Study on Financial Sector Reform in Nepal

(Overall Impact and Public Ownership of Financial Institutions)

Undertaken by:

Dileep K Adhikary, Rambabu Pant, Bhisma R Dhungana

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South Asian Network of Economic Institutes (SANEI)

Pakistan Institute of Development Economics, Quaid-i-Azam University,

Islamabad 44000, Pakistan

Project Research & Management Associates P Ltd

New Baneswore, GPO Box 2044, Kathmandu, Nepal

prama@hons.com.np

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PREFACE

Financial sector reforms have been initiated in several countries including Nepal. For many of them, the financial sector remains at a relatively early stage of development, and continues to display a number of weaknesses. Under the reform program of Nepal, the large state owned commercial banks (SOCBs) are main targets on restructuring that still dominate the banking sector, in terms of total assets. These banks are gradually being restructured and put on a more stable financial footing. The reform also aims at doing away with government ownership and enhancing competitiveness of the financial sector. Accordingly, the re-engineering of the central bank and capacity building programme for the financial sector as a whole are as well incorporated.

The efficiency of the financial sector influences the efficiency of the real sector as a whole. The financial sector reform programme introduced in Nepal holds importance additionally given the entire economy facing turmoil on account of political instability brought about by internal conflicts. Whether the reform programme is successful and whether it is heading towards the right direction is, therefore, a major cause for concern to all stakeholders. The study examines the state of implementation, issues at hand and the impacts made on the turnaround of the ailing financial intermediaries and on the competitiveness of the banking sector. And it draws the learning points for the Nepal's ongoing reform process which could have significant lessons for other countries in the south-Asia as well, given the socio-economic and cultural proximity of the region as a whole.

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ACRONYM

ABBS	Any Branch Banking System
ADB	Asian Development Bank
ADBL/N	Agricultural Development Bank Limited/Nepal
AMC	Asset Management Company
AML	Anti Money Laundering
ALM	Assets and Liability Management
ATM	Automated Teller Machine
BAFIA/O	Banks and Financial Institutions Act/Ordinance
CAMELSS	Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risk, Systems.
CBPASS	Commercial Banking Problem Analysis and Strategy Study
CEO	Chief Executive Officer
CIB	Credit Information Bureau
CRS	Compulsory Retirement Scheme
CSR	Corporate Social Responsibility
CST	Coordination and Support Team
DFID	Department of International Development
DRT	Debt Recovery Tribunal
EPFC	Employees Provident Fund Corporation
FSR	Financial Sector Reform
FSRP	Financial Sector Reform Project
FSSS	Financial Sector Strategy Statement
FSTAP	Financial Sector Technical Assistance Project
GDP	Gross Domestic Product
GoN	Government of Nepal
HO	Head Office
HMG/N	His Majesty's Government of Nepal (Old Government)
HR	Human Resource
HRM	Human Resource Management
IBIS	Integrated Banking Information System
IMF	International Monetary Fund
IRAF	Institutional Risk Assessment Framework.

IT	Information Technology
M&A	Merger and Acquisition
MIS	Management Information System
MoF	Ministry of Finance
MoICS	Ministry of Industry, Commerce & Supplies
MS	McKinnon and Shaw
NBL	Nepal Bank Limited
NGO	Non-Governmental Organization
NIDC	Nepal Industrial Development Corporation
NRs	Nepali Rupees
NPA	Non-Performing Assets
NPL	Non-Performing Loans
NRB	Nepal Rastra Bank
OED	Organisation for Economic Development
PWC	Price Waterhouse and Cooper
RBB	Rastriya Banijya Bank
SAARC	South Asian Association of Regional Cooperation
SANEI	South Asian Network of Economic Institute
SEBO	Securities Exchange Board
SMS	Short Message Service
SOCB	State Owned Commercial Banks
TOR	Terms of Reference
UK	United Kingdom
US	United States of America
VRS	Voluntary Retirement Scheme
WTO	World Trade Organization

EXECUTIVE SUMMARY

Financial sector is the backbone of the economy. Basically, the financial sector has to be competitive, broad based and within the range of customers outreach and affordability for the general pubic. Until mid 1980s, the financial sector of Nepal was not opened up for the private sector. Financial sector liberalization in Nepal started from mid-80s by opening the banking system to the private sector. Various reform measures were introduced after this including implementation of CBPASS Report of 1992. But as the reforms were undertaken in piecemeal basis; the financial system continued to be weak, fragmented and inefficient. The progress was insufficient to cope up with the demand for increased level of reforms in the financial sector. In November 2000 the government issued Financial Sector Strategy Statement (FSSS) specifying five strategic fronts to generate a more competitive (well regulated, sound, market oriented and stable) financial system to contribute to macro-economic stability, private sector led economic growth, and poverty reduction on a sustainable basis. The strategies comprised of initiating strong corporate governance, enhancing the authority and capacity of NRB, improving legislative regime and judicial processes, enhancing accounting and auditing standards, and promoting financial discipline through disclosure and competition. FSSS outlined several action fronts through NRB.

In the meantime, the weaknesses of the financial system were highlighted by various studies. In this context a study by the World Bank (2002) had also pointed out weaknesses in the Nepal's financial sector as of weak and fragmented legal financial environment, weak and fragmented accounting and auditing environment, and poor competition in the banking sector, etc. In order to address all the deficiencies of system a comprehensive reform package was designed in 2000/2001 and put to implementation in July 2002 with the financial and technical support of a number of donors under the co-ordination of the World Bank. The reform package had three major dimensions i.e. the reengineering of the central bank - NRB, restructuring of two state owned commercial banks - RBB and NBL, and the overall capacity building of the financial sector including legal and institutional reforms.

The reform program launched in July 2002 has passed five years. This study seeks to review and analyse the financial sector reform effort on public owned financial enterprises, with a view to identifying and institutionalizing best practices. The methodology is a mix of quantitative and qualitative methods, aimed at reviewing the benefits of reform from the perspectives of different stakeholders i.e. customers, owner/ shareholders, bank management, and regulatory authorities.

Regulatory oversight

Before, the FSRP, NRB was lacking autonomy handicapped by the old Act with provisions of less effective regulative regime. In order to increase the autonomy and capability of central bank for making its monetary policy, supervisory and regulatory functions effective and enhance the regulatory regime for the financial sector, the accomplishments under FSR included a) replacement of the existing Charter of NRB and strengthening of the NRB's internal system and procedures (improvement of rules and by-laws, b) corporate reorganization of NRB on functional mode, (accounting and auditing function, inspection and supervision bye laws, staff downsizing, and strengthening HR, IT, Legal and other areas), and c) formation of the Coordination and Support Team (CST) to monitor and implement the FSRP.

New NRB Act enacted in 2002 provided more authority and autonomy to NRB to formulate and implement monetary policy and discharge its role towards the modern financial system. NRB made improvements in the regulatory regime by issuing 16 directives and 2 guidelines, intervened in problem banks and introduced Risk Management Mechanism for banking and financial institutions. NRB is capacitated in terms of authority, prudential norms and regulations. Its efficiency and effectiveness in banks supervision and regulation has improved. NRB's capacity will further enhance once the reengineering of NRB is complete.

Services Front

a. Banks

There are several categories of financial service providers active in formal and informal sectors in Nepal. Apart from the commercial banks, the financial system has outgrown to include development banks, microfinance development banks, finance companies, non-government micro-credit institutions, and non-government cooperative societies.

FSR was, however, designed primarily to support RBB and NBL from further deterioration and readying them for privatization. To improve the operational capacity of these two big commercial banks, the professional management teams were placed in NBL in July 22, 2002 and in RBB in January 16, 2003. These professional management teams carried out restructuring of the organisation, downsized staff and introduced better management practices and computer application. There is now an adequate system and procedures for the banking operation in terms of documented policies, enhanced risk management skill in bank employees, increased level of good governance, resumed profitability, reduction in negative capital adequacy, reduction in the level of NPL, and competition in the markets especially in quality of services and products

The government has not yet withdrawn from the ownership in NBL and RBB for lack of sufficient progress in rightsizing these institutions and readying them for privatisation with strategic investors.

For other banks the consideration was put on to make the sector competitive by a) eliminating the current restrictions on foreign ownership, b) moving away from direct participation in banks by the government and NRB, and c) doing away with the current mandated lending requirements, the establishment of rural branches, and the cross holding in banks. FSR considered restructuring of ADB/N and winding up NIDC. But, the intended reform of the latter has not gone satisfactory ahead.

b. Microfinance

Financial sector reform programme envisaged developing an improved system of micro-finance in respect of restructuring and privatization of the Grameen Bikas Banks, and providing sustainable micro-finance services through private sector institutions. On establishing improved system for micro-finance the Grameen Bikas Banks are yet to be fully restructured and privatized. Some new microfinance institutions have come into existence due to liberal policy on capital requirements. However, the establishment of a second tier institution to regulate the micro-finance institutions, the monitoring of the NGOs and saving and credit cooperatives operation and their regulatory jurisdictions still has remained an issue in the financial system.

c. Finance Companies

Finance companies are important players in the financial sector that come in between banks and microfinance institutions. Financial sector reform did not consider any specific programmes of reform except regulative and legal reforms, though at times NRB had to take additional corrective measures over a few of them for reasons of management problems. There are a few apparent issues in respect of their loan practices and capital injections. All the finance companies are required to enhance their capital base by 2013 AD.

Capacity Building

The capacity building in the financial sector was envisaged by way of legal reforms and improvement in professional supports. The first one included formulation of appropriate legislations (Debt Recovery Tribunal Act, 2002, Secured Transactions Act 2006, Bank and financial Institution Act 2006, Insolvency Act, 2006), and improvements on Company Act 1997 and Contract Act 1998. The second one comprised of transforming Bankers' Training Center into Banker's Training Institute, strengthening Credit Information Bureau and enhancing public information through supporting Financial Journalism. Not much has happened in this front apart from converting CIB into a company and upgrading its IT Platform. In order to enhance the recovery of NPL, a Debt Recovery Tribunal (DRT) has been formed and is functioning to date.

FSR Achievements

At the start of the reform in 2002 both NBL and RBB were positioned as failed institutions with operating losses and huge negative net-worth. The financial sector in general and banks in particular were operating on a fragmented legal platform. NRB as a central bank was not fully autonomous, did not have full authority to regulate the financial sector and was grossly incapacitated to carry out the supervisory function. The reform has addressed the legal shortfall; still some associated regulations have not taken off the ground (cross border issues, and home/host country supervisory co-ordinations, and documented prompt correction action rules for identified early warning signals). The reform has helped NRB to be on the driving seat with capacity to do so; still some elements of capacity remain to be developed (especially in enhancing the supervisory capabilities). The reform has enabled the failed banks back to the profit, but issues such as negative networth, succession plan, union-management relation and divestment of government ownership to strategic investors remain to be addressed.

The public ownership of financial institutions has continued. The public ownership in respect of government, NRB and government owned corporations is significant. Though NRB pulled out of a few institutions in post 2002 FSR period, the ownership on the part of the government and the government owned organisations remains intact. The measures necessary for readying and initiating the process of divestiture remain to be undertaken.

FSR Impacts

Financial sector reform programme initiated on comprehensive basis has discharged significant impact and development in the system compared to piecemeal initiations made in the past.

With the reform, the qualitative and quantitative performance levels of the NRB regulated financial institutions are improving. The legislative regime and regulatory order have improved. The internal management system, risk analysis practices, and governance levels within the banks and financial institutions have improved. The institutional infrastructures of supporting institutions have been established.

The market share of private sector banks has begun to increase. The share of the two largest banks RBB and NBL that stood at 39.4% and 43.7% of the total commercial banks deposits and lending activities respectively in 2002 decreased to 30.5% and 22.5% in 2006. While private commercial banks were almost able to hold the market share in both deposits mobilisation and lending activities, RBB and NBL experienced a significant fall in their share of deposits and lending. This clearly indicate the banks under reform no longer hold the dominant position in banking business as there has been quite a rise of the private sector banks.

For the banking sector as a whole, enactment of BAFIO/BAFIA and doing away with restrictions has been a good move. NRB's inspection system has been strengthened. However, certain basic requirements for prudent management of banks which look simple but could have long run consequences on the overall sustainability of the institutions are still lacking. For example, credit appraisal methodologies both for projects and working capital requirements could be a case in point. A Secured Transactions Act needs to be implemented with utmost urgency for collaterals.

With financial sector reform, naturally, the business sector would expect that doing business with the banks would be hassle free and that the banks would be proactive to the fund requests and would be a non-profit sharing business partner carrying equal risk, i.e. every one would loose if a business fails. The single obligor limit seems to be inadequate to finance the large projects to the private sector due to low level of capital base of the banks and financial institutions. Therefore, banking sector has only been able to partially meet the demand for financial resources in large projects such as infrastructure developments.

Loan customers of selected branches of the banks feel that, with the reform, responses to their demand are getting better though still collateral orientation and absence of adequate emphasis on the appraisal of the business prospects continue to be a major stumbling block for business expansion of both the banks and the borrowers. There has not been change on the time taken by the banks following the first response, but majority are satisfied as it is much more comfortable to deal with the bank now. They however want change for an easier loan as they feel the banks could have done better in respect of providing flexible business based competitive services.

Similarly, the availability of financial products is not felt adequate as per the customers' needs and expectations.

Business community at large are critical of the way FSR wanted to handle the defaulters through blacklisting and auctioning without segmenting the market failure case from fraudulent case, and without considering what should make the business get going in a proactive manner. Banks are acting on their own interest in total disregard for a partnership approach. The community feels that apart from improvement in the layout and streamlining of their own wrongdoings, there is virtually no difference in doing business with the banks. There are ample scopes of promoting business ventures but the financial sector is still shying away of being proactive, business friendly, and risk daring.

Further, the financial intermediaries are yet to honour the principle of limited liability of the corporate customers.

Lessons

Financial sector reform at the outset was also an effort to stop the collapse of the banking sector given the size and condition of the ailing banks. The reform agenda of restructuring of NBL and RBB considered that these banks are too big to fail which seems to be appropriate in view of their wide spread network and customer outreach. At the end year of the Phase I of the reform what has been achieved is that the ailing banks have been turned around. Therefore, too big to fail concept has worked to some extent otherwise it would have been significantly destructive to the economy as the government had moral and legal responsibility for billions of public deposits which constituted a significant percentage of the GDP. But, non-penalising of the promoters and management responsible for the downward trend of the banks cannot be appreciated although it is legally a very difficult proposition.

A major change in the credit culture has been initiated with the implementation of the reform programme particularly by way of credit information and blacklisting procedure. The banks have effectively passed on the message among the borrowers specially the defaulters that bank credit is not a free lunch. This is perhaps a major change brought about by the reform programme in the last five years.

Issues at stake are correcting negative capital fund of NBL and RBB as foremost. Injecting capital and management succession and ultimately doing away with government ownership are other major challenges ahead. It was envisaged that these banks will be restructured completely within three years and privatized within this period. At the moment the FSR seems to getting stuck and not moving in terms of capital injection, management succession and divestiture of government ownership. That the management team placed in the NBL has withdrawn despite the request of the central bank to continue the contract for another 6 month period. It would add only woes to achieve the project objective and goals. Reward and penalty clause should be introduced in such assignments to produce better results.

Nepal's reform programme has not been able to complete all the components of reform agenda as earlier planned. It lacked adequate discussion, co-ordination and information sharing system among the stakeholders during the project preparation, finalization and implementation stages. The reform process hinges on integration of efforts of all stakeholders including the government and judiciary. It also requires that financial sector reform should not be carried out in isolation or in total disregard for other sectors of business economy. The importance and significance of CSR activities has been overlooked, which could be cared with proper guidelines. And despite agreeing to the need of designating effective and professional notary public for transaction on negotiable instruments it has not been effectively complied with for no obvious reasons.

It is equally important that NRB's supervisory and regulatory function is carried out on a professionally basis. In this regard the several steps of a considerable significance have been identified. In the context of opening of Nepal's banking sector for foreign competition from 2010 what is discernible is that there will be prospects to foreign banks and both opportunities and threats for the Nepali banks. Till then several measures as pointed out by Nepal Bankers Association should be completed.

By 2010, the Nepalese financial market is going to be opened up for global competition and the presence of banks especially from the Asian countries can be envisaged. Improving institutional competitiveness through right sizing, increment in capital base, enhancement in training and computerization, refinement of operating policy and procedures along with strengthening of professional management capacity in FSR is essentially a solution that will enhance the capability of the banking and financial institutions and put them in right track to cope up with globalization, and integrate the market to South Asian economies.

It is found that generally the project implementation period is conservatively fixed at project design phase ignoring the ground realities that tend to differ very significantly. This demands that the reform programme should be reasonably adequate to complete all the activities. Further, a financial sector reform carried out without putting in place the exit policy within a time frame will not produce desired result. A financial sector reform carried out without considering benefit to the customers might be good for the short run but not in the long run. A financial sector reform carried out without consideration of peripheral supportive thrusts in the like of bankruptcy, management of non-performing assets or business reconstructions will create bottlenecks.

A financial sector is just like any other sector of business economy. The corrections aimed at financial players at the cost of other sectoral players could work if the entire economic sectors feel the benefits of the reforms. The government should put all the supports and interventions in a coordinated way so that it can boost up the real sector through efficient financial system and mechanism.

I. INTRODUCTION

1.1 Background

It is argued that the financial sector is a lifeline of all economic activities and the sector in itself is just one economic pursuit which thrives on financing to other economic activities. Just like every economic activity it has to use resource efficiently on the one hand and market its products/services on the other across the range of customers outreach and affordability. Financial business is crossing the national boundaries and has encompassing the global spectrum these days. Globalization of the financial sector has instilled further threats and opportunities to improve the level of services offered by these institutions. Therefore, competitive strength has been of paramount importance in the financial institutions. In this regard the situation is not alike everywhere, "while some countries have been successful in eliminating underlying distortions and restructuring their financial sectors in the beginning of the new millennium, in some cases financial sectors remain underdeveloped". The financial sector reforms, especially a comprehensive one, would be a turn around approach to cope up with the threats of global competitiveness in carrying out the financial services.

Financial Sector Reform in Nepal

Financial sector liberalization in Nepal started in mid-80s especially to ease the pressure on state owned financial institutions. As there were only two commercial banks: NBL and RBB under government ownership, the banking sector was first opened up to the private sector. Some other liberalization measures initiated at that time were the deregulation of interest rates, provision of current account convertibility, use of indirect instruments of monetary policy through open market operations etc. In order to improve the performance of Nepalese banking system, a study named "commercial banking problem analysis and strategy study" commonly known as CBPASS was undertaken in 1990 and the report of 1992 identified a number of operational and structural bottlenecks in Nepal's banking sector including the extent of non-performing assets and additional capital injection requirements for NBL and RBB. A programme of recovery was initiated and government also injected capital to these banks. But the system could not achieve the desired goals mainly because the reforms were undertaken in piecemeal basis and that additional capital injection was done much before the adequate reform in the banks. The basic cause of the weakness of the financial sector reform design was: “(i) lack of commitment by the Government to change its basic mindset towards the state-owned banks, including a much stronger emphasis on commercial orientation and on preparation for eventual privatization; (ii) absence of an Action Programme to introduce drastic changes in the managerial culture to ensure that managers were professionals with autonomy and accountability; and (iii) lack of specific fundamental reforms needed to achieve a major improvement in financial and operational performance of the banks" (OED Performance Audit Report, 1995). The financial health of these banks begun to continuously deteriorate and the necessity of a comprehensive programme was felt by the government.

In order to find out the actual position regarding the position of two state owned banks, KPMG/Barents was hired to carry out a diagnostic review of Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL) in 1999/2000, which concluded: (a) the banks' management is basically dysfunctional; (b) there are no reliable data available on the loan portfolio; (c) financial accounting is primitive and not according to international standards (accounts are virtually all manual and annual statements have not been produced for over six years); (d) business strategies are not in place; (e) human resource policy is weak and counterproductive; (f) management information systems and record keeping are very basic; and (g) governance and management are highly politically driven and lacking a commercial focus.

Since, the role and outreach of these banks were extremely high in the economy and these banks were too big to fail, the Government of Nepal decided to launch a comprehensive reform programme. In November 2000 the government issued Financial Sector Strategy Statement (FSSS) outlining the financial sector reform programme. The main elements of the FSSS are: (see Appendix A for details)

1. Reduce the role of the Government in the financial sector as a direct owner of financial institutions while strengthening its role as a supervisor and regulator of banks and financial institutions;

2. Require strong corporate governance by ensuring that banks (in particular the two largest commercial banks) are owned and managed by "fit and proper" private investors;

3. Strengthen the role of Nepal Rastra Bank (NRB) in the overall financial system by drafting a new Act to provide sufficient autonomy in the conduct of monetary policy, banking system regulation and supervision, and the licensing of banks and non-banks;

4. Improve existing banking and financial legislation and judicial processes for enforcing financial contracts; Improve auditing and accountancy standards within the banking sector; and

5. Promote financial discipline through adequate disclosure and competition.

Accordingly the NRB, the central bank was placed as an implementing authority for the reform programme and was also required to undertake the following activities under FSSS:

1. Reform the financial sector legislation,
2. Strengthen the bank supervision and inspection
3. Restructure and enable privatization of NBL and RBB,
4. Enhance competitions in the banking sector,
5. Reform the auditing and accounting capabilities,
6. Enable broad-based banking,
7. Streamline the ownership structure of the banks,
8. Revamp the Bankers' Training Institute,
9. Restructure the Credit Information Bureau,
10. Establish Assets Reconstruction Company,
11. Revamp research and financial monitoring capabilities of the NRB,
12. Broaden and deepen the financial system in the country,
13. Meet sectoral financing requirements,
14. Take measures for ADB/N and NIDC,
15. Establish Development Banks at Regional Level,
16. Strengthen the Rural Development Banks, and
17. Establish Credit Rating Agency.

In the mean time, a study by the World Bank (2002) was carried out which pointed the following weaknesses in the Nepal's financial sector, and those aspects were also considered to be resolved in the reform programme. The weaker areas to be addressed to make the financial sector sound, competitive and prudent were as follows:

A Weak and Fragmented Legal Financial Environment

The NRB Act 1955 was seriously outdated and deficient with respect to issues of central bank autonomy, accountability, and governance. And there was a fragmented legal environment owing to institutionally focused laws. "A proliferation of laws covering various classes of deposit-taking institutions had permitted legal arbitrage. New legislation was required in such areas as collateral, credit activity, bankruptcy law, and so on."

A Weak and Fragmented Accounting and Auditing Environment

The timeliness and reliability of financial data was extremely poor as a result of weak accounting and auditing tradition. Not only the banks financial position was not perfectly understood, the lending decisions were also difficult for the banks for weak corporate sector accounting.

Poor Competition in the Banking Sector

The competition in the banking sector was poor which made intermediation of funds within the banks and non-banks inefficient leading to poor services as against providing more efficient and cost-effective solutions to the banking public. Credit information system was not effective to get necessary information on non-performing borrowers; capacity building in the sector remained very weak; and the general publics' low level of understanding about financial sophistication was indicating "that it did not serve as an effective check and balance within the system."

In the context, generic lessons learned from previous interventions in the financial sector towards reform were equally noteworthy, which compelled to think on the following aspects:

(a) Sustainable banking sector reforms require that the autonomy and technical skills of the regulator to be enhanced.

(b) Legal framework reforms are critical to ensure successful implementation.

(c) Sequencing is important for successful financial sector reform.

(d) Reforms should include rationalization of processes and procedures and should be backed by vigorous enforcement.

(e) Reforms should focus on a limited number of key activities.

(f) Forcing reforms from outside is not sustainable.

(g) Re-capitalizing commercial banks without fundamental reforms in the ownership and governance structures of the banks is not likely to be successful.

In consideration of these, a comprehensive reform package was designed in 2000/2001 and put to implementation in July 2002 with the financial and technical support of a number of donors under the co-ordination of the World Bank. The overarching objective of the Reform Programme in the Financial Sector was to improve the sector in order to bring macro-economic stability and promote private-sector-led economic growth: the development of an efficient banking system that is capable of developing new financing mechanisms and instruments to meet private sector needs.

The reform package consisted of three key dimensions i.e. the reengineering of the central bank - NRB, restructuring of two state owned commercial banks - RBB and NBL, and the overall capacity building of the financial sector including legal and institutional reforms. On the restructuring of the RBB and the NBL, the reform measures mainly focused on right-sizing the banks and improving operational levels through the professional management teams.

The following sectoral, outcome and output indicators were defined for the financial sector reform programme:

Sectoral Indicators:

Comprehensive financial sector reform that eliminates the need for additional (real or contingent) budgetary support for the financial system - once the banks have been restructured and privatized or liquidated.

Outcome/Impact Indicators:

1. Laying the basis for a modern legal framework for the financial sector;
2. Strengthening of NRB's supervisory function - in particular, its ability to enforce prudential regulations and relevant banking legislation - based on internationally accepted norms;
3. An increase in the range and sophistication of financial instruments and services available at competitive prices;
4. Enhanced accounting and auditing standards within the banking sector; and
5. A more prudently operated financial sector with better trained staff, a better informed general public, and an enhanced system of credit information.

Output Indicators:

1. Producing quarterly off-site and annual on-site bank supervision reports (with accompanying analysis), on a timely basis, for each of the banks operating in Nepal;
2. Finalizing a new Central Banking Act, Banking and Financial Institutions Act, and other ancillary financial sector legislations (Companies Act, Debt Recovery Tribunal Act/ Insolvency Law);
3. Producing audited financial data for RBB and NBL, conforming to international accounting standards, within four months of the end of the financial year;
4. Preparing a restructuring plan for privatization/liquidation of RBB and NBL;
5. Creating a leaner, more efficient, and professional Central Bank;
6. A strengthened Bankers' Training Center and more reliable and timely data from the Credit Information Bureau; and
7. Enhanced financial performance within the two largest banks managed by the professional management teams.

Accordingly, the financial sector reform plan was conceived in the following phases and comprised of the following components:

Phase I: Diagnostic and planning 2002-2007

Bringing in management consultant teams to restructure and re-engineer the central bank; and reform the two large commercial banks (RBB and NBL).

Phase II: Implementing the agreed actions 2004-2008

(i) right-sizing the two commercial banks through the implementation of voluntary retirement schemes (VRS) to reduce operating costs and make them viable for privatization; (ii) bringing in a Sales Advisor to assist in the privatization; (iii) providing further assistance to a second phase of central bank re-engineering; and (iv) supporting the continuation of professional management team support up until the point of bank privatization.

Phase III: Intensive training for NRB staff and a follow-up evaluation

Phase III (not included in the existing project agreement) would involve support for financial re-engineering of the banks (re-capitalization) at the point of sale after satisfactory changes in governance arrangements and cost restructuring have taken place.

Initially, the time schedule for the project activities was fixed as follows:

Table 1: Schedule of Project Activities

Components	Duration	Start	Finish
Re-engineering NRB	4 years	July 1, 2002	June 30, 2006
Restructuring the two banks: RBB	3 years	May 1, 2002	April 30, 2005
NBL		June1, 2002	May 31, 2005
Capacity building in the financial sector	4 years	June 30, 2002	June 29, 2006
Source: Appendix C			

Table 2: Key Activities and Target Dates

Activities	Date
1. Restructuring and ownership reform of RBB: - Arrangements to commence management team work - Preparation of ownership reform	 May 1, 2002 May 1, 2004
2. Restructuring and ownership reform of NBL: - Arrangements to commence management team work - Preparation for ownership reform	 June 1, 2002 June 1, 2004
3. Reform in financial sector legislation	Jan 16, 2002
4. Strengthening bank supervision and inspection - Implementation of Ms. Santos' Manual for ISD/NBISD - Logistics support programme	 Jan 16, 2002 Dec 15, 2001
Source: Appendix C	

Improvements in various activities have taken place since the financial sector reform was launched. Apart from the strengthening NRB's supervisory and regulatory function, NBL and RBB were replaced by new foreign management team. Both the teams came up with a vision for these banks and several activities were undertaken to apply and reinforce internationally accepted institutional and prudential norms. Dialogues with big defaulters were initiated and billions of rupees were recovered. Similarly, huge amount of delinquent loan were restructured through consultation and negotiation with these defaulters. A detailed human resources management (HRM) plan was designed and implemented with a few rounds of voluntary retirement schemes (VRS). Backlog of accounting records and financial audit were updated. New information technology (IT) platforms have been created in both the banks and management information system (MIS) have been significantly improved. Several incentives packages were announced for the employees. However, the restructuring period for the RBB and NBL of two years was not sufficient and has been further extended time and again.

Statement of the Problem

A considerable change has been found out in the Nepali financial sector in the last two and half decade. First of all, the financial sector was opened partially to the foreign and the local private sector which resulted in the establishment of a number of joint venture banks in Nepal. This was followed by openings for the private sector to establish finance companies and savings and credits cooperatives. The sector was also further liberalized to compete in deposit and lending activities. As a result, the quantity of banking and financial institutions increased which in turn significantly expanded the scope and volume of banking activities in terms of deposit mobilization and lending activities as well as network expansion and introduction of various products and services.

Until the initiation of comprehensive financial sector reform the success was, however, built around the inefficiency of the two state owned commercial banks, which are too big to fail. Given the overwhelming proportion of the non-performing assets owing to poor quality credits and bad credit culture in the system a reform was needed which otherwise was threatening to the entire financial system. The reform as such was put forward to build efficiency, prudence, bring down the degree of the non-performing assets and strengthen the overall financial sector including the improvements at the regulatory and supervisory level.

As Nepal is bound to open the entry of foreign bank branches under WTO obligations from 2010 onwards, pertinent questions are raised as to the overall capacity of the domestic banks and financial institutions to withstand competition from more efficient and resilient foreign banks and their subsidiaries. In the dawn of this situation, the comprehensive financial sector reform programme has been launched in Nepal with the technical assistance of DFID, World Bank and IDA. It will be appropriate to analyse the outcomes of the reform so that how far the problems have been addressed and what elements have not been completed and which elements have contributed to the unaccomplishment of the reform agenda. Similarly, it is appropriate to analyse the sustainability of benefits of reforms and explain the benefits gained by the end-users of the financial services. It is in this context this research holds a considerable significance to draw lessons from the ongoing reform process. It may also provide some useful key learning points to other member states of SAARC as well.

1.2 Objectives of the Study

The study seeks to review and analyse how far the gains derived under the financial sector reform process have been institutionalized and what lasting impact the reform measures made on these publicly owned financial intermediaries in particular and the Nepali banking sector in general. How do the end-users view the benefits of reform initiatives and what major distortions are removed through the reform programme?

Research Questions

The study will focus on the emerging questions based on the evaluation of implementation of financial sector reform measures under Phase I and Phase II:

a) Overall
   - Are the objectives of the strategy paper announced by the government in 2000 achieved?
   - How far the capacity building of financial sector achieved?
   - How far the legislative reform concluded?

b) NRB
   - How far the regulatory & supervisory capacity of NRB strengthened?

c) RBB/NBL
   - What impact did the reform measures make on the overall functioning of the publicly owned financial intermediaries i.e. NBL and RBB?
   - What is the prospect of government ownership investment to private and/or foreign institutional investor?
   - Alternately can these banks be managed with continued government ownership and if so what are the areas where further policy as well as structural reform are needed especially in the context of the entry of foreign banks after 2010 as per the World Trade Organisation (WTO) commitments?

d) Banking Sector
   - What are the impacts of the reform measures on the overall banking sector vis a vis reforms undertaken in these two publicly owned banks i.e. RBB fully owned by the government and NBL partially owned by the government.

e) Non-banking Sector
   - What lessons could be replicated to other publicly owned financial institutions such as the Agricultural Development Bank Limited (ADBL), Nepal Industrial Development Corporation

(NIDC), Employees Provident Fund (EPF), and etc.?

The financial sector reform has become a global phenomenon with new initiatives to make it competitive, responsive and within reach. The start made by Nepal needs to be thoroughly assessed as it needs to prepare itself to the opening of the sector to the foreign banks in 2010. The research will contribute to transform the sector towards that end and will provide key learning points to other member states of SAARC.

1.3 Research Methodology

The research is designed partly analytical and partly judgmental in nature. The study uses both primary and secondary information. The published data from the banks, Nepal Rastra Bank and other institutions that included the World Bank were the source of secondary information. The primary information were generated through open-end questionnaire administered to banks management, major stakeholders and end-users. Necessary consultations are carried out with the management of the central banks on the future of the reform process and specific areas where further reform measures should be undertaken.

At the outset of the study, secondary information were collected and analysed during January-February 2007. Primary data were collected in March-May 2007 for which checklists were developed to get response of the bank management, branch managers and loan officers. Further, questionnaires were developed to get the responses of bankers and business associations and end users. Detail information were drawn as follows:

Banks' customers

- survey of market: this comprise of open perspective of trade and industrial associations
- survey of customers/small end-users in rural and sub-urban areas: Eight branches have been covered in the study, selection comprised two within Kathmandu valley and outside two places in central region per bank. Eight customers in random basis were selected from the borrower list provided by each of the selected bank branch. The questions focused on the qualitative aspects of the bank performance in terms of credit appraisal, collateral requirements, time to process, post-credit supervision, and repayments systems.

Bank governance and management

- interaction and discussion with, departmental chiefs, branch managers (8) and loan officers (8) on:

1. Improvement from weakness to strength
2. Extent of System Improvement
3. Services Improvement (products: new, continued, and dropped)
4. Customer Services (Fronts: establishment, operations, marketing, /Process: credit appraisal to

disbursement)

5. Behavioral change / change management
6. CSR/VRS

Regulatory bodies

- interaction with concerned department and high officials of Nepal Rastra Bank

The collected information were processed and analysed to describe the achievements, impacts and learning points. Basically, the following measurements have been made:

- Project objectives and targets
- Project performance
- Project implementation difficulties
- Future strategy
- Support and co-ordinations, etc.

II. LITERATURE REVIEW

This segment brings to focus the importance of the finance and financial system, the aspects of financial liberalisation and the execution of financial sector reform in general and South Asia as coming from the researches undertaken by the scholars.

2.1 Financial Sector & Development

Schumpeter (1911) recognized the importance of bank as financier to the entrepreneurship and bank credit for the economic development. Fisher (1933) stated the importance of financial system.

Persbich (1950), Nurkse (1953), and Lewis (1954) explored allocation of finance for investment. Gurley and Shaw (1955) propounded the 'Debt Hypothesis' and highlighted the importance of credit supplied through financial intermediaries. Further, Gurley and Shaw (1960 and 1967) clearly articulated the importance of financial intermediation in the development process.

Gerschenkorn (1963) focused on the key role of banking system in both short-run and long-run economic growth. Elaborating the Debt Hypothesis Patrick (1967) and Porter (1967) concluded that an efficient financial system could intermediate savers and borrowers to mobilize higher level of a bi-directional causality between financial development and economic growth. In the 'Demand following' approach, the demand for financial services is dependent on the growth of real output, trade and modernization of agriculture and other subsistence sectors. In the 'Supply leading' approach, the creation of financial institutions and their services occur in advance of their demand.

Cameron et al (1967) discussed the historical relationship between the development of banking system and the industrialization process of European countries and Japan. Goldsmith (1969) empirically analysed the financial structure and economic growth of 35 countries over the period 1860 to 1963 using different measures of financial development (Financial inter-relation ratio, Relative size of financial structure, Degree of penetration of different financial instruments, Relative financial intermediation ratio, Financial intermediation ratio, Financial interrelation matrix, and Distribution of total source funds). He found a positive correlation between financial development and the level of economic activity: as the size of the financial sector enlarges relative to the size of the economy, the country develops. Financial system plays an important role in mobilization and allocation of savings from the primary lenders and ultimate borrowers (Blake, 1992).

All the above studies suggest that development of financial system has great contribution to economic development through mobilizing and allocating resources in the efficient way for a nation.

2.1.1 Supporting Financial Liberalisation

McKinnon (1973) and Shaw (1973) argued that financial liberalization leads to financial deepening and promotes economic growth. Financial repression characterized by interest rate administration, selective credit control, high reserve requirements, and restriction on foreign financial transactions would shallow financial system and distort economic growth. Financial repression refers to the government control over the financial sector by means of laws, regulations and informal controls, which distorts the prices of financial services - the interest rates and foreign exchange rates - and hinder the financial intermediaries to operate in their full potential.

Kapur (1976) modeled that a higher required reserve ratio would reduce the ratio of loans to money and lower the rate of economic growth. Galbis (1977) has shown that entirely self-financed traditional economy has a low constant return of capital while external finance relying modern sector has higher constant returns to capital. The supply of loan is determined by the demand for deposits and the reserve requirement. Demand for bank loans is a fixed fraction of capital stock (Mathieson, 1979). Competitive forces can maintain the money market equilibrium, credit market equilibrium and normal level of profits in the financial system. The imposition of ceilings on interest rates (both lending and deposit) is likely to encourage monopoly or oligopoly in the financial market.

The financial liberalization expands financial intermediation between savers and investors (Fry, 1982). Financial intermediation increases the incentives to save and invest, and improves the efficiency of investment.

Diamond and Dybvig (1983) explored the idea of liquidity constraints to test various types of interventions in the commercial banking system, deposit insurance for example. They concluded that deposit insurance was justified to prevent costly liquidity crises and eliminate the deposit panic. However, the presence of deposit insurance may provide incentive to banks to lend on more risky projects.

Diamond (1984) developed a model in which a financial intermediary improves corporate governance. He stated that lenders could not observe borrowers' projects freely, while financial intermediaries have that advantage. According to Boyd and Prescot (1986) financial intermediaries may reduce the costs of acquiring and processing information and thereby improve resource allocation.

Roubini and Sala-i-Martin (1992) analyzed the relationship between financial repression and growth policies through a theoretical model. The empirical analysis of 53 countries including those of Latin America, found financial repression leading to negative real interest rates, high reserve requirement and the high inflation tax. A higher degree of financial repression has been found to be associated with lower economic growth; however their result did not imply causal relation between inflation and growth.

Warman and Thrilwall (1994) tested the financial liberalization hypothesis by differentiating financial savings and total savings distinctly. They found financial savings positively related with real interest rate, investment positively related with the credit supply from the banking system, and that the total saving remained invariant to the changes in real interest rate. They concluded that favourable impact of financial liberalization (higher real interest rate) on economic growth must come through efficiency of investment.

Fry (1995) found the following facts about the financial systems in developing economies. 1. The commercial banks dominate the financial system and the role of the capital market is very small in financial intermediation. 2. The financial system is heavily taxed in the form of reserve or high powered money. (Money holders pay the inflation tax with the erosion of its purchasing power.) 3. Banking systems face a high-required reserve ratio and prevalence of ceilings on deposit and interest rates.

These studies have suggested that financial liberalization leads to financial deepening, has more efficient interlinkage to monetary policy making implementation and deregulation contribute more to make financial market efficient. Moreover, supportive institutions like deposit insurance and other facilitating institutions are also equally important in deregulated regime.

2.1.2 Against Financial Liberalisation

The result of financial liberalization is not uniform, i.e., positive in some countries where it was adopted gradually (in most of the cases of Asian countries) while it boosted financial crisis in others (Latin American countries). The financial reform is concentrated on set up of necessary institutions to support a smooth functioning of the financial system. Prudential regulation, supervision, uniform accounting and auditing standard, human skill development and legal reforms as well as restructuring and reengineering of existing institutions are focused as part of the financial reform for a successful financial system.

Post Keynesian models of effective demand are influenced by capital accumulation in contrast to the McKinnon-Shaw model of financial liberalization. The financial liberalization may lead to fall in output and growth and further contribute instability in the financial system. If the interest rates are left to be determined by the market forces, the demand and supply of savings (loanable funds) will or will not balance itself. The argument is that the markets are not necessarily stable to self equilibrate. A rise in savings does not necessarily rise in investment and so savings and investment are not automatically equilibrated through the mechanism of interest rate.

Jaffee and Russel (1976) have shown that demand constraints in financial markets may exist even in the absence of government intervention. Stiglitz and Weiss (1981) modeled that informational asymmetry motivated credit rationing where the market denies funds to potential borrowers. They assumed that high-risk borrowers would pay the lenders a high rate of interest if the project yield is sufficiently high and pays the net yield otherwise. Townsend (2002) suggested an alternative safety net strategy, an optimal allocation of risk bearing as a bench mark to evaluate the financial sector reforms and safety net policies useful in both crisis period as well as in the long run.

Van Wijnbergen (1982, 1983a, 1983b,) Buffie (1984), Kohasaka (1984) criticized McKinnon-Shaw approach of financial liberalization by using a mark up pricing framework, a cost push inflation model and Keynesian adjustment mechanisms. The neo-structuralists models predict the opposite effects of financial development and liberalization in contrast to that of the MS models. Taylor (1983) criticized McKinnon and Shaw hypothesis for two reasons. First, following the Keynesian approach, an increased desire to save reduces the aggregate demand. Second, higher interest rates may not encourage savers to reallocate their wealth portfolio to interest bearing financial assets.

Fama (1980) analyzed frictionless competitive market by applying Modiglani-Miller theorem and concluded that financial structure was irrelevant, but Fama (1985) stressed on the importance of the financial intermediaries (commercial banks in particular). In an open market, credit is not available as a perfect substitute of bank finance for certain class of borrowers. Mankew’s (1986) analysis for credit markets has shown that a small rise in risk less interest rate leads to a large fall in lending because it forces the loan rate up and reduces the quality of borrowers. This ultimately forces the market vulnerable to collapse. Balasssa (1988) examined the impact of policy imposed (endogenous) distortions on resource allocation. The market distortions have undesirable effect on the efficiency of resource allocation and employment in developing countries. He has shown that policy imposed distortions in the product markets tend to aggravate these adverse affects in the economy of the low-income countries.

In a closed economy, financial liberalisation increases excess supply of savings and loans resulting a fall in equilibrium interest rate, on the one hand, and increases the marginal propensity to save while reducing aggregate consumption on the other. As per (Burkett and Dutt 1991) it results into a fall in aggregate output and reduced profit rate ultimately discouraging entrepreneur for further investment. In an open economy, financial liberalization often leads to over-valuation of real exchange rate, which further reinforces a squeeze in aggregate demand and cause financial instability. If banks have been involved in positive maturity transformation, liberalization could cause them large losses due to a rise in short term deposit rates, and fixed long-term loans. As the banks make loss, they are less interested to make new loans. Thus, financial liberalisation may cause banking system increasingly fragile.

Stiglitz (1996) criticized financial liberalization and suggested for government interventions to make the market function better and improve the performance of the economy. The government should insure the financial system, implicitly or explicitly, while reducing the problem of moral hazard by increasing capital requirements (risk weighted capital adequacy ratio). Given information imperfections, mild financial repression (Stiglitz, 2002) can improve investment efficiency. (Low interest rate improves the average quality of investment; increases firm equity due to low cost of capital; improves export performance; and encourage lending to high technological sectors). According to Stiglitz, costly information creates market failures. Information is public good and monitoring is costly for individuals.

Stiglitz and Greenwald (2003) presented a fundamentally new approach to monetary economics based on Information Economics, focusing on the role of money on facilitating transactions and that of credit in facilitating economic activities. They emphasize on the demand for and supply of loanable funds requiring an understanding of how banks and other institutions process information to evaluate the credit worthiness about their borrowers. They explain the factors determining the willingness and ability of banks to provide credit, explore the consequences of credit inter-linkages within the economy describe the implication of conduct of policy and analyse the changes in the economic structure (like the effectiveness of monetary policy, and economic stability).

The above studies pointing out the discrepancies of leberalised financial sector also highlight that there are benefits of liberalizations but it could distort the market if not well regulated and prudently managed. Therefore, the continuous reforms with adequate safeguard measures like safety nets will be beneficial for the system.

2.2 Financial Liberalisation

2.2.1 Elements of Financial Reform

Drawing from the experience of developing countries, Eltony describes of the aspects of the financial reform as follows:

1. Intermediation Approach

A necessary prerequisite for successful reform is the adoption of prudent macroeconomic policies that would result in positive real interest rates. Second, reforms tend to expand banks' gross lending margins that can be corrected by a strengthening of bank supervision, by further reducing the reserve requirements, and by a rapid implementation of competition-enhancing measures.

"The credit expansion that continues for a long period after reform could threaten macroeconomic stability through putting pressure on price levels and the external accounts imbalance. This would occur if real interest rates were negative in the post-reform period, as this would encourage a more rapid growth of credit and slower growth of deposits. While negative real interest rates are common in pre-reform periods, their impact on credit tends to be limited by application of direct credit controls. In contrast, if positive real interest rates were maintained, the growth of credit would slow down compared to the initial post-reform period. This would be emphasized by a rise in the growth rate of deposits that would also react favorably to the development of financial instruments and institutions, and to banks becoming more efficient deposit users following the reduction in the central bank role as liquidity provider".

"Financial liberalization tends to affect the cost of funds in complicated ways. First, the removal of interest rate controls allows banks to price credits and risks more appropriately and this may cause an increase in interest rate margins since controlled lending rates were usually set too low in the pre-reform period. Second, risk premiums tend to rise in the post-reform period as banks significantly expand their loan portfolio to new borrowers with unconventional risks. Thirdly, upward pressure is placed on the gross interest margin since competition in credit markets increases only slowly relative to that in the deposit markets. Against those factors, financial liberalization also tends to put downward pressure on the cost of funds. First, reserve requirements are normally lowered as part of the reform package that reduces the cost differences between deposit and lending rates. Second, competition is increased through the reduction of barriers to entry".

2. Monetary and Credit Directions

"Financial reform is usually associated with increases in the ratios of money, financial assets and credit to the private sector, to GDP, while the ratio of currency to deposits falls following the reforms. Thus, the effect of financial liberalization on the behavior of the key monetary and credit aggregates needs to be taken into account in setting monetary targets in the post-reform period. Financial liberalization also tends to be followed by a period in which credit growth exceeds the growth of deposits with financial institutions. This phenomenon can be explained as follows. In the pre-reform period, both deposits and credit tend to fall. The decline in the former reflects a voluntary portfolio response to financial repression. In the post-reform-period there is a gradual portfolio adjustment by depositors to the new liberal financial situation. In contrast, credit growth in the pre-reform period is constrained by direct controls with an excess demand for credit. Once the direct controls are removed, financial institutions respond by meeting the excess demand for credit and credit expands rapidly. This has the impact of increasing imbalances, and putting pressure on prices and the country's external accounts. The credit boom can pose a threat to economic stability; its appropriate management is a crucial element of successful financial liberalization".

3. Monetary Policy

"Financial liberalization requires the ability to manage interest rates and liquidity and credit aggregates through market-oriented instruments of monetary policy, i.e., indirect instruments, rather than through direct administrative fixing of various interest rates. However, in the immediate post-reform period, there is a space for using direct controls which would line up credit growth with the otherwise lagging growth of bank deposits. While there is a need for an early implementation of indirect monetary instruments, credit ceilings may be used on a temporary basis, and so long as they are supported by positive real interest rates. Money markets require an active involvement of the central bank in order to ensure the existence of a reciprocal market in bank reserves. In doing so, the central bank should switch gradually from being the principal market maker to creating and supporting the financial deepening of the market. In this capacity, the central bank should withdraw (or inject) reserves at own initiative in anticipation of surpluses (and deficits) emerging in the market while leaving market participants to make their own decisions. Thus, indirect momentary instruments are essential for the development of money markets and the deepening of financial markets".

