BANKING POLICIES

In the present context of the development and expansion of financial sector together with open and liberal economic policy, directed credit programme has become a matter of controversy. Hence, in order to create a professional environment for commercial banks, and in the context where adoption of indirect instruments are becoming more effective than the direct ones in the monetary management, following withdrawal schedule has been worked out for 2002/03 and eliminate priority sector lending by 2007/08.

Credit flow to Priority Sector						
Fiscal Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Portion of the total outstanding credit in %	7	6	4	2	2	Not Compulsory

Commercial Banks

Policy Guidelines on the Establishment of Commercial Banks

Receiving applications for the establishment of commercial banks has been stopped since 1995. Visualizing that such an administrative restriction is not in conformity with the liberal financial policy, the following new policy guidelines have been made public on 16 May 2003:

(a) Paid up Capital: To establish a commercial bank of national level having its office in Katmandu, joint investment with foreign bank and financial institution or a management contract (TSA) at least for 3 years with such institutions is required. The paid up capital of such bank must be at Rs.1000 million.

To establish the commercial banks in all the places in the Kingdom other than in the Kathmandu Valley, the paid up capital must be Rs. 250 million.

(b) Share Capital: In general, the share of commercial banks will be available for the promoters (70 percent) and general public (30 percent). The foreign banks and financial institution could have a maximum of 67 percent share investment on the Commercial banks of national level. In order to provide adequate opportunity for investment to the Nepali promoters in national level banks, only 20 percent of total share capital will be made available to general public on the condition that the foreign bank and financial institutions are going to acquire 50 percent of the total share. In the case of commercial banks to be established outside Kathmandu Valley, share investment of promoters and general public should stand at 70 percent and 30 percent, respectively.

(c) **Banks already in operation:** Banks that is already in operation and those who have already acquired letter of intent before the enforcement of these provisions have to bring their capital level within seven years, i.e. by 16 July 2009, as per the recently declared provision. Such increase in the capital should be at a rate of 10 percent per annum at the minimum.

(d) **Legal procedures:** Banks to be established with foreign promoters' participation have also to be registered fulfilling all the legal processes prescribed by the prevalent Nepal laws.

(e) **Concerning upgradation:** Banks to be established outside Kathmandu Valley could be allowed to operate throughout the Kingdom including Kathmandu Valley only on the condition that they have operated satisfactorily at least for a period of three years and they have brought their paid up capital level to Rs. 1000 million and also fulfilled other prescribed conditions. Until and unless such banks do not get license to operate throughout the Kingdom, they will not be allowed to open any office in Kathmandu Valley.

(f) **Promoters' share payment procedures:** Of the total committed share capital, the promoters has to deposit in NRB an amount equal to 20percent along with the application and another 30 percent at the time of receiving the letter of intent on a interest free basis. The bank should put into operation within one year of receiving the letter of intent. The promoters have to pay fully the remaining balance of committed total share capital before the bank comes into operation. Normally, within 4 months from the date of filing of the application, NRB should give its decision on the establishment of the bank whether it is in favor or against it. If it declines to issue license, it has to inform in writing with reasons to the concerned body.

(g) **Promoters' qualification and experience:** Action on the application from promoters will not be initiated if it is proved that their collateral has been put on auction by the bank and financial institution as a result of non-payment of loans in the past, who have not cleared such loans or those in the black list of the Credit Information Bureau and 5 years have not elapsed from the date of the removal of their name from such list. The application will be deemed automatically cancelled irrespective of it being on any stage of process for license issuance if the above events are proved. Of the total promoters, one-third should be its chartered accountant or at least a graduate of Tribhuvan University or recognised institutions with major in economics or accountancy, finance, law, banking or statistics. Likewise, one-fourth promoters should have the work experience of bank or financial institution or similar nature.

(h) **Promoters' share:** Promoter Group's share can be disposed or transferred only on the condition that the bank has been brought in operation, the share allotted to the general public has been floated in the market and after completion of 3 years from the date it has been registered in the Stock Exchange. But before the disposal of such shares it is mandatory to get approval from NRB. The share allotted to general public has to be issued and sold within 3 years from the date the bank has come into operation. Failing to fulfill such provisions, the bank cannot issue bonus shares or declare and distribute dividends. Shareholders of the promoters group and their family members cannot have access to loans or facilities from the same institution.

(i) **Branch expansion:** The Commercial banks established in national level will initially be authorized to open a main branch office in Kathmandu Valley. They will be authorized to open one more branch in Kathmandu Valley only after they have opened two branches outside Kathmandu Valley.

(j) **Disqualify from becoming director:** An individual who is already serving as a director in one of the bank or financial institutions licensed by NRB cannot be considered eligible to become the director in other banks or financial institutions. Also, stock brokers, market makers and also an individual and institution involved as an auditor of the bank and institutions carrying on financial transactions cannot be a director.

Development Banks

At present, 21 development banks in 9 districts of the Kingdom are in operation.

Policy Guidelines on Establishment of Development Banks

The following new policy guidelines have been made public on 21 May 2002

(a) Paid up capital

	Development Bank	Micro-Finance Development Bank*
National Level	Rs. 320 million	Rs. 100 million
Excluding Kathmandu		

Valley **		
4 to 10 districts	Rs. 50 million	Rs. 20 million
1 to 3 districts	Rs. 20 million	Rs. 10 million

Source: Economic Survey

January 2003, a regulatory provision has been made for the development banks (except micro-financing development banks) to collect deposits through mobilization of savings. The total deposit collected under such provision could be up to 20 percent of allowed total deposit collection limit of the bank. By such an arrangement, the general public holding savings account will have the additional alternative investment opportunity through such savings.

