CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Nepal though rich in its natural beauty and resources, stands at the bottom even among the least developed countries. Nepal is at its development phase, it is rich in art and craft, culture and religion. During the period of Rana regime, rare developmental activities were seen at. After the emergence of democracy, Nepal proceeding in the path of development step by step. Its developmental move is seen in each and every sector but not so satisfactorily. In the least developed countries like Nepal, plans and policies are developed either from the technical assistance of donor agencies or the local talents are used. As a result, the planning part of the development effort remains generally good as against implementation. So, to boost up the economy, proper supervisory and monitoring body is essential. In the context of the favorable macroeconomic indicators and based on the concept of competitive financial system, Nepal Rastra Bank has been implementing the policy of monetary so as to provide dynamism to the economy. In the light of the global that a strong, well managed, and efficient financial system would contribute positively to the sustainable development of the economy, the NRB has set its priority in devising and implementing appropriate legal, regulatory, managerial, and supervisory policies and provisions aimed at building a sound and stable financial sector.

Banking system occupies an important place in a nation's economy. A banking institution is indispensable in a modern society. It plays a vital role in the development of economy of the country and forms the core of the money market in an advanced country. In the current background of the rapid expansion of the bank and financial intuition network along with the financial sector liberalization, the implementation of this monetary policy will enhance the effectiveness of the NRB to undertake appropriate regulation, supervision and monitoring responsibilities for the qualitative development of the financial sector. For supervision, regulation and monitoring of Banks and financial institutions, NRB has issued NRB Directives.

NRB has set down various rules and regulation for banks and the banks has to follow them. So, NRB is also known as banker's bank. If the banks do not follow the rules and regulations issued by the central bank, the bank will be obliged to pay penalties. Generally, to bring uniformity and to amend the rules and regulations, NRB issues directives to the commercial banks from time to time and amends them on "need basis". The commercial banks have to modify their functions accordingly.

1.1.1 Evolution of Banking Industry in the World

The evolution of banking industry had started a long time back, during ancient times. There was reference to the activities of moneychangers in the temple of Jerusalem in the New Testament. In ancient Greece the famous temples of Delphi and Olympia served as the great depositories for peoples' surplus funds and these were the centers of money lending transaction. Indeed the traces of "rudimentary banking" were found in the Chaldean, Egyptian and Phoenician history. The development of banking in ancient Rome roughly followed the Greek pattern. Banking suffered oblivion after the fall of the Roman Empire after the death of Emperor Justinian in 565 AD, and it was not until the revival of trade and commerce in the Middle Ages that the lessons of finance were learnt anew from the beginning. Money lending in the middle Ages was, however, largely confined to the Jews since the Christians were forbidden by the Canon law to indulge in the sinful act of lending money to others on interest. However, as the hold of the Church loosened with the development of trade and commerce about the thirteenth century Christians also took to the lucrative business of money lending, thereby entering into keen competition with the Jews who had hitherto monopolized the business.

As a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy and the Bank of Venice, founded in 1157 was the first the public banking institution. Following it were established the Bank of Barcelona and the Bank of Genoa in 1401 and 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate until the eighteenth century. With the expansion of commercial activities in Northern Europe there sprang up a number of private banking houses in Europe and slowly it spread throughout the world. In Nepal, modern banking starts from the establishment of Nepal Bank Limited.(Shrestha, 2010: 85)

1.1.2 Development of Banking Industry in Nepal

In the country, the development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. Involvement of landlords, rich merchants, shopkeepers and other individual moneylender has acted as fence to institutional credit in presence of unorganized money market.

In Nepal "Udyog Parishad (Industrial Development Board) was constituted in 1936 AD. One year after it's formulation, it formulated the "Company Act" and "Nepal Bank Act" in 1937 A.D.

In the year 1934 AD, the establishment of Nepal Bank Ltd, with the Imperial Bank of India came into existence under "Nepal Bank Act, 1937" as the first bank of Nepal, inaugurated by this Majesty King Tribhuwan on November 1937.

Rastriya Banijya Bank, the second bank and acting as commercial bank was established in the year 1965. RBB being the largest commercial bank plays a major role in the economy. The financial shapes of the two old banks have a tremendous impact on the economy. That is the reason why these banks still exist in spite of their bad position.

Thus, we can say that modern banking practices began only before the Second World War with the establishment of the first banking institute, Nepal Bank Limited, which was establishment as a joint venture of government and private individuals.

Earlier banks were different from modern commercial banks in many respects. The banks, which operated in the past, combined central banking functions such as issue of currency, with commercial banking operations like accepting deposits and financing

Business. In course of time this practice was abandoned and specialized institutions for the central banking functions were created. Now, a central bank can be easily distinguished from a commercial bank sue to their objectives and unique functions.

On the long run Commercial Bank Act was felt, accordingly it was established in 1974 AD. According to section 2(a) of Commercial Bank Act 1974, the commercial banks are the heart of the economic system.

In modern times, commercial banks, which are facilitated, regulated and supervised by the Central bank, confined them and concentrated in their activities of fulfilling the financial needs of their customers.

The opening of NABIL bank in 1985, opening commercial banks was opened to the private sector. Then whole lot of commercial banks was opened in Nepal. Today all the Banks expect Nepal Bank Ltd. and Rastriya Banijya Bank are making profit. The inefficiency of these two public sector banks has lead to the success of other private banks.

As the commercial bank grew they stopped entertaining small projects. Thus a scope for opening finance companies emerged. In 2042 B.S., finance company Act was passed; but private sector kept stony silence till 2049 B.S. The first break came in month of Shrawan of that year, when first company Nepal Housing and Development Finance Company came.

Financial liberation took place in Nepal in the mid 1980's. The reform measures included deregulation in interest rate determination, portfolio management, market-based tenders for government securities sales, non-subsidized credits etc. the market would determine the cost of funds and rate of lending. Banks must innovate to remain in the forefront. Better use of funds, easily availability of funds to the entrepreneurs, better returns to the depositors, professional approach towards customer satisfaction.

Whatever name we give to banks, like Business banks, Retail banks, clearing banks, Joint venture banks, Merchant Banks etc., they all perform the same basic function. Like other organization, the main objective of the banking industries will be profit maximization and wealth maximization.

Now 32 commercial banks, 87 development banks, 79 finance companies, 21 micro development banks, 19 micro finance companies and 38 NGO's . They all have got their own rules & regulations and own vision but ultimately they are serving Nation to build huge financial resources and mobilizing it in the best possible way.

The banking sectors remained still for a long period time but as the time passed on many developments occurred. In the present scenario, Nepal banking system is evolving itself as a powerful instrument of planning and economic growth of all the developed and underdeveloped sectors. The scope and scale of banking too have undergone substantial change in response to the saving and credit needs of people.(Shrestha,2011: 16)

1.1.3 Institutions in Nepalese Financial Systems

Table 1.1

Organizations under NRB Regulation, Supervision & Monitoring in Nepal

Organization	No of institutions in 2012
Central Bank	1
Commercial Banks	32
Finance Companies	79
Development Banks	81
Micro-Credit Development Banks	12
Savings & Co-operatives (Limited Banking)	16
NGOs licensed by NRB	46
Employee Provident Fund	1
Citizens Investment Trust	1
Total	**268**
Note: The above list does not include the Cooperatives licensed by Cooperatives Board.	

Source: www.nrb.org.np as on 7th June 2012

Note: The above list does not include the Cooperatives licensed by Cooperatives Board.

1.1.4 Challenges of Financial System of Nepal

As financial sector has evolved as the biggest sector in the economy, There are altogether 162 financial institutions representing Class A, B, C and D as per Banks & Financial Institutions Act and currently more than 20 thousand people working in these institutions.

While doing root cause analysis, two very strong reasons have evolved. The first reason being the poor quality of loans due to non-compliance of basic credit principles while granting loans coupled with lack of credit-skills assessment and the second reason being almost all the financial institutions by and large being involved only in dealing with undifferentiated vanilla banking products. For example, if someone needs a car loan, which is typically a commercial bank product, he or she can walk into any development bank in the country.

After considering the factors, we can safely conclude that for a true and sustainable financial sector reform, other than addressing issues on Loan Recovery and Loan Management, we also need to focus on capacity building of the financial market players by providing them platforms which will enable them to acquire specialized and focused knowledge on global banking products. It is highly evident, that in-depth exposure of these products will not only add significant value to the customers of the banking sector, but also will enable the banks to witness many new openings from where additional revenue streams can be generated for the banks.

1.1.5 NRB, the Central Bank of Nepal as a Regulatory Body

Nepal Rastra Bank is known as the central bank of Nepal. It was established on the nation's control under NRB act 1955 on April 26th, 1956, as a non-profit organization fully subscribed by the government. Prior to this bank, there was no such formal organization that controls and regulates the monetary system in the country. It is an autonomous body with the main objective of developing of the countries economy using different financial tools. As per the NRB act, the main objectives of the bank are as fallows:

1. To issue notes
2. To promote the use of Nepalese notes in the country as the use of Indian currency was very popular in Nepal prior to its establishment.
3. To stabilize the foreign currency system with the domestic currency.
4. To promote banking system throughout the country.
5. To advice the government with regards to fiscal and monetary policies for the economic development of the country.
6. To facilitate in the transactions of the government.

The organizational structure of the bank is similar to all other banks throughout the world. The top body of bank is its Board of Directors who sets goals and objectives and defines policies. The Board of Directors is comprised of four representatives from the government, two deputy governors and the governor is the chairperson of the Board. In order to achieve its goals and objectives, it has its monopoly rights to develop its own policies.(Shrestha, 2010: 44)

1.1.6 Regulation of NRB

It is always in need of regulating body so that the financial institutions are lead in the proper track. Without the regulating body, these financial institutions will track themselves according to their motives. These motives may lead themselves to the profit but without the welfare of the country and its economy. So, NRB issues directives from time to time. The directives issued by NRB to the commercial Banks in short are related with the points given below:

1. The provision of minimum capital fund to be maintained by the commercial bank.
2. The provision of loan classifications and loan loss provisioning on the credit.
3. The provision relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
4. The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.
5. Regulation relating to minimization of risk inherent in the activities of commercial banks.

6. The provision of institutional good governance to be followed by commercial banks.
7. Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of commercial banks.
8. Regulation relating to investment in shares and securities by commercial banks.
9. The provision of submission of statistical data to the NRB. Banking management division and inspection and supervision division.
10. Regulation relating to sale and ownership transfer of promoters shares.
11. Regulation relating to, stringent blacklisting procedure for loan defaulters.
12. The provision relating to compulsory deposited amount of NRB.
13. Regulation relating to developing the branch office of commercial banks.
14. Provision relating to interest rates.
15. Provision relating to collection of financial sources.
16. Provision relating to consortium financing.

1.1.7 Commercial Banks of Nepal

According to banks and financial institution act 2063 “Commercial banks are those banks which are established under this act to perform commercial function. The commercial banks pool together the saving of the community and arrange for their productive use.

Commercial banks are the major component in the financial system. They work as the intermediary between depositors and lenders and facilitate in overall development of the economy, with major thrust in industrial development.

Commercial bank came into existence mainly with the objectives of collecting the idle funds, mobilizing them into productive sector and causing and overall economic development.

1.1.8 Growth of Commercial Banks in Nepal

The banking sector in Nepal stated with the establishment of Nepal Bank Limited. Today, we got 32 commercial banks in operation. The commercial banks of Nepal can be categorized into two types Public Sector and Private Sector. Public sector banks include the two old banks NBL and RBB. Private sector comprises the other 32 banks.

Table 1.2
Commercial Banks Guided by NRB Directives

1. Nepal Bank Ltd.
2. Rastra Banijya Bank Ltd.
3. NABIL Bank Ltd.
4. Nepal Investment Bank Ltd.
5. Standard Chartered Bank Nepal Ltd.
6. Himalayan Bank Ltd.
7. Nepal SBI Bank Ltd.
8. Nepal Bangladesh Bank Ltd.
9. Everest Bank Ltd.
10. Bank of Kathmandu Ltd.
11. Nepal Credit and Commerce Bank Ltd.
12. Lumbini Bank Ltd.
13. Nepal industrial and commercial Bank Ltd.
14. Machhapuchhre Bank Ltd.
15. Kumari Bank Ltd.
16. Laxmi Bank Ltd.
17. Siddhartha Bank Ltd.
18. Agriculture Development Bank Ltd.
19. Global Bank Ltd.
20. Citizen Bank International Ltd.
21. Prime Commercial Bank Ltd.
22. Bank of Asia Nepal Ltd.
23. Sunrise Bank Ltd.
24. DCBL Bank Ltd.
25. NMB Bank Ltd.
26. KIST Bank Ltd.
27. Janata Bank Nepal Ltd.
28. Civil Bank Ltd.
29. Commerz and Trust Bank Ltd.
30. Mega Bank Ltd.
31. Century Bank Ltd.
32. Sanima Bank Ltd.

Source: Banking & Financial Statistics of NRB 2012

1.2 Focus of the Study

The present study focuses on the capital structure of the selected commercial banks of Nepal. Special attention has been made to examine the capital availability in the respective banks in comparison with the benchmarks set out by the central bank (Nepal Rastra Bank). Further, an attempt has also been made to examine the loan loss provision practiced in these commercial banks vis-à-vis stability requirements as directed by NRB. To simplify the study, sampling method has been taken out of 32 commercial banks, only three commercial banks has been selected, namely, Nabil Bank Limited, Standard Chartered Bank Nepal Ltd and Everest Bank Ltd.

1.3 Statement of Problems

In 21st century, the increasing trend of banking sector in the country, there is a mushrooming growth of commercial banks in private sector as well as in joint venture. A large number of banking, serving in the small sector will obviously increase the top competition for survival which might leads to keen rivalry among them to occupy the bigger part. So there may offering of uneconomic rate of interest, including in risky enterprises, unhealthy competition etc. such situations may endanger the deposits of general public. In order to safeguard the public deposits and ensure the economic stability in the country, NRB issues directives from time to time to commercial banks. The directives are related to various performances of the banks and the banks are required to follow the directives. There are 22 directives related to the banking supervision and regulations.

In the beginning, due to lack of proper regulations Nepalese Commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problems of bad debts, overdue loans, accrued interest, accumulations of non-banking assets and excess liquidity in the banking system. Viewing the need of structural reform amidst these adverse implications, NRB has issued suitable directives to run commercial banks in a healthy competitive manner to ensure the sustainable developments of the overall banking system. As the banking sector is highly affected by various negative factors of the economy, this sector is facing numerous problems as stated above. Among them the following problems are especially focused for this research purpose.

1. By the year 2070 B.S. all commercial banks are required to have capital base of two billion. It is felt that some commercial banks will have difficulty to fulfill these requirements.
2. As per one of the current directions issued by Nepal Rastra Bank, commercials banks are required to arrange for loan loss provision as per the classification of loans advances. It is beamed that this has been same disciplinary in providing for the loan losses.

1.4 Objectives of the Study

NRB has under taken various activities for the banking and financial development since its establishment. NRB has issued various directives for commercial banks and other financial institutions for regulation, supervision and monitoring. The overall objective of the study is to review directives of the NRB related to commercial banks. But special attention is given to capital adequacy and loan loss provision of commercial banks. The specific objectives of this study are given below.

1. To assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB.
2. To study the loan loss provision of selected commercial banks and compares their provision with the concerned directive of NRB.
3. To make necessary recommendations to the commercial banks and Nepal Rastra Bank for improvement in the findings of the early two objectives of this study.

1.5 Significance of the Study

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

1. This research will help commercial banks to reassess their strategies and policies to cope with the development created by the recent changes made in the directives by NRB.
2. It helps NRB to find out condition of the compliance of directives, their shortcoming and take necessary actions.
3. This study will have importance on various groups but it is particularity dedicated to Nepal Restra Bank, commercial banks and financial institutions, depositors, borrowers, shareholders and other stake holders of the banks and financial institutions, and other research on similar matters.

1.6 Limitations of the Study

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

1. The study concerns with the directives issued by NRB. There are 22 directives issued by the NRB. It is almost impossible to take in account all the directives issued and make the study on them. So, only two directives are taken into account for the study.
2. To find out the compliance of the directives issued, the study doesn't focus on all the financial institutions. The study is only made for the commercial banks and sampling technique is used to choose three banks out of 32 commercial banks and comparative study is made.

1.7 Organization of the Study

The study has been organized into five chapters each devoted to some aspects of the study of the NRB directives. The chapters one to five consist of introduction, review of literature, research methodology, presentation and analysis of the data and summary, conclusions and recommendation. To follow the simple research methodology, it is rational behind this kind of organization of the study as:

CHAPTER -I: INTRODUCTION

It deals with introduction of the main topic of the study like general background, statement of the problems, objective of the study and organization of the study and other introductory framework.

CHAPTER -II: REVIEW OF LITERATURE

It includes with the review of available relevant studies. It will includes the conceptual review of the related books, journals, articles and the published and unpublished research works as well as thesis. It will also include review of NRB directives issued for commercial banks.

CHAPTER -III: RESEARCH METHODOLOGY

It describes research methodology employed in this study i.e. research carried out in this size and shape. For the purpose various financial and statistical tools and techniques are defined which is used for the analysis of the presented data.

CHAPTER -IV: DATA PRESENTATION AND ANALYSIS

This chapter is the major part of the whole study in which all collected relevant data are analyzed and interpreted by the help of different financial & statistical tools. In this chapter we will explain the major findings of the study.

CHAPTER -V: SUMMARY, CONCLUSION AND RECOMMENDATIONS

It contains the summary of the study, conclusion recommendation and suggestion on the basis of the study.

CHAPTER- II
REVIEW OF LITERATURE

Review of literature is an essential part of all studies. It is not only a way to discover what other research in the area of our problem has uncovered, but also helps to avoid investigating problems that have already been definitely answered. It is an integral and mandatory process in research works. It is necessary to show how the problem under investigation relates to previous research within theoretical framework and in such situation, the underlying theory needs to be reviewed well.

The research has also reviewed related literatures. Firstly, it has reviewed literature for conceptual framework which help to develop concept about NRB directives (focusing on capital adequacy and loan loss provision), and terms related with it. Then important finance journals, previous master's degree level theses, articles and newspapers related to the research topics were reviewed on the second part. It helps the researcher not only to find out the research gap but also helps to precede this study in a systematic manner.

