Deposit Assessment in Nepal

MAY 2011

Commissioned by

International Finance Corporation
World Bank Group

MicroSave
Market-led solutions for financial services

Ministry of Foreign Affairs

Commissioned by IFCs Access to Finance Advisory Department

Published in the United States of America, May 2011

MicroSave has over a decade of experience in providing practical, client-responsive, market-led solutions to assist financial service providers and institutions working with low-income clients succeed and achieve their mission and business objectives. It has a history of working alongside financial institutions, telecom operators and FMCG companies, livelihood institutions and development agencies of varied institutional forms and sizes throughout Africa and Asia. It has undertaken assignments in Afghanistan, Bangladesh, Cambodia, Cameroon, China, Colombia, Egypt, Ethiopia, Ghana, India, Indonesia, Kenya, Malawi, Nepal, Nigeria, the Philippines, Sierra Leone, South Africa, Sri Lanka, Sudan, Tanzania, Uganda and Vietnam.

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ACKNOWLEDGMENTS

Deposit Assessment in Nepal was written by Diana Lewin, Anil Paul, Manoj K Sharma, and Graham A.N. Wright. This report is part of a wider study supported by the International Finance Corporation (IFC). The 'Industry Mapping of Small Balance Deposits in South Asia (India, Nepal, Sri Lanka and Bangladesh)' is a comprehensive market study that details the needs and preferences of micro-savings clients in South Asia and to support the development of client-responsive products and delivery processes. IFC conceptualised, guided, and supported this study and its wider dissemination. Provision of financial services, especially savings and insurance, is at an inflexion point and all stakeholders are concerned about financial exclusion of low-income populations. This study provides direction and enables financial institutions to offer tailored products to low-income people. IFC and *MicroSave* would like to recognize, with deep appreciation, the financial support from the Netherlands' Ministry of Foreign Affairs for this study. Grant support from the trust fund enabled this study that will benefit vast numbers of financially underserved people worldwide.

This report is the result of the ideas and hard work of many people at many organisations, especially the commercial banks, development banks, microfinance development banks, credit cooperatives, financial NGOs and insurance companies that were a part of this study. *MicroSave* is also grateful to the Centre for Microfinance Nepal, specially Sushila Gautum and Tejhari Ghimire, Sabin Raj Shrestha, SASFP, World Bank and sector experts who gave their time and support to the study. We especially recognise Amit Kumar Garg and Nitin Garg for their support in institutional assessment and market research, which were an integral part of this study.

Above all, we thank the clients who patiently gave us their time during the extensive market research for the report. Their contributions regarding savings products and services, and the way in which they manage their finances without many options provided invaluable insight. We hope and believe that the future for financial inclusion is bright, and that this report will play a role in informing the overall direction, products, and the delivery channels for broadening and deepening the outreach of formal financial systems.

MicroSave Team

LIST OF ABBREVIATIONS	
BAFIA	Banking and Financial Institutions Act
CB	Commercial Bank
CBB	Chimmek Bikas Bank
CD	Credit-to-Deposit
CIT	Citizen Investment Trust
CMF	Center for Microfinance
DB	Development Bank
DCGC	Deposit Credit Guarantee Corporation
EBL	Everest Bank Limited
EPF	Employees' Provident Fund
FC	Finance Companies
FINGO	Financial Intermediary NGO
GDP	Gross Domestic Product
GDS	Gross Domestic Savings
IB	Insurance Board
KSK	*Karmachari Sanchaya Kosh* (Employees' Provident Fund)
MBAN	Microfinance Bankers' Association of Nepal
MDB	Microcredit Development Bank
MIFAN	Microfinance Association of Nepal
NBA	Nepal Bankers' Association
NEFSCUN	Nepal Federation of Savings and Credit Co-operative Unions
NIBL	Nepal Investment Bank Limited
NLK	*Nagarik Lagani Kosh* (Citizen Investment Trust)
NPR	Nepalese Rupee
NRB	Nepal Rastra Bank
NUBL	Nirdhan Uthan Bank Limited
POSB	Post Office Savings Bank
RMDC	Rural Microfinance Development Centre
RRDB	Regional Rural Development Bank
RSRF	Rural Self Reliance Fund
SACCOs	Savings and Credit Co-operatives
USD	United States Dollar

Exchange Rate: 1 USD = 73.19 NPR

1. BACKGROUND OF THE STUDY

IFC's Access to Finance (A2F) department caters to both policy and project-related advisory work on financial markets, financial institutions and financial infrastructure. Microfinance is a core product of A2F and expanding small-scale deposits is a flagship initiative. With numerous large, successful and internationally known institutions in Bangladesh, India, Nepal and Sri Lanka, microfinance is well-established in South Asia. For a variety of reasons, however, most institutions focus on microcredit and the development of savings services has lagged seriously behind. This paper surveys the current supply and demand for microdeposit services in Nepal.

2. MACROECONOMIC ENVIRONMENT

2.1 DEMOGRAPHICS, REGIONAL DIFFERENCES AND MIGRATION PATTERNS[1]

- Ecologically, Nepal is divided into three areas: the Terai[2], hills and mountains, and administratively into five development regions: far-western, mid-western, western, central and eastern.

- The five development regions are further divided into 14 zones, 75 districts and 3,915 village development committees (VDCs).

- The population of Nepal in 2001 was 23.15 million, with a population density of 157.3 persons per km^2.

- Life expectancy at birth is 67 years.[3]

Figure 1: Geographical and Administrative Divisions of Nepal

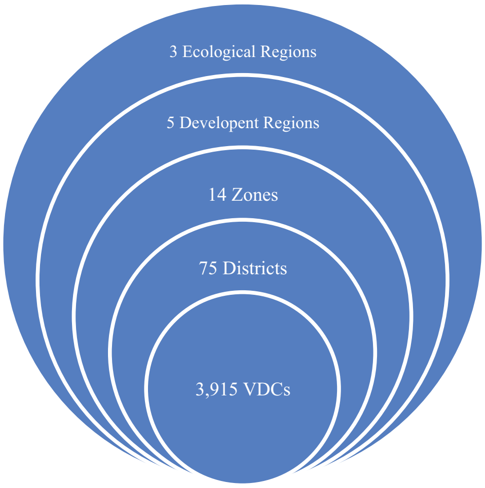
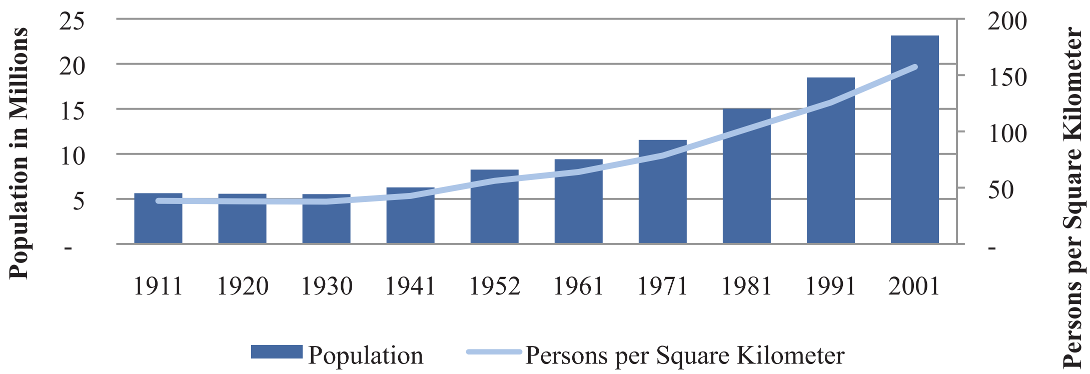


Figure 2: Population Changes During the 90-Year Period, 1911-2001

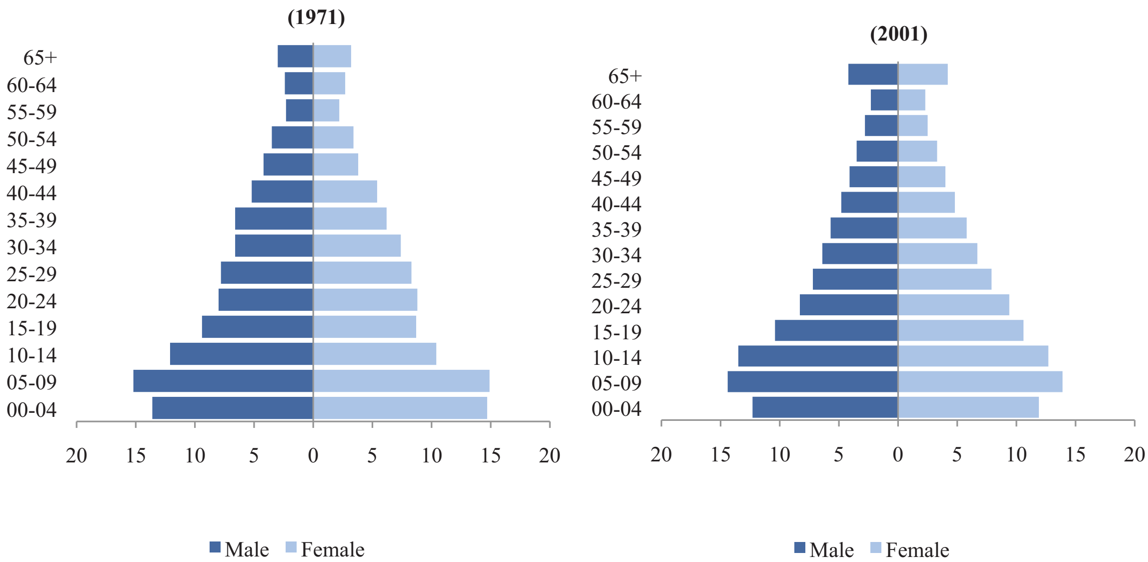


1 *Unless otherwise stated, all population statistics are extracted from the Population Monograph of Nepal, Central Bureau of Statistics, Kathmandu, Nepal, 2003.*
2 *The word Terai is presumed to be derived from Persian, meaning "damp". Various Hindi and Urdu dictionaries also define it as land at the foothills of mountains, damp and swampy. Encyclopaedia Britannica implies the meaning of "Terai" as "moist land".*
3 *World Bank Statistics.*

- The sex ratio stood at 96.8 in 1952-54 and at 99.8 in 2001. In 1981, the ratio reached 105, but historically, there have been more women than men in the country.

- Also, the sex ratio has been consistently lower in rural areas, except for the 1971 and 1981 censuses. In the 20-34 age group, there have usually been more women than men, but recently this band has expanded to include the 15-44 age bracket. These trends are consistent with Nepal's tradition of migration. The increase in age bracket with a skewed sex ratio – from 20-34 to 15-44 – shows that the age at which men migrate from Nepal has dropped from 20 to just 15 years, and the age at which they return has increased from 34 to 44. Male migrants generally return home to join their families for retirement.

Figure 3: Population Pyramids, 1971 and 2001

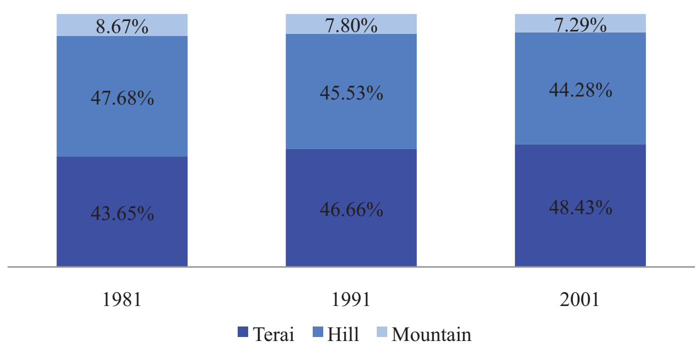


- The population in central Nepal as a percentage of the country's total population, has increased from 32.68% in 1981 to 34.69% in 2001, mainly due to the high rate of population growth in Kathmandu and surrounding districts, and in central Terai.

- Overall, the central region has the highest population density (293.02 persons per km^2), particularly Kathmandu with 2,739 persons per km^2; central Terai with 422 persons per km^2; and eastern Terai with 454 persons per km^2.

- Historically, the country's population has migrated from mountainous and hilly areas towards the Terai. Initially, the plains were covered with dense forest and infested with malaria and other transmissible diseases. Later, with control of diseases and deforestation, Terai became home to 48.43% of Nepal's population in 2001, against 35% in 1954. Fertile agricultural land and employment opportunities are the key reasons leading to this increase in migration.

Figure 4: Population by Ecological Region



- Nepal's population is also migrating from rural to urban areas as people search for more employment opportunities, particularly in Kathmandu.

- The age and gender analysis of the rural and urban areas shows that the concentration of younger population is higher in rural areas as compared to urban areas. However, the percentage of population in the 20-49 age group is highest in urban areas, reflecting the trend of migration for livelihood/work opportunities.

- The growth in urban population is due to migration from rural to urban areas and an increase in the number of areas classified as urban (from 10 in 1981 to 58 in 2001). Out of the total urban areas, only two are in the mountains.

- The central region (particularly the Kathmandu area) has the highest percentage of urban population, followed by the eastern region.

- In addition to the trend of migration – from rural to urban, and from the hills and mountains to Terai – the number of Nepalese going abroad for employment has also grown with every passing year. According to the Nepal Rastra Bank, 1,394,281 individuals took institutional approval for foreign employment in the period from 2006-07 to 2008-09. Nepal has an emigration rate of 3.9%,[4] with 95% of migrants moving to Asian countries, particularly India, Malaysia, Qatar, Saudi Arabia, UAE, Kuwait and Bahrain, among others.[5]

- The literacy rate in the population aged six and above has increased consistently since 1971. The country's literacy rate was 53.74% in 2001, a significant improvement from 13.9% in 1971. Urban men have the highest literacy rate at 80.90% and rural women have the lowest at 39.32%.

- In 2001, 63.43% of the population was economically active, including 71.68% of men and 55.29% of women, indicating that men are primarily responsible for sustaining households.

Figure 5: Population by Development Region

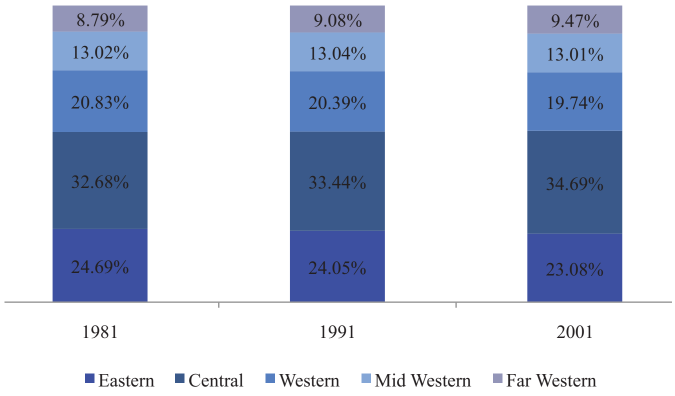


Figure 6: Urban and Rural Population

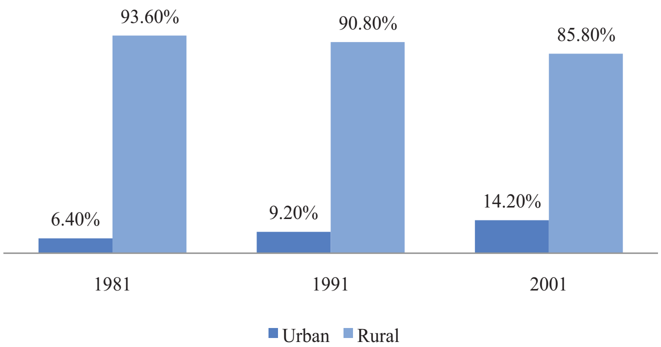
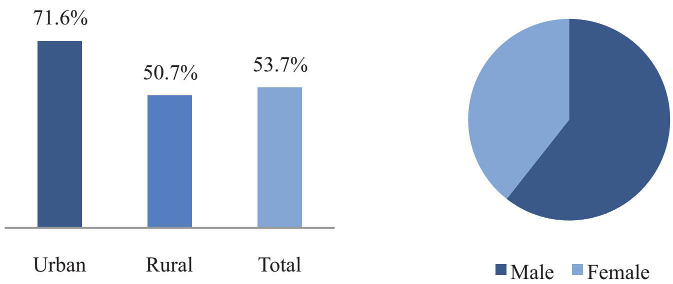


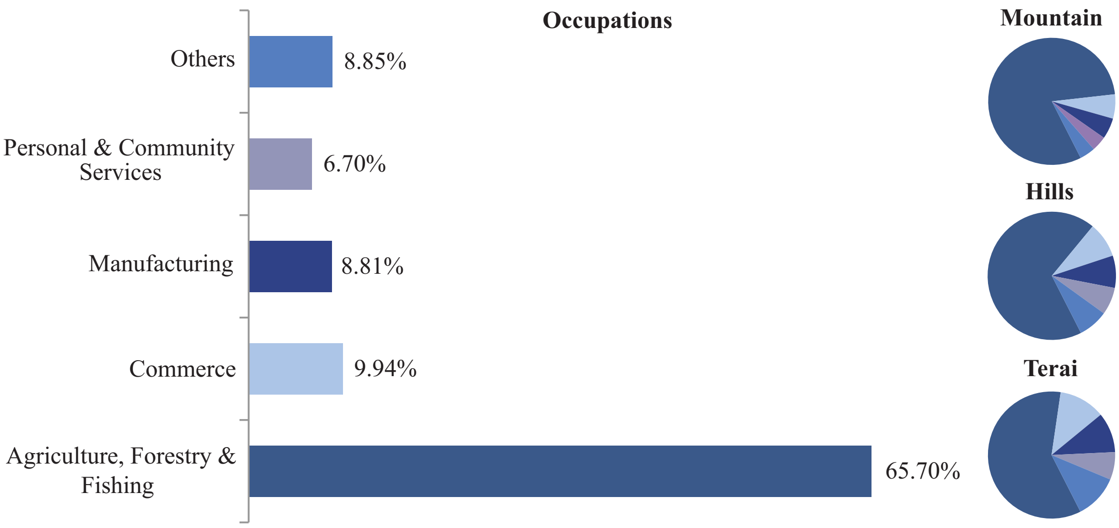
Figure 7: Literacy Rates and Distribution of Male/Female Among the Literate Population



- Nepal has experienced a shift in occupations – from agricultural activities to non-agricultural activities. In 1971, 95% of the population was involved in agriculture; this reduced to 65.7% by 2001.

4 *Human Development Report 2009.*
5 *Nepal Economic Survey 2008-2009, Nepal Rastra Bank.*

Figure 8: Occupations and Segregation by Mountain, Hills and Terai



- The percentage of population engaged in agriculture is much higher in the mountains as compared to the hills and Terai (80.71%, 68.48% and 59.80%, respectively). A higher percentage of population in the Terai is engaged in commerce and manufacturing (11.76% and 10.20%, respectively, in the Terai against 6.19% and 5.32%, in the mountains). The far-western region is the most dependent on agriculture, with 76.76% of the population engaged in agricultural activities and only 5.57% engaged in manufacturing and 6.02% in commerce.

- The percentage of self-employed people has decreased from 85.82% in 1971 to 62.73% in 2001. The last census showed that only 3.8% of the economically active population consisted of employers or entrepreneurs, 24.63% were employed workers and the remaining 8.83% were unpaid family workers.

- In 2001, the unemployment rate was 8.8%.[6] According to the Nepal Labour Force Survey, conducted in 2008, unemployment was 2.1% compared to 1.8% in 1998-99. According to the CIA Factbook, unemployment in Nepal was estimated at 46% in 2008.

2.2 POVERTY

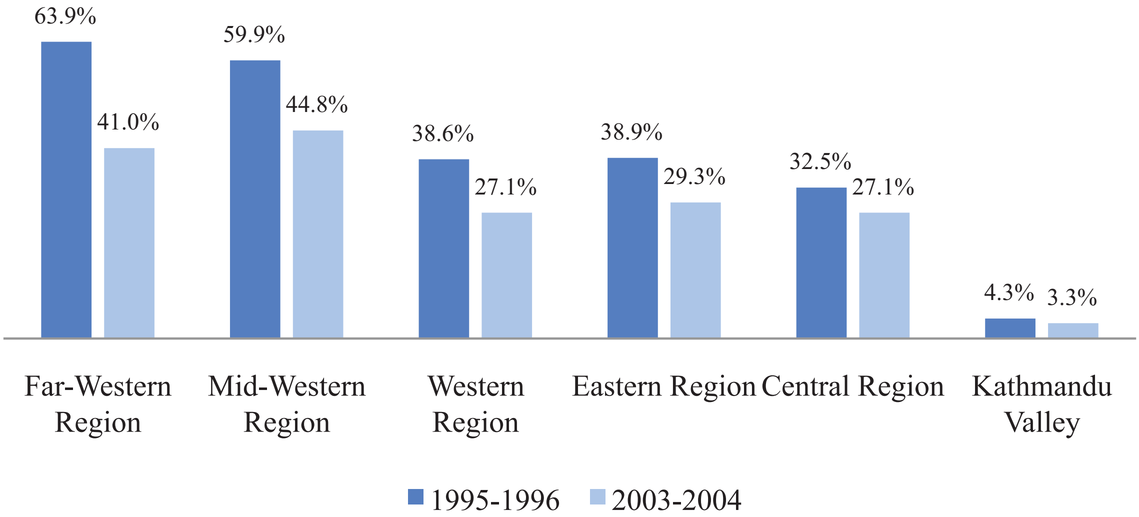
Nepal is the poorest country in South Asia and the 12th poorest country in the world.[7] According to the 2003-04[8] Nepal Living Standards Survey, and as it can be observed in *Figures 9-11*, the overall poverty has decreased significantly from 41.76% in 1995-96 to 30.85% in 2003-04. The survey takes average annual income of NPR 7,696 (USD 105.15) as the national poverty line.

