INDUSTRY STATUS REPORT

BASED ON THE ONLY COMPREHENSIVE QUARTERLY INDUSTRIAL SURVEY OF NEPAL

NEPAL RASTRA BANK UNIFIED DIRECTIVES SPECIAL

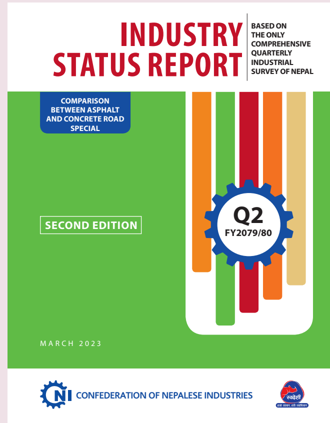
FOURTH EDITION

Q4
FY2079/80

SEPTEMBER 2023

CONFEDERATION OF NEPALESE INDUSTRIES

INDUSTRY STATUS REPORT (PREVIOUS EDITIONS)



Scan the QR code to access digital ISRs

ACKNOWLEDGMENT

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The team would like to extend sincere gratitude towards Mr. Deepak Raj Joshi, Dr. Gunakar Bhatta, Mr. Binit Jain, Mr. Rinesh Ram Sainju, Mr. Sabin Shrestha, Mr. Roshan Karmacharya, Mr. Raju Pokhrel, Ms. Simrik Shrestha, Ms. Spandan Acharya. Also, many thanks to Moti Marasini for designing the ISRs impeccably.

About Industry Status Report

The Industry Status Report (ISR) provides a comprehensive analysis on the state of various industries in Nepal, leveraging an in-house survey. In Nepal, what explains misdirected policy interventions aimed at private sector growth? The absence of periodically available primary data on Nepali industries is one of the key reasons. Against this backdrop, ISR is produced as an effort to promote evidence-based policy-making. Each quarter, CNI Research Cell conducts an industrial survey and publishes this report to tease out changes across critical variables that either promote or stifle growth in industries.

What does the survey cover?

1	2	3	4	5	6
Business Performance: industry capacity utilization, revenue trends, demand in domestic market and market competition, trade	**Finance:** interest rates, the share of the loan, access to finance	**Skills and Employment:** employment, share of employees that received training	**Industrial Ecosystem:** regulation and industry administration, transportation and infrastructure	**Business Outlook:** confidence in the industrial sector, new investment plans	**Nepal Rastra Bank (NRB) Unified Directives**

Industry Status Report (FY 2079/80, Q4 Edition)

The Industry Status Report (FY 2079/80, Q4 Edition) has the benefit of comparing survey data from four consecutive quarters. The current report covers the fourth quarter of the fiscal year 2079/80(i.e Baisakh to Asadh 2080). The data was gathered from the survey conducted from 30 July to 12 September 2023.

Apart from presenting the findings of the survey, each ISR covers one theme in depth. The First Edition of FY 2079/80 focused on the CNI Business Assessment Survey. The Second Edition of FY 2079/80 covered the Comparison Study of Rigid Pavement and Flexible Pavement. The Third Edition covered CNI's suggestions on Federal Budget 2080/81. This edition covers Nepal Rastra Bank's Unified Directives. The focus is given more to the provisions that are useful for the general public. The aim of this special is to promote financial literacy among a broader audience. It tries to ensure that people from various backgrounds and levels of expertise can grasp the key points of NRB directives. It intends to serve as a source of information regarding the banking system of Nepal.

KEY STATISTICS (FY 2079/80, Q4 EDITION)

Number of surveyed industries:

64 ↑ (Q3 63)

Total employees covered:

14389 ↓ (Q3 15021)

Average employment per company:

224.83 ↓ (Q3 238)

Average operational capacity utilization:

61.77% ↓ (Q3 65%)

Share of loan on working capital:

34.71% ↓ (Q3 37.19%)

Average interest rate on loans:

12.51% ↑ (Q3 11.74%)

Average revenue growth rate:

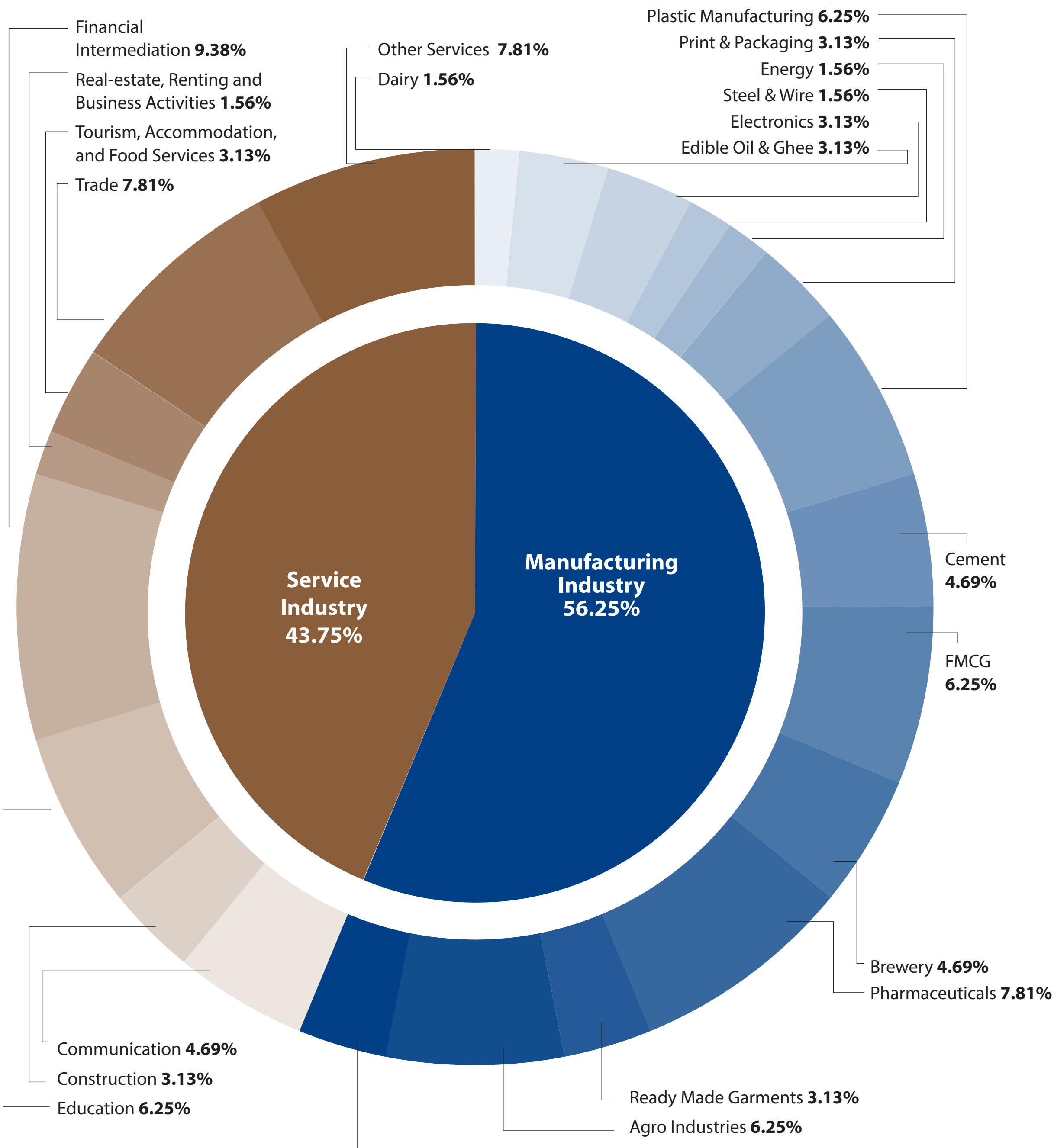
4% ↑ (Q3 -0.47 %)

