nepal Bank Limited



The above data shows that the total capital fund and core capital is increasing in fiscal year 2060/61 to till date except 2061/62 and 2062/63. Likewise supplementary capital is increasing trend in fiscal year 2060/61, 2063/64 and 2064/65 while decreases in 2061/62 and 2062/62. If we see the figures then Nepal bank has subsequently increased its capital fund by increasing its core capital more than that of supplementary capital. The portion of core capital in total capital fund is around 70% in five-year average while that of supplementary capital is around 10% in five-year average. It means contribution of core capital is more in growth of total capital fund. Core capital play vital role in safeguarding both the survival of the bank and stability than that of supplementary capital.

Figure 4.5
Core Capital to RWA of Nepal Bank Limited

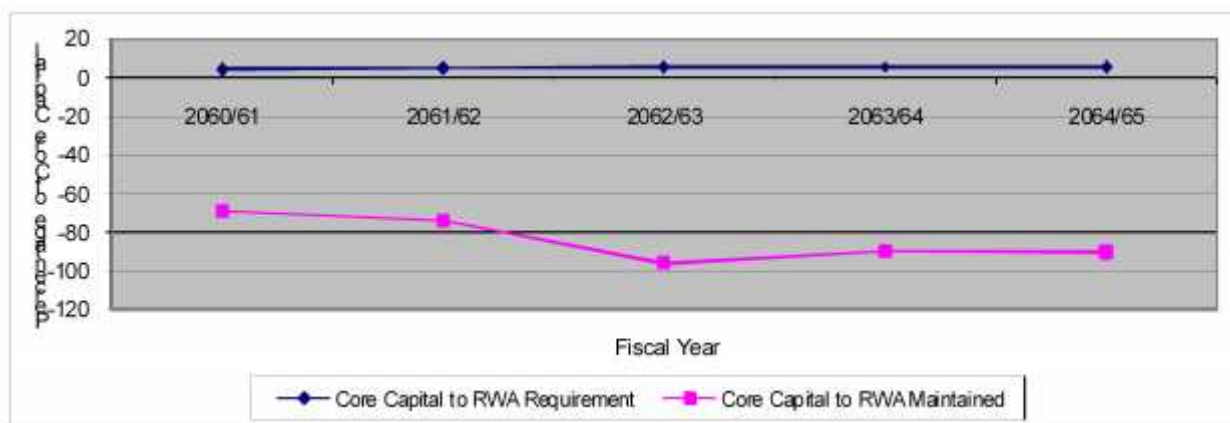
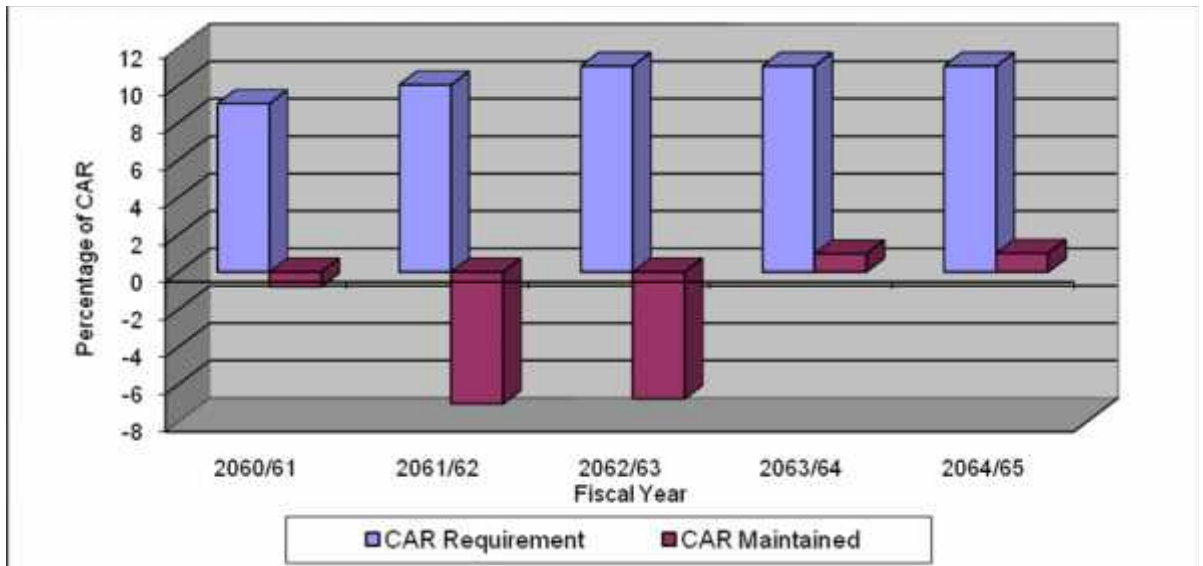


Figure 4.6
CAR to RWA of Nepal Bank Limited



It is seen that from the above data that Nepal bank has not maintained its capital adequacy norms. To comply with NRB norms, this bank has subsequently increased its capital fund by increasing more in its core capital. But supplementary capital is in decreasing trend till FY 2062/63 and after in fiscal year 2063/64 it gradually increased. At the same time its risk-weighted assets is also increasing each year. If we see the contribution to total capital fund then the portion of core capital is very high and is insufficient enough to meet the CAR also not taking into consideration of supplementary capital.

The capital adequacy ratio and core capital to RWA of Nepal bank Ltd, during the fiscal year 2060/61, 2061/62, 2062/63 and 2063/64 is out of the limit and negative shortfall by 9.78% and 64.5, 12.046% and 68.13, 17.17% and 90.44, 10.03% and 84.16% respectively than NRB requirement. So as to fulfill the requirement of Nepal bank to increase its capital base, in the fiscal year 2064/065 the bank has able to earn profit. Lastly, the CAR and core capital to risk weighted assets ratio indicate the positive or better condition of the bank after 2064/65.

To maintain the required capital adequacy norms, Nepal bank has allocated huge portion of profit into different reserve fund, which ultimately reduce the shareholders dividend.

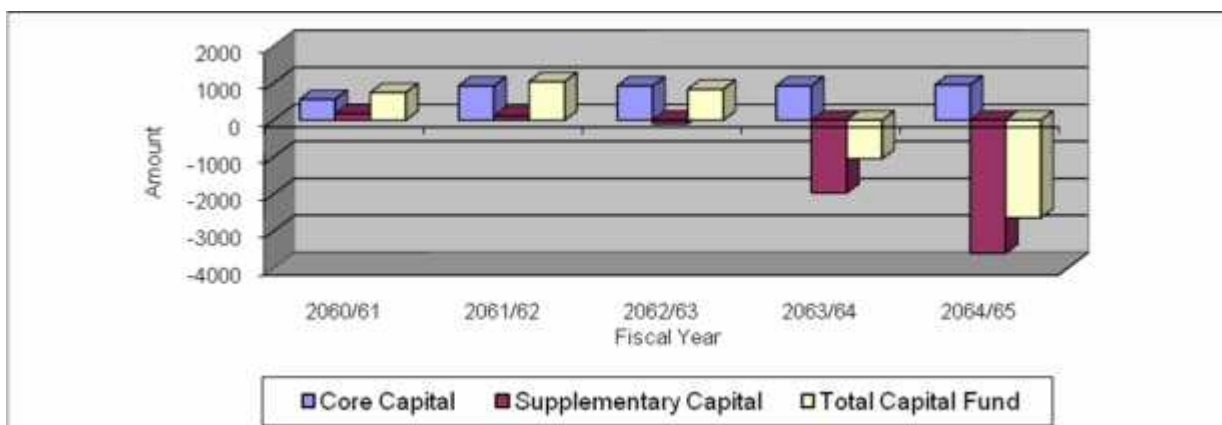
Table 4.3
Capital Fund of Nepal Bangladesh Bank Ltd.

(Amount in Rs in million.)

Fiscal Year	2060/61	2061/62	2062/63	2063/64	2064/65
Core capital	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Supplementary capital	8519.81	7896.16	9836.7	13632.91	17586.8
Total capital fund	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
RWA	8519.81	7896.16	9836.7	13632.91	17586.8
NRB Requirement (%)					
Core capital to RWA	4.5	5	5.5	5.5	5.5
CAR	9	10	11	11	11
Actual Maintained (%)					
Core capital to RWA	13.54	29.50	16.52	-10.26	-1.74
CAR	17.82	33.11	14.92	11.52	4.82
Excess or Short Fall in (%) Core Capital to RWA					
Percentage	9.04	24.5	11.02	-15.71	-7.24
RWA (Rs)	3.77	7.68	6.17	14.15	39.56
Excess or Short Fall in (%) Capital Adequacy Ratio					
Percentage	8.82	23.11	3.92	0.52	-6.18
Amount	3.67	7.24	2.19	-0.46	-33.76

Source: Annual Report of NBBL, 2060/61 to 2064/65.

Figure 4.7
Capital Fund of Nepal Bangladesh Bank Limited



The above data shows the total capital fund and capital is in increasing trend but supplementary capital fund decreases in 2062/63 to 2064/65. If we see the given data of Nepal Bangladesh bank limited has subsequently increased its capital fund by increasing its core capital more then supplementary capital. The portion of core capital in total capital fund is around 60% in five-year average while that of supplementary capital is around 8% in five-year average. It means that the contribution of core capital is more in growth of total capital fund. Core capital plays an important role in safeguarding both the survival of the bank and stability of the financial system so commercial bank gives more priority to core capital than that of supplementary capital.