2.1 Conceptual Framework

2.1.1 NRB Directives

Guidelines issued by NRB to banks and financial institution for regulation, supervision and monitoring is termed as NRB directives. NRB is authorized bank to regulate, control and develop the banking system; it gives permission for the setting up of new commercial bank and financial institutions and lastly, serves as a lender of last resort to commercial banks and financial institutions. The NRB's mandate incorporates the supervision, regulation and monitoring of all commercial banks, development banks, and finance companies as well as licensed NGOs and the co-operative engaged in micro finance. As NRB has the effective functioning of banks and financial institutions; it should issue guidelines for them, which are called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it. (Shrestha and Bhandari, 2011: 96)

2.1.2 Review of NRB Directives

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

Similarly, in our country too commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problem of bad debts, overdue loans, accrued interest, accumulation of non-banking assets and excess liquidity in the banking system. In addition to these expected happenings new challenger were added to the Nepalese banking sector due to the adverse development in the domestic economy resulting from deteriorating peace and security situation and continuous persistence of natural calamities inside the country on one hand and the global recession primarily caused by international terrorism on the other. Viewing the need of structural reform amidst these adverse implications, NRB issued directives to run commercial banks in a healthy competitive manner to ensure the sustainable development of the overall banking system. (Shrestha and Bhandari, 2011: 113)

The financial sector reform of Nepal was initiated in mid 1980s. Since then NRB has been playing pioneer role in regulation, supervision and monitoring of commercial banks by issuing directives. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows:

1. The provision of minimum capital fund to be maintained by the commercial bank.
2. The provision of loan classifications and loan loss provisioning on the credit.
3. The provision relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
4. The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.
5. Regulation relating to minimization of risk inherent in the activities of commercial banks.
6. The provision of institutional good governance to be followed by commercial banks.
7. Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of commercial banks.
8. Regulation relating to investment in shares and securities by commercial banks.
9. The provision of submission of statistical data to the NRB. Banking management division and inspection and supervision division.
10. Regulation relating to sale and ownership transfer of promoters shares.
11. Regulation relating to, stringent blacklisting procedure for loan defaulters.
12. The provision relating to compulsory deposited amount of NRB.
13. Regulation relating to developing the branch office of commercial banks.
14. Provision relating to interest rates.
15. Provision relating to collection of financial sources.
16. Provision relating to consortium financing.
17. Provisions Relating to Lending to Deprived Sector
18. Provisions Relating to Amalgamation, Merger and Upgrading
19. Provisions Relating to Know Your Customers
20. to Subsidiary Companies
21. Provisions Relating to E- Banking Service
22. Miscellaneous Provisions

(www.nrb.org.np)

2.1.3 Capital Adequacy

Capital adequacy ratios are a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposures. An international standard, which recommend minimum capital adequacy ratios, has been developed to ensure banks can absorb a reasonable level of losses before becoming insolvent. By applying minimum capital adequacy ratios serves to protect depositors and promote the stability and efficiency of the financial system.

Two types of capital are measured- tire one capital, which can absorb losses without a bank being required to cease trading, e. g .ordinary share capital, and tire two capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors, e. g. subordinate debt.

The "Basle Committee" (centered in the Bank for International Settlements), which was originally established in 1974, is a committee that represents central banks and financial supervisory authorized of the major industrialized counties (the GIO counties). The committee concerns itself with ensuring the effective supervision of banks on a global basis by setting and promoting international standards. Its principal interest has been in the area of capital adequacy ratios. This statement knows as the "Basle Capital Accord". It contains a recommended approach for calculating capital adequacy ratios and recommended minimum capital adequacy ratios for international banks. It has been adopted by the OECD countries and many other development nations. The Reserve Bank applies the principles of the Basal Capital Accord in New Zealand. (Rose, 2002: 88)

Minimum Capital Adequacy Ratios

The Basle Capital Accord sets minimum capital adequacy ratios that supervisory authorities are encouraged to apply. These are:

- Tier one capital to total risk weighted credit exposures to be not less than 4 percent;
- Total capital (i.e. tier one plus tier two less certain deductions) to total risk weighted credit exposures to be not less than 8 percent;

There are some further standards applicable to tier two capital:

- Tier two capital may not exceed 100 percent of tier one capital;
- Lower tier two capital may not exceed 50 percent of tier one capital;
- Lower tier two capitals are amortized on a straight line basis over the last five years of its life.

The reserve bank will not register banks in New Zealand that do not meet these standards and maintaining the minimum standards is always made a condition of registration.

- If the registered bank is incorporated in New Zealand, then the minimum standards apply to the financial reporting group of the bank.
- If the registered bank is a branch of an overseas bank, then it is the capital adequacy ratios of the whole overseas bank (and not the branch), which are relevant. Overseas banks which operate as branches are registered in New Zealand on the condition that they comply with the capital adequacy ratio requirements imposed by the financial authorities in their home country and that these requirements are no less than those recommended by the Basal Capital Accord.

When a registered bank falls below the minimum requirements, it must present a plan to the Reserve bank aimed at restoring capital adequacy ratios to at least the minimum level required. Even though a bank may have capital adequacy ratios above the minimum levels recommended by Basal Capital Accord, this is no guarantee that the bank is “safe”. Capital adequacy ratios are concerned primarily with credit risks. There are also other types of risks, which are not recognized by capital adequacy ratios e.g. inadequate internal control systems could lead to large losses by fraud, or losses could be made on the trading of foreign exchange and other types of financial instruments. Also capital adequacy ratios are only as good as the information on which they are based, e.g. if inadequate provisions have been made against problem loans, then the capital adequacy ratios will overstate the amount of losses that the bank is able to absorb. Capital adequacy ratios should not be interrupted as the only indicators necessary to judge a bank’s financial soundness. (Rose, 2002: 196)

2.1.4 Significance of Capital Adequacy

Capitals adequacy requirement is a must for effective running of bank capitals adequacy play a catalytic role in protection of bank from getting failure and as well as it also helps generate sufficient confidence among depositors and creditors. Thus purpose of capital adequacy ratio is to protect the interest of depositors and creditors by making bank keep more risk –free assets and by increasing their capital base. Adequate capital keeps the bank healthy and robust against all the contingencies and enhances the image of the bank in the financial market. Higher the capital adequacy ratio the more sound the bank is.

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

2.1.5 Executive Summary of Basal Committee on Banking Related Capital Adequacy (2003)

1. The Basel Committee on Banking Supervision (the Committee) has decided to introduce a new capital adequacy framework to replace the 1988 Accord. The Committee seeks views on its proposed approaches and on its plans for future work.
2. This new capital framework consists of three pillars: minimum capital requirements, a supervisory review process, and effective use of market discipline. With regard to minimum capital requirements, the Committee recognizes that a modified version of the existing Accord should remain the "standardized” approach, but that for some sophisticated banks use of internal credit ratings and, at a later stage, portfolio models could contribute to a more accurate assessment of a bank's capital requirement in relation to its particular risk profile. It is also proposed that the Accord's scope of application be extended, so that it fully captures the risks in a banking group.
3. The world financial system has witnessed considerable economic turbulence over the last two years and, while these conditions have generally not been focused on G-10

countries directly, the risks that internationally active banks from G-10 countries have had to deal with have become more complex and challenging. This review of the Accord is designed to improve the way regulatory capital requirements reflect underlying risks. It is also designed to better address the financial innovation that has occurred in recent years, as shown, for example, by asset securitization structures. As a result of this innovation, the current Accord has been less effective in ensuring that capital requirements match a bank's true risk profile. The review is also aimed at recognizing the improvements in risk measurement and control that have occurred.

4. The Committee is committed to ensuring that any review of the Accord should meet the following supervisory objectives:
5. the Accord should continue to promote safety and soundness in the financial system and, as such, the new framework should at least maintain the current overall level of capital in the system;
6. the Accord should continue to enhance competitive equality;
7. the Accord should constitute a more comprehensive approach to addressing risks
8. The Accord should focus on internationally active banks, although its underlying principles should be suitable for application to banks of varying levels of complexity and sophistication.
9. In constructing a revised capital framework, the importance of minimum regulatory capital requirements continues to be recognized. This is the first pillar of the framework. The Committee is now stressing the importance of the supervisory review of an institution's capital adequacy and internal assessment process as the second pillar. The third pillar, which the committee has underlined in recent years, is the need for greater market discipline. The Committee believes that, taken together, these three elements are the essential pillars of an effective capital framework.
10. With regard to minimum regulatory capital requirements, the Committee is building on the foundation of the current Accord, which will serve as a "standardized" approach for capital requirements at the majority of banks. In so doing, the Committee proposes to clarify and broaden the scope of application of the current Accord. With regard to risk weights to be applied to exposures to sovereigns, the Committee proposes replacing the existing approach by a system that would use

external credit assessments for determining risk weights. It is intended that such an approach will also apply, either directly or indirectly and to varying degrees, to the risk weighting of exposures to banks, securities firms and corporate. The result will be to reduce risk weights for high quality corporate credits, and to introduce a higher-than-100% risk weight for certain low quality exposures. A new risk weighting scheme to address asset securitization and the application of a 20% credit conversion factor for certain types of short-term commitments are also proposed.

11. For some sophisticated banks, the Committee believes that an internal ratings-based approach could form the basis for setting capital charges, subject to supervisory approval and adherence to quantitative and qualitative guidelines. The Committee will (in consultation with the industry) be examining these issues, and will seek to develop an alternative approach based on internal ratings within the same timeframe as its review of the "standardized" approach. The Committee believes that this will be an important step in the effort to align more closely capital charges with underlying risk. Looking further ahead, the Committee will closely monitor developments in portfolio credit risk modeling for its possible use in regulatory capital calculations.
12. The Committee is also examining the capital treatment of a number of important credit risk mitigation techniques. To assist in this process, the Committee is seeking comment on approaches for devising a sound and consistent approach for credit derivatives, collateral, guarantees, and on-balance-sheet netting.
13. The existing Accord specifies explicit capital charges only for credit and market risks (in the trading book). Other risks, including interest rate risk in the banking book and operational risk, are also an important feature of banking. The Committee therefore proposes to develop a capital charge for interest rate risk in the banking book for banks where interest rate risk is significantly above average, and is proposing to develop capital charges for other risks, principally operational risk.
14. The second pillar of the capital adequacy framework, the supervisory review of capital adequacy, will seek to ensure that a bank's capital position is consistent with its overall risk profile and strategy and, as such, will encourage early supervisory intervention. Supervisors should have the ability to require banks to hold capital in

excess of minimum regulatory capital ratios – a point underscored in the course of the Committee's discussions with supervisors from non-G-10 countries. Furthermore, the new framework stresses the importance of bank management developing an internal capital assessment process and setting targets for capital that are commensurate with the bank's particular risk profile and control environment. This internal process would then be subject to supervisory review and intervention, where appropriate.

15. The third pillar, market discipline, will encourage high disclosure standards and enhance the role of market participants in encouraging banks to hold adequate capital. The Committee proposes to issue later this year guidance on public disclosure that will strengthen the capital framework.
16. Looking to the future, the Committee believes that the Accord must be responsive to financial innovation and developments in risk management practices. The Committee's longer-term aim is to develop a flexible framework that reflects more accurately the risks to which banks are exposed. The Committee therefore will examine further ways of making the capital adequacy framework more risk sensitive and welcomes comments on how best to do this.
17. The Committee seeks comments from all interested parties by 31 March 2000, and plans to set forth more definitive proposals later in the year 2000.

2.1.6 Consultative Paper on a New Capital Adequacy Framework (2005)

1. This paper sets out the Committee's proposals for a new capital adequacy framework.
2. The merits and weaknesses of the existing Accord are briefly discussed, along with the Committee's objectives for a new Accord.
3. Today's rapidly changing world requires a broad-based and flexible capital adequacy framework. The Committee believes this objective is best accomplished through three pillars: minimum capital requirements; a supervisory review of capital adequacy; and market discipline. Each of these three complementary pillars is needed for supervising both the overall financial health of the banking industry and

that of individual institutions, though none can substitute for effective bank management.

4. The Committee believes that, by focusing on risk and risk management, the new framework has the potential to meet the challenges of innovations in increasingly complex financial markets.

2.1.7 NRB Directives Related to Capital Adequacy

1. Minimum Capital Adequacy Ratio

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

Capital adequacy as a legal requirement that a financial institution should have enough capital to meet all its obligations and fund the services it offers.

The provision of minimum capital fund to be maintained by the commercial banks as per directed by NRB since fiscal year 2058/059 is as follows:

Table 2.1

Capital fund to be maintained by Commercial Banks

Time Period	**Capital fund in % on the basis of Total risk weighted assets**	
	Core capital	**Total capital fund**
2060/061	4.50	9.00
2062/063	5.00	10.00
2063/064 to till date	5.50	11.00

Source: Unified Directives 2063/064

2. Classification of Capital

According to unified directives 2063, capital is divided in to two parts i.e. core capital and supplementary capital. Core capital and supplementary capital is also known as Tier-1 capital and Tier-2 capital respectively.

I. Core Capital (Tier-1 Capital)

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

- Share Capital Share Premium
- Irredeemable preference shares
- General reserve fund
- Cumulative profit/loss
- Capital Redemption Reserve
- Capital adjustment fund.
- Other free reserves

  Following items should be deducted while calculating core capital:

- Goodwill
- Excess investment in shares and other securities of organized institutions determined by NRB.
- Investment in shares and other securities of organized institutions in which bank or financial institution has own financial interests.
- Fictitious Assets.

II. Supplementary Capital (Tier-2 Capital)

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

- Loan loss provision for pass loan, total excess amount of provision over the NRB requirements for substandard, doubtful and loss category of loans and loan loss provision made for restructured or rescheduled loans.
- Assets revaluation reserve
- Hybrid capital instruments
- Unsecured subordinated term debt
- Exchange equalization reserve
- Provision for possible loss in investment and investment adjustment fund.

Notes:-

i. Under supplementary capital exchange equalization reserve is deleted through the amendment unified directive 2063.

ii. Loan loss provision up to 1.25% of total risk weighted assets is considered as supplementary capital.

iii. Gain from revolution of assets is transferred to Asset revolution reserve but fund in asset Revolution reserve up to 2% of supplementary capital is treated as supplementary capital.

iv. Hybrid capital instruments include those securities which are issued without collateral security, fully paid, lower priority in payment than depositors and creditors, and participation in loss or can be converted into equity capital.

v. Subordinate term debt includes debentures or bonds which are issued without any collateral security and low priority in payment than depositors and maturity period more than five years. But these instruments should not be issued to raise capital more 50% of core capital fund.

3. Total Risk Weighted Assets

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

I. On- Balance Sheet Risk-Weighted Assets

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

Table 2.2

Risk-Weighted on-Balance Sheet Assets

On Balance Sheet Assets	**Risk Weighted %**
➢ Cash balance	0%
➢ Gold (Tradable)	0%
➢ Balance at NRB	0%
➢ Investment on Government bonds/ securities	0%
➢ Investment on NRB bonds/ securities	0%
➢ Fully secured loan against own FDR	0%
➢ Fully Secured Loan against Government Securities	0%
➢ Balance at domestic banks & financial institutions	20%
➢ Fully secured loan against other banks FDR	20%
➢ Balance with foreign banks	20%
➢ Money at Call	20%
➢ Loan against the Guarantee of Internationally Rated Banks	20%
➢ Other Investments with Internationally Rated Banks	20%
➢ Investment on share, debentures and bond	100%
➢ Other Investment	100%
➢ Loan, Advances and Bills Purchased/Discounted	100%
➢ Fixed assets	100%
➢ All Other Assets	100%

Source: Unified Directives 2063/064

II. In order to determine the value of Risk –Weighted Assets

Off balance sheets items of a bank the items are grouped into four categories and accordingly risk weight of 10%, 20%, 50% and 100% have been assigned .The risk weight assigned for off –balance sheets items, the value of the off-balance sheets items shall be multiplied by their respective risk –weights and then added together.

Table 2.3

Risk –Weighted off –Balance Sheets Items

Off –Balance Sheets Items	**Risk Weighted %**
➢ Bills collection	0%
➢ Forward foreign exchange contact.	10%
➢ L/C with maturity of more than 6 months (full value)	20%
➢ Guarantee provided against counter guarantee of internationals rated foreign bank	20%
➢ L/C with maturity of more than 6months (full value)	50%
➢ Bid bond	50%
➢ Performance bond	50%
➢ Advance payment guarantee	100%
➢ Financial guarantee	100%
➢ Other guarantee	100%
➢ Contingent Tax Liability	100%
➢ Irrevocable loan commitment	100%
➢ Contingent Liability in Respect of Income Tax	100%
➢ Other contingent liabilities (including Acceptances & Endorsements)	100%

Source: Unified Directives 2063/064

4 . Capital Adequacy Ratio

Capital Adequacy Ratio is calculated by using following formula:

$$\text{Capital Adequacy Ratio (CAR)} = \frac{\text{Core Capital} + \text{Supplementary Capital}}{\text{Risk Weighted Assets.}} \times 100$$

OR,

$$\text{CAR} = \frac{\text{Tier - 1 Capital} + \text{Tier - 2 Capital}}{\text{Risk Weighted Assets.}} \times 100$$

Total Risk Weighted Assets = Risk-Weighted on-Balance Sheet Assets **+** Risk –Weighted off –Balance Sheets Assets

5. Statements to be submitted to NRB

Banks are required to submit the report of capital adequacy along with other required data related with it, on a quarterly basis within one month from the end of each quarter.

6. Duration to Maintain Capital Adequacy

In case capital adequacy ratio is found shortfall board of directors of banks are required submit cause of shortfall of capital adequacy and capital planning and programs prepared in order to meet capital adequacy requirements within 35 days. After receiving proposed plan and program NRB directs bank to fulfill the requirement with in certain time stipulated by NRB to that institution. Bonus and bonus shares can not be issued while three is shortfall of capital.

7. Action against not fulfilling the Requirement of Capital Adequacy Ratio

- Prohibition on opening of new branch
- Refinancing facility from NRB is not provided
- Prohibition on loan distribution
- Prohibition on accepting new deposits
- Other actions as per NRB Act 2058, Article 100.

2.1.8 Loan classification and Loan Loss Provision

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

In such loan means money lend at interest. In commerce and finance term loan is used as the transfer of money or other property on promise of repayment along with interest, usually at a fixed future date. Loan loss provision is an arrangement made in order to safeguard from bankruptcy if loaned amount is not recovered or if the debtors default on repayment of loan. It provides buffer against future unexpected losses.

Loan and advances are the most profitable assets of commercial banks. This is the primary source of income of the bank. Loan and advances account for the largest part of the revenue of the bank. But bank need to be careful about the safety of such loan and advances because bank may be influenced by bad debts and loan and advances are least liquid assets among the entire bank's assets. Bank may feel difficulty to realize them on short notice.

Loan and advances are classified in different ways for different purposes. As per NRB guidelines loan are classified as pass, substandard, doubtful and loss. Banks and other financial institutions have to maintain loan loss provision according to loan category. Provisions of NRB directives for loan classification and loan loss provisioning is analyzed in details in next topic.

2.1.9 NRB Directives Related to Loan Classification and Loan Loss Provision

1. Classifications of Loan and Advances

Effective from FY 2060/61 banks shall classify outstanding principal amount of loan and advances on the basis of aging. As per the directives issued by NRB, all loans and advances shall be classified into the following four categories:

a) Pass Loan

Loans and advances whose principal amount are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing loans.

b) Sub-Standard Loan

All loans and advances that are past due for a period of 3 months to 6 months shall be included in this category.

c) Doubtful Loan

All loans and advances which are past due for a period of 6 months to 1 year shall be included in this category.

d) Loss

All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

Loans and advances falling in this category of sub-standard, Doubtful and loss are classified and defined as Non-performing loan. It is appropriate in the view of the banks management; there is not restriction in classifying the loan and advances from low risk category to high risk category. For instance, loans falling under substandard may be classified into doubtful or loss and loans falling under doubtful may be classified into loss category. The term loan and advances also includes bills purchased and discounted.

