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ROYAL MONETARY AUTHORITY OF BHUTAN

RMA/FISD/03/2009-2010 8114

April 27, 2010

The Managing Director  
Bank of Bhutan Ltd.  
Phuntsholing, Bhutan

The Director  
National Pension & Provident Fund  
Thimphu, Bhutan

The Managing Director  
Bhutan National Bank Ltd.  
Thimphu, Bhutan

The Chief Executive Officer  
Druk PNB Bank Ltd.  
Thimphu, Bhutan

The Managing Director  
Bhutan Development Finance Corporation Ltd.  
Thimphu, Bhutan

The Chief Executive Officer  
T Bank Ltd.  
Thimphu, Bhutan

The Chief Executive Officer  
Royal Insurance Corporation of Bhutan Ltd.  
Thimphu, Bhutan

The Chief Executive Officer  
Bhutan Insurance Ltd.  
Thimphu, Bhutan

Dear Sir(s),

**Subject: Revision to PR 2002**

We would like to inform you of the recent changes in the Prudential Regulations 2002 pertaining to definition of related party, minimum capital requirement, regulation on credit concentration (consortium financing), asset classifications and transitional stipulations, launching of new products, information on foreign currency cash transactions, suspicious transaction reports and regulations on share ownership of financial institutions and regulations on investment of the financial institutions.

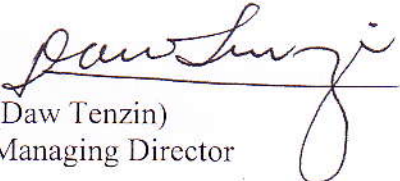
The PR 2002 has been updated to ensure consistency with the Regulations for Establishment of Banks and Insurance Companies in Bhutan and to keep in line with the international best practices. A detailed abstract of the changes is attached herewith for your kind reference. A copy of the amended PR 2002 is available on the RMA's website at [www.rma.org.bt](http://www.rma.org.bt).



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**ROYAL MONETARY AUTHORITY OF BHUTAN**

Further, we would also like to inform you that the Financial Institutions Supervision Division of the RMA is hereby renamed as Financial Regulation and Supervision Department.

Sincerely,

  
(Daw Tenzin)  
Managing Director

Cc: Compliance officer(s), all FIs for your kind information and necessary compliance.

# **ROYAL MONETARY AUTHORITY OF BHUTAN**

## **FINANCIAL REGULATION AND SUPERVISION DEPARTMENT**

### **PRUDENTIAL REGULATIONS 2002**

**In exercise of the powers conferred by Part II, 6(c) and Part VIII of the Royal Monetary Authority of Bhutan Act, 1982 and Article 26, Part V of the Financial Institutions Act of Bhutan 1992, the Royal Monetary Authority of Bhutan (RMA) hereby issues these regulations to the financial institutions in Bhutan. These regulations shall come into force from 1 June 2002 and supersede the existing Prudential Regulations 1999. These regulations shall be amended in part or as a whole when the RMA feels the need to affect such changes.**

## SECTION – 1

### REGULATIONS FOR DIRECTORS AND CHIEF EXECUTIVES OF THE FINANCIAL INSTITUTIONS

#### APPOINTMENT OF DIRECTORS AND CHIEF EXECUTIVES

- 1.3.3 The composition of Board of Directors should be such that every two of the five directors must have more than five years experience in banking, finance, **insurance and other related business of the financial institutions**.<sup>1</sup>
- 1.3.4 As a matter of desirable practice not more than one member of a family (spouse, children and/or economically dependent persons) or a close relative (up to second generation) or an associate (partner, employee, director, etc.) should be on the Board of the financial institution. The definition of a family or close relative provided by the RMA shall be binding.<sup>2</sup>

## SECTION - 2

### REGULATIONS ON RELATED PARTY TRANSACTIONS

#### 2.2 DEFINITION OF RELATED PARTY

For the purpose of these regulations, a party is considered to be related if he/she has the ability to control, or exercise significant influence over the financial institution in making financial and operating decisions, and includes the following:-

- (a) **significant owner**;<sup>3</sup>
- (b) a member of the Board of Directors
- (c) officers and employees of the institution;
- (d) spouse and children of persons specified in (a) (b) and (c);

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<sup>1</sup> Amended on March 29, 2010

<sup>2</sup> Amended on July 20, 2009

<sup>3</sup> Amended on March 29, 2010

Significant owner means a person who either acting alone or in concert with other person represents 10% or more of the capital of the **financial institution** or can exercise control over the management of the **financial institution**

- (e) any individual for whom a director, **significant owner**, officer or employee is a guarantor;
- (f) any firm or company in which a significant owner, director and officer or employee has an interest as owner, partner, or has a direct or indirect equity interest equal to or exceeding 10 percent of the paid-up equity capital;
- (g) another financial institution with cross-shareholding in, or a high degree of influence over the financial institution;
- (h) the parent company, subsidiary ,fellow subsidiaries and affiliates of the financial institution.