Average share of imported raw materials by the manufacturing industry:

35.02% ↓ (Q3 37.96%)

Note: Q3 in the parenthesis denotes the third quarter of the FY 2079/80

COMPOSITION OF THE INDUSTRIES SURVEYED



METHODOLOGY

The Industrial Status Report (FY 2079/80, Q4 Edition) is based on a quarterly survey of 64 industries.

The respondents are categorised under the Nepal Standard Industrial Classification (NSIC) Code for the purpose of the survey and further aggregated into two distinct industrial sectors: the manufacturing industry, and the service industry. Since most of the agro-based industries in the survey sample were involved in the agro-processing business, they have been subsumed under the manufacturing category.

The sample was drawn from CNI membership located across Nepal.

Questions are tailored to specific industries. Respondents were asked questions, depending on their respective industries, using a survey platform called KoBoToolbox. The survey questions are available online.

The basic assumption in this report rests on the fact that the respondents have provided correct information.

THE UNIT OF ANALYSIS

The unit of analysis is one industrial establishment.

BUSINESS PERFORMANCE

Periodic performance measurement is a vital part of monitoring the growth and progress of any business. This section summarises the performance of industries within key variables in Q4 2079/80 and compares it with the survey responses from previous quarters.

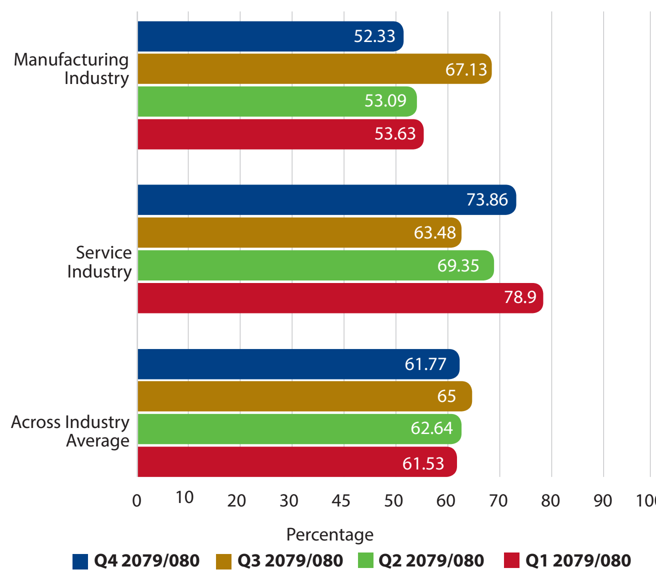
INDUSTRY CAPACITY UTILISATION: 61.77%

KEY INDUSTRY INSIGHT I

On average, the industries were operating at **61.77%** in Q4 79/80 whereas they were operating at 65% in Q3 79/80. During Q4 79/80, the service industry was operational at **73.86%**, which has increased from **63.48%** in Q3 79/80.

The capacity utilisation of the manufacturing industry in Q4 79/80 remained at **52.33%** while it was **67.13%** in Q3 78/79.

INDUSTRY CAPACITY UTILIZATION

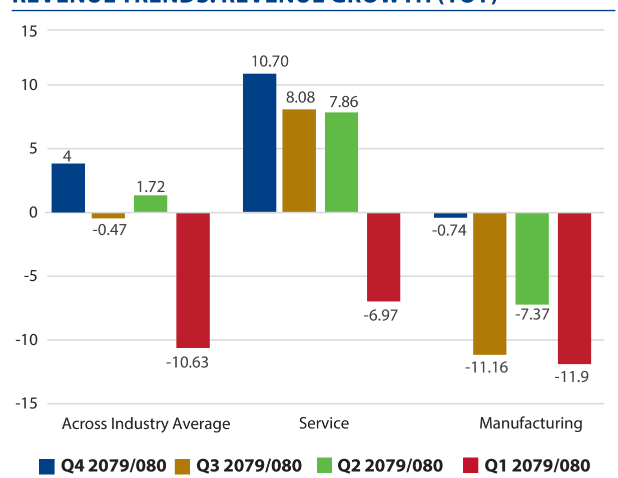


REVENUE TRENDS: REVENUE GROWTH: 4%

KEY INDUSTRY INSIGHT II

In Q4 79/80, the across-industry-average revenue growth rate was **4%,** whereas it was -0.47% in Q3 79/80. The revenue growth in the manufacturing sector in Q4 79/80 experienced a decline of 0.74%. It was -11.16% in Q3 79/80. The consistent negative growth of revenue in manufacturing sector is seen as a result of fall in aggregate demand and slowdown in the economy.

