

**The Role of Nepal Rastra Bank for the Development
of
Commercial Banking in Nepal**

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DECLARATION

I hereby, declare that the work reported in this thesis entitled “ **The Role of Nepal Rastra Bank for the Development of Commercial Banking in Nepal** ” submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of **Master of Business Studies (M. B. S.)** Under the supervision of **Mr Ropak Joshi**, Principal of Khwopa College Bhaktapur, affiliated to Tribhuvan University.

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LIST OF ABBREVIATIONS

ADB	=	Asian Development Bank
ADBL	=	Agricultural Development Bank Nepal
BIS	=	Bank of International Settlement
BOP	=	Balance of Payment
BS	=	Balance Sheet
B.S.	=	Bikram Sambat
BAFIA	=	Banks and Financial Institution Act
CAR	=	Capital Adequacy Ratio
CB(s)	=	Commercial bank (s)
CBS	=	Central Bureau of Statistics
C/D Ratio	=	Credit Deposit Ratio
CEO	=	Chief Executive Officer
CIB	=	Credit Information Bureau
Co.	=	Company
CRR	=	Cash Reserve Requirement
EBL	=	Everest Bank Limited
Ed.	=	Edition
Forex	=	Foreign Exchange
FSR	=	Financial Services Representative
FY	=	Fiscal Year
GBB	=	Grameen Bikas Bank
GRP	=	Graduate Research Project
HMG/N	=	His Majesty Government of Nepal
Ibid	=	in the same place, from the same book
IBRD	=	International Bank for Reconstruction & Development
Id	=	the same
IMF	=	International Monetary Funds
IS	=	Interest Spread
KBL	=	Kumari Bank Limited
Ktm.	=	Kathmandu
LBL	=	Lumbini Bank Limited
Ltd.	=	Limited
MBS	=	Masters in Business Studies
n.p.	=	No date of Publication

NBL	=	Nepal Bank Limited
NCC	=	Nepal Credit and Commerce Bank Limited
NGO(s)=		Non-government Organization(s)
NIC	=	National Insurance Company
NICB	=	Nepal Industrial & Commercial Bank
NIDC	=	Nepal Industrial Development Corporation
No., nos	=	Number(s)
NPA	=	Non Performing Assets
NPL	=	Non-Performing Loan
NRB	=	Nepal Rastra Bank
NSBL	=	Nepal SBI Bank Limited
Op. cit	=	in the work cited
P & L A/C	=	Profit & Loss Account
Pvt.	=	Private
RBB	=	Rastriya Banijya Bank
RFP	=	Request for Proposal
SBI	=	State Bank of India
TRWA	=	Total Risk Weighted Assets.
TU	=	Tribhuvan University
TUCL	=	Tribhuvan University Central Library
WB	=	World Bank

CHAPTER I

INTRODUCTION

1.1 Background of the Research

This research work is done with the main purpose of analyzing the supervisory role of the Central Bank and its impact to the commercial banks of Nepal. The research tries to study and analyze the information of eight commercial banks in regard to the compliance of two directives issued by the

Central Bank. The first directive is regarding the maintenance of minimum capital fund and the second directive is related to loan loss and provisioning. The research also tries to identify the financial position to meet the obligations of the depositors of these banks and classifies the banks as strong, average and weak in terms of their compliance of two directives issued by Nepal Rastra Bank. In addition to this, the research tries to observe the monitoring role of the Central Bank.

The overall financial picture of a country comprises of many institutions: Central Bank and other financial institutions such as Commercial Banks, Development Banks, Finance Companies, Micro Credit Development Banks, etc. The country can foster economically when these main players of financial system of any country actually play their role effectively. Central Bank with its guidance should be ever alert and be able to keep things in control. Similarly, financial institutions should be able to create a favorable environment to overall socio-economic development of the country by abiding to the laws, directives and guidance of the regulatory and monitoring authority.

Since Nepal is a developing country, its central bank needs to play a development role along with other regular monetary, supervisory and policy making role. The data shows that the number of commercial banks is on the rise since last few years, however the quality of banking service and financial performance is yet to grow at all parts of the country.

Commercial Banks and their activities are generally subject to much closer official supervision than other kinds of businesses. The following important aspects of the economic

and financial life of the country justify the need of proper and efficient supervision of the commercial banks.

(a) They occupy a central place in the payments mechanism for households, government and business.

(b) They accept deposits, which are widely regarded as “money”; which are expected to be repaid in full, either on demand or at their due term; and which constitute part of society’s financial assets.

(c) In market economies Banks play a major role in the allocation of financial resources, intermediating between depositors of surplus funds and would-be borrowers, on the basis of active judgments as to the latter’s ability to repay.

This is in marked contrast to practice under conditions of central planning, where banks would typically act merely as passive conduits for the distribution of funds, without the necessity to make credit decisions.

The primary justification for banking supervision is to limit the risk of loss to depositors, and by so doing to maintain public confidence in banks. And while supervision naturally focuses on the individual bank, supervisors must also be alert to the possibility that problems in one institution may have wider, systemic repercussions on others as well.

1.2 Objectives of Bank Supervision

Pradhan (2062) in his article mentioned that good macroeconomic policy and a stable and growing real economy are the preconditions for a sound banking system. A sound banking system is a precondition for a healthy macro economy and efficient macroeconomic policy formulation. Central Banks need to supervise banking institutions because banks play a critical role in the working of a market economy. The balance sheets of banks are virtually a mirror of the economic and commercial life of a country. The key consideration for the involvement of a central bank in supervision is to maintain the confidence in the banking system. While maintaining this basic condition, it is also to the interest of the country to see that credit and other banking services are readily available at competitive prices. Another aspect of central bank supervision is to control credit creation which supports the fulfillment of social and other objectives and help to implement monetary policy.

The basic objective of NRB supervision is to conduct a direct assessment of the overall condition of the banking institutions based on off-site and on-site evaluation of the institution's capital, assets, management, earnings, liquidity and a review of their records, systems and internal control and to determine whether the institution has complied with relevant mandatory and regulatory requirements. It also helps to facilitate the detection of frauds, malpractices, abuses of power by management and staff and undesirable trends and imprudent practices, such as deterioration in the quality of loan portfolio and the concentrations of risks.

Since the last two decades, the world of finance has undergone profound changes as evidenced by the rapid technological development for processing and transmitting data, the growing internationalization of financial system, the increasing phenomena of financial innovations coupled with competition and deregulation. This new financial environment has necessitated the development of new and the adaptation of existing supervisory policies, practices and procedures.

Banks are supervised in order to achieve both long-term financial stability and sectoral efficiency. A weak regulatory framework and poor supervision provide backgrounds for inefficient and unsafe banking practices, which increase the risk of bank failure and internal instability.

Supervisors must be alert to all such possibilities. Sometimes the concerns may be judged sufficient to prompt some kind of official support to the banking system. Although such a decision would be for the central bank and government rather than supervisors alone, the detailed institutional knowledge of the supervisors would be an invaluable input.

1.3 Current Scenario of Banking Sector in Nepal

Financial system of Nepal is still in its primary stage of development. It has very short history of few decades. Small but fast growing financial sector comprises of commercial banks, development banks, finance companies, micro-finance institutions, pension funds, cooperatives etc. So far, development of financial services in the country is uneven. In urban areas of the country, advanced banking services are available while many rural areas are shortage of banking services.

At present there are altogether 31 commercial banks in Nepal. Rastriya Banijya Bank is fully owned by HMG of Nepal while in case of Nepal Bank Ltd, HMG of Nepal is major shareholder. Most of commercial banks were established during late eighties and early nineties due to liberalization of financial sector. Number of financial institutions is also growing. The financial system comprises of 79 Finance Companies, 87 Development Banks, 21 Micro-Credit Development Banks. There are also 16 licensed savings and credit cooperatives and 38 non-government organizations for limited banking transactions. Keeping in view, such fast growth of financial institutions a department for supervision of Development Banks and Financial Institutions was established in 1998. At present there is Bank Supervision departments for supervision of commercial banks, Financial Institutions Supervision Department for the supervision of Development Banks and Finance Companies and Micro-Finance Promotion & Supervision Department for the supervision of Micro Credit Development Banks and other institutions. There is a Bank and Financial Institution Regulation Department to formulate policy and small directives of all types of institutions and granting license to operate any types of banks and financial institutions.

This research study takes into its consideration the eight commercial banks viz. Agricultural Development Bank Ltd., Nepal Bank Ltd., Nepal SBI Bank Ltd., Everest Bank Ltd., NCC Bank Ltd., Lumbini Bank Ltd., NIC Bank Ltd., and Kumari Bank Ltd. Their brief overview is as follows:

With the main objective of providing institutional credit for enhancing the production and productivity of the agricultural sector in the country, the Agricultural Development Bank, Nepal was established in 1968 under the ADBN Act 1967, as successor to the cooperative Bank. The Land Reform Savings Corporation was merged with ADBN in 1973. Subsequent amendments to the Act empowered the bank to extend credit to small farmers under group liability and expand the scope of financing to promote cottage industries. The amendments also permitted the bank to engage in commercial banking activities for the mobilization of domestic resources.

Agricultural Development Bank Limited (ADBL) is an autonomous organization largely owned by Government of Nepal. The bank has been working as a premier rural credit institution since the last three decades, contributing a more than 67 percent of institutional credit supply in the country. Hence, rural finance is the principal operational area of ADBL.

Besides, it has also been executing Small Farmer Development Program (SFDP), the major poverty alleviation program launched in the country. Furthermore, the bank has also been involved in commercial banking operations since 1984.

The enactment of Bank and Financial Institution Act (BAFIA) in 2063 B.S. abolished all Acts related to financial institutions including the ADBN Act, 1967. In line with the BAFIO, ADBL has been incorporated as a public limited company on July 14, 2005. Thus, ADBL operates as an "A" category Financial Institution under the legal framework of BAFIA and the Company Act, 2063.

Nepal Bank Limited (NBL), the first bank of Nepal was established in November 15, 1937 A.D (Kartik, 30, 1994). It was formed under the principle of Joint venture (Joint venture between govt. & general public). NBL's authorized capital was Rs. 10 million & issued capital Rs. 2.5 million of which paid-up capital was Rs. 842 thousand with 10 shareholders. The bank has been providing banking through its branch offices in the different geographical locations of the country.

The shareholding pattern of the bank is as follows:

Table No. 1.1: Shareholding Composition

Shareholding Composition

S.N	Ownership	Percent
1	Government of Nepal	40.49
2	'A' Class Financial Institutions	4.92
3	NRB Licensed Financial Institutions	3.42
4	Other Institutions	0.52
5	General Public	49.94
6	Others	0.71
	Total	100

Nepal Credit & Commerce Bank Ltd. (NCC Bank) formally registered as Nepal - Bank of Ceylon Ltd. (NBOC), commenced its operation on 14th October, 1996 as a Joint Venture with Bank of Ceylon, Sri Lanka. It was the first private sector Bank with the largest authorized capital of NRS. 1,000 million. The Head Office of the Bank is located at Siddhartha Nagar, Rupandehi, the birthplace of Lord Buddha, while its Corporate Office is placed at Bagbazar, Kathmandu.

The name of the Bank was changed to Nepal Credit & Commerce Bank Ltd., (NCC Bank) on 10th September, 2002, due to transfer of shares and management of the Bank from Bank of Ceylon, an undertaking of Government of Sri Lanka to Nepalese Promoters.

At present, NCC Bank provides banking facilities and services to rural and urban areas of the country through its 18 branches. The Bank has developed corresponding agency relationship with more than 150 International Banks having worldwide network.

The authorized capital of the Bank is Rs. 2 Billion, issued capital is Rs. 2 Billion and paid up capital of the Bank is Rs. 1.4 Billion

Lumbini Bank Limited is offering a wide range of banking solutions and services particularly customized to the needs of the customers. Established in 1998, this is the first regional commercial bank in Nepal, which started its operation from Narayangarh spreading its wings to further fourteen more places at Hetauda, Butwal, Naxal, Biratnagar, Parsa Bazaar, Indrachowk, Baneshwor, Bardhghat, Parasi, Suryabinayak, Gwarko, Damauli, Mangal Bazaar and Lanku of Chitwan District.

The Bank is highly committed to assure of the standard and excellence in the services it offers. Our team is guided towards obtaining new challenges and opportunities. Backed by state-of-the-art technology and experienced professionals adept in modern banking management, it strives to make banking simple, fast and customer friendly.

The Bank has restructured various products, as a part of an ongoing process, to cater to the retail segment. The newly structured products in retail segment cover Personal Loan, Home Loan, Auto Loan, Mortgage Loan, Educational Loan, Time Loan, and Loan against Shares.

Its commitment extends further, from its customers, investors, stakeholders and employees to society at outsized. By focusing on sustainability and corporate social responsibility, it aspires to be a role model institution in responsible Banking. Its foundations have been inscribed with stringent Corporate Governance measures, whereby transparency, disclosure, instruction norms and accountability have paramount importance, in order to safeguard the trust and wealth of each and every stakeholders and customers. The Bank has finalized an e-commerce strategy and developed the necessary internet banking modules.

The ownership pattern of the bank comprises of 66% Promoters and 34% of its shares hold by the general public.

Everest Bank Limited (EBL) started its operations in 1994 with a view and objective of extending professionalized and efficient banking services to various segments of the society. The bank is providing customer-friendly services through its Branch Network. All the branches of the bank are connected through Anywhere Branch Banking System (ABBS), which enables customers for operational transactions from any branches.

With an aim to help Nepalese citizens working abroad, the bank has entered into arrangements with banks and finance companies in different countries, which enable quick remittance of funds by the Nepalese citizens in countries like UAE, Kuwait, Bahrain, Qatar, Saudi Arabia, Malaysia, Singapore and U K.

The Bank has set up its representative offices at New Delhi (India) to support Nepalese citizen remitting money and advising banking related services.

Nepal SBI Bank Ltd. (NSBL) was incorporated in July 7, 1993 as the 8th commercial bank in Nepal. Under the Banks & Financial Institutions Act, 2063, Nepal Rastra Bank granted fresh license to NSBL classifying it as an "A" class licensed institution on April 26, 2006. The Authorized, Issued and Paid-Up Capitals have been increased to Rs. 200 Crores, Rs. 166.16 Crores and Rs. 165.36 Crores, respectively. In terms of the Technical Services Agreement concluded between SBI and the Bank, SBI provides management support to the bank through its 3 expatriate officers including Managing Director who is also the CEO of the Bank. A core management team viz. Central Management Committee (CENMAC) consisting of the Managing Director, Chief Operating Officer, Chief Financial Officer and Assistant General Manager(Credit) oversees the overall banking operations in the Bank. The Bank's corporate status has undergone change from its previous status as a Joint-venture Bank to a Foreign Subsidiary Bank of SBI. Presently fifty five percent of the total share capital of the Bank is held by the SBI, fifteen percent is held by the Employee Provident Fund (EPF) and thirty percent is held by the general public.

The Bank has 50 physical outlets including 43 branches, 6 extension counters and a Corporate Centre, thus being one of the largest private banks in Nepal.

The current shareholding constitutes of:

- Proportion of Ownership held by SBI- 55%
- Employee Provident Fund (EPF), undertaking – 15%
- General Public comprising of more than 10,000 shareholders – 30%

Nepal Industrial & Commercial Bank Limited (NIC Bank) commenced its operation on 21 July 1998 from Biratnagar. The Bank was promoted by some of the prominent business houses of the country. The current shareholding pattern of the Bank constitutes of promoters holding 51% of the shares while 49% is held by the general public. NIC Bank has over 34,000 shareholders. The shares of the Bank are actively traded in Nepal Stock Exchange with current market capitalization of about NPR 10,493 million.

The Bank has grown rapidly with 34 branches throughout the country while several branches are planned to be opened this year. All branches are inter-connected through optical fiber as well as V-Sat and are capable of providing real time on-line transactions.

NIC Bank was the first commercial bank in Nepal to have received ISO 9001:2000 certification for its Quality Management System standard in the year 2006. The Bank has recently been certified under the upgraded ISO 9001:2008 standards for the Bank's Quality System on Commercial Banking Activities for the first time in Nepal. Furthermore, NIC Bank became the 1st Bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its Global Trade Finance Program, enabling the Bank's Letter of Credit and Guarantee to be accepted/ confirmed by more than 200 banks worldwide.

To add to these achievements, the Bank has also been awarded the "Bank of the Year 2007-Nepal" by the world-renowned financial publication of The Financial Times, U.K.-The Banker.

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 1,485,000,000 of which 70% is contributed from promoters and remaining from public.

Kumari Bank Ltd. (KBL) has been providing wide - range of modern banking services through 28 points of representations located in various urban and semi urban part of the country, 19 outside and 9 inside the valley. The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS Banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, Utility Bill Payment Services, Inward and Outward Remittance services, Online remit Services and various other banking services.

1.4 Statement of the Problem

Nepal has relatively small banking area compared to the developed nations. The number of banks and financial institutions are slowly coming up. The banks and financial institutions are gradually practicing modern banking practices recently. Banking culture is slowly coming to the scene. Central Bank is coming with new and unified directives. In this context, some of the failures of this sector are quite prevalent. These failures are caused by number of reasons and can be tackled by efficient, strict and up-to-date guidelines by the Central Bank.

The weak financial position of most of the government-owned financial institution, negative net worth and huge accumulated losses of the government-owned CBs, higher proportions of non-performing assets (NPA) and large interest rate spread between lending and borrowing rates in the formal financial sector. Besides, there is predominance of the informal financial system with high interest rate differentials between the formal and informal sectors of the economy.

However, in recent scenario in Nepalese Banking sector, various mispractices have been seen. Some of the problematic banks as declared by NRB are Samjhana Finance, Gorkha Development Bank, Nepal Share Markets, United Finance, etc. The depositors' money has been put at risk. Also, most of these have greater proportion of Non-performing loans.

There may be various underlying causes for the problems seen in the banking sector in Nepal. However, the political instability, inefficient government bureaucracy all have led to the institutions to pose the depositors' money at risk.

The Central Bank of Nepal, Nepal Rastra Bank (NRB) issues directives. The directives are revised considering the need of time as well as considering other factors which will affect the economy of the country. The directives cover various aspects of the banking sector and aims at keeping the financial scenario of the country in balance.

Financial institutions are required to oblige with the directives issued by the Central Bank. The directives, if not properly addressed, can cause major unrest in the financial system of the country. The directives need to be properly monitored as they are the major tool to supervise and monitor the financial institutions. Any rule should be strictly obeyed. These directives which have the potential to change the financial scenario of the country are even more important in that they should be strictly monitored.

This study is based on the primary and secondary data of eight banks regarding the selected directives. Since the two directives more or less give a good picture of the financial health of commercial bank, this study did not consider other relevant directives. So, the actual outcome of the research may be biased to some degree. Also, the data provided in the questionnaire solely depends on the sincerity of the data provider, the result cannot be deemed as fully correct.

The first directive which is related to maintenance of minimum capital fund or capital adequacy is important as it calls for the banks and financial institutions to keep more portion of their capital in the form of liquid assets. The second directive which is related to loan classification and provisioning has its own importance in protecting the depositors' money and also in maintaining adequate provisions for both the performing as well as non-performing loans.

The research is directed towards solving of following research issues:

- What are the factors that affect the supervision of the Central Bank?
- What can be done for establishing effective, efficient and systematic supervisory regime of Central Bank?

1.5 Objectives of the Study

The main research objectives focus on examining the supervisory role of the central bank and many other aspects for the development of banking in Nepal. Among these aspects, the following are the main objectives of this study:

1. To examine the supervisory role of the Central Bank.
2. To list the directives laid by Nepal Rastra Bank regarding capital adequacy and loan classification and provisions.
3. To find out to what extent the commercial banks are following the directives of NRB.
4. To analyze the monitoring system and its implementation of directives.

1.6 Research Questions

For the identification of major problems related to improving the supervisory role of the central bank, issues will be identified from literature and ranked through research of expert opinions.

Basically the following research questions are analyzed in this research to find the precise conclusion about the concerned topic related to central bank of Nepal.

- Does supervision of central bank helps in improving the banking and financial system?
- Is there any relationship between the supervisory role of NRB and the effectiveness of the banking system?
- Is the supervisory role of Central Bank of Nepal satisfactory?
- Do Commercial Banks comply with the directives issued by the Nepal Rastra Bank?

1.7 Significance of the Study

This research study is mainly based on the supervisory guidelines or directives of Nepal Rastra Bank. Even though several research have been conducted on the directives of Nepal Rastra Bank, this study is different from them in the sense that this research deals with the

insights of two of the prominent directives of Nepal Rastra Bank and their overall impact on the commercial banks. The directives of the Central Bank holds the key to the good financial health of the nation and therefore its actual insight as well as overall impact needs to be clear to all the stakeholders.

This study shall mainly assist commercial banks to reassess their strategies and policies to comply with the changes made and to be made in the directives. This study shall also help other Commercial Banks and other financial institutions because of the similarity in the directives issued by the Central Bank. Similarly policy makers of the Central Bank and further researcher in similar topics may benefit from the study. Various recommendations and suggestions will also be posted at the end of the study.

1.7.1 Operational Definitions

i. Dependent Variable

Bank Supervision is the dependent variable here, as it is the Central Bank or any institution of any country that supervise the Banks and Financial Institutions situated there.

ii. Independent Variables

- **No. of Banks & Financial Institutions**

There are already 31 commercial Banks in the country. Further, the no. of development banks, finance companies, micro-credit development banks all lead to the complexity of the financial system and hence, difficult for supervision.

- **Supervisors' Ability**

The ability of the supervisors who supervise the Banks and Financial Institutions also determines the effectiveness of the supervision system of the Central Bank.

- **Network of Institution**

The larger the network or the number of branches of the institution, the more difficult it is for the supervisory authority to supervise the institution.

- **Supervision Policies/Acts/By-Laws**

The existing policies/acts/bye-laws of the Country regarding supervision of the Banks and Financial Institutions also affect the supervisory role of the concerned authority.

- **No. of Supervisors**

The more the number of supervisors in Central Bank, the easier it is for the supervisors to keep track of the activities of the Banks and Financial Institutions.

1.8 Limitations of the Study

This study is a requirement of MBS Program. It will mainly be limited by following factors.

- Although NRB has varieties of policies such as economic development, monetary, foreign exchange etc. this study can't cover whole financial system. It covers only on the supervisory policy of NRB that need to be complied by different financial institutions.
- Among the various directives issued by the Central Bank, the study covers the only two directives that need to be complied by the Commercial Banks.
- Only eight commercial banks are covered by the research.
- The study covers only a five-year period data of the selected Commercial Banks.
- The study is also based on secondary data and the degree of truth depends on the secondary information provided by the concerned institutions.

