Chapter-1
Introduction

1.1Background of Study

Nepal is a landlocked and least developed country in the world. Though the half century-long development practice of Nepal through its planned development endeavor takes overall socio-economic development as its overarching goal, Nepal's level of socio-economic development has been remained among the lowest in the world characterized by low per capita income, rampant poverty, mass unemployment , low life expectancy, low literacy and condition that perpetuate poverty as a cyclical effect.

Since the Nepalese economy is characterized by the subsistence agriculture, which is traditional non-mechanized, and livelihood oriented sector, poverty has been emerged as one of the threatening challenge along with the increasing population. Over dependency of the population of the subsiste4nce agriculture, which is traditional, non-mechanized and livelihood oriented sector, poverty has been emerged as one of the threatening challenge along with the increasing population. Over dependency of the population on the subsistence agriculture accompanied with slow industrial growth has resulted unemployment and disguised unemployment, which have further accelerated poverty. In the economics like Nepal where there is technological deprivation, lack of innovation and lack of alternative sources of employment, tremendous effort is required in order to improve the situation of the poverty stricken sections of the population.

Presently, Nepal is facing the most challenging issue of political conflict and instability for the last 14 years. It has been the most heart-felt problem for an individual, an organization as well as for economic development of the country. It is generally accepted that political stability, space and security one the one and good governance on the other are the pre-requisites for the socio-economic development of a country. But unfortunately, both of them are lacking in the present context of Nepal. Bothe the domestic and foreign investment in development sector of Nepal is decreasing and being diverted to other sector and other countries due to security situation of the country. It has raised the question mark on development assistance from foreign countries and organizations. Accordingly, human rights aspect has also been an issue for concerned persons, groups and organizations. All these aspects have been deteriorated the socio-economic development of the nation. So, the time has come for Nepal to be serious for creating an environment for investment ad truehearted willing to provide development assistance to the country. Still the condition has not been so severe and donor countries and organizations have been responding to Nepalese request for her development by establishing and developing prioritized economic infrastructure, encompassing almost all sector indispensable for it was socio- economic development. Likewise, it is also the concerned matter of development thinkers that most of the development partners have been saying to rethink about heir development partner of Nepal. Recently in June 28, 2004 the official said: "now the time has come for Nepal to think seriously about its unstable political situation. If the political situation goes on as usual the government of Japan has to rethink of the extending Japan's Official Development Assistance (ODA) of Nepal."

Banks are among the most important financial institutions in the economy and essential business in thousands of local towns and cities in this context, there is much confusion about exactly what a bank is. Certainly, banks must be identified by the functions (service and roles) they perform in the economy. "Banks are financial intermediaries, similarly to credit union, savings and loan associations and other institutions selling financial services. The term financial intermediary simply means a business that interacts with two types of individuals or institutions in the economy. Defect spending individuals or institutions whose current expenditures for consumption and investment exceed their current receipts of income and who therefore need to raise funds externally by negotiating loans with and issuing securities to other units.

On the other hand, surplus spending individuals or institutions, whose current receipts of income exceed their current expenditures on goods and services so they have surplus fund to save and invest. Therefore, there should be someone who can bridge these two individuals or institutions so that those who have surplus funds can be deverted to the deficit units. Hence, banks are that institution that performs this indispensable task to intermediation between two individuals and institutions in order to raise funds and then loaning those funds to deficit spending individuals or institutions" (Shakespeare Vidya , 1999:21)

A joint venture bank is formed of two forces between two or more enterprises for the purpose of carrying out a specific operation. Joint venture banks are the commercials banks formed by joining the two or more enterprise for the purpose of carrying out specific operation such investment in trade, business and industry as well as in the form of negotiation between various group of industries or traders to advice mutual exchange of goods and services. Joint venture banks are the mode of trading to advice mutual exchanges of goods and services for sharing competitive advantages by performing joint investment scheme between Nepalese investor, financial and non-financial institution as well as private investors and their parent bank each supplying fifth percent of the investment .the parent banks, which have experiences in highly merchandised and efficient modern banking services in many parts of the world have come to Nepal with higher technology advance management skills . Joint ventures banks are established by joining difference force and with ability to achieve a common goal with each of the partner. They are more efficient and effective monitory institution in modern banking fields than other old type of bank in Nepalese context. The primary objective of joint venture banks is always to earn profit by investing or granting the loan and advances to the people associates with trade, business, industry etc. That means they are required to mobilize their resources properly to acquire profit. How well a bank manages in investment has a great deal to do with the economic health of the country because he bank loans support the growth of economic activities of the country. Nowadays there is very much competition in banking market but less opportunity to make investment. In this condition, joint venture banks can take initiation in search of new opportunity, so that, they can survive in the competitive market and earn profit. But investment bank must follow sound investment and fund mobilizing policy.

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

At the time when the banks are concerned only with their financial viability, the role to develop banking, such like developmental and promotional role, regulatory role and supervisory role. A bank makes rules and regulations for the growth and to promote banking sector in the country. Nepal Rasta Bank has been playing an important role by creating suitable environment to establish commercial bank, developmental bank, seventy-four finance companies, forty-seven financial non-government organization, seventeen financial cooperatives(licensed by NRB for limited transaction), as at mid January 2007. NRB makes rules regarding licensing operation, audit etc. Nepal Rasta bank act 1955 has given regulatory authority to it. Thus, Nepal Rasta Bank issues different guidelines/ policies/ directives to different financial institutions to operate such institution effectively.

According to the NRB act 2058, section 23(A), "The central bank has legal provision to regulate, to supervise and to direct. The tools that NRB used to control and monitor the financial institutions of the country are circular popularly known as Nepal Rasta Bank directives".

Commercial banks are established on the basis of only the Banks and financial institutions act, 2063.these banks are such type of banks, which accept deposits from the public and re-lend these deposits to the people for short periods. Most commercial banks are privately owned joint venture banks.

The Nepalese economy has not become successful in creating an investment friendly environment. The private sector does not seem to be confident with the current economic political environment. In such a situation, there remain fewer possibilities to materialize the slogan of public private partnership. Nepalese economy is experiencing increasing internal challenges. In this situation of ongoing socio-political anomaly, the economic development of the country is not just happened easily. The government needs huge resources to develop the country properly. To fulfil the objective of economics to development of the country, one of the most important sources is capital. This is generated by Bank and other financial institutions. Before going to in depth of the study, it is better to give the introduction of Nepal Rastra Bank.

1.1.1 Nepal Rastra Bank – The Central Bank of Nepal

The history of Nepal Rastra Bank is not longer in Nepal. It began with the independence of Nepal from Rana Regime in 1950. After the independence from Rana Regime, Planned effort of economic development was initiated and in almost all economic planning, Nepal Rastra Bank has played significant role, Nepal Rastra Bank has been playing crucial role towards fulfilling Nepal's development aspirations. It has instrumental in bringing about substantial improvements in the statue of socio economic development in the country. Hardly, any sector of the economy exists which has been untouched by the guideline of Nepal Rastra Bank. The Nepal Rastra Bank is responsible of management and supervision of the monetary and credit system of the country. This central bank has been given wide power under the various provisions of the following legislation, Nepal Rastra Bank Act 2058, Banks and Financial Institutions Act 2063. The provisions of this Act are applicable to domestic as well as joint venture banking institutions.

Prior to the establishment of Nepal Rasta Bank in 2013, Nepal Bank Limited, the first and only commercial bank, had to perform some of the function of the central bank. Before the establishment of Nepal bank ltd, there was Tejarath Adda, which was established with a view to extent credit to the public on the security of gold and silver. Up to 2013, the Nepal bank ltd was one and only financial institution and taking charge except commercial banking function. NRB later took a lead role as the central bank of the country and assumed the responsibility of ensuring proper management of the issuance of Nepalese currency notes ; making proper arrangement for the circulation of Nepalese currency through out the kingdom; stabilizing the exchange rates of Nepalese currency; mobilizing capital for development; encouraging activities related to expansion of trade and industry and developing banking.

"Against the background, an urgent necessity was felt for the establishment of a central bank dedicated to the development of banking and finance to promote trade and industries, to manage circulation of national currency and to maintain exchange rate stability, Hence the Nepal Rastra Bank Act 1955 was formulated." (40 Years of Nepal Rastra Bank 1996:36)

"Nepal Rastra Bank was established as a central bank on Baishkh 14, 2013. The bank was empowered to Act to have direct control over banking institution within the country. It also took over the treasury function of “Mulukikhana Adda” (Government Treasury) and started issuing currency in 1959and also thus relieved the various “Mal Addas” (Revenue Office) of their work in the connection.” (40 Years of Nepal Rastra Bank 1996:37)

According to Nepal Rastra Bank Act 2058 the bank has the following objectives:

(i) Formation and management of monetary and foreign exchange policies for stability and balance of payment, which is essential for economic development.

(ii) Promote essential liquidity for the stability of banking and financial sectors.

(iii) Develop healthy, secured and strong system of payment.

(iv) Regulation, supervision and monitoring of banking and financial system.

(v) Promote overall banking and financial system within the country to increase the public faith upon banks and financial institutions.

1.1.2 Function of Nepal Rastra Bank

Besides objective Nepal Rastra Bank has some function, which should be known “as the country central bank. This bank has sole right to issue currency notes and coins and is responsible to manage to country’s foreign exchange reserves. This bank other important functions include; developing banking and financial system in the country, regarding advice to the government on financial and economic matter, mobilizing capital and managing public debt. This banks also acts as a banker to government besides serving as lender of the last resort. As in various other developing countries, the bank undertakes a number of developmental functions that are intended to support the country’s efforts towards accelerated developmental of the overall economy. “ 40 years of NRB 1996:195)

As a central bank, the Nepal Rastra Bank has been carrying out all the important functions of the central banking as in other developing countries. The following are the functions executed by the Nepal Rastra Bank are as follows.

1) Statutory functions/ basic function

A) Issue of Note : This is basic and prime function of **,** which is their monopoly right like in other countries. It is the final authority of currency. It issue required notes and coin for the country. The granting of monopoly right of note issue makes it easier to maintain uniformity in money and control the quality of money. The NRB issued bank notes for the first time on 19^{th} February 1960. NRB Act 2012 has prohibited other banks to issue currency. It has the power to control and manage the issue notes. This issue of notes in Nepal is based upon the proportional reserve system. Before the establishment of Nepal Rastra Bank the government treasury; i.e. Saddr Mulikikhana Adda carried this function. In Nepal, Nepal Rastra Bank must deposits fifty percent gold, silver or foreign exchange and fifty percent Nepali coins or securities for note issue.

B) Banker of the Government : Central bank serves as a banker to the government. All necessary banking facilities for the government are available from central bank. It receives payment on behalf of government and also makes payments on its behalf. A central bank is required to lend money to the government when called upon to do so. Government revenue like tax flows to government only in certain parts of year, while funds are wanted at all times. Hence government borrows temporarily from central bank in time of need. It performs agency function for the government like purchase and sells of government securities and forign securities manage internal and external public debt and handles remittance. Government adopts and implements various kind of fiscal and monetary policy foreign exchange policy, banking policy from time to time as required by up coming and on going trends with close consultant and assistance of central bank. It acts as the agent of the government in three dealings with IMF. The World Bank International Finance corporations etc.

C) Banker's Bank: Nepal Rastra Bank acts as a promoter advisor, controller and banker of all the commercial bank in the country. It surveys and research for new bank establishment area of credit expansion and make available of necessary data for the development and promotion of banking system in the country.

Being a central bank, the commercial banks are directed and controlled by NRB. As the banker's of the bank the commercial banks have to deposit a certain proportion of their deposits as reserves with the central bank. These reserves help the central bank to control the issue of credit by commercial banks. They also keep their spare cash with the central bank on which they draw as and when needed. This is how it serves as a banker's bank.

D) Control of Credit: Most important function of a central bank today is the control of credit, i.e. regulating the volume and direction of bank loans. Level of employment, level of process etc is based on the volume of credit. If credit supply decreases below optimum level, deflation will overtake the economy. Both situations are conductive to economy. Central bank designed optimum limits by different ways like open market operation, tax rate credit rationing cash reserve ratio and direct intervention.

E) Foreign Exchange Management and Control : The one of the important function of Nepal Rastra Bank is manage controls of country's foreign exchange reserves and the external value of the rupees. The 'Foreign Exchange Control Act' was regulated in October 1960. The Act also equipped the bank for bringing about the use of single currency through out the kingdom. Foreign exchange transaction was also by quoting exchange rates for US dollar, Sterling Pound and Swiss Franc in term of Nepalese rupees. The exchange rates between Indian and Nepalese are also fixed by NRB. “Nepal Rastra Bank is the only one authority who controls the receipt and payment of the foreign currencies. It fixes the value of the rupee against all currencies. It has also authorized all the commercial banks to fix the value of rupee according to the foreign exchange market.” (Vaidya, 1999:67) Nepal Rastra Bank will either purchase or sell convertible foreign currency only at the time of intervention.

2) Development functions:

A) Publication of Economic Indicators of the Country: The one of the most important function of NRB is publication of economic indicators of the country who has the final authority to publishes different data pertaining to the economy of the country like money supply, credit balance of payment, prices etc time to time.

B) To assist in the Banking System in the Country : As a central bank “NRB plays dynamic role in the development and promotion of banking industry in the country. It can regulate all the banks to open branches in the remote areas of the country on the one hand and motivates the public to bring rural banks in the country such as Eastern Rural Development Bank far Western Rural Development Bank.” (Vaidya 1999:67)

C) Training Facility: In order to develop the skill of staff working in different banks, it organizes different training programs at its training unit for better performance and well management of any institutions. The training centre provides trainings on different subject such as money and banking agriculture credit, audit and reconciliation and industrial finance etc.

D) Financing in Priority Sector : Agricultural and Industrial sector cannot run without capital and the other hand commercial banks have unutilized resources. So the directives issued by

NRB to commercial banks in 1974 to invest at least 5 percent of there total deposit liabilities in priority sector. “Nepal Rastra Bank is the ultimate authority that can regulate to the commercial banks to finance in priority sector (like agriculture sector, small scale industries etc.) at confessional interest rates set by the government which is happening in Nepal “ (Vidya, 1999:67)

E) Supervision of Bank : The NRB Act 1955 has empowered the NRB to supervise and control the commercial banking operations and to direct necessary movement. In beginning period NRB used to inspect the commercial bank only one year and scope was limited to the foreign transaction only. Letter on the bank prepared a comprehensive manual for inspection with many objectives. Generally NRB inspect the commercial banks by on site and off site method. The NRB watches the banks and financial institution through the different publication.

F) Banking Promotion Board : NRB has set up a Banking Promotion Board in 1968 in order to develop a banking system in the country. The banking promotion board organized a first ten days national level banking development seminar in Kathmandu January 1969 with purpose to generate public awareness to exchange ideas and opinions and to innovate new ideas in the field of banking.

The main objective of Banking Promotion Board is to promote banking activities all over the country with corporate governance through creation of awareness among the general public about the service provided by the bank both in term of deposit mobilization and credit extension.

G) Custodian of National Reserves: It is the central bank, which serves as the custodian of nations reserves of gold and international currency. It is its duty to take appropriate measure to safeguard these reserves.

H) Provision of Clearing House Facilities: The central bank performs the duty of clearing house for cheques. It settles the accounts of commercial banks and enables them to clear their dues by the process of book entries.

1.1.3 Role of Central Bank in Modern Banking System:

The banking system has been modernized and become complex and so as the role of central bank is also becoming very critical. By nature central bank is a regulatory authority to flourish and control the banking system. In this regard, central bank designs its policies, rules, regulations and programs in such a way that may pay a catalytic role for the modernization of the banking system.

- Central bank designs its monetary policy in such a way that would help to augment the private and productive sector's credit. For this, it coordinates with government sector (fiscal policy). Otherwise fiscal sector would have crowed the private sector out, which is taken as a focal point, otherwise the banking system would not have been in a position to meet the required amount of money and / or services to the economy in a great deal.

- This is the age of liberalization and globalization. So, many foreign banks have been established in the economy with tailor made modern facilities. On the other hand there are many financial innovations and products in the market. Tendency on off balance sheet transaction has increased. Thus risk factors are also mounting equally up. The increased sophistication in banking services like automated machine, credit cards, electronic funds transfers, computerized clearing house service etc further tended to increase liquidity of quasi money. By this, estimation of the money supply has become a difficult task to the central bank. So keeping abreast of the time dynamic and changed banking scenario, central bank itself tries to be very efficient and aware to regulate and monitor the financial and economic dilemma and tries to prevent financial and economic distortion in the economy.

- National interest also became an inseparable part of the job to the banking system. Mostly, in the developing countries there are several compulsions to the banks to go to the prioritized sectors indicated by the government. Their financial intermediation in the deprived and rural sector has proven to be nectar for economic uplift. So, central bank also makes the policies and directives in such an approach that the banks shall not face any difficulties to cultivate their prime objective viz profit optimization.

- As the economy opened up and competition rose mushroom growth of different types of financial intermediaries including banks has been observed. Bank failings may be common in the developed economy but in developing economy it would be very dangerous and painful for their sustainable economic growth. We can cite a recent example of the cries of south East Asian economy few years ago. Failure of financial system in Thailand and created a chain effect and other neighboring trading partners were also badly affected by the so-called 'contagion' and 'spill-over' effect. It was happened due to the reasons like local currency pegging with hard currency, over confidence irrational portfolio management (i.e. mismatch) commercial lending heavily concentrated on real estate business and big houses incapable manpower for business forecasting, lack of appropriate/ efficient monitoring and supervision of the banking sector from concerning authorities etc. So, to safeguard the economy in general and financial system in particular from this type of advisory, central bank always tries to be capable on supervising and monitoring the overall banking system scientifically.

- Owing to the time demand, central bank introduces full phased computerization and electronic banking services into its own organization too because, central bank is an operator of government accounts, monitor and facilitator of the banking system, custodian of money and manager of monetary and external sector. Thus it has to install a computerized technology to render the fast and reliable service to the economy. By doing so, all the functions of the central bank will come under networking system and its employees will also demonstrate a full potential for the betterment of the institution. After taking these measures, the whole economy would benefit through 'Economies of Scale'.

1.1.4. Development of Commercial Bank in Nepal:

"The history of banking in Nepal may be described as component of the gradual and formerly evaluation in the financial and economic sphere of the Nepalese life. Even now the financial system is still in the evolutionary phase. The existence of unorganized money market consisting of landlords, Shahukars (rich merchants), shopkeepers and other indigenous individual money lenders has acted as barrier to institutionalized credit. These institutions although quite underdeveloped could still mobilize funds from a wide range of different sources. For many years, the indigenous individual wealthy agriculturists, landlords, merchants and traders conducted some banking activities along with their other business occupations. The activities were fragmented and mostly localized" (40 years of NRB 1996:29)

Nepal Bank Limited was the first commercial banks of Nepal. It is taken as the milestone of modern banking of the country. It was established on 30th Kartik 1994, which was incorporated as a semi government organization with an authorized capital of Rs 10 million of which 51 percent share was owned by the government and rest by the private shareholders. It started with collected of Rs 170,200 from public deposit. From the beginning it has rendered the4 following services to the customers:

- Accepted deposit,

- Extend loan,
- Invest government bond and securities,
- Perform agency function,
- Act as banker to the government,
- Render customer service(i.e., issue of bill of exchange, hounds)

Until mid-1940s, only metallic coins were used as medium of exchange. So the government need of separate institution or body to issue national currencies and promote financial organization in the country.

Later Nepal Rasta Bank was established as a central bank of Nepal in 2013b.s under the Nepal Rasta Bank act 2012b.s.

With the establishment of NRB, he process of banking development started to gain momentum. Rastriya Banijya bank was established, dated 10th Magh 2022, under the Nepal Rastra banijya Bank act, 2020 B.S. as a 2nd commercial Banks of Nepal. It is the fully state owned and providing banking facilities with an authorized capital of Rs 10 million. These two commercial banks, with 319 branches in the kingdom, are from the largest group of finical institutions.

Nepal is an agricultural country and agriculture is basis occupation of major Nepalese people. The development of this sector plays the primary role in the economy. So the first separate institution in agriculture financing namely Agriculture Development Bank was established, dated 7th Magh 2024.

For more than two decades, no more Banks have established in the country.

After declaring free economy and privatization policy, HMG encouraged the foreign Banks for joint venture in Nepal . as a result Nepal Arab Bank Ltd(NABIL) came into existence on 29th Ashad 2041 under commercial Bank act-2031B.s. as a joint venture Bank. It has the authorized capital of

Rs 030 millions, 50 % share is held by union Bank of Middle East, Dubai, 20%by Nepal Industrial Development Corporation, Nepal insurance corporation and securities Marketing centre and rest by the general public. This is the first modern Bank with latest banking technology. Then a lot of commercial banks have been opened in a country.

NEPAL INDOSUEZ BANK was established on 26th Falgun 2024 as a joint venture of Indosuez bank, France and public shareholder with an authorized capital of rs 120 millions.