REVENUE TRENDS: REVENUE GROWTH (YOY)



GROWTH IN MARKET DEMAND 4.76% AND *MARKET COMPETITION 92.86% (*Perception-based question)

KEY INDICATOR III & IV

The survey result shows that the average growth of demand for goods and services was **4.76%**. The highest recorded growth rate was an impressive **88%**, while the largest decline observed was a significant **55%**. The demand of manufacturing industries has declined by **4.77%**.

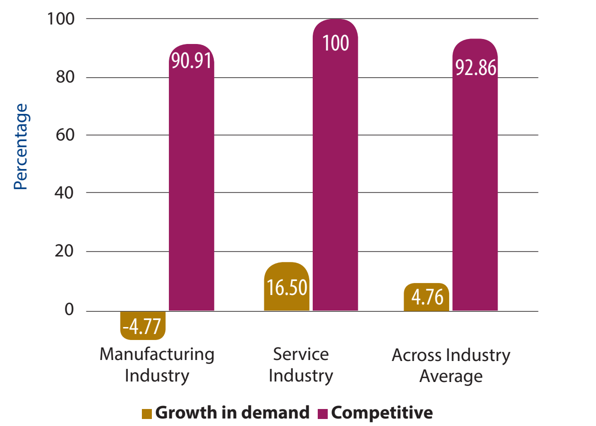
Furthermore, on average **92.86%** of the surveyed industries perceived their goods to be competitive in the market in relation to imported goods, which gives optimism to the domestic industries. The confidence among the domestic businesses regarding their competitiveness and sufficient market demand for domestic products is a critical factor for expanding a broader industrial base in Nepal.

SHARE OF RAW MATERIALS IMPORTED: 35.02%

KEY INDUSTRY INSIGHT V

The survey results show that manufacturing industries significantly rely on raw materials sourced from global markets. Out of the total raw material required, on average **35.02%** of raw materials was imported from the global market in Q4 79/80. There has been a decrease in imports of raw materials as compared to Q3 79/80 which was **37.96%**.

GROWTH IN MARKET DEMAND AND COMPETITIVENESS

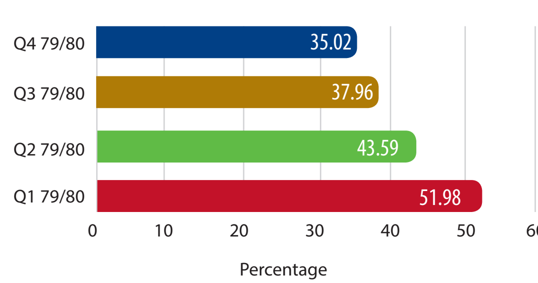


EXPORT: 32.35%

KEY INDUSTRY INSIGHT VI

In Q4 79/80, **32.35%** of the respondent manufacturing industries successfully exported their goods. Compared to the previous quarter, which recorded an export rate of 33.33%, the export in this quarter has declined. The average proportion of exports out of their production has declined from 12.51% in Q3 79/80 to **11.41%** in Q4 79/80. These findings suggest that while more firms are engaging in exporting their products, the overall share of exports is experiencing a decline.

RAW MATERIALS IMPORTED



FINANCE

This section provides insights into the ability of industries to access credit and prevailing interest rates.

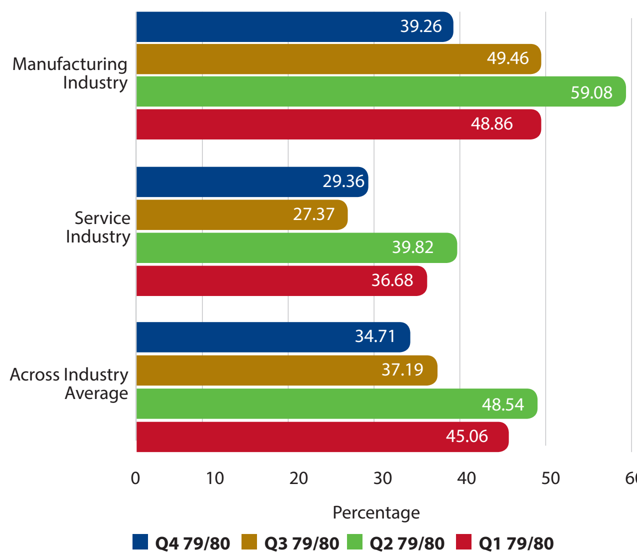
SHARE OF LOAN ON WORKING CAPITAL: 34.71%

KEY INDUSTRY INSIGHT VII

The result of the survey shows that in Q4 79/80, **34.71%** of working capital was met through credit from banks and financial institutions whereas it was **31.19%** in Q3 79/80.

The average rate of interest in working capital loan stands at **12.19%** in Q4 79/80 which is an increase from **11.38%** in Q3 79/80.

SHARE OF LOAN ON WORKING CAPITAL



AVERAGE INTEREST RATE: 12.51%

KEY INDUSTRY INSIGHT VIII

In Q4 79/80, the average interest rate on loans was **12.51%** whereas it was **11.74%** in Q3 79/80.

In Q4 2079/80, average interest rates on loans for manufacturing industries was **12.41%** while for service industries it was **12.69%.**

INTEREST RATES

	Q1 79/80	Q2 79/80	Q3 79/80	Q4 79/80
Across Industry Average	12.77	13.13	11.74	12.51
Service	12.15	12.78	11.2	12.69
Manufacturing	12.57	12.94	12.41	12.41

SKILLS AND EMPLOYMENT

This section highlights the trends in employment and skills of the employees in the industries.

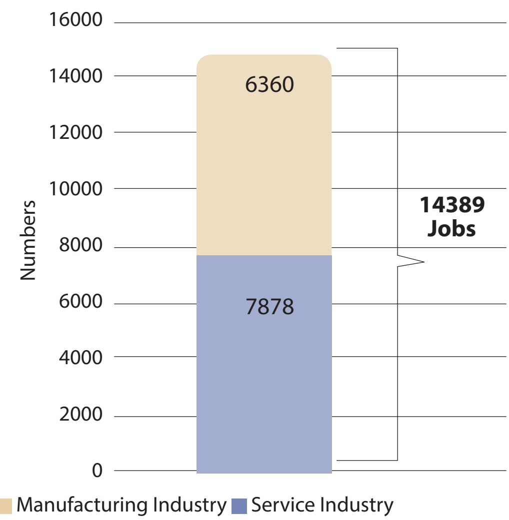
TOTAL EMPLOYMENT: 14389

KEY INDUSTRY INSIGHT IX

The surveyed industries employed **14389** staff in total. On average, an industry establishment employed **224.83** individuals, with the range being **2-5000.** This indicates, on average, CNI member networks comprise large business enterprises. With **7878** employees, the service sector is the largest employing sector, followed by the manufacturing industry with **6360** employees.