4. Prudential Supervision Measures

"The soundness of the banking system has implications on how to manage the reform process. This is because a system that is burdened with rolling over of loans of weak firms or large nonperforming loans cannot easily change lending priorities to new venues and investments. In addition, higher interest rates on deposits will compound the cash flow problems, and higher lending rates only deteriorate the bad debt problem. Weak institutions tend to also become a greater source of pressure on central bank resources thereby affecting monetary policy. More importantly, financial reforms themselves may weaken the banking sector. For instance, the removal of credit restrictions before proper credit approval processes are put in place may result in an increase in lending to more risky projects and to new activities. This is particularly critical if, as in the developing countries, (implicit or explicit) deposit guarantees exist which leave investors largely indifferent as to where they place their deposits. Thus, financial liberalization in some developing countries implementing financial reforms was followed by a financial crisis. It should therefore be emphasized that financial sector and monetary authorities face difficult constraints and may lose their effectiveness if a significant part of financial institutions have sizeable non-performing loans and face constant cash flow problems. Therefore, measures to deal with banking sector problems would need to be put in place before financial reform starts. In addition, banks need to be encouraged to improve their internal credit assessment, risk appraisal systems and strengthen their accounting and disclosure practices".

5. Status of Competition

"The banking systems in countries embarking upon financial reform are usually characterized by oligopoly market structures. As a result, the speed of adjustment of deposit and lending rates to changes in monetary policy conduct is often slow, and the margin between deposit and lending rates also tends to adjust slowly. While enhancing competition and interest rate liberalization have a positive impact on financial competition, the impact tends to happen with a lag".

6. The Role of Stock Markets

"A key question that always arises during the financial reform process concerns what sequence to pursue when developing non-banking financial markets. The international experience appears to suggest that money markets and the markets for short-term instruments such as treasury bills and bankers' acceptances should be developed prior to long-term markets. This is because the development of well-capitalized dealers in securities is easier in short-term instruments than in long-term instruments such as shares and other stocks. The capital markets sophistication and exchange skills developed through short-term instruments can then be translated into long-term instruments over time. The development of capital markets, within a sound regulatory framework, requires a number of structural reforms including; an effective privatization plan; a macroeconomic environment that is conducive to increasing the private sector share in the economy; and the strengthening of market forces through improving information flows, accounting standards, property rights, pricing efficiency, and tax reform. Finally, political stability is vital for the development of sound capital markets".

2.2.2 Implementing Financial Liberalisation

The development of a financial sector necessarily involves a wide range of policy actions, and structural and institutional reforms. The appropriate sequencing and coordination of reforms is important for the following reasons:

- Inappropriate sequencing of reforms could cause excessive risk taking and financial instability.
- Limited institutional capacity necessarily requires some prioritization of reform elements.
- Given the numerous policy and operational reforms in each area of financial policy, setting priorities could facilitate and encourage the adoption of reforms; hence, this aspect of financial sector assessments is important.

Alexander, Baliño and Enoch (1995) discussed the indirect instruments of monetary policy in the context of financial liberalization: The instruments used like money, credit and interest rates, should be predictable and under the control of monetary authority. If the instruments are flexible, and monetary effects can be changed quickly, the ability to control can be enhanced. The central bank can use the instruments to solve the bank specific problems as well. Effective use of a mix of monetary policy instruments, selected by the central bank according to the need of the economy, requires coordination between them while maintaining the overall level of liquidity.

Wong (1997) showed that the more risk-averse banks would set higher optimal spreads. Under decreasing absolute risk aversion, bank optimal interest spreads would increase with an increase in the marginal administrative cost of loans. First, a marginal increase in the administrative cost makes loans more costly to grant. This induces the bank to reduce the amount of loans by charging a higher loan rate, ceteris paribus. Second, it decreases the bank's profit in every possible state. This induces the bank to raise its loan rate, as it becomes more risk averse and thus, less willing to take on more risky loans. Wong shows that an increase in the bank's equity capital has a negative impact on the spread when the bank faces little or no interest rate risk; otherwise, the effect is ambiguous.

Analysing the experience of 24 countries that underwent financial reforms during 1980s and 1990s, Claudia Dziobek and Ceyla Pazarbasioglu (1998) found that the problem of systemic crises was caused by weak banking supervision, political interference, inadequate capital and outmoded domestic banking system, etc. Bank performance can be improved by systemic bank restructuring to restore solvency, profitability and offer financial intermediation to both the savers and investors while improving public confidence on the banking system. Financial restructuring improves the balance sheet of a bank by raising capital or reducing the liabilities or revaluing the assets so that bank insolvency is restored.

Demirgüç-Kunt and Maksimovic (1998) examined how external growth financing of the firms is affected by the variegated legal and financial systems. They found that in countries with an efficient legal system the firms would use long-term external financing; active and large stock market and a large banking sector are also associated with externally financed firm growth. They compared firms' financial structures in 32 developed and developing countries and found the greatest difference to be in the provision of the long-term credit by estimating a financial planning model to obtain a maximum growth rate that each firm in their country sample could attain without access to long-term financing.

Using bank level data from 80 countries (developed and developing) during the period 1988-1995, Demirguc-Kunt and Huizinga (1998) found that differences in interest margins reflected a variety of determinants: bank characteristics, macroeconomic conditions, taxation, deposit insurance regulation, market structure and legal and institutional factors. Banks in countries with a more competitive banking sector have smaller margins and are less profitable. Higher degrees of bank concentration and capital ratios are associated with higher interest margins. Banks that rely heavily on deposits are less profitable due to high operating expenses of branch networks. Domestic banks have lower margins and profits compared to foreign banks in developing countries, while the opposite holds true in industrially developed countries.

Sundararajan and Johnston (1999) reviewed the practical experiences of financial reforms in Argentina, Chile, Indonesia, Korea, the Philippines and other 40 IMF member countries since the late 1970s. An orderly and well-supported financial sector reform could lead to higher; sustainable economic growth while inadequately supported, and inappropriately sequenced reform leads to trouble. They pointed out that the challenge of financial reform in strategic improvement of financial sector efficiency while achieving and maintaining stability in the financial system. Properly managed financial reforms could contribute to strong improvements in economic growth and efficiency. Lessons learned from previous reforms in the financial sector suggest that the linkages between various components of the financial sector are important. Any successful reform includes an increase in real interest rates, management of credit growth following reforms, improvements in banking efficiency in the post-reform period.

Menkhoff (2000) mentions of the weak financial institutions that played a decisive role to cause financial crisis. He has characterized bad banking as: weak financial institutions, fragility of financial system, structural weaknesses in the financial sector to price and manage risks properly, and imprudent lending associated with relationship and corrupt practice. Bad banking would create excessive credit growth, over-investment and asset price bubble.

Demirguc-Kunt and Detragiache (2000) tested whether the deposit insurance system would hold a probability of banking crisis, by using a panel data from 61 countries over a period 1980 - 1987. They defined systemic crisis as a situation when a large segments of the banking sector cannot operate without special assistance of the monetary authority and becomes insolvent or illiquid. They found that explicit deposit insurance was detrimental to bank stability particularly when interest rate is liberalized but institutional environment is weak. In other words, appropriate institutions and effective prudential regulations and supervision can offset the adverse affects of deposit insurance and stability in the banking system.

Galindo et al (2002) examined whether financial liberalization reduces the cost of external finance to firms and promotes growth by using data from 28 countries during 1973 to 1998. They found that financial development by allowing cheaper funds stimulated growth of economic sectors depending upon external finance. Financial liberalization is a condition that under certain situations (structural reform to support financial markets and protect creditors right) promotes financial sector development and stimulates growth. If legal set up regarding creditors' protection and prudential regulation is in place financial liberalization can help promote growth notably.

Kamansky and Schmulker (2002) examined the dynamic effects of both the domestic and external liberalization on financial markets. They constructed a comprehensive chronology of financial liberalization in 28 countries encompassing the evolution of restrictions on domestic financial institutions, capital account and foreign access to the domestic capital market. They found that financial liberalization might trigger financial excesses in short run; it also triggers better functioning financial markets by supporting institutions.

Honohan (2003) discussed the implicit and explicit taxes in the financial sector including reserve requirements and seignorage as well as directed credit. He argues that some financial sector taxation have unanticipated large and damaging effects and they should be moderated. Financial sector should not be tax-exempted but should be so designed so that vulnerabilities of sensitivity to arbitrage and sustainability to inflation could be safeguarded.

Demirguc-Kunt et al (2003) examined the impact of bank regulations, concentration, inflation and national institutions on bank net interest margins by controlling bank specific characteristics of 1400 banks of 72 countries for a period 1995-1999. They found that tighter regulation on bank entry activities and inflation would boost net interest margins. Concentration is positively associated with net interest margins.

Beck, Demirguc-Kunt and Maksimovic (2003) highlighted the importance of legal system and financial institutions for the financial decisions of firms like capital structure and dividend policies. The financial intermediaries and legal system provide some of the key functions of resources mobilization for investment, monitoring their performance, and resolving the conflicts of interest among different parties involved.

Classens, Klingbel and Laeven (2004) analyzed the role of institutions in resolving systemic banking crises for a broad sample of countries. Banking crises are fiscally costly, especially when policies of substantial liquidity support, explicit government guarantees on the liabilities of financial institutions and forbearance from prudential regulations are used widely. Higher fiscal outlays do not accelerate the recovery from a crisis. Better institutions including less corruption, improved law and order, legal system, and bureaucracy reduce the likelihood of occurrence of crisis.

The above studies have specially dealt on implementation and progress aspects of financial liberalization. They have suggested that appropriate sequencing and co-ordinations are vital for success of reform. Accordingly, the implementation of reform measures have resulted in smaller margins, better capital ratios, improvements in banking efficiency, stronger financial system, and enhanced creditors protection and regulations and resolved financial crises in most of the nations.

2.2.3 Measuring Financial Liberalisation

Demirguc-Kunt and Detragiache (1998) explored empirically whether financial liberalization enhances higher output growth through financial development on cross-country data of 53 developed and developing countries for a period 1980-1995. They found financial crisis more prone to financial liberalization. Bandiera, Caprio, Honohan and Schiantarelli (1998) constructed a 25 year time series index of financial liberalization for each of eight developing countries: Chile, Ghana, Indonesia, Korea, Malaysia, Mexico, Turkey and Zimbabwe and conducted an econometric analysis. They find that the pattern of effects differ across countries.

Bandiera, Caprio, Honohan, and Schiantarelli (2000) analysed the impacts of financial liberalization in Chile, Ghana, Indonesia, Korea, Malaysia, Mexico, Turkey, Zimbabwe by using data over 1970-94. The study found no systematic and reliable real interest rate effect on saving, while the effects of liberalization have a mixed record. Rather they found negative relationship in most of the cases. Furthermore, the effects of the financial liberalization index on saving are mixed: negative and significant in Korea and Mexico, positive and significant in Turkey and Ghana.

Reinhart and Toktladis (2001) compared the impact of financial liberalization in 50 countries over the period 1970-1998 by using annual data series of gross national savings, gross investment, current account balance, foreign direct investment, GDP growth, consumption, real interest rates, ratios of narrow to broad money (M1/M2), credit to private sector and spread between lending and deposit rates. They found that financial liberalization, as measured by M2/GDP and credit to the private sector, would lead to financial deepening.

Belford and Greenidge (2003) have constructed a set of financial indices for 12 countries, which are consistent with a-priori knowledge of financial liberalization existing in specific countries. Their index captures financial liberalization of those countries for a period of 23 years from 1979 to 1999, and assessed the government policies regulating inward and outward financial transactions.

The above studies have suggested that financial liberalization and reforms lead to financial deepening and also have risk of systemic crisis. Therefore, provision of financial safety nets is also equally important to be considered within the reform program.

2.3 Impacts of Financial Liberalisation

Since the mid-1970s, many developing countries have been implementing financial liberalization programmes. A study conducted by Bisat, Johnston, and Sundararajan (1992) examined in detail the experience of five countries with financial sector reform and liberalization: Argentina (1976-81), Chile (1974-80), Indonesia (1983-88), Korea 1980-88) and the Philippines (1980-84). Furthermore, Fry (1988) presented a general review of issues of financial reform. The interaction between economic growth and financial sector reform is presented by Sundararajan (1985 and 1987), and Gertler (1988).

Financial reforms have brought about significant improvement in monetary and credit aggregates in many of these countries where reform has been introduced. Financial sector reform has certainly had a noticeable impact on the cost of intermediation: real interest rates and gross interest margins. However, there is scope for even more improvements over the next years as competition enhancing measures and administrative costs reduction interventions are adopted. (Eltony)

2.3.1 Economic Growth

There is consensus that (a) the effect of financial liberalization (financial opening) on growth depends on institutional quality; (b) the growth effects of financial iberalization could be large and statistically significant for a wide range of countries (in the middle range of incomes and institutional quality); and (c) the development of adequate institutional capacity appears to be an important and necessary precondition for coping with volatility and reaping net gains from liberalization (Obstfeld and Taylor, 2004). However, building institutions raises issues of institutional design and of the scope of reform strategies—priorities and sequencing—that need to be understood (IMF 2003a).

Greenwood and Jovanovic (1990) and Bencivenga and Smith (1992) models postulate that savings behavior directly influences not only equilibrium income levels but also growth rates. That means financial markets can have a strong impact on real economic activity. On the other hand, Murinde and Eng (1994) and Luintel and Khan (1999) used endogenous growth models to show a two-way relationship between financial development and economic growth. However, despite the emergence of new growth theories, the debate on the direction of causality between financial development and economic growth is still on.

Greenwood and Jovanovic (1990) used Pareto-optimal competitive model to show causal relationship between financial development and economic growth. Economic growth provides the development of financial structure and, in turn, allows for higher growth through efficiency in investment. Assuming that many entrepreneurs solicit capital and that capital is scarce, financial intermediaries produce better information on firms, thereby induce a more efficient allocation of capital.

Stulz (1999) examined the effects of a country's financial structure on economic growth. He concluded that financial intermediaries were prerequisite for economic growth.

Beck, Levine and Loyaza (2000) assessed the empirical relationship between the level of financial intermediary development and (i) economic growth, (ii) total factor productivity growth, (iii) physical capital accumulation, and (iv) private savings rate by using pure cross-country instrumental variable estimator to extract the exogenous component of financial intermediary development, and a new panel technique to control for biases associated with simultaneity and unobserved country specific effects. The finding is that (after controlling for potential biases) the financial intermediaries exert a large positive impact on total factor productivity growth (which feeds through to overall GDP growth), and the long run links between financial intermediary development and both physical capital growth and private savings rates are weak.

Levine et al (2000) examined influences of financial development on economic growth and the impact of legal and accounting systems like creditors rights, contract enforcement in the level of financial development by using pooled cross country and time series data of 74 countries for the period 1960 to 1995. They found financial development positively associated with economic growth.

Demrgic-Kunt and Levine (2001) studied the relationship between financial structure and economic development of 150 countries. They have found: 1. Banks, non-banks and stock markets are larger, more active and efficient in richer countries. Financial systems are more developed in richer countries than in developing countries on average. 2. Stock markets are more active and efficient relative to banks in richer countries. 3. Financial systems tend to become more market oriented as a country becomes richer.

La Porta et al (2002) generated an alternative indicator of financial development by using the degree of public ownership of banks to find that publicly owned banks are less effective at facilitating transactions, mobilizing savings, acquiring information about firms, managing risk, exerting corporate governance and credit allocation. They have provided direct evidence on connection between economic growth and the services provided by the financial intermediaries. They have shown that higher degree of public ownership is associated with lower levels of financial development and slower economic growth.

Angadi (2003) examined for a possible link between financial structure and economic activities and defined financial infrastructure as the complex of financial system, accounting standards and payment and settlement system. The financial system itself consists of financial institutions, markets, and instruments. He discussed a direct and symbiotic relationship between sound and efficient financial infrastructure and economic development. He stated that financial systems would tend to become more market oriented as a country becomes richer.

Calderon and Liu (2003) examined pooled data of 109 countries to examine the direction of causality between financial development and economic growth by employing Gewke Decomposition test. They found the five distinct results as: 1. Financial Development generally leads economic growth, 2. Bi-directional causality between financial development and economic growth, 3. In developing countries, financial deepening causes more to growth than industrial countries (supply leading supportive), 4. Financial development has larger effect on economic growth in long run, 5. Financial deepening contributes economic growth through more rapid capital accumulation and productivity growth.

Beck, Dimirguc-Kunt and Levine (2004) assessed direct relationship between financial intermediary development and changes in income distribution by using averaged data from 52 countries, both developing and developed, over the period 1960-1999. They found financial development to be pro-poor. In countries with better developed financial system, the income of the lowest income group grows faster than average GDP per capita and inequality in income falls more rapidly. Since finance has a positive impact on long-run economic growth, and income distribution is also affected favorably to establish the fact that financial development is pro-poor.

The above studies highlight that financial developments lead to economic growth and when the country becomes rich, financial system tend to be market oriented, tend to be more favourable for equality income distribution and supportive for private sector led financial system.

2.3.2 Other Fronts

In a ‘general steady state equilibrium’ model of three period-lived overlapping generations, Bencivenga and Smith (1992) have found that high reserve requirement is associated with coexistence of informal financial sector. They analyzed the impact of interest rate ceilings, reserve requirement, inflation rate as well as capital investment and output level in a closed economy model Domestic financial liberalization would simply shift funds from the informal to formal financial sectors. Further, they have shown that financial intermediaries improve corporate governance by economizing on monitoring costs, which reduced credit rationing and thereby boost productivity, capital accumulation, and growth.

Bayoumi (1993) examined the effects of financial deregulation on personal saving within an overlapping generations framework and found that deregulation would produce an exogenous short-run fall in saving, some of which is recouped over time. He also found that the decline in household saving was associated with financial innovation. Saving is also sensitive to wealth, real interest rates and current income.

Gibson and Tsakalotos (1994) argued that market failures would discourage the liberalization process.

The designing of appropriate financial institutions and serious exhuming of the existing ones should be done before or at least at the beginning of financial reform as a part of reform strategy so that problems of information asymmetry and market failure can be solved in a timely manner. They have suggested for an alternative strategy for effective liberalization with the development of appropriate financial institutions better able to serve the real sector of the economy. It is because the real sector can meet its needs of external finance only through the liberalization of the financial sector.

King and Levine (1993a, 1993b, 1993c) have found that besides identifying the best production technologies, financial intermediaries may also boost the rate of technological innovation by identifying those entrepreneurs with the best chances of successfully initiating new goods and production processes.

Levine and Zervos (1996) analyzed the data for 16 developing countries and found that capital markets became more volatile after capital account liberalization while they become more liquid, larger and integrate more with the international markets; information access becomes easier with the growth in size and liquidity of the stock markets. Substantially better functioning stock markets cannot be found in countries that have officially adopted of international accounting standard and laws regarding investors' protection than the countries do not have.

Levine (1997)'s empirical studies show the following: 1. Both financial intermediaries and stock markets become larger relative to the GDP, 2. Banks assets grow relative to that of the central bank, 3. Non-banks grow importantly as a country become richer over time. Due to different factors of production, financial structure develops overtime. Further, Levine (2004) suggested that the countries with better functioning financial system (whether bank-based or market-based), would grow faster and it eases constrains on external finance.

Rajan and Zigales (1998) discussed how the financial development affect the growth on the basis of 36 industries across 42 countries where U.S. is dropped from the analyses since it is used to identify external dependence. More developed financial system can minimize the effects of moral hazard and adverse selection problems as well as overcome market frictions, and hence, reduce the costs of funds. Thus, firms relying more on external finance will be more affected than those relying on their sources of internal finance. By using firm level data in the USA, they find the need for external finance to the firm.

Barnard and Thomsen (2002) discussed the importance of the financial sector reforms relative to other reforms in situation of less monetization and credit constraints to the small and medium enterprises in Russia. They argued that failure to accelerate to financial sector reforms could pose potentially serious threat to macroeconomic stability. They suggested promoting privately owned banks, restructuring and privatizing state-owned banks by means of deposit insurance, implementing International Accounting Standards and disclosure norms while strengthening regulation and supervision. Strengthening creditor rights, combating money laundering, improvement of bank capital, bankruptcy procedures as well as establishment of credit information bureau are important in achieving financial stability.

Jappeli and Pagano (1994) compared the incidence of liquidity constraints between underdeveloped countries with imperfect financial market and highly competitive markets of Greece, Italy, Japan, Spain, Sweden, UK and the USA. They have found that higher level of financial development significantly associated with lower liquidity constraints

The above studies suggest that developments of other sectors are also equally important. Improvements in accounting, auditing, institutionalization of financing system and good governance are required for the overall financial sector development.

2.4 Financial Reform in South Asia

Chowdhury (2002) examined the financial sector reform experience of Bangladesh. While there have been some improvements in competition and efficiency, loan defaults still remain a significant problem. There is urban bias in loan allocation and shift of resources away from the rural sector. The main obstruction in the area of loan recovery is political interference. Arguing that without moral norms donor agency-engineered formal institutional reforms become meaningless, he concludes that effective implementation of an optimal policy mix depends on complex political and institutional factors. Failing to address, perhaps market-oriented policy reform may increase transactions cost.

Cooray (2003) reviewed the regulatory reforms in the financial sector of Sri Lanka and evaluated the effects of policy reforms examining two phases of the financial reform (pre- and post- 1989 periods). He measured the width of the financial sector by the presence of number of financial instruments and markets, depth by the volume of deposits, and resilience by the ability to bounce back from a price change. The process of reforms though is incomplete, financial reform has not only increased the width and depth of the financial system, but also increased competition, and mitigated constraints on resource allocation. Operational and allocative efficiency in the credit market has increased and the financial sector has become resilient. Fiscal discipline is promoted and ratios of investment, national savings, as well as domestic savings have been increased after adopting the measures of reforms in the financial sector.

Demitriades and Luintel (1996) examined the effects of banking sector policies on the process of financial development and economic growth of Nepal over the period of 1960-1992 by using unrestricted error correction model (UECM). They constructed the index of financial repression by using principal component method to quantify the influences of banking sector policies on financial development, independently of the interest rate. They could not find support for real interest rate as determinant of financial development, but, came to a conclusion that financial depth influence economic growth and vice-versa.

Khanal (2003) criticized economic reforms in Nepal for an abrupt initiation. Reforms are criticized for no assessments of the existing domestic conditions, absence of participatory process to enlist cooperation of the stakeholders. As a result of reforms, there was a massive devaluation of domestic currency, tariff rates at the lowest in South Asia, eased portfolio investment and foreign direct investment. Further, it lacked prioritization and sequencing of policies. It could not address structural and institutional weaknesses and ignored reforms in agricultural sector. Further reforms are criticized for unbalanced liberalization where reform in some areas was far ahead without achieving concrete positive outcomes. Lack of effective policy monitoring, inadequate accounting standards and auditing practices, obsolete book keeping and inaccurate reporting of statements and above all weak supervisory mechanism, corruption and rent seeking behaviour reduced the benefits of reforms by itself.

Bhetuwal (2005) examined the financial liberalisation in Nepal by constructing index of financial liberalisation in respect of a) entry barriers, b) interest rate controls, c) credit controls, d) regulations and securities market, e) restrictions in international financial transactions, and f) privatisation of the financial sector each classified into fully repressed, partially repressed, largely liberalised and fully liberalised. He developed the index of financial development in respect of a) ratio of liquid liabilities of the financial system to GDP, b) ratio of credit to private sector to GDP, c) ratio of domestic assets of commercial banks to the sum of domestic assets of central and commercial banks, and d) ratio of private sector credit to total loans and advances of commercial banks. His analysis reveals the bi-directional causality between these two indicating financial liberalisation leading to financial development and vice versa. He observed that still there were some structural and institutional weaknesses, making reform efforts less effective. The reform has little impact on mobilisation of financial saving, interest rate and currency stabilisation.

III. FINANCIAL SECTOR REFORM NEEDS & AGENDA

3.1 Regulatory Regime of the Financial System

Nepal Rastra Bank (NRB) is a central bank established in 1955 under the special Charter. The Charter designates NRB as a principal regulator of financial sector in Nepal. Still outside its jurisdiction are Postal Savings Bank (which is managed by the government), Employees Provident Fund and The Citizen Investment Trust, saving and credit cooperatives or community based organisations, (mostly not licensed by the NRB), and of course the informal financial sector.

NRB has the sole responsibility to build a sound and healthy financial system in the economy. It involves creating an enabling environment, regulatory services in the like of policy and directives, inspection and supervision, interventions in respect of safeguarding depositors and shareholders, performance monitoring of system and dissemination of financial sector information. NRB's role and performance was poor in the past limited due to the lack of autonomy, an inadequate and outdated legal framework, the poorly trained and unproductive staff (with poor incentive mechanisms, a severely compressed salary structure, and inadequate training opportunities), and an inappropriate structure as well. Besides, NRB's direct representation on bank boards and ownership of development banks contributed to diffuse responsibilities, created conflicts of interest, and undermined its credibility.

Until 2001, two third of the Basel Core Principles for Effective Banking Supervision out of 25 were not implemented in the financial system. A study by the World Bank (2002) pinpointed weaknesses on the part of NRB to carryout the regulatory functions effectively. At the outset, the governing act of the NRB imposed limitations as it was designed in 1955 for a central bank operating in a government-controlled economy, and supervising government-owned banks. The central bank had limited authority for effectively managing monetary policy, improving the financial infrastructure, strengthening and improving financial markets and their supervision, and facilitating the growth of the financial sector. Therefore, NRB was failing to comply fully with Basel Core Principles while the preconditions required by the Basel Committee hardly existed in Nepal. The system was lacking adequate legal framework for the banking operation and banking sector related judicial procedures, sound accounting principles and auditing practices, a market-based banking business, exit and crisis management policies, and deposit insurance and safety net schemes.

The systemic weaknesses made it difficult for the NRB from taking action against problem banks. Therefore, at the first stage to strengthen the regulative regime, seven new banking regulations were issued in March-April 2001 to address weaknesses of the banking system. But, unless fully enforced the regulations would not have a positive effect on the financial sector. Despite the authority to regulate and supervise banks and financial institutions, the system was deficient to provide supervisors with adequate legal protection or with the operational independence and resources they needed to perform their jobs. The supervisors were thus handicapped to enforce the corrective measures needed to prevent and resolve banking problems. Further, NRB's structure to carry out supervisory functions comprised four units, under two different deputy governors, with few staffs. Consequently, surveillance of financial institutions did hardly exist as a specific function and reporting of information was neither timely nor comprehensive enough.

The effective supervision requires a matching capacity to do so in terms of prudential norms, appropriate structure and staff capacity. Thus a reengineering of the central bank was put as one of the three thrust areas of the financial sector reform programme. The key specifications of the reform programme comprised the following:

General

(a) Remove direct participation by NRB- and the Government - from the financial sector.
(b) Shed the development banking functions by NRB
(c) Undertake a human resource reengineering exercise within NRB - including the implementation of a VRS, complete revision of existing HR policies, and a de-compression of the salary structure
(d) Develop a tiered regulation system in line with international best practices.

Banking Supervision

(a) Implement and enforce the new regulations (minimum capital requirements, provisioning policy, etc) on the same basis for all banks.
(b) Utilize the support of experienced external consultants in the enforcement of the new regulations.
(c) Define a programme to include an annual review of RBB and NBL and biennial review of all the other banks.
(d) Make inspection reports available one month after the on-site visit
(e) Stop rotation of banking supervision staff.
(f) Apply stricter criteria in approving banking licenses.
(g) Make human resource policy changes to enable improved systems for staff selection and career advancement, and greater knowledge sharing.

Restructuring of Departments

(a) *Human Resources Department.* Computerize the HR function, develop new HR policies, design a VRS, and implement a decompressed salary system Consultancy and hardware support were the main components of this support.

(b) *Bank Operation and Bank Inspection & Supervision Departments*. Support the establishment and implementation of an appropriate system of supervision and regulation of banks and non-banks - both on-site supervision and off-site supervision. Consultancy and hardware support included in respect of enhanced technical and physical support for the work of the department in the form of additional desk top computers, lap top computers for on-site examiners, international experts to assist with on-the-job training (for the complete two year examination cycle of all the commercial banks), and classroom training as related to bank supervision, computing, and English (report writing).

(c) *Supervision of the Management Teams*. Recruit a bank restructuring expert to work closely with the Banking Operations Department of the NRB, over a two-year period, to supervise the management teams in RBB and NBL on a day-to-day basis.

(d) *Accounting and Auditing Department.* Recruitment of accountants who will strengthen the accounting and auditing capacities of NRB and gradually move them to internationally accepted accounting standards. Revision of the Accounting Manual to reflect Internal accounting standards and the external audit by a well recognized international accountancy firm to be initiated.

(e) *Research Department*. The programme aimed at supporting a training programme involving both formal higher degree training as well as capacity building through attendance at seminars and conferences. Support the further development of the NRB library as an important research facility for the staff of the NRB (and others), as well as the further computerization of the department. Support the development and dissemination of more economic research papers from the Central Bank through Quarterly Bulletins and the Annual Report.

(f) *Information Technology Support*. Support the development of a holistic IT strategy and IT infrastructure within the NRB, through technical assistance and some limited hardware and software support. Serious investment in up-dated IT systems, including the purchase of a computerized General Ledger system for the institution

(g) *Additional Support*. Support to other NRB departments:

* Legal Department. Technical and financial support to engage consultants and legal experts to review the legislative framework in the financial sector and assist GoN in the implementation of this component.
* Internal Audit. Support to be provided to boost the capacities of this important activity. (Preparing audit manuals, etc.)
* Training Support. Training to NRB staff, but within the context of a Comprehensive

Training Plan based on a review of existing skills, required skills, and a properly undertaken gap analysis.

* Other Departments. Small amounts of additional funding to be provided to meet needs for consultancies and studies as and when they arise.

3.2 Operative Regime of the Financial System

The financing business is done by several categories of financial operators in Nepal which are found active in formal and informal sectors. Government put an effort to provide formal financial services throughout the country with such measures as directed lending programme or banks network extension into interiors or establishing specialized institutions. Rural credit and credit in the prioritized area were targeted to be provided through focused institutions. However, various studies indicate that the role of informal sector is still significant in the rural and urban areas. Not only that, the informal sector prevails right within the Kathmandu valley and the overseas remittances have contributed further to enhance the existence of informal markets.

At the start of first ever-financial sector reform in 1984 the financial sector was represented by the 2 state-owned commercial banks, 2 development banks and 1 postal savings bank. Besides, stock exchange, insurance company, and provident fund were established by the government. The reform opened the door for the private sector participation in commercial banking although the state still continued to be the predominant player. As such, the financial system has grown to include development banks, microfinance development banks, finance companies, non-government micro-credit institutions, and non-government cooperative societies involved in limited banking activities.

The number of banks and financial institutions regulated by the NRB are exhibited in the table below:

Table 3: Establishments in the Financial Sector Regulated by the Central Bank

SN	Types	Category	2001/2	2002/3	2003/4	2004/5	2005/6
1	Commercial Banks	Large	2	2	2	2	3
		Joint venture	9	9	9	6	6
		Local	5	6	6	9	9
2	Development Banks	Large	2	2	2	2	2
		Local	9	9	12	24	27
3	Finance Companies		53	59	59	60	70
4	Micro-finance						
4.1	Micro-credit Dev Banks	Grameen	5	5	5	5	5
		Local	6	6	6	6	6
4.2	Financial Cooperatives		35			20	19
4.3	Financial NGOs		25	39	43	46	47
Source: Banking & Financial Statistics, No.-39-47, NRB							

NBL established in 1937 with 51% government ownership and a second one RBB which was promoted in 1966 under 100% government ownership are the premier commercial banks. Two development banks were promoted by the government one for supporting industrial sector in 1959, i.e. Nepal Industrial Development Corporation (NIDC), and the next for supporting agricultural sector in 1965, i.e. Agricultural Development Bank (ADB/N). After the economic liberalisation more commercial banks under different modalities (government, private and foreign joint venture, or private and foreign joint venture or private only) followed. New development banks on the other hand sprang up totally in the private sector. But the quality of service and financial soundness along with legislative regime could not improve.

In the meantime, KPMG Barents Group made a comprehensive assessment of NBL and RBB, in June 2000 and found serious shortfalls in all aspects of the governance, management, and operations of these banks. The KPMG report concluded that the banks' loan assets are highly overstated and extremely risky and that, as a consequence, the banks was found technically insolvent. The report estimated the negative net worth of NBL at NRs 6-10 billion (US$85 to 142 million) and that of RBB at NRs 14-18 billion (US$200 to 255 million). This was serious as RBB and NBL, the two largest banks, accounted for 41.9% of the commercial banking deposits, 48.3% of the loans and advances, and 47.9 percent of the total sources and use of the commercial banking system as in mid-July 2001. At the time, the stock of loan losses within these two banks was estimated to be between NRs 25 to 29 billion (US$368 to US$426 million).This represented 7.5 to 8.6 percent of Nepal's GDP and between 40-46 percent of Nepal's budget.

A study by the World Bank (2002) pinpointed weaknesses of the banking sector in general and two large commercial banks: Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) in particular. These were noted to be as follows:

<u>Weak and Fragmented Legal Framework:</u> The report stated about the critical gaps in the legal framework which has plenty of sub-sectoral and institution specific laws and regulations. These have created a fragmented legal environment and, as a result, a fragmented financial system, thereby stifling competition. There was a need for strengthening or amending associated legal framework such as Financial Intermediary Act (1998), Company Act 1997), and Insolvency and Liquidation Laws. Without strengthened laws and proper enforcement, any intervention in the financial sector was unlikely to have a meaningful and long-lasting impact.

<u>Weak Corporate Governance</u>. The government's and the central bank's involvement in the sector as owner and operator inevitably had lead to conflicts of interest. And within the institution, the corporate governance was extremely weak for no clear rules of engagement between a company's

management, its board, its shareholders, and other stakeholders. The situation was aggravated by weak systems, poor procedures, and information asymmetry. Accounting and auditing practices were highly deficient and could not provide financial statements at times - even though banks and finance companies were required to be audited annually by external auditors selected by the shareholders annual general meeting.

Lack of Competition. Despite the rapid growth of the financial system over the past decade, the competitive environment critical for ensuring the benefits to borrowers, depositors, other users of financial services, and shareholders was largely absent. The lack of competition reflected both the fragmentation of the system and the dominance of the two large (but inefficient) government dominated commercial banks. The government authorities were of view that the efforts to enhance competitive pressure should rely on market-oriented approaches rather than mandates such as those for interest rate spreads and priority sector lending which had increased distortions in the market and further burdened the financial institutions.

Poor Banking Culture. The elements of a good banking culture were almost nonexistent in Nepal, whether among banks or among their customers. Firm level data were largely unreliable, and banks were forced to reconstruct firm accounts from client estimates. On the other hand, banks often extend credit on the basis of collateral rather than creditworthiness which had seriously handicapped effective enforcement of the prudential regulations. Only a small number of banks had put in place satisfactory internal guidelines. The Credit Information Bureau, which maintained records of the blacklisted customers to whom banks couldn't extend credit, was hindered in its operations by the lack of cooperation from the banks.

Information Asymmetry and Lack of Financial Sophistication. At that time the public had limited knowledge of the financial position of banks, and had little access to financial information. When financial institutions' accounts and annual statements were disclosed, they were neither timely nor reliable - even if audited as the accounting and auditing practices were often below the international standards.

Corruption. Fraud, self-dealing, insider dealing, and improper evaluation of collateral had been among the reported abuses. This could be only checked by putting in place transparent systems, checks and balances at every level, and a system of continuous monitoring within and between financial institutions.

Inadequate Banking Services for the Poor. The emphases on the social dimensions of banking had not helped in the past. Most of the policies aimed at benefiting the poor (directed credit, branch opening policies) were too broad, and they created considerable operating disincentives within the financial system while achieving a minimal or even negative impact on their intended target audience.

The health of the development banks in the financial sector was not good as well before the initiation of FSRP. The government owned development banks ADB/N and NIDC were facing similar problems. ADB/N and NIDC were studied at length over eleven aspects/issues by Price Water and Cooper (PWC) Thailand over a period of two years and completed in July 2003. They were found in serious trouble with 95% non-performing assets of NIDC and over 50% of ADB/N.

In view of these weaknesses, it was recommended to replace the existing legislations, restructure the ailing banks and improve their capacity to operate and sustain. The specific reforms outlined for the banks and financial institutions comprised of:

<u>General</u>

a) Withdrawing the government from ownership of financial institutions
b) Creating an appropriate environment for establishing a sound financial sector
   - Implementing the provisions of the new Nepal Rastra Bank Act and finalizing the new Banking and Financial Institutions Act.
   - Strongly enforcing the new regulations on bank supervision - with no exceptions.
   - Requiring all financial institutions to submit externally audited financial statements (conforming to international accounting standards) within four months after the end of the year.
   - Requiring the central bank to dispose of shares in any institution that it supervises and to develop a five-year plan for disposing of shares in all financial institutions.

<u>RBB/NBL</u>

- Restructuring and Ownership Reform

a) Put in place the management teams for RBB and NBL to stem further deterioration of the health of these banks.
b) Prevent undue interference in the management team's functioning.
c) Undertake human resource re-engineering employing voluntary retirement schemes at a fairly early stage, and automation.
d) Begin vigorous loan recovery efforts.
e) Include strategic investors that bring value added skills and expertise to the banks, on privatization.
f) Consider the liquidation option for the two banks - if successful and quick privatization to "fit

and proper" owners is not considered a likely outcome.

g) Undertake close monitoring and supervision by the NRB during this period to thwart undue dealings and protect depositors.

- Establishment of Assets Management Corporation (AMC)
- Continuous Management Team support prior to privatization

Joint Venture Commercial Banks:

a) Eliminate the current restrictions on foreign ownership beyond 66 percent to attract "good name" banks that could bring discipline, know-how, and technological benefits to the Nepali financial sector.
b) Move away from direct participation in banks by the government and NRB, should withdraw from direct participation in the boards of commercial banks
c) Replace the current mandated lending requirements on commercial banks with better directed policies that result in less operating disincentives.
d) Review and remove the current policy that requires the establishment of rural branches whenever urban branches are established.
e) Prohibit cross holding in banks.

ADB/N and NIDC

a) Carryout reforms in ADB/N: (The restructuring plan was endorsed by ADB/N Board and the Cabinet approved it in February 2004). The plan included bringing ADB/N under Banking and Financial Institutions Ordinance (BAFIO), reconstitution of the Board, financial and organisational restructuring, and institutional strengthening components.
b) Wind up NIDC: (as it was found to be not having revival potential with more than 95% non-performing assets). A disengagement plan was proposed to be prepared within two years and get disengaged. However, the Cabinet on February 2004 decided to restructure it for possible privatization failing which it would be liquidated. The preparatory time frame was extended up to mid-July 2005. If privatization option does not stand chance by then liquidation would be followed.

3.3 Capacity Building of the Financial Sector

Apart from the reform focused at the central bank and ailing commercial and development banks, financial sector reform has targeted the financial sector in entirety through legislative improvement and installing professionalised services.

The weaknesses in the legislations was to be corrected with respect to regulatory body, financial intermediaries and related field in financial governance and business organisations. Accordingly, these were targeted under the financial sector reform programme to be prepared and implemented:

a) Amend NRB Act, 1955
b) Enact Banks and financial institutions ordinance/act (BAFIO/BAFIA)
c) Enact Secured transactions ordinance/act
d) Enact Insolvency ordinance/act
e) Amend Company ordinance/act
f) Enact Asset Management Company Act

The financial intermediaries needed support out of regulatory oversight and internal operations as well, purely from a professional services perspective. In this regard, the following reforms were proposed:

(a) Bankers' Training Center. Strengthening the role of this institution through:
- development of a strategic plan, design of appropriate course work, modem and enhanced teaching methodologies and equipment (including computers),
- support for enhanced training capabilities. Capacity to establish twining arrangements with a good foreign Banker's Training Institute to be explored.

(b) Credit Information Bureau (CIB). Strengthening the credit information process as an important building block within the overall financial sector reform effort. The targets were:
- Incorporation as a company to exercise legal power and to be operated by the active participation of private sector banks.
- IT upgradation and reengineering the processes

(c) Financial Journalism. Improving the general public's awareness for a more effective check and balance on bad banking behavior:
- Develop the capacity of local journalists to better convey financial sector issues to a relatively unsophisticated banking public.
- Provide some regional training, attachments, as well as bringing financial journalists from India to interact with Nepali journalists

Summation

To sum up, the financial sector reform programme had thus considered broadly three weaker dimensions of financial sector for the improvement, and the financial sector technical assistance support and fund were sought for implementation of the following components:

1. Re-engineering of Nepal Rastra Bank

   Re-engineering of NRB consists of legal reforms making new act providing the central bank more autonomy and responsibility, improving regulatory and supervisory capability, improving other policy matters and strengthening IT platform as well as other related departments and functions. The specific agenda, functional improvements are provided under various topics below.

2. Restructuring of NBL and RBB

   This comprise the placement of professional management team for restructuring of the bank, building system and procedures, improving HRM, IT, ALM, Risk management, Accounting and auditing. The necessity of reform, specific agenda and progress has been elaborated below under different topics.

3. Capacity Building in the Financial Sector

   The capacity building programme deals with the developing legal and regulatory regime for the financial system, institutional reforms, introducing of new institutions such as BTC, CRA, AMC, Strengthening of CIB, Developing financial journalism, privatizing rural development banks, establishing more focused institutions for micro credit delivery, and promoting governance and financial discipline in the system, etc.

IV. FINANCIAL SECTOR REFORM ACTIONS & ACHIEVEMENTS

4.1 State of Regulatory Oversight

4.1.1 NRB and Banking System

One of the objectives of FSR is to increase the autonomy and capability of central bank for making its monetary policy, supervisory and regulatory functions effective and enhance the regulatory regime for the financial sector.

In 2002, New NRB Act has been enacted addressing major difficulties that existed in the old act of 1955. The new Act has empowered the NRB to carryout such functions as prudent in order to meet its objectives, which comprise the following:

(a) economic and price stability

1. To formulate and implement monetary and foreign exchange policies in order to maintain the stability of price and balance of payments for sustainable development of the economy,

(b) financial system stability

1. To promote stability and liquidity in banking and financial sector,
2. To develop a secure, healthy and efficient payment system.
3. To regulate, inspect, supervise and monitor the banking and financial system, and
4. To promote entire banking and financial system of Nepal and to enhance its public credibility.

In this way, NRB Act, 2002 has been promulgated. It has provided clear authority, responsibility and accountability for NRB. The Act has provided NRB the power to address the problem bank resolution aspects. This Act has also incorporated provision for annual monetary policy announcement and implementation. After enactment of the new Act and launching of the comprehensive financial sector reform, major policy changes were announced through the strategy paper of the financial sector reform programme that included the development of system and rules in the NRB as well. As alluded above, NRB objectives are focused for internal and external stability as well as maintaining a sound and efficient financial system.

Within the reform programme, NRB has undergone significant internal restructuring and reengineering to transform it into a professional central banking institution, which would ensure prudent banking practices and help develop healthy financial intermediation that can support the growth of the economy. The progress made with regards to the implementation of reform plan underscores the following achievements:

General

Direct participation in the financial sector -remove	NRB withdraw the appointments of directors in banks & financial institutions begin to divest the ownership from banks and financial institutions including insurance sector.
Development banking functions-shed	NRB withdraw the lending requirements in the priority sector in the phase-wise manner. Facilitated the entry policy for micro finance institutions by increasing the ownership ceiling for banks and financial institutions up to 25% from 15%. Lowered the level of capital for development banks operating in rural areas. More focus to establish development Banks.
Human resource reengineering	Implementation of a VRS, complete revision of existing HR policies, and a de-compression of the salary structure
Tiered regulation system in line with international best practices –develop	Set of new directives (17), Guidelines (2) Various circulars and new licensing policy prepared and implemented.

On the general front of reforms, the government is yet to withdraw from the ownership of financial institutions including NBL and RBB. Though NRB is pulling out of ownership, the government and government owned institutions still hold the stake in many bank and financial institutions (See 4.4). On creating appropriate environment for the financial sector, NRB Act has been replaced and all financial institutions have been brought under one umbrella: Banking and Financial Institutions Ordinance which now has been enacted by the Parliament.

Banking Supervision/Regulation

Implement and enforce the new regulations	The gap analysis undertaken by foreign consultant and as per recommendation a new set of directives issued and implemented.
Annual review of RBB and NBL and biennial review of all the other banks	Review of all commercial bank on on-site basis once a year. Quarterly monitoring of progress of NBL and RBB.
Make inspection reports available one month after the on-site visit	This is currently the practice
Stop rotation of banking supervision staff.	A clear policy has been announced and implemented
Apply stricter criteria in approving banking licenses -	A new licensing policy has been announced in 2007, underwhich all the qualifications are tested before providing licenses.
Human resource policy changes to enable improved systems for staff	New staff by-law prepared and implemented long term & midterm HR policy prepared and incorporated in strategic plan.

On banking supervision and regulation fronts the following improvements have been made:

- In order to strengthen the regulatory and supervisory functions, NRB hired a banking consultant to address the weaker parts of the regulations and shortcomings. As per the consultant's advice, NRB at the first instance issued seven directives, which were extended to 16 by 2006. These are now called unified regulations and by September 2007 it has reached to 17. Moreover, 2 guidelines: Know your customer (KYC) and Credit policy were issued. Apart from that NRB has issued various circulars.

The NRB Directives cover most of the areas of prudential regulation which comprise of:

- Regulation regarding capital adequacy ratios
- Regulation regarding loan classification and loan loss provisioning.
- Regulation regarding single obligor limits and credit concentration.
- Regulation regarding accounting policies and preparation of financial statements
- Regulation regarding risk management in the credit and investment, liquidity, foreign and interest rate risk management.
- Regulation regarding good corporate governance.
- Compliance with supervision reports and reporting
- Regulation regarding Investments
- Regulation relating to financial reporting and financial returns
- Regulation relating to Buy and sale of promoters' share
- Regulation regarding consortium financing
- Regulation regarding credit information and blacklisting of defaulted borrowers.
- Regulation regarding liquidity and cash reserve ratio (CRR)
- Regulation regarding expansion of Branches and offices of banks and financial institutions
- Regulation regarding to Interest rates
- Regulation regarding resource Mobilization
- Regulation regarding deprived sector loan.

- Control over weak banks and resolution

  With the introduction of NRB Act, 2002 and BAFIA, 2006, NRB has been able to intervene on time the problem banks and financial institutions. Within last 5 years, NRB has taken control over three commercial banks and initiated restructuring to make them sound and healthy. These banks are NBL, Lumbini Bank Limited and Nepal Bangladesh Bank Limited. Among these three, NBL is getting direct support under FSR and two others are still under restructuring programme of NRB in other forms.

- Proactive-strategy regulating and strengthening financial system. In this regard Credit Risk Management Mechanism has been introduced through:

- Standard credit policy manuals
- Loan recovery guidelines,
- Write-off policy

Loan files and loans portfolio have been continuously reviewed, measured and managed by the banks themselves. Risk monitoring, assessment and management system and asset/liability management guidelines are in place in all the commercial banks.

Restructuring

Human Resources Department	VRS 3 times, organizational setup completed incentives enhanced. Plan and policies prepared,
Bank Operation and Bank Inspection Departments	Set of rules, regulations, policies prepared and implemented. Risk based on-site and off site manual prepared and implemented
Supervision of the Management Teams	Monitoring and reporting on quarterly basis
Accounting and Auditing Department	Manuals prepared and implemented.
Research Department	Capacity enhanced.
Information Technology Support	Is continuing. Significant improvement not happend to date.
Additional Support- Legal Dept, Internal Audit Dept	Capacity enhanced.
Additional Support- Training	Focused training for regulators and supervisors completed and on going by BTC, NRB

As part of the restructuring process, the following improvements have been made in order to strengthen the NRB's internal system and procedures:

- Following Rules and by-laws were improved:

  NRB Function Management Rules

  NRB Note Replacement Rules

  NRB Note Destruction Rules

  NRB Notes and Coins Rules

  NRB Internal Auditing and Inspection By-laws

  NRB Expenditure Management By-laws

  NRB Personnel Service By-laws

  NRB Inspection & Supervision By-laws

  NRB Authority Delegation By-laws

  NRB Audit Committee (Procedures) Directives NRB Auction Directives

- Corporate re-organization of NRB on functional mode completed:

  Accounting and auditing functions have been strengthened by establishing an accounting cell of chartered accountants. Assigned to review the exiting system and prepare several guidelines, manuals and policies for NRB, this cell is preparing accounting manual, audit manual, budget manual, auction guidelines, internal audit bye-law, internal control system manual, design reconciliation system, suggest the areas for merging of activities of public debt department and Kathmandu banking office of NRB, settle the un-reconciled items of mint department of NRB, design a system to have up date of reconciliation of general accounts, prepare a policy document for fixed accounts and current account. This cell has almost completed all the activities and is at the concluding phase. Hereafter, the cell would do the pilot testing and conduct training programme for the users.