NEPAL GRIND LAYS BANK, the Nepalese really saw modern banking when Nepal grind lays bank was established on 16th Magh 2043. This is also another joint venture between the grind lays bank of U.K. Nepal bank Ltd and the general public. Today the name of this bank has been changed into standard chartered bank limited. In Nepal there are massive entrances of foreign banks as the country followed economic liberalization.

The Himalayan Bank Ltd is a joint venture with Habib Bank of Pakistan. It started its operation in 5th Magh 2049 with paid up capital of Rs. 60 millions.

NEPAL SBI BANK LTD is a joint venture between employers provident fund and State bank of India, established in 23rd ashad 2050 in technology collaboration with IFFC bank Ltd. Of Bangladesh.
On 2st kartik 2051, Nepal Everest Bank ltd was entered into joint venture commercial banking with Punjab National bank of India (PNB). PNB holds 20% equity stake in the Bank.

BANK OF KATHMANDU LTD was established in a joint venture with syan bank of Thailand on 28th Falgun 2051.

Similarly other joint venture banks in Nepal are Bank of Cylon as a joint venture with Srilanka bank established on 28th ashoj 2053, and today the name of this bank has been changed into Nepal Credit and Commerce Bank Ltd.

In the beginning, most of the bank came into exist as a joint fully stated owned, those banks are as follows,

- LUMBINI BANK was established on 1st Shawn 2055 in Narayangadh. This is the first regional bank of Nepal.
- NEPAL INDUSTRIAL AND COMMERCIAL BANK was established 5th Shawn 2055; it does not have any joint venture yet. But it has employed senior managers from India to handle its operation. MACHHAPUCHRE BANK STARTED its operation on 17th Ashoj 2057, its head office is established in Pokhara.
- KUMARI BANK was established on 21st Chatira 2057 and its head office is in Katmandu. This bank has introduced internet Banking which is a hi-tech banking system of the world.
- LAXMI BANK was established on 21st Chaitra 2058.its head office is situated in Katmandu. Siddhartha bank was also established.

The banking industry is the life blood of economy. It is the bridge of nation’s development. The entry of commercial banks functions led to rapid growth of banking system. The government’s liberalization policy led to a dozen of commercial banks actively playing in the financial market of the counter. “Suggestion for the development of banking in the country on the basis of area approach is being made by the policy makers recently. The central idea behind this is that, depending on there area of operation and location, commercial bank could be assigned particular areas where they act as place sector in providing integrated banking facilities. The establishment of commercial and industrial bank in Biratnagar, Lumbini bank in Narayangadh, Machhapuchhre bank in Pokhara are some of the example in the introduction of Nepal development bank from the private sector in exemplary in the history of banking in Nepal. Many of theses banks have shown tremendous progress in term of deposits, lending or in customer base within a short period of time. In addition the government has also introduced five regional development banks, which have boost up the income of poor in rural areas" (vaidya, 1999:108)

Commercial banks should establish under the banks and financial institution act,2063(BAFIA).this ordinance set out regulations for licensing, supervision and cancellation of license of commercial bank is the dominant one. Commercial bank have strictly follows the rules and regulations issued by NEPAL RASTA BANK.

1.1.5 Regulations relating to commercial banking activities in Nepal:

Establishment: commercial bank are required to be registered under company Act and Bank and financial institution Act, 2063 in order to begin operation. The bank is registered under company Act only if NRB gives a letter of intent for opening the bank and make recommendation thereto.

National level bank with head office in Katmandu can be established only if there will be joint venture with a foreign bank and financial institution or there will be technical service agreement with such institutions for minimum 3 years.

Generally, minimum 30% shares should be sold to general public. This limit can be reduced to 20% only when foreign banks hold minimum50% shares in a bank. Foreign banks can hold maximum 67% stake in a bank.

Paid up capital; minimum paid up capital required for a new commercial bank is as under;

(i) Rs.250 million to operate all over Nepal except Katmandu valley.
(ii) Rs.1000 million to operate all over Nepal.

Existing banks were required to raise their capital fund to minimum Rs 1000 million by mid July 2009 through minimum 10% paid-up capital increment every year.

Reserves: Banks are required to transfer 20% of their net profit to general reserve until such reserve doubles the paid up capital. They are to transfer 25% of exchange fluctuation gain to Exchange Fluctuation Reserve. If there is any gain from revaluation of assets, the same should be transferred to Asset Revaluation Reserve. Similarly capital assets received in the form of gift/donation should be shown as Capital Reserve.

Capital Adequacy Ratio (CAR): Capital Adequacy Ratio id the relationship between shareholders' fund (Capital Fund) to total risk weighted assets of the bank. The higher the CAR the less levered the bank and the safer from depositors' point of view because the proportion of the shareholders' stake to the risk weighted assets is also high.

Declaration/ distribution of dividend, expansion of branches, availing refinance from Nepal Rastra Bank, disbursement of loans, acceptance of fresh deposits etc are prohibited until fulfillment of CAR shortfall.

Branch and Counter Expansion: Banks are required to obtain approval from NRB to open any branch or counter. Bank establishment with head office in Kathmandu can have one Main Branch Office in Kathmandu. They need to open one branch outside Kathmandu valley for opening one additional branch in Kathmandu.

Normally, Banks are not allowed to open counters in metropolitan and semi-metropolitan cities except for short term special occasions. Except for the counters establishment the premises of Royal Palace, Hospitals and foreign diplomatic missions and for specific purpose like remittance and pension distributions, all other counters should be converted to branches within two years failing which they should automatically closed.

Directive Credit: Banks have to extend a certain percentage of loan and advances in the deprived and priority sector. Currently deprived sector lending should be at least 0.25% to 3% depending on the banks and priority sector lending at least 12% inclusive of deprived sector lending to their total credit portfolio. However, monetary policy of 2059/60 B.S. announced by NRB has pledged to phase out priority sector credit programmed in next five years but to continue with deprived sector credit programmed.

In case of shortfall in any sector (deprived and priority), the concerned bank has to pay penalty at the highest lending rate of the bank during the shortfall period that is monitored quarterly.

Cash Reserve Ratio: As per NBR regulation regarding maintenance of minimum liquidity effective from 06 Shrawan 2059 B.S. Banks re required to maintain cash reserve as under:

a) 5% of total deposit must be held at account maintained by the bank with Nepal Rastra Bank.

Single Borrower's Limit: Single borrower limit refers to the maximum credit limits that can be extended to customer, firm, company or companies of the same group. Such a limit is currently as under:

a) Funded: 25% of Core Capital
b) Non-Funded: 50% of Core Capital

The bank were a single borrower enjoys credit limit (exposure) more than above should bring it within the limit by mid-July 2003. If above limit is not observed by a bank hundred percent provision expenses should be provided on the loan amount exceeding the single obligor limits (SOL).

Interest Rate : Banks are free to fix interest rate on deposits and loans. Interest rates on all types of deposits and loans should be published in the local newspapers and communicated to Nepal Rastra Bank minimum on a quarterly basis and immediately when revised.

Deviation of 0.50% from the published rate is allowed on all types of loans and deposits.

Loan Classification Provisioning: A bank is required to classify their loan on the basis of overdue aging schedule and provide on a quarterly basis as follows:

Type	Provision Requirement	Criteria
Pass	Principal overdue up to 3 month	1%
Substandard	Principal overdue up to 6 month	25%
Doubtful	Principal overdue up to 1 year	50%
Bad	Principal overdue above 1 year	100%

Pass loan is called 'Performing' and others are called 'Non-Performing' assets. Provision requirement in case of loan given against personal guarantee only is additional 20% for Pass, Substandard and Doubtful loans. Provision requirement for restructured rescheduled and swapped loan is 12.5%

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

Investment portfolio of the bank should be accounted at market value or cost whichever is less. If investment securities have not been listed in the stock market, investments should be valued at cost.

Sectoral Credit Limit: Credit concentration in one sector increases the risk of a bank. Hence, NRB

Requires banks to monitor its credit portfolio in following ways:

a) Level I sector where credit of a bank ranges from 50 to 100% of core capital.

Bank has to devise a proper credit Information System to monitor such credit at least quarterly.

b) Level II Sector where credit of a bank is above 100% of core capital.

Board of Directors of he bank should decide annually whether it wants/ does not want to have credit exposure more than 100% in any sector. Decision of the Board should be notified to banking Operation Department and Supervision & Inspection Department of NRB.
Prohibition : Banks are prohibited to do following activities:

- Purchase and sale of goods with transaction motive.
- Purchase of fixed assets not for own use.
- Expending credit facilities against the security of own share.
- Extending credit facilities to the director of the member of his undivided family.
- Extending credit facilities to the shareholder holding more than 1% share and to his undivided family.
- Extending business credit facilities to the employees and their undivided family.
- Extending credit to the company where the director or the members of his undivided family have 10% stake.
- Acting as the managing agent.
- Declaration/ distribution of dividend to shareholders before complete amortization of preliminary expenses. Accumulated loss and before appropriation of fund for capital adequacy, reserves and provisions.

1.2Focus of the Study

1) The following important directives are mainly focused in this study.

    - Directive no.1: Provision of maintains of minimum capital fund by the commercial banks.
    - Directive no.2: Provision of loan classification and loan loss provisioning on the credit.
    - Directive no.3: Provision of limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
    - Directive no.4: Provision of accounting policies and format of the financial statements to be followed by commercial banks.
    - Directive no.5: Provision of minimization of risk inherent in the activities of commercial banks.

2) Impact of such directives on the commercial banks.

3) Implementation of such directives or not by commercial banks.

1.3 Statement of the Problem

In its 50 years of history various activities were undertaken by Nepal Rastra Bank NRB Act 1955 gives the full authority to Nepal Rastra Bank. Banks should be established and operate under NRB's rules and regulations. There are almost seventeen commercial bans: one of them is founded lately in Nepal, even though the banking today is not healthy and sound. In developing country like Nepal, the most of the people are not conscious about the banking system. So the main problem is the lack of banking knowledge itself.

Some banks may have very low capital adequacy ratio while some banks may have piled up non-performing assets (substandard, doubtful, bad loans). The people have been raising question over the correctness of credit classification and provisioning of some banks. NRB issues directives from time to time to commercial banks. The banks must be followed such directives. There are twelve directives related to banking prudential regulations to be followed by the banks. Likewise, Directive no. 2 (2005) related to loan classification and provisioning, all commercial banks are suppose to categorize the loans disbursed to the customers into different groups on the basis of their past due periods. The loan classification and provisioning norms directs the banks to classify the loans into six different categories in old provisions. The banks are categorizing the loans into four different categories according to new issue. Each category of the loan amount requires certain percentage of it's to be provisioned for the probable loss. This amount is deducted by the profit of the bank. Similarly, other directives viz, capital adequacy ratio, single borrower limit, according policy, maintaining liquidity risk has also been changed. This may also affect in banking operation.

Banks seems to be not serious towards the research and development. Sometimes their loan portfolio is diversified. While sometimes concentrated, most of the banks not have a single well-managed training centre. So, banks should focus on research, training and development. Most of the banks are in weak position. Government interference in functioning of banks is another interruption to obey regulations of banks directed by NRB. The change of government policies is directly link to change of management in these banks.

Similar other impact may be observed because of the changes made in directives, The directives, if not properly addressed have potentials to wreack the financial system of the nation, as they are the only tools of the NRB to supervise and monitors the financial institutions. The directives in themselves are not that important unless properly implemented.

1.4 Objectives of the Study

"Financial sector reform requires sound and good corporate governance for sustainable growth. It is extremely been essential to the protection of right of the shareholders, clarity in duties and responsibilities of all stakeholders, disclosure and transparency and legal framework to sufficiently address good governance mechanism. It is envisaged that all these measures will ensure a healthy growth of financial sector. Enhancing the supervisory role of the central bank, strengthening accounting and auditing practices and finally increasing competition among the actors of financial sector are some of the measures initiated to develop an active and strong financial system in Nepal." (Fifty Years of NRB) Thus NRB has undertaken various activities for the banking and financial development since its establishment. NRB has issued various regulations and directives to commercial banks to make the banking sector effective. The main objectives of the study are to review directives of the NRB related to commercial banks. The study will conducted with the broad objective of examining the state of NRB functions in the commercial banks in Nepal. The specific objectives of this study are given below.

1. To find out impact of the changes in NRB directives on commercial banks.
2. To observe positive and negative impact of NRB directives during the research.
3. To figure out whether NRB directives are actually being implemented by commercial banks or not.
4. To suggest necessary recommendations based on findings for the betterment of the concerned organization.

1.5 Significance of the Study

Nepal Rastra Bank is the main figure of this research study. The directives of NRB are one which government authority controls the banks in the country. NRB issue directives to the commercial banks from time to time in order to maintain stability in the financial market. The directives are issued on the basis of monetary policies and the success of the monetary policies of the country depends on the directives of the central bank and its central role. So it is important to research on the directives. In the process of economy development, it has become necessary to develop NRB directives to meet commercial banks objectives. The commercial banks are supposed to follow the rules and regulations laid down by the NRB. This research though small but placed insight about the effects of the directives of the directives of the commercial banks and the implementation by them. The directive of the central bank holds a central role in obtaining the success of the monetary policies.

This research will also provide useful and meaningful references materials. Various suggestions will be presented to concerned two banks namely, Nabil bank Limited and Nepal SBI Bank Limited, at the end of this research. Nepal Rastra Bank official to act effectively for the implementation of the directives can use such suggestion.

A very good way of doing this would be by analyzing the progress made in NRB's Directives. The study of this kind could contribute in filling knowledge gap and throw the light on NRB Directives practices in the country.

1.6 Limitations of the Study

Although there has existed twenty commercial banks in Nepal, only two commercial banks namely, Nabil Bank Limited and SBI Bank Limited are taken to study. The sample therefore may not represent the entire population.

The new directives issued by Nepal Rastra Bank applicable to banks and financial institutions comprise sixteen directives, issued in 2062 B.S. Due to lack of materials and middle of the fiscal year, this thesis is mainly based on the previous directives. However the changes have been noted wherever possible. Previous issued directives focused only on commercial banks but new directives must be followed by banks and all other financial institutions from the beginning of 2062/63. This new directives cover all the banks and non bank financial institutions. So it is also called unified directives. Previous directives contained twelve directives. There is no any difference between new and previous directives except directives no 11(Provision of consortium financing) and directive no 4, which changed the format of financial statements of banks and financial institutions. The general directives are taken as guidelines. So all the directives are not considered for the study due to the time limit and the data availability. In addition only the directives issued in 2002 & new have been considered for the study.

The commercial banks formulate their own policies after properly studying the directives of the central banks. They have close relationship between NRB Directives and commercial banks policies and always acting as a bridge between the NRBV and commercial banks. Hence NRB issues directives from time to time and commercial banks are supposed to follow the rules and regulation and directives. In issuinng of previous directives. There are eleven directives. But in the study, only five selective directives i.e. directives number 1 to 5 are highlighted among the directives.

The study consist both qualitative and quantitative analysis because of no data availability. The presentation and analysis have been made on the basis of comparative analysis of the data of Nabil Bank and Nepal SBI bank.

1.7. Profile of Concerned Bank

a) Nepal SBI Bank Limited (NSBIBL)

Nepal SBI bank Limited (SBI) was established under the Company Act 1964, in 1993, this bank is the joint venture of State Bank of India and Nepali promoters. The State Bank of India holds 50% share of total investment. Nepal SBI Bank Limited managed by the State Bank of India under the joint venture and technical services agreement signed between it and Nepali promoters. It shares subscription in given as:

- State Bank of India (India) 50%
- Employee Provident Fund 15%
- Agriculture Development Bank (Nepal) 5%
- Nepalese Public 30%

The main objective of the bank is to carryout modern banking business in the country under the Bank and Financial Institutions Act 2063 and to provide loan on agricultural, Commercial and industrial sectors.

The following facilities have been providing by the bank are:

- International trade and bank guarantee.
- Any branch banking
- Conventional banking facilities
- Remittances etc.

b) NABIL Bank Limited

Nepal Arab Bank Limited was established under the Company Act 1964 in 12 July 1984, (Renamed as Nabil Bank Limited since 1st jan 2002) as a first joint venture bank of Nepal. This bank is the joint venture of Union Bank of Middle East, Duabi and Nepali promoters. It has the authorized capital of RS 30 million, 5 percent share is held by Union Bank of Middle East, Dubai, 20 percent by Nepal Industrial development Corporation, Nepal Insurance Corporation and Securities Marketing Centre and rest by the general public. This is the first modern bank with latest banking technology. Then a lot of commercial banks have been opened in the country.

Nabil launched its operation with a marketing concept, i.e. customer is the king in the market. Nabil started knocking the doors of customer breaking the trend of knocking the door of a bank by a customer. Nabil seems to have truly followed the definition of customer given by Mahatma Gandhi, “A customer is the most important visitor on our premises. He does not depend on us. We are dependent on him. He is not an interruption on our business. He is purpose of it. He is not an outsider on our business. He is part of it. We are not doing him a favors by serving him. He is doing us a favor by giving us a opportunity to do so.

1.8. Organized of the study

The thesis outlook is divided into the following five chapters:

Chapter 1: “Introduction chapter” which including why the researcher choose this topics. This chapter includes background of the study, focus of the study, statement of the problem, objectives of the study, significance of the study, limitations of he study, organization of the study.

Chapter II This chapter is concerned with literature review. The reading materials of this chapter are conceptual review and review of related studies.

Chapter III This chapter consists of research methodology, express the way and use technique while studying applied in research process; this includes research design, population and sample sources of data method of data analysis.

Chapter IV: This chapter has covered the "Presentation and analysis of data" with presenting charts, figures and other satirical tools, mathematical tools and financial tools.

Chapter V: This chapter is concerned with output of thesis as summary, conclusion and recommendation for improvement.

CHAPTER II
REVIEW OF LITRATURE

2.1 Conceptual/Theoretical Review

2.1.1 Bank-Evolution and concept:

Little is known about banking before the middle-ages. The Greeks and Mesopotamians had banks, as did the Romans. The civilizations regarded banking as "unnatural" but some banks were allowed to operate. There is no unanimity among the economists about the origin of the word 'banking' the term bank derives form the Latin 'bancus', which refers to the bench on which the bankers would keep its money and his records. Some persons trace its origin to the French word 'Banque' and the Italian word 'Banca' which means bench for keeping, lending and exchanging of money or coins in the market place by money lenders and money changers." (Vaidya, 1999:18), thus there is difficult to say whether the term 'bank' has been derived from "Bancus", "Banca" or "Banque" and German word 'Bank' means a joint stock company.

The height to which modern banking has developed is a contribution of slow and gradual process. Today's Modern banks provide various facilities and services for the customer. It is the fastest, easiest and safest way of transacting money. We can find out that it had not been an easy revolutionary act. Banking has bit by bit developed through centuries and decades. It is necessary to know how the present banking system gradually developed. It has crossed various phases to come to the modern form. In ancient time goldsmith, businessman, and moneylender used to perform the work of banking in every country. Traditional forms of banking were traced during civilization of Greek, Rome and Mesopotamia. Hence the following people are ancestor of modern banks.

- Merchants
- Moneylender
- Goldsmith

  - Merchants: merchants are the ancestor of the modern bank. Merchant had to remit money from one place to another place, which was not an easy task. They used to provide loan, exchange gold-silver and safety deposit the valuable ornaments. The merchants were trusted and they became popular easily. They issued letters similarly to today's promissory notes to make trading, which was accepted by all people. They used to make trading through actual coins on the periodic basis.

- Moneylender: the next credit goes to the moneylenders. Moneylender used to give loan to public and receive interest. People used to give loan to public and receive interest. People used to deposit money for safety. These deposits were not withdrawn on regular and similar basis. The moneylenders so utilized the amount deposited and earn return on them. So, seeing a good perspective they started collecting deposits providing small interest on it and then advancing loans charging a higher interest.

- Goldsmiths: Goldsmiths also play an important role in developing banks. They used to valuable properties like gold, silver, metals and coins too. They had sound credit standing in the society so they were very popular. Fear of theft and robbery led people to keep their valuables in the custody of the goldsmiths. Goldsmiths used to charge commission for safekeeping and used to return the valuables on demand. The depositors had to visit goldsmiths for part and full withdrawal of gold, silver and coins. Gold and silver used to remain with the goldsmith for a relatively long period but coins had to be withdrawn from time to time. In order to remove the inconvenience, goldsmith used to give receipts which were known as goldsmith's note. It was made payable to bearer on demand and soon they enjoyed circulation. Thus, we can regard goldsmiths as the profounder of promissory notes. From the above study we can conclude that moneylenders, merchants and goldsmiths are the ancestor of banking system.