Average employment among sectors: The service industries was at the top with **271.66** jobs while the manufacturing sector right behind with **181.71** jobs.

EMPLOYMENT IN SURVEYED INDUSTRIES



New Hiring: 832

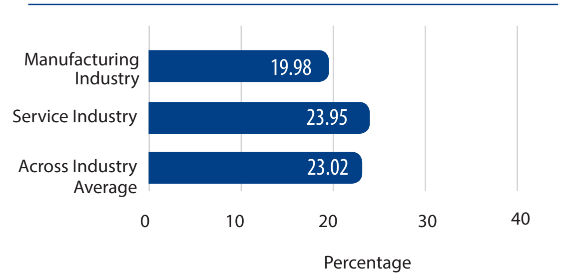
The surveyed industries collectively hired a total of 832 new staff members, while the number of applicants were 6710. This indicates that, on average, more than 8.06 individuals applied for one announced position.

SKILL GAP AND TRAINING: 23.02% RECEIVED TRAINING

KEY INDUSTRY INSIGHT X

The survey result shows that across sectors **23.02%** of the total employees received training during Q4 of FY 79/80. The service industry sector trained around **23.95%** of the total workforce, while the manufacturing industry sector provided training to **19.98%** of its employees.

SHARE OF EMPLOYEE THAT RECEIVED TRAINING



INDUSTRIAL ECOSYSTEM

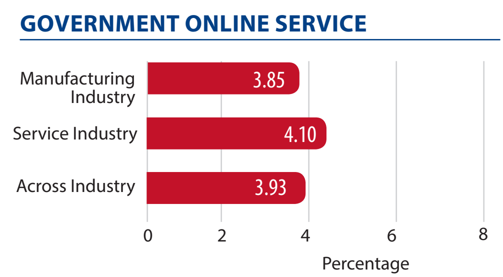
This section focuses on the various aspects of the regulatory environment, transportation and infrastructure that have a direct bearing on the competitiveness of industries.

EXPERIENCE WITH GOVERNMENT ONLINE SERVICE

KEY INDUSTRY INSIGHT XI

Although the government has been prioritising digitization of the economy, the survey results reveal that respondents on average were not delighted with the quality of online services provided by various public entities. When asked to rank the quality of services on a scale of 1 to 10 (with 1 being the lowest and 10 being the highest) 15 respondents ranked the service. The average score of respondents was **3.93.** Manufacturing-industry responded with a score of **3.85**, while the service industry with an average score of **4.10.**

Government online service	Q4 79/80
Manufacturing Industry	3.85
Service Industry	4.10
Across Industry Average	3.93



CONSTRAINT TO CURRENT OPERATIONS OF BUSINESS

KEY INDUSTRY INSIGHT XII

The surveyed respondents identified that the top three constraints for the business operations in the Q4 were political instability, prevailing tax rates, and Too Many Visits to Government Offices

For the manufacturing and service sector the top issue was political instability.

Constraint to current operations of Business

- **Political instability,**
- **Prevailing tax rates,**
- **Too Many Visits to Government Offices**

UTILITIES

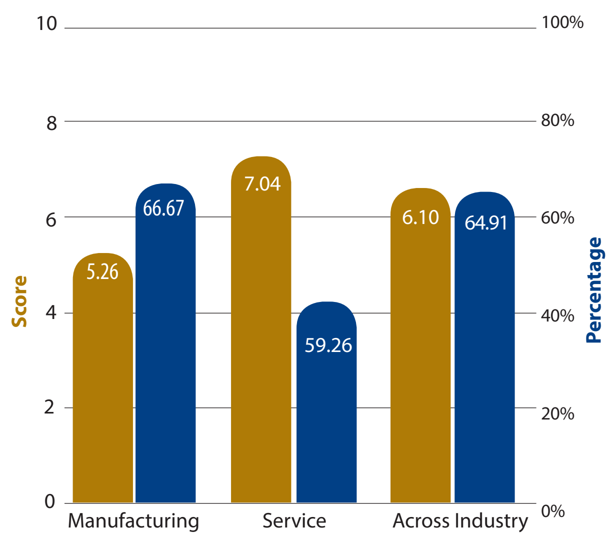
ELECTRICITY: 6.10 OUT OF 10 FOR QUALITY OF ELECTRICITY SUPPLIED

KEY INDUSTRY INSIGHT XIII

The survey result showed **64.91%** of the industries still use generators as the quality of electricity is not reliable. The respondents also mentioned, since the electricity supply provided by NEA is from a common feeder for an area, this reduces the reliability so a separate feeder is essential for commercial purposes. Those manufacturing industries using generators as alternative sources of energy stated there is an additional **12.99%** of cost increase due to the use of generators.

In response to the question that was asked to the respondents to rate the quality of electricity provided in the scale of 1 to 10, with one being the worst and 10 being the best, the average response was **6.10.**

ELECTRICITY QUALITY AND USE OF GENERATOR



MAJOR CHALLENGES

Out of the 64 respondents, 42 responded to the question, and they had the option to select up to 3 choices from a total of 11 options regarding major challenges of business. Among the responses, Excess Competition Affecting Price Margins, Low Disposable Income Among Nepali Consumers and Access to Finance were the most common responses that respondents wanted to solve.

Responses
Excess Competition Affecting Price Margins
Low Disposable Income Among Nepali Consumers
Unauthorised goods in the market
Consumer Bias for Foreign Goods/ Services
Under invoiced by competitors

TRANSPORTATION AND LOGISTIC HURDLES

The respondents identified major challenges of transportation and logistics as quality of roads, frequent road blockage and Inadequate warehouse facilities.

