

CHAPTER I

INTRODUCTION

1.1 General Background

Commercial banks are the one who provides complete financial solutions to its valued customers. They are a risky business which are constantly regulated by regulatory authority i.e. Nepal Rastra Bank. In the process of providing complete financial services, they assume various kinds of risks among which credit risk covers the significant portion of the total risk. While commercial banks have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or lack of attention to changes in economic and/or other circumstances that can lead to deterioration in the credit standing of a banks counterparties. Since the exposure to credit risk continues to be the leading sources of problems in commercial banks world-wide, the banks should now have a keen awareness of the need to identify, measure, monitor, manage and control the credit risk as well as determine that they hold adequate capital against these risks and that they are adequately compensated for the risks assumed.

Though the banking sector has been facing different types of risks, major banking problems have been either explicitly or indirectly caused by the weakness in credit risk management. So, in this study, the researcher has focused mainly on the credit risk management being a core banking concept of the commercial banks in Nepal. However, the brief introduction of other risks like liquidity risk, interest risk, operation risk, market risk and foreign exchange risk is also included.

1.1.1 Assessing credit risk

Credit risk is an investor's risk of loss arising from a borrower who does not make payments as promised. Such an event is called a default. Another term for credit risk is default risk. Investor losses include lost principal and interest, decreased cash flow, and increased collection costs, which arise in a number of circumstances

Thus, banks and financial institutions deploy their maximum time in managing credit risk. The bank's willingness to undertake or maintain credit risks is determined by the recognition, evaluation and weighing of all positive and negative factors of a proposal. The purpose of credit risk assessment is to determine the customer's ability to meet his obligations to the Bank (and to other lenders and creditors) as they fall due.

Credit risk assessment thus involves:

1. Determining the Maximum Credit Risk

The following factors must be considered:

- Principal Risk: that the customer may not be able to repay indebtedness.
- Income Risk: that the customer may not be able to meet interest and fee payments as they fall due.

2. Analyzing Financial and Other Information

The financial and non financial information must be relevant and up to date in order to carry out meaningful credit risk assessment. Analysis of the information, evaluation and weighing of all positive and negative factors with a view of determining credit limits and associated terms and conditions is a matter of subjective judgment. Each officer in the credit approval process must be satisfied that he has sufficient information on which to make a recommendation or decision. Risk assessment will include, but not limited to an analysis of the following:

- Management strengths and weaknesses including the honesty, integrity and reliability of the customer and willingness to honor obligations.
- The customer's knowledge, management expertise and ability to implement strategies to ensure obligations are met.
- Financial strength, including its ability to repay loans and meet commitments based on historical and projected financial statements.
- Business environment and general business outlook.
- Current and future business prospects including external conditions affecting the customer such as economic and political trends, role and position in the industries in which the customer operates, position of the industries in the business cycle and vulnerability to technological change.
- The size and structure of the proposed facilities and their fit with customer needs
- Past performance of facilities
- Environmental risks.
- Revenue / Earnings for the Bank.
- The nature and value of security (to be given) to the Bank and to other lenders.

3. Assessing Safety

It must always be remembered that the longer the duration of exposure, the more difficult it is to assess a customer's creditworthiness.

If the customer is a member of a group, a safety assessment of both the borrowing entity and overall customer group is desirable.

The Bank does not normally undertake exposure to a customer simply because it is fully secured by attractive and high value real estate mortgages. It must be established that the customer would have ability, and would be willing; to meet his financial commitments to the Bank, and it is highly unlikely that the Bank would have to enforce the security to recover its dues.

When the assessment has been completed, it may be decided that (additional) security is required to offset a weakness in the credit proposal, preclude other lenders or creditors from controlling the customer's assets and provide the Bank with a backup in case the customer fails.

Officers involved in the credit risk assessment must be satisfied that the positive factors outweigh the negative factors of the proposal.

In addition to it, significant resources and sophisticated programs are used to analyze and manage risk. Some companies run a credit risk department whose job is to assess the financial health of their customers, and extend credit (or not) accordingly. They may use in house programs to advice on avoiding, reducing and transferring risk. They also use third party provided intelligence. Companies like **Standard & Poor's, Moody's Analytics, Fitch Ratings, and Dun and Bradstreet** provide such information for a fee.

Most lenders employ their own models (credit scorecards) to rank potential and existing customers according to risk, and then apply appropriate strategies. With products such as unsecured personal loans or mortgages, lenders charge a higher price for higher risk customers and vice versa. With revolving products such as credit cards and overdrafts, risk is controlled through the setting of credit limits. Some products also require security, most commonly in the form of property.

Credit scoring models also form part of the framework used by banks or lending institutions grant credit to clients. For corporate and commercial borrowers, these models generally have qualitative and quantitative sections outlining various aspects of the risk including, but not limited to, operating experience, management expertise, asset quality, and leverage and liquidity ratios, respectively. Once this information has been fully reviewed by credit officers and credit committees, the lender provides the funds subject to the terms and conditions presented within the contract (as outlined above).

Credit risk has been shown to be particularly large and particularly damaging for very large investment projects, so-called megaprojects. This is because such

projects are especially prone to end up in what has been called the "debt trap," i.e., a situation where – due to cost overruns, schedule delays, etc. – the costs of servicing debt becomes larger than the revenues available to pay interest on and bring down the debt.

1.1.2 Mitigating credit risk

Lenders mitigate credit risk using several methods:

- ❖ **Risk-based pricing:** Lenders generally charge a higher interest rate to borrowers who are more likely to default, a practice called **risk-based pricing**. Lenders consider factors relating to the loan such as loan purpose, credit rating, and loan-to-value ratio and estimates the effect on yield (credit spread).
- ❖ **Covenants:** Lenders may write stipulations on the borrower, called **covenants**, into loan agreements:
 - Periodically report its financial condition
 - Refrain from paying dividends, repurchasing shares, borrowing further, or other specific, voluntary actions that negatively affect the company's financial position
 - Repay the loan in full, at the lender's request, in certain events such as changes in the borrower's debt-to-equity ratio or interest coverage ratio.
- ❖ **Credit insurance and credit derivatives:** Lenders and bond holders may hedge their credit risk by purchasing **credit insurance** or **credit derivatives**. These contracts transfer the risk from the lender to the seller (insurer) in exchange for payment. The most common credit derivative is the **credit default swap**.
- ❖ **Tightening:** Lenders can reduce credit risk by reducing the amount of credit extended, either in total or to certain borrowers. For example,

a distributor selling its products to a troubled retailer may attempt to lessen credit risk by reducing payment terms from *net 30* to *net 15*.

- ❖ **Diversification:** Lenders to a small number of borrowers (or kinds of borrower) face a high degree of unsystematic credit risk, called **concentration risk**. Lenders reduce this risk by diversifying the borrower pool.

- ❖ **Deposit insurance:** Many governments establish **deposit insurance** to guarantee bank deposits of insolvent banks. Such protection discourages consumers from withdrawing money when a bank is becoming insolvent, to avoid a bank run, and encourages consumers to holding their savings in the banking system instead of in cash.

In addition to it, NRB has been constantly focusing on managing credit risk and applying its credit risk managing tools to govern every banks and financial institution to protect and act on behalf large depositors and shareholders. NRB being central bank plays a mentor and patron role in risk managing. The main tools applied by NRB to monitor and mitigate those risks are listed below but not limited to following:

1. Implementing BASSEL II (Capital Adequacy)

Institution	Minimum Capital Reserve as per Risk Weighted Exposure	
	Primary Capital	Supplementary Capital
"A" class	6%	10%
"B" & "C" Class	5.5%	11%
"D" Class	4%	8%

2. Loan loss provisioning

3. Single obligor limit and sector wise lending
4. Investment provisions
5. Consortium loan arrangements
6. Credit information and black listing
7. Merger and acquisition policy

All above tools including other as required by NRB are very effective tools that checks and monitors credit risk. Every banks and financial institution must comply with the terms and conditions stated on Unified NRB Directives 2068. Here, minimum standard threshold are stated below which the banks and financial institutions are obliged to comply. Mitigating credit risk is not a simple job, careful analysis and adequate time must be devoted. Despite of tremendous effort shown by NRB, many banks plays on loopholes and thus become problematic and helpless. Moreover, senior officials and even the chairman involvement in providing loans on nepotism basis and utilizing funds for personal use has created many serious problems that has degraded the banking position and its values. For instance, we have witnessed these problems in Nepal Share Markets and Finance Ltd., Gorkha Development Bank, Capital Merchant Bank, and even Vibor Bikas Bank Ltd. These are the lively examples of poor portfolio management and poor lending consequences. NRB must envisage these and future problems and come up with more effective and accurate policies and guidelines in order to maintain good banking reputation in the eyes of the public and provide safer place for depositors. Though, we have been experiencing more and more tougher policies implemented by NRB under helm of governor Mr. Yuv Raj Khatiwada, tight rules and regulation are even sought on urgent basis to control threatening downsizing economy.

1.1.4 Banking System in Nepal

Sound banking system is crucial means to accelerate the development of a country by strengthening the economic condition in this globalized economy of

the twenty first century. This requires well developed corporate culture, proper risk management techniques, appropriate return for risk assumed and healthy competitive environment that facilitate mobilization of small saving in the commercial and industrial sectors that will enhance the economic and social welfare of a country.

In Nepal, establishment of Nepal Bank Limited on Kartik 30,1994 Bikram Sambat (1937 A.D.) begin providing financial solutions to its customers.. This marked the beginning of an era of formal banking in Nepal. Until then all monetary transactions were carried out by private dealers and trading center. Nepal Rastra Bank, the central bank of Nepal was established in 1956 A.D to discharge the central banking responsibilities including guiding the development of the embryonic domestic financial sector followed by Rastriya Banijya Bank in 1966 A.D. As Nepalese government took liberal economic policy in 1980s, joint venture banks started to operate since 1984 A.D with the establishment of NABIL Bank Ltd. erstwhile known as Nepal Arab Bank Ltd. Commercial banks collect deposits from individuals and invest them in part as loans and advances to the borrowers and receive interest as the output of the business. Commercial banks profit and operation costs are borne by theses interest collected from the borrowers. When these interest as well as the principal are not collected in due time, the existence of the bank and the deposits of individuals will be in threat. So, necessary arrangements must be implemented by the banks and government to avert this situation. In addition to the credit risk, the bank also faces other risks. According to the Nepal Rastra Bank Unified Directives 2067, the major sources of risk are credit risk, operation risk, Market risk, foreign exchange risk, interest rate risk and liquidity risk etc.

Brief Introduction of Kumari Bank Ltd. (KBL)

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03,

2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 1,485,000,000 of which 70% is contributed from promoters and remaining from public. Kumari Bank Ltd has been providing wide - range of modern banking services through 28 points of representations located in various urban and semi urban part of the country, 19 outside and 9 inside the valley. The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS Banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, Utility Bill Payment Services, Inward and Outward Remittance services, Online remit Services and various other banking services.

Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 30 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers. The bank has been able to get recognition as an innovative and fast growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission. The key focus of the bank is always center on serving unfulfilled needs of all classes of customers located in various parts of the country by offering modern and competitive banking products and services in their door step. The bank always prioritizes the priorities of the valued customers.

Mission Statement

Our mission is to deliver innovative products and services to our customers, use these innovative products to achieve financial inclusion, and do so by exemplifying good corporate governance, proactive risk management practices, and superior corporate social responsibility.

Vision Statement

Our vision is to be the preferred financial partner to our customers, a center of career growth to our employees, and to maximize our shareholders' value, while contributing to our nation's financial sector and to its economic welfare.

Key Person: - Radesh Pant (CEO)

Brief Introduction of Machhapuchchhre Bank Ltd. (MBL)

Machhapuchchhre Bank Limited was registered in 1998 as the first regional commercial bank to start banking business from the western region of Nepal with its head office in Pokhara. Today, with a paid up capital of above 1,314 million rupees, it is one of the full fledged commercial bank operating in Nepal; and it ranks in the topmost among the private commercial banks.

Machhapuchchhre Bank Limited is striving to facilitate its customer needs by delivering the best of services in combination with the state of the art technologies and best international practices.

Machhapuchchhre Bank Limited is the pioneer in introducing the latest technology in the banking industry in the country. It is the first bank in Nepal to introduce centralized banking software named GLOBUS BANKING SYSTEM developed by Temenos NV, Switzerland. Currently it is using the latest version of GLOBUS, referred as **T-24 BANKING SYSTEM**. The bank provides modern banking facilities such as Any Branch Banking, Internet Banking and Mobile Banking to its valued customers.

The bank in the last few years have really opened up with branches spread all around the country. At this stage, it has its Corporate Office in Kathmandu and branch offices in other parts of Kathmandu, Damauli, Bhairahawa, Birgunj,

Banepa, and different parts of Pokhara in addition to the Head Office in Naya Bazar, Pokhara. A full-fledged banking branch is in operation in Jomsom located high up in the mountains too. The bank aims to serve the people of both the urban and rural areas. The bank intends to open many more branches in the coming years and have planned to open more than 4 branches in the year 2009/10.

1.2 Focus of the Study

The Study is focused on measurement and comparison of credit risks of the selected commercial banks i.e. MBL and KBL, analysis of Credit Risk Management systems and practice followed by the Nepalese Commercial Banks by taking KBL and MBL as the sample banks, the analysis of the directives of Nepal Rastra Bank issued to commercial banks and also is focused on finding out if the banks have taken proper measures to be adequately compensated for the credit risk they hold.

1.3 Statement of Problems

Banking industry has always seemed a profitable, charming and glamorous in the eye of everyone (layman) since its inception. They are assumed to yield high rate on invested assets with the net profit of the whole commercial banking system of Rs. 7,330.72 million in Mid January 2011. However, unlike general perception, the industry is threatened with immense challenges and competition to sustain and outpace those within the industry, mainly due to rising competition among commercial banks in addition to weakening economic situation of the country, indicated by the GDP growth rate of 3.50% the fiscal year 2067/68 B.S.