CHAPTER II

LITERATURE REVIEW

2.1 Literature Review

The main aim of the literature review is to consider the study done on the study of the thesis. For this, several books, dissertations, reports, handouts and articles published in journals and newspapers are reviewed. This chapter also seeks to scan the literature efficiently, using manual or systematic methods, to identify a set of useful articles and books and perform critical appraisal to apply principles of analysis to identify unbiased and valid studies.

There are many studies related to the central bank. But some studies have been conducted regarding the role of NRB as a supervisor of the overall financial sector of Nepal. An attempt has been made to provide a comparative perspective for evaluating and interpreting the significance of one's finding.

Nepal initiated FSR back in 1980s with donor initiative & assistance observing the need to reduce the gap between information and data assessment. In this process, some progress was made in terms of re-capitalization of the government banks, divestment, branch consolidation, introduction of new regulatory and prudential norms and cleaning up the B/S of bad loan locked bank. But the reform process was started in the later 1990s due to political instability and government's priority in areas other than financial system. In between, the country observed from very close by, the financial crisis in the neighboring region. Keeping in mind the financial crisis and its effects in the Asian region, the NRB is now focusing its attention on the reform measures in the financial sectors as a drive towards new financial architecture.

Principal Reasons for Banking Supervision

Rose (2002) points out that following are the main reasons for the supervision of banks:

- To protect the safety of the public deposit.

- To control the supply of money and credit in order to achieve a nation's broad economic goals such as high employment and low inflation.
- To ensure equal opportunity and fairness in the public's access to credit and other vital financial services.
- To promote public confidence in the financial system, so that savings flow smoothly into productive investment and payments for goods and services are made speedily and efficiently.
- To avoid concentrations of financial power in the hands of a few individuals and institutions.
- To provide the government with credit; tax revenues, and other services.
- To help sectors of the economy that have special credit needs (such as housing, small business and agriculture).

2.2 Basic Principles of Banking Supervision

Ware (1996) in his report on banking supervision has outlined the following necessary issues in regard to the Banking Supervision.

General Principles of Supervision

Underlying the diversity of supervisory regimes and practices which exist in different countries are some common objectives and judgments.

As objectives, supervisors seek to ensure that banks are

- (a) Financially sound
- (b) Well managed, and
- (c) Not posing a threat to the interests of their depositors

Although supervisors need to have some understanding of the markets and the business environment in which banks operate, they cannot be expected to know as much as the bankers themselves about the commercial realities of banking. Anyway, it is *not* the supervisor's role to make the commercial decisions that are the prerogative of bank management. Rather, the supervisor monitors and evaluates the overall strategies, policies and performance of the bank - where appropriate with reference to specific legal or

prudential criteria - and reaches a view as to the soundness of the bank and the competence of those running it.

The following are the various approaches seen in the banking supervision:

a) On-site supervision

Espenilla (2007) is of the view that the on-site examination assumes a different focus, from a compliance-based exercise to one that puts emphasis on the soundness of governance and risk management and the effectiveness of the audit function. Its conduct entails reliance on enhanced analytic skills and judgment calls of examiners. The method for implementing the rating system for banks, known as CAMELS, has likewise undergone review to reflect the new approach. Moreover, examination teams are now expected to discuss more candidly with banks how ratings were determined.

b) Off-site supervision

Off-site surveillance involves data collection and analysis, self-assessment by the authorised entities, periodical system audits by qualified professionals and market intelligence. Periodical analysis of the data is carried out to discern patterns and/or trends for further policy actions, if any (Reserve Bank of India Annual Report 2010-2011).

c) Risk Based Supervision

The risk-based supervision approach represents a forward-looking approach to supervision. In using this approach, supervision/examination of a bank is focused on inherent risks in major business lines and the risk control system. This approach allows greater room for proactive actions by the supervisory authority to prevent problems from arising within the bank. (<http://www.bi.go.id>) Risk-based supervision saves supervisory resources and helps to promote a more safe and sound financial system. It saves resources because it focuses regulatory resources on areas of higher risk and usually requires substantially less transaction testing. By getting institutions to manage risks as opposed to correcting symptoms of problems, as in case of traditional supervision, supervisors focus their actions on identifying and preventing the causes of problems and thereby requiring improvements in management practices and systems. The risk-based supervision is not

transaction based but it is system-based inspection. In this approach, the regulator and supervisor enter into the depth and details of the system and procedures for managing and controlling risks, (Bank Supervision Report of NRB, 2010)

d) Compliance Based Supervision

The compliance-based supervision approach essentially stresses the monitoring of bank compliance for enforcement of the regulatory provisions relevant to bank operations and management. This approach refers to the past condition of the bank with the objective of obtaining assurance that the bank is operated and managed properly in compliance with prudential banking principles. <[http:// www.bi.go.id](http://www.bi.go.id)>.

e) Macro Prudential Supervision

An approach that supplements traditional supervision and regulation of individual firms or markets with explicit consideration of threats to the stability of the financial system as a whole. Ultimately, the goal of macro prudential supervision and regulation is to minimize the risk of financial disruptions that are sufficiently severe to inflict significant damage on the broader economy (Bernanke, 2011 in Article Implementing a Macroprudential Approach to Supervision and Regulation). The purpose of macro-prudential supervision is to identify sources of systemic risk and recommend remedial action (Trichet, 2009 in article Macro-prudential supervision in Europe). Macro-prudential perspective evaluates and monitors the financial system as a whole. Globally, it is felt necessary to initiate the practices of combined efforts of micro and macro prudential perspectives to create a stronger supervisory framework. As perceived in the global experience, adopting macro prudential supervision has been an issue to be addressed for the stability of Nepalese financial system, (Bank Supervision Report of NRB, 2010)

f) Stress Test

Elliott (2009) is of the view that the stress test is intended to determine what would happen to bank capital levels if the economy shrank substantially more than is already anticipated, while house prices fell further. The fundamental idea is to ensure that the banking behemoths that dominate the system will have more than sufficient capital to withstand even a very bad economic environment. Such an environment would exacerbate the losses on the toxic assets that created the initial problems for financial institutions. The stress test is intended to capture all sources of credit and investment losses that would be affected by a more severe economic downturn. The stress tests will be used to impose additional, temporary, capital requirements.

2.3 Banking Risks

The danger that a certain unpredictable can occur that could generate imbalances in cash flow is known as banking risks. The nature of qualitative asset transformation could give rise to risks because of mismatched balance sheets. The main forms of banking risks are mentioned below:

a) Credit risk

The risk that the bank's counterparty might not pay on the due date. Though most often associated with lending, credit risk arises whenever another party enters into an obligation to make payment or deliver value to the bank, e.g. in foreign exchange or securities transactions.

b) Liquidity risk

The risk that the bank might itself fail to meet its obligations when they fall due.

c) Yield risk

The risk that the bank's assets may generate less income than the expense generated by its liabilities.

d) Market risk

The risk of loss resulting from movements in the market price of financial instruments in which the bank has a position. Such instruments include bonds, equities, foreign exchange and associated derivative products.

e) Operational risk

The risk of a failure in the bank's procedures or controls, whether from external causes or as a result of error or fraud within the institution.

f) Ownership/management risk

The risk that shareholders, directors or senior management might be unfit for their respective roles, or actually dishonest.

Any banking risk is heightened if it appears in concentrated form - for example through large exposures to single or related counterparties, industrial sectors, countries or currencies.

g) Forex Risk

The risk that arises due to the transaction of foreign currencies. As Banks involve in different foreign currency transactions such as letter of credit, forex risk arises in the banking system too.

2.4 Key Prudential Issues

The key prudential issues of the commercial banks as per the directives of the Nepal Rastra Bank are explained below:

a) Capital adequacy

A bank's capital is required as a cushion to absorb losses, which should be borne by shareholders rather than depositors, and to finance the infrastructure of the business. The importance of capital adequacy is indicated by the development of an internationally accepted measure by the Basel Committee on Banking Supervision in 1988, based on what is known as the "risk asset" approach.

This approach defines the elements of capital for supervisory purposes, allocates weights to different broad categories of asset (e.g. government securities, loans to banks, customer advances) and expresses capital as a percentage of total risk-weighted assets.

The Basel Committee on Banking Supervision is a committee of banking supervisory authorities that was established by the central bank governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

According to Basel Committee, a minimum result of Capital Adequacy Ratio of 8 percent is widely accepted, though national authorities are free to impose higher standards on their banks - and often do so. As originally designed, this approach was only concerned with credit risk, but at the beginning of 1996 the Basel Committee published proposals to bring market risks into the calculation of capital requirements. Countries represented on the Basel Committee are committed to implementing those proposals by end-1997.

Decline in capital ratios have different explanations. The most common include:

- A rapid increase in risk-weighted assets;
- A reduction in the absolute amount of capital, e.g. Redemption of subordinated loans;
- Overall losses in the bank operations; and
- Adverse exchange rate movements, where there is a currency mismatch between risk-weighted assets and regulatory capital.

Improving the capital position addresses the symptom. The supervisor should also seek to understand in each instance why the capital ratio fell to determine if other measures are needed. In the first case of the instances listed above, the supervisor must assess whether the bank has the financial strength and the managerial and organizational capacity to handle the new risks. In the second case, the supervisor should determine if the reduction of capital is voluntary or involuntary, on the bank's part. In the third case, the underlying causes of the losses must be identified. A temporary loss, for example, emanating from unexpected market developments, calls for a different treatment from that of a bank that consistently makes a loss. In the fourth case, the supervisor should assess the bank's management of its foreign exchange exposure.

Where the bank's capital adequacy ratio has fallen below the supervisory and/or statutory minimum, the powers of the supervisor to take formal action against the bank to restore the ratio should be triggered. If the existing shareholders are unable to provide the necessary capital injection, various other options can be considered, such as:

- Selling or securitizing assets, thereby reducing the capital needed to support the business;
- Switching the portfolio from higher to lower risk weighted assets;
- Cutting operating costs and capital expenditure, including bonuses to managers and directors;
- Limiting or restricting the payment of dividends;
- Restricting redemption of subordinated debt or other instruments; and
- Bringing in a new shareholder who can contribute new capital.

A less obvious problem is where the bank's capital adequacy ratio falls significantly, for example, because the bank incurs a loss, to a level below what the market expects for the bank in question, but still remains above the supervisory and/or statutory minimum. This may affect confidence in the bank, particularly if there is an expectation that it may fall further in future. In such circumstances a capital injection (perhaps restoring the capital adequacy ratio to the level before the loss was incurred) may also be appropriate, in order to reassure depositors and the market in general that the position of the bank will remain secure. In such cases, the supervisor will need to co-operate closely with bank management.

b) Liquidity

The ability to meet its financial obligations on time, especially in relation to repayment of inter-bank borrowings and customer deposits, is crucial to a bank's reputation and even its continued existence. Banks need to manage liquidity to that end, not least because their prime economic function of intermediation necessarily entails maturity transformation – for in general borrowers seek funds of longer term than banks' deposit liabilities.

Banks have three principal ways of arranging their liquidity, usually employing them in combination.

- (i) Holding a stock of readily marketable liquid assets capable of being turned into cash quickly in response to unforeseen needs.
- (ii) Using information on the residual maturity of assets and liabilities to analyze future cash flows, and setting limits on mismatches or net positions in particular time bands.
- (iii) Borrowing in the market to smooth out cash flows by reducing mismatches in particular time bands.

c) Asset quality

The central issue in relation to the quality of a bank's assets is the ability of its borrowers to service and repay loans. Problems with asset quality are very often a key element in the failure of banks, with losses too large to be absorbed by capital. In the USA and other countries which practice detailed on-site examination of banks, the review of individual loans is a major focus of the process. Supervisors will expect banks to establish, and adhere to, documented lending policies. These should specify such items as the standards which loan applications must meet, credit assessment and loan authorization procedures, the regular monitoring of the performance of each loan, and its periodic review by staff independent of the original lending officers.

The early identification of problem loans is important if remedial action is to succeed, and banks may to this end employ grading systems for loans. Such systems use information on each loan to classify it in the range from trouble-free to problematic or worse. The numbers of categories and precise criteria used in the classification process may vary widely. Some countries, including the USA, assign ratings to individual loans as part of the examination process in order to evaluate the quality of banks' assets on a consistent basis. NRB has a directive of asset quality and provision in which the Banks have to categorize total loan in four classes from good to bad.

d) Earnings

Declining bank earnings may have different causes. These include:

- Unprofitable investments in new activities or in branches, subsidiaries or overseas operations;
- Insufficient diversification and unsustainable income streams;
- Unreliability of non-core income items;
- Poor cost control; and
- Increased competition in core activities, leading to net interest margin compression.

Deteriorating earnings will lead directly to reduced liquidity and weaker solvency, so these problems must be addressed. Banks must be required to reduce or restructure unprofitable activities (e.g. close branches) and to reduce costs (e.g. cut bonuses and salaries and/or the number of employees). If the problems are severe, a significant reorganization of the bank may be necessary. In parallel, relevant measures such as changes to the bank's strategic business directions and operating plans to turn around its earnings must be taken.

e) Management

A bank's success or failure in large part depends on the experience, capability, judgment and integrity of its board of directors and senior executives. Indeed, when banks fail, deficiencies at these levels are invariably discovered. At the same time, evaluation of management is as much art as science and involves the making of difficult judgments.

The board of directors should be strong, independent and actively involved in the bank's affairs, particularly in establishing and reviewing strategy and policy, and monitoring risk and performance. Directors and executives are responsible for setting, and ensuring adherence to, policies and procedures covering all aspects of the bank's activities. Important in this is creating an organizational structure in which individual responsibilities and reporting lines are clear, and effective communication is facilitated.

g) Sensitivity to Market Risk

The policies and procedures lay down by directors and senior executives of a bank are intended to control risks, safeguard assets, control liabilities, and provide accounting and other systems which record all transactions and commitments in a timely manner while providing management with reports enabling it to identify and assess the risks of the business. In order to be effective, internal controls need to be comprehensive, clearly documented, periodically reviewed, understood by those involved in the relevant activities or processes, and enforced. Three fundamental concepts are of wide application - authorization, reconciliation and segregation regarding this aspect:

Basis for an Effective Supervisory System

An effective supervisory system rests on: legislation relating to banking and its supervision; the supervisory regime itself; and an appropriate legal and accounting environment. It should be noted that various parts of the financial sector, other than banks, may also be subject to supervisory regulation of one form or another. Attention may therefore need to be given to possible overlaps or gaps in regulation; to questions of consistency and fairness across the financial sector; and to the justification for any gradations of treatment as between different classes of institution. The researcher's concern is, however, only with the supervision of banks, so does not address those other issues, important though they are.

a) Banking legislation

Legislation must first define which institutions are to be regarded as "banks". One approach is to define a bank in terms of taking deposits from the public; another is to do so in terms of taking deposits and making loans. In either event, unauthorized deposit-taking should be prohibited and penalties for doing so be laid down. It is for national consideration whether the law should distinguish between different types of banks, for example large and small, full service or specialized, and domestic or foreign.

b) The supervisory regime

Goodhart (2000) is of the view that giving supervisory powers to an independent central bank is especially advantageous if public institutions are weak, coordination between different public sector agencies is troublesome, or skilled human resources are scarce.

It is for national consideration whether licensing and supervision should be entrusted to the central bank or to some other agency. In either event, it is most important that the supervisory authority be independent of political or other outside pressure, so that its decisions can be made on objective supervisory grounds. It is equally important that there should be a mechanism by which the supervisory authority is accountable to government or parliament for the discharge of its duties. Precise questions concerning the statutory position of the supervisor and the balance between independence and accountability are, however, beyond the scope of this thesis. Historically, some countries have favored on-site examination as the core of their supervisory approach, while others have preferred to employ off-site surveillance. A growing consensus holds that a combination of these is desirable. Some countries also started a practice of supervision by other agencies than the Central Bank. For example, in UK, there is a separate agency for the supervision of Banks and Financial Institutions there.

c) Legal and accounting environment

An appropriate legal and accounting framework is essential not only for effective supervision in a market economy, but also for banks themselves to serve their economic purposes; this proposition rests on the underlying presumption that in a market-orientated system private enterprises can, and do, fail.

Off- And On-Site Approaches

As noted earlier, supervisors in different countries have in the past concentrated either on off-site analysis and review of information submitted by banks, or on obtaining the information themselves through on-site inspection. These approaches have increasingly become seen as complements rather than alternatives, forming a powerful combination when deployed in a coordinated manner.

The principal characteristics of each are discussed below.

a) Off-site supervision

Off-site monitoring covers the period in the supervisory cycle between on-site examinations.

- Off-site monitoring:

- *Looks back* at the results of the last on-site examination and checks for the correction of financial problems revealed at the last examination.
- *Looks ahead* to the next examination and identifies areas of emerging risk for the examiners to focus on.
- *Describes* in a written analysis the current condition and performance of the bank
- *Compares* the bank's condition and performance to similar banks
- *Recommends* changes to the CAMELS rating, a targeted examination, or a fullscope examination earlier than scheduled, if necessary (Tasky, 2008 in Article Introduction to Banking Supervision).

This involves the receipt, review and analysis of financial statements and statistical returns submitted to the supervisors. The analysis of this information facilitates the monitoring of each bank's performance and of its observance of supervisory requirements over time, so that emerging problems may be identified. The process can thus assist in making the most effective use of any on-site inspection resources. Comparison of a bank's data and performance with those of its peers can also be illuminating. These off-site procedures depend on the timely provision by banks of accurate information, without which the whole process is flawed from the outset. An important element in on-site inspection is the verification of suitable data samples. By its nature, while off-site review and analysis can readily deal with matters (e.g. capital, liquidity, and large exposures) which can be quantified, it is less well suited to qualitative issues such as management strength and operational risks. But one aspect of off-site supervision, central to the UK approach to supervision, which nevertheless has much value in relation to these judgmental questions, is the periodic, wide-ranging interview with an institution's senior management; and of course one would hope that supervisors and bank management would maintain close

contact with each other outside the formal program. This supervision is based on the daily to annual returns designed by Central Bank and reported by Commercial Banks.

b) On-site supervision

On-site supervision includes:

- Interviews with management
- Inspecting the written policies and procedures of the bank and the degree to which those written policies and procedures are followed
- Evaluating whether the bank's financial statements accurately show the bank's capital- requires a determination of the value of the bank's assets
- Checking the accuracy of accounting records
- Checking the adequacy of internal controls and the audit function
- Checking for compliance with laws and regulations
- Writing a "Report of Examination" that summarizes findings and assigns a *rating* to the bank (Tasky, 2008).

Inspection provides an independent check on a bank's operations and condition, as well as enabling off-site supervision data to be verified. Using a sampling approach, as distinct from one of full audit, inspectors focus on the bank's accounting and control systems, and its adherence to its own policies and procedures in all aspects of the business, and make informed judgments about management capabilities. The limited availability of suitably skilled staff has led some countries to enlarge the role of external auditors to encompass monitoring and reporting on supervisory matters; at least one, by contrast, faced with an undeveloped accountancy profession, has chosen to build on an existing body of central bank inspectors by transforming their role into that of supervisors. In some countries this role is given to either external auditors or some independent bodies.

2.5 Some Reflections on the Supervisor's Task

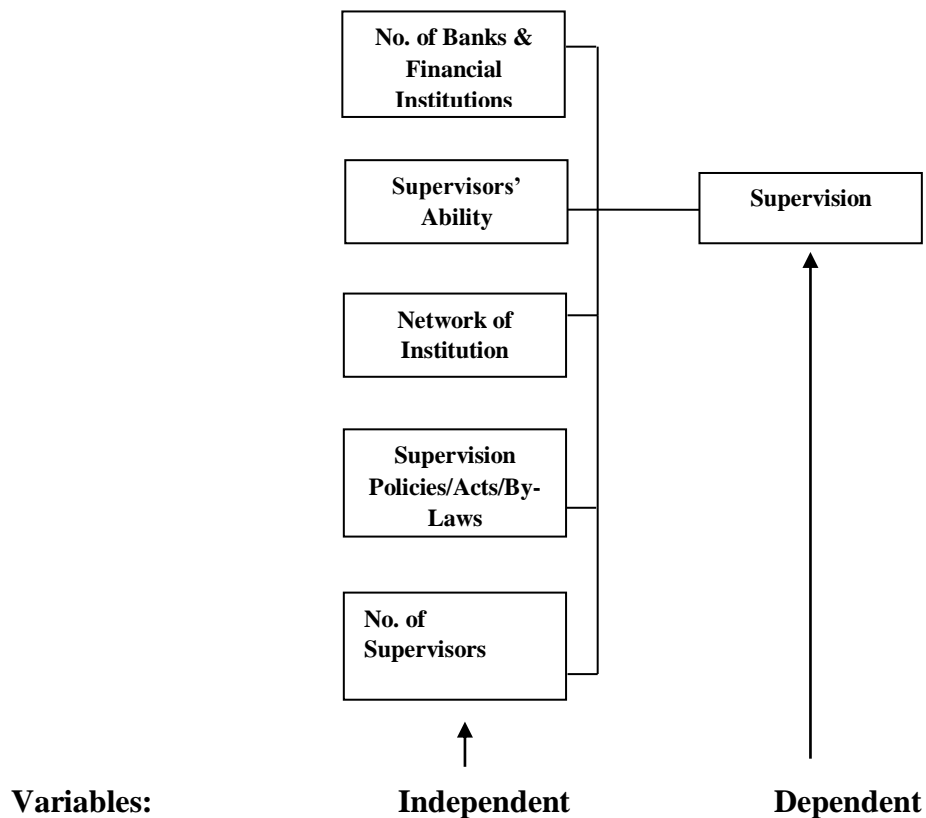
The supervisor's objective of minimizing the risk of loss to depositors is sometimes interpreted to mean that he should ensure that no bank ever fails. Such is not the case, for a basic principle of a market orientated system is that, while some enterprises thrive, others must of necessity fail and make their exit. For supervisors to prevent that would raise the

problem known as “moral hazard”: knowledge that any mismanaged bank would receive official support would reduce or remove management’s incentive to operate in a prudent manner, and that of depositors to exercise care in choosing where to place their funds. Nor is it a supervisor’s job to take commercial decisions which properly belong to bank managements, but rather to evaluate the latter’s performance and the policies and procedures they put in place. Some may be tempted to the view that the most effective way of averting loss to depositors is to prevent banks’ taking any risks. Such a view misunderstands the essential nature of banking, which leads banks to run the risks outlined in Section 3 of BAFIA above if they are to provide the services of money transmission and financial intermediation which are their distinctive contribution to the market economy. The supervisor’s concern is that bank managements should identify, understand, monitor and control such risks - for the biggest risk is the one that management has yet to identify or understand.