Responses
Quality of Roads
Frequent road Blockage
Arbitrary Prices

BUSINESS OUTLOOK

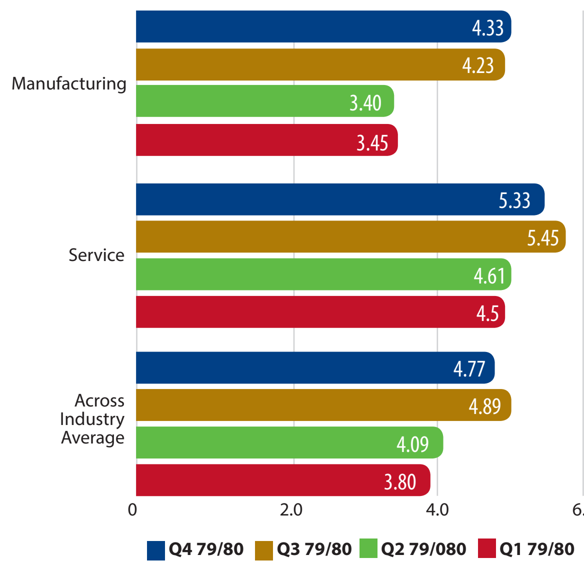
This section presents the confidence level of surveyed industries for their own business and aggregates responses regarding investment plans for the next quarter.

BUSINESS CONFIDENCE: LOW

KEY INDUSTRY INSIGHT XIV

On the whole, industrialists are not optimistic that their business is going to perform well for the next 3 months. When asked to rank the favorability (confidence measures) for their business on a scale of 1 to 10 (with 1 being the least favourable and 10 being the most favourable) in terms of revenue and investment opportunities, regulatory environment, access to finance, labour and better utility facilities, the across-industry-average score is **4.77.** The manufacturing industry is comparatively less confident as per the survey respondents. This can be a result of the unfavourable macroeconomic situation. Key Indicator XIV does not paint a conducive environment for businesses currently.

HOW FAVORABLE IS REST OF THE FISCAL YEAR FOR YOUR OWN BUSINESS?

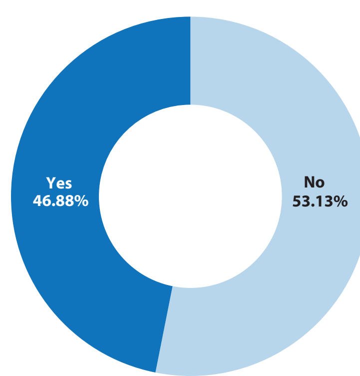


53.13% DO NOT HAVE NEW INVESTMENT PLANS

KEY INDUSTRY INSIGHT XV

The survey result shows that **53.13%** of respondents do not have any new investments planned for the upcoming quarter. This is mostly explained by restricted access to credit. Only **46.88%** of respondents said they have planned for new investment in the upcoming quarter.

NEW INVESTMENT PLANS



NEPAL RASTRA BANK (NRB)

DIRECTIVES SPECIAL

NEPAL RASTRA BANK (NRB)
DIRECTIVES SPECIAL

BACKGROUND

Nepal Rastra Bank (NRB) is the central bank of Nepal, established under Nepal Rastra Bank Act, 2012 BS. It is the regulatory body of the Nepalese banking system. Its objectives are stated in section 4 of the concerned act , which are to maintain financial stability , interest rate stability, economic growth etc.

To meet these objectives it has a duty to maintain a sound and efficient banking system to support economic growth and development. For this, NRB issues directives to bank and financial institutions (BFIs). BFIs need to comply with it mandatorily. In order to achieve this objective, NRB regularly issues directives for Banks and Financial Institutions as per need. These directives and guidelines cover various aspects of banking and financial operations, including prudential regulations, monetary policy, and foreign exchange management.

This write up has been prepared with an objective to foster financial literacy among a diverse audience. This has been prepared in collaboration with Nepal Rastra Bank Executive Director Mr. Gunakar Bhatta and Assistant Director Mr. Binit Jain. The primary emphasis is placed on provisions that benefit the wider public.

For this publication, followings have been incorporated:

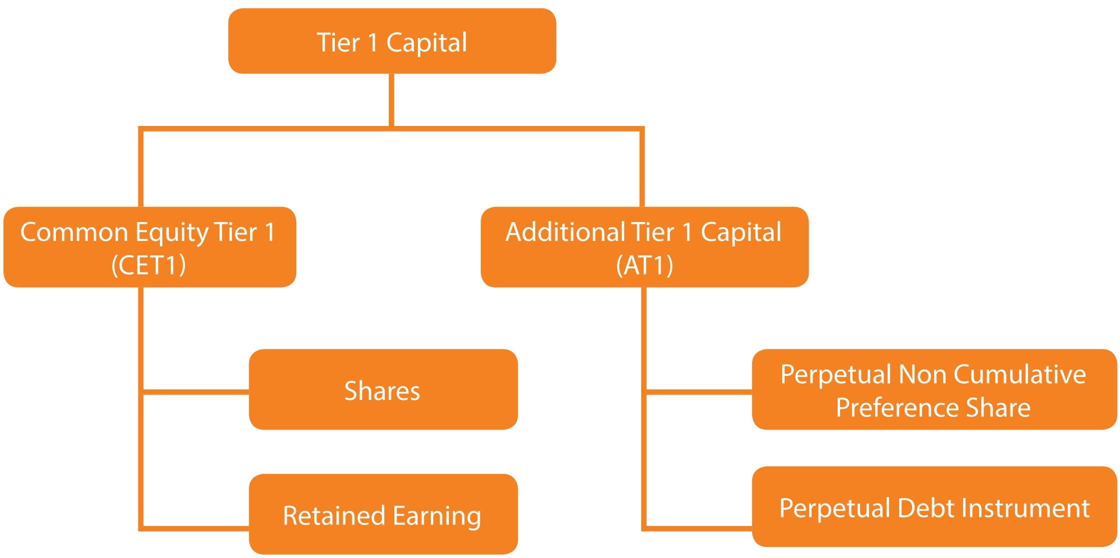
1) Directive 1- Capital Adequacy Framework
2) Directive 2- Loan disbursement, classification and loan loss provisions
3) Directive 5- Risk Management
4) Directive 15- Interest rate
5) Directive 20- Financial literacy