Inspection and supervision byelaws were prepared and implemented from 2004 comprising both the offsite and on-site manuals. Accordingly, the functions of the department have been strengthened. The knowledge and skills of staff have been strengthened by providing in house and foreign trainings around 1000 within the programme period.

HR, IT, Legal and other area strengthening programmes are underway. The size of staff level has been downsized from nearly 3000 staff to 1543 by January 2007. Specific policies, procedures and programmes have been introduced including formulation of long term strategic plan for the NRB. IT Prototype development completed to strengthen the IT platform of the central bank and modernize the processes.

- The Coordination and Support Team (CST) has been formulated to monitor and implement the FSRP as being the NRB as a implementing agency of the government. The Coordination and Support Team (CST) that has been formed within Nepal Rastra Bank in the Bank and Financial Institution Regulations Department, under the FSTA, will continue to administer this project. The Executive Director of this department heads the CST and provides overall guidance and leadership on matters of project implementation. The CST is supported by a Financial Management Specialist and a Procurement Specialist. The CST is also supported by adequate ancillary staff and facilities.

4.1.2 Overview of Achievements

The reform contemplated a lean and efficient and professional central bank. The reform spanned two fronts: institutional capacity building and supervisory/regulatory actions. The first was addressed through restructuring of the organization, right sizing, development and career advancement of human resource, and IT infrastructure in place in full scale with topical policies and operational rules/bye-laws. The second was addressed through a replacement of the charter providing needed autonomy and authority to the central bank. The actions that follow thru consisted of putting in place desired regulations and enforcement of the same over the banking and financial institutions on the one hand and extending supervision of the management teams placed at NBL and RBB and at times in other weak banks.

Broadly the system seems to be in place now. What has not happened yet effectively is timely inspections of non-banks and taking recourse to prompt actions for all banks and financial institutions. NRB withdrew its senior staffs from the board of directors of the banking and financial institutions but yet divestment of its shares remains to be completed in same institutions. Besides, with respect to its own governance NRB is behind in research, critical reviews in dealing with future issues on the one hand and devolution of the authority to the respective departments and development of professional core within the departments on the other.

The state of reengineering of NRB is still incomplete. As envisaged by Phase II, the IT up gradation and training programmes for building the capacity of the regulators and supervisors are yet to be completed. No doubt NRB is capacitated in terms of authority, prudential norms and regulations and the efficiency and effectiveness in banks supervision and regulation has improved and could be at the aggressive level with Phase III. With the reforms made to improve the regulatory function of the NRB, the banking system is observed to gain the following strength:

- Adequate system and procedures for the banking operation in banks and financial institutions
- Documented policies
- Enhanced risk management skill in Bank employees
- Increased level of good governance
- Sustainable profitability in the system
- Increased level of paid up capital
- Reduction in the level of NPL in the system
- Competition in the markets specially in quality of services and products

In order to strengthen the supervisory capability of the central bank, on-site and off-site manual have been prepared and implemented. On-site manual was implemented from 2002. The staff level has been reduced to acceptable level by launching the VRS and CRS programmes. In order to improve the IT system, consultant has been hired and study has been completed, but the procurement aspect has not yet been completed.

For an organisation to remain successful, reengineering is a continuous process as such NRB has to evolve on the same front. The turnover and transfer of the staff could make the Bank Supervision Department and, Bank & Financial Institution Regulation Department extremely vulnerable in terms of staff capacity as well as institutional memory. Therefore, the new practice adopted - not to make frequent transfer should be implemented strongly.

4.2. State of Operative Situation

4.2.1 Commercial & Development Banks

<u>Reform in NBL/RBB</u>

a) Reform at the organization level

The professional management teams were placed in NBL and RBB in July 22, 2002 and January 16, 2003 respectively for two years. The contract was extended first time for one year and second time for two years with contract cost reduced in the extended periods.

Stabilize the operational and financial positions of the banks	Various operational manuals prepared and implemented, Banks turned to gain profitability.
Human resource programme	Training- Regularly conducted (more than 9000 employees) Right sizing- From 11 thousand to 6 thousand.
Branch restructuring and improvement programme	Branch rationalized and reduced from 400 to 221.
NPAs, Debt Recovery Procedures, and Blacklisting	Strengthened
Accounts/Audit - five months from the report date	Completed up to 2006. 2007 July figures are being audited.
Information Technology selection and implementation	Completed. 80 percent of transaction covered by IT system.
Preparation for ownership reform	Not yet completed due to political turmoil.

To be specific, the professional management teams did the following in the respective bank:

- Reorganisation
  - Standardized System and procedures put to place
  - Management Plan and Strategic plan, Branch operation manual prepared and implemented
  - Organizational structures re-organized
  - Bank branches rationalized (NBL: brought down to 107 from over 200; RBB: brought down to 114 from over 200) and staffs right sized through VRS and other modes
  - Audit manuals prepared and sound audit culture established

- Information Technology (IT)
  - IT Plan prepared and implemented
  - RBB: RBBSYS in 24 branches and Pumori Plus in 40 branches out of 114 branches, Integrated Banking Information System (IBIS) pilot testing in 4 branches; NBL: NEWTON in 44 branches out of 107 branches
  - KASTLE Software introduced for Treasury operations and Human resource.

- Account and Finance
  - Capital Plan of the banks (NBL and RBB) prepared and submitted
  - Statutory audits of last several years completed and made up-to-date up to 2005/06.
  - New Accounting Manual, New Audit Manual, Budget Manual, charts of accounts prepared and implemented
  - Quarterly financial statements are being published on regular basis
  - Branch rating system introduced in RBB in terms of ability to attract deposits and loan recovery
  - Pending reconciliation items have decreased and are updated from 2002.
- Human resource
  - Long term HR plan and Skill enhancement plan prepared and implemented (around 6139 NBL staff and 2923 RBB staff imparted training)
  - Monetary benefits hiked for employees by on an average 40% from the beginning of FY 2004/05 at NBL and 45% at RBB.
  - Staff level downsized through VRS schemes from 11235 in 2002 to 6261 in 2006: RBB from 5583 to 3301 (1632 off in three phases) + 163 off from CRS; NBL from 5652 to 2960 (2369 off in three phases)
  - New Staff Bye-laws prepared and enforced
  - Reward and punishment system initiated.
- Credit and banking services
  - Standard credit manuals, loan recovery guidelines, problem loan guidelines, loan write-off policies, inspection manual prepared and implemented.
  - Loan files and loan portfolio reviewed, risk element measured on regular basis.
  - Risk monitoring, assessment and management system are in place.
  - New consumer loans (auto, home, margin, education, and personal) introduced and international banking connections and services expanded
  - Cases filed to DRT for recovery NPA: around 1500 cases have been filed (RBB: 547 cases amounting Rs.10031 million by mid July 2006; NBL: 958 cases totaling a principal and interest amount of NRs 13726 million).
  - Non performing debt recovered - RBB: Principle NRs. 6018 million and interest NRs.3876 million total NRs 9894 million by mid-July 2006; NBL: NRs 5062 million principal and NRs 2428 million interest total NRs. 7490 million by mid July 2006
  - Book write off of NPA - RBB: around NRs. 4000 million & NBL around NRs. 4000

million. (Principal excluding interest)

- Deposits

- Restructured deposit interest rate and reduced interest rates
- Computerized banking services begun
- ABBS (NBL 21 branches), RBB 18 Branches
- SMS balance information (RBB)

b) Reform at selected branches

The study team visited four branches each of NBL and RBB (two within and two outside Kathmandu valley). The specific findings are noted as follows:

Branch setting

- Layout improved,
- Documents processing improved.
- System procedure compliance maintained, and any exception required for the faithful customer is forwarded to the central office for decision.

Customers services-deposits

- Computerized services
- SMS banking for balance information (RBB)
- Customers complaints minimal,
- ABBS introduced
- ATM not yet started (NBL), Services from ATM started in RBB
- Deposits on rising trends

Customers services-loan

- Customers will first approach the relationship officer (not yet positioned in RBB, NBL Chabahil) and loan committee makes decision.
- The processing time reduced with loan processed within 3 days for complete documents but those requiring HO approval would take 7 days. New business loan might take 15 days. Earlier it was taking more than month.
- Document completion by the customers might take 21-30 days.
- 50% margin on collateral, good customer might get 60-70% on HO approval.
- Mostly consumer loans (house, education, auto, margin) by numbers (not yet in RBB Dhading), business loans based on financial statements but extended to the tune of 30% of sales, 70% of stock with collaterals for the ongoing concerns.

- Credit extension somewhat low but credit quality enhanced
- Credit limit per case authorised to the branch stands at NRs 10 million for RBB main branch, NRs 5 million for NBL main branch, and it varies in other depending on the locations: NRs 0.7 and 0.2 millions for NBL other branches at main and interior locations respectively and NRs 2 and 0.3 million for RBB other branches at main and interior locations respectively

Overall business

- Branch on profit (Branch profitability study on annual basis)
- NPA down
- Business growth observed

Issues that remain

- Staff motivation: Behavioral change towards customers but age and habit might be the limiting factor. Old habits die hard.
- Lending (staff size and capacity/skill, Market/credit appraisal)
- Consumer loan centralised (NBL)

Performance Indicators

Both the banks (RBB & NBL) have achieved significant progress by financial indicators. The accomplishment on financial performance is presented in the table below:

Table 4: RBB & NBL Performance Indicators – Financial

(NRs. in million)

Indicators	RBB			NBL		
	Status July 2002	Project Target 2006	Actual July 2006	Status July 2002	Project Target 2006 *	Actual July 2006
Debt Recoveries						
a. NPA Level Actual (Rs)	14889	9268	8048	10834	5008	2262
b. As % of Gross Loan	55	39	35	56.27	32.93	18.18
c. Recovery of NPL Principal (Rs)	NA	1690	1523	NA	1020	1138
d. Recovery of NPL Interest (Rs)	NA	960	1055	NA	333	655
Business/Revenue Growth						
a. Good Loans (Rs)	12148	14643	15055	8419	10199	10180
b. Net Interest Income (Rs)	(602)	1445	1529	(185)	1048	1275
c. Non-Funded Income (Rs)	378	975	482	616	505	443
d. Deposit (Rs)	38994	41800	45820	34265	36400	35830
e. Non-Interest Deposit (% of Total	12.75	17.34	17.76	13.7	14.6	18.1
Operating Efficiency						
a. Net Spread (1/2 year annualized)	(0.93)	4.40	4.47	0.1	6.3	8.4
b. Net Interest Margin (do)	(1.93)	4.15	4.12	(0.50)	1.2	1.6
c. Net Op. Income to Total Assets	(0.51)	3.76	3.31	0.9	8.1	4.1
d. Cost to Income (before extra item)	(434)	56	53	70.9	60.5	64.6

Profitability						
a. NPBT (before extraordinary item)	(7068)	2212	1733	(3071)	2400	2421
b. ROA (half year figure annualized)	(15.72)	(6302)	2.90	(9.00)	4.7	3.4
Staff Efficiency						
a. Staffing Level	5583	2578	1733	5652	3100	2960
b. Income/staff (1/2 year annualized)	0.38	1.07	0.87	0.36	0.79	0.84
c. Staff Expenses to Income (%)	0.36	0.24	0.26	61	28	27
d. Staff Cost (% of Total Op. Cost)	22.7	39.0	38.6	40	37	36
Capital Fund						
a. Net Worth (Rs)	(17451)	(17650)	(18590)	(9954)	(4840)	(6302)
b. General Loan Loss Provision (Rs)	109	323	461	92	894	484
Computerization of Branch						
a. Deposit (Covering % of Total)		47	75		85	75
b. Loans (Covering % of Total)		42	42		84	85
Disclosure Requirement						
a. Annual Audit Statement by		4 months	1 month	7 month	15 days	4 months
b. Quarterly Provisional by		1 month	1month	6 month		15 days
* derived from the contract document,						
Source: Nepal Rastra Bank, NBL and RBB						

Other Banks

Following the implementation of the reform programme, there have been a number of changes affecting the entire banking system. The government has enhanced the level of foreign ownership from 67 percent to 75 percent, but the government and NRB holdings in the banks remain to be disposed off. The banks are also directed not to maintain cross holdings in other banks and financial institutions licensed by the NRB. Accordingly, NBL and RBB have disposed off the shares of other banking and financial institutions. But it remains to be fully complied with.

The compulsory priority sector lending to the tune of 12% of total credit has also been done away with. The mandatory opening of rural branches to open up urban branch has also been withdrawn. Interest rate determination for credit lending is left at the sole discretion of the banks and financial institutions.

The specific reforms targeted for Agricultural Development Bank is going on since July 2004 with the restructuring plan. The Bank has been converted into a limited company and brought under umbrella act. Newly reincarnated Agricultural Development Bank Limited (ADBL) has been graduated into full fledged commercial bank. The bank is undergoing restructuring and strengthening of the rural finance sector. Technical areas that are being strengthened include a) risk management, b) credit appraisal, c) training, d) corporate plan, e) accounts and internal audit, and f) management information system. Recapitalization and portfolio management constitute other fronts. The non-performing loans have been reduced from 36% in 2002 to 25.6% by April 2007. Government is injecting capital to strengthen its capital base and adequacy ratios.

But, the intended reform of Nepal Industrial Development Corporation (NIDC) has not gone satisfactory ahead. Though its liquidation was proposed, it is now incorporated under development bank and confining to limited operations. If privatization is considered in place of liquidation it is converted into a limited company and brought under umbrella act. There is a need of further evaluation of whether its business stands saleable or not? NIDC regional offices at Biratnagar, and Nepalgunj have been closed upon completion of property valuation reports. Pokhara, and Dhangadhi offices remain to be closed. A total of 118 staff took VRS. Property in Butwal has been disposed off. A report on privatisation process was prepared by a team of MoICs, MoF and CEO of NIDC, but yet no final decision is in place.

The performances of the commercial banks with financial sector reform over the position prior to reform are highlighted below.

Table 5: Performance of Banks – Commercial

Commercial banks - TOTAL						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)	185144.7	203879.3	233811.2	252409.8	291245.6
2	Borrowings (Rs mn)	2349.5	3170.4	3023.6	6842.9	9519.6
3	Loans (Rs mn)	113174.6	124522.4	140031.4	159641.4	173383.4
4	Deposits/loans (%)	163.6	163.7	167.0	158.1	168.0
5	Borrowings/loans (%	2.1	2.5	2.2	4.3	5.5
Commercial Banks - NBL, RBB, ADBL						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)	93076.8	97051.9	105869.3	105333.5	111135.8
2	Borrowings (Rs mn)	371.1	214.3	338	4960.1	6068.9
3	Loans (Rs mn)	56361.3	56319.7	55144.6	56816	50085
4	Deposits/loans (%)	165.1	172.3	192.0	185.4	221.9
5	Borrowings/loans (%	0.7	0.4	0.6	8.7	12.1
Commercial Banks - excluding NBL, RBB & ADBL						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)	92067.9	106827.4	127941.9	147076.3	180109.8
2	Borrowings (Rs mn)	1978.4	2956.1	2685.6	1882.8	3450.7
3	Loans (Rs mn)	56813.3	68202.7	84886.8	102825.4	123298.4
4	Deposits/loans (%)	162.1	156.6	150.7	143.0	146.1
5	Borrowings/loans (%	3.5	4.3	3.2	1.8	2.8
Source: Quarterly Economic Bulletin vol.41,NRB mid -January 2007						

Likewise, the performances of the development banks with financial sector reform over the position prior to reform are highlighted below.

Table 6: Performance of Banks – Development

Development Banks -Total (including ADBL						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)	24677.4	28802.4	29427.2	33957.8	35902.6
2	Borrowings (Rs mn)	5932.1	5889.4	5959.9	5117.8	5226.2
3	Loans (Rs mn)	27554.8	31026.9	31905.2	29893.7	31224.2
4	Deposits/loans (%)	89.6	92.8	92.2	113.6	115.0
5	Borrowings/loans (%	21.5	19.0	18.7	17.1	16.7
NIDC						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)		522.5	522.5	522.5	522.5
2	Borrowings (Rs mn)	1418.2	1349.5	1349.5	1349.5	1349.5
3	Loans (Rs mn)	1486.8	2065.5	2065.5	2065.5	2065.5
4	Deposits/loans (%)		25.3	25.3	25.3	25.3
5	Borrowings/loans (%	95.4	65.3	65.3	65.3	65.3
ADBL						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)	20807.9	23941.8	26235.9	27874.8	29612.4
2	Borrowings (Rs mn)	4440.3	4053.7	3664.9	3606.4	522.4
3	Loans (Rs mn)	23062.3	26699.0	29343.3	32152.5	33393.4
4	Deposits/loans (%)	90.2	89.7	89.4	86.7	88.7
5	Borrowings/loans (%	19.3	15.2	12.5	11.2	1.6
Development Banks excl NIDC & ADBL						
SN	**Particulars**	**July 2002**	**July 2003**	**July 2004**	**July 2005**	**July 2006**
1	Deposits (Rs mn)	24677.5	28802.5	29427.1	33957.8	35902.6
2	Borrowings (Rs mn)	5932.0	5889.4	5959.9	5117.8	5226.2
3	Loans (Rs mn)	27554.8	31026.9	31905.2	29893.7	31224.3
4	Deposits/loans (%)	89.6	92.8	92.2	113.6	115.0
5	Borrowings/loans (%	21.5	19.0	18.7	17.1	16.7
Source: 1. Quarterly Economic Bulletin vol.41, NRB mid -January 2007 NRB 2. Banking & Financial Statistics No. 41-47, NRB Mid July 2003-06 NRB						

4.2.2 Microfinance

Microfinance is another window of the financial sector which comprises of formal and informal actors. At the formal level and under the regulation of the central bank there are micro-credit development banks (Grameen and local category), financial cooperatives and financial NGOs. As specified in Table-3 there were 11 micro-credit development banks in 2002 and the same number continues; there were 39 cooperatives which has come down to 19 in 2006 (as NRB is not accrediting new ones and those accredited are being delicensed due to non-compliance to regulations); there were 25 NGOs which has gone up to 47 in 2006. The share of informal actors continues to be large whether community unions or individual schemes operating in localised areas.

Micro-credit institutions, in particular the Grameen Bikas banks are not in good shape and also there are confusions with respect to regulation of cooperatives. Some Grameen Bikas banks are still suffering from political interference in terms of appointment of the board and the senior management and at times even in staff recruitment. The Grameen model of micro-credit delivery has differential operative bases in the Terai and the hills requiring a differential approach failing which the micro financing institutions will face increasing recovery and sustainability problems. Often the employee unions come in the way against restructuring and rightsizing these banks.

Financial sector reform programme therefore envisages developing an improved system of micro-finance. The programme specifics comprise of:

- Restructuring and privatization of the Grameen Bikas Banks
- Consider ways of ultimately providing sustainable micro-finance services through private sector institutions

NRB is divesting shares from Grameen Bikas Banks but it is still not complete. On establishing improved system for micro-finance the Grameen Bikas Banks are yet to be fully restructured as well. This apart, the private sector is quite active in this front through NGOs and saving and credit cooperatives. The monitoring of their operation and their regulatory jurisdictions has remained an issue in the financial system. These institutions are by nature different than other banking institutions and should have different modality of self regulation and different procedures to monitor the performance.

Not much reform has outreached this category of financial operators. So far as the performances are concerned, these are highlighted below for the regulated microfinance sector. As per Access to Financial Services Survey 2006, microfinance development banks accounted for 37% of the total loan portfolio of the regulated institutions and 23% of deposits; financial NGOs represented 22% of the loan portfolios and 53% of deposits and financial cooperatives had a share of 6% of the loan portfolio and 1% of deposits at 2005.

Table 7: Performances of Microfinance Institutions

SN	Particulars	July 2002	July 2003	July 2004	July 2005	July 2006
Development Banks (Micro)						
	(Dev Banks -nos.)	6	6	6	6	6
1	Deposits (Rs mn)	73.6	174.2	225.8	309.0	432.7
2	Borrowings (Rs mn)	336.5	1065.9	1298.7	1726.6	3021.2
3	Loans (Rs mn)	337.7	1118.5	1663.7	2071.6	2686.5
4	Deposits/loans (%)	21.8	15.6	13.6	14.9	16.1
5	Borrowings/loans (%	99.6	95.3	78.1	83.3	112.5
Development Banks (Grameen)						
	(Grameen -nos.)	5	5	5	5	5
1	Deposits (Rs mn)	341.1	451.6	473.6	439.8	499.8
2	Borrowings (Rs mn)	1181.0	1324.9	1471.9	1675.9	2303.7
3	Loans (Rs mn)	1145.9	1309.1	1358.4	1466.0	1616.5
4	Deposits/loans (%)	29.8	34.5	34.9	30.0	30.9
5	Borrowings/loans (%	103.1	101.2	108.4	114.3	142.5
Financial Cooperatives						
	(Fin. Coops -nos.)	34	34	21	20	19
1	Deposits (Rs mn)	1570.7	1924.5	1679.8	1769.0	2011.6
2	Borrowings (Rs mn)	58.7	66.4	41.1	46.2	70.7
3	Loans (Rs mn)	1313.6	1463.2	1310.7	1440.7	1665.4
4	Deposits/loans (%)	119.6	131.5	128.2	122.8	120.8
5	Borrowings/loans (%	4.5	4.5	3.1	3.2	4.2
Financial NGOs						
	(Fin. NGOs -nos.)	25*	39**	47	47	47
1	Deposits (Rs mn)					
2	Borrowings (Rs mn)	26.1	91.1	220.4	437.6	541.8
3	Loans (Rs mn)	30.7	48.8	115.5	258.7	439.8
4	Deposits/loans (%)					
5	Borrowings/loans (%	85.0	186.7	190.9	169.0	123.2
* reported by 15, ** Reported by 25						
Source: Banking and Financial Statistics & Non-bank Financial Statistics, Nepal Rastra Bank						

Micro-credit development banks are in profit and the capital adequacy ratio stood at 18% well above the 8% norm prescribed by NRB in 2005. Only 2 out of 5 Grameen development banks are in profit and the consolidated capital adequacy ratio stood at poor 7% in totality in 2005, but the two in profit are maintaining 11% norm prescribed by NRB. The private sector run and managed Grameen replication programmes are however relatively well managed with reasonable level of profitability. As per Access to Financial Services Survey 2006, 14 of the 20 financial cooperatives are in profit and the consolidated capital adequacy ratio stood at 15% in 2005 (half maintaining above 15%) as against 10% prescribed by NRB though many central banks are prescribing 15-20%. Only 7 financial NGOs are in profit and the consolidated capital adequacy ratio stood at 8.6% in 2005 which is below international standards, but, 12 NGOs maintained above 12%.

4.2.3 Finance Companies

Finance companies are the next important player in the financial sector that come in between development banks and microfinance institutions. As specified in Table-3 the numbers have increased form 53 in 2002 to 70 in 2006. Finance company was first promoted by the government which still continues and the others have come in the private sector, some of whom have come as a joint venture between local private and foreign bank and financial institutions. They serve the middle class clients as the big ones go to the banks and the poor ones go to the micro-financiers. Finance companies are considered fast service provider compared to the banks as the time for loan decisions are relatively short. Finance companies are also providing Merchant Banking Services in the financial system.

Financial sector reform did not consider any specific targeted programme of reform for this category of financial institutions, though at times NRB had to take into care the management of a few of them for reasons of management problems. There are a few apparent issues in respect of their loan practices and capital injections. The internal management system together with MIS and the documentation aspect as well as quality of human resources need to be assessed before they become another area of major burden.

Table 8: Performance of Finance Companies

SN	Particulars	July 2002	July 2003	July 2004	July 2005	July 2006
	(Fin. Cos -nos.)	54	57	58	59	70
1	Deposits (Rs mn)	13453.9	16510.3	19391.7	22341.6	24332.5
2	Borrowings (Rs mn)	244.8	134.3	1306.5	990.8	1154.8
3	Loans (Rs mn)	11949.6	14473.7	17540.8	21223.3	27078.9
4	Deposits/loans (%)	112.6	114.1	110.6	105.3	89.9
5	Borrowings/loans (%	2.0	0.9	7.4	4.7	4.3
Source: Banking and Financial Statistics (Mid July 2006), Nepal Rastra Bank						

The performances are highlighted above show that the finance companies hold significant position in mobilizing deposits and extending credits.

As per Banking and Financial Statistics 2006, 18 finance companies were not making profit while 52 were in profit in 2006. The net profit of 70 finance companies has stood at NRs. 572.1 million. The consolidated capital fund stood at NRs. 4.3 billion which was at 10.03% of the risk weighted assets that amounts less than the NRB prescribed 11%. Besides the non-performing loan stood at 7.66% in 2006 which seems to be within the manageable limit compared to the banks.

4.2.4 Overview of Achievements

NBL/RBB

At the start of the reform in 2002 both NBL and RBB were failed institutions with poor systems, operating losses and huge negative net-worth. As these banks stand now, they have started making profits from FY 2003/04, but, on the question of correcting negative networth the banks management hold the view that to earn the way back to a capital base in compliance with NRB regulations is not possible in a realistic time frame from their own earnings. Government needs to inject the required level of capital from its own budget to comply with the NRB's regulation. The turnaround has happened for improved governance on a system plank with lean but trained staff, reorganized structure and defined procedures, and competitive technology on the one hand and moves to correct the loan services and corner the defaulters on the other.

A significant change in the lending procedures and objective has been observed in recent days. The banks at the central and branches claim that collateral based practices are gradually replaced by objective lending. In the past, the loans were distributed, as customers wanting to milk bank were extended loans by order, these days customers first see the Relationship Officer who looks at the project, the customer and the collateral, and compiles and places the file before loan committee after assessing the risk associated with the loan. Of the total loans 10% are a new and 90% are renewals, customers at large remain to be attracted as the excess liquidity continues.

The banks management had have some problems with the unionism in the banks though it opens up the opportunity as well. It is a problem when the unions overstep their role interfering with management actions and decisions. It is an opportunity when management is able to sell the idea and engage them in a way productive to the bank. The managements have made efforts to make the unions productive segments in the banking environment, but by nature they usually overstep management functions with occasional work stoppages.

As to the succession plan, professional management team at NBL recommended transferring of management team member as permanent staff members within the bank but that did not happen. The middle level managers by and large are professionally sound though are not ready to take over as they are in middle stages of development. RBB as well has developed a succession plan identifying key managerial positions to be replaced and the potential candidates.

Other Banks

At the outset the other banks were considered to be in good shape and competing at the time of design of financial sector reform barring Agricultural Development Bank (ADB/N) and Nepal Industrial Development Corporation (NIDC). So the reform concentrated on easing some restrictions such as extent of foreign ownership, mandatory credit requirements and mandatory opening of rural branches which now have been done away with. Second the reform contemplated going by recommended actions with regards to ADB/N and NIDC on a mode external to the FSR. ADB/N has now become a full fledged commercial bank registered as a limited company doing away with the charter and undergoing organisational and services restructuring. NIDC, however, has fallen to inaction and the government is responsible for the status quo.

Finance Companies

The reform process encompassed the finance companies to operate under unified directive applicable equally to other banks and financial institutions. Finance companies do not require staying as a finance company for ever. They could be upgraded to higher level (development bank or even commercial bank) if they meet the NRB criteria including the prescribed capital base. NRB feels that the performances of most of the finance companies and the capacity to manage the risk and governance are improving.

Microfinance Institutions

Microfinance institutions are specialized and focused lending institutions in the rural community. Previously, these activities were undertaken by the commercial banks themselves under the directed lending programme of the NRB. Afterwards, investing in the shares of microfinance institutions and wholesale lending to microfinance institution were the modalities followed by the commercial banks to avoid their direct presence in rural areas where they could not even manage to recover their overhead expenses. But now, the number of micro finance institutions has increased as the capital requirement for establishing such institution is low in comparison to other banks and financial institutions.

The outreach of these institutions has increased with the liberal policy applied to them. As per the reform programme, NRB has started divesting the shares of Grameen banks, enabling the private sector to participate and enhance the level of performance of these institutions. Moreover, a separate act for self regulation has been envisaged and the second tier regulatory concept is being perceived for such type of institution.

4.3 State of Capacity Building

4.3.1 Legal framework and other supports

Apart from replacement of NRB charter, the following improvements were made in the legal regime:

Bank and financial Institution Act 2006 formulated and implemented which has consolidated the entire fragmented act governing the bank and financial institutions.

Insolvency Act enacted in 2006 in order to facilitate the liquidation aspects of the companies including the banking institutions.

Companies Ordinance,2006 which has turned into Company Act, 2006 has governed the all operating areas for the companies including banking companies. The establishment, operational aspects have been strengthened in the new act.

The Debt recovery act 2002 has been enacted to resolve the legal proceedings related to the recovery of NPL.

The Secured Transaction Act, 2005 has been enacted but some of its infrastructure has not yet been formed for implementation.

Strengthening of the Bankers Training Centre as a focal institution for improving staff capacity of banks and financial institutions has gone ahead with study (strategic planning) underway. The other fronts of action are yet to move ahead awaiting for the study to complete.

Strengthening of Credit Information Bureau has focused on improving institutional strength. It has been incorporated as a company and the capital has been strengthened and the restructuring process is underway. It maintains the list of blacklisted borrowers upon the request of the commercial banks and financial institutions. The functional scope have been widened within FSRP. Now, it maintains both good and bad information of all the borrowers with loan outstanding greater than NRs 2.5 million. The procedure of blacklisting of defaulters has to be complied with the directives issued by NRB in this regard. The computerization aspect has been completed and now commercial banks and financial institutions can send information through on-line system and get information on real time basis.

Improving the state of financial journalism in terms of coverage of financial news and views, and capacity of financial journalists through training and interactions has been cared. Already, several financial journals providing a good coverage of news and views on economy, business and financial matters have come to the board. A kind of support that is being extended consists of regular conference and interactions, training and observation of foreign system, and occasional topical trainings for the financial journalists.

In order to enhance the recovery of NPL, a Debt Recovery Tribunal (DRT) has been formed. To expedite the special cases of banks and financial institutions' loan recovery aspects, it has been a major mile-stone in the Nepali financial system. As of July 2006, 13 commercial banks have approached the DRT through 1795 appeals to recover loans worth NRs. 28473.5 million. Out of which 265 cases have been finalised to recover NRs. 3770.0 million. Similarly, financial institutions have appeal with 190 applications to recover NRs. 3150.0 million in DRT. Out of that 68 cases have been finalized by the DRT for the recovery of NRs. 682.4 million.

What has not been completed is the formation of Assets Management Company which is under project preparation stage. Nothing has moved as to formation of Credit Rating Agency and advancement of studies at University.

4.3.2 Overview of Achievements

Legal framework

The legal framework is reasonably in place to strengthen the legal regime for the financial system with the promulgation of the following:

- DRT Act 2002
- Banks and Financial Institutions Ordinance 2003 which turned to BAFIA 2006
- Secured Transactions Ordinance 2005
- Insolvency Act 2007
- Companies Act 2006
- Contract Act 1998

The legal framework, however, needs improvement, such as consistency among them (e.g. BAFIA vs Company Act vs Insolvency Act regarding stay on assets), rehabilitation apart from liquidation under Insolvency (Insolvency Act, 2007 has now included rehabilitation as well), encouragement of out of court settlements, restructuring including favorable tax treatment, and etc. Besides, improvements are needed at process stages in implementation such as registration of collateral, securitisation of assets, contracts and loan covenants, informal workout processes, bank supervision, and etc. (World Bank)

Central bank has begun to discuss the policy matter with the banking community before initiating any directives and policies that concern the stakeholders. It has a significant contribution from the stakeholders for correction and refinement before these are put to implementation. This has been the good tradition initiated within FSRP.

Other Supports

In the name of capacity building of the financial sector, FSR took up training, mechanism for credit information collection and dissemination, and enhance the flow of information to public through financial journalism. Despite some supports Bankers Training Centre is yet to become an autonomous and a focal training institute for banking and financial institutions, Credit Information Bureau has become more a Blacklisting Bureau and less a credit information due to various constraints associate with its development. Financial journalism has failed to take off the ground satisfactorily as the actions fail to be properly shaped to cover the vast mass and area. And other envisaged supports are yet to take off the ground.

4.4 Change in Public Ownership

The government ownership of financial institutions that include 3 commercial banks, 1 development bank, one finance company, 6 micro-finance institutions including Grameen bikas banks has continued. NRB divested its stake from six institutions during the FSR period 2002-2007 (3 being total divestiture) and continues to have stake in 8 financial institutions.

1. Pashimanchal GBB NRS 30,000,000.00
2. Madhayamanchal GBB NRS 44,400,000.00
3. Purbanchal GBB NRS 40.050, 000.00
4. Citizen Investment Trust NRS 15,990,000.00
5. Rastriya Beema Sansthan NRS 197,945.00
6. NIDC NRS 47,445,000.00

Besides, 14 other government/NRB invested organizations are holding investment in host of banks and financial institutions. The measures necessary for readying and initiating the process of divestiture remain to be undertaken.

Table 9: Public Ownership of Financial Institution

(NRs in Million)

S.N.	Investor	Total No. Of Invested institutions	Invested Total Amount Rs.
1	Agricultural Development Bank	5	86.1
2	Citizen Investment Trust	3	193.1
3	Deposit & Credit Guarantee Corpn	3	1.6
4	Employees Provident Fund	7	182.6
5	Government of Nepal	10	3380.7
6	Madhya Pashimanchal Grameen Bikas Bank	1	0.8
7	Madhymanchal Grameen Bikas Bank	1	0.8
8	Nepal Bank Limited	8	23.7
9	Nepal Rastra Bank	8	133.2
10	Nepal Stock Exchange	1	1.6
11	NIDC	2	76.2
12	Pashimanchal Grameen Bikas Bank	1	0.8
13	Purbanchal Grameen Bikas Bank	1	0.8
14	Rastriya Banijya Bank	9	118.6
15	Rastriya Bima Sansthan	5	153.2
16	Sudur Pashimanchal Grameen Bikas Bank	1	0.8
	Total		4354.7
Source: Nepal Rastra Bank (see Appendix D for details by organization)			

The banks are not yet ready for dispensing with the government ownership. Nor the government is serious in going ahead on it (as per the plan privatisation expert is not yet appointed), though the managements claim that the potential strategic investors are out there showing continued interest. Further, in the long run the banks will not be able to sustain on a competitive basis on government ownership.

V. IMPACTS OF FINANCIAL SECTOR REFORM

The study aimed at assessing the results of the financial sector reform process in respect of a) the health of the financial system through improved order and functioning of legal and regulatory oversight, and operations and profitability of the publicly owned financial intermediaries in particular and the Nepali banking sector in general, and b) ease of doing business with the banks for the customers. This meant successes built on the achievement on the part of FSSS by way of legal reforms, system improvement, and capacity building of the regulatory body (NRB), and the banks particularly (RBB and NBL). This also meant replicability to other banks and capacity building to face the foreign banks after 2010 AD when these will be allowed to operate in Nepal under WTO obligations.

FSSS specified five strategic fronts to generate a more competitive (well regulated, sound, market oriented and stable) financial system to contribute to fiscal consolidation, macro-economic stability, private sector led economic growth, and poverty reduction on a sustainable basis. The strategies comprised initiating strong corporate governance, enhancing the authority and capacity of NRB, improving legal and judicial processes, improving accounting and auditing standards, and promoting financial discipline through disclosure and competition. FSSS specified several action fronts through NRB and the state of achievement through the implementation of FSRP stand as follows:

Table 10: FSSS Action fronts and FSRP Achievements

SN	Action fronts	Achievements	To be achieved
1	Legislation	NRB, BAFIA, Insolvency, Secured transaction, DRT, Company Guidelines	Bankruptcy, AMC, M&A, CRA
2	Bank supervision & inspection (NRB)	Staff & system	-
3	Restructuring & privatisation (RBB/NBL)	Restructuring	Privatisation
4	Competition in banking sector	To some extent	Services at lowest cost
5	Accounting & auditing capabilities	Standards & compliance	-
6	Broad-based banking	To some extent	Adequate services mix
7	Streamlining ownership structure	Minimization in cross holding; increased limit for foreign participation	Divestiture of all cross holding
8	Bankers Training Institute	Study underway	Transformation of BTC
9	Credit Information Bureau	Registered as a company, restructuring, IT upgrade	Broad based services.
10	Assets Reconstruction Company	Draft act forwarded	Establishment of AMC
11	Research & monitoring (NRB)	Study completed	Revamping strength
12	Broadening & deepening financial system	Improving	Tie-up with the economic development

13	Sectoral financial requirements	* , Make presence of B & FIs in needy areas.	Yet to be targeted
14	Restructure ADB/N, NIDC	ADB/N underway, NIDC under recovery targets	NIDC transformation
15	Development banks at regional level	Policy formulated. All regions covered	
16	Grameen/Rural development banks	Policy formulated, privatized some.	Complete divestiture
17	Credit Rating Agency	Not completed	Act yet to be drafted
* Capital requirement for opening regional financial institutions decreased to make their presence for supplying finance			

This shows that a number of the FSSS specified action fronts have been achieved while a number of others remain to be accomplished. As of now, with the reform, the qualitative and quantitative performance levels of the regulated financial institutions are improving. The legislative regime and regulatory order have improved. The internal management system, risk analysis practices, and governance levels within the banks and financial institutions have improved. The institutional infrastructures of supporting institutions such as Credit Information Bureau Limited (CIBL), DRT have been established. The financial system as a whole has begun to restore profitability ensuring a certain degree of stability and sustainability in the financial system.

5.1 Banking Sector

Nepal's financial sector is growing at the rate of 12.5% per annum with respect to deposits and at 11.5% as to credits indicating an increase in liquidity as well over a period of four years from 2002 to 2006. The banking sector (commercial banks and ADBL which changed from development banks category to commercial banks category) holds an overwhelming position despite fall in deposits mobilisation (sharing 88.6% in 2006 as against 90.3% in 2002) but maintaining almost a status quo in extension of credits (sharing 76.7% in 2006 against 76.3% in 2002).

Table 11: Commercial Banks Share of Deposits & Credits

		Deposits			Credits		
SN	**FY**	**Fin sector NRs mn**	**C Banks % Fin Sec**	**C Banks % GDP**	**Fin sector NRs mn**	**C Banks % Fin Sec**	**C Banks % GDP**
1	2002 July	205135.3	90.3	43.0	148290.7	76.3	26.3
2	2003 July	228736.4	89.1	44.3	165119.1	75.4	27.0
3	2004 July	258742.3	90.4	46.7	184389.1	75.9	28.0
4	2005 July	284115.2	88.8	46.0	209053.7	78.3	29.8
5	2006 July	327995.2	88.8	48.2	230509.0	76.7	29.3
Source: GDP based at basic prices from Economic Survey 2006, and Appendix E Table 1							

As a percentage of GDP the banking sector has improved from 43% (for outstanding deposits) and 26.3% (for outstanding domestic credits) to 48.1% and 29.3% of GDP respectively over the period of four years.

a) Banks under direct support

The share of the two largest banks RBB and NBL stood at 39.4% and 43.7% of the commercial banks deposits mobilisation and credit extension respectively in 2002 which decreased to 30.5% and 22.5% in 2006. While the commercial banks were almost able to hold the market share in both deposits mobilisation and credit extension, RBB and NBL experienced a significant fall in share of both deposits and credits. This clearly indicates that the banks under reform no longer hold the dominant position in banking business as there has been quite a growth in the private sector banking activities.

Table 12: NBL/RBB's Share of Deposits & Credits

		Deposits: % of Com. Banks			Credits: % of Com. Banks		
SN	**FY**	**NBL/RBB**	**NBL**	**RBB**	**NBL/RBB**	**NBL**	**RBB**
1	2002 July	39.4	18.4	21.0	43.7	18.6	25.1
2	2003 July	36.3	17.0	19.0	38.2	15.5	22.7
3	2004 July	32.7	15.5	17.2	32.8	13.7	19.1
4	2005 July	30.9	13.8	17.1	28.9	10.9	18.0
5	2006 July	30.5	13.3	17.2	22.5	7.0	15.5
Source: Appendix E							

The above figure indicates that the position of the two largest banks has scaled down from being dominant players to major players on resource and services. The trimming down has not helped to correct the negative capital fund situation of these two banks. And, the competitive capacity of the private sector banks vis-à-vis the government owned banks stands better.

RBB:

Deposits are rising (by about NRs 7 billion in four years) despite low key promotional efforts and low interest levels. The growth is higher than average growth of the banking sector. It has contributed to excess liquidity as credit front continues to be lacklusture, fluctuating between NRs 28.6 billion and NRs 26.9 billion. The principal credit products are: a) consumer loan (housing, auto, education), b) business loan (mostly trading/working capital/LC based) not much project establishment/term loans, (education, food processing are major thrust areas) c) lending against shares and government bonds, and d) remittance.

Rationalization of the branch (down to 114), computerization of the branch (up to 65), trimmed down staff level (down to 3301 in July 2006) and enhanced staff efficiency with training, improved layout and initiation of one window system of services backed by operating manuals on accounts, audit, and credit operations have been the key reform fronts. These together with induction of performance incentive ranging 0-14% have contributed towards stabilizing RBB's business.

The bank has been able to bring down the level of non performing loans/assets from above 60% to 35% in July 2006. Negative networth has come down slightly from NRs 22392 million as of July 2003 to NRs 18590 million as of July 2006. While the banner 'government owned' has contributed to upsurge in deposits and that the management team has been effective in controlling the credit operations, much remains to be done in reducing the non-performing loans and correcting the negative networth. The bank has prepared the capitalization plan but remains to be implemented, seemingly for reasons of lack of adequate resources with the government. The bank has prepared the succession plan but remains to be implemented.

NBL:

Deposits have maintained almost at status quo situation despite somewhat upward trend fluctuating in between NRs 36 and 34 billion. Credit is constantly falling from NRs 20.0 billion to NRs 12.0 billion contributing to the excess liquidity. Though there has been checking on easy loans to susceptible borrowers, efforts made to improve the credit flows through introduction of new consumer loans have not helped to lift the credit extension.

Alike RBB, rationalization of the branch (down to 107), computerisation of the branch (up to 44), trimmed down staff (down to 3301) and enhanced efficiency through various measures such as training, improved layout and one window system of services backed by operating manuals on accounts, audit, credit operations, assets and liability management (ALM) have been the key reform fronts of NBL. The bank has been able to bring down the level of non performing loans/assets substantially as it changed from above 60% to 18.18%. Negative net worth has come down from NRs 10 billion to NRs 6 billion in July 2006.

As with RBB, NBL is currently facing a dual challenge of managing excess liquidity and correcting the negative networth, which would require substantial new capital injection on the other. This apart the immediate issues for its sustainable business are in getting strategic investor and management succession.

b) Banks outside direct support

What do the bankers outside the mainstream of direct reform process feel about the financial sector reform? An interaction with Nepal Bankers Association has brought to light some significant remarks.

First, it was observed that the banking community has not been well informed about the objectives, programme components and progresses made towards it. Effective communication is lacking apart from occasional media briefings and discussion with bilateral and multilateral agencies. Many bankers opined not knowing much about FSR and what is meant for them as their knowledge is peripheral. Something is being done at NBL and RBB about negative net worth and excessive non-performing assets. These two failed because they were doing social service (having bank branches to run government accounts but without business customers). The treatment to these banks showed regulatory forbearance by the government and the central bank vis-a-vis other private sector banks. They are operating with negative capital and non-compliance in most of the critical areas (e.g. capital, SOL, periodical reporting) of the central bank regulations.

Second, the bankers also hold the view that their requirements are different from the requirements of the two banks under reform. They feel that they are doing exactly the same what they would be doing in absence of FSR. The bankers feel that they face and live with competition while the government allowed these ailing banks to survive.

Third, the intervention came albeit late for two private sector banks that failed (Lumbini Bank and NB Bank) irrespective of the fact whether that was part of FSR or not. The frauds have not been brought to book; even statutory auditors who failed to notice have been spared. The bankers feel that severe punishment needs to be meted out to fraudulent activities and legal provision be made accordingly.

Fourth, the banks consider BAFIO/BAFIA as a good move, NRB's inspection have become good. Public trust with NRB has enhanced.

In addition, they hold the view that the banking sector has been able to partially meet the demand of the emerging financial market in Nepal in that it has helped the growth of the credit uptake and assisted the industries to plan their future credit requirements. The financial sector reform has definitely done some good, but a lot more needs to be done in that the very basic foundation of credit appraisal methodologies not only for projects but also for simple working capital requirements should be put in place. It will assist the central bank in implementing a unified acceptable approach towards credit evaluation of units and prevent over-financing the units, a factor contributing to very high NPA level. A Secured Transactions Act needs to be implemented with utmost urgency so that priority of charges on collaterals could be registered and in the event of invocation, the Act could be properly used with the help of an efficient judiciary system. NRB could come out with a comprehensive post disbursal monitoring in tandem with the international policies.

5.2 Business Sector

Financial sector is contributory to the basics of business operation that is business needs money and on top of self-funds, it is provided by the financial intermediaries. Banks in the past have been security oriented as they primarily looked upon the collateral but did not look at the project viability or the business prospects and the process of getting bank loans was tiresome. With financial sector reform, naturally, the business sector would expect that doing business with the banks would be hassle free and that the banks would be proactive to the fund requests and would be a business partner sharing equal risk, i.e. every one would loose if a business fails.

a) <u>Loan customers of selected branches</u>

Altogether 64 loan customers in 8 branches of NBL and RBB were surveyed; seven of them dealing with the bank for the last one year and ten of them doing business with the bank for more than 20 years. Majority of the loans comprised of home loans (14), followed by overdraft (12) and others. 35 customers were provided loan on the basis of project hypothecation with collateral while 24 were provided purely against collateral and only 4 against hypothecation (in case of auto loans). Property (house and land) outside the business holding were put as collateral against most of these loans (48) while the rest comprised of business owned property. 14 of them were of the loan size below NRs 1 million, 11 exceeded NRs 10 million and the rest were in between.

On the question of changes they have actually felt in dealing with the ongoing financial sector reform they opined the following:

Table 13: Changes in the Banks

SN	Response to demand		Quality of appraisal		Banks now look to	
1	Quick & appreciative	49	Collateral Based	34	Business turnover	38
2	Inquisitive & business like	9	Project & collateral Based	5	Enough stocks	19
3	Negative on style	6	Project Based	25	Source of income	23
4					Party goodwill/reliability	7
	Total respondents	64		64		64
Source: Field Survey, 2007						

They also said that the strings that banks want to attach comprises of:

- Project Scheme
- Map registration
- Documents of the Property
- Firm registration certificate
- Financial Statement
- Two years balance sheet
- Tax clearance etc.
- Income source related documents
- Letter from educational institutions for specific type of loans
- Description of the transaction
- Documents related to the business proposal

In responding to loan requests, majority (39) said that the bank communicates only verbally without formal letters regarding the documentation to be complied with by the customers, and 14 said that first time it provides a copy of appraisal report, a letter at times of renewal and only verbally later. As to the time taken by the bank the customers made the following responses:

Table 14: Response Time of NBL/RBB

SN	Time taken by the bank	Shortest Days/cases	Longest Days/cases
1	to make the first response on the application	1/37	7/7
2	to give the LOI on the clarification provided	1/11	45/1
3	to call for the agreement following LOI & further submission	1/1	90/2
4	to release the first installment following the papers completed	1/4	30/1
5	to release the all installments	NA/32	90/1
Source: Field Survey, 2007			

Regarding supervision of the loan performance by the bank 11 customers said that it takes stock list and transaction information and equal number (11) said that there has been never any comment. Others in limited numbers said about positive comments from the banks. 11 customers reported no supervision or not applicable, 15 indicated of quarterly visits, and others reported of monthly (4), half yearly (5) and annual (9) visits. Some others reported of sudden visit or when the staff is changed or at time of release of installment.