2.6 Theoretical Framework

Theoretical framework is a mechanism that underlies an observed relationship between an independent variable and a dependent variable via the inclusion of a third explanatory variable, known as a moderate variable.

Figure 2.1: Theoretical Framework



1. Dependent Variable

The dependent variable is dependent on the independent variable. As the experimenter changes the independent variable, the change in the dependent variable is observed and recorded. Bank Supervision is the dependent variable here, as it is the Central Bank or any institution of any country that supervise the Banks and Financial Institutions situated there.

2. Independent Variables

An independent variable is the variable you have control over that you can choose and is able to manipulate. With the change of independent variable there is change of dependent variable. In some cases, you may not be able to manipulate the independent variable as it could be fixed.

- **No. of Banks & Financial Institutions**

There are already 31 commercial Banks in the country. Further, the no. of development banks, finance companies, micro-credit development banks all lead to the complexity of the financial system. Theory says that there is a direct and positive relationship between the supervisory role of the Central Bank and no. of banks and financial institutions.

- **Supervisors' Ability**

The ability of the supervisors who supervise the Banks and Financial Institutions also determines the effectiveness of the supervision system of the Central Bank. Thus, there is a direct and positive relationship between supervisors' ability and the supervisory role of the Central Bank.

- **Network of Institution**

The larger the network or the number of branches of the institution, the more difficult it is for the supervisory authority to supervise the institution. There is a positive relationship between the network of institution and the supervisory role.

- **Supervision Policies/Acts/By-Laws**

The existing policies/acts/by-laws of the Country regarding supervision of the Banks and Financial Institutions also affect the supervisory role of the concerned authority. These policies clearly spell out the terms and conditions regarding the supervision. Thus, supervision policies/acts/by laws directly affect the supervisory role of the Central Bank.

- **No. of Supervisors**

The more the number of supervisors in Central Bank, the easier it is for the supervisors to keep track of the activities of the Banks and Financial Institutions. Thus, the no. of supervisors directly affects the supervisory role of the Central Bank.

2.7 Bank Supervision in Nepal

Pradhan (2062) in NRB Golden Jubilee Publication points out that supervision of banks and financial institution is one of the prime responsibilities of the supervisory authority. Effective supervision of these institutions is an essential component of a strong economic environment. The task of supervision is to ensure that banks operate in a safe and sound manner and that they hold capital and reserves sufficient to support the risks that arise in their business. Strong and effective banking supervision contributes in enhancing effective macroeconomic policy along with financial stability in any country. While the cost of banking supervision is high, the cost of poor supervision has proved to be even much higher. Banks are supervised in order to achieve both long term financial stability and sector efficiency. This is done through the promotion of safe and efficient banking practices and institutions-to support sound private business development and meet individual bank customer needs. A weak regulatory framework and poor supervision provide grounds for inefficient and unsafe banking practices, which increase the risk of bank failure.

Preventing systemic risk, protecting small depositors and containing financial crimes are concrete steps in attaining these objectives. They require that the supervisors enforce fundamental discipline in the banking system with the support of well-crafted laws and regulations and the presence of strong in-house supervisory expertise. Like most banking supervisory authorities all over the world, at the backdrop of the inspirations of the above mentioned supervisory motives, Nepal Rastra Bank (NRB) has adopted a two-prong approach to monitor and supervise the financial health of the financial institutions under its purview through off-site surveillance and on-site inspections.

Nepal Rastra Bank Act 2001 ensures whether commercial banks are operating prudentially and complying with regulatory requirements. The ultimate objective of the supervision lies in the protection of the depositors' interest. Nepal Rastra Bank is heading towards successful implementation of Basel II in our country. For this we have already formed an accord implementation group for proper analysis and formulation of necessary directives. This will again enhance our strength in the course of supervision.

NRB Supervision mainly adheres to following key operating principals to guide its processes:-

a) Compliance-Based Supervision

The compliance-based supervision approach essentially stresses the monitoring of bank compliance for enforcement of the regulatory provisions relevant to bank operations and management. This approach refers to the past condition of the bank with the objective of obtaining assurance that the bank is operated and managed properly in compliance with prudential banking principles.

b) Risk-Based Supervision

Risk-Based supervision is a process by which the risks facing each supervised bank is analyzed and an appropriate supervisory strategy is developed. The supervisory strategy is customized to each bank, thereby avoiding the rigid supervisory processes. Risk-focused supervision relies heavily on internal risk management processes. Those banks with a demonstrated ability to identify, measure, monitor and control the risk of financial loss will receive a reduced level of regulatory scrutiny during offsite financial analysis and compliance review. Reduced regulatory scrutiny may include infrequent examinations and minimal or no transaction testing and reduced application information and processing time requirements.

c) Integrated Overall Supervision

Integrated supervision is the coordinated implementation of one or combination of supervisory activities among all supervisory functions in order to make the best possible decisions. There are various approaches taken by NRB under it, for example, on-site supervision, off-site supervision, compliance based supervision, risk based supervision, etc.

d) Coordinated Supervision within the Department

Bank Supervision Department has onsite and offsite divisions. On site inspection report is reviewed during annual offsite review and the offsite review is taken as supplementary to the onsite supervision. There are other separate departments for the supervision of Banks, Development Banks, Finance Companies, Micro-Finance, etc.

e) Service and Outreach

Bank Supervision Department is committed to providing the best quality service possible. One means by which it will pursue this goal is by making resources available to the banking industry as many ways as possible: through participation in industry gatherings and presentations offered to industry representatives, and by making division staff available on a consulting basis. This department recognizes customer service as a key in its ultimate goal of excellence in supervision.

f) Open and Honest Communications

Bank Supervision Department believes that open and honest communication is an important part of the supervisory process. As a part of these communication means' we are committed to providing banking industry with the best professional guidance and assistance possible. Informal contacts with commercial banks and industry associations are encouraged as a means by which to respond promptly to issues and development.

g) Reduced Regulatory Burden

Bank Supervision Department believes that the public interest in a stable and efficient financial system is best served by minimizing the regulatory burden that is placed on the industry. The degree and regulatory burden is based on the financial soundness of each individual bank.

h) Use and Understanding of Technology

Bank Supervision Department recognizes the value of technology as applied in the supervisory framework. Among other applications, management and staff are committed to employing technology to monitor the condition and operation of supervised commercial banks to the greatest possible extent.

i) Professional and Technical Competence

Bank Supervision Department actively encourages the development of professionalism and technical competence among its staff. The combined effect of personal contact with banks between examination and the quarterly review and analysis of CAMELS results will undoubtedly improve our staff's ability to assess and supervise the condition of any particular bank. It is also our goal for the quarterly financial analysis to foster a closer and more personal working relationship with each bank.

Banking supervision should foster an efficient and competitive banking system that is responsive to the public need for good quality financial services at the reasonable cost. It should be recognized that there is a trade-off between the level of protection that supervision provides and the cost of financial intermediation. But however, supervision cannot and should not provide an assurance that the banks will not fail. In a market economy, bank failures are a part of risk taking. Such matters cannot be the responsibility of the supervisors. But however, they should have in place adequate arrangements for resolving problem bank situation. For strengthening effective supervision certain infrastructure elements are of paramount significance. Where such elements do not exist, supervisors should seek to persuade their government to put them in place. It is very essential that the licensing process establishes the same high standards as the process of ongoing supervision which is very much lacking in the context of NRB supervision.

Similarly, there is some lacking in the foundation necessary to achieve a sound supervisory system in our context. The existing supervisory systems have not been able to take into account the nature of and risks involved in the local banking market. The systems do not consider the extent it needs to supplement international standard with additional requirements to address particular risks and general conditions prevailing in its own

market. Furthermore, the dynamic functions of banking supervision in our context have not been able to match up with changes in the market place. Hence, it has been essential for strengthening NRB supervision that supervisors must be prepared to reassess periodically their supervisory policies and practices in the light of new trends or developments. There are certain preconditions necessary for effective banking supervision.

Those prerequisites include:

- i) Sound and sustainable macro-economic policies.
- ii) A well-established and developed public infrastructure.
- iii) Effective market discipline.
- iv) Procedures for effective and efficient resolution of banking problems.
- v) Appropriate level of systemic protection.

Hence in order to strengthen the supervisory capability of the Bank and to ensure the financial stability and to ensure healthy financial sector development in Nepal, a stronger and more effective central bank is essential. Proper banking supervision is particularly important to ensure prudent banking practices to help develop healthy financial intermediation which can support the growth of the economy. For this purpose, it is very pertinent that we have a glimpse at the core principles of effective supervision. They are stated in 7 different groups hereunder.

2.8 Directives of Nepal Rastra Bank

Nepal Rastra Bank being the central bank of Nepal issues directives to various financial institutions including commercial banks. Recently, Nepal Rastra Bank has categorized all the financial institutions of the country as Class A, B, C or D depending upon the required capital and the kind of operations institutions perform. Commercial banks fall under Class 'A' financial institution.

With the changing nature of the financial scenario of the country as well as globally, Nepal Rastra Bank modifies the issued directives so that it is in accordance to the prevailing standard practice internationally. The donor agencies such as World Bank and International Monetary Fund also enforce certain modifications in the directives.

The stringent regulations set by Nepal Rastra Bank are regularly and strictly monitored by the Central Bank thereby maintaining a healthy financial picture of the country as well as safeguard the deposits of the general public.

Bajracharya (2001) points out that Nepal Rastra Bank issues directives that broadly covers four important areas viz.

- Foreign Exchange
- Directives relating to banking regulations and prudential norms
- Credit Information Bureau
- List of formats and tables

Out of these four broad categories the one that interests most is the directives relating to banking and regulations and prudential norms. Nepal Rastra Bank issues 10 directives under this category. This research focuses mainly in the first two directives of this category. The directives are as follows.

2.8.1 Directive No. 1: Capital Adequacy Norms

Maintenance of Minimum Capital Fund

Commercial banks or Class ‘A’ Financial Institutions need to maintain the prescribed proportion of minimum capital fund on the basis of the risk weighted assets. As per the directives issued by the Central Bank, the banks need to follow the time table:

Based on its risk-weight assets, a licensed institution shall have to maintain the following capital adequacy ratio: -

Table 2.1: Minimum Capital Fund to be maintained

Institution	Minimum capital fund to be maintained based on the risk-weight assets (percent)	
	Core capital	capital fund
"A" Class	6.0	10.0
"B" and "C" Class	5.5	11.0
"D" class	4.0	8.0

(Source: Unified Directives of NRB, 2011).

Capital of Commercial Banks

For the purpose of Capital Fund, the capital of the bank is divided into two components; Core Capital and Supplementary Capital.

Core Capital:

Core Capital of commercial banks includes:

- a. Paid up capital (ordinary share)
- b. Proposed bonus share
- c. Share premium
- d. Irredeemable preference shares
- e. General Reserve Fund
- f. Accumulated Profit/loss
- g. Capital Redemption Reserve
- h. Capital Adjustment Fund
- i. Calls in advance
- j. Other free reserves

The amounts in the following heads shall be deducted while calculating core capital:-

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

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

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

- f. The amount of purchasing of land and houses for self purposes not abiding by Directives of this Bank.
- g. The amount invested in residence, buildings construction and land development exceeding the limit.
- h. The share underwriting not could be sold within the prescribed time-limit.

Supplementary Capital:

Supplementary Capital of commercial banks includes:

- a. Provisions for general loan loss
- b. Assets Revaluation Fund
- c. Hybrid capital instruments
- d. Unsecured Subordinated term loan
- e. Exchange Equalization Fund
- f. Investment Equalization Fund

The Capital Adequacy Ratio (CAR) is calculated by dividing eligible regulatory capital by total risk weighted exposure. The total risk weighted exposure shall comprise of risk weights calculated in respect of bank's *credit, operational and market* risks. To calculate *Credit Risk*, Simplified Standardized Approach (SSA), has been prescribed in the initial phase.

In order to be consistent with the Basel-II framework, the credit risk for the regulatory capital purpose shall be computed by segregating the exposure in the following 11 categories.

- a) Claims on government & central bank
- b) Claims on other official entities
- c) Claims on banks
- d) Claims on corporate & securities firms
- e) Claims on regulatory retail portfolio
- f) Claims secured by residential properties
- g) Claims secured by commercial real state
- h) Past due claims

- i) High risk claims
- j) Other assets
- k) Off balance sheet items

For calculating *operational* risk, Basic Indicator Approach (BIA) is followed. Under the basic indicator approach, banks must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted alpha) of positive annual gross income.

The capital charge for operational risk may be expressed as follows:

$$K_{BIA} = [\sum (GI_{1..n} \times \alpha)]/N$$

Where:

K_{BIA} = capital charge under the Basic Indicator Approach

GI = annual gross income, where positive, over the previous three years

N = number of the previous three years for which gross income is positive

α = 15 percent.

Source < <http://www.garp.org> >

Operational risk-weighted assets are determined by multiplying the operational risk capital charge by 10 (i.e., the reciprocal of the minimum capital ratio of 10%) and adding together with the risk weighted exposures for credit risk.

The effects of other forms of market risk are minimal. Thus, a net open position approach has been devised to measure the capital requirement for *market* risk. As evidenced by its name, this approach only addresses the risk of loss arising out of adverse movements in exchange rates.

For capital adequacy purposes, banks should calculate their net open position in the following manner:

- a. Calculate the net open position in each of the foreign currencies.
- b. Convert the net open positions in each currency to NPR as per prevalent exchange rates.
- c. Aggregate the converted net open positions of all currencies, without paying attention to long or short positions.
- d. This aggregate shall be the net open position of the bank.

Risk-weighted assets in respect of market risk are determined by multiplying the capital charges by 10 (i.e., the reciprocal of the minimum capital ratio of 10%) and adding together with the risk weighted exposures for credit risk.

The format for preparing capital adequacy ratio and risk-weighted assets is shown in the appendix.

2.8.2 Directive No. 2: Loan Classification and Provisioning Norms

Clause 1:

Classification of outstanding loans and advances on the basis of aging

The loans and advances of a commercial bank shall be classified on the basis of aging of the principal amount.

Clause 2:

Classification of Loans and Advances

As per the directives issued by NRB, all loans and advances of the banks need to be classified into the following four categories:

- Pass Loan
- Sub-Standard Loan
- Doubtful Loan
- Loss

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

- (a) Pass: Loans/advances which have not overdue and which are overdue by a period up to three months.
- (b) Sub-standard: Loans/advances which are overdue by a period from three months to a maximum period of six months.

(c) Doubtful: Loans/advances which are overdue by a period from six-months to a maximum period of one year.

(d) Loss: Loans/advances which are overdue by a period of more than one year.

The loans which are in pass class and which have been rescheduled/restructured are called as "the performing loan, and the sub-standard, doubtful and loss categories are called non-performing loans.

Additional arrangement in respect of Pass Loan

Loans and advances fully secured by gold, silver, fixed deposit receipts and HMG securities shall be included under "Pass" category. However, where collateral of fixed deposit receipt or HMG securities or NRB Bonds is placed as security against loan for other purposes, such loan has to be classified on the basis of aging.

Additional arrangement in respect of Loss Loan

Even if the loan is not past due, loans having any of 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
- The borrower has been declared bankrupt
- The borrower is absconding or cannot be found
- Purchased or discounted bills are not realized within 90 days from the due date
- Owing to non-recovery, initiation as to auctioning or the collateral has passed six months and if the recovery process is under litigation
- Loans provided to the borrowers included in the blacklist and where the Credit Information Bureau blacklists the borrower

Additional arrangement in respect of Loss Loan

The classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

Relating to Collateral

The collateral used by the bank to back up the loans and advances need to be adequate enough to cover up the principal and interest amount in the event of non-realization of the principal and the interest amount.

Provisions Relating to Rescheduling and Restructuring of Loans

(1) In case a licensed institution is convinced on the following bases stated in the written action plan submitted by the debtor, it may reschedule or retract the loan: -

- (a) Evidence showing that documents relating to loans and security are adequate;
- (b) Bases on which the licensed institution is convinced of the possibility that the rescheduled or restructured loans would be recovered;

(c) In addition to submission of written plan of actions for rescheduling and restructuring loans at least 25 percent of the interest due to be paid until the date of rescheduling or restructuring of such a loan has been paid;

(2) While rescheduling or restructuring the loans to the industries which have been recommended by the Sick Industries Preliminary Inquiry and Recommendation Committee formed under Government of Nepal, a minimum of 12 percent of interest has to be paid, other procedures need to be fulfilled and rescheduling and restructuring shall have to be carried out making a provision for twenty-five percent loan loss.

Provided that in the event where the loan has been rescheduled and restructured based on payment of less than 12 percent of interests, provision for loan loss has to be made based on the duration upon expiry of the deadline according to the prevailing provisions.

"Rescheduling" means the process of extending the time limit of repayment of the loan availed by the customer.

"Restructuring" means the process of changing the nature or terms and conditions of altering the restrictions on or changing the time limit of the credit facilities (Unified Directives of Nepal Rastra Bank, 2010).

Loan Loss Provisioning

The loan loss provisioning, on the basis of the outstanding loans and advances and bills purchases is classified as follows:

Table 2.2: Loan Classification & Provision

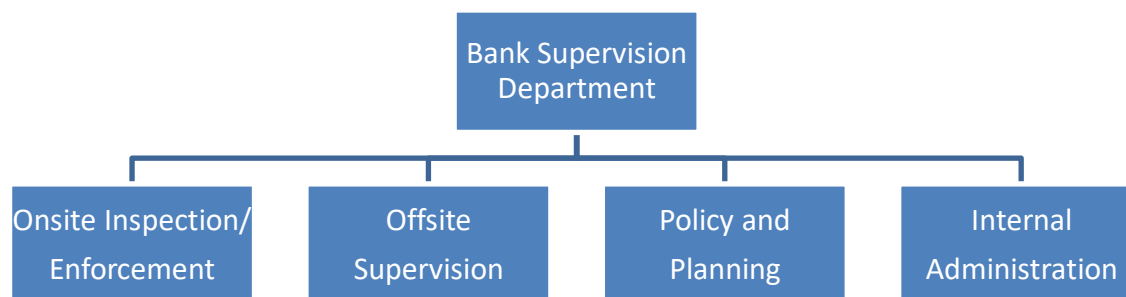
Classification of Loan	Loan Loss Provision	
Pass	1 Percent	General Loan Loss Provision
Sub Standard	25 Percent	Specific Loan Loss Provision
Doubtful	50 Percent	
Loss loan/the loan extended to blacklisted persons, firms, company or corporate body	100 Percent	

(Source: Unified Directives issued by NRB, 2068)

2.9 Organization of Bank Supervision Department

In order to discharge its obligations effectively, Bank supervision Department has divided its function into various divisions and units. The department comprises of onsite inspection/enforcement division, off-site supervision division, policy and planning unit and internal administration unit. Besides these, there are various projects in operation in the department relating to Basel II implementation and monitoring and surveillance of problematic banks.

Figure 2.2: Organization of Bank Supervision Department



2.9.1 Responsibility of Divisions and Units of the Bank Supervision Department

Onsite Inspection/Enforcement

This division is responsible to conduct the on-site examination of the banks in accordance with the annual plan of the department. The onsite examination can be a regular full scope corporate level examination or a targeted special inspection or even a follow up inspection. In order to create a flexible working structure, with an ability to respond quickly to the changes in the banking environment, the responsibility of the onsite examination and the enforcement has been designated to the same team. What it implies is, the same group of personnel responsible for conducting on-site examination is also responsible for ensuring that the directions of Nepal Rastra Bank are adhered to by the banks. However, the banks being examined and enforced might be different.

Off-site Supervision

This division carries out the off-site surveillance of all the commercial banks, operating in Nepal. The core objective of this function is to conduct periodic financial review of the banks in order to identify the potential problems and to gauge the compliance to prevailing laws and statute as well as to support the on-site function of the department. In order to pursue its objectives through systemic development, the Department has devised an off-site supervision manual which has been put into effect. The supervision manual provides guidelines on the objectives, procedures and prescribed documents of the off-site supervision.

Policy and Planning

This unit of the department is responsible for the formulation and periodic review the annual plan of the department, in context with the practices of the international supervisory agencies. This unit is also responsible for coordinating the interaction programs, seminars, and workshops in issues relevant to the supervision function, with participation from the external stakeholders, as well. The supervisory function of Nepal Rastra Bank is in the stage of evolution and thus it is crucial that a relation with international supervisory agencies be maintained. This relationship is likely to bring into the fore new techniques and developments in the field of supervision. The policy and planning unit is entrusted to maintain such relationship and to notify the department of new developments in the international arena, on a periodic basis.

Internal Administration

There is a separate internal administration unit within the Bank Supervision Department. The unit is responsible for the personnel related matters like placement within the department, leave records, payment of salaries and other benefits. This unit also overlooks the supply of office equipments and stationery in the department in liaison with the General Services Department of NRB. (Annual Bank Supervision Report of NRB, 2009/10).

Narayan, A. and Ghosh, S. (2008) view that supervision could be carried out by one agency for systemic stability, a second for prudential supervision and a third for consumer protection and conduct-of-business considerations. Bajracharya (1989) in his dissertation has observed that NRB should encourage the CBs to extend long term credit in addition to the short and medium term credit so that the amount of credit will increase on one hand and large industries will established on the other. If the CBs find their resources inefficient for invest, raising interest rate on deposits should collect more deposit. However, in the present change context the CBs have invested for fairy long term. Due to the liberal economic policy followed by NRB, interest rates are fixed by market mechanism. There is also high liquidity in the market and banks also have increased their NPA in their Balance Sheet year by year.

Shrestha (1975) in her thesis has observed that the CBs are still following their traditional lending policies. They extended the loans on the basis of securities. But the people in our

country are unable to provide sufficient securities that calls for the need for NRB to improvise traditional lending policies. At present, CBs are offering a variety of credit model or schemes to the rural poor people viz. Small farmer Development Program, Intensive Banking Program, Banking with Poor, Grameen Bank Financial System, Deprived Sector Credit etc. through group securities. This proves NRB has already made an effort to avail credit the people without precious securities. In this context the program of getting loan due to lack of securities seems the secondary problem. While the lack of education and a proper banking habit among the people is the most important one. This is how the studies of the past are not so relevant in this changed context. This present study is carried out to fill the gap arisen out of changed with updated information.