"During the early periods, although the banking business was mostly done by private individuals, many countries established public banks either for the purpose of facilitating commerce or to serve the government. The bank of Venice established in 1157 A.D., in supposed to be the most ancient bank. Originally, it was not a bank in the modern sense, being simple and office for the transfer of the public debt."(shekhar and shekhar, 1992:1-2), In the world the word "bank" mainly recognized after the establishment of "risk bank" of Sweden in 1656, In the middle of 17th century, before the establishment of this bank, there had established other banks like bank of Bancelona (1401A D) and bank of Genoa (1407 A D) These banks played an important role for the development and expansion of the modern banking system in Europe.

Thus, banking is an old as trade itself and its simplest from was money managing. But, banking in its modern from dated back to 1100 A.D. "The first banks were in the great centers of international trade in the middle ages, these centers were in Italy, on the western shores of the Mediterranean and in the costal areas of northern and western Europe. General banking practice developed most rapidly in Italy. One of the earliest station banks was the vital of Venice, formed in 1157. it was formed as a result of forced loan made by merchants to the government of Venice, and it handled only government debt. The earliest deposit bank in Europe was the TAULA DI COMPI in Barcelona, Spain, established 1401. Medieval banking developed most in Florence, Italy and was closely connected with the wool trade. The most famous Florentine banking families were the 2500s, families such as the medicos of Italy and the foggers of Augsburg, German, succeeded the orders Florentine banking families as the lending bankers. The foggers were closely connected with the mining industry. In 2587, the first public bank was established. It was the bank of Venice, also known as the Banco di rialto or Banco Della piazza. The business of bank of Venice was entirely separated from merchant trading. Economist regard the bank of Venice as having started the era of modern banking . The spread of modern banking through Europe was rapid from the late 1600s on wards. In 1609, the Bank of Amsterdam was founded in the Netherlands, in imitation of the Bank of Venice. It was the first bank of its kind north of the Alps. The Bank of Hamburg was founded in 1619 and the bank of Nuremberg in 1621. By 1700 there were many private banks in Europe and more then 20 public banks. In England was formed as a public company, with capital subscribed by the number of shareholders. The bank obtained a monopoly in joint stock banking (banking carried on by public companies). This meant that for many years English Banking developed in the form of small privately owned local banks. Banking developed late in the United States. The first successful bank was the bank of North American, which opened in Philadephia in 1782." (The world Book Encyclopedia, 1966:63-64),

The history of bank in Nepal is not so old. Like other countries goldsmiths merchants, and money lenders were the ancient bankers of Nepal. In the past, there was merchant namely, "Sankhdhar" who paid all tile debts of people existing in the country at that time. Since then he introduced a new era called "Nepal Sambath. This record proves the existing of money Lending function at that time.

'Tejarath Adda' established during the tenure of the then Prime Minister Ranoddip Singh (B.S. 1933) was the first step towards the institutional development of banking in Nepal. Tejarath Adda did not collect deposits from the public but gave loans to the employees and public against the bullion. Banking in modern sense started with the inception of Nepal Bank Limited on B.S. 1994-07-30. Nepal Bnnk Limited had a Herculean responsibility of attracting people toward banking sector from predominant money lenders' net and of expanding banking services. Being a commercial bank; it was natural that NBL paid more attention to profit generating business and preferred opening urban centres, (Dahal and Dahal, 2002:10- 11)

Integrated and speedy development of the country is possible only when competitive banking service reaches nooks and corners of the county.

Keeping this in mind, government set up Rastriya Banijya Bank (RBB) in B.S. 2022.10.10 as fully government owned commercial bank. As the name suggests, Commercial bank are to carry out commercial transactions only.

But commercial banks had to carry out the functions of all types of financial institutions Hence, Industrial Development canoe (IDC) was set up in 2013 for industrial development. In 2016, IDC was converted to Nepal Industrial Development Corporation (NIDC). Similarly, Agricultural Development Bank (ADB) was established in B.S. 2024.10.07.t0 provide finance for agricultural produces so that agricultural productivity could be enhanced by introducing modern agricultural techniques. More over Security Exchange centre was established in 1976 to enhance capital markets activities.

Securities Exchange Centre was renamed Nepal Stock Exchange (NEPSE) th in 1993. NEPSE opened its trading floor on 13th Jan 1994(Dahal and Dahal, 2002.11). Thus the concept of bank was not developed at once. It is the result of gradual evolution for long period. Banks provide a wide range of services to the people so banks have become an essential in modern society.

The lexis 'Banking' is a derivative of the terminology "banks". Bank itself is an organization engaged in any or all of the various functions of banking viz, receiving, collecting, transferring, paying, lending, investing, dealing, exchanging and servicing (safe deposit, trusteeship, agency, custodianship) money and claims to money both domestically and internationally".(NRB Prashikchan,2060:147)

The principal type of banking in modern industrial world is commercial banking and central banking. A commercial banking is a dealer in money and substitute for money, such as checks or bills of exchange. It also provides a variety of financial services. The basis of his business is burrowing from individuals, firms, and occasionally government i.e.; receiving "deposits" from them, with their recourses and also with its own capital. The banker makes loans or extends credit and also invests in securities" (Encyclopaedia Bvitannica, 1981:699- 700) Thus to maintain banking system a bank must have cash balances on hand in order to pay its depositors upon demand.

Another type of banking is carried on by central bunks. Central barks are banker to governments and "lender of last resort" to commercial bunks and or facial institutions. Heavy are often responsible for formulating and implementing their country's monetary and credit policies, usually in co-operation with government," (Encyclopaedia Bvitannica, 1981:699- 700) . There are other institutions, other than central banks, often called bunks, such as Saving Banks, Development Banks, Investment Banks, Co-Operative Banks, Finance Companies, merchant bank, trust Companies and Building societies, Export and Import Bank (EXIM) do not perform the banking functions but are best to know as financial intermediaries. But they take part in taking deposits and landing money, and credit money, Three tapes of banks viz., commercial banks, saving banks and central banks are main banks.

A commercial banks means the bank which deal in exchanging currency, accepting deposit, giving loans and doing commercial transactions, Commercial Bank Act, 2031

Saving banks is such type of bank which accepts deposits on a longer-term basis than commercial banks. Such deposits are repayable only after short notice, not on demand. But, saving banks make loans for longer period in comparison to commercial bank.

There are different logics enhanced on the definition of central banking. V. Smith had said that the primary definition of central banking system in which a single bank has either complete or residuary monopoly in the note issue. But R.W. Hawtrey regarded that the central banking is basically related with lender of the last resort function. On the other hand, A.W.'

Shaw was more concerned with credit control function while defining the concept of central banking. The Bank of International Settlement (BIS) has urge; that the central bank is the bank to which has been entrusted the duty of regulating the volume of currency and credit in the country. For a common understanding we can say that the central banking is that system which is empowered by the law is meant as a sole agent to issue and circulate notes and coins, to control the monetary and banking system and to maintain external as well as internal stability. In this regard what ever the definitions enhanced so far? basis crux is on the efficient regulations, monitoring and supervision of the banking system by the central bank for the betterment of the country.

Although other remaining banks do not perform the banking functions so allele but is best to know as financial intermediaries. They also play the vital role for the development of the Nation. Development Banks are established for the development of certain sector. They collect fund from share capital, debentures, long term deposits and refining from central banks. They normally give long term loan and provide technical and other advice as well."(Dahal and Dahal 2002:18).

Nepal Industrial Development Corporation and Agricultural

Development

Bank are development banks established for the development of industrial and agricultural sectors respectively.

“Export and Import Banks deal in foreign exchange and specialize in foreign trade. They open LCs and G'tees in foreign currencies. They make financing for export and import transactions, supplies information about foreign exchange; execute swap, forward contract, remittances, discounting bills etc.” (Dahal and Dahal 2002:18). Since there are no exim banks in Nepal, commercial banks discharge the function of EXIM banks.

Building Societies give loan for the construction of buildings. Nepal Awash Bikash Bitta Company (2049 B.S) is the first such a finance company in Nepal.

Co-operative banks underlying purpose of Co-operative bank is a cooperation among member. They collect deposit among members and give loan mainly to members only. Navjeevan Cooperative Society Limited, Dhangadhi is the first co-operative bunk of Nepal.

Merchant Bank deals with the acceptance of bill of exchange, the issue and placing of loans and securities, portfolio and unit trust management, forex dealing and some banking services. They also advise companies on acquisition, mergers and other financial matters. In Nepal Finance companies are involved in merchant banking activities. Merchant Banking and Finance Limited and NIDC Capital Market Limited have been found active in the merchant banking activities.

All types of banks are important to every country for the growth and development of the nation. Banks creates credit and also it expands business by developing a system of branches. “Banks with branches can use surplus deposits from one area to provide loans in areas where funds are inadequate to meet the needs of local borrowers”. (The world Book Encyclopaedia, 1966:62), in most countries legislation related to commercial bank is similar although it is adapted to differing political system and economic situation.
The government of most countries have right to back inspection.

2.1.2 Central Bank-Concept and Functions

The concept of central banking is of recent origin. Prior to the commencement of twentieth century there had been no clearly defined concept of central banking. But as the time changed, there is no country in the world which does not have a central bank. It is the bank that works as the leader of the money market. It is the chief of all banks operating in a country. It supervises, regulates and controls the functions of commercial banks and other financial institutions. The central bank also works as the baker to the government and advises the government on several matters. It is the only organization who monitors the whole economy of the country.

Therefore, central bank is an important financial institution in every sovereign independent country in modern times. It is the apex of economy's banking system. Central bank is the central arch of the monetary and fiscal framework in every country of the world and its functions are indispensable for proper functioning of the economy and fiscal operations of the government.

The history of central bank is very old. In twentieth century, most of the banks in England, France, and Sweden etc were assuming more power that not considered them central banks. They were enjoying the right of note issue and were acting as the banker for the government and some times works as an agent for the government as well in the financial matters.

However, they were not known as central banks but referred as the banks of note issue or national banks. The oldest central bank is Riks Bank of Sweden which was established in 1656. The bank of England came in 1694.

The bank of England is the first bank to work as the position of the central bank and to develop all the fundamentals of central banking which are under operation. “The fundamentals, principles and tools and instruments developed by the bank of England were universally accepted by all the banks all over the Country." (Vaidya, 1999:50)

The successful functioning of Bank of England forced other counties to think about the concept and principles of the central balks.

As a result, The Bank of France was established in 1800 with the assistance of State Funds and private capital. Similarly, the bank of Russia was established in 1860 as a state bank. The objectives of the bank were to control monetary circulations, manage debt of the Russia and consolidate the whole of Russian Empire. In order to manage currency, Bank of Japan was established in 1882. These growing trends central barks made possible to almost European countries to have a central bank by the end of 19th century.

Where as the Federal Reserve System was established in 1914 to operate the functions of central bank. The international financial conference held in Brussels in 1920 encouraged all the European countries to establish a central bank in their respective countries. A resolution was passed in this conference those countries which had not yet established a central bank should proceed to do so as soon as possible, not only with a view to facilitating the restoration and maintenance of stability In their monetary and banking system. But in the interest of the world co-operation." The bank of Netherlands was founded in l814 on the ruins of old bank of Amsterdam. The national bank of Austria is the result of the reorganization of bank of Austria Hungary in 1877, was established in 1817 to mange deteriorated situation of over issue paper currency. In nineteenth century, the bank of Norway, The National Bank of Copenhagen renamed The National Bank of Denmark; the Bank of Spain was also established in 1817, 1818 and 1856 respectively. Today the number of central bank stands over 150. The above resolution has encouraged lot of countries to establish central banks in different part of the world. The establishment of international monetary fund, which is the highest body in the world to control monetary systems, in 1944, facilitated the starting of central banks in Asia and Africa. Today, central bank is a common organization for managing economic system in any country in the world. Central banks have became and important organization of the government. Previously, central banks privately owned and in the form of joint stock bank. In other words they were managed by the shareholders of the organization. It is because the subjective of the bank was to finance to government from the private sector's (Vaidya, 1999:50 -51).

By seeing the development of central banking, it can be defined as an institution taking a responsibility of issuing currency or managing the expansion and contraction of the volume of money and also act as banks of government and for other banks. Central bank is the bank who acts in accordance with government policy as guardians and controllers of a country's monetary system, issuing notes and coins to the public, and providing the chief financial link between a country's financial system and the rest of the world's (The World Book Encyclopedia, 1966:60) “The guiding principle for a central bank whatever functions or group of functions it performs at any moment is that it should act only in the public interest and without regard to profit as a primary consideration”. (Dekock, 1974:16-17)

The meaning of central bank has been defined in different ways according to situation and needs. Different authors have given different definitions for central bank. Therefore, it is very difficult to give a precise definition of central bank. The momentum took place when it started to work as the bankers bank much later not as the privately owned bank as discussed. That is why, the meaning of central bank varied according to time and situation.

In this context Dekock observes, "central bank have developed their own code of rules and practices, which can be described as the art of central banking but which, in a changing world, is still in process of evolution and subject of periodical readjustments. In the past, there was no much difference in the meaning and dentition between and ordinary bank with the central bank except in some areas.

According to M.H. Dekock, (a central bank is a bank which constitutes the apex of monetary and banking structure of its country and which performs, as best as it can in the national economic interested, which are as follows:

- The regulation of currency in accordance with the requirements of the business and the general public for which purpose it is granted either the sole right of note issue or at least as partial monopoly thereof.
- The performance of general banking and an agency services for the country.
- The custody of cash reserves of the commercial banks.
- The custody and management of the nation's reserves of the international currency.

- The granting of accommodation, in the form of discounts of collateral advances , to commercial balks, bill brokers and dealers, or other financial institutions and general acceptance of the responsibility of lender of the last resort.
- The settlement of the clearance balance between the bunks; and
- The control of credit in accordance with the needs of business with a view to carrying out the broad monetary policy adopted by the country.

Dekock further elaborated the definition of central banks by, "A further requisite of real central bank is that should not, to any great extent, perform such banking transactions as accepting deposits from the general public and accommodation regular commercial customer with discounts and advances.

It is now almost generally accepted that a central bank should conduct direct dealing with the publics only in such forms and to such extent as, in the circumstance of the particular country, it considers absolutely necessary for the purpose of carrying out its monetary and banking policy."

Kisch and Elkin define central banking as, "The maintenance of stability of country standard which involves the control of monetary circulations."

The International Bank for the settlements defines a central bank as, "The bank in any country which has been entrusted the duty of regulating the volume of currency and credit the country."

According to Hawtrey, "The central bank is to act as the lender of the last resort."

Vera Smith defines it as, "The primary definition of central banking is a banking system in which a single bank has complete or a residuary monopoly in the note issue."

The central banking is entirely different from commercial or other branches of banking and that its main aim is to serve in the public interest and not to secure to profits. The functions of central bank and the obligations resting upon it are of a very special character calling for skill, experience and judgment of a kind different from those, which must be possessed commercial banks. No banker can neglected the rule of credence and safety, but the object of commercial banker is to make a profit. The situation of a central bank is such that it must often undertake operations which are not only profitable, but result in losses, its aims must be the economic welfare of the country's (Shekhar & Shekhar, 1999:523).

A Central Bank is the most important financial institutions of the country because it manages the expansion and contraction of money supply and economic development in the country. Central bank is the important factor for the financial mobilization of the country. Central bank is the government's bank world over like it is the head of monetary and banking sector. It formulates monetary policy. The central bank plays a significant role in developing country to develop the banking system for the mobilization of resources and using them in the priority areas to match development plan's". (Pant, 1971:38)

In appearance the main distinction between a central bank and a commercial bank is that nowadays, the central bank does not involve much in banking, but the more fundamental different is one of aim. The commercial bank thinks primarily of making a profit, whereas the central bank thinks the effect of its operations on the working of the economic system. A commercial bank has its shareholder and is expected to do the best it can for them. But the government by contrast, usually owns the central bank. The commercial bank may be few or many and they are to the found doing business with the general public all over the country. There is only one central bank in each country. It has few officers and it does little, if any business for the general public. Its market operation are mainly impersonal and confined to what is necessary for influencing the country's financial business in the directed by economic policy." (Sayers 1967:17-18)

The central bank is referred in different names particularly reserve banks in most countries. The logic behind the name has also equal significance as it has full right for bank reserves which is one of the peculiar functions of the central bank. According to the above definitions, we can summaries it as. an organization that is authorized to manage the whole economic system in country, maintains the cash reserves of the commercial banks, issue notes and work as a lender of the last resort to all commercial banks. It also works as the banker to the government and to commercial banks. It is the only organization who has full authority of note issue and manages the currency.

The central bank is the non profit organization although it generates profit in the course of its function. In short, the objective is to serve the board national interest in monetary matters and to support the economic policies of the government.

The basic objective of most of the central billet is to act as a promoter of monetary stability and a catalyst of a sound financial structure. Issuing currency and working as a government's banker and financial advisor is also considered as the primary objective. It is said that in order to meet the objective, central balks have their own guiding principals in promoting the economic and financial interest of the economy without regard to macroeconomic stability as a basic consideration. Any central bank, therefore, carries out its primary functions within the context of broader oral. of promoting sound, healthy and efficient economic and financial sector, maintaining price stability and ensuring a sound balance of payment system and situation in the country. Besides this some central banks, mostly in developing countries, focus on attaining a high level of employment, reducing poverty and restructuring financial system in their quest for the primary goal and accordingly frame their core functions to attain these several goals. Whatever the objectives or goals set by the central bank, the several interest of the central bank is to ensure the availability of money and credit in the economy at the desired cost and volume. In this context any central bank would perform various functions as the banker for currency issue custodian of international reserve, safeguarding the value of the currency and banker and financial advisor to the respective government.

These objectives and functions are well addressed through formulation and implementation of monetary policy and overall management of financial system. In a simple language, the general price level which is also known as the average exchange rate for money against all goods and services, and its changes over time, plays a significantly important role in any society simply because it influences the nature, scope and fundamental characteristics of any country's economic and social relationship over the period of time. It is, thus up no wonder that the central bank of the country becomes unlimited guardians of the purchasing power of money.” (N.R.B Prashikchan, 19611:136). Whatever the decorative phrases we do use to portray the role, capable and relevance of the central bank, the unlimited responsibility is the management of money. “For at root money - serving as a store of race and medium of exchange- is the lubricant that enables the society to recognized itself to achieve economic growth.”

The first concern of a central bank is the maintenance of a soundly based commercial banking structure. While this concern has grown to apprehend the operations of all financial institutions, including the several groups of non-bank financial intermediaries, the commercial banks remain the core of the banking system. A central bank must also co-operate closely -with the national government. Indeed, most governments and central banks have become intimately associated in the formulation of policy” (Encyclopedia Britannica, 1981: 708), Thus, it is difficult to lay-down any hard and fast regarding the function of the central bank. The powers and the range of development functions may be vary in different countries as depend upon country's need and economic condition. Mostly some development functions are to found importance.

Monopoly of note issue: generally central bank enjoys the monopoly of note issue of various denominations and supplies to the market as per requirement. There are various systems regarding note issue. The system of a central bank differs from others. In Nepal, Nepal Rastra Bank issues notes based on proportional reserve system. This power of central bank enables them to regulate and control money supply in the country" (Dahal & Dahal, 2002:25). Free of the most important functions of a central bank is the issue of legal tender currency, the main reasons for the concentration of note-issue in a Central bank may be found in the necessity of bringing about uniformity in the note circulation of a country and of avoiding the anomaly of over-issue by many balks established with the primary motive of securing profits. Further, the monopoly enjoyed by a bank, which has close connections with the state, confers on the notes a distinctive prestige. 'These notes are capable of commanding public confidence. Above all, the vary basis of monetary management is closely correlated with the capacity of a central bank to vary the total amount of legal tender currency according to the requirements of trade and industry. Thus, it invariably fallows that a central bank, which is endowed with the necessity powers of monetary management, must be equipped with the monopoly of note issuers (Shekhar do Shekhar, 1999:5234, thus, no other bank the central bank is authorized to prince currency notes. In this regards, Deblock explains, “The privilege of note issue was almost everywhere associated with the origin and development of central bands. In fact, until the beginning of twentieth century, they were generally known as banks of issue.” Thus we can say that a central bunk is the producer of currency in a country.

- Custodian of cash reserves of commercial bank: The centralization of cash reserve's in the central bank in a source of great strength to the banking system of any country. Centralized cash reserves can at least serve as the basis of a larger and more elastic credit structure than if the same amount were scattered among the individual banks. The centralization of cash reserves is conductive to economy in their use and to increased elasticity and liquidity of the banking system and of the credit structure as a whole but only in an indirect manner. It is, in fact, tie central banks function of rediscount and lender of last resort, which directly serves to promote such economy, elasticity and liquidity” (DeKock, 1974:58-59). This central bank is the bank, which is the custodian of the commercial bank's cash reserve. These functions of central bank associated with the function of bank of issue and Government's banker.

- **Government's Bank:** central bank discharges following tasks for the government:-
  - Advice to the government on various aspects of the economy.
  - Maintenance of accounts of government bodies.
  - Fund Transfer, LC and Guarantee transaction for government bodies.
  - Rising of public debt.
  - Overdraft facility to government.