Historical Provisions Relating to Loan Classification is depicted in the following table:

For fiscal year 2060/2061 B.S.

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

For fiscal year 2061/2062 B.S.

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

For fiscal year 2062/2063 B.S.

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

For fiscal year 2063/2064 B.S.

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

2. Additional Arrangement in Respect of Pass Loan

Loan and advances fully secured by gold, silver, fixed deposit receipts, credit cards and government securities shall be include under “pass” category. Loans against fixed deposit receipts of other banks shall also qualify for inclusion under pass loan. However, where collateral of fixed deposit receipt or government securities or NRB bonds is placed as extra security, such loan has to be classified on the basis of clause 1 to clause 7. While renewing working capital loan having maturity period up to one year can be classified as pass loan. If the interest of working capital nature loans and advance is not regular, such loan and advances should be classified on the basis of interest outstanding period.

3. Additional Arrangement in Respect of loss Loan

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

a. Security is not sufficient,
b. The borrower has been declared bankrupt,
c. The borrower is absconding or cannot be found,
d. Purchased or discounted bills are not realized within 90 days from the due date and non fund based letter of credit and guarantees etc are not realized with in 90 days from the date of conversion into fund based are not realized within 90 days,
e. The credit has not been used for the purpose originally intended,
f. Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation,
g. Loan provided to the borrowers included in the blacklist of credit information center (CIC),

h. Project or business is not in operative conditions, project or business is not in operation,
i. Credit Card Loan is not written off within 90 days from past due date.

4. Additional Arrangements in Respects of Term Loan

In respect of term loans, the classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

5. Prohibition to Recover Principal and Interest by Overdrawing the Current Account and Exceeding the Overdraft Limit

Principal and interest on loans and advance shall not be recovered by overdrawing the borrower's current account or where overdraft facility has been extended, by overdrawing such limit. However, this arrangement shall not be constructed as prohibitive for recovering the principal and interest by debiting the customers' account. Where a system in the bank exists as to recovery of principal and interest by debiting the customers' account, and recovery is made as such resulting in overdraft, which is not settled within one month, such overdrawn principal amount shall also be liable to be include under the outstanding loan and such loan shall be downgraded by one step from its current classification. In respects if recognition of interest, the same shall be as per the clause relating to income recognition mentioned in directives no 4.

6. Letter of Credit and Guarantees

If letter of credit and guarantees and other contingent liabilities converted into fund based liabilities and have to be paid, in such condition such loan shall be classified as pass loan within 90 days from the date of conversion into fund based. After 90 days such loan shall be classified as loss loan.

7. Rescheduling and Restructuring of the Loan

If the bank is confident on the following bases of written plan of action submitted by borrower, it may reschedule or restructure the loans and advances. Clear bases of rescheduling or restructuring should be attached with loan files.

a. If there is proof of adequate documents and collateral security relating to loan.
b. If the bank is confident in recovery of restructured or rescheduled loans and advances.

In addition to written plan of action for rescheduling or restructuring of loan, payment of at least 25 percent of total accrued interest up to the date of rescheduling of restructuring should have been collected.

8. Loan Loss Provisioning

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

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

2.2 Review of Article and Journals

Khatiwada (2008) in his article, *"Banking Sectors Reform in Nepal I & II: Implications for Corporate Governance"* on "The Telegraph Weekly", states "Recent financial crisis have revealed a number of data deficiencies, notably in pledged assets deposits held in financially weak domestic banks & their foreign affiliates, valuation practices leading to bank valuation of assets being significantly difference from market value and complicating assessment of the realizable value of reserve assets. Similarly, public information is lacking in many countries on the off-balance sheet activities of the authorities that can affect foreign currency resources. There was lack of information on the authorities' financial derivatives activities. Also observed was the inadequate information of actual and potential foreign liabilities of the monetary authorities & central government. FSR envisages for measures for mitigating this information and data gap problem as well. Nepal initiated FSR back in 1980s with donor initiative & assistance. In this process, some progress was made in terms of re-capitalization of the government banks, divestment, branch consolidation, introduction of new regulatory & 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 religion. 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." (Khatiwada, April 30, 2008 & May 7, 2008)

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 or 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 18 May 2008. 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.

Generally, the promoters of the CBs could possess 70 percent of the total share capital and 30 percent is required to be sold to the several public. Foreign banks could invest a maximum of 67% of the total share of the CB of the national level. Also, if the foreign bank agreed to acquire at least 20 percent of the total share capital should required to be sold to the general public. This required to be sold to Nepalese promoters to invest at an optimum level.

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 Kingdom 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.

Shrestha P (2009), in his articles *"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 hand 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 vicinity. To encourage the banks to establish branches in rural areas, NRB should extend certain incentives to them.

Adhikari R. P (2008), in his articles, *"Development of Banking and Financial Sector in past 25 Yrs"*, states that during the 90's the trend of CBs' branches expansion seems low than past due to the liberal policy followed by government and also NRB. Thus, it is necessary to change the present policy of NRB for rapid branch expansion of CBs.

2.3 Review of Previous Studies

Pandey S. (2002) entitled *"A Case Study of Himalayan Bank Ltd, NRB Directives their Implementation and Impact on the Commercial Bank"* concluded the following finding and recommendation. This study concluded that change in NRB directives has lot of impact on commercial banks rules and regulations as well as activities. Because of new directives, commercial bank has to increase the operational cost. Dividends to shareholders and bonus to the employees are scaled down due to decrease in profits of the banks. He also said that the changes in directives would bring prosperity of the shareholders depositors, employees and the economy as a whole in a long run. The tough time through which the bank is undergoing at present will prevail only for a short period. His suggestion to NRB is that the NRB should issue directives after doing proper homework. NRB must strengthen the functioning of its credit information bureau. NRB should be practical and should issue directives applicable in the context of Nepal. Directives should not be issued only to meet the international standards. Otherwise complaints may arise from commercial banks. However, in the present context, the commercial banks have to comply such directives and perform activities accordingly.

Shrestha S. (2007) entitled *"NRB Guidelines on Investment Policy of Commercial Bank in Nepal; A Case Study of Nabil Bank Ltd."* concluded the following finding and recommendation. In this study conclude that NRB has to play active or vital role to enhance the operation of commercial banks, development banks, finance companies and co-operatives. Strengthening and institutionalization of the commercial banks is very important to have a meaning relationship between commercial banks and national development through shift of credit to the productive industrial sectors. At the same time the series of reforms such as consolidation of commercial bank, directing attention to venture capital financing, appropriate risk return trade off by linking credit to timely repayment schedules avoiding imperfections, allowing flexibility in lending, one window service from NRB, strong supervision and monitoring form NRB, diversity scope of activities of commercial banks, professional culture within commercial banks etc. all these are necessary to ensure better future performance of commercial banks that have already been established and growing in Nepal.

Bhattarai M. (2008) entitled *"NRB capital Adequacy Norms for the Commercial Banks and its Impacts Case study of Bank of Kathmandu and Himalayan"* concluded the following finding and recommendation. *Bank* there was a significant impact of the directives on the various aspects of the commercial banks. Also, it was found that banks would fall short in supplementary capital but can maintain its total capital according to the new directives relating to capital adequacy norms. All the changes in NRB directives made impact on the bank and results were the increase in the operational procedures of the bank increased the operational cost of the bank. Short term decreases in profitability, which results to lesser dividends to shareholders and lesser bonus to the employees. Reduction in loan exposure of the bank decreases in interest income but increases the protection to the depositors' money. Increased protection to the money of the depositors through increased capital adequacy ratios adds more stringent loan related directives and increase in demand for shareholder's contribution in the banks by foregoing dividends for loan loss provisions and various other reserves to increase the core capital.

2.4 Research Gap

All the above studies are concerned with the research related to impact of NRB Directives on various aspects of commercial banks. There is very limited study done on Capital Adequacy and Loan Loss Provision with respect to NRB Directives by previous researchers. The most of the studies have been used as financial tools and secondary data. They have only included summary, findings and conclusion in their study but not recommend concrete suggestions to solve the findings problems.

Thus, to fill up the gap, researcher have been conducted this research topic through light on working on Capital Adequacy position and Loan Loss Provision status to suggest the possible measures for the betterment and welfare of the banking sectors. Researcher have used financial as well as statistical tools like ratio analysis, standard deviation, coefficient of correlation, probable error, regression analysis and primary tools. Almost all the ratios have been applied to cover the analytical part and fulfill the objectives of this study. It involves more recent data of selected banks for five years. Probably this study may be the first research of its kind in the area.

CHAPTER - III

RESEARCH METHODOLOGY

By research methodology we mean an overall method used while taking part in research activity. "Research methodology refers to the various sequential steps to be adopted by researcher in studying a problem with certain objectives in view" (Kothari, 1994: 56). To perform this activity, the chapter includes Research design, Population and sample, the sampling procedure, data gathering procedure and the data analysis procedures have been included.

The study focuses on the directives issued by Nepal Rastra Bank to the financial institutions to control and regulate these institutions especially to the commercials banks. The study is made with respect to capital adequacy and loan loss provisioning especially to the 3 commercial banks of Nepal namely, Standard Chartered Bank Nepal Ltd, Everest Bank Ltd, and Nabil Bank Limited. The banks are compared by the financial performance of the banks on the basis of the annual report provided and mainly on Profit and loss accounts and Balance sheet.

3.1 Research Design

A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework for the project that stipulates what information is to be collected, form which sources and by what procedures. Thus a research design is a plan for the collection an analysis of data. For research there exits different types of research design like; Historical research, Descriptive research, Case study research, Field study research, analytical research, True experimental research and so on. The research study is made on the directives issued by the central bank on capital adequacy and loan loss provisioning. For this study, we have taken 3 banks out of 32 commercial banks in Nepal. Expletory and analytical studies will be made to obtain the objectives.

3.2 Population and Samples

There are all together 32 commercial banks operating in the country namely, Nepal bank limited, Rastriya Banijya Bank, Agriculture development bank, NABIL bank, Nepal Investment bank, Standard chartered bank Nepal limited, Himalayan bank limited, Nepal SBI bank limited, Nepal Bangladesh bank, Bank of Kathmandu Ltd., Everest bank Ltd., Nepal credit and commercial bank Ltd., Nepal industrial and commercial bank Ltd., Lumbini bank Ltd., Machapuchhere bank Ltd., Siddhartha bank Limited, Laxmi Bank Ltd, Kumari bank Limited, Global Bank Ltd, Citizens Bank International Ltd, Sunrise Bank Ltd, Bank of Asia Nepal Ltd and Prime Commercial Bank Ltd, Development Credit Bank Ltd ,NMB Bank Ltd., Kist Bank Ltd. and Janta Bank Ltd., Civil Bank Ltd., Commerz and Trust Bank Ltd., Mega Bank Ltd. and Century Bank Ltd. and Sanima Bank Ltd. It will be lengthy, time-consuming and vague while taking into consideration of all these institutions. So, only three banks namely Nabil Bank Ltd, Standard Chartered Bank Nepal Ltd, and Everest Bank Ltd are selected on the simple random basis taking into considaration of availability of data , current performance and numbers of years operation and their comparative studies are made.

3.3 Sources of Data

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

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

3.4 Data Collection Techniques

To collect data, frequent visits were made to the central bank and different commercial banks. Mainly secondary data published and provided by NRB, and concerned commercial banks, annual reports etc are used for research works. Primary data and information were collected from interview and discussion with experts, NRB officials and other required people. Questionnaires were used to the concerned banks to find whether they were fully satisfied by the directives issued and to find the correction measures and suggestions to be made to the NRB to gather primary information.

Besides, to draw the useful information, several visits were made to Central Library, American Center, Rastra bank library, British council, World Bank etc. Internet websites were browsed to get the required information. Except for the stated sources, a detailed review of literature has been carried out to draw the required information.

3.5 Data Analysis and Presentation Procedure

The data are analyzed on the basis of the information gathered from the bank's annual report especially, balance sheet, capital adequacy sheet, loan provisioning sheet etc so as to get the desired objective. Tables, graphs and charts have been presented to analyze and interpret the findings. The comparative study has been made and banks are analyzed and ranked on the basis of their performance. The data gathered from the banks are compared with the directives issued by the central bank and analysis is made on implementation and compliance aspects. Descriptive analysis method is used for analysis of primary data.

3.6 Necessary Tools and Techniques for Analysis

The main analytical tools and techniques used for analysis are as follows.

3.6.1 Financial Tools

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

1. Capital Adequacy Ratio

The term used to describe or measure of a bank's capital fund. It is expressed as a percentage of a bank's risk weighted credit exposures. Capital adequacy ratio is calculated on the basis of core capital supplementary capital and total risk weighted assets of the bank.

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

To measure the adequacy of capital fund

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

Where,

Total capital fund = Core capital + Supplementary capital

2. Non Performing Loan to Total Loans and Advances Ratio

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

It is calculated as follows;

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

3. Provision for NPL to NPL

This ratio is used to find out the provision held for non-performing loan. This ratio measures up to what extent of risk interest in NPL is covered by loan loss provision held for NPL. Since higher ratio safe guard against future contingencies that may create due to non performing loan, higher ratio is preferred by bank or in other words banks have cushion of provision to cope the problem that may he cause due to NPL.

It is calculated as follows:

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

4. Loan Loss Provision to Total Loan and Advances:-

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

It is calculated as follows;

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

3.6.2 Statistical Tools

1. Correlation Coefficient

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

$$\text{Karl pearson's correlation coefficient } (rxy) = \frac{\sum xy}{\sqrt{\sum x^2 \times \sum y^2}}$$

Where,

$x = X - \bar{X}$

$y = Y - \bar{Y}$

N= numbers of observations

x & y = variables

2. Coefficient of Determination

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

It is calculated as follows:

Coefficient of Determination $(rxy)^2$ = (Correlation of coefficient)^2

3. Probable Error

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

It is calculated as follows:

PE (r) = 0.6745 $\times$ SE (r)

Where,

r= correlation coefficient

SE= Standard Error = $\frac{(1-r^2)}{\sqrt{n}}$

Limits for population correlation coefficient = r $\pm$ PE (r)

3.6.3 Method of Primary Data Analysis

Data generate through question arise and personal interview of commercial banks bank officials academicians and Depositors are analyzed using descriptive method and are presented in table wherever necessary.

The study is confined in limited banks considering the time constraint. The findings should not be generalized. The study is only focused on commercial banks which have been relating to the NRB directives. Since data of the study is of non- experimental type; chance of observation errors may take place. Similarly, primary data are based on survey of personal interview and questionnaire; there can be selective bias because of non-response error. So this study is just to fulfill the partial requirement of the MBS of Tribhuvan University.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

"The main purpose of analyzing the data is to change it from an unprocessed form to an understandable presentation. The analysis of data consists of organizing, tabulating, performing statistical analysis and drawing inferences" (Wolf & Pant 2009). So, this chapter deals with the presentation and analyzing of the data that we brought in the raw form to be processed so that understandable meaning is given.

The necessary data that are brought from the concerned institutions are organized and classified for analysis. The data will be on questionnaires, data collection forms, and note cards. They are tabulated and compared with the standard ones and presented in the graphs, charts and analyzed to find or check the relation. It is necessary to arrange the data so that it makes some sense to the researcher and so that it can later be presented to the reader of thesis.

The data and information are collected from the concerned banks, libraries, booklets, published reports, journals, internet website and for the primary data interview with the concerned officials are made and filled questionnaires from the respective banks are brought and they are organized and classified in such a form that it is easy for the analysis. The data are tabulated after the rearrangement of raw data. Then they are presented in the form of figures, graphs, charts so that it will be easy for the analysis. The result from the data is compared with the directive issued by the Nepal Rastra Bank and if there is deviation found is checked. The part of capital adequacy and the loan loss provision is checked and interpreted so that the easy meaning is given out.

4.1 Analysis of Capital Adequacy of Nepalese Commercial Banks

Capital adequacy ratio is the relationship between shareholders' fund (capital fund) to total risk weighted assets of the bank. The higher the capital adequacy ratio, the less levered the bank and safer from depositors point of view because the proportion of the shareholders' stake to the risk weighted asset is also high. Risk weight is assigned to various assets and off-balance sheet items of the bank to arrive at the risk weighted assets. According to NRB directives No. 1 2062/063 Banks in Nepal are required to have minimum 5.5% core capital and 11% total capital fund of total risk weighted assets. Total capital funds include core capital (tier I capital) and supplementary capital (tier II capital).

Capital adequacy ratio is calculated on quarterly basis (mid-October, mid-January, mid-April and mid-July. Where the minimum core capital is not met, the shortfall should be covered within six months. Shortfall should be made up by reallocation of assets and/or by injecting fresh capital.

4.1.1 Capital Fund Analysis of Nabil Bank Ltd.

Table 4.1
Capital Fund of Nabil Bank Ltd.

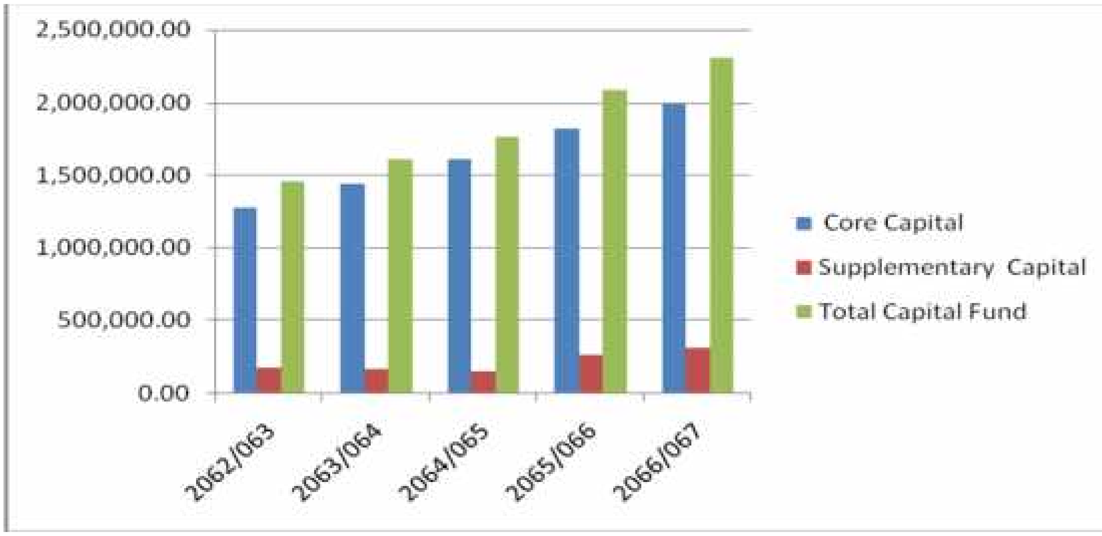
(Amount in Rs.'000')

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
Core Capital	1,276,849.13	1,439,454.30	1,610,510.31	1,823,044.42	1,992,849.72
Supplementary Capital	178,246.48	169,961.99	155,562.22	266,279.61	314,837.38
Total Capital Fund	1,455,095.61	1,609,416.29	1,766,072.53	2,089,324.02	2,307,687.10
Total RWA	11,145,732.46	11,872,009.41	14,193,071.63	16,976,368.43	19,171,142.22

Source: Annual Reports of Nabil Bank Ltd.