Presently, we are even witnessing many serious liquidity crises in the market and other credit related inefficiencies that has had seriously hit the market, even threatening the existence of those banks. Thus, NRB has recently announced a special refinancing scheme to banks and financial institutions to

manage liquidity as per its circular no. 27 dated 2068/03/13 bearing reference no. 27/0387/068. However, these loans become due on six month from the date of refinance/interbank borrowing obtained and must be paid off with accrued interest thereon at 7% interest rate. Similarly, the banks and financial institution obtaining such loans are restricted to transact interbank borrowing and other similar facilities such as Credit Sale etc unless the earlier such transactions are settled.

Similarly, embracing liberalized policy on entrant of foreign banks to operate their branch in Nepal without joint venture of Nepalese investors has threatened existing indigenous banks and financial institution. This has resulted in increased pressure for Nepalese commercial banks to compete with foreign banks. Additionally, commercial banks are compelled to increase their paid up capital to Rs. 2 billion by Chaitra End 2068 has challenged most of the commercial banks in Nepal. Pertaining to it, few banks such as Bank of Asia, KIST bank, Sunrise Bank and Prime bank were not able to meet the ceiling and were in process to issue right share or auction their unsold shares and comply with regulating authority. Banks not complying it shall be penalized according the directive.

Major problem of the banking sector in Nepal is the Credit Risk. Poor lending practices, which are indicated by poor financial analysis of borrowers, inadequate or substandard collateral and poor portfolio analysis, poor tracking of credit and intention of borrowers to default and also involvement of banks directors and management to use fund for their own welfare and purpose have resulted in the high amount of Non Performing Loans of major commercial banks such as Rastriya Banijya Bank Ltd (RBBL), Agriculture Development Bank, and Nepal Bangladesh Bank Limited had the excess NPL to Total Loans ratio of 11.05%, 8.12% and 14.39% respectively in the mid January 2011. Because of the high amount of non-performing loan of these banks, these banks

carries high amount of accumulated loss, which is indicated by the high amount of negative retained earnings and negative capital funds.

These huge negative capital funds of two big banks namely RBB and NBL have negative impact on capital base of the Nepalese banking system. The negative capital fund of Rs. 4498.35 million of Nepal Bank Limited and Rs. 10,363.70 million of Rastriya Banijya Bank in mid January 2011 had a serious impact on capital fund of overall commercial banks.

The Non Banking Asset (NBA) is also the major problem in banking industry. Out of the total Non Banking Assets, the share of NBL, RBB and Agriculture Development bank Ltd is almost 52%. Because of this phenomenon, the management of these banks has been handed over to the foreign experts. Likewise, Lumbini Bank Limited (LBL), because of its continuous poor performance, was taken over by NRB for few years however, the management of the bank was handed over to the private sectors.

Present challenges to the banking sector are to invest the money in productive as well as new sector and to manage the accumulated non-performing loan. The non-performing loan for entire commercial banking industry is Rs. 15,834.28 million in mid July 2011 which is 3.15% of Total Gross Loan.

Further, the introduction of new Unified directives by the NRB in 2068 B.S. has also provided the commercial banks different measures related to credit risk, interest rate risk, foreign exchange risk, liquidity risk and operation risk coupled with maintaining adequate capital to safeguard the interest of investors, depositors and shareholders. The commercial banks need to comply with these prudential's, which have also provided the challenges to the commercial banks of Nepal. Among these, the loan loss provisioning and capital adequacy measures have been providing the major challenges to Nepalese commercial banks. As per NRB Unified Directive 2068 the capital

adequacy ratio is 6% on Primary capital (Core Capital) and 10% on Total Capital (Primary +Supplementary).

Likewise, implementation of Basel II from 2007 in Nepal in parallel way has also been the challenge for Nepalese Commercial Banks. Basel II is mainly concerned with the management of various types of risks and the capital framework for providing enough cushions to absorb the risk faced by commercial banks. The Basel II has categorized Nepal as the high-risk country with ECA (Export Credit Rating Agencies) rating 7. This means that the Nepalese Commercial banks assets are rated risky up to 200%. (Basel, 2005)

Machhapuchhre Bank Ltd and Kumari Bank Ltd established as 14th and 15th commercial banks in Nepal respectively are not isolated with above mentioned challenges and problems faced by the entire banking industry. More specifically, the major problems related to these banks are proper compliance of NRB Directives and international measures. NRB had instructed to then Chairmen of Machhapuchhre Bank to step down from his position as chairman in 2002. The decision was taken after the central bank's Monitoring and Supervision Department found out that the chairman was Managing Director of another company that was blacklisted by the Credit Information Center (CIC). The researcher has selected Kumari Bank Ltd. (KBL) and Machhapuchhre Bank Limited (MBL) as the samples for the study. Since their date of establishment and the size of capital are also quiet similar, these two banks are chosen for study. Both the banks are in the growing stage, but in order to achieve their expected growth target, these banks must be able to manage the various risks, especially, the credit risk.

Therefore, within this liberalized competitive market scenario, the stringent credit risk management, compliance of NRB's prudential and Basel II are the major problems and challenges for these banks to sustain and grow in the industry.

Thus this research particularly focuses on the problem faced by the commercial banks that connects with KBL and MBL. The research is focused on

- What are the total loans and advances to total deposit ratio of the sample banks?
- What is the capital adequacy ratio of the sample banks? Had they been able to maintain the adequate capital as per NRB?
- What is the non-performing loan to total loans and advances ratio?
- What is the loan loss provision to total loans and advances ratio?
- What is the security wise loan position of the sample banks?
- What is the real estate lending position of the sample banks?
- How could identify the different types of risk particularly on credit risk?
- What are the specific credit risks that have seriously hit KBL and MBL along with other commercial banks and financial institutions?
- How to measure these risks and maintain good corporate governance?

1.4 Objectives of the Study

The major objective of this study is to identify the way of maintaining credit safety for selected commercial banks and other financial institutions as well. For this, the credit threats are examined, analyze and interpreted to various concerned authority and corrective actions and measures are listed out and the most suitable one is opted to mitigate the risk. The major objectives of the study are listed out as below.

- To examine and analyze the total loans and advances to total deposit.
- To examine and analyze the capital adequacy ratio.
- To examine the non-performing loan to total loans and advances.
- To examine and analyze loan loss provision to total loans and advances ratio.
- To examine and analyze security wise loans loan classification.

- To examine and analyze real estate lending.
- To examine the credit position of the sample banks.

1.5 Significance of the Study

From the very beginning of banking era, it is responsible for the overall growth and development of economy. It pools large borrower and saver together. It makes huge investment possible from the pooled funds. Thus, proper management of credit risk is mandatory in every organization. No organization can escape from ever changing environments such as Political, Economic, Social, and Technological that keeps on threatening. The success of any organization largely depends on how efficiently funds are being managed, its good portfolio and its ability to manage various risks. Banking sector involves several risks, which need to be handled promptly for the survival and growth. As this research focuses on analyzing credit risks and their management in reference to NRB directives and measures, it will provide valuable insight to different stakeholders about the major problems of banks and bank's action for its management.

The research has its significant to various stakeholders as listed below.

- To banks and financial institutions licensed and governed by NRB. Their officials and higher management to take credit related decisions and correct their earlier mistakes. Also, this research highlights the major NRB guidelines related to credit to mitigate risk. This in turn helps the banks and its officials to perform better and comply to guidelines provided by NRB.
- To various individuals who has direct or indirect relation or transaction with the banks and financial institution. Poor lending leads to failure, thus individuals are careful in depositing their life time savings to those institutions that have properly managed their portfolios and have

minimal credit risk shown by minimal or no bad loans, adequate capital reserves and liquidity etc.

- To the governing body to tighten the existing guidelines to avoid loopholes that institutions keep on playing. Further, provide insight and envisage policymaker on emerging credit risk identification to smooth the current liquidity crisis and help problematic banks and financial institutions.
- To Investor, Creditor, depositor & borrower. The Investor, Creditor and depositor can collect, interpret and analyze data and make appropriate decision on whether to invest on particular organization or not. Depositor with these measures can make decision on depositing their lifelong saving on sound organization. Borrower can evaluate the organization and decide to borrow the funds from organization having lower cost of fund thereby minimizing their own cost itself.

1.6 Limitations of the Study

The study is based on sole research and analysis made by sole individual. Various journal and articles extracts has been the addendum. Thus the reliability of the research largely based upon the directives, journal, articles and newspapers. Management, resource mobilization and time constraints limit the in-depth study of all commercial banks operating except commercial banks under study.

- Primary data especially through personal interview, Financial disclosure and questionnaire. Moreover, the primary data are collected during the period of February 2012 to May 2012. Therefore, any changes in the general view, concepts and behavior of the people before and after the period are not included in the study. Therefore, the accuracy of results and conclusions highly depends on the reliability of these facts and the time and situation of data collection.

- The evaluation is made through the analysis of financial statement published and presented by the banks. Therefore generalization of the whole banking industry cannot be made.
- The secondary data of only five years are taken. Inaccessibility of sufficient information also limits the conclusion drawn from study.

1.7 Organization of the Study

The study organized in following manner:

Chapter I is the introductory part of the study. This chapter describes the general background of the study, focus of the study, statement of the problem, objectives of study and limitations of the study.

Chapter II includes a discussion on the conceptual framework and review of the related and pertinent literature available. The conceptual considerations and review of related literature conducted in this chapter provides a framework with the help of which the study has been accomplished.

Chapter III describes the research methodology employed in the study. In this chapter, research design, nature and sources of data, methods of data collection and tools and techniques of data analysis are discussed.

Chapter IV consists of presentation and analysis of data, which deals with the empirical analysis of the study and the major findings of the study.

Chapter V is the summary, conclusion and recommendations of the study.

CHAPTER II

REVIEW OF LITREATURE

The review of literature is a crucial aspect of planning of the study and NRB directives for the study. The main purpose of literature review is to find out what work have been done in the area of the research problem.

2.1 Concept of Credit

Credit is the amount of money lent by the creditor to borrower either on the basis of security or without security. Credit and advances is an important item on the asset side of the balance sheet of a commercial bank. Bank earns interest on credits and advances which is one of the major sources of income for banks. Bank prepares credit portfolio; otherwise it will not only effect debts but also affect profitability adversely. (Varshney and Swaroop, 1994:6)

Credit is financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return of obligation repay on specified date on demand. Bank generally grants credit on four ways: (Chhabra and Taneja, 1991: 4)

- Overdraft
- Cash credit
- Direct credit
- Discounting of bills

For bank's overall corporate strategy and strategic plan at least three critical components are needed. They are: (Joseph, 1998:112)

- Business plan
- Framework for risk management
- Strategies for corporate control.

These are the basic components provide a solid foundation for managing value and risk planning, it focuses in just an operating and competing in the financial services industry. The modern strategic approach also includes a framework for risk management and strategic for completing in the component fits for the modern idea of the basic business of banking as measuring, managing and accepting risk. The bank's objective is to manage value and risk by maximizing those or eliminating those that destroy value.

The main task of commercial bank is to collect funds as deposit through several sources and lend them to different sectors like; manufacturing, transportation, trade, construction, communication and other public utilities etc. Doing all these activities every bank has to face so many risks. There are several types of risk prevailed in the banking industry, but the major area of the risk are widely recognized, i.e. credit risk, market risk and operating risk etc.

The credit risk is the potential financial loss resulting from the failure of customers to honors fully the terms of loan or contract. On the other hand, the market risk includes balance sheet risk and trading risk such as potential risk to earning and capital resulting from changes in interest rate, liquidity conditions, impact of foreign exchange rate fluctuations etc. Meanwhile operating risk arises from the natural disasters, errors in processing and settlement of transactions safeguarding of assets, system failure, fraud and forgery.

2.1.1 An Overview on Credit Risk

Credit risk is defined as the possibility that a borrower will fail to meet its obligations in accordance with the agreed forms and condition. Credit risk is not restricted to lenders doing activities only but includes off balance sheet and interbank exposures. The goal of C.R.M. is to maximize the bank risk adjusted rate of return by maintaining the C.R.E. within acceptable parameters. For most banks, loan is the largest and most oblivious resources of credit. However, other sources of credit risk exist throughout the activities of banks including in

the banking book and in the trading book and also in both on and off balance sheet. Banks are increasingly facing credit risk or counterparty risk in various financial instruments other than loans including acceptance, inter bank transactions, trade financing, foreign exchange transaction and guarantee and the settlement of transactions.

Credit is regard as the most income generating assets especially in commercial banks. Credit is regarded as the heart of commercial bank in the sense that, it occupies large volume of transaction. It covers the main part of investment. It is the main factor for creating profit and determining the profitability. It affects the overall economy.

In today's context, it also affect on national economy in some extent because if the bank provides credit to retailer, it will make the customer status. Similarly, it provides cash to trade and industry too. The government will get tax from them and help to increase national economy. It is also the security against depositors. It is supposed from the very beginning that Credit is the wealth maximization derivative. However, other factors can also affect profitability and wealth maximization but the most effective factor is regarded as credit risk. It is the most challenging task because it is backbone in commercial banking. Thus effective management of credit should seriously be considered. Management is the system which helps to complete the task effectively. Credit risk management is also the system which helps to manage credit effectively, in other words, credit risk management refers the management of credit exposure arising from loans, corporate bodies, and credit derivatives. Credit exposures are the main sources of investment in commercial banks and return on such investment is supposed to be main sources of income.

2.1.2 Credit Risk Management

Financial environment is dynamic. In this dynamic financial environment fluctuation in interest rates, exchange rates and commodity and real estate price

are not something new. These fluctuations in economic and financial variables destabilize the corporate strategies and performance of bank. Thus, it is necessary that bank has a framework of risk management. Effective credit risk management allows a bank to reduce risk ad potential non performing assets. Once bank understand their risk and their cost they will be able to determine their most profitable business. Therefore the bank must have an explicit credit risk strategy by organizational changes, risk measurement techniques and fresh credit processes and system. While talking about the credit risk management, five C's of creditworthiness should be considered and they are:

❖ **Character**

The good character and intention of the borrower is very important and thus should be seriously considered. Information about the character of the client can be gathered from his working place, reference, neighbors and other places he is associated with. This job tediously but should be carried out for secure investment.