- **An advisor & Banker to the Government:** Another most important function of a central bank is an advisor & bankers of government. “In every country, the government receives and spends huge amount enough taxation. The government receives taxes and borrows large sums from the money market. Such multiple financial operations of the government are likely to have a disturbing influence on the money market. The central bunk gives appropriate advice to the government in operating its financial matters. Another banking service rendered by the central bank to the government in the provision of the necessary foreign exchange required to discharge the obligations of the government in connection with the foreign trade of the country. Another function of central bank is to arrange short term loans and advances to the government in anticipation of collection of taxes. (Vaidya, 2001: 72-73}. Hence,

central bank discharges asks for the government such like advice to the government on various aspects of the economy, fund transfer letter of credit and guarantee transaction for government bodies maintenance of accounts of government bodies, rising of public debt etc.

- **Credit Control:** commercial bunks create credit by giving animal. Creation of credit means creation of money. Creation of credit is good for economy to a certain level only. However, excess credit creation can have serious repercussion on the stability of price and foreign exchange. Depending upon the need of economy, central bunks contract/expand commercial bank's capacity to create credit through bunk rate, Statutory Liquidity Ratio and open market operation" (Dahal & Dahal, 2002:26).

- **Lender of the last resort:** When and they cannot collect from other sources, they knock the door of the central bank elemental bank as the lender of the last resort gives loans to banks with or without securities. Though central banks try to rescue failing banks in a number of ways, it will not be prudent for every bank to except all types of support from central banks. Central banks normally rescue those banks which are 'too big to fail' and the banks which can be revived. The rate central bank applies while lending money is known as the 'bank rate' or 'refinance rate'. "(Dahal & Dahal, 2002:27).

- **Management of foreign exchange:** ha central bank is entrusted with the responsibility of managing foreign exchange (forex) of the country. Since forex has a direct link with country's international trade, remittance and movement of capital, caution should be exercised while making any rules. In economically advance countries, we she an uninterrupted movement of capital. Central banks in such countries let the market determine exchange rate but do not hesitate to intervene in the market if it deems the prevailing exchange rate is inconsistent with economic fundamentals. Country to this, central bank in the developing counties exercise control's all the aspects of foreign exchange but the wave of liberalization has forced them to develop their power. Nevertheless, it should act like a watch dog to ensure that the country does not face balance of payment (BOP) problem" (Dahal & Dahal, 2002:25-26).

- **Bank of central clearance, settlement and transfer:** "In the absence of a central agency for clearance and settlement each bank has to enter into a separate clearance and settlement transaction with other balks individually which is very inconvenient to all Banks (Vaidya, 2001: 74). Hence, central bank plays a role as the clearinghouse for settlement. It operates as the clearinghouse for all its related banks as a matter of mechanism or of bookkeeping.

  About the middle of the nineteenth century bank of England developed the function of central clearance and settlement. There after the other banks gradually took it up. Although not usually regarded as an important factor, central clearance and settlement has generally been accepted as a necessary function of central bank.

- **Regulation, supervision and control:** A central bank is the supervisor of the financial sector. It makes regulations for operation of financial institutions. It gives license to them for operation, makes regulation regarding Statutory Liquidity Ratio (SLR), Cash Reserve Ratio (CRR), capital adequacy, interest structure, foreign exchange, credit portfolio, loan classification and provisioning, income recognition, to name a few, in the same direction. It regularly monitors to ensure proper implementation of its rules. In case of violation, it takes different types of actions. A central bank is empowered even to snatch the license of operation" (Dahal to Dahal, 2002:25)

- **Other miscellaneous function:** Central banks collect periodic data to know the fiscal and monetary condition of country. They publish periodic data with regard to balance of payment, international trade, money supply etc, and also they organize training for the employees of various financial institutions for the development of sound banking system. The Reserve Bank of India had established (Banker's Training College' in 1954. Similarly Nepal Rastra Bank had also established 'Banker's Training Centre' in 1978. Apart from it central banks makes available reports, information to the commercial banks and other financial institutions by arranging seminar, carrying various surveys etc.

Above all developing functions are very much important for the development of sound banking system and corporate governance. Both of developing and un-developing countries financial institutions play the vital role for the economic growth of nation and a central bank is a guardian of financial institutions. There are some principles of central bank. According to the Encyclopedia Britannica, the principles of central banking grew up in response to the recurrent British financial crises of l9th century. The cause of the fluctuations in output and employment make the banks cautions enough in maintaining its liquidity position. This raises the need for a disinterested outside authority able to view economic and financial developments objectively and to exert some measure of control over the activities of the banks. A central bank must also cooperage closely with the national government. Indeed, most central banks and governments have become intimately associated in the formulation of policy.

* **Open market operations:** Deliberate and buying and selling of government and other an approved security in the money market by the central bank, on its own initiative is called open market operations. Broadly, open market operations include purchase and sale by the central bank in the market of government securities, other securities, banker's acceptances and foreign exchanges. It is very simple to understand this principle. During boom, a period of dangerous for economy stability, the central bank sells the government and other approved securities from its securities portfolio in the market to reduce the aggregate supply of money in the economy. Buyers of these securities pay the central bank by drawing on their cash deposits in the barks. It pearls the reduction of size of bank's deposit held with central bank. Reduction in their cash reserves

forces the balks to reduce their advances and refuse future loans. On the other hand, in slump economy, the central bank buys the government and other securities by paying cash. As a result, it increases the cash reserves of commercial bunks which are used to support additional loans." (Vaidya, 1999:62-63)

The central bank and national economy: since no modern economy is self-contained, central bank must give considerable attention to trading and financial relationships with other countries. If goods are brought abroad, there is a demand for foreign currency to pay for them. Alternatively, ' if goods are sold abroad, foreign currency is acquired that the seller ordinarily wishes to convert into his own currency. These two sets of transactions usually passed through the banking system. (Encyclopedia Britannica, 1981:708. The objective may be achieved more directly by reevaluating a country's exchange rate.

- **Relationships with commercial banks:** the willingness of a central bank to offer support to the commercial banks and to other financial institutions in time of crises was greatly encouraged by the gradual disappearance of weaker institutions and a general improvement in bank managements (Encyclopedia Britannica, (1981: 700)

- **Responsibility to the government:** Over the years central banks have acquired the number of well defined responsibilities to their respective governments. It has become the matter to accept responsibility for the financial affairs of the government. “As banker to the government, furthermore, the central bank has an obvious responsibility to provide routine banking services, such as arranging loan flotation and supervising their service Renewal and redemption”. (Encyclopedia Britannica, 1981:709)

- **Direct actions:** Direct action refers to coercive measure taken by the central bank against an offending commercial bank or financial institution. In other words, it is a refusal to rediscount or grant further rediscount facilities to the defaulting banks. It also includes directives to banks generally concerning their lending and investing operations. More precisely, direct action refers to all forms of controls and direction which the central bank may enforce upon the entire banking system or upon a particular bank or bank concerning lending and investment. Direct action also takes the form of charging a penal rate of interest for money borrowed beyond the prescribed amount of refusing to grant further rediscounting facilities to. The offending backs". (Vaidya, 1999:62- 64)

- **2.1.3 Importance of Central Bank:** A central bank performs a number of important functions which assist. Directly in national development. Further, most of the countries in the world have established central bank in their respective countries. It is obvious from this that its importance cannot be ignored due to its importance in monetary and fiscal management in a country. According to Shakespeare Vaidya (1999:55-56), there are some importances of central bank:-

- **Objectives:** The objective of central bank and other commercial banks are different with one another. The objective of a central bank is to assist the government in the implementation of economic policies without any profit mobilization whereas the objectives of remaining banks is to earn profit mobilizing funds form the general public.

- **Banker's Bank:** Central bank is the banker's bank. In other words, it monitors and controls whole of the functions of banks operating in a country. It assists in healthy competition among banks in a country. Hence, its presence it important

- **Origin of Banking Policies:** A central bank is the origin of all banking policies under which all the banks are suppose to operate.

Therefore, a central bank guides and assists in operating banking system as a whole.

- **Monetary Control:** It is the only bank who reserves right to issue notes and currency. It issues currency after full analysis of unemployment, inflation, and economic growth etc. of a country.

- **Lender of the Last Resort:** The central bank also acts as a social worker. In case of any problems and emergency to any of the banks operating under it, central bank comes forward to rescue them temporally from such problems. No other bands will be interested and assist as well voluntary to other bad. Hence, central bank is important for such difficulties also.

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

- **Banking Regulatory Authority:** A central bank has full authority to interfere in the banking market i.e., to all banks in terms of implementing its policies. It can penalize the banks in case they go out of the central bank's policy or the termination of the license and out o also can restrict their working dimensions to a large extent.

2.1.4 Commercial Bank- Concept and Functions

The bunks which perform all kinds of banking business are known an commercial banks. Generally commercial banks deal with finance, trade hand commerce. Since their deposits are for a short period these banks normally advance show- term loans to the businessmen and traders. They specially avoid long. term landing. Majority of the commercial banks are in the public sector. They are established with the capital collected by issuance of share in public. Hence the commercial banks are also called joint stock banks. A commercial hank is a business bank or profit earning institution. Banks are intermediaries in following funds from those who have surplus money to those who need it. This bank collects (saving) money scattered in a country and provides short-term loan to the entrepreneurs and individuals.

Commercial banks are the organized on a joint stock company system, preliminarily for the purpose of earning of profit. They can be either of branch banking type with a large network of branches or of the unit banking type. Although the commercial balks attract deposits of all kinds' current, savings and fixed their resources are chiefly drawn from current deposits, which are repayable on demand. So they attach much importance to the liquidity of their investments and such they specialize in satisfying the short term credit needs of business rather than the long term."

The commercial banks invest in securities of many classes of issue. Some of the larger ones buy and sell government securities in capacities as dealers, and almost all are willing to act as agents for their customers in executing orders to buy and sell securities of all kinds. The larger commercial banks, too, maintain the great bulk of foreign exchange facilities, and many smaller ones have corresponded relationships with these banks to enable them also to buy and sell foreign currencies (Kent, 1972:209). The bulk of the deposits commercial banks accept from the public are of short- term maturity. Therefore, most of their lending is confined to short-term purpose. Their lending activities are concentrated heavily on low risks high profit commercial activities. However the lending operations of commercial banks have undergone considerable charges over time. These balks now provide finance for production purposes in agriculture and industry. They also take part in medium and long-term project lending, usually sharing the risk with other agencies through syndicate or consortiums.

"Although commercial banks are privately owned business enterprises they have been given the extraordinary power to create money in the form of demand deposits, all well as to extinguish money so create" (Kent, 1972:323).

Commercial banks are 'financial intermediaries' for they also borrow from those who are not immediately spending all their current receipts and they lend to those who have intentions of immediate spending in goods beyond the range of their own current receipts." (Sayers, 1967:17)

Among all commercial bank is the perfect example of financial intermediately. Commercial banks are not only to carry out commercial transaction but also had to carry out the functions of all type of financial institutions. Thus the commercial banks are the heart of financial institutions which hold the deposits of public & government and make funds available to borrowers such like governments individuals etc. They affect the monetary policy of country because there are media which provide our medium of exchange. Hence the most important type of financial institution in every country in commercial banks in term of aggregate assets. The typical commercial banks have a very large number of branches scattered all over the countries.

At present, the function of commercial bank have been widely developed and extended. 'Therefore we can not exactly say all functions. However we can discuss its major functions under following heading.

A) **Accepting Deposits or Borrowings:** Banks attract the idle savings of people in the form of deposits. These deposits may be current, saving and fixed accounts. Current account or demand deposits are repayable on demand without any notice. Usually no interest is paid on them because the bank cannot utilize short term deposits, and must, therefore, keep cent percent reserve against them on the other hand, a little commission is charged for the services rendered by it. Fixed or time deposits can be withdrawn only after the expiry of the period for which these deposits have been made. Higher rate of interest is paid in this account because bank can invest such amount safely for certain period. Time may range from three months to several years. The usual rate in Nepal today varies between 10% and 13% depending upon the time period for which deposits are made. Saving deposits stand midway between current and fixed deposits. Depositors cannot be withdrawn savings as soon as they need. Only limited amounts can be drawn at a time as allowed in a week.

The rate of interest in such account is less then that on the fixed deposits.

B) **Giving Loans/ Lending:** After collecting money by way of deposits, a bank invests it or lends it out. The bank earns profit by giving amounts deposited with it in the form of loans. Since the bank creates credit with its deposit, it is cried manufacturer of credit. According to traditional concept commercial bunks can grant only for show- term credit. Bus nowadays, it also provides long-term credit loan advanced by the bank can be in any one of the following ways:

- **Cash Credit:** Cash credit is a way of lending by the balks. When a person wants a loan from a bank he/she has to satisfy the manager about his ability .to repay, the soundness of the venture and his ' honesty of purpose. In addition, bank 'may require a tangible security like shires, debentures, just personal guarantee etc. Loans are deposited in current account and borrower can draw required amount. He has to pay interest on these withdrawn amounts, Principle along with interest has to be paid the period expires.

- **General Loans and Advances:** These are generally long-term 1 b ked by adequate security like gold silver, securities, which Mrs K , are easily marketable, stable in value and liquid. Some barks offer h 1 loans without security for reliable clients of good t e persona , prestige and credibility. The bank charges interest on entire amount of loan. The loan provided against export bills is called advances.

- **Bank Overdraft:** Sometimes bad permit their clients to overdraw their accounts i.e. to draw more than the amount deposited. This is IIrlowlz as overdraft loan. The amount of permissible overdraft varies with the financial position and credibility of the clients.

- **Call Loans:** Short loans are called call loans. Such loans are given for short period of time. Interest along with principle must be returned on expiry. Usually interest rate on such loans happens to be high.

- **Discount of Bills:** The bank provides loan by discounting bills such as bills of exchange. Investment in bills is considered as the best hand safe investment by banks. After the maturity of the bills the bank receives full payment of the bill. The commercial bank make the bills rediscovering by the central bank encase off the sites of money.

- **Credit Creation:** Commercial backs create credit on the basis of deposits. They hold a pertain portion of- cash reserve to meet obligations. The rest of the deposit amount is invested in loan financing which yields higher rates of interest as compared to those payable on deposits. Loan issued are not cash amounts. Loans are deposited in current account in the name of borrowers. Deposits amount with loan Borrowers draw as when necessary. Commercial bank 11 ' s a orate a specific amount of gash sr this necessary. The remaining portion goes for further loans that are again deposited in borrowers account. Thus loan creates deposit which again creates loans. This is credit creation. Money many times in excess of actual amount of deposits is created therefore banks are manufacturer of credit.

C) **Miscellaneous Functions:** the sanctions other than main functions are called agency functions. The bank charges minimum fee for undertaking such agencies. This agency function and other functions can be explained as follows:

- **Remitting Funds:** Banks remit funds for their customers through bank drab to any place where they have branches or agencies. This is the economical and sat: way of sending money.

- **Income Receiving and Payment:** Thee bank receives the dividend, interest on shares and debentures etc and makes payments of insurance premium, rent, income tax, electricity bills etc. periodically.
- **Purchase and Sale of Securities:** The commercial bunks discount the securities of the businessmen and make them cash payments. Businessmen may not have to wait for the maturity date due to this facility. Banks also sale securities on the order of customers.

- **To Issue Letter of Credit:** A letter of credit acts as mediator between businessmen and barks. It has provided extensive facilities to businessman and industrialist around the world.

- **Trust and Attorney:** Commercial Banks works as I the administrator, trustee, executor and attorney in settlement of will and accounts of the customers.

- **Safe Custody:** Ornaments and valuable documents can be kept in safe deposit with a bank in its strong lockers, on payment of small charge. Thus the risk of theft is avoided.

- **References:** Bank provides references about the financial position of their customers when required. This is done when the customers want to establish business connections with some new firms within or out side the country.

- **Issue credit Instruments:** The bank issues traveller's cheques, dry and Master Card to the customers.

The two essential functions pf commercial banks may best be summarized as the borrowing and lending of, money. They barrow money by taking all kinds of deposit- Deposits may be received on current account where by the banker incurs the obligation of paying legal tender after the expiry of a fixed period or on deposit account whereby the bankers undertakes to pay the customer an agreed rate of interest on it in return for the right to demand from him an agreed period of notice for withdrawals. Thus a commercial banker, whether it is through current account or fixed deposit account, mobilizes the savings of the society. Then he provides this money to those who are in need of it by granting overdrafts or fixed loans or by discounting bills of exchange or promissory notes. Thus, the primary function of a commercial banker is that of a broker and dealer in money. By discharging stint's function efficiently, a commercial banker fenders very valuable service to the community by increasing the productivity capacity of the country and There by accelerating the place of economic development. He gathers the small saving of the people, thus reducing to the lowest limits idle money.

Then he combines there small holdings in amounts large enough to be profitably employed in those enterprises where they are most called for and most needed. Here, he makes capital effective and gives industry the benefits of capital, both of which otherwise would have remained idle. Take for instance, the practice of discounting bills. By converting future claims into present money, the commercial banker bridges the time element between the sale and actual payment of money. This enable the seller to carry on his business without any hindrance and the buyer will get enough time to realize the money. Thus we have seen that a banker receives deposits, which he has to repay according to his promise, and makes them available to those people who are really in need of them. He is actually distributing his deposits between the borrower and his own vaults. Herein lies the most delicate of the function of the commercial banker.

2.1.5 Modalities of Banking: There are several popular modalities of banking as follows; nevertheless, these modalities may differ country to country. corresponding to their stage of economic development, size of the economy, existing political and legal system viz. federal as well as state system as in USA or India, level of urbanization, size of the population, historical background of the country, level of the infrastructural development etc. here in this paper, few banking models have been discussed in short.

- **Commercial Banking:** Traditionally, the phrase 'commercial banking' has been used several times but has not yet been defined clearly. lf relate this term with so called 'commercial Loan Theory' of banking, the bank assets (except for cash) should consist exclusively of commercial loans, that is short term loans to business for financing the production and transaction of goods and holding inventories. But in practice, banks are no longer the exclusive suppliers of credit for financing short term business needs and banks hold today many long term assets including long term loans to business and government. Thus, if we take commercial banking, as literal meaning, it can be misleading. Thus in present day situation, it should be taken as an entity carrying out the commercial activities either long term or short term or the both.

- **Dual Banking:** In a general perspective, commercial banking is highly regulated business to start in most of the countries. In other to commence a new bank, it is first necessary to obtain permission of the respective authority either from government or the monetary authority as per the concerned countries' own internal law. If we cite example of the United States, there is a dual nature of governance of the political and legal bodies viz. central (or Federal) and State System. So far the implementation of the rules and the regulation is concerned. State are free to make and launch separate laws and rules within own state. In such countries, banks can be established under the Central Law (Charter) or State Laws. Thus, there may exit two types of banks either regulated by the National (Central) Law or by the State Law and it is known as 'Dual Banking'. This system is very popular in the US because several concessions and facilities are available there offered by the State Government. This type of dual political and economic system is seen in India also. In Nepalese context, we can not find this type of dual banking system. However.

Initiating a new bank in Nepal also requires approval from Nepal Rasta Bank.

- **Unit banking:** A commercial banking institution operating a single banking office and is not controlled by any other corporation or bank is known as 'Unit Banking'. This banking system is popular in the USA. So far the Nepalese system is concerned; this type of concept seems still to come.

- **Branch Banking:** A single banking corporation that offers a full line of banking service in two or more office is called branch banking. This type of banking practice is seen over the world, say, from USA, UK, and Canada to Burma, Somalia and Nepal etc.

- **Bank Holding Companies:** In 1970s, there was a movement of opening up of the bank holding company in the US. A bank holding company (BHC) is a holding company that owns the controlling interest in one or more banks. In order to hold the banks by the company, it ought to acquire approval from the Monetary Authority as per the separate law especially designed for this purpose. This concept is known as ‘group Banking’ also.

- **Chain banking:** Chain banking is very similar to holding company except that the holding company device is not used. Instead, a banking chain is held together through ownership of two or more banks by the individual, by members of the board of directors of the banks (inter-linking directorates) and the like.

- **Correspondent Banking:** The mechanism knitting the banking system together is known as correspondent banking. In general, the small banks place their deposits in the city banks nearby. The city banks, in turn, place their deposits in the grant banks in the metropolitan or regional big cities and so on. And these banks keep reciprocal deposits with one another. In this manner, a web of banking relationships is built up that ultimately connects each bank in the economy to every other. In this course, the small bank's that owns the deposit in the city bank nearby is the respondent bank and the city bank that holds deposit for the small balks is called the correspondent bank and thereby a collective name of this system is termed as correspondent banking system.

- **Electronic Banking:** Electronic Banking, more commonly called the Electronic Fund transfer System (EFTS), is simply the application of the computerized technology to the banking system. There has been observed different types of mechanism in practice while rendering the electronic banking services e.g. Automated Tailor Machine (ATM), Point- of-sale (POS) System viz. computer terminal in retail stores that arranges the information and fund from the bank deposit of the customer to the bank deposit of the store, Automated Clearing House (EFTS), and computer net- working in the whole banking system to assist and assure the quick and/or quality banking services. After the promulgation of caber law, E-banking is becoming even more popular. However, this law hasn't been in existence in Nepal yet.