## **2.3 RESTRICTIONS ON LENDING TO **SIGNIFICANT OWNERS**,DIRECTORS, OFFICERS AND EMPLOYEES**

### **2.3.1** A financial institution shall not extend credit to:-

- (a) any of its significant owner beyond a maximum limit of 10 Percent of the institution's capital fund.
- (b) any of its directors beyond a maximum limit of 10 percent of the institution's capital fund, and
- (c) any of its officers or employees exceeding 5 percent of the institution's capital fund.

### **2.3.2** For the purpose of deriving the limits specified in Section 2.3.1 above, the following loans shall be aggregated:-

- (a) loans and advances granted to the **significant owner**, director and officer or employee personally;
- (b) loans and advances granted to the spouse, children and to any other direct dependents of the **significant owner**, director and officer or employee;
- (c) loans and advances to a firm or company of which the **significant owner**, director and officer or employee is owner, partner, or in which he/she has an equity interest exceeding 10 percent of the equity capital. Such loans and advances shall be aggregated in proportion to the **significant owner's**, director's, officer's or employee's equity in the firm or company. Where the **significant owner**, director and officer or employee owns 50 percent or

more of the firm or company's equity stock, the total loan exposure to that firm/company shall be aggregated.

- (d) loans and advances guaranteed by the **significant owner**, director and officer or employee.

**2.3.3** Sanction of loans and advances to a **significant owner** or director beyond 5 percent of the institution's capital fund and to an officer or employee beyond 1 percent of its capital fund, must have the prior approval of the Board. In other words, if an institution's exposure to a **significant owner** or director is 5 percent of its capital fund, any further loan or advance to him/her must have the prior approval of the Board. Similarly, if the institution's exposure to an officer or employee is 1 percent of its capital fund, any further loan or advance to him/her must have the prior approval of the Board.

**2.3.4** Where a default occurs in respect of any loan granted to a **significant owner**, director and officer or employee, he/she shall not be eligible for any further loan until the loan account has been regularized.

**2.3.5** A report of all outstanding loans and advances granted to **significant owner** directors and officers or employees must be submitted to the Board at each meeting thereof.

## **2.4 GRANTING OF FAVORED TERMS PROHIBITED**

**2.4.1** All loans to related persons (i) shall be on the same terms and conditions, including interest rates, fees, margins and security, as those applicable at the time of origination to similar loans to any other person who is not a related person of the financial institution; (ii) shall not involve more than the normal risk of repayment or any other unfavorable features, and (iii) the financial institution shall apply credit underwriting procedures that are no less stringent than those applied for comparable transactions with persons who are not related person.<sup>4</sup>

## **2.5 RESTRICTIONS ON LENDING TO LEGAL ENTITIES RELATED TO THE FINANCIAL INSTITUTIONS AS SPECIFIED UNDER ARTICLE 48 OF FI ACT 1992 AND SECTION 2.2 OF PR 2002.**

**2.5.1** A financial institution shall confirm to the following limits and requirements with regard to lending to the following related parties:

- a) holding **or parent**<sup>5</sup> company
- b) subsidiary of the holding **or parent company**

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<sup>4</sup> Amended on July 20, 2009

<sup>5</sup> Amended on March 29, 2010

c) companies in which the holding **or parent** company has a direct or indirect equity interest equal to or exceeding 10 percent

d) Financial institutions' subsidiaries and its affiliates

## **SECTION - 3**

### **REGULATIONS ON THE CODE OF ETHICS FOR DIRECTORS AND EMPLOYEES OF THE FINANCIAL INSTITUTIONS**

#### **3.2 PRINCIPLES OF ETHICAL CONDUCT**

##### **3.2.5 Confidentiality**

- (a) The confidentiality of relations and dealings between a financial institution and its customers is paramount in maintaining the financial institution's reputation. Thus, staff and Directors must take every precaution to protect the confidentiality of customer information and transactions. In accordance with Article 23 of the FIA, no staff or Director shall divulge information regarding any customer, or any correspondence, accounts or dealings of the financial institution or its customers, to any person other than administrative or judicial authorities.
- (b) Business and financial information about any customer may be used or made available to third parties only with the prior written consent of the customer, or in accordance with arrangements for the proper interchange of information between financial institutions and **Credit Information Bureau**<sup>6</sup> about credit risks, or when disclosure is required by law.

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<sup>6</sup> Amended on March 29, 2010

**SECTION - 4**  
**REGULATIONS ON SHARES TRADING**

**4.4 INFORMATION ON SIGNIFICANT OWNER OF LISTED COMPANIES<sup>7</sup>**

The depository under the Royal Securities Exchange of Bhutan shall inform and submit to the Financial Regulation and Supervision Department of Royal Monetary Authority of Bhutan, the list of all the significant owners of the listed companies on a monthly basis.