- Poverty remains lowest in the central development region, particularly in the Kathmandu Valley.

6 *World Bank Statistics.*
7 *"Poverty in Nepal", extracted from the World Bank website.*
8 *Unless otherwise noted, all figures taken from Nepal Living Standards Survey 2003/04, Central Bureau of Statistics, December 2004.*

- Poverty increases as we move towards the western region, with far-western and mid-western regions having the highest poverty headcount.

Figure 9: Poverty Headcount Ratio by Development Region



- When looking at the country's geographical regions, poverty used to be highest in mountain areas (57% in 1995-96), but has decreased significantly in recent years. In 2003-04, the hill areas had the highest poverty count at 35%, and Terai had the lowest poverty headcount ratio at 28%. As mentioned earlier, Terai areas rely on diversified sources of income and less on agriculture.

- While poverty has reduced throughout the country, both in 1995-96 and 2003-04, poverty figures were higher in rural areas as compared to urban areas, providing further impetus to poor people to migrate to urban areas.

- According to the survey, reduction in poverty can be attributed to migration to urban areas, income from remittances and higher wages in the agriculture sector. In addition, the World Bank explains that the rate of fertility has decreased in Nepal since the 1980s, reducing the size of households and having an impact on poverty.

- Even though absolute poverty has reduced, the Gini Coefficient[9] has increased from 0.34 in 1992-93 to 0.41 in 2003-04, indicating that the income gap between the poor and the rich has widened.[10]

Figure 10: Poverty Headcount Ratio by Rural/Urban

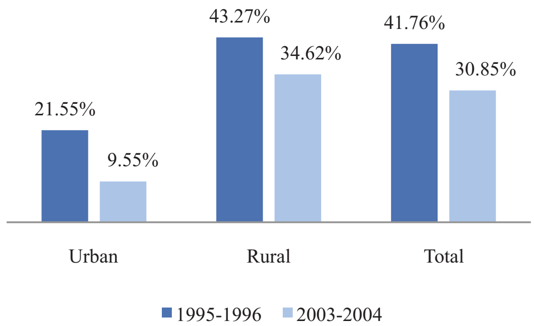
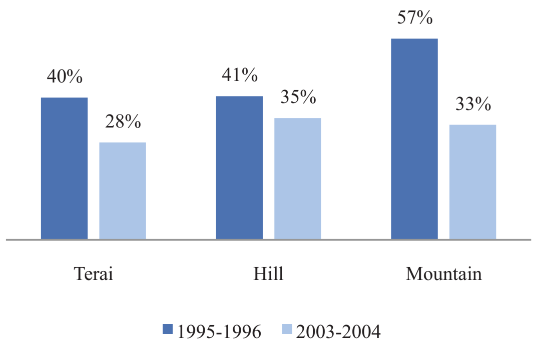


Figure 11: Poverty Headcount Ratio by Ecological Region



9 *The Gini coefficient is a measure of the inequality of a distribution (commonly used as a measure of inequality of income or wealth), a value of 0 expressing total equality and a value of 1 maximal inequality..*

10 *Nepal Economic Survey 2009/2010, Ministry of Finance. Government of Nepal.*

2.3 HUMAN DEVELOPMENT

- The Human Development Index (HDI) provides a composite measure of human development and includes factors, like life expectancy, education level and per capita income (as an indicator of standard of living).[11]

- Between 1980 and 2007, Nepal's HDI steadily increased from 0.309 to 0.553; out of 182 countries, Nepal has an HDI ranking of 144. Compared to its HDI ranking, Nepal ranks poorly on the basis of GDP per capita (ranking 165 with GDP per capita at PPP USD 1,049), but is slightly better in life expectancy (ranking 115 with life expectancy at birth being 66.3 years), adult literacy rate (ranking 130 with 56.6% of the population above 15 years of age being literate), and combined gross enrollment ratio (ranking 136 with 60.8% of the population enrolled in primary-, secondary- and tertiary-level education).

2.4 MACROECONOMIC TRENDS

TABLE 1: MACROECONOMIC INDICATORS

Indicator	2004-05	2005-06	2006-07	2007-08	2008-09	2010E*
Exchange Rate (NPR to USD)[12]	72.06	72.32	70.49	65.02	76.84	N/A
Inflation (%)[13]	4.5	8.0	6.4	7.7	13.2	7.5
Treasury Bill Rate (91 days)[14]	3.94	3.25	2.77	5.13	6.80	N/A
Inter-bank Lending Rate[15]	4.71	2.13	3.03	3.61	3.44	N/A
** E=Estimate*						

- The NPR is pegged to the Indian Rupee (INR); therefore, the fluctuations in NPR to USD rate can be attributed to the changes in INR to USD. According to the International Monetary Fund (IMF), the peg is required to maintain macroeconomic and financial stability.[16]

- According to the IMF, inflation trends in Nepal also follow those of India. IMF reports that inflation in Nepal mirrored that of India up to 2007-08, until loose monetary conditions in 2008-09 caused Nepal to surpass India. Inflation rate is once again converging with that of India; however, inflationary pressures remain high in Nepal even as inflation in India is on the rise.[17]

11 *Human Development Report, 2009: Nepal. Extracted from http://hdrstats.undp.org*

12 *Source: Nepal Economic Survey 2008-09, Fiscal Year 2008/09, Published by Government of Nepal, Ministry of Finance, July 2009. http://www.mof.gov.np/publication/budget/2009/pdf/english_full.pdf. Exchange rate mentioned is the Annual Average of buying and selling rates, 11 months average of the current fiscal year.*

13 *Source: Ibid. Annual Inflation Based on Consumer Price Index. Data for 2008-09 is an estimate calculated using the first 8 months' average. Source for estimates: Economic and Social Survey of Asia and the Pacific 2010, Published by United Nations, ESACAP, Economic and Social Commission for Asia and the Pacific. http://democracyforburma.word.press.com/2010/05/11/economic-and-social-survey-of-asia-and-the-pacific-2010/..*

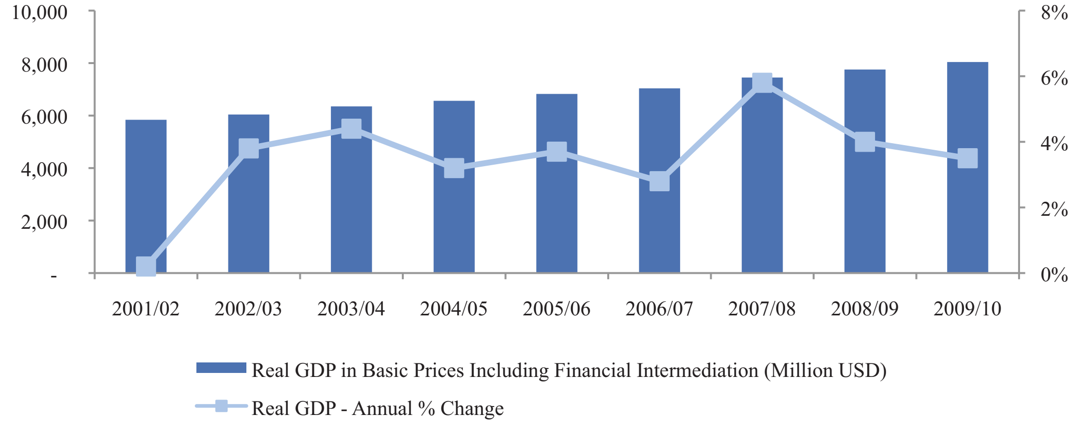
14 *Source: Ibid. T-bill rates represent the weighted average of the discount rate.*

15 *Source: Ibid.*

16 *IMF Article IV Report, July 2010.*

17 *Ibid.*

Figure 12: Real GDP and GDP Growth



According to the Economic Survey 2009-10, published by the Ministry of Finance, the annual budget targeted an economic growth rate of 5.5% for the financial year 2009-10. However, the target could not be achieved. The survey attributes the failure to the following reasons:

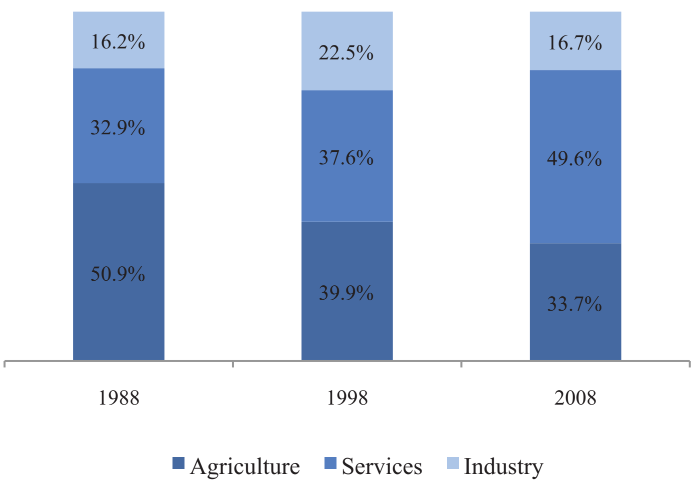
- frequent closures *(bandh)*,
- strikes,
- labour problems,
- shortage/interrupted energy supply, and
- contraction of the external market.

In addition, adverse monsoon conditions affected the agricultural output (with contribution of agriculture in GDP increasing by only by 1% as compared to 3% in the previous year). Agriculture represents a third of Nepal's economy.

2.4.1 Structure of the Economy

- In the past few years, Nepal has become less dependent on agriculture. The share of income from agriculture, as a percentage of GDP, has reduced from 50.9% in 1988 to 33.7% in 2008. This trend can be attributed mostly to the growth in the services industry, which has grown from 32.9% in 1988 to 49.6% in 2008. [18]
- The industrial sector's contribution to the GDP in percentage terms has, after a significant spike in 1998, slipped back to the 1988 level (16.2% in 1988 and 16.7% in 2008).

Figure 13: Structure of the Economy (% GDP)



18 Nepal Rastra Bank – Economic Report 2008/09, Published by Nepal Rastra Bank, Research Department,

Case Study 1: Remittances in Nepal – Vishnu's Family in Hasposa VDC, Sunsari

Vishnu is the father of two girls and lives in a joint family. Three years ago he came back from Kuwait, where he had spent several years working as an electrician. During his stay in Kuwait, Vishnu saved some money, which he used to buy a tractor upon his return to Nepal. Vishnu's family currently has multiple assets and diversified income sources (agriculture, tractor rental, flower gardening, a buffalo, and a kirana shop).

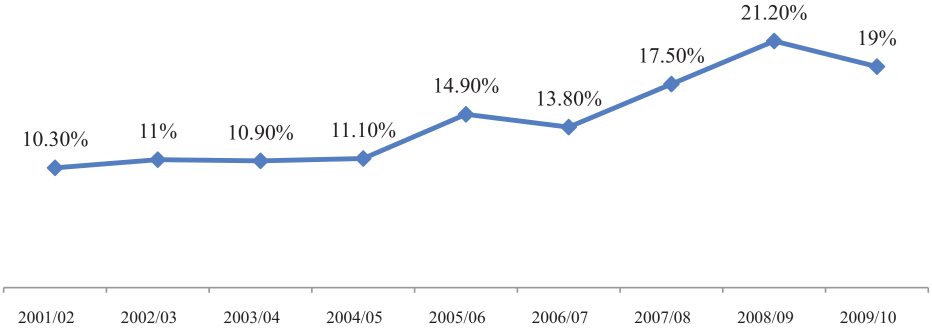
When we asked Vishnu where he saves, he mentioned that he had a couple of bank accounts in commercial banks. In addition, Vishnu's wife participates in informal savings groups and is a client of Chhimek Bikas Bank, a microfinance development bank. However, Vishnu's wife does not know the exact number of groups in which she is a member. In one of the informal groups, Vishnu's wife saves NPR 100 (USD 1.37) per month and can get a loan of up to NPR 30,000 (USD 410) without collateral and up to NPR 100,000 (USD 1,366) with collateral. Vishnu's daughters also save; they both have a piggy bank, each, and are saving up to buy a bicycle and new clothes.

In the future, Vishnu plans to grow his horticulture business and send his daughters to Kathmandu for higher studies.

2.4.2 The Role of Remittances in the Economy

- Remittances are playing an increasingly important role in the growth of the economy and in reduction of poverty.
- The total amount of remittances, as a percent of GDP, have increased from 10.30% in 2001-02 to an estimated 19% in 2009-10.[19]
- According to the Nepal Labour Force Survey conducted in 2008, 30% of the enumerated households received remittances. The survey also shows that, last year, the average amount of remittance was NPR 19,721 (USD 269).[20]

Figure 14: Remittance Income as a Percentage of GDP



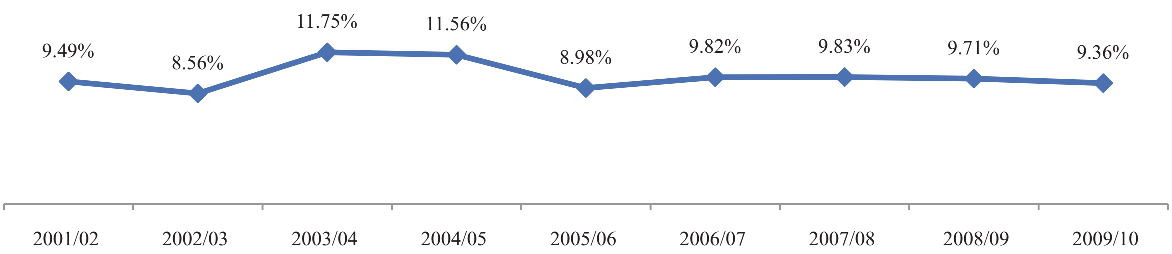
19 Nepal Economic Survey 2009-2010, Ministry of Finance.
20 Nepal Labour Force Survey 2008, Central Bureau of Statistics.

2.4.3 *Gross Domestic Savings*

- The Gross Domestic Savings (GDS) at current prices has increased from NPR 43,600 million (USD 596 million) in 2000-01 to NPR 110,751 million (USD 1,513 million) in 2009-10, reflecting a 15% growth in GDS in comparison to 20.1% growth in the previous year.

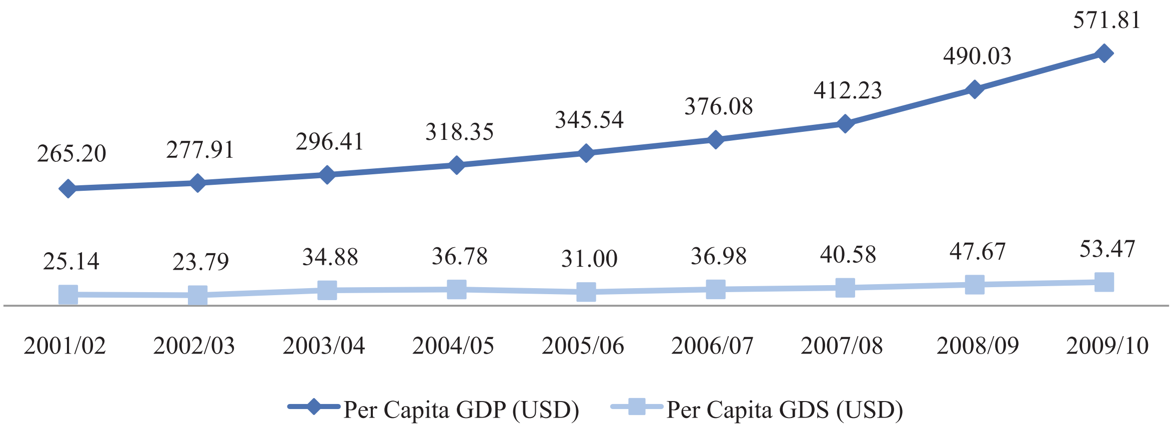
- Despite an increase in both consumption and savings, it is estimated that savings will be limited to 9.4% of the GDP, reflecting a slight decline from 9.8% in the previous year. During the last decade (2000-01 – 2009-10), the GDS declined by 0.13% from the earlier 9.49%. Nepal has one of the lowest GDS in South Asia, compared with Indian GDS in 2008 at 34.3% and the regional average of 17.2%.[21]

Figure 15: Growth in GDS as a Percentage of GDP



2.4.4 *Per Capita GDP Against Per Capita Gross Domestic Savings*

Figure 16: Per Capita Income Against Per Capita GDS



21 Source: World Bank Statistics as available at http://data.worldbank.org.

- With GDP per capita increasing over time, consumption is increasing at a faster rate than savings. This trend continues even during periods of low economic growth.

- According to the Economic Survey 2008-09, conducted by the Ministry of Finance, millions of Nepalese youths are going overseas due to dearth of employment opportunities in the country, and thus the amount of remittances being sent to relatives in Nepal is increasing. However, a large portion of these remittances is being spent on consumption items and imported consumer goods, as well as on purchase of real-estate. Therefore, the growth of remittances has not yet been reflected in a higher financial savings rates.

2.5 DOING BUSINESS IN NEPAL

Nepal ranks 123 out of 183 countries on 'Ease of Doing Business'. The country has a ranking of 87 for starting a business, 148 for employing workers, 113 for getting credit, 73 for protecting investors, 124 for paying taxes, 161 for trading across borders, 122 for enforcing contracts and 105 for closing businesses.

According to an Enterprise Survey, conducted in 2009, more than 60% of firms reported political instability as their greatest obstacle in conducting business in the country, and almost 30% reported electricity problems as the main constraint. Other firms (less than 5% for each of the following factors) reported labour regulations, access to finance, transportation and inadequately educated workforce as their greatest obstacles in conducting business. In addition, the country ranks 149 in regulatory quality and 143 in control of corruption.[22]

In its Economic Survey Report 2009-10, even the Ministry of Finance recognises that the business environment is not conducive for attracting investors. This hinders growth in industries such as agro-processing, high-value herbs processing, tourism, hydropower, education and health, thus affecting the country's GDP.

3. LEGAL AND REGULATORY FRAMEWORK AND FINANCIAL INFRASTRUCTURE

The financial sector in Nepal is governed by the Banks and Financial Institutions Act (BAFIA), 2006. The Financial Intermediary Societies Act, 1999 and the Co-operatives Act, 1992 regulate the non-banking financial intermediaries: financial intermediary non-governmental organisations (FINGOs) and savings and credit co-operatives (SACCOs), respectively. The Nepal Rastra Bank Act, 2002, entrusted the regulatory responsibility of the financial sector with Nepal Rastra Bank – the central bank of Nepal. The regulatory responsibility of the insurance sector lies with the Insurance Board and is governed by the Insurance Act, 1993.

Nepal's formal financial sector has both banking and non-banking sectors. Banking sector comprises of Nepal Rastra Bank (NRB) and class A commercial banks (CB). The non-banking sector, includes class B development banks, class C finance companies, class D microcredit development banks (including the five Grameen Bikas banks), SACCOs with

22 *Business Environment Snapshot, Nepal. Published by the World Bank.*

limited banking license, and FINGOs performing limited banking activities and other financial institutions, such as insurance companies, Employees' Provident Fund, Citizen Investment Trust, postal saving offices and the Nepal Stock Exchange.

The semi-formal sector primarily includes savings and credit and other types of co-operatives registered with the Department of Co-operatives (but not licensed by NRB). Co-operatives in Nepal are single or multipurpose, with single purpose co-operatives, including small farmer, dairy, agriculture, and electricity, among others. The informal sector is characterised by informal groups, essentially associations of people who pool their savings funds to extend credit to their members, such as *Dhikuti* groups. Moneylenders, traders, friends and relatives are also part of the informal sector.

3.1 FORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN NEPAL

Nepal's banking system has grown rapidly during the last two decades. The economic liberalisation policy, particularly the liberalisation of the financial sector in 1980, paved the way for establishment of new banks and non-bank financial institutions in the country. Consequently, by the end of July 2009, 26 banks and 216 non-bank financial institutions, licensed by NRB, were in operation. Out of them, 26 were class A commercial banks, 63 were class B development banks, 77 were class C finance companies, 15 were class D microcredit development banks, 16 were savings and credit co-operatives and 45 were financial intermediary NGOs licensed by the NRB. Postal banks and insurance companies also comprise the formal sector. NRB officials note that they have stopped issuing limited licenses for SACCOs and FINGOs until further notice.