- **Central Banking:** The central bank is referred in different names particularly reserve banks in most countries. The logic behind the name has also equal significance as it has its full right for bank reserves which is one of the peculiar functions of the central bank. Thus, a central bank is an organization that is authorized to manage the whole economic system in a country, maintains the cash reserves of the commercial banks, issue notes and work as a lender of the last resort to all commercial banks. It also works as the banker to the government and to commercial banks. It is the only organization who has full authority of note issue and manages the currency. The central bank is the non profit organization although it generates profit in the course of its function. In short, the objective is to serve the board national interest in monetary matters and to support the economic policies of the government.

2.1.6 Factors Responsible for the Advent of Modern Banking

It is little bit cumbersome to distinguish the exact meaning of modern banking and traditional banking. It is a subjective issue so far. As the technology changes and new financial tools emerge l the economy, the 'so-called modern banking' existing today would be termed as traditional and obsolete one tomorrow. However, operation of the banking service with contemporary tools, efficient human resources and new technology en-mass

can be termed as a modern banking or vice versa.
Arguments can be extended in support of the advent of the several modem banking. However, principal phenomenon discussed in the text follows have made environment conductive for the inception of modern banking system’

- **Organization change:** The numbers of banks and bank branches have been established as ‘mushroom growth’ style over the world. Especially, after the financial globalization and liberalization, this trend is in ‘accelerations’. This up-shutting expansion in banking business has brought a realization of modernized and dynamic concept of banking in providing the services efficiently and swiftly. In this connection, banks are willingness or unwillingly compelled to reform, renovate and expand their organizational structure and layout.

- **Change in Nature of Loan Demand:** Previously, there was a small volume of credit for small types of business and industrial activities. But, after the evolution of ‘the theory of division of labour’ and specializations, there has been a spectacular change in economic activities, and the industrial revolution also took place. Thus, the nature and tendency of lending changed form individual borrowing to corporate borrowing. For this, simple types of appraisals were not sufficient to maintain an appropriate portfolio. For this project industry/business appraisal, advanced types of programming, different types of financial ratio analysis, credit risk evaluations etc were needed and these factors led the banking system towards modernization.

- **Competition and Protection of Public interest:** This is an age of ‘cut-throat-competition' then before. There are so many banks commencements, mergers and/or liquidations over the world. This is quite natural in the competitive environment. In contrast, the banking system ought to consider in protecting the interest of the depositors. So, to survive in the competitive market on reasonable mark-up with protection of the depositors interest is a main challenge to the banking system. And, this condition virtually invited modernization in the banking system.

- **Responsibility to Reduce Regional Imbalances:** Especially after the incarnation of the ‘state Intervention policy’ with so-called collapse of classical Theory' the banks were liable to participate in the government's programs of reducing sector-wide disparities. Either on the basis of poverty line or the prioritized sub-sectors, banks is to shake hands with poor through finance. Government has had identified diverse mandatory areas to embark upon. In this course, banks are compelled to implement their strategies of credit planning, bank marketing and customer service in such a way that enables them in making trade off between social obligation and business motive. Advent of this type of condition motivated the banking system in the direction of modern out look.

- **New Innovations Reduce regional Imbalances:** The most responsible factor for modernization the banking system is significant improvements in the technology. Technology has affected all the corners of economic and social system. Previously, there were traditional activities on lending and deposit, but how the nature of those transactions has changed, for example, there were foreign exchange transactions in a controlled terms viz. direct quotation and exchange, but now there are so many types of forward and future transaction (derivative product) with managed floating system. Even in the lending side also, transaction trends has been diverted from individual to syndicate loans and consortium financing. In the part of customer service, there are computerized banking services with Automated Tailor Machine (ATM), Electronic Fund Transfer, and Electronic Clearing- House, implementation of the concept of 'step-at-Door Service' for deposit collection and loan disbursement. Nature of the transactions is also changed. For example, collateral based lending practices based on goodwill, faith, track record, personal guarantee, and project financing. Most of the business transactions are inclined to “off balance-sheet” (non-fund based) nature like guarantee, letter of credit etc.2

2 sources: Banking News Letter, Banking Promotion Committee, are, May/JuIy-2003

2.1.7 Assets and Liabilities of Commercial Banks: The instrument that shows the assets and liabilities of a commercial bank ij its balance sheet. It is usually prepared at the end of each year; therefore, tho balance sheet of bank is very important not only to its management but also to general public since the bank deals in other people's money. In addition, the business of the bank or its financial position is reflected by the situation of its assets and liabilities ice. its balance sheet. It also portrays the results of balls operations during the year. The balance sheet may also be used as the indicators of sources of funds and uses of the same.

*** Assets:** Assets are the valuable possessions owned by the business firm, which should be capable of being measured in monetary terms. They must be future benefits. It represents stored purchasing power egg. cash, money claims egg, receivable, and tangible and intangible items which can be used for a business motive. Land, building, plant or stocks are tangible assets while trademarks, copyrights, patents or goodwill are intangible assets.
include cash (which may be held in the form of credit balances with other bunks: usually with a central bank but also, in varying degrees. with correspondent bmikslls liquid assets (money at call and short notice, day to day money, short term government paper such as treasury bills and notes, and commercial bills of exchange, all of which can be converted readily into cash without risk of substantial loss); investments and securities (substantially medium tea and longer term government (ties- sometimes including those of local authorities such as state, sects provinces or municipalities and in certain countless participation's and shares in industrial concerns); loans and advises made to customers of all kinds, though primely to trade and industry (in an increasing numbers of countries, these include term loans and also mortgage lompl; and, finally, 'the bank's premises, f'ulmiture and fittings (written down , as a rule to quite nominal fipzresl". (Encyclopaedia Britannica, 1981: 7064 hi A bank's assets A11 the current assets are those resources of the bunks that are expected to convert into cash within the accounting period or the operating cycle of the business. Long-term assets are not for the sale, it held for periods longer the the accounting period. Among the assets of balks investments are less liquid than money-market assets such as call money and treasury bills. A bank may mobilize its assets in several ways. Bunks may demand repayment of loans or sell securities or borrow from the central bank.

***Liabilities:** Liabilities are economics obligations to pay cash provide goods or debts payable in future by the 51114 to its creditors. Creditors, bills payable, wages and salaries payable, interest payable , taxes payable, bonds, debentures, borrowing from bads and financial institutions, depends from general public are types of liabilities.

A bank's main liabilities consists its capital and deposits. They should be repayable on demand or only after the lapse of a period of' time. Deposits, Which is the bank's liabilities to the general public consists of borrowed money. A bank creates deposits by acquiring assets weather these assets br cash or any other claims on the government or promises to pay to customers or even the buildings where the banking operation operates. ne increased in deposits related increase in the potential liability to pay out cash and the increase in deposits with the commercial banks is accompanied by a corresponding increase in commercial bank holdings of money claims that years equivalent to cash then planking confidence on the part of the depositors .is the true basis of stability confidence as steadier if there exits a central .bank to act as a amender of last resort" Another means of maintaining confidence employed in' some countries is deposit insurance which protect, the Small depositor against less in the event of a bank to inure. such protection was the declared purpose of the mobilization" of b k d In Argentina between l 946 and 1957. Banks receiving deposit act merely as agents of the government owned government controlled central bank all deposits being guaranteed by the state. (Encyclopaedia Britannica, 1981:706)

Reserves are the liabilities included in ca ital Bank should hold as cash reserve and maintain a ratio of cash to deposits. “lf a minimum cash ratio is required by law, a portion’s As of a bank's assets is in effect frozen and available to meet sudden demands for cash from the banks customers. 1 awarder to provide more 'flexibility required ratios are frequently based on the average of cash holdings over a specified period such as we Week or month”, (Enclopaedia Britannica,1981:1706). If bank fail to hold cash, it could not met the claims of deposits from public and banking could not long survive.

2.1.8 Banking Supervisory and Regulatory System

Being the guardian of banking sectors central bank has power and did authority to supervise and regulate the banking sector. Central bank has to supervise weather banking sector is functioning properly. If the balks are not running smoothly, it proves to be' detrimental to the economy of the country and to the interest of depositors and shareholders. The main objectives of the supervising the balks are financially sound, well managed and not posing a threat to the interest if their depositors. A central bank makes rules, issues instructions from time to time with regards to many aspects viz., credit control, liquidity; Sectoral limit etc. According to Dahal and Dahal, the purpose of supervision is manifold:

- To see whether operation has been carried out in i|onforll-lity with 1| ir laid down policies.

- To see whether banking sector is complying with existing elks and the instruction of NRB.

- To see whether people have trust towards them.

- To see whether management and internal control system ls effective.

- To we see the organization has sound financial standing.

  Every central bank has got a separate supervision department. Staff of the supervision department adopts following procedures to have information (in aforesaid matters:

- Off-side Inspection: There are three types of supervision, which the central bank uses to inspect the position of the bunks to see whether they are implementing the directives, or not. One of them is off-site inspection, ne off-site inspection is related to the financial analysis of the concerned financial institution on the basis of profit and loss account, balance sheet and other data received by the central bank. Depending upon the nature of reports, they are received on a weekly/monthly/quarterly/hi- annually/annually basis .off-site review and analysis deal with matters such as; capital adequacy, cash reserve ratio ICR'RI requirement, loan . classification and provision, profitability, priority sector credit, deprived sector credit etc.

- **Special Inspection:** Special inspection refers to inspection for specific purpose. Such an inspection is made as and when its need is felt.
- **On-site Inspection:** On-site inspection is carried out by the inspector or the team of inspectors by visiting the office of financial institutions. They check various files such as loan, account operation, expenses, LC, guarantee remittance etc. and see whether they are in conformity with the existing rules. They check physical balance of cash and bullion with record. If certain lapses observed have to be rectified immediately, the inspectors advise the concerned authority accordingly.

  After collecting information through aforesaid ways the central bank prepares the report confining all the findings. In case of irregularities and deviations, instructions and advice are given to rectify them. At least, suggestions are put forward for the overall interest of the financial institutions. lf the organization is found to have violated? neglected the rules and regulations, the concerned authority at the recommendation of supervision department takes necessary actions which range from reprimand to snatching license.

2.2 Review of Related Studies

2.2.1 Directive review

Nepal Rastra Bank has recently issued twelve directives on the code of conduct for board director and employees of barks and non-ba|s financial institutions (Unified directives). These directives are issued as authorized by Section 22 of the NR.B Act. The section 22 of N.R.B Act read as (|-l-l)e bank may issue directives from time to time to commercial bads and financial institutions regarding banking operations, currency & credits. It shall be the duty of commercial bank and financial institutions to comply with such directives, These kinds of dir' actives as such are new from the regulator side. Ethical standard in any financial institution js normally set at the time of establishment of the entity. such regulation may be governed by the personnel rule in the case of employee and law or by oath to the directors.

Banking business is challenging day by day. such challenges to the banking business are faced not only from the extends element but also within the bank. The business of banking needs to be operated in highly professional manner keeping the balks financial health sound it any point ot- time. Tss line of business is also needs public confidence during its whole life However it is observe from different element of the society that banking Inc Nepal are not being operated in such a manner to deserve sufficient public confidence. It is also not operated with due consideration of its long-term financial health. In some of the cases they have already been loosed going concern. Even mistake in banking business are not bearable but banking fraud in number of balks are being noticed. No adequate penalties to individual director or employees are levied so far to compensate the loss caused by them to the system or to the bank. Similarly, number of business conflict within the operator of bank is being noticed, where the director or personnel of bunks are involved to damage the prestige of the bank. This environment in banking business is not only the challenges to the individual bank but also became big challenge to the banking & financial sector is a whole and more to the central bank of the country. In order to safeguard from further damage in to the banking sector and to have a healthy competition within the sector new directives on code of ethics may help a lot to this banking industry.

In general, N.RB guideline is virtually guided by financial normalization and thus covers the following different dimensiona- minimum requirement of ,capital fund (core capital and supplementary capital) loan loss provision ,and classification of loan, provision of credit limit and facility accounting policies and financial statement that should be maintain by commercial balks, risk minimization, corporate governance, regulatory directives, provision of investment. on share and securities, provision of consortium financing by bank and provision of black listed customers .

The new directives issued by Nepal Rostra Bank applicable to balks and financial institutions comprise sixteen directives, issued in 2062 B.s. sue to lack of materials and middle of the fiscal year, this thesis is mainly based on the preview: directives. However the changes have been noted wherever possible. Previous issued directives focused only on commercial balks but new directives must be followed by balks and an other juaucjal ustjtutions form the beginning of 062/63. yes new djrxtjms cover all the yanks and ,non-bank Francie institutions. so it is also called unified directives.

Previous directives contained eleven directives. There is no any difference between new and previous directives except directives no.! 1 (Provision of ,consortium financing) and directive no.4 which changed the format of financial statements of bads and financial institutions. so, the tensed directives are as follows:

Directive No.l: Regulation relating to maintenance of minimum capital fund by the bunks and financial institutions.

Diredive no. 2: Regulation relating to loan classifaction and loan loss provisiong.

Directive no. 3: Regulation relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.

Directive no. 4: Regulation relating to accounting policies apd format of the financial statements to be followed by bank and non-bank financial ip' jubilations.

Directive no. 5: Regulation relating to minimization of risk inherent in the activities of bank and non-bank financial institutions.

Directive no. 6: Regulation relating to good corporate governance of back and non-bank financial institutions.
Directive no. 7: Regulation relating to timegame for implementation of regulatory directives issued in connection with inspection and supervision of the bunks.

Directive no. 8. Regulations relating to investment in shares, debentures and securities by bank and non-bank financial institutions.

Directive no. 9: Regulation relating to submission of statistical data to Nepal Rostra Bankz Banking Management Division and Inspection and Supervision Division by bank and non-bank financial institutions.

Directive no.10: Regulation relating to sale and re-registration of foundation shares of bank and non-bank financial institutions.

Directive no.11 : regulation relating to consortium financing by bank and non-bank financial institutions.

Directive no.12: Regulation relating to loan and willful defaulter or blacklisted information should be given to Nepal Rostra Bank by bank and non-bunk financial institutions.

Directive no. 13: Regulation relating to Compulsory Balance.

Directive no. 14: Regulation relating to brancla/office.

Directive no. 15: Regulation relating to interest rate Directive no. 16: Regulation relating to collection of financial resources f N Out of sixteen directives, this research work is limited. to the following six directives.

Directive no.1: Provision of Capital Adequacy Ratio:

Total Capital Fund is defined as the sum of core capital and stlpplemental-y capital. Value of goodwill shall not be included for the purpose of calculation of capital fund. Following Instruments are contained the features of both debt and equity, which are called hybrid capital instruments.

i. Unsecured fully paid-up instruments issued by the bank which are it nsecure , subordinates to (Priority of payment after) depositors and creditors and ilable to absorb losses as well as convertible into ordinary capital.

ii. Instrument, which am con- redeemable at the option of the holder except with the approval of Nepal Rastra Bank.

iii. pellne'tual or long-term preference stock (shares) convertible into common stock if the profit-loss accost becomes negative.

iv. Unsecured and subordinated debt instruments (priority of payment after the depositors) issued by bank with a minimum maturity term of over five years and limited life redeemable preference shares. To reflect the diminishing value of these instruments, a discount (amortization) factor of 20 percent during the last five years shall be applied. The issue of theme instruments by bunks 'shall not exceed 50% of their core capital.

Banks should provide 100% provision if securities are not listed in the stock exchange.

Directive no. 2: **Regulation relating to Provision of loan classification and loan loss provisioning.**

With an objectives to minimize the possible loss of credits extended 'by commercial bunks, as provided under Section 23 (1) of Nepal Rastra Bnnk Act 2012 (with amendment) relating to development and regulation of 61
banking system, this directives in respect of loan classification and provisioning has been issued in exercise of authority under Banks and Financial Institutions Act 2063. (BAFIA)

i. A bank is required to classify their loans and advances on the basis of ageing of the principle.
ii. All loans and advances need to be classified into the following four Dulles.
  - ❖ **Pass:** Loans and advances whose principle amounts are not past due and past due for a period up to 3 month shall be included in this category.

These are classified and deemed as Performing Loans.

  - ❖ **Sub-standard:** Al1 loans and advances that are past due for a period of 3 month to 6 months shall be included in this category.

  - ❖ **Doubtful:** A1l loans and advances which are past due for a period of 6 month to 1 year shall be included in this category.

  - ❖ **Loss:** Al1 loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

Loan and Advances falling in this category of Sub-standard, Doubtful anti loss are classified and defined as Non-performing Loan.

iii) Commercial bunks should classify on the basis of the following time table according to NRB Directives.

Classification	For FY 2059/60	For FY 2060/61	For FY 2061/62	For FY 2062/63
Pass	Loans not pass due and past due up to 3 months.	Loans not past due and past due up to 3 months.	Loans not past due and past due up you3Months.	Loans not past due and past due up to 3 months.
Sub-Standard	Loans and advances past due for a 3 months to 1 years.	Loans and advances past due of over 3 months to 9 months	Loans and advances past due for a period of over to 3 months to 6 months	Loans and advances past due for a period for a 3 months to 6 months
Doubtful	Loans and advances past of over 1 year to 3 years	Loans and advances past of over 9 months to 2 years.	Loans and advances past of over to 2 years.	Loans past advances past of over 6 months to 1 years.
Loss	Loans and advances past due for a period of over 3 years	Loans and advances past due for a period of over 2 years.	Loans and advances for a period of over 1 year.	Loans and advances past due for a period for a period of over 1 year.

iv) Loans should be classified as loss in following cases:

- No securities at al or security that is not in accordance with the borrower's agreement with the bank.
- The borrower has been declared bankrupt.
- The borrower is absconding or cannot be found.
- Purchased or discounted bills are not realized within 90 days from the due date.

- The credit has not been used for the purpose originally intended.
- Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation.
- Loans provided to the borrowers to the borrowers included in the blacklist and were the Credit Information Bureau blacklists the borrower.

  v) The banks need to be classified 1% of pass loan to general loan loss provision and remaining three sub-standard, doubtful and loss with 25% , 50% and 100% respectively should be provisioned for the possible losses.
- Banks can reschedule and restructure loan in non-performing loan receiver submit the external reasons.
- Insured priority at 25% of the provision percentage to loss.
- Banks have to be provisioned 25% of each year for non-performing banking assets until sell.

Directive no 3, Regulation relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.

With the objective to minimize the concentration risk resulting from of the credit extended by the commercial banks to a single borrower or group of related borrowers as well as to the single sector of the economy, as provided under Sector 23 (1) of Nepal Rastra Bank Act 2012 (with amendment) relating to development and regulation of banking system, this directives has been issued in exercise of authority under under Section 22 of the same Act.

i. As per NRB Directives, banks should classify into fund-based loan (trust receipt, overdraft, term loan etc) and non-fund based loan (guarantees, letter of credit, commitments etc). the NRB has brought following limit:

Loans and advance	From FY 2002/2003
Fund based	25% of core capital
Non-fund based	50% of core capital

ii. Banks should not maintain above limit, when loan provided under guarantees of fixed receipts, banks deposits, government securities NRB debentures and rated national and international banks.

Directive no.4: Regulation relating to provision of the financial statements to be followed by bank and non-bank financial

institutions.

i) The period of Shrawan to Ashad shall be fiscal year of all Commercial banks. Banks need to take Shrawan – Ashad (mid July/mid August- mid June/mid July) as a fiscal year.

ii) Banks need to annual report sheet, profit and loss account and cash flow statement in annual report after auditing according to the statutory from issued by NRB.

iii) Banks need to publish financial statement including following subject:

- No change to be made in the prescribed format and accounting heads.
- Annually distributed, recorded and written-off of principle and interest of loans and advances.
- Reconcile account according to past due.
- Weighted average interest rate spread of deposits and loss.
- Transaction related to non-balance sheet and off – balance sheet.
- Classification of assets and liabilities as per NRB Directives relating reducing liquidity risk on the basis of maturity period.
- Collateral for borrowing loans.
- Other necessary documents to inform and understand balance sheet and P/L account.

<u>Directive no. 5:</u>Regulation relating to provision of minimization of risk inherent in the activities of bank and non-bank financial institutions.

As per NRD Directives, NRB has classified the risk related to bank and non-bank and non-bank financial institutions transaction into four sectors.

- Liquidity risk
- Interest rate risk
- Foreign rate risk
- Foreign exchange risk
- Risk related to loan and investment.

Clause 1: Provision of reducing liquidity risk

i) Banks need to classify time interval on the basis of payment period and maturity period.

a. Assets and liabilities with maturity period from 0-90 days.
b. Assets and liabilities with maturity period from 91-180 days.
c. Assets and liabilities with maturity period from 271-365 days.
d. Assets and liabilities with maturity period above 1 year.

ii) NRB has brought following directives for liquidity are as:

- 7% of current and saving deposits liabilities and 4.5% fixed deposits liabilities should be balance at NRB.
- 2% of total deposits liabilities should be cash in vault.
- NRB has scrapped the provision of secondary reserves.

iii) Cash in vault shall include only the local currency and foreign currency except clearing cheques.

iv) Liabilities with unfixed maturity period.