**4.5 COMPLIANCE REQUIREMENTS FOR THE ROYAL SECURITIES EXCHANGE OF BHUTAN<sup>8</sup>**

The Royal Securities Exchange of Bhutan shall comply with the following regulation:-

- (a) Securities Exchange Regulation 1993
- (b) Rules Governing the Official Listing of the Securities
- (c) Rules of the Exchange

**4.6 COMPLIANCE REQUIREMENT FOR BROKERAGE FIRMS<sup>9</sup>**

All Brokerage firms and their staff shall comply with the requirements of the Control of Brokers Regulations 1993.

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<sup>7</sup> Amended on March 29, 2010

<sup>8</sup> Amended on March 29, 2010

<sup>9</sup> Amended on March 29, 2010

## SECTION - 5

### REGULATIONS ON SUBMISSION OF ANNUAL ACCOUNTS

#### 5.1 INTRODUCTION

**5.1.1** As takers and custodians of public funds, financial institutions have a responsibility for the prompt finalization and publication of their annual financial results. A delay in the publication of final accounts usually indicates poor management of the financial institution concerned, which would reduce public confidence in the management of the institution.

Part VIII, Article 51 of the Financial Institutions Act provides, inter alia, that:-

**5.1.2** The form and the content of the annual balance sheet and profit and loss account of a licensed financial institution should be approved by the RMA;

**5.1.3** Every licensed financial institution is required, within three months after the close of each financial year to prepare a balance sheet and profit and loss account as of the last working day of that year.

**5.1.4** All financial institutions must send to the RMA the auditor initialed balance sheet, profit and loss account and external auditor's report described in Section 1 (b) of Article 52 of the Financial Institutions Act. The submission of these final accounts to the RMA shall be within 14 days of its preparation by the statutory auditors. In addition, the financial institutions shall also submit two copies of their annual report to the **Financial Regulation and Supervision Department** of the RMA.

**5.1.5** In terms of Article 53, Part VIII of the Financial Institutions Act, a licensed financial institution must publish its annual audited accounts in a national newspaper. Further, a financial institution must also publish its un-audited accounts in a national newspaper on a half-yearly basis.

**5.1.6** If a financial institution should have problems in finalizing its draft accounts early due to differences in opinion between its management and external auditors over income recognition and provisioning for bad and doubtful debts, the institution concerned and its external auditors should discuss and resolve these matters with the **Financial Regulation and Supervision Department** of the RMA to avoid delay in finalizing the accounts. Under such situation, it is mandatory for the external auditors and the financial institution to meet with the RMA examining officers to finalize the necessary provisions. If the auditors do not agree with the management, they may submit the draft accounts with a "subject to proviso" on the disputed items.

**SECTION - 6**  
**REGULATIONS ON CAPITAL REQUIREMENT**

**6.2 MINIMUM CAPITAL REQUIREMENT<sup>10</sup>**

(i) The minimum paid-up capital for different types of financial institutions shall be as follows:-

(a)	Bank	-	Nu.300 million.
(b)	Non-bank financial institution	-	Nu.200 million.
(c)	Non-bank finance company	-	Nu.100 million.

(ii) No license shall be issued to a financial institution until the paid-up portion of its subscribed capital amounts to the minimum prescribed level, indicated above.

(iii) All existing banks and non-bank financial institutions shall raise their paid-up capital to the minimum prescribed amount indicated in (i) (a) and (b) above latest by January 1, 2009.

(iv) <sup>11</sup> Except for those financial institutions which are exempted by the RMA in consideration of the special circumstances relating to the nature of its business all financial institutions shall be a public limited company registered under Companies Act 2000 and listed with any stock exchange in Bhutan.

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<sup>10</sup> Amended on March 31, 2008

<sup>11</sup> Amended on March 29, 2010

## SECTION - 8

### REGULATIONS ON CREDIT CONCENTRATION

#### 8.4 LIMIT ON CREDIT TO A SINGLE BORROWER

8.4.3 Exposure to a single borrower shall be determined on the following basis:

- (a) Term loans - the outstanding balance (principle + interest)
- (b) Overdrafts & working capital advances - the **sanctioned limit, or the outstanding balance, whichever is greater.**
- (c) Off-balance sheet items - the off-balance sheet amount *less* margin money

#### 8.5 LIMIT ON CREDIT TO TEN LARGEST BORROWERS

The aggregate of loans and advances granted by a financial institution to its ten largest borrowers, including economically dependent persons, shall not at any time, exceed 30% of its total loan portfolio. For the purpose of this regulation, economically dependent person shall have the same meaning as a single borrower.

The determination of loan aggregates for the ten largest borrowers shall be based on 8.4.3 above.