❖ **Capacity**

It can be describe as a customer ability to pay. It is measured by applicants past performance records. For this an interview with applicants, customers\suppliers will further clarify the situation. The gross income, expenses and net income should be analyzed whether the borrower lives on salary\wages or any other forms of income sources. Whether the borrower has extra income source other than usual based which should be used to repay the scheduled installments should be considered.

❖ **Capital**

Capital provides a caution to absorb operating and assets losses that might otherwise impair debt repayment. This, in fact, is the insurance against the loans granted to the borrowers.

❖ Collateral

Sufficiency of collateral is necessary to ensure the recovery of loan. In case of default, by any cause, the collateral kept should have value enough to recover the loan granted and interest borne by it. It is recommended that only 50% of the value of collateral is granted as loan, but considering other factors like character of borrower and his credit worthiness, this percentage can be made flexible.

❖ Conditions

Borrowers may be subject to unfavorable economic conditions beyond their control. Repayment depends not only upon character, capacity and collateral but those factors over which the borrower exercise little or on control. As for example: natural calamities or drastic economic crises etc.

Risk depends upon the quality found in each 'C' and the combination of these five Cs, assuming the same conditions prevails; the following guidelines are suggested.

Table 2.1.
Guidelines of Assessing Risk

<i>Applicant character</i>	<i>Credit risk</i>
Character + Capacity	Very low
Character + Capacity without capital	Low to moderate
Character + Capacity but insufficient capital	Low to moderate
Character + Capital but impaired character	Moderate
Character + Capital without character	High
Character + Capital without capital	High
Character + No capital + No capacity	Very high
Capital + No character + No capacity	Very high
Capacity + No character + No capital	Fraudulent

2.2 Reviews on Unified Directive 2068 Related to Credit Risk

The Unified Directive 2068 issued by NRB has great impact on every commercial banks and financial institutions. This unified directive brings every bank at par and complies with its rules and regulation. Besides this directive NRB keep on issuing circular for newer regulation and including addendum and replace of earlier directive. The directives issued over the time are the tools used by the central bank to control and monitor banks and financial institutions. This directive attempts to regularize prudential regulation on every banks and financial institutions and have proven an effective control mechanism for overall regulation. The credit related directives are discussed briefly below:

2.2.1 Directive No.1- Regulation to Maintain Minimum Capital Fund by the Commercial Bank as per NRB Directive

Capital adequacy ratio (CAR) is the relationship between capital funds to total risk weighted assets of the bank. The higher the CAR, the less levered the bank and safer from depositor's point of view because the proportion of shareholders' stake to the risk weighted assets 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. Banks in Nepal are required to have minimum 6% core capital and 12% total capital fund of total risk weighted assets.

Table 2.2
Fund Required on the basis of WRA (%)

Core capital	Capital fund
6	12

Source: NRB directives 2004/2005

❖ **Classification of Capital:**

To calculate the capital fund, commercial banks should classify the capital in two parts;

- a) Core capital
- b) Supplementary capital

And,

Capital fund= core capital + supplementary capital

Provision for pass loan made up to 1.25% of total risk weighted assets is treated as supplementary capital.

$$\text{Capital fund ratio} = \frac{\text{core capital} + \text{supplementary capital}}{\text{Sum of weighted risk assets}} \times 100$$

Where, sum of weighted risk assets (WAR) = Total WRA appeared in balance sheet+ Total WRA appeared outside the balance sheet

2.2.2 Directive No. 2-Classification of Loans and Advances and Loan Loss Provision

Each Loan is different. Thus Loans and Advances are classified according to the due period. A due period is a period when a borrower fails to pay his promised obligation to the banks and financial institutions. A borrower failing to pay his/her obligation for a period more than 3 months falls under this category. The basic logic behind this is, the provisioning of specific percentage of entire loan outstanding upon failure of borrower to exercise his/her obligations. The provision amount is deducted from the profit so that the bank can utilize this sum if the borrower does not exercise his obligation and goes bankrupt. This measure or tool of NRB is very effective since certain portion of the profit is secured for contingency.

A. Classification of Loans and Advances

a. Pass Loan

All Loan and Advances whose principal and interest payment is regular i.e. not due or if due but has not crossed 90 days falls under this category. This category requires **1% provision** on outstanding balance of loans and advances.

b. Substandard Loan

Loans and Advances whose either principal or interest payment is due for more than 3 months but has not crossed 6 months falls under this category. This category requires **25% provision** on outstanding balance of loans and advances.

c. Doubtful Loan

Loans and Advances whose either principal or interest payment is due for more than 6 months but has not crossed 1 year falls under this category. This category requires **50% provision** on outstanding balance of loans and advances.

d. Bad Loan

Loans and Advances whose either principal or interest payment is due for more than 1 Year falls under this category. This category requires **1000% provision** on outstanding balance of loans and advances.

❖ Pass Loans and advances are called Performing loans whereas Substandard, Doubtful and Bad loans are called non-performing loans and advances.

B. Additional arrangement for Pass Loan

❖ Following Loans and advances can be considered as Pass Loan

- a) Loans and advances that are fully secured by bullions (Gold, Silver).
- b) Loans and advances that are fully secured by Fixed Deposit Receipt.

- c) Loans and advances that are secured by government securities or NRB issued Bonds.

But, if the government securities and NRB issued Bonds are pledged as secondary collateral those loans and advances must be provisioned on the basis of ageing as shown above 1

- ❖ Working Capital Loans having maturity of one year can be classified under pass category if renewed. If interest is due on those loans then it must be categorized on the basis of due days of interest.

C. Additional arrangement for Bad Loan

Even if the loan is not past due, loans and advances showing following characteristics are considered as Bad Loan

- a. Market value of collateral insufficient to cover loan amount.
Declared Bankrupt of Borrower.
- b. Borrower missing or absconding
- c. Non-funded facilities including bills purchased converted into funded facilities but not yet recovered within 90 days.
- d. Misuse of Loans
- e. If Non recovery of loan succeeded by auction process exceeds 6 months or recovery of loans under litigation process.
- f. Loans and advances extended to Black listed borrowers.
- g. Project and business under threat of operation.
- h. Exceed of 90 days for credit card loan.
- i. Overdue Trust Receipt Loan

D. Additional arrangement for 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 overdue installment.

❖ **Principal and Interest cannot be recovered by overdrawing the account of the customer.**

❖ **Rescheduling and restructuring of Loan**

Banks may reschedule or restructure such loans upon receipt of the written plan of action from the borrower citing the following reasons.

- a. Evidence of adequate collateral and documentation regarding Loans.
- b. An evaluation of the borrower/ enterprise's management with particular emphasis on efficiency, commitment and high standards of business ethics.

To reschedule or restructure the loans, it is mandatory that at least 25% of past due interest up to rescheduled or restructured date should be paid by the borrower. If all interests have been recovered before renewal of loans, it can be categorized into Pass Loan.

2.2.2.1 Loan Loss Provisioning

1. The following are the provision percentage.

Table 2.3
Loan Loss Provisioning

Pass Loan	1%
Substandard	25%
Doubtful	50%
Bad	100%

Loan loss provision set aside for performing loan is defined as "General Loan Loss Provision" and Loan Loss provision set aside for Non-Performing Loan is defined as "Specific Loan Loss Provision"

2. Loan Loss Provisioning in respect of reschedule, restructured or swapped loan.

- A. For rescheduled/restructured loan, loan loss provision should be at least 12.5%.
- B. In case of rescheduling or restructuring or swapping of insured or guaranteed priority sector credit, the loan loss provisioning shall be provided at one fourth of the percentage mentioned in clause (a)
- C. If interest and principal of rescheduled/restructured loans have been served regularly for two years, such loans can be converted into "Pass Loan" Category.

2.2.3 Directive No. 3 (Single Obligor Limit and Sector wise Lending)

A. Single Obligor Limit

This tool of NRB is effective in checking the credit concentration risk of the banks and financial institutions. Single Obligor refers to the credit facility being extended to single person, firm, company or a group of the borrowers, meaning that banks and financial institutions are provided certain threshold to extend credit facilities. Banks and financial institutions and extend credit facilities including fund based and non fund based facility to the tune of **25% of the Primary Capital.**

B. Credit facility extended to Hydropower, Transmission Line and Cable car operation.

The single obligor limit, however, does not hold 25% threshold in sector like Hydropower development, transmission line and cable car operation. Banks and financial institutions can extend credit facilities including fund based and non fund based facility to the tune of **50% of the Primary Capital.**

1. Exception on Limit of Credit Facility

Banks and financial institution need not comply to above mentioned threshold in following circumstances.

- a. Loans and advances extended by fully securing it by Fixed deposit receipt, government securities and government bonds, guarantee provided by multilateral banks, International Monetary fund and
- b. Loans and advances extended to Nepal Oil Corporation, Nepal Food Corporation.

2. Interrelation between borrowers shall be kept under same group.

- a. If a company or a person holds 25% of more share of another company comes under same group.
- b. Member of Same group, firm
- c. Personal guarantee provided by a person, company to another person or company.
- d. Credit facility extended to different borrower from same collateral.

C. Sector wise Lending

This tool of NRB checks sector concentration risk. If banks and financial institutions keeps on extending credit facilities to same sector and if unfortunately the sector has no profitable future, then a bank and financial institutions existence comes into threat. Thus this risk must be checked.

D. Arrangement for Real Estate Lending

This tool of NRB has proven to be one of the best tools. We have been witnessing a serious problem in real estate sector form past few years. The real estate sector were booming and the price hike was everywhere by brokers and investors investing in it. NRB according to its circular have made below mentioned provisions under real estate lending.

a. Loans and advances extended to this sector can lend only 60% of fair market value of the properties mortgage in favor of the bank to avail credit facilities.

b. Following threshold is defined and shall be maintained within the prescribed date.

Table 2.4
Real Estate Arrangement

Topic	Asadh 2068	Asadh 2069
(a) Residential Real Estate	Maximum of 30% of Total Loans and advances	Maximum of 30% of Total Loans and advances
(b) Commercial Complex & Residential Apartment Construction Loan		
(c) Construction Completed & Revenue Generating Commercial Complex		
(d) Other Real Estate	Maximum of 15% of Total Loans and advances	Maximum of 10% of Total Loans and advances
1. Land Purchase & Plotting Loan		
2. Loan of NPR 5.00 million and above without specified Reason (personal Loan, Mortgage Loan, Flexi Loan)		
3. Others		
Total (a+b+c+d)	Maximum of 30% of Total Loans and advances	Maximum of 25% of Total Loans and advances

2.2.4 Directive No. 17 (Deprived Sector Lending)

NRB has created provisions for every banks and financial institutions to create deprived sector lending so as to promote deprived sectors. Banks and financial institutions are penalized if not met minimum criterion/threshold on this lending. The minimum criterion/threshold set for various licensed institutions are as below:

Licensed Institutions	Required % of Out. Loans and Advances
"A" Class Licensed Institutions.	3%
"B" Class Licensed Institutions.	2.5%
"C" Class Licensed Institutions.	2%

For this purpose, NRB has defined deprived sector as less earning Individuals, socially deprived womens, Dalits, Blinds, Deafs, Differently able people etc..

This minimum criterion/threshold shall be met by banks and financial institution after successful operation of 1 year.

Following direct investment made on loans and advances are eligible for contribution on deprived sector.

- a. Deprived or less earning individuals, micro finance etc.
- b. Micro Hydropower Project producing less than 50KW electricity, Solar Home System, Solar Cooker, Solar Dyer, Solar Pump, Biogas, Improved Water Mill, Improved Cook Stoves and wind energy.
- c. Lending under tri-party arrangement involving manpower agency, foreign employment seeking individuals and banks for threshold upto 150,000.00
- d. Reserve created by NRB on Youth and small entrepreneurship.
- e. Other small and micro finance projects.

Following indirect investment made on loans and advances are eligible for contribution on deprived sector.

- a. Lending made to "D" class licensed institutions and other small credit co-operatives in an understanding to flow the sum lendd to various deprived sectors as defined by NRB.
- b. Lending made to small Farmer Co-operatives in an understanding to make small lending to various units.

2.2.5 Directive No. 11 (Consortium Loan Financing)

- (i) Definition: Loans and advances availed to a borrower, Firm, Company or Project under consensus agreement between participating licensed banks and financial institution is called Consortium Loan Financing.
- (ii) About Consortium: Borrower, Firm, Company or Project can only make banking transaction from Lead or participating bank to use the consortium loan. The same is applicable to Loose consortium.

A Project financed by two or more banks without forming consortium group/bank under paripasu collateral arrangement is called Loose Consortium.

A. Required Conditions/Covenants:

- (i) Banks and Financial institutions licensed by NRB can only participate as a consortium banks and financial institutions.

But, Provident Fund, Citizen Investment trust and Insurance companies can also participate or become a lead bank under consortium loan arrangement.

- (ii) If any institutions are participated beside one stated in section "c", NRB must be notified.

A. Other Institution granting loan and open account:

1. No additional loans and advances shall be granted to the borrower by non participating banks and financial institution. However, in case of urgency or contingency such loans that add up to existing consortium loan is allowed.

2. The borrower, firm, company and project is not allowed to open accounts on non participating banks and financial institutions. However, in case of urgency or contingency such account operation is allowed.

B. Disbursement of Loans and Timing: Once the application for consortium loan is filed and consortium banks are formed, the consortium banks and

financial institutions must decide whether the applied loans and advances shall be availed or not by within 90 days.

C. Selection of Consortium Banks: The selection of Consortium banks can be made by the borrower itself and the lead bank where borrower has applied consortium loan for.

But, once the consortium banks are formed, no new participation banks can entry without approval from existing consortium bank's decision.

D. Selection of Lead Bank: Bank or financial institution granting highest share in loans and advances among the participating bank, experience in handling consortium loans can have long relationship with the client/borrower is selected as the lead bank.

E. Disbursement of Loans and advances must be carried out via lead bank. Same is applicable in settlement issues. If settlement is possible in partial basis then the settlement is carried on proportionate basis.