Figure 4.1

Capital Fund of Nabil Bank Ltd.



The above data and figure shows that the total capital fund and core capital is in increasing trend from fiscal year 2062/063 to till date. But supplementary capital is decreased in fiscal year 2064/065 and 2065/066. If we see the figures, we can see that Nabil bank has subsequently increased its capital fund by increasing its core capital more than that of supplementary capital. The portion of core capital in total capital fund is 88.24% in five-year average while that of supplementary capital is 11.76% in five-year average. While portion of core capital fund in fiscal year 2066/067 is 86.36% and portion of supplementary capital is 13.64%.It means contribution of core capital is more in growth of total capital fund. Core capital plays vital role in stability and survival of the bank than that of supplementary capital. Total RWA of the bank is also increasing every year from fiscal year 2062/063 to 2066/067.

Table 4.2

Differential Analysis of Total Capital Fund of Nabil Bank Ltd.

Fiscal Year	Total RWA (Rs'000')	NRB Requirement (%)		Actual Maintained (%)		Differential (%)			
		Core Capital to RWA	CAR	Core Capital to RWA	CAR	Core Capital to RWA	Amount (Rs'000')	CAR	Amount (Rs'000')
2062/063	11145732.46	5	10	11.46	13.06	6.46	720014.32	3.06	341059.41
2063/064	11872009.41	5.5	11	12.12	13.56	6.62	785927.02	2.56	303923.44
2064/065	14193071.63	5.5	11	11.35	12.44	5.85	830294.69	1.44	204380.23
2065/066	16976368.43	5.5	11	10.78	12.31	5.28	896352.25	1.31	222390.43
2066/067	19171142.22	5.5	11	10.40	12.04	4.90	939385.97	1.04	199379.88

Source: Annual Reports of Nabil Bank Ltd.

Figure 4.2

Core Capital to RWA of Nabil Bank Ltd.

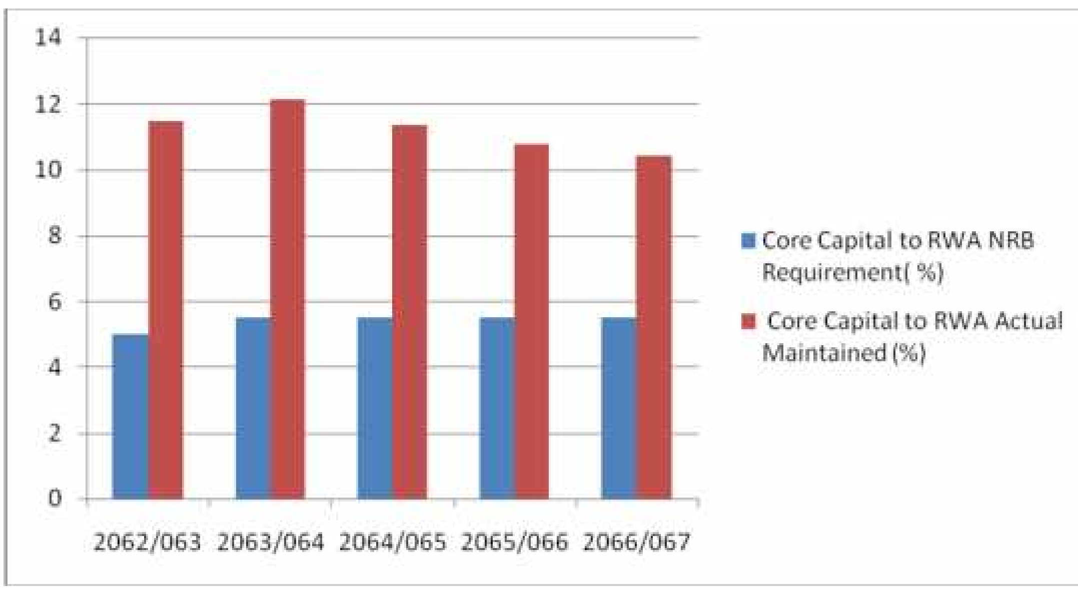
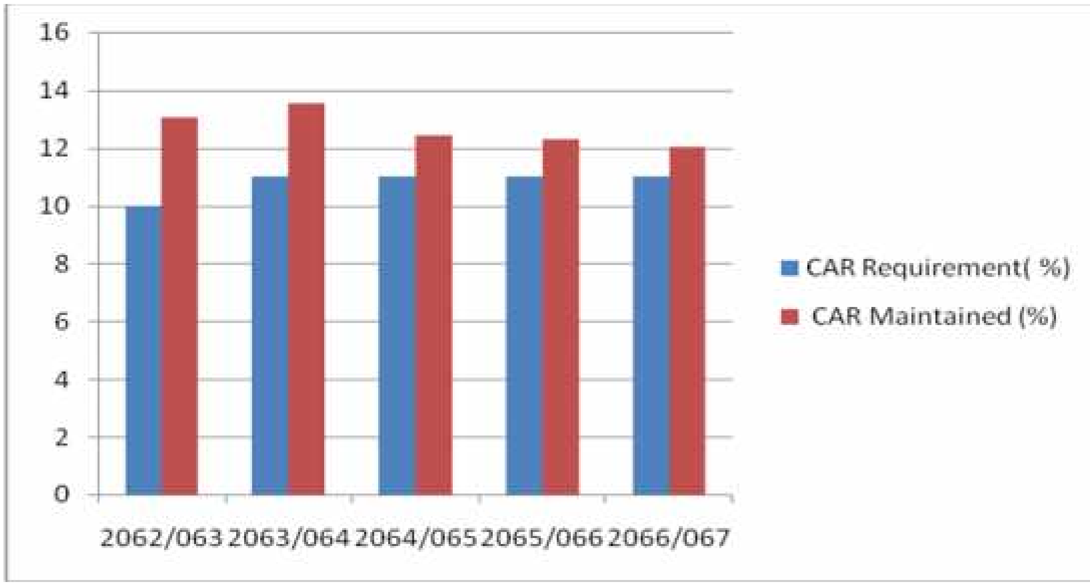


Figure 4.3

CAR Requirement & CAR Maintained by Nabil Bank Ltd.



We see that from the above data that Nabil bank has maintained its capital adequacy norms. To comply with NRB norms, this bank has subsequently increased its capital fund by increasing more in its core capital. But supplementary capital amount is decreased from fiscal year 2062/063 to 2065/066. But it is increased in fiscal year 2062/63 and 2066/067. At the same time its risk-weighted assets is also increasing each year. If we see the contribution to total capital fund then the portion of core capital is very high and is sufficient enough to meet the CAR also not taking into consideration of supplementary capital.

Core capital to RWA and Capital Adequacy Ratio of Nabil bank ltd. during the fiscal year 2059/60, 2063/064, 2064/065, 2065/066 and 2066/067 is within the limit and even excess by 6.46% and 3.06%, 6.62% and 2.56%, 5.85% and 1.44%, 5.28% and 1.31%, 4.90% and 1.04% respectively than NRB requirement. Core Capital to RWA and CAR is increased in fiscal year 2063/064 and since then they are continuously decreasing but they are above the NRB requirements. In order to fulfill the requirement of NRB, Nabil bank has increased its capital base. Lastly, the CAR and core capital to risk weighted assets ratio indicate that the positive or better condition of the bank.

4.1.2 Capital Fund Analysis of Standard Chartered Bank Nepal Ltd.

Table 4.3

Capital Fund of SCB Nepal Ltd.

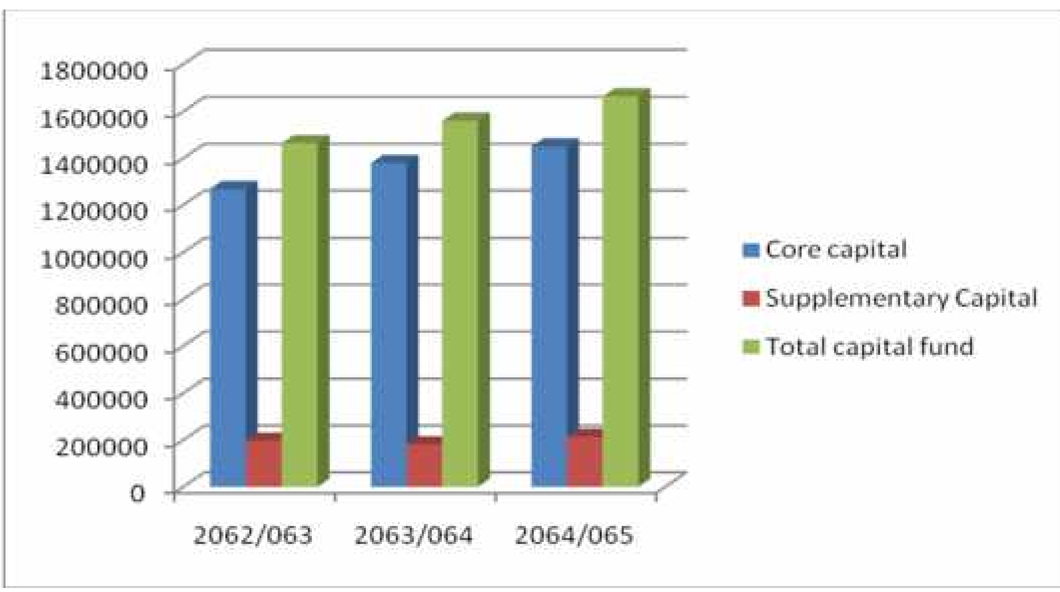
(Amount in Rs.'000')

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
Core capital	1268588.86	1378971.72	1450185.18	1606898.00	1951117.00
Supplementary Capital	196260.74	181183.93	214175.84	237344.00	274167.00
Total capital fund	1464849.60	1560155.65	1664361.02	1844242.00	2225284.00
Total RWA	10307526.85	10023087.57	10497531.78	12369488.44	14168420.04

Source: Annual Reports of Standard Chartered Bank Nepal Ltd.

Figure 4.4

Capital Fund of Standard Chartered Bank Nepal Ltd.



The above data shows the total capital fund and capital is in increasing trend but supplementary capital fund is decreased in 2062/063 then after it is gradually increasing up to fiscal year 2066/067. If we see the given data, standard chartered bank ltd. has subsequently increased its capital fund by increasing its core capital more then supplementary capital. The portion of core capital in total capital fund is 87.41% in five-year average while that of supplementary capital is 12.59% in five-year average. It means contribution of core capital is more in growth of total capital fund. Core capital play important role in safeguarding both the survival of the bank and stability of the financial system so commercial bank give more priority to care capital than that of supplementary capital.

Table 4.4

Differential Analysis of Total Capital Fund of Standard Chartered Bank Nepal Ltd.

Fiscal Year	Total RWA	NRB Requirement (%)		Actual Maintained (%)		Differential (%)			
		Core Capital to RWA	CAR	Core Capital to RWA	CAR	Core Capital to RWA	Amount (Rs)	CAR	Amount (Rs)
2062/063	10307526.85	5	10	12.31	14.21	7.31	753480.21	4.21	433946.88
2063/064	10023087.57	5.5	11	13.76	15.57	8.26	827907.03	4.57	458055.10
2064/065	10497531.78	5.5	11	13.81	15.85	8.31	872344.89	4.85	509130.29
2065/066	12369488.44	5.5	11	12.99	14.91	7.49	926474.68	3.91	483647.00
2066/067	14168420.04	5.5	11	13.77	15.71	8.27	1171853.9	4.71	666757.80

Source: Annual Reports of Standard Chartered Bank Nepal Ltd.

Figure 4.5

Core Capital to RWA of Standard Chartered Bank Nepal Ltd.

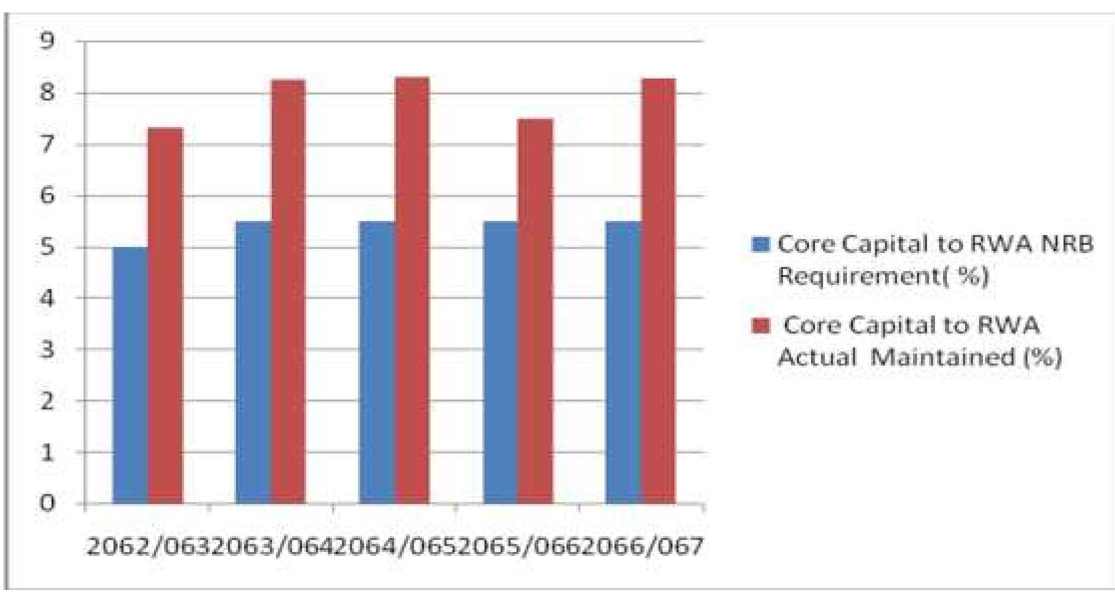
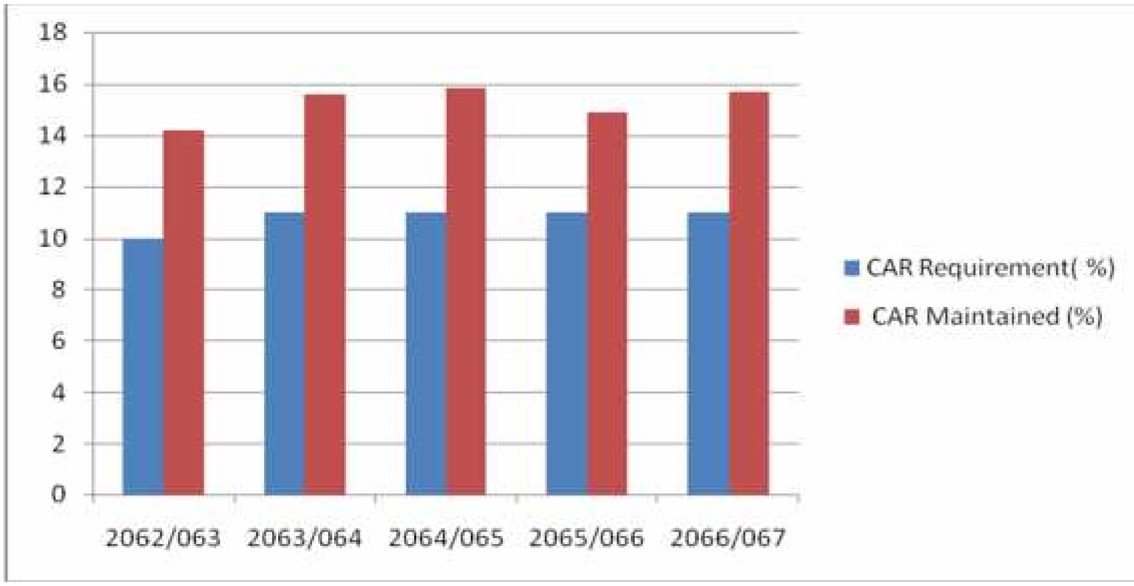


Figure 4.6

CAR Requirement & CAR Maintained by Standard Chartered Bank Nepal Ltd.



The core capital to risk weighted assets of standard chartered bank during the fiscal year 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 exceeds the limit by 7.31%, 8.26%, 8.31%, 7.49% and 8.27% as well as capital adequacy ratio exceeds the limit by 4.21%, 4.57%, 4.85%, 3.91%, and 4.71% in those years. This shows that standard chartered bank has fulfilled the NRB guidelines regarding capital adequacy. This bank has subsequently increased its capital fund by increasing more in its core capital as well as supplementary capital in small amount. At the same time its risk weighted assets is also increasing each year. If we see the composition of total capital fund, the portion of core capital is very high and in sufficient enough to meet the CAR also not talking into consideration of supplementary capital. If we see the figure, core capital, supplementary capital and total capital fund is increasing every year in decreasing ratio. Risk weighted assets of standard charted bank is also increasing every year. From above analysis, it is concluded that SCB has far ahead in implementation of NRB guidelines regarding capital adequacy.

4.1.3 Capital Fund Analysis of Everest Bank Ltd.

Table 4.5

Capital Fund of Everest Bank Ltd.