55 customers said that they are satisfied by the bank's services; only 3 were not satisfied at all while others were partially satisfied. 50 customers have not rescheduled the bank loan while 10 have rescheduled time and again, which the bank agrees looking at the business transaction and loan behavior (8), or would not mind for the short period, as there is extra benefit for the bank (7).

With the reform 21 customers felt that it was now comfortable to deal with the bank, while 19 considered that the comfort was only a little bit, and 13 said that they want more ease in dealing with the bank. As to the changes in the behavior of the bank staff 21 customers reported that the negative attitude was down, while 17 said that it was only a little bit and not enough; 9 were of the opinion that it was more active and helpful than in the past and 5 stated that they have not changed their behavior yet as old mentality continues.

On the question regarding any differences in variety in services and service delivery 10 customers held the view that there was newness in bank setup and services approach while 8 did not see comparable change vis-a-vis the private banks. 6 customers reported of fast service delivery and 5 saw newness in services.

Only 8 customers had no transaction with other banks. As to the question why they transacted with other banks 10 of 30 reporting transactions said that there were lots of facilities and attractive schemes, others provided varying reasons such as evening counter, less complexity, and etc.

Stating that the bank services should be as good as others on service delivery and market oriented, the customers have specified sorts of changes there should be in general in the banks. These are:

- Easy loan flow: documentation / renewal procedure must be easier
- Minimum 3 years firm registration provision for lending is impractical
- Record with other banks also must be recognized
- Commission for swap loans must be low
- Still central office oriented, authority must be transferred to the branches
- Management should be more systematic and proactive

On the question that what the customer would do as a banker himself, the following suggestions have been offered:

- Try to provide services as good as private banks
- Give some time for upliftment of the business transaction
- Deep study of the business proposal
- Accept flexibility as per the time
- Concentrate on customers facility
- Apply the policy and manuals properly
- Problems would be solved by making coordination with central office
- Reform must be seen in practical rather than making documents more complex
- Skill enhancement of the employees and less complexity in the procedure
- Timely monitoring
- Genuine collateral evaluation
- Customer education.

b) Comments from businessmen

Officials and members of Federation of Nepal Chamber of Commerce and Industry (FNCCI) are critical of the way the banks are *behaving* or have been asked to behave under the directives of NRB. Who are the customers of the bank? Whom you are targeting? Whether the economy would move on the fronts of consumers loan and remittances. Why genuine business customers are treated alike as fraudulent customers. What FSR would achieve if business/industrial sector remains sick?

Business community is of view that one of the worst outcomes of FSR is the black listing (note: the blacklisting procedure was initiated decades ago but the implementation aspect strengthened within

FSRP). The way blacklisting is done should not be the way to do it. This harasses investment sentiment as it intends to criminalize the business people who have faced difficulties out of market failure while genuinely pursuing the business. It does not distinguish the one doing fraudulent activity out of bank finances secured through political favors. Lot of loans was provided on political pressure (what constitute a political pressure and favour is hard to define and challenged) and cannot be recovered as it has been misused. The business that suffered out of market failures can not be put to the same basket. As such business community seems to feel blacklisting is a humiliation to all business people. They opt that the banks should differentiate fraudulent cases from market failure cases. NRB should consult to business people to define fraudulent activity.

Banks while trying to be the policeman are paying less to the depositors and have excess liquidity nowhere to invest. Yet they are in profit for heavy spreads they are allowed to enjoy. Business sector on the other is forced to move away from the bank to outer sources. Banks instead of pursuing dialogues and adjustments are akin to police action and auction. It does not help the business and also contributes loss to the economy.

Business community sees a need for improvement in the Insolvency Act. The bank restructuring needed to go hand in hand with economy restructuring. Bank is an integral part of the business and financial system. But the environment is not business friendly. They never had the policy and never tried to promote Asset management company/Reconstruction bank as done in some of the neighboring countries. Businesses are working for the banks, but banks are not as they do not play a role for financial discipline and injecting money whenever the business needs. Government must be forthcoming to provide to the business sector the kind of support and investment guarantee meted to the financial sector.

Business community feels that there is no difference in the banking despite FSR. Banks do not have faith on the project financing they are after collaterals. They do not have capacity and audacity to bear risk. Their project appraisal capacity has not improved. And FSR has infact lowered their capacity to take risk. Collaterals apart, FSR or not, the business sector was and is at ease in dealing with the private sector banks and despite the reform at RBB/NBL the attraction is still not there.

With the remittance income consumer credit has become a new threshold of banking business, but, the everlasting support to the economy comes out of business expansion which can happen in hydro-electricity, tourism and knowledge based business which currently is facing lack of business environment as well as unpreparedness of bank to move from risk avoiding to risk taking stage. The single obligor limit seems to be inadequate to finance the large projects to the private sector due to low level of capital base of the banks and financial institutions. Though there are consortium approaches to meet the fund requirements it is quite a long process and time consuming.

While appreciating improvement in NRB, the business community has pointed out that its compliance and monitoring of the banking and financial services is still weak. Business community contends that while depositors be insured, the banks should be allowed to fail. With or without FSR the incompetent management/board/promoters have been protected and rewarded. It is they who benefit at the end of turnaround or capital injection.

For a business friendly approach by the banks, the business community is suggestive of the following:

- No blacklisting. It is either a genuine case of market failure or a fraudulent and willful default case. Market failure case is a loss to the bank as well not solely to the business. Fraudulent case should not be a loss to the bank and should be strictly dealt with. Absence of this approach will not contribute to businessmen, banks and society to flourish.
- No personal guarantee. Honour the principle of limited liability. Regarding banking sector grudge on the genuinity of the business information, at least a start has to be made. Trust starts before lending, no point making excuses after lending. The regulation has to be there for action against those who provide false information, against auditors who sign the false information.
- Project lending. The bank has to further improve their credit appraisal capacity within and independent assessment through listed consultants.

Business community say it strongly that the FSR alone without trying to improve the investment climate is not good. Improvement in investment climate means at least three things: a) labour reform (protect employment but not the employees), b) improvement in government service delivery (in relation to administrative compliance, tax and other matters), and c) development of infrastructure. The business community has also demanded that there has to be flexibility in allowing investments outside the country. The investments have not stopped but the legality would provide value addition to the economy.

5.3 Outcome Assessment

The financial sector in general and banks in particular were operating on a fragmented legal platform. The reform has addressed the legal shortfall; still some associated regulations have not taken off the ground (cross border issues, and home/host supervisory co-ordinations, and documented prompt correction action rules for identified early warning signals systemic risk management modalities etc.). The legislative order is now much improved but still awaits the reform in respect of insolvency, co-sharing of the same logic between the legislations, and swiftness of judiciary practices.

NRB as a central bank was not fully autonomous, did not have full authority to regulate the financial sector and was grossly incapacitated to carry out the supervisory function. The reform has helped NRB to be on the driving seat with capacity to do so; still some elements of capacity remain to be developed (especially in enhancing the supervisory capabilities & IT systems). NRB now is in better situation to make the regulatory oversight but the capacity building is prone to staff transfers and practices.

The reform has enabled the failed banks back to the profit, but continuing negative net worth, succession and government withdrawal remains to be addressed. That the government has not moved fast enough to pull out of the shareholding, it could derail the improvements made in RBB and NBL. It seems nobody is on the charge for locating and involving strategic investor for the RBB and NBL and there is still confusion with regards to taking strategic steps for NIDC and bringing EPF and CIT under regulatory oversight of NRB.

The FSSS targeted improvement in the financial system and FSR has shown that it could be improved. Five outcome indicators were set for FSRP. Laying the basis for a modern legal framework has been completed but co-sharing of the same logic between the legislations remains to be complied with. NRB's supervisory function - in particular, its ability to enforce prudential regulations and relevant banking legislation - based on internationally accepted norms has been strengthened but remains to be seen in respect of quick responses as the issues crop up. An increase in the range and sophistication of financial instruments and their availability at competitive prices was something expected but has not happened barring a change in focuses. Enhancement of accounting and auditing standards within the banking sector was attained. Finally, the expectation was of a more prudently operated financial sector with better-trained staff, a better-informed general public, and an enhanced system of credit information. The banks now have the better-trained staff, but no headway has been made on the information fronts.

Formal Financial Sector

Despite hard times on Nepali economy resulting from insurgencies and then owing to prolonged political instability, the financial sector is on the leaps and bounds in contrast to other sectors of business economy that witnessed downturn. In a sense this is a dichotomy if we listen to the business sector. Basically, medium and large business experienced a tight situation in sustaining the operations while cottage and small business seem to operate on a limited threshold. As such the banks turned to the consumers who could spend as the country was receiving foreign remittances, though the consumer loan was the domain of finance companies. But a rise in the consumer loan had only a limited effect in lowering the liquidity of the banks.

At the core of FSR was rescuing of the largest two banks RBB and NBL. The reform has brought about system improvement in these banks in terms of operating policy and procedures defined and refined, rationalisation and capacity building of branches and staff. RBB was able to increase deposits and maintain the credit level while NBL maintained the deposit level but had a fall in credits. FSR gave them the efficiency but could not stop their share in total banking business falling from almost half to quarter of the total banking sector operations.

Issues at stake are correcting negative capital base as foremost. Injecting capital and management succession and ultimately doing away with government ownership are major challenges ahead. The private banks on their part expect that they be meted with equal treatments vis-à-vis government owned banks. They are however appreciative of BAFIO/BAFIA, improvement in NRB's regulatory oversight and supervision system improvements and some restrictions lifted on foreign ownership, and mandatory credits.

Borrowers of the banks feel that, with the reform, responses to customers demand are getting better though collateral oriented approach predominantly still occupy their mindset. There has not been change on the time taken by the banks following the first response, but majority are satisfied as it is much more comfortable to deal with the bank now. They however want change for an easier loan as they feel the banks could have done better in respect of competitive services with flexibility and business based approaches.

Business community at large are critical of the way FSR wanted to handle the defaulters through blacklisting and auctioning without segmenting the market failure case from fraudulent ones, and without considering what should make the business get going in a proactive manner. Banks are acting for their own interest in total disregard for a partnership approach. The community feels that apart from improvement seen in the layout and streamlining of their own wrongdoings, there is virtually no difference in dealing with the banks. There are ample scopes of promoting business ventures but the question of proactive and business friendly and risk daring financial sector remains unanswered.

Formal vs Informal Sector

Apart from the NRB regulated financial institutions there are around 15000 financial NGOs (47 regulated) and 2490 financial/small farmers cooperatives (19 regulated) and family and friends who are by far the largest informal providers. Access to Financial Services Survey, 2006 carried out by the World Bank has reported that the use of banks is limited, financial NGOs and cooperatives play a large role in facilitating deposit and loan accounts, and informal borrowing far exceeds formal borrowing. Banks serve 26%, financial NGOs and cooperatives serve 18%, and microfinance and Grameen banks serve 4% of the households. On the loan front, informal sector alone is serving 38% of the households sector alone is serving 15% and both sectors together are serving 16% of the households. 69% of foreign remittances come through informal channels.

Access to Financial Services Survey, 2006 points out that banks find it difficult to serve small loan takers profitably for such reasons as:

- Banks procedures are too complex
- Overdrafts are inappropriate for many small businesses
- Interest rates do not reflect the costs of serving them
- Banks demand high levels of immovable collateral
- Banks do not measure staff and loan performance

The services from micro-finance institutions too have limited outreach for reasons of:

- A complicated geo-political environment
- Weak technical capacity
- Lack of commercial orientation and slow professionalisation
- Distortions created by government's deprived sector lending programmes

Access to Financial Services Survey, 2006 has suggested 6 initiatives to increase the access by the formal sector, these are:

- Create a technical assistance fund to help banks develop appropriate products and procedures
- Develop an enabling environment that makes small business lending safer, cheaper and faster
- Promote the micro-finance industry by upgrading technical skills, reenergizing the sector and reforming state-owned providers
- Create a legal and regulatory environment that protects micro-finance consumers and promotes stability
- Enhance the financial literacy of migrants and tackle legal and regulatory obstacles in the India-Nepal corridor
- Promote a viable loan scheme for migrants

Cost-Benefit Situation

The first phase of Financial Sector Technical Assistance Project (FSTAP) credit agreement was signed on April 30, 2003 with a closing date of June 30, 2007 with a tag of US $30.1 million to cover the cost of management teams in RBB and NBL, reengineering of NRB and capacity building of the financial system. The funding is contributed by allocation of IDA Credit: US $16 million, DFID Grant: US $10 million and GoN Grant: US $4.1 million.

The second phase of the FSTAP credit agreement was signed on June 10, 2004, with a closing date of April 29, 2009 with a tag of US $75.5 million to restructure and right size the RBB and NBL and strengthen the supervisory capacity and computerization works. The funding is contributed by allocation of IDA Credit: US $68.5 million, Grant: US $7.0 million.

Out of the total budget arrangement as above the following cost has been incurred in FSRP up to March 2007.

Table 15: FSR Cost July 2002-March 2007

(NRs. in Million)

Item	RBB	NBL	Others	Total
1. Management Contract	428.7	813.2		1241.9
2. Automation	53.2	88.1		141.3
3. Voluntary Retirement Scheme	2267.5	1621.8		3889.3
4. Capital Injection				0
5. Re-engineering of NRB & Capacity Building			253.5	253.5
Total NRs million	2749.4	2523.1	253.5	5526
Source: Nepal Rastra Bank				

As against the budget allocation of NRs 7550 million, the cost of FSR amounted to NRs 5526 million by March 2007 as above.

Table 16: Costs of & Gains Resulting from FSR

(NRs. in Million)

SN	Particulars	RBB			NBL			Remarks
		2002	2006	2002-6	2002	2006	2002-6	
1	FSR costs			2749			2523	Loan
2	NPL	14883	12315	10094	10834	2262	6842	2003-6 recovery
3	Benefits derived	(19009)*	(20735)	4051	(10636)	(6682)	3395	Net Profit
4	Capital fund	(15010)**	(22582)	(8733)	(12895)	(7861)	1537	2003-6 change
The management teams for restructuring works were placed in NBL in July 2002 and in RBB in January 2003. * Cumulative loss in RBB in 2003 was NRs. 23858 million** The shortfall of capital in RBB in 2003 had reached NRs. 24089 million								
Source: Table 15 & Appendix E								

McKinnon-Shaw hypotheses indicate that the financial sector reform has the potential for efficiency gains that would lead to the decline of transaction costs. At the outset, the reform has brought about the gains in the NBL and RBB in respect of recovery of NPL, profit and changes in capital fund. This shows that, while the ailing banks are back to profit, much needs to happen with respect to financial position which is as yet negative in terms of networth.

The cost-benefit analysis reflects that the FRSP outcome (benefit) is more than that of cost incurred in the project. The cost of Reform in terms of GDP in Nepal also seems to be low in comparsion to South East Asian countries.

VI. LEARNING POINTS

6.1 Nepal's Reform Process

The financial sector as a whole was faced with challenges of several kinds. Starting with poor economic and security situation, mention could be made of:

- Poor legislative regime in the system
- Low transparency and disclosure level in the system
- Poor regulative and supervisory capability
- Poor corporate governance and credit culture
- Poor professionalism, skill and competency
- Weak internal and external competitive capability
- Inadequate institutional infrastructure on rural micro credit delivery
- Lack of computerization in the system
- Political interference in government owned banks

It must be reckoned that FSR was articulated to address the most of these issues but has not still covered them in full measure; this makes the very term "comprehensive financial sector reform" confusing to various stakeholders, let alone the public who remain ignorant any way. Notwithstanding to the namesake, the direction is grossly confined to the banking sector. Even for the banks, which are not directly involved in programme implementation, FSR remains much less understood. Therefore, adequate discussion among the stakeholders before launching the programme and wide dissemination among the stakeholders and the general public seemed lacking.

Reform is a transformation of the system from old one to new and modern one, which also encompasses paradigm shift in traditional mindset and cultural changes. But this is of course difficult to be captured in a short period. Specially taking action on the defaulters (due to the resistance on the blacklisting procedures and passport seizure), implementing adequate and transparent disclosures system, timely completion of financial audits, and etc. are grossly inadequate.

On the other hand, some of the activities like building legislative and regulative regime has got significant improvement. The re-enactment of NRB Act and BAFIO/BAFIA that has been able to influence the entire sector and the system in general have been very helpful to move the banking system in right direction. Financial sector reform was an effort to stop the collapse of the banking sector given the size and condition of the ailing banks at the start of the process; in turn ailing banks have been regenerated back to survival path. 'Too big to fail' has worked to some extent otherwise it would have been significantly destructive to the economy. But, scot-free exit to promoters and management responsible for the downward trend of the banks cannot be appreciated although legally it remains a Herculean task to bring the wrong doers to task.

Defaulters have been targeted and blacklisting system has been enforced. As a result, a major change in the credit culture seems to have emerged with the implementation of the reform programme. It is the message among the borrowers specially the defaulters that bank credit is not a free lunch. This is perhaps a major change brought about by the reform programme in the last five years. But, banking sector cannot remain detached itself from the business sector by being harsh throughout with stringent measures like blacklisting and auctioning off the property. It seems to be driven by 'you loose and I gain' dictum. For the fraudulent cases, bank management is responsible, and for market failure cases it is nobody's fault. These two scenarios need different treatments. The banking services must be business friendly.

The banks made effort to improve financing through appropriate reviews of the proposals and recourse to systematic procedures. Still, the project appraisal capacity of the bank needs strengthening so as not to finance projects at the edge. With the remittance income consumer credit has become a new threshold of banking business, but, the everlasting support to the economy comes out of business expansion which can happen in hydro-electricity, tourism and knowledge based business which currently is facing lack of business environment as well as unpreparedness of bank to move from risk avoiding to risk taking stage. The single obligor limit seems to be inadequate to finance the large projects to the private sector due to low level of capital base of the banks and financial institutions. Central Banks has announced a new licensing policy to increase the capital base for existing & new Banks & Financial Institutions. Central Bank has announced a new licensing policy to increase the capital base for existing and new banks and financial institutions. Now there are consortium approaches to meet the fund requirements it is quite a long process and time consuming.

What has not been achieved is trimming of the non-performing loans (NPL) which stands a whopping 35 % at RBB, 18 % at NBL and 14% in the banking system at present which could only be reduced or eliminated first by segmenting the willful default case and genuine market failure case, and second by transferring the willful default cases to the recovery tribunal and pitching a combination of measures for market failure cases from loan reschedules to bailing out to take over by establishing a body like reconstruction and re-strengthening agency.

What has not been achieved as well is doing away with negative net worth of the banks. Negative capital remains to be effectively addressed, until then, both NBL and RBB will continue to remain in the high risk category. It could be corrected by reducing the capital base of the existing shareholders, and pumping in fresh capital, including from strategic investor to comply with the requirement of the capital fund as per NRB directive. NBL and RBB are doing business without capital as per prescribed directives of the central bank. This situation should be removed first and if such system could not be improved within this programme, the reform programme will not have a lasting impact to the financial system.

FSR has brought a programme for the increment in capital base through which private sector banks are raising their capital base continuously. It is planned to increase the paid up capital of banks almost four times within a decade. (i.e.from NRs. 500 million to NRs. 2000 million by 2013 AD). However, the critical/core of the problems of capital in NBL and RBB remain to be addressed. In order to expedite the reforms in RBB and NBL, government should inject capital in these banks as soon as possible so that the privatization process could be expedited fast as per target. It was envisaged that these banks will be restructured completely within three years and privatized within this period. But it has not happened mainly due to existence of negative capital in these banks. It is essential to have an exit policy. At the moment the FSR seems to getting stuck and not moving in terms of capital injection, management succession and divestiture of government ownership.

The importance and significance of corporate social responsibility (CSR) activities has been overlooked in the existing reform project. As a responsible corporate citizen, the importance of contribution and support to the people and the society where an entity is operating is enormous. Guidelines identifying the sectors to be focused in the CSR activities by an entity under reform should be prepared and incorporated as a part of the reform objectives.

One can not understand as to why notary public is still not effectively functioning. However, some initiations have been started to establish professional notary public office and amendment in the existing Negotiable Instrument Act.

As the informal sector could not be replaced in relative terms by the formal sector, the issue needs to be assessed from a long run perspective and one can not expect significant changes in short period

What next?

The success of Nepal's reform process hinges on integration of efforts and accountability of all stakeholders including the government and judiciary. It also requires that financial sector reform be carried out not in isolation or in total disregard for other sectors of business economy. It is equally important that NRB's supervisory and regulatory function is carried out at its best professionally and efficiently. In this regard the following steps hold considerable significance:

- Reforming blacklisting directive with limited liability concept with enhanced credit information and improved creditor rights
- Effective implementation of Insolvency act
- Enhancing transparency of business houses through timely audits and disclosures

- Articulating exit policy and action specifics
- Completing associated legal reforms such as bankruptcy laws and banking fraud laws
- Strengthening training by way of autonomous BTC under ownership of banks and financial institutions
- Completing the establishment of Assets Management Company in the like of business reconstruction agency
- Separating out ownership and control of the banking and financial institutions
- Developing new Negotiable Instruments Act (Securitization Act), etc
- Building new supportive institutions such as Deposit insurance companies, Credit rating agencies, etc.

While it will take some time to implement the succession plans, the banks need to consider hiring the professional staffs in the top position form the market at competitive rates. There is a lot of scope to do so for the recovery of skill gap in the short run too. Therefore, the privatization work should be expedited as soon as possible in order to achieve long term sustainability.

As per the World Bank, Nepal stands at 100th position out of 175 countries regarding ease of doing business. The five country comparison regarding ease of doing business is given below.

Table 17: Ease of Doing Business: Nepal vs Other Countries

SN	Country	Ease of doing business	Private credit to GDP (%)	Explanation and as at 2006
1	Nepal	100	29	Improved to 42% in 2006; improving bankruptcy & credit information systems
2	USA	3	146	Strong credit information system, specialised bankruptcy processes
3	UK	6	136	Strong bankruptcy and credit information systems
4	Thailand	18	100	Good credit information system, insolvency laws need improvement
5	South Africa	28	76	Successful in creating a strong credit information system
6	India	134	30	Working toward better credit information and creditor rights
Source: World Bank				

This reflects that the position is not very conducive to the business sector and a lot has to be done in this front. In order to have improvement in credit information and improved level of creditor rights the following aspects should be installed in the system very strongly and systematically:

To have a enhanced credit information:

- Reliable and broader credit information system
- More robust financial statement from borrowers
- Improved credit and project analysis/appraisal
- Effective regulatory oversight of banks' loan portfolios
- Consolidated supervision of business loans by NRB

To improve the creditor rights:

- Registration of collateral
- Securitisation of assets for collateral
- Enforceable contracts and loan covenants
- Informal workout processes
- Bankruptcy laws with absolute priority
- Mechanism for out of court settlement

Therefore, it is recommended to install such provisions in the Nepalese financial system.

The Nepalese financial system has to pass through a lot of institutional and system reforms in the various areas, in the context of opening of Nepal's banking sector for foreign competition from 2010. What is discernible is that there will be prospects to foreign banks and opportunities for the Nepali banks as well. Given the size of Nepali economy and the state of marketisation, foreign banks will be attracted to open branches in secure places which obviously is the Kathmandu valley and concentrate on generating fee income business "that does not require the use of deposits for funding but instead allows the income to fall directly to the bottom line". Of course there are huge prospects for long run investment in infrastructures depending upon the prospects of social stability. It is expected that the new market entrants will focus on corporate lending, trade finance and foreign exchange. This will of course increase the competition with the private sector banks where they will have the opportunity to face it and sustain through options like alliances, merger or affiliations. When private sector banks started in Nepal they had the unique opportunity of benefiting from the inefficiency of the government owned banks. Now it might be the foreign banks enjoying from the structural weakness of the Nepalese banks unless we effectively address institutional weakness very quickly.

Regarding the areas where further policy as well as structural reform is needed especially in the context of the entry of foreign banks after 2010 as per the World Trade Organisation (WTO) commitments, NBA is specific in pointing out the following:

- Basel II will require to be implemented immediately in line with the Basel II Accord to build up database of Nepalese banking sector for implementing advance approach in the long run.

- Merger and acquisition (M&A) directives or policy need to be issued to facilitate consolidation in the financial sector.
- Assets Management Company and Credit Rating Agencies should be in place.
- Anti Money Laundering (AML) Laws should be enacted immediately to prevent/control money laundering activities.
- Quick development of infrastructure for the enforcement of laws especially relating to financial sector e.g. insolvency act, secured transactions act, securities act, DRT Act, Revenue Tribunal Act, Trust Act, etc.
- Regulation/Directives for the Foreign Bank's Branch operation will require to be rolled out.
- Organizational reform of the Company Registrar Office, Securities Exchange Board (SEBO) and Nepal Stock Exchange (NEPSE) needs to be initiated to make them autonomous and automated to further improve the service standards.
- Securities listing rules and regulation need to be revamped to align them with the international practices.
- NRB's supervisory role should be further strengthened to meet the Basel II requirements.
- Fix regulation should be liberalized further to enable the market grow and integrate with the rest of the world.

Moreover, new issues are coming up, and the regulators and state agencies need to be more pro-active to design and implement the long term plan to address the new challenges of the system.

6.2 Feeler for South Asia

As South Asia is emerging as next growth centre of the world, economic reforms including financial sector reforms are part of the game. These were initiated in early to late 1980's and continue to date. Financial sector reforms were introduced to forestall a generalised banking system collapse and to build an efficient and competitive financial system. The reforms have centred on legal, institutional and peripheral aspects of the financial system that strengthen the regulatory capacity of the central bank, corporate governance and financial discipline at the banks, and infrastructure for financial and market intermediation.

Bangladesh initiated FSRP in 1990s that slowed down in late 1990s and again picked up in the first half of 2000s. India, in the wake of balance of payments crisis in 1991, crafted its own design for economic and financial improvement. Pakistan kick started banking sector reforms in 1988 and has completed three phases. Sri-Lanka embarked upon the reform in 1990's but experienced policy vacuum following 2004 elections and reinitiated efforts afterwards. With the reform there has been lot of improvements but the reform process are not complete in having an efficient and competitive financial system.

What lesson Nepal's FSR could provide to South Asia as a whole? Nepal's experience of the reform in opting for best practices for improvising the sector in general and bad institutions in particular would be of a great value. The reforms should be an ongoing regular programme for any system rather than a time specific one time effort. To make the benefits of reform programme sustainable, regulators should be pro-active all the times.

The Nepal's financial sector reform programme being one of the most important programmes of the government and being implemented by the central bank, it has got continuation despite of changes in the political leadership. Among the three components of comprehensive financial sector reform programme, restructuring of NBL and RBB has got momentum in comparison to other components such as reengineering of NRB and capacity building programme of financial sector. The privatization process for RBB and NBL has not been completed in projected time, due to instability in economic and political fronts. Therefore, political stability is one of the most important components to make any reform programme success.

Improving institutional competitiveness through right sizing, training and computerization, refinement of operating policy and procedures along with professional management is essentially a solution applicable to banking and financial institutions in South Asia. Doing business strictly on project merits rather than the political favours and the transparent procedures coupled with team authority on business decision do constitute an associate best practice element. It has been learnt that, to tackle with social pressure and political intervention for installing professionalism in the poor institutions, foreign management will be beneficial, as domestic professionals could not resist due to their social and cultural inclusion. Nonresidents with international banking exposure should be given priority in such management team, if possible.

Improving regulatory oversight and bringing banks and financial institutions under one umbrella act constitutes another important step to be followed. Basically, for this international exposure and practice is needed. To install a new system, new laws and new skills should be introduced. Umbrella act has contributed a lot to consolidate the legal fragmentation governing the similar nature of financial institutions.

Within the financial sector reforms in Nepal, specially on banking system, the entry and operation modalities for banking system have been significantly improved but the exit modality for banks and financial institutions are still poor as it lacks adequate policies for financial safety nets and deposit insurance companies to protect the depositors in case of bank failures. The central bank still has to improve the exit modalities for the problem banks and financial institutions.

Recently, the management team placed in the NBL has discontinued after the expiration of contract, despite the request of the central bank to continue the contract for another 6 months period. It has created confusion and disturbances in the restructuring plan, programme and sprit, which might cause difficulty in achieving the project objective and goals. As such contracting for a sufficient period and inclusion of reward and penalty clause in such assignments could produce better results. The multilateral donors should not always have soft corner while designing project documents and contractual obligations for such management teams and consultants.

Whether the reform should be carried out by the domestic professionals or international skills should be hired for the purpose is a debatable issue that crops up in almost all the countries where donors have assisted the programmes and foreign professionals are hired in the programme. The Nepal's' experience shows that foreign management could be useful to forestall political pressure and to deal effectively with those grossly and willfully not fulfilling borrowers' obligations to pay on time. This modality also has a great impact on transferring skills to the local manpower involved in the assignment and also sensitizing borrowers' corporate responsibility.

Nepal's reform programme has not been able to complete all the components of reform agenda as earlier planned. It has been observed that there is lack of adequate discussion, co-ordination and information sharing among the stakeholders during the project preparation, approval and implementation stages. Therefore, a well developed information dissemination system from the beginning to the end of project could contribute more to achieve the project objective with less debate and hurdles.

It is found that generally the project implementation period is fixed very conservatively at the project designing phase though the ground reality tends to differ very significantly, which creates complications in the implementation period. Therefore, while designing the reform programme similar experiences elsewhere should be considered and project period should be reasonably adequate to complete all the activities. Reform programme has to deal with social, economic and technological and cultural reform aspects which is a time consuming task, that should be considered while designing the project. It is always more practical to keep reasonable project implementation period right in the beginning rather than keep on renewing the contractual period time and again which has been Nepal's' experience in the FSR programme. The donors, planners should take the responsibility for such lapses.

The sequencing of project activities is another critical area which needs to be carefully considered. For example in Nepals' case, the IT upgradation could not get started until two and half years because the management team could not procure and install the system on time. This had a lot of delays and confusion in various other aspect of the programme for example the right sizing of the organization, improvements in Accounting & Records development and implementation of the MIS programme, follow up and supervision etc. Therefore, if there is institutional reform and it requires IT up gradation and installation aspects, then those areas should be initiated first than other areas of reform in order to complete the project in time.

A financial sector reform carried out without putting in place the exit policy within a time frame will not produce desired result. A financial sector reform carried out without considering benefit to the customers might be good for the short run but not in the long run. A financial sector reform carried out without consideration of peripheral supportive thrusts in the like of bankruptcy, management of nonperforming assets or business reconstructions will create bottlenecks.

A financial sector is just like any other sector of business economy. The corrections aimed at financial sector without considering benefit to the entirety of the economic sector will not be long lasting.

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APPENDIX-B: Financial Sector Strategy, 2000

Strategy Paper of HMG/Nepal on the Financial Sector Reform Programme

Background

Nepal began financial reforms in mid-1980 with a view to enhance efficiency in financial services. Accordingly, the licensing policy for banks and other financial intermediaries have been liberalized. As a consequence, the number of banks and financial institutions have been increased substantially. Presently, 13 commercial banks, 46 finance companies, 35 cooperative institutions, 25 non-government organizations (NGOs) and postal saving banks have been in operation. Along with liberal entry policy, commercial banks and other financial institutions have been given freedom to fix interest rates on their deposit and loan portfolio. As such, the statutory liquidity ratio (SLR) has been withdrawn to enable commercial banks in allocating funds on their own discretion; foreign exchange exposure has been granted and cash reserve ratio reduced. Recently, bank rates have been revised with a view to enhancing investments in agricultural and industrial sector, including export as well as redirecting larger financial resources towards poverty alleviation in rural sector. Further prudential and regulatory norms for banks and financial institution is in the process of revision under World Bank technical assistance and the new set of prudential regulation will be implemented in a time bound manner from the beginning of the next fiscal year.

The initiation of these measures has made the need for further reform and consolidation a matter of urgency. HMG/N's own concern on the financial sector reform has found good support and backing by the multilateral donor agencies. In particular, the World Bank, the International Monetary Fund and the Asian Development Bank are prepared to support substantive and comprehensive reforms by HMG/N in its efforts and endeavors related to financial sector reform strategy and programme. At a time when two large state owned banks, having nearly two-third of market share in commercial banking industry, are in serious trouble, the proposed reform programme would definitely help to improve the functioning of these banks. In addition, the overall financial sector reform programme is expected to make a vital contribution towards supporting private sector led economic growth through enhanced resource allocation to potential growth sectors.

Against this background, the objective of this paper is to highlight and emphasize the urgency of reform programme needed for the development of a competitive, efficient and healthy financial sector. This paper also sets out the Central Bank's views on the role of the banking and non-banking financial sectors and their relationship with the government, and amplifies government's policy on some key issues affecting the performance of the financial sector. In this context, the programme is expected to assist in creating a sound, prudently managed and well-supervised financial sector in Nepal that is competitive, dynamic and capable of contributing towards macroeconomic stability and more rapid and sustained economic growth.

The Banking Sector

As in any other economy, the banking sector has to play a vital role in the economic development of the country through facilitating the intermediary process in between capital surplus and deficit units. The banking sector has to play dual role of mobilizing as well as allocating the limited resources towards people' needs so as to develop the economic system.

For the efficacy and efficiency of the banking system, all banks have to be prudent and have commercial orientation in their activities. The banking business has to be conducted on commercial basis and the responsibility and accountability of the banking sector for its activities has to be defined clearly. The banking activities should also be compliant with the regulations issued by Nepal Rastra Bank, and should not in general, be directed by the government and other interested parties to serve their own interest, such as assisting particular sector, borrowers or groups on a non-commercial basis and undertaking social programmes.

Accordingly, Nepal Rastra Bank will have to enforce the internationally accepted standards of loan classification and provisioning requirements, liquidity and reserve requirement, capital adequacy requirement, exposure limits, single borrower limit etc. for the effective, efficient and sound banking system. Consequently, the poor lending decisions motivated by personal interest and benefit would be stopped by ensuring transparency for all stakeholders i.e. the shareholders, depositors, creditors, investors and the bank management.

A sound system of corporate governance is much demanded for the maintenance and development of a well-managed banking system. In this regard, the Nepal Rastra Bank would also come up with appropriate prudential regulations that amplify a code of governance for all banks to follow. This code will have to clearly set out the rights and duties of directors, owners as well as management and also specify the functions reserved for the board.

In the last few years, the government has undertaken general reform measures, viz. Interest Rate Deregulation, Phasing out of Statutory Liquidity Requirement (SLR), Bad Loan Provisioning, Capital Market Reforms, Foreign Exchange Liberalization, some of which were encompassed in the CBPASS package. However, still much remains to be done, and there is now an urgent need to undertake important measures to strengthen and deepen the reform process. This will require a concerted effort from all the concerned parties involved. In this regard, the government will need to provide an overall stable and positive macro-environment along with financial support or capital injection if needed. The Nepal Rastra Bank will have to provide effective regulatory oversight, supervision and strict enforcement. Similarly, the banking sector will have to improve its efficiency, strengthen its financial condition and undertake more prudent lending. The industrial and business sector could augment this process by providing proactive support toward reducing the NPA and instill confidence in the banking system by improving their corporate governance behavior.

The Non-Banking Sector

The non-banking sector consisting of finance companies, development banks, cooperatives and non-government organizations doing limited banking business, constitutes as yet a small but ever growing component of financial sector. The non-banking sector provides ample opportunity to improve financial intermediation process in course of economic development of the country. Indeed, non-bank financial institutions can frequently generate a more competitive financial system than can the entry of additional commercial banks. Thus, this sector would be diversified for the complementary role and new areas of services they provide in relation to the commercial banks. In particular, the central bank realizes the restructuring need of the large two government owned development banks, bringing financial cooperatives under its supervisory domain, and ensuring healthy growth of the finance companies and the micro finance sector. There is a further need to bring non-bank financial institutions like The Employees Provident Fund and The Citizen Investment Trust under the regulatory and supervisory domain of the Central Bank The stock market should also be working in a transparent, predictable and stable manner to mobilize long term capital in the industrial sector.

The Government's Role

There is a critical need to reform, revitalize and modernize the financial sector. The government is endeavoring to achieve a privately owned and managed banking system, which provides economic, and efficient financial intermediation in the economy. The inefficiency of the banking sector stems mainly because of the problems in two state owned banks, viz., Nepal Bank Limited and Rastriya Banijya Bank. Meanwhile, the Agricultural Development Bank and Nepal Industrial Development Corporation are also facing similar type of problems. This condition provides little incentive for the other private joint venture banks to become innovative, competitive, and efficient in extending their services.

In the past, the government has played a vital role in the establishment and operation of the financial system; and that has resulted in strong political influence over the operation of most banking activities. In addition, lack of adequate supervisory and regulatory oversight in the Nepal Rastra Bank has led to structural and operational weaknesses in the financial system, which need to be urgently addressed. Thus, the government and also the central bank need to re-orient their activities from being active participants in the financial sector and should proceed towards being a stronger regulator and supervisor of the overall financial system. In view of these, the banking sector reform strategy would:

- initiate a strong corporate governance by ensuring that banks are owned and managed by private investors and professionals by implying the progressive withdrawal of HMG/N from the ownership of all financial institutions and also refraining from promoting financial institutions primarily with the equity participation of the government or government owned institutions.
- enhance the authority and the ability of the Nepal Rastra Bank for effective supervision of banks and non-bank financial institutions and enforce regulations as well as move towards increased autonomy of the central bank,
- improve the existing legal and judicial processes for enforcing financial contracts,
- improve auditing and accountancy standards within the banking sector, and
- promote financial discipline through adequate disclosure and competition.

The Role and Strategy of Nepal Rastra Bank

To enhance the role of the Nepal Rastra Bank in the overall financial system of the country, it becomes necessary to think over various models, which confers greater autonomy and independence to the Nepal Rastra Bank. Thus, the Nepal Rastra Bank will work closely with the World Bank and IMF team for the amendment of the existing Nepal Rastra Bank Act, 1955 to provide sufficient autonomy in conducting monetary policy, regulation and supervision of banking and non-banking financial sector and licensing of banks and non-banking financial institution. The central bank also recognizes the critical importance of effective supervision within an appropriate regulatory framework to ensure that the banking sector fulfills its dual responsibility of protecting depositors' savings and allocating such saving in the most productive sectors for faster economic growth. The Nepal Rastra Bank would also encourage transparency in disclosing the financial information by banks particularly through the introduction of higher auditing and accounting standards that enables depositors in making prudent decision on the selection of banks they want to deal with. The Nepal Rastra Bank would also ensure that banks adopt standard practices in their operations: mainly in their lending behavior and interest calculation methods. Besides this, the Nepal Rastra Bank would also need to develop policies encouraging the establishment of privately managed institutions, industrial financing, capital market development and export financing. The establishment of credit rating agency, cooperative bank, export import bank and investment bank could be a case in point towards this direction. The government fully supports the effort of Nepal Rastra Bank in strengthening banking supervision, enforcement and regulation. The Nepal Rastra Bank would focus on the following reform measures in the financial sector.

1. Reform in the Financial Sector Legislation

The need for financial legislative reform will involve the amendment, or promulgation of a new Nepal Rastra Bank Act, Commercial Bank Act and other Financial Institutions act. Alternatively, a Financial Institutions Act, which covers both commercial banks and other deposit taking financial institutions, could be promulgated as one piece of legislation. These acts will accommodate modem and supportive regulations, especially in the area of banking supervision. Reform of ancillary financial sector legislation will also be necessary to replace the currently highly fragmented legal system. Debt Recovery Act, Bankruptcy Act, Merger and Acquisition Act would be the major output of the reform process. The promulgation of these acts will help the consolidation of the financial sector in many ways, especially on enhancement of fair and efficiency based competition. The central bank is committed to instill strict financial discipline in order to break the default trend by enhancing competitions, efficiencies and controlling the malpractice, cartelling & monopolistic or oligopolistic behavior.

2. Strengthening Bank Supervision and Inspection

The strengthening of the supervisory capabilities of the Nepal Rastra Bank should also be initiated under the financial sector reform programme. This will require the recruitment of a longer-term, experienced bank supervisor to assist the implementation of strategic plan for regulatory development, on-site supervision, off-site supervision and the implementation of a human resource development plan. The programme should improve on-site bank supervision capacity by recruiting more accountants, improving training and introducing risk rating (Credit Rating) system. However, it is worthwhile to explore other modalities of monitoring and supervision including independent Monitoring and Supervision body. This will also extend the supervisory capacity to cover non-banks and development banks. This is one area where technical assistance from the International Monetary Fund and World Bank could also be sought. The entire bank examination of RBB and NBL would clearly be a priority for an initial phase of enhanced banking supervision.

3. Restructuring and Privatization of NBL and RBB

As the largest commercial bank, RBB has a potentially important role to play in the economy. However, political intervention, weak management, poor financial information system and ever growing bad loans have tremendously impacted on RBB's financial health. Recent auditing work has also revealed a high negative net worth, weak internal control and information systems, and poor internal financial management. In the same way, NBL has also suffered from the overall inefficiency, a negative net worth and low level of competition in the banking system. The government's policy of successively selling shares to the general public and increasing private sector representation on its board was aimed at avoiding the deteriorating situation as of the RBB. Nonetheless, NBL still does not operate like a private bank, does not have a strategic banking partner amongst its private shareholders and lacks a strategic direction and medium term vision. Addressing these problems within NBL will be an important component of the restructuring process. Thus, after ascertaining the true financial and operational position of RBB and NBL, it will be important to employ technical support to assist in developing a strategic plan for the implementation, such as, downsizing, privatization, splitting, merger, acquisition, etc. In the same way, technical support will also be required to implement any strengthening work identified by the reform proposal, which will be working on the financial and operational position of RBB and NBL.

4. Enhance Competition in the Banking Sector

The basic purpose of reform of the NBL and RBB should be designed to correct anomaly in the banking sector, enhance competition and increase an efficient intermediary role of the banks and non-banks. The government as well as the Nepal Rastra Bank aim to foster competitive banking and non-banking sectors in the country so as to ensure that the banking services are provided at the lowest possible intermediation cost. In this regard, the government will not allow the banking industry to be dominated by a single bank or group of banks. Therefore, the present ownership structure of NBL and RBB will be gradually changed by their privatization and entry of new reputed, fit and proper private sector banks and financial institutions. To ensure continuing effective competition, the Nepal Rastra Bank would permit new banks to be set up only by qualified, professional and experienced promoters. Similarly, the Nepal Rastra Bank will also relax some of the provisions in providing licenses especially for the foreign banks coming in joint venture by increasing the percentage shareholding that they can retain in a bank in Nepal above the current 50 percent. The detail criteria and qualifications, following internationally accepted standard practices, uniform criteria and norms, will be re-announced publicly by the Nepal Rastra Bank and accordingly provide licenses to new banks. Furthermore establishment of branches of internationally reputed banks will be promoted under the terms and conditions and procedures set by the NRB.

5. Reform on Auditing and Accounting Capabilities

Information on operations, performance and status of banks and other financial institutions or overall transparency of the whole financial system is highly important. Publishing of financial statements, their performances and auditing reports etc. on a regular basis is also needed to make the financial sector more transparent. However, the prevailing weak accounting and auditing practice has indicated that the timelines and reliability of financial data, particularly of NBL, RBB and NIDC is extremely poor. Thus, in order to operate the financial system efficiently, the accounting and auditing status of the poorly managed banks should be strengthened. To cope with this, the phase wise introduction of internationally accepted accounting and auditing standards for the banking and non-banking financial sector should be initiated. Further in respect of bank branches, which cross specified ceiling of transactions, Branch audit will be made mandatory. Moreover, an appropriate environment will be created for international accounting firms to be operated in the kingdom.

6. Broad-Based Banking

The government's emphasis on broad based banking service will be met by providing adequate mix of financial services to all the needed sectors / persons. These services should be provided through appropriate private institutions at market interest rate. Alternatively, these services could be provided through proper budgetary provisions for any subsidy to be provided in any areas. The directed and subsidized lending through banking system will ultimately be phased out with the provision of alternative private financial institutions catering such services.

7. Streamlining Ownership Structure

Appropriate policy action will also be taken to avoid undue concentration on the ownership of banks and financial institutions. As such, no single person and group will be allowed to hold a controlling stake in more than one banking institution. In the case of poorly managed banks, a reputed and strategic investor will be allowed to hold controlling shares in that bank. Cross holding of capital in the commercial banking industry will be eliminated and promoters having significant shareholding will be barred from accessing financial resources from their own institutions in which they hold significant ownership.

8. Establishment of Bankers' Training Institute

In addition to the aforementioned policy goals, other financial support activities should also be initiated by the Nepal Rastra Bank jointly with the coordination of all commercial banks and the government. In this regard, the NRB will endeavor to establish a separate Bankers' Training Institute, jointly financed and managed by the NRB and other banks. The newly established institute will provide ample opportunity to up-grade the working skills and research capacity of the staff involved in the commercial banks.

9. Restructuring of Credit Information Bureau

To make the lending activities more prudent, the genuine credit information about the borrowers is required. In this regard, the present Credit Information Bureau would be revamped to provide effective and efficient information service. Essential technical support would also be given to the Bureau to restructure and improve its modus operandi.

10. Establishment of Assets Reconstruction Company

The programme would also initiate an appropriate plan to improve loan recovery and reduce Non Performing Loan of banking and non-banking financial institutions. Hence, efforts will be made to initiate an Assets Reconstruction Company in the coming fiscal year to improve the loan portfolio status of the banking system.

11. Revamping Research and Financial Monitoring Strength of the Central Bank

In order to keep the policy makers well abreast of the financial market condition and for facilitating prudent decision making, the research and statistical wings of the Nepal Rastra Bank would be strengthened.

12. Broadening and Deepening the Financial System in Nepal

It is also felt that there is an important need to establish an environment in which a broad range of financial institutions and financial instruments are developed. Nevertheless, the commercial banking is likely to remain the largest component of the financial system for some time, there is also a need to develop debt and equity markets, leasing companies, venture capital facilities, further strengthen the stock market, insurance markets, micro-finance, pension and provident funds, and so on. Thus, the establishment of a broad range of instruments into which savers can deposit their funds as well as a broad range of lending instruments, involving both debt and equity, will also assist the overall development of the economy.

13. Meeting Sectoral Financing Requirements

As the country is overwhelmingly based on rural economy, it has also been envisaged to ensure that the adequate financial services are provided to support the activities of this sector. Moreover, other sectoral needs, such as industrial financing, housing finance and so on, would also be provided on the competitive cost.

14. Other Measures

The NRB has also envisaged to announce a specific time bound plan to restructure Agricultural Development Bank and Nepal Industrial Development Corporation in the next phase. Meanwhile, the government feels that the establishment of a sound and properly regulated banking system is the key principle and the regulation of deposit taking institution is fundamental. Thus, appropriate measures would also be introduced to regulate all deposit taking institutions as the commercial banks.

15. Establishment of Development Banks at Regional Level

Efforts will also be made to augment the flow of rural credit by giving priority to establish development banks at regional and local level. However, the general thrust of the government will be less government involvement in the financial sector.

16. Strengthening of Rural Development Banks

The NRB will also undertake organizational and financial strengthening programmes for rural development banks established with the objectives of alleviating poverty in the rural areas. Recognizing the importance of rural sector and development finance, the government aims the development of rural credit and development finance via the private sector, including divestiture of such rural and development financial institutions currently owned or controlled by HMG and/or NRB.