#### 8.6 LARGE LOANS AND ADVANCES

The total of a financial institution's large advances shall not, at any time, exceed eight times its capital fund. For the purpose of this regulation, large advances are defined as follows:

	<u>Sector</u>	<u>Amount</u>
(a)	Manufacturing	Nu. 10,000,000 and above
(b)	Trade & Commerce	Nu 5,000,000 and above
(c)	Housing & Construction	Nu 3,500,000 and above
(d)	Services including Tourism	Nu 3,500,000 and above
(e)	Transport	Nu 2,000,000 and above
(f)	Agriculture	Nu 1,000,000 and above
(g)	Personal/Others	Nu 1,000,000 and above

## 8.7 CONSORTIUM FINANCING<sup>12</sup>

Notwithstanding any limits provided under Section 2.3, 8.4 and 8.5, consortium financing (CF) of large value loans by two or more FIs may be permitted in line with the following criteria:

- (a) require a lead financier who shall maintain all the original records and files pertaining to the CF loan account.
- (b) the amount of loans sanctioned shall not, in any way, exceed the 30% prudent limit prescribed by the RMA. However, if the quantum of loan is extremely high, and it exceeds the 30% limit of all the financial institutions, the financing of the large borrower may be carried out in proportion to the respective capital funds of the financial institutions, but not exceeding 50% of the capital fund of the financial institution.
- (c) In case of financing to any related party by the FI under consortium financing, the FI shall not be the lead financier.

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<sup>12</sup> Amended on March 29, 2010

## SECTION - 9

### REGULATIONS ON ASSET CLASSIFICATION AND PROVISIONING

#### 9.4 EVALUATION AND CLASSIFICATION OF CREDIT EXPOSURES<sup>13</sup>

##### 9.4.7 *Watch Exposures*

Watch exposures shall be those credit exposures having potential weaknesses that deserve close attention, and which, if left uncorrected, may at some future date result in deterioration of the repayment prospects or where the available information points to a certain deterioration of the debtor's financial position. A risk exposure shall be classified as watch, if any one of the following conditions exists:

- (i) principal or interest payments have been overdue 31 to 60 days;
- (ii) questions exist regarding the value, condition of and/or control over the collateral;
- (iii) the debtor uses the loan for purposes other than those specified in the loan agreement;
- (iv) there is a declining trend in the borrower's operations or an imbalanced position in the balance sheet, but not yet to the point where repayment is jeopardized;
- (v) the debtor has delayed the supply of information under 9.4.6 (iv) by more than 30 days following the reporting date or the quarter.

##### 9.4.8 *Sub-standard exposures*

Substandard exposures shall be those credit exposures where well-defined weaknesses exist with respect to debt servicing, or the available information points to the debtor's unstable financial position, indicating a condition insufficient for the full repayment of his debts to the financial institution and to other creditors. A risk exposure shall be classified as Substandard, if any one of the following conditions exists:

- (i) principal or interest payments have been overdue 61 to 90 days;

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<sup>13</sup> Amended on March 29, 2010

- (ii) the debtor's financial position has substantially worsened and may result in inability to repay his/her obligations, and uncertainty over control of collateral;
- (iii) the debtor has delayed the supply of information under 9.4.6 (iv) by more than 60 days following the reporting date or such quarter.

#### **9.4.9 *Doubtful Exposures***

Doubtful exposures shall be those credit exposures where serious weaknesses exist with respect to their servicing, or the available information indicates a probability for the debtor to repay only part of his debts to the financial institution due to his deteriorated financial position. A risk exposure shall be classified as Doubtful, if any one of the following conditions exists:

- (i) principal or interest payments have been overdue 91 to 180 days;
- (ii) the debtor suffers from a lasting shortage of working capital;
- (iii) the financial position of the debtor has worsened to an extent which makes doubtful the full repayment of his obligations under the prevailing terms and circumstances;
- (iv) the debtor has delayed the supply of information under 9.4.6 (iv) by more than 90 days following the reporting date or the quarter.

#### **9.4.10 *Loss Exposures***

Loss exposures are those credit exposures which do not generate direct or indirect return to the financial institution, and are deemed un-collectible. A credit exposure shall be classified as Loss, if any one of the following conditions exists:-

- (i) principal or interest payments have been overdue for more than 180 days;
- (ii) the debtor has been, voluntarily or involuntarily, declared bankrupt;
- (iii) the debtor is in a liquidation procedure, and there is a risk of leaving creditors unsatisfied.

Characteristics of less severe classification categories should also be considered when classifying a credit exposure as Substandard, Doubtful, or Loss.