Shrestha (2052) in his article “The Role of NRB in Reference to the CBs”, has clearly viewed that all the CBs branches and financial institutions are established only in urban areas from where the huge population living in rural areas cannot get any banking facilities on one side and on the other the higher number of institutions established in urban areas are facing caught throat competition which may lead to the question of their existence. He has viewed that CBs should establish branches as per need of the nation. He has emphasized that appropriate policy to establish branches in the rural areas should be followed. CBs and the financial institutions carrying similar functions should not be allowed to establish in close areas. Goodhart (2000) argues that supervision should be organized around the two purposes of systemic stability (prudential supervision) on the one hand and customer protection.

Above studies were conducted in an atmosphere of controlled regime. Presently, CBs enjoy much freedom in their operation. The findings of above studies may indicate certain aspect of the expansion of branch of CBs, but are not relevant to our study. Prior to 1990, certain policies of NRB on banking development scheme, interest subsidy, interest free loan, and loss compensation policy were in existence. They were in specific boundaries before the liberalization, which could not be incorporated, in the foregoing studies. The present study focuses on the policies of NRB in commercial banking development after liberalization. Thus, the present study is more relevant than the above studies & following two studies are also more related in the present context. Kalathoki (2000) in his dissertation has concluded that NRB's role in the banking development in the country has not been effective. His major suggestions were focused on increasing bank deposits through insurance schemes; worker's saving scheme and NRB's role to persuade banks to

maintain the spread gap of 5%. Further, the provisions of loss compensation scheme and interest free loan to the newly established CBs in remote areas were optioned to be beneficial. Also, there should be regular meeting & communication with the banks to sort out the problems and to make programs successful.

Pandey (2002) recommended in his dissertation that observation and supervision both on-site and off-site by NRB to the directives are properly and fully followed by banks.

The monitoring aspect has been strengthened by various types of penalties laid down by NRB for the non-compliance of the directives. He further recommended to NRB are:

- i. The new directives of NRB are very good and meet the international standards. They will become irrelevant if they are not implemented properly. His study has been observed that the CBs have been raising questions on the timing of the directives and NRB believes that they are making excuses out of this. In this context, his study strongly recommended to NRB to hold meeting with the CBs and listen to their complaints. If the complaints are relevant and acceptable, the directives have to be amended so that they become implementable or else, convince the CBs that such complaints have no meaning and that NRB is right.
- ii. Also, NRB should not only issues directives for the sake of issuing them but a proper analysis needs to be done to combat the problems associated with the directives. It should not happen like the directives related to L/C, where prior study was not done and within a few days of the issuance of the directives, they had to be amended.
- iii. NRB has to strengthen the functioning of its CIB so that the CBs receive the details of the blacklisted borrowers in quick time. This will reduce chances of creating bad quality assets on their BS.
- iv. NRB should be more practicable while issuing the directives. The directives should not be issued to meet the international standards only but also, they need to be applicable in the context of Nepal and it should try and avoid ambiguity in the directives, which are found there in the present directives. It should come up with the straightforward directives leaving no loopholes that can be manipulated.

Financial arena needs to know the key elements that need to be supervised and the role of central bank in doing so effectively. Banks are generally associated with different types of risks and they have to be aware of such risks for many reasons including the supervisory requirement of the Central Bank. The Central Bank as well as the commercial banks also needs to know the globally practiced process of Supervision framework. The Bank of England, the first central bank of the world through the Centre for Central Banking Studies publishes handbooks from time to time aiming at different sectors of the economy. Ware (1996) further explores some basic principles of banking supervision. First of all, it addresses the general question of why banks need to be supervised, and sets out the basic aims of supervision. One has to see if NRB has the same aims when it comes to supervising the commercial banks. The book then examines the nature of banking risks. Next, the key areas of prudential supervision are discussed – namely, capital adequacy, liquidity, asset quality, risk concentration, management and systems and controls. Banks and their activities are generally subject to much closer official supervision than other kinds of businesses; the reason lies in their role and nature. The discussion on the roles and nature of banks shall justify the much closer and in depth supervision of the banks. Information provided by banks to the central bank play vital role for the purpose of evaluation and analyzing the economic, monetary and financial activities of the nation. Directives issued by the Nepal Rastra Bank (NRB) from time to time require the banks to submit various statistical returns to NRB at various time intervals.

<<http://www.kantipuronline.com>>

According to Mahat (2007), Banks raise resources mainly by accepting deposits from public. The depositors, especially retail depositors, cannot effectively protect themselves, as they cannot collect much information on the operations of the bank. Even if they collect the information, most of them cannot analyze and interpret it properly. It will also be impossible for the depositors of a bank to coordinate with each other in order to protect their interest. Business conducted by banks usually looks obscure to the outsiders. It is widely believed that instability of one bank would have contagion effect in the economy of a nation. Therefore, inspection and supervision department of NRB has high degree of oversight in the banking sector. Norms regarding submission of information by the banks and financial institutions to NRB are meant for ensuring good corporate governance, transparency, protection of the interest of depositors, and analyzing the economic, monetary and financial activities of the nation. Although it is the duty of banks to submit

statistical returns and other information demanded by NRB on time, NRB was experiencing difficulty in timely collection of such information and returns. To ensure the compliance of norms, the regulators should have a legal mechanism to ensure compliance of its regulations. They should also have recourse available if their regulations are not followed or violated. In this context, Banks and Financial Institutions Ordinance, 2006 has introduced the imposition of severe penalties to the errant banks and their office-bearers. This provision is expected to improve the information efficiency of banks and financial institutions.

2.10 Supervision Practices in Different Countries

In India, The Banking Regulation Act, 1949 empowers the Reserve Bank of India to inspect and supervise commercial banks. For dedicated and integrated supervision over all credit institutions, i.e., banks, development financial institutions and non-banking financial companies, the Board for Financial Supervision (BFS) was set up in November 1994 under the aegis of the Reserve Bank of India. <<http://www.rbi.org.in>>

Hall (2002) cites in the Article 'Banking Regulation and Supervision in Japan' that under the supervisory reforms of June 1998, a new supervisory body, the "Financial Supervisory Agency" (FSA), was created. Acting as an agency under the Prime Minister's office, and hence independent of the MoF, it assumed the roles of licensing, inspection and supervision (of banks, securities firms and insurance companies) previously performed by the MoF. Budnevich (1998) states in the article 'notes on banking supervision and regulation in Chile' that the supervisory agency in the banking sector of Chile is the Superintendency of Banks and Financial Institutions (SBIF). In Italy, the Banking Supervision Department is entitled to supervise the Banks and Financial Institutions there (Circular 263 of 27 December 2006, new regulations for the prudential supervision of banks).

2.11 New Licensing Policy for Commercial Banks

Until the mid-1980s, Nepal financial sector was dominated by two large government-owned CBs (RBB and NBL), and competition in the financial system was enhanced only

after the entry of three joint-venture banks (Nepal -Arab Bank Ltd., Nepal -Indosuez Bank Ltd., and Nepal -Grindlays Bank Ltd.). As of mid-Jan 2009, 25 CBs existed in the country.

While forming its licensing policy, the NRB has given emphasis on policy issues rather than administrative control measures and has granted operating licenses to CBs that fulfill its policy criteria. A study undertaken in 1995 A.D. by the NRB, for instance, suggested that, there was growing concentration of CBs inside the Ktm. Valley, incentives in the form of lower paid-up capital should be provided to those banks that set up their head offices outside the Ktm. Valley. The NRB has been emphasizing on such types of policy - oriented issues in the licensing of CBs with the primary objective of promoting efficient intermediation by financial institutions through increased competition. In this regard, a new licensing policy for opening CBs was made effective from 18th May 2002. The main features of the policy are given below.

Paid – Up Capital

1. New CBs set up at the national level are required to have a minimum paid up capital of Rs. 2.0 billion.
2. Permission would be granted to set up a national level commercial bank with the head office in Ktm. Valley provided that it is a joint venture with foreign bank or foreign financial institution or it had a technical service agreement (TSA) with such a bank or financial institution for at least three years.
3. The banks under operation and the banks already possessing operating licenses were required to extend their paid up capital to Rs. 2.0 billion by mid-July 2009. The paid-up capital should be increased by 10% every year up to FY 2008/09. The banks to set up with participation of the foreign banks would be registered by fulfilling the legal formalities as per the Nepalese law.
4. The banks established outside the Ktm. valley would be permitted to operate in the Ktm. valley and all over the country provided that they performed satisfactory for at least three years, subsequently extended its paid-up capital to Rs.2 billion, and complied with all the other prescribed terms and conditions. These banks will not be permitted to open any types of office in the Ktm. Valley unless they are allowed to function there.

5. A minimum of 20% of the total share capital committed by the promoters need to be deposited with the application and another 30% after receiving the letter of intent at the interest-free account of the NRB. The bank should start operations within a year of receiving the letter of intent. The remaining amount agreed upon by the promoters would be paid within four months of the date of application whether to grant permission to set up the bank or not. If the decision is taken not to the establishment of bank, the NRB would present a written clarification to the applicant specifying the reasons (Unified Directives of NRB, 2011).

CHAPTER III

RESEARCH DESIGN AND METHODOLOGY

3.1 Research Design

This section contains the information about the methodological issues used in the process of the study. It focuses on tools and techniques used in the research process. The chapter consists of entire research process including formulating research questions, research design, population and sampling procedure, data collection procedure and data analysis procedure. It is important to discuss jointly about NRB and its commercial banking policies. For this purpose descriptive as well as analytical research design has been followed. Secondary data collected for the purpose of the study have been systematically analyzed.

3.2 Source of Data

This study is primarily based on the secondary source of data. So, the necessary data for the study are collected mainly from the concerned commercial banks. The study is concerned with the supervisory role of NRB. For this purpose, commercial banking statistics, annual reports, quarterly economic bulletins published by the NRB, the commercial banking bulletins published by the selected CBs are used. Other secondary source of information compiled from the Bank & Financial Institution Regulation Department of NRB, previous studies and reports, Journals and other published & unpublished related documents are the basic data source. A separate bibliography presented at the end would give a full idea of the sources consulted for this study.

3.2.1 Data Collection

The study uses only one major source of data which is the secondary data. The study is based only on the secondary data. Books on central banking publication of the NRB and many others related materials had been studied. The collected data are arranged systematically in the particular tabular form according to the need of the study.

Likewise, for the purpose of the study, data is also taken in an unstructured manner, discussion among the employees of NRB, and related commercial banks. The purpose of such interviewing was to drive primary information regarding their attitude towards existing policy. The decision made from the informal meeting, discussions and seminar held with other national and international financial community is also included in the study.

The research also refers various other sources of secondary data. The major sources of secondary data are as follows:

- Supervision Department of Nepal Rastra Bank
- Regulation Department of Nepal Rastra Bank
- Directives of Nepal Rastra Bank
- Published Audited financial report of NIC Bank.
- Published Audited financial report of NCC Bank.
- Published Audited financial report of Nepal Bank.
- Published Audited Financial Reports of Agricultural Development Bank
- Published Audited Financial Reports of Lumbini Bank
- Published Audited Financial Reports of Kumari Bank
- Published Audited Financial Reports of Nepal SBI Bank
- Published Audited Financial Reports of Everest Bank
- Published and unpublished bulletins, reports of Nepal Rastra Bank
- Published studies, reports and articles of various authors
- Journals and other published and unpublished reports from Shanker Dev Campus Library, Securities Exchange Board of Nepal Library and Nepal Rastra Bank Library
- Thesis, research of various past students of Tribhuvan University
- Website of Nepal Rastra Bank
- Website of Bank of International Settlements
- Various other websites and periodicals

3.3 Description of the Sample

Out of total 31 Commercial Banks currently working in the Nepalese Banking System, the study focuses only on eight banks – Agricultural Development Bank Ltd., Nepal Bank Ltd., Nepal SBI Bank Ltd., Everest Bank Ltd., NCC Bank Ltd., Lumbini Bank Ltd., NIC Bank

Ltd., and Kumari Bank Ltd. These banks are basically chosen on the basis of their ownership structure, establishment date which is similar to keep in pair. Two government banks, ADBL and NBL, two Joint Venture Banks, Nepal SBI and Everest, Two Locally owned Private Banks, NIC and Kumari, Two Problematic Banks once declared by NRB, Lumbini and NCC have been selected from among the available which have more than five years published data.

3.4 Validity and Reliability

The purpose of any research is to determine if a theory is supported or not based on statistical analysis. In order for research to be conducted on a theory, it must first be operationalized. To operationalize a theory, all variables must be defined and the methods of conducting the research must be determined. Once this is done, the resulting statement about the relationship is called a hypothesis. The hypothesis is what gets tested in any research study.

Validity refers to the degree in which our test or other measuring device is truly measuring what we intended it to measure. The outcome of this testing is shown in the analysis part of the report.

Reliability is synonymous with the consistency of a test, survey, observation, or other measuring device. Reliability means the test's consistency in output of the report among different administrations. In this report, 'supervisory role of the central bank helps in making banking system effective but with supportive data and information, the statement of the problem can be defined appropriately making the report more reliable.'

In order to make sure that the data is reliable, the correct forms and formats as prepared by NRB have been followed. Such forms are the standards laid out by the BASEL committee and hence, the analysis of the data can be said to be of having reliability and validity at the same time.

In this research, the researcher has practically made full effort to assure that the measurement devices used are both valid and reliable to find out the significant results

3.5 Analysis Plan

In this research, two types of tools are used in order to analyze the collected data. The tools are as follows:

- **Capital Adequacy Ratio**

Commercial banks should hold adequate capital according to safeguard the money of the depositors. NRB has specifically given the minimum required capital adequacy ratios to be maintained by the commercial banks. These ratios are based on the total risk weighted assets of the institution for the same period.

$$\text{Capital Adequacy Ratio (CAR)} = \frac{\text{Core Capital} + \text{Supplementary Capital}}{\text{Total Risk Weighted Assets (TRWA)}}$$

$$\text{Core Capital Ratio} = \frac{\text{Core Capital}}{\text{Total Risk Weighted Assets (TRWA)}}$$

- **Loan Classification and Provisioning**

NRB directives follow classification of loans depending upon its aging. Each loan class must maintain certain percentage of provisioning given in the directive laid down by the Central Bank. Also, the main indicator of Credit position of a bank is given by NPL.

$$\text{Nonperforming loan to Total loan (NPL Ratio)} = \frac{\text{Non Performing Loan}}{\text{Total Loan}}$$

It is to be noted that Non Performing Loan includes sub-standard, doubtful and bad loan including re-structured/re-scheduled loan. The NPL to Total Loan is compared with the standard and as a result, analysis is done whether NRB is taking appropriate actions for the non-compliance or not. NRB directives has laid out that the provision for pass loan should not be more than 1 percent, Sub-standard no more than 25 percent, Doubtful minimum of 50

percent and loss loan to the extent of 100 percent while rescheduling and restructuring, provision of at least 12.5 percent has to be made as loan loss under pass loan.

Similarly, in order to provide a clearer picture of the study the researcher has used statistical tools as well. Data obtained through secondary sources is used in order to perform the percentile analysis of the research.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

This chapter is based on the findings from analysis of secondary data, observation and discussions done with experts of Central Bank and Commercial Banks.

4.1 Directive No. 1: Capital Adequacy Ratio

A Capital of a bank is the sum total of all the contributions made by the shareholders. Total Capital of a bank is the sum of Core Capital and Supplementary Capital.

The Central Bank has assigned risks to various types of assets depending upon its liquidity and risk. Higher weight is given to those assets with high risk and low (longer) liquidity and vice versa. Along with the liquidity and risk, NRB also takes into consideration, various international standards to assign the weight.

Capital Adequacy Ratio is basically the ratio of total capital fund to the total risk weighted assets. The central bank has revised the capital adequacy requirement of the banks over recent years. The rate required for core capital adequacy ratio has been increased from 4.5 percent in the year 2058 to 6 percent in the year 2063 which is currently on implementation. Similarly the rate required for total capital adequacy ratio has increased from 9 percent in the year 2058 to 12 percent in the year 2063 and it has been revised to 10 percent since last 3-4 years. NRB started the implementation of BASEL Capital Accord since Fiscal Year 2065/66 for class 'A' Banks. It should be noted here that the shortfall of supplementary capital can be fulfilled by adding more core capital fund. But, shortfall of core capital cannot be compensated by adding more supplementary capital.

This ratio mainly deals with the asset side of the balance sheet of the commercial banks. In order to compute the Capital Adequacy Ratio, total risk weighted amount (TRWA) needs to be computed first. For calculating the TRWA, both the on-balance sheet assets and off-balance assets need to be considered.

The details of the Capital Fund maintained over various periods of several Banks are as follows:

Table 4.1: Capital Adequacy Ratio of Everest Bank for the period 2062/63-2066/67

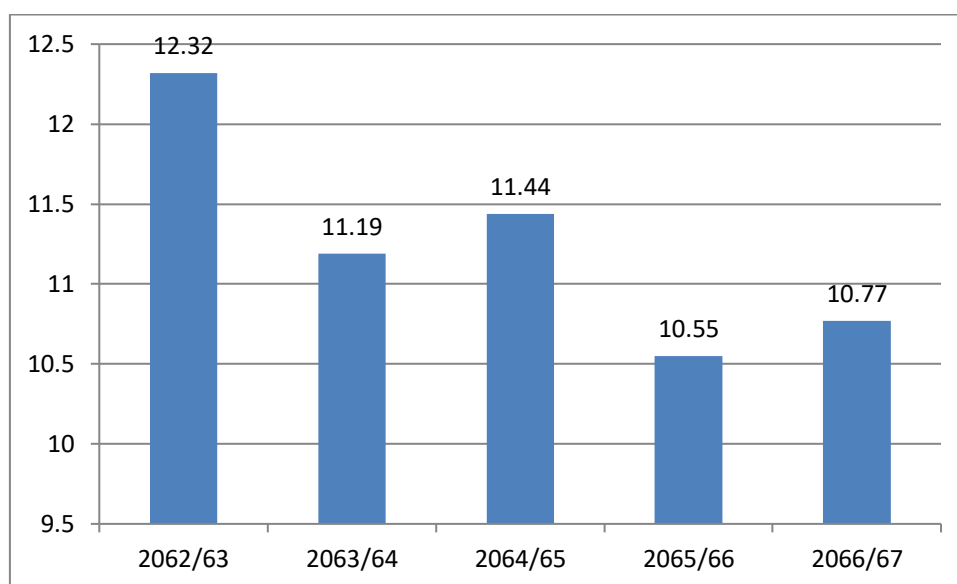
(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	927550	1171133	1900859	1981579	2537092
Supplementary Capital	463789	504982	505197	722291	720049
Total Capital Fund	1391339	1676115	2406056	2703870	3257141
Total Risk Weighted Assets (TRWA)	11291137	14976737	21039879	25619753	30240428
Core Capital to TRWA (%)	8.21	7.82	9.03	7.73	8.39
Capital Fund to TRWA (%)	12.32	11.19	11.44	10.55	10.77
Required Core Capital to TRWA (%)	5.5	5.5	5.5	6	6
Required Capital Fund to TRWA (%)	11	11	11	10	10
Surplus / Deficiency Core Capital (%)	2.71	2.32	3.53	1.73	2.39
Surplus / Deficiency Total Capital (%)	1.32	0.19	0.44	0.55	0.77

(Source: Annual Report of Everest Bank Ltd.)

Since the beginning, Everest Bank has been successfully meeting the minimum necessary core capital adequacy ratio and total capital adequacy ratio. From table 4.1, it can be seen that Everest Bank has surplus capital than needed to oblige with the Central Bank directive. In the fiscal year 2062/63, the bank seems to have enough fund and minimum investment (risk based). But in the next fiscal year, its total risk weighted asset increased from 11291137 thousand to 14976737 thousand. The increment in the risk weighted asset resulted in the decrement of required ratios. But still, the bank has enough capital bases. In the next few fiscal years also the bank seem to become more confident and as a result its TRWA is growing to a larger proportion than its growth in capital thereby further decreasing the capital adequacy ratio, yet the bank is complying with the NRB directives.

Figure 4.1: Capital Fund to TRWA of EBL



As can be seen in figure 4.1, the Capital Adequacy Ratio of Everest Bank for the last five fiscal years has been shown. The Bank has been well maintaining the CAR and is performing satisfactorily.

Table No. 4.2:

Capital Adequacy Ratio of Nepal SBI Bank for the Period 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	964,420	1,145,479	1,394,064	1692371	2430021
Supplementary Capital	278,151	299,322	328,123	319667	304425
Total Capital Fund	1,242,570	1,444,800	1,722,187	2012038	2734447
Total Risk Weighted Assets	9,159,270	10,873,279	13,975,708	16872717	22320356
Capital Fund to TRWA (%)	13.57	13.29	12.32	11.92	12.25
Core Capital to TRWA (%)	10.53	10.53	9.97	10.03	10.89
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Capital Fund to TRWA (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	5.03	5.03	4.47	4.03	4.89
Surplus / Deficiency Total Cap (%)	2.57	2.29	1.32	1.92	2.25

(Source: Annual Report of Nepal SBI Bank Ltd.)

While going through the capital adequacy ratio of the past five fiscal years of Nepal SBI Bank in table 4.2, the Bank also has been maintaining adequate capital adequacy ratio and core capital adequacy ratio. Since the fiscal year 2062/63, it has been maintaining the capital adequacy ratio till the fiscal year 2066/67. The ratio has been decreasing due to the increase in total risk weighted assets of the Bank. The core capital to TRWA has been fluctuating but still the required ratio has been met. The total capital has been surplus by 5.03 percent in the fiscal year 2062/63 and it has been still surplus by 4.89 percent in F/Y 2066/67.