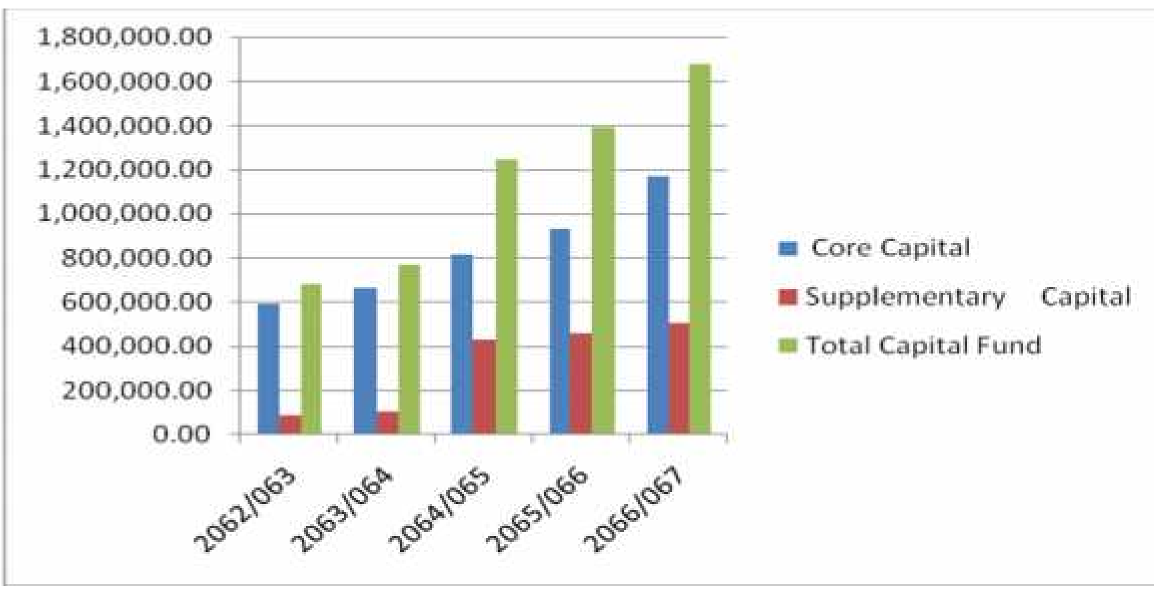
(Amount in Rs.'000')

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
Core Capital	597,009.00	663,269.00	815,567.00	932,745.00	1,171,123.00
Supplementary Capital	87,154.00	103,610.00	431,995.00	458,594.00	504,982.00
Total Capital Fund	684,163.00	766,879.00	1,247,562.00	1,391,339.00	1,676,105.00
Total RWA	5,707,030.00	6,924,807.00	9,195,588.00	11,273,293.00	14,976,737.00

Source: Annual Reports of Everest Bank Ltd.

Figure 4.7

Capital Fund of Everest Bank Ltd.



The above data and figure shows that the total capital fund, core capital and supplementary capital is in increasing trend from fiscal year 2062/063 to till date. If we see the figures, we can see that Everest bank has subsequently increased its capital fund by increasing its core capital more than that of supplementary capital. Supplementary capital has increased in large amount in fiscal year 2061/061. This increase is due to issue of EBL 6% debenture Rs.30,00,00,000.00. The portion of core capital in total capital fund is 72.49% in five-year average while that of supplementary capital is 27.51% in five-year average. While portion of core capital fund in fiscal year 2066/067 is 69.87% and portion of supplementary capital is 30.13%. It means contribution of core capital is more in growth of total capital fund. Core capital plays vital role in stability and survival of the bank than that of supplementary capital. Total RWA of the bank is also increasing every year from fiscal year 2062/063 to 2066/067. Total RWA is Rs.14976737000 in fiscal year 2066/067 which was only Rs.570703000 in fiscal year 2062/063. The bank is success in increasing capital fund in accordance with increase in RWA of the bank.

Table 4.6

Differential Analysis of Total Capital Fund of Everest Bank Ltd.

Fiscal Year	**Total RWA**	**NRB Requirement (%)**		**Actual Maintained (%)**		**Differential (%)**			
	Amount (Rs'000')	Core Capital to RWA	CAR	Core Capital to RWA	CAR	Core Capital to RWA	Amount (Rs'000')	CAR	Amount (Rs'000')
2062/063	5,707,030.00	5	10	10.46	11.99	5.46	311,657.50	1.99	113,460.00
2063/064	6,924,807.00	5.5	11	9.58	11.07	4.08	282,404.62	0.07	5,150.23
2064/065	9,195,588.00	5.5	11	8.87	13.57	3.37	309,809.66	2.57	236,047.32
2065/066	11,273,293.00	5.5	11	8.27	12.34	2.77	312,713.89	1.34	151,276.77
2066/067	14,976,737.00	5.5	11	7.82	11.19	2.32	347,402.47	0.19	28,663.93

Source: Annual Reports of Everest Bank Ltd.

Figure 4.8

Core Capital to RWA of Everest Bank Ltd.

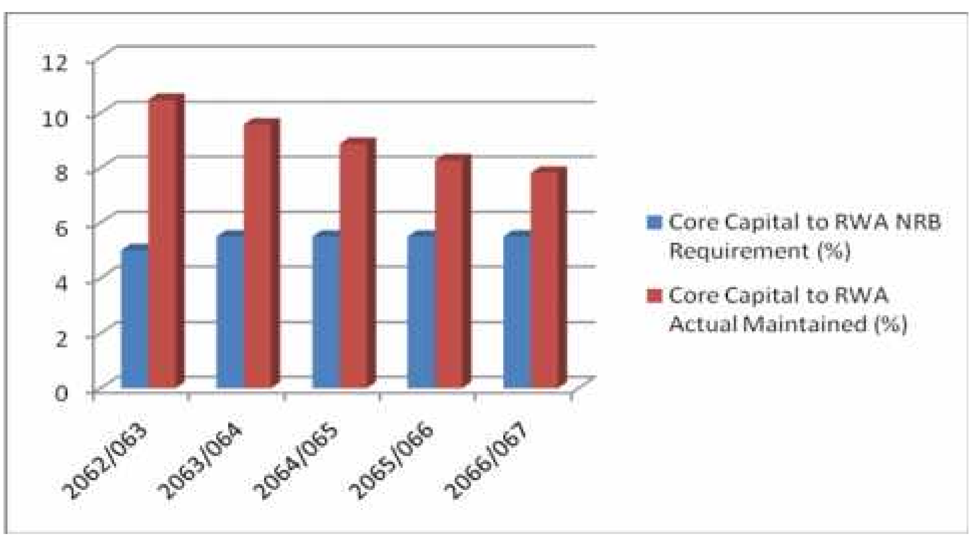
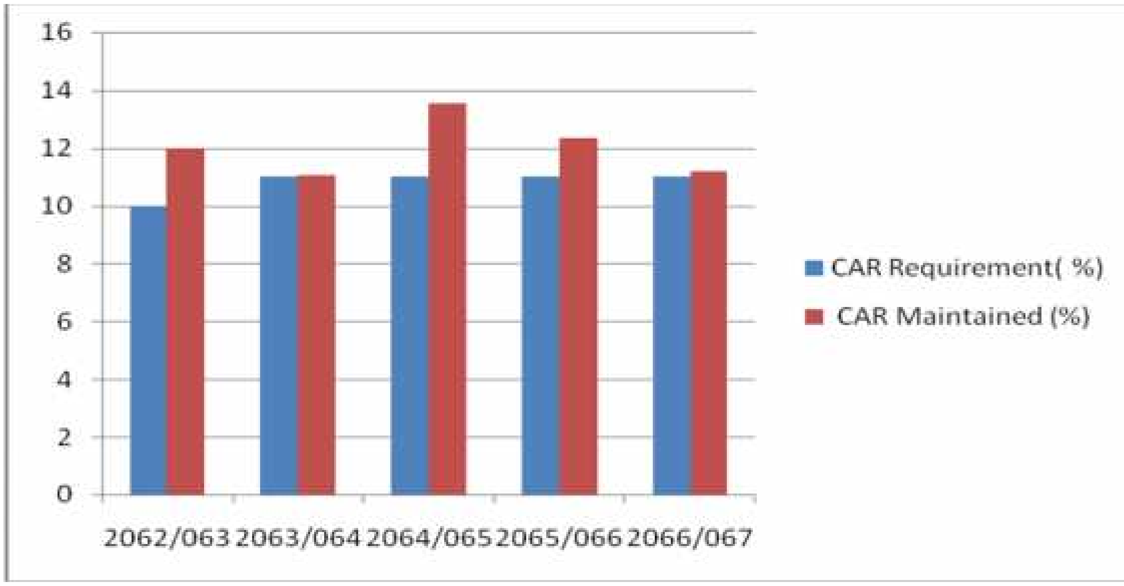


Figure 4.9

CAR Requirement & CAR Maintained by Everest Bank Ltd.



We see that from the above table and figure that Everest bank has fulfilled capital adequacy guidelines of NRB. To comply with NRB norms, this bank has subsequently increased its capital fund by increasing in its core capital and supplementary capital. At the same time its risk-weighted assets is also increasing each year. If we see the contribution to total capital fund then the portion of core capital is high and is sufficient enough to meet the CAR also not taking into consideration of supplementary capital.

Core capital to RWA and Capital Adequacy Ratio of Everest bank ltd. during the fiscal year 2059/60, 2063/064, 2064/065, 2065/066 and 2066/067 is within the limit and even excess by 5.46% and 1.99%, 4.08% and 0.07%, 3.37% and 2.57%, 2.77% and 1.34%, 2.32% and 0.19% respectively than NRB requirement. Core Capital to RWA is continuously decreased from fiscal year 2062/063 to 2066/067. Similarly, CAR is also decreased in every year except 2064/065. Though these ratios are continuously decreasing, they are above the NRB requirements. In order to fulfill the requirement of NRB, Everest bank has increased its capital base. The CAR and core capital to risk weighted assets ratio indicate that the positive or better condition of the bank. But in the last year CAR is near to NRB requirements. This is just above by 0.19%. In coming year it may be difficult for the bank to fulfill the NRB requirements relating to capital adequacy. For this bank have to increase its capital base either issuance of new shares or retaining of the profit.

4.1.4 Comparative Analysis of Core Capital to RWA of Sample Banks:

Table 4.7

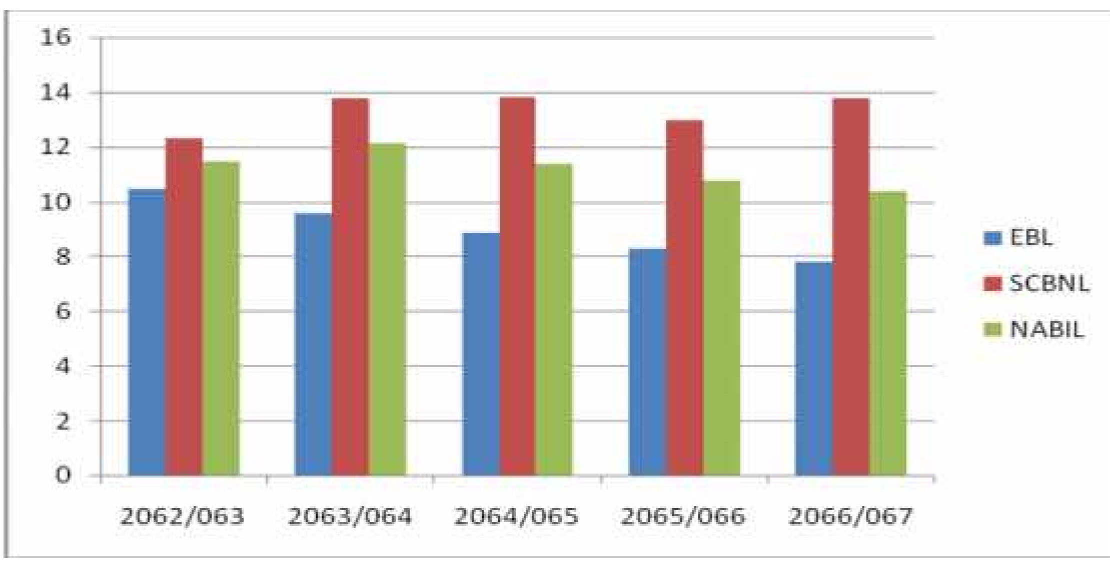
Comparative Analysis of Core Capital to RWA of Sample Banks

Fiscal Year	EBL	SCBNL	NABIL	Highest
2062/063	10.46	12.31	11.46	12.31
2063/064	9.58	13.76	12.12	13.76
2064/065	8.87	13.81	11.35	13.81
2065/066	8.27	12.99	10.78	12.99
2066/067	7.82	13.77	10.4	13.77

Source: Annual Reports of Sample Banks

Figure 4.10

Comparative Analysis Core Capital to RWA of Sample Banks



In above table and chart comparative analysis of core capital to risk weighted assets is shown. The presentation shows that core capital to risk weighted asset of SCBNL is highest in each year and NABIL bank is second in rank. EBL is in third. The highest core capital to risk weighted assets from fiscal year 2062/063 to 2066/067 is 12.31, 13.76, 13.81, 12.99, and 13.77 respectively.

4.1.5 Comparative Analysis CAR of Sample Banks

Table 4.8

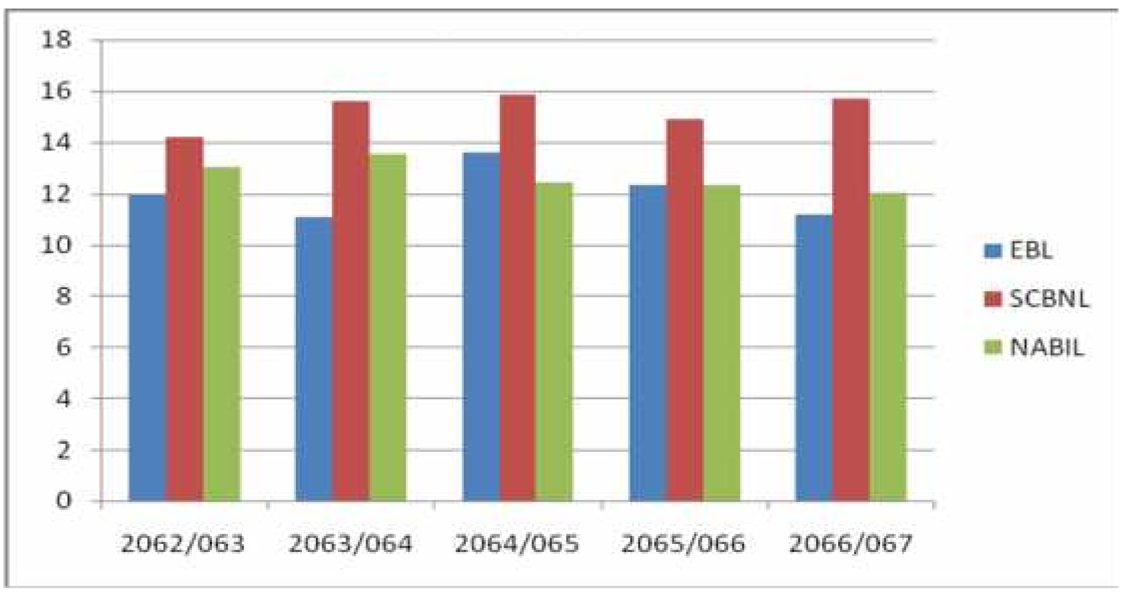
Comparative Analysis CAR of Sample Banks

Fiscal Year	EBL	SCBNL	NABIL	Highest
2062/063	11.99	14.21	13.06	14.21
2063/064	11.07	15.57	13.56	15.57
2064/065	13.57	15.85	12.44	15.85
2065/066	12.34	14.91	12.31	14.91
2066/067	11.19	15.71	12.04	15.71

Source: Annual Reports of Sample Banks

Figure 4.11

Comparative Analysis CAR of Sample Banks



In above table and figure, we can see the comparative analysis of capital adequacy ratio of sample banks in fiscal year 2062/063 to 2066/067. SCBNL is the bank who is in highest rank in CAR whose CAR is 15.71 in fiscal year 2066/067. NABIL bank is in second rank except the fiscal year 2064/065 and 2065/066. EBL is in third rank in fiscal year 2062/063 and second rank in 2064/065. But EBl is in third rank in fiscal year 2066/067.

4.2 Analysis of Loan Classification and Provisioning of Nepalese Commercial Banks

Loan classification refers to the process that the banks uses to review their loans portfolio and assign loans to categories of grades based on the perceived risk and other relevant characteristics of loans. The process of continual review and classification of loans enables banks to monitor the quality of their loan portfolios and when necessary, to take remedial action to counter deterioration in the credit qualities of their portfolios. Loan loss provisioning is a method that bank use to recognize a reduction in the realizable value of their loans. Bank managers are expected to evaluate credit losses and their loan portfolios on the basis of available information-a process that involves a great deal of judgment and is subjected to opposing incentives.

Nepal Rastra Bank have issued the directive regarding the classification and provisioning of the loan which the commercial banks needs to follow which can be summarized from the following table:

Table 4.9
Loan Loss Provision Required By NRB

Loan Category	Period	% to be Provisioned
Pass	Loans and advances not past due and past due up to 3 months.	1%
Restructured & Rescheduled	Loans restructured or rescheduled	12.50% and more or less depending on the conditions.
Substandard	Loans and advances past due for a period of over 3 months to 6 months.	25%
Doubtful	Loans and advances past due for a period over 6 months to 1 year.	50%
Bad	Loans and advances past due for a period of over 1 Year.	100%

Source: Unified Directives 2064/065

Loan loss provision set aside for performing loan is defined as general loan loss provision and loan loss provision set for non-performing loan is defined as "Specific loan loss provision". Banks shall as of the end of Ashoj, Poush, Chaitra and Ashadh prepare the statement of outstanding loan and advances classified on the basis of aging and submit the particulars to the bank and financial institution regulation department and commercial bank supervision department of NRB with in one month from the end of each quarter.

4.2.1 Loan and Loan Loss Provision of Nabil Bank Ltd.

Table 4.10

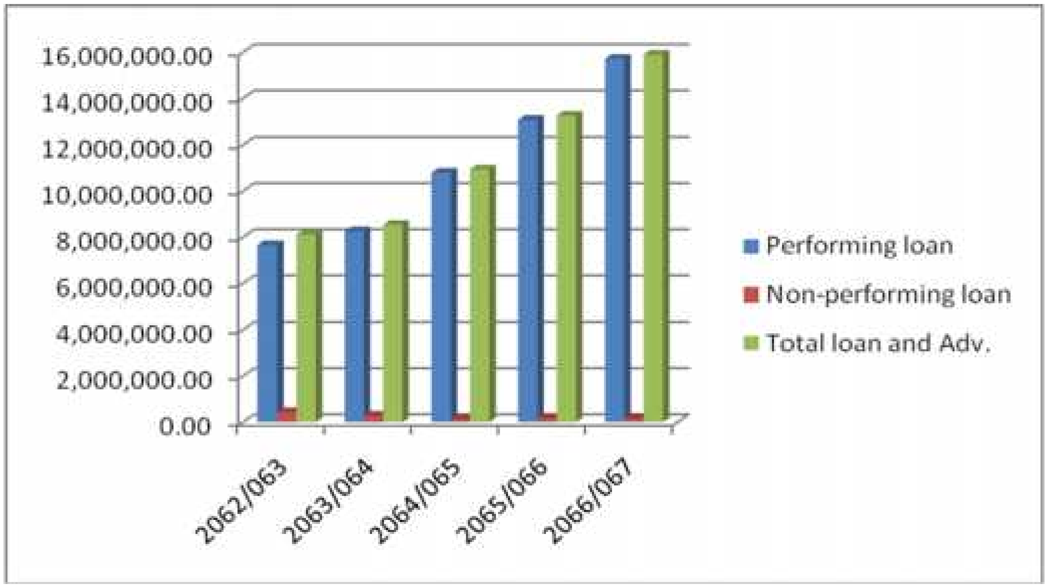
Loan and Loan Loss Provision of Nabil Bank Ltd.