F. Duties and Responsibilities of Lead Bank.

- ❖ Act as an agent for consortium participating banks.
- ❖ Co-ordinate between consortium banks and act as correspondent.
- ❖ Call Consortium meeting at least once in every three months.
- ❖ Call consortium meeting in contingency or urgency within 15 days.
- ❖ Meet short term need of the borrower.
- ❖ Collect and proceed for required documents for extending credit to borrower.
- ❖ Make arrangement for required collateral mortgages.
- ❖ Safe keeping of all security documents obtained from borrower.
- ❖ Collect, interpret and disseminate all information, financials obtained from borrower to consortium participating banks.

- ❖ Make effort in any litigation issues.
 - ❖ Collect information from Credit information centre.
 - ❖ Act according to the NRB guidelines in this issues.
- G. Decision of Majority shall be respected.
- H. Duties and Responsibilities of Participating Bank
- ❖ Provide consent letter for processing of consortium Loans.
 - ❖ Participate in consortium meeting.
 - ❖ Act as per the covenants of consortium decision.
 - ❖ Provide timely transfer of funds after disbursement of participating banks portion.
 - ❖ Implement decision led by consortium meeting.
 - ❖ Provide services according to consortium facility agreement to borrower.
- I. Provide additional loans and advances to borrower with agreed covenants and according to decision of consortium meeting.
- J. Withdrawing share from Consortium Banks: No banks and financial institution can withdraw their share from the agreed share before the successful operation of the project. If any participating banks and financial institutions desire to take share of the withdrawing bank after successful operation of project, then the withdrawing bank can exit from the consortium group.
- K. Appointment of Auditor and Consultant: Consortium banks and financial institutions can appoint an auditor and consultant in favor of them. The fees shall be paid proportionate to loans and advances extended to the borrower.
- L. Provide Reports to regulatory authority in timely manner.

2.3 Review of Related Studies

2.3.1 Review of Journals

When government decides to establish banks with joint ventures, two benefits were expected. First that competition would force domestic banks. Thus, Nepal

Bank Ltd. and Rastriya Banijay Bank have to improve their services and efficiency. Second, the introduction of new banking procedures methods and technology would occur. (Madlin and Snock 1998: 4)

There has been substantial growth in the number of joint venture banks in Nepal since 1990s. The basic reason behind this is the government's deliberate policy of allowing foreign J.V.B. to operate in Nepal. Government's liberalization policy also encourages the traditionally run domestic commercial banks to enhance their efficiency and computerization and prompt customers services by setting them to the exposure of the joint venture banks. (Shrestha M.K.,1990:16)

Mr. Sharma explains in his article," Joint venture banks in Nepal coexisting of crowding out."(Sharma M.R., 1988:3.42) That it would be definitely unwishful for Nepal not to let joint venture bank to operate in the country and not to take advantage of additional means of resources mobilization as well as harbinger of new in banking. But it will certainly be unfortunate for the country to let the development of the J.V.B.s at the cost of domestic banks. So far, one should admit frankly, no differential treatment has been made to the domestic and joint venture banks, at least from the latter's bargaining.

If the joint venture banks show strength and briskness to come forward to share the trails and tribulation of this poor country, both types of bank will collapse and co-exist complementing each other, contributing to the nation's accelerated development. On the contrary if the J.V.B. use their strength against treading to the cumbersome path of development along with the domestic banks and government, they will eventually throw out the domestic banks from the more profitable and lucrative urban sectors unless reincarnated by the determination of the government. Mr. Sharma has made a comparative study of two different natures of banks, especially on nature of transaction and expertise in banking network. J.V.B.s basically was oriented in urban areas where the local banks

are setup and conducted their transaction both in urban and remote areas. Moreover a number of commercial banks are situated in rural rather than in urban areas.

Mr. Thapa, in his article, "Financial system of Nepal" (Thapa, G.B., 1994:29-30) has expressed his view that the commercial banks including foreign joint venture banks seem to be doing pretty well in mobilizing deposits. Likewise, loans and advances of these banks are also increasing but compared to the high credit needs particularly by the newly emerging industries, the banks still seem to lack adequate funds. The banks are increasing their lending to non-traditional along with traditional sectors.

He has also studied that out of all commercial banks operating in the country, Nepal Bank Ltd. and Rastriya Banijaya Bank are operating with nominal profit, the later turning towards negatives from time to time. Because of non-recovery of accrued interest, the margin between interest income and interest expenses is declining. They have heavy burden of personal and administrative overhead. On the other hand, foreign joint venture banks are functioning in an extremely efficient way. They are making huge profit year after year. Because of their effective persuasion on loan recovery, overdue and defaulting loans have been limited resulting in high margins between interest income and interest payment.

2.3.2 Review of Thesis and Dissertations

Regmi (2004) has written thesis on Credit management of commercial banks with reference to Nepal Bangladesh Bank Ltd. and Bank of Katmandu. In his thesis, he has stated liquidity matters, unfair competition between banks and service institutions, lack of enough profitable investment sectors, poor recovery process and lengthy and ineffective legal process in the recovery of credit as a statement of research problem.

Mr. Regmi has concluded in his thesis that, both of the banks have sufficient liquidity. It shows that banks have not got investment sectors to utilize their

liquid money; both of the banks have provided modern facilities to its customers and have used modern technology; non performing credits are increasing. So, he conclude that credit is not satisfactory; because of increasing in no-performing credit bank should increase its provision for credit loss; lack in efficiency in the management of credit become the process of recovery is slow; due to increase in the non performing credit, bank's profit is decreasing year by year.

His major findings of the study are as follows:

- ❖ Cash and bank balance of both banks are high. Unused cash and bank balance do not provide return to the bank, therefore some percentage of cash and bank balance should be invest somewhere in profitable sector.
- ❖ Nonperforming assets of both banks are high. It does not provide return to banks therefore bank should increase its effort to recover its credit on time.
- ❖ Weighted average capital funds of both banks are lesser than the required as per directive issued by N.R.B. Therefore, he suggested to increase the amount of the capital fund for overcome out from panelize by N.R.B.
- ❖ Few customers are unsatisfied with the service charges and interest of credit; therefore, he suggested that banks should decrease service charges and interest charges.

Tiwari (2006) has written thesis on A study on Credit management of Himalayan Bank Ltd. emphasizing credit risk as one of the significant risk. The basic objective of the study is to have insight into the credit management aspects of the HBL. This aims to examine the efficiency, effectiveness in lending policy.

His major objectives of the study are:

- ❖ To examine the impact of deposit in liquidity

- ❖ To analyze the portfolio behavior of lending and measuring the ratio of loans and advances made in different sector
- ❖ To examine the asset management effectively.
- ❖ To analyze the lending effectively of the bank.

His major findings of the study are:

Though the optimal standard of current ratio should be 2:1 for convention measure of liquidity it is not appraisable on banking. The credit to private sector to the credit rate shows the high intensity of bank investment in private sector. Investment to total loans and advance & investment ratio shows the better practice of HBL in investment to safe asset to that on risky assets. The interest income to total income ratio shows the dependency ratio. The interest income to interest expenses ratio is higher i.e. mean 2.0484. The lending seems consistent and seems effective. The considerable decrease in loan loss provision shows.

Regmi (2009) Central Department of Economics) have written thesis on the Credit risk, he attempted to describe, analyze, interpret various credit risk associated with banks and financial institutions. He also described the various other risks involved in operating banks and financial institutions. His thesis to some extent had a broader concept and aspects than other the researcher looked at. He also attempted to co-inside the then directives issued by the NRB in monitoring and managing the credit risks of the banks.

He emphasized that, the banks and financial institutions must strictly comply to the directives and policies issued by the NRB. However, the policy and directives issued by the NRB are itself vague and ambiguous which do not give a clear picture and thus provides room for manipulation. The major findings of the study are:

- A. The major problems in credit risk are related to the broad areas of concentrations, credit processing and market and liquidity sensitive credit exposures. From his analysis on primary data, it is found that the majority of the banks have emphasized on lending. Hence, too much concentration on lending has degraded and eliminated other functions of commercial banks and hence complimented on poor lending practices.
- B. Similarly, lack of systematic and thorough credit processing is also the major source of credit risk in these banks. The problems in credit processing include lack of thorough credit assessment, absence of testing and validation of new lending techniques, subjective decision-making by senior management, lack of effective credit review process, failure to monitor borrowers or collateral values, and failure of banks to take sufficient account of business cycle effects.

However, the thesis has serious problems as well. The researcher has attempted to write thesis on credit risk mitigation and hence discussed various tools as advised by NRB vide its directive, 2068. But the researcher has failed where actually a problem is and what are the measures to control and correct them. Only directives, issued by the NRB is not sufficient to control and monitor credit risk. The banks and financial institutions itself create some lending policies and risk management departments that constantly monitors total and marginal credit risk from each new lending.

Maharjan (2010) has written thesis on Core risk in banking, CRM. According to her credit has been the major source in developing economy and has substantial risk, thus needs to be controlled in time.

Her major objectives of the study are:

- ❖ To evaluate better policy and procedural guidelines that the bank should follow to lessen the credit risk

- ❖ To collect the opinion for effective credit management of BOK and NIC.
- ❖ To analyze and interpret guidelines and policies issued by NRB in line with controlling the credit lending of banks and financial institution.

Her major findings of the study are:

- ❖ Credit has been the major use of total fund of both the banks. In average BOK has mobilized 67.01% of its Total Assets to that of NIC having utilized 71.89% of total asset.
- ❖ The Non performing credit in total credit amount is in decreasing trend in both the banks. The non performing credit has occupied 2.67% of the total credit in BOK & 1.85% in NIC on an average.
- ❖ In average the substandard credit, doubtful credit and credit loss has covered 28.38%, 13.53%, 58.09% of the total credit respectively in BOK while 8.55%, 14.15% & 77.17%. of the total credit has been occupied by substandard, doubtful and loss respectively by NIC.
- ❖ Credit risk of BOK seems higher than that of NIC as a result of BOK keeping credit loan loss provision higher than NIC in respect to total credit.
- ❖ BOK has been more dependent in single borrower than NIC. The average exposure to single borrower to total credit of BOK is 2.85% and that of NIC is 2.33%.
- ❖ The pace of decrease in doubtful credit will be higher than other in the forthcoming fiscal years in BOK.

Khadgi (2010) has written thesis on A study on credit risk management of Nepal Investment bank Ltd. She has also attempted in describing the various risk involved in the banking operation and credit risk being one of the most important one.

Her major objectives of the study are:

- ❖ To analyze the credit procedures of the banks and recovery status and control over the credit portfolio.
- ❖ To find out credit quality portfolio faced by the banks.
- ❖ To provide suitable recommendation & suggest additional measures for improvement of credit risk management.

Her major findings of the study are:

- ❖ Liquidity Ratio: The cash and bank balance to total deposit of NIBL is fluctuation during the study period. The mean ration is 0.093 times in the study period.
- ❖ Asset Management Ration: Loans and advances to fixed deposit ratio are increasing trend in overall. The mean ratio is 2.9432 time at the research period. The total loan & advances to total deposit ratio of NIBL is in increasing trend. The average mean ratio of NIBL is 0.718 times in the study period.
- ❖ Leverage Ratio: The debt to equity ratio of NIBL is in increasing trend during the thesis period. The average mean ratio is 14.24 times.
- ❖ Profitability Ratio: The total net profit of NIBL is in increasing trend
- ❖ Lending Efficiency ratio: The loan loss provision to total loans and advances ratio of NIBL is in decreasing trend. The highest ratio is 3.11% in year 2004/5 and lowest in 2007/8 with 1.93%. The mean ratio of the study period is 2.73%.

Bhandari (2011) has been conducted the research work into the matter of financial risk and profitability of Nepalese commercial banks. Into this research study the researcher has been tried to evaluate the level of financial risk and profitability of five selected commercial banks along credit risk and level of profitability as well as the level of required return for this risk to compensated cost of bearing those risk. The main objective of this research work is to find out financial risk and profitability of five commercial banks those are operated within the boundary of Nepal. As this research work has found that Nepalese

commercial banks are being able to exclude the capital risk by maintaining adequate level of capital fund with them as per the requirement determined by the central bank, Nepal Rastra Bank. On the other hand, these selected five commercial banks are being able to reduce the level of credit risk by making provision as per the direction of Nepal Rastra Bank as well as as per the level determined by international institution Basel Accord.

Dhakal (2011) has written dissertation on "A study on Credit risk management of Standard Chartered Bank (SCB) and Rastriya Banijya Bank (RBB) ". This thesis has some practical implication because she has attempted to compare a private sector bank and government sector bank and its performance. Standard Chartered Bank has been able to manage its credit risk and is the number one bank in Nepal. Non-Performing Loans of almost 0% has shown its mastery in managing credit risk. The other counterpart, Rastriya Banijya Bank Ltd, on the other hand has 9.81% of Non-Performing Loans to total Loans, this indicated that the government sector bank is not doing well in minimizing credit risk mitigation. The basic findings of this study is, SCB being one of the most prudently and well managed commercial banks in Nepal, this bank has adopted and complied each and every policies and guidelines issued by the central bank. It has its own lending policies and practices which keeps itself far better than other commercial banks in Nepal.

Her major objectives of the study are:

- ❖ To find the status of growth of non-performing loan, total loan and loan loss provisioning of the respective banks.
- ❖ To analyze the lending portfolio i.e. concentration and sector wise lending
- ❖ To find out the portfolio of investment in government sector.
- ❖ To find out the risky and low risk weighted asset of the bank.
- ❖ To find out relationship between total deposits and total lending

Her major findings of the study are:

- ❖ The researcher has conducted with objective spirit of analyzing credit risk management of Standard chartered Bank Nepal Ltd and Rastriya Banijya Bank Ltd with respect of analysis of NPL, Portfolio management (Sectorwise lendign) positiono f risk weighted assets, investment in government securities and status of Margin lending
- ❖ Although both banks have decreasing trend of NPL, RBB has higher NPR as compared to SCBNL which has affected its capital base.
- ❖ Both Sectors has high percentage of lending in other sector. This means they have not invested in sector as explicitly listed by NRB, meaning that the fund has not been mobilized in economy booming sectors.
- ❖ Capital adequacy of SCBNL is comparatively good than that of RBB.