- Core capital form current deposit and compensating balance need to include in time interval above one year.
- Saving deposit should be taken as long-term liabilities.

Clause 2 : Provision of reducing interest rate risk.

i) As per NRB Directives banks need to classify time interval as follows:

- Assets and liabilities with maturity with maturity period from 0-90 days.
- Assets and liabilities with maturity with maturity period from 91-180 days.
- Assets and liabilities with maturity with maturity period from 181-270 days.
- Assets and liabilities with maturity with maturity period above 1 year.

ii) Banks should include assets and liabilities of unfixed maturity period under the following provisions:

- Assets should be included in 'A Floating rate Loan with Interest Adjusted Periodically.
- Core capital from current deposit and compensating balance need to include in time interval above one year.
- Saving deposits should be taken as long-term liabilities.

Clause 3: Provision of reducing the foreign exchange risk.

i) Banks need to show net position of both short term (1 month or less than 1 month) and long term maturity period on classification of foreign exchange as monetary value.

ii) NRB has brought the net position of foreign exchange maximum up to 30% of core capital.

Clause 4: Provision of reducing risk related to loan and investment. Directive no-2: (Loan classification and loan loss provisioning) and directives no-3. Single obligor limit) are taken as a lasis of reducing the risk related to loan and investment.

All above these types of directives are issued only by the NRB and the commercial banks have to follow such directives with commercial banks own policies.

2.2.2 Articles Review

2.2.2.1. NRB Takes Charges of Lumbini Bank

Business Age, vol 4, focuses that the NRB's has merged the non-banking operation departments and the banking operation department. Recently, NRB has established a new Research Department (RD) on order to expedite the supervisions of the functioning of all financial institutions in the country. The research Department is expected to be Responsible for the regulation and monitoring of all those instution that are operating in Nepal.

2.2.2.2. NIBL Awarded Nepal's "Bank of the Year 2005"

"Nepal investment banks limited (NIBL) has been awarded the prestingious "Bank of the year 2005" by the first Nepal bank to win the award two times counting the "Bank of the year 2003" award. It received the first award soon after Nepalese took over its ownership and management.
This award is given on the basis of the growth and performances in term of capital, assets, returns on equity and management quality, states a press release issued by NBIL ". (Business Age, September 2005:7)

2.2.2.3. Nepal Investment Bank Ltd. (NIBL) & Kumari Ltd. (KBL) have signed as agreement to share ATM/POS network for their respective card businesses, making it the first instance of the country's commercial banks coming together to share their ATM/POS network . with this agreement all Visa card transactions can be conducted through the ATMs of both banks.
KBL has acquired associate membership of visa International through NIBL and can also issue and acquire both domestic as well as international Visa cards.
Both NIBL jas eight ATMs and KBL has four ATMs situated at strategic locations at Kathmandu and Pokhara. Similarly there is more than 500 point of Sale (POS) terminals owned by NIBL and now available for use customers of both banks.
Both the banks say they are planning to enhances their network in the near future." (Business Age, June 2005:8)

2.2.2.4. NRB withdraw Restriction in Commercial Banks

Business Age, Volume 4, focuses about the further establishment of commercial banks in Nepal, where NRB has withdrawn the seven-year restriction. Under new directives, commercial banks must maintain paid-up capital equivalent to Rs1 billion and Rs 25 million at the national and regional levels respectively. This provision stipulates one compulsory requires the joint investment of foreign banks or financial institutions and a Nepal firm, company etc. for the operation of such commercial banks. These new NRB banking policy has affected the Royal Army's longstanding plan to establish a separate commercial bank under its management ownership. Also there may be negative effect on foreign investment because of no registration of new banks starting from the year 1995 due to excess of competition aroused by massive investment following the adoption of liberal policy.

It has also pointed out the possibility of Chinese investment may be come in the baking sector with joint venture of Nepalese government, which aims to make Nepal a tourist destination.

2.2.3. thesis Review

In the context of Nepal Rastra is the central bank of Nepal. There are many studies related to central banks. But, some studies have been conducted regarding the role of NRB in economic development of Nepal and few studies are conducted on the NRB role for banking development.

In 2001, members of Chartered Accounts of Nepal has written an unpublished book, which was related to the guideline of NRB. They have shown the effectiveness' of guideline must be followed by commercial banks.

Sontosh Pandey, in his thesis has observed that the changes in NRB Directives have made the impacts on the commercial banks. Because of previous directives, banks have to increase the operational cost and dividends to shareholders and bonus to the employees are down due to decrease in profits of banks. He has also observed about the protection of deposits of public because of directions, its foresight results lead to bank financially healthy and stronger in future. Finally, he laid down about the changes in directives will bring prosperity to the sharelohders, depositors, employees and the economic to the country as whole. He suggested, in this thesis, to NRB that the NRB should issue directives after being proper homework. NRB must strengthen the should issue directives to be applicable in context of Nepal, not only to meet the international standards, otherwise complaints from commercial banks may arise. However, in the present context, the commercial banks must be comply such directives and maintain its policies. And NRB has directed commercial banks to obey such rules and regulations; otherwise NRB will take action as per NRB Act, 1955.

Above study is based on the directives to commercial banks and study consists only three directives. Presently, NRB has issued directives relating to banks and financial institutions regulation and prudential comprises twelve directives. The finding of above study may indicate the certain impact of the new directives to the commercial banks and maintaining rules of directives by Limited of NRB and commercial banks and maintaining rules of directives by Himilayan Bank Limited. The previous directives already had been changed. Thus, the present study is more relevant than above. This study will also carry out to fill the gap, which was lack in the previous study.

Chapter III
Research methodology

3.1. Introduction

Research methodology refers to various sequential steps (along with a rational of each step) to be adopted by a researcher in studying a problem with certain objective/objects in a view. It would be appropriate to mention that research projects are not susceptible to be studies will determine the particular steps to be taken order too. (C.R. Kothari 1990:19)

Research is the investigating by planning, structuring with strategy to find out the problems and to control the variance. Research refers to a search of knowledge, which may be scientific research or significance to solve various operational and planning problems of business and industry. "The purpose of research is to discover answers to questions through the application of scientific procedures. The main aim of research is to find out the truth which is hidden which has not been discovered at yet".)C.R. Kothari, 1990:7)

"The history of research methodology gives the student the necessary training in gathering materials and arranging or card indexing them, participation in field work when required and also training in techniques for the collection of data appropriate to particulars problem, in the use of statics, questionnaires and controlled experimentation and in recording evidence, strong it out and interpreting it."

The basis objective of this study is to 'impact and implementation of Nepal Rastra Bank (NRB)'s Guidelines (Directives) on Bank and Non-Banks Financial Institutions , a study of Nabil Banks Limited and Nepal SBI Bank Limited'. An attempt is made to carry out the following activities in this study:-

- Review the change NRB's Directives and define.
- Conduct out the existing situations and problems re3garding NRB's Directives.
- Conduct structure interview regarding benefit and weaknesses of the Nepal Rastra Bank's Directives.
- Conduct study of previous unpublished research works.

3.2. Research Design

The analysis of its this study is based on certain research design keeping as the objectives of the study in mid. Generally research design means definite procedures and techniques, which guideline profound ways for research, ability. This study evaluates the impact of NRB's directives swith help of maintained research design. For this purpose the research design of this study is used for analytical as well as descriptive methods of collected data. The selection of this type of research has become necessary keeping in view the quantity and quality of information that is available.

3.3. Population and Sample

There are twenty commercial banks, thirty-nine development banks and five rural development banks are operating in Nepal. Among all, this study comprises two commercial banks namely; Nabli Bank Limited and Nepal SBI Bank Limited have been selected as sample for this from entire population.

3.4. Sources of Data

The researches use two types of data collection:

- Primary Data and
- Secondary Data

"The primary data are those which are collected a fresh and for the firm time and happen to be original character. The secondary data, on the other hand, are those which have already been passed through the statistical process". (C.R.Kothari 1990:117)

This study is based on both primary and secondary data. The primary data have been collected through questionaries and personal interview whereas the secondary are gathered from published articles, journals report etc. as this research consist of various references as of secondary data, which are collected by using secondary sources such as:

A) Directives of NRB.
B) Annual report of the Nabil Bank Limited and Nepal SBI Bank Limited.
C) Previous related studies.
D) Published articles of different authors.
E) Journals and other Tribhuvan University Library, Nepal Rastra Bank Library, post-Graduate Campus Library.

3.5. Method of Data Analysis:

In this research three types of tools used for analysis to make the study specific and reliable.

i. Financial tools
ii. Statistical tools
iii. Mathematical tools

i. Financial Tools - Various financial tools are used for analysis. The basis tools used are as follows:

1. Capital Adequacy Ration (CAR): Capital Adequacy Ration is the relationship between shareholders' fund (Capital Fund) to total risk weight assets of the bank. The higher the CAR, the less levered the bank and the safer from depositors point of view because the proportion of the shareholders' take to the risk weight assets is also high. On the country it reduces the profitability due to idle fund. Declaration/ distribution of dividend, expansion of branches, availing refinance from Nepal Rastra Bank, Disbursement of loan, acceptance of fresh deposits etc are prohibited until fulfillment of CAR shortfall. To protect the banks from bankruptcy, commercial banks should maintain capital adequacy (CAR).

   Capital Adequacy Ratio (CAR) =

2. Loan classification and provisioning – The amount of loans in the various categories has been calculated by using the amount of NRB. A part from, for each catergoy, the actual provisioning amounts have been calculated according to the directions laid down by NRB.
3. Single Borrower's Limits – Single borrower's limits refers to the maximium credit limits that can be extended to a customer, firm company or companies of the same group. The formula and figure that lay down by NRB have been used to calculated the single borrower limit.
4. Accounting policy and structure of financial structure- To calculate the accounting policy and structure of financial structure, the models and chart have been used.
5. Risk reducing on activities of commercial banks- In order to computer the risk reducing on activities of commercial banks, the model and formula as laid down by NRB has been used.

ii. <u>Statistical tools-</u> The multiple bar diagrams are presented as statistical tools where it is necessary to compare between, old provision and new provision.

iii. <u>Mathematical tools</u> – percentile analysis has been used for the analysis of the collected from the questionnaires.

CHAPTER - IV

Data Presentation & Analysis

The main objectives of this chapters are to review and present the NRB's directives and its impact on the commercial banks .In this regard directives no.1 to 5 issued by NRB are presented and data collected from Nepal SBI Bank Ltd. Add Nabil bank Ltd.are presented and analysed. Information about the impact and implementation of directives are collected by using qustionaire from different commercial banks and NRB's supervision and impaction division and also analyzed on percentile basis.

4.1.1 Direction No.1: provision of minimum capital funds to be maintained by the commercial banks.

Capital is the excess of assets over liabilities and can be defined as the wealth , which employed for the production . Total capital fund is the sum of the core capital and supplementary capital. Core capital is the first tier and supplementary capital is the second tier capital. As per NRB's directives the Nepal SBI Bank Ltd. and Nabil Bank Ltd. has maintained. It's fund as shown below.

Table-1

Nepal SBI Bank Ltd & Nabil Bank Ltd.

Total Capital fund as at 15 July, 2008

(In Rs.)

Particulars	Napal SBI Bank Ltd.	Nabil Bank Ltd.
Total Core capital (A)	1,14,54,78,649	2,36,35,98,989
Total Supplementary Capital(B)	29,93,21,607	63,51,31,175
Total Capital Fund (A+B)	**1,44,48,00,256**	**2,99,87,30,164**

Source : Annual report of Napal SBI Bank Ltd. and Nabil Bank Ltd.
(See Appendix 2 for details.)

Above chart shows that the Nabil Bank is the stronger in total capital fund than the Napal SBI Bank as well as Nabil Bank has maintained it's capital fund more than one billion whereas Napal SBI Bank has lower than this amount. It can also be seen that the difference of paid –up capital of Nepal

SBI Bank and Nabil Bank is Rs. 185.31 (i.e Rs.874.52-Rs.689.21) million.Which is gretter than the Nepal SBI Bank Ltd.Existring banks are required to raise their capital fund to a minimum Rs. 1,000 million by mid – July 2010 through minimum 10% paid-up capital increment every year.

Capital Adequency Ratio (CAR) is the ratio of share holders fund total capital fund of the bank to the total risks weighted assets. (TRWA)

$$\text{Capital Adequency Ratio} = \frac{\text{Total Capital Fund}}{\text{Risk weighted Assets}}$$

Banks should maintain such capital adequency ratio according to the NRB directives in order to protect the depositors money against the bank failure. Banks are required to maintain capital adequency in three different ways, the core capital adequency ratio, the supplementary capital adequency ratio and the total capital adequency ratio capital adequency deals only with the assets site of the balance sheet of the banks. The TRWA is calculated under consideration of both the on- balance sheet assets and the off- balance sheet assets.

Table- 2
Nepal SBI Bank Ltd & Nabil Bank Ltd.
Total risk weight assets as at 15 July, 2008

(In Rs.)

Particulars	**Napal SBI Bank Ltd.**	**Nabil Bank Ltd.**
Total on balance sheet assets (A)	14,45,16,51,062	2,36,35,98,989
Total off- Balance Sheet (B)	28,17,29,998	63,51,31,175
Total Risk weighted Assets (A+B)	**17,26,89,50,760**	**33,31,58,87,226**

Source : Annual report of Napal SBI Bank Ltd. and Nabil Bank Ltd.
(See Appendix 3 for details.)

On the basis of new directives Nepal SBI Bank Ltd. and Nabil Bank Ltd. has shown their capital adequency ratio is as follows

Table- 3
Nepal SBI Bank Ltd & Nabil Bank Ltd.
Capital Adequency Ratio as at 15 July, 2008

(In million of Rs.)

Particulars	**Nepal SBI Bank Ltd.**			**Nabil Bank Ltd.**		
	Min. Req.	**Actual. Figures**	**Short fall / Excess**	**Min. Req.**	**Actual. Figures**	**Short fall / Excess**
Total Core Capital	768.664	1,394.064	625.40	933.70	2,363.59	1,429.89
Total Supp.Capital	7,68.664	328.12	(440.544)	933.70	635.13	(298.57)
Total Capital Fund	1,537.328	1,722.184	184.856	1,864.40	2,998.72	1131.32
TRWA	-	13,975.70	-	-	2,70,105.64	-
Capital Ade. Ratio (%)	11	12.32	1.32	9.08	9.18	0.10
CAR wrt. Core Cap (%)	5.5	9.97	4.47	5.5	7.31	1.81
CAR wrt. Supp. Cap (%)	5.5	2.35	(3.15)	5.5	1.87	3.63

Source : Annual report of Napal SBI Bank Ltd. and Nabil Bank Ltd.
(See Appendix 2 & 3 for details.)

The new provisions of the NRB directives have made to increase the core capital & Supplementry capital to meet the required total capital fund. Neapl SBI Bank has maintained it's capital adequency of 12.32 % , which is excess by 1.32 %, contributed 9.97 % of it by the core capital & 2.35 % by the supplementary capital . Likewise Nabil Bank has also fulfilled it's capital adequency of 9.18 % with excess of 0.10 % contributed 7.31 % of it by the core capital and 1.87 % by the supplementary capital . On the basis of total risks weighted assets the minimum requirement of capital adequacy ratio with respect to core capital and supplementary capital is 6 % each the short fall of supplementary capital can be compensated by the excess amount of caore capital.But a short fall in the core capital can not be compensated by excess amount of Supplementry capital.

In order to see the impact of the directions , new arrival directions should be compared with previous directions .There was a capital adequacy 11% for capital fund and capital adequacy with respect to core capital and supplementary capital were 5.5%.As per new directions banks are required to income its capital fund to maintain the figures given by NRB directions i.e 12% from 2004/2005 and 6% by both core capital and supplementary capital respectively.

4.1.2 Directions No.2 Provision of loan classification and loan loss provisioning on the credits .

It is the primary function of any commercial bank to accept deposits from public and give loan to concerned people .Earning from such loan and advance occupy a major space in income statement of the bank.The asset side of the balance sheet of any bank is dominated by loan and advances .As it can be seen that 58.51% and 57.87% of the total assets of SBI Bank and Nabil Bank respectively are covered by loans, advance and bills purchase as of FY 2007 /2008 (see appendix 5 for details). The profit of the banks depends on the interest received from borrowers and paid to the depositor.Banks may be unable to repay the depositor money when banks fail to the loan amount and interest on it .

One of main purposes of NRB's new directives to loan classification and provisioning is to protect the deposit of public .As per new directives issued by NRB ,a bank should classify their loan on four different categories while previous directives shows the same loans and advance were categories into six different categories .It consists "Good ,Acceptable ,indicative of sub standard, doubtful and bad " with old provision,a loan would be bad only after it was a past du for a period of five years or above but the new directives shows the loans with past due for a period of three years or above under loss and 100% provision has to be made for such loans.

On the basis of new dirtectives Nabil Bank Ltd and Nepal SBI Bank Ltd. have provided the loan loss provisioning as follows:

Table- 4
Nepal SBI Bank Ltd & Nabil Bank Ltd.
Classification of Loans and Provisioning as at 15 July ,2008

(In Rs.)

Particulars	Provision Requirement (%)	Nepal SBI Bank Ltd		Nabil Bank Ltd.	
		2007/2008	2006/2007	2007/2008	2006/2007
Total Loan (A)		**12,74,62,16,214**	**1,00,65,05,2194**	**21,75,94,60,334**	**15,90,30,23,765**
Pass*	1	16,56,88,642	15,79,48,092	29,47,40,395	25,53,43,669
Substandard	25	5,66,279	5,44,869	3,23,05,327	5,66,36,400
Doubtful	50	98,69,035	38,92,644	2,12,65,253	71,90,443
Loss	100	4,56,395,830	44,22,15,888	4,60,96,041	3,81,45,522
Total provision(B)		**63,25,17,786**	**60,46,01,493**	**39,44,07,016**	**35,72,45,035**
Net Loan (A-B)		**12,11,36,98,428**	**9,46,04,50,701**	**21,36,50,53,318**	**15,54,57,78,730**

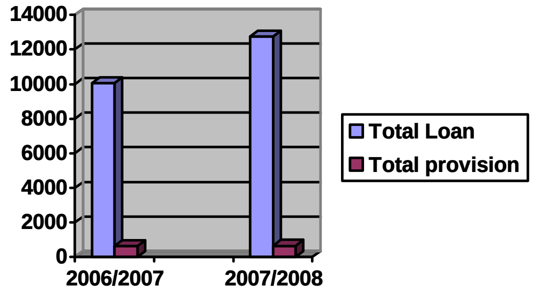
Source: Annual report of Nepal SBI Bank Ltd. & Nabil Bank Ltd.
(See Appendix 4 for details)

*Note: Pass loan provision= Pass loan provision+ Restructed loan provision.

The following data of FY 2006 /2007 and 2007/2008 shows the impact of changes in directives related loan loss provision from new provision .These differences are shown more clearly through the use of multiple bar diagram .It is presented below separately :

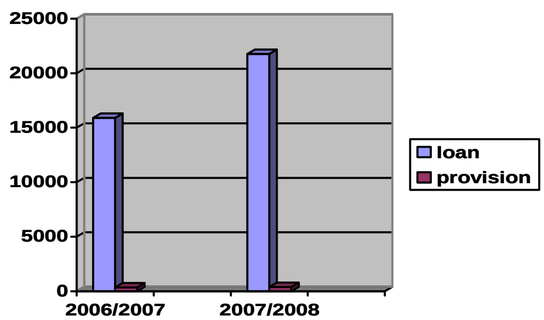
Difference of total loan and total provisioning of Nepal SBI Bank Ltd .for FY2006/2007 &2007/2008

(In million of Rs)



Difference of total Loan and total provisioning of Nabil Bank Ltd. for the F/Y 2006/2007& 2007/2008

(In million of Rs.)



From above chart and statistical diagrams it can be sen that the new directives has made the banks to categories its loans into four different categories .Nepal SBI Bank has increased its net loan amount by 4.62% from Rs.604.60 million to Rs.632.52 million .This reflects that SBI Bank's loan exposure is stepped upward while the loan exposure of the Nabil bank has been increased by 10.40% from Rs.357.25 million to Rs.394.40 million .Likewise Nepal SBI Bank and Nabil Bank have increased its performing loan . Nepal SBI Bank has reduced its substandard Loan while increased in Nabil Bank .the doubtful loan of SBI Bank decreased whereas increased in Nabil Bank Ltd. this is because the of period of the loan has been changed under new provision that " indicative of substandard " and " substandard " loan have brought into this one category. Decreased in the amount of doubtful loans is due to the new provision fall under loss loan and not doubtful loans but there is increased in the amount of loss loan in SBI Bank while decreased in Nabil Bank

The provision of loan means the net profit of the banks will come down by such amount .Increase in loan loss provisions decrease in profit result to decrease in dividends .Hence, Nepal SBI Bank has loan loss provision of Rs.632.52 million and Nabil bank Rs 394.40 million in FY 2007/2008 that means the net profit of the Nepal SBI Bank and Nabil Bank has come down by these amount respectively .Due to arrival of new directives, bank have to suffer decrease in profit .The impact of this directives will also reduces profit of banks in coming year i.e. profitably .But its positive impact is that it strengthens the financial conditions of the banks by controlling the credit risk and reduces the risks related to deposits .So, it can be said that banks suffer it only for short term while the good financial conditions and safety of loan will make banks prosperity resulting in increasing profits for long terms .