## 9.5 NON-PERFORMING LOANS (NPL)<sup>14</sup>

**9.5.1** A credit exposure shall be classified as non-performing when any of the following conditions exist:

- (a) *Term loan with pre-established repayment schedule* – an installment is due, but remains unpaid for more than 60 days from the first day of default.
- (b) Overdrafts and working capital advances shall be classified as non-performing under following conditions:
  - i. the loan outstanding amount in the loan account exceeds the sanctioned limit continuously for 60 days or more;
  - ii. when the account has been dormant for 60 days or more, and the outstanding amount is in excess of the sanctioned limit;
  - iii. when the loan outstanding balance is less than the sanctioned limit, but there have been no payments in the account for 60 days or more, or the payments received are insufficient to cover the interest accrued during the period;
  - iv. the term of the overdraft facility or working capital advance has expired.
- (c) *Bankers Acceptances, Trust Receipts, Bills of Exchange and other instruments of similar nature* – when the instrument is due but remains unpaid for 60 days or more after the maturity date.
- (d) *Credit Cards* - when the cardholder fails to settle his minimum monthly repayment of 10% of the loan outstanding for 60 days or more, or when the payments received are insufficient to cover the interest accrued during the period.
- (e) *Revolving credit facilities, lump-sum loans, leasing loans, hire-purchase loans and bullet loans* - when principal or interest is due, but remains unpaid for 60 days or more from the first day of default.

**9.5.2** *Treatment of credit with quarterly, semi-annual, annual, bullet or lump-sum repayments* - Where repayments are scheduled at intervals of 3 months or longer, the credit is classified as non-performing when a repayment is due and remains unpaid for 60 days or more from the first day of default. A financial institution shall not, under any circumstances, fix a loan repayment schedule against any type of credit exceeding one year.

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<sup>14</sup> Amended on March 29, 2010

**9.5.3 Treatment of loans secured by cash or cash substitutes** - If a loan is fully secured, all as to principal and interest and cost of collection, by cash or cash substitutes, the loan will be classified as non-performing if it is due and remains unpaid for 120 days or more from the first day of default. Cash or cash substitutes are defined as below:-

- (a) Fixed deposits or recurring deposits with set-off rights
- (b) Securities issued by the RGOB and irrevocable guarantees or step-in rights by the RGOB
- (c) RMA Securities

**9.5.4 Treatment of partial repayments of loans** - For the purposes of ascertaining the period in arrears, each repayment must be made in full. If the borrower settles his monthly repayment partially, the repayment is still deemed to be in arrears.

**9.5.5 Reclassification of non-performing loans as performing** - A non-performing loan can be reclassified as performing once the total installment in arrears falls below 2 months installments. For example, if a loan is 5 months in arrears and the borrower pays 4 months installments, the non-performing loan can be reclassified as performing as the total period in arrears is below 2 months (60 days). When the loan is reclassified as performing, interest can be recognized as income on an accrual basis. If the loan remains at all times below 60 days in arrears, the loan can be classified as performing and interest can be accrued and recognized as income.

**9.5.6 Granting of new loan for a non-performing account** – The same financial institution shall, under no circumstances, sanction new or additional loans to a borrower, in order to regularize a non-performing loan account. However, a financial institution trying to realize the collateral charged to it for the non-performing loan, could grant or transfer a loan to an independent party wishing to purchase the collateral. The loan to the third party shall be granted based on the normal credit evaluation criteria, including the credit-worthiness of the third party.

## **9.6 RESTRUCTURED, RESCHEDULED, RENEWED AND ENHANCED CREDIT EXPOSURES**

**9.6.1 Restructured Credit Facility** – A restructured credit exposure is one whose original terms and conditions have been modified principally. This may include a change in the type or structure of facility, or changes to the existing terms and conditions to assist the borrower overcome its genuine shorter-term financial difficulties -particularly where the longer term prospect of the business or project is still deemed to be viable. When the borrower enters into schemes of arrangement of this nature, the new facility will constitute a restructured facility.

However, such a facility may be granted only in the case of credit exposures that have been regular and have genuine unforeseen financial constraints.

**9.6.2 Rescheduled Credit Facility<sup>15</sup>** – A rescheduled credit facility is one whose repayment terms have been modified, but the principle terms and conditions of the contract have not changed significantly. Normally, rescheduling of loans and advances shall be permitted if all interest arrears have been fully paid by the borrower from primary sources other than through the creation of new loans from the same institution. However, rescheduling may also be permitted if the financial institution is satisfied that the borrower is unable to pay his installments due to circumstances beyond his control, and that the problem is of short-term nature. This includes, amongst others, lengthening the repayment tenor of the facility. A change in the form of the credit facility from a term loan to an overdraft facility or vice versa, does not constitute a rescheduled facility as the original terms of the contract have changed significantly.