2.4 Concluding Remarks

Into the previous researches the researchers have been made the focus on the operating risk and total business risk of selected institutions. But, into this present research work the researcher has been tried to find out the clear judgment of credit risk position of selected two Nepalese commercial banks. Those two Nepalese commercial banks are Kumari Bank Limited and Machhapuchhre Bank Limited. By making central focus to this credit risk of this banks this research has been made a try to draw the clear vision of these banks performance in the context of credit risk management. Credit risk is only on part among the total financial risk and business risk bore by the selected instutions but it has vital role to determine the firm's capability to sustain into the financial market for long time perspective. That's why; this research is made a step towards the evaluation of selected two Nepalese commercial banks in the context of credit risk management by using five years data from the fiscal year 2006/07 to the fiscal year 2010/11.

CHAPTER-III

RESEARCH METHODOLOGY

Research is the process of a systematic and in-depth study or search of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of the relevant details or data. It is a careful search or inquiry into any subject matter, which is an endeavourer to discover or find out valuable facts, which will be use full for further application or utilization. The research that involved the discovery of new techniques, modification of old concepts or a knocking off an existing theories, concepts and techniques is always contributing to the sector of research. It may develop a hypothesis and test it by establishing relationship between different variables and identify the means for problem solving.

Research methodology describes the methods and process applied in the entire aspect of the study. The main objective of this research is to measure the credit risk of the selected commercial banks and to study the various management techniques and principles used by the Nepalese commercial banks to manage credit risk. Thus, this chapter consists of the research methodology applied in the study for the fulfillment of the stated objectives. Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, sample size and selection process, data collection procedure and data procession and presentation techniques and tools.

3.1 Research Design

Research design means defining procedures and techniques which guide to study and propound ways for research work. It is an analytical as well as descriptive approach to achieve the objectives. It is the arrangement of condition for collection and analysis of data relevance to the study purpose

with economy in procedure. In order to make type of research, this fulfills the objectives of the study.

The study is the blend of descriptive and analytical type of research. Historical data are used to identify and analyze the credit risk of a bank in the past period. Similarly, management system, organizational structure and policies for mitigating the credit risk and the credit risk management procedures have been presented in descriptive form so as to identify the current status from which pitfalls can be identified. From collection of past data and information from key informants, the credit risk management system has been analyzed and recommendations have been made for improving the credit risk management of banks. Since only two banks have been selected for the study, this study is a comparative study between these two banks in credit risk and their management system.

3.2 Population and Sample

The large group about which the generalization is made is called the population under study, or the universe and small portion on which the study is made is called the sample of the study.

Research population would be all banks and financial institutions of Nepal. Due to various circumstances it would not be possible to attempt all the number of research population regarding in this dissertation. The researcher has been selected two commercial banks as the sample banks among all Nepalese commercial banks population of 32 banks. Those banks are Kumari Bank Ltd and Machhapuchhre Bank Ltd. in the process of selecting those sample banks the method of random sampling is used by the researcher. Hence, these banks have been chosen as a sample to better examine where the problem is and the measures to overcome those lax in credit standards.

3.3 Sources and Types of Data

In each research work there are two types of data are used they are primary and secondary. Those research which has been done at the first time is used the primary data. On the other hand those researches which have been followed by previous research works are used mainly secondary data as per the research need. Each research project has its own data needs and data sources. Some research has used both data nature as the research objectives demanded. For this study, only the secondary data have been taken mainly from the related sources of annual reports, auditor's reports, balance sheet, P/L account, cost detail sheet, previous thesis and other relevant published and unpublished documents as well as websites related to Kumari Bank Ltd. and Machhapuchchhre Bank Ltd.

3.4 Methods of Presentation & Analysis

Analysis and presentation of the data is the core of each and every research work. In order to get the concrete results from this research, data are analyzed by using different types of tools. Here into this research work mainly tow kinds of financial and statistical tools are used to conduct analysis of research to achieve its major objectives. Basically, following two techniques are used to explain the collected data.

3.4.1 Statistical Tools

The relationship between two or more variables can be measured by using statistical tools. In this study the following statistical tools are used

Bar Diagram:

Bar diagram are one of the easiest and the most commonly used methods of presenting the numerical data. They present the data by means of bars, or rectangles of equal width. The length of the bars represents the given figures and the width may be of any size.

Mean:

The sum of all the observations divided by the number of observations is called Mean. In such cases all the items are equally important. It is usually denoted by \bar{X} . It is defined by the following formula:

$$\text{Mean } (\bar{X}) = \frac{\sum X}{N}$$

Where,

$\sum X$ = the sum of observations

N = no. of observation

Standard Deviation (S.D.):

The standard deviation is defined as the positive root of the mean of the squared deviations from their mean of a set of values. It is also known as Root Mean Square Deviation. It is usually denoted by the Greek letter δ (Small Sigma)

The SD is calculated by the following formula:

$$SD = \sqrt{\frac{\sum X^2}{N} - \left(\frac{\sum X}{N}\right)^2}$$

Coefficient of Variation (CV)

The relative measure of dispersion based on SD is called coefficient of SD.

Thus,

$$\text{Coefficient of SD} = \frac{\delta}{\bar{X}}$$

100 times coefficient of SD is called coefficient of variation. It is denoted by C.V. thus,

$$CV = \frac{\delta}{\bar{X}} \times 100$$

3.4.2 Financial Tools

Among the various financial tools available here only the tools of ratio analysis has been used to measure the credit risks of selected Nepalese commercial banks for the research duration of five years from the fiscal year 2006/07 to the fiscal year 2010/11.

Ratio Analysis

Ratio is the mathematical relationship among two or more variables. Here this analysis tool of ratio analysis has been used to evaluate the credit risk position of Kumari Bank Limited and Machhapuchhre Bank Limited individually as well as comparatively too. In this study, the following ratios have been as per requirement of the research need to achieve the goal of this study.

- i. Loans and advances to Total Risk Weighted Assets Ratio
- ii. Non-Performing Loan to Total Loans and advances Ratio
- iii. Loan Loss Provision to Non Performing Loan Ration
- iv. Loan Loss Provision to Total Loans and Advances
- v. Core Capital to Total Risk Weighted Asset (RWA)
- vi. Supplementary Capital to Total Risk Weighted Asset
- vii. Capital Fund to Total Risk Weighted Asset (RWA)

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

This chapter deals with the presentation, analysis and interpretation of relevant data of sampled commercial bank in order to fulfill the objectives of this study. To obtain best result, data have been analyzed according to the research methodology as mentioned in third chapter. The purpose of this chapter is to introduce the mechanism of data analysis and interpretation. With the help of this analysis, efforts have been made to highlight comparative credit risk management status of selected Commercial banks (CBs). For analysis, different types of analytical methods and tools such as financial ratio analysis and statistical tools are used to draw the conclusion of the study. Similarly analyzed results are graphically represented for the visibility and simplicity of conclusion.

The detail presented and analysis of this research has been done by using tools and techniques described and prescribed into the third chapter of this same research work. Those tools and techniques are financial tools and techniques as well as statistical tools.

4.1 Ratio Analysis

As described and prescribed by the third chapter of this research study of ratio analysis has been maintained below.

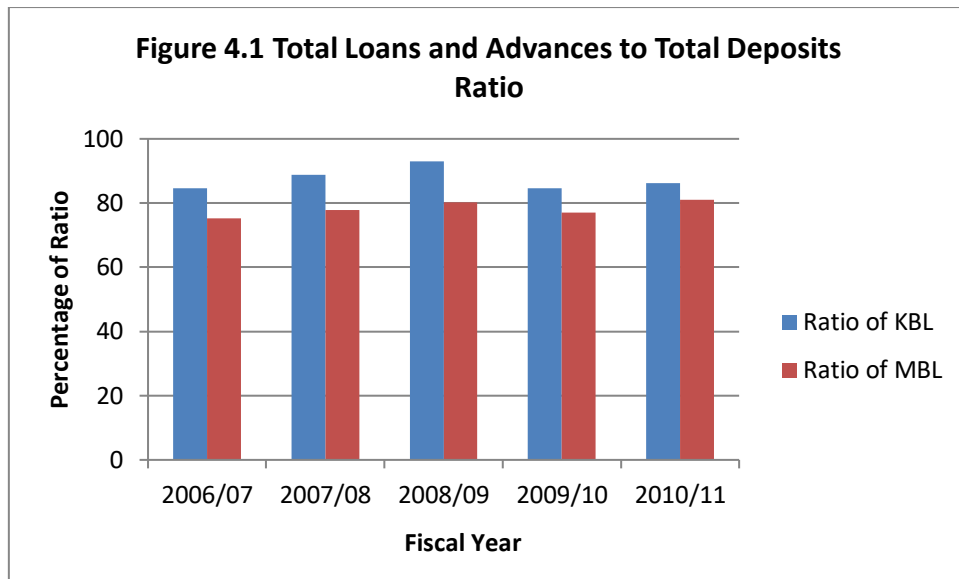
4.1.1 Total Loans & Advances to Total Deposit. (Credit to Deposit Ratio)

This ratio measures to the extent that bank is successful to manage its total deposit on loan & advances for the purpose of income generation or not. A high ratio indicates better mobilization of collected deposit and vice-versa. But it should be noted that too high ratio might not be better from liquidity point of view.

Table 4.1**Total Loans & Advances to Total Deposit. (Credit to Deposit Ratio) Rs. In Million**

Fiscal Year	KBL			MBL		
	Total Loans & Advances	Total Deposits	Ratio (%)	Total Loans & Advances	Total Deposits	Ratio
2006/07	8,929.01	10,557.42	84.58	7,129.89	9,475.45	75.25
2007/08	11,335.09	12,774.28	88.73	8,642.32	11,102.24	77.84
2008/09	14,593.35	15,710.40	92.89	12,516.01	15,596.79	80.25
2009/10	14,765.91	17,432.25	84.70	14,289.79	18,535.92	77.09
2010/11	14,626.07	16,986.00	86.11	14,731.04	18,161.80	81.11
		Mean	87.40			78.31
		S.D.	3.49			2.38
		C.V.	3.99			3.04

As per the table 4.1 the average percentage of ratio of total loans and advances to total deposits of Kumari Bank Limited for the total research duration is 87.40% with the standard deviation of 3.49%. The co-efficient of variation of this bank for this five years research duration is 3.99% which indicated the relative degree of risk involved into issue of loans and advances with respect of total deposits fund collected by this commercial bank, Kumari Bank. On the other hand the commercial bank, Machhapuchhre Bank Limited has got the average ratio of total loans and advances to total deposits fund collected by this during the fiscal year 2006/07 to the fiscal year 2010/11 is 78.31% with the value of standard deviation of 2.38%. This bank has been faced the value of per unit risk indicated by the co-efficient of variation is 3.04%. all these information calculated and obtained here are also presented into the following figure.



Source: Annual Reports

As per the above table and figure we can see that MBL has better maintain the CD ration. But it should be noted that while calculating CD ratio Shareholders equity is added to deposit to yield true CD ratio as per the directive of NRB 2068. From above figure we can see MBL has maintain better liquidity position to that of KBL but if we consider Shareholders equity then MBL will have excess liquidity which has substantial effect on its profitability. Thus, from above we can say that MBL has maintained high liquidity and KBL has made efficient use of available resources.

4.1.2 Capital Adequacy Ratio (Basel II)

Capital Adequacy is to maintain sufficient capital fund in consideration with Total risk weighted Exposure.

We know,

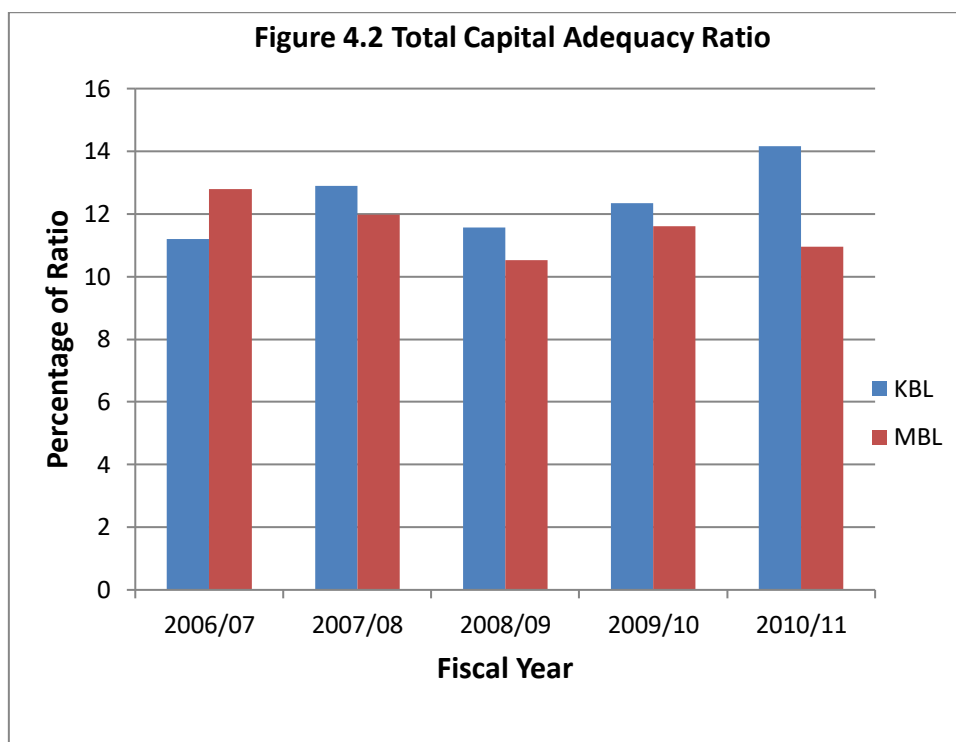
$$\text{Minimum Capital Fund Required} = \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Exposure}}$$

Table 4.2
Capital Adequacy Ratio

Fiscal Year	KBL			MBL		
	Total Risk Weighted Exposure	Total Capital Fund	Ratio (%)	Total Risk Weighted Exposure	Total Capital Fund	Ratio
2006/07	9,959.91	1,115.21	11.20	7,632.00	976.07	12.79
2007/08	14,418.71	1,858.21	12.89	9,200.66	1,101.73	11.97
2008/09	17,743.24	2,050.91	11.56	11,435.20	1,202.74	10.52
2009/10	17,220.69	2,124.63	12.34	15,308.32	1,777.48	11.61
2010/11	17,336.87	2,456.42	14.17	17,402.63	1,906.32	10.95
		Mean	12.43			11.72
		S.D.	1.17			0.94
		C.V.	9.41			8.02

From above table 4.2, it is obvious that both banks have been meeting minimum required capital Adequacy. However, as we discussed earlier that banks and financial institutions are only meeting minimum standards, if they truly want to minimize risk and have sound financials then they have to go beyond the expectations of the NRB. In above figure, we can see both banks ratio are hovering around the required minimum criteria posed by NRB i.e. 10%. KBL seems to have maintained pretty good ratio throughout the period than that of MBL. It has 11.20% in fiscal year 2006/07 to that of 12.79 of MBL. Similarly, it has maintained 14.17% in fiscal year 2010/11 to that of 10.95% of MBL. This shows that both banks have been adequately safeguarding their investments. However, this does not confirm because the banks and financial institutions may put more risky investments to the lesser one. The average ratio maintained by KBL is 12.43 and its s.d is 1.17. On the other hand, the average ratio maintained by MBL is 11.72 with s.d of 0.94. The

lesser standard deviation of 0.94 in MBL shows that the capital adequacy ratio maintained by MBL is less volatile to that of KBL.