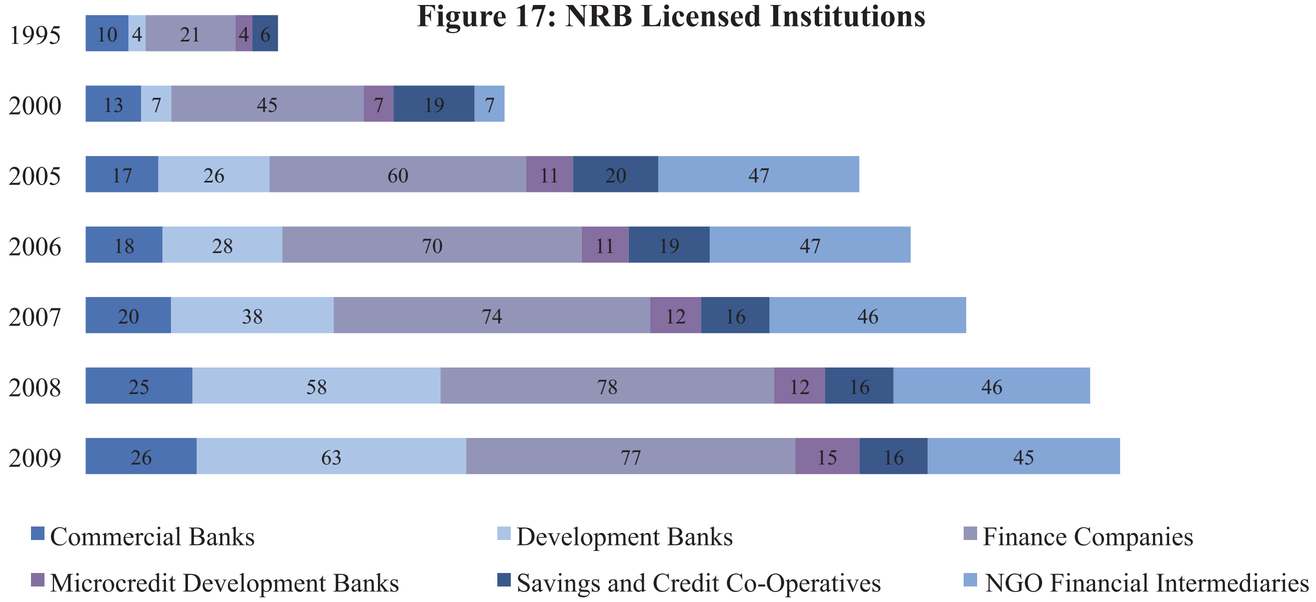


Figure 17: NRB Licensed Institutions

3.1.1 Financial Sector Regulation in the Formal Sector and Role of NRB

The summary of regulations and regulators associated with each form of institution are specified in *Table 2.*

Table 2: Summary of Regulators and Applicable Acts in the Formal Financial System in Nepal

Institution Type	Regulated by	Applicable Acts
Commercial Banks (Class A) Development Banks (Class B) Finance Companies (Class C) Microcredit Development Banks (Class D)	• Nepal Rastra Bank • Registrar of Companies	• Banking and Financial Institutions Act, 2006 • Companies Act, 1991 • Nepal Rastra Bank Act, 2002
Savings and Credit Co-operatives (SACCOs)	• Nepal Rastra Bank • Registrar of Co-operatives	• Co-operative Act, 1992 • Nepal Rastra Bank Act, 2002
Non-Governmental Organisations (FINGOs)	• Nepal Rastra Bank • Chief District Officer/ Registrar of Co-operatives	• Registration of Associations Act, 1977 • Financial Intermediary Societies Act, 1999
Postal Office Savings Bank	• Government of Nepal	• Post Office Savings Bank Regulation, 1976
Insurance Companies	• Insurance Board	• Insurance Act, 1992

The Nepal Rastra Bank (NRB) was established in 1956 under the Nepal Rastra Bank Act, 1955. A new Act in 2002 recast the functions and objectives of the NRB in light of the growth in the number of institutions and scope of activities in the financial sector. According to the Nepal Rastra Bank Act, 2002, the NRB is entrusted with carrying out the functions of a central bank and has the responsibility of licensing, monitoring and guiding the financial sector in Nepal. The objectives of establishing the central bank are as follows:

- To formulate the necessary monetary and foreign exchange policies in order to maintain and manage the stability of prices and the balance of payment for sustainable development of the economy;
- To promote stability and liquidity required in the banking and financial sector;
- To issue bank notes and coins;
- To develop a secure, healthy and efficient system of payments;
- To license, regulate, inspect, supervise and monitor the banking and financial system;
- To promote the entire banking and financial system and to enhance its public credibility; and
- To extend co-operation in the implementation of economic policies of the Government of Nepal.[23]

23 *Nepal Rastra Bank Act, 2002.*

The Banks and Financial Institutions Act (BAFIA) regulates commercial banks, development banks, finance companies and microcredit development banks in Nepal. BAFIA is an amended and consolidated version of all the five prevailing legislations[24] relating to banks and financial institutions. The Act consolidates provisions relating to the establishment, operation, management and regulation of banks and financial institutions. BAFIA classifies the licensed banking institutions into:

- Class A - Commercial Banks (CB)
- Class B - Development Banks (DB)
- Class C - Finance Companies (FC)
- Class D - Microcredit Development Banks (MDB)

The classification is based on the minimum paid-up capital. The minimum paid-up capital for the licensed institutions prescribed by NRB is given in *Table 3*.

TABLE 3: MINIMUM PAID-UP CAPITAL REQUIREMENT FOR FINANCIAL INSTITUTIONS (IN MILLIONS)[25]

Category of Financial Institution	Operational Boundaries			
	National	Regional	4 – 10 Districts	1 – 3 Districts
A. Commercial Banks	NPR 2,000 (USD 27.33)			
B. Development Banks				
> With leasing business	NPR 640 (USD 8.74)		NPR 300 (USD 4.10)	NPR 300 (USD 4.10)
> Without leasing business	NPR 640 (USD 8.74)		NPR 200 (USD 2.73)	NPR 100 (USD 1.37)
C. Finance Companies				
> With leasing business	NPR 300 (USD 4.10)			NPR 300 (USD 4.10)
> Without leasing business	NPR 200 (USD 2.73)			NPR 100 (USD 1.37)
D. Microcredit Development Banks	NPR 100 (USD 1.37)	NPR 60 (USD 0.82)	NPR 20[26] (USD 0.27)	NPR 10 (USD 0.14)

The Act also outlines regulations regarding the process for incorporation and licensing of banks and financial institutions and securities:

- The management (board of directors and chief executive) of banks and financial institutions;

24 *In the absence of parliament, an integrated Banks and Financial Institutions Ordinance, 2003 was enacted repealing five Acts: Agricultural Development Bank Act, 1967, Commercial Bank Act, 1974, Finance Company Act, 1985, Nepal Industrial Development Corporation Act, 1990 and Development Bank Act, 1996. The ordinance converted to Banks and Financial Institutions Act with effect from August 01, 2006.*

25 *Directive issued by NRB, E.PRA.Nridheshan No. 21/067*

26 *In addition to the 10 districts, MDB can also operate in 5 hill districts.*

- Classification of licenses;
- Capital requirements;
- Permitted financial transactions by each class;
- Power to regulate, inspect and supervise by NRB;
- Provisions relating to supply and recovery of credit;
- Maintenance of accounts, records, returns and reports; and
- Provisions relating to mergers and liquidation.

The scope of activities allowed for each type of financial institution is summarised in *Table 4*.

TABLE 4: SCOPE OF ACTIVITIES ALLOWED TO EACH TYPE OF FORMAL FINANCIAL INSTITUTION[27]

	Class A	Class B	Class C	Class D	SACCOs	FINGOs
Accept/refund deposit (with or without interest)	√	√	√	√ §	√ §	√ §
Offer credit with or without collateral	√	√	√	√ §	√ §	√ §
Offer credit for leasing and hire purchase, housing finance	√	√	√	NM	NM	NM
Hypothecation	√	x	x	NM	NM	NM
Provide over draft facility	√	√	√	NM	NM	NM
Appoint agents	√	√	NM	NM	NM	NM
Issue debit/credit cards	√	√	NM	NM	NM	NM
Install ATM/cash dispensing machines	√	√	√	NM	NM	NM
Accept/transfer/payments through electronic medium	√	√	NM	NM	NM	NM
Deal in foreign exchange	√	√	√ ‡	NM	NM	NM
Purchase and sale of gold and silver bullion, shares, debentures, bonds for itself or on behalf of its customers.	√	√	√	NM	NM	NM
Work as an agent of CBs and other financial institutions	NM	NM	NM	NM	NM	√
Extension counters	√	√	√	x	x	x
Branchless / mobile branch banking	√	√	x	x	x	x

NM = Not mentioned. § = From members only; In the case of class D institutions, they can accept deposits from non-members after obtaining prior approval from NRB. ‡ = INR only.

27 *Table has been prepared based on information extracted from the Bank and Financial Institutions Act, 2006, Co-operative Act, 1992, Financial Intermediary Societies Act, 1999 and Unified Directives 2067 (July 2010).*

3.1.2 Commercial Banks (Class A)

Banking, in the modern sense, started with the inception of Nepal Bank Limited (NBL) on November 15, 1937 under the Nepal Bank Act, 1937. NBL was the first commercial bank of the country, accepting deposits, giving loans and rendering other banking services to the public, as well as acting as a bank to the government. In 1956, Nepal Rastra Bank was established and the second commercial bank, Rastriya Banijya Bank (RBB) was set up in 1966 as a fully government-owned commercial bank.

In July 2009, there were 26 commercial banks in Nepal.[28] Class A banks are allowed to enter into the widest scope of activities (refer to *Table 4*) and are therefore, subject to stricter regulations and supervision by the NRB. The minimum paid-up capital requirement for obtaining a license under this category is NPR 2,000 million (USD 27.33 million). Until recently, once a class A bank was established, no limitations were applied to it as far as expansion was concerned. However, since this fiscal year (2010-11), certain restrictions have been imposed, for instance, for each new branch to be opened within the Kathmandu Valley, the bank must open one branch outside the Kathmandu Valley.[29]

3.1.3 Development Banks (Class B)

Many development banks have been set up through active participation of the private sector after the Development Bank Act, 1996, came into effect. The main objective of the Act was to enhance agriculture, industry and commerce by extending credit facility to the public. Prior to this Act, there were only two government-owned development banks: Agricultural Development Bank (which was converted into a commercial bank in 2006) and Nepal Industrial Development Corporation. At present, development banks operate under BAFIA, 2006, and are classified as class B financial institutions. NRB is the regulatory authority for development banks.

The minimum paid-up capital requirement for obtaining a national license under class B category is NPR 640 million (USD 8.74 million), and lower minimum capital requirements apply according to the number of districts to be covered, as detailed in *Table 3*. Out of 63 development banks, 11 operate at the national level and the rest are district-level development banks. *Table 4* shows the scope of activities allowed to them.

3.1.4 Finance Companies (Class C)

Finance Companies (FCs) are also registered as public limited companies under the Office of the Company Registrar and are governed by the Finance Company Act, 1985. The Finance Company Act was issued as part of the liberalisation process in Nepal in the 1980s to promote the establishment of banking institutions with a lower capital requirement. Later, FCs were brought under the purview of BAFIA, 2006, and classified as class C entities.

28 *Banking and Financial Statistics No.53, Nepal Rastra Bank, Mid-July 2009.*
29 *Directive No.14/067 Unified Directives 2067Bai.Bi.Ni.Bi./Niti/Paripatra/50/066/67 dated 16 July 2010.*

Finance companies can also be established at a national or district level and the minimum paid-up capital requirement depends on the geographic coverage (see *Table 3*). The activities that can be taken up by finance companies are more restricted when compared to class A and class B institutions, with a prohibition on hypothecation and permission to deal only in Indian Rupees and not in other currencies. Recent directives have allowed finance companies to install ATM/cash dispensing machines.[30] Though financial companies are allowed to open extension counters, they cannot offer branchless banking services.

3.1.5 Microcredit Development Banks (Class D)

Microcredit development banks (MDBs) are registered as public limited companies under the Office of the Company Registrar. These companies are licensed under BAFIA, 2006, and classified as class D entities. The minimum paid-up capital requirement for obtaining a license under category D is the lowest out of the classified institutions and varies according to the reach of the institution, whether it will be set up at the national, regional or district level (see *Table 3*). If permission is granted to work in 1-10 districts, MDBs can also work in five additional hill districts without infusing additional capital. According to the Monetary Policy of 2007-08, MDBs are allowed to expand, but they have to infuse an incremental paid-up capital of NPR 2.5 million (USD 22,124), over and above the initial paid-up capital, for every additional adjoining district. The provision was intended to expand financial services in rural areas and to give MDBs avenues for expansion.[31]

Class D institutions include the five regional rural development banks established by the NRB between 1992 and 1996 to extend financial services to the rural population in each of the five development regions. The scope of activities allowed for MDBs is summarised in *Table 4*.

In an attempt to increase deposit mobilisation in the country and improve liquidity for class D institutions, NRB recently issued a directive[32] whereby MDBs can seek permission from NRB to mobilise deposits from the general public, i.e. from non-members. Under this provision, MDBs can only offer savings and fixed deposits with tenor of up to two years. In order to obtain such permission, MDBs must comply with the specified criteria, including, but not limited to, showing profitability for the last three years; fulfilling all directives issued by the NRB; amending Memorandum and Articles of Association to include deposit mobilisation services from the general public; having policies for deposit, credit and mobilisation of funds in place; having non-performing assets of less than 5%; and having at least 2,500 members.

"...to increase deposit mobilisation **in the country and improve liquidity for class D institutions, NRB has recently issued a directive whereby MDBs can seek permission from NRB to mobilise deposits from the general public, i.e. from non-members."**

3.1.6 Financial Intermediary Non-Governmental Organisations (FINGOs)

FINGOs are societies registered under the Associations Act, 1977. Seven or more members can jointly apply to the district authority to register as a society. Societies that have three years experience in the social sector and have specified microfinance in their object clause can apply to NRB for a limited banking license. Having this license enables them to take up financial intermediation by providing microcredit to low-income people to improve

30 *Directive No.21/067 Unified directives 2067). Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/16 July 2010-09-14 Monetary Policy 2007/2008, Nepal Rastra Bank, July 2007.*

31 *Monetary Policy 2007/2008, Nepal Rastra Bank, July 2007.*

32 *Directive No.16/067 (Unified directives 2067); Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/dated 2067.3.32/16 July 2010*

their economic condition. Only societies with a limited banking license from NRB can start financial intermediation. NRB is required to conduct necessary enquiries and issue the license within 75 days from the date of application. The license must be renewed every two years. In mid-July 2009, there were 45 FINGOs licensed by the NRB.[33]

The minimum capital requirement for setting up a FINGO is NPR 100,000 (USD 1,366), which consists of membership fees, reserves and capital grants. Non-government organisations with at least 500 members in the Kathmandu Valley and Terai, and 300 in other districts (and with least 50% women members), can apply for a financial intermediation license. FINGOs can apply to the NRB for authorisation to expand into adjoining districts. Usually, the NRB will allow expansion into one district per fiscal year; however, FINGOs can apply for more districts and the NRB will grant the permission based on its evaluation of the proposal, business plan and fulfilment of minimum requirements, including NPA and repayment rate.[34]

FINGOs are authorised to encourage low-income people to form groups; to provide microcredit to any group or member thereof for operating microenterprises, with or without collateral; to mobilise deposits from members; to provide training and organise workshops to improve entrepreneurial skills; and to work as agents of commercial banks and other financial institutions. Full or partial income tax exemption on the income earned by the society is available.

3.1.7 Savings and Credit Co-operatives (SACCOs) with Limited Banking License

SACCOs are community-based financial institutions that are owned and controlled by the members. A co-operative can be registered if 25 members submit an application with the required documents to the Registrar of Co-operatives. A society or union may accept savings deposits only from its members and also offer loans to them. Citizens of Nepal, who reside within the jurisdiction of the co-operative society, and who want to avail its services, can obtain membership by buying shares. SACCOs are governed by the Co-operative Act, 1992, rules set in the by-laws of the institution and by the seven principles of co-operatives: (1) open and voluntary membership, (2) democratic member control, (3) member's economic participation, (4) autonomy and independence, (5) education, training and information (6) co-operation among co-operatives and (7) concern for the community.

The Co-operative Act, 1992, outlines details about the formation and operation of co-operative societies and unions of different categories. The Act governs the formation, registration, membership and working procedures of SACCOs (among others). SACCOs were established to enable farmers, artisans, low-capital and low-income groups, labourers, landless and unemployed people, or social workers of the country to work for the economic and social development of the general consumers on the basis of mutual co-operation.

33 *Source:http://brf.nrb.org.np/List_Bank_n_Non_Banks.htm*
34 *Based on discussion with Mr. Bhopal Prasad Kaphle, Executive Director, Microfinance Supervision and Promotion Department, Nepal Rastra Bank.*

A society must obtain the prior approval of NRB in order to engage in banking business. Licensed SACCOs should comply with the conditions prescribed and the directives issued by NRB. The limited banking license does not carry with it any right to generate deposits from non-members. Licensed co-operatives have used this recognition from the NRB to demonstrate their financial soundness to the general public and, thereby, to fuel increase in membership and deposits.

NRB directives indicate the following requirements for co-operative societies holding a limited banking license:[35]

- Share capital requirement, as outlined in *Table 5*.

Table 5: Share Capital Requirement for Licensed SACCOs

Type of Office	Share Capital Requirement
Office in metropolitan district and is operating within a district	NPR 10 million (USD 136,631)
Office in sub-metropolitan district and is operating within a district	NPR 5 million (USD 68,315)
Office in municipality district and is operating within a district	NPR 2.5 million (USD 34,158)
Office in other places and is operating within a district	NPR 1 million (USD 13,663)

- Limit its operations to one district only. As per the new directive issued by the Registrar of Co-operatives in August 2010, SACCOs can request permission from the Registrar for expansion in up to five adjoining districts. The Registrar may grant the permission at its discretion and based on fulfilment of the specified criteria. [36]

- Collect deposits or advances from members up to 10 times the core capital.

- Collect savings, deposits and term-deposits with a maximum tenure of three years.

- Maintain 1% of total deposits and advances with NRB.

- Maintain 7% of total deposit liability as liquid assets, with 2% as cash in vault or in a current account in any commercial bank.

- Determine interest rates and service fees by the Board of Directors at their discretion, and inform NRB's non-banking management division of any changes by written notice.

SACCOs are required to maintain updated records of its meetings and accounts, and submit an annual report on its business to the Registrar of Co-operatives. The report should contain policies and plans finalised with respect to the distribution of savings, names of directors and their remaining term, the date fixed for meetings of the general assembly, and other particulars prescribed by the Registrar from time to time.

35 *Directive to Co-operative Societies Holding a Limited Banking Transaction License, Enacted in 2002. Available at: http://www.cgap.org/p/site/c/template.rc/1.1.5981/*

36 *Discussion with Mr, Madhab Prasad Paudyal, Manager at VYCCU SACCOs*

3.1.8 *Post Office Savings Bank*

In Nepal, the Post Office Savings Bank (POSB) was set up as a deposit mobilisation agency to cultivate the habit of saving among ordinary people by mobilising small amounts. POSB was established under the general guidance of the Post Office Savings Banks Regulations, 1976, to offer banking services to the rural population, which does not have access to bank branches. The POSB initially started operations in four district post offices. Presently, there are 117 POSBs in Nepal: 70 district post offices, four regional postal directorates, one general post office and 42 area post offices. Of these, only 58 post offices have the permission to invest savings mobilised through NPR 50,000-100,000 (USD 442-884) loans to employees of the Ministry of Information and Communication at an interest rate of 10% per annum. The POSBs, which are not permitted to invest savings, are required to remit 10% of their deposits to the Central Money Order office and the remainder to selected financially sound commercial banks.[37]

Post Office Savings Bank Regulation, 1976, outlines the procedures for opening a POSB, formation and functions of the Post-Office Savings Bank Advisory Committee, products offered, procedures to open accounts, deposits, withdrawals and functions and duties of the POSB. Administration and operation of POSBs is also regulated by the Post Office Operations Manual, 2003, and the Post Office Savings Bank Investment Manual, 2003.

POSBs offer two types of accounts with similar terms and conditions: one general account which pays 7% interest per annum, and an elderly citizen's account for people who are over 70 years old, which pays 8% per annum. Currently, POSBs have an approximate outreach of 40,000 accounts with a savings balance of about NPR 1 billion (USD 13.7 million).