UNIFIED DIRECTIVES

DIRECTIVE 1: CAPITAL ADEQUACY FRAMEWORK

a. Tier 1 capital (Core Capital)

Tier 1 capital is the highest quality capital that a bank holds to absorb potential losses. It measures a bank's financial strength and ability to withstand adverse conditions. Composition of Tier 1 Capital is illustrated below:



b. Tier 2 capital

Tier 2 capital is a secondary layer of regulatory capital for banks, providing supplementary loss absorption capacity beyond Tier 1 capital. It includes instruments with less permanence and lower loss-absorbing capabilities, such as subordinated debt, certain hybrid securities, general loan loss provisioning, etc. While subordinated to Tier 1 capital, Tier 2 capital enhances a bank’s resilience and compliance with regulatory capital requirements.

c. Risk weighted assets

Risk-weighted assets represent the total assets of a bank, adjusted for risk, based on the level of risk associated with each asset or exposure (both funded and non funded). Different types of assets carry different risk weights as determined by regulatory guidelines.

Some of the risk weight for loan are:

Loan Headings	Risk Weight
All Claims on Government of Nepal/ NRB	0%
Claims on Domestic Corporate (Credit rating Score equivalent to AAA)	50%
Claims on Domestic Corporate (Unrated)	100%
Claims secured by residential properties	60%
Claims on regulatory retail portfolio	75%
Personal Hire Purchase/Personal Auto Loans more than 25 lakh	125%
Real Estate loans for land acquisition and development (Other than for institutions/ projects registered/ licensed and approved by Government of Nepal for land acquisition and development purposes)	150%
Real Estate loans for land acquisition and development (For institutions/projects registered/ licensed and approved by Government of Nepal for land acquisition and development purposes)	100%
Lending against shares more than Rs. 50 lakh	150%
Past due claims (except for claim secured by residential properties)	150%
Bid Bond, Performance Bond and Counter guarantee	40%
Unpaid Guarantee Claims	200%

How does risk weight affect the interest rate?

If the risk weight is high, the interest rate will be high too. On the other hand, if the risk weight is low, the interest rate will be low. From the above table of risk weight, it is clear that lower risk weight is assigned for less risky loans such as loans against government bonds with 0% risk weight because the government bond is backed by the government's guarantee that it will return the mentioned amount within the specified date. Similarly, lending against shares with loans of above Rs. 5 million has higher risk weight, because there is no guarantee that you will always be profited from share market and share market is considered as a volatile market worldwide.

For example, keeping other requirements aside and considering only capital and risk weighted exposures, if a Bank has a capital of Rs. 16.5 million, then it could provide a total loan amount of Rs. 300 million for AAA rated companies. Similarly with the same amount of capital it could provide Rs. 150 million for unrated companies. While it could provide only up to Rs. 100 million to share trading companies with loan size of above Rs. 5 million each. From this example it is clear that the return on capital for a Bank is greater if it lends to lower risk weighted assets and therefore, it could reduce interest rates in lower risk weighted portfolios.

d. Capital Adequacy Ratio

Capital adequacy ratio is an essential regulatory requirement aimed at ensuring that banks have enough capital to absorb potential losses and remain solvent in times of financial stress. Regulatory authorities set minimum CAR thresholds, which banks must maintain to comply with prudential regulations. The minimum CAR should be 11% of Risk Weighted Assets and Core Capital Adequacy Ratio should be 8.5% of Risk Weighted Assets for Class "A" banks. Which, however, might increase based on the requirement of Counter Cyclical Buffer.

Formula to calculate Capital Adequacy Ratio (CAR)

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

e. Counter cyclical buffer (CCB)

When the banking sector experiences excessive credit growth followed by an economic downturn, the losses incurred can be significant. These losses can disrupt the stability of the banking sector and create a harmful cycle. Therefore, the banking sector increases its capital defenses which is known as a CCB. The Central Bank applies a counter cyclical buffer when the gap between credit and GDP exceeds by 5 points. It is applied in CET 1 so the lending capacity of banks gets reduced. The rates of CCB at different point difference is listed below:

Credit to GDP Gap(t) = Credit to GDP Ratio(t) – Trend(t)

Countercyclical Buffer Requirement

Credit to GDP Gap	Buffer Requirement in Terms of CET 1
Up to 5 points	0%
Above 5 to 7.5 points	0.5%
ABove 7.5 to 10 points	1.0%
Above 10 to 12.5 points	1.5%
Above 12.5 to 15 points	2.0%
Above 15 points	2.5%

CCB example

FY	Private sector Credit
2074/75	70.68%
2075/76	75.42%
2076/77	84.27%
2077/78	95.11%
2078/79	95.04%
Average	**84.10%**

The average of credit to GDP ratio over the previous five years, or the trend(t) of credit to GDP ratio, is shown in Table 1 and is 84.1%. In FY 2079/80 the credit to GDP ratio stands at (t) 91.10%.

- Trend (t) = 84.10%
- Credit to GDP ratio in FY 2079/80 (t) = 91.10%
- Credit to GDP Gap(t) = Credit to GDP Ratio(t) – Trend(t)

  = 91.10%%-84.10%

  = 7.00%

Here the credit to GDP Gap (t) is 7.00% (points), so as per the Capital Adequacy Framework, 2015 the CCB will be 0.5%.

DIRECTIVE 2: LOAN DISBURSEMENT, CLASSIFICATION AND LOAN LOSS PROVISIONS

S.N.	Loan Category	Types	Overdue time period	Required Provisions
1	Performing Loan	Pass	Up to 1 month	1.25%
		Watchlist	>1-3 month	5%
3	Non-Performing Loan	Substandard	>3-6 months	25%
		Doubtful	>6-12 months	50%
		Loss	1 year +	100%