- (i) Financial institutions must reassess the borrower’s financial position once again and make a full credit evaluation of the borrower’s financial condition and prospects for repayments before the loan can be rescheduled to avoid “ever-greening” of the loan. In this regard, financial institutions are permitted to reschedule a loan once in two years only and not more than three times during the term of the loan.
- (ii) Where rescheduling occurs before a loan account is classified as non-performing, the account will still be classified as performing. It will only be classified as non-performing when, in aggregate, the borrower fails to settle his repayments for 60 days or more from the first day of default.
- (iii) Where rescheduling occurs after a loan account has been classified as non-performing, the account shall continue to be classified as non-performing. The rescheduled loan can only be classified as performing when repayments under the new terms have been complied with for a continuous period of 6 months or when the loan becomes well secured by cash or cash substitutes.

**9.6.3 Renewed Credit facility** – A renewed credit facility is normally provided in the case of working capital advances or overdraft facilities, whose tenor are usually for a period of one year. Renewal of overdraft and working capital advances could be carried out only at the maturity of the facility, provided that the account has been regular and actively operated. Overdraft facilities and working capital advances classified as non-performing cannot be renewed unless and until it is regularized.

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<sup>15</sup> Amended on March 29, 2010

**9.6.4** *Enhancement of Term Loans/Overdrafts/Working Capital Advances (additional loan)* – Enhancement of loans may be considered, only if, the project or business under consideration is still under progress and yet to be completed. Financial institutions may grant such a facility, provided that the loan on the whole could be adequately serviced and sufficiently covered by collateral properties. However, in the case of overdrafts and working capital advances, enhancement of limits could be considered only if the account has been regular.

**9.6.5** Financial institutions may restructure, reschedule, renew or enhance a credit facility only upon a written application from the borrower and based upon a written resolution of the Credit Committee. If extension of such credit facilities exceeds the sanctioning authority of the Managing Director/Credit Committee, then the approval must be sought from the Board of Directors.

## **9.7 ALLOCATION OF LOAN LOSS PROVISIONS**

Financial institutions are required to review the adequacy of the general and specific provisions for all loans at all times to ensure that the provisions set aside are reflective of their potential losses.

**9.7.1** General Provisions and Specific provisions for loan losses shall constitute an element of accounting expense and an adjustment for the book value of balance-sheet assets.

**9.7.2** *General Provisions* for Loan Losses shall be allocated against exposures classified as Standard and Watch.

**9.7.3** *Specific Provisions* shall be allocated against exposures classified as Substandard, Doubtful, and Loss.

**9.7.4** General and Specific Provisions for Loan Losses shall also be allocated to cover classifications of contingent liabilities recorded as off-balance-sheet items.

## **9.8 PROVISIONING REQUIREMENTS**

Financial institutions shall allocate provisions as a percentage of the principal amount of each risk exposure as follows:-

	<u>Category</u>		<u>Provisioning Requirement</u>
i.	Standard	-	1.5 percent;
ii.	Watch	-	1.5 percent;
iii.	Substandard	-	20 percent; 30 percent for Sector with highest exposure <sup>16</sup>
iv.	Doubtful	-	50 percent; 60 percent for Sector with highest exposure

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<sup>16</sup> Amended on 10<sup>th</sup> March, 2008

v. Loss/litigation/suspended - 100 percent.

**9.8.1** <sup>17</sup>Provisions on credit extensions such as overdrafts, working capital advances and credit cards, which do not have pre-established repayment schedules, shall be allocated as follows:

i. Credit facilities on which no repayments have been received for 61 to 180 days shall be classified Substandard, requiring 20% provisioning.

ii. Credit facilities with no repayments for more than 180 days, or whose term has expired, shall be classified as Loss and require 100% provisioning.

**9.8.2** Provisions against credit exposures secured by risk-free collateral shall be maintained in an amount being the net difference between the principal amount and the value of the risk-free collateral. For this purpose, precious metals, cash deposits in the banks, and securities issued by RMA or by the Royal Government of Bhutan shall be deemed to be “risk-free collateral.”

## **9.9 SUPERVISION OVER AND REPORTING OF THE EVALUATION AND CLASSIFICATION OF RISK EXPOSURES AND PROVISIONING**

**9.9.1** Financial institutions shall disclose in their annual published reports the impact on its accounts of the general provisions and specific provisions maintained towards loan losses, as well as the aggregate amounts of classified credit exposures and restructured exposures in their portfolios.

**9.9.2** Depending on the efficiency of credit and investment policies of a financial institution, the RMA may require the financial institution to enforce a stricter evaluation and classification of credit exposures.

**9.9.3** The RMA may carry out a re-classification of risk exposures, if a financial institution has not evaluated and classified its exposures according to the provisions of these regulations. In such cases, financial institutions shall make corrective accounting entries.

## **9.10 <sup>18</sup>TRANSITIONAL STIPULATIONS**

(a) By 31 December 2010, each financial institution shall have reclassified loans under the “Watch” category from (31 to 90) days to (31 to 60) days.