17. Establishment of Credit Rating Agency

The NRB will also put efforts in establishing Credit Rating Agency in the coming fiscal year so as to make the debt instruments more confidential and trustworthy to the potential investors, and it is expected that it will contribute to the development of capital market in the country.

18. Timetable

The implementation of the aforesaid regulations and reform policies will be initiated from the next fiscal year.

APPENDIX C: Financial Sector Reform Programme

Project Plan

The Nepalese financial sector is in need of vigorous reform for addressing the various institutional and structural deficiencies that have impact and implications for the sustained growth and vitality of this sector.

Reform is vital for strengthening the financial system as well as improving its capability to face the vulnerability to the likely instability and other uncertainties that could affect the evolving financial system. The various components of the financial sector technical assistance project (FSTAP), viz., strengthening (re-engineering) the Nepal Rastra Bank, addressing the problems of the two big banks (Rastriya Banijya Bank and Nepal Bank Ltd.) and capacity building within the banking system, .

Institutional problems and systemic challenges of the Nepalese Banking System

RBB and NBL, the two largest banks, account for 41.9 percent of the commercial banking deposits, 48.3 percent of the loans and advances, and 47.9 percent of the total sources and use of the commercial banking system as in mid-July 2001.

Even after a long and strong presence of the formal financial structure, a relatively large share of the rural financial needs in still being met by the informal financing arrangements. Problems like weakening or negative net-worth, higher proportions of non-performing assets (NPA), large interest rate spread between lending and borrowing rates in the formal financial sector, predominance of the informal financial system in the rural areas, and high interest rate differentials between the formal and informal financial markets of the economy have remained the major deficiencies of the financial system in Nepal.

Need

- Conditions like raising the efficiency in financial intermediation, maintenance of competitive and comprehensive interest rate structure,
- Promoting autonomy and professionalization in the financial sector transactions
- Inevitable for achieving a deep, broad, healthy and dynamic financial sector environment.

Project Development Objective

1.1 The overarching foal of the FSRP is to create a well-regulated, sound, market oriented and stable financial system, which will help form the basis for fiscal consolidation, macro-economic stability, private sector-led economic growth and poverty reduction on a sustainable basis.

1.2 The FSTAP represents the phase-wise programme, focusing on three broad objectives:
   a) reforming the commercial banking sector
   b) helping to strengthen and develop the regulatory and supervisory framework and the monetary policy capability of the central bank and
   c) creating supportive, stable and sound financial system to enhance the growth and building up the capabilities to run the system efficiently.

The Objectives

a) To create sound, stable and healthy financial system,

b) To broaden and deepen the financial system in the economy,
c) To enable the policymakers to fully and timely avail the sound financial statistics.
d) To canalize adequate resources, on lowest possible cost, to promote sustained, broad-based growth momentum,
e) To build the capacity of staff inside the institutions to identify and tackle the problems in the financial system,
f) To increase the autonomy and capability of central bank for making its monetary policy, supervisory and regulatory functions effective,
g) To improve and update the legal and judicial framework for the financial system, and
h) To drastically reduce the NPA, improve the financial intermediation efficiency and build a strong and stable financial system, thereby promoting growth and reducing poverty.

Outputs

- Strengthened capabilities of the central bank to enforce prudential rules and regulations.
- Adequate and up-to-date legal framework
- Increased share of financial system owned and operated by the private sector.
- Availability of new and innovative financial products and services
- Availability of adequate professionals and financial experts
- Timely and adequate availability of information
- Development of a stable financial system and drastically reduced NPA level.
- Increased financialization of the resources and improved efficiency in the financial intermediation.
- Improved monetary policy capability

Re-engineering the NRB US$ 4.6 million

a) Human Resource Department
b) Bank Operation and Bank Inspection Departments: Strengthening the central Bank's Supervisory Capabilities and Prudential Norms and Regulations.
c) Supervision of the Management Teams
d) Accounting and auditing Department
e) Research Department Support
f) Information technology support
g) Additional support to departments

Restructuring and Ownership Reform of RBB and NBL: US$24.69 million

a) Restructuring and Ownership reform
   - Bringing in management teams to take over all aspects of banking operations,
   - Establishment of NRB's Evaluation and Monitoring Cell,
   - Immediately help the to stabilized the operational and financial positions of the banks
   - Develop a Human Resource Programmes for the banks including training programme, retrenchment programme,
   - Logistic Support for Management Consultants,
   - Branch Restructuring and Improvement Programme,
   - Preparation for Ownership Reform.
b) Establishment of Assets Management Company (AMC)

Capacity building in the financial sector : US$0.70 million

a) Bankers Training Center
b) Credit information Bureau (CIB)
c) Financial Journalism

Economic and Financial analysis of the project

As the reforms have been initiated to improve the financial health of the institutions and strengthen the various components of the financial system, such reforms are basically of the nature of institutional strengthening through better corporate governance and enhancement of implementation capability through promotion of appropriate legislative and management improvement framework.

Reform in the financial system would promote a well-developed, compatible and strong financial system that is stable and resilient and the one that contributes to the promotion of a self-sustained, high growth development framework.

Reforms would improve operating efficiency and effectiveness in the delivery of al types of financial services

Project Risk

1. A weak/ Fragmented Legal Financial Environment
2. A weak/Under-developed Accounting and Auditing Environment
3. A weak Human Resource (high proportion level of junior level staff, and overstaffing in the banks)
4. Inadequate Infrastructure and physical facilities (means of communications, non-computerization of rural branches)

Organizational Responsibilities of the Project

NRB has established the Coordination and Support Team (CST) to oversee all the coordination functions and administrative, procurement, disbursement and financial management arrangements of the Project.

Implementation Plan

Schedule of Project Activities

Components	Duration	Start	Finish
Re-engineering NRB	4 years	July 1, 2002	June 30, 2006
Restructuring the two banks:			
RBB NBL	3 years	May 1, 2002 June1, 2002	April 30, 2005 May 31, 2005
Capacity building in the financial sector	4 years	June 30, 2002	June 29, 2006

Key Activities and target Dates

Activities	Date
1. Restructuring and ownership reform of RBB:	
- Arrangements to commence management teak work	May 1, 2002
- Preparation of ownership reform	May 1, 2004
2. Restructuring and ownership reform of NBL:	
- Arrangements to commence management team work	June1, 2002
- Preparation for ownership reform	June1, 2004
3. Reform in financial sector legislation	Jan16, 2002
4. Strengthening bank supervision and inspection	
- Implementation of Ms. Santos' Manual for ISD/NBISD	Jan16, 2002
- Logistics support programme	Dec 15, 2001

Monitoring and Evaluation

a. Progress reports from the CST
b. Periodic Project performance evaluation reports by the CST, and it will prepare an annual report on Project progress and effectiveness.
c. Project Completion Report at the end of the project

1. Project Component 1: Re-engineering NRB

a. Human Resource Development programme
- HRD Planning and Implementation
- Organizational Development
- Education and Training Programme, and
- Voluntary Retirement Scheme (VRS) & Benefits Package including the Remuneration Mechanism.

b. Building Supervisory Capabilities and Prudential Norms and Regulations
- Preparation of Manuals and Modalities of Inspection and Supervision for ISD, NB/ISD,
- Implementation of Ms. Santos Report,
- Formulation and Implementation of other relevant regulations,
- Implementation of Manuals for ISD/NB-ISD, and
- Logistic Support Programme.

c. Legislative Reform Programme
- Enactment of new NRB Draft Act,
- Formulation of Deposit-Taking Institutions Act,
- Formulation of assets Management Company Act,
- Formulation of Credit Information Institution Act,
- Formulation of Credit Rating Institution Act,
- Formulation of Bankruptcy Act,
- Formulation of Mergers and Acquisition Act, and
- Formulation of Consultant's Financial Legal Expert cell in NRB.

d. Capacity Building Programme
- Banking Operations Department,
- Non-Bank Operations Department,
- Foreign Exchange Department,
- ISD-NB/ISD,
- Public Debt Department, and
- Accounts and expenditure Department.

e. Revamping Research and Monitoring Strength of the Central Bank
- Strengthen Research and Analysis Wing,
- Strengthen Statistical Wing,
- Strengthen Balance of Payments and Price Wings,
- Strengthen Central Treasury Wing (with the objective of deriving the government cash position, especially the overdraft instantly).

2. Project Component 2: Restructuring/ownership reform of RBB and NBL (US$24.70 million)

Accordingly the management teams would be expected to (i) take complete management and financial control of the day-to-day running of the banks; (ii) immediately help to stabilize the operational and financial position of the banks; (iii) bring in an accounting team to help strengthen the accounts of the banks; (iv) develop a human resource programme for the bank which would determine, inter alia, a training programme, a VRS programme, concluding branch restructuring and improvement programme, and facilitating and appropriate package of remuneration for bank staff; and (v) prepare the bank for ownership reform.

a. Restructuring and Ownership Reform of RBB

- Management Consultancy Programme for RBB,
- Establishment of NRB's Evaluation and Monitoring Cell for RBB,
- Logistic Support for Management Consultants in RBB,
- Preparation of Manuals,
- Automation and Computerization of RBB,
- Branch Restructuring and Improvement Programme,
- Preparation for Ownership Reform.

b. Restructuring and Ownership Reform of NBL

- Management Consultancy Programme for NBL,
- Establishment of NRB's Evaluation and Monitoring Cell for NBL,
- Logistic Support for Management Consultants in NBL,
- Preparation of Manuals,
- Automation and Computerization of NBL,
- Branch Restructuring and Improvement Programme,
- Preparation for Ownership Reform.

3. Project Component: Other Financial Sector Reform (US$ 0.73 million)

a. Reform on Auditing and Accounting Capabilities

- Preparation of Modalities of Accounting and Auditing Manuals for Commercial Banks and Deposit-Taking Institutions, and
- Implementation of Accounting and Auditing Manuals

b. Financial Infrastructure Development Programme

- Study, Project Preparation and Establishment of a New Banker's Training Institute,
- Study, Project Preparation and Establishment of Assets Management Company,
- Study, Project preparation and Restructuring of Credit information Institution.
- Study, Project preparation and Establishment of Credit Rating Institution,
- Study, Project preparation for the Development of Financial journalism in Nepal, and
- Study, Project preparation for Facilitating Finance and Banking Studies Support in Univ.

IDA's contribution for this component would be US$ 0.66 million.

APPENDIX D: Status of the Public Ownership

(Share Investment in Banks & Financial Institutions by Government of Nepal, NRB and State-owned Enterprises)

S.N.	Investor	Invested institution	Invested NRs.. In million
1	Agricultural Development Bank	Nepal SBI Bank	6.00
		Nepal Housing Development Finance Co. Ltd.	6.00
		Sana Kisan Bikas Bank Ltd.	70.00
		Madhymanchal Grameen Bikas Bank	3.00
		Deprosc Development Bank	1.12
	Total		86.12
2	Citizen Investment Trust	Lumbini Bank Ltd.	30.00
		Laxmi Bank Ltd.	55.00
		Himalayan Bank Ltd.	108.11
	Total		193.11
3	Deposit & Credit Guarantee Corporation	Madhymanchal Grameen Bikas Bank	0.60
		Madhya Pashimanchal Grameen Bikas Bank	0.20
		Rural Micro Credit Dev Center (RMDC)	0.80
	Total		1.60
4	Employees Provident Fund	Lumbini Bank Ltd.	70.00
		Nepal SBI Bank	18.00
		Nepal Cottage & Small Industries Dev Bank	24.00
		Nepal Dev & Employment Promotion Financial Institution	48.00
		Nepal Merchant Banking & Finance Ltd.	14.50
		Nepal Development Bank	8.00
		NIDC Capital Markets Ltd.	0.10
	Total		182.60
5	Government of Nepal	Nepal Bank Limited	154.03
		Rastriya Banijya Bank	1,172.30
		Agricultural Development Bank	1,585.98
		Nepal Industrial Dev Corporation	412.73
		Nepal Housing Development Finance Co. Ltd.	6.00
		Sana Kisan Bikas Bank Ltd.	20.00
		Pashimanchal Grameen Bikas Bank	9.90
		Purbanchal Grameen Bikas Bank	4.95
		Sudur Pashimanchal Grameen Bikas Bank	4.95
		Madhya Pashimanchal Grameen Bikas Bank	9.90
	Total		3,380.74
6	Madhya Pashimanchal Grameen Bikas Bank	Rural Micro Credit Dev Center (RMDC)	0.80

	Total		0.80
7	Madhymanchal Grameen Bikas Bank	Rural Micro Credit Dev Center (RMDC)	0.80
	Total		0.80
8	Nepal Bank Limited	Rural Micro Credit Dev Center (RMDC)	5.20
		Sana Kisan Bikas Bank Ltd.	5.00
		Pashimanchal Grameen Bikas Bank	3.00
		Purbanchal Grameen Bikas Bank	1.50
		Madhymanchal Grameen Bikas Bank	3.00
		Sudur Pashimanchal Grameen Bikas Bank	1.50
		Madhya Pashimanchal Grameen Bikas Bank	3.00
		Deprosc Development Bank	1.50
	Total		23.70
9	Nepal Rastra Bank	Nepal Development Bank	16.00
		Nepal Cottage & Small Industries Dev Bank	16.00
		Rural Micro Credit Dev Center (RMDC)	21.05
		Pashimanchal Grameen Bikas Bank	0.60
		Citizen Investment Trust	0.01
		Rastriya Beema Sansthan (life&non-life)	1.60
		Sudur Pashimanchal Grameen Bikas Bank	40.05
		Madhya Pashimanchal Grameen Bikas Bank	37.90
	Total		133.21
10	Nepal Stock Exchange	Nabil Bank Ltd.	1.64
	Total		1.64
11	NIDC	Nabil Bank Ltd.	49.17
		NIDC Capital Markets Ltd.	27.00
	Total		76.17
12	Pashimanchal Grameen Bikas Bank	Rural Micro Credit Dev Center (RMDC)	0.80
	Total		0.80
13	Purbanchal Grameen Bikas Bank	Rural Micro Credit Dev Center (RMDC)	0.80
	Total		0.80
14	Rastriya Banijya Bank	Nepal Investment Bank	88.59
		Nepal Housing Development Finance Co. Ltd.	6.00
		Samjhana Finance Ltd.	6.80
		Rural Micro Credit Dev Center (RMDC)	5.20
		Pashimanchal Grameen Bikas Bank	3.00
		Purbanchal Grameen Bikas Bank	1.50
		Madhymanchal Grameen Bikas Bank	3.00
		Sudur Pashimanchal Grameen Bikas Bank	1.50
		Madhya Pashimanchal Grameen Bikas Bank	3.00
	Total		118.58

15	Rastriya Bima Sansthan	Nepal Investment Bank	88.59
		Nabil Bank Ltd.	47.52
		Nepal Development Bank	8.00
		Nepal Housing Development Finance Co. Ltd.	9.00
		NIDC Capital Markets Ltd.	0.10
	Total		153.21
16	Sudur Pashimanchal Grameen Bikas Bank	Rural Micro Credit Dev Center (RMDC)	0.80
	Total		0.80

APPENDIX E: Financial Sector Performance Data

Table No.1

Financial System at a Glance

(NRs.. In million)

		Mid - July						Mid-Jan	Mid-July
		2000	2001	2002	2003	2004	2005	2006	2006
1	Capital Fund	8686.4	10993.5	15827.2	20031	-1474.3*	-9088.1*#	-8127.71	-7444.573
	Commercial Banks	77.50%	74.90%	64.50%	0.6	692.0%(-)**	210.5%(-)**	217.95%(-)**	238.28%(-)**
	Development Banks ^	3.60%	5.70%	17.20%	20.60%	282%(+)	52.15%(+)	57.63%(+)	64.22%(+)
	Finance Companies	17.10%	17.50%	16.80%	0.2	247.8%(+)	46.76%(+)	45.81%(+)	53.94%(+)
	Micro Credit Development Banks ##				3.10%	45.29%(+)	8.14%(+)	10.16%(+)	11.15%(+)
	Others^^	1.80%	1.90%	1.60%	1.40%	16.8%(+)	3.44%(+)	4.34%(+)	4.96%(+)
2	Borrowing				11650.9	13102.9	16217.6	19656.44	21830.26
	Commercial Banks				27.20%	23.10%	42.20%	43.84%	43.61%
	Development Banks ^				50.50%	45.50%	27.70%		23.94%
	Finance Companies				1.20%	0.1	6.10%	6.67%	5.29%
	Micro Cr. Development Banks ##				20.50%	21.10%	0.2	0.24	24.39%
	Others^^				0.60%	0.30%	0.0	2.49%	2.77%
3	Deposits	165981.9	197325.6	205135.3	228736.4	258742.3	284115.2	299228.9	327995.18
	Commercial Banks	93.30%	92.10%	90.30%	89.10%	90.40%	88.80%	88.81%	88.80%
	Development Banks ^	0.10%	1.30%	2.40%	2.80%	1.50%	2.40%	2.17%	1.80%
	Finance Companies	5.90%	5.90%	6.60%	7.20%	7.50%	7.90%	8.13%	8.34%
	Micro Cr. Development Banks ##				0.30%	0.30%	0.30%	0.27%	0.28%
	Others^^	0.60%	0.70%	0.80%	0.80%	0.60%	0.60%	0.61%	0.78%
4	Other Liabilities				96632.6	117061.3	183080.3	187781.06	163766
	Commercial Banks				89.70%	89.40%	93.40%	93.09%	88.96%
	Development Banks ^				6.80%	7.10%	0.0	3.67%	6.53%
	Finance Companies				2.30%	2.40%	1.60%	2.39%	3.69%
	Micro Cr. Development Banks ##				0.70%	0.70%	0.80%	0.49%	0.68%
	Others^^				0.40%	0.30%	0.30%	0.35%	0.15%
5	Liquid Fund	50421.4	58587.3	55133.5	43782	53448.8	45792.5	44902.75	47736.53
	Commercial Banks	95.70%	94.90%	90.60%	87.20%	86.50%	83.80%	81.34%	81.37%
	Development Banks ^	0.40%	0.0	3.40%	5.80%	4.30%	4.90%	6.33%	3.27%
	Finance Companies	3.40%	3.50%	5.20%	6.10%	8.40%	8.50%	8.71%	11.28%
	Micro Cr. Development Banks ##				0.0	1.10%	1.40%	2.48%	2.77%
	Others^^	0.50%	0.60%	0.80%	0.90%	0.80%	1.30%	1.14%	1.31%
6	Investment	19488.5	27398.5	39279.7	51457.9	55903.1	66499.1	72649.3	88959.57
	Commercial Banks	92.20%	92.90%	87.10%	88.20%	88.80%	90.50%	90.84%	92.37%
	Development Banks ^	1.30%	1.80%	8.30%	6.70%	6.30%	0.0	2.78%	2.38%
	Finance Companies	5.80%	4.60%	4.10%	4.60%	4.50%	3.60%	3.71%	3.13%
	Micro Cr. Development Banks ##				0.0	2.20%	2.30%	1.92%	1.88%
	Others^^	0.70%	0.70%	0.50%	0.50%	0.30%	0.60%	0.74%	0.24%
7	Loans and Advances	106996	124048.9	148290.7	165119.1	184389.1	209053.7	219347.82	230509.042
	Commercial Banks	0.9	0.9	76.30%	75.40%	75.90%	78.30%	78.24%	76.71%
	Development Banks ^	0.70%	2.30%	14.70%	14.90%	13.80%	9.20%	8.42%	8.76%
	Finance Companies	8.50%	8.80%	8.10%	8.80%	9.50%	10.20%	10.88%	11.75%
	Micro Cr. Development Banks ##				1.50%	1.50%	1.70%	1.78%	1.87%
	Others^^	0.80%	0.0	0.90%	0.90%	0.70%	0.70%	0.69%	0.91%
8	Other Assets				96691.9	93691.2	152979.7	161639.77	138941.78
	Commercial Banks				100.80%	101.70%	97.20%	97.32%	94.19%
	Development Banks ^				-4.40%	-5.50%	0.0	-0.38%	1.98%
	Finance Companies				2.70%	2.90%	1.90%	0.02	2.58%
	Micro Cr. Development Banks ##				0.30%	0.30%	0.40%	0.48%	0.65%
	Others^^				0.60%	0.50%	0.40%	0.48%	0.01
9	Total Assets / Liabilities	225553.5	273946.2	314567.1	357050.9	387432.2	474325.9	498539.66	506129.339
	Commercial Banks	92.90%	91.80%	87.40%	85.60%	87.70%	86.70%	86.54%	0.85
	Development Banks ^	0.70%	1.70%	0.1	7.50%	4.70%	4.90%	4.56%	5.26%
	Finance Companies	5.80%	5.80%	5.90%	6.20%	0.1	6.40%	6.79%	7.68%
	Micro Cr. Development Banks ##				1.20%	1.30%	1.30%	1.44%	1.62%
	Others^^	0.70%	0.70%	0.70%	0.70%	0.60%	0.70%	0.67%	0.75%

Including micro-credit development bank up to mid-July 2002. Figures in 1999 and 2000 do not include ADB/N and NIDC due to unavailibity of data.
* The negative figure is due to Rastriya Banijya Bank's total negative retained earning, which was not included in the previous year.
** (-) sign indicates negative figure and (+) sign indicates positive figure.
# It includes negative retained earnings of both NBL and RBB.
^ Figures of Commercial Banking Branches (ADB/N) are deducted.

Table No 2

Sources and Uses of Fund of Commercial Banks and ADBN

(Aggregate)

									(NRs.. in million)
S.N.		Mid-July						Mid-Jan	Mid-July
		2000	2001	2002	2003	2004	2005	2006	2006
1	CAPITAL FUND	6729.2	8230.2	10202.5	11814.6	-10201.7	-19129.5	-17715.1	-17742.1
	a. Paid-up Capital	4067.4	5504.1	6431.0	7726.0	8350.0	9723.9	10081.5	10571.7
	b. Statutory Reserves	1976.7	1787.1	2540.0	2820.0	3385.0	3825.9	4519.5	4841.7
	c. Share Premium						10.0	10.0	10.0
	d. Retained Earning			260.9	75.7	-25056.1	-34292.8	-34292.1	-34912.0
	e. Others Reserves	685.2	939.0	970.6	1192.9	3119.4	1603.5	1966.0	1746.5
	1. Ex.Eq.Fund						541.1	489.2	369.7
	2. Other						1062.5	1476.8	1376.8
2	BORROWINGS	3346.6	2308.7	2349.5	3170.4	3023.6	6842.9	8617.5	9519.6
	a. NRB	428.1	411.8	1167.7	1437.0	731.6	4488.6	2585.3	3644.5
	b. "A"Class Licensed Institution	2918.5	1896.9	953.4	1599.2	1770.5	1347.2	1847.9	1991.9
	c. Foreign Banks and Fin. Ins.	0.0	0.0	228.5	134.2	521.4	27.6	2966.5	2273.2
	d. Other Financial Ins.						979.6	1217.8	
	e. Bonds and Securities								1610.0
3	DEPOSITS	154943.0	181767.0	185144.7	203879.3	233811.2	252409.8	265731.8	291245.6
	a. Current	20319.5	25100.7	24327.0	28862.5	33729.9	34646.4	32920.7	37386.6
	Domestic						29196.3	27452.4	32794.6
	Foreign						5450.0	5468.3	4592.0
	b. Savings	65703.6	80988.4	83855.6	97238.9	114137.2	129995.0	139576.4	151639.4
	Domestic						123899.0	133738.0	145701.7
	Foreign						6095.9	5838.5	5937.7
	c. Fixed	62204.2	65322.3	64171.4	63287.6	65130.9	67318.2	69585.1	76572.8
	Domestic						59053.9	60695.0	63555.6
	Foreign						8264.3	8890.1	13017.2
	d. Call Deposits	3715.8	7691.8	10531.9	12027.9	18061.1	17681.7	20778.0	22722.1
	e. Others	2999.9	2663.8	2258.8	2462.4	2752.1	2768.5	2871.6	2924.7
	4 Bills Payable						480.2	567.0	599.6
5	Contra Account						2105.0		
6	Other Liabilities	44452.6	59221.3	77221.2	86697.4	113183.6	92900.7	98644.5	86580.7
	1. Sundry Creditors						2986.1	6377.6	4513.5
	2. Loan Loss Provision						31419.2	31633.8	26097.4
	3. Interest Suspense a/c						39070.5	41071.6	36083.1
	4. Others	44452.6	59221.3	77221.2	86697.4	113183.6	19424.9	19561.5	19886.7
7	Reconcillation A/c						65319.8	70812.2	47230.1
8	Profit & Loss A/c						10104.8	4783.2	11272.7
	SOURCES OF FUNDS	209471.5	251527.2	274917.9	305561.7	339816.7	411033.8	431441.1	428706.2
1	LIQUID FUNDS	48240.0	55583.3	49937.2	38163.6	46252.8	38369.4	36522.0	38842.1
	a. Cash Balance	4139.1	4775.1	5494.8	5440.4	4719.3	5137.3	5202.1	6306.6
	Nepalese Notes & Coins	3507.0	4116.9	4881.1	4735.9	4283.8	4763.8	4779.1	5908.6
	Foreign Currency	632.1	658.2	613.8	704.5	435.5	373.5	423.0	398.0
	b. Bank Balance	32236.0	37230.9	31115.2	21334.4	26579.7	21173.5	18079.8	24309.2
	1. In Nepal Rastra Bank	16945.1	21440.9	23170.3	16867.6	22728.2	17859.5	12746.5	21058.2
	Domestic Currency						16501.0	13118.7	20866.6
	Foreign Currency						1358.6	-372.2	191.6
	2. "A"Class Licensed Institution	676.9	796.1	928.2	683.7	1825.1	848.9	1961.9	1288.9
	Domestic Currency						835.2	1932.2	1287.7
	Foreign Currency						13.7	29.7	1.2
	3. Other Financial Ins.						0.0	0.0	0.0
	4. In Foreign banks	14613.9	14993.9	7016.7	3783.1	2026.4	2465.1	3371.4	1962.1
	c.Money at Call	11864.9	13577.3	13327.3	11388.8	14953.8	12058.7	13240.1	8226.3
	Domestic Currency						1482.0	2216.0	1805.5
	Foreign Currency						10576.7	11024.1	6420.8
2	INVESTMENTS	17608.8	25100.9	28573.8	39045.5	42384.3	50822.0	50555.9	57539.1
	a. Govt.Securities	17608.8	25100.9	28573.8	39045.5	42384.3	47560.0	50066.7	56898.0
	b. NRB Bond						118.2	0.0	566.7
	c. Govt.Non-Fin. Ins.						100.4	0.4	0.0
	d. Other Non-Fin Ins.						0.0	0.4	0.0
	e Non Residents						3043.4	488.4	74.4
3	SHARE & OTHER INVESTMENT	358.5	345.6	5636.0	6340.8	7284.3	9359.1	15440.0	24634.7
	1. Non Residents						6467.5	14328.3	17515.0
	2.Others						2891.5	1111.7	7119.7

4	LOANS & ADVANCES	96324.9	109121.1	113174.6	124522.4	140031.4	159641.4	167612.5	173383.4
	a. Govt. Entp.	2114.3	2909.6	2651.1	2867.7	2519.4	2442.5	5100.3	4988.7
	i. Financial	695	1209.1	991.2	965.1	1137	648.9	663.4	762.8
	ii. Non-Finan.	1419.3	1700.5	1659.9	1902.6	1382.4	1793.6	4436.9	4225.9
	b. Pvt. Sector	92241.8	104209.3	109043.3	120343.4	136403.5	157198.9	162512.2	168394.7
	c. For. Bills P.& D.	1820.4	1887.2	1322.2	1143.8	1050.4			
	d. Foreign A. B. C.	148.4	115	158	167.5	58.2			
5	BILL PURCHED						3909.2	3934.1	3353.8
	a. Domestic Bills Purchased						745.7	750.5	669.6
	b. Foreign Bills Purchased						1053.4	1349.9	1230.9
	c. Import Bills & Imports						2110.1	1833.7	1453.3
6	LOANS AGAINST COLLECTED BILLS						168.2	70.2	83.0
	a. Against Domestic Bills						21.7	10.3	21.2
	b. Against Foreign Bills						146.5	59.9	61.8
7	Contra Account						2105		
8	FIXED ASSETS						3809.6	4120.3	4026.7
9	OTHER ASSETS	46939.3	61376.3	77596.3	97489.4	103863.8	50728.5	60363.4	52632.7
	a. Accrued Interests	16125.8	19888.5	23742.8	27722.2	34458.5	38786.5	42078.5	36718.0
	Govt. Entp.	372	334.3	308.2	297.8	180.3	161.9	903.5	297.7
	Private Sector	15753.8	19554.2	23434.6	27424.4	34278.2	38624.6	41175	36420.3
	b. Staff Loans / Adv.							4364.2	4448.0
	c. Sundry Debtors						2427.5	5356	1750.5
	d. Cash In Transit						795.8	589.3	513.6
	e. Others	30813.5	41487.8	53853.5	69767.2	69405.3	8718.7	7975.4	9202.6
10	Expenses not Written off						262.4	227.6	377.5
11	Non Banking Assets						1269.9	1409.3	2109.7
12	Reconcillation Account						75288.9	79702.7	59040.3
13	Profit & Loss A/c						15300.1	11483.1	12683.2
	USES OF FUNDS	209471.5	251527.2	274917.9	305561.7	339816.7	411033.7	431441.1	428706.2

Table No. 3

Non Performing Loan Status of Commercial Banks

Banks	Mid-July 2003			Mid-July 2004			Mid-July 2005			Mid-January 2006			Mid-July 2006		
	Total Gross Loan (In Million)	**NPL (In Million)**	**NPL to Total NPL Gross loan in (%)**	**Total Gross Loan (In Million)**	**NPL (In Million)**	**NPL to Total NPL Gross loan in (%)**	**Total Gross Loan (In Million)**	**NPL (In Million)**	**NPL to Total NPL Gross loan in (%)**	**Total Gross Loan (In Million)**	**NPL (In Million)**	**NPL to Total NPL Gross loan in (%)**	**Total Gross Loan (In Million)**	**NPL (In Million)**	**NPL to Total NPL Gross loan in (%)**
1. Nepal Bank Limited	18132.33	10964.91	60.47	17937.66	9640.08	53.74	16866.55	8372.11	49.64	16375.40	7824.18	47.78	12879.22	3233.90	25.11
2. Rastriya Banijya Bank	26608.83	16005.32	60.15	25105.68	14470.52	57.64	25835.20	13689.34	52.99	25831.56	13230.90	51.22	27158.89	12313.84	45.34
4. Nepal Investment Bank Limited	5921.79	117.09	1.98	7338.57	181.44	2.47	10453.16	280.87	2.69	11719.40	269.50	2.30	13171.54	302.94	2.30
5. Standard Chartered Bank Nepal Limited.	6000.16	247.95	4.13	6693.86	252.20	3.77	8420.87	226.31	2.69	7969.85	230.30	2.89	9206.28	195.17	2.12
6. Himalayan Bank Limited	10844.60	1092.84	10.08	12919.63	1147.46	8.88	13451.17	1001.35	7.44	16558.10	1303.00	7.87	15939.63	978.69	6.14
7. Nepal SBI Bank Limited	4795.84	561.67	11.71	5531.83	345.82	6.25	6739.35	441.02	6.54	8022.60	532.00	6.63	8232.11	520.26	6.32
8. Nepal Bangladesh Bank Limited	7961.51	1013.28	12.73	9644.70	1042.18	10.81	9626.91	1832.94	19.04	10311.40	2605.00	25.26	8478.77	1040.34	12.27
9. Everest Bank Limited	5049.58	111.19	2.20	6095.84	104.76	1.72	7900.09	128.81	1.63	9617.99	125.00	1.30	10154.86	121.85	1.20
10. Bank of Kathmandu Limited	4856.03	420.87	8.67	6008.31	399.94	6.66	6182.05	308.51	4.99	6970.30	370.00	5.31	7542.75	190.17	2.52
11. Nepal Credit and Commerce Bank Limited	3396.41	700.83	20.63	4717.30	600.05	12.72	6011.90	519.26	8.64	6131.50	692.80	11.30	5914.44	655.91	11.09
12. Lumbini Bank Limited	2618.55	302.96	11.57	3222.75	237.30	7.36	3685.13	561.13	15.23	3733.50	797.00	21.35	4384.00	1401.58	31.97
13. Nepal Industrial & Commercial Bank Limited	2562.86	170.69	6.66	3743.09	146.59	3.92	4909.36	185.43	3.78	5869.70	211.00	3.59	6657.38	173.09	2.60
14. Machhapuchhre Bank Limited	1495.86	31.10	2.08	2540.79	24.98	0.98	5130.22	19.86	0.39	5460.30	44.00	0.81	6068.90	16.99	0.28
13. NABIL Bank Limited	8113.68	449.63	5.54	8548.66	286.68	3.35	10946.74	144.51	1.32	12025.80	319.00	2.65	13278.78	165.98	1.25
16. Laxmi Bank Limited	775.94	0.00	0.00	1750.93	0.00	0.00	2726.14	44.49	1.63	3474.90	42.00	1.21	4274.56	27.78	0.65
15. Kumari Bank Limited	2137.59	36.32	1.70	3697.99	28.19	0.76	5681.01	53.99	0.95	6103.90	100.00	1.64	6010.19	54.09	0.90
17. Siddhartha Bank Limited	629.03	0.00	0.00	1567.83	25.22	1.61	2634.93	67.93	2.58	3283.97	67.90	2.07	3869.28	51.84	1.34
18. Agriculture Development Bank Ltd.													25087.23	5326.00	21.23
Total	**111900.59**	**32226.66**	**28.80**	**127065.40**	**28933.41**	**22.77**	**147200.78**	**27877.84**	**18.94**	**159460.17**	**28763.58**	**18.04**	**188308.81**	**26770.42**	**14.22**

Table No. 4
Source and Use of Funds of Nepal Bank Limited

(NRs.. in million)

		Mid-July						Mid-Jan	Mid-July
		2000	2001	2002	2003	2004	2005	2006	2006
1	CAPITAL FUND	1044.2	1125.7	1349.5	1449.1	1064.3	-10347.5	-10370.5	-10066.5
	a. Paid-up Capital	380.4	380.4	380.4	380.4	380.4	380.4	380.4	380.4
	b. General Reserve	544.6	544.6	544.6	557.2	557.2	699.3	699.3	1045.3
	c. Share Premium						0	0	0
	d. Retained Earning						-11672.7	-11672.7	-11672.7
	e. Others Reserves	119.2	200.7	424.6	511.5	126.7	245.5	222.5	180.5
	1. Ex.Eq.Fund						118.1	118.1	0
	2. Other						127.4	104.4	180.5
2	BORROWINGS	235.5	266.2	215.0	52.4	0.0	1124.85	1530.9	1717.4
	a. NRB	234.2	264.8	213.7	52.4	0.0	1124.46	1530.9	1717.4
	b. "A"Class Licensed Institution	1.4	1.4	1.4	0.0	0.0	0.34	0	0
	c. Foreign Banks and Fin. Ins.	0.0	0.0	0.0	0.0	0.0	0	0	0
	d. Other Financial Ins.						0.05	0	0
	e. Bonds and Securities								
3	DEPOSITS	35578.7	35528.6	34060.1	34737.4	36288.5	34744.2	34056.7	35444.9
	a. Current	5033.2	5000.7	4311.7	4689.5	6300.0	5714.43	4941.1	6030.5
	Domestic						5522.66	4776.5	5873.6
	Foreign						191.77	164.6	156.9
	b. Savings	17888.4	20281.6	19851.5	21534.5	22063.0	22671.8	22795.3	23547.9
	Domestic						22665.5	22787.2	23538.9
	Foreign						6.26	8.1	9
	c. Fixed	12275.8	9921.8	9731.8	8396.9	7481.0	6269.26	6216	5790.9
	Domestic						6263.32	6193.6	5784.5
	Foreign						5.945	22.4	6.4
	d. Call Deposits	0.0	0.0	7.8	12.4	270.0	2.75	0	0
	e. Others	381.2	324.5	157.4	104.1	174.5	85.97	104.3	75.6
4	Bills Payable						169.2	61.7	76.1
5	Contra Account								
6	Other Liabilities	9261.7	13947.3	28191.9	30090.6	26711.0	36401	35888.5	23575.4
	1. Sundry Creditors						814.477	1821.7	1641.5
	2. Loan Loss Provision						9249.89	8048.2	3269.6
	3. Interest Suspense a/c						13629.7	13606.2	6456.8
	4. Others	9261.7	13947.3	28191.9	30090.6	26711.0	12707	12412.4	12207.5
7	Reconcillation A/c						1767.96	2236.4	1056
8	Profit & Loss A/c						1399.5	922.9	2329.7
	SOURCES OF FUNDS	46120.1	50867.7	63816.6	66329.5	64063.8	65259.2	64326.6	54133.0
1	LIQUID FUNDS	7648.6	8050.5	8063.8	4770.6	6444.0	5886.2	4286.1	5517.4
	a. Cash Balance	1614.1	1784.8	1648.9	1420.9	969.4	1020.7	935	1116.5
	Nepalese Notes & Coins	1314.0	1479.4	1409.9	1198.1	885.9	942.5	844.5	1048.4
	Foreign Currency	300.1	305.4	239.0	222.8	83.5	78.2	90.5	68.1
	b. Bank Balance	6034.5	6265.7	6410.9	3349.7	4452.6	4315.5	3241.1	4400.9
	1. In Nepal Rastra Bank	1736.0	3050.4	3307.4	2524.1	3783.5	3793.6	2676.2	3702.9
	Domestic Currency						2626.6	2645.5	3702.2
	Foreign Currency						1167	30.7	0.7
	2. "A"Class Licensed Institution	205.2	328.1	244.0	84.8	129.1	183.8	170	291.8
	Domestic Currency						183.8	170	291.8
	Foreign Currency						0	0	0
	3. Other Financial Ins.						0	0	0
	4. In Foreign banks	4093.2	2887.2	2859.5	740.8	540.0	338.1	394.9	406.2
	c.Money at Call	0.0	0.0	4.1	0.0	1022.0	550	110	0
	Domestic Currency						550	110	0
	Foreign Currency								
2	INVESTMENTS	5406.1	6720.0	7115.2	11722.8	10593.8	13838.6	11332.2	11776.9
	a. Govt.Securities	5406.1	6720.0	7115.2	11722.8	10593.8	11278	11332.2	11776.9
	b. NRB Bond						0	0	0
	c. Govt.Non-Fin. Ins.						0	0	0
	d. Other Non-Fin Ins.						0	0	0
	e Non Residents						2560.6	0	0
3	SHARE & OTHER INVESTMENT	56.3	56.3	37.6	59.8	429.9	51.2	3125.0	2644.5
	1. Non Residents						0	3077.7	2597.2
	2.Others						51.2	47.3	47.3

4	LOANS & ADVANCES	22863.7	22062.3	20997.5	19266.1	19141.7	17456	15650	12180
	a. Govt. Entp.	906.5	597.8	652.2	743.0	491.3	572	816	766
	i. Financial	0.0	0.0	0.0	62.5	102.5	168.9	239.3	248
	ii. Non-Finan.	906.5	597.8	652.2	680.5	388.8	403	577	518
	b. Pvt. Sector	21656.1	21131.0	20103.4	18335.1	18616.7	16884	14834	11415
	c. For. Bills P.& D.	177.1	234.2	139.2	88.4	33.7			
	d. Foreign A. B. C.	124.0	99.3	102.7	99.6	0.0			
5	BILL PURCHED						1073.3	784.4	610.7
	a. Domestic Bills Purchased						22.6	3	1.6
	b. Foreign Bills Purchased						21.2	21	15.3
	c. Import Bills & Imports						1029.5	760.4	593.8
6	LOANS AGAINST COLLECTED BILLS						1.3	0.0	0.0
	a. Against Domestic Bills						1.3	0.0	0.0
	b. Against Foreign Bills								
7	Contra Account								
8	FIXED ASSETS						208.9	213.8	210.6
9	OTHER ASSETS	10145.5	13978.6	27602.5	30510.2	27454.4	15731.5	17690.6	10504.9
	a. Accrued Interests	5327.4	6958.2	8793.0	9772.9	11498.8	12950.6	13606.4	6456.0
	Govt. Entp.	298.8	101.9	132.1	195.1	141.0	161.9	696.5	128.3
	Private Sector	5028.6	6856.3	8660.9	9577.8	11357.8	12788.7	12909.9	6327.7
	b. Staff Loans / Adv.							1359.5	1314.2
	c. Sundry Debtors						322.4	256.8	254.9
	d. Cash In Transit						147.1	354.1	513.6
	e. Others	4818.0	7020.4	18809.5	20737.3	15955.6	2311.4	2113.8	1966.2
10	Expenses not Written off						122.3	97.8	128
11	Non Banking Assets						169.3	284.5	798.2
12	Reconcillation Account						388.4	1837.9	737.4
13	Profit & Loss A/c						10332.2	9024	9024
	USES OF FUNDS	**46120.1**	**50867.7**	**63816.6**	**66329.5**	**64063.8**	**65259.2**	**64326.6**	**54133.0**

Table No. 5

Source and Use of Funds of Rastriya Banijya Bank

									(NRs.. in million)
		Mid-July						**Mid-Jan**	**Mid-July**
		2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2006**
1	CAPITAL FUND	1482.9	1506.7	1538.2	1557.5	-23839.8	-21437.9	-20199.4	-20282.5
	a. Paid-up Capital	1172.3	1172.3	1172.3	1172.3	1172.3	1172.3	1172.3	1172.3
	b. General Reserve	68.2	68.2	68.2	68.2	369.2	276.2	540.8	540.8
	c. Share Premium						0	0	0
	d. Retained Earning					-25607.0	-23032.3	-22001.9	-22085.0
	e. Others Reserves	242.4	266.2	297.7	317.0	225.7	145.9	89.4	89.4
	1. Ex.Eq.Fund						140.4	83.9	83.9
	2. Other						5.5	5.5	5.5
2	BORROWINGS	151.5	146.9	156.1	161.9	338.0	3215.7	2238.4	4351.5
	a. NRB	151.5	146.9	156.1	161.9	338.0	3215.7	91	1646
	b. "A"Class Licensed Institution	0.0	0.0	0.0	0.0	0.0	0	100	440
	c. Foreign Banks and Fin. Ins.	0.0	0.0	0.0	0.0	0.0	0	2047.4	2265.5
	d. Other Financial Ins.	0.0	0.0	0.0	0.0	0.0	0	0	0
	e. Bonds and Securities								0
3	DEPOSITS	38410.9	40500.4	38964.6	39308.6	40313.6	43489.2	41105.6	45700.7
	a. Current	4234.0	4864.0	4639.7	4687.9	5227.5	6419.8	6110.2	7891.2
	Domestic						6341.1	6066.7	7872.8
	Foreign						78.7	43.5	18.4
	b. Savings	15904.8	18822.1	18997.2	20861.2	23288.9	26848.2	27794.2	29494.9
	Domestic						25690	27695.7	29480.3
	Foreign						1158.2	98.5	14.6
	c. Fixed	17836.4	16477.2	15166.6	13579.5	11572.8	9001.5	7027.5	8103.8
	Domestic						8712.2	7027.5	8099.9
	Foreign						289.3	0	3.9
	d. Call Deposits	29.5	0.8	6.7	2.2	134.6	1034.9	38.1	45
	e. Others	406.3	336.3	154.4	177.8	89.8	184.8	135.6	165.8
4	Bills Payable						38.3	30	40.8
5	Contra Accounts						1429.6		
6	Other Liabilities	25003.9	31490.7	35459.2	41070.3	64012.7	40601.2	41392.9	42099.9
	1. Sundry Creditors						575.2	1227.6	602.7
	2. Loan Loss Provision						15214.4	14382.5	13593.1
	3. Interest Suspense a/c						21558.6	22626.8	24786.8
	4. Others	25003.9	31490.7	35459.2	41070.3	64012.7	3253	3156	3117.3
7	Reconcillation A/c						11299.2	5780.1	7227
8	Profit & Loss A/c						4136.5	1596.5	4343.2
	SOURCES OF FUNDS	65049.2	73644.7	76118.1	82098.3	80824.5	82771.8	71944.1	83480.6
1	LIQUID FUNDS	13633.4	14559.8	15089.9	8158.8	10704.1	6714.9	4583	7495.5
	a. Cash Balance	1042.5	899.6	853.8	1016.4	840.4	1027.1	905.8	1086.6
	Nepalese Notes & Coins	856.5	736.1	725.0	884.6	738.4	919.8	848.4	1006.5
	Foreign Currency	186.0	163.5	128.8	131.8	102.0	107.3	57.4	80.1
	b. Bank Balance	12440.9	13660.2	14236.1	7142.4	9763.7	5687.8	3677.2	6408.9
	1. In Nepal Rastra Bank	10195.7	11881.8	13077.4	5917.5	8845.8	4788.2	1988.2	5959.7
	Domestic Currency						4788.2	1983.1	5959.7
	Foreign Currency						0	5.1	0
	2. "A"Class Licensed Institution	-31.3	-36.0	-43.7	6.8	709.9	105.2	1233.4	109.2
	Domestic Currency						107.7	1233.4	109.2
	Foreign Currency						-2.5	0	0
	3. Other Financial Ins.						0	0	0
	4. In Foreign banks	2276.5	1814.4	1202.4	1218.1	208.0	794.4	455.6	340
	c.Money at Call	150.0	0.0	0.0	0.0	100.0	0	0	0
	Domestic Currency						0	0	0
	Foreign Currency						0	0	0
2	INVESTMENTS	4256.1	5576.3	4088.5	4137.1	2918.9	6494.8	5524.4	9025.7
	a. Govt.Securities	4256.1	5576.3	4088.5	4137.1	2918.9	6494.8	5524.4	9025.7
	b. NRB Bond						0	0	0
	c. Govt.Non-Fin. Ins.						0	0	0
	d. Other Non-Fin Ins.						0	0	0
	e Non Residents						0	0	0
3	SHARE & OTHER INVESTMENT	80.6	80.6	82.1	95.8	223.1	2058.1	2581.6	2753.2
	1. Non Residents						0	2358.3	2445.8
	2.Others						2058.1	223.3	307.4

4	LOANS & ADVANCES	29140.6	28424.7	28516.0	28258.9	26781.7	28614	25480	26864
	a. Govt. Entp.	95.7	634.7	561.0	566.1	302.9	323	2074	1606
	i. Financial	0.1	0.1	0.0	0.1	0.0	0	0.1	3.3
	ii. Non-Finan.	95.6	634.6	561.0	566.0	302.9	323	2074	1603
	b. Pvt. Sector	28565.3	27446.5	27622.5	27403.5	26211.5	28291	23406	25258
	c. For. Bills P.& D.	456.8	327.7	316.6	276.8	267.3			
	d. Foreign A. B. C.	22.9	15.8	15.9	12.5	0.0			
5	BILL PURCHED						305.8	314.0	300.9
	a. Domestic Bills Purchased						19.2	55.4	28
	b. Foreign Bills Purchased						286.6	258.6	272.9
	c. Import Bills & Imports						0.0	0.0	0.0
6	LOANS AGAINST COLLECTED BILLS						0.0	0.0	0.2
	a. Against Domestic Bills								0.2
	b. Against Foreign Bills								
7	CONTRA						1429.6		
8	FIXED ASSETS						549.4	566.4	603.3
9	OTHER ASSETS	17938.5	25003.3	28341.6	41447.7	40196.7	25419.8	30897.9	30034.5
	a. Accrued Interests	9268.3	11277.3	13302.1	15401.4	19136.8	21504.1	23080.5	24739.4
	Govt. Entp.	73.2	232.4	162.8	92.8	29.5	0.0	190.3	142.3
	Private Sector	9195.1	11044.9	13139.3	15308.6	19107.3	21504.1	22890.2	24597.1
	b. Staff Loans / Adv.							1983.9	1944.7
	c. Sundry Debtors						1128.4	3793.4	536.8
	d. Cash In Transit						645.5	186.7	0.0
	e. Others	8670.2	13726.0	15039.5	26046.3	21059.9	2141.8	1853.4	2813.6
10	Expenses not Written off						0	0	0
11	Non Banking Assets						273.2	325.6	403
12	Reconcillation Account						7164.1	548.1	3607
13	Profit & Loss A/c						3748.1	1123.2	2393.5
	USES OF FUNDS	65049.3	73644.7	76118.1	82098.3	80824.5	82771.8	71944.1	83480.6