3.1.9 *Citizen Investment Trust (Nagarik Lagani Kosh)*

The Citizen Investment Trust (CIT) was incorporated on March 18, 1991 under the Citizen Investment Trust Act, 1990, in order to expand investment opportunities by encouraging the general public to save and by bringing dynamism into the development of capital markets in the country. The main objectives of CIT are: to help small and medium savers by providing them opportunities to benefit from the capital markets; to expand the social security coverage by providing a pension scheme; to develop a base for institutional investors in the securities market (creating long-term pension and mutual funds available for investment); and to provide the services as a debenture trustee for the management of secured debentures.

CIT's services, include savings mobilisation through gratuity funds, pension funds, insurance funds and mutual fund schemes; investment in corporate shares, debentures and government securities; financing corporate bodies; providing loans for purchasing shares; and capital market services, which include debenture trustee services, underwriting of public issues and consultancy services.

37 *The Evolution of Post-office Savings Bank in Nepal by Shree Dhar Gautum. Chapter IX, Nepalese Financial Systems–Growth and Challenges*

3.1.10 Employees' Provident Fund (Karmachari Sanchaya Kosh)

The EPF was established under the *Karamachari Sanchaya Kosh* (Employees' Provident Fund) Act, 1962. The primary objectives of *Karamachari Sanchaya Kosh* (KSK) are to mobilise savings through the compulsory provident fund contribution from employer and employee and to manage the fund in order to help the beneficiaries at the time of retirement. Until 1978, the EPF coverage was limited to the government and semi-government organisations, but later it was extended to cover the teaching staff at both public and private schools, and other employees at schools, universities, diplomatic missions and non-governmental organisations employing more than 10 people.

Table 6: Number of Contributors to EPF

Area	Number of Contributors
Civil (Government Organisations)	88,000
Nepal Army	91,000
Nepal Police and Nepal Armed Police	78,000
Private Organisations, Corporate Sector	95,000
Education	88,000
Total	**440,000**

Currently, EPF's membership is 440,000 members (2.5% of the total active population). Members are required to contribute at least 10% of their salary to their EPF account, and employers are required to match the employees' contributions. The EPF provides additional benefits to its members, including accident indemnity, funeral grants, insurance and special loans. The breakdown of contributors in the year 2010 is shown in *Table 6*.[38] The interest rate offered on EPF deposits in the year 2010-11 is 8%.[39]

3.2 SEMI-FORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN NEPAL

SACCOs registered under the Co-operative Act and societies (non-government organisations) registered under the Societies Act are involved in mobilising deposits in Nepal. Those institutions which do not have a limited license from the NRB are considered to be a part of the semi-formal sector.

SACCOS are owned and managed by members. Under the Co-operative Act, SACCOs are permitted to mobilise savings from members and offer credit facilities to them.

According to the Nepal Federation of Savings and Credit Co-operative Unions Ltd. (NEFSCUN) there are more than 6,000 SACCOs in the country.[40] Many of them are inactive, closed or just exist on paper. Seven-hundred-and-thirty organisations (34 district unions and 696 SACCOs) are direct members of NEFSCUN and another 700 are indirect members through district unions.[41] Only 16 SACCOs are registered with the NRB for a limited banking license.

38 http://nlkosh.org.np/

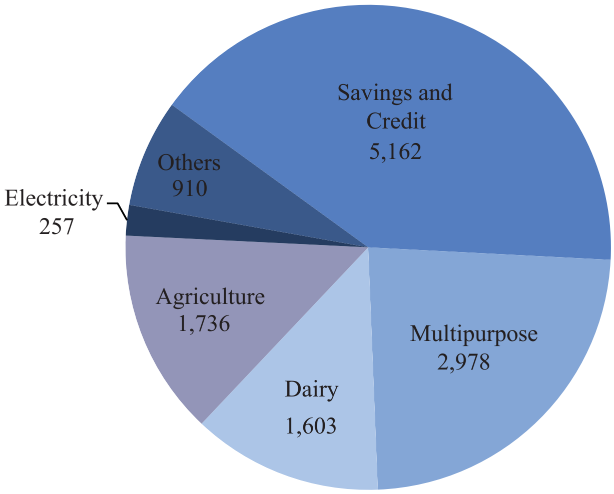
39 The Board of Directors of EPF fix the rate of interests on PF deposits while considering the total PF Deposit, total investment, total interest or dividend received from investments and administrative expenses.

40 Excerpts from the expert interview with NEFSCUN senior management.

41 As per Clause 2 of The Co-operative Act, 1992: Five Single-Purpose Primary Co-operatives can form a Single-Purpose Co-operative Union, and 5 Multi-purpose Primary Co-operatives or 5 Single-Purpose Co-operative Unions can form a District Co-operative Union. Five Single-Purpose Co-operative Unions or 25 Single-Purpose Primary Co-operatives can also form a Single-Purpose Central Co-operative Union. Finally, a National Co-operative Federation can be formed by 15 District Co-operative Unions, Single-Purpose Co-operative Unions, and Single-Purpose Central Co-operative Unions.

As per the regulations, all SACCOs must be members of either the District Union or the Federal Union. However, most SACCOs do not have a membership, as they do not see value in associating with federated structures at either the district or national level. Other types of co-operatives can also take deposits and give loans to their members. According to the unofficial data provided by the Department of Co-operatives, there are 12,646 co-operatives in Nepal (as on April 15, 2009). A pictographical break-up of different types of co-operatives has been given in *Figure 18*.

Figure 18: Number of Co-operatives in Nepal by Category (April 2009)



3.3 INFORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN NEPAL

The informal sector is comprised of about 20,000 informal community-based organisations, such as self-help groups and the ROSCAs, together known as *Dhukuti*. The term originates from the Nepali word *dhukuti,* which means a storage box used for valuables or food grains. A *Dhikuti* is a financial self-help group which originated from a system of communal food grain storage for the needy. With the onset of the market economy, *Dhikutis* expanded quickly and became an informal people's bank, providing capital for small businessmen as well as farmers. Its resources are solely derived from internal savings mobilisation. A *Dhikuti* can be defined as a rotating credit association in which equal amounts of money are collected from the participants at regular intervals and allocated to one member at a time. The rotation is determined mostly by secret tender with the funds going to the lowest bidder, except at the first and last rounds. Most *Dhikuti* groups are formed by 10 to 30 members, with open access to both men and women. The cycle of rotation is usually semi-annual and annual for smaller groups. Members are usually fined for not attending a meeting and each group has a founder and an administrator. Default within these groups normally remains low.[42]

There are also a large number of other informal groups, like unregistered co-operatives. In addition, moneylenders, traders and friends are also the other informal sources of finance. Friends and family are the main providers of informal loans in both urban and rural areas. Within informal groups, there are various community groups, including: mothers' groups, women's groups, farmers' groups, veterinarians', teachers', retired army personnel, community forestry and microentrepreneurs' groups.

The rates charged by moneylenders for borrowing is around 36% per annum (flat), whereas informal groups charge 18-24% per annum (declining balance). Local NGOs pay interest rates ranging from 8-12% on the savings they mobilise. However, instead of paying interest on deposits in cash, informal groups usually add the interest earned on borrowings to the depositor's account(s) at the end of the year.

3.4 INSURANCE SECTOR

The insurance sector in Nepal is regulated by the Insurance Board and is governed by the Insurance Act, 1993. The Insurance Board is an autonomous corporate body constituted

42 *Source: http://www.gdrc.org/icm/dhikuti.html*

to systemise, regularise, develop and regulate the insurance system. According to the Act, three categories of services can be offered by an insurer: life, non-life and reinsurance.

Figure 19: Types of Insurance in Nepal

Life Insurance

- Whole Life Insurance
- Endowment Life Insurance
- Term Life Insurance

Non-Life Insureance

- Fire Insurance
- Motor Insurance
- Marine Insurance
- Aviation Insurance
- Engineering and Contractor's Risk Insurance
- Miscellaneous Insurance

Re-Insureance

- Re-insurance companies (though re-insurance companies have not yet been registered in Nepal)

The Board is the licensing authority for the insurer, insurance agent, surveyor and broker. It also frames the policies for making investments and acts as the arbitrator in disputes between the insurer and the insured. The license to do insurance business must be renewed every year through a renewal fee. An insurance company has to assess its financials and have its liabilities valued by an actuary once every three years and submit this report to the Board. Insurance companies in Nepal are required to deposit funds as per the liabilities of conducting insurance business within Nepal.[43]

At present, there are no insurance companies providing reinsurance services in the country. Local companies depend on overseas insurance companies for reinsurance by paying a reinsurance premium to cover their liabilities. Given the situation, the Insurance Board (IB) has been making efforts to establish a reinsurance company as the country´s insurance market has already matured and grown to a formidable size. The Board has already incorporated the provisions related to the establishment of a reinsurance company in the draft of the new Insurance Act. Based on the findings of the IB, the government had announced in its budget for the year 2008-09 that it would grant an operating license for a reinsurance company in the country. Despite these efforts, a reinsurance company is yet to be established.

The records of the IB show that general insurance companies, in the absence of local reinsurance coverage, are currently transferring as much as 98% of their premium to reinsurance companies abroad to cover their risks. In case of life insurance, about 20% of the total mobilised premium is sent abroad to pay for reinsurance.[44]

43 The insurer shall deposit the following amounts in the reserve fund for the liabilities of its insurance business within the Kingdom (now Republic) of Nepal: (i) An amount not less than the total liability as specified by the actuary on the basis of the insurance policies issued by the insurer for the life insurance business, (ii) An amount not less than fifty percent of the net insurance premium shown in the income and expenditure of the non-life insurance business, (iii) Fifty percent of the profit earned until the amount equals the paid-up capital of the insurer operating the non-life insurance business, (iv) An amount of one hundred fifteen percent of the balance amount of payment against claims made on the insurer before the expiry of each fiscal year.

44 http://www.myrepublica.com/portal/index.php?action=news_details&news_id=21375

3.5 QUALITY OF SUPERVISION

According to NRB officials, the central bank has two departments for supervising. The first department is in-charge of supervising commercial banks, and the second one is in-charge of other financial institutions, including class B, C, D, limited licensed SACCOs and FINGOs. As on June 2010, class A commercial banks had been visited once a year, while other financial institutions were visited once every two years. However, the staffing of the two units seems disproportional: the unit in charge of the supervision of 27 commercial banks is staffed with nearly 60 persons, whereas the unit in charge of all other financial institutions (roughly 200) is staffed with only 50 persons.

In addition to the on-site visits, the NRB conducts off-site supervision by analysing monthly reports from institutions on key balance sheet and income statement figures, as well as ratios, including capital fund, credit-to-deposit ratio, cash reserve requirement (CRR), and statutory liquidity ratio (SLR). However, leading bankers and microfinance experts are of the opinion that while NRB's on-site supervision is good, their off-site monitoring is not effective and that NRB needs to be strengthened in terms of its capacity and skills. As one leading expert noted, "*NRB doesn't have the expertise or capacity to supervise...they only reach some of the institutions once in three years"*.

> ***"NRB doesn't have the expertise or capacity to supervise...they only reach some of the institutions once in three years".***
> ***- Leading microfinance expert***

There is widespread concern that the recent directive to enable MDBs to take deposits from the public will further stretch the resources and capacity of the regulatory authority. The NRB is aware of some of its weaknesses and is hoping that some of the problems will be resolved once the second tier institution (STI) is established and empowered to regulate and supervise class D MDBs, limited license SACCOs and FINGOs.

With regards to non-licensed SACCOs and other co-operatives, even though there are attempts to strengthen the co-operative sector and guidelines and standards have been developed, the Registrar of Co-operatives does not have the capacity to enforce them. Currently, the Office of the Registrar does not have the manpower for supervision. According to Mr. Sudarsan Dhakal, Registrar of Co-operatives, they would need at least 60 employees, with graduate degrees to monitor 30 to 50 co-operatives in a year, but they only have 8. In addition, the Registrar recognises that the existing staff is weak. Of the 8 staff members in the Registrar's office, only one is an officer and the others are junior level staff. The Co-operative Department also faces challenges due to high staff turnover (as government staff is rotated every two years) and budget constraints. The Registrar believed that an independent co-operative authority would solve some of the problems; at the very least, it would reduce the rotation of staff. Other experts added that NEFSCUN does play a supervisory role with their SACCOs members, but overall they are also weak in terms of capacity.

3.6 GOVERNMENT DEVELOPMENT INITIATIVES IN MICROFINANCE

Historically, the Government of Nepal has been very active in promoting financial services in the country. In 1974, the NRB formulated a policy to enable provision of institutional credit to the poorest sector of the economy and directed all commercial banks to compulsorily lend at least 5% of their deposit liabilities to the poor. The policy later evolved into the existing "deprived sector lending" (explained below).

In addition, the NRB played an important role in building the rural financial system through equity investments in several institutions, including the Nepal Industrial Development Corporation (NIDC) in 1959 and the Agriculture Development Bank of Nepal (ADB) in 1968. In 1992, based on the Grameen Bank model of Bangladesh, the government established two regional rural development banks (RDBs) with majority shareholding from the NRB (66.75% and 58.5%), one in each of the eastern and far-western development regions. By June 1996, three RDBs, one in each of the other three development regions, had also been established. However, these initiatives were focused on the spread of microcredit rather than microsavings. [45] Later on, the Government identified the need to create a platform to enable institutions to mobilise microdeposits, and, accordingly, the legal structure for MDBs was created under the purview of NRB, and later on FINGOs were also authorised to mobilise savings.

3.6.1 Deprived Sector Lending

To ensure credit opportunities for the poorer sections of the population (including microfinance clients), Nepal Rastra Bank has imposed "deprived sector lending" requirements on commercial banks, development banks and finance companies. The deprived sector includes low-income and socially backward women, tribes, lower caste, the blind and hearing impaired and physically handicapped persons, marginal and small farmers, craftsmen, labourers and landless families.

Licensed institutions in class A, B and C are required to lend at least 3%, 2% and 1.5% of their total outstanding loans and advances to the deprived sector.[46] Institutions may achieve the targets prescribed for reaching the deprived sector either by lending directly to the end user or through loan or equity support to other microfinance institutions.

Class A, B and C institutions willing to extend credit to the deprived sector are also permitted to establish a separate class D microcredit institution as a subsidiary. The promoters' share in the ownership of subsidiary company can be a minimum of 51% and a maximum of 70% of the paid-up capital. A minimum of 30% of the shares should be offered to the public.[47]

3.6.2 National Microfinance Policy 2008

The Government of Nepal has issued the National Microfinance Policy, 2008. The policy provides flexibility in the areas of microsavings, microcredit, microinsurance and money transfers. The policy seeks to:

- Develop simpler microfinance services to cover the geographical and socioeconomic diversities of Nepal;

45 *Pradhan, Krishna Kumar. "Development Finance", Nepal Rastra Bank in Fifty Years, Nepal Rastra Bank, Kathmandu, Nepal, July 2005.*

46 *Directive No.17/067 Unified directives 2067, Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/16 July 2010-09-14.*

47 *Directive No.20/067 Unified directives 2067); Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/16 July 2010-09-14.*

- Provide a legal basis to both the suppliers and the receivers of services to work together on the basis of mutual understanding and co-operation;

- Provide support to develop and strengthen institutions and build capacities of MFI practitioners through training;

- Establish a National Microfinance Development Fund to mobilise funds from domestic and donor agencies, and provide wholesale financing to microfinance institutions;

- Legally recognise local community institutions and savings credit groups involved in microfinance and linked to other microfinance institutions;

- Encourage microsavings and adopt a simplified policy for MFI deposit mobilisation;

- Establish a second tier institution (STI) under the NRB for effective regulation, supervision, monitoring and evaluation of microfinance institutions.

However, most stakeholders, including FINGO representatives and MDBs, are not in favour of the last initiative. Mr. Dharma Raj Pandey, Chairman of Nepal Microfinance Bankers' Association says, *"Our demand is to be supervised and regulated directly by NRB"*. Mr. Pitambar Prasad Acharya, Chairman of MIFAN adds, "*We are not sure if this will be positive for FINGOs...now we are doing well; in [the] future we don't know what to expect"*.[48]

> ***"We are not sure if this [establishment of an STI] will be positive for FINGOs...now we are doing well; in [the] future we don't know what to expect".***
>
> ***- Pitambar Prasad Acharya***
> ***Chair of MIFAN***

In order to effectively regulate financial intermediaries, such as MDBs, SACCOs and FINGOs, a greater degree of monitoring and supervision is required. This can be achieved by either strengthening the supervision structure under the NRB or by the establishment of a second tier institution. For now, the NRB is more inclined towards establishing a separate entity and a draft of the Microfinance Bill enshrining this has been submitted to the Government of Nepal for consideration.

3.6.3 Wholesale Funds

The Rural Self Reliance Fund (RSRF) was established in 1991 to provide credit to rural and deprived people to carry out income generating activities, thereby helping them achieve economic self-reliance. The RSRF is managed by the NRB and provides wholesale lending to NGOs, co-operatives and financial intermediaries. Government of Nepal and Nepal Rastra Bank have provided a corpus fund of NPR 20 million (USD 273,261) and NPR 100 million (USD 1,366,307), respectively to the RSRF. However, according to microfinance experts, the funds available to each institution through the RSRF (NPR 2,000,000 or USD 27,326) are quite limited and take too long to obtain (approximately 6 months).[49]

48 Based on expert interviews conducted in June 2010.

49 Expert interview with Mr. Pitambar Prasad Acharya, Chair of MIFAN and Executive Director of DEPROSC Nepal and Ms. Ambika Pradhan, Principle Director, Manushi FINGO.

3.7 DEPOSITOR PROTECTION/DEPOSIT INSURANCE

In its 2006-10 strategic plan, the NRB outlined that a "deposit insurance system will be initiated for safeguarding public depositors, particularly the small savers who cannot assess risk". Furthermore, NRB has declared in its Monetary Policy for 2010-11 that necessary policy and institutional arrangements will be made to protect the interest of small individual depositors by means of compulsory insurance of saving and fixed deposits of up to NPR 200,000 (USD 2,733). The issue of deposit insurance has been in discussion for a while and there are several initiatives have been taken in this direction, which are at different stages of development. Some of them are listed below:

- According to press reports,[50] the Deposit Credit Guarantee Corporation (DCGC) has increased its paid-up capital to NPR 210 million (USD 2.87 million) and launched a programme, effective from July, 17 2010, whereby the entity will insure savings and fixed deposits up to NPR 200,000 (USD 2,733), to be held initially at class D institutions. The entity would charge NPR 0.20 for every NPR 100 guaranteed. Depositors with a bankrupt institution would get their money back within 90 days from the date of liquidation. Such deposit insurance, however, is not compulsory and it remains the responsibility of the individual depositors to cross check with the institution whether their deposits are guaranteed or not. However, in interviews held in June last year with experts and representatives from the NRB, FINGO and Commercial Bankers Association, most stakeholders are not in favour of DCGC being responsible for this function, and doubt the entity's capacity (in terms of manpower, capital and technical ability).

- After the recent crash of Nepal Development Bank, NRB has paid greater attention towards deposit insurance and is thinking of launching a system under the NRB that would cover up to NPR 200,000 (USD 2,733). During an interview, NRB officials mentioned that the entity is planning to create a holding company to provide deposit insurance (possibly one holding company for both commercial banks and MDBs or two separate entities). NRB envisages that commercial banks would have a stake and contribute towards raising the capital for this entity. However, the NRB recognises that they would have to issue the necessary regulation (as BAFIA does not allow for deposit insurance business) and would also need to acquire the technical expertise. However, given the country's current political situation, the NRB is doubtful if the proposal will be approved in the near future.

- NEFSCUN is also considering getting into deposit insurance, but this is at an early stage. They are considering operating a deposit guarantee system for all SACCOS, but this would require a high degree of commitment from the member. NEFSCUN representatives recognise that they would face capacity constraints in managing such funds, and that if SACCOS are asked to deposit 10% of their liquidity at NEFSCUN for the purpose of deposit guarantee, many of them will be reluctant.

50 My Republica Newspaper: http://www.myrepublica.com/portal/index.php?action=news_details&news_id=20996 and The Himalayan Times: http://www.thehimalayantimes.com/fullNews.php?headline=DCGC%27s+deposit+guarantee+&News

3.8 LIQUIDITY MANAGEMENT

- Commercial banks, development banks and finance companies must maintain 5.5% of their total deposit liabilities with the NRB as cash reserve ratio (CRR), whereas finance companies not accredited to operate current account must maintain 2% CRR. Likewise, class D financial institutions that mobilise public deposits must also maintain 2% CRR.