(b) By 31 December 2011, each financial institution shall have reclassified loans under the “Substandard” category from (91 to 360) days to (61 to 90) days.

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<sup>17</sup> Amended on March 29, 2010

<sup>18</sup> Amended on March 29, 2010

- (c) By 31 December 2012, each financial institution shall have reclassified loans under the “Doubtful” category from (361 to 720) days to (91 to 180) days.
- (d) By 31 December 2013, each financial institution shall have reclassified loans under the “Loss” category from (721 and above) days to (181 and above) days.

The financial institutions may concurrently submit both reports (old and new) on asset classification until 31 December 2013.

## SECTION-14<sup>19</sup>

### **REGULATIONS ON SHARE CAPITAL OWNERSHIP OF BANKS**

**14.1** Financial Institutions carrying on banking activities shall not, directly or indirectly, without prior written authorization from the RMA:

(a) come under common ownership with, or become owned to more than twenty percent of its equity by:

- i. enterprises; and
- ii. non-bank financial institutions

(b) permit the investment described under Section 14.1 (a) above to exceed the equivalent of 25 percent of its net worth.

**14.2** Financial Institutions carrying on banking activities shall not be owned by another bank exceeding five percent of its paid-up capital.

**14.3** No individual, together with his/her immediate family<sup>20</sup> members and companies in which he/she has ownership of 10 percent or more, can hold more than 20 percent of the paid-up share capital of the bank.

**14.4** The ownership of the Joint Venture Bank (foreign bank) in the proposed bank shall not exceed 51 percent of the paid up share capital of the bank at any point of time.

**14.5** No holding/parent company can have ownership in two or more banks exceeding 5 percent of the paid-up capital of the respective bank(s).

**14.6** It shall be mandatory for the banks to submit a report to RMA in the event a natural or legal person or an entity holds more than ten percent of the share capital issued.

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<sup>19</sup> Amended on March 29, 2010

<sup>20</sup> Immediate family means spouse of an individual, the individual's minor children and any of the individual's children (including adults) residing in the individual's home.

**SECTION-15<sup>21</sup>**

**REGULATIONS ON INVESTMENTS IN EQUITY BY BANKS**

**15.1** Financial institutions carrying on banking activities shall not, directly or indirectly, without prior written authorization from the RMA:

(a) purchase shares, become partner in, or acquire an interest that in the aggregate amounts to more than 20 percent of the equity of the:

- i. projects or enterprise; and
- ii. non-bank financial institutions

(b) permit the investment described in Section 15.1 (a) above to exceed the equivalent of 25 percent of its net worth.

**15.2** No financial institutions carrying on banking activities shall be permitted to invest in another bank exceeding 5 percent of the paid-up capital of the other bank.

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<sup>21</sup> Amended on March 29, 2010

## SECTION-16<sup>22</sup>

### REGULATIONS ON SHARE CAPITAL OWNERSHIP OF NON-BANK FINANCIAL INSTITUTIONS

- 16.1** Non-bank financial institutions shall not, directly or indirectly, without prior written authorization from the RMA:
- (a) come under common ownership with, or become owned to more than 20 percent of its equity by:
    - i. enterprises; and
    - ii. other financial institutions which are not in the same line of business
  - (b) permit the investment described under Section 16.1 (a) above to exceed the equivalent of 25 percent of its net worth.
- 16.2** No non-bank financial institution shall be owned by another non-bank financial institution exceeding 5 percent of its paid-up capital.
- 16.3** No individual, together with his/her immediate family members and companies in which he/she has ownership of 10 percent or more, can have ownership of more than 20 percent of the paid-up share capital of the non-bank financial institution.
- 16.4** No company together with its subsidiaries can have ownership in non-bank financial institutions more than 25 percent of the paid-up capital of the non-bank financial institution.
- 16.5** No holding company can have ownership in two or more non-bank financial institutions exceeding 5 percent of the paid-up capital of the respective non-bank financial institutions.
- 16.6** It shall be mandatory for the non-bank financial institutions to submit a report to RMA in the event a natural or legal person or an entity holds more than ten percent of the share capital issued.

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<sup>22</sup> Amended on March 29, 2010

**SECTION-17<sup>23</sup>**

**REGULATIONS ON INVESTMENTS IN EQUITY BY NON- BANK FINANCIAL INSTITUTIONS**

**17.1** Non-Bank Financial institutions shall not, directly or indirectly, without prior written authorization from the RMA:

(a) purchase shares, become partner in, or acquire an interest that in the aggregate amounts to more than 20 percent of the equity of the:

- i. projects or enterprise; and
- ii. other financial institutions which are not in the same line of business

(b) permit the investment described in Section 17.1 (a) above to exceed the equivalent of 25 percent of its net worth.