Table No. 6

Assets and Liabilities of Agricultural Development Bank

								(NRs.. in million)
S.N		2000 Jul	2001 Jul	2002 Jul	2003 Jul	2004 Jul	2005 Jul	2006 JulP
1	**Paid up Capital**							
	Government	1,358.40	1,388.50	1,411.00	1,433.50	1,456.00	1,586.00	6,478.00
	Nepal Rastra Bank	30.00	30.00	30.00	30.00	30.00	-	-
	Individuals & Cooperatives	61.20	72.90	77.00	83.40	88.60	91.60	-
	Total	1,449.60	1,491.40	1,518.00	1,546.90	1,574.60	1,677.60	6,478.00
2	**Reserves & Surplus**	128.80	135.80	300.90	327.30	(7,437.10)	(7,288.90)	(6,763.90)
3	**Deposits**							
	Current	684.80	1,098.60	1,078.90	1,273.30	896.90	1,824.00	1,279.50
	Savings	8,290.30	10,389.20	11,086.60	12,850.90	14,682.80	15,121.00	16,225.40
	Fixed	5,411.50	5,472.00	7,722.60	8,761.80	9,856.60	10,085.00	11,426.20
	Others	710.70	817.90	919.80	1,055.80	799.70	843.90	694.30
	Total	15,097.30	17,777.70	20,807.90	23,941.80	26,235.90	27,874.80	29,625.40
4	**Borrowings**							
	Nepal Rastra Bank	54.70	255.40	250.80	250.60	277.50	331.20	229.50
	Com. Bank & Others	807.30	1,170.90	791.70	766.70	742.80	665.60	282.30
	Foreign	3,852.70	3,664.60	3,397.80	3,036.40	2,644.60	2,609.60	10.60
	Total	4,714.70	5,090.90	4,440.30	4,053.70	3,664.90	3,606.40	522.40
5	**Compulsory Savings**	8.10	8.50	4.00	8.20	8.20	23.40	6.40
6	**Other Liabilities**	6,641.10	7,637.10	7,884.20	11,916.40	13,776.90	14,456.20	13,675.20
7	**Liabilities /Assets**	28,039.60	32,141.40	34,955.30	41,794.30	37,823.50	48,037.60	43,543.50
8	**Loan**							
	Agricultural	12,890.70	14,782.40	16,673.70	18,615.70	19,686.80	21,166.40	16,512.90
	Commercial	4,475.30	5,566.60	6,388.60	8,083.30	9,656.50	10,986.10	8,470.40
	Total	17,366.00	20,349.00	23,062.30	26,699.00	29,343.30	32,152.50	24,983.30
9	**Investment**							
	Shares	51.50	52.60	138.20	137.00	25.30	25.60	36.00
	Government Securities	2,316.10	1,978.30	1,504.40	967.70	669.80	20.20	397.00
	Fixed deposit	435.10	552.60	690.70	798.50	2,040.30	1,446.90	1,078.60
	Total	2,802.70	2,583.50	2,333.30	1,903.20	2,735.40	1,492.70	1,511.60
10	**Cash and Bank Balance**	2,540.00	270.00	252.00	2,765.00	2,910.00	3,477.00	4,768.00
11	**Other Assets**	0.90	0.50	3.90	71.90	180.80	324.70	673.90

Table No. 7

Source and Use of Funds of Development Banks (Aggregate)

								(NRs. in Million)
		Mid-July					Mid-Janaury	Mid-July
		2001*	2002	2003	2004	2005	2006	2006
1	CAPITAL FUND	322.3	2,685.7	4,122.6	4,158.7	4,754.9	46,843.6	4,684.4
	a. Paid-up Capital	316.3	2,358.1	2,400.8	2,505.4	3,152.7	30,447.6	3,044.8
	b. General Reserves	0.8	294.2	214.9	220.9	230.2	2,546.9	254.7
	c. Share Premium	-	-	-	-	-	1.0	0.1
	d. Retained Earning	-	-	-	-	-	257.0	25.7
	e. Others Reserves	5.2	33.4	1,506.8	1,432.4	1,371.9	13,591.1	1,359.1
	1. Ex.Eq.Fund	-	-	-	-	-		-
	2. Other	-	-	-	-	-	13,591.1	1,359.1
2	BORROWINGS	0.1	5,932.1	5,889.4	5,959.9	5,117.8	52,357.3	5,235.7
	a. NRB	0.1	302.6	1,115.2	1,175.9	1,142.8	11,373.0	1,137.3
	b. "A"Class Licensed Institution	-	4,156.3	687.1	696.9	683.0	7,692.0	769.2
	c. Foreign Banks and Fin. Ins.	-	-	-	-	-	-	-
	d. Other Financial Ins.	-	1,473.2	4,087.1	4,087.1	3,292.0	33,117.3	3,311.7
	e. Bonds and Securities	-	-	-	-	-	175.0	17.5
3	DEPOSITS	2,196.0	24,677.5	28,802.5	29,427.2	33,957.8	342,887.4	34,288.7
	a. Current	-	-	-	-	-	421.0	42.1
	Domestic	-	-	-	-	-	421.0	42.1
	Foreign	-	-	-	-	-		-
	b. Savings	-	-	-	-	-	19,619.0	1,961.9
	Domestic	-	-	-	-	-	19,619.0	1,961.9
	Foreign	-	-	-	-	-		-
	c. Fixed	-	-	-	-	-	41,158.0	4,115.8
	Domestic	-	-	-	-	-	41,158.0	4,115.8
	Foreign	-	-	-	-	-		-
	d. Call Deposits	-	-	-	-	-	4,307.0	430.7
	e. Others	-	-	-	-	-	1,039.0	103.9
4	Bills Payable	-	-	-	-	-	6.0	0.6
5	Other Liabilities	38.1	5,089.6	8,577.2	9,412.0	15,002.8	149,790.0	14,979.0
	1. Sundry Creditors	6.5	0.9	520.8	525.4	17.9	378.0	37.8
	2. Loan Loss Provision	-	-	-	-	-	2,094.0	209.4
	3. Interest Suspense a/c	-	-	-	-	-	1,597.0	159.7
	4. Others	31.6	5,088.7	8,056.4	8,886.6	14,984.9	1,411.8	141.2
6	Reconcillation A/c	-	-	281.9	256.1	62.8	1,098.0	109.8
7	Profit & Loss A/c	43.3	(543.3)	(658.8)	(1,312.4)	(1,081.1)	(9,112.1)	(911.2)
	Total Sources of Funds	2,599.8	37,841.5	47,014.7	47,901.5	57,815.0	583,870.2	58,387.0
1	LIQUID FUNDS	479.4	3,629.5	4,137.0	4,053.7	4,562.7	47,094.6	4,709.5
	a. Cash Balance	11.9	3,057.3	725.1	742.1	657.2	6,566.3	656.6
	Nepalese Notes & Coins	-	-	-	-	-	893.0	89.3
	Foreign Currency	-	-	-	-	-	57.0	5.7
	b. Bank Balance	467.5	572.2	3,411.8	3,311.6	3,905.5	31,777.3	3,177.7
	1. In Nepal Rastra Bank	5.6	54.9	1,459.4	1,514.0	1,253.4	13,668.1	1,366.8
	Domestic Currency	-	-	-	-	-	2,318.0	231.8
	Foreign Currency	-	-	-	-	-	50.0	5.0
	2. "A"Class Licensed Institution	417.9	482.7	1,863.4	1,632.6	2,465.8	16,984.2	1,698.4
	Domestic Currency	-	-	-	-	-	3,129.0	312.9
	Foreign Currency	-	-	-	-	-	1.0	0.1
	3. Other Financial Ins.	44.1	34.6	89.0	165.0	186.3	1,125.0	112.5
	4. in Foreign banks	-	-	-	-	-		-

	C. Money at Call	-	-	-	-	-	8,751.0	875.1
	Domestic Currency	-	-	-	-	-	8,751.0	875.1
	Foreign Currency	-	-	-	-	-		-
2	INVESTMENT IN SECURITIES	50.0	1,624.0	1,161.7	1,114.7	474.9	5,179.7	518.0
	a. Govt.Securities	50.0	1,624.0	1,161.7	1,114.7	474.9	5,151.7	515.2
	b. NRB Bond	-	-	-	-	-		-
	c. Govt.Non-Fin. Ins.	-	-	-	-	-	28.0	2.8
	d. Other Non-Fin Ins.	-	-	-	-	-		-
	e Non Residents	-	-	-	-	-		-
3	SHARE & OTHER INVESTMENT	65.3	1,167.6	1,217.6	1,196.9	1,516.2	15,024.9	1,502.5
	1.1 Non Residents	-	-	-	-	-	220.0	22.0
	2.Others	-	-	-	-	-	3,193.0	319.3
4	LOANS & ADVANCES	1,841.0	27,554.8	31,026.9	31,905.3	29,893.7	302,137.5	30,213.8
	a. Govt. Entp.	-	-	-	-	-	21,831.0	2,183.1
	i. Financial	-	-	-	-	-	21,831.0	2,183.1
	ii. Non-Finan.	-	-	-	-	-	67.0	6.7
	b. Pvt. Sector	1,841.0	27,554.8	31,026.9	31,905.3	29,893.7	280,306.5	28,030.7
5	BILL PURCHED	-	-	-	-	-	24.0	2.4
	a. Domestic Bills Purchased	-	-	-	-	-	20.0	2.0
	b. Foreign Bills Purchased	-	-	-	-	-	4.0	0.4
	c. Import Bills & Imports	-	-	-	-	-		-
6	LOANS AGAINST COLLECTED BILLS	-	-	-	-	-	-	-
	a. Against Domestic Bills	-	-	-	-	-		-
	b. Against Foreign Bills	-	-	-	-	-		-
7	FIXED ASSETS	-	-	-	-	-	1,506.0	150.6
8	OTHER ASSETS	164.0	3,865.6	9,433.3	9,603.9	21,279.5	206,182.5	20,618.2
	a. Accrued Interests	63.3	23.1	1,175.5	1,314.8	212.6	1,787.7	178.8
	Govt. Entp.	-	-	-	-	-	4.0	0.4
	Private Sector	-	-	-	-	-	1,783.7	178.4
	c. Sundry Debtors	13.0	8.8	6,053.0	6,053.1	11.1	351.5	35.2
	d. Cash In Transit	-	-	-	-	-	1.0	0.1
	e. Others	87.7	3,833.6	2,204.8	2,236.0	21,055.9	204,042.3	20,404.2
9	Expenses not Written off	-	-	-	-	-	342.0	34.2
10	Non Banking Assets	-	-	-	-	-	2,154.0	215.4
11	Reconcillation Account	-	-	34.1	18.2	57.5	1,090.0	109.0
12	Profit & Loss A/c	-	-	4.2	8.7	30.4	3,135.0	313.5
	Total uses of Fund	2,599.8	37,841.5	47,014.7	47,901.5	57,815.0	583,870.2	58,387.0
* Excluding NIDC and ADB/N.								
Previous Figure of NIDC and ADB/N								

Table No. 8

Assets and Liabilities of Nepal Industrial Development Corporation

					(NRs. In Million)
		2003	2004	2005	2006
1	CAPITAL FUND	1,570.1	1,570.1	1,570.1	1,570.1
	a. Paid-up Capital	415.8	415.8	415.8	415.8
	b. General Reserves	67.5	67.5	67.5	67.5
	c. Others Reserves	1,086.8	1,086.8	1,086.8	1,086.8
2	BORROWINGS	1,349.5	1,349.5	1,349.5	1,349.5
	a. NRB	778.5	778.5	778.5	778.5
	b. "A"Class Licensed Institution	-	-	-	-
	c. Foreign Banks and Fin. Ins.	-	-	-	-
	d. Financial Institutions	571.0	571.0	571.0	571.0
	e. Bonds and Securities	-	-	-	-
3	DEPOSITS	522.5	522.5	522.5	522.5
	a. Current	522.5	522.5	522.5	522.5
	b. Savings	-	-	-	-
	c. Fixed	-	-	-	-
	d. Other Deposit	522.5	522.5	522.5	522.5
4	Bills Payable	-	-	-	-
5	Other Liabilities	-	-	-	-
	a. Sundry Creditors	-	-	-	-
	b. Loan Loss Provision	-	-	-	-
	c. Interest Suspense a/c	-	-	-	-
	d. Others	-	-	-	-
6	Reconciliation A/c	-	-	-	-
7	Profit & Loss A/c	(976.5)	(976.5)	(976.5)	(976.5)
	TOTAL LIABILITIES	2,465.6	2,465.6	2,465.6	2,465.6
1	LIQUID FUNDS	221.0	221.0	221.0	221.0
	a. Cash in hand	0.0	0.0	0.0	0.0
	b. In Nepal Rastra Bank	0.8	0.8	0.8	0.8
	c. "A"Class Licensed Institution	220.2	220.2	220.2	220.2
	d. Other Financial Ins.	-	-	-	-
2	INVESTMENTS	132.1	132.1	132.1	132.1
	a. Govt.Securities	-	-	-	-
	b. Share & Deben.	111.1	111.1	111.1	111.1
	c. Other Investment	20.9	20.9	20.9	20.9
3	LOANS & ADVANCES	2,065.5	2,065.5	2,065.5	2,065.5
	a. Govt. Entp.	-	-	-	-
	b. Pvt. Sector	2,065.5	2,065.5	2,065.5	2,065.5
4	BILL PURCHED	-	-	-	-
5	LOANS AGAINST COLLECTED BILL	-	-	-	-
6	FIXED ASSETS	-	-	-	-
7	OTHER ASSETS	47.1	47.1	47.1	47.1
	a. Accrued Interests	3.0	3.0	3.0	3.0
	b. Sundry Debtors	-	-	-	-
	c. Others	44.1	44.1	44.1	44.1
8	Expenses not Written off	-	-	-	-
9	Non Banking Assets	-	-	-	-
10	Reconciliation Account	6.0	6.0	6.0	6.0
11	Profit & Loss A/c	-	-	-	-
	TOTAL ASSETS	2,465.6	2,465.6	2,465.6	2,465.6

Table No. 9

Source and Use of Funds of Finance Companies (Aggregate)

(NRs. In Million)								
	Mid- July						Mid-January	Mid-July
SOURCES AND USES	2000(46)	2001(48)	2002(54)	2003(57)	2004(58))	2005(59)	2006(63)	2006(70)
1. CAPITAL FUND	1,489.5	1,928.9	2,662.1	3,205.2	3,653.8	4,250.0	3,723.7	4,314.8
a. Paid-up Capital	945.1	1,220.6	1,522.6	1,947.4	2,155.8	2,411.5	2,814.7	3,356.7
b. General Reseves	186.0	242.6	303.2	339.1	405.5	481.1	580.8	586.5
c. Share Premium	-	-	-	-	-	-	5.7	-
d. Retained Earning	-	-	-	-	-	-	258.1	306.4
e. Others Reserves	72.5	70.6	182.7	43.3	99.9	129.6	64.4	65.2
1. Ex.Eq.Fund	-	-	-	-	-	-	-	-
2. Other	-	-	-	-	-	-	64.4	65.2
2. BORROWINGS	175.9	215.0	244.8	134.3	1,306.5	990.8	1,311.8	1,154.8
a. NRB	-	-	-	13.9	-	-	-	-
b. "A"Class Licensed Institution	175.9	215.0	244.8	120.4	1,306.5	990.8	779.0	995.0
c. Foreign Banks and Fin. Ins.	-	-	-	-	-	-	-	-
d. Other Financial Ins.	-	-	-	-	-	-	97.6	140.9
e. Bonds and Securities	-	-	-	-	-	-	435.2	18.9
3. DEPOSITS	9,748.6	11,654.0	13,453.9	16,510.3	19,391.7	22,341.6	24,332.5	24,332.5
a. Current	-	-	-	-	-	-	26.7	16.8
Domestic	-	-	-	-	-	-	26.7	16.8
Foreign	-	-	-	-	-	-	-	-
b. Savings	-	-	-	-	-	-	6,580.0	8,118.1
Domestic	-	-	-	-	-	-	6,580.0	8,118.1
Foreign	-	-	-	-	-	-	-	-
c. Fixed	-	-	-	-	-	-	17,389.9	19,007.6
Domestic	-	-	-	-	-	-	17,377.7	19,007.6
Foreign	-	-	-	-	-	-	12.2	-
d. Call Deposits	-	-	-	-	-	-	74.0	56.0
e. Others	-	-	-	-	-	-	261.9	153.0
4. Bills Payable	-	-	-	-	-	-	-	-
5. Contra Account	-	-	-	-	-	-	-	-
6. Other Liabilities	1,392.5	1,665.1	1,825.5	1,788.5	2,231.2	1,945.6	4,007.0	5,262.0
1. Sundry Creditors	-	-	-	-	-	-	247.7	766.4
2. Loan Loss Provision	285.9	395.1	653.6	875.4	992.6	1,227.8	1,364.3	1,206.0
3. Interest Suspense a/c	-	-	-	-	-	-	827.5	830.2
4. Others	-	-	-	-	-	-	1,565.8	2,356.0
7. Reconcillation A/c	-	-	-	-	-	-	176.2	201.1
8. Profit & Loss A/c	243.2	334.2	266.4	478.2	615.5	908.7	322.1	572.1
TOTAL SOURCES OF FUNDS	13,049.7	15,797.2	18,452.7	22,116.5	27,198.7	30,436.7	33,871.5	38,856.2
TOTAL USES OF FUNDS	13,049.7	15,797.2	18,452.7	22,116.4	27,198.7	30,436.7	33,871.5	38,856.2
1. LIQUID FUNDS	1,728.6	2,048.5	2,862.4	2,674.0	4,469.8	3,904.9	3,910.2	5,386.7
a. Cash Balance	95.6	139.9	170.4	109.0	132.1	125.9	125.2	198.7
Nepalese Notes & Coins	-	-	-	-	-	-	125.2	198.7
Foreign Currency	-	-	-	-	-	-	-	-
b. Bank Balance	1,633.0	1,908.6	2,692.0	2,565.0	4,337.7	3,779.0	3,372.5	3,821.6
1. In Nepal Rastra Bank	20.1	17.2	31.2	178.9	430.1	440.9	678.9	749.9
Domestic Currency	-	-	-	-	-	-	678.9	749.9
Foreign Currency	-	-	-	-	-	-	-	-
2. "A"Class Licensed Institution	1,612.9	1,891.4	2,660.8	2,386.1	3,907.6	3,338.1	2,130.2	2,305.6
Domestic Currency	-	-	-	-	-	-	2,128.7	2,305.6

Foreign Currency	-	-	-	-	-	-	-	-
3. Other Financial Ins.	-	-	-	-	-	-	563.4	766.1
4. In Foreign banks	-	-	-	-	-	-	-	-
c.Money at Call	-	-	-	-	-	-	412.4	1,366.4
Domestic Currency	-	-	-	-	-	-	412.4	1,366.4
Foreign Currency	-	-	-	-	-	-	-	-
2. INVESTMENTS	1,129.2	1,268.0	1,623.4	2,392.4	2,510.5	2,411.2	1,169.8	963.2
a. Govt.Securities	842.8	837.2	1,120.0	702.4	1,270.0	567.5	1,143.8	963.2
b. NRB Bond	-	-	-	-	-	-	-	-
c. Govt.Non-Fin. Ins.	-	-	-	-	-	-	-	-
d. Other Non-Fin Ins.	286.4	430.8	503.4	1,690.0	1,240.5	1,843.7	26.0	-
e Non Residents	-	-	-	-	-	-	-	-
3. SHARE & OTHER INVESTMENT	-	-	-	-	-	-	1,528.8	1,821.2
1. Non Residents	-	-	-	-	-	-	-	1,821.2
2.Others	-	-	-	-	-	-	1,528.1	-
4. LOANS & ADVANCES	9,062.8	10,865.3	11,949.6	14,473.7	17,540.8	21,223.3	23,848.2	27,079.0
a. Govt. Entp.	-	-	-	-	-	-	-	-
i. Financial	-	-	-	-	-	-	-	-
ii. Non-Finan.	-	-	-	-	-	-	-	-
b. Pvt. Sector	-	-	-	-	-	-	23,848.2	27,079.0
c. For. Bills P.& D.	-	-	-	-	-	-	-	-
d. Foreign A. B. C.	-	-	-	-	-	-	-	-
5. BILL PURCHED	-	-	-	-	-	-	14.3	16.4
a. Domestic Bills Purchased	-	-	-	-	-	-	14.3	16.4
b. Foreign Bills Purchased	-	-	-	-	-	-	-	-
c. Import Bills & Imports	-	-	-	-	-	-	-	-
6. LOANS AGAINST COLLECTED BILLS	-	-	-	-	-	-	-	-
a. Against Domestic Bills	-	-	-	-	-	-	-	-
b. Against Foreign Bills	-	-	-	-	-	-	-	-
7. Contra Account	-	-	-	-	-	-	-	-
8. FIXED ASSETS	-	-	-	-	-	-	900.3	967.7
9. OTHER ASSETS	1,129.1	1,615.4	2,017.3	2,576.3	2,677.6	2,897.3	1,625.2	1,963.7
a. Accrued Interests	-	-	-	-	-	-	941.5	854.4
Govt. Entp	-	-	-	-	-	-	-	-
Private Sector	-	-	-	-	-	-	941.5	854.4
b. Staff Loans / Adv.	-	-	-	-	-	-	-	-
c. Sundry Debtors	-	-	-	-	-	-	138.6	144.5
d. Cash In Transit	-	-	-	-	-	-	15.1	0.7
e. Others	1,129.1	1,615.4	2,017.3	2,576.3	2,677.6	2,897.3	530.1	964.1
10. Expenses not Written off	-	-	-	-	-	-	46.3	32.5
11. Non Banking Assets	-	-	-	-	-	-	385.7	423.4
12. Reconcillation Account	-	-	-	-	-	-	179.1	124.1
13. Profit & Loss A/c	-	-	-	-	-	-	264.2	78.5

*Figures in paranthesis show the number of Finance Companies.

Table No. 10

Source and Use of Funds of Rural Development Banks (Aggregate)

(NRs. in Million)

SOURCES AND USES	2000 Mid-July	2001 Mid-July	2002 Mid-July	2003 Mid-July	2004 Mid-July	2005 Mid-July	2006 Mid-Jan	2006 Mid-July
1. CAPITAL FUND	310.6	307.5	308.1	303.2	317.3	303.9	316.3	316.3
a. Paid-up Capital	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5
b. General Reserves	2.8	2.6	2.7	2.5	1.8	3.0	16.7	16.7
c. Share Premium	-	-	-	-	-	-	-	-
d. Retained Earning	-	-	-	-	-	-	0.4	0.4
e. Others Reserves	9.3	6.4	6.9	2.3	17.0	2.4	0.7	0.7
1. Ex. Eq. Fund	-	-	-	-	-	-	-	-
2. Other	-	-	-	-	-	-	0.7	0.7
2. BORROWINGS	783.0	1,070.6	1,181.0	1,324.9	1,472.0	1,675.9	2,005.8	2,303.7
a. NRB	61.4	10.0	32.3	39.4	-	-	49.5	28.0
b. "A" Class Licensed Institution	-	-	-	-	-	-	1,586.4	939.6
c. Foreign Banks and Fin. Ins.	-	-	-	-	-	-	-	-
d. Other Financial Ins.	721.6	1,060.6	1,148.7	1,285.4	-	-	369.9	1,336.1
e. Bonds and Securities	-	-	-	-	-	-	-	-
3. DEPOSITS	218.1	283.4	341.1	451.6	473.6	439.8	456.5	499.8
a. Current	-	-	-	-	-	-	-	-
Domestic	-	-	-	-	-	-	-	-
Foreign	-	-	-	-	-	-	-	-
b. Savings	-	-	-	-	-	-	452.7	478.8
Domestic	-	-	-	-	-	-	452.7	478.8
Foreign	-	-	-	-	-	-	-	-
c. Fixed	-	-	-	-	-	-	-	-
Domestic	-	-	-	-	-	-	-	-
Foreign	-	-	-	-	-	-	-	-
d. Call Deposits	-	-	-	-	-	-	-	-
e. Others	-	-	-	-	-	-	3.8	21.0
4. Bills Payable	-	-	-	-	-	-	-	-
5. Other Liabilities	237.2	329.8	197.5	227.5	285.4	403.2	389.1	376.6
1. Sundry Creditors	-	-	-	-	-	-	3.1	0.9
2. Loan Loss Provision	-	-	-	-	-	-	150.2	34.3
3. Interest Suspense a/c	-	-	-	-	-	-	7.2	18.3
4. Others	237.2	329.8	197.5	227.5	285.4	403.2	228.6	323.1
6. Reconciliation A/c	-	-	-	-	-	-	67.2	79.8
7. Profit & Loss A/c	0.4	5.4	(121.0)	(101.7)	(185.4)	22.4	8.6	43.1
TOTAL LIABILITIES	1,549.3	1,996.7	1,906.7	2,205.4	2,362.8	2,845.2	3,243.5	3,619.3
1. LIQUID FUNDS	187.6	121.7	166.8	211.3	257.1	294.4	246.6	300.2
a. Cash Balance	8.3	14.5	17.8	19.7	11.2	10.9	11.8	16.7
Nepalese Notes & Coins	-	-	-	-	-	-	11.8	16.7
Foreign Currency	-	-	-	-	-	-	-	-
b. Bank Balance	179.3	107.3	149.0	191.6	245.9	283.5	234.8	138.9
1. In Nepal Rastra Bank	45.2	1.9	16.7	1.8	6.6	83.5	19.5	10.9
Domestic Currency	-	-	-	-	-	-	19.5	10.9
Foreign Currency	-	-	-	-	-	-	-	-
2. "A"Class Licensed Institution	134.1	105.4	132.2	189.8	127.2	184.7	215.3	111.3
Domestic Currency	-	-	-	-	-	-	215.3	111.3
Foreign Currency	-	-	-	-	-	-	-	-
3. Other Financial Ins.	-	-	-	-	112.1	15.3	-	16.7
4. in Foreign banks	-	-	-	-	-	-	-	-

C. Money at Call	-	-	-	-	-	-	-	144.6
Domestic Currency	-	-	-	-	-	-	-	144.6
Foreign Currency	-	-	-	-	-	-	-	-
2. INVESTMENT IN SECURITIES	42.4	7.5	7.5	7.5	579.9	660.6	1.0	-
a. Govt. Securities	42.4	7.5	7.5	7.5	-	-	1.0	-
b. NRB Bond	-	-	-	-	-	-	-	-
c. Govt. Non-Fin. Ins.	-	-	-	-	-	-	-	-
d. Other Non-Fin Ins.	-	-	-	-	-	-	-	-
e Non Residents	-	-	-	-	-	-	-	-
3. SHARE & OTHER INVESTMENT	211.5	380.6	458.6	529.9	-	-	960.9	1,148.6
1 Non Residents	-	-	-	-	-	-	-	-
2. Others	211.5	380.6	458.6	529.9	-	-	960.9	1,148.6
4. LOANS & ADVANCES	733.2	1,000.3	1,145.9	1,309.1	1,358.4	1,466.0	1,543.1	1,616.5
a. Govt. Entp.	-	-	-	-	-	-	-	-
i. Financial	-	-	-	-	-	-	-	-
ii. Non-Finan.	-	-	-	-	-	-	-	-
b. Pvt. Sector	733.2	1,000.3	1,145.9	1,309.1	1,358.4	1,466.0	1,543.1	1,616.5
5 BILL PURCHED	-	-	-	-	-	-	-	-
a. Domestic Bills Purchased	-	-	-	-	-	-	-	-
b. Foreign Bills Purchased	-	-	-	-	-	-	-	-
c. Import Bills & Imports	-	-	-	-	-	-	-	-
6. LOANS AGAINST COLLECTED BILLS	-	-	-	-	-	-	-	-
a. Against Domestic Bills	-	-	-	-	-	-	-	-
b. Against Foreign Bills	-	-	-	-	-	-	-	-
7. FIXED ASSETS	-	-	-	-	-	-	19.2	13.8
8. OTHER ASSETS	239.7	323.6	127.9	147.6	167.4	220.8	217.3	246.1
a. Accrued Interests	-	-	-	-	-	-	2.1	-
Govt. Entp.	-	-	-	-	-	-	-	-
Private Sector	-	-	-	-	-	-	2.1	-
c. Sundry Debtors	-	-	-	-	-	-	1.7	-
d. Cash In Transit	-	-	-	-	-	-	1.9	-
e. Others	239.7	323.6	127.9	147.6	167.4	220.8	211.6	246.1
9. Expenses not Written off	-	-	-	-	-	-	0.2	-
10.Non Banking Assets	-	-	-	-	-	-	-	-
11. Reconciliation Account	-	-	-	-	-	-	65.3	73.1
12. Profit & Loss A/c	134.9	162.9	-	-	-	203.5	189.9	221.0
TOTAL ASSETS	1,549.3	1,996.7	1,906.7	2,205.4	2,362.8	2,845.2	3,243.5	3,619.3

Table No. 11

Source and Use of Funds of Micro-Credit Development Banks

							NRs. in Million
	2000	2001	2002	2003	2004	2005	2006
CAPITAL FUND				312.4	350.4	435.8	514.1
a. Paid-up Capital				2.2	222.3	249.7	272.4
b. General Reserves				0.1	11.0	100.1	110.8
C. Retained Earning				0.2	12.6	0.0	40.9
d. Other Reserves				0.7	104.6	86.0	90.0
BORROWINGS				1065.9	1298.7	1726.6	3021.2
a. NRB				33.5	19.9	10.3	9.7
b. Other Bank				377.4	606.9	671.4	1940.5
c. Other Financial Institutions				655.0	672.0	1044.9	1071.0
DEPOSITS				174.2	225.8	309.0	432.7
a. Current				0.0	0.0	0.0	0.0
b. Term Deposit				20.2	0.0	14.2	432.7
c. Other Deposit				154.0	225.8	294.9	0.0
Bills Payable				0.0	0.0	0.0	78.0
OTHER LIABILITIES				496.1	687.6	915.3	319.4
a. Sundry Creditors				5.1	8.3	8.4	57.4
b. Loan Loss Provision				0.0	0.0	0.0	80.1
c. Interest Suspense a/c				0.0	0.0	0.0	12.7
d. Other				491.1	679.3	907.0	169.2
Reconciliation A/c				0.0	0.0	0.0	136.1
P/L ACCOUNT				1.0	38.3	68.1	76.6
TOTAL LIABILITIES				2049.7	2600.8	3454.9	4578.1
LIQUID FUNDS				230.3	314.9	353.9	1021.2
a. Cash Balance				4.1	3.5	3.1	3.0
b. Bal. with NRB				61.1	52.6	106.9	125.2
c. Bal. with Dom. Bank				165.1	258.9	243.8	735.9
d. Bal. with Financial Insts.				0.0	0.0	0.0	92.4
e. Other Bank & Fin. Ins.				0.0	0.0	0.0	0.0
f. Money at call				0.0	0.0	0.0	64.7
INVESTMENTS				510.6	650.9	855.5	524.0
a. Govt.Securities				162.5	162.5	162.5	270.0
b. Share & Deben.				0.0	0.0	6.6	0.0
c. Other Investment				348.1	488.4	686.4	254.0
LOANS & ADVANCES				1118.5	1463.7	2071.6	2686.5
a. Agriculture Sector				244.4	141.3	182.6	0.0
b. Industrial Sector				0.0	6.4	21.0	0.0
C. Housing and Real Estate				0.0	0.0	0.0	0.0
d. Business Sector				0.0	0.6	0.5	0.0
e. Service Sector				0.0	108.4	188.1	0.0
f. Loan Against Fixed Deposit				0.0	0.0	0.0	0.0
g.Others				874.0	1207.0	1679.5	0.0
a. Govt. Entp.				0.0	0.0	0.0	0.0
b. Financial				0.0	0.0	0.0	869.1
c. Non-Finan.				0.0	0.0	0.0	10.8
d. Pvt. Sector				0.0	0.0	0.0	1806.6
BILL PURCHED				0.0	0.0	0.0	0.0
LOANS AGAINST COLLECTED BILLS				0.0	0.0	0.0	0.0
FIXED ASSETS				0.0	0.0	0.0	64.3
OTHER ASSETS				190.3	122.4	168.3	146.0
a. Interest Accrued				3.8	4.0	6.8	24.9
b. Sundry Debtors				0.5	8.1	14.6	19.3
c. Other				186.1	110.3	146.9	101.8
P/L ACCOUNT				0.0	0.0	0.0	0.0
Expenses not Written off				0.0	0.0	0.0	0.4
Non Banking Assets				0.0	0.0	0.0	0.0
Reconciliation Account				0.0	0.0	0.0	135.3
Total Assets				**2049.7**	**2600.8**	**3454.9**	**4577.7**

Table No. 12

Source and Use of Funds of Co-operative Societies (Aggregate)

(NRs.. in Million)								
SOURCES AND USES	Mid- July						Mid-Jan	Mid-July
	2000(35)	2001(34)	2002(34)	2003(34)	2004(21)	2005(20)	2006(19)	2006(19)
1. CAPITAL FUND	157.1	204.6	246.9	273.0	247.2	266.3	0.0	324.8
a. Paid-up Capital	137.7	169.3	191.8	218.6	191.7	203.9	0.0	0.0
b. General Reseves	9.3	14.0	21.7	33.5	31.1	34.0	0.0	0.0
c. Others Reserve	10.1	21.4	33.4	20.9	24.5	28.4	0.0	0.0
2. DEPOSITS	1073.2	1425.2	1570.7	1924.5	1679.8	1769.0	0.0	2011.6
a. Saving	582.9	653.7	730.3	971.3	865.3	976.0	0.0	0.0
b. Fixed	490.3	654.3	697.2	802.5	626.8	576.1	0.0	0.0
c. Other	0.0	117.3	143.2	150.7	187.7	216.9	0.0	0.0
3. BORROWINGS	62.5	66.8	58.7	66.4	41.1	46.2	0.0	70.7
a. NRB	0.8	0.5	0.4	0.4	0.0	0.0	0.0	0.0
b. Commercial Banks	61.6	58.9	56.4	61.3	36.4	36.2	0.0	0.0
c. ADB/N	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
d. Others	0.1	7.4	1.9	4.7	4.7	10.0	6.8	0.0
4. OTHERS	163.9	303.3	413.5	394.6	432.2	384.7	0.0	0.0
5. P/L ACCOUNTS	26.3	25.4	32.0	-8.1	-47.8	-4.6	0.0	0.0
TOTAL SOURCES OF FUND	1483.0	2025.4	2321.9	2650.4	2352.5	2461.6	0.0	2877.3
TOTAL USES OF FUND	1483.0	2025.4	2321.9	2650.4	2352.5	2461.6	0.0	2877.3
1. LIQUID FUNDS	265.2	354.4	448.6	389.1	413.1	448.7	0.0	493.2
a. Cash in Hand	32.7	143.2	33.3	42.0	34.0	35.8	0.0	43.6
b. Bal. with NRB	6.0	7.0	12.3	28.3	20.1	20.2	9.7	12.8
c. Bal. with Dom . Bank	226.5	204.3	403.0	318.8	359.0	392.6	0.0	436.8
2. INVESTMENTS	138.1	180.6	188.8	251.9	181.5	142.1	0.0	161.5
a. Govt. Securities	68.8	62.4	56.5	48.2	40.9	32.7	0.0	32.7
b. NRB Bond	2.3	18.8	26.2	54.5	86.8	87.3	0.0	50.0
c. Others	67.0	99.4	106.1	149.2	53.8	22.1	0.0	78.9
3. LOANS &	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ADVANCES	875.1	1221.2	1313.6	1463.2	1310.7	1440.7	0.0	1665.4
a. Commercial Loan	512.1	627.0	659.7	609.3	547.6	635.0	673.1	741.2
b. Production Loan	69.2	103.4	142.1	64.5	40.1	73.0	94.5	32.8
c. Loan against on FDR	43.8	53.5	52.0	49.6	70.4	73.3	87.7	85.0
d. Others	250.0	437.3	459.7	739.8	652.5	659.4	653.7	806.5
4. OTHERS	181.9	250.7	343.8	532.1	447.2	430.2	550.1	557.2
5. P/L ACCOUNTS	22.6	18.5	27.2	14.1	0.0	0.0	0.0	0.0

*Figures in Parenthesis Show the number of Cooperatives.

Table No. 13

Source and Use of Funds of Micro Finance NGOs

Mid-July 2000-2006

	(NRs.. in Million)						
	2000	2001	2002	2003(24)	2004(44)	2005(47)	2006(47)
1. Fund				6.3	14.5	27.0	45.6
2. Staff Welfare Fund				5.6	9.5	19.1	26.2
2.1. Staff Welfare Fund				0.1	0.6	1.1	1.9
2.2. Staff Provident Fund				0.9	0.7	5.1	4.3
2.3. Others				4.6	8.2	12.9	20.1
3. Saving and Deposits				0.0	0.0	0.0	0.0
4. Total Borrowings				91.1	220.4	435.9	541.8
4.1 Domestic				87.0	207.5	422.9	534.0
a. CSD				0.1	1.4	0.0	1.1
b. Dom. Bank				56.4	15.1	333.2	344.1
c. Dev. Bank				3.1	6.8	18.6	46.0
d. Financial institutions				2.7	37.8	59.5	138.1
e. Social Intuitions				1.4	0.9	1.9	1.9
f. Commission (C.A.)				0.0	1.5	9.7	2.8
4.2. Foreign Institutions				4.1	13.0	13.0	7.7
a. Financial Institutions				0.0	3.5	4.2	2.6
b. Social Institutions				2.6	6.6	7.3	4.1
c. Others				1.5	2.9	1.5	1.1
5. Risk Bearing Fund				1.6	15.1	30.8	13.1
6. Other Liabilities				20.4	33.6	117.1	201.3
a. Sundry Debtors				3.7	5.2	23.6	16.5
b. Others				16.6	28.4	93.6	18.8
7. P/L Account				12.4	2.5	9.8	59.9
Total Sources of Fund				137.4	295.6	639.7	894.3
Total Uses of Funds				137.4	295.6	639.7	894.3
1. Cash in Hand				3.8	1.6	12.3	10.7
2. Bal. With Dom. Banks				14.7	104.7	156.2	121.3
3. Micro Credit				48.8	115.5	258.0	439.8
4. Govt. Bond				50.2	10.2	23.7	485.6
5. Fixed assets				7.2	13.7	32.7	50.0
5.1. Land and Building				3.9	7.3	23.6	34.3
5.2. Furniture and Fixtures				1.0	1.8	2.7	2.2
5.3. Vehicles				0.6	1.2	2.2	5.0
5.4. Computer and Office eq				1.7	3.4	4.2	7.4
6. Others				4.6	50.0	156.8	223.9
6.1. Interest Receivable				0.0	0.1	2.8	2.3
6.2. Stationary Stock				0.2	0.3	0.6	0.9
6.3. Staff Loan				1.1	1.8	2.2	2.0
6.4. Sundry Debtors				0.9	3.0	6.2	9.1
6.5 Others				2.4	44.7	144.9	209.5
7. P/L Account				8.1	0.0	0.0	0.0

Table No. 14

List of Class A Licensed Financial Institution (Commercial Banks)

Mid-July, 2006

Names	Operation Date (A.D.)	Head Office	Telephone No.:	Fax no.
1. Nepal Bank Limited	11/15/1937	Dharmapath, Kathmandu	4221185	4222383
2. Rastriya Banijya Bank	1/23/1966	Singhdarbarplaza, Kathmandu	4246022/ 4268302	4252931
3. NABIL Bank Limited	7/16/1984	Kantipath, Kathmandu	4429546	4429548
4. Nepal Investment Bank Limited	2/27/1986	Durbar Marg, Kathmandu	4228229/ 4225257	4228927/ 4226349
5. Standard Chartered Bank Nepal Limited.	1/30/1987	Naya Baneshwar, Kathmandu	4781469	4780762
6. Himalayan Bank Limited	1/18/1993	Thamel, Kathmandu	4227749	4222800
7. Nepal SBI Bank Limited	7/7/1993	Hattisar, Kathmandu	4435516	4435612
8. Nepal Bangladesh Bank Limited	6/5/1993	Naya Baneshwar, Kathmandu	4783972/75	4780106/ 4490824
9. Everest Bank Limited	10/18/1994	Lazimpat, Kathmandu	4443377	4443160
10. Bank of Kathmandu Limited	3/12/1995	Kamaladi, Kathmandu	4414541	4418990
11.Nepal Credit and Commerce Bank Limited	10/14/1996	Siddharthanagar, Rupandehi	071-521921/ 4246991	071-521953/ 4244610
12. Lumbini Bank Limited	7/17/1998	Narayangadh, Chitawan	056524150/ 4243158	056-524250/ 4227590
13. Nepal Industrial & Commercial Bank Limited	7/21/1998	Biaratnagar, Morang	021-521921/ 4262277	021-522748/ 4241865
14. Machhapuchhre Bank Limited	10/3/2000	Prithvichowk, Pokhara	061-530900/ 4443681	061-530500/ 4418537
15. Kumari Bank Limited	4/3/2001	Putali Sadak, Kathmandu	4232112	4231960
16. Laxmi Bank Limited	4/3/2002	Adarshanagar, Birgunj	011-663425/26	011-663427
17. Siddhartha Bank Limited	12/24/2002	Kamaladi, Kathmandu	4442919/920	4442921
18. Agriculture Development Bank Ltd.	3/16/2006	Ramshahapath, Kathmandu	4252358	4262718

List of Class B Licensed Financial Institution (Development Banks)

S.N.	Names	Operation Date(A.D.)	Head Office	Telephone No.:	Fax No.
1	Agriculture Development Bank	1968/10/19	Ramshahapath, Kathmandu	4252359/60	4248946
2	Nepal Industrial Development Corporation	1959/06/15	Durbar Marg, Kathmandu	4227220/ 4222560	4227428
3	Nepal Development Bank	1999/01/31	Kamaladi, Kathmandu	4245740	4245753
4	Uddyam Development Bank	1999/02/22	Tandi, Chitawan	056-560380	056-523086
5	Malika Development Bank	1998/12/27	Dhangadhi, Kailali	091-524800	091-524800
6	Siddhartha Development Bank	1998/08/20	Butawal-11, Rupandehi	071-545543/ 546502	071-550457
7	Development Credit Bank Ltd.	2001/01/23	Kamaladi, Kathmandu	4231120/ 4221420	4231469
8	United Development Banks Ltd.	2001/05/06	Jeetpur, Bara	053-520593	053-520920
9	Nepal cottage and Small Ind. Dev. Banks	2001/01/19	Heritage Plaza, Kathmandu	4268719/20	4269308
10	Narayani Ind.Development Bank.	2001/10/17	Ratna Nagar-1, Chitawan	056-561258	056-528516
11	Pashimanchal Bikas Bank	1995/04/01	Butawal-8, Rupandehi	071-549899	071-549901
12	Sahayogi Bikas Bank	2003/10/21	Murali chowk-4, Janakpurdham	041-525971/72	41-525971
13	Pashupati Bikash Bank	2004/01/01	Banepa, Kavre	011-660385/84	011-660383
14	Karnali Bikash Bank	2004/02/18	Nepalgunj, Banke	081-526014/15	081-526044
15	Triveni Development Bank Limited	2004/07/26	Bharatpur, Chitawan	056-528831	056-522992
16	Annapurna Development Bank Limited	2004/08/23	Banepa, Kavre	011-660480	011-660481
17	Bhrikuti Bikas Bank Limited	2004/08/19	Shankar Nagar, Butawal	071-562436	071-562437
18	Shubhechchha Bikas Bank Limited	2004/09/14	Narayangadh, Chitawan	056-526014/15	056-526044
19	Bageshowri Bikas Bank Limited	2004/10/19	Dhambojhi chowk, Nepalgunj	081-526254	081-52634
20	Sanima Bikas Bittiya Sanstha	2004/11/26	Nagpokhari, Kathmandu	442897/80	4428969
21	Gaurishankar Bikas Bittiya Sanstha	2004/11/19	Kawasoti, Nawalparasi	78-540040	78-540469
22	Gorkha Bikas Bank Limited	2004/12/01	Putalisadak, Kathmandu	4255650	4-242829
23	Gandaki Development Financial Institute	2005/01/19	New Road, Pokhara	061-540466	061-541255
24	Infrastructure Development Financial Institute	2005/04/29	Banepa, Kavre	011-660542/43	011-660552
25	Business Development Financial Institute	2005/05/10	New Road, Pokhara	061-540725	061-540724
26	Biratlaxmi Financial Institute Limited	2005/05/11	Biratnagar, Morang	021-538051/52	021-538218
27	Excel Credit and Commercial Bittya sanstha	2005/07/21	Anarmani,Birtamod,Jhapa	023-543564	023-543563
28	Merchat Bikas Bittiya Sanstha Ltd.	2005/09/15	Tribhuvannagar, Ghorahi,Dang	082-560732	082-560907
29	Himchuli Bikas Bittiya Sanstha Ltd.	2005/11/07	Mahendrapool, Pokhara	061-542300/400	061-542333

List of Class C Licensed Financial Institution (Finance Company)