As per the above figure 4.2 indicated the total capital adequacy of Kumari Bank Limited is higher than the capital adequacy maintained by Machhapuchhre Bank Limited. So, this figure has shown the trends of these two commercial banks for the period of five recent fiscal years from the fiscal year 2006/07 to the fiscal year 2010/11. The trends of both banks are on fluctuation and reached the lowest point at the fiscal year 2008/09. After this fiscal year both banks are improving the level of total capital fund which is clearly seen into the above figure 4.2. this ratio of total capital adequacy to total risk exposures has been include some specific items of risk exposures of total assets as per the weighted given by Nepal Rastra Bank.

The total risk weighted exposure is calculated as below:

Calculation of Capital Adquacy.		
Risk weighted exposures under each 11 categories of Credit Risk		
S.No.	Particulars	Risk Weight
1	Claims on government and central bank	0 to 150%
2	Claims on other official entities	0 to 150%
3	Claims on banks	20-150%
4	Claims on Corporate and securities firms	20-150%
5	Regulatory Retail Portfolio	75%
6	Claims secured by residential properties	60%
7	Claims secured by Commercial real estate	100%
8	Past due claims	150%
9	High Risk claims	150%
10	Other Assets	0 to 100%
11	Off Balance Sheet Exposures	0 to 100%
	Total	Sum(1:11)
Total Risk Weighted Exposure Calculation Table		
1	Risk Weighted Exposure for Credit Risk	-
2	Risk Weighted Exposure for Operational Risk	-
3	Risk Weighted Exposure for Market Risk	-
4	Total Risk Weighted Exposures	Sum (1+2+3)
a	Add: 3% of the total RWE due to non compliance to Disclosure Requirement	-
b	Addition to RWE as per supervisory review (3%)	-
c	Add: ...% of Total Deposit due to Insufficient Liquid Assets -	-
5	Total Risk Weighted Exposures	Sum(4+a+b+c)
6	Total Capital Fund	-
7	Capital Fund to Risk Weighted Exposure	Divide-(6/5)
<i>*Three Years Bassel Classification Shown in Appendix</i>		

4.1.3 Non-Performing Loan to Total Loans and Advances Ratio

Non-performing loans to total loan and advances ratio shows the percentage of non-recovery loans in total loan and advances. This ratio is calculated as dividing non-performing loan by total loan and advances. Loan loss provision is the function of substandard credit which is also known as non performing loan (NPL). Higher the NPL, higher would be deduction on profit because of provision.

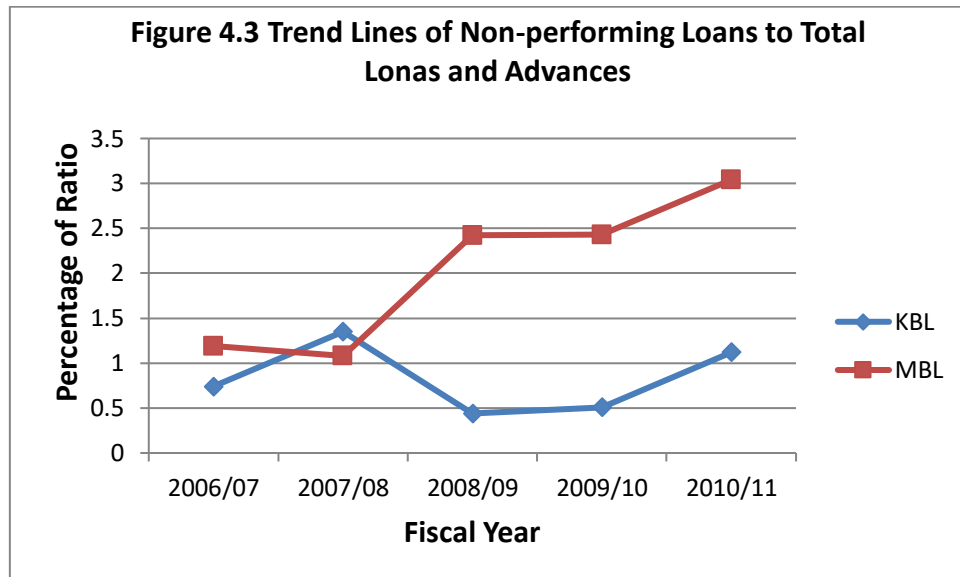
Table 4.3
Non-Performing Loan to Total Loans and Advances Ratio

Fiscal Year	KBL			MBL		
	NPL	Total Loans & Advances	Ratio (%)	NPL	Total Loans & Advances	Ratio
2006/07	66.12	8,929.01	0.74	85.17	7,129.89	1.19
2007/08	152.48	11,335.09	1.35	92.92	8,642.32	1.08
2008/09	64.54	14,593.35	0.44	302.84	12,516.01	2.42
2009/10	75.51	14,765.91	0.51	347.58	14,289.79	2.43
2010/11	164.22	14,626.07	1.12	448.28	14,731.04	3.04
		Mean	0.83			2.03
		S.D.	0.39			0.86
		C.V.	46.99			42.36

From above table 4.3 it is clear that the Non Performing Loan to Total Loans and advances ratio of MBL is increasing every year besides 2007/08. This shows that performance of MBL is degrading each year. From above data it is clear that the borrowers of MBL have been defaulting each year. NPL of MBL has increased from 85.17 million in year 2006/07 to 92.92 in year 2007/08. In fiscal year 2008/09 this NPL has increased by approximately 210 million. This has serious problem of non-payment by the defaulter which in turn reduces the overall profitability of the bank. In turn general people will have negative impact of it and compel them to withdraw their deposit from the bank and creating liquidity problem in MBL.

On the other hand, KBL has been decreasing its NPL over the years. It faced serious problem in year 2007/08 where it had NPL of 152.48 million. However, this NPL was reduced in succeeding year 2008/09. This might have been possible either regularized payment by the borrower or settlement of the NPL.

From this data, we can also assume that MBL is not quite proactive in lending and able to recover the NPL whereas KBL seems to be very good at handling these situations.



As this above figure 4.3 indicated the trend line of non-performing loans to total loans and advances of both commercial banks are on fluctuation nature. The trend line of Kumari Bank Limited has been decreased till the fiscal year 2008/09 after increased into the fiscal year 2007/08. Then after the fiscal year 2008/09 the ratio of non-performing loans to total loans and advances is slowly increased which indicated that the control of management over the non-performing loans is become loose. On the other hand after the fiscal year 2007/08 Machhapuchhre Bank Limited has suffering from the increasing trend of non-performing into the total loans and advances of this banks for the research duration of five year from the fiscal year 2006/07 to the fiscal year 2010/11 which is not good symbol to this bank.

4.1.4 Loan Loss Provision to Total Loans and Advances Ratio

The provision for loan loss reflects the increasing profitability of non-performing loan. Increase in loan loss provision decreases profit which results to decrease in dividend. But its positive impact is that it strengthens the financial condition of banks by controlling the credit risk and reduces the risk related to deposit. The low ratio indicates the good quality of assets in total volume of loan and advances. High ratio indicates more risky assets in total volume of loan and advances.

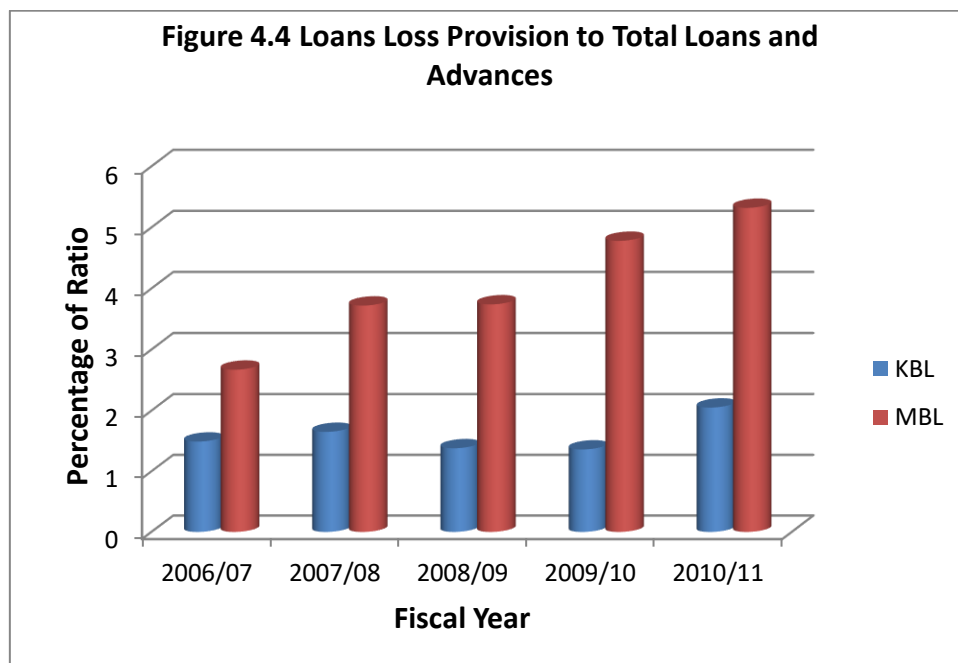
Table 4.4
Loan Loss Provision to Total Loans and Advances Ratio

Fiscal Year	KBL			MBL		
	Provision for Loan Losses	Total Loans & Advances	Ratio (%)	Provision for Loan Losses	Total Loans & Advances	Ratio
2006/07	133.42	8,929.01	1.49	190.05	7,129.89	2.67
2007/08	187.29	11,335.09	1.65	321.75	8,642.32	3.72
2008/09	201.91	14,593.35	1.38	468.45	12,516.01	3.74
2009/10	200.17	14,765.91	1.36	682.74	14,289.79	4.78
2010/11	300.16	14,626.07	2.05	784.01	14,731.04	5.32
		Mean	1.59			4.05
		S.D.	0.28			1.03
		C.V.	17.61			25.43

From the above table MBL has been maintaining high provision for possible loan losses to that of Kumari bank Ltd. This does not mean that MBL is maintaining additional cushion for the possible losses, this argument is supported by the higher NPL in table 4.3. MBL is maintaining only required reserves made mandatory by NRB, no additional provision is made for future losses. Similar case is also for KBL. We can notice that MBL has its provision increasing over the years with due cushion for additional NPL. It had made

provision of 190.05 million in year 2006/07 and hence increased over the years to 784.01 in year 2010/11.

The average loan loss provision of Kumari Bank Limited for the research duration of five year is 1.59% along the value of standard deviation of 0.28%. In comparison of total average of loans loss provision of Kumari Bank Limited with standard deviation seems to be higher. These values of average and standard deviation are generating the value of co-efficient of variation of 17.61%. Similarly, average loan loss provision of Machhapuchhre Bank Limited for the research duration of five year is 4.05% along the value of standard deviation of 1.03%. In comparison of total average of loans loss provision of Kumari Bank Limited with standard deviation seems to be higher. These values of average and standard deviation are generating the value of co-efficient of variation of 25.43%. This trend of both banks about loans loss provision has been also has been presented graph which has been shown into the figure 4.4.



As discussed earlier, all banks and financial institutions only meet the minimum criteria to make arrangement as directed by NRB directive 2068. Here if provision for possible loan loss had been made by keeping enough cushion then the banks would have been safer for next period and fiscal years but they do not do so, because if they make additional provision then their profit would be lessen. We are witnessing every bank and financial institutions are attempting to make larger profits by only meeting the minimum requirements. We even are witnessing the fact that even banks and financial institutions are providing additional loans to the borrower simply to avoid the required provision. This can create higher profit for that particular period but the profit is not sustainable one. Because one day the same customer is going to default and then the bank may suffer great loss. This situation is found in every banks and financial institutions.

4.1.5 Security wise Loan Classification

This analysis will help to identify the various types of securities on the basis of which loans have been provided by KBL. This also assists to analyze the credit risk of a bank. As more liquid the collateral, low credit risk to the bank. Here, security wise lending includes 12 types of securities, including collateral less lending.