- Statutory liquidity requirement (SLR) was introduced in 2009-10 to enhance the financial soundness of banks and financial institutions. Commercial banks, development banks, finance companies and other financial institutions, which are not authorised to operate current accounts, are required to maintain 15%, 11%, 10% and 6% SLR ,respectively. Class D financial institutions, which mobilise deposits from the general public are also required to maintain 4% SLR. Investments in government securities, cash in vault, deposits held with the NRB (including the cash reserve requirements of bank and financial institutions) can be used to arrive at the SLR.[51]

- Class D licensed institutions are required to maintain with the NRB a mandatory cash reserve equivalent to a minimum of 0.5% of the amount of savings collected and funds borrowed. They must maintain a minimum of 2.5% of their total deposit liabilities in the form of liquid assets, which comprise of the following: (a) cash in vault, (b) investments in government securities, (c) investments in NRB bonds, (d) deposits maintained with class A institutions.

- According to IMF's Article IV report (July 2010), the NRB recently introduced a credit-to-deposit (CD) ratio limit for banks. The CD ratio must not exceed 95% at the end of 2009-10, 85% by end of 2010-11 and 80% by the end of 2011-12.

- As mentioned in the NRB Act, 2002, the NRB can provide discount facilities, loans and refinance facilities, for a maximum period of six months, to commercial banks and finance companies that have accounts with the NRB against appropriate collaterals. The commercial banks and financial institutions can avail the last resort facility for a maximum of one year post consent from Government of Nepal.[52]

3.9 FINANCIAL LITERACY

The *MicroSave* research team could not find any details regarding government or donor programmes with a focus on financial literacy/awareness. A Banking Promotion Board (BPB) was established in 1968 with representatives from the Government, banks and trading communities. The main objective of the Board was to promote banking activities across the country by creating awareness among the general public on banking services, both in terms of deposit mobilisation and credit extension. However, the activities of the BPB seem to be limited to business promotions of member banks through publicity, problem identification and advocacy.

51 *Directives No.13/067 (Unified directives 2067); Bai.Bi.Ni.Bi./Niti/Paripatra/50066/67/Dated:2067.3.32/July 16, 2010 and Monetary Policy 2010/2011, Nepal Rastra Bank.*
52 *Monetary Policy, Nepal Rastra Bank, 2008-2009.*

3.10 CAPACITY BUILDING RESOURCES AND NETWORK INSTITUTIONS

3.10.1 The Rural Microfinance Development Centre Ltd. (RMDC)

The Rural Microfinance Development Centre Ltd. (RMDC), established in 1998, is an apex wholesale lender and capacity building institution for the promotion and development of Nepal's microfinance sector. RMDC is a public limited company promoted by the NRB, 13 commercial banks, five RRDBs, the DGDC and the Nirdhan Utthan Bank Ltd., with a paid-up capital of NPR 320 million (USD 4.37 million). The RMDC is categorised as a class D financial institution under BAFIA.

Major activities of the RMDC, include provision of wholesale loans, institutional capacity building support to its partner MFIs and training support to end borrowers in areas, like adult literacy, non-formal education, gender sensitisation, group development, leadership development, and entrepreneurial and occupational skills development. On July 15, 2009, the RMDC entered into partnership with 79 organisations comprising 7 MDBs, 9 DBs, 24 FINGOs and 39 SACCOs. The RMDC also plays a role in supervising and monitoring its partner MFIs through quarterly visits. The organisation is very strict about ensuring on-time repayment and proper utilisation of funds.

3.10.2 Centre for Microfinance (CMF)

The Centre for Microfinance (CMF) is the offspring of a project implemented by the Canadian Centre for International Studies Co-operation funded by the USAID. The CMF is now an autonomous private company registered under the Companies Act. The CMF provides training, technical assistance and consultancy services to strengthen the microfinance sector in Nepal through a committed team of microfinance professionals. The CMF also undertakes studies, research, documentation and is involved in dissemination as well. In collaboration with its partners within the region, the CMF has also been coordinating various conferences and lobbying with the NRB and the government on policy issues.

***The CMF provides** training, technical assistance and consultancy services, as well as studies, research, documentation and dissemination to strengthen Nepal's microfinance sector.*

3.10.3 Network Institutions

The following networking institutions are instrumental in developing standards and norms for MFIs and also in ensuring compliance among member institutions:

- Nepal Bankers Association
- Microfinance Bankers' Association of Nepal (MBAN)
- Microfinance Institutions Association of Nepal (MIFAN)
- Nepalese Federation of Saving & Credit Co-operative Union Ltd. (NEFSCUN)

These institutions have been involved in advocacy to create conducive policy environment in Nepal. More details about these institutions are included in *Annexure 1*.

4. MICRODEPOSIT SERVICE PROVIDERS: OUTREACH, METHODOLOGIES AND PRODUCTS

In July 2009, the total deposits mobilised in Nepal were NPR 674,584 million (USD 9,217 million) and total loans advanced were NPR 511,753 million (USD 6,992 million). Commercial banks, which constitute only 10.74% of the total number of licensed deposit-taking institutions, mobilised the majority of deposits (83.5%) and advanced the majority of loans (78%) in terms of value.

Figure 20: Institution-Wise Share in Aggregate Deposit

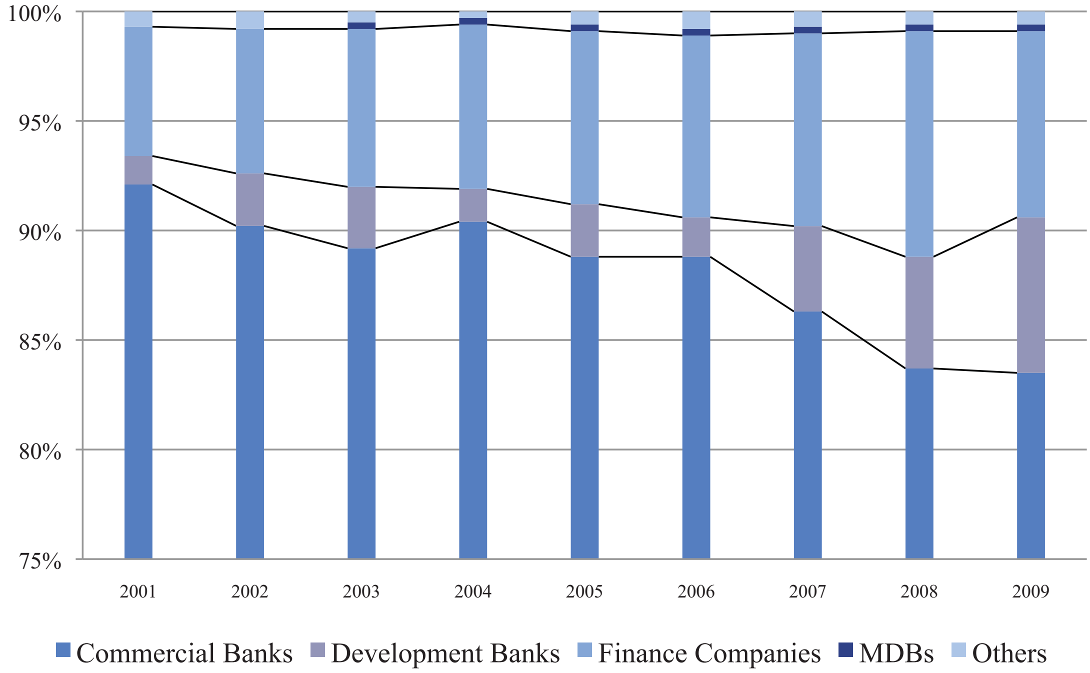


Figure 21: Distribution of Deposits (2009)

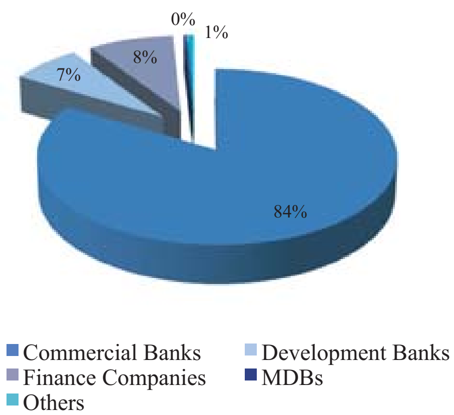
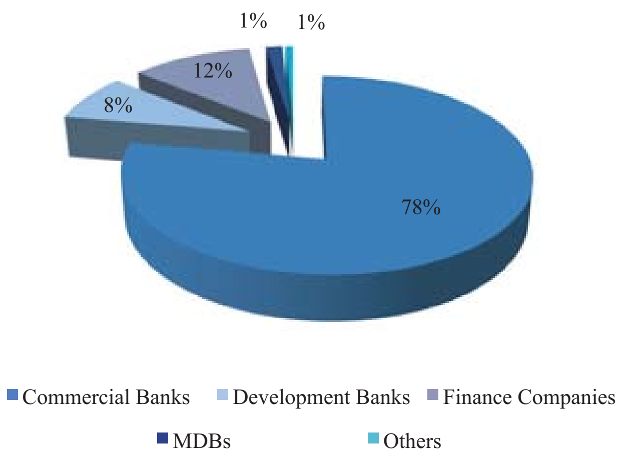


Figure 22: Distribution of Loans (2009)



4.1 COMMERCIAL BANKS, DEVELOPMENT BANKS AND FINANCE COMPANIES

4.1.1 *Methodologies and Outreach*

Commercial banks, development banks and finance companies generally service their clients through physical branches/counters. Other than branches, ATMs, internet banking and mobile banking platforms provide convenient touch points for clients to carry out banking transactions. In the last two years, it has become possible to perform simple tasks, like balance enquiries, chequebook requests, fund transfers and bill payments, through the internet and mobile banking facilities. Cash withdrawals, within prescribed limits, have been made very convenient through ATMs. Generally, banks target people with regular and stable incomes who conduct high value, but less frequent transactions. Commercial banks also offer 'anywhere banking' services through which customers can access banking services at any branch of the same bank. Recently, the policy has been amended and ATMs can be installed even by licensed B and C class banks and financial institutions.[53] Other licensed institutions, like SACCOs and FINGOs, may install stand-alone ATMs meant only for their members.

In July 2009, class A, B and C financial institutions established 1,167 branches. A majority of these branches (65%) were established by commercial banks, followed by development banks (21%) and finance companies (14%). Out of all branches, 50% are located in the central region, which includes Kathmandu, followed by the western region (23%). *Table 7* shows the number of branches in each of the ecological regions. It is clear from the table that the concentration of branches is highest in the Kathmandu Valley and Terai, with lower penetration in hills/mountains.

Figure 23: Region-Wise Distribution of Bank Branches (A, B, and C)

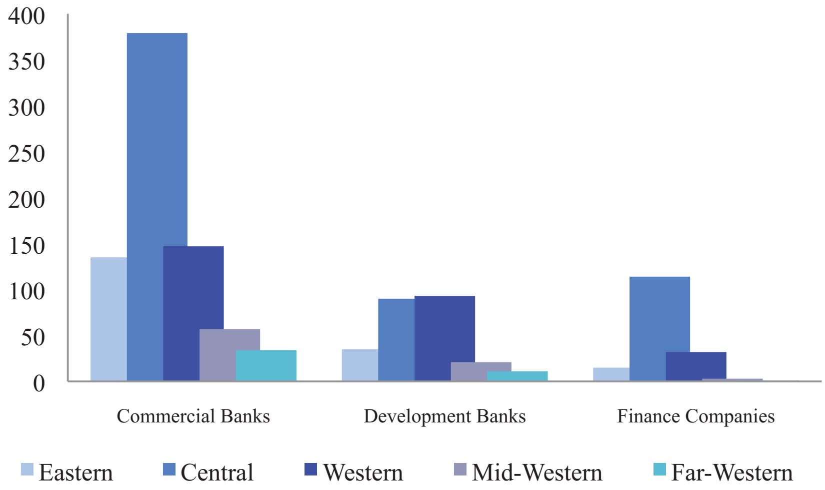


Table 7: Number of Commercial Bank Branches in each Ecological Region[54]

	2007	2008	2009
Kathmandu Valley	126	157	239
Terai	197	242	307
Hills/Mountains	129	156	206
Total	**452**	**555**	**752**

53 *Directive No.21/067 Unified directives 2067) Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/July 16, 2010-09-14*
54 *Economic Survey Report 2009 – Published by Nepal Rastra Bank.*

In July 2009, there were 752 commercial bank branches in Nepal. In 2008-09, the number of bank branches increased by 52% in the Kathmandu Valley, 32% in the hills and 27% in the Terai. In an effort to expand the reach of the country's financial services to its remote areas, the NRB issued a directive whereby, to get permission for a new branch in the Kathmandu Valley,[55] a bank is required to open at least one branch outside the Kathmandu Valley. However, even before the directive was issued, banks had already started searching for opportunities in the country's remote areas, as the main markets had saturated.

According to an economic survey conducted by the NRB at end of financial year 2008-09,[56] a fair degree of progress has been made in recent years in terms of financial inclusion. From 2007 to 2009, the population covered per branch has reduced by 9%, the per capita deposit has increased by 44%, and the per capita loan has increased by 42%.

Table 8: Financial Expansion and Deepening Indicators – Commercial Banks

	Mid April 2007	Mid April 2008	Mid April 2009
Commercial Bank Branches	546	591	617
Population Per Branch	47,120	44,499	42,832
Per Capita Deposit (USD)	173	195	249
Per Capita Loan (USD)	172	201	244

Even though NRB's directives for the business correspondent model and mobile branch banking are in place (refer to *Annexure 2*), few banks, like the Everest Bank Limited, have introduced them.[57] Though the Everest Bank has introduced a Point of Transaction (POT) machine – manufactured by the Mumbai-based company Financial Inclusion Network and Operations Limited (FINO), India – to collect door-to-door deposits in remote areas, the programme is yet to break even. The Everest Bank also initiated the 'bank on wheels' mobile banking service in September 2007.

Other banks that have introduced m-banking services, include NABIL Bank, Kumari Bank, Bank of Kathmandu, Machhapuchhre Bank, Nepal Bank Limited and Laxmi Bank. The services offered through mobile phones vary from bank to bank. NABIL Bank offers a real-time, pre-paid mobile top-up directly from the account to Nepal Telecom mobile subscribers. Machhapuchhre and Nepal Bank Limited offer features, like account balance verification, exchange rate information, account statements (last five transactions), PIN change and print requests. On the other hand, Laxmi Bank offers bill payments and transfers to peers, and Kumari Bank also offers payment to merchants, payments, and cash-in/cash-out through either a network of agents or at its branches.

55 *Directive No.14/067 Unified Directives 2067Bai.Bi.Ni.Bi./Niti/Paripatra/50/066/67 dated 16 July 2010*
56 *Economic Survey 2008/09 – Published by Nepal Rastra Bank*
57 *Refer to Annexure 2: Overview of Regulations on Extension Counters, Branchless Banking, and Mobile Branch Banking.*

Case Study 2: Alternate Delivery Channels of Commercial Banks

Business Correspondent Model by Everest Bank Limited

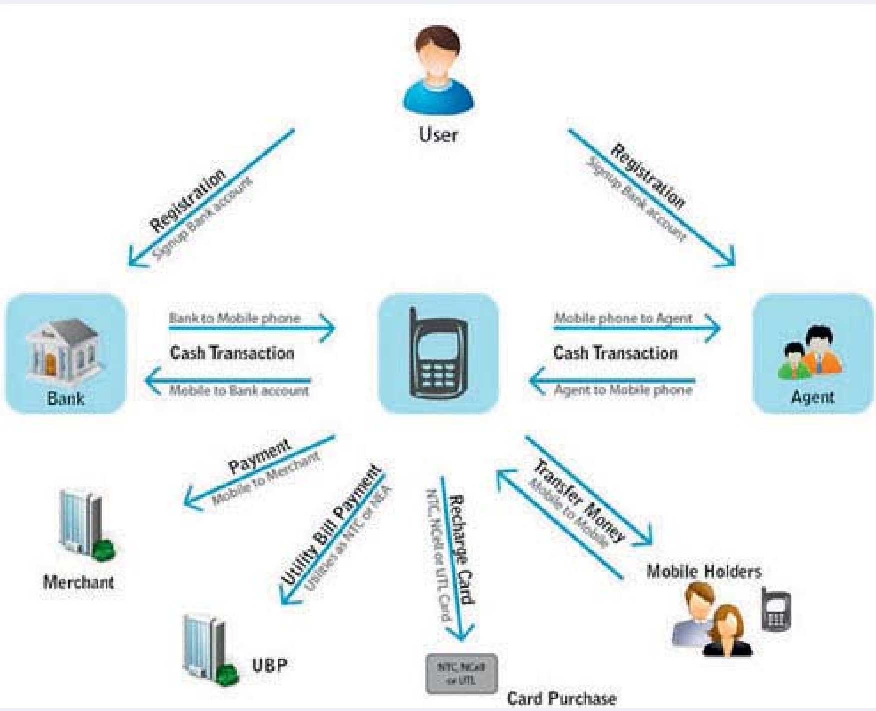
In 2009, in an attempt to provide banking facilities to even the most remote villages, Everest Bank Limited (EBL) introduced a new product – Everest Bank Ghar-Dailo Banking Sewa (banking service at your doorstep). The product is offered through FINO's POT machines, using smart cards. Through this delivery channel, the customer can get banking facilities at their doorstep. Under the doorstep-banking system, the bank identifies and appoints business correspondents (BC/agents), who are given a POT devide to accept deposits and service withdrawals. Account holders are issued a smart card bearing his/her photograph. The account holder can also accept foreign remittances through this system. Once the transaction is complete, the customer receives confirmation through the voice prompt of the machine and a signed transaction receipt.

Bank on Wheels by Everest Bank Limited

Everest Bank started its mobile branch banking operations in September 2007 in three major cities in the Jhapa district. This service was the first of its kind in Nepal. The bank provides the following services through its mobile branches: cash deposits, withdrawals not exceeding NPR 500,000 (USD 6,832) per day, issuance of a chequebook, account statements, ATM cards, and collection and verification of credit related files.

Mobile Wallet by Kumari Bank

On August 17, 2010, the Kumari Bank, in partnership with Leapfrog Technology, a US-based software company, launched the Kumari Mobile Cash service, which uses mobile phones to provide access to financial services. The first of its kind in Nepal, this service pioneers the "mobile wallet" concept, which allows users to store cash balances in their mobile phones. Users are then able to deposit and withdraw cash from their mobile phones, and use the stored cash value to remit to anyone, anytime, anywhere. At present, this service is available through all of Kumari Bank's 28 branches and 189 authorised agent locations across the nation.



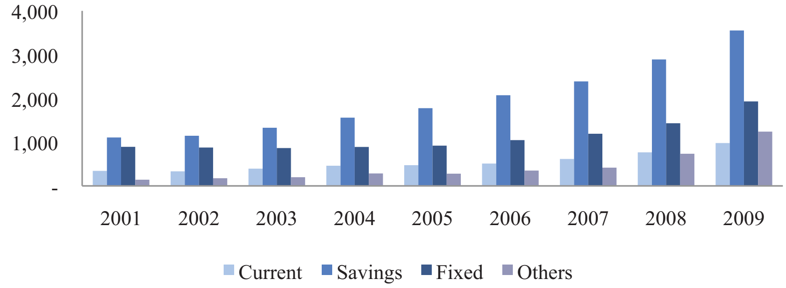
The service is currently supported by Nepal Telecom GSM phones and will soon be extended to the NCell network, as well as to CDMA networks. This service safely, efficiently and conveniently allows users to perform the following functions from their mobile phones: deposit cash, transfer (remit) money to family and friends, transfer funds from a Kumari bank account to a mobile phone and vice versa, transfer funds from one Kumari bank account to another, withdraw cash from branches or from a Kumari Mobile Cash agent, pay bills at restaurants, shops and stores (Kumari Mobile Cash Merchant), pay utility bills, and recharge pre-paid airtime.

The section below shows the types of accounts offered by the class A, class B and class C banks, as well as the break-down of deposit composition by type of accounts and its evolution.

4.1.2 DEPOSIT PRODUCTS

Commercial banks, development banks and finance companies provide a range of financial services to their customers, such as credit, deposit, investment banking, foreign exchange and remittance. Depending on the customers' needs, banks offer facilities like ATMs, debit/credit cards, internet/mobile banking, bill payment facilities, flexible branch timings, safe deposit locker facilities, foreign exchange, etc.

Figure 24: Deposit Ratio of Commercial Banks (Million USD)



4.1.2.1 Savings Deposit Accounts

Savings deposit accounts offer liquidity by allowing withdrawals on demand and often require low minimum balances. Almost all products offered by banks insist on a minimum balance, which varies from zero to NPR 50,000 (USD 683), depending on the facilities offered. Lately, most commercial banks have introduced low balance or zero balance accounts in an effort to capture the lower income segments, reducing the minimum balances that were previously in the range of NPR 10,000 to NPR 50,000 (USD 137 - USD 683).

Most banks have similar minimum documentation requirements for opening an account in compliance with KYC[58] norms and often do not charge for the service. Savings deposit accounts earn interest of 2% to 8% per annum on daily or monthly balances, depending on the bank. Many banks offer savings deposit accounts targeting a particular audience such as salaried employees, children, women and senior citizens. These accounts often require higher minimum balances, but offer higher interest rates as well. Specific banks offer some or all of the following facilities on their savings deposit accounts: anywhere banking services, ATM facilities, debit cards, e-banking facility, free chequebook facility and bill payment services, among others.