S.N.	Names	Operation Date(A.D.)	Head Office	Telephone No.	Fax No.
1	Nepal Housing Development Fina	1992/07/26	Naya Baneshwor, Kathmandu	4780259	4782753
2	Nepal Finance and Savings Co.Lt	1993/01/06	Kamaladi,Kathmandu	4220031	4241237
3	NIDC Capital Markets Ltd.	1993/01/26	Kamaladi, Kathmandu	4423219	4423401
4	National Finance Co.Ltd.	1993/05/07	Pako Newroad, Kathmandu	4228380	4222920
5	Annapurna Finance Co.Ltd.	1993/09/30	Chipledhunga, Pokhara	061-522671	061-525797
6	Nepal Share Markets Ltd.	1993/10/19	Ramshahapath, Kathmandu	4252332	4248845
7	Peoples Finance Ltd.	1993/04/15	Tripureshwor, Kathmadu	4260991	4262405
8	Himalaya Finance & Savings Co.L	1993/11/11	Sundhara, Kathmandu	4250172/ 4259376	4273884
9	United Finance and Leasing Co.	1994/12/12	Kamaladi, Kathmandu	4240779/813	4246551
10	Union Finance Co. Ltd.	1995/12/26	Durbarmarg, Kathmandu	4241648/49	4241645
11	Mercentile Finance Co. Ltd.	1994/11/10	Adarshnagar, Birgunj	051-522274	051-521673
12	Kathmandu Finance Ltd.	1994/11/10	Putalisadak, Kathmandu	430506/27	4421506
13	Inbesta Finance Ltd.	1995/07/17	Adarshnagar, Birgunj	051-526214	51-521178
14	Narayani Finance Ltd.	1995/03/08	Narayangadh, Chitwan	056-520313/45	056-522230
15	Gorkha Finance Ltd.	1995/03/12	Kantipath, Kathmandu	4220337	4258239
16	Nepal Housing & Merchant Financ	1995/04/11	Dillibazar, Kathmandu	4430838	4416849
17	Paschhimanchal Finance Co.Ltd.	1995/04/09	P.B.No.11, Butawal	071-541649	071-541924
18	Universal Finance & Capital Mark	1995/04/27	Kantipath, Kathmandu	4240998	4245895
19	Samjhana Finance Co. Ltd.	1995/05/03	Banepa, Kavre	011-664561	011-661207
20	Goodwill Finance & Investment Co	1995/05/16	Dillibazar, Kathmandu	4422878	4416052
21	Shree Investment & Finance Co. L	1995/06/01	Dillibazar, Kathmandu	442616/ 4415344	4421779
22	Siddhartha Finance Co. Ltd.	1995/05/25	Siddarthanagar, Bhairahawa	071-521478	071-523272
23	Lumbini Finance & Leasing Co. Lt	1995/06/26	Thamel, Kathmandu	4423443	4425655
24	Yeti Finance Co. Ltd.	1995/07/23	Bank Road, Hetauda	057-520822/ 521842	057-521842
25	Standard Finance Ltd.	1995/07/23	Pautalisadak, Kathmandu	4244504	4226529
26	ACE Finance Co. Ltd.	1995/08/15	Kantipath, Kathmandu	4249396	4249477
27	International Leasing & Finance C	1995/10/31	Naya Baneshwor, Kathmandu	4782010	4782267
31	Bhajuratna Finance & Saving Co.	1996/01/09	Kantipath, Kathmandu	4249534	4261316
32	General Finance Ltd.	1996/02/02	Chabahil, Kathmandu	484753	4484753
33	Nepal Shreelanka Merchant Bank	1996/02/04	Kamaladi, Kathmandu	4440300	4441034
34	Alpic Everest Finance Ltd.	1996/07/16	Baghbazar, Kathmandu	4266936	4241605
35	Nepal Merchant Banking & Financ	1996/11/26	Durbarmarg, Kathmandu	4246160	4246156
36	Nava Durga Finance Co.Ltd.	1997/02/09	Itachhe, Bhaktapur	6612999	6611999
37	Pokhara Finance Ltd.	1997/03/16	Gairapatan, Pokhara	61-531145	061-531610
38	Janaki Finance Ltd.	1997/03/07	Janakpurdham, Dhanusha	041-521586/ 523339	041-523340
39	Central Finance Co. Ltd.	1997/04/14	Kupondole, Lalitpur	5522289/ 5521402	5523526
40	Premier Finance Co. Ltd.	1997/05/08	Manbhavan, Lalitpur	5550412	5550412
41	Arun Finance & Saving Co. Ltd.	1997/08/17	Putalibazar, Dharan	025-23185	025-524450
42	Multipurpose Saving & Investmen	1998/04/15	Saptari, RajbiRaj	031-521170	031-521980
43	Butwal Finance Co. Ltd.	1998/06/21	Butawal, Rupendehi	071-44288/ 44888	7148711
44	Nepal Bangladesh Finance & Lea	1999/04/18	Main Road, Biratnagar	021-530972/973	021-521851
45	Shrijana Finance Ltd.	1999/12/14	Siraha, Lahan	033-560769	033-560769

46	Om Finance Ltd.	2000/09/17	New Road, Pokhara-9	061-532600/700	061-532800
47	Cosmic Merchant Banking & Fina	2000/11/20	Lal Durbar Marg, Kathmandu	4223154/78	4232678
48	World Merchant Banking & Finan	2001/08/10	Main Road, Hetauda	057-521129	057-523229
49	Capital Merchant Banking & Fina	2002/02/01	Battisputali, Kathmandu	4471458	4496321
50	Crystal Finance Ltd.	2002/02/13	Bag Durbar, Kathmandu	4218269/ 270/271	4219058
51	Royal Merchant Banking & Finan	2002/02/14	Durbarmarg, Kathmandu	4242900	4231349
52	Guheshworil Merchant Banking &	2002/06/13	Jawalakel, Lalitpur	5521506	5536169
53	Patan Finance Ltd.	2002/06/18	Man Bhawan, Lalitpur	5539475	5544206
54	Kist Merchant Banking & Finance	2003/02/21	Kamalpokhari, Kathmandu	4444463/ 4435463	4444838
55	Fewa Finance Ltd.	2003/04/30	Pokhara, Chipledhunga	061-538300/400	061-538738
56	Everest Finance Co. Ltd.	2003/07/02	Siddarthanagar, Bhairahawa	071-526507	071-526508
57	Birgunj Finance Ltd.	2003/08/21	Adarshnagar , Birgunj	051-523468	51530764
58	Prudential Merchant Banking & Fi	2003/06/06	Dillibazar, Kathmandu	4445988	4446453
59	Investment Credit and Finance Co	2003/06/14	Bhatbhateni, Kathmandu	4425292	4425294
60	IME Financial Institution	2005/06/28	Kantipath, Kathmandu	4239170/71	4218083
61	Sagarmatha Merchant Banking an	2005/08/29	Lalitpur, Maanvawan	5547841/ 5535158	5535419
62	Shikhar Bittya Sanstha Ltd.	2005/09/15	Kathmandu, Thapathali	4239290/9291	4239289
63	Civil Merchant Bittiya sanstha Ltd	2005/09/18	Kathmandu, Kuleshwor	4289524/596	4289524
64	Prabhut Bittiya sanstha Ltd.	2006/02/16	Kathmandu, Kantipath	254580/81	4262315
65	Imperial Bittiya sanstha Ltd.	2006/03/08	Kathmandu, Putalisadak	4432373/ 4427923	4435314
66	Kuber Bittiya sanstha Ltd.	2006/03/24	Kathmandu, Putalisadak	4239797/98	4439796
67	Tilottama Bittiya sanstha Ltd.	2006/05/04	Rupandehi, Butawal	071-560769	071-541683
68	Valley Bittiya sanstha Ltd.	2006/05/11	Kathmandu, Maharajganj	4374001	4376911
69	Seti Bittiya sanstha Ltd.	2006/06/07	Kailaly, Tikapur		091-560966
70	Hama Bittiya sanstha Ltd.	2006/06/16	Kathmandu, Tripureshwor	4249503	4261148

List of Class D Licensed Financial Institution (Micro Credit Development Banks)

S.N	Names	Operation Date(A.D.)	Head Office	Telephone No.	Fax No.
1	Purbanchal Grameen Bikas Bank	1993/03/28	Biratnagar, Morang	021-529817/ 522740	021-524259
2	Sudur Pashimanchall Grameen Bikas Bank	1993/03/28	Dhangadhi, Kailali	091-522624	091-522963
3	Pashimanchall Grameen Bikas Bank	1995/04/01	Butawal-8, Rupendehi	071-549899/ 541596	071-541289
4	Madhya Pashimanchal Grameen Bikas Bank	1995/04/01	Nepalgunj, Banka	081-522011	081-522024
5	Madhymanchall Grameen Bikas Bank	1996/07/08	Janakpur, Dhanusha	041-520785/ 521642	041-521642
6	Nirdhan Utthan Bank	1999/04/13	Rupandehi, Bhairahawa	071-523764/68	071-521647
7	Rural Microfinance Development Centre	1996/12/06	Putalisadak, Kathmandu	4268020	4247702
8	Deprosc Development Bank	2001/07/03	Narayanghat, Chitwan	056-561183/ 4261354	056-561183
9	Chhimek Development Banks	2001/12/10	Makawanpur, Hetauda -4	057-521574	057-522460
10	Shawalamban Development Banks Ltd	2002/02/22	Janakpur, Dhanusha	41-524342	041-525748
11	Sana Kisan Vikas Banks	2002/03/11	Bijulibazar, Kathmandu	4781032	4783930

List of Cooperatives (Non Classified)

S.N.	Names	Operation Date(A.D.)	Head Office
1	Nabajivan Co-operative Society Ltd.	1993/12/15	Dhangadi, Kailali
2	Sagun Co-operative Society Ltd.	1994/10/9	Kathamandu
3	Nepal Co-operative Society Ltd.	1994/12/30	Kathamandu
4	The Sahara Loan,Savings & Investment Co-op.Soc. Ltd	1995/04/15	Sarlahi
5	Bindabasini Saving Fund Co-operative Society Ltd.	1995/06/21	Khopasi, Kavre
6	Mahila Co-operative Society Ltd.	1995/09/27	Kathmandu
7	Bahooddeshya Saving & Loan Co-op.Society Ltd.	1995/12/25	Jhapa
8	Rajshree Saving & Invest.Co-op Society Ltd	1996/02/19	Sarlahi
9	Sahakari Bittiya Bikas Sanstha	1996/06/16	Nepalgunj, Banke
10	Manakamanal Sahakari Sanstha Ltd.	1997/02/18	Banepa, Kavre
11	Very Co-operative Sanstha Ltd.	1997/03/05	Nepalgunj, Banke
12	Viccu Saving & Loan Co-operative Sanstha	1997/08/11	Gaindakot,Navalparasi
13	Amarawati Bahu-Uddeshiya Cooperative Sanstha Ltd.	1997/12/03	New Baneshwor, Kathmandu
14	Kisan Bahu-Uddeshiya Cooperative Sanstha Ltd.	1998/12/29	Lamkee,Kailali
15	United Saving & Credit Co-op. Sanstha Ltd.	1998/02/13	Kathmandu
16	Himalaya Co-operative Ltd.	1998/04/29	Kathmandu
17	Star Bahoo-Uddesyiya Saving & Credit Co-op Ltd.	1998/04/14	Biratnagar
18	Yeti Saving & Credit Co-operative Sanstha Ltd	1998/11/22	Kathmandu
19	Upakar Savings Fund & Credit Co-operative So. Ltd.	2000/03/21	Walling, Sayanja

List of Non Government Organization (Non Clasified)

S.N.	Names	Operation Date(A.D.)	HeadOffice
1	Nepal Grameen Bikas Samaj Kendra	2000/06/05	Biratnagar
2	Nepal Grameen Bikas Sanstha	2000/06/05	Kathmandu
3	Nepal Sikara Grameen Bikas Karyakram	2000/06/05	Chitawan
4	Chartare yuba Club	2000/06/05	Baglung
5	Mahuli Samudyik Bijkas Kendra	2000/06/12	Saptari
6	Samudayik Yuba Club	2000/06/29	Bardiya
7	Samudayik Mahila Bikas Kendra	2000/07/14	Saptari
8	Grameen Samudayako Lagi yojana Pratavuti, Nepal	2000/08/2305	Dhankuta
9	Grameen Jagaran Manch (Programme Co-ordination Office)	2000/09/11	Baglung
10	Sarbodaya Grameen Bikas Sangh	2000/09/26	Saptari
11	Jan Jagaran Manch	2000/10/26	Rasuwa
12	Rastriya Shaichik Tatha Samajik Bikas Sanstha	2000/10/01	Parbat
13	Dhaulagiri Community Researh Dev. Centre	2000/10/21	Baglung
14	Nepal Enviroment & Pollution Eradication UNESCO Nepal	2001/07/05	Gangabu
15	Society of Local Volunteers Efforts Nepal (Solve)	2001/07/10	Dhankuta
16	Women Enterprises Association of Nepal	2001/09/24	Kathmandu
17	Center for Women's Right and Development	2002/04/30	Kathmandu
18	MANUSHI	2002/05/03	Kathmandu
19	Life Development Society	2002/06/18	Morang
20	Women Development and Child Care Foundation	2002/07/02	Saptari
21	Mahila Adarsha Sewa Kendra	2002/07/02	Kthmandu
22	Patan Buisiness and Professional Women	2002/07/02	Lalitpur
23	Women Development Centre	2002/07/02	Chitwan
24	Womens Self -Relient Society	2002/07/14	Chitwan
25	Women Development Centre of Nepal	2002/07/12	Lalitpur
26	Bhagawan Youth Club, Alapot, Ktm.	2002/07/23	Kathmandu

27	Creative Women Environment Development Association,Kathmandu	2002/07/24	Kathmandu
28	Srijana Community Development Center,Siraha	2002/07/25	Siraha
29	Shreejana Development Center,Kaski	2002/08/22	Kaski
30	Cottage & Small Industries Organization,Kathmandu	2002/09/02	Kathmandu
31	Rural Area Dev. & Research Programme,Parbat	2002/09/03	Parbat
32	Adarsha Yuba Club,Bhaktapur	2002/09/06	Bhaktapur
33	Society Welfare Action Nepal (SWAN),Dang	2002/10/25	Dang
34	Social Upgrade in Progress of Education Region (SUPER),Dang	2002/10/29	Dang
35	Nepal Women Community Service Center,Dang	2002/10/30	Dang
36	Forum for Rural Women Ardency Development,Sunsary	2002/12/30	Sunsari
37	Gramin Mahila Bikash Sanstha	2003/04/23	Dang
38	Ama Samaj Shangh,Chitawan	2003/04/29	Chitwan
39	Gramin Mahila Utthan Kendra,Dang	2003/06/18	Dang
40	Khurkot Youba Club ,Parbat	2003/09/14	Parbat
41	Tharu Tatha Raji Mahila Samaj,Kailali.	2003/09/18	Kailali
42	Nari Avudya Kendra	2003/10/24	Chitwan
43	Mahila Upakar Manch	2003/10/29	Banke
44	Chhimek Samaj Sewa Sanstha	2004/09/29	Kathmandu
45	Sawabalamban Bikash Kendra	2004/11/01	Kathmandu
46	Bikash Aayojana Sewa Kendra	2004/11/01	Kathmandu
47	Grameen Swyamsewak samaj	2005/11/20	Sarlahi

APPENDIX F: Survey: Checklist/Questionnaire/Responses

Annex 1: Checklist/Questionnaire

A. Bank's Branch Office

1. Service improvement

Deposit

Computerise, ABBS and other services. Any difference in deposit collection after reform.

Loan

Type of Loans - new and continuation of the old one (Consumer loan, Business loan, Gold / Silver or other loan). Repayment time limit and increase or decrease in loan flow after financial sector reform.

2. System improvement

Loan Processing

Branch limit

Branch recommendation limit

Any problem in application of directives (loan policy, account manual or operation manual) of the central office.

3. Number of customer

Deposit customers

Loan customers

4. Bad debts (NPA's)

Any change in NPA after reform.

5. Branch in profit or loss

6. Staff

Number staffs before reform

Present number and trained staffs

Staffs & types of trainings

Loan staff

7. Customer complaints

Complaints on Deposits

Complaints on Credits

B. Banks' Market/Customers/End-users-1

Survey of Market

(open perspective of trade and industrial associations)

1. Is it banking sector internal matter or something of importance to business sector?
2. What sorts of changes you are looking at that there should be in the banks?
   a) in general:
   b) that would help business:
   c) that would build relationship between business and banks
   d) that you would not do of above as yourself a banker
3. What changes you have actually felt with the ongoing financial sector reform?
   a) response to demand
      quick and appreciative/negative on style/inquisitive and business like/...
   b) credit appraisal
      quality of appraisal of the project
      look to the project or does not matter so long as collateral is sufficient
      type of things banks now look to
      strings that banks want to attach
      do they give you the appraisal report and allow you to respond
   c) collateral
      rank: project hypothecation/pledge of assets/personal guarantee
      is project hypothecation simply a talking factor or a practice
      bank in the project management team
      credit control resorted to by the bank
   d) time taken by the bank
      to make the first response on the application/project report
      to give the LOI on the clarification provided
      to call for the agreement following LOI and further submission
      to release the first installment following the papers completed
   e) post credit supervision
      what kind of supervision bank is doing?
   f) repayments
      how it is arranged?
      how the bank is ensuring it?

when does the bank agree to rescheduling of credit?

4. Is there a feeling of the comfort in dealing with the bank and getting finances?
5. Sorts of thing that should improve in general?

B. Banks' Market/Customers/End-users-2

Survey of Customers

1. How long you have been dealing with ... bank?
   a. Bank funded projects
   b. Type of financing instruments
   c. Interest rate
   d. Collateral placed
   e. Other important information on securing bank funds
2. What sorts of changes you are looking at that there should be in the banks?
   a. In general:
   b. That would help business:
   c. That would build relationship between business and banks
   d. That you would not do of above as yourself a banker
3. What changes you have actually felt with the ongoing financial sector reform?
   a. Response to demand

      Quick and appreciative/negative on style/inquisitive and business like/...

   b. Credit appraisal

      Quality of appraisal of the project

      Look to the project or does not matter so long as collateral is sufficient

      Type of things banks now look to

      Strings that banks want to attach

      Do they give you the appraisal report and allow you to respond

   c. Collateral

      Rank: project hypothecation/pledge of assets/personal guarantee Is project hypothecation is simply a talking factor or a practice

      Bank in the project management team

      Credit control resorted to by the bank

   d. Time taken by the bank

      To make the first response on the application/project report

      To give the LOI on the clarification provided

To call for the agreement following LOI and further submission

To release the first installment following the papers completed

e. Post credit supervision

What kind of supervision bank is doing?

f. Repayments

How it is arranged?

How the bank is ensuring it?

When does the bank agree to rescheduling of credit?

4. Is there a feeling of the comfort now in dealing with the bank and getting finances?

5. Is there significant changes in the behavior of staff towards customers?

B. Banks' Market/Customers/End-users-3

Survey of small end-users in rural and sub-urban areas

1. How long you have been dealing with ... bank?

   a. Bank funded projects

   b. Type of financing instruments

   c. Interest rate

   d. Collateral placed

   e. Other important information on securing bank funds

2. What changes you have actually felt with the ongoing financial sector reform?

   a. Response to demand

   Quick and appreciative/negative on style/inquisitive and business like/...

   b. Rredit appraisal

   Quality of appraisal of the project

   Look to the project or does not matter so long as collateral Type of things banks now look to

   Strings that banks want to attach

   Do they give you the appraisal report and allow you to respond

   c. Collateral

   Rank: project hypothecation/pledge of assets/personal guarantee

   Is project hypothecation is simply a talking factor or a practice

   Bank in the project management team

   Credit control resorted to by the bank

   d. Time time taken by the bank

To make the first response on the application/project report

To give the LOI on the clarification provided

To call for the agreement following LOI and further submission

To release the first installment following the papers completed

e. Post credit supervision

What kind of supervision bank is doing?

f. Repayments

How it is arranged?

How the bank is ensuring it?

When does the bank agree to rescheduling of credit?

3. Is there a feeling of the comfort now in dealing with the bank and getting finances?

C. Capacity Building on Financial Sector

a. Reform on Auditing and Accounting Capabilities

- Preparation of Modalities of Accounting and Auditing Manuals for Commercial Banks and Deposit-Taking Institutions, and
- Implementation of Accounting and Auditing Manuals

b. Financial Infrastructure Development Programme

- Study, Project Preparation and Establishment of a New Banker's Training Institute,
- Study, Project Preparation and Establishment of Assets Management Company,
- Study, Project preparation and Restructuring of Credit information Institution.
- Study, Project preparation and Establishment of Credit Rating Institution,
- Study, Project preparation for the Development of Financial journalism in Nepal, and
- Study, Project preparation for Facilitating Finance and Banking Studies Support in University.

PLUS

a. Training through an upgrading of the Bankers' Training Center

b. Improved public awareness through better financial journalism

c. Better information through Credit Information Bureau.

Annex 2: Survey of Bank Loan Customers

1. List of Banks Surveyed

S.N	Banks & Branches	Customers
1	NBL Main Branch	8
2	NBL Chabahil	8
3	NBL Hetaunda	8
4	NBL Banepa	8
5	RBB Mainbranch	8
6	RBB Suryabinayak/Bhaktapur	8
7	RBB Birgunj	8
8	RBB Dhading	8
	Total	**64**
Source: Survey, March-April 2007		

2. Dealing with Bank (in Yrs)

S.N.	Dealing years	Customers
1	<1	7
2	1-<2	5
3	2-<5	12
4	5-<10	13
5	10-<15	9
6	15-<20	8
7	>20	10
	Total	**64**
Source: Survey, March-April 2007		

3. Loan details

3.1 Loan Size

S.N.	Loan	Number of Customers
1	Below NRs 1 million	14
2	1 to under 2 million	14
3	2 to below 3 million	9
4	3 to under 5 million	8
5	5 to 10 million	8
6	10 million & above	11
	Total	**64**
Source: Survey, March-April 2007		

3.2 Collateral Type

S.N.	Collateral	Frequency
1	House /& Land / & stocks	48
2	Land	7
3	Shares	1
4	Factory Building / & Land	2
5	Auto it self	8
6	Petrol pump	1
7	Industry/ Land / & house	2
	Total	**69**
Source: Survey, March-April 2007		

3.3 Type of Loan / Interest Rate

S.N.	Loan	Interest Rate	Number of Customers *
1	Project Hypothecation	8 - 10	34
2	Overdraft	8 - 11	12
3	Project Term	8 - 10	5
4	Working Capital Term	8 - 10	2
5	Auto	6 - 7	8
6	Margin	6.5	1
7	LC	7 - 8.5	4
8	TR	7 - 8.5	4
9	Bank Guaranty		7
10	Education	8 - 10	2
11	Home	7 - 10	12
12	Hire purchase	11	1
	Total		**92**
Note: * Customers are lending more than one type of loan			
Source: Survey, March-April 2007			

4. What sorts of changes there should be (general)

S.N.	Comments	Number of Customers
1	Interest rate must be decrease	8
2	It should be made as good as other jointventure & pvt. Banks in regard of service delivery and market oriented	7
3	Documentation / Renewal procedure must be easier & practical	7
4	Still central office oriented. Authority must be transfer to the branches like in the other banks	7
5	Should be fully computerized	6
6	Application/ Full phase application of Any Bank Services	4
7	350 days banking, internet banking, evening counter, debt card and ATM facility should be provide	4
8	Employees must be well trained / efficient	3
9	Easy loan flow	2
10	Basic facilities should be increase	2
11	Stock List is un necessary in the case of enough collateral	2

12	Some discount should be provide for prime customers	2
13	Loan amount against the collateral is very low (60%). It must be increase upto 80%	2
14	Priority must be given to the old customers	2
15	Some attractive schemes must be launched for outstanding customers	1
16	Policy in OD investment must be changed	1
17	Minimum 3 years firm registration provision for lending is impractical	1
18	Record with other banks also must be recognized	1
19	Commission for swap must be decrease	1
20	Lots of changes are seen already	1
21	Bank shouldn't be a friend of good time	1
22	Management should be more systematic	1
23	Competition with other private and joint venture banks	1
24	Outdated services must be changed	1
25	Building valuation system is not practical	1
26	Pay attention on customer care	1
27	Delay in decision may cause divert towards the other banks	1
28	More information must be provide to the uneducated customers which cause they wouldn't face the difficulties	1
29	Customers must be classified and Identity card would be good, like in the Agriculture Dev. Bank	1
30	IC transaction must be valid	1
31	Instead of call for other date bank should react immediately on the customers demand	1
32	Commission is very high in comparison to the private banks	1
33	More collateral for Heir purchase is impractical	1
34	Application is unnecessary for check transaction	1
35	Commission against the collection of other banks cheque is not good	1
36	Offer should be negotiable	1
37	Separate counter for Pension, Remittance etc.	1
38	Home loan for business purpose (like school) is necessary	1
	Total	**82**
Source: Survey, March-April 2007		

5. Banks interest areas in appraising loans

S.N.	Banks Interest areas according to customers	Number of Customers
1	Business transaction/ Annual turnover	38
2	Enough Stocks	19
3	Bad debts	1
4	Regular on payment of the interest	1
5	Repayment capacity	3
6	Strong collateral	12

7	Party goodwill/reliability	7
8	Project feasibility	1
9	Industrial progress status	2
10	Assurance of the repayment	2
11	Intension of lending	1
12	Source of Income	23
13	Performance of the company which has issued the shares	1
14	Past record	2
15	Nothing is necessary if relation is good	1
16	Evaluation of the property	1
17	Situation for investment	1
18	Customers' Necessity	1
19	There is no exact standard, Depends on staffs monopoly(Access and influence)	2
20	Professional profile	1
	Total	**120**
Source: Survey, March-April 2007		

6. Time taken by the bank

to make the first response on the application/project report		**to give the LOI on the clarification provided to give the LOI on the clarification provided**		**to call for the agreement following LOI and further submission**		*** to release the first installment following the papers completed**		**to release the all installments (in days)**	
days	customers	days	customers	days	customers	days	customers	days	customers
1	37	1	11	1	1	1	4	Not Applicable	32
2 - 5	5	2 - 5	10	2 - 5	5	2 - 5	7	Depends on completion of construction work	9
6 - 10	7	6 - 10	14	6 - 10	23				
		11-15	8	11-15	9	11 - 15	3	30	1
		16-30	2	16-30	8	16≥	1	60	2
		31≥	1	31-60	2			90	1
				61≥	2				
*	Depends on registration process of the collateral property in the Land revenue office						16		
	It take time due to Swap from other bank						1		
	after submission of all type of documents						3		
	Depends on loan type						1		
	After completion of DPC						2		
	Depends on other partners						1		
	Not Applicable						4		
Total	**49**		**46**		**50**		**43**		**45**
Source: Survey, March-April 2007									

7. Post credit supervision

S.N.	Comments on supervision	Number of Customers
1	Not applicable	6
2	Monthly visit	4
3	Quarterly visit	15
4	Half yearly	9
5	Yearly	5
6	Some times suddenly	4
7	When the bank staffs are changed	3
8	There no any specific routine	4
9	Never before delay in repayment	1
10	Monitoring of construction site before loan sanction and at the time of release the due installments	7
11	They will come in contact to increase or decrease the margin, It depends on stock exchange rate	1
12	Never	5
	Total	**64**
Source: Survey, March-April 2007		

8. Ever re-scheduled

S.N.	Loan re-scheduling	Number of Customers
1	Never	50
2	One time	3
3	Some times	10
4	In the time of economic instability and blocked	1
	Total	**64**
Source: Survey, March-April 2007		

9. Ease in dealing with banks

S.N.		Number of Customers
1	Now very comfortable/ Relation is also good	21
2	Little bit	19
3	Looks easier/comfort & faster than in the past	13
4	Fast service delivery due to the computer	6
5	More improvement is needed to compete with the private banks	2
6	Looks like private banks in the case service & hospitality	2
7	Lots of changes has seen	1
8	Still weakness are seen in the operation and technical part	1

9	Problems found as it is in the days of pension distribution	1
10	Renewal process and other formalities are not easy yet	1
11	Improve only on Interest rate/ Also found improvement on consumer loans	1
12	Main branch looks comfortable but other branches are sill in very bad condition	1
13	Still uncomfortable due to the loan amount limitation	1
	Total	**70**
Source: Survey, March-April 2007		

10. Behavioral changes

S.N.		Number of Customers
1	A little bit / and not enough	17
2	More active and helpful than in the past	9
3	Banking competition/ new strict management/ trainings/ changing time made them compel to change their negative attitude	21
4	Lots improvement could be seen	4
5	They hasn't changed their behavior yet/ old mentality	7
6	They have to deal with uneducated customers that's why they couldn't change their behaviour	1
7	They are good (Already/Till now)	5
8	Still depends on personal relationship	2
9	Due to the tight working schedule they couldn't pay attention otherwise they are good	1
10	Now they are improved but not as good as private banks	1
11	Except in the Loan department other staffs couldn't impress the customers	1
12	More training on service delivery & customer care is needed	2
13	They are always good for big parties only	1
	Total	**72**
Source: Survey, March-April 2007		

11. Other changes

S.N.		Number of Customers
1	Newness in counter/ building / computerize/ Market oriented offers / staffs good behaviour	10
2	Couldn't see big difference/ Not enough in comparison of pvt. Banks	8
3	Fast service delivery	6
4	There is some newness in services and service delivery like computerised, consumer loan, ABS system, not necessary to wait on queue & fast delivery	5
5	Some improvements are seen than in the past	4
6	Variety in service types	1
7	Not newness/ Still complexity	2
8	Low interest rate than in the past	1
9	Well behavior	1
10	Though some varieties of services are increased but unskilled staffs couldn't	1

	deliver that kind of services	
11	Some new facilities are found like consumer loan. In the case of educational and home loan RBB is more good than other Joint venture & private banks	1
12	Due to the lack of publicity nobody knew about RBB's new facilities and service delivery.	1
13	Installment could be pay also in the central office, it's a new	1
14	Cheque for hypo loan is new and they also pay attention on customer care	1
	Total	**72**
Source: Survey, March-April 2007		

12. Transaction with other Banks

S.N.		Number of Customers
1	Next to the home that's why	1
2	Process is vary fast than in the NBL	1
3	Provides good loan amount against the collateral (70%)	1
4	RBB is not in favour of us that's why we want to go to other banks	1
5	New offer, new products, market oriented offers	1
6	Evening counter facility	3
7	They have lots of facilities / fast in cheque collection and less complexity in everything	3
8	Lots of facilities and attractive sehemes are already there in the other banks	10
9	Lots of institutions like NEA/NTC never accept the Bank guarantee of NBL	1
10	Service and offer was not as good as these days in NBL	2
11	Those days home loan wasn't available at NB	1
12	When the relation with NBL was not good I have no any options	1
13	Their working style is still unsatisfactory	2
14	There is no facility of LC and fast service in NBL Banepa	1
15	They are providing lots of facilities like more faster service, Low service charge, easily release of the collateral, renew is not necessary in Agricultural Dev. Bank	1
16	Very old relation with them before improvements have seen in RBB	1
17	Due to the partnership with other organizations	1
18	Standard Charter Bank doesn't call for other collateral in hire purchase	1
	Total	33
Source: Survey, March-April 2007		

APPENDIX G: Financial Sector Reform in SAARC

This segment draws the state of financial sector reform in Bangladesh, India, Pakistan and Sri-Lanka directly reproducing what was written by the respective authors. The permission to reproduce remains to be taken.

A. Bangladesh

-Fakhruddin Ahmed, (2005)

Financial sector of Bangladesh, like most developing countries, is dominated by banking enterprises. Banks at early stages of history of Bangladesh were nationalized and there was mismatch between assets and liabilities. The central bank of the country had limited tools to manage monetary policy. Direct tools namely determination of SLR/CRR, administered interest rate policy and moral suasion were the main instruments of monetary policy. Most banks pursued a policy of financial deepening through extending bank branches to the remote and rural areas without considering financial viability. In this situation, causality between economic growth and performance of the financial sector could not be established.

There was a major policy shift in early 1980s when private sectors banks were allowed in the country. In addition to the existing 19 public sector and foreign banks, 10 new private banks opened their business during early 1980s. Thereafter, another 7 and 13 banks started commercial banking in the country during mid-1990s and early 2000s respectively. The sector embarked upon a Financial Sector Reform Programme in the 1990s which primarily aimed at entrusting additional powers to the central bank by strengthening efficacy of its instruments. Interest rates were liberalized; open market operation was activated by introducing new bills. Attempts were made to improve governance in the financial sector. The pace of reform slowed down during the second half of 1990s, but picked up speed from the early part of the current decade.

Structure

Currently, the banking sector comprises of 4 nationalized commercial banks (NCBs), 5 government-owned specialized banks (SBs) dealing with development finance in specialized sectors, 30 private commercial banks (PCBs) and 10 foreign commercial banks (FCBs). The structure of the banking system has changed substantially over the last few years. NCBs' role has gone down. Their share in total assets went down from 54 percent in 1998 to 40 percent in 2004. On the other hand, PCBs' share went up from 27 percent in 1998 to 43 percent in 2004. The change reflects adoption and implementation of new policies for the banking sector.

Banking Sector Reforms

A. Regulatory Reform

Corporate Governance

(a) Governance structure of banks has been strengthened; better disclosure and transparency standards have been introduced and dissemination to the public at large has been mandated. Banks are required to publish selected financial information in at least two major daily newspapers. Fit and proper tests have been prescribed for bank directors, chief executives and advisors.

(b) Some restrictions have been imposed on the composition and tenure of the bank Directors. The maximum number of Directors in a bank has been limited to 13. The roles and functions of the Board and management were clarified and redefined. Near relations are no longer allowed to be directors in the same bank. These restrictions may be seen as undue interference into business activities of a bank by the central bank. At the same time, it must be realized that banks are different from other businesses and are public companies whose most important function is to protect deposits of the public. The directors of a bank, therefore, have some degree of public responsibility beyond protecting their own and other shareholders' interests. Banks are amongst the most regulated industries in most countries and the regulatory authorities have wide ranging power in these countries.

(c) Bangladesh Bank's capacities to supervise and regulate banks effectively, monitor non-performing loans, enforce actions against banks found violating regulations and laws have been strengthened. (So far 65 bank directors and chairmen lost their directorships for loan default, insider lending practices and other violations. Four managing directors of banks were removed). This process is ongoing.

(d) Audit Committees were mandated for all banks with clear guidelines and TORs. Banks have been asked to strengthen their internal control system.

(e) The Bangladesh Bank recently introduced Early Warning System (EWS). Banks which are exhibiting certain weaknesses, and deteriorating trends in selected indicators will be brought under EWS to ensure that appropriate steps are taken to address the issues before the situation deteriorates further. Monitoring of 'problem banks' has been strengthened through agreements on clear, quantifiable targets for improvement and monthly returns on performance.

(f) Government borrowing from the banking system is now market based and the annual volume of borrowing is limited, allowing greater room for the private sector. Private sector credit grew at over 14 percent during the last fiscal year.

Risk Management

Core Risk Management Guidelines on five major risks e.g. credit risk management, foreign exchange risk management, asset-liability risk management, internal control and compliance, and anti-money laundering have been issued by the Bangladesh Bank. These lay down policies, processes, procedures and structures that will lead to better governance and improved services. These are now under various stages of implementation in the banks. Bangladesh Bank also organized training of officers from commercial banks at its training academy to help implement the risk management guidelines. These measures will help the banking system to manage major i.e., credit, market and operational risks much better than before. Given the increasing importance, separate prudential guidelines have been issued for consumer credit and small business loans.

Loan Recovery

Stringent loan rescheduling conditions have been introduced to stop ever greening of loans. An upper limit on a bank's exposure to a particular customer or group was introduced. Strict measures have been laid and enforced on loan loss provisioning, and tier 1 and tier 2 capital adequacies. Loan write off guidelines were issued by the Bangladesh Bank, allowing the banks for the first time, to write off "bad" debts against which full provisioning has been made. The Bangladesh Bank has fixed the limit of the total of single borrower/single group-borrower credit by a bank. Such large loan limits have been linked to bank's NPL ratio. The BB is encouraging syndication of several banks for large loans and has issued guidelines for restructuring of existing such loans.

The ratio of gross non-performing loans (NPLs) of the banking system stood as high as 41 percent in 1998, which came down to 31.5 percent in December 2001. As a result of the policies adopted in recent years, the NPL of the banking system as a whole went down to 17.6 percent in December 2004. NCBs' gross NPL ratio has improved from 37 percent to 25.3 percent, and the net position has also improved from 25.2 percent to 17.6 percent during 2001-2004. PCBs' gross NPL position has improved from 17 percent to 8.5 percent, and net NPL of the PCBs has gone down from 5.5 percent to only 3.4 percent at the end of 2004. The improvement in the NPL of private banks has been remarkable.

Deepening of Money Market

Financial instruments of varying tenure such as repo and reverse repo, and five-year and ten-year Government Investment Bonds have been introduced. Efforts are continued to develop the government and corporate bond market and the functioning of the primary dealership. The BB and the Securities and Exchange Commission agreed to allow the government bonds to be traded in the stock exchange. BB, SEC and NBR have developed an enabling legal, regulatory framework for bonds/ securitization of receivables. Securitization of receivables of private financial institutions has started. Several securitization transactions were completed during the past few months. Securitization should become a new, less costly source of financing new activities. Work is ongoing on securitization of Jamuna Bridge revenue.

Exchange rate and Interest Rate

The interest rates have become flexible and now show a declining trend. Introduction of repurchase agreement and reverse repurchase agreement, strict limit on government borrowing from banks, reduction in SLR and reduction in yield on T-bills have contributed to this downward flexibility. The weighted average rate for loans and advances, which stood at 13.8 percent in December 2001 went down to 10.8 percent in December 2004. The reduction in interest rates has resulted in higher investment by the private sector. Strengthening of the regulatory measures and their enforcement by BB has improved the quality of financial intermediation by the banking system, leading to better allocation of resources.

As a part of the liberalization effort, floating exchange rate regime has been successfully introduced in May 2003. Further reform in simplifying and streamlining foreign exchange operations and payments system is underway.

B. Legal Reforms

Beginning 2001-02, some Acts were either amended or enacted to revitalize the financial sector. Money Laundering Prevention Act, 2002 gave BB responsibility for prevention of money laundering offences. Banks Nationalization Order was amended in 2003. Among others, the amendment requires disclosure of financial statements to the Board and the BB and gives BB greater say in the appointment and removal of MDs. Bank Company (Amendment) Act 2003, helped the BB to raise capital requirement of the banks to Tk. 1 billion. Financial Loan Court Act 2003 provided the authority to set up special courts dealing exclusively with default loans. It has prescribed time limits for courts to give judgment on original and appeal suits; mandated banks to sell collaterized security before filing cases; and provided alternative dispute resolution mechanism.

C. Institutional Reforms:

Bangladesh Bank *Strengthening*

As a central bank, the Bangladesh Bank is mandated to promote the operation of a stable and sound financial system. Bangladesh Bank also is mandated to conduct the monetary policy to ensure price stability and support growth. We have initiated a capacity building programme in the Bangladesh Bank. Departments have been restructured to improve internal coordination. Service standards have been introduced for work in the different departments. Workflow analysis has been initiated to bring in greater speed and ensure quality. These measures have led to greater speed in decision making. Bangladesh Bank moved its accounting to International Accounting Standard (IAS) two years ago and the audit of its accounts of FY 2004 were found by the external auditor to be fully compliant with International Financial Reporting Standard (IFRS). The Bangladesh Bank Strengthening Programme includes (a) computerization of the operations of the Bangladesh Bank, (b) human resource development through reforms of recruitment, promotion and compensation policies, (c) restructuring the different departments, (d) reengineering the business processes, (e) automation of the Clearing House, (f) capacity building in the core activities i.e. monetary policy, regulation of the financial sector, and research and policy analysis. The goal is to transform the decades-old traditional and manual system to a modern, automated system.

The improvement in capacity will enable the Bangladesh Bank to perform its roles effectively and assert its independence, while winning the respect of the stakeholders.

Impact of Reform

Following restructuring initiatives, financial sector further deepened as measured by M2/GDP ratio. The ratio, which stood at 28 percent in FY 1996, went up to 39 percent in FY 2004. Two other indicators namely, total credit to GDP ratio and private credit to GDP ratios show similar trend.

The impact of the reform can also be realized by analyzed the developments in the CAMEL framework, which considers Capital Adequacy, Asset Quality, Management Soundness, Earnings and Liquidity. These may be discussed in some details. Capital Adequacy: The BB raised minimum capital requirement on risk-weighted basis, as per Basle standard, from 8% to 9% in 2002. Minimum capital requirement of banks was raised to Tk. 1000 million ($17 million) from Tk. 400 million in 2003. The minimum capital requirement of Non-Bank Financial Institutions (NBFIs) was also raised from Tk. 50 million to Tk. 100 million in 2001 and further to Tk. 250 million from June 2003.

Many banks have floated their shares in capital market to achieve the target of capital adequacy. Most banks, other than NCBs, are now well capitalized. PCBs' capital adequacy ratio has increased from 9.9 percent in December 2001 to 10.3 percent in December 2004. Private banks are now listed in the capital market which helped revive the capital market. In total market capitalization, the share of banks rose from 10% in June 1998 to 47% in December 2004.

The reasons for increasing the minimum capital requirement are not often clearly understood. Firstly, the higher is the net worth of a bank in relation to deposits, the more likely it is that it will be able to weather any shock, including bank collapse. Equally importantly, the size of the equity is a measure of what stakes the ownerdirectors have in seeing that the banks are run profitably. The higher the stakes, the less will be the temptation to do things to the detriment of the bank's interest.

Asset Quality: Asset quality remained poor all through the history of Bangladesh. However, there have been significant improvements in recent years. Much of the problem is a manifestation of corruption, politics of public ownership, weak banking management, poor staffing quality, inadequate regulation and weak supervision. Actions taken over the last 3 years described earlier have led to significant improvements, which include improvement in NPL position.

Non-Performing Loan Ratio

Management Soundness: Though it is difficult to measure management soundness, attempt may be made by using different ratios such as total expenditure to total income, operating expenses to total expenses, earnings and operating expenses per employee, and interest rate spread. In particular, a high and increasing expenditure to income ratio indicates the operating inefficiencies that could be due to weaknesses in management.

Expenditure to income ratio of the banking sector has improved from 99.9 percent in 2000 to 93.9 percent in 2003.

Earnings: Earning and profitability of the banking sector have also improved in recent years as measured by return on assets (ROA) and return on equity (ROE). ROA improved from 0.01 percent in 2000 to 0.7 percent in 2004 and ROE improved from

0.3 percent to 13.0 percent during the same period. Although the net interest income of the NCBs has been negative since 2000, the overall banking industry experienced a consistent upward trend. The performance of private banks is significantly better than that of public ones. It is also notable, however, that some improvement of NCBs has happened only recently.

Liquidity: Presently, commercial banks are required to hold 16 percent of their total deposits as statutory liquidity requirement (SLR) which includes a 4.5 percent cash reserve requirement (CRR). Liquidity indicators measured as percentage of demand and time liabilities (excluding inter bank items) of the banks indicate that all the banks maintained excess liquidity over the minimum requirement. However, foreign private banks maintained higher levels of liquidity than domestic banks. In 2004 excess liquidity has gone down to 8.7 percent from the level of 9.9 percent last year.

Conclusion

From a poorly performing sector owing to lack of competition, weak governance, public ownership and inefficient management, the banking industry is, after the recent reform initiatives taken, poised for rapid development. Good progress has been made in deregulating interest rate, functioning of the floating exchange system, strengthening prudential regulations, enhancing the capacity of the central bank, introducing new monetary instruments, strengthening legal environment and reforming nationalized commercial banks. Private commercial banks have now greater share in assets, credit and deposits.

While a lot has been achieved during the past three years, it is needed to continue to move forward with additional measures to widen and deepen reforms. As the demand for loans in the traditional areas becomes more and more limited, the BB is encouraging banks to find new areas of lending; areas including agriculture and agro based industries, small enterprises, housing and consumers' credit. As regards loans to small business, Bangladesh Bank has established a Tk. 1 billion refinancing facility under which participating financial institutions can get refinancing at the bank rate i.e. five percent, for loans between Tk. 0.2 million and Tk. 5.0 million disbursed to enterprises anywhere in Bangladesh, as either term loan or working capital. The IDA has approved a contribution of $10 million and the ADB is finalizing a proposal to contribute $30 million to the Bangladesh Bank's Refinancing Facility. Bangladesh Bank has also a refinancing facility for agro-based industries of larger sizes located in rural areas.

The other important challenge that the banking sector is facing, is introduction of information technology in the banking system in an aggressive manner. This is required to improve management efficiency, reduce operational cost, improve customer services, and increase transparency. The BB would continue the journey on the path it has chosen.

B. India

Dr Y V Reddy, 2006

Progress of reforms

India embarked on a strategy of economic reforms in the wake of a balance-ofpayments crisis in 1991; a central plank of the reforms was reforms in the financial sector, and with banks being the mainstay of financial intermediation, the banking sector. At the same time, reforms were also undertaken in various segments of financial markets, to enable the banking sector to perform its intermediation role in an efficient manner. The thrust of these reforms was to promote a diversified, efficient and competitive financial system, with the ultimate objective of improving the allocative efficiency of resources, through operational flexibility, improved financial viability and institutional strengthening. The reform measures in the financial sector can be envisaged as having progressed along the following lines.

First, the reforms included creating a conducive policy environment - these were related to lowering of the erstwhile high levels of statutory pre-emption in the form of reserve requirements, gradual rationalisation of the administered interest rate structure to make it market-determined and streamlining the allocation of credit to certain sectors.

Second, the efficiency and productivity of the system has been improved by enhancing competition. Since the onset of reforms, clear and transparent guidelines were laid down for establishment of new private banks and foreign banks were allowed more liberal entry. A precondition for new banks was that the bank had to be fully computerised ab initio. This was done in order to infuse technological efficiency and productivity in the sector and also to serve as a demonstration effect on existing banks. As many as ten new private banks are operating in India at present; foreign banks operating in India numbered over 30 at end-September 2005. Competition was encouraged among public sector banks also.

Third, the ownership base in domestic banks has been broad-based. The equity base of most public sector banks was expanded by infusing private equity, though the government continued to retain majority shareholding. At present, public sector banks with hundred per cent government ownership comprise around 10 per cent of commercial bank assets compared to around 90 per cent at the beginning of reforms.

The share of listed private banks - both old and new - in total assets of private banks, stood at over 90 per cent at end-March 2005.

Fourth, a set of micro-prudential measures were instituted, to impart greater strength to the banking system and also to ensure their safety and soundness with the objective of benchmarking against international best practices (risk-based capital standards, income recognition, asset classification and provisioning requirements for nonperforming loans as well as provisioning for ‘standard’ loans, exposure limits for single and group borrowers, accounting rules, investment valuation norms). These norms have been tightened over the years in order to gradually converge towards international best practices.

Fifth, the process of regulation and supervision has also been strengthened. A strategy of on-site inspection and off-site surveillance mechanism together with greater accountability of external audit has been instituted. This has been complemented with a process of prompt corrective action mechanism. Sixth, in tandem with the improvements in prudential practices, institutional arrangement to improve supervision and to ensure integrity of payment and settlement systems has been put in place. As early as in 1994, a Board for Financial Supervision (BFS) was constituted comprising select members of RBI Board to pay undivided attention to supervision. The BFS ensures an integrated approach to supervision of banks, non-banking finance companies, urban cooperative banks, select development banks and primary dealers. As part of the process of ensuring a coordinated approach to supervision, a High Level Co-ordination Committee on Financial and Capital Markets (HLCCFCM) was constituted in 1999 with the Governor, RBI as Chairman, and the Chiefs of the securities market and insurance regulators, and the Secretary of the Finance Ministry as the members to iron out regulatory gaps and overlaps. To minimise settlement risks in the money, government securities and forex markets, the Clearing Corporation of India Ltd (CCIL) was established in 2002. Acting as a central counterparty through notation, the CCIL provides guaranteed settlement, thereby limiting the problem of gridlock of settlements. A Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) has also been recently constituted to prescribe policies relating to oversight of the financial infrastructure relating to payment and settlement systems. Finally, to address the systemic risks arising from growth of financial conglomerates, the RBI has put in place an oversight framework which envisages periodic sharing of information among the concerned regulatory bodies.

Seventh, the legal environment for conducting banking business has also been strengthened. Debt recovery tribunals were introduced early into the reforms process exclusively for adjudication of delinquent loans in respect of banks. More recently, an Act to enforce securities and recover loans was enacted in 2003 to enhance protection of lenders rights. To combat the menace of crime-related money, the Prevention of Money Laundering Act was enacted in 2003 to provide the enabling legal framework. The Credit Information Companies (Regulation) Act, 2004 has recently been enacted by the Parliament which is expected to enhance the quality of credit decision making. The Government is considering several major legal amendments to enhance the powers of the RBI. Major changes relate to removal of the restrictions on voting rights in banks, providing legal basis for consolidated supervision, removal of the floor of 25 per cent in respect of statutory liquidity ratio and empowering the RBI to supercede the board of a banking company.

Eighth, the reforms have focused on adopting appropriate processes in order to ensure development of various segments of the markets. In the banking sector, the Indian Banks' Association (IBA) has emerged as an important self-regulatory body working for the growth of a healthy and forward-looking banking and financial services industry. In the debt market segment, the RBI interacts closely with Fixed Income Money Market Dealers Association of India (FIMMDA) and the Primary Dealers Association of India (PDAI) for overall improvement of government debt markets and promoting sound market practices. With regard to the payments system infrastructure, the introduction of the Real Time Gross Settlement (RTGS) system since 2004 has made it possible for large value payments to be transacted in a faster, efficient and secure manner. In order to enhance transparency of secondary market trades in government securities, a screen based anonymous order matching system has been operationalised.