Regulatory Directives to Development Banks

Following regulatory directives have been issued to Development Banks effective from 23 January 2003:

(a) Capital fund: Following provisions have been made for a minimum capital fund based on total risk weighted assets to be adopted by the development banks:

Fiscal Year	Primary Capital Fund (%)	Total Capital Fund (%)
2002/03	5	10
2003/04	5.5	11
2004/05	6	12

Regulatory Provisions for Micro-finance Development Banks

The following regulatory provisions for Micro-finance Development Banks have been issued and made effective from FY 2002/03:

(a) Capital fund: The micro-finance development banks require maintaining a primary and total capital adequacy ratio respectively at 2 and 4 percent by the end of FY 2003/04, at 3 and 6 percent by FY 2004/05 and 4 and 8 percent from FY 2005/06 onwards based on total risk weighted assets.

(b) **Financial resource mobilization:** The micro-finance development bank can mobilize resources up to 20 folds of their total primary capital. Such resources mobilization includes collection of deposit from member groups, borrowings and debentures. If the resource mobilization has already exceeded the limit prior to this provision, it has to be brought within the set limit by Mid-July 2003.

(c) **Compulsory CRR and liquid funds:** The banks require to deposit in NRB, or in other banks or financial institutions approved by it in case where it does not exist, an amount equal to 0.5 percent of their savings and borrowing fund as compulsory Cash Reserve Ratio. Similarly, they also require maintaining liquidity of 2.5 percent of their total savings fund in their vault or government treasury bills or NRB bonds or in the form of deposit in a commercial bank.

(d) **Loan classification and loan loss provision:** At the end of each fiscal year, banks are required to loan classify due loan and advances on the basis of expiration of their repayment time into four groups as good, inferior, doubtful and bad and has to make the loan loss provision at 1 percent, 25 percent, 50 percent and 100 percent respectively.

(e) **Jurisdiction, governance, loan limit and interest rate:** The regulatory provision clearly mentions about the geographical jurisdiction and branch expansion, institutional governance, per group members and micro-financing limit and interest rates and services charge

Finance Companies

By mid-March 2003, the number of finance companies licensed under the Finance Company Act, 2042 B.S., to conduct financial transactions has totaled 55. Additional 3 companies have been issued such licenses between mid April 2002 and mid-March 2003. These companies are already in operation.

Policy Guidelines on the establishment of Finance Companies

The following policy guidelines have been issued and made effective from 21 May 2002:

(a) Paid up capital:

- National level company conducting financial transaction including leasing – Rs. 150 million,
- National level company conducting financial transaction excluding leasing – Rs. 50 million,
- Company conducting financial transaction in any one district of Eastern, Central (excluding Kathmandu Valley) and Western development region excluding leasing –Rs. 20 million, and
- Company conducting financial transaction in any one district of Mid-western and Far-western development region excluding leasing – Rs. 10 million.

(b) Special priorities will be given to the company to operate in any one of the districts of any development region where the density of the financial intermediaries and financial institution are low.

(c) The promoters and general public has to invest 60 percent and 40 percent, respectively on the total share capital of all the above financial companies.

(d) Finance companies, which are in operation in Kathmandu Valley, have to settle themselves in one of the national level companies as described above. In case of the companies operating outside Kathmandu Valley, they have to decide about the jurisdiction they want to remain within 6 months from the date they are informed. Likewise, finance companies being desirous to upgrade their operations should successively fulfill the conditions, such as paid up capital reaching to one step higher, 3 years operating experience, etc.

(e) The policy spells clearly about promoters' paid up capital, actions on the application for opening a company, disposal of promoters' share and black listing, prohibition in the access to loans by promoters and their families and refraining them to become a director in other banks or financial institutions.

Cooperatives

NRB has issued permits to 34 Savings and Credit Cooperatives among those registered with the Department of Cooperatives under the Cooperatives Act, 2048 B.S. to conduct limited banking transactions.Of the 34 cooperatives, 11 are operating in rural areas as small farmers' cooperatives and 23 are in urban and semi-urban areas.

Regulatory provisions for Co-operative Institutions

The following regulatory provisions for Co-operative Institutions operating limited banking transactions have been issued and made effective from FY 2002/03:

(a) Capital fund: The co-operative institutions have to maintain based on total risk weighted assets, the primary and total capital adequacy ratio respectively at 4.5 percent and 9 percent by FY 2002/03 and from FY 2003/04 onwards at 5 percent and 10 percent.

(b) Financial resources collection: The co-operative institutions can mobilize resources up to 10 folds of their total primary capital from its member groups by way of collection of deposit and borrowings. Such deposits will include savings deposit and time deposits having 3 years maturity.

(c) Compulsory reserve fund and liquid fund: The co-operative institutions are required to maintain at least 1 percent of their total deposits and advances in NRB as cash reserve requirement. They are also required to maintain as liquid funds at least at 7 percent of the total deposits in their vault or in any current account with a commercial bank or in government treasury bills or NRB bonds or in any banks or financial institution licensed by NRB. But this does not include the deposits maintain by with other co-operative institutions.

(d) Loan classification and loan loss provision: On a half-yearly basis, the co-operatives are required to loan classify the due loan and advances into four groups as good, inferior, doubtful and bad and has to make the loan loss provision respectively at 1 percent, 25 percent, 50 percent and 100 percent.

(e) Institutional governance, credit limit, interest rate, investment: The regulatory directive clearly mentions about institutional governance to be adopted, credit limit, fixation of interest rates and investment policy.

Source : Economic Survey