Figure 25: Deposit Ratio of Development Banks (Million USD)

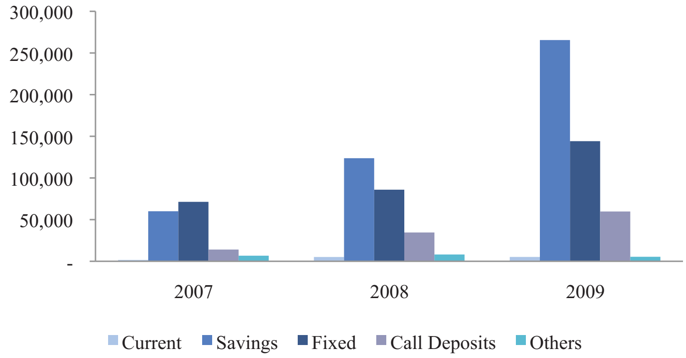
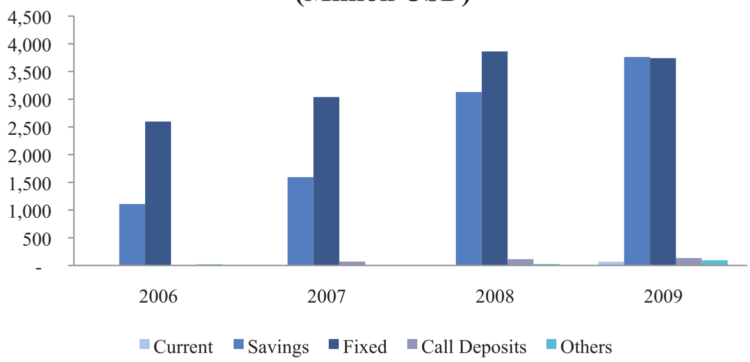


Figure 26: Deposit Composition of Finance Companies (Million USD)



4.1.2.2 Term Deposit Accounts

Term deposit accounts can be recurring (where equal deposits are made at fixed intervals over a fixed period of time) or fixed (where a onetime deposit of a higher amount is made at the time of account opening). Withdrawal from a fixed account is not permitted during the lock-in period and a penalty is levied in case of premature withdrawal. The interest offered is higher than the normal savings deposit and ranges from 5% to 11%, depending on the duration. Loan facilities are also provided by certain banks against fixed deposits. No charges are levied for opening the account.

58 *KYC requirements include: (i) name and signature, (ii) name of father and husband, (iii) permanent address proof (citizenship certificate, passport, water/electricity bill, location map prepared by the bank staff who has visited the place, if necessary voter's identity card, or certificate of land ownership), (iv) temporary address, (v) date of birth, (vi) telephone number, (vii) citizenship/passport (number and particulars), (viii) photocopy of identity card if employee of Government of Nepal or Government of Nepal owned institutions, and (ix) photo.*

Case Study 3: M-Banking in Nepal – Scope and Challenges

During the market research in four districts of Nepal, low-income individuals expressed their need for trustworthy, secure and easily accessible places to save. Low-income individuals attributed high value to the ability to deposit and withdraw anytime at their convenience from a nearby place. Given the geography of the country and percentage of rural population, satisfying these needs poses a challenge for financial service providers in terms of capacity and cost. Other countries with similar challenges have tried to overcome them through the establishment of mobile banking systems, few of which have successfully enabled the rural poor to make financial transactions from their mobiles. Such context gives rise to the question: Is there scope for m-banking in Nepal?

The table below presents enabling and limiting factors for implementation of m-banking in the country.

Enabling Factors	Limitations
1. ***Demand side research*** repeatedly suggested that people need a convenient, fast and easily accessible mode to save.	1. ***Evolving payments and settlement system:*** The payment system in Nepal is dominated by cash transactions. Bank drafts, cheques, SWIFT payments and plastic card-based transactions, credit and debit cards, are also available, but their use is limited.[63] Nepal still relies on manual clearing of cheques through eight offices of the NRB,[64] distributed across the country (no automated clearing house) and does not have an electronic payment system. In July 2009, there were 500,000 debit cards and 17,000 credit cards issued by banks, and 520 ATMs throughout the country. The ATMs are interconnected through a national switch managed by SmartChoice Technologies Pvt. Ltd (SCT). The company is an integrated shared services network for ATMs and point-of-sale (POS) terminals. The SCT network is fully integrated and supports multiple device types and card acquiring standards.[65] In November 2009, SCT and its e-commerce partner and payment solution provider D-Sys Private Limited signed up to provide e-payment solutions for SCT members. However, the system is still in its nascent stage. The NRB plans to establish and operate a Real Time Gross Settlement System (RTGS) and a Scripless Securities Settlement System.[66]
2. ***High percentage of mobile ownership:*** According to the Nepal Telecommunication Authority, there are at least 7,648,710 mobile users, constituting approximately 27.3% of the total population.[59]	2. ***Weak co-operation between telecos and banks***: As quoted by Laxmi Bank, Bank of Kathmandu, and even NTC, telecom companies have thus far been resistant to the deployment of USSD services for m-banking. NTC complains that they cannot work with just one bank and they need a standard approach from the banking sector.
3. ***Presence of a telecom company with high market share:*** Nepal Telecom (NTC), a government-owned company, provides service to 62% of all mobile users in the country.[60] Establishment of a public-private partnership with NTC (given it is willing to cooperate) would enable great outreach through just one tie-up.	3. ***Unstable/unreliable mobile network***: As quoted by staff of Laxmi Bank and Bank of Kathmandu (both banks in process of implementing m-banking solutions), and experienced by the team during its visit to Nepal, the mobile phone network is unstable, with users facing difficulties in making calls and often receive the same text messages several times by error.
4. ***Wide mobile network coverage*** reaching the hilly and mountain areas, which otherwise have limited infrastructure. In May 2009, out of 3,913 village development committees, the TTC had its CDMA coverage in 2,765 of them.[61] With expected growth in the telecom infrastructure, the number of cellphone users in the country is expected to reach 22 million in the next five years.[62]	
5. ***No regulatory obstacles***: The NRB has not yet issued any direct guidelines on m-banking services. However, branchless banking directives have been issued and could be extended to cover m-banking as well. According to NRB directives, commercial and development banks can start branchless banking activities if they comply with some norms, like: signing an MOU with a technical service provider; compliance with industry standard security features (not specified or detailed); purchase of an original license for the software in use; arrangements for network security and database confidentiality; integrity and authenticity of the transactions; insurance of cash or other assets involved in providing the service and business limits for branchless banking. In addition, locations where the technology will be used should be decided and business correspondents used should be safe and centrally located (however, the term 'safe' is not specified).	

59 *Ibid.*
60 *Source: Nepal Telecom Company website. Available at http://www.ntc.net.np/cdma/cdmaCoverage.php*
61 *Source: Interview with Lochan Lal Amatya, Manager, NTC.*
62 *Mathema, Sushil Ram, Article on "Payment System", Published in "Nepal Rastra Bank in 50 Years", Nepal Rastra Bank, Kathamndu, 2005.*
63 *Source: "Payment and Settlement System in Nepal", presented at the 6th SAARC Payments Council Meeting on November 03, 2009, Thimphu, Bhutan, Nepal Rastra Bank.*
64 *http://www.sct.com.np/*
65 *Strategic Plan 2006-2010, Nepal Rastra Bank. Available at: http://www.nrb.org.np/cpd/strategicplan_new.php*

4.1.2.3 Current Accounts

Current accounts are generally used as business accounts with no restrictions on the frequency of transactions and are typically non-interest bearing. Certain banks offer facilities for electronic transfer, chequebooks and ATMs to current account holders. Minimum balances kept in these accounts are generally high and ledger maintenance fees are charged if the balance drops below the minimum level stipulated.

4.1.2.4 Retirement Funds

Many banks offer retirement funds as a savings option for employees in the organised sector. However, the NRB and the Inland Revenue Department must approve such schemes before they can be launched. Approved retirement deposit schemes are exempted from tax. The fund matures at the time of retirement and generally accrues interest rates ranging from 7% to 9%. Depending on the bank, additional benefits, such as insurance, may also be available with this product.

4.1.3 Marketing and Promotion Strategies of Banks

Commercial banks do marketing by installing hoardings at conspicuous places and advertise through the internet, print and visual media. Banks generally create product awareness through advertising campaigns, using product brochures and advertisements in vernacular language. Other promotional activities, like sponsorship of events and setting up stalls, are also used for marketing.

In addition, banks use the following techniques for promoting their products and services:

- *Attractively Named Products for Target Audience:* Most commercial banks offer products targeted at children, women, and the elderly. For example, Everest Bank Limited's *Naari Bachat Khata,* Kumari Bank's *Subha Laxshmi Savings*, NABIL's NABIL's *Nari Bachat* (women's savings); EBL's *Baal Bachat Khata*, Kumari's Twinkle Star Savings, and NABIL's *Bal Bachat* (children's accounts); and Kumari Bank's 50-Plus Savings, NABIL's *Jestha Bachat* (for the elderly) and EBL's *Bishesh Savings* (for special needs).

- *Special Features and Benefits:* Most savings accounts are marketed with some special facilities, which may include ABBS (any branch banking service), internet banking, free debit card and chequebook, free health check-up and discount on locker facility, among others. In addition, targeted accounts offer special benefits, such as privilege lounge facility, free accident insurance and utility payments (Nepal Investment Bank Limited [NIBL] for its high value customers), movie tickets, cookery classes, discounts on consumer goods, special token of memento at the time of account opening, birthday gift every year, discount on education loans, free training program in banking for school children (Kumari Bank on children's savings), free utility payments, special privilege counter, and other discounts on fees and commissions (Kumari Bank on 50 Plus Savings account).

- *Any Branch Banking Service (ABBS) and 365 Days Banking*: Banks promote their anytime/anywhere services by providing ABBS, evening counters, ATMs, and more recently, e- and m-banking services.

Based on the information gathered and given the existing competitive scenario, most banks do not spend time or money on market research or product development. They focus on advertising and promoting special programmes to attract clients. The recently introduced credit-to-deposit ratio[66] has further increased competition to attract deposits, which explains the wide range of promotional offers available in the market.

***Most banks focus** their efforts (and expenses) on advertising, promotion, and special programmes to attract clients rather than market research and product development.*

4.2 MICROCREDIT DEVELOPMENT BANKS AND FINGOS

4.2.1 Methodologies and Outreach

4.2.1.1 Grameen Model

Microcredit development banks and FINGOs generally follow Bangladesh's Grameen Bank model in which the bank provides credit for micro-level income generating activities on a group guarantee basis. A group comprises of five women, typically drawn from homogeneous socioeconomic strata. Four to five such groups form a centre and each centre is serviced by a loan officer. The group gathers to do financial transactions on a weekly, fortnightly or monthly basis. Generally, both savings and loan repayments are collected by the loan officer from the clients' doorstep and deposited at the branch. However, for security reasons (which emerged due to the political unrest in the country), a few institutions require clients to come to the branch with their repayment instalments. In addition, Chhimek Bikas Bank (CBB) and Nirdhan have recently introduced alternate methods to reduce operating costs and increase outreach. (See CBB model detailed in Section 4.2.1.2).

According to Mr. Dharma Raj Pandey, Chairman of Nepal Microfinance Bankers Association, in June 2010, MDBs had an outreach of 617,000 clients in 56 districts of the country. Furthermore, in July 2010, FINGOs had an outreach of approximately 400,000 clients in 38 districts, said Mr. Pitambar Prasad Acharya, Chairman of MIFAN.

4.2.1.2 Chhimek Bikas Bank Model

The Chhimek Bikas Bank has developed a variation of the traditional Grameen model. No cash transactions take place at the unit meetings; instead, clients have to come to the branch office to deposit their savings and loans instalment one to two days before the due date.

66 *IMF Article IV Report, July 2010. NBR has mandated that Credit-to-Deposit ratio of Banks should not to exceed 95% by end of 2009/10, 85% by end of 2010/11 and 80% by end-2011/12.*

Recently, the CBB introduced the Self-Discipline Member system, in which members conduct group meetings and receive a cash payment for this service. The self-discipline member must meet the following criteria:

<table>
<tr><th colspan="3">Table 9: The Self-Discipline Member System of Chhimek Bikas Bank</th></tr>
<tr><th>Criteria</th><th>Benefits</th><th>Responsibilities</th></tr>
<tr>
<td>1. Able to read and write
2. Excellent attendance and repayment record
3. Positive attitude towards CBB
4. Unit recommendation
5. Approval from guardian
6. Able to give time for training and other activities, as needed</td>
<td><table>
<tr><th># Members in Unit</th><th>Benefit per Meeting (NPR)</th></tr>
<tr><td>Up to 15</td><td>150 (USD 2.05)</td></tr>
<tr><td>16 to 20</td><td>175 (USD 2.39)</td></tr>
<tr><td>21 to 25</td><td>200 (USD 2.73)</td></tr>
</table></td>
<td>1. Loan analysis
2. Loan utilisation supervision
3. Update passbooks
4. Loan application
5. Loan disbursement
6. Member recruitment and group formation</td>
</tr>
<tr><td colspan="3">Source: Discussion with CBB's Senior Management Team</td></tr>
</table>

4.2.1.3 Self Reliance Group Model (SRG Model)

Microfinance operations in the hilly regions of Nepal entail high operating costs due to low population density and poor infrastructure facilities. The SRG model was designed by Nirdhan Utthan Bank Ltd. to reduce operational expenses and allow them to serve areas with low population density. In the SRG model, bulk loans are given to a unit/centre, which, in turn, manages the on-lending process. Loan disbursement to the member, repayment collection and delinquency management are done by the members during their monthly meeting. The interaction of members with the loan officer is minimal and confined to supervision and record maintenance. The centre lends to the members, adding a margin that gives the centre a spread to meet its expenses.

4.2.2 Products

Class D microcredit development banks and FINGOs provide credit and deposit services. MDBs also provide remittance service through franchise agreements. Deposit products include compulsory savings, voluntary savings, recurring deposits, life/pension savings and disaster savings. MDBs generally offer high interest rates ranging from 6% to 8%. Most savings accounts of the MDBs and FINGOs are directly or indirectly linked to credit and have restrictions on withdrawal. For example, Chhimek Bikas Bank offers a voluntary savings account, however, the institution has developed a system of incentives to ensure that clients always deposit some amount in the account and maintain funds.

4.2.2.1 Compulsory Savings

Most microcredit development banks offer this type of account, in which clients must deposit a minimum fixed amount of money periodically (at the same frequency as the loan instalment). While clients can deposit any amount of surplus money with them, the minimum deposit amount is fixed.

- Deposit amount varies roughly from NPR 16-40 (USD 0.22-0.55) per month.
- Restrictions often apply on withdrawal (minimum balance to be maintained in the account and total withdrawal only at the time of termination of membership).

4.2.2.2 Voluntary Savings

MDBs also offer voluntary savings accounts, in which clients can deposit as much as they want. However, many times the account provides incentives for not withdrawing.

- The minimum balance is generally lower than on compulsory savings, ranging from NPR 10-100 (USD 0.14-1.36).
- Withdrawal is more flexible than in compulsory savings, often without restrictions.

4.2.2.3 Life/Pension Savings

This type of account was recently introduced by a few MDBs to ensure long-term availability of funds. For 8 to 16 years, the account is a recurring deposit account, where clients have to deposit an amount of NPR 50 (USD 0.68) or more, on a monthly basis. Most of the institutions have developed schemes where the money becomes 150% or 200% of the amount deposited, depending on the tenure chosen.

4.2.2.4 Disaster Savings

A few MDBs also offer a disaster savings account, which is a cash security with insurance coverage, in case of natural disasters. The terms below reflect the features of the disaster savings account of Chhimek Bikas Bank:

- Client must deposit 5% of the general loan amount at the time of loan disbursement and keep it with the institution for the tenure of the loan. They must deposit this amount if it is a first cycle loan and need not deposit for subsequent loan cycles, provided they have subscribed to the Pension Scheme Account.
- Client can withdraw the savings (i) at the time of disasters, like flood, landslide, earthquake and snake bite, (ii) after the completion of five years (if the balance is below NPR 3,000/USD 41), or (iii) if balance in the account exceeds NPR 3,000 (USD 41).

4.3 SAVINGS AND CREDIT CO-OPERATIVES IN NEPAL

In 2009, there were 16 NRB-licensed SACCOs established under the Co-operative Act, 1991. According to the Registrar of Co-operatives, another 5,162 non-licensed SACCOs were operating across the country in April 2009, serving a total of 714,516 members.

SACCOS offer the widest range of products and most often deliver door-to-door services through collectors. Common products among co-operatives include:

- Compulsory savings: Members fix the minimum amount. In rural areas, the amount starts from NPR 5 and goes up to NPR 500 (USD 0.68 up to 68.49) per month, whereas in urban areas the amounts are usually higher. Members cannot withdraw these savings unless they terminate membership, but they can take a loan against 90% of the savings (for the first loan) and then the loan available may increase as they pay on time and maintain a good standing. In some cases, members can take up to five times their savings balance.

- Recurring deposit: Regular monthly/weekly/daily savings.

- Piggy bank savings: Members obtain a piggy box in which they can save any amount at any time. The SACCOs collector has the key of the piggy box and takes the funds from the piggy box on a regular basis, usually monthly.

- Children savings (often through piggy bank): Children deposit the amount in the piggy bank and on a weekly/monthly basis, the SACCO staff will collect it from the house or parents will deposit the money at the SACCO.

- Fixed deposits, current accounts, emergency savings for medical expenses, pension savings (similar to life/pension savings of MDBs), and single-purpose savings, including festivals, education, mobile and motorcycle savings, among others.

4.4 INSURANCE

In July 2010, there were seven life insurance companies and 16 non-life insurance companies in Nepal. Dr. Anil Bhattarai, Executive Director of the Insurance Board, explained that the insurance sector in Nepal is not well-developed, that there is a lack of awareness about insurance and that poor business culture by insurers has led to unhealthy and low-quality services in the market. Insurance services have not yet reached the rural and low-level income groups and the market is fragmented, with too many insurers chasing too little business. Dr. Bhattarai added that due to political uncertainty, investors' confidence remains low. However, the industry does recognise that there is scope for growth in microinsurance.

***Challenges facing** the insurance sector include: lack of awareness, poor business culture which has led to low-quality services and limited outreach has led to a fragmented market.*

To foster the insurance sector, the Insurance Board recently proposed the Insurance Bill, 2010, which introduces the microinsurance concept and underlines its importance in the country. Side by side, the Insurance Board is working with the Microinsurance Academy, India, to develop the regulatory approach for microinsurance for formal insurers and also for mutually beneficial organisations. According to Mr. Sudarsan Dhakal, Registrar of Co-operatives, a national policy for microinsurance is lacking and the existing regulation does not enable co-operatives to provide this service.

In order to fill this gap to some extent, NEFSCUN has initiated a mutual aid programme. NEFSCUN Mutual Aid is a co-operative-based financial security system, aimed at pooling resources among members of co-operatives, who are excluded from formal social protection mechanisms. In January 2007, NEFSCUN started issuing a death risk policy (DSP) with double accidental death benefit; in October 2008, NEFSCUN introduced the Co-operative Security Policy (CSP), a 10-year term combined savings and death risk policy. At the end of 2009, insurance services were provided to members of 29 SACCOs and another 31 SACCOs have signed memoranda of co-operation, and are gearing up to offer insurance policies to their members. By the end of 2011, NEFSCUN wants to expand its insurance services to 120 SACCOs reaching more than 5,800 members and their households. The institution receives technical assistance from the Agriterra and Microinsurance Association in the Netherlands (MIAN).[67] There are other smaller programmes spread throughout the country with lower outreach. However, these are not recognised as significant initiatives.[68]

Case Study 4: Microinsurance Initiatives at Nirdhan Uthan Bank Ltd[70]

Nirdhan Uthan Bank Ltd (NUBL) provides microinsurance products in addition to its savings and loan products. NUBL clients are highly vulnerable to economic shocks caused by events, such as death of family members, illness, destruction of assets or disabling injuries; their insurance products are developed to address these needs. Nirdhan currently has two types of microinsurance products:

1. ***Livestock Insurance:*** NUBL has linked up with the Deposit Credit Guarantee Corporation (DCGC) to provide this service. When clients take loans for acquiring livestock, they pay 3% of the value to the DCGC, and the government matches it with an additional 3% payment. If the animal dies and this is verified by a veterinary office, the agency pays 80% of the loan amount. If the livestock is alive at the end of the loan, the client is refunded 20% of the premium.