Ninth, the banking system has also witnessed greater levels of transparency and standards of disclosure with greater volume of information being disclosed as Notes on Accounts in their balance sheets. Salient among these include major profitability and financial ratios, details of capital structures, as well as movements in nonperforming loans, movements in provisions, advances to sensitive sectors, to mention a few. The range of disclosures has gradually been expanded over the years to promote market discipline.

Tenth, corporate governance in banks has improved substantially over the years. A Consultative Group was constituted to explore the issue in all its facets in accordance with best extant practices. Based on its recommendations, in June 2002, banks were advised to adopt and implement appropriate governance practices. As part of its efforts to promote sound corporate governance, the RBI has been focusing on ensuring 'fit and proper' owners and directors of the bank and laying stress on diversified ownership. Banks have been advised to ensure that a nomination committee screens the nominated and elected directors to satisfy the 'fit and proper' criteria.

Features of reforms

The unique features of the progress in financial sector reforms may be of some interest to this audience. First, financial sector reforms were undertaken early in the reform cycle. Second, the reforms process was not driven by any banking crisis, nor was it the outcome of any external support package. Third, the design of the reforms was crafted through domestic expertise, taking on board the international experiences in this respect. Fourth, the reforms were carefully sequenced in respect to instruments and objectives. Thus, prudential norms and supervisory strengthening were introduced early in the reform cycle, followed by interest rate deregulation and gradually lowering of statutory pre-emption. The more complex aspects of legal and accounting measures were ushered in subsequently when the basic tenets of the reforms were already in place.

A unique feature of the reform of public sector banks, which dominated the Indian banking sector, was the process of financial restructuring. Banks were recapitalised by the government to meet prudential norms through recapitalisation bonds. The mechanism of hiving off bad loans to a separate government asset management company was not considered appropriate in view of the moral hazard. The subsequent divestment of equity and offer to private shareholders was undertaken through a public offer and not by sale to strategic investors. Consequently, all the public sector banks, which issued shares to private shareholders, have been listed on the exchanges and are subject to the same disclosure and market discipline standards as other listed entities. To address the problem of distressed assets, a mechanism has been developed to allow sale of these assets to Asset Reconstruction Companies which are in the private sector and operate as independent commercial entities.

In terms of the processes also, certain interesting features of the reforms are in evidence. The first has been its gradualism, wherein reforms were undertaken only after a process of close and continuous consultation with all stakeholders. This participative process with wider involvement not only encouraged a more informed evaluation of underlying content of policies but also enhanced the credibility of policies and generated expectations among economic agents about the process being enduring in nature. The second has been a constant rebalancing of reform priorities predicated upon the domestic and global business environment, institution of prudential practices, upgradation of the regulatory and supervisory framework, institution of appropriate institutional and legal reforms and the state of openness of the economy. The third important feature of the reforms has been its harmonisation with other policies dictated, among others, by the state of preparedness of the financial sector and above all, the underlying macroeconomic environment. Fourth, the reforms have progressed with emphasis on the common person with the aim of developing a system that is responsive to the needs of all sections of society.

Assessment of impact

How useful has been the financial liberalisation process in India towards improving the functioning of markets and institutions? First, with the development of appropriate market regulation and associated payment and settlement systems and the greater integration into global markets, the financial markets have witnessed rapid growth and robustness. A range of instruments in domestic and foreign currency are traded in financial markets. In addition, the market in corporate bonds has been spurred with increased use of external credit ratings. Further, derivative products covering forwards, swaps and options as also structured products are transacted enabling corporates and banks to manage their risk exposures. The market in securitised paper both mortgage backed and asset backed securities has also grown significantly supported by a well developed credit rating industry. Second, liberalisation in financial sector has led to emergence of financial conglomerates since banks have diversified their activities into insurance, asset management securities business, etc. Third, prudential regulation and supervision has improved; the combination of regulation, supervision and a better safety net has limited the impact of unforeseen shocks on the financial system. In addition, the role of market forces in enabling price discovery has enhanced. The dismantling of the erstwhile administered interest rate structure has permitted financial intermediaries to pursue lending and deposit taking based on commercial considerations and their asset-liability profiles. The financial liberalisation process has also enabled reduction in the overhang of non-performing loans: this entailed both a ‘stock’ (restoration of net worth) solution as well as a ‘flow’ (improving future profitability) solution. The former was achieved through a carefully crafted capital infusion from the fisc, which aggregated, on a cumulative basis, to about one per cent of GDP; the flow solution, on the other hand, necessitated changes in the institutional and legal processes which were implemented over a period of time.

Moreover, financial entities have become increasingly conscious about risk management practices and have instituted risk management models based on their product profiles, business philosophy and customer orientation. Additionally, access to credit has improved, through newly established domestic banks, foreign banks and bank-like intermediaries. Moreover, government debt markets have developed, enabling RBI to undertake monetary policy more effectively, providing options to banks for liquidity management and allowing less inflationary finance of fiscal deficits. The growth of government debt markets has also provided a benchmark for private debt markets to develop.

There have also been significant improvements in the information infrastructure. The accounting and auditing of intermediaries has strengthened. Availability of information on borrowers has improved which will help reduce information asymmetry among financial entities. The technological infrastructure has developed in tandem with modern-day requirements in information technology and communications networking. Moreover, the concept of finance has permeated across various institutions and a 'finance view' of all market transactions has emerged. Finally, the quality of human capital involved in the financial sector has typically been of the highest genre, facilitating non-disruptive progress of the reforms process.

The improvements in the performance of the financial system over the decade-and-a-half of reforms are also reflected in the improvement in a number of indicators. Capital adequacy of the banking sector recorded a marked improvement and stood at

12.8 per cent at end-March 2005, comparable to 13.0 per cent for the US during the same period. Typically, the capital adequacy position of developed countries has remained range-bound within 10-14 per cent and judged from that standpoint, our capital position compares favourably with those numbers.

On the asset quality front, notwithstanding the gradual tightening of prudential norms, non-performing loans (NPL) to total loans of commercial banks which was at a high of 15.7 per cent at end-March 1997 declined to 5.2 per cent at end-March 2005. These figures are broadly comparable to those prevailing in several leading European economies (like Italy, Germany and France) which typically ranged within 4-7 per cent of total loans and lower than those in most Asian economies, although they were higher than those prevailing in countries such as, the US, Canada and Australia. Net NPLs also witnessed a significant decline and stood at 2.0 per cent of net advances at end-March 2005, driven by the improvements in loan loss provisioning, which comprises over half of the total provisions and contingencies.

Operating expenses of banks in India are also much more aligned to those prevailing internationally, hovering around 2.21 per cent during 2003-04 (2.16 per cent during 2004-05). In developed countries, in 2004, banks' operating expenses were 3.5 per cent in the US and 2.8 per cent in Canada and Italy and 2.6 per cent in Australia, while they were in the range of 1.1 to 2.0 per cent in banks of other developed countries such as Japan, Switzerland, Germany and the UK. Bank profitability levels in India as indicated by return on assets have also shown an upward trend and for most banks has been a little more than one per cent.

Incidentally, the turnaround in the financial performance of public sector banks has resulted in the market valuation of government holdings far exceeding the recapitalisation cost. The Indian experience has shown that a strong regulatory framework which is non-discriminatory, market discipline through listing on stock exchanges and operational autonomy has had positive impact on the functioning of the public sector banks.

Work in progress

Financial sector reform is a continuous process that needs to be in tune with the emerging macroeconomic realities and the state of maturity of institutions and markets, mindful of financial stability. In this changing milieu, there are several areas which are being addressed now.

The first issue pertains to capital account convertibility. In view of the rapid changes that have taken place over the last few years and the growing integration of the Indian economy with the world economy, the RBI has recently set up a Committee comprising eminent policymakers, financial sector experts and academia to suggest a roadmap for fuller capital account convertibility. The Committee is required to, in this context, examine the implications of fuller capital account convertibility on monetary and exchange rate management, financial markets and financial system.

The second issue relates to the fiscal area. The institution of the rule-based fiscal policy, as envisaged in the Fiscal Responsibility and Budget Management Act, 2003 (FRBM) has been on revenue-led fiscal consolidation, better expenditure outcomes and rationalisation of tax regimes to remove distortions and improve competitiveness of domestic goods and services in a globalised economic environment. In this context, the RBI has refrained from participating in the primary issues, except in exceptional circumstances. These de facto arrangements, which have been working satisfactorily for some period, have come into effect through legislative sanction effective April 1, 2006. While Central Government restated its commitment to fiscal consolidation as per FRBM Act, several state governments have enacted legislation on similar lines while some others are in the pipeline.

An important issue, specifically relating to the banking sector, is consolidation. Despite the liberalisation process, the structure of the Indian banking system has continued without much change though development finance institutions were merged with banks. The consolidation process within the banking system in recent years has primarily been confined to a few mergers in the private sector segment induced by financial position of the banks. Some mergers may take place in future for compliance with minimum net worth requirement or norms on diversified ownership. The RBI has created an enabling environment by laying down guidelines on mergers and acquisitions. As the bottom lines of domestic banks come under increasing pressure and the options for organic growth exhaust themselves, banks will be exploring ways for inorganic expansion.

The fourth aspect is the role of foreign banks. In terms of assets, the share of foreign banks has roughly been around a quarter within the non public sector banking category. They are dominant in certain segments, such as, the forex market and the derivatives market, accounting for over half of the off-balance sheet exposure of commercial banks. The RBI had, in February 2005, laid down clear and transparent guidelines which provide a roadmap for expansion of foreign banks. As it stands at present, foreign ownership in domestic banks is quite significant. In several new private banks, this share is well over 50 per cent; these banks account for around half of the total assets of domestic private banks. Even in several public sector banks, the extent of foreign ownership within the private holding is close to that of the domestic private holding.

The fifth issue pertains to Basel II. Commercial banks in India are expected to start implementing Basel II with effect from March 31, 2007 though a marginal stretching is not ruled out in view of the state of preparedness. They will initially adopt Standardised Approach for credit risk and Basic Indicator Approach for operational risk. After adequate skills are developed, both at the banks and also at supervisory levels, some banks may be allowed to migrate to the Internal Rating Based (IRB) Approach. Under Basel II, Indian banks will require larger capital mainly due to capital required for operational risk. The RBI has introduced capital instruments both in Tier I and Tier II available in other jurisdictions. In addition, the RBI is involved in capacity building for ensuring the regulator's ability for identifying and permitting eligible banks to adopt IRB / Advanced Measurement approaches.

The sixth aspect is the role of capital in case of regional rural banks (RRBs) and cooperative banks, which provide banking services primarily in the rural and semiurban areas. The problems with regard to this segment have been widely documented: these include constraints on timely credit availability, its high cost, neglect of small farmers and continued presence of informal lenders. It is argued that most part of the cooperative credit structure is multi-layered, undercapitalised, over-staffed and underskilled, often with high level of delinquent loans. The RRBs also appear to share these problems, although there are several viable institutions in this category. These are being addressed on a priority basis. A national-level committee had recently made recommendations to revive and restructure the rural cooperative credit structure. These have been accepted by the government which has set up a National Level Implementation and Monitoring Committee under the Chairmanship of the Governor for overall guidance in implementation. A process of revitalising RRBs and urban cooperative banks in a medium-term framework is also underway.

Seventh, we are adopting a three-track approach with regard to capital adequacy rules. On the first track, the commercial banks are required to maintain capital for both credit and market risks as per Basel I framework; cooperative banks on the second track are required to maintain capital for credit risk as per Basel I framework and surrogates for market risk; RRBs on the third track which though subject to prudential norms do not have capital requirement on par with the Basel I framework. In other words, a major segment of systemic importance is under a full Basel I framework, a portion of the minor segment partly on Basel I framework and a smaller segment on a non-Basel framework. Even after commercial banks begin implementing Basel II framework in March 2007, we may witness Basel I and non-Basel II entities operating simultaneously. This would not only ensure greater outreach of banking business, but also, in the present scenario of high growth, enable them to usefully lend to the disadvantageous sections and successfully pierce the informal credit segment.

The eighth issue of relevance is that of financial inclusion. While resource limitations experienced by low-income households will continue to constrain their access and use of financial products, the challenge remains for developing appropriate policies, procedures and products that can overcome this difficulty within the bounds of resource constraints. Apart from greater latitude in the range of identity documents that are acceptable to open an account, there is also a need for independent information and advisory service. This needs to be supplemented by nurturing appropriate public-private partnerships. Some development to this effect is already evidenced in the significant growth and development of micro-finance activities. Selfhelp groups formed by non-government organisations and financed by banks represents an important constituent of this development process in India.

As part of its ongoing efforts to encourage greater financial inclusion, the Annual Policy Statement released in April 2006, gives particular attention to issues relating to farmers. A beginning has already been made to ensure greater outreach of banking facilities in rural areas through appointment of reputed non-governmental organisations (NGOs) / post offices, etc., as banking facilitators and banking correspondents. A Working Group has also been proposed to ensure greater outreach of banking facilities in rural areas and to ensure availability of bank finance at reasonable rates. A Working Group has also been proposed to suggest measures for assisting distressed farmers, including provision of financial counseling services and introduction of a specific Credit Guarantee Scheme under the Deposit Insurance and Credit Guarantee Corporation (DICGC) Act. The conveners of the State Level Bankers Committee in all States/Union Territories have been advised to identify at least one district in their area for achieving 100 per cent financial inclusion by providing a 'no-frills' account and a general purpose credit card (GCC). A Technical Group has also been proposed to renew the existing legislative framework governing money lending and its enforcement machinery so as to provide for greater credit penetration by the financial sector in the rural areas at reasonable rates of interest.

The final area that has gained prominence in the recent past relates to customer service. The focus of attention is on basic banking services provided to the common persons and the need for ensuring effective customer grievance redressal as also fair practice code. A Banking Ombudsman facility has been established covering all States and Union Territories for redressal of grievances against deficient banking services. The recently constituted Banking Codes and Standards Board of India is an important step in this regard which is expected to ensure that the banks formulate and adhere to their own comprehensive code of conduct for fair treatment of customers. Additionally, constitution of a Working Group has been proposed in the latest policy to formulate a scheme for ensuring reasonableness of charges offered by banks on its various services.

It is widely acknowledged that India is the repository of the best of human skills, especially in the financial sector. The technological competence of the Indian workforce is perhaps presently part of folklore. The present levels of growth optimism about the economy suggest that India is expected to remain one of the important growth drivers of the global economy in the near future. The financial infrastructure and regulatory framework in the country are broadly on par with those prevailing internationally. We are working towards evolving a globally competitive banking sector, stressing on banking services relevant to our socio-economic conditions and contributing to both growth and stability.

C. Pakistan

Muhammad Arshad Khan and Sajawal Khan, 2007

In Pakistan, the banking sector reforms were launched in the early 1990s.The objective of these reforms were to make the financial industry more competitive and transparent by privatizing formerly nationalized commercial banks, liberalizing interest rates and credit ceilings, strengthening the supervisory capacity of central bank and standardized accounting and auditing systems (Iimi,2004).

Prior to the 1990s, the financial sector in Pakistan remained heavily controlled. Interest rates were set administratively and were usually remained negative in real terms. Monetary policy was conducted primarily through direct allocation of credit. Money market was under-developed, and bond and equity markets were virtually nonexistent. Commercial banks often had to lend priority sectors with little concern for the borrowing firm's profitability. Despite the opening of non-bank financial sector for private investment in mid-1980s, state owned financial institutions hold almost 93.8 percent of the total assets of the entire financial sector at the end of 1980s. Moreover, the status of financial institutions were precarious due to, inter alia, high intermediation costs resulting from overstaffing, large number of loss-incurring branches, poor governance with low quality banking services, accumulation of non-performing loans and inadequate market capitalization. These inefficiencies and distortions caused severe macroeconomic difficulties in the late 1970s and 1980s and distorted economic growth. In order to remove these distortions and spur economic growth, the government of Pakistan undertook a wide range of reforms in the early 1990s to strengthen its financial system and to provide an adequate macroeconomic environment.

The financial sector reforms includes: (i) liberalization of interest rates by switching from an administrated interest rate setting to a market based interest rate determination; (ii) reduction of controls on credit by gradually eliminating directed and subsidized credit schemes, (iii) creation and encourage of the development of secondary market for government securities, (iv) strengthen the health and competition of the banking system by recapitalizing and restructuring the nationalized commercial banks (NCBs) increasing their autonomy and accountability, (v) improving the prudential regulations and supervision of all financial institutions, and (vi) allowing free entry of private banks in the financial market.

The financial sector reforms which were launched in the early 1990s can be classified into three phases. These three phases of financial sector reforms can be termed as first generation of reforms. All commercial banks were nationalized in January, 1974, with the aim at making credit availability to highly priority sectors of the economy which previously had limited access to investable funds (see Haque and Kardar, 1993 for detailed account).

First Phase of Financial Reforms (1988 -1996)

The first phase reforms aimed at creating efficient, productive, and enabling environment of operational flexibility and functional autonomy. The first phase of financial reforms includes: first, the government liberalizes the market entry of private and foreign banks in order to gain efficiency and enhance competition within the financial sector. Secondly, two of the state-owned commercial banks, i.e. Muslim Commercial Bank (MCB) and Allied Bank Limited (ABL), were partially privatized between 1991 and 1993. Thirdly, major state-owned commercial banks and DFIs were downsized in terms of branches and employees. Fourthly, credit ceiling as an instrument of credit control was abolished, credit-deposit ratio (CDR) was also abolished and open market operation is now instrument of monetary policy and SBP at regular intervals conducted auctions of government securities. Fifthly, loan recovery process was strengthened by establishing banking courts and standardizing loan classification and accounting rules. Finally, State Bank of Pakistan (SBP) was granted full autonomy. However, the financial markets segmentation continued owning continuing controls on interest rates on government debts and to specialized credit programmes. Second Phase of Financial Reforms (1997-2001)

In late 1996 the financial sector was on the verge of collapse with about one-third of the banking assets stuck up in the form of defaults and NPLs. Liquidity problems had begun to emerge as disintermediation spread and banking losses increased. Most cases of loan defaults remained unresolved because of the ineffective judiciary system. These problems rooted in a failure of governance and lack of financial discipline. Political interference had vitiated the financial intermediation function of the banking system and the borrowers expected not to repay loans they took, especially from NCBs and development finance institutions (DFIs). NCBs and DFIs were the main loss makers because of over 90% of their loans are defaulted. Excess manpower, large branch network and undue interference by labour unions resulted large operating losses. Poor disclosure standards and corruption was widespread. These serious problems created a demand for further reforms. As a result, the second phase of banking sector reforms was introduced in the early 1997. These reforms addressed the fundamental causes of crisis and corruption and strengthen the corporate governance and financial discipline. In this regard, the cost structure of banks was firstly restructured through capital maintenance and increased by public funds. The early phase of financial reforms as a part of financial restructuring policies started in the late 1980s to earlier 1990s. 10 new private banks started their operations in 1991 and 23 private domestic banks operating in the country including HBL, ABL, MCB and UBL. The process of liberalization started in the early 1990s and except NBP more than 50 percent shares of the public sector have been privatized. There are about 14 foreign banks have been operating in the country. The second phase of banking sector reforms started from 1997 to 2001.

Secondly, partially privatized commercial banks were privatized completely. Third, bank branches were fully liberalized and allow private banks to grow faster and increase their market share. Fourthly, loan collateral foreclosure was facilitated and strengthened to reduce default costs and to expand lending to lower tier markets, including consumer banking. Fifthly, national savings schemes were reformed so as to integrate with the financial market. Sixthly, mandatory placement of foreign currency deposits was withdrawn. Lastly, Strengthened SBP to play more effective role as regulator and guardian of the banking sector and phase out the direct and concessional credit programmes to promote market integration.

Third Phase of Financial Sector Reforms (2002-2004)

In this phase several major changes and significant positive shifts in the regulatory atmosphere to strengthen the financial system and introducing structural improvements. Some of the more important developments have been seen in the following areas: Consolidation, Privatization and Regulations: During the 1990s, mushroom growths in commercial banks and non-bank financial institutions have been seen and a few of which has low capitalization, inadequate/inappropriate staffing, poor risk management practices and a marginal portfolio quality. The central bank sought out to consolidate the banking sector by raising the minimum capital requirement. The minimum capital requirement was 1 billion for 2003, 1.5 billion for 2004 and is set at 2 billion for 2005. There have been 17 mergers and acquisitions and several in the pipeline. Weak entities have been eliminated. The average capital base of a commercial bank has risen from 1.8 billion for 2000 to 3.7 billion for 2003. Now all banks are required to maintain at least 8% of the risk weighted assets as capital requirement. The regulatory oversight for a sizeable chink of the financial system (such as leasing companies, modarabas, investment banks, mutual funds and insurance companies) has been moved to the Securities and Exchange Commission (SECP), but SECP failed to build capacity in order to handle this inflows. The SECP lacks on-site inspection capability.

Universal and Consumers Banking: Banks are allowed to form separate subsidiaries to function as mutual funds, asset management companies, venture capital, foreign exchange companies, etc. Furthermore, banks are encouraged to expand their lending operations to middle and lower income groups. A large range of consumer asset products such as credit cards, auto loans, clean installment loans, housing finance, etc., is being marketed aggressively. The NPLs in this sector is significantly lower than that of corporate sector. Similarly, SME financing has also become part of the lending toolkit. However, several banks are away from this sector because of high-risk perception.

Automation and Prudential Regulations: ATM coverage is relatively low and online banking offered by most of the banks. Central bank itself is making a significant progress in this area. Credit information date and credit rating agencies data is now available on line. Similarly, central bank has been steadily moving away from its tradition of intrusive regulation and directed lending. Unlike late 1980s, much more permissive regulatory atmosphere prevails today. The central bank also modernized and revised prudential regulations for corporate and commercial banking, SME financing, Microfinance institutions and consumer financing.

Banking Audit, Supervision and Corporate Governance: SBP's compliance with Basle Core Principles is generally high. SBP now conduct comprehensive on-site inspections using a standardized CAMELSS for rating the overall condition of a bank. SBP also developing an early warning system called IRAF. For the corporate governance, both SBP and SECP issued codes of corporate governance. Corporate disclosure standards have improved. However, there is a need to reform the taxation structure and the tax collecting institutions.

Out-of-Court Settlement of NPLs: Two third of the stock of NPL involves a single lender. Recovery of NPLs involves internal and external hurdles. The pressure from influential borrowers often exerted through government, and intrusive regulatory environment. To reduce the level of NPLs, the government and SBP, established the committee for revival of sick industrial units (CRSIU) and corporate and industrial restructuring corporation (CIRC). The committee claims that it has revived 172 industrial units involving an outstanding NPLs of Rs. 46 billion. However, World Bank concluded regarding the assessment of CIRSU that "in the absence of operational analysis, there would generally appear little increment in the value of the project. Future viability and renewed distress of these projects are of concern. No track is kept of financial or operational details of the projects after revival". In 2002 because of growing NPLs and the failure of CIRC, national accountability bureau (NAB) and CIRSU, the SBP issued guidelines whereby banks are actively encouraged to settle NPLs with borrowers at the fore sale value (FSV) of the underlying collateral. Under this scheme, borrowers were required to deposit 10% down payment at the time of signing the settlement agreement and repay remaining amount in 12 quarterly installments. This scheme encourages a lot of defaulters to come forward and settle their longstanding liabilities. Similarly, under the debt recovery programme, EDR (Excess Debt Recovery) had write-off efficiency ratio of 5:1(i.e. for each of provisions written off it would generate a cash recovery of Rs. 5). Under these guidelines Rs. 52 billion of NPL has been settled at the cost of around Rs. 35 billions.

Results of the Financial Restructuring

The objectives of financial restructuring policies were to forestall a generalized banking system collapse and to establish a viable banking system in the country. It was expected that financial and operational restructuring policies strengthened the microeconomic foundations of the banking system. However, commercial banks have been slow to mobilize deposits, which play a significant role in financial intermediation. As Akhtar (2007) pointed out that the successful transformation and restructuring of the financial industry depends on some critical factors such as: (i) promoting higher degree of depth and efficiency in financial intermediation process by effective resource mobilization and channeling these resources to promote economic growth, (ii) improving the financial performance and strengthening soundness of financial institutions, and (iii) extending the outreach of financial services to poor segment of the society.

Results Accomplished: (Ishrat Husain)

(a) Financial markets in Pakistan have been liberalized and have become competitive and relatively efficient but still remain shallow.

(b) The array of financial instruments available for various types of transactions in the market has widened but the evolution of new instruments has to remain on track.
(c) Financial infrastructure has been strengthened but the legal system is still too time consuming and costly for the ordinary market participants.

(d) Regulatory environment has improved and the capacity of regulators to oversee and monitor is much better today but the enforcement and prompt corrective action capabilities need to be further enhanced.

(e) Financial soundness indicators of the system show an upward moving trend in almost all dimensions but there are weaknesses and vulnerabilities that require to be fixed.

(f) Corporate governance rules have been clarified and conform to best international practices but their consistent application and voluntary adoption by the industry remain uneven.

(g) Financial sector is opening up to the middle and lower income groups but the commitment and mindset of the providers are still out of sync with the new realities.

D. Sri Lanka

Financial Sector Assessment ADB (2005)

The key element of a financial sector strategy for Sri Lanka is continuation of the broad reform measures initiated in the 1990s. The key elements of financial sector reform strategy are:

a. Complete the financial sector legal reforms, including a new banking act, central bank act and anti-money laundering statute.

b. Reform of the state-owned financial institutions, addressing not only asset quality and capital issues, but modernization so that Sri Lankans will be able to take full advantage of electronic payments, ATMs, credit and debit cards.

c. Stringent enforcement of prudential standards for both public and private sector banks to avoid the market distortions, higher costs for consumers and extraordinary profits for well-run banks arising from the lack of competitiveness of weak banks.

d. Address weaknesses in the infrastructure for financial services, including introduction of modern insolvency provisions through revision of the companies act.

The thrust of these reforms has been to reduce the direct participation of government in the financial sector concurrently with establishment of the necessary legal framework and government infrastructure for a sound and competitive financial system. Much has been accomplished, but there is a significant unfinished agenda.

There is uncertainty over the financial sector policy direction following the April 2004 elections. In contrast to the detailed financial sector matrix included in Regaining Sri Lanka, the current government's policy statement contains few specific objectives or commitments regarding the financial sector.

This policy vacuum poses the risk of a loss of momentum, but also provides an opportunity to help shape the policy direction of the government. The Financial Sector Reforms Committee, which had overseen a wide range of reform measures, has effectively been wound up. The Financial Cluster of the newly created National Committee for Economic Development will now address issues of financial sector policy.

There is an opportunity for the international community to assist the work of the Financial Cluster in providing recommendations, but perhaps more importantly by providing technical support. It is not yet clear how the work of the Financial Cluster will be advanced, as to date a secretariat has not been established, and government has indicated that the necessary technical support for the Financial Cluster is expected to be provided by the CBSL and Ministry of Finance. Both these organizations are resource constrained, as the staff with the capacity to support policy initiatives of the Financial Cluster is already over-committed.

The work of the Financial Cluster to date has focused on putting forward initiatives that had been brought to the point of introduction under the previous regime. Provided that the government continues with its practice of quietly endorsing the financial sector initiatives of the previous administration (except for those where it has explicitly charted a new course, such as abandoning the privatization of People's Bank) there will be a need for technical assistance in a range of areas. The work of the Financial Cluster could be advanced through the provision resources to permit quick access to consultants to provide assistance in areas specifically defined through terms of reference developed by the Financial Cluster. This would ensure that the resources were targeted to the projects and policies identified by the Cluster for priority attention.

Elements of a recommended financial sector reform strategy are discussed below under the broad headings of: legal reform; institutional strengthening; enhancing the infrastructure of financial and market intermediation; and reform of state-owned banks. Timing and sequencing cut across these headings. The first priority is government commitment to a financial sector strategy. In the near term, there is need for commitment to a clear way forward for People's Bank and the introduction of revised financial sector statutes. Medium-term priorities should be reforms of the state-owned banks and introduction of modern insolvency provisions. As an ongoing part of the reform process, there will be a need for continuing training and development of the supervision staff of the CBSL and other agencies. Even more importantly will be the ongoing need for stringent application of prudential standards, ensuring that weak institutions are either reformed or exit the market.

A. Legal Reform

Work on many of the needed new or revised laws has begun, and in many cases is well advanced. These laws are needed both to address relatively narrow legal issues, and more broadly to provide a better foundation for competition in the financial sector. Nevertheless, these laws are likely to have difficulty getting priority on the parliamentary agenda as there are few votes to be won through the passage of the legislative foundation for an efficient and competitive financial sector. The laws in some cases require difficult or unpopular decisions, and in all cases the payback will only become evident over an extended period of time.

In the near term, the focus on legal reform should be to introduce three key laws which have already received substantial attention: the new banking law, the new central bank law, and an anti-money laundering statute. In the medium and longer term, modern insolvency provisions need to be introduced into the companies act.

Government has opted not to pursue the elimination of the legal distinctions between the various commercial banks and licensed specialized banks. Rather than introduce a single banking license in the new banking act, and continuation under the banking act of institutions currently incorporated under their own statute, the draft currently under discussion would seek to achieve greater consistency between the legal framework for commercial banks and licensed specialized banks while preserving the distinction between them. This approach does not provide the full benefits available from moving to a single license and single legislative authority for all institutions licensed as banks. The most important is facilitating competition in the market.

NSB, DFCC and NDB have all moved in varying degrees away from their original narrow mandates. Completing this transition by allowed broader freedom to undertake all activities permitted for licensed commercial banks could introduce vigorous and innovative competitors in the commercial banking market. DFCC and NDB have already displayed resourcefulness in indirectly entering the commercial banking market through the acquisition of small banks. This innovativeness would be better employed in directly serving customers rather than finding creative ways to circumvent the restrictions in their enabling legislation.

Moving to a single banking license is not without risks. The internal systems and controls and acquisition of the necessary skills for commercial lending will require significant investment by the specialised banks, particularly NSB. If the needed capacity for risk management is not built prior to entering the commercial lending market, ensuing loan losses could be disastrous. For this reason, supervisory restrictions, such as near term limits on growth of commercial credit for newly licensed commercial banks, or licenses with additional business powers conditional upon meeting supervisory norms for risk management, should be used to mitigate the potential for serious credit and operational risk losses as specialised banks enter new markets.

In addition to enhancing competition, moving to a single banking act and single license will greatly facilitate future revisions of the legal framework. Currently, changes to the banking act may have to be mirrored in the enabling legislation of the state-owned banks and licensed specialized banks. In the past, such changes have not always been wholly consistent across all the legislation. A single act will also facilitate supervision by removing any possible doubt that institutions incorporated under their own statute are fully subject to the remedial provisions of the banking act, including intervention.

Creation of the FSA has been mooted as a means of strengthening the supervision of non-bank financial institutions and facilitating the development of effective consolidated supervision of financial groups. Since these objectives are important to create a modern prudential framework, government needs to either fully commit to the near term creation of the FSA, or alternatively, ensure that the supervision functions are strengthened within their current institutional structure. In either case, the FSA or the existing agencies will have to coordinate with the CBSL in consolidated supervision.

Work is well advanced on the draft central bank law to replace the monetary authority act. Introduction of a new act will complete the legal transformation of the CBSL into a modern central bank by more clearly establishing its independence and accountability for monetary policy, banking supervision, and oversight of the payments system. Amendments to the existing law have been used to remedy some of the major deficiencies, but clarifying the objectives and establishing the independence of the central bank is best achieved through new legislation.

Introduction of an anti-money laundering statute will soon become a priority in order to preserve donor support for Sri Lanka. Avoidance of Financial Action Task Force blacklisting will soon no longer be sufficient, as the international community increasingly expects countries to have modern anti-money laundering legislation and the required implementing infrastructure. Sri Lanka should be proactive, especially since technical assistance in preparing the law has already been provided, rather than waiting until the absence of anti-money laundering provisions become contentious in bilateral and multi-lateral relations.

B. Institutional Strengthening

Reform and reorganization of the CBSL pursuant to the central bank strengthening project is nearing completion. While further progress is required on many fronts, significant strides have been made in bank supervision, as least in as far as capacity to monitor performance through off-site analysis and verify supervisory information through on-site work.Further training and development will be required on an ongoing basis, but the biggest future challenge will be taking timely and decisive action to deal with identified problem institutions.

The cultural and institutional preference for forbearance and rescue operations is likely to continue. This is a legitimate policy option; however, the decision should be consciously taken in the full knowledge that there are costs to the financial sector and economy more generally from opting not to require inefficient institutions to exit the market. Rescues drag down the stronger institutions providing support and divert resources from use by more productive banks. The predisposition to forbearance also undermines supervisory authority, as there is a wide-spread perception in the banking community that there are few consequences for violation of prudential norms.

Within the CBSL there is a need for further capacity building for the oversight of non-bank institutions. To date, bank supervision has received a higher priority. However, many of the nonbanks accept deposits from the public, and thus the standard of prudential oversight needs to be brought up to the same level as is exercised over the banks.

A further issue requiring high priority attention is the development of approaches for consolidated supervision. While the need has been recognized due to the prevalence of complex corporate groups and bank involvement in most financial services activities through subsidiaries or affiliates, little progress has been made to date. The CBSL has received technical assistance on approaches for bank-led conglomerate groups, but some of the basic requirements for effective consolidated supervision are not yet in place. As an initial minimum step, there needs to be a memorandum of understanding among the domestic supervisory authorities (CBSL, IBSL and SEC) to permit information sharing and coordination in the oversight of conglomerate groups.

Determining the best approach for further substantive progress in consolidated supervision may be contingent on decisions regarding the establishment of the proposed FSA. If the FSA is to be established in the near term, it may make sense for further work on consolidated supervision to be phased to coincide with the workplan of the new agency. If there is to be any delay in the introduction of the FSA, then approaches to consolidated supervision need to be developed by the CBSL in conjunction with the IBSL and SEC.

C. Infrastructure for Financial and Market Intermediation

Important steps have been taken to introduce greater disclosure and enhance market discipline of financial institutions; however, these will have limited effect so long as there is widespread regulatory forbearance and orchestrated rescues. Banks are required to publish quarterly summary financial statements and their rates and charges, which helps consumers to make informed choices. The CBSL should further enhance disclosure by publishing financial statement information on individual banks. This information already is published quarterly by the banks, but the CBSL should make it readily available through its website and/or in published reports.

Banks were required by the CBSL to obtain a rating by end-June 2004, however, not all banks have done so. Not only does this defeat the objective of having ratings on all banks available to the public, it again reinforces the perception that there are few consequences for failure to meet the CBSL standards.

The initiatives already underway to strengthen governance should be continued. The CBSL governance code for banks is generally appropriate, but it is not yet clear that directors view themselves as sufficiently independent of management, or have the means to independently review and verify management information. It will take time for the culture of stewardship to permeate Sri Lanka boards of directors. For financial institutions, this can be fostered by holding directors accountable for institutional adherence to CBSL norms. For example, consideration should be given to legal action against the directors of Pramuka Bank for breach of fiduciary duty to depositors. Less dramatically, the CBSL should hold boards accountable for plans to address deficiencies identified in on-site examinations.

The long term cadastral survey and land registry reform project will address some of the concerns with the process for registering and enforcing security interests. In the medium term, it would be beneficial to establish a single central registry for moveable property, and to automate the land and moveable property registry offices.

Specific tax measures affecting the financial sector need to be reviewed in the broader context of fiscal reform. The debit tax generates small amounts of revenue for government, is expensive to administer, and despite exemptions which should exclude most individual accountholders, may create the impression that government discourages the use of non-cash means of payment. Application of the VAT to banks, while understandable from the perspective of generating consistent revenues for government, is prudentially unsound, increases the costs of intermediation, and may particularly discourage foreign banks. It is often necessary to balance conflicting policy objectives, but taxes related to income are preferable from the perspective of financial sector soundness and development.

The major strides made in providing a modern payment and settlement system, including an RTGS, will not yield anything like their full benefits until the participating financial institutions upgrade their own infrastructure. Speed and certainty are lost, and efficiency gains are unrealized because electronic payment instructions have to be delivered by fax or messenger to the many un-computerized and un-networked locations of People's' Bank, Bank of Ceylon and National Savings Bank. Financing the necessary investment in modernizing these state-owned institutions may be a challenge, but without the investment, there is little hope of gaining the coast and efficiency advantages for Sri Lankan consumers and businesses from moving away from the predominance of cash transactions.

D. Reform of State-Owned Banks

The one clear financial sector policy commitment made by the new government is that privatization of state-owned banks is off the agenda. However, this clear statement creates a large unanswered question about the future direction of People's Bank. While less obvious because of its relatively better financial condition, Bank of Ceylon is in desperate need of investment in upgrading systems and skills. Clarity is also required regarding the future of National Savings Bank, which could continue as a narrow bank, or might possibly be developed into a broader competitive force.

Despite progress made under interim management, People's Bank is still burdened with high volumes of non-performing loans, high costs, overstaffing and inadequate systems. The road to privatization would have addressed these issues, with new private owners expected to make the much needed investment in systems and provide the longer term strategy direction and management of the bank.

Without privatization, government must provide these key elements of the reform strategy. It remains to be seen if the recently submitted restructuring plan, planned NRs.1 billion expenditure to computerize 60 branches, and three tranche recapitalization plan are sufficient. Spreads in the banking industry are unlikely to narrow so long as one of the market share leaders requires enormous spreads to cover its inefficiency and loan losses as well as accumulating capital to earn its way out of deficit over many years. Thus, failure to effectively implement the turnaround plan means that the rest of the economy will bear the indirect costs of an inefficient and undercapitalized banks for many years.

While Bank of Ceylon is not without its problems, its reported financial condition is much superior to People's' Bank. One of the challenges is that needed computerization requires a significant capital investment. Due to the necessity to rely on internally generated capital, this programme will be phased in over a number of years. Another challenge is dealing with staffing issues, reducing headcount while improving the skills and capacity.

Government has indicated that the state-owned banks, in common with other large state owned enterprises, are expected to achieve results comparable to commercial entities. Creation of SEMA may provide a vehicle to insulate the banks from direct political influence, but there will still be difficulties reconciling the conflicts between commercial mandates and government policy objectives. Further, there has been insufficient guidance provided to the SEMA members, and in turn to the boards and management of the state-owned enterprises, regarding government's expectations.

While each state-owned enterprise is developing its strategic and business plan, there is no certainty that these will be consistent with government policy objectives. Thus, the resulting plans, at least for the state-owned banks, are broadly in line with the current institutional direction, lacking a clearly defined vision or objectives. Proposed reforms are of an evolutionary nature, lacking decisive attempts to deal with overstaffing and inefficient operations in the absence of an indication that government is prepared to support such politically unpopular measures.

Successful reform of the state-owned banks requires, among other things, successful reform of other state-owned enterprises. In particular, Ceylon Petroleum Corporation and the Ceylon Electricity Board will have to operate within hard budget constraints. Currently, shortfalls in the state-owned enterprises are financed through draw-downs of credit from the state-owned banks. This mechanism has been used to shield consumers, at least temporarily, from the costs of increasing oil prices by maintaining fixed prices for petroleum products and electricity. With the petroleum corporation and electricity board having to pay rising oils prices while maintaining fixed retail prices, losses are inevitably incurred, and financed through the state-owned banks. This permits government to mitigate voter unrest over increasing prices, however, if People's Bank and Bank of Ceylon are to operate with a commercial mandate, government will have to stop using these banks to finance subsidized oil and electricity.

National Savings Bank, the state-owned narrow bank, also requires modernizing, and equally importantly a decision on its future role. Management of NSB has considered a range of new business options, most of which involve developing new investment activities and decreasing the portion of funds held in government securities. These initiatives could develop NSB into a much greater competitive force in financial services, but such a strategy brings its own risks. NSB's efficiency and profitability relative to other Sri Lankan institutions derives primarily from its narrow focus. Should NSB be given a broader mandate, it will be important to invest in management, staff and systems upgrades to ensure that the ability to manage risk increases commensurately with the additional risk arising from new activities.

APPENDIX H: Persons Met

Nepal Rastra Bank

1. Mr. Krishna B Manandhar, Deputy Governor
2. Mr. Surendra M Pradhan, Banking Inspection & Supervision Department

Nepal Bank Limited

1. Mr. Craig McAllister, CEO, Central Office
2. Mr. Bimal K Timilsena, Central Office
3. Mr. Keshav P Pathik, Kathmandu Main Branch
4. Mr. Madhav H Mool, Kathmandu Main Branch
5. Mr. Bhanu B Joshi, Kathmandu Main Branch
6. Mr. Kul R Chalise, Kathmandu Main Branch
7. Mr. Shyam Sundar Kandel, Chabahil Branch
8. Mr. Suresh Siwakoti, Chabahil Branch
9. Mr. Suvash C. Poudyal, Hetaunda Branch
10. Mr. Prakash C. Adhikari, Hetaunda Branch
11. Mr. Kaji Bd. Khatri, Banepa Branch
12. Mr. Shanta K Shrestha, Banepa Branch

Rastriya Banijya Bank

1. Mr. Janardan Acharya, Central Office
2. Mr. Ashish Garg, Central Office
3. Mr. Sanjeev Shakya, Central Office
4. Mr. Bhesh R. Panthi, Bishal Bazaar, Main Branch
5. Mr. Amarendra Dev, Bhaktapur Branch
6. Mr. Ramesh Thakuri, Bhaktapur Branch
7. Mr. Manoj Kumar Barma, Birgunj Branch
8. Mr. Purushottam Aryal, Dhading Branch
9. Mr. Bhumi Kandel, Dhading Branch

Nepal Bankers' Association (NBA): Thursday, May 24 2007

1. Mr. Radhesh Pant, President, Executive Committee
   (Managing Director, Bank of Kathmandu Ltd.)
2. Mr. Sashin Joshi, Vice-President, Executive Committee (CEO, NIC Bank Ltd.)
3. Mr. Anil K. Shah, Member, Executive Committee (CEO, NABIL Bank Ltd.)
4. Mr. Ashoke Sumsher J. B. Rana, Member, Executive Committee (CEO, Himalayan Bank Ltd.)
5. Mr. Prithu N. Rana, Alternate Member, Executive Committee

(Managing Director, Nepal Development Bank Ltd.)

6. Mr. Anurag Mishra, Alternate Member, Executive Committee
   (Head-Client Relationships, Standard Chartered Bank Nepal Ltd.)
7. Mr. Basu Deb Ram Joshi, Advisor, Executive Committee (CEO, Nepal Bangladesh Bank Ltd.)
8. Mr. Amit Koirala, Observer, Executive Committee
   (Resident Representative, American Express Bank, Rep. Office)
9. Mr. Bhuvan Dahal, Head-Finance & Planning, Nabil Bank Ltd.
10. Mr. Sunder Kandel, Sr. Manager - Operation, Siddhartha Bank Ltd.

Business Sector - Bank Customers

1. Mr. Purna Ratna Shakya, Lalitpur
2. Mr. Narayan Bir Joshi, Exhibition Road, Kathmandu
3. Mr. Narayan Prasad Siwakoti, Chabahil, Kathmandu
4. Mr. Surendra Shrestha, Indra Chok, Kathmandu
5. Mr. Padma Siwakoti, Ranjana Gually, Kathmandu
6. Mr. Sanjeev Ratna Tuladhar, Chaksibari Marg, Kathmandu
7. Mr. Naba Raj Timilsina, Chabahil, Kathmandu
8. Mr. Yug Ratna Tuladhar, Bagbazzar, Kathmandu
9. Mr. Rudra Nepal, Chabahil, Kathmandu
10. Mr. Raju Shrestha, Chabahil, Kathmandu
11. Mr. Shri Krishna Shrestha, Chabahil, Kathmandu
12. Mr. Nabin Acharya, Chabahil, Kathmandu
13. Mr. Dayanidhi Sapkota, Chabahil, Kathmandu
14. Mr. Rabindra Gurung, Jorpati, Kathmandu
15. Mr. Maheshwor Shrestha, Chabahil, Kathmandu
16. Mr. Rameshwor Choulagain, Dakchhindhoka, Kathmandu
17. Mr. Rajesh Shrestha, DurbarMarg, Kathmandu
18. Mr. Arun Kumar Singh, Otu, Kathmandu
19. Mr. Bhola Raj Pandey, Pako, Kathmandu
20. Mr. Anand Pd. Shrestha, Guchchatole, Kathmandu
21. Mr. Raju Siwakoti, Putalisadak, Kathmandu
22. Mr. Pusparaj Rana, Kamalpokhari, Kathmandu
23. Mr. Joshi, Dallu Awas, Kathmandu
24. Mr. Ram Shrestha, Nardevi, Kathmandu
25. Mr. Bishnu Prashad Neupane, Bhaktapur
26. Mr. Rabi Prajapati, Hanumante, Bhaktapur
27. Mrs. Roshani Maiya Dhaubanjar, Suryabinayak, Bhaktapur
28. Mr. Buddha Lal Kuru, Koshaltar, Bhaktapur

29. Mrs. Sharada Niraula, Dhunchapakha, Bhaktapur
30. Mr. B. Parajuli, Koshaltar, Bhaktapur
31. Mr. Jhari Lal Khanga, Suryabinayak, Bhaktapur
32. Mr. Romance, Koshaltar, Bhaktapur
33. Mr. Puspa Kaji Shrestha, Basuchok, Banepa
34. Mr. Gopal Bhakta Shrestha, Buspark, Banepa
35. Mr. Kanchha Kumar Shrestha, Hospital Road, Banepa
36. Mr. Hiramani Sharma Nepal, Banepa
37. Mr. Dinesh Kaji Pradhan, Buspark, Banepa
38. Mr. Muneswor Kayastha, Banepa
39. Mr. Satyajeet Bhail, Hospital Road, Banepa
40. Mr. Rudra Lal Shrestha, Nala, Banepa
41. Mr. Bimal Agrawal, Mainroad, Birgunj
42. Mr. Rebati Pd. Sonar, Hospital Road, Birgunj
43. Mr. Sushil Mittal, Birgunj
44. Mr. Murali Manohar Pendey, Birgunj
45. Mr. Hari Narayan Pd. Gupta, Gita Mandir Road, Birgunj
46. Mr. Raju Shrestha, Birta Bazzar, Birgunj
47. Mr. Ajaya Agrawal, Adarshanagar, Birgunj
48. Mr. Mahendra Bd Amatya, Om Asram, Birgunj
49. Mr. Vishnu Shrestha, Simachok, Hetaunda
50. Mr. Dhruwa Karki, Hetaunda
51. Mr. Deepak Rijal, Simachok, Hetaunda
52. Mr. Jnyan Krishna Prajapati, Hetaunda
53. Mr. Govinda Shaha, Ratamate, Hetaunda
54. Mr. Suresh Shrestha, TCN Road, Hetaunda
55. Mr. Khadka Bd. Gopali, Hetaunda
56. Mr. Badri Shankar Shrestha, Hetaunda
57. Mr. Ganesh Kumar Shrestha, Puchhar bazzar, Dhading
58. Mr. Bhimsen Kumar Shrestha, Shir bazzar, Dhading
59. Mr. Narayan Kumar Shrestha, Bich bazzar, Dhading
60. Mr. Thaneswor Rijal, Bich bazzar, Dhading
61. Mr. Dhruwa Rijal, Bich bazzar, Dhading
62. Mr. Tanka Kumar Shrestha, Puchhar bazzar, Dhading
63. Mr. Indra Bd. Shrestha, Bich bazzar, Dhading
64. Mr. Hari Bd. Shrestha, Puchhar bazzar, Dhading

Business Sector- FNCCI/General

1. Mr. Diwakar Golchha, 1st Vice President, FNCCI

2. Mr. Kush K Joshi, 2nd Vice President, FNCCI
3. Mr. Narendra Basnet, CNI
4. Mr. Rajendra Kabra, Industrialist
5. Mr. Rajendra Kabra, Industrialist
6. Mr. Govinda D Pandey, Sr. Consultant, FNCCI