**17.2** Non- Bank financial institutions shall not be permitted to invest in another non-bank financial institutions (with same line of business) more than 5 percent of the paid-up capital of the other non-bank financial institutions.

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<sup>23</sup> Amended on March 22, 2010

## SECTION-18

### **REGULATIONS ON ESTABLISHMENT OF BRANCHES, AGENCIES, AND OTHER SUCH OFFICES OF FINANCIAL INSTITUTIONS AND NEW PRODUCTS**

#### **18.1 ESTABLISHMENT OF BRANCHES, AGENCIES, AND OTHER SUCH OFFICES OF FINANCIAL INSTITUTIONS**

**18.1.1** The RGOB has played a vital role in encouraging the financial institutions to establish their branches/agencies in the dzongkhags in order to promote balanced economic development and to address the financial services need of the general public. However, the policy and setting up of new branches/agencies should be decided and undertaken based on respective institution's yearly business growth and plans, potential for business at the new centers for opening of branches, profitability of the proposed branches, redeployment of staff where surplus manpower has been identified and for extending efficient and prompt customer service to the clientele of the institution. Additionally, while considering such expansions, regulatory aspects of promoting a fair and competitive financial sector development should be taken into account.

**18.1.2** Therefore, in accordance with Article 16 of the Financial Institutions Act 1992, no financial institutions shall, without the prior permission of the RMA, establish branches, agencies, and other such offices.

#### **18.2 LAUNCHING OF NEW PRODUCTS<sup>24</sup>**

All financial institutions must seek written approval from the RMA prior to the introduction of new products to the public. Further, the financial institutions are required to fulfill the prerequisite conditions listed below for the launching of the new products and furnish the details to RMA accordingly:-

- i. Board's approval on launching of new products
- ii. Adherence to principles on fair treatment of consumers which would include:
  - a. Disclosure to customers on terms and conditions associated with the product
  - b. An adequate and effective system for resolving and monitoring customer complaints
  - c. Suitably trained staff to educate the customer on the product
- iii. Required to put in place adequate policies and procedures designed to ensure that the customer has practical understanding of products so as to meet the client's objectives.

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<sup>24</sup> Amended on March 29, 2010

## SECTION – 19

### REGULATIONS ON MONEY LAUNDERING

#### **19.5 INFORMATION ON CASH TRANSACTION** <sup>25</sup>

Banks must maintain record of any single cash transaction (including inward and outward international fund transfer) of more than Nu.1 million and should be reported to the RMA on a quarterly basis.

#### **19.6 INFORMATION ON FOREIGN CURRENCY CASH TRANSACTION** <sup>26</sup>

Any single cash transaction of foreign currencies and Indian Rupees of more than Nu.0.5 million and Nu.1 million respectively by a person/entity should be reported to the RMA on a quarterly basis.

#### **19.7 SUSPICIOUS TRANSACTION REPORT** <sup>27</sup>

Reporting entities are required to promptly report to RMA any transaction that generates a reasonable suspicion that the transaction is aimed at or related to money laundering or terrorist financing or that generates a reasonable suspicion that the transaction involves proceeds of crime.

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<sup>25</sup> Amended on March 29, 2010

<sup>26</sup> Amended on March 29, 2010

<sup>27</sup> Amended on March 29, 2010

## SECTION - 20

### REGULATIONS ON ON-SITE EXAMINATIONS OF FINANCIAL INSTITUTIONS

- 20.1** In terms of Article 54 of the Financial Institutions Act of Bhutan 1992, the Examining Officers of the Royal Monetary Authority shall conduct on-site examinations of each financial institution as and when found necessary.
- 20.2** The financial institutions are required to make available to the Examining Officers of RMA all records and documents to enable them to ascertain the overall financial condition of the institution. Furthermore, the employees and officers of the financial institution are required to provide such information concerning any aspects of the financial institution's operations, which the Examining Officers may reasonably request to determine its safety and soundness.
- 20.3** A copy of the Examining Officers' on-site report of examination shall be submitted to the Board of Directors and Executive Management of the financial institution and shall be discussed by the Board of Directors at its meeting immediately succeeding receipt of the report.
- 20.4** Each member of the Board of Directors shall acknowledge receipt and perusal of the report of examination on the form provided at the time of the Board Meeting.
- 20.5** *Management of the financial institution is required to respond to the findings in the report within 14 working days of the meeting of the Board of Directors referenced in 20.3 above.*
- 20.6**<sup>28</sup> Management of the financial institution shall report to the RMA the necessary actions/measures/remedies taken by the Board based on the findings of the on-site inspection report, within 6 months from the date of submission of the on-site inspection report.

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<sup>28</sup> Amended on March 29, 2010

## **SECTION – 22**

### **REGULATIONS FOR COMPLIANCE OFFICERS**

#### **22.1 INTRODUCTION**

**22.