2. ***Micro-life Insurance:*** Recently, NUBL entered into partnership with the American Life Insurance Company for term life insurance of its clients. Under this scheme, the clients need to pay NPR 7 per NPR 1,000 and as premium. The premium and benefits are as follows:

Loan Amount (NPR)	Premium (NPR)	Benefit (NPR)	Benefit for Accident Death (NPR)
10,000 (USD 137)	70 (USD 0.96)	12,800 (USD 175)	22,800 (USD 312)
20,000 (USD 274)	140 (USD 1.92)	25,600 (USD 351)	45,600 (USD 625)
40,000 (USD 410)	280 (USD 3.84)	51,200 (USD 701)	91,200 (USD 1,249)

5. CLIENT'S NEEDS AND PREFERENCES

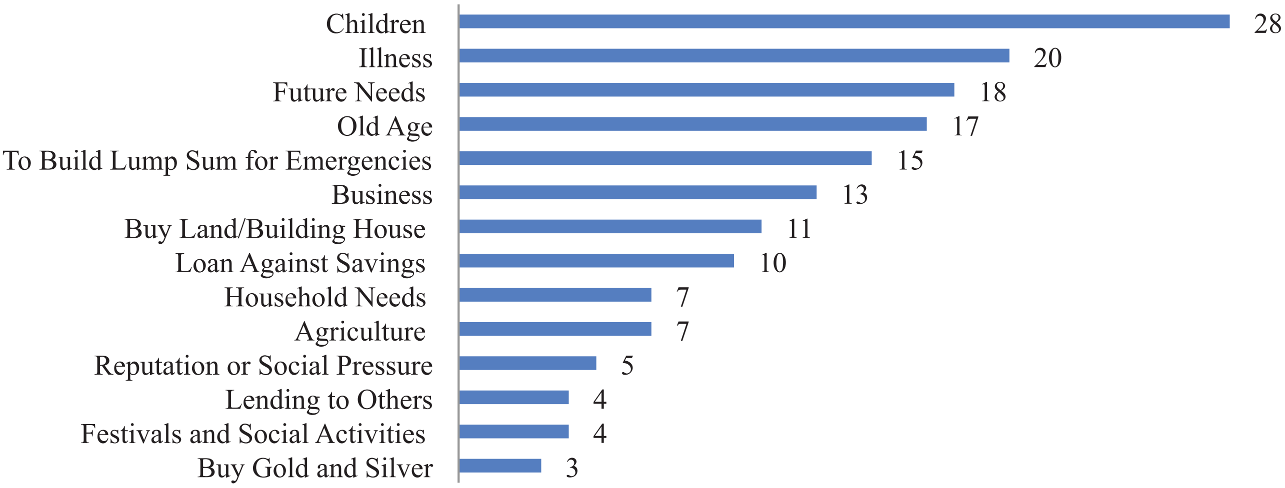
The section given below reflects the results of a market research study conducted in the Terai, hills and mountainous areas to understand the savings behaviour and preferences of low-income people in Nepal. The research reflects the answers of 330 respondents. The detailed findings of the study are presented in the Nepal Market Research Report.

67 Source: NEFSCUN Website http://www.nefscun.org.np/pages/mutual_aid_program.php
68 An Inventory of Microinsurance Schemes in Nepal, International Labour Organisation, Available at: http://www.ilo.org/public/english/protection/socsec/step/download/714p1.pdf
69 Five year strategic planning document of Nirdhan, revised as on 2010.

5.1 PURPOSE OF SAVINGS

Figure 27 shows the most common reasons to save, as cited by the respondents of the research. As can be observed, children and illness are the most common reasons for people to save. The reasons why people save for their children, include education, marriage and the desire to leave an inheritance. With regards to illness, people usually cannot plan for these expenses and thus, when in need, they have to borrow from friends or from other sources at high interest rates. It is therefore important for them to save for this purpose.

Figure 27: Purpose of Savings



Other commonly cited purposes for savings are future needs and for building lump sums for emergencies. These two reasons reflect the fact that many people do not save for a specific purpose, but for a combination of needs or unexpected circumstances that may arise in future. In addition, a good number of respondents save for old age. Surprisingly, people in Nepal also save to maintain their reputation or because of social pressure, as other people in their community also save. This factor is probably influenced by the strong presence of co-operatives in providing financial services. There are several co-operatives in every area and almost every person in every community is a member of one co-operative or another. Since these co-operatives are managed by people from the community itself, people feel pressurised to save.

In addition to the purposes cited above, people save to take loans against savings. This is also a reflection of the savings culture in Nepal, where most of the institutions (co-operatives, FINGOs, and MDBs) offer loans based on savings balance. Taking a loan against savings is also one of the reasons why people save in several institutions, as this increases their chances of accessing loans and can obtain a higher amount by pooling loans from several institutions.

Finally, purchasing land and building a house as well as money for household needs are other common reasons for saving. People, especially in hill and mountain areas, save for consumption smoothing purposes, which also reflects the lower income levels and the seasonality of income in these areas.

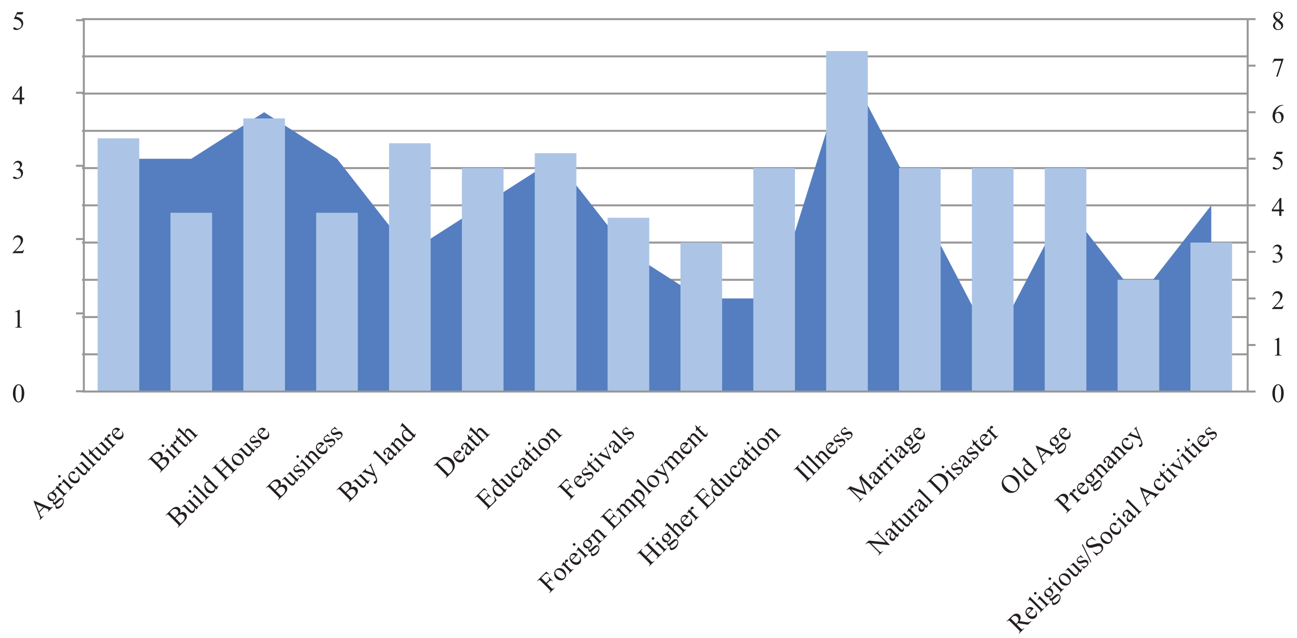
5.2 LIFE CYCLE EVENTS THAT CREATE FINANCIAL PRESSURE

During the research, participants shared that several life cycle events create financial pressure on them. Most of the respondents indicated illness as the event that causes most financial pressure, as it forces people to take credit at high interest rates to meet expenses. Buying land or building houses created the second highest financial pressure, with participants attributing the pressure to the large amount of money involved. Participants also explained that there are not many sources of credit available for buying land or houses. Most of the time, in addition to using all their saved money, participants need to take credit from multiple sources, thereby creating high financial pressure.

Education of children was also cited as a high-pressure life cycle event. Although these are regular expenses, they are related to the children's future and therefore, respondents consider it extremely crucial. Agriculture was also mentioned as a high-pressure expense, as most of the respondents are dependent on agriculture for their means of livelihood. Agriculture expenses mainly include fertilisers and seeds.

Foreign employment was also quoted as a high-pressure life cycle event, as many people see very limited opportunities within the country and want/feel compelled to go outside for work. This requires an initial expense, which they often struggle to manage.

Figure 28: Life Cycle Analysis – Financial Pressure and Prominence



Other life cycle events that create high financial pressure include:

- *Death*: People feel bound to fulfil the culture and the rituals after dealth and these generally imply high expenses.

- *Birth*: A financial pressure is built during the birth of a child only when the delivery is through C-section operation; otherwise, most people plan in advance and do not face financial pressure due to the birth of a child.

- *Marriage*: The level of pressure caused by marriage varies dramatically across areas and according to the prevalent traditions. In a few places where love marriages are common, people indicated there is no high financial pressure at the time of marriage. In areas where the dowry system still prevails, marriage was considered one of the most high pressure financial events. However, in some of the areas visited, people explained that marriage is a planned expense or people spend only as much as they can afford, therefore, it does not cause much financial strain.

- *Old Age*: High financial pressure during old age was attached to the fear of children not taking care of their parents or not having enough savings.

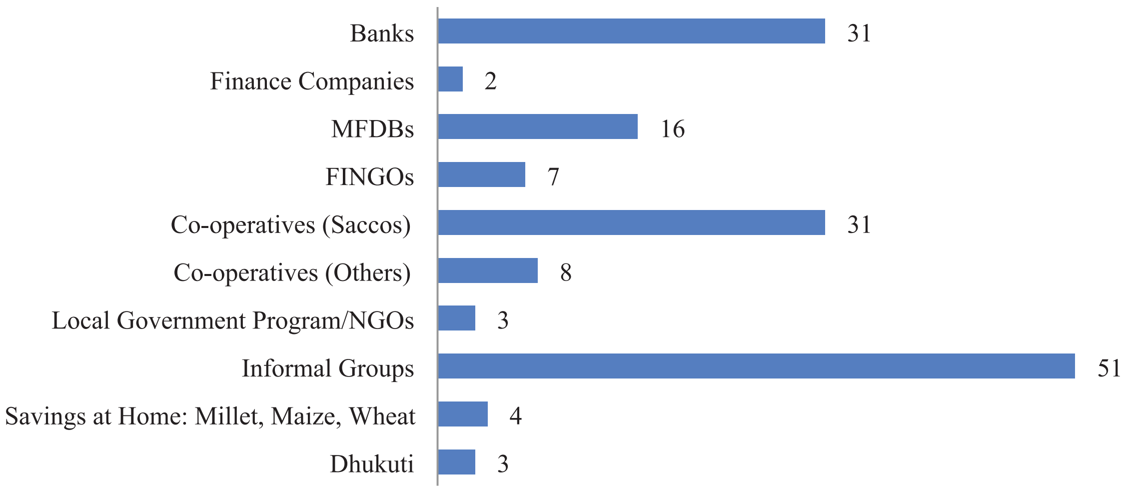
- *Religious and Social Activities*: Most people spend on religious and social activities as per their capacity. However, they feel compelled to celebrate and spend on certain occasions.

5.3 INSTITUTIONS BEING USED AND EXISTING SAVINGS PRODUCTS

5.3.1 Where People Save

Nepalese have a strong savings culture and put their money in a variety of formal, semi-formal and informal institutions, with most people saving in many places at the same time. *Figure 29* reflects the institutions mentioned by people and the frequency of mentioning each type of institution.

Figure 29: Where People Save



As can be observed, most people save in informal groups, banks and SACCOs. Savings in other co-operatives, MDBs and FINGOs are also quite common. Only a few people mentioned that they save in finance companies, NGOs or local government programmes, at home or in *Dhukuti* groups. Informal groups include those of mothers, women, farmers, veterinarians, teachers, retired army staff, community forestry, and microentrepreneurs groups.

In addition to saving money, people in hilly and mountain areas save in commodities like corn, red chillies and spices that they use for household purposes throughout the year.

The results of the research match Nepal Rasta Bank's findings in a 2008 Household Budget Survey, as portrayed in *Table 10* below. According to the survey, Nepalese put their cash mostly in co-operatives (18.70%) or commercial banks (12.20%).

TABLE 10: DISTRIBUTION OF HOUSEHOLDS REPORTING USAGE OF CASH BY AREA OF USAGE ACROSS DOMAIN[71]

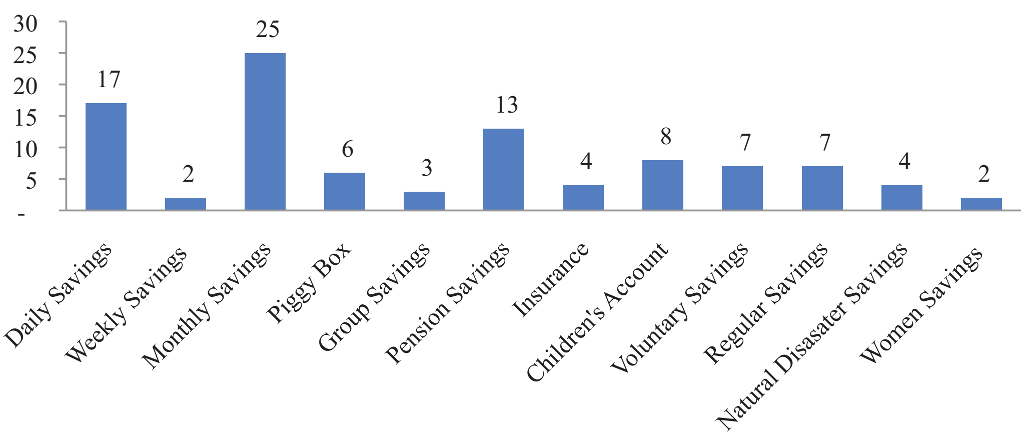
Type of Institution	R/U Markets		By Ecological Regions			Overall Market
	Rural	Urban	Terai	Hill	Mountain	
Commercial Bank	8.60%	15.50%	10.20%	13.60%	10.60%	12.20%
Development Bank	0.60%	1.30%	1.50%	0.70%	0.50%	1.00%
Finance Companies	1.20%	1.70%	1.80%	1.30%	1.00%	1.50%
Co-operatives	26.80%	11.10%	18.60%	18.10%	26.00%	18.70%
Share	7.10%	8.30%	7.30%	7.30%	13.50%	7.70%
Loan	3.70%	3.60%	4.30%	3.20%	3.40%	3.60%
Self	71.20%	72.00%	71.10%	72.60%	65.40%	71.70%
Property Purchase	3.90%	2.90%	4.30%	2.80%	4.30%	3.40%
Other	11.30%	10.40%	13.20%	8.70%	17.80%	10.80%

Note: Column totals may exceed 100% because of multiple responses.

5.3.2 PRODUCTS PEOPLE USE

Because of the strong presence of SACCOs and other co-operatives in almost all areas of Nepal, there are a wide range of products available for saving. Co-operatives offer the widest range of products, which are designed and managed by people from the community to suit different needs.

Figure 30: Products Currently Being Used



70 *Household Budget Survey 2008, Nepal Rastra Bank.*

One of the most commonly used products is monthly savings. Except for banks, this compulsory savings product is available in all other institutions. The high percentage of people saving on a monthly basis can be attributed to the prominence of compulsory products from co-operatives and MDBs, as well as the monthly meetings of informal groups.

The next most commonly used product is the daily savings product. Generally, daily wage earners in market areas save every day, as this allows them to save small amounts at home or their place of business. Most often, the product comes with a door-to-door collection service. The ability to save small amounts and have an at-home/door-to-door collection were two highly desired product attributes.

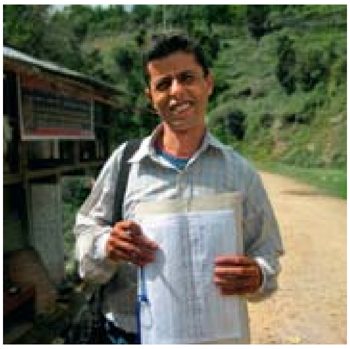


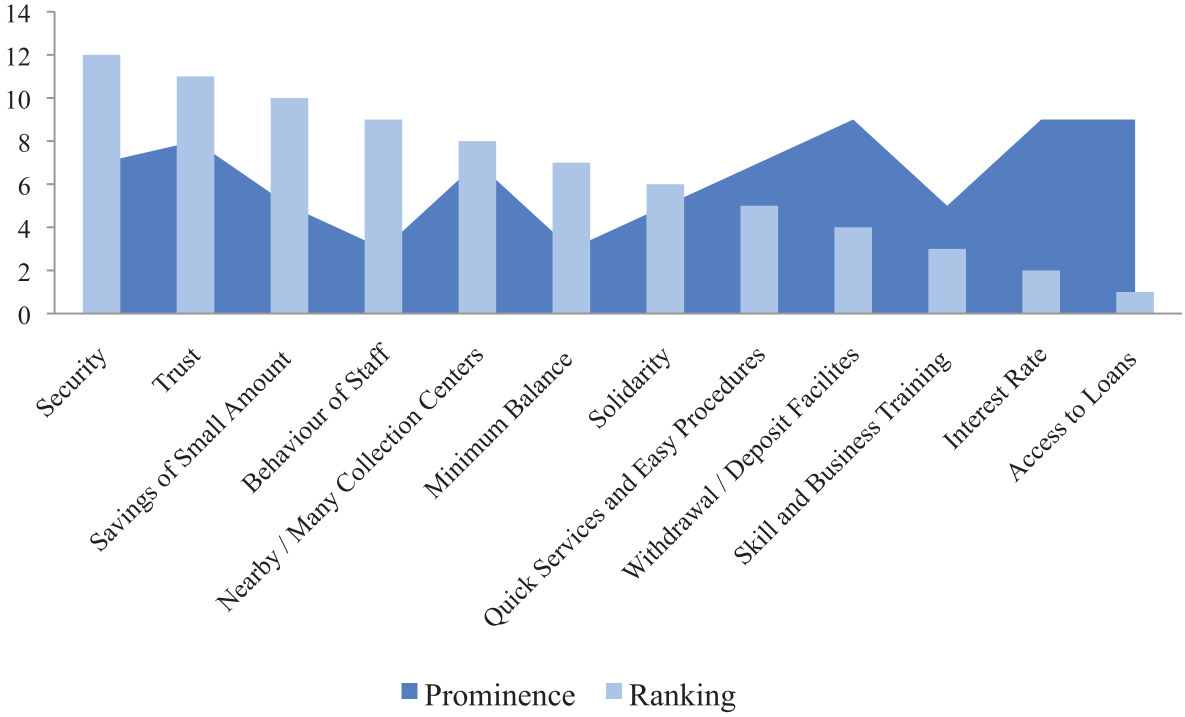
Photo of a Janasachetan door-step daily savings collector.

Pension savings is the next most-used product, and it is offered by almost all co-operatives, FINGOs and MDBs. Other popular products, include children's accounts, with most co-operatives offering the product to children of members or through schools.

Most people save at branches or group meetings, and few even get their savings collected through the door-to-door service. Overall, most of the products being offered do not provide easy withdrawal options or flexibility to deposit and withdraw.

5.4 PREFERENCES WITH REGARDS TO PRODUCT ATTRIBUTES AND INSTITUTIONS

Figure 31: Product Attribute Ranking



In the graph above, ranking is the weighted average of the position of the attribute on the ranks – i.e. how important it was overall to respondents. Prominence means how many times it was mentioned in the focus group discussions. So for example, "security" is the most important attribute, but it did not actually come up in all group discussions; conversely "access to loans" is not very important, but came up regularly, in almost all group discussions.

The most-desired product attributes that were cited by respondents are:

5.4.1 Security

Security of money was cited as the most important product attribute. People want to save in an institution where their money is safe and secure. They feel that registered institutions, working in the community, are safe. Overall, people feel more secure if the institution is local and has employees from the community itself. One of the reasons why security is considered the most important attribute is that most respondents, or someone known to them, has lost money in a financial institution.

Case Study 5: Losing Money in Informal Groups

Given the prevalence of informal groups in Nepal, it is natural to expect that some of them will be better than others and there will be shrewd people who will take advantage of the unsuspecting. During the research, the team heard several stories of people losing their money. One such story was that of Mrs. Nirmaya Nepali from the Namdu Village Development Committee of Dolakha District. Nirmaya's family belongs to the Dalit community, a group of people who form the lowest strata of the society. Nirmaya earns about NPR 60 (USD 0.82) per day in wages, and her husband, Mr. Amber Nepali, is a tailor.

Four years ago, Nirmaya joined a savings group in her village and was saving NPR 50 (USD 0.68) per month. There were 50 people in that group, led by a management committee, which would collect the amount and use it for their own purposes. When other members of the group found out that the use of funds was not proper, they stopped saving money in the group and the group collapsed. Although some members were able to recover the amounts they had saved, Nirmaya never saw her money again.