4.1.3 <u>Directive no.3: provision of single oblig or limits</u>

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

With a view to safeguard the depositors money and protect the banks from bankruptey, NRB has issuing directives from time to time under the prudention norms. The directives related to single oblig or limits main objective is to set up limits on the maximum amount of loans that can be lend to a single borrower of group of borrowers. The single obligor limits is based only on the core capital in the new directives whereas these limits were based on the total capital fund as per old provision. The total core capital of Nepal SBI Bank Ltd. and Nabil bank Ltd. are Rs.1394064015 and Rs.2363598989 respectively in FY 2007/2008. So the single obligor limit is computed as percentage gives by the NRB directives .the percentage of single obligor limit to be applied for SBI Bank Ltd. and Nabil Bank Ltd.are as follows.

Table no. 5
Nepal SBI Bank Ltd & Nabil Bank Ltd.
Classification of Loans and provision

Comparative chart of the single obligor Limit between new provision and old provision

(In Rs .)

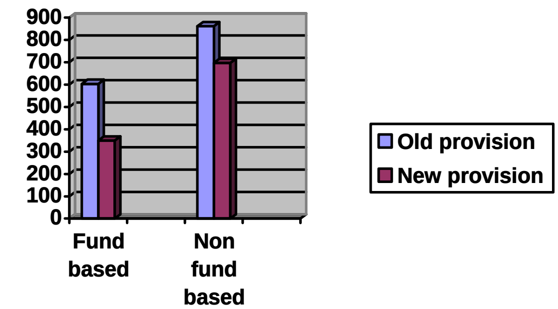
New provisions			Old provisions		
Limits	Nepal SBI Bank Ltd.	Nabil Bank Ltd.	Limits	Nepal SBI Bank Ltd.	Nabil Bank Ltd.
Fund based : 25% of total core capital	348516004	590899747	Fund based 35% of total capital fund	602765379	1049555557
Non fund based 50% of total core capital	697032008	1181799495	Non - fund based : 50% of total capital fund	861093399	1499365082

Source : Annual report of Nepal SBI Bank Ltd. & Nabil Bank Ltd.(See Appendix 2 for details)

The following comparison data of old provision and new provision on fund based and non - fund based shows the impact of changes in directives related to single borrower limits. These data are presented more clearly through the use of multiple bar diagram . it is shown below separately.

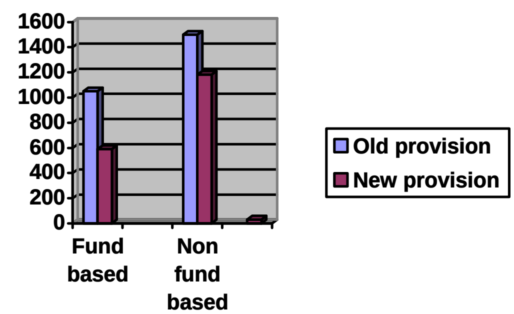
Comparison of single obligor limit between old provision and new provision maintained by Nepal SBI Bank Ltd.

(In million of Rs.)



Comparison of single obligor limit between old provision and new provision maintained by Nabil Bank Ltd.

(In million of Rs.)



From the above chart , it clears that the limits of loans has come down by both fund based and non- fund based due to the changes brought about by the directives , reduction of the limits by such a huge amount will surely make an impact on banks . The single obligor limit were previously based on the total capital fund , which comprise both core capital and supplementary capital . but the new provision is based only on the core capital , which is lower than the total capital fund (i.e. 1394064015 < 1722186798 of Nepal SBI Bank Ltd. and 2363598989 < 2998730164 of Nabil Bank Ltd.) (see appendix 2 for details)

In case of the loans already disbursed before 16 July 2002 single obligor limit has to be maintained 40% fund based and 75% non-fund based of core capital up to the end of F/Y 2001/2002 . but 25% for fund based 50% for non - fund based of poor capital applicable from the end of 2002/2003 .

The single obligor limit for fund based loan of Nepal SBI Bank Ltd. and Nabil Bank is Rs. 348516004 & Rs.590899747 respectively. If the banks has distributed excess amount of loan limit than it has to increase the core capital in order to fill the gap, if any exceeded amount of loans with in the limit , where the core capital of the bank include the paid -up capital , share premium , non-redeemable preference shares, general reserves and accumulated profit /loss account and profit of this years . If there is no possibility of increasing core capital banks must reduce the loan exposure of the customers .It will substaintially reduce the banks capacity to finance this will make an advance impact on the profitability of the banks . NRB has forwards formula to calculate the amount of core capital to be increased in case of exceeding the limit . Suppose , if excess amount is increased by 1%, added risk weighted asset should be 1% of amount of loan disbursed link wise ,the required additional core capital is needed to be calculated for 6%of added risk weighted assets .Hence, Nepal SBI Bank and Nabil Bank should maintain its single obligor limit by additional core capital to total core capital or must cut down the loans for single client.

4.1.4 Directives no . 4 : Provision of accounting policy and the structure of financial statement to be followed by the commercial banks.

Accounting is the process to ascertain profit or loss during a specified period to show financial condition of the business on a particular date these accounting records have to be maintained to measure the income of the business. Accountants have developed certain rules and procedures for good accounting practices and procedures . the accounting provision plays a very important role to determine the income of a particular accounting period. It helps in ascertaining the true and fair position of a business entity entries in accounting data and records reported in financial statements must be based on determined evidence. Bank statements for amount of cash at bank are one of the example of objective evidence, which are capable of verification.

The secret of successful banking is to distribute resources into different type of assets to get sound balance between liquidity and profitability .Nepal SBI Bank limited and Nabil Bank limited prepare the financial statements in conformity with generally accepted accounting principles(GAAP) and as per NRB directives .Using the format given by

NRB, the balance ,profit and loss account ,profit and loss account appropriation account and cash flow statement of Nepal SBI Bank and Nabil are presented in appendix no. 5,6,7and 8 respectively .The analysis of accounting policy is done on the basis of these financial statements which are as follows:

It can be seen that liabilities side consists of share capital of Nabil Bank Rs. 689.21 million and deposits account is the major part consisted in liabilities side which is 85.95% of total liabilities amounting to Rs. 31915.047 million. Loan is the dominant part of assets side containing 57.54% of total assets. likewise share capital of Nepal SBI Bank is Rs.874.53 million and the amount of loans cover 70.48% of total assets while 58.65% of total liabilities are deposits account . (See appendix 5)

This year interest income, interest expenses , profit for the year and closing cash balance of Nepal SBI Bank are Rs.970.51 million , Rs.454.91 million , Rs.247.77 million , Rs.308.10 and Nabil Bank are Rs.1978.69 million, Rs.758.43 million ,Rs.746.46 million ,Rs.511.42 million respectively.(see appendix 6,7and 8)

From the above it is clear that both Nepal SBI and Nabil are following the rules laid down by NRB. The major accounting polices adopted by Nepal SBI and Nabil are summarized on the basis of data available (annual report of Nepal SBI Bank Ltd. and Nabil Bank Ltd)are as follows :

- Interest expenses on interest bearing deposits liabilities and borrowings from other banks are accounted for on accrual basis .
- Interest income on investments are recognized on accrual basis .
- Interest income on loans and advances are recognized as income on cash basis.
- Gratuity has been accounted for on cash basis .
- Dividend investment share is recognized on cash basis.
- Commission incomes from bills purchased guarantee etc are accounted for on cash basis.
- Income from staff loans, leave encashment has been accounted for on cash basis.
- The Nabil bank has appropriated additional Rs1 million from profit and shown under "contingent Reserve ".
- Assets and liabilities denominated in foreign currencies are translated at the prevailing buying rate of exchange as on 15 July 2008.
- Income realized from the differences between buying and selling rates of foreign currency is accounted for as trading gain/loss.

- Income realized from the revaluation of foreign currency is accounted for as revaluation gain/loss.
- Provision for possible losses have been made to cover doubtful loans and advances , overdraft, bills purchased .The level of loan loss provision is determined from 1% to 100% on the basis of classification of loans and advances overdraft, bills purchased in accodances with the directives of NRB.
- Fixed assets are carried at cost less accumulated depreciation. Fixed assets are depreciation on written down value method at the rates prescribed by income tax Act, 2058(B.S.)

4.1.4 Directives no.5: provision of reducing the risk on the activities of commercial banks

Risk is the chance or possibility of meeting changes and suffering loss, which outcomes may be the failure of any institutions. Every bank involves in different activities , one of the primary activities of commercials bank is to another party as loans so, banks have to face credit risk, interest rate risk and liquidity risk. Price of securities is affected by such risk.

As per directives of NRB banks need to classify the assets and liabilities on the basis of maturity period to reduce the liquidity risk and interest rate risk. The classification of assets and liabilities based on maturity period ,the net financial assets of SBI is Rs. 1695.49 million and Nabil bank has nil (see appendix 9&10)

Similarly , NRB has put forward the provision for balance at NRB in percentage . Banks has to maintain a certain level of liquidity to total deposit liabilities in the form of cash and bank balance (primary reserve) treasury bill and government / central bank bonds (secondary reserve) primary reserve is cash reserve ratio (CRR) and the secondary reserve is the statutory liquidity ratio . but as per new directives there is no provision of secondary reserve . Banks are required to maintain its liquidity according to the new directives . the liquidity maintaining by Nepal SBI Bank and Nabil Bank are shown below :

Table-6
Nepal SBI Bank Ltd & Nabil Bank Ltd.
Liquidity maintained as at 15 July,2008
(in million Rs.)

Provision reqirement	Nepal SBI Bank Ltd.			Nabil Bank Ltd.		
	Min.req.	Actual figures	Short fall excess	Min. req	Actual figure	Shortfall/
(a) Balance at NRB: 7% of current & saving deposit 4.5% of fixed deposit laibilities	413.65 308.47			1,221.10 380.88		
Total balance at NRB	722.12	403.81	(318.31)	1,601.98	1,829.47	227.49
(B) cash in vault : 2% of total deposits liabilities	274.31	308.10	33.79	114.55	511.43	396.88

Source : Annual report of Nepal SBI Bank Ltd. & Nabil Bank Ltd.(See Appendix 5 & 11)

From above , it is clear that both banks have maintained liquidity ratio . The Nepal SBI Bank 's liquidity fall short by Rs 318.31 million . whereas Nabil Bank's liquidity is excess by Rs. 227.49 million from the minimum required ratio . SBI Bank has to cover this shortfall amount of Rs 318.31 million by the end of next fiscal year . the inadequate liquidity may collapse the bank so bank should maintain an optimum level of liquidity in order to avoid demerits associated with maintaining inadequate or an excess liquidity.

Bank should be prepared to cover the shortfall by borrowing or by liquidating assets in case of outflows of liquidity. In this case the balance at NRB can be maintained with the with excess amount of total deposits up to 1% added in the balance with the NRB or on such shortfall amount even after compensation of excess amount of cash in vault (cash in vault include only the local currency and foreign currency except clearing cheque)

Banks are required to maintain the net position of foreign exchange up to a maximum level of 30 % of core capital to reduce foreign exchange risk

. that means Rs. 418.21 million Of Nepal SBI Bank and Rs. 709.08 million of Nabil Bank , which is shown below :

Table - 7
Nepal SBI Bank Ltd. & Nabil Bank Ltd.
Net position of foreign exchange as at 15 July, 2008
(In Rs.)

Particulars	**Nepal SBI Bank Ltd.**	**Nabil Bank Ltd.**
Core	1394064015	2363598989
provision	30%	30%
Net position	418219205	709079697

Source: Annual report of Nepal SBI Bank Ltd. & Nabil Bank Ltd.(See Appendix 2 for details)

Banks need to maintain for loan loss based on loan classification according to directive 2 and single obligor limit according to directive no.3 for the reduction of risk relating to credit and investment that means banks need to classify the loans according to the NRB directives in to four categories to minimum loan risk and the given percentage should be provisioned for the possible losses. There should be no excess amount of loans , if it exceeds the limit banks should bring within the limits as per provision of obligor limits, which are already defined more clearly in previous pages. All the risk should be properly analysed so that repayment can be forecasted in advance.

4.1.6. Analysis of questionnaire

Questionnaire No. 1Impact of NRB's Directives on commercial bank:

The analysis of primary data collected through questionnaire. Impact of NRB's Directives on commercial banks are based on the questionnaires distributed to the management department of ten banks, namely Nepal SBI Bank ltd., investments Bank Ltd., Nepal industrial and commercial bank ltd, Siddhartha bank ltd., standard chartered bank ltd. In addition, Everest bank ltd. The respondents of these questionnaires are 20 in total where the samples of questionnaires were 25. The model of prepared questionnaire and respondent's response are shown in appendices. The data are converted into percentage based on the total number of respondents.

About the positive impact and negative impact of NRB's revised directives question no1 different person have different opinion. It is found that 70% of them say there is positive impact as safety of loans, 30% of the respondents felt that there is negative impact such as declining profit of the bank due to decrease in loan amount. Hence, it is seen that new directives will save the loans amount of the banks even through there is decreases in loan amount resulting negative impact on bank's profitability.

The respondent about the question no.2 shown more effective that 100% respondent agree newly issued directives. It seems that the new directives come with improving leaving its drawbacks behind. But it cannot be said that it is perfect one.

The responses of the question no.3, i.e., 60% of the respondents return the answer that the directives issued by NRB to commercial banks are important to keep the sound financial health of the banks and it protects the deposits of general public and 40% of the respondents felt it keeps the sound financial health and it protect the deposits of general public. These reason shows directives are very important to protect a whole economic condition of country.

Question no4; mainly focus on the problems currently facing by commercial banks because of newly issued directives,40% of the respondents felt there is decrease in loan amount while 20% of them say is no problems at all but 20% say there will decrease in profitability while 10% say that it will increase its operating cost decrease loan amount and decrease profitability of banks and remaining 10% agree with the banks have o increase its operating a cost, decreasing loan amount and decreasing profitability of banks. These answers pull towards existence of negative impact on commercial banks in the form of decrease in loan amount as a result of banks also decrease.

When asked about the maximum benefit taker from new directives related to capital fund requirement or capital adequacy in question no. 5,705 respondents felt that the depositors will take the maximum benefit due to safeguard of them deposits. While 20% of them answered that the loan receiver will take maximum benefit and 10% of them think that no one take the benefit.

Positive impact of revised directive re3lated to minimum capital requirement is found from responses of question no. 6 when asked the question about views on the minimum capital requirement, which has to maintain minimum paid –up capital from 250 million to 10000 million by mid July 2009, 65% of the respondents favor with higher the capital, stronger the banks and 35% feels it will affect the profitability of banks because banks have to rise there capital fund minimum of 10% paid up capital increment every year.

Question no7 is about the directives related to capital adequacy enhances the financial strength of the banks, 100% respondents reacted positively.

When asked about the impact of new directives on credit exposure of banks in question No. 8 ., it is found that there is negative impact on commercial banks. Where 70% react that it will decrease profits of banks in coming year due to decrease in loan amount, but 10% are in confused stage and 20% of them think it will increase profit of bank in coming years due to protection of loan leads to protection of banks from bankruptcy.

Question no9 is asked mainly to find out how the directives related to single borrower limit affect the banks, 75% felt that banks have to increase the core capital because the limits are based on core capital not total capital fund. at the same moment 15% of the respondents felt that the profitability will decrease income of banks will disburse more than single obligor limit so the interest income of banks will decrees while 10% respondents felt that the profitability will decrease because banks cannot disburse more than single obligor limit so the interest income of banks decrease while 10% respondents answered so the interest income of banks will decrease while 10% respondents answered that there will decrease in loan amount.

The bankers are asked in question no 10 about the important of directive related to single borrower limit, 100% respondents agree with important of such directive to commercial banks protect the bank from bankruptcy.

Question no11 is about any changes necessary in accounting policy and the structure of financial statement. 80% respondents respond positively whil 20% may not know whether it should be changes or not. This reason force to say there may still have some defects.

Question no. 12 about the directives related to accounting policy is made as cushion against possible losses and to reflect the true picture of bank's assets, most of the respondents i.e. 80% felt it true 20% felt it false.

Question no. 13 is about the directive no 4 related to provision of accounting policy and the structure of financial statements. 60% respondents say it keeps a systematic and permanent record of all financial transaction of business, it is also important to make transparent true and fair position of a business entity to its shareholders, of the depositors and concerned people and as whole it protects the property of the business. While 20% feel that it only keeps a systematic and permanent to make transparent true and fair position of a business entity to its shareholders, depositors and concerned people. These responses give the positive impact of directives to the commercial banks as well as concerned people.

In question no. 14,95% respondents felt it protects the banks from bankruptcy as well it safeguards the deposits and strengthens backbone of the banks but 5% felt it only safeguards the deposits.

When asked about the impact of changing the directives in maintaining liquidity in question no15,40% person felt that it only increase the primary reserves and 40% say it protects the banks from bankruptcy and 20% say it decrease the profitability of banks. Therefore it has both positive and negative impact to the commercial banks.

This is the last question, which is about the action taken by NRB in case of violation of rules, consisting eight questions. Each question has two alternatives i.e. right or wrong. Respondents have answer eight right or wrong.

i. 100% respondents say it is right about NRB's action to make rearrange provision within three month and submit to NRB.
ii. 70% respondents view to prevent to declare and distribution dividends is right 30% disagree.

iii. The view about to prevent the refinancing facilities from NRB is 70% right but 30% wrong.
iv. The action taken by NRB to commercial bank with preventing in lending loans is 75% of them say right but 25% say it is wrong
v. 65% of the respondents say it is right decision to prevent in taking deposits by banks and 35% say it is wrong to prevent to take deposits.
vi. When the question about answer comes as wrong to take such action but 20% agree with this.
vii. Prevent to open new branches is 80% right while 20% say it may be wrong.
viii. Charging fines in case of violation of rules 80% agreed and 20% disagreed.

Questionnaire No. 2: Implementation of NRB's directives by commercial banks.

This analysis is based on the questionnaires collected from the Nepal Rastra Bank's Supervision and Inspection Division. The model of prepared questionnaire and the respondents table are shown in appendices. The results have been converted into percentage basis on the total number of respondent. The respondents of these questionnaires are 5 in total.

The first question was asked about that the banks are fully following the directives issued by NRB. Of them agreed while 20% disagreed that in some cases they are not following the directives.

The second question was asked about the objectives behind the changes made in provisions of the directives, 60% result is to uplift banking system in Nepal to international standard, and 20% of the result is to protect the deposits of the general public while 20% result for strong financial position of the banks. This result shows that the new directives are made with a view to protect the deposits as well as to meet international standards and strengthening financial position of the banks.
The third question is about how you supervise to see whether banking sector is complying with existing acts and the instructions of NRB, 80% of them answered that they review the functioning of financial institution

and takes necessary actions in case of violation of rules. While 20% say they only review functioning of financial institutions.

The fourth question is concern about, the effectives of supervisor system for sound management and internal control. 40% of the people answered offsite supervision; on-site supervision and special supervision are effective for sound management system and internal control system while 20% for only offsite supervision, while 20% answered only on-site supervision and 20% for only special supervision.

The fifth question is about which provision is applicable to give for banks that meet the standards higher than the directives, 100% of the respondents felt there is no provision at all.

The sixth and final question is about the type of action they take in case of violation of rules, it is observed that 60% them agreed with action will be taken like suspend the license issued to such bank, restriction on the payment of dividend them answered restriction on the lending or investment business while 40% of them answered that the NRB will only restrict on the payment of dividend.

4.2. Major Finding

This research mainly focuses on the directives of NRB to the commercial banks and their impact and implementation. The following findings are found from secondary data also from primary data (questionnaires) are stated during the time of the study:

1. Capital Adequacy Ratios

The capital adequacy ratio has changed as per new NRB directives. During the research it is seen that banks need to maintain its minimum paid-capital from Rs-250 million to Rs 1000 million by mid-July 2010. And, capital adequacy ratio of bank has been changed to 12% from 11% from FYs in 2007/2008. The capital adequacy ratio of Nepal SBI Bank is express by 1.57% while Nabil banks stands at 12.31% with excess for 0.32%. Nepal SBI has total capital fund 1722.184 of Rs million comprising of Rs. 1394.064 million core capital and Rs 328.12 million supplementary capitals and total capital fund of Nabil Bank is Rs.