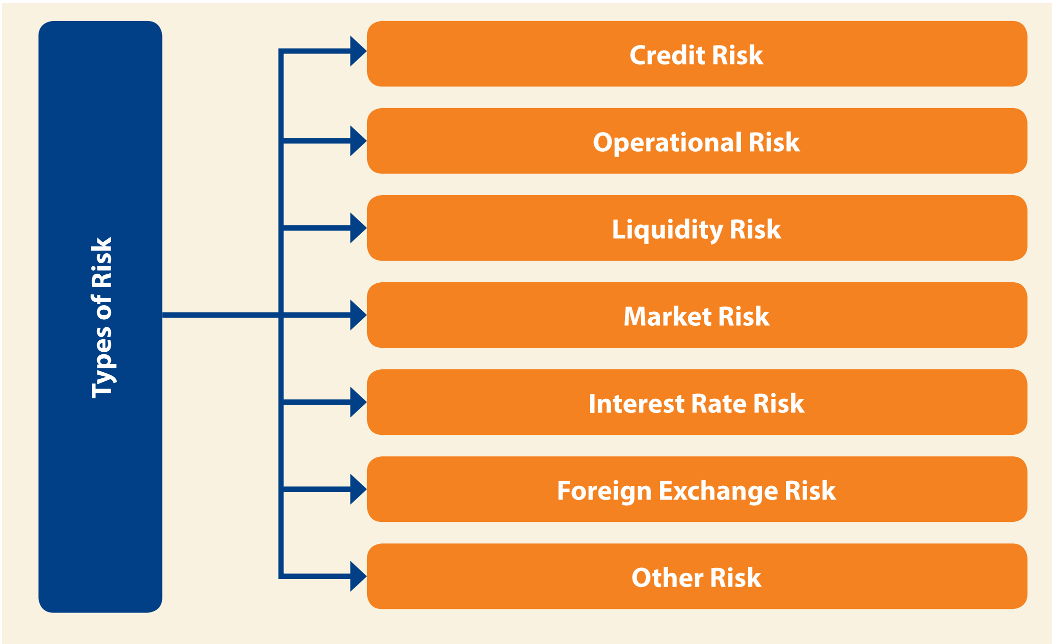
- Provisions on rescheduling and restructuring of loan
  - Rescheduling of loan refers to the process of extending the period/ time of payment of loans/facilities taken by the customer.
  - Restructuring of loan refers to the process of changing the nature or condition of the loan/facility or reducing restrictions.
- Criteria for Loan Rescheduling and Restructuring Eligibility
  - Documents relating to the loan and evidence of adequacy of security
  - Grounds on which the licensee is confident of the possibility of recovery of the debt, and if the organization is confident of the continuity of the business through reorganization and/or restructuring,
  - In addition to the submission of a written action plan to reschedule and/or restructure the loan, at least twenty-five percent of the outstanding interest amount has been collected up to the date of rescheduling and/or restructuring of such loan.
  - Performing loan can be restructured and/or rescheduled under following conditions with minimum of 12.5 percent of the loan loss provision
    - If restructuring and/or restructuring is undertaken for the first time.
    - If restructured and/or rescheduled to be paid in equal installments.
    - If the loan is restructured and/ or rescheduled with a maximum grace period of one year.

    - Besides above regular provisioning of restructuring / rescheduling, NRB has eased out restructuring for sectors like hotels & restaurant, livestock farming, construction related industries, education sector, healthcare sector, projects suffered from natural disaster such as floods/ earthquakes, and loan up to NPR 50 million in other sectors. However, the loan should be performing loan as on Chaitra End 2079. Such restructuring and rescheduling should be done before Poush End 2080 to enjoy such benefits.
- BFI should lend a maximum amount of NPR 2 crore at rate of interest base rate plus at most 2% premium charge for 100% domestic raw material based manufacturing industries, food production, exporting industries, business industries (except import based) etc. A maximum of NPR 20 lakh can be granted against the collateral of agricultural land that does not have a motorable road. This type of lending must be approved within 7 working days otherwise BFI must inform the borrower with clear reason.
- If a loan is requested for the purpose of establishing a vaccine production industry recognized by the Government of Nepal for the treatment of epidemic diseases, the banks and financial institutions shall evaluate the business plan and provide loans at the base rate.
- BFIs can add a maximum of 2 percent points to the base rate on the loan up to NPR 20 crore to establish a hospital with up to 100 beds in the locality where there is no hospital.
- When granting loans to the private sector for the construction of information technology parks and industrial parks, the interest rate shall be determined by adding a maximum of 2 percentage points of premium to the base rate.
- The maximum limit of Debt Service to Gross Income Ratio should be maintained at 50%. Debt service refers to the total amount that a borrower has to pay e.g. EMI, interests, etc. for the loan taken from all BFIs. Gross Income means the income without any deductions such as taxes or other expenses. One can take total monthly gross income and total monthly debt obligation for easy understanding.
- The upper limit of debt service to gross income ratio (DTI), for the first time purchaser of a residential home should be 60%.
- BFI can lend professional overdraft loans of up to NPR 5 Lakh from the total professional loan limit of NPR 15 Lakh. This loan can have a maximum tenure of 7 years and must be paid in equal money installment (EMI).
- For natural person, PAN registration is required for borrowing NPR 25 lakh or more from one or more BFIs combined. Even, the PAN is required for natural person if total borrowing of their group accounts including borrower is Rs. 25 lakhs or above.

Similarly credit rating of borrower is required to lend and renew loans equals to or more than NPR 50 crore.

- BFIs are required to obtain and analyze Initial Environmental Examination (IEE) and Environmental Impact Assessment (EIA) of the projects or industries prior disbursement of loan wherever such documents are required for establishment/ operation of such projects or industries. For the industries/ projects where IEE and EIA are not required for their establishment, the Bank to analyze the environmental impact and lending to be done based on these impact assessments.
- BFIs shall analyze the compliance by borrower in relation to applicable provisions of Environment Protection Act - 2076, Environment Protection Rules - 2077, Labor Act – 2074, "Guideline on Environmental & Social Risk Management for Banks and Financial Institution issued by NRB", other relevant government regulations while extending loan and advances.
- In the process of extending or renewing loans amounting to Rs 50 lakh or less for businesses and enterprises, there is no compulsion to BFIs for obtaining the most recent tax payment certificate and/or the updated tax payment/filing certificate from the borrower.
- Borrowers with multi-banking loans equals to or exceeding Rs. 2 billion need to convert their loans into co-financing arrangements i.e. consortium loan. If not converted, these loans will be classified as watch list with applicable loan loss provisioning of watch list category. However, loans provided under deprived sector lending to licensed Microfinance Institutions are exempted. Additionally, when the loans provided to licensed institutions eligible for providing hire purchase loan against the fixed assets like vehicles and machineries with loan amount not more than 50% of their purchase price with full insurance coverage are not required to be converted to consortium financing.