(Amount in '000')

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
Performing loan	**7,664,053.46**	**8,261,978.12**	**10,802,229.68**	**13,096,157.78**	**15,724,729.78**
Pass	7,664,053.46	8,261,978.12	10,802,229.68	13,010,864.15	15,638,481.98
Restructured	-	-	-	85,293.63	86,247.80
Non-performing loan	**449,630.76**	**286,675.92**	**144,506.89**	**182,624.48**	**178,293.98**
Sub standard	76,311.97	22,139.92	22,072.56	62,665.91	119,704.60
Doubtful	279,117.41	65,552.22	1,934.09	29,565.95	14,471.65
Loss	94,201.38	198,983.77	120,500.24	90,392.61	44,117.73
Total loan and Adv.	**8,113,684.22**	**8,548,654.04**	**10,946,736.58**	**13,278,782.26**	**15,903,023.76**
Total LLP Maintained	**357,732.24**	**358,664.19**	**360,566.58**	**356,239.11**	**357,245.03**
Pass	122,587.93	127,733.99	235,345.57	130,343.14	175,502.58
Restructured	-	-	-	83,958.16	79,841.09
Sub Standard	18,320.23	5,140.97	6,865.46	42,573.90	56,636.40
Doubtful	136,619.82	32,384.36	1,415.93	13,896.06	7,119.44
Loss	80,204.26	193,404.87	116,939.62	85,467.84	38,145.52
Total LLP Required	**329,478.61**	**319,914.65**	**235,007.72**	**334,908.87**	**317,505.61**
Pass	76,640.53	82,619.78	108,022.30	130,108.64	156,384.82
Restructured	-	-	-	83,958.16	79,841.09
Standard loan	19,077.99	5,534.98	5,518.14	15,666.48	29,926.15
Doubtful	139,558.71	32,776.11	967.05	14,782.98	7,235.83
Loss	94,201.38	198,983.77	120,500.24	90,392.61	44,117.73
Differential LLP	**28,253.62**	**38,749.54**	**125,558.85**	**21,330.24**	**39,739.42**
Pass	45,947.40	45,114.21	127,323.27	234.50	19,117.76
Restructured	-	-	-	-	-
Standard loan	(757.77)	(394.01)	1,347.32	26,907.43	26,710.25
Doubtful	(2,938.89)	(391.76)	448.88	(886.91)	(116.39)
Loss	(13,997.12)	(5,578.90)	(3,560.62)	(4,924.78)	(5,972.21)
Some Ratios					
LLP to Total Loan & Adv.(%)	4.41	4.20	3.29	2.68	2.25
NPL to Total Loan & Adv.(%)	5.54	3.35	1.32	1.38	1.12
LLP for NPL to NPL (%)	52.30	80.55	86.65	77.72	57.15

Source: - Annual Reports of Nabil Bank Ltd.2062/063 – 2066/067

Figure 4.12
Loan Classification of Nabil Bank Ltd.



Above table and figure of loan and loan loss provision shows that total loan and advances is increasing every year compare to previous year. Similarly, performing loan is also increasing every year but non performing loan is in decreasing up to fiscal year 2064/065 but it is increased in fiscal year 2065/066. It is again decreased in fiscal year 2066/067 by little amount which is good for the bank. Sub standard loan is in decreasing trend up to fiscal year2064/065 but it is increase by large volume in fiscal year 2065/066 and 2066/067. On the other hand doubtful loan is in decreasing trend up to fiscal year 2064/065. But it is increased in fiscal year 2065/066. And it is again decrease in fiscal year 2066/067 to Rs.14471.65 thousands. Loss loan is increased in 2063/064 in comparison to last year. After 2063/064 loss loan is decreased every year in comparison to previous year which is positive symbol of the performance of the bank. From the analysis we can see that loan and advance is in increasing trend. In case of loan loss provision, it is highly fluctuating in nature. It is increase in some year and decreased in some year. But the total loan loss provision is nearly stable in every year of study period. Provision for doubtful loan and substandard loan is fluctuating and is lowest in fiscal year 2064/065 and 2063/064 respectively. Provision for restructured loan is decreased in comparison to previous year. In the portfolio of total loan and advances portion performing loan is 97.81% while NPL is 2.19% in five years average. Nabil is trying to make its assets good and earn interest without bearing any risk.

From above presentation, we can conclude that Nabil Bank Ltd. is maintaining the loan loss provision required by NRB in aggregate. Total loan loss provision is excess in each year. But Provision requirement for each category of loan is not meet in some cases. In fiscal year 2062/063 and 2063/064 provision for sub standard, doubtful and loss loan is short by Rs.757770 and Rs.394010, Rs.2938890 and 391760, and Rs.13997120 and Rs. 5578900 respectively. But the provision for the pass loan is excess than NRB requirement by Rs.45947400, Rs.45114210, Rs.127323270, Rs.234500, and Rs.19117760 respectively in 2062/063 to 2066/067. Similarly loan loss provision for doubtful loan is short by Rs.886910 and Rs.116390 in fiscal year 2065/066 and 2066/067. Provision for loss loan is short in every year of study period. LLP for performing loan is also surplus in every year but the LLP for non performing loan is short in 2062/063 to 2064/065 but it is excess in 2065/066 and 2066/067. Despite of no fulfillment of requirement in some categories of loan and advance, in total loan loss provision is excess than requirements of NRB directives in each year of study period. This fact leads the conclusion that possible loss due to bad quality of loan and advances is backed by the loan loss provision.

The ratio of loan loss provision to total loan & advances of Nabil Bank Ltd. ranges from 2.25% to 4.41% in different years. Since, high provision is to be maintained for non-performing loan, higher ratio indicates high portion of non-performing loan in the total loan and advances. But high ratio exceeding the requirements is good for safeguarding the future possible loss. The loan loss provision to total loan and advances ratio is 4.41%, 4.20%, 3.29%, 2.68%, and 2.25% respectively in fiscal year 2062/063 to 2066/067. The LLP to total loan and advance ration is in decreasing trend.

Provision for non performing loan to non performing loan ration of Nabil Bank Ltd. is 52.30, 80.55, 86.65, 77.72, and 57.15 percentages respectively in fiscal year 2062/063 to 2066/067. This ration measures up to what extent of risk inherent in NPL is covered by loan loss provision held for NPL. Since higher ratio is safeguard against future contingencies that may be created due to non performing loan, higher ration is preferred by the bank or in other words banks have cushion of provision to cope the problem that may cause due to NPL. In above data we can see that non performing loan and provision for non performing loan both are decreasing up to fiscal year 2064/065. But in fiscal year 2065/066 NPL and provision for NPL is increased and again decreased in fiscal year 2066/067. On the other hand ration is increasing up to fiscal year 2064/065 which shows higher risk is covered by the provision. But the ration is decreased in 2065/066 and 2066/067. Similarly NPL to total loan and advance is in decreasing trend which is good sign for the bank. It is 5.54%, 3.35%, 1.32%, 1.38% and 1.12%in 2062/063 to 2066/067 respectively.

4.2.2 Loan and Loan Loss Provision of Standard Chartered Bank Nepal Ltd.

Table 4.11

Loan and Loan Loss Provision of Standard Chartered Bank Nepal Ltd.

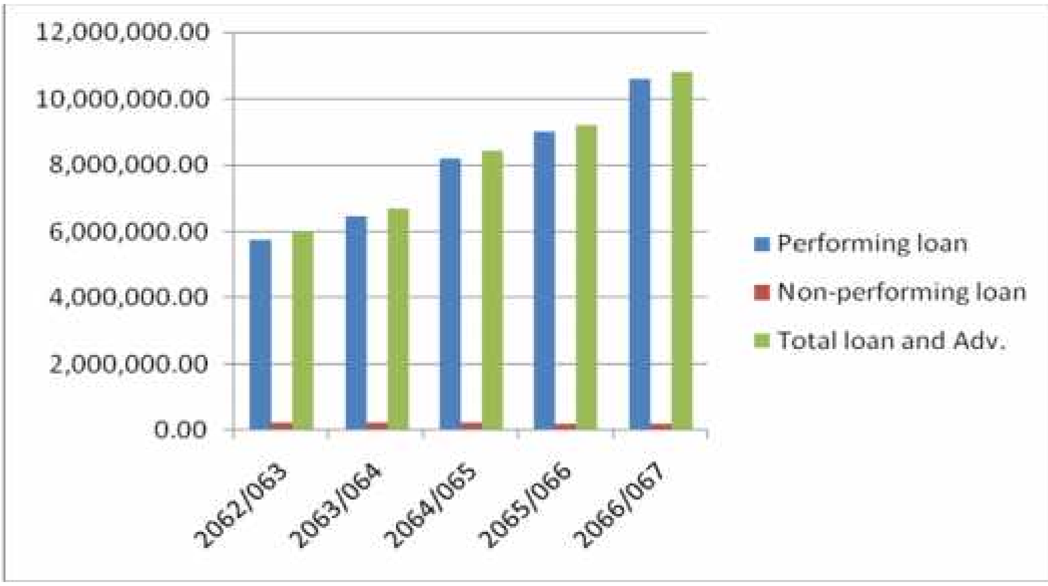
(Amount in '000')

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
Performing loan	**5,752,213.97**	**6,441,664.20**	**8,194,560.39**	**9,010,347.90**	**10,593,131.20**
Pass	5,752,213.97	6,441,664.20	8,194,560.39	9,010,347.90	10,593,131.20
Restructured	-	-	-	-	-
Non-performing loan	**247,948.67**	**252,198.11**	**226,308.40**	**195,932.32**	**197,017.16**
Sub standard	7,052.54	-	10,443.02	16,492.34	16,453.98
Doubtful	130,000.00	130,989.04	104,521.47	65,608.28	66,193.52
Loss	110,896.13	121,209.07	111,343.92	113,831.70	114,369.66
Total loan and Adv.	**6,000,162.64**	**6,693,862.31**	**8,420,868.79**	**9,206,280.21**	**10,790,148.36**
Total Loan loss provision	**304,339.12**	**276,620.23**	**277,661.01**	**270,862.40**	**287,511.22**
Pass	94,179.86	64,416.64	81,945.60	90,103.48	105,931.31
Restructured	-	-	-	-	-
Sub standard	1,763.14	-	2,610.75	4,123.09	4,113.49
Doubtful	97,500.00	90,994.52	81,760.74	62,804.14	63,096.76
Loss	110,896.13	121,209.07	111,343.92	113,831.70	114,369.66
Total Loan Loss Provision Required	**235,181.40**	**251,120.23**	**248,161.01**	**240,862.40**	**257,511.23**
Pass	57,522.14	64,416.64	81,945.60	90,103.48	105,931.31
Restructured	-	-	-	-	-
Sub standard	1,763.14	-	2,610.75	4,123.09	4,113.50
Doubtful	65,000.00	65,494.52	52,260.74	32,804.14	33,096.76
Loss	110,896.13	121,209.07	111,343.92	113,831.70	114,369.66
Differential Loan Loss Provision	**69,157.72**	**25,500.00**	**29,500.00**	**30,000.00**	**30,000.00**
Pass	36,657.72	-	-	-	-
Restructured	-	-	-	-	-
Sub standard	-	-	-	-	-
Doubtful	32,500.00	25,500.00	29,500.00	30,000.00	30,000.00
Loss	-	-	-	-	-
Some Ratios					
LLP to Total Loan & Adv.(%)	5.07	4.13	3.30	2.94	2.66
NPL to Total Loan & Adv.(%)	4.13	3.77	2.69	2.13	1.83
LLP for NPL to NPL (%)	84.76	84.14	86.48	92.26	92.16

Source: - Annual Reports of Standard Chartered Bank Ltd.

Figure 4.13

Loan Classification of Standard Chartered Bank Nepal Ltd.



Above the data of loan and loan loss provision shows that total loan and advances is increasing every year compare to previous year. Similarly, performing loan is also increasing every year but non performing loan is fluctuating over the study period. It is increased in fiscal year 2063/064 but it is decreased in fiscal year 2064/065 and 2065/066. It is again increased in fiscal year 2066/067 by little amount which is not good for the bank. Sub standard loan is in increasing trend over the study period. On the other hand doubtful loan is in decreasing trend over the study period ignoring the minor increment. Loss loan is not so much fluctuating over the study period. It is stable although total loan and advances is in increasing trend over the study period. This is the positive aspect of the bank. From the analysis we can see that loan and advance is in increasing trend. In case of loan loss provision, it is slightly fluctuating in nature. It is increase in some year and decreased in some years. But the total loan loss provision is nearly stable in every year of study period. Provision for substandard loan is in increasing trend. It is 1763.14 thousands in fiscal year 2062/063 and it has reached to Rs.4113.49 thousands in 2066/067. Provision for doubtful loan is in decreasing trend. But it is slightly increased in fiscal year 2066/067. This loan loss provision is Rs.97500 thousand in 2062/063 and has reached to Rs.63096.76 in 2066/067. Provision for restructured loan is null during the study period. In the portfolio of total loan and advances portion performing loan is 97.28% while NPL is 2.72% in five years average. SCBNL is trying to make its assets good and earn interest without bearing any risk.

From above presentation, we can conclude that SCBNL is maintaining the loan loss provision required by NRB in aggregate. Total loan loss provision is excess in each year. Provision requirement for each category of loan is fulfilled in all cases. The provision for the pass loan is excess than NRB requirement by Rs.36657720 in 2062/063. Similarly loan loss provision for doubtful loan is excess in every year of the study period. LLP for performing loan as well as nonperforming loan is surplus in every year. This fact leads the conclusion that possible loss due to bad quality of loan and advances is backed by the loan loss provision.

The ratio of loan loss provision to total loan & advances of Standard Chartered Bank Nepal Ltd. ranges from 2.66% to 5.07% over the study period. LLP to total loan and advance ratio is 5.07%, 4.13%, 3.30%, 2.94%, and 2.66% in fiscal year 2062/063 to 2066/067 respectively. Since high provision is to be maintained for non-performing loan, higher ratio indicates high portion of non-performing loan in the total loan and advances. But high ratio exceeding the requirements is good for safeguarding the future possible loss. The LLP to total loan and advance ratio is in decreasing trend. This is due to increasing quality of assets.

Provision for non performing loan to non performing loan ratio of Standard Chartered Bank Nepal Ltd. is 84.76, 84.14, 86.48, 92.26, and 92.16 percentages respectively in fiscal year 2062/063 to 2066/067. This ratio measures up to what extent of risk inherent in NPL is covered by loan loss provision held for NPL. Since higher ratio is safeguard against future contingencies that may be created due to non performing loan, higher ratio is preferred by the bank or in other words banks have cushion of provision to cope the problem that may cause due to NPL. In above data we can see that non performing loan and provision for non performing loan both are decreasing but in fiscal year 2063/064 and 2066/067 slight increased in comparison to previous year. Similarly NPL to total loan and advance is in decreasing trend which is good sign for the bank. It is 4.13%, 3.77%, 2.69%, 2.13% and 1.83% in 2062/063 to 2066/067 respectively. From the decreasing trend of Nonperforming loan and advance, we can conclude that the quality of loan and advances is increasing every year. This short of result is the symbol of the prosperity of the bank.

4.2.3 Loan and Loan Loss Provision of Everest Bank Ltd.

Table 4.12

Loan and Loan Loss Provisioning of Everest Bank Ltd.

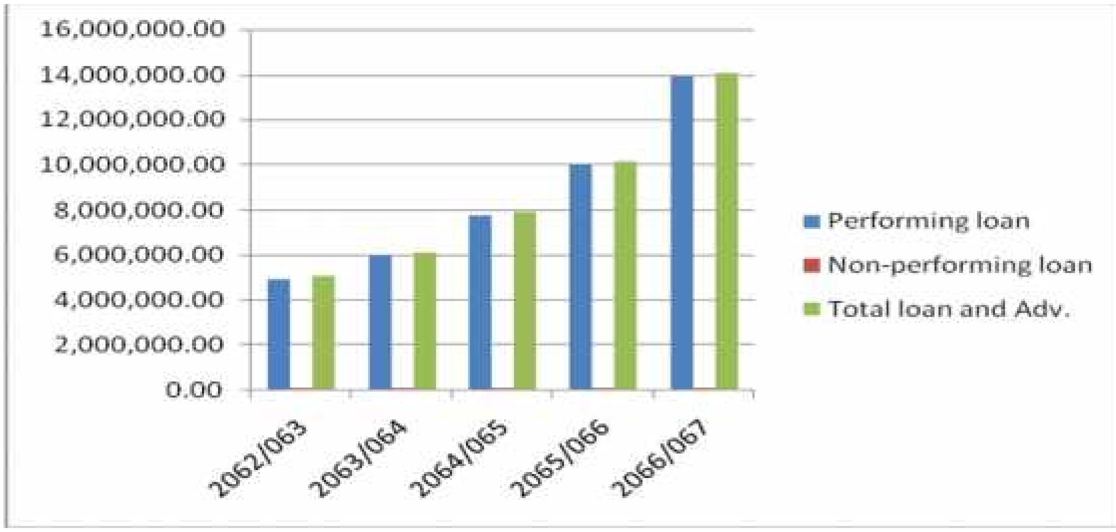
(Amount in '000')

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
Performing loan	**4,938,390.21**	**5,991,085.72**	**7,771,282.53**	**10,007,018.66**	**13,969,507.15**
Pass	4938390.21	5991085.72	7771282.53	9757195.14	13750623.01
Restructured	-	-	-	249,823.52	218,884.14
Non-performing loan	**111,191.11**	**104,755.36**	**128,807.75**	**129,235.79**	**113,178.94**
Sub standard	41954.71	11082.57	4408.74	10669.33	4218.48
Doubtful	38055.78	40494.73	1977.47	683.78	2353.29
Loss	31180.62	53178.06	122421.54	117882.68	106607.17
Total loan and Adv.	**5,049,581.32**	**6,095,841.08**	**7,900,090.28**	**10,136,254.45**	**14,082,686.09**
Total Loan loss provision	**141,120.66**	**211,718.48**	**281,418.80**	**334,946.77**	**418,604.44**
Pass	80423.48	135522.41	156906.34	182826.93	282405.48
Restructured	-	-		31,227.94	27,360.52
Standard loan	10488.68	2770.64	1,102.18	2667.33	1054.62
Doubtful	19027.88	20247.37	988.74	341.89	1176.65
Loss	31180.62	53178.06	122421.54	117882.68	106607.17
Total Loan Loss Provision Required	**110,081.09**	**136,106.92**	**202,225.29**	**249,691.79**	**273,705.19**
Pass	49,383.90	59,910.86	77,712.83	97,571.95	137,506.23
Restructured	-	-	-	31,227.94	27,360.52
Sub Standard	10,488.68	2,770.64	1,102.19	2,667.33	1,054.62
Doubtful	19,027.89	20,247.37	988.74	341.89	1,176.65
Loss	31,180.62	53,178.06	122,421.54	117,882.68	106,607.17
Differential Loan Loss Provision	**31,039.58**	**75,611.55**	**79,193.51**	**85,254.98**	**144,899.25**
Pass	31,039.58	75,611.55	79,193.51	85,254.98	144,899.25
Restructured	-	-	-	-	-
Sub Standard	-	-	-	-	-
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Some Ratios					
LLP to Total Loan & Adv.(%)	2.79	3.47	3.56	3.30	2.97
NPL to Total Loan & Adv.(%)	2.20	1.72	1.63	1.27	0.80
LLP for NPL to NPL (%)	54.59	72.74	96.67	93.54	96.16

Source: - Annual Reports of Everest Bank Ltd.