Figure 4.2: Capital Adequacy Ratio of NSBL

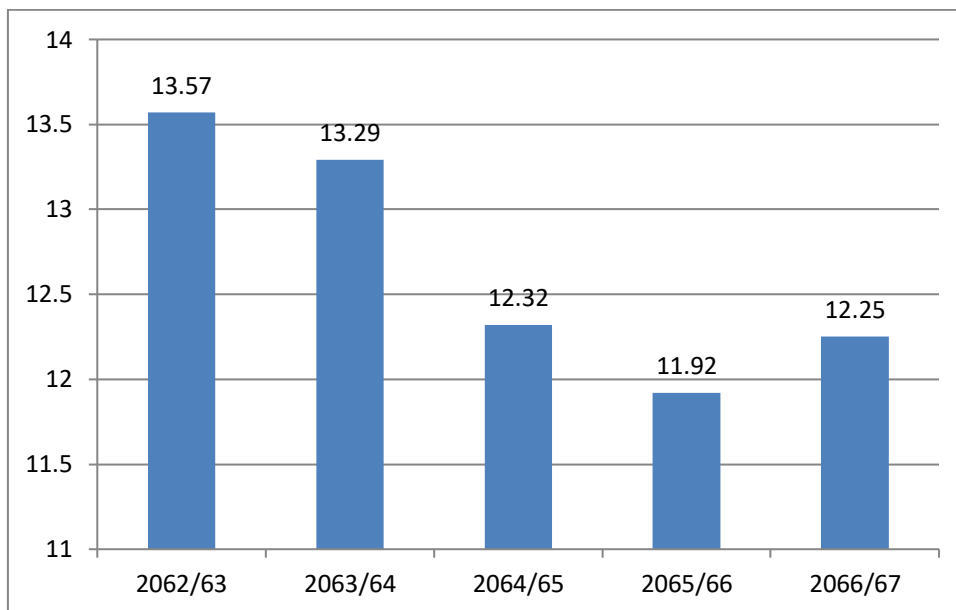


Figure 4.2 shows the capital adequacy ratio of Nepal SBI Bank of the last five fiscal years. The result shows that the Bank has maintained the ratio satisfactorily. Hence, the performance of the Bank is good.

Table No. 4.3: Capital Adequacy Ratio of NIC Bank for the period 2062/63-2066/67*(Rs. in thousands)*

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	761,129	911,807	1,293,750	1,649,007	1,750,459
Supplementary Capital	275,71	296,801	321,969	305,927	260,102
Total Capital Fund	1,036,839	1,208,608	1,615,719	1,954,935	2,010,561
Total Risk Weighted Assets	7,656,131	9,905,036	12,321,131	15,741,613	15,559,349
Capital Fund to TRWA (%)	13.54	12.20	13.11	12.42	12.92
Core Capital to TRWA (%)	9.94	9.21	10.50	10.48	11.25
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Capital Fund to TRWA (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	4.44	3.71	5	4.48	5.25
Surplus / Deficiency Total Cap (%)	2.54	1.20	2.11	2.42	2.92

(Source: Annual Report of NIC Bank Ltd.)

Table No. 4.3 shows the capital adequacy ratio of NIC Bank for the last five fiscal years. The Bank also has been maintaining the required total capital ratio and required core capital ratio. The required total capital has been met by NIC Bank and it was surplus by 2.54 percent in the fiscal year 2062/63. Its capital adequacy ratio has been surplus till the last fiscal year i.e. 2066/67. The required core capital has also been adequate and it has been increasing till the last fiscal years.

The total risk weighted assets has also been increasing but it suddenly decreased in the F/Y 2066/67. As a result, the capital adequacy ratio too increased in the last fiscal year.

Figure 4.3: Capital Fund to TRWA of NIC

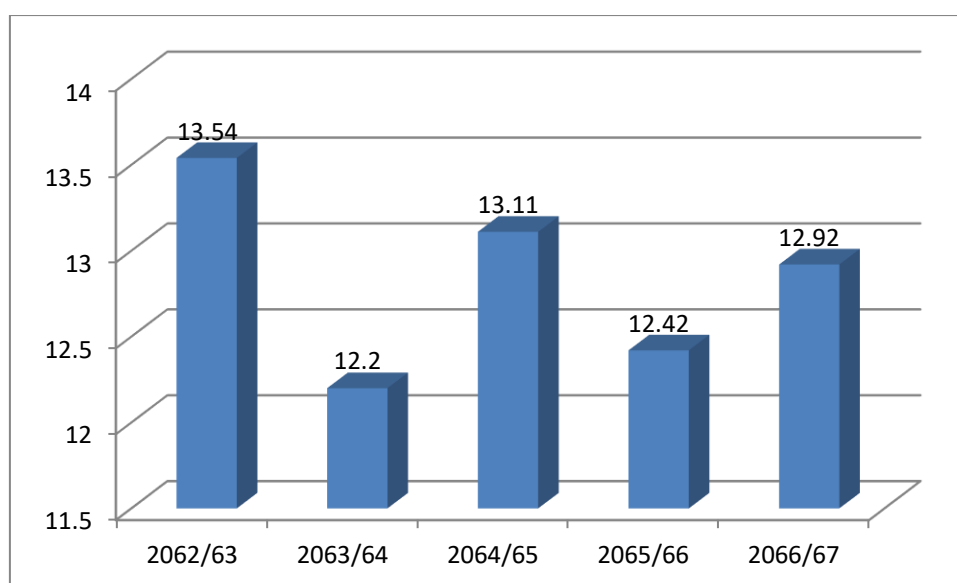


Figure 4.3 shows the capital adequacy ratio of NIC Bank of the last five fiscal years. The bank too has been maintaining the CAR and can be regarded as a good bank.

Table No. 4.4

Capital Adequacy Ratio of Kumari Bank for the period 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	858,520	1,019,893	1,359,032	1,612,799	1,772,135
Supplementary Capital	82,459	95,314	523,894	438,108	352,490
Total Capital Fund	940,979	1,115,207	1,882,926	2,050,908	2,124,625
Total Risk Weighted Assets	7,625,050	9,959,911	13,070,379	17,743,239	17,220,685
Core Capital to TRWA (%)	11.26	10.24	10.40	9.09	10.29
Capital Fund to TRWA (%)	12.34	11.20	14.41	11.56	12.34
Required Core Capital to TRWA (%)	5.5	5.5	5.5	6	6
Required Total Capital to TRWA (%)	11	11	11	10	10
Surplus / Deficiency Core Capital (%)	5.76	4.74	4.9	3.09	4.29
Surplus / Deficiency Total Capital (%)	1.34	0.20	3.41	1.56	2.34

(Source: Annual Report of Kumari Bank Ltd.)

Table No. 4.4 shows the capital adequacy ratio of Kumari Bank of the last five fiscal years. The Bank also has been maintaining the required total capital ratio and required core capital ratio. The required total capital has been met by the Bank and it was surplus by 1.34 percent in the fiscal year 2062/63 and by 2.34 percent in the F/Y 2066/67. Its capital adequacy ratio has been surplus till the last fiscal year i.e. 2066/67. The required core capital has also been adequate and it has been fluctuating but complying with the NRB directives till the last fiscal years. The total risk weighted assets has also been increasing but it suddenly decreased in the F/Y 2066/67.

Figure 4.4: Capital Fund to TRWA of KBL

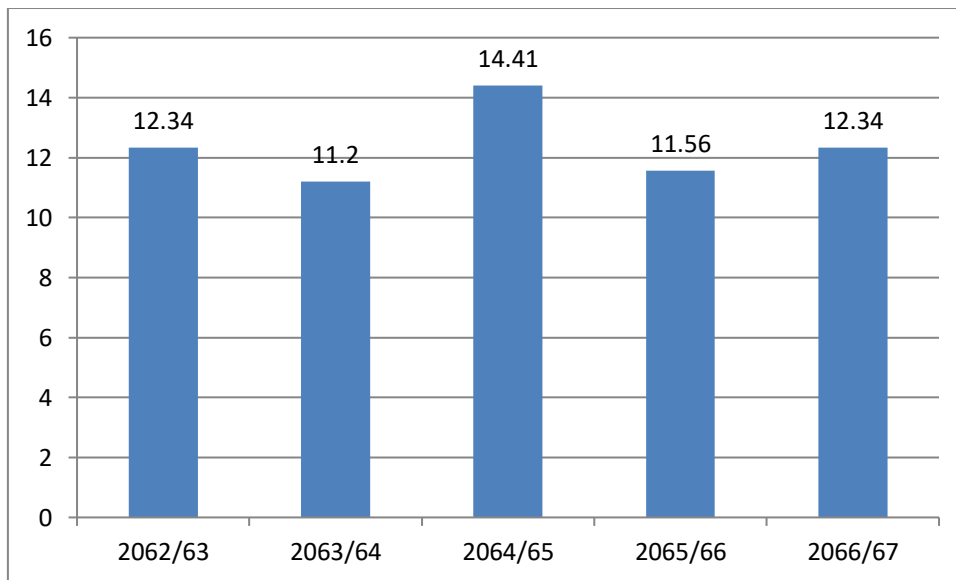


Figure 4.4 shows the total capital to TRWA of KBL for the last five fiscal years. This bank too has been maintaining the standards set by NRB and hence, the Bank has been performing well.

Table No. 4.5**Capital Adequacy Ratio of Nepal Bank Ltd. for the period 2062/63-2066/67***(Rs. in thousands)*

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(6,374,479)	(6,334,739)	(6,325,869)	(5,061,437)	(4,867,051)
Supplementary Capital	520,561	905,454	710,527	-	579,550
Total Capital Fund	(5,853,918)	(5,429,286)	(5,615,342)	(5,061,437)	(4,287,501)
Total Risk Weighted Assets	18,244,940	19,511,273	22,957,432	36,305,751	43,726,247
Capital Fund to TRWA (%)	(32.09)	(27.83)	(24.46)	(13.94)	(9.81)
Core Capital to TRWA (%)	(34.94)	(32.47)	(27.55)	(13.94)	(11.13)
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Capital Fund to TRWA (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(40.44)	(37.97)	(33.05)	(19.94)	(17.13)
Surplus / Deficiency Total Cap (%)	(43.09)	(38.83)	(35.46)	(25.94)	(19.81)

(Source: Annual Report of Nepal Bank Ltd.)

Table No. 4.5 shows the capital adequacy ratio of Nepal Bank of the last five fiscal years. The Bank has not been maintaining the required total capital ratio and required core capital ratio. The required total capital has not been met by the Bank and it was deficit by 43.09 percent in the fiscal year 2062/63 and by 19.81 percent in the F/Y 2066/67. This is due to the cumulative loss that the Bank had been achieving before. Its capital adequacy ratio has been deficit till the last fiscal year i.e. 2066/67. The required core capital has also been inadequate although the deficit capital has been declining through the fiscal years and hence not complying with the NRB directives till the last fiscal years. The total risk weighted assets has also been increasing till the F/Y 2066/67.

Figure 4.5: Capital Fund to TRWA of NBL

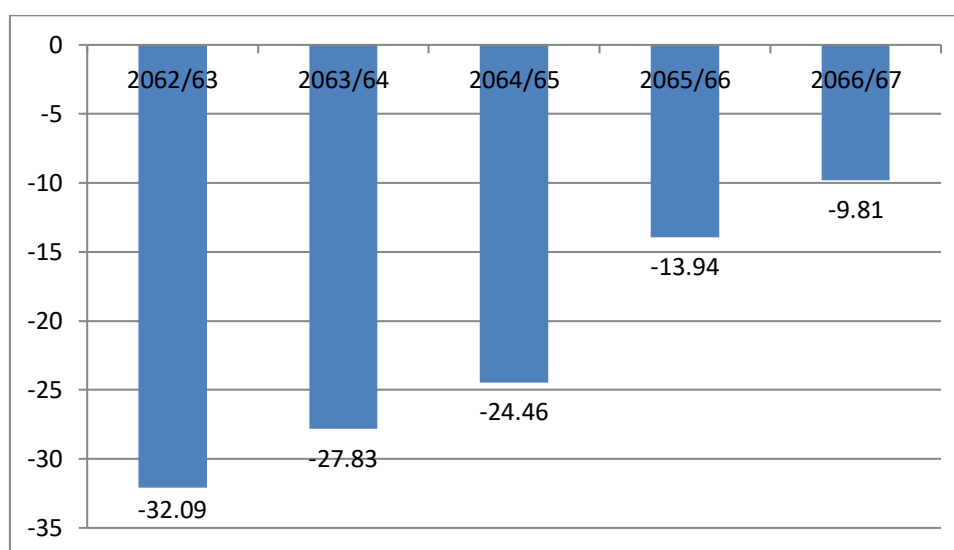


Figure 4.5 shows the total capital to TRWA of Nepal Bank Limited of the last five fiscal years. As can be seen in the figure, the bank's capital adequacy ratio has been negative and hence, not performing well for the all five fiscal years.

Table No. 4.6

Capital Adequacy Ratio of Agricultural Development Bank Ltd. for the period 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(836,067)	1,121,002	2,742,069	7,788,561	10,692,933
Supplementary Capital	-	901,224	2,394	3,278,097	3,350,023
Total Capital Fund	(836,067)	2,022,226	5,136,423	11,066,658	14,042,956
Total Risk Weighted Assets	40,147,906	41,815,283	45,016,759	70,553,368	76,737,107
Capital Fund to TRWA (%)	(20.82)	4.84	11.41	15.69	18.30
Core Capital to TRWA (%)	(20.82)	2.68	6.09	11.04	13.93
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(26.32)	(2.82)	0.59	5.04	7.93
Surplus / Deficiency Total Cap (%)	(31.82)	(6.16)	0.41	5.69	8.3

(Source: Annual Report of Agricultural Development Bank Ltd.)

Table No. 4.6 shows the capital adequacy ratio of Agricultural Development Bank of the last five fiscal years. The Bank has not been maintaining the required total capital ratio and

required core capital ratio for the fiscal years 2062/63 and 2063/64 but after that the ratio has been maintained till the last three fiscal years.. The required total capital has not been met by the Bank and it was deficit by 31.82 percent in the fiscal year 2062/63 but surplus by 8.3 percent in the F/Y 2066/67. The required core capital has also been adequate and it has been fluctuating with deficit for the first two fiscal years 2062/63 and 2063/64 but complying with the NRB directives till the last three fiscal years and as a result surplus by 7.93 percent in the F/Y 2066/67. The total risk weighted assets has also been increasing till the F/Y 2066/67.

Figure 4.6: Capital Fund to TRWA of ADBL

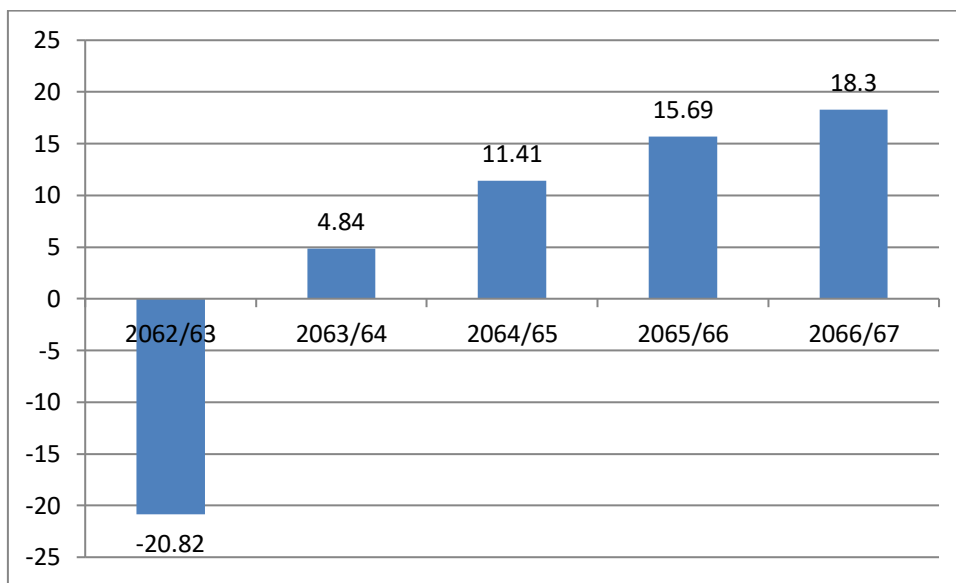


Figure 4.6 shows the capital adequacy ratio of ADBL of the last five fiscal years. From the figure, it can be seen that the CAR of ADBL was negative and slowly it picked up for the last four fiscal years. However, the performance has been not satisfactory for the first two fiscal years.

Table No. 4.7**Capital Adequacy Ratio of Lumbini Bank Ltd. for the period 2062/63-2066/67***(Rs. in thousands)*

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(727942)	(435805)	287,553	946,911	1363927
Supplementary Capital	56763	-	77713	51,473	138571
Total Capital Fund	(671178)	(435805)	365267	998,385	1502499
Total Risk Weighted Assets	4818648	5586347	6083509	5,614,201	6103451
Capital Fund to TRWA (%)	(13.93)	(7.80)	6.00	17.78	24.62
Core Capital to TRWA (%)	(15.11)	(7.80)	4.73	16.87	22.35
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(20.61)	(13.30)	(0.77)	10.87	16.35
Surplus / Deficiency Total Cap (%)	(24.93)	(18.80)	(5.00)	7.78	14.62

(Source: Annual Report of Lumbini Bank Ltd.)

Table No. 4.7 shows the capital adequacy ratio of Lumbini Bank of the last five fiscal years. The Bank has not been maintaining the required total capital ratio and required core capital ratio for the fiscal year 2064/65 but after that the ratio has been maintained till the last two fiscal years. The required total capital has not been met by the Bank and it was deficit by 24.93 percent in the fiscal year 2062/63 but surplus by 14.62 percent in the F/Y 2066/67. The required core capital has also been fluctuating with deficit for the first three fiscal years, however complying with the NRB directives for the last two fiscal years and as a result surplus by 16.35 percent in the F/Y 2066/67. The total risk weighted assets has also been increasing till the F/Y 2066/67.

Figure 4.7: Capital Fund to TRWA of LBL

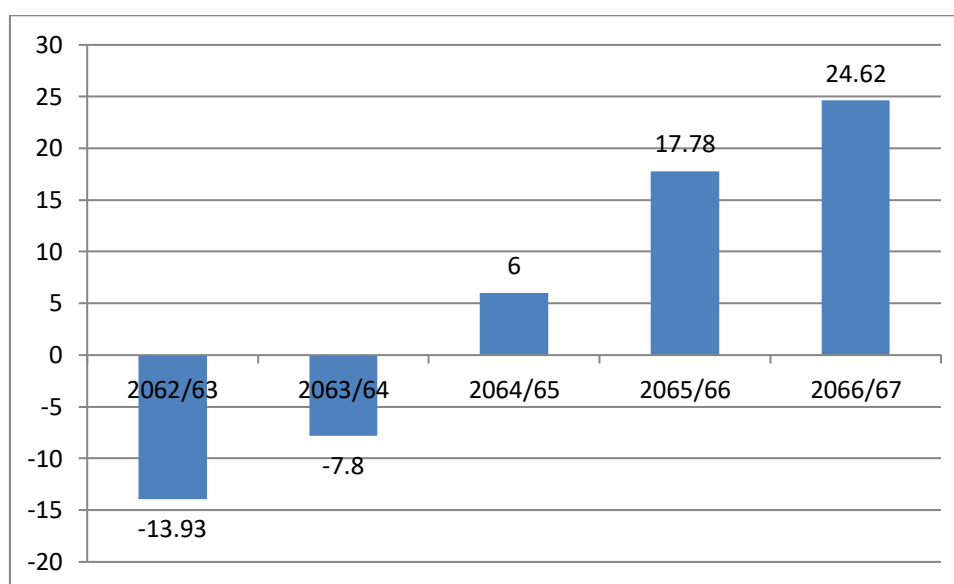


Figure 4.7 shows the capital adequacy ratio of Lumbini Bank of the last five fiscal years. The performance regarding CAR has not been good and it was negative for the first two fiscal years. However, it has been performing well for the last two fiscal years.

Table No. 4.8

Capital Adequacy Ratio of NCC Bank Ltd. for the period 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(373611)	(574911)	634,897	881,335	1,356,258
Supplementary Capital	117681	-	97993	113,184	134,530
Total Capital Fund	(255930)	(574910)	732890	994,520	1491
Total Risk Weighted Assets (TRWA)	7392536	6296556	6608974	8983854	10691
Capital Fund to TRWA (%)	(3.46)	(9.13)	11.09	11.07	13.94
Core Capital to TRWA (%)	(5.05)	(9.13)	9.61	9.81	12.69
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Capital Fund (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(10.55)	(14.63)	4.11	3.81	6.69
Surplus / Deficiency Total Cap (%)	(14.46)	(20.13)	0.09	1.07	3.94

(Source: Annual Report of NCC Bank Ltd.)

Table No. 4.8 shows the capital adequacy ratio of NCC Bank of the last five fiscal years. The Bank has not been maintaining the required total capital ratio and required core capital ratio for the fiscal years 2062/63 and 2063/64 but after that the ratio has been maintained till the last three fiscal years. The required total capital has not been met by the Bank and it was deficit by 14.46 percent in F/Y 2062/63 and by 20.13 percent in the fiscal year 2063/64 but surplus by 3.94 percent in the F/Y 2066/67. The required core capital has also been fluctuating with deficit for the fiscal years 2062/63 and 2063/64 but complying with the NRB directives till the last three fiscal years and as a result surplus by 6.69 percent in the F/Y 2066/67. The total risk weighted assets has also been increasing till the F/Y 2066/67.

Figure 4.8: Capital Fund to TRWA of NCC

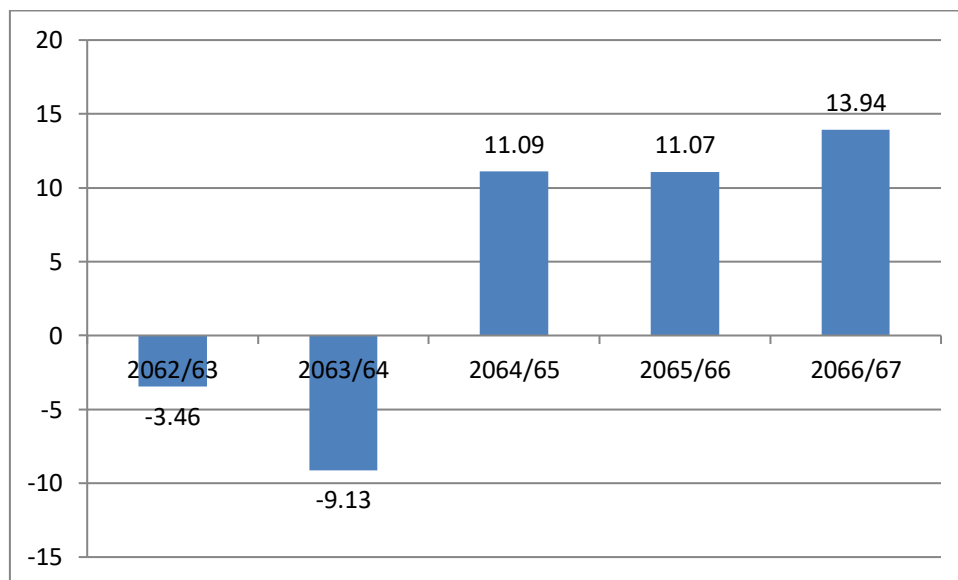


Figure 4.8 shows the total capital to TRWA of NCC Bank for the last five fiscal years. The performance was not good for the first two fiscal years. However, it did well in the last three years.