Table 4.5
Security wise Loan Classification of KBL

Particulars	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
A. Secured	9,062.43	11,522.38	14,795.26	14,966.08	14926.23	12,586.54
1. Against Security of Movable/Immovable Assets	7,463.68	10,565.02	13,444.86	14,152.77	14,043.76	11,934.02
2. Against Guarantee of Local Licensed Institutions	-	-	-	-	-	-
3. Against Government Guarantee	-	-	-	-	-	-
4. Against Guarantee of Internationally Rated Bank	-	-	-	-	-	-
5. Against Security of Export Documents	12.25	-	1.82	2.32	-	3.28
6. Against Security of Fixed Deposit Receipts (a+b)	106.89	112.95	55.36	53.26	103.2	86.24
a. Own FDR	21.95	6.96	2.79	53.26	-	16.99
b. FDR of Other Licensed Institutions	84.94	105.99	52.57	-	-	48.70
7. Against Security of Government Bonds	-	-	-	6.81	-	1.36
8. Against Counter Guarantee	-	-	-	-	-	-
9. Against Personal Guarantee	-	-	-	-	-	-
10. Against Other Securities	1,479.61	844.41	1,293.23	750.92	779.27	1,029.49
B. Unsecured		-	-	-	-	-
Total	<u>9,062.43</u>	<u>11,522.38</u>	<u>14,795.26</u>	<u>14,966.08</u>	<u>14,926.23</u>	<u>12,586.54</u>

Table 4.6
Security wise Loan Classification of MBL

Particulars	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
A. Secured	6,146.57	7,326.01	8,964.06	12,984.46	14,972.53	10,078.73
1. Against Security of Movable/Immovable Assets	5,151.20	6,510.13	7,880.16	12,174.98	14,215.57	9,186.41
2. Against Guarantee of Local Licensed Institutions	159.17	378.30	57.22	188.12	235.62	203.69
3. Against Government Guarantee	-	-	-	52.21	129.84	36.41
4. Against Guarantee of Internationally Rated Bank	-	-	-	-	-	-
5. Against Security of Export Documents	-	-	-	-	-	-
6. Against Security of Fixed Deposit Receipts (a+b)	123.83	229.98	242.33	285.34	133.19	202.93
a. Own FDR	40.37	18.77	4.44	18.83	27.74	22.03
b. FDR of Other Licensed Institutions	83.46	211.20	237.89	266.51	105.45	180.90
7. Against Security of Government Bonds	2.46	-	-	-	-	0.49
8. Against Counter Guarantee	-	-	-	-	-	-
9. Against Personal Guarantee	-	184.60	98.24	99.39	118.80	100.21
10. Against Other Securities	709.90	23.00	686.12	184.41	139.51	348.59
B. Unsecured	-	-	-	-	-	-
Total	6,146.57	7,326.01	8,964.06	12,984.46	14,972.53	10,078.73

From above table 4.5 & 4.6, we can see KBL & MBL has extended its majority of loans and advances by keeping security of movable and immovable properties of mean Rs. 11934.02, million and 9,186.41 million respectively. This indicates that both banks have given considerable concentration on

adequately safeguarding the loans and advances extended by collateral. But this not means that the loans and advances extended shall perform well, this is only a collateral part, a borrower can default despite of adequate and quality collateral. Moreover, the collateral may be unqualified and inadequate since only figure cannot summarize whole scenario. In addition to it, if a borrower fail to pay the interest and principal amount then pledged collateral must be auctioned, this may take plenty of time and non sellable of collateral still exists.

Lending against FDR has no risk and requires 0% risk according to the Basel II. Both banks have extended credit facility in this category. KBL has mean average lending of 86.24 million to that of 202.93 of MBL. This portfolio shows better management of risk and mitigation of credit risk as well, since; no risk weight is assigned to this category. However, at current situation we can see many banks and financial institutions have very high liquidity problems. Thus, lending against security of FDR has witnessed threat as well. This problem has been seen with FDR of World Merchant Banking and finance ltd., Vibor bikas bank ltd, Gorkha development bank ltd. and Nepal share markets and finance ltd.

Lending against sole personal guarantee is witnessed more in MBL. This has high risk since it does not assure on payment of accrued interest and principal on timely basis. Since, lending has been made on the basis of personal relationship and without pledging of collateral there is high chances of borrower defaulting. Hence, these loans must be timely monitored and controlled. From this point of view, MBL seems to have made very risky lending. Rs. 118.80 million (Year 2010/11) falls under threat and necessary provisioning arrangement is required.

Lending against other securities consists of shares pledged as security. As we are very much aware that investment in security is very risky. Hence, lending made on its basis is risky, proper timely monitoring pertaining to the changing prices in shares must be monitored and margin call shall be made accordingly.

This claims high risk since market value of underlying assets can clash at any point of time. Thus these lending carries 150% weight age as per Basel II.

4.1.6 Real Estate Lending

We have been witnessing a serious problem in real estate sector form past few years. The real estate sector were booming and the price hike was everywhere by brokers and investors investing in it. Now, with this decision made by NRB many banks and financial institutions existence has come into threat. Thus, NRB has been controlling lending into these sectors and thus provided ceiling to meet within the stipulated time and this sector segregation has been made compulsion in banks financial reports.

Table 4.7
Real Estate Lending of KBL

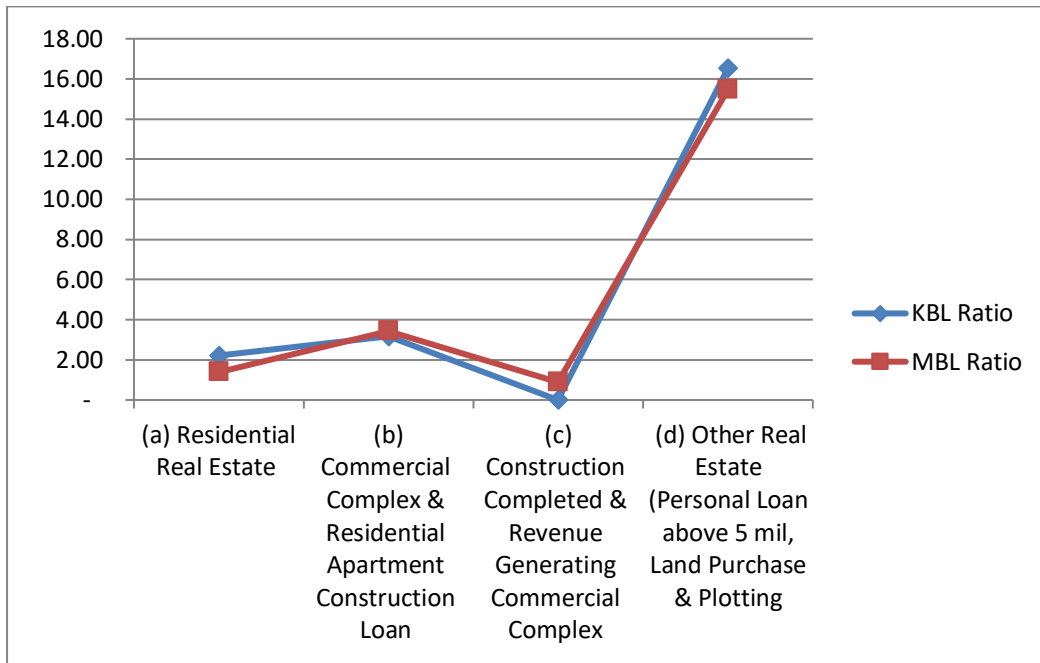
Topic	Asadh 2068	Asadh 2069	13-04-2011	Ratio %	16-07-2010	Ratio %
(a) Residential Real Estate	30% or less	30% or less	332.95	2.20	1,171.52	8.11
(b) Commercial Complex & Residential Apartment Construction Loan			478.63	3.17	490.45	3.39
(c) Construction Completed & Revenue Generating Commercial Complex			-	-	-	-
(d) Other Real Estate (Personal Loan above 5 mil, Land Purchase & Plotting)	15% or Less	15% or Less	2,498.80	16.53	2,813.59	19.47
Total (a+b+c+d)	25% or less	25% or less	3,310.38	21.90	4,475.56	30.97
Total Loans and Advances			15,113.71		14,451.76	

Table 4.8
Real Estate Lending of MBL

Topic	Asadh 2068	Asadh 2069	13-04-2011	Ratio %	16-07-2010	Ratio %
(a) Residential Real Estate	30% or less	30% or less	217.74	1.39	779.27	5.20
(b) Commercial Complex & Residential Apartment Construction Loan			535.27	3.43	485.21	3.24
(c) Construction Completed & Revenue Generating Commercial Complex			138.42	0.89	-	-
(d) Other Real Estate (Personal Loan above 5 mil, Land Purchase & Plotting)	15% or Less	15% or Less	2,415.49	15.47	3,038.97	20.30
Total (a+b+c+d)	25% or less	25% or less	3,306.92	21.17	4,303.44	28.74
Total Loans and Advances			15,618.28		14,972.53	

Above table represents the real estate lending made by KBL and MBL in last 3rd quarter ending 13/04/2011 & fiscal year 2066/67. The data was available for only those periods since this segregation in real estate has come into effect recently. As per NRB Circular, banks and financial institutions must downsize their real estate lending on other real estate sector including personal lending and for land purchase and plotting in 15% or less. This threshold has not been met by both banks in 3rd quarter and fiscal year 2066/67. KBL has 16.53% in 3rd quarter and 19.47% in f/y 2066/67. MBL has 15.47% and 20.30%. Now, both banks must downsize this ratio to 15% or less within f/y 2067/68 and total real estate lending to 30% or less. However, both banks have met total real estate lending threshold of 30%. Now let's compare both banks real estate in a graph.

Figure 4.5
Real Estate Lending Comparison of KBL & MBL



From above figure 4.7 it is obvious that both banks have similar exposure in real estate. Both banks seem to have comfortable position for lending on real estate. They even meet 25% of total exposure that must be downsized within Asadh 2069. However, this does not mean they do not possess credit risk. As we are witnessing a serious downfall in real estate lending, many real estate players are being unable to pay their accrued interest. This shall continue unless a new regulation in favor of real estate sector is made. Thus, until then there is a high risk in real estate lending. This means the total exposure of around 22% of both bank has come into threat. This threat must be minimized by making additional provisioning for possible losses.

4.2 Major Findings

From the above analysis of credit risks, following major findings have been obtained:

1. Credit risk is one of the most important risks that a manager should deal on. Dealing with it requires extensive knowledge and experiences. Lack of systematic and thorough credit processing is also the major source of credit risk in these banks. The problems in credit processing include lack of thorough credit assessment, absence of testing and validation of new lending techniques, subjective decision making by senior management, lack of effective credit review process, failure to monitor borrowers or collateral values, and failure of banks to take sufficient accounts of business cycle effects etc. Likewise the market sensitive and liquidity sensitive exposures also increase the credit risk of these banks. Similarly, it is found that both banks have their own rating system of the credit client and the sectors. Both banks have ranked 1st to the manufacturing sector where as the agriculture sector has been ranked the last on the basis of priority. KBL has chosen others sector and real estate business in 2nd and 3rd position respectively, where as the MBL has just opposite preference in these sectors.
2. From the analysis from Credit to deposit ratio MBL seems to have maintain better liquidity position to that of KBL but if we consider Shareholders equity to deposit side to calculate CD ratio as per NRB directive then MBL will have excess liquidity which has substantial effect on its profitability. This problem is looked after in KBL. Thus, from above we can say that MBL has maintained high liquidity that may possess adverse effect in its profitability and KBL has made efficient use of available resources.
3. Capital Adequacy ratio is one of the major tool implemented by Basel II and same has been implemented here by NRB in order to minimize the possible credit risks. Both banks maintained required minimum ratios. They have only met the minimum criteria as prescribed by the NRB. Higher the capital adequacy ratio, higher comfortable zone is obtained for the banks and financial institutions.

4. Higher non performing loan of MBL indicates lower credibility of the borrowers. This means, there has been some inefficiency in lending, which has resulted in non-payment of interest and principal by the borrower. If this continues, survival of MBL comes into threat. In contrast to it, KBL's performance is found satisfactory since it has lower NPL as compared to MBL. Standard Chartered Bank, Nabil Bank has NPL of almost zero. This shows their high credit standard performance.
5. Both banks have maintained required minimum provision as per the category of their lending. No additional provisions are created to mitigate future credit risk. Prudentially both banks has maintained sufficient provisions but we cannot make sure that the recovery of accrued interest and principal has been made by the cash deposit of the borrower, since we have been witnessing these settlements by additional loans provided to the customers. This is done to avoid accumulation of NPL and create additional provision that directly reduces the profitability of banks. Hence, they provide additional loans and settle past dues.
6. Most of the Loans and advances of both banks has been secured with movable and immovable securities. This does not make sure in timely payment of accrued interest and principals. The basic rule in extending credit to borrower is the repayment capability. Lending against personal guarantee is observed in MBL which shows high risk lending arrangement. However, this is nil in most recent year of KBL, MBL has extended credit to the tune of 118.8 million in this category. This makes MBL more risky to that of KBL.
7. Real estate lending was a very lucrative business until NRB regulated this sector with very tight regulations. Every banks and financial institutions were extending credit to these real estate players which are one of the most non-productive sectors. A huge exposure of many banks and financial institutions was seen. This is observed in KBL and MBL as well with 21.90% & 21.17% respectively. This ratio meets the minimum criteria as prescribed by NRB; however, lending to single sector for more than 20% is itself a threatening situation.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Summary

Banks and financial institutions are responsible for the overall development of the country. Banks and financial institutions, which collect the scattered small-small saving from nook and corner of the country and invest them to the needy one in productive sector thereby multiplying the economic reform. Credit risk being one of the major risks in banking sectors requires plenty of consciousness and pro-activeness in lending. Thus, to make a comparative analysis of banking sector, 2 banks were taken as sample using judgmental sampling method. KBL and MBL have been taken for comparative study because of their similarities in terms of business size, date of establishment, capital size etc. Both primary and secondary data have been used in this study.

Various credit risk mitigating and arising factors were studied. Appropriate statistical and financial tools have been applied to analyze the collected data. The data of five consecutive years of the two banks have been analyzed to meet the objective of the study. The major risk in KBL and MBL is associated with credit decision as the proportion of credit risk on total risk is high. The credit risk of these banks mainly arises due to non-payment of loan by borrowers, poor appraisal of borrower's financial condition and substandard collateral. Poor tracking of borrowers and improper diversification of lending across industries also result in higher credit risk in commercial banks. The major problems in credit risk can be categorized into three areas of concentration; credit processing, and market and liquidity-sensitive credit exposures.