2998.72 million with core capital of Rs. 2363.59 million and supplementary capital Rs. 635.13 million. The total risk weight assets comparing on- balance sheet and off-balance of Nepal SBI is Rs 20,898 million and of Nabil is Rs 45,345 million. It can be seen that both bakes have shortfall of supplementary capital, which can be fulfilled by the surplus in core capital according to the directives.

2. Loan classification and provisioning

Banks are required re-categorize the loan four different categories as per new directives. The percentage of proving required to made by the commercial banks for each category of loan are100% provision for loss loan (i.e. the loans with past due for a period of one year or above). The data given by the Nepal SBI and Nabil bank shows the impact of the directives. The amount of total provision of Nepal SBI has increased total loan provision amount from Rs 605million to 633 million with increases in total loan amount from Rs 10065 million to 12746 million while increasing loan Rs. 15903 million from Rs 21759 million. This means that the net profit of Nepal SBI and Nabil will decrease by Rs 137.29 million and 1.9 million respectively. But loan amount Nepal SBI and Nabil has been increased by 22.29% and 21.3% respectively. This means increase in total loan amount increase the total provision, which result to affect the bank's profitability.

3. Single Obligor Limited:

The new provision of single obligor limit laid down the limits for the borrower based on fund and non-based on capital fun. According to new directives, the limits for the borrower on both fund based and non-fund based loan have come down. This study shows that the limits of Nepal has loan have come down. This study shows that the limits of Nepal SBI has come down to Rs. 348 million from 603 million and the limits of Nabil Bank has also scaled down from Rs.1049 million to Rs 590 million of fund based loans. In the similar way, the non-fund based loans has also been decreased in Nepal SBI from Rs.861 millionto Rs 697 million and in Nabil from Rs 1099 million to Rs 1181 million. With decrease in the limits banks must cut down the loan disbursement to clients and some of the customers if any have to repay part of their loans very soon.

4. Accounting policy:

According to new provisions banks have prepared the financial statements thoroughly in conformity GAAP, Act and Banks and Financial institutions Act, 2063 (BAFIA). Banks have made balance sheet, profit and loss account, profit and loss appropriation account, cash flow statements and loss account, profit and loss appropriation account, cash flow statement and other stated schedule as per new directives. All these account deals with the account of the banks. Interest expenses on interest deposits liabilities and interest income on earning assets & investment are accounting for on accrual basis. Interest income on loans and advances are recognized as income on cash basis. The Nabil Bank has appropriated additional Rs 1 million from profit under contingent reserve.

Fixed assets are carried at cost less accumulated depreciation. Nepal SBI Bank and Nabil Bank uses the written down value method to depreciation the fixed assets at the rates prescribed by income Tax, Act 2002.

Due to the change in accounting policy, 25%of the revaluation exchange gains should be apportioned as exchange fluctuation reserve. Accordingly, amount of Rs. 1.14 million of Nepal SBI and Rs. 6.4 million of Nabil has credited directly to the exchange Fluctuation Reserves which results to reduce the net profit for the year by such amount.

5. Reducing the risk

Banks have classified the assets and liabilities based on maturity period into five different time interval. Banks are required to be maintained the liquidity based only on primary reserve. The secondary reserve has been scrapped out from 22 july,2002 banks need to keep balance at NRB such as 7% of current and saving deposits and 4.5% of fixed deposit liabilities, where as cash in vault should be 2% of total deposits liabilities. Nepal SBI Bank has short fall amounting to Rs 318.32 million while Nabil bank has shortfall in balance at NRB respectively. Therefore in case of Nabil, the bank requires another Rs 227.49 million to meet the requirement of balance at NRB. This can be fulfilled with adding 1% excess amount of cash in vault.

6. **Impact of the NRB directive on the commercial banks:**

This research study is based on the primary survey also. The survey shows the new directives have both positive and negative impact on commercial banks.

Positive impact:

i. Maintaining the capital adequacy enhances the financial strength of the banks.

ii. Maintaining and reducing the risk on activities of commercial banks will protect from bankruptcy and it keeps the deposits of depositors safe that maintain the banks reputation.

iii. Loan loss provisioning minimizes the credit risk.

iv. Directive s issued by NRB are very important to keep the sound financial health of the bank, to protect the banks from bankruptcy as well to protect the deposits of general public. It makes safety 0f loans. Overall, the directives strengthen the financial conditions of the banks.

v. Accounting policy keeps a systematic and permanent records of all financial transaction of the business, which protects the property of the business.

Negative impact:

i. New provision of single obligor limit has made the banks either to increase its core capital or reduce the loan amount to single borrower.

ii. Fund based and non-fund based limits has been recued which makes the backs to cut down loan disbursement amount.

iii. It is found that 70% respondent felt there should be change in the accounting policy so that accounting policy laid down by NR may not have negative impaction commercial banks.

iv. Because of removing secondary reserve, banks have to increase the primary reserve to maintain the liquidity ratio.

v. Banks have been facing decreasing profitability as a result of following directives. Due to decreasing in credit exposure of interest income from loan has decrease in credit it will decrease profit of banks in coming years.

vi. Overall negative impact of banks are facing now is the decreasing profitability with decreasing loan amount.

7. Implementation of NRB Directives by commercial banks

From the data collected from Nepal SBI Bank Ltd. And Nabil Bank Ltd. It has been found that both banks are following the NRB's directives. The presented data clear that SBI has maintained a capital adequacy ration at Rs. 13.57% and Nabil is Rs. 12.31% when the requirement is 12%. Both banks have categorized the loans and advances according to the format given by NRB. Both banks have obeyed the directives and rules laid down by NRB. All the balance sheet, profit and loss account, cash flow statement and another and stated schedule by NRB have prepared as according to the format given by the directives issued by NRB Banks have maintained the liquidity risk as per provision.

The collected responses from NRB's inspection division clears that the banks are implementing the directives. But in some cases they are not following the directives. The concerned authorities of NRB undertake the on- site supervision, off-site supervision and special and the instruction of NRB or not. They review function of financial institution as well take necessary action in case of violating the directives.

Chapter v

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1. Summary

This research is about the NRB's guidelines on commercial bank and its impact and implementation. The general directives have been taken as guidelines. The study includes only five selective directives i.e. Directives number 1-5 among the 16 directives related to banking regulations and prudential norms. There are twenty-six commercial banks in Nepal but in this study only two commercial bank viz, Nepal SIB Bank Ltd. and Nabil Bank Ltd. are selected as example. This study reveals that the increasing provisioning amount would decrease the profitability of the commercial banks .In this study ,both Nepal ,SBI Bank and Nabil Bank have been fully implementing the NRB's directives. Capital Adequacy Ratio of Nepal SBI and Nabil are 12.32% and 9.18% respectively , which are more than 9%. The banks have categorized the loan amount into four different categories. The increasing loan loss-provisioning amount decreases the profit of the banks and vice-versa. The change in the single obligor limits brought down the limits of the fund based and non-fund based loans ,which result to reduce the loan exposure of the banks. Due to the change in accounting policy ,both banks have transferred 25% of the total revaluation gain to Exchange function Reserve. Banks are following the directives but in some cases like supplementary capital and balance at NRB there is short falls. The excess amount of core capital in supplementary capital and 1% excess amount of total deposits in balance at NRB can compensate this short fall.

Banks are required to increase their primary reserve to remove secondary reserve effective from 22July 2002.As a whole it can be seen that new directives are made with a view to protect the deposits of depositors and for safety of loans , which enchances the financial strength of the banks. Even that it has adverse effect in profitability of the banks but this decreasing profit will affect the banks only for short term. Although the study is limited to only two banks, it however allows knowing that thereis a significant impact of such directives on the various aspects of the commercials banks. However NRB Directives help to maintain stability of commercial banks in the financial market and to uplift the banking secter in Nepal to international standards.

5.2. Conclusion

This study related to NRB directives concluded that all the change in NRB Directives made both positive and negative impact on the commercial banks. Even through this is limited to only two sample i.e., Nepal SBI Banks and Nabil Bank, among entire population, it clear the new directives issued by NRB make a good impact more than bad impact on the various aspects of the banks. It can be seen that provision has been changes and the increased provisioning amount has decreased the profitability of the commercial banks. Apart from it, loan exposure has been cut down by the NRB. Therefore, reduction in loan amount results to decrease the interest income from loans, which will decrease the profit of the banks in coming years. Decreasing profitability always push-towards lesser dividends to the shareholders, and lesser bonus to employees. Besides, the change in the single obligor limits, all the commercial banks have to increase their core capital, which will increase the expenses. Thus, recently main problems faced by banks are increasing operating cost and decreasing loan amount resulting decrease in profits o the banks.

Apart from sides, it also has positive sides. Recently the problems of banks are increasing operating cost and decreasing loan amount resulting decrease in profit of the banks. But it is only for short term because the directives are more effective to protect the banks from bad loans, which protect the bank from bankruptcy as well as protection of deposits of depositors. Increased in capital adequacy ratio strengthen the bank's financial position, loan related provision will make safety of loans except that risk reducing provision will protect the banks from liquidation. The accounting policy of NRB will help to win the trust of concerned people like shareholders, depositors, employees etc. because of making transparent, true and fair pictures of business. Above all it can be concerned that newly issued directives are more beginning. To avoid the decreasing profit of the banks, they should search the alternative such like more investments in other business, banks should adopt new technology according to demand of time and must not only interest income for profits. Finally, the changes in directives may bring flourish to all the people shareholders, depositors and employees and the economy of the country as a whole.

5.3. Recommendations

The recommendations to Nepal SBI Bank Ltd., Nabil Bank Ltd. and also to Nepal Rastra Bank are presented based on the analysis of data i.e., secondary data and primary data, major findings of the study and conclusions in order to improve the performance by avoiding shortcomings.

Recommendations to Nepal SBI Bank Ltd and Nabil Bank Ltd

On the basis of the analysis, directives issued by NRB are found very important not only to build the commercial banking in Nepal but also to maintain country's economic stability. Thus it is why the bank should obey its directives and rules. Both Nepal SBI banks and Nabil banks are implementing the directives rules and regulations laid down by NRB. They are good in maintaining the provisions of the directives. Even them some recommendations seem relevant based on finding from the study. The following recommendation are presented as follows.

- ❖ The banks have to make its like two wheels of one cart so banks cannot run in the absence of only one of them. One can be achieved only at the cost of the others. Only liquid banks can attract more low cost deposits, which helps in reducing interest expenses and give loan to good customers at lower rate, which results in requirement of less provision and high net profit. So. Banks should increase their reserve to maintain the liquidity risk. On the basis of findings, balance at NRB has shortfall of SBI Bank 318.31 million. Thus SBI Bank better performance even after adding 1% excess amount of cash of total deposits.

- ❖ With the reduction the single Obligor limits of fund based and non fund based loans, both banks have only two alternative either to limit its customer within standard or to increase its core capital. Due to limits, which are based on core capital not on total capital fund as per new directives, banks must increase their core capital instead of reducing the clients to expose itself more credit risk. It will be good for banks that higher the capital stronger the banks.

- During the research it is seen that banks are recently facing the decreasing profitability due to reduction in loans amount its interest income put it is only for short term. There are other sources, which banks should adopt to increase its profits. Banks can increase its banking services not only in the heart of capital city but also in distant area. Banks must adopt the new technology such as information technology so that it will be timely able to update management information system, internal housekeeping, and reports.

Recommendations to NRB

On the basis of the responses made by commercial banks about the directives NRB should make the following activates.

- NRB need to be practical, whichever rules made by NRB should not make rules only to meet the international standards but it must useful the context of Nepal.
- NRB has to make its supervisory system stronger to make sure that banks are not violating the rule of NRB.
- In the question of action taken by NRB in case of violation of rules, NRB may think before decide. The collected questionnaires suggest that the NRB should not suspend the license of such bank at once and charging fine may be wrong ion some cases.
- The newly issued directives have certain changes in provisions. Its main objective is to protect the deposits of the depositors and to uplift the banking system in Nepal to international standards. But, to combat the problems associated with the directives NRB, it needs to carry out proper homework and consultation with different banking experts. They become irrelevant if they are not implemented.
- To reduce the credit risk and bad quality of assets in the bank's balance sheet, Credit information Bureau should be strengthened.
- At, last NRB may have made provision for such banks, which meet the standards of directives. It may be rewarded or admit such banks for counseling as banking expert.

Based on the research study, the interest rate offered by banks on deposits has been lower than the information rate; there is a strong case for bringing it up. But the method adopted recently by the central bank to bring about the correction the rate charged on loans, the central bank has indicated that it is going back to regulate system discarded longer ago.

No, doubt, the huge difference between the interest on the deposits accepted and the loans advanced by banks, called the :Spread is an intermediation margin and if it low in this market or there isn't enough competition.

Experience shows that the increased number of bank or finance companies is not sufficient to ensure better competition. A new bank is more likely to emulate the functioning of the existing banks. Alternatively, avenues should be made available for the small as very to park their saving and for the borrowers to borrow funds. As of today, they have nowhere else other than banks to approach. The existing stock market has very limited options for them.

Almost every bank has been focusing only in strengthening its legal department by hiring full-time lawyers well as outside consultants, while activities in marketing, credit risk analysis and monitoring the loan portfolio are still rudimentary. This naturally makes the bank's investments highly risk and the interest rate they have to charge the borrowers are bound to be high in order to cover the risk. Financing professionally managed corporate is less risky and some of them are getting back finances at interest rate lower than the highest interest rates the banks pay on the deposits.

Therefore, Nepal Rastra bank should immediately start measures where the banks become more efficient, for example, in risk analysis and monitoring the portfolios. Nut these measures must be market-oriented. One such step would be issuing publicly tradable securities by NRB itself. Similarly, even private limited companies should be encouraged to borrow from the general people by issuing publicly tradable securities. The credit information company (that is now limited to a blacklisting of the companies can be easily developed as such as agency to rate such securities.

The recent news that NRB is making all the government bonds tradable in the stock exchange signals one step in the right direction, but it is one going to be sufficient. NRB must come out with more actively in the market to spur competition and make it imperative for the banks to be more efficient.

2.1.4. History of Commercial Banks In Nepal

The kingdom of Nepal lies along the southern slopes to Himalaya. Through the modern banking institution has a very recent origin in Nepal. Some crude bank operation was known to have been practiced even in the ancient time. Through the term "Bank" is new thing for Nepalese economy. There was banking business in the form at money leading business done by several persons. "It is one possible to give correct chronological history in view the fact that not authentic historical record is available in respect of banking, it can be inferred from references in the history of Nepal, regarding the rebuilding of kathmandu in 723 A.D. by Gunakam Dev from the borrowing and that of Tankadhari action of introduction of Nepalese Sambat. Some 57 years the rafter to make the repayment and all debts that money leading have been prevent long before that."

Money lending business is down by Tankadhari during the ruling of Jayashiti Malla in the 14th century ; he classified the people in 64 classes on the basis of their occupations. Tankadhari were of them who occupy money lending and commercial business activities. Money lending business particularly for financing the foreign trade with Tibt becomes popular during the Mallas. If we go through the Nepalese history we find the Nepalese participation in foreign trade with Tibet. Indian is very popular in foreign trade beginning. The money lenders at that time advanced for commercials transaction against personal securities. The farmer also used to bowwow money from such lenders.

There were certain practices in this business such as to charge rate of interest and other extra dues on loans and advanced or to purchase the standing crops at very low price in consideration of partial repayment at soon. There all causes are due to the absence of deposit function. Those money lenders don't accept deposits from the people but only want to advance their own money. Thus sources of funds were very limited and money lenders have monopoly on such business activities.

In reference of banking development of Nepal, Y.P. pant that "The history of banking and currency in the country become definite only from the 15th century that is in the Lichhivi period when first coins were printed with the advance of the 7th century coins of red copper started to be used for exchange purpose. Later on during 12th century in the work of various reforms measures initiated by the rules particularly during the Malla period staed the inspiratiuon of the King names and data on the coin."

Further steps were taken on this ground Randip Singh (1877-1885) established "Tejarath Adda" in kathmandu. Tejarath Adda was government financial institution supply credit to people at 5% rate of interest against security of gold, silver and ornaments."

And government servant can also take loans from the "Tejarath Adda" against the personal of the security. During the time of Chandra Samser (1901-1991) Credit facilities of the "Tejrath Adda" were extended to some other part of the country by opening its branches at that time value of loan for consumption purpose was large and to control various rate of interest ranging from35% to 57% and also the crub unfair practices on the part of the money lenders. In this regard Y.P. pant express "In the overall government of banking system in Nepal the 'Tejarath Adda' may be regarded as the father of modern banking institutions and for quite a long time it rendered good services to the government servant as well as to the general public. The institution adopted one of the elementary functions of the granting loans against gold, silver and other collateral securities which probably weren't considered then to be a function falling with in the competence of banking."

Slowly by taking all these into account in the year 1997 A.S. a semi government bank was established to remove to remove the inconveniences cause to the people and hindrances on the economic development of country due to absence of modern banking system known as Nepal Bank Limited and was incorporated under the Nepal Bank act. 1936. The banks 51% share held by HMG and 49%.

"till the establishment of Nepal Rastra Bank in 1956 A.D. NBL. Remained the only financial institution of the country. Its contribution to sustain and improve the economic aspect of nation cannot be underrated. NBL discharged the jobs of central bank to a port beginning till the establishment of the central bank. During the period NBL played vital role in helping in creating the banking habits among the people, wadding magnetized area and helping business communities, the government in various way." Due ti NBL's nature and scope of the business, the bank was unable to regulate and manage currency credit and central banking function properly. At same time, with growing realization and need for promoting banking activities in the country, the establishment of a central bank has become urgent. As a result, Nepal Rasra Bank was established on April, 1956 under the NRB Act. 1955 as central bank.

"the establishment of NRB set a milestone in the history of banking in Nepal. After this new way of thinking and new sort of sprit arise in the field of banking NRB was established with an objective of supervising, protecting and directing function of commercial banking activities. Although the NRB established in 1956, it took entirely a decade to consolidate its power as the bankers' bank and controller of the credit, NRB started issuing currency only in 1959 A.D."

In a view of the various development programs launched after the beginning of planned development in the country, government established another commercial banks, Rastra Banijaya Bank in public sector on 23rd jan. 1966 to provide banking facilities and to help economic development. Till 1974 A.D. (2031 B.S.) to commercial banks NBL and RBB were functioning under two different acts. So it was felt necessary to introduce a new commercial bank act to bring these two commercial banks under the some policy and rule. On 2031 B.S were introduced new commercial bank act 2031 B.S After then NBL and RBB banks are functioning under the commercial banks act. 2031

In 1963 A.D. a cooperative bank was established that was converted later into agriculture development bank in 2024 B.S. to be the main financial institution for small rural. Agro industrial and cooperative sectors. For a specific purpose of industrial development of the country. Nepal industrial development corporation was established under the NIDC Act 2016 B.S. it was set up with an objective of conducting feasibility study market survey, financing for the development of the industry etc.

The tasks of banks are very dynamic, complex and riskier also. In this context only local commercials banks could not play their role in development of modern banking, Realizing this fact, the government felt that joint venture banks could contribute significantly in the formation and mobilization of internal capital for trade and commerce. As management of these JVB's are mainly held by foreign banks. It was felt some competitive advantages like increase skilled personal with modern banking knowledge, efficient banking service, advance management skills and international network of bank branches, accordingly government introduced a new banking policy in 1980. The policy allowed foreign banks to operate and joint venture bank provide autonomy to fix interest rate to a certain limited and introduced auctioning of government securities. These reforms are considered partial liberalization and ways to open economic policy. As a result first join venture bank Nepal Arab bank limited 2042 and Nepal Grindlays Bank limited 2043 were established.

Nepal entered a new era of development following the history political change with the restoration of parliamentary system of government based on multi-part democracy in 1991 A.D. As an important strategy in resource mobilization, democratic elected government has given priority to foreign investment, private sector participation and economic liberalization. In order to encourage foreign investment policy in 1992. Forging investment is expected to supplement in management, skill and productively and providing access to international market.

In this context HMG/N has encouraged foreign investment in Nepal by providing attractive incentive and facilities within liberal and open economic policy. The importance attached to foreign investment is clearly elected in the new constitution. In the directive principles of the constitution, it is started that a policy of attracting foreign capital and technology shall adopted.

When democratically elected government banks introduced liberalization and open economy policy, the number of joint venture banks increased rapidly. Himalayan Bank Ltd (2049 B.S.) Nepal SBI Bank Ltd (2050 B.S.) Nepal Bangladesh Bank Ltd. (2051 B.S , Everest Bank Ltd (2051 B.S) were established and are providing full fledge banking services. A number of other financial institutions are also emerged in the country such as NIDC, employee provident fund, Insurance company, cooperative organization etc. Newly Kumari Bank and Laxmi Bank which are also providing smooth and efficient banking services to meet the different needs of the people, society and the nation.