Figure 4.14

Loan Classification of Everest Bank Ltd.



Above the data of loan and loan loss provision shows that total loan and advances is increasing every year compare to previous year. Similarly, performing loan is also increasing every year but non performing loan is fluctuating over the study period. It is decreased in fiscal year 2063/064 but it is increased in fiscal year 2064/065 and 2065/066. It is again decreased in fiscal year 2066/067 which is good for the bank. Sub standard loan is in decreasing trend over the study period. It is decreased by large volume in fiscal year 2063/064. Increment can be seen in fiscal year 2065/066. Similarly doubtful loan is also in decreasing trend over the study period ignoring the minor increment. Unfortunately Loss loan is in increasing over the study period. It is increase in large volume up to 2064/065. Since then it has adapted the decreasing trend and reached Rs.106607170 in fiscal year 2066/067. This shows some positive signals. Increase in loss loan is also caused by the large increment in total loan and advances over the study period. From the analysis we can see that loan and advance is in increasing trend. In case of loan loss provision, total loan loss provision increasing every year over the study period. Loan loss provision for performing loan is also increasing every year of the study period. Provision of restructured loan is decreased in comparison to previous year. Provision for substandard loan is in decreasing trend over the study period. It is 10488.68 thousands in fiscal year 2062/063 and it has reached to Rs.1054.62 thousands in

2066/067. Provision for doubtful loan is also in decreasing trend. But it is slightly increased in fiscal year 2063/064 and 2066/067 in comparison to previous year. This loan loss provision is Rs.19027.89 thousand in 2062/063 and has reached to Rs.1176.65 thousand in 2066/067. Provision for loss loan is in increasing trend during the all year of the study period which is not the good for the bank. Loss loan provision is Rs.31180.62 thousand in 2062/063 and it is reached to Rs.106607.17 thousands in 2066/067.In the portfolio of total loan and advances portion performing loan is 98.64% while NPL is 1.362% in five years average. Everest Bank Ltd. is trying to make its assets good and earn interest without bearing any risk.

From above presentation, we can conclude that EBL is maintaining the loan loss provision required by NRB. Total loan loss provision is excess in each year. Provision requirement for each category of loan is fulfilled in all cases. The provision for the pass loan is excess than NRB requirement by Rs.31039580, Rs.75611550, Rs.79193510, Rs.85254980 and 144899250 in 2062/063 to 2066/067 respectively. LLP for performing loan is surplus in every year. Provision for the non performing loan is same as requirements of NRB. This fact leads the conclusion that possible loss due to bad quality of loan and advances is backed by the loan loss provision.

The ratio of loan loss provision to total loan & advances of EBL ranges from 2.79% to 3.56% over the study period. LLP to total loan and advance ratio is 2.79%, 3.47%, 3.56%, 3.30%, and 2.97% in fiscal year 2062/063 to 2066/067 respectively. Since high provision is to be maintained for non-performing loan, higher ratio indicates high portion of non-performing loan in the total loan and advances. But high ratio exceeding the requirements is good for safeguarding the future possible loss. The LLP to total loan and advance ratio is in decreasing trend. This is due to increasing quality of assets.

Provision for non performing loan to non performing loan ratio of EBL is 54.59, 72.74, 96.67, 93.54, and 96.16 percentages respectively in fiscal year 2062/063 to 2066/067. This ratio measures up to what extent of risk inherent in NPL is covered by loan loss provision held for NPL. Since higher ratio is safeguard against future contingencies that may be created due to non performing loan, higher ratio is preferred by the bank or in other words banks have cushion of provision to cope the problem that may cause due to NPL. In above data we can see that non performing loan and provision for non performing loan both are in increasing trend over the study period. But in fiscal year 2063/064 and 2066/067 slightly decreased in comparison to previous year. Similarly NPL to total loan and advance is in decreasing trend which is good sign for the bank. It is 2.20%, 1.72%, 1.63%, 1.27% and 0.80% in 2062/063 to 2066/067 respectively. From the decreasing trend of nonperforming loan and advance, we can conclude that the quality of loan and advances is increasing every year. This short of result is the symbol of the prosperity of the bank.

4.3 Correlation Analysis

Table 4.13

Correlation Analysis between Net Profit and Loan and Advances

Banks	Coefficient of Correlation	Relationship	Co-efficient of Determination	Probable Error	6*PE	Significant or Insignificant
NABIL	0.9830	High degree of positive correlation	0.9663	0.01017	0.061020	Significant
SCBNL	0.9103	High degree of positive correlation	0.8286	0.05169	0.310138	Significant
EBL	0.9841	High degree of positive correlation	0.9684	0.009527	0.057163	Significant

Source: Annex- I

As we know net profit is the important for the bank. Total loan and advances disbursed by the bank plays important role in the income generation of the bank. The correlation coefficient between the loan and advances and net profit describes the degree of relationship between these two variables. Between these two variables loan and advances is independent variable where as net profit is dependent variable. Hence through this comparison we can find out the changes taken place in net profit with every charge in loan and advances. To what extend is the impact of loan and advances on net profit of bank can be calculated or is exhibited by the correlation coefficient.

The above table shows that coefficient of correlation (r) between loan and advances and net profit of NABIL, SCBNL and EBL is 0.9830, 0.9103 and 0.9841 respectively. This analysis shows that there is high degree of positive correlation between loan and advances and net profit of all these selected banks. It means with every increase in the volume of loan and advances there will also be increment in the Net profit with the some volume.

The coefficient of determination (r^2) for NABIL is 0.9663; it means 96.63% of the total variation in Net profit (dependent variable) has been explained by the loan and advances (independent variable). Likewise for SCBNL is 0.8286, it means 82.86% of the total variation in Net profit (dependent variable) has been explained by the loan and advances (independent variable). Finally for EBL is 0.9684, it means 96.84% of the total variation in Net profit (dependent variable) has been explained by the loan and advances (independent variable).

The correlation of coefficient of NABIL, SCBNL, and EBL is 0.9830, 0.9103 and 0.9841 respectively which is greater than 6 times the values of their respective probable error. Hence we can interpret that the correlation between two variables loan and advances and Net profit of all the three banks is certain and significant and as well as there is closeness between these two variables.

4.4 Primary Data Analysis

Primary data are collected form the officials of commercial banks, NRB, Individual investors and academicians. Questionnaire developed by the researcher was duly filled by the respondents. More than one respondent have been included form the same organization as possible. The respondents of the data cover the personalities involved in policy formulation and implementation relating to NRB directives.

Table 4.14

Primary Data Analysis I

		Answer Options					
Q.N.	**Statement**	**A**		**B**		**C**	
		No.	**%**	**No**	**%**	**No.**	**%**
1	How effective is the role of NRB in regulating and supervising of the commercial banks	19	63.33	11	36.67	0	0
2	Which supervisory system is best	2	6.67	3	10.00	25	83.33
3	What are the effects of the NRB directives on commercial banks	5	16.67	3	10.00	22	73.33
4	What is the reason behind the change made in the directives	8	26.67	16	53.33	6	20.00
5	Why NRB directives are necessary to the commercial banks	6	20.00	17	56.67	7	23.33

In the first query, how effective is the role of NRB in regulating and supervising of the commercial banks; 19 respondents i.e. 63.33% expressed that the role of NRB is effective and 10 respondents i.e. 33.33% expressed that the role of NRB is satisfactory. From the analysis of the opinions we can conclude that the role of NRB for regulating and supervising is effective due to similar opinion conveyed by the majority of the sample.

Opinion regarding to question "which supervisory system is best"; 2 respondents i.e. 6.67% opined that the off site inspection is best, 3 respondents i.e. 10.00% opined that the on-site inspection is the best and 25 respondents opined that both supervisory system are best. Analysis of the opinions reveals that the both supervisory system seems best.

For understanding effect of NRB directives on commercial banks by question no 3 " what are the effects of the NRB directives on commercial banks" majority portion agreed on the option "c" that is maintaining safe and sound banking system (i.e. 73.33% is 22 respondents). That supports, focus of NRB directive is to maintain safe and sound banking system.

Major portion i.e.53.33% of the respondents put their argument on option b that is to develop the better financial institutions has been seems main cause of time to time changes made on NRB directives.

6 respondents i.e. 20% of the sample says that NRB directive are necessary for protecting the banks and financial institutions where as 17 respondents i.e. 56.67 % opined that NRB directives are needed for enhancing the credibility of the financial system of the country. Similarly, on the option c i.e. to protect the interest of the depositors, 7 respondents i.e.23.33 % are agreed.

Table 4.15

Primary Data Analysis II

		Answer Options					
Q.N.	**Statement**	**A**		**B**		**C**	
		No.	**%**	**No**	**%**	**No.**	**%**
1	Are the commercial banks implementing the directives issued by NRB?	16	53.33	12	40.00	2	6.67
2	Do you think it necessary to implement the directives issued by NRB?	26	86.67	3	10.00	1	3.33
3	Is there any weakness in NRB directives	15	50.00	12	40.00	3	10.00
4	What is the reason for setting capital adequacy norms?	20	66.67	2	6.67	8	26.67
5	How your banks wish to meet the increase requirement capital as prescribed by NRB?	17	56.67	8	26.67	5	16.67
6	Who will be benefited most by maintaining capital adequacy requirement?	22	73.33	6	20.00	2	6.67

Opinion regarding to question “are the commercial banks implementing the NRB directives”; 16 respondents i.e. 53.33% opined that the commercial banks are implementing the NRB directives, 12 respondents i.e. 40.00% opined that the commercial banks are not implementing the NRB directives and 2 respondents i.e. 6.67% opined that they don’t know. Analysis of the opinions reveals that the commercial banks are implementing the directives.

In the seventh query, do you think it is necessary to implement the directives issued by the NRB; 26 respondents i.e. 86.67% expressed that it is necessary to implement the NRB directives, 3 respondents i.e. 10.00% expressed that not necessary to implement the directives of NRB and 1 respondent i.e. 3.33% expressed that he dose not know. From the analysis of the opinions we can conclude that it is necessary to implement the NRB directives due to similar opinion conveyed by the majority of the sample.

15 respondents i.e. 50% of the sample says that there are weaknesses in NRB directive where as 12 respondents i.e. 40 % opined that there are not weaknesses in NRB directive and 3 respondents opined that they are unknown. From this opinion we can see that there are weaknesses in NRB directives due to majority of the respondents are agreed on this fact.

In the ninth query, majority of the respondents i.e. 66.67% are agreed on the fact that the reason for setting the capital adequacy standard by NRB is to protect the interest of the depositors. Similarly in the tenth query 56.67% of respondents are agreed on the fact that commercial bank wishes to meet capital adequacy standard by raising core capital.

Opinion regarding to question “who will be benefited most by maintaining capital adequacy requirement”; 22 respondents i.e. 73.33% opined that the depositors will be benefited most by maintaining the capital adequacy requirements, 6 respondents i.e. 20.00% opined that shareholders and 2 respondents opined that others. Analysis of the opinions reveals that the depositors will be benefited most by the maintaining capital adequacy requirements.

Table 4.16

Primary Data Analysis III

Q.N.	Statement	Answer Options A No.	A %	B No	B %	C No.	C %
12	The commercial bank allows free to set capital adequacy ratio by them?	13	43.33	14	46.67	3	10
13	Whether loan and advance are reviewed on periodic basis?	17	56.67	10	33.33	3	10.00
14	Is capital adequacy requirement set by NRB fit for regulation and supervision of commercial bank?	18	60.00	10	33.33	2	6.67
15	Does the increase in requirement Rs.2 billion capital acts as barrier for new entrants?	2	6.67	16	53.33	12	40.00
16	Are the provisions in NRB directives about the black listing the loan defaulter adequate?	4	13.33	17	56.67	9	30.00
17	Are you satisfied that with existing requirement for the loan and loan loss provision?	23	76.67	5	16.67	2	6.67

In the twelfth query, majority of the respondents i.e. 46.67% are agreed on the fact that the commercial bank should allow free to set capital adequacy requirements. Similarly in the thirteenth query 56.67% of respondents are agreed on the fact that loan and advances are reviewed on periodic basis.

For query no 14, 18 respondents i.e. 60.00% of the sample says that capital adequacy requirements set by the NRB fit for the regulation and supervision of commercial banks where as 10 respondents i.e. 33.33% opined No, its too high and 2 respondents opined that no it is not adequate. From this opinion we can see that capital adequacy norms set by the NRB fit for regulating and supervising commercial banks.

From the analysis of the query no 15, we can conclude that 2 billion capita dose not act as barrier for new entry of commercial banks. This fact is backed by the 53.33% of the sample. Similarly it is opined that provisions in NRB directives about the black listing of the loan defaulter are not adequate.

In the last query, are you satisfied with the existing requirements for the loan and loan loss provision; 23 respondents i.e. 76.67% expressed that yes, 5 respondents i.e. 16.67% expressed that no and 2 respondents i.e. 6.67% expressed that do not know. From the analysis of the opinions we can conclude that the respondents are satisfied with the existing requirements for loan and loan loss provision due to similar opinion conveyed by the majority of the sample.

4.5 Major Findings of the Study

The major findings of the research study entitled "Capital Adequacy and Loan Loss Provision of Commercial Banks with Reference to NRB Directives." are as follows:

Nabil Bank Ltd.

- Total capital fund and core capital of NABIL bank is in increasing trend from fiscal year 2062/063 to 2066/067. But supplementary capital is decreased in fiscal year 2064/065 and 2065/066. NABIL bank has subsequently increased its capital fund by increasing its core capital more than that of supplementary capital. The portion of core capital in total capital fund is 88.24% in five-year average while that of supplementary capital is 11.76% in five-year average.
- Nabil bank has maintained its capital adequacy norms laid down by NRB. Core capital to RWA and Capital Adequacy Ratio of Nabil bank ltd. during the fiscal year 2059/60, 2063/064, 2064/065, 2065/066 and 2066/067 is within the limit and even exceed by 6.46% and 3.06%, 6.62% and 2.56%, 5.85% and 1.44%, 5.28% and 1.31%, 4.90% and 1.04% respectively than NRB requirement.
- Total loan and advances is increasing every year compare to previous year. Similarly, performing loan is also increasing every year but non performing loan is decreasing up to fiscal year 2064/065 but it is increased in fiscal year 2065/066. It is again decreased in fiscal year 2066/067 by little amount which is good for the bank.

- In the portfolio of total loan and advances, portion of performing loan is 97.81% while portion of non performing loan is 2.19% in five years average.
- NABIL is maintaining the loan loss provision required by NRB in aggregate. Total loan loss provision is excess in each year. But Provision requirement for each category of loan is not meet in some cases. In fiscal year 2062/063 and 2063/064 provision for sub standard, doubtful and loss loan is short by Rs.757.77 and Rs.394.01, Rs.2938.89 and 391.76, and Rs.13997.12 and Rs.5578.90 thousands respectively. But the provision for the pass loan is excess than NRB requirement by Rs.45947.40, Rs.45114.21, Rs.127323.27, Rs.234.50, and Rs.19117.76 thousands respectively in 2062/063 to 2066/067. Similarly loan loss provision for doubtful loan is short by Rs.886.91 and Rs.116.39 in fiscal year 2065/066 and 2066/067. Provision for loss loan is short in every year of study period. LLP for performing loan is also surplus in every year but the LLP for non performing loan is short in 2062/063 to 2064/065 but it is excess in 2065/066 and 2066/067.
- The loan loss provision to total loan and advances ratio is 4.41%, 4.20%, 3.29%, 2.68%, and 2.25% respectively in fiscal year 2062/063 to 2066/067. The LLP to total loan and advance ratio is in decreasing trend. Provision for non performing loan to non performing loan ratio of NABIL is 52.30%, 80.55%, 86.65%, 77.72%, and 57.15% respectively in fiscal year 2062/063 to 2066/067.
- NPL to total loan and advance is in decreasing trend which is good sign for the bank. It is 5.54%, 3.35%, 1.32%, 1.38% and 1.12%in 2062/063 to 2066/067 respectively.

Standard Chartered Bank Nepal Ltd.

- Total capital fund and core capital is in increasing trend but supplementary capital fund is decreased in 2059/60 then after it is gradually increasing up to fiscal year 2066/067. The portion of core capital in total capital fund is 87.41% in five-year average while that of supplementary capital is 12.59% in five-year average.
- The core capital to risk weighted assets of standard chartered bank during the fiscal year 2059/60, 2060/61, 2061/62, 2062/63 and 2066/067 exceeds the requirements by 7.31%, 8.26%, 8.31%, 7.49% and 8.27% as well as capital adequacy ratio

exceeds the limit by 4.21%, 4.57%, 4.85%, 3.91%, and 4.71% in those years. This shows that standard chartered bank has fulfilled the NRB guidelines regarding capital adequacy. Core capital, supplementary capital and total capital fund is increasing every year in decreasing ratio. SCBNL has far ahead in implementation of NRB guidelines regarding capital adequacy.

- Total loan and advances is increasing every year compare to previous year. Similarly, performing loan is also increasing every year but non performing loan is fluctuating over the study period. Loss loan is not so much fluctuating over the study period. In the portfolio of total loan and advances portion performing loan is 97.28% while NPL is 2.72% in five years average.
- In case of loan loss provision, it is slightly fluctuating in nature. But the total loan loss provision is nearly stable in every year of study period. Provision for substandard loan is in increasing trend. It is 1763.14 thousands in fiscal year 2062/063 and it has reached to Rs.4113.49 thousands in 2066/067. Provision for doubtful loan is in decreasing trend. But it is slightly increased in fiscal year 2066/067. This loan loss provision is Rs.97500 thousand in 2062/063 and has reached to Rs.63096.76 in 2066/067. Provision for restructured loan is null during the study period.
- SCBNL is maintaining the loan loss provision required by NRB. Total loan loss provision is excess in each year. Provision requirement for each category of loan is fulfilled in all cases. The provision for the pass loan is excess than NRB requirement by Rs.36657720 in 2062/063. Similarly loan loss provision for doubtful loan is excess in every year of the study period. LLP for performing loan as well as nonperforming loan is surplus in every year.
- LLP to total loan and advance ratio is 5.07%, 4.13%, 3.30%, 2.94%, and 2.66% in fiscal year 2062/063 to 2066/067 respectively.
- Provision for non performing loan to non performing loan ratio of SCBNL is 84.76%, 84.14%, 86.48%, 92.26%, and 92.16% respectively in fiscal year 2062/063 to 2066/067. NPL to total loan and advance is in decreasing trend which is good sign for the bank. It is 4.13%, 3.77%, 2.69%, 2.13% and 1.83% in 2062/063 to 2066/067 respectively.