Both banks has developed their own CPG (Credit Policy Guidelines) that direct their credit officers to comply as per the bank's policy. This brings consistency and standard in the lending policy. In addition to it, they have separate risk management department, which constantly keeps on exercising to mitigate

credit risk. However, this policy has been only transcribed in paper, had these been implemented in full capacity and understanding, there would not have been such major credit lax. This has been observed by the non performing to total loans and advances ratio of 0.51% and 2.41% of KBL and MBL respectively. Increasing trend of this ratio on MBL has posed threat to the depositors of the bank.

Increasing cost of fund has pressurized both banks to increase their interest rate on lending, this in turn have adverse effect on repayment capability of the banks and financial institutions. Every banks and financial institution have been vying for the same deposits, which created constant increase in the interest rate; this in turn increases the inflation of the nation. Moreover, both banks have been observed to have utilized the collected deposites on loans and advances only. Though, lending is the basic function of the banks, it is not the only function. We have witnessed investment in treasury and other debt instruments floated by government of Nepal. This is basically seen in Standard Chartered Bank. Almost investment and loans and advances are equal in this bank.

Concentration of both banks on single sector has also pose threat to depositors and investors of banks. Almost 21% of total lending to real estate sector, one of the most unproductive sector, has created high risk, since these players are unable to pay at least interest accrued.

Conclusions

A better decision can lead a business towards a path of sustainable growth and success. A better management team with properly addressed duties and responsibilities to each departments and its head can better perform and add up to a better decision. A company's shareholders must be separated with management team, since in judgment of a shareholder can harass sound and judgmental decision.

Majority of banks and financial institutions are now facing problems due to involvement of Executive chairman, one who is also a shareholder and a holder of top position, favoring nepotism in granting loans and advances has created serious issues in present banking era.

Commercial banks are established with an objective to maximize the shareholders' value by performing the function of mobilizing the idle funds collected from the society to productive sector, which will help to achieve the economic development of a country.

Proper risk management is required to remain competitive in the market to achieve the goals. With the increase in NPL, the loan loss provisioning will also increase simultaneously leading to decrease in profit. Thus banks and financial institutions must prepare for the worst scenario and maintain sufficient provision exceeding the required minimum criteria. This not only helps in hard time but also reduces the tax liability for the period.

Thus, For minimizing the loss arising due to occurrence of the credit risks, capital adequacy have been maintained by these banks within the standard prescribed by NRB. However, the trend of Capital Adequacy ratio of these banks suggests that both the banks need to increase their capital fund.

Major lending to single sector is found in both banks; however, this is seriously ill for the health of banks and financial sectors. Other problems related to insufficient collateral, borrower's negative character and manipulation of credit must be frequently checked.

Recommendations

Based on the findings in chapter four and above conclusions the following recommendations have been put forward.

1. Firstly, Credit risk management is not a simple process. Thus, both banks, KBL and MBL, must update and maintain proper credit/lending policy. This must be prepared by professional bankers and scholars with substantial knowledge and experience in this field. The policy must be

prudently and strictly followed by all the lending staffs. The policy must be reviewed and analyzed periodically. Addendums and amendments must be made over the time.

2. Following the normal guidelines of NRB and acting upon this also reduces many of the credit risk arising from borrower's defaulter, lack of proper credit appraisals, black listed borrowers, and willful defaulters. The over confidence in commercial banks regarding credit appraisal efficiency and negligence in taking information from Credit Information Bureau has caused many bad debts in the bank. Hence, the bank is recommended to follow the directives of NRB strictly and be more cautious and realistic while granting loans and advances. The major solution of reducing the risk is to avoid lending in the more risky area until the bank is fully satisfied regarding the future viability of the project. Although the government has established an office named 'Debt Recovery Tribunal' in order to help the banks for recovery of bad debts. An additional effort for establishment of 'Assets Management Company', which helps the banks in collecting their debts and improving their credit rating efficiency, should be initiated.
3. Both banks must initiate to put forward their plans to invest in rural areas. This can be led by SME lending. These loans are relatively small in portfolio but have less risk of default. Hence these sectors must be given special priority by both banks and shall also be promoted by government and NRB to flow credit in the rural economy.
4. The increasing non performing loan of MBL must be checked in time so that the bank can recover from being insolvent. Both positive and negative strategy must be initiated. Decreasing interest rate and providing subsidy on interest due can somehow facilitate and entice borrower to pay his loans. On the other hand taking action regarding

recovery of loan such as auctioning and taking a sincere harsh step to recover loans must be taken soon.

As compared to MBL, KBL has considerably low Non performing loans. If the bank has followed prudent banking practice this is a very good sign. But if not, this must be checked in time, because this can hamper the sustainability in the long run.

Additional extra provisions must be created to that of required minimum criteria as required by NRB. This can help in upcoming difficult situation of both banks.

5. Both banks must try to tap the untapped areas to accelerate the economic growth of those areas. This not only facilitates the new area, it also adds to the net profit of the banks. The rural economy has always been realizing the credit needs; the dominancy of non-organized moneylender in this area has been prevailing. To compromise between the liquidity and credit need of rural economy, the bank is highly recommended to expand its credit in this area. This helps to minimizing idle funds in business and at the same time contribute to the national economy.
6. Both banks are recommended to reduce their lending in Real Estate sector, since; this sector is one of the most unproductive sectors. We have noticed a galloping demand for Flats and Housing in Kathmandu Valley. This is due to the availability of infrastructure, better employment opportunities, educational opportunities, access to better health and sanitations. The increasing population to urban and sub urban areas and demand for the additional land and building can be met by newly constructed Flats and housing colonies. Hence, banks and FI's with proper examination and possible future prospects should only invest to these sectors. We have witnessed lending to these sectors without proper analysis and forecast future prospects. Every new player

in these sectors was enjoying credit facilities from different banks and FI's just in as sake of lucrative returns. This in turn led to the galloping rise in prices of land and building. Now this sector has been demoralized by the NRB and hence the creditors are being unable to repay the interest along with the principal. Thus, the life time saving of depositors has come into threat.

7. The regulatory authority must come up with new and additional regulating circulations that bind the banks and FI's regarding credit risks and safeguard the hard earning of deposit holders.

8. Being an investor and depositors one should must analyze the bank and FI's past transactions, financial before depositing. We are aware that every deposit holder is attractive towards lucrative investment giving them higher return. But as an active investor and citizen we must analyze various issues and consequences of this. As a result of higher cost of fund, the banks and FI's are compelled to invest collected high cost deposit into lending at high rate and risky assets. This in turn exposes threat to the deposit of the depositors. In addition to it, the high rate on lending in turn increases inflation and this burden is ultimately going to be borne by the individual citizen (Depositors). Hence, we must check the credibility, financials, management teams etc. before depositing funds. Banks and FI's having low cost of fund, experienced and professional management teams can better safeguard our life time savings.

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APPENDICES

Appendix 1

FIVE YEARS BALANCE SHEET OF KUMARI BANK LIMITED

<i>RS IN MILLIONS</i>					
Capital & Liabilities	2010/11	2009/10	2008/09	2007/08	2006/07
Shares Capital	1306.02	1304.94	1070.00	750.00	625.00
Reserves and Surplus	479.74	320.02	298.89	275.63	238.85
Debenture and Bonds	400.00	400.00	400.00	-	-
Borrowings Outstanding	429.74	293.42	100.00	212.97	251.40
Deposits Liabilities	17432.25	15710.39	12774.28	10557.42	7768.96
Bills Payables	42.31	7.09	65.30	16.55	11.92
Proposed Dividend Payables	156.82	6.53	-	-	6.58
Income Tax Liabilities	-	0.23	(9.65)	11.01	0.30
Other Liabilities	275.59	432.89	331.79	94.73	107.27
Total Capital & Liabilities	<u>20522.46</u>	<u>18538.51</u>	<u>15026.60</u>	<u>11918.31</u>	<u>9010.27</u>

Assets	2010/11	2009/10	2008/09	2007/08	2006/07
Cash Balances	574.07	549.11	565.64	190.75	135.79
Balances with Nepal Rastra Bank	1664.00	1120.76	244.58	384.84	210.55
Balances with Banks/FIs	485.77	106.44	123.62	96.52	43.28

Money at Call & Short Notice	120.00	30.00	55.36	372.22	145.00
Investments	296.16	1510.83	2138.80	1678.42	3994.95
Loans and Advances	14765.91	14593.35	11335.09	8929.01	6891.86
Fixed Assets	285.64	247.83	222.00	189.32	91.93
Non Banking Assets	-	-	3.14	2.39	3.59
Other Assets	320.22	380.26	338.37	74.83	93.32
Total Assets	<u>20522.46</u>	<u>18538.51</u>	<u>15026.60</u>	<u>11918.31</u>	<u>9010.27</u>

Appendix 2
FIVE YEARS BALANCE SHEET OF
MACHHAPUCHHRE BANK LIMITED

<i>RS IN MILLIONS</i>					
Capital & Liabilities	2010/11	2009/10	2008/09	2007/08	2006/07
Shares Capital	1627.20	1479.27	901.34	821.65	715.00
Reserves and Surplus	146.31	220.92	262.01	178.61	216.09
Debenture and Bonds	-	-	-	-	-
Borrowings Outstanding	150.00	-	88.51	228.50	131.68
Deposits Liabilities	18535.92	15596.79	11102.24	9475.45	7893.33
Bills Payables	15.40	24.44	10.31	21.48	11.37
Proposed Dividend Payables	-	-	8.65	4.31	5.64
Income Tax Liabilities	-	11.76	3.04	7.37	10.46
Other Liabilities	203.96	157.58	122.45	70.22	86.29
Total Capital & Liabilities	<u>20678.79</u>	<u>17490.38</u>	<u>12498.55</u>	<u>10807.61</u>	<u>9069.83</u>

Assets	2010/11	2009/10	2008/09	2007/08	2006/07
Cash Balances	1049.33	743.20	560.32	385.94	280.42
Balances with Nepal Rastra Bank	1094.66	1755.98	893.3	785.69	489.09
Balances with Banks/FIs	315.72	267.47	1343.95	112.45	44.41
Money at Call & Short Notice	661.56	-	70.00	694.00	718.47

Investments	2096.79	1246.16	1443.55	1278.47	1190.83
Loans and Advances	14289.79	12516.01	8642.32	7129.89	6068.43
Fixed Assets	732.29	664.16	535.89	259.54	104.94
Non Banking Assets	-	4.50	-	3.39	12.53
Other Assets	438.63	293.30	218.22	158.25	160.70
Total Assets	<u>20678.79</u>	<u>17490.38</u>	<u>12498.55</u>	<u>10807.61</u>	<u>9069.83</u>

Appendix 3

KUMARI BANK LTD				
Risk weighted exposures under each 11 categories of Credit Risk:				
S.No.	Particulars	2008/09	2009/10	2010/11
1	Claims on government and central bank	-	-	-
2	Claims on other official entities	151.31	89.94	25.48
3	Claims on banks	114.01	258.41	280.67
4	Claims on Corporate and securities firms	6,385.25	7,036.56	7,668.63
5	Regulatory Retail Portfolio	1,389.81	1,381.80	1,476.93
6	Claims secured by residential properties	646.72	690.38	776.14
7	Claims secured by Commercial real estate	2,152.68	3,636.38	2,614.68
8	Past due claims	237.17	89.72	399.74
9	High Risk claims	4,543.77	1,477.98	1,131.35
10	Other Assets	633.79	578.81	581.47
11	Off Balance Sheet Exposures	798.39	1,017.88	1,197.19
12	Total	17,052.89	16,257.86	16,152.28
Total Risk Weighted Exposure Calculation Table				
1	Risk Weighted Exposure for Credit Risk	17,052.89	16,257.86	16,152.28
2	Risk	713.92	909.51	1,099.01
3	Risk Weighted Exposure for Market Risk	49.81	53.88	92.29
4	Total Risk Weighted Exposures	17,816.63	17,221.25	17,343.58
	Add: 3% of the total RWE due to non compliance to Disclosure Requirement	-	-	-
	Addition to RWE as per supervisory review (3%)	-	-	520.31
	Add: ...% of Total Deposit due to Insufficient Liquid Assets -	-	-	-
	Total Risk Weighted Exposures	17,816.63	17,221.25	17,863.89
5	Total Capital Fund	2,060.80	2,376.94	2,580.56
6	Capital Fund to Risk Weighted Exposure	11.57	13.80	14.45

Appendix 4

MACHHAPUCHCHHRE BANK LTD				
Risk weighted exposures under each 11 categories of Credit Risk:				
S.No.	Particulars	2008/09	2009/10	2010/11
1	Claims on government and central bank	-	-	-
2	Claims on other official entities	130.31	130.31	151.91
3	Claims on banks	279.83	279.83	237.38
4	Claims on Corporate and securities firms	7,014.32	7,014.32	6,643.13
5	Regulatory Retail Portfolio	2,530.75	2,530.75	2,596.20
6	Claims secured by residential properties	457.10	457.10	462.08
7	Claims secured by Commercial real estate	1,325.14	1,325.14	2,380.08
8	Past due claims	179.82	179.82	563.85
9	High Risk claims	2,407.73	2,407.73	83.63
10	Other Assets	1,062.11	1,062.11	1,145.46
11	Off Balance Sheet Exposures	1,325.19	1,325.19	1,026.77
	Total	16,712.30	16,712.30	15,290.87
Total Risk Weighted Exposure Calculation Table				
1	Risk Weighted Exposure for Credit Risk	16,712.30	16,712.30	15,290.87
2	Risk Weighted Exposure for Operational Risk	788.11	788.11	934.80
3	Risk Weighted Exposure for Market Risk	47.39	47.39	31.25
4	Total Risk Weighted Exposures	17,547.81	17,547.80	16,256.92
	Add: 3% of the total RWE due to non compliance to Disclosure Requirement	-	-	-
	Addition to RWE as per supervisory review (3%)	-	-	325.14
	Add: ...% of Total Deposit due to Insufficient Liquid Assets -	-	-	820.57
	Total Risk Weighted Exposures	17,547.81	17,547.80	17,402.63
5	Total Capital Fund	1,961.90	1,979.55	1,899.91
6	Capital Fund to Risk Weighted Exposure	11.18	11.28	10.92