After this bitter experience, Nirmaya lost trust in savings groups. She, her family and friends formed a mother's group, where they collected NPR 300 (USD 4.10) from each person, but they do not keep any cash. With the funds raised, they bought some utensils for use during social occasions, like marriages, parties and funerals.

Mrs. Nirmaya and Mr. Amber Nepali waiting for a bus to Kathmandu in Charikot, Dolakha

5.4.2 Trust

Trust came up as the second most important attribute and is related to how an institution is perceived. According to market research respondents, the perception of trust is based on factors like: (i) the institution being registered; (ii) the institution having an office building in the community; (iii) the institution having well-built and computerised branches. As shown in *Figure 33*, people perceive commercial banks, MDBs and registered SACCOs as more trustworthy than any other form of institution.

5.4.3 Saving in Small Amounts

The ability to save in small amounts also emerged as one of the desired attributes of a savings product. This is also the reason for most of the respondents chosing to save with groups and/or with other informal institutions and not with banks/formal financial institutions.

As shown in *Figure 33*, finance companies, development banks and MDBs do have some options for saving small amounts. However, usually respondents do not want to save in finance companies as many companies have closed. This was also reflected in the low score of finance companies on the attribute of security. MDBs give an option to save small amounts, but most of the savings are offered with limited withdrawal options.

5.4.4 Nearby/Numerous Collection Centres

Having numerous collection centres nearby was a commonly cited and much-desired attribute. Respondents explained that branches/offices should not be more than 15-20 minutes away, even if one was walking. This is generally applicable when institutions do not provide door-to-door collection services. Respondents felt that if the branches are far away then it would translate into high cost of travel and there is also the added risk of carrying cash over long distances.

In addition to branches, some of the SACCOs accept deposits at their collection centres, this facility was appreciated by respondents. Development banks and MDBs are considered to have a better reach because development banks are located within communities and some MDBs provide door-to-door collection facility.

5.4.5 Quick Services and Easy Procedures

Most of the respondents wanted quick services and easy procedures. These include the account opening process and deposit/withdrawal processes. The analysis suggests that banks, development banks and some of the limited banking license institutions rank high on this attribute.

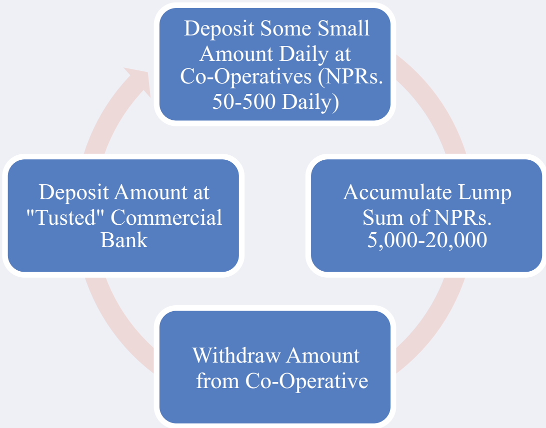
5.4.6 Withdrawal/Deposit Facility

Respondents also wanted flexible withdrawal/deposit facilities. At present, most of the institutions do not offer flexible withdrawal and deposit services. Some of the registered SACCOs do provide withdrawal options and are thus considered better than other existing institutions.

Overall, it can be observed that the Nepal market offers a variety of long-term savings products (education, foreign employment, purchasing land/building house, death and old age). However, short-term savings products, in which clients can easily withdraw at times of need (agriculture, illness and emergency), are not so common in the market.

Case Study 6: Convenience of Co-operatives Versus Trust of Banks

Figure 32: Savings Management Cycle



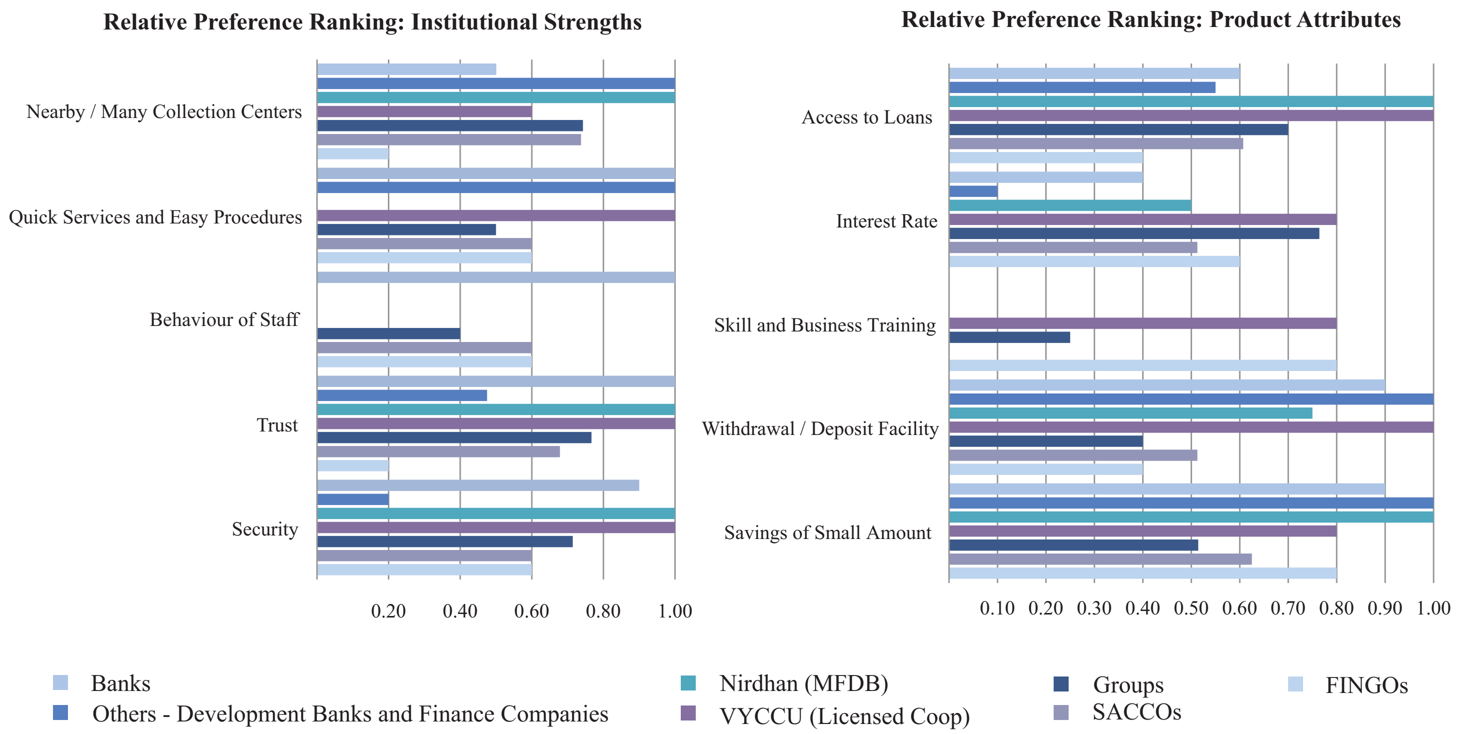
During the course of the research, the team met many individuals who saved at registered or unregistered co-operatives simply because they provide the convenience of daily door-to-door collection. These individuals had a higher level of trust in commercial banks, but preferred the convenience provided by co-operatives. Most of these individuals are entrepreneurs, who generate a small amount of daily savings. Due to their long business hours and distance from bank branches, they open one or several accounts at a nearby co-operative.

The way these individuals manage their savings is portrayed in *Figure 32*. Basically, individuals deposit small amounts of cash with the co-operative collector, who visits their shops on a daily basis. The amount of deposits range roughly from NPR 50-500 (USD 0.68-6.80). After depositing for a month or so, and once a lump sum had accumulated, they withdraw the money from the co-operative and deposit it at their preferred commercial bank. The team met some individuals who had fixed rules for withdrawal; for example, Mr. Arun Siddhi Tuladhar commented, “When I reach NPR 15,000 (USD 205) in my co-operative account, I withdraw”. Similarly, other individuals accumulated amounts ranging from NPR 5,000-20,000 (USD 68-273) before withdrawing from the co-operative account and depositing it in a more secure commercial bank.

Mr. Manoj Dahal at his embroidery shop, with his four co-operative passbooks.

On one instance, the team met Mr. Manoj Dahal, a small shop owner, who has four co-operative passbooks (see photograph). When asked why he does not deposit his daily savings in a bank, he explained, “Banks are too far, but the co-operatives collect from my shop every day. If I keep the money in my pocket, I may spend it on unnecessary items, so I prefer to deposit with them. The moment I reach NPR 5,000 in any of the accounts, I withdraw and deposit it with a bank”. Knowingly or unknowingly, Mr. Dahal is diversifying his risk. He knows that co-operatives in the area cannot be completely trusted, but he values the convenience which they offer. By depositing his daily savings in multiple institutions, he ensures the amount at risk becomes lower. Many Nepalese manage their savings in a similiar fashion. They use the convenience of co-operatives, but trust the formal institutions, like banks to save big amounts.

Figure 33: Relative Preference Ranking - Institutional Strengths and Product Attributes



6. SUMMARY AND RECOMMENDATIONS

Despite significant improvement over the last decade, Nepal remains the poorest country in South Asia and the 12th poorest country in the world. Though poverty is decreasing in the country and human development indicators, like literacy levels and per capita income, are improving, spark inequalities persist. For example, poverty and literacy levels are much worse in rural areas when compared to urban settlements, influencing migration towards urban centres.

The financial sector is also growing rapidly, with a large number of institutions focused on urban areas, while making efforts to reach the more remote parts of the country. The role of remittances in the economy is becoming more and more important with every passing year, as more Nepalese are going abroad for employment due to lack of opportunities and political instability at home. In many towns visited during the market research, there was at least one person from almost every household who was working abroad. The political scenario and business environment remains unstable, and this continues to affect daily business as well as the growth of the economy.

Although the country is slowly becoming less dependent on agriculture, the sector still plays a major role in the economy and often dictates its rate of growth. As the market research suggests, people often rely on a mix of seasonal and regular sources of income, including small businesses, trading and agriculture, to meet their needs. In addition, they rely on animal husbandry, services, salaried employment and remittances.

With regard to access to deposit services, people in Nepal often save in multiple institutions in the formal, semi-formal and informal sector, just to be eligible to take loan from any one of them at a time of need and to diversify their risk, in case any of them fails. Commercial banks and development banks conduct their operations in semi-urban and urban areas and rarely serve the low-income clients. The most relevant players in the formal and semi-formal sector for microdeposit mobilisation are SACCOs, followed by MDBs and FINGOs. While SACCOs offer client-friendly products, most of them are long-term saving products. SACCOs often offer door-to-door collection on daily/monthly basis and in hilly/mountain areas, co-operatives are the most important players. MDBs and FINGOs mostly offer credit-linked products, which do not provide the flexibility to deposit and withdraw at the clients' convenience. Nepal also has a large number of informal institutions, with almost every person depositing their money in an array of informal groups.

Formal institutions, like commercial banks, financial companies and development banks, are traditionally not considered to be a part of the microfinance sector. However, in order to overcome the tough competition and saturation of their traditional urban markets, some of them have started focussing on rural/remote areas. Efforts are being made to develop mechanisms to serve low-income clients. Such initiatives include provision of low-balance savings accounts, piggy box savings with door-to-door collection, and the POT system (introduced by Everest Bank).

The strength of systems and risk management ability is highest among commercial banks, however, they do not have the delivery channels to reach poor clients. MDBs and SACCOs rely on basic systems, whose scalability may be questionable; however, their outreach amongst the target clientele is good. Nonetheless, any effort to scale up microdeposit mobilisation in Nepal, irrespective of the targeted institutional format, will have to be accompanied by investment in capacity building, system development and technology.

Regulation and supervision remain issues of concern, as the Central Bank has a limited capacity to supervise the large number of institutions under its purview and the Department of Co-operatives is severely constrained by the lack of strength in terms of human resources and in the capacity of the existing resources.

6.1 THE WAY AHEAD

6.1.1 Investment in R&D of Market-led Savings Products

Other than member-owned co-operatives, deposit taking institutions in Nepal offer a narrow range of products that do not always suit the needs of the clients. According to the market research, low-income people in the country demand savings products where they can deposit and withdraw at their convenience. As there is no tradition in the industry to invest in product research and development, most of the products offered by commercial and development banks are inspired by the offerings of co-operatives working in the areas

> *"In an agrarian economy like Nepal, where the cash flows are fluctuating, there is a need for appropriate saving products to balance the ups and downs".*
> *- Mr. Narihari Dhakal*

or based on guesses of what clients need. Commercial banks spend most of their marketing efforts/resources on advertising and promotions; and MDBs are more focussed on credit, therefore, relying primarily on compulsory saving products. As microfinance expert Mr. Narihari Dhakal noted, "In an agrarian economy like Nepal, where the cash flows are fluctuating, there is a need for appropriate saving products to balance the ups and downs". Savings products should be market-led and provide the client the flexibility to deposit and withdraw according to his/her needs. Narihari also mentioned that deprived sector lending guidelines have been a retrograde step for institutions providing microfinance services and has diverted their attention from client-focussed savings products "to the extent that MFIs can obtain cheap funds from the commercial banks, but they will have little or no motivation to make efforts to improve their deposit product offerings".

6.1.2 Capacity Building and Technology

Capacity building resources in Nepal are scarce and only a few organisations take full advantage of them. As MFIs shift their focus from credit to savings, capacity building will be required for product development, risk management, and internal audit and control. In addition, the difficult geography of Nepal requires a higher amount of investment in accessing technology-based solutions and developing agency-based models.

6.1.3 Regulation and Supervision

Despite efforts to strengthen the regulation and supervision of MDBs, FINGOs and licensed SACCOs (by the second tier institution – STI), thousands of co-operatives with broad presence in all parts of the country remain unregulated. As the research suggests, these co-operatives fill the gap caused by absence of regulated institutions, yet people remain vulnerable to loss of their savings in these institutions. If the government wants to ensure that the deposits of low-income people are safe, it will have to come up with an adequate framework of regulation and supervision for co-operatives. Currently, the Registrar of Co-operatives is understaffed and faces high staff rotation. In the future, the Office of the Registrar needs to be strengthened, its capacity enhanced and the rotation of staff minimised. In addition, the Registrar needs to come up with a framework for appropriate regulation and supervision of the thousands of co-operatives spread across the country.

6.1.4 Strengthening of Institutions/Limits to New Entrants

Nepal's financial sector is composed of a large number of financial institutions spread across the country (with highest density in the Kathmandu Valley and other urban areas). However, currently the system cannot provide adequate monitoring and supervision for such a large number of players. New players in the sector may further increase competition, reduce margins and segment the market even further. A systematic approach towards sector strengthening the sector by way of consolidation as well as capacity building, of both the regulator and the service providers, will benefit the economy and the people.

6.1.5 Microinsurance

Currently, there is neither an appropriate framework nor any interest from insurance companies to provide microinsurance services. To overcome this gap, and as the market research suggests, many service providers offer a pension savings product or disaster savings, which serves as an insurance proxy. On one hand, lack of domestic reinsurance companies makes providing insurance more expensive for service providers, while on the other hand, providing microinsurance services requires the ability to handle a large number of small premium policies, which have to be marketed mostly in remote/rural areas, adding to the cost. At present, the products being offered are mostly oriented towards protecting the portfolio of the institutions, rather than providing adequate risk coverage to the clients. The presence of a local reinsurance company, fostering the insurance-provider and MFI partnerships for distribution of products, and providing technical assistance for product design may help in changing the present picture of microinsurance in Nepal.

Annexure 1: Details about Financial Industry Association in Nepal

1. ***Nepal Bankers Association (NBA)***

   Nepal Bankers Association is a network of commercial banks which is currently comprises of 30 members. The NBA was formed to establish collective efforts and enhance the relationship and co-ordination among commercial banks. The association strives to:

   1. Develop fair and healthy competition among banks,
   2. Maintain uniform policies and procedures for banking transactions,
   3. Develop and adopt creative and modern technology,
   4. Provide suggestions to the NRB and the Government regarding policy related issues,
   5. Exchange client information in accordance with the law of the land
   6. Organise and conduct trainings, seminars, conferences from time to time with a view to enhance the knowledge, skill, efficiency and productivity of the employees in the banking sector.

2. ***Microfinance Bankers' Association of Nepal (MBAN)***

   The Microfinance Bankers' Association of Nepal (MBAN) is a network of microcredit development banks and regional rural development banks. The MBAN takes up advocacy and lobbying with the Government and the NRB for developing microfinance policies.

3. ***Microfinance Association of Nepal (MIFAN)***

   Microfinance Association of Nepal (MIFAN) is a network of financial intermediary non-government organisations (FINGOs). The MIFAN is registered under the Society Regulation Act, 1978, and affiliated with the Social Welfare Council. The key activities of the MIFAN, include networking, advocacy and lobbying, capacity development, research, knowledge management and information dissemination and resource mobilisation for members and the whole microfinance sector. Currently, the MIFAN is a network of 24 FINGOs.

4. ***Nepalese Federation of Saving & Credit Co-operative Union Ltd. (NEFSCUN)***

   NEFSCUN is the national apex body, registered under the Co-operative Act, 1992, for savings and credit co-operatives (SACCOS) and their district unions in Nepal. NEFSCUN's mission is to represent, promote, strengthen and provide technical support to members to become viable community-based financial institutions.

   NEFSCUN extends training support, organises exposure visits and provides financial services and technology (NECOS – a software for co-operatives, in native languages, developed in association with the Canadian Co-operative Association) to its members. Presently, NEFSCUN has 639 member SACCOS and district unions, representing approximately 325,000 individual members and covering 56 districts in Nepal (in June 2009).

Annexure 2: Overview of Regulations on Extension Counters, Branchless Banking, and Mobile Branch Banking

1. ***Extension Counters***

   Class A, B and C banks are authorised to open extension counters to offer deposit collection, cheque payment and foreign currency exchange transaction. However, approval from NRB's Foreign Exchange Department shall be necessary for conducting foreign exchange buying/selling transactions. Extension counters shall not be allowed to open within the Kathmandu Valley, metropolitan city and sub-metropolitan city area. However, extension counters may be opened in these areas for short periods, not exceeding 35 days, for deposit collection, cheque payment and foreign currency exchange transactions, especially at places having a trade festival, fair or market.

   Banks can also open counters within the vicinity of the NRB, court compound, hospitals, offices of foreign diplomatic missions as well as for distribution of pension to Nepalese working abroad and for Government transaction purposes. However, these counters shall not carry out any transactions other than collection of deposit and payment in Nepali rupees. Similarly, the NRB may grant approval to open extension counters within the compounds of utility providers (telephone, electricity, water and insurance), only for the purpose of collection of payments to them. [72]

2. ***Branchless Banking***[73]

   Licensed class A commercial banks and national-level class B development banks willing to operate remote/rural branchless banking facilities may be allowed to do so in areas other than in municipality/sub-metropolitan/metropolitan cities within the Kathmandu Valley. Branchless banking services may be made available by using smart cards through point of transaction (POT) machines with the assistance of business correspondents (agents).

   For obtaining branchless banking permission, the interested banks should convince the NRB about the security and risk control mechanisms of the system to be used (including hardware, software, data communication and transmission). The bank should ensure the security of the network and database, and obtain insurance for cash and other assets used to provide the service. The services that can be offered through the channel are limited to accepting and payment of deposit and credit transactions within Nepal only and in Nepalese currency. The directives also indicate that the bank should assign a parent branch for controlling the activities of the business correspondent, and that transaction data must be updated with the bank systems after the closing of daily transactions.

3. ***Mobile Branch Banking Services***[74]

   Class A commercial banks and national-level class B development banks may operate mobile banking services in places which are unbanked. Mobile banking services may be operated in places/areas all over the country except within the metropolitan and sub-metropolitan areas and the municipalities of the Kathmandu Valley. NRB directives indicate that for operation of mobile branch services, any nearby branch can be declared as a liaison/controlling office. In addition, the bank must obtain insurance for the cash, cash in transit, vehicle, staff and other assets involved in the mobile branch banking services.

   According to the directives, the vehicle used for mobile banking should be fully equipped with necessary infrastructure and the institutions providing such services shall identify and mitigate the risks of providing such services and develop specific standards of internal audit and control. The bank shall not charge any additional service fees and should ensure the transaction immediately reflects in the customers' accounts and statements through real-time updates. Transactions allowed under mobile branch banking services include customer's deposit and remittance only.

71 *Directive No.14/067 Unified directives 2067); Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/16 July 2010-09-14*
72 *Directive No.14/067 Unified directives 2067); Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/16 July 2010-09-14*
73 *Directive No.14/067 Unified directives 2067); Bai.Bi.Ni,Bi/niti/paripatra/50/066/67/ dated 2067.3.32/16 July 2010-09-14*

DEPOSIT ASSESSMENT IN NEPAL

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