When a bank has adequate core capital and total capital a bank is considered to be stable and can easily meet its obligations in terms of the payment to be made to the depositors. On the other hand, when a bank does not have adequate capital or has capital adequacy ratio which is less than required, the bank can increase its ratio by either increasing its capital or decrease the risk weighted assets.

When a bank decides to increase the capital, it can increase its equity capital which increases the permanent capital of the bank. When a bank has excess capital and accumulated profit

and general reserves it can become a burden in future. Bank can also issue new shares. This will increase the number of outstanding shares and would subsequently decrease the earning per share causing some loss to the shareholders.

When a bank does not meet the capital adequacy ratio, it cannot make further investments because investments increase TRWA. So, any extra deposits the bank attracts are either idle or invested in those areas which have zero risk. But the problem is that investing in areas which has zero risk nets less profits and may not even match the rates that have to be given to the depositors causing bank to incur loss.

Also, reducing TRWA is not easy. The bank has to withdraw its investments with risks such as loans, bonds, debentures and shares investments.

So, the easy way of increasing the capital fund is to increase the supplementary capital. Supplementary capital is a temporary source of capital. With the increase in capital, the bank can now make more investments there by adding further risk-weighted assets.

4.1.1 Discussions about Capital Adequacy Ratio

Capital of a bank is the total sum of the contributions made by all the shareholders of the bank. Total Capital of the bank is a sum total of Core Capital or first tier capital and Supplementary Capital or second tier capital.

Banks are required to maintain capital adequacy in three ways; the core capital adequacy ratio, the supplementary capital ratio and the total capital adequacy ratio.

Capital adequacy ratio deals with the asset side of the balance sheet of the banks. For this purpose, the bank first calculates the TRWA by considering both the balance sheet assets as well as the off-balance sheet assets.

The central bank has assigned certain risk weight to each asset category of the bank. The assignment of the risks to each asset is done on the basis of the liquidity and risk of the asset. Higher the liquidity and risk of the asset higher the risk weight is. The central bank follows certain international standard such as Basel Committee to assign a risk weight. With the

improvement of the directives according to the evolving financial picture of the country, Nepal Rastra Bank has been able to efficiently safeguard the money of the depositors.

It is to be noted that the shortfall in the Supplementary Capital can be compensated by the use of the excess amount of Core Capital. However, the shortfall of Core Capital cannot be compensated by the excess amount of Supplementary Capital.

When a bank has shortfall (as per the directive) of Capital fund with respect to TRWA, it can either decrease its TRWA or increase its capital. If the bank decreases its TRWA, it has to draw its money from investing in financial instruments such as shares and debentures which has high risk factors and invest them in an area which has zero risk factor or keep it idle. Since investing in areas with high risk factor fetches high return to the bank and investing in areas with low risk factor fetches low return, this activity will eventually cause some loss to the bank.

Another possibility is to increase its capital. Capital can be increased by increasing just the core capital, increasing just the supplementary capital or to increase both. Increasing Core Capital has some negative impacts. With the increase in equity capital, there will be an increase in the permanent capital, which can become a burden in future when the bank has more capital in accumulated profit and general reserves. Also, with the issuance of new shares, the earning per share (EPS) decrease as the number of shares outstanding would increase thereby causing subsequent loss to the shareholders.

So a good way of increasing the capital is to increase the Supplementary Capital provided that the Core Capital is beyond threshold. The Supplementary Capital is the temporary source of Capital and it can be increased by financial instruments such as debenture. With excess capital funds, banks can afford to invest more in areas with risk factors thereby increasing TRWA.

With the changing directives, the total Capital fund as per the latest directive is 10 percent of the TRWA with the condition that at least 6 percent of the Capital fund need to come from the Core Capital.

4.2 Directive No. 2: Loan Classification and Provisioning

Table No. 4.9
Loan Classification and Provision of Everest Bank for the year 2062/63-2066/67
(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	10007	13969	18,709	24351	28112
Non-performing Loan (NPL) (B)	130	113	127	118	43
Total Loan (C=A+B)	10,136	14,082	18,836	24470	28156
NPL to Total Loan (B/C)	1.28%	0.80%	0.68%	0.48%	0.16%

(Source: Annual Report of Everest Bank Ltd.)

Table No. 4.9 shows that Everest bank has a good credit department since most of its loans fall in the “Good” category. This actually helps the bank a lot. When the loan is in the “Good” category, the provision required is just 1 percent of the loan amount. This reduces the total provision to be made which actually helps to increase the profit of the bank. The bank has always made the necessary required provision.

The important point to consider here is that NPL to Total loan of Everest Bank has been almost equivalent to the ideal condition. The standard ratio is anything below 5 percent and the Bank has been so far successful. The Non-performing Loan to Total Loan was 1.28 percent in the F/Y 2062/63 and it was 0.16 percent in the F/Y 2066/67 which is an outstanding result.

At the same time, the credit growth of the bank is also pretty impressive. It is quite easy to have a good credit growth but the important point is to have most of the credits or loan in the “Good Loan” category.

Figure 4.9: NPL to Total Loan of EBL

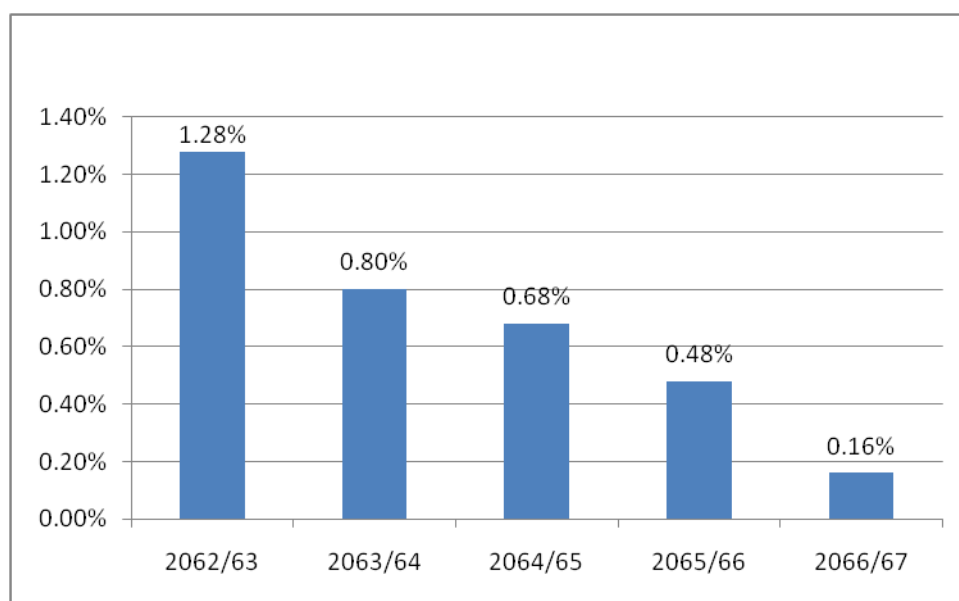


Figure 4.9 shows the NPL to Total Loan of Everest Bank of the last five fiscal years. The performance of the Bank according to this result can be said a good one. The result shows that the NPL is less than 1 percent which is itself a good result.

Table No. 4.10

Loan Classification and Provision of Nepal SBI Bank for the year 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	7,736,120	9,606,296	12,257,806	17698507	15296096
Non-performing Loan (NPL) (B)	505,336	458,755	488,410	265133	315954
Total Loan (C=A+B)	8,241,456	10,065,052	12,746,216	17963651	15612050
NPL to Total Loan (B/C)	6.13 %	4.56 %	3.83 %	1.48 %	2.02 %

(Source: Annual Report of Nepal SBI Bank Ltd.)

Table No. 4.10 shows the Loan Classification and Provision of Everest Bank of the last five fiscal years. NPL to Total loan of Nepal SBI Bank has been almost equivalent to the ideal condition. The standard ratio is anything below 5 percent and the Bank has been so far successful for the last four fiscal years as it was 6.13 percent in the F/Y 2062/63. The Non-performing Loan to Total Loan was 2.02 percent in the F/Y 2066/67 which is a mediocre result.

At the same time, the credit growth of the bank is also pretty impressive. It is quite easy to have a good credit growth but the important point is to have most of the credits or loan in the “Good Loan” category.

Figure 4.10: NPL to Total Loan of NSBL

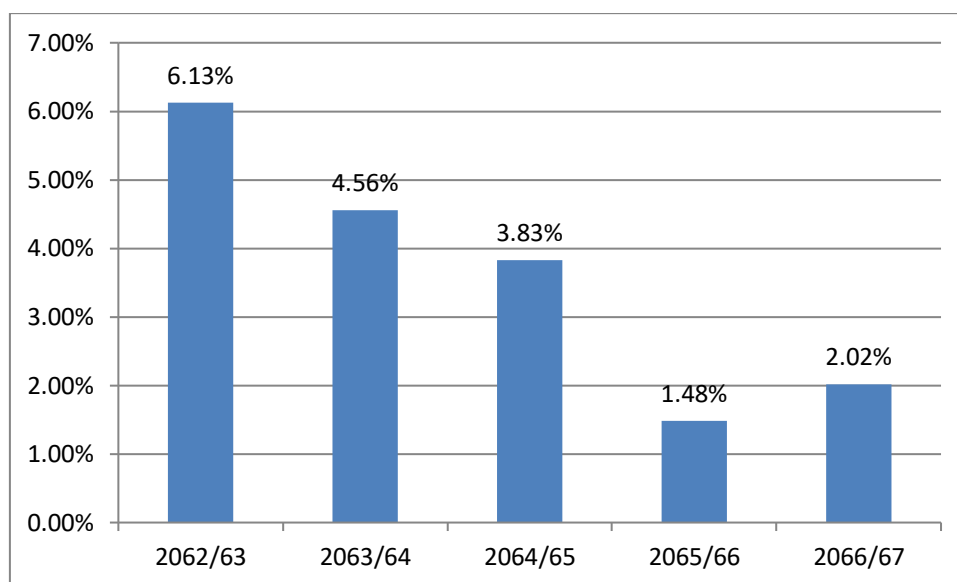


Figure 4.10 shows the NPL to Total Loan of Nepal SBI of the last five fiscal years. The result shows that the NPL was above 5 percent for the fiscal year 2062/63. Later on, the results show that it was satisfactory with less than 2 percent in the fiscal year 2065/66 and 2.02 percent in the fiscal year 2066/67.

Table No. 4.11

Loan Classification and Provision of NIC Bank for the year 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	6,722,570	9,027,509	11,367,167	13,786,67	12,836,811
Non-performing Loan (NPL) (B)	179,554	101,140	98,167	129,178	92,493
Total Loan (C=A+B)	6,902,124	9,128,649	11,465,334	13,915,850	12,929,304
NPL to Total Loan (B/C)	2.60 %	1.11 %	0.86 %	0.93 %	0.72 %

(Source: Annual Report of NIC Bank Ltd.)

Table No. 4.11 shows the Loan Classification and Provision of NIC Bank of the last five fiscal years. NPL to Total loan of NIC Bank has been almost equivalent to the ideal

condition. The standard ratio is anything below 5 percent and the Bank has been so far successful for last five fiscal years. The Non-performing Loan to Total Loan was 2.60 percent in the F/Y 2062/63 and 0.72 percent in the F/Y 2066/67 which is a first-class result.

At the same time, the credit growth of the bank is also pretty impressive. It is quite easy to have a good credit growth but the important point is to have most of the credits or loan in the “Good Loan” category.

Figure 4.11: NPL to Total Loan of NIC

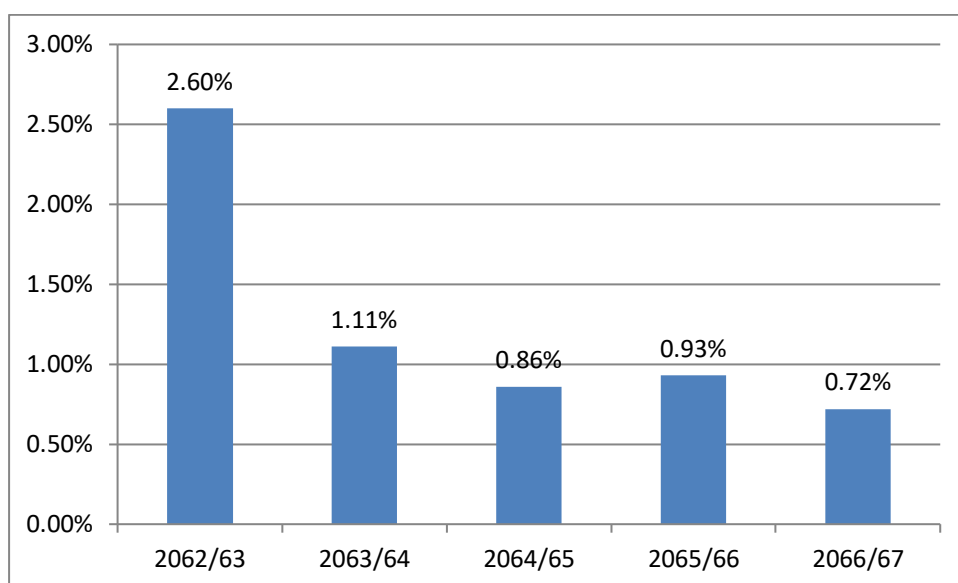


Figure 4.11 shows the NPL to Total Loan of NIC Bank of the last five fiscal years. The result shows that the NPL was less than 1 percent for the last three fiscal years and hence, the result is satisfactory.

Table No. 4.12

Loan Classification and Provision of Kumari Bank for the year 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	6,943,434	8,996,315	11,369,905	14,730,719	14,890,570
Non-performing Loan (NPL) (B)	64,353	66,119	152,476	64,543	75,510
Total Loan (C=A+B)	7,007,788	9,062,433	11,522,380	14,795,261	14,966,080
NPL to Total Loan (B/C)	0.92 %	0.73 %	1.32 %	0.44 %	0.50 %

(Source: Annual Report of Kumari Bank Ltd.)

Table No. 4.12 shows the Loan Classification and Provision of Kumari Bank of the last five fiscal years. NPL to Total loan of Kumari Bank has been almost equivalent to the ideal condition. The standard ratio is anything below 5 percent and the Bank has been so far successful for last five fiscal years. The Non-performing Loan to Total Loan was 0.92 percent in the F/Y 2062/63 and 0.50 percent in the F/Y 2066/67 which is a first-class result.

At the same time, the credit growth of the bank is also pretty impressive. It is quite easy to have a good credit growth but the important point is to have most of the credits or loan in the “Good Loan” category.

Figure 4.12: NPL to Total Loan of KBL

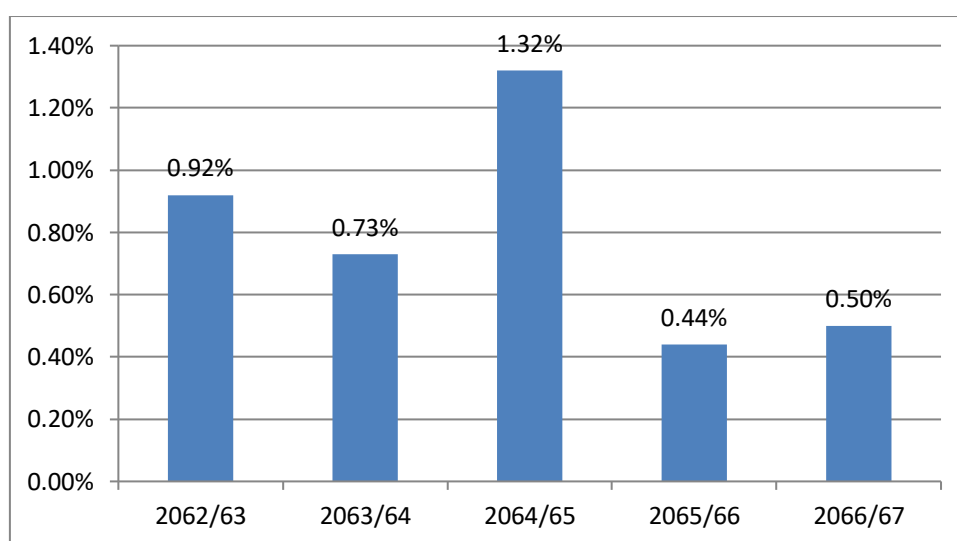


Figure 4.12 shows the non-performing loan of Kumari Bank of the last five fiscal years. From the figure, it can be seen that the Bank’s NPL is well below 5 percent and has been performing well and hence, on this basis it can be said that its performance is satisfactory.

Table No. 4.13
Loan Classification and Provision of Nepal Bank for the year 2062/63-2066/67
(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	10,179,371	11,900,571	13,697,852	18,593,370	23,832,678
Non-performing Loan (NPL) (B)	2,262,183	1,856,049	2,067,145	966,723	1,219,674
Total Loan (C=A+B)	12,441,554	13,756,620	15,764,997	19,560,094	25,052,352
NPL to Total Loan (B/C)	18.18 %	13.49 %	13.11 %	4.94 %	4.87 %

(Source: Annual Report of Nepal Bank Ltd.)

Table No. 4.13 shows the Loan Classification and Provision of Nepal Bank of the last five fiscal years. NPL to Total loan of Nepal Bank has not been equivalent to the ideal condition for the first three fiscal years till 2064/65. The standard ratio is anything below 5 percent and the Bank has not been so far successful for first three fiscal years which was 18.18 percent in the F/Y 2062/63 and 13.11 percent in the F/Y 2064/65. The Non-performing Loan to Total Loan was 4.94 percent in the F/Y 2065/66 and 4.87 percent in the F/Y 2066/67 which is an average result.

Figure 4.13: NPL to Total Loan of NBL

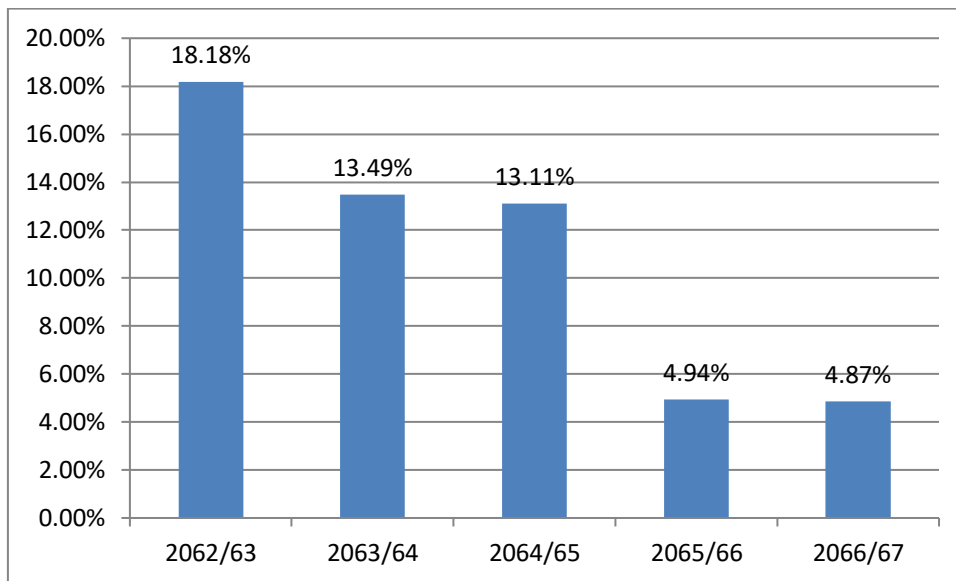


Figure 4.13 shows the non-performing loan to total loan of Nepal Bank Ltd. of the last five fiscal years. The figure shows that the Bank has not been performing well and its NPL was greater than 5 percent for the three fiscal years till 2064/65. However, the bank was able to reduce its NPL to below 5 percent for the last two fiscal years. Even though, the bank's performance cannot be said to be satisfactory.

Table No. 4.14
Loan Classification and Provision of Agricultural Development Bank for the year
2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	26,451,752	28,255,074	32,324,208	34,580,329	36,273,500
Non-performing Loan (NPL) (B)	6,858,994	6,185,295	4,280,510	3,720,774	3,309,372
Total Loan (C=A+B)	33,310,746	34,440,369	36,604,718	38,301,103	39,582,872
NPL to Total Loan (B/C)	20.59 %	17.96 %	11.69 %	9.71 %	8.36 %

(Source: Annual Report of Agricultural Development Bank Ltd.)

Table No. 4.14 shows the Loan Classification and Provision of Agricultural Development Bank of the last five fiscal years. NPL to Total loan of ADBL has not been equivalent to the ideal condition for the last five fiscal years. The standard ratio is anything below 5 percent and the Bank has not been so far successful for all the fiscal years which was 20.59 percent in the F/Y 2062/63 and 11.69 percent in the F/Y 2064/65. The Non-performing Loan to Total Loan was 9.71 percent in the F/Y 2065/66 and 8.36 percent in the F/Y 2066/67 which is not a good result.

Figure 4.14: NPL to Total Loan of ADBL

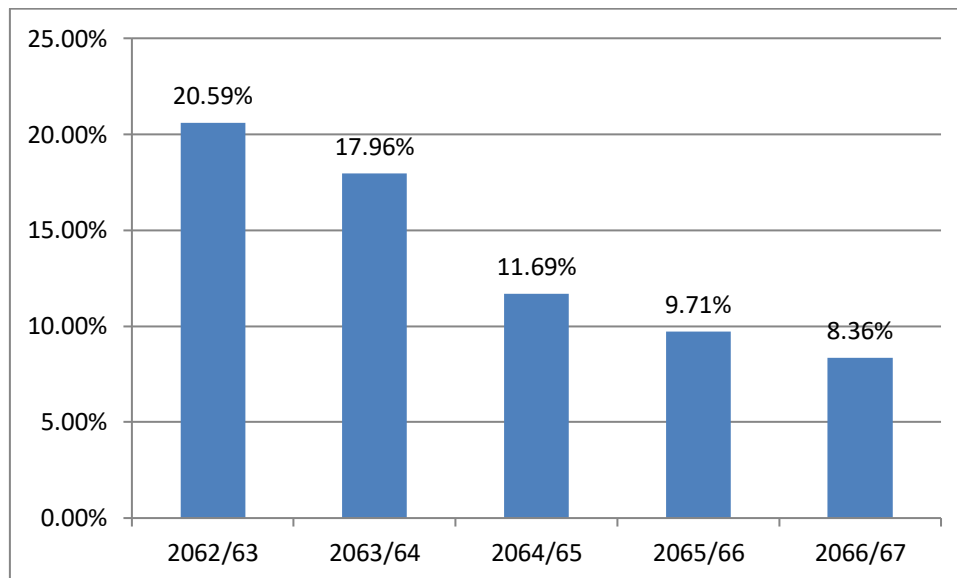


Figure 4.14 shows the NPL to Total Loan of ADBL of the last five fiscal years ending 2066/67. It shows that the bank's NPL is not to the standard and it is well above the standard

of 5 %. Although the trend is decreasing, however the bank's performance cannot be regarded as a satisfactory one.