Figure 4.8

Core Capital RWA of Nepal Bangladesh Bank Limited

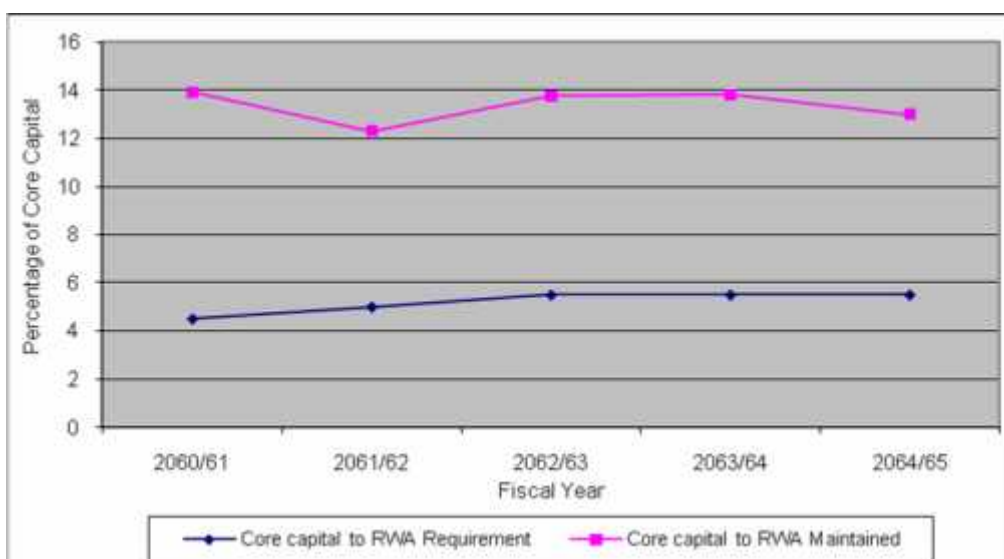
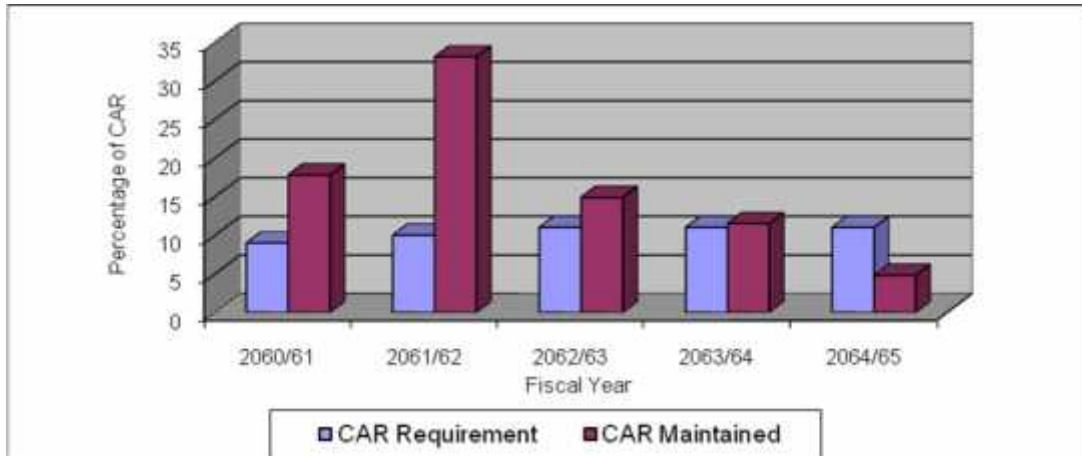


Figure 4.9: CAR to RWA of Nepal Bangladesh Bank Limited



The core capital to risk weighted assets of Nepal Bangladesh bank during the fiscal year 2060/61, 2061/62 and 2062/63 is within the limit but in 2063/64 and 2064/65 it is out of limit and over by 9.04%, 24.5% and 11.02%, and 7.49% respectively as well as capital adequacy ratio is within the limit and shows that Nepal Bangladesh bank has maintained its capital adequacy norms, which is the guidelines of NRB. Thus bank has subsequently increased its capital fund by increasing more in its core capital and as well as supplementary capital has also increased in small amount. At the same time its risk weighted assets is also increasing each year if we see the contribution of total capital fund than the portion of core capital is very high and is sufficient enough to meet the CAR also not talking into consideration of supplementary capital. If we see the growth figure of core capital, supplementary capital and total capital fund is increasing every year but is decreasing ratio. Risk weighted assets of Nepal Bangladesh bank is increasing every year except in 2063/64 and 2064/65 so as to fulfill the NRB directives.

Nepal Bangladesh bank has reduced the loan loss provision in every fiscal year from 2060/61 to till date. It reduced the loan loss provision than after reduced the supplementary capital. Therefore, the supplementary capital of the bank is decreasing in fiscal year 2063/64 to 2064/65. Than after in the next fiscal year the bank has increased the exchange equalization reserve, it would be increased by the supplementary capital.

To maintain the required capital adequacy norms, Nepal Bangladesh bank had allocated huge portion of its profit to different reserve fund, which ultimately reduce the shareholders dividend.

4.2 Loan and Loan Loss Provision Analysis

Table 4.4
Loan and Loan Loss Provision of Rastriya Banijya Bank Limited
(Amount in Rs. in million)

Fiscal Year	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Non-performing Loan (NPL)	8519.81	7896.16	9836.7	13632.91	17586.8
Sub standard	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Doubtful	8519.81	7896.16	9836.7	13632.91	17586.8
Bad	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Total Loan and Advance	8519.81	7896.16	9836.7	13632.91	17586.8
Loan Loss Provision (LLP)	15214.4	13593.1	8967.5	8906.4	8866.7
Performing loan	6085.7	5437.2	3587.0	3562.6	3546.7
Sub Standard loan	3042.9	2718.6	1793.5	1781.3	1773.3
Doubtful	4564.3	4077.9	2690.3	2671.9	2660.1
Bad	1521.5	1359.3	896.6	890.7	886.7

Provision Maintain in %

Pass loan	1.41	0.99	0.99	0.99	1.28
Substandard	12.13	11.31	25.16	25.8	25
Doubtful	47.36	12.73	46.8	50.12	50
Bad	99.45	97.84	98.38	91.8	99.01

NRB Requirement (%)

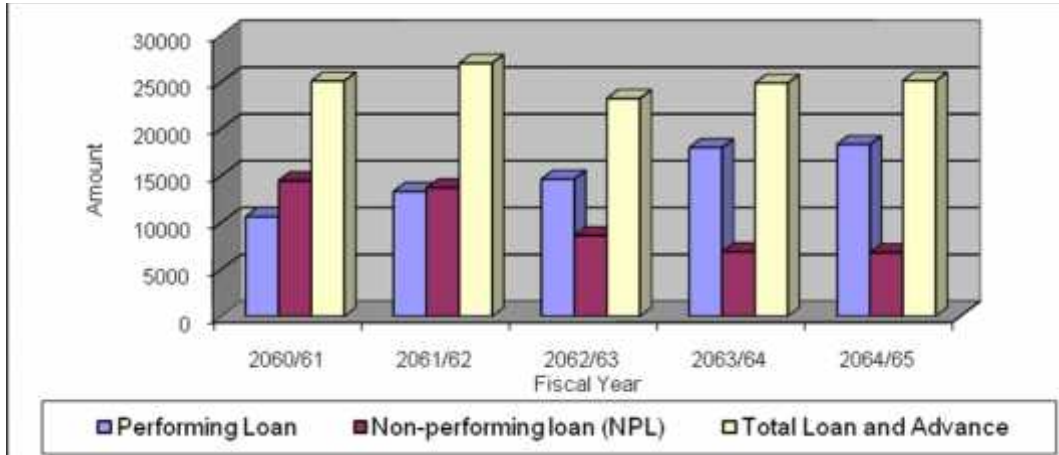
Pass loan	1	1	1	1	1
Substandard	25	25	25	25	25
Doubtful	50	50	50	50	50
Bad	100	100	100	100	100

LLP to total loan & Advance	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
NPL to total loan & Advance	8519.81	7896.16	9836.7	13632.91	17586.8
LLP to NPL	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4

Source: Annual Report of RBB, 2060/61 to 2064/65.

Figure 4.10

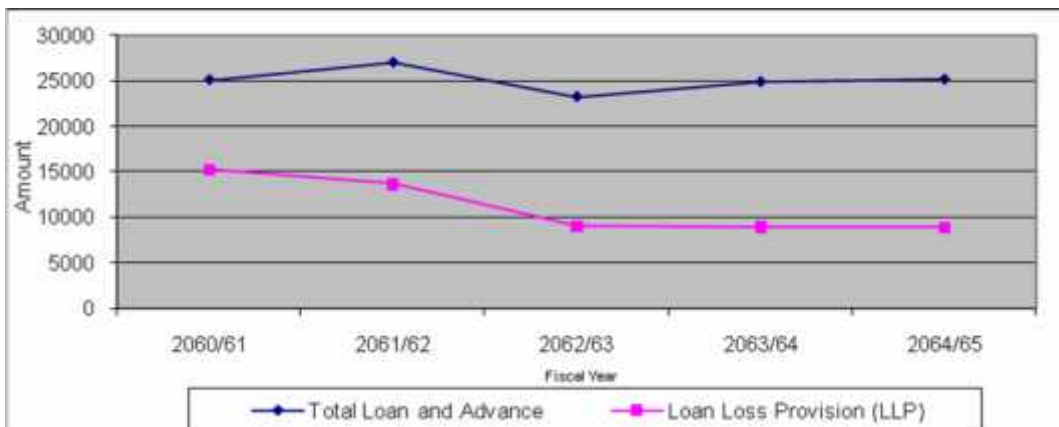
Portfolio of Loan and Advance of RBB



If we see the loan and loan loss provision table, then what we see is in the total loan and advances, the portion of performing loan is increasing every year while portion of non performing loan is decreasing but in the year 2060/61 to 2061/62 it has increased and then after it has decreased. To overcome the problem of non-performing asset RBB is reducing its NPL account as well as also reduces the burden of maintaining high provision for NPL account. Total loan and advances increases more than 10% in the year 2061/62 with the increase in performing loan, which is good, sign for RBB as interest earned in loan amount in the main source of income for commercial banks. Due to the norms of NRB directives RBB is reducing non-performing loans.

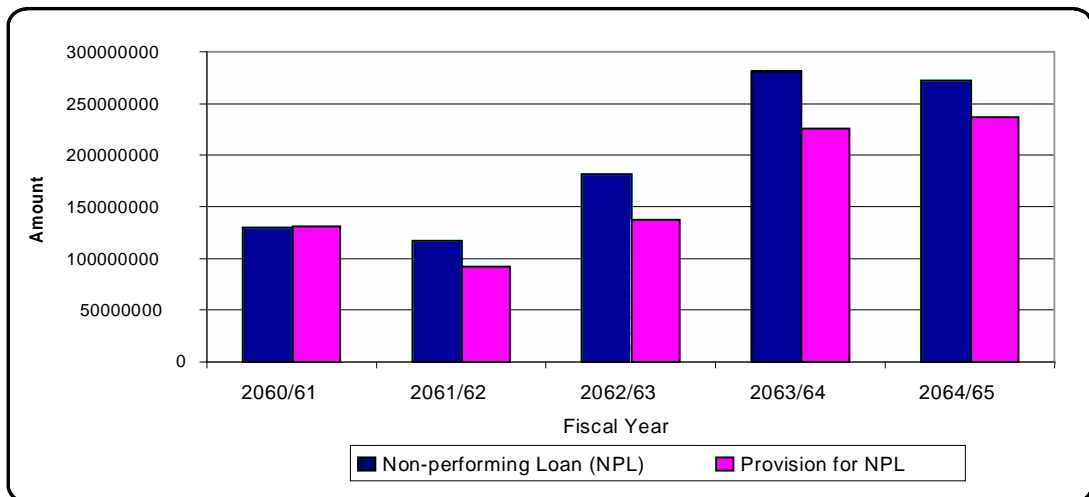
Figure 4.11

Loan Loss Provision and Total Loan and Advance



The ratio of loan loss provision to total loan & advances of Rastriya Banijya Bank ranges from 60.60% to 35.28% in different years. Since, high provision is to be maintained for non-performing loan, higher ratio indicates high portion of non-performing loan in the total loan and advances but here data shows low ratio, which is also in decreasing trend that means non performing loan of Rastriya Banijya Bank is decreasing every year in the total volume of loan and advances. So we can take it as Rastriya Banijya Bank's efficient, then there might be high portion of non-performing loan in the total loan portfolio.

Figure 4.12
NPL and Provision for NPL of RBB



Rastriya Banijya Bank is not complying with the NRB norms for loan loss provision. It is maintain by Rastriya Banijya Bank falls short by few percentage in each year and also NPL is decreased in the year 2062/63 and 2063/64 by more that 10% compared to previous year. In the portfolio of NPL portion of bad was very high, which is not good sign for Rastriya Banijya Bank so, by not maintaining the required provision and high portion of bad can expose Rastriya Banijya Bank to risk and also can't cope with the future contingencies that may cause due to NPL. High provision is better but since amount maintained for provision remains idle and does not yield any return. It may have negative impact in return or profit, which will be affected

so to remain unaffected from profit viewpoint, the NRB norms for loan loss provision should be appropriate or NPL has reduced as per the guidelines.

Table 4.5
Loan and Loan Loss Provision of Nepal Bank Ltd.

(Amount in Rs. in million)

Fiscal Year	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	8297.58	8494.5	10179.41	11900.6	13758
Non-performing loan (NPL)	9640.08	8372.0	2262.18	1856.0	2243.10
Sub standard	2892.02	2511.6	678.65	556.8	672.93
Doubtful	5784.04	5023.2	1357.30	1113.6	1345.90
Bad	964.2	837.2	226.23	185.6	224.17
Total loan and & Advance	17937.66	16866.5	12441.59	13756.6	16001.1
Loan Loss Provision (LLP)	9249.89	3269.6	2376.3	2256.1	2763.0
Performing loan	3699.9	1307.8	950.5	902.4	1105.2
Sub Standard loan	1849.9	653.9	475.3	451.2	552.6
Doubtful	2774.9	980.9	712.9	676.8	828.9
Bad	925.2	327.0	237.6	225.7	276.3

Provision Maintain in %

Pass loan	1.94	1.6	1.55	2.18	1.64
Substandard	24.08	24	23.22	31.1	67.93
Doubtful	49.55	48.95	49.4	73.21	47
Bad	69.95	85.14	97.2	97.05	94.55

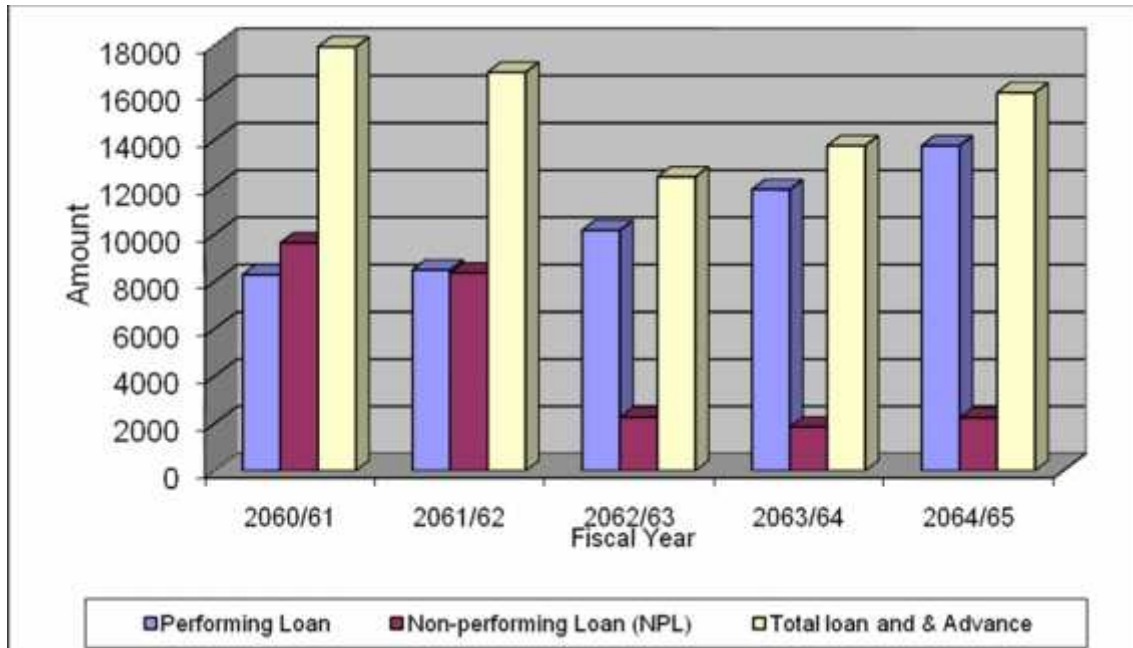
NRB Requirement (%)

Pass loan	1	1	1	1	1
Substandard	25	25	25	25	25
Doubtful	50	50	50	50	50
Bad	100	100	100	100	100

LLP to total loan & Adv.	51.56	19.38	19.09	16.40	17.26
NPL to total loan & Adv	53.74	49.63	18.18	13.49	14.01
LLP to NPL	95.95	39.05	105.04	121.55	123.17

Source: Annual Report of Nepal Bank Limited, 2060/61 to 2064/65.

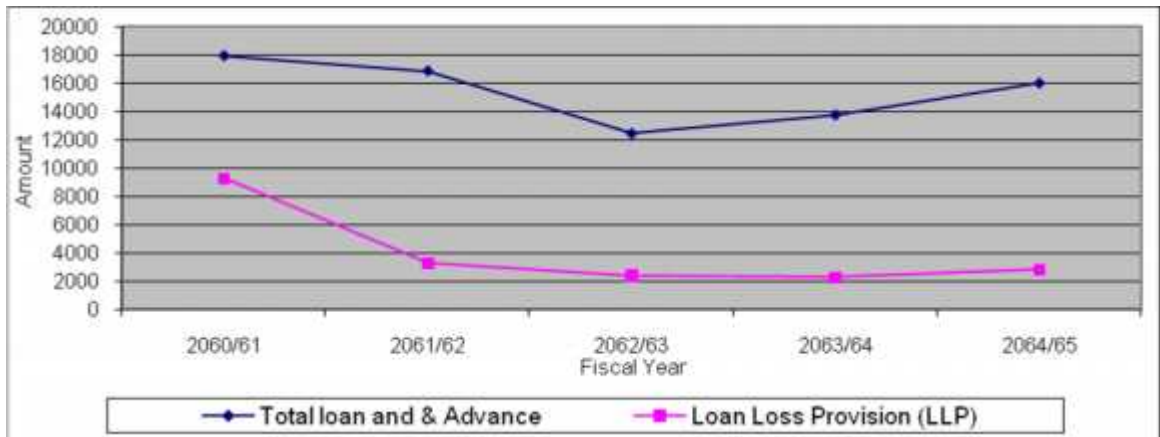
Figure 4.13
Portfolio of Loan and Advance of Nepal Bank Limited



As per the above table of loan and loan loss provision shows the total loan and advances are increasing every year compare to previous year; similarly to previous year. In the year 2060/61 and 2061/62, NPL has huge amount which should be reduced this year NPL decreased the percentage around 45-50%. In the portfolio of total loan and advances portion of performing loan is around 96.25% while remaining is NPL. This shows that Nepal bank is distributing its loan very carefully and by increasing the portion of performing loan in the portfolio, Nepal bank is trying to make its assets good and earn interest without bearing any risk. Due to the norms of NRB directives Nepal bank is increasing its portion of performing loan in the portfolio of total loan and advances. There by reducing the burden of maintaining high provision for NPL.

Figure 4.14

Loan Loss Provision of Nepal Bank Limited



The ratio of loan loss provision to total loan and advances of Nepal bank is around 16.40% to 51.56% in different years. Since, high provision is being maintained for Non performing loan, higher ratio means high portion of non performing loan in the total loan and advances and lower ratio indicates low portion of non performing loan is the total loan and advances but here data shows the ratio has decreased in a slow rate every year in the total volume of loan & advances. It also signifies the good quality of assets in the total volume of loan and advances as well as Nepal bank's efficiently and effectively towards its strong management of its loan and advances and coping with probable loan loss and also complying with the NRB norms. If there had not been NRB guidelines to maintain high provision on non-performing loan then, there might be high portion of non-performing loan in the total loan portfolio.

Nepal bank is complying with the NRB norms for loan loss provision. Although, the loan loss provision of Nepal Bank is gradually decreasing each year but during the year 2062/63 and 2063/64 NPL have declined dramatically to a huge amount to the tune of 45 percent to 50 percent. So, if the NPL is decreasing. It is a good sign for banking sector. And in that category Nepal Bank is performing very efficiently and effectively, as maintaining high provision provides security form loan loss but maintaining in excess may be disadvantageous to the bank. As amount maintained for

provision remains idle and does not yield any return, it may have negative impact in return or profit will be affected.

Table 4.6
Loan and Loan Loss Provisioning of Nepal Bangladesh Bank Ltd.

(Amount in Rs. in million)

Fiscal Year	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	8602.52	7793.97	6869.38	5523.5	6061.4
Non-performing loan	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Sub standard	8519.81	7896.16	9836.7	13632.91	17586.8
Doubtful	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Bad	8519.81	7896.16	9836.7	13632.91	17586.8
Total Loan and Adv.	-23839.8	-21437.9	-20282.5	-18385.1	-17195.4
Loan Loss Provision	1184.5	1691.9	3633.7	3460.1	4122.01
Performing loan	473.8	676.8	1453.5	1384.1	1648.8
Standard loan	236.9	338.4	726.7	692.0	824.4
Doubtful	355.4	507.6	1090.1	1038.0	1236.6
Bad	118.4	169.1	363.4	346.0	412.3

Provision Maintain in (%)

Performing loan	1.73	1.64	1	1	1
Substandard	25	25		25	25
Doubtful	74.95	75	64.47	78.22	95.75
Bad	100	100	100	100	100

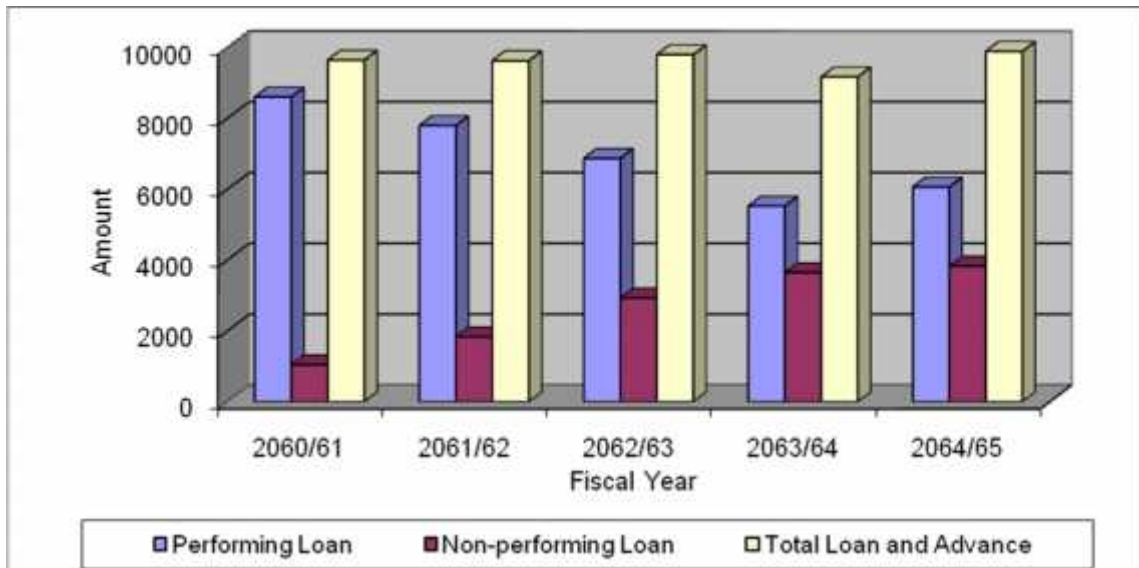
NRB Requirement (%)

Performing loan	1	1	1	1	1
Substandard	25	25	25	25	25
Doubtful	50	50	50	50	50
Bad	100	100	100	100	100

LP to total loan & Adv.	12.28	17.57	37.09	37.73	41.67
NPL to total loan & Adv.	10.80	19.039	29.87	39.76	38.71
LLP to NPL (%)	113.65	92.30	124.14	94.90	107.64

Source: Annual Report of NBBL, 2060/61 to 2064/65.

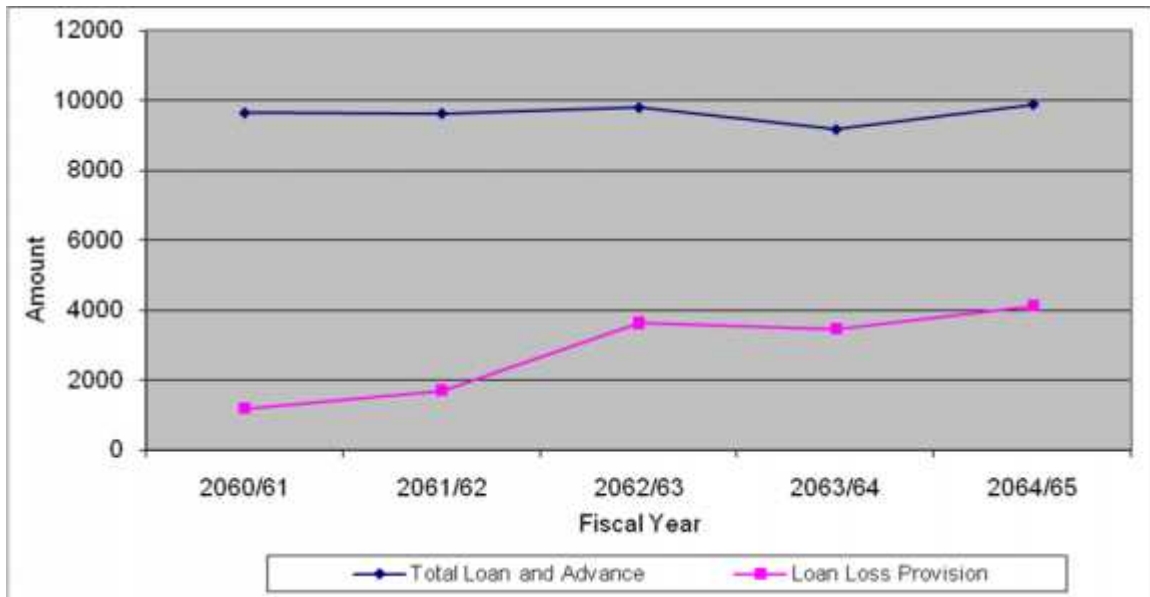
Figure 4.15
Portfolio of Loan and Advances of Nepal Bangladesh Bank Ltd.



As per above table of loan and loan loss provision shows the total loan and advances are increasing every year compare to previous year. Similarly, pass loan (performing loan) is also increasing but if we see the NPL then there is little bit increases in the fiscal year 2061/62 but next year it has increased for a little amount and the fiscal year 2063/64 onwards the NPL has increased consistently for next year. In the portfolio of total loan and advances portion of pass loan (performing loan) is around 86% while remaining is NPL. This shows that Nepal Bangladesh bank should distribute the loan very carefully and by increasing the portion of performing loan in the portfolio. Nepal Bangladesh bank is trying to make its assets good and earn interest without bearing any risk. Due to the norms of NRB directives Nepal Bangladesh bank is increasing its portion of performing loan in the portfolio of total loan and advances.

Figure 4.16

Loan Loss Provision of Nepal Bangladesh Bank Limited



The ratio of loan loss provision (LLP) to total loan and advances of Nepal Bangladesh banks is around 12.28% to 41.67% in different years. Since, high provision is to be maintained for the non-performing loan (NPL), higher ratio indicates high portion of non-performing loan in the total loan and advances. The Nepal Bangladesh Bank loan loss provision is increasing of every year i.e. fiscal year 2060/61 to 2064/65. It indicates that increasing loan loss provision is the sign of the bad quality of assets in the volume of loan and advances. So we can take it, as Nepal Bangladesh Bank is not efficiency and effectively managing of its loan and advances and coping with probable loan loss and also complying with the NRB norms. If there had not been NRB guidelines to maintain high provision on non-performing loan, then there might be high portion of non-performing loan in the total loan portfolio.

in the following year Nepal Bangladesh Bank has corrected its mistake and complies with the NRB norms.

Nepal Bangladesh Bank has maintained the provision in excess for pass loan (performing loan) in the fiscal year 2060/61 and 2061/62. In reaming fiscal

years it has not maintained its provision as per NRB requirement. Maintaining high provision is to provide security from loan loss but maintaining in excess may be disadvantageous to the bank. As amount maintained for provision remains idle and does not yield any return, it may have negative impact in return or profit will be affected so, to remain unaffected from profit viewpoint bank must maintain provision as required.

4.3 Single Borrower Limits

Single borrower limits is the limit which should not be more than the one set by regulatory authorities to extend maximum amount of loan to a single borrower or a group of borrowers. The bank gives loans to various sectors for the long-term survival of the banks by receiving deposits from general public so that depositors' deposits are the major portions of the bank's lending liability and the loan and advances of the banks to the borrowers is the major portion of its total assets. Therefore the banks should be more careful while making loans otherwise banks may fail to make repayment of the deposits to the depositors, which results in the liquidation of the banks.

With a view to safeguard the depositors money and protect the banks from bankruptcy. NRB has issuing directives from time to time under the prudential norms. The directives related to single borrower limits has the main objectives is to set up limits on the maximum amount of loans that can be lend to a single borrower or group of borrowers. The single borrower limit is based only on the core capital in the new directives whereas these limits were based on the total capital fund as per old provision. The total core capital of NB bank, Nepal bank and RBB bank are given below. So, single borrower limit is computed as percentage given by the NRB directives. The percentage of single borrower limit to be applied for NBBL, NBL and RBB are as follows:

Table 4.7

Comparative Data of the Single Borrower Limit of RBB

New Provision Limits			Old Provision Limits	
Year	Fund based	Non fund based	Fund based	Non fund based
	25% of core capital	50 % of core capital	35% of total capital fund	50% of total capital fund
	-21437.9	-20282.5	-18385.1	-17195.4
	7896.16	9836.7	13632.91	17586.8

Table 4.8

Comparative Data of the Single Borrower Limit of Nepal Bank Ltd.

New provision limits			Old provision limits	
Year	Fund based	Non fund based	Fund based	Non fund based
	25% of core capital	50 % of core capital	35% of total capital fund	50% of total capital fund
2060/61	234.4	468.8	372.505	532.15
2061/62	269.925	539.85	-3621.625	-5173.75
2062/63	356.425	712.85	-3523.28	-5033.25
2063/64	416.8	833.6	637.21	910.3
2064/65	428.15	856.3	667.275	953.25

Source: Annual Report of NBL, 2060/61 to 2064/65.

Table 4.9

Comparative Data of the Single Borrower Limit of NBBL

Year	New provision limits		Old provision limits	
	Fund based	Non fund based	Fund based	Non fund based
	25% of core capital	50 % of core capital	35% of total capital fund	50% of total capital fund
2060/61	141.275	282.55	260.33	371.9
2061/62	231.275	462.55	363.335	519.05
2062/63	231.275	462.55	292.516	417.88
2063/64	231.275	462.55	-363.37	-519.1
2064/65	238.065	476.13	-923.44	-1319.2

Source: Annual Report of NBBL, 2060/61 to 2064/65.

The following comparison data of old and new provision on fund based and non fund based shows the impact of changes is presented more clearly through the use of multiple bar diagram. It shows below separately.

Figure 4.17

Comparative Figure of Single Borrower Limit of RBB

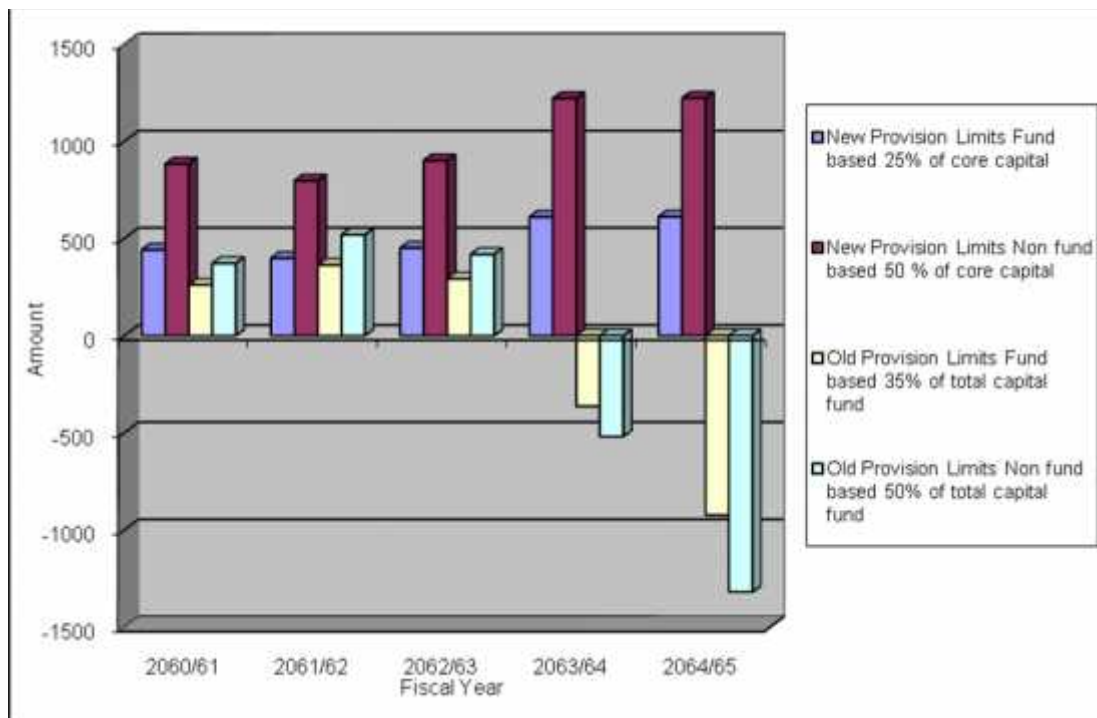


Figure 4.18

Comparative Figure of Single Borrower Limit of Nepal Bank Ltd.

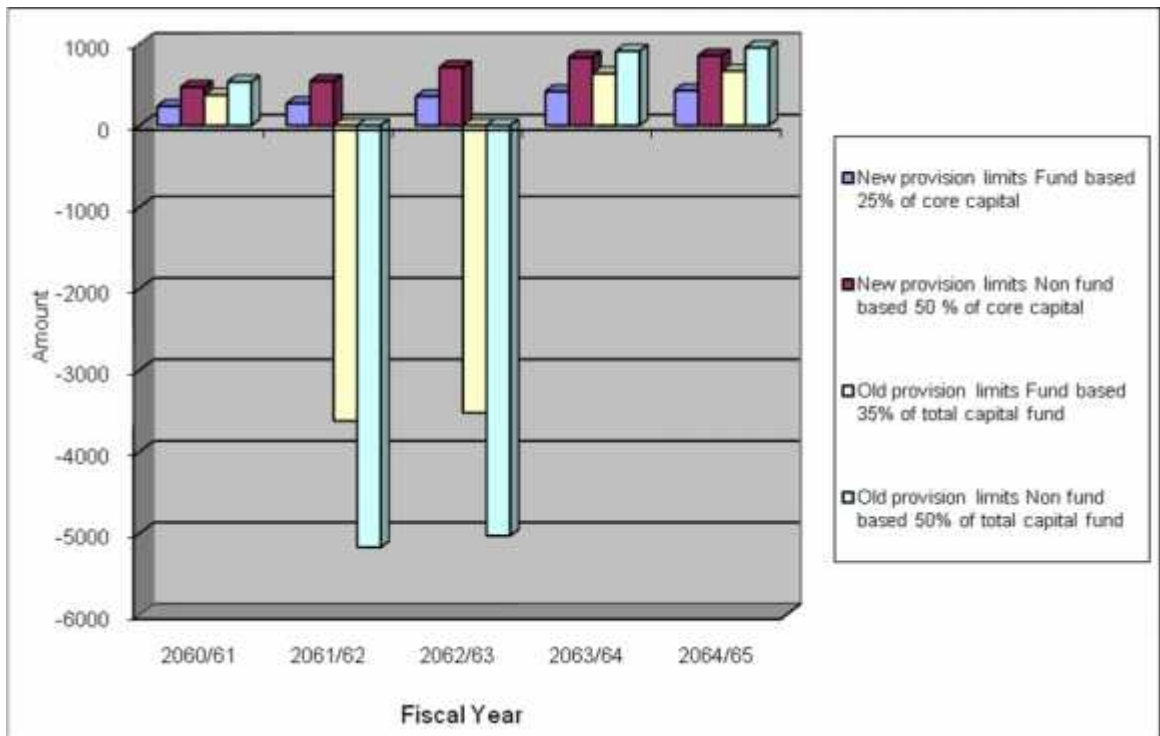
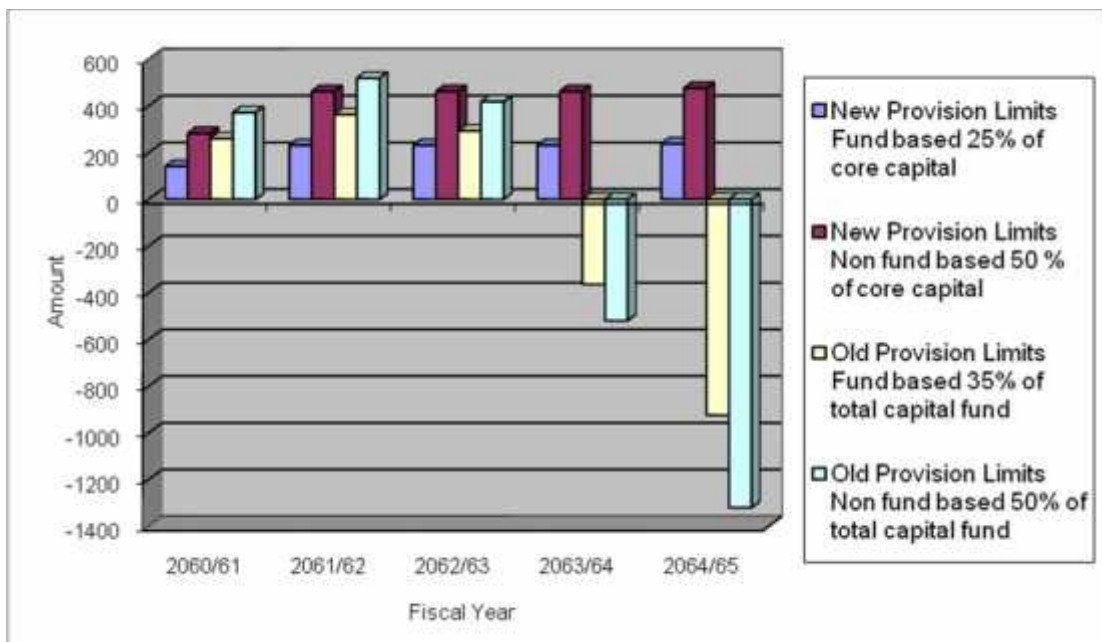


Figure 4.19

Comparative Figure of Single Borrower Limit of NBBL



From above Figure it clearly shows that the limits of loan has come down by, which is lower than the total capital fund.

Incase of the loans already disbursed before 16th July 2002, single borrower limit has to be maintained 40% of fund based and 75% of non-fund based of core capital up to the end of fiscal year 2001/02. But 25% of fund based and 50% of non-fund based of core capital is applicable for the start of the 2002/03 to onward.

The single borrower limit of NBBL, NBL and RBB is above the table. If the banks has distributed excess amount of loan limit then it has to increases the core capital in order to fill the gap, if any exceeded amount of loans within the limit, where the core capital of the bank includes the paid-up capital share premium, Non-redeemable preference shares, general reserves and accumulated profit/ loss account and profit of this year. If there is no possibility of increasing core capital, banks must reduce the loan exposure of the customers. It will substantially reduce bank's capacity to finance this will make an adverse impact on the profitability of the banks.

4.4 Primary Data Analysis

Primary data are collected from listed commercial bank and investors or depositors as well as individual academicians. More than one respondent have been included from the same organization as far as possible. The respondent of the data cover personalities involving in policy formulation with the position of NRB directives.

Table 4.10
No of Respondents

S. No.	Designation	Number
1	NRB Officials	10
2	Staffs of the commercial banks	12
3	Individual investors	6
4	Academicians	4
Total		32

Source: Field Survey, 2009

All together 32 respondents are analyzed in this section. In the first query that, How effective is the role of NRB in regulating and supervising of the commercial bank; 22 respondents were with the opinion that, they are highly effective while 10 respondents were with the opinion that, NRB plays good what extend are the effect of the NRB Directives on commercial bank; 18 of the respondents agreed that it helps in promoting safe and sound banking system, 10 of the respondent agreement to facilitate bank customers and 4 of the respondent agreed with the constraint bank activities. The fourth query was what is the reason behind the changes made in the directives?, 16 of the respondents were in opinion with to develop the better financial institutions. 12 people opines that to meet the international standard and 4 people said that the constraint bank activities and fifth questionnaire was to survey the opinion of the respondents why NRB directives are necessary to the commercial bank; 14 person said to protect interest of depositors, 12 person

said to enhance the creditability of the financial system and 4 person said to protect the financial institution.

Table 4.11
View on Effectiveness and Necessary of NRB Directives in Regulating and Supervising the Commercial Bank

S.N.	Statement	Weight			Mean	Ranking
		1	2	3		
1.	How effective is the role of NRB in regulating and supervising of the commercial bank?	-	10	22	2.69	I
2.	Which supervisory system is the best?	5	7	20	2.47	II
3.	What are the effects of the NRB Directives on commercial bank?	2	10	18	2.38	III
4.	What is the reason behind the change made in the directives	4	12	16	2.37	IV
5.	Why NRB directives are necessary to the commercial bank?	4	12	14	2.19	V

Source: Field Survey, 2009

The respondent of the sample have been presented as it is, sum of the respondents didn't assign the rank for the given alternatives has been shown in the no response column. The first query indicates that the most of the respondent agree with the highly effective supervising and regulating role of NRB on commercial bank. The mean of the first query is near about the rank 5. It means the NRB regulating or supervising role is better for the commercial bank. The second questionnaire indicates that the more than 50% of respondents agree that the both onsite and offsite inspection system is the best. So the NRB has always used to the onsite and offsite supervisory system. The third query finds out that the NRB directives support the commercial bank to promoting safe and sound banking system as well as facilitates the customers and the depositors. The fourth query indicates that the half of the respondent agrees with the better financial institution and most of the remaining respondents agree with to meet the international standard.

Finally the fifth query indicate that all commercial banks has to necessarily implement the NRB directives which to protect the interest of depositors and to enhance the creditability of the financial system and to protect the financial institution.

Table 4.12
View on Implementation and Need of NRB Directives and Capital Adequacy Norms

S.N.	Statement	Weight			Mean	Ranking
		1	2	3		
1.	Are the commercial banks implementing the directives issued by NRB?	5	2	25	2.63	I
2.	Do you think it is necessary to implement the directives issued by NRB?	4	9	15	2.09	V
3.	Is there any access or shortfall in NRB directives?	9	5	17	2.19	IV
4.	What is the reason for setting capital adequacy norms?	6	7	18	2.31	III
5.	How your banks wish to meet the increase requirement capital as prescribed by NRB?	10	10	12	2.06	VI
6.	Who will be benefited most by maintaining capital adequacy requirement?	2	10	18	2.3	II

Source: Field Survey, 2009

Among the six alternatives provided, the respondents ranked that, the first query: Are the commercial banks implementing the directives issued by NRB; 25 respondents had the opinion in “yes” 2 respondents were with the negative opinion and 5 respondents were without any opinion. Most of the respondents agreed with the commercial banks were implementing the NRB directives regularly and minority of the respondent doesn't know about the NRB directives. The second query was that Do you think it is necessary to implement the directives issued by NRB; 15 respondent showed that they were agreed with the necessary implementation of the directives and remaining respondent don't know about the NRB directives as well as they

said that it is not necessary to implement the NRB directives on commercial banks. The fourth questionnaire was that, what are the reasons for setting capital to protect the interest of the depositors for setting capital adequacy norms. The fifth query was How your bank wish to meet the increase requirement of capital as prescribed by NRB; 12 respondents were in the favor of increasing the core capital 10 respondents were with their opinion by increasing the supplementary capital and only 10 respondents were in the favor of adopting mergers and acquisitions of the same category commercial banks. It indicates that, all respondents equally emphasized to increase the core capital, supplementary capital and merger and acquisitions of the same types of firms. Finally sixth query that, who will be benefited most by maintaining capital adequacy requirement; 18 respondents agreed that, the depositors would be benefited by maintaining capital adequacy requirement. 10 respondents agreed with the shareholder also be benefited and 2 respondent agreed that the others would be benefited, who are relating to the commercial banks.

Table 4.13
View on Capital Adequacy and New Directives for Regulation and Supervision of Commercial Bank

S.N.	Statement	Weight			Mean	Ranking
		1	2	3		
1.	Are the commercial banks allowed free to set capital adequacy ratio by them?	2	4	25	2.66	I
2.	Whether loan and advance are reviewed on periodic basis?	3	8	20	2.47	IV
3.	Is capital adequacy requirement set by NRB fit for regulation and supervision of commercial bank?	0	2	25	2.46	V
4.	Does the increase in requirement of Rs. 2 billion capital shall create a barrier for new entrants?	6	4	22	2.5	III
5.	Are the provisions in NRB directives about the black listing of the loan defaulter adequate?	6	10	16	2.31	VII
6.	Are you satisfied with the existing requirement of the percentage of the loan and loan loss provision of NRB?	6	2	24	2.56	II
7.	Do you think that commercial bank will be affected by new directives relating to borrower limit?	5	3	24	2.41	VI

Source: Field Survey, 2009

The first query was that: Should the commercial bank allow free to set capital adequacy ratio by them; 25 respondents were not in the favor of setting capital adequacy ratio by commercial banks. 4 respondents agreed to set Capital Adequacy Ratio by the commercial bank and 2 respondents don't know about the question. The 2nd query that whether loan and advance are reviewed on periodic basis; 20 respondents were in the opinion to review the loan & advances on periodic basis regularly, 8 respondents were not in the opinion of reviewing the loan & advance on periodic basis. The third query was that capital adequacy requirement set by NRB is fit for regulation and supervision of commercial bank; 25 respondent agreed with the right to setting capital adequacy requirement by NRB for its effective regulation and supervision on commercial bank and only 2 respondent did not agree to set the capital adequacy requirement by NRB. The fourth query was that Does

the increase in requirement of Rs. 2 billion capital shall create a barrier for new entrants; 22 respondents were with the opinion that, although the new capital requirement Act will create a barrier for new entrants but in long-term it will benefit the bank and financial institutions. 4 respondents were having neutral opinion regarding the new capital requirement Act. 6 respondents were not in the favour of new CRA. They were with the opinion that, it will stop the new players to make their entries in the banking industry. The fifth query was that Are the provisions in NRB directives about the black listing of the loan defaulter adequate; 16 respondents were confirming that NRB have issued enough provisions to protect the banks from the defaulters. 10 respondents still have their opinion that, the existing provision of NRB are not sufficient enough to protect the bank from defaulters. 6 respondents were with the view that the NRB provisions can help to protect the bank only to some extent by the loan defaulters. The sixth query that, Are you satisfied with existing requirement for the loan and loan loss provision of NRB; 24 respondents showed their opinion that the loan and loan loss provision of present ratio is adequate to commercial banks. More than 50% respondent satisfied with the NRB loan loss provision directives, only 2 respondents commercial bank activities and 5 respondents did not know about the question; 3 respondents were of the opinion that, it is effecting the bank adversely.

4.5 Major Findings of the Study

The major findings of the study are as follows:

a. Rastriya Banijya Bank Limited

Capital adequacy ratio and core capital of RBB bank during the study period were not within limit and even short fall. Core capital to RWA is highest in the year 2060/61 while capital adequacy ratio is also highest in the same year 2060/61. The CAR is highly decreased during the fiscal year 2060/61 and then it slightly increases and core capital to RWA is fluctuating in every year. But if we see the figure of core capital, Supplementary capital and total

capital fund then core capital is towards increasing trend. If we see the structure of total capital fund then contribution of core capital in total capital fund is around 60% while that of supplementary capital is only 16%. Core capital plays the dominant role in total capital fund. RBB also gave more priority to core capital rather than supplementary capital. RWA is also increasing every year.

b. NBL Bank Limited

Capital adequacy ratio and core capital of NBL bank during the study period were in short fall position. Core capital to RWA and CAR is the highest in the year 2062/63 and slightly decreased in the fiscal year 2063/64 and 2064/65 compared to the fiscal year 2062/63 but if we see the figure of the core capital, supplementary capital and total capital fund core capital is in increasing trend as well as RWA is also increasing every year. In the portfolio of total capital fund contribution of core capital is around 70% while that of supplementary capital is only 8% so that core capital plays dominate role in total capital fund. NBL Bank gave more priority to core capital rather than supplementary capital.

In the portfolio of total loan and advances, pass loan occupied around 96.25% while that of NPL is around 18% in average 5 year. The trend of pass loan is increasing every year while the trend of NPL decreased during the fiscal year 2060/61 to 2063/64 but in fiscal year the 2064/65 NPL has increased. Bad loan of NBL is fluctuating every year. If the bad loan increases, loan loss provision also increase in the same ratio. Provision for all loans is not sufficient during the fiscal year 2060/61 to 2064/65. Provisioning value is increasing every year.

c. Nepal Bangladesh Bank Limited

Capital adequacy ratio and core capital of NB bank during the study period were within the limit and even short fall in some year. Core capital to RWA is highest in the year 2060/61 while capital adequacy ratio is also highest in

the year 2060/61. The CAR and core capital to RWA has slightly fluctuated during the fiscal year 2060/61 to 2064/65 but if we see the figure of Core Capital, Supplementary Capital and Total Capital Fund then Core Capital is in increasing trend while there is fluctuation in the supplementary capital but the total capital fund is in increasing trend. If we see the structure of total capital fund then contribution of core capital in total capital fund is around 76% while that of supplementary capital is only 9% NB Bank gave more priority to core capital rather than supplementary capital. RWA is in fluctuating position.

In the portfolio of total loan advances pass loan is around 80% while that of NPL is around 7% in average of five year. The trend of pass loan is in increasing trend every year and NPL is increasing trend during the FY 2060/61 to 2062/63 thereafter it decreases in 2064/65. Bad loan of NBBL is fluctuating every year. Provision for doubtful loan is not sufficient in the fiscal year 2062/63 in the NRB requirement.

Findings of Primary Data:

- a. The NRB regulating and supervising role is better for commercial bank operations.
- b. The onsite and offsite supervisory system of NRB is more relevant and appropriate for the banking operations.
- c. The NRB directives support the commercial bank to promoting safe and sound banking system as well as facilitate the customers and the depositors.
- d. The half of the respondent agreed with the idea of developing better financial institution and most of the remaining respondents agree on meeting the international standard as regard to the reasons behind the frequent changes in directives.
- e. Based on the respondents' opinion, majority of the respondents have opined that NRB directives are necessary to protect the interest of

depositors as well as to enhance the creditability of the financial system.

- f. The commercial banks were implementing the NRB directives regularly and minority respondent don't know about the NRB directives.
- g. More than 50% respondents agreed with to protect the interest of the depositors for setting capital adequacy norms. The respondent agrees with the interest of the depositors.
- h. All respondent have equally emphasized in the increasing core capital, supplementary capital and merger and acquisitions of the same types of firms.
- i. Majority of the respondents were in the opinion that, commercial banks should not be allowed freely to set their norm of capital adequacy ratio, rather it should be under the strict directives of NRB.
- j. Loan and advance should be reviewed on periodic basis.
- k. Capital adequacy requirement set by NRB are fit for regulation and supervision of commercial bank.
- l. The increase in requirement of Rs. 2 billion Capital Requirement Act shall create a barrier for new entrants.
- m. The provisions in NRB directives about the black listing the loan defaulter are enough/adequate.
- n. The loan and loan loss provision of present ratio is adequate to commercial banks.
- o. Commercial bank shall not be much affected with the new directives of single borrower limit.

CHAPTER - FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

This study of " Implementation and Impact of NRB Directives" (A Study on selected the Commercial Banks in Nepal) is primarily based on the primary and secondary data provided by the concerned commercial banks and the respondents. Among the existing listed commercial banks three commercial banks have been randomly taken/selected as samples for the study. The main objective of the study is to understand and assess the Impact and the Implementation of the NRB Directive and further review and analyze them in context of the Nepalese commercial banks. Needless to mention that, most of the listed commercial banks are similar in nature in terms of their infrastructure, objectives and various services provided to the customer. For the purpose of the study; the information as gathered and collected, pertaining to a justified period of five years that is from 2060/61 to 2064/65.

A comprehensive detail of the information collected is presented with its specific analysis and further the conclusion drawn through this study under the various chapters and headings. Chapter One, is concerned with the introduction of the whole study. It explained about the selected banks, concentration of the study objectives, statement and organization of the study, which provides guideline for entire study. Chapter Two, is concerned with the review of study as well as the review of related previous studies, journals and article etc. Chapter Third, specifies the guidelines, tools and research design to achieve the objectives of the study.

Chapter Four, Pertains to the Analysis of data, where some financial and statistical tools are used. Ratio analysis is the main financial tools used in this study. The study also includes the statistical tool like Correlation Coefficient and Probable error. Data are collected through different sectors and annual report of related banks. But the Primary data are generated through personal

interview of financial officers and officers of NRB which is covered under Chapter Four. Capital Adequacy Ratio maintains the existence and provide the status to any Commercial Banks as per the NRB norms and guidelines.

5.2 Conclusion

This Study “Implementation and Impact of NRB Directives” (A Study on Selected Commercial Banks in Nepal) has tried to analyze the impact of NRB directives on current banking industry and effort was also made to actions and correcting of the indicated remarks.”

The effect of NRB directives on commercial banks can be pointed out as following in two aspects of positive and negative part.

Positive Aspects:

-) Complying with the NRB norms the bank will be rated as healthy and shall help to maintain stronger financial environment for the longer term.
-) One of the most positive aspects is protecting the banks from bankruptcy and fraud.
-) The money of depositors is secured through capital adequacy norms and loan loss provisioning.
-) NRB directives intend to bring prosperity not only to the bank but also to its shareholders, depositors, employees and also to the economy of the country as a whole.
-) At the moment when the country has already acceded to WTO and the regional economic integration being a seriously discussed issue, adopting international standard in the banking industry will make it efficient and competitive with the international banks.
-) Effect of Credit risk is minimized through the loan loss provision.
-) All directives are important for the regular operation of the banks and keep the financial system /industry strong.

Negative Aspect:

-) Since, Nepal is a developing country with a small economy, where banking history is not so old, adopting international standards is not suitable and viable and will be hard for compliance. That means more chances of non-compliance.
-) Strict disbursement of loan will reduce credit and as a result interest income will be affected adversely.
-) Revision and frequent changes in directives leads to unstable financial environment or management.
-) Increase in the operational procedures of the bank, means increasing additional cost of the bank.
-) Banks profit will be higher, but it should not fulfill the desire of shareholder and employee. It means commercial bank pays the less interest to its depositors and fewer bonuses to its shareholders, which will finally make dissatisfaction in the customers.
-) Banks should have to put large portion of investible fund separately provisioned, as Capital Adjustment reserves; which will be affecting the (Net Profit) income.

Since, for every matter, there are always positive and negative aspects, we must adopt its Positive aspects. Negative aspects should be considered and focused on how to take more benefit from it and for this we have to concentrate on implementation part. So the strategy and procedure adopted for implementation will play a vital role on getting benefit from it. Commercial banks should be very careful from implementation side. So that, if we see the implementation part of the selected banks for fulfilling the capital adequacy norms, single borrower (obligor) limit and loan loss provision norms, they have adopted following measures.

Rastriya Banijya Bank Ltd.

-) It collected bad debt on timely.
-) Its large portion of net profit was allocating in capital adjustment fund.
-) General reserve fund and retained earning was also increased.
-) More focus given on core capital as shortfall in supplementary capital can be fulfilled from core capital.
-) Contribution of core capital on total capital fund is around 60%.
-) Increase in pass loan around 80% in the portfolio of total loan and advances.
-) Provision created for all loans thereby securing the position of bank from defaulters.
-) Took necessary steps for reducing NPL.

NBL Bank Ltd.

-) Regularly, NBL bank able to collect bad loan on time.
-) General reserve fund and retained earnings was also increased.
-) NBL bank may have not maintained the CAR, as per the provision of NRB.
-) Contribution of core capital in total capital fund is around 70%.
-) Increase in pass loan in the portfolio of total loan and advances.
-) Taken necessary steps for reducing NPL.
-) Core Capital is in increasing trend. So that, the single borrower credit is also increasing holding the limit constant.

Nepal Bangladesh Bank Ltd.

-) Core capital is increasing every year. It means that, the large portion of net profit was allocated in capital adjustment reserve.
-) General reserve fund and retained earning was also increased.
-) Contribution of core capital to total capital fund is around 75% while remaining is supplementary capital.
-) Taken necessary steps for reducing NPL.

During the analysis period, Capital Adequacy norms set by NRB is increasing Year 2060/61 to 2062/63 and then after it is constant, it means a large portion of the net profit is allocated in Capital Adjustment reserves. Though, the Net profit is in increasing trend; the percentage of the bad loan recovered to Net Profit is more fluctuating in RBB in comparison to NBL and NBBL. Such fluctuations finally create dissatisfaction in the eyes of the shareholders by giving them uncertain benefits on their shares.

In the analysis period, Performing Loan is in increasing trend in all the three sample banks RBB, NBBL and NBL Banks, which shows their good quality of Loan portfolio but for RBB the performing loan was maximum in 2064/65 and declined for two subsequent years followed by a marginal increment in 2063/64. It is clearly indicated in the ratio of non-performing loan to total loan and advance and the provision to loans and advances. Rastriya Banijya Bank and Nepal Bank require strong policies for its Loan disbursements or otherwise it is exposed to Risk and future contingencies because of its high NPL and the provision. Decreasing in the Provision is a direct indication of maintaining good quality loan and advances, but in RBB and NBL case it is just opposite which shows high reserves in the Provision which directly affecting the returns.

The Directives related to the Single borrower Limit is based only on the Core Capital in the new directives; whereas these limits were based on the Total Capital fund in the old provision. The analysis clearly shows that, the single borrower limits have come down by both Fund based and Non-fund based due to the changes brought about by the new directives.

5.3 Recommendations

On the basis of the above findings, the following suggestions are recommended with regards to the NRB directives issued for commercial banks.

Recommendations to Selected Commercial Bank:

On the basis of the analysis; directives issued by NRB are very important to build not only a sound banking system in Nepal but also a milestone for the country's economic stability. The commercial banks should obey its rules. All banks are implementing the directives' laid down by NRB. Selected banks have well in maintaining the provisions of the directives.

a. Rastriya Baniya Bank Limited

RBB has shortfall of CAR in Year 2060/61 and was followed by shortfall of Supplementary Capital in fiscal year 2062/63 through fiscal year 2064/65. It has been recommended for RBB to maintain the CAR without violating the required level. The Non-performing Loan is relatively higher and bank has to be very careful for its Loan disbursements, and should try to become more efficient in increasing in the portion of Pass loans in the portfolio. It is recommended to utilize the loans and advances as much as possible so as to increase its profitability.

b. NBL Bank Limited

NBL has excess core capital ratio in all years except 2064/65. In which it is nearly equal to the required CAR. This implied that the bank has accumulated owners fund in an attempt to meet the capital requirement. The excess investments by the owners reduce their returns on investment. Hence NBL is recommended to be aware of the return on equity investment to shareholders.

c. Nepal Bangladesh Bank Limited

NBBL has shortfall of supplementary capital in Year 2060/61 to 2062/63, thus bank has to increase its supplementary capital to meet the supplementary capital ratio, even though it can be compensated by the excess amount of the core capital. NBBL has minimum of core capital among the three selected

banks, it is difficult itself to protect from various risks, enjoy with huge and good clients and be able to mobilize its deposits. Bank has to maintain the CAR so as to maintain better goodwill in the financial market among its customers and stakeholder. Bank has to reduce the loan exposure to its customers with the reduction in the single borrower limits of the Fund based and Non-Fund based loan. In the portfolio of total loan and advances portion of pass loan is around 80% while the remaining is NPL. It means NBBL has to increase the portion of pass loan in the portfolio of total loan and advances.

-) NPL of Sample Companies are in increasing trend during the observed period. Similarly, its provisioning has also increased so as to secure itself from burden of NPL. So banking sectors needs to be very careful and strict in disbursement of loan and advance and also the enhancement of the monitoring and recovery activities.
-) Bad loans are also seem to be increasing, so they must be very careful and take necessary steps so that they can recover bad loans and stop increasing NPLs.
-) Provisioning for different loans and advances are not maintained as per NRB requirement during the study period. It is very dangerous for commercial banks. It should not take risk by not maintaining the required provision. Since future is uncertain and no one knows which loan has to be write-off & when it is so commercial banks are recommended not to violate provisions made by NRB.
-) In the name of increasing capital base, commercial banks are generating the earnings to its shareholders. Since shareholders are the

Recommendations for NRB:

NRB shows concern to the various bank's officers before setting standard norms on different aspect of commercial bank. The complaints and criticisms of bank official should be considered accordingly, consequently are optimal standard will be achieved and will satisfy almost everyone related with commercial banks.

-) The central bank has come up with the new directives. The directives are very good and meet the international standards. However, they become irrelevant if they are not implemented properly. It has been observed that the commercial banks have been raising questions on the timing of the directives and Nepal Rastra Bank believes that they are making excuses out of this. In this context, it is strongly recommended to NRB to hold meeting with the commercial banks and listen to their complain.
-) As we know, directives are tools of NRB to supervise, monitor and control the financial instructions, it must be formulated taking into consideration, and the positive as well as negative impacts on the commercial banks. Issuing wrong or unsuitable provisions may ruin the conditions of commercial banks instead of enhancing its situation. NRB should take necessary actions to ensure that its recent directives have been followed by all commercial banks equally.
-) NRB has to strengthen the functioning of Credit Information Bureau Ltd. (CIB) so that the commercial banks receive the details of the blacklisted borrowers in quick time. This will reduce chances of creating bad quality assets in the bank's balance sheet.
-) NRB has to improve its Supervision and Monitoring Capability so as to help & ensure the implementation of NRB directives fully.

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