DIRECTIVE 5 : RISK MANAGEMENT



- **Credit risk** refers to the potential loss faced by lenders or creditors when borrowers fail to fulfill their financial obligations, leading to the non-repayment of borrowed funds or interest payments as agreed upon in a loan or credit agreement.
- **Operational risk** refers to risks created due to the working manpower, process, system and external events.
- **Liquidity risk** refers to the potential for an individual or entity to face difficulties in converting assets into cash quickly enough to meet financial obligations or take advantage of investment opportunities.
- **Market risk** refers to risks that arise due to fluctuation in indices such as price and interest rates.
- **Interest rate risk** refers to risks that arise due to fluctuation in interest rates.
- **Foreign exchange risk** refers to risks that arise due to fluctuation in foreign exchange rates.
- **Other risk** refers to risk such as reputation risk, strategic risk, AML/CFT risk, legal risks, environment, social and climate change risk.

DIRECTIVE 15: INTEREST RATE

A) Deposit

- The interest rate offered on deposits can only be revised on a monthly basis. Prior to the commencement of each Nepali month, information about the upcoming month's deposit interest rate must be publicly disclosed. The interest rate variation can be a maximum of 10% of the highest and lowest of industry average of previous month. For example if the deposit rate was 8% in preceding month, the interest must be between 8.8 (+10%) and 7.2% (-10%).
- Deposit rate on institutional deposit must be at least 2% lower than individual deposit rate.
- The variance between the maximum and minimum interest rates on any interest providing deposit accounts should not exceed 5%.
- At least 1% additional interest on remit accounts.
- Minimum maturity term of FD must be 3 months for individuals and 6 months for institutions.
- The maximum allowed differences in interest rates of any type of saving accounts is 2%.

B) Loan (Lending)

Types of interest rate on lending

- **Fixed**
  - A fixed interest rate remains constant for the duration of the loan or investment, regardless of any changes in market interest rates. The interest rate may be reviewed for the first time in 7 years and thereafter every 5 years with the written consent of the borrower.
- **Adjustable**
  - An adjustable interest rate, also known as a variable interest rate, can change over time based on fluctuations in market interest rates.
  - The interest rate is determined as Interest on Loan= Base Rate + Premium Charge
  - Example : Base rate= 8.5% , premium charge= 2.5%, interest rate = 8.5%+2.5% = 11%
    - Base rate might change every month. If base rate increase

from 8.5% to 9%, now the interest will increase from 11% to 11.5%

- Base rates include: Deposit cost, Cash Reserve Ratio (CRR) cost, Statutory Liquidity Ratio (SLR) cost, Bank's operational cost.

- A premium rate is an additional fee or cost that is added to a regular price. The premium rate can not be changed in the whole loan tenure of term loan and up to maturity of revolving loans.

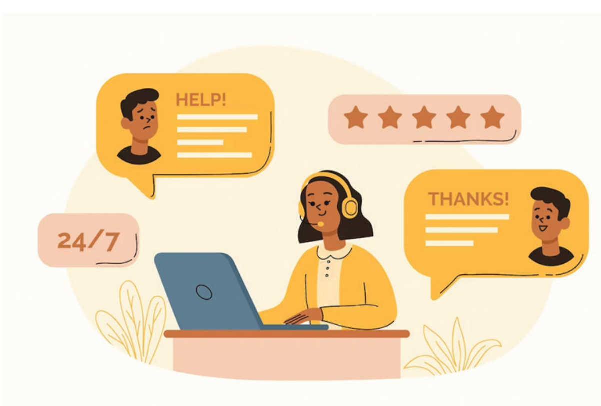
C) Spread Rate

- Spread rate refers to the difference between the interest rate that a financial institution pays on deposits and the interest rate it charges on loans. BFI should maintain the following spread at most by the end of the month.

Class A	**4%**
Class B & C	**4.6%**

DIRECTIVE 20: FINANCIAL LITERACY

- BFIs can not charge for tasks like opening an account, issuing checks, providing balance information, and more, they cannot charge the customer any fees for these services. However, if the customer asks for duplicate account statements for a specific period, a small fee may apply.
- BFIs cannot charge any additional renewal fees when issuing electronic cards in Nepali currency, apart from the initial fee until the card reaches its expiry date.
- No service charge on loan against FD receipts of own bank.
- Service charges on loan for "A," "B," and "C" shall be limited to a maximum of 0.75%, 1.00%, and 1.25%, respectively.
- Loan renewal fees & commitment fees shall not exceed 20 percent of service fee.
- Maximum allowable processing fee while extending loan to Microfinance Institution is up to 0.50%.



- The variance in service charge, administrative charge, prepayment charge should not exceed 0.25% among similar types of customers.
- No prepayment fees shall be levied on loan amounts up to 50 lakhs in all types of loan.
- A designated "Information and Grievance Handling Desk" should be set up by the BFI to hear complaints from the general public and its customers.
- Banks and financial institutions should keep the link of NRB's complaint portal "gunaso.nrb.org.np" on their website to facilitate the hearing of complaints related to their operations.
- For term loans with a repayment period of over one year, no additional fees can be charged after loan approval, except for fees payable to third parties. For eg; bank cannot charge additional amount in insurance fee to borrower.
- BFIs cannot provide any financing services unilaterally without customer consent. If such services are provided BFI must refund with 10% additional.

About CNI

The Confederation of Nepalese Industries (CNI) was established by the captains of Nepal's industrial and corporate sector on April 17, 2002. Its core mandate is to help enhance the business environment for the private sector.

It has a membership base consisting of nearly all of the big corporate houses of Nepal, Nepali blue-chip companies, joint venture companies, etc. spread across a wide and diversified spectrum of industries.

About CRC

CNI Research Cell was established due to a dearth of evidence-based research on Nepali industries, especially based on primary data. CNI aspires to be a trusted development partner of the Government of Nepal. The data and research generated by CRC is transparent, unbiased and will be kept confidential. The team comprises Deputy Director Mr. Ravi Kumar Prajapati and Officer Ms. Rashmi Poudyal.

CONFEDERATION OF NEPALESE INDUSTRIES