Everest Bank Ltd.

- Total capital fund, core capital and supplementary capital of EBL are in increasing trend from fiscal year 2062/063 to 2066/067. The portion of core capital in total capital fund is 72.49% in five-year average while that of supplementary capital is 27.51% in five-year average. While portion of core capital fund in fiscal year 2063/64 is 69.87% and portion of supplementary capital is 30.13%. It means contribution of core capital is more in growth of total capital fund.
- Core capital to RWA and Capital Adequacy Ratio of Everest bank ltd. during the fiscal year 2059/60, 2063/064, 2064/065, 2065/066 and 2066/067 is within the limit and even excess by 5.46% and 1.99%, 4.08% and 0.07%, 3.37% and 2.57%, 2.77% and 1.34%, 2.32% and 0.19% respectively than NRB requirement. Core Capital to RWA is continuously decreased from fiscal year 2062/063 to 2066/067. Similarly, CAR is also decreased in every year except 2064/065. Though these ratios are continuously decreasing, they are above the NRB requirements.
- Total loan and advances is increasing every year compare to previous year. Similarly, performing loan is also increasing every year but non performing loan is fluctuating over the study period. It is decreased in fiscal year 2063/064 but it is increased in fiscal year 2064/065 and 2065/066. It is again decreased in fiscal year 2066/067 which is good for the bank. In the portfolio of total loan and advances portion performing loan is 98.64% while NPL is 1.362% in five years average.
- In case of loan loss provision, total loan loss provision increasing every year over the study period. Loan loss provision for performing loan is also increasing every year of the study period. Provision for loss loan is in increasing trend during the all year of the study period which is not the good for the bank. Loss loan provision is Rs.31180.62 thousand in 2062/063 and it is reached to Rs.106607.17 thousands in 2066/067.
- EBL is maintaining the loan loss provision required by NRB. Total loan loss provision is excess in each year. Provision requirement for each category of loan is fulfilled in all cases. The provision for the pass loan is excess than NRB requirement by Rs.31039580, Rs.75611550, Rs.79193510, Rs.85254980 and 144899250 in 2062/063 to 2066/067 respectively. LLP for performing loan is

surplus in every year. Provision for the non performing loan is same as requirements of NRB.

- LLP to total loan and advance ratio of EBL is 2.79%, 3.47%, 3.56%, 3.30%, and 2.97% in fiscal year 2062/063 to 2066/067 respectively.
- Provision for non performing loan to non performing loan ratio of EBL is 54.59%, 72.74%, 96.67%, 93.54%, and 96.16% respectively in fiscal year 2062/063 to 2066/067. NPL to total loan and advance is in decreasing trend which is good sign for the bank. It is 2.20%, 1.72%, 1.63%, 1.27% and 0.80% in 2062/063 to 2066/067 respectively.

Nepal Rastra Bank

- The role of NRB for regulating and supervising is satisfactory in the present due to similar opinion conveyed by the majority of the sample. Focus of NRB directive is to maintain safe and sound banking system.
- To develop the better financial institutions has been seems main cause of time to time changes made on NRB directives. NRB directives are needed for enhancing the credibility of the financial system of the country.
- Both supervisory systems, on-site and off-site are best for regulating commercial banks.
- The commercial banks are implementing the directives issued by NRB to some extent which is necessary to implement for safe, sound, and best performing financial system. The majority of the respondents believe that there are some weaknesses in NRB directives.
- Depositors will be benefited most by the maintaining capital adequacy requirements. So, the commercial bank should allow free to set capital adequacy requirements. Present capital adequacy norms set by the NRB fit for regulating and supervising commercial banks.
- Provisions in NRB directives about the black listing of the loan defaulter are not adequate. The existing requirements for loan and loan loss provision are satisfactory.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter is the important chapter for the research because this chapter is the extracts of all the previously discussed chapters. This chapter consists of mainly three parts: Summary, conclusion and recommendation. In summary part, revision or summary of all four chapters is made. In conclusion part, the result from the research is summed up and in recommendation part, suggestion and recommendation is made based on the result and experience of thesis. Recommendation is made for improving the present situation to the concerned parties as well as for further research.

5.1 Summary

Central banking is the recent origin. Prior to the commencement of the twentieth century, there had been no clearly defined concept of central banking. But today, there is no country in the world which doesn't have central bank. It is the bank that acts as the lender of the money market. It supervises, regulates and controls the functions of commercial banks and other financial institutions. It also acts as banker of the government and advices the government on several matters. It has been essential for the proper functioning of the economy.

NRB lays down various rules and regulation for bank and the banks need to follow them. So, it is also known as banker's bank. If the banks do not follow the rules and regulations issued by the central bank, the bank will be obliged to pay penalties. Generally, to bring uniformity and to amend the rules and regulations, NRB issues directives to the commercial banks from time to time and amends them on "need basis". The commercial banks have to modify their functions accordingly.

This study *"Capital Adequacy and Loan Loss Provision of Commercial Banks with Reference to NRB Directive"* is primarily prepaid for the partial fulfillment of the requirements of master of business studies (MBS). This study is mainly based on secondary and primary data provided by concerned banks and respondents. This research is the case study of three commercial banks namely, SCBNL, NABIL, EBL for the compliance of directives issued by NRB. The research study mainly focus on the two areas of the directives issued by NRB for the commercial banks namely, capital adequacy norms and the various types of loan and its provisioning in different sectors. The main objectives of the research study are to assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB; to study the loan loss provision of selected commercial banks and compares their provision with the concerned directive of NRB and to provide necessary recommendations to the commercial banks and Nepal Rastra Bank for improvement in the findings of the early two objectives of this study. Although the study is limited to the three commercial banks out of the 32 commercials banks acting in the country, it however reveals that there was a significant impact of the directives on the various aspects of the commercial banks. Information is collected during the period 2062/063 to 2066/067. The collected information is presented, analyzed and conclusion is drawn from the study. The research report is prepared as prescribed by the central department of management; Tribhuvan University.

Chapter one is concerned with the introduction of the whole study. It explained about the background of the study, need and objectives, statement of problem, limitations and organization of the study, which provides guideline for entire study.

Chapter two is concerned with the review of related previous studies, journals & article etc and books. A detail review of NRB directives is made under this chapter. It gives idea about the conceptual framework of the study.

Chapter three specifies the guidelines, tools, procedures and research design to achieve the objectives of the study.

Chapter four is for the analysis of data. Some financial and statistical tools are used. Ratio analysis is the main financial tools used in this study. Correlation coefficients between the relevant figures as well as probable error are considered as the main statistical tools in this study. A differential analysis between actual position of the selected banks and requirements of NRB is made as required by research objectives.

Secondary data were collected through annual report of related banks; publications of NRB, and websites of the concerned banks. But the primary data were gathered through questioners filled by the commercial banks officials, NRB officials, investors and academicians. All these work are of the 4th chapter.

Through the organized research work, the researcher has found that NRB directives are fulfilled by the commercial banks of Nepal. Sample study and field survey shows this fact. Guidelines related to capital adequacy and loan and loan loss provision are fulfilled in most cases but in some cases directive are not enacted by the banks.

5.2 Conclusion

From the research work entitled "A Study of NRB Directives with Special Reference to Capital adequacy and loan Loss Provision" some major conclusions are drawn which facts are cited as follows:

- NRB directives related to capital adequacy are implemented by the selected commercial banks. Capital adequacy ratios of all selected banks are above the requirements of NRB in all year of the study period 2062/063 to 2066/067. All the sample banks have paid more attention to core capital rather than supplementary capital although 50% of the total capital fund requirement can be fulfilled by the supplementary capital. All the banks have issued right share, bonus share to increase capital fund.
- Loan classification is made according to the NRB directives. Loan loss provision requirements as per directives are not fully implemented by the commercial banks.
- Among the selected commercial banks SCBNL and EBL have fully implemented the NRB directives related to loan loss provision. They have managed extra loan loss provision than requirements of the NRB directives.

- Although aggregate loan loss provision of NABIL is excess over the requirement of NRB, provision for loss loan is short than NRB requirements in every year of the study period. Provision for doubtful loan is also short than NRB requirement except in fiscal year 2064/065. But the provision for pass loan is excess for all year.
- Similarly the researcher has reached the conclusion that role of NRB is effective in regulating bank and financial institutions. Both off-site and on-site inspections are best for regulating bank and financial institutions. NRB directives are implemented for safe and sound banking system and developing the better financial institutions. Commercial banks are implementing the directives although there are some weaknesses in NRB directives.
- Capital adequacy norms are set by the NRB in order to protect the depositors. Depositors are the prime beneficiary of the capital adequacy norm. Little bit liberal capital adequacy norms should be set where bank may fell free to exercise. Only increment in paid up capital dose not works as barrier for new entry of commercial banks. Loan and loan loss provision requirements of directives are satisfactory although directives related to black listing of loan defaulter are not adequate.
- The coefficient of correlation, coefficient of determination and probable error of all the sample banks shows that net profit is closely related with total loan and advances. If the loan and advances increases, there is increase in net profit too. So, net profit depends on total loan and advances as well as other investment of banking activities. Since net profit is the net income for the banks which is net amount i.e. deducting of various expenditure amount. Specially, increment in pass loan leads the increment in net income of the bank.

5.3 Recommendations

Based on the analysis, interpretation & conclusions, certain recommendation can be made here so that the concerned authorities, future researchers, academicians, bankers can get some insights on the directives of the NRB related to commercial banks.

- Commercial banks are only focusing on core capital although they can fulfill the capital adequacy requirements by using supplementary capital up to the 50% of total capital fund. Commercial banks should also pay the attention toward raising the supplementary capital so that the excess of core capital can be cushioned for the hard period.
- The greatest problem for the some commercial banks may be to reach two billion paid up capital by the year 2070 B.S. This increment in the capital can be made by the issue of common share, right share, bonus share, debenture or bonds and capitalization of profits.
- Capital adequacy of EBL is in decreasing trend and paid of capital is also low. So, EBL should take initiatives to increase its capital base to meet the requirements in coming future. Risk of shortfall of capital can be seen for EBL while analyzing the data.
- NABIL should take care about maintaining the loan loss provision required by the directives. NABIL should distribute its provision properly as directed by the guidelines of the NRB. Although total loan loss provision of NABIL is excess but short fall can be seen in some categories of the loan. So, proper distribution should be made.
- NPL of the sample company are in increasing trend from observed period. Similarly, its provisioning is also increased to secure itself from burden of NPL. The banking sector needs to be very careful and aware in disbursement of loan and advances.
- Loss loan is also seems to be increasing, so must be very careful and must take necessary steps so that they can recover bad loan and stop from becoming loss loan, substandard and doubtful loan.
- Provision for different loans and advances are not maintained as per NRB requirements by the some banks. It is very dangerous to commercial banks. Since future is uncertain and no one knows which loan has to be write off when so commercial banks need to maintain its provisions as per NRB requirements so as to secure its position from defaulters.

- Internal audit department should be made stronger which should regularly check and monitor to make sure that the directives issued are properly implemented. Proper feedback should be provided to the different departments to reach their objectives which maybe for the compliance of the directive issued.
- NRB should consult with the various commercial bank officials before setting standards on different aspects of commercial banks. Complains and criticism of bank official should be considered accordingly.
- Issuance of new directives or revising of norms should not be made just to meet the international banking norms or standards. They should be issued only after properly analyzing its importance, suitability, and impact on commercial banks.
- NRB also has to strengthen the functioning of its credit information so that the commercial banks receive the details of the blacklisted borrowers in quick time.
- NRB should improve its corporate culture and good governance in order to ensure proper regulating and supervising of the commercial banks. It should change the attitude of the supervisory staffs and proper training and skill development program should be conducted.
- The supervisory and monetary body of NRB should be made powerful so that they can penalize the commercial banks on non-compliance of the directives. Frequent supervision should be made so that the commercial banks are ready to show that they are updated and are on the track shown by NRB.

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www.nabilbank.com

www.nrb.org.np

www.standardchartered.com

Annex – I

Correlation Analysis of NABIL Bank ltd.

Net Profit	**Loan &Advances**	X=X-$\bar{X}$		Y=Y-$\bar{Y}$	y^2	*xy*
416.24	7795.95	-123.94	15361.12	-3212.14	10317843.38	398112.632
455.31	8189.99	-84.87	7202.917	-2818.1	7941687.61	239172.147
520.11	10586.17	-20.07	402.8049	-421.92	178016.4864	8467.9344
635.26	12922.54	95.08	9040.206	1914.45	3665118.803	182025.906
673.96	15545.78	133.78	17897.09	4537.69	20590630.54	607052.168
2700.88	**55040.43**		**49904.14**		**42693296.81**	**1434830.79**

Mean ($\overline{X}$) = $\frac{\sum X}{n}$ = $\frac{2700.88}{5}$ = 540.18

Mean ($\overline{Y}$) = $\frac{\sum Y}{n}$ = $\frac{55040.43}{5}$ = 11008.09

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

$= \frac{1434830.79}{\sqrt{49904.14 \times 42693296.81}} = 0.9830$

Coefficient of Determination

Coefficient of Determination $(rxy)^2$ = (Correlation of coefficient)^2
= $(0.9830)^2$ = 0.9663

Probable Error

PE (r) = $0.6745 \times$ SE (r) = $0.6745 \times \frac{(1-r^2)}{\sqrt{n}}$ = $0.6745 \times \frac{(1-0.9663)}{\sqrt{5}}$ =0.01017

Correlation Analysis of Standard Chartered Bank Nepal Ltd.

Net Profit	**Loan &Advances**	$X = X - \overline{X}$		$Y = Y - \overline{Y}$	y^2	xy
506.93	5695.82	-79.35	6296.422	-2241.65	5024994.723	177874.928
537.8	6410.24	-48.48	2350.31	-1527.23	2332431.473	74040.1104
536.24	8143.21	-50.04	2504.002	205.74	42328.9476	-10295.2296
658.76	8935.42	72.48	5253.35	997.95	995904.2025	72331.416
691.67	10502.68	105.39	11107.05	2565.21	6580302.344	270347.482
2931.40	**39687.37**		**27511.14**		**14975961.69**	**584298.71**

Mean ($\overline{X}$) = $\frac{\sum X}{n} = \frac{2931.10}{5} = 586.28$

Mean ($\overline{Y}$) = $\frac{\sum Y}{n} = \frac{39687.37}{5} = 7937.47$

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

$= \frac{584298.71}{\sqrt{27511.14 \times 14975961.69}} = 0.9103$

Coefficient of Determination

Coefficient of Determination $(rxy)^2$ = (Correlation of coefficient)^2

$= (0.9130)^2 = 0.8286$

Probable Error

PE (r) = $0.6745 \times$ SE (r) = $0.6745 \times \frac{(1 - r^2)}{\sqrt{n}} = 0.6745 \times \frac{(1 - 0.8286)}{\sqrt{5}}$ =0.05169

Correlation Analysis of Everest Bank ltd.

Net Profit	loan &Advances	X=X-$\bar{X}$		Y=Y-$\bar{Y}$	y^2	*xy*
94.18	4908.46	-93.75	8789.06	-3466.85	12019048.92	325017.19
143.57	5884.12	-44.36	1967.81	-2491.19	6206027.62	110509.19
168.21	7618.67	-19.72	388.88	-756.64	572504.09	14920.94
237.29	9801.31	49.36	2436.41	1426.00	2033476.00	70387.36
296.41	13664.01	108.48	11767.91	5288.70	27970347.69	573718.18
939.66	**41876.57**		**25350.07**		**48801404.32**	**1094552.85**

Mean ($\bar{X}$) = $\frac{\sum X}{n}$ = $\frac{939.66}{5}$ = 187.93

Mean ($\bar{Y}$) = $\frac{\sum Y}{n}$ = $\frac{41876.57}{5}$ = 8375.31

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

$= \frac{1094552.85}{\sqrt{25350.07 \times 48801404.32}} = 0.9841$

Coefficient of Determination

Coefficient of Determination $(rxy)^2$ = (Correlation of coefficient)^2

= $(0.9841)^2 = 0.9684$

Probable Error

PE (r) = $0.6745 \times$ SE (r) = $0.6745 \times \frac{(1 - r^2)}{\sqrt{n}} = 0.6745 \times \frac{(1 - 0.9684)}{\sqrt{5}}$ =0.00952

Annex – II
Questionnaire

Dear Sir/Madam,

The purpose of this study is to access the performance of NRB directives on commercial banks. The information supplied will be used only for research purpose and high level of secrecy will be maintained. Please read the following statement and tick (   ) at the appropriate number that comes closest to your opinion.

Regards

Chiran Thapa

<u>Details of Respondent:</u>

Age:………… Sex:…………….

Profession:……………………………………………

Position:…………………………….. Experience in profession (in years)………

1. How effective is the role of NRB in regulating and supervision of the commercial banks?

   a) Effective   b) Satisfactory   c) Poor

2. Which supervisory system of NRB is best for regulating commercial banks in your opinion?

   a) Off-site inspection
   b) On-site inspection
   c) Both

3. What are the effects of NRB directives on commercial banks?

a) Safeguarding the depositors

b) Constraints the bank activities.

c) Maintaining safe and sound banking system.

4. What is the cause of changes made on NRB directives in time to time?

a) To meet the international standard

b) To develop the better financial institutions

c) To meet the need of time

5. Why NRB directives are necessary for the commercial banks?

a) To protect the banks and financial institutions

b) To enhance the credibility of financial system

c) To protect the interest of the depositors

6. Are commercial banks implementing the NRB directives?

a) Yes B) No c) Don't know

7. Do you think it is necessary to implement the directives issued by NRB?

a) Yes B) No c) Don't know

8. Is there any weakness in NRB directives?

a) Yes B) No c) Don't know

9. What is the reason for setting capital adequacy standard by NRB?

a) To protect the interest of the depositors

b) To protect the borrowers

c) To protect the financial institution

10. How your bank wishes to meet capital adequacy norms as prescribed by NRB?

a) By increasing core capital

b) By increasing supplimenty capital

c) By increasing the quality of assets

11. Who will be benefited most by maintaining capital adequacy requirements?

a) Depositors b) Shareholders c) Others

12. Should the commercial banks allow free to set capital adequacy ratio by themselves?

a) Yes B) No c) Don't know

13. Whether or not the loan and advance are reviewed on periodic basis?

a) Yes B) No c) Don't know

14. Is capital adequacy requirement set by NRB fit for regulation and supervision of commercial bank?

a) Its all right b) No, It's too high c) No, It's not adequate

15. Does the increase in requirement Rs.2 billion capitals Act as barrier for new entrants?

a) Yes B) No c) To some extend

16. Are the provisions in NRB directives about the black listing the loan defaulter adequate?

a) Yes B) No c) To some extend

17. Are you satisfied with the existing requirement for the loan and loan loss provision?

a) Yes B) No c) Don't know