Table No. 4.15
Loan Classification and Provision of NCC Bank for the year 2062/63-2066/67

(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	4609260	3515349	4413735	6986612	8146576
Non-performing Loan (NPL) (B)	1289905	1606872	867316	197069	241322
Total Loan (C=A+B)	5899165	5122221	5281051	7183681	8387898
NPL to Total Loan (B/C)	21.87 %	31.37 %	16.42 %	2.74 %	2.88 %

(Source: Annual Report of NCC Bank Ltd.)

Table No. 4.15 shows the Loan Classification and Provision of NCC Bank of the last five fiscal years. NPL to Total loan of NCC Bank has not been equivalent to the ideal condition for the first three fiscal years till 2064/65. The standard ratio is anything below 5 percent and the Bank has not been so far successful for first three fiscal years which was 21.87 percent in the F/Y 2062/63 and 16.42 percent in the F/Y 2064/65. The Non-performing Loan to Total Loan was 2.88 percent in the F/Y 2066/67 which is a good result compared to the previous fiscal years.

Figure 4.15: NPL to Total Loan of NCC

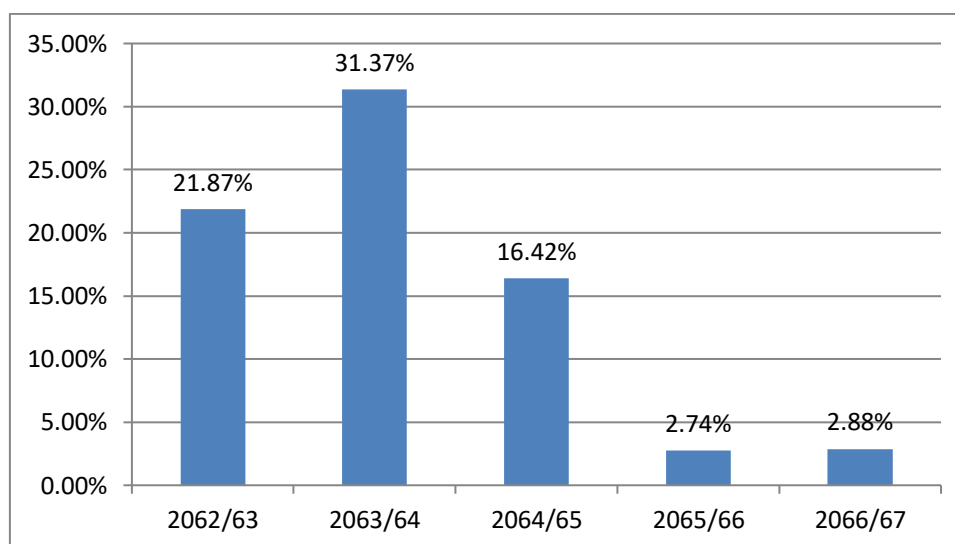


Figure 4.15 shows the NPL to Total Loan of NCC Bank of the last five fiscal years. The figure shows that the bank's performance has not been to the standard till fiscal year 2063/64 where its NPL was above 5 percent. However, its NPL decreased to 2.74 percent in the fiscal

year 2065/66 and to 2.88 percent in F/Y 2066/67. Hence, its performance can be said to be of an average one.

Table No. 4.16
Loan Classification and Provision of Lumbini Bank for the year 2062/63-2066/67
(Rs. in thousands)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	2982344	3937465	4,566,647	5166818	5244134
Non-performing Loan (NPL) (B)	1339243	1007036	800,662	514576	248776
Total Loan (C=A+B)	4321586	4944501	5,367,309	568139	549291
NPL to Total Loan (B/C)	30.99 %	20.37 %	14.92 %	9.06 %	4.53 %

(Source: Annual Report of Lumbini Bank Ltd.)

Table No. 4.16 shows the Loan Classification and Provision of Lumbini Bank of the last five fiscal years. NPL to Total loan of Lumbini Bank has not been equivalent to the ideal condition for the first four fiscal years till 2065/66. The standard ratio is anything below 5 percent and the Bank has not been so far successful for first four fiscal years which was 30.99 percent in the F/Y 2062/63 and 14.92 percent in the F/Y 2064/65. The Non-performing Loan to Total Loan was 4.53 percent in the F/Y 2066/67 which is an average result.

Figure 4.16: NPL to Total Loan of LBL

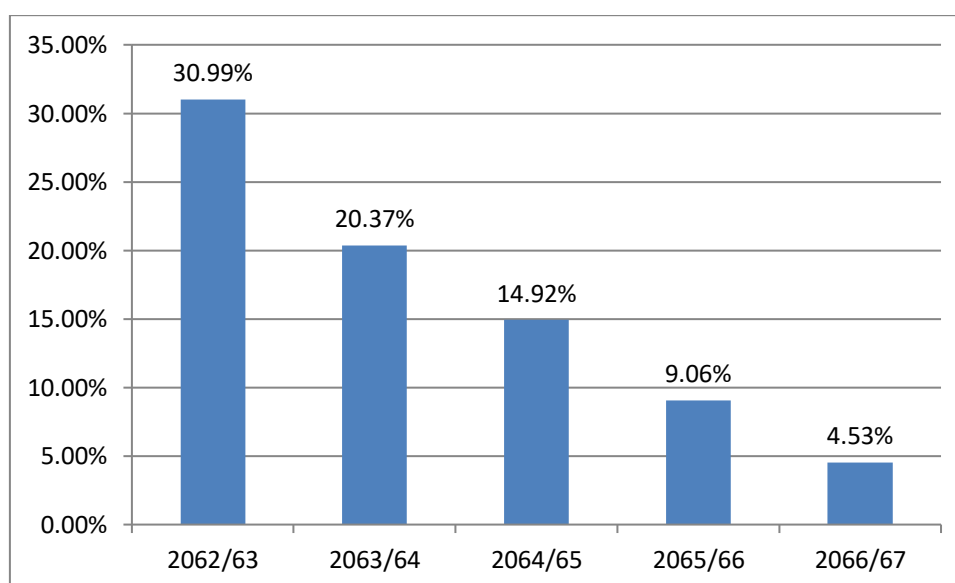


Figure 4.16 shows the NPL to Total Loan of Lumbini Bank Ltd. for the last five fiscal years. It shows that the bank's performance was not satisfactory and was above 5 percent till four

fiscal years ending 2065/66. However, it was able to decrease its NPL below 5 percent in fiscal year 2066/67. Thus, the result shows that the performance is not of a good standard.

4.2.1 Discussions about Loan Loss Provision

A commercial bank generally accepts deposits from one party and disburses loans and advances to another party. A commercial bank generally profits from the spread of the difference between the interest rate given to the depositors and the interest rate received from loans.

An observation of the balance sheet of the commercial bank clearly reflects that deposit it draws consists of the major portion of the liabilities of the bank. Similarly, loans and advances consist of the major portion of its assets.

Since the spread commercial bank enjoy between the interest rates given to the depositors and interest rates taken from the borrowers, the failure of activity in any one party severely affects the other party.

The point to be noted here is that the loans and advances of the bank which is made by using the money of the depositors, which is a liability to be repaid later, carry a considerable risk. This risk factor is so dangerous that it can bring a bank to some degree of bankruptcy.

The failure of a bank to repay the depositor can force Central Bank to stop the bank from accepting further deposits and making further investments. This ultimately may lead the bank to file a bankruptcy thus affecting all the parties from depositors, shareholders and employees. Therefore, borrower's risk or the risk of non-payment of the loans is one of the major risk commercial bank faces.

One of the main objectives of the Central Bank is to protect the money of the depositors. When majority of the loans and advances made by the bank comes from the depositor's money, there is a probability of facing the possible risk mentioned above. The directives issued by central banks has put some check on loan classification and provisioning so that the borrower's risk is minimum.

As said earlier, majority of the loans and advances made by a bank comes from the depositor's money. Therefore, the money of the depositors is under some degree of risk. But the return they get is much lower than the risk faced. At the same time, the shareholders of the bank are not exposed to the loans and advances while getting handsome dividends. The timely modification of the directives has caused a major change in this regard and has played a leading role in safeguarding the depositor's money.

The new directives have revised the classification of the loan by revising the aging of the loans and the provisioning to be made against such classifications. With this, the provisioning to be made is slowly increased thereby decreasing the profit of the bank. This results in less or no dividends to the shareholders. A decrease in the dividends may sometime affect the reputation of the bank and its stock value.

There is an increasing tendency of playing with the depositor's money by the banks and financial institutions as proved by the declaration of problematic banks by the central bank. With only a small portion of the total loan exposure contributed by the capital, the shareholders were exposed to very less risks compared to the depositors. With the modified directives, there will be a good contribution from the shareholders as well.

The new directives have reduced the risks of the depositors and will help strengthen the financial health of the banks. Also, the directives will caution the banks while providing loans to their clients. Hence, on a long-term basis, banks will enjoy a better cushion against the disbursed loans with huge capital and also, improve their financial strength with adequate provisioning.

CHAPTER V

SUMMARY AND CONCLUSION

5.1 Summary

The research mainly targeted the two directives issued by Nepal Rastra Bank. Among the thirty one commercial banks eight banks were considered for the research. The research also tries to find out the possible repercussions of the directives and its modifications to the commercial banks. The research also analyzed the performance of the selected commercial banks in regards to the selected directives for the selected period. With the analysis the research tries to rate the performance of the selected bank as Good, Satisfactory and Bad. Out of the eight commercial banks, two banks, Everest Bank Limited and Nepal SBI Bank are Joint Venture Banks, two are government Banks, Nepal Bank Limited and Agricultural Development Bank, two are the banks which were once declared problematic by NRB viz. Lumbini Bank Limited and NCC Bank Limited, two are Private Banks, NIC Bank Limited and Kumari Bank Limited.

Along with these, the research also finds out through questionnaires how banks have been implementing the directives and how the Central Bank has been monitoring and supervising the directives and what are some of the impacts of the directives in the performance and activities of the commercial banks.

Supervision of banks and financial institutions is one of the prime responsibilities of the supervisory authority. Effective supervision of these institutions is an essential component of a strong economic environment. The task of supervision is to ensure that banks operate in a safe and sound manner and that they hold capital and reserves sufficient to support the risks that arise in their business. Strong and effective banking supervision contributes in enhancing effective macroeconomic policy along with financial stability in any country. While the cost of banking supervision is high, the cost of poor supervision has proved to be even much higher.

The basic objective of NRB supervision is to conduct a direct assessment of the overall condition of the banking institutions based on off-site and onsite evaluation of the

institution's capital, assets, management, earnings, liquidity and a review of their records, systems and internal control and to determine whether the institution has complied with relevant mandatory and regulatory requirements. It also helps to facilitate the detection of frauds, malpractices, abuses of power by management and staff and undesirable trends and imprudent practices, such as deterioration in the quality of loan portfolio and the concentrations of risks.

Since the last two decades, the world of finance has undergone profound changes as evidenced by the rapid technological development for processing and transmitting data, the growing internationalization of financial system, the increasing phenomena of financial innovations coupled with competition and deregulation. This new financial environment has necessitated the development of new and the adaptation of existing supervisory policies, practices and procedures.

The major findings that have been found are as follows:

Capital Adequacy Ratio has been sufficiently maintained by NIC Bank, Everest Bank, Nepal SBI Bank, Kumari Bank but not being maintained by Nepal Bank, ADBL, NCC Bank and Lumbini Bank.

- The required Capital Adequacy Ratio of NCC Bank was negative for the first two fiscal years and surplus for the last three fiscal years.
- The required capital adequacy ratio of Lumbini was deficient for the first three fiscal years and surplus for the last two fiscal years.
- Similarly, the CAR of ADBL was deficient for the first two fiscal years and surplus for the last three fiscal years.
- The required capital adequacy ratio of Nepal Bank was negative for all the five fiscal years and hence, deficient for all the fiscal years.
- The CAR of Kumari, Everest, NIC and Everest was surplus for all the five fiscal years.

The non-performing loans of NIC, Everest, Nepal SBI, Kumari has been below 5% since the last five years but the results of Nepal Bank, ADBL, NCC and Lumbini regarding NPL to Total Loan has not been satisfactory. As below 5% NPL to Total Loan is the acceptable

standard in the international practice, those Banks having below 5% NPL are regarded as good one.

- NPL to Total Loan of NCC had less than 5% NPL to Total Loan only in the last two fiscal years while in Lumbini Bank, the result was less than 5% only in the fiscal year 2066/67.
- ADBL has over 5% NPL for the last five fiscal years which is not a good result.
- Nepal Bank too had less than 5% NPL only in the last two fiscal years.
- Nepal SBI Bank has above 5% NPL only in the first fiscal year 2062/63.
- Everest Bank has less than 1% NPL for the last four fiscal years which is a very good result.
- NIC Bank and Kumari Bank have good results regarding NPL to Total Loan.

5.2 Conclusion

Some of the implications found out by the research are as follows:

- When the provisioning amount for loan is increased it decreases the profitability of the commercial bank.
- Commercial banks needed to increase the capital or decrease the TRWA in order to meet the new capital adequacy ratio.
- The depositors' money is protected more by the change in the capital adequacy ratio and change in the loan classification.
- Increased demand for shareholder's contribution in the banks by foregoing dividends for loan loss provisions and various other reserves to increase the core capital.
- Shareholders may experience decrease in dividends and employees may experience lesser bonuses due to short term decrease in profitability which resulted because of the stringent directives.
- Overall loan exposure of the bank is reduced thereby decreasing the interest income but increasing the protection of the depositor's money.
- The overall impact of all the results of the change in the directives actually ensures that the bank pay proper respect to the depositors money.
- Even though the bank may face short term decreased profitability, the financial health of the bank will definitely improve in the long run which can be measured by various

empirical values and other non measurable values such as faith of the depositors and trust of the shareholders and employees and overall improvement of the economy of the financial sector.

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Appendix 1

Capital Adequacy Ratio of Everest Bank for the period 2062/63-2066/67

(Rs. in thousands)

EVEREST BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	927550	1171133	1900859	1981579	2537092
Paid-up Share Capital	378000	378000	491,400	638821	830467
Non Redeemable Preference Share	140000	140000	340,000	0	
Capital Adjustment Fund	132300	170100	220,100	284100	367147
Capital Reserve Fund	1226	13226	19,226	25226	31226
Deferred Tax Reserve			9,445	33723	34518
Capital Redemption Reserve			60,000	140000	140000
Share Premium	6427	6427	206,427	14780	14780
Debenture Redemption fund			0	120000	180000
Proposed bonus share		113,400	147,420	191646	249140
General Reserve	173566	232848	323,091	450839	617193
Profit/Loss Account	108640	130547	83,750	82444	72621
Goodwill					
Investment in Shares under underwriting Arrangement	(12609)	(13,414)	-	-	-
Supplementary Capital	463789	504982	505197	722291	720049
General Loan Loss Provision	97572	137506	185553	242486	280308
Redeemable/Cumulative Preference Shares				200000	200000
Exchange Equalization	16650	16968	20378	22044	22044

Reserve					
Asset Revaluation Reserve	0	0	0		
Hybrid Capital Instrument	0	0	0		
Subordinated Term Debt	300000	300000	240000	180000	120000
Additional Loan Loss Provision	43567	49703	57666	77761	97697
Reserve for Contingencies	6000	805	1600		
Total Capital Fund	1391339	1676115	2406056	2703870	3257141
On Balance-sheet Assets	10476979	14099274	19472332		
Off balance transaction	814158	877463	1567547		
Total Risk Weighted Assets	11291137	14976737	21039879	25619753	30240428
Core Capital to TRWA (%)	8.21	7.82	9.03	7.73	8.39
Total Capital to TRWA (%)	12.32	11.19	11.44	10.55	10.77
Required Core Capital to TRWA (%)	5.5	5.5	5.5	6	6
Required Total Capital to TRWA(%)	11	11	11	10	10
Surplus / Deficiency Core Capital (%)	2.71	2.32	3.53	1.73	2.39
Surplus / Deficiency Total Capital (%)	1.32	0.19	0.44	0.55	0.77

(Source: Annual Report of Everest Bank)

Appendix 2

Capital Adequacy Ratio of Nepal SBI Bank for the Period 2062/63-2066/67

(Rs. in thousands)

Nepal SBI BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	964,420	1,145,479	1,394,064	1692371	2430021
Paid-up Capital	640,236	647,798	874,528	874528	1653624
Preference Share	0	0	0	0	0
Capital Adjustment Fund	192,413	60,000	230,000	65000	50000
Capital Reserve Fund					
Debenture Redemption fund	-	-	-	85714	114286
Proposed bonus share		255,300	57,142	349811	207700
General Reserve	140,709	191,691	241,245	304520	382868
Deferred Tax Reserve	0	0	0	18985	26985
Profit/Loss Account	1,706	666	1,529	3849	4249
Less:					
Goodwill					
Miscellaneous Assets not written off	-	-	-	34484	-
Fictitious Assets	1,702	1,035	689,681	-	-
Investment arising out of underwriting commitments	8,943	8,943	9,691	9691	9691
Supplementary Capital	278,151	299,322	328,123	319667	304425
General Loan Loss Provision	70,841	91,487	117,922	149467	173584
Exchange	7,3089	7,835	10,200	10200	10200

Equalization Reserve					
Asset Revaluation Reserve	0	0	0	0	0
Hybrid Capital Instrument	0	0	0	0	0
Subordinated Term Debt	200,000	200,000	200,000	0	0
Investment Adjustment Fund	0	0	0		642
Unsecured Subordinated Long term loan	-	-	-	160000	120000
Total Capital	1,242,570	1,444,800	1,722,187	2012038	2734447
On Balance-sheet Assets	8,485,105	10,021,958	12,938,524	6049768	6475417
Off balance transaction	674,166	851,321	1,037	477740	868526
Total Risk Weighted Assets	9,159,270	10,873,279	13,975,708	16872717	22320356
Total Capital to TRWA (%)	13.57	13.29	12.32	11.92	12.25
Core Capital to TRWA (%)	10.53	10.53	9.97	10.03	10.89
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	5.03	5.03	4.47	4.03	4.89
Surplus / Deficiency Total Cap (%)	2.57	2.29	1.32	1.92	2.25

(Source: Annual Report of Nepal SBI Bank)

Appendix 3

Capital Adequacy Ratio of NIC Bank for the period 2062/63-2066/67

(Rs. in thousands)

NIC BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	761,129	911,807	1,293,750	1,649,007	1,750,459
Paid-up Capital	600,000	660,000	943,877	1,140,480	1,311,552
Preference Share	0	0	0	0	0
Capital Adjustment Fund	60,000	0	0	0	0
Capital Reserve Fund					
Share Premium	0	0	0	41,874	41,874
Debenture Redemption fund	-	-	2,192	42,192	82,192
Proposed bonus share	-	132,000	190,080	171,072	
General Reserve	76,777	108,472	157,084	220,570	310,539
Deferred Tax Reserve				3,100	2,775
Cumulative Profit/Loss	22,683	11,892	1,627	30,557	2,094
Current Year's Profit/Loss Account	2,321	-	-	-	-
Less:					
Goodwill					
Intangible Assets	652	558	1,109	838	567
Investment in associates					
Supplementary Capital	275,71	296,801	321,969	305,927	260,102
General Loan Loss Provision	66,895	90,197	113,505	137,711	128,368

Exchange Equalization Reserve	4,681	5,626	8,567	10,408	13,421
Asset Revaluation Reserve	0	0	0	0	0
Hybrid Capital Instrument	0	0	0	0	0
Subordinated Term Debt	200,000	200,000	197,808	157,808	117,808
Investment Adjustment Reserve	0	0	0	0	504,620
Additional Loan Loss Reserve	4,1334	979	2,089	-	-
Total Capital	1,036,839	1,208,608	1,615,719	1,954,935	2,010,561
On Balance-sheet Assets	7,380,372	9,565,960	11,824,278	-	-
Off balance transaction	275,759	339,075	496,853	-	-
Total Risk Weighted Assets	7,656,131	9,905,036	12,321,131	15,741,613	15,559,349
Total Capital to TRWA (%)	13.54	12.20	13.11	12.42	12.92
Core Capital to TRWA (%)	9.94	9.21	10.50	10.48	11.25
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	4.44	3.71	5	4.48	5.25
Surplus / Deficiency Total Cap (%)	2.54	1.20	2.11	2.42	2.92

(Source: Annual Report of NIC Bank)

Appendix 4

Capital Adequacy Ratio of Kumari Bank for the period 2062/63-2066/67

(Rs. in thousands)

KUMARI BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	858,520	1,019,893	1,359,032	1,612,799	1,772,135
Paid-up Share Capital	625,000	750,000	1,070,000	1,186,099	1,306,016
Non Redeemable Preference Share					
Capital Adjustment Fund	37,500	150,000	107,827	-	-
Capital Reserve Fund					
Deferred Tax Reserve					
Capital Redemption Reserve	-	-	20,000	115,000	210,000
Other Free Funds	125,000				
Proposed bonus share	-	-	-	118,837	-
General Reserve	50,809	84,862	119,848	172,136	235,444
Cumulative Profit/Loss	20,211	35,031	41,357	20,727	20,675
Less:					
Goodwill					
Investment in Shares under underwriting Arrangement					
Supplementary Capital	82,459	95,314	523,894	438,108	352,490

General Loan Loss Provision	68,770	89,577	113,321	147,247	148,866
Redeemable/Cumulative Preference Shares					
Exchange Equalization Reserve	5,331	5,737	5,853	5,861	6,381
Asset Revaluation Reserve	0	0	0	0	0
Hybrid Capital Instrument	0	0	0	0	0
Subordinated Term Debt	-	-	400,000	400,000	400,000
Additional Loan Loss Provision	8,358	-	4,720	-	-
Other Reserve	-	-	-	-	7,243
Total Capital Fund	940,979	1,115,207	1,882,926	2,050,908	2,124,625
On Balance-sheet Assets	7,217,427	9,401,588	12,309,296	-	-
Off balance transaction	407,623	558,322	761,083	-	-
Total Risk Weighted Assets	7,625,050	9,959,911	13,070,379	17,743,239	17,220,685
Core Capital to TRWA (%)	11.26	10.24	10.40	9.09	10.29
Total Capital to TRWA (%)	12.34	11.20	14.41	11.56	12.34
Required Core Capital to TRWA (%)	5.5	5.5	5.5	6	6

Required Total Capital to TRWA (%)	11	11	11	10	10
Surplus / Deficiency Core Capital (%)	5.76	4.74	4.9	3.09	4.29
Surplus / Deficiency Total Capital (%)	1.34	0.20	3.41	1.56	2.34

(Source: Annual Report of Kumari Bank)

Appendix 5

Capital Adequacy Ratio of Nepal Bank Ltd. for the period 2062/63-2066/67

(Rs. in thousands)

NEPAL BANK LTD.	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(6,374,479)	(6,334,739)	(6,325,869)	(5061437)	(4,867,051)
Paid-up Capital	380,383	380,383	80,383	380,383	380,383
Preference Share	0	0	0	0	0
Capital Adjustment Reserve	114,115	152,153	190,191	228,230	2 66,268
Capital Reserve Fund					
Dividend Adjustment Reserve	0	0	0	7,486	7,486
Debenture Redemption fund	0	0	0	259,736	2 59,736
Proposed bonus share					
General Reserve	1,286,767	1,332,157	1,380,000	1,558,851	1,608,727
Deferred Tax Reserve					

Cumulative Profit/Loss	(8,122,003)	(8,151,492)	(8,023,441)	(8,023,441)	(7,252,355)
Current Year's Profit/Loss	-	-	-	660,414	-
Other Free Reserve	13,549	13,549	13,549	6,063	6,063
Less:					
Goodwill					
Intangible Assets					
Investment in excess of prescribed limit	(47,289)	(61,489)	(266,551)	(139,159)	(143,359)
Supplementary Capital	520,561	905,454	710,527	-	579,550
General Loan Loss Provision	483,683	868,576	578,367	-	508,796
Exchange Equalization Reserve	25,734	25,734	51,017	-	67,968
Asset Revaluation Reserve	0	0	0	0	0
Hybrid Capital Instrument	0	0	0	0	0
Subordinated Term Debt					
Provision for Loss on Investment	11,143	11,143	81,143	-	-
Additional Loan Loss Reserve	-	-	-	-	2,786
Total Capital	(5,853,918)	(5,429,286)	(5,615,342)	(5,061,437)	(4287501)
On Balance-sheet Assets	17,429,490	19,031,280	22,274,475	-	-

Off balance transaction	815,450	479,992	682,957	-	-
Total Risk Weighted Assets	18,244,940	19,511,273	22,957,432	36,305,751	43,726,247
Total Capital to TRWA (%)	(32.09)	(27.83)	(24.46)	(13.94)	(9.81)
Core Capital to TRWA (%)	(34.94)	(32.47)	(27.55)	(13.94)	(11.13)
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(40.44)	(37.97)	(33.05)	(19.94)	(17.13)
Surplus / Deficiency Total Cap (%)	(43.09)	(38.83)	(35.46)	(25.94)	(19.81)

(Source: Annual Report of Nepal Bank Ltd.)

Appendix 6

Capital Adequacy Ratio of Agricultural Development Bank Ltd. for the period 2062/63-2066/67

(Rs. in thousands)

AGRICULTURAL DEVELOPMENT BANK LTD.	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	-836,067	1,121,002	2,742,069	7,788,561	10,692,933
Paid-up Capital	1,625,000	1,625,000	2,077,500	2,077,500	3,037,500
Irredeemable	4,853,000	5,903,000	6,400,000	6,400,000	6,400,000

Preference Share					
Capital Adjustment Reserve	-	-	-	3,865,576	3,860,888
Capital Reserve Fund					
Dividend Adjustment Reserve					
Debenture Redemption fund					
Proposed bonus share					
General Reserve	482,679	694,369	828,217	1,039,737	1,329,440
Deferred Tax Reserve	-	-	-	-	540,530
Cumulative Profit/Loss	-8,079	-6,950	-6,418	-5,453,820	-4,391,668
Current Year's Profit/Loss	282,111	-	-	-	-
Other Free Reserve					
Less:					
Goodwill					
Investment in shares of licensed institutions	-	-	-	52,423	48,173
Investment in excess of prescribed limit	-	151,380	146,064	88,008	35,585
Supplementary Capital	-	901,224	2,394	3,278,097	3,350,023

General Loan Loss Provision		268,992	313,432	881,917	959,214
Exchange Equalization Reserve	-	709	3,697	9,221	9,221
Redeemable Preference Share	-	-	-	2,300,000	-
Hybrid Capital Instrument					
Subordinated Term Debt	-	-	1,371	-	2,300,000
Provision for Loss on Investment		108,832	143,481	86,958	81,588
Additional Loan Loss Reserve		522,691	562,709		
Total Capital	(836,067)	2,022,226	5,136,423	11,066,658	14,042,956
On Balance- sheet Assets	39,420,642	40,720,421	43,749,192		
Off balance transaction	727,264	1,094,862	1,267,566		
Total Risk Weighted Assets	40,147,906	41,815,283	45,016,759	70,553,368	76,737,107
Total Capital to TRWA (%)	(20.82)	4.84	11.41	15.69	18.30
Core Capital to TRWA (%)	(20.82)	2.68	6.09	11.04	13.93
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(26.32)	(2.82)	0.59	5.04	7.93

Surplus / Deficiency Total Cap (%)	(31.82)	(6.16)	0.41	5.69	8.3
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(Source: Annual Report of Agricultural Development Bank Ltd.)

Appendix 7

Capital Adequacy Ratio of Lumbini Bank Ltd. for the period 2062/63-2066/67

(Rs. in thousands)

LUMBINI BANK LTD.	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(727942)	(435805)	287,553	946,911	1363927
Paid-up Capital	500000	600000	995,710	1,096,078	1294548
Irredeemable Preference Share					
Capital Adjustment Reserve					
Capital Reserve Fund					
Dividend Adjustment Reserve					
Debenture Redemption fund					
Proposed bonus share					
General Reserve	21631	60112	125,642	192,083	252896
Deferred Tax Reserve					
Cumulative Profit/Loss	(1245370)	(1,091,447)	(829328)	(602,544)	(179046)
Current Year's Profit/Loss				265,765	
Other Free Reserve					
Less:					

Goodwill					
Investment in shares of licensed institutions					
Investment in excess of prescribed limit	(4203)	(4,471)	(4,471)	(4,471)	(4,471)
Supplementary Capital	56763	-	77713	51,473	138571
General Loan Loss Provision	28172	-	44404	49,804	51383
Exchange Equalization Reserve	1669	-	1,669	1,669	1,669
Redeemable Preference Share					
Hybrid Capital Instrument					
Subordinated Term Debt					
Provision for Loss on Investment	268				85317
Additional Loan Loss Reserve	26654	-	31640		
Total Capital	(671178)	(435805)	365267	998,385	1502499
On Balance-sheet Assets	4487274	5178453	5543529		
Off balance transaction	331374	407893	539981		
Total Risk Weighted Assets	4818648	5586347	6083509	5,614,201	6103451
Total Capital to TRWA (%)	(13.93)	(7.80)	6.00	17.78	24.62
Core Capital to TRWA (%)	(15.11)	(7.80)	4.73	16.87	22.35
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio	11	11	11	10	10

(%)					
Surplus / Deficiency Core Cap (%)	(20.61)	(13.30)	(0.77)	10.87	16.35
Surplus / Deficiency Total Cap (%)	(24.93)	(18.80)	(5.00)	7.78	14.62

(Source: Annual Report of Lumbini Bank Ltd.)

Appendix 8

Capital Adequacy Ratio of NCC Bank Ltd. for the period 2062/63-2066/67

(Rs. in thousands)

NCC BANK LTD.	2062/63	2063/64	2064/65	2065/66	2066/67
Core Capital	(373611)	(574911)	634,897	881,335	1,356,258
Paid-up Capital	698415	699117	1,399,558	1,399,558	1,399,671
Irredeemable Preference Share					
Capital Adjustment Reserve					
Capital Reserve Fund					
Dividend Adjustment Reserve					
Debenture Redemption fund					
Proposed bonus share					
General Reserve	30481	30481189	130,232	2 13,324	298,079
Deferred Tax Reserve					
Cumulative Profit/Loss	(468188)	(1149280)	(1268986)	(539,848)	(208,847)
Current Year's Profit/Loss	(595019)	(115928)	398392	-	-
Other Free Reserve					
Less:					
Goodwill					
Investment in equity of licensed institutions	39300	39300	24300	77,500	132,645
Investment in excess of prescribed limit				14,600	
Other Deductions				177,021	

Supplementary Capital	117681	-	97993	113,184	134,530
General Loan Loss Provision	92407	-	4 8,276	112,298	133,644
Exchange Equalization Reserve	275	-	886	886	886
Redeemable Preference Share					
Hybrid Capital Instrument					
Investment Equalization Reserve	25000	-			
Provision for Loss on Investment		-	25000		
Additional Loan Loss Reserve		-	23831		
Total Capital	(255930)	(574910)	732890	994,520	1491
On Balance-sheet Assets	6456288	5622891	5846845		
Off balance transaction	936247	673665	762129		
Total Risk Weighted Assets	7392536	6296556	6608974	8983854	10691
Total Capital to TRWA (%)	(3.46)	(9.13)	11.09	11.07	13.94
Core Capital to TRWA (%)	(5.05)	(9.13)	9.61	9.81	12.69
Reqd. Core Capital Ratio (%)	5.5	5.5	5.5	6	6
Reqd. Total Capital Ratio (%)	11	11	11	10	10
Surplus / Deficiency Core Cap (%)	(10.55)	(14.63)	4.11	3.81	6.69
Surplus / Deficiency Total Cap (%)	(14.46)	(20.13)	0.09	1.07	3.94

(Source: Annual Report of NCC Bank Ltd.)

Appendix 9

Loan Classification and Provision of Everest Bank for the year 2062/63-2066/67

(Rs. in thousands)

EVEREST BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	10007019	13969507	18,709,121	24351570	28112694
Pass	9,757,195	13,750,623	18,555,269	24248590	28030839
Restructured	249823	218,884	153,852	102980	81854
Non-performing Loan (NPL) (B)	129266	113179	127310	117985	43706
Sub-standard	10699326	4,218,482	6,306,745	1360792	5469421
Doubtful	683784	2,353,289	745,926	28514320	12633778
Bad	117882	106,607	120,258	88110120	25602782
Total Loan (D=A+B)	10,136	14,082	18,836	24470	28156
Total Provision (C)	334639	418,604	497,346	584881	600044
Net Loans (D-C)	9770950	13664081	18339086	23884673	27556356
Loan Loss Provision	334,947	418,604,423	497,346	584881	600043
Pass	97,571	137,506	185,553	242486	280308
Restructured	31227	27,360	19,231	12872	10231
Sub-standard (E)	2667	1,054	1,576	340198	1367
Doubtful (F)	341892	1,176,645	372,963	14257	6316
Bad (G)	117883	106,607	1202577	88110	25602
Additional Provision	85255	144,899	170,355	226816	276217
NPL to Total Loan (B/D)	1.28%	0.80%	0.68%	0.48%	0.16%
Net NPL to Total Loan (B-(E+F+G))/D	0.08%	0.03%	0.03%	0.06%	0.04%

(Source: Annual Report of Everest Bank Ltd.)

Appendix 10

Loan Classification and Provision of Nepal SBI Bank for the year 2062/63-2066/67

(Rs. in thousands)

Nepal SBI BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Classification of Loan and Advances					
Performing Loans (A)	7,736,120	9,606,296	12,257,806	17698507	15296096
Pass	7,393,297	9,262,671	11,981,058	17471059	15081169
Restructured	342,821	343,624	276,747	227448	214926
Non-performing Loan (NPL) (B)	505,336	458,755	488,410	265133	315954
Sub-standard	1,797,016	3,284,812	3,874,789	12975351	13236
Doubtful	3,842,595	11,167,991	21,626,680	1113939	11339
Bad	499,697	444,302	462,909	251044	291380
Total Loan (D=A+B)	8,241,456	10,065,052	12,746,216	17963651	15612050
Total Provision (C)	614,720	604,601	632,518	483093	480302
Net Loans (D-C)	7626736	9460450	12113698	17480558	15131748
Loan Loss Provision	614,720	604,601	632,517	483093	480302
Pass	70,841	91,4867	117,923	173584	149467
Restructured	46,278	66,461	47,764	60346	39071
Sub-standard (E)	318	545	566	3190	2741
Doubtful (F)	1,921	3,893	9,869	219	3685439
Bad (G)	495,361	442,216	456,396	245755	285338
Additional Provision	-	-	-	-	-
NPL to Total Loan (B/D)	6.13%	4.56%	3.83%	1.48%	2.02%

Net NPL to Total Loan					
(B-(E+F+G))/D	0.09%	0.12%	0.17%	0.09%	0.15%

(Source: Annual Report of Nepal SBI Bank Ltd.)

Appendix 11

Loan Classification and Provision of NIC Bank for the year 2062/63-2066/67

(Rs. in thousands)

NIC BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	6,722,570	9,027,509	11,367,167	13,786,67	12,836,811
Pass	6,689,502	9,019,678	11,350,45	13,771,077	12,836,811
Restructured	33,068	7,831	16,709	15,594	-
Non-performing Loan (NPL) (B)	179,554	101,140	98,167	129,178	92,493
Sub-standard	654,368	6,133	9,632	2,422	18,648
Doubtful	7,865	928	11,760	61,131	19,170
Bad	171,036	94,078	76,774	65,625	54,675
Total Loan (D=A+B)	6,902,124	9,128,649	11,465,334	13,915,850	12,929,304
Total Provision (C)	246,160	187,252	200,656	236,456	197,290
Net Loans (D-C)	6655964	8941398	11264678	13679394	12732014
Loan Loss Provision	246,160	187,252	200,656	236,456	197,290
Pass	66,895	90,197	113,505	137,711	128,368
Restructured	4,133	979	2,089	1,949	-
Sub-standard (E)	163,592	1,533	2,408	606	4,662
Doubtful (F)	3,932	464	5,880	30,566	9,585
Bad (G)	171,036	94,078	76,774	65,625	54,675

Additional Provision	-				
NPL to Total Loan (B/D)	2.60%	1.11%	0.86%	0.93%	0.72%
Net NPL to Total Loan (B-(E+F+G))/D	0.06%	0.06%	0.11%	0.23%	0.18%

(Source: Annual Report of NIC Bank Ltd.)

Appendix 12

Loan Classification and Provision of Kumari Bank for the year 2062/63-2066/67

(Rs. in thousands)

KUMARI BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	6,943,434	8,996,315	11,369,905	14,730,719	14,890,570
Pass	6,876,565	8,957,703	11,332,149	14,724,716	14,886,637
Restructured	66,869	38,612	37,756	6,003	3,933
Non-performing Loan (NPL) (B)	64,353	66,119	152,476	64,543	75,510
Sub-standard	12,2367	10,378	58,321	13,083	10,149
Doubtful	32,745	38,636	78,966	31,735	34,178
Bad	19,372	17,104	15,188	19,724	31,183
Total Loan (D=A+B)	7,007,788	9,062,433	11,522,380	14,795,261	14,966,080
Total Provision (C)	115,932	133,420	187,293	201,914	200,167
Net Loans (D-C)	6891855	8929013	11335088	1459335	14765912
Loan Loss Provision	115,932	133,420	187,292	201,914	200,167
Pass	68,770	89,577	113,321	147,247	148,866
Restructured	8,358	4,827	4,720	750	492
Sub-standard (E)	3,059	2,595	14,580	3,271	2,537
Doubtful (F)	16,3723	19,318	39,483	30,922	17,089
Bad (G)	19,372	17,104	15,188	19,724	31,183

Additional Provision	-	-	-	-	-
Gross NPL to Total Loan (B/D)	0.92%	0.73%	1.32%	0.44%	0.50%
Net NPL to Total Loan (B-(E+F+G))/D	0.36%	0.30%	0.72%	0.07%	0.17%

(Source: Annual Report of Kumari Bank Ltd.)

Appendix 13

Loan Classification and Provision of Nepal Bank for the year 2062/63-2066/67

(Rs. in thousands)

NEPAL BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	10,179,371	11,900,571	13,697,852		23,832,678
Pass	9,547,007	11,180,439	13,697,852	18,593,370	23,708,233
Restructured	632,364	720,132	-	18,074,954	1 24,444
				518,416	
Non-performing Loan (NPL) (B)	2,262,183	1,856,049	2,067,145	966,723	1,219,674
Sub-standard	46,763	17,246	63,977	64,764	326,034
Doubtful	87,942	29,848	20,580	17,888	16,207
Bad	2,127,478	1,808,955	1,982,587	884,070	877,433
Total Loan (D=A+B)	12,441,554	13,756,620	15,764,997	19,560,094	25,052,352
Total Provision (C)	2,685,392	2,698,142	2,513,034	1,945,195	1,491,396
Net Loans (D-C)	9756162	11058478	13251963	17614899	23560956
Loan Loss Provision	2,685,391	2,698,142	2,513,034	1,945,195	1,491,396
Pass	202,617	170,161	578,367	565,423	5 08,796
Restructured	281,066	698,415	-	464,629	15,556
Sub-standard (E)	13,150	5,498	57,066	20,373	81,509
Doubtful (F)	61,079	15,112	10,433	10,700	8,103
Bad (G)	2,127,478	1,808,955	1,867,167	884,070	877,433
Additional Provision	-	-	-	-	-
NPL to Total Loan (B/D)	18.18%	13.49%	13.11%	4.94%	4.87%
Net NPL to Total Loan (B-(E+F+G))/D	0.49%	0.19%	0.84%	0.26%	1.01%

(Source: Annual Report of Nepal Bank Ltd.)

Appendix 14

Loan Classification and Provision of Agricultural Development Bank for the year 2062/63-2066/67

(Rs. in thousands)

AGRICULTURAL DEVELOPMENT BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	26,451,752	28,255,074	32,324,208	34,580,329	36,273,500
Pass	25,553,855	26,899,183	31,343,205	32,857,853	35,241,946
Restructured	897,897	1,355,891	981,002	1,722,476	1,031,554
Non-performing Loan (NPL) (B)	6,858,994	6,185,295	4,280,510	3,720,774	3,309,372
Sub-standard	688,688	547,736	460,100	602,409	444,690
Doubtful	1,155,929	1,050,041	667,922	793,206	651,817
Bad	5,014,377	4,587,519	3,152,488	2,325,159	2,212,865
Total Loan (D=A+B)	33,310,746	34,440,369	36,604,718	38,301,103	39,582,872
Total Provision (C)	8,409,833	7,188,036	6,015,290	5,698,007	5,705,915
Net Loans (D-C)	24900914	27252333	30589428	32603096	33876957
Loan Loss Provision	8,409,833	7,188,036	6,015,290	5,698,007	5,705,915
Pass	255,539	268,992	313,432	329,815	353,809
Restructured	112,237	169,486	122,625	221,236	128,944
Sub-standard (E)	172,172	136,934	115,025	151,686	126,941
Doubtful (F)	577,964	525,020	333,961	396,603	337,208
Bad (G)	5,014,377	4,587,519	3,152,488	2,325,159	2,269,521
Additional Provision	2,277,543	1,500,085	1,977,758	2,273,508	2,489,492
NPL to Total Loan (B/D)	20.59%	17.96%	11.69%	9.71%	8.36%

Net NPL to Total Loan					
(B-(E+F+G))/D	3.29%	2.72%	1.86%	2.21%	1.45%

(Source: Annual Report of Agricultural Development Bank Ltd.)

Appendix 15

Loan Classification and Provision of NCC Bank for the year 2062/63-2066/67

(Rs. in thousands)

NCC BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loans (A)	4609260	3515349	4413735	6986612	8146576
Pass	4166623	3183329	4222918	6861324	8030205
Restructured	442637	332020	190817	125288	116370
Non-performing Loan (NPL) (B)	1289905	1606872	867316	197069	241322
Sub-standard	89847	85582	24769	12319	21009
Doubtful	147101	388064	110062	12239	57858
Bad	1052957	1133226	732485	172510	162456
Total Loan (D=A+B)	5899165	5122221	5281051	7183681	8387898
Total Provision (C)	1256477	1414579	863194	325487	393180
Net Loans (D-C)	4642688	3707642	4417857	6858194	7994718
Loan Loss Provision	1256477	1414579	863194	325487	393180
Pass	51031	31804	48276	73503	86615
Restructured	64812	42091	23831	71843	108524
Sub-standard (E)	22358	21393	6073	3096	7926
Doubtful (F)	72061	194032	54984	6120	28928
Bad (G)	1046216	1125258	730029	170925	161185
Additional Provision	-	-	-	-	-

NPL to Total Loan (B/D)	21.87%	31.37%	16.42%	2.74%	2.88%
Net NPL to Total Loan (B-(E+F+G))/D	2.53%	5.20%	1.44%	0.24%	0.52%

(Source: Annual Report of NCC Bank Ltd.)

Appendix 16

Loan Classification and Provision of Lumbini Bank for the year 2062/63-2066/67

(Rs. in thousands)

LUMBINI BANK	2062/63	2063/64	2064/65	2065/66	2066/67
Classification of Loan and Advances					
Performing Loans (A)	2982344	3937465	4,566,647	5166818	5244134
Pass	2777632	3770204	4,441,749	4981548	5139633
Restructured	204712	167260	124,898	185270	104502
Non-performing Loan (NPL) (B)	1339243	1007036	800,662	514576	248776
Sub-standard	52431	42851	12,290	1556	2586
Doubtful	26562	23419	5,288	1291	24068
Bad	1260250	940765	783,083	511728	222123
Total Loan (D=A+B)	4321586	4944501	5,367,309	568139	549291
Total Provision (C)	1337691	1103814	877,815	698006	385647
Net Loans (D-C)	2983895	3840687	4489494	4983388	5107263
Loan Loss Provision	1337691	1103814	877,815	698006	385647
Pass	28172	78999	57,551	49782	51400
Restructured	26654	64527	33,569	136756	99502
Sub-standard (E)	12687	10713	3,072	389	646
Doubtful (F)	12999	11710	2,644	645	11976
Bad (G)	1257179	937866	780,978	510433	222123
Additional Provision	-	-	-	-	-

NPL to Total Loan (B/D)	30.99%	20.37%	14.92%	9.06%	4.53%
Net NPL to Total Loan (B-(E+F+G))/D	1.30%	0.95%	0.26%	0.05%	0.26%

(Source: Annual Report of Lumbini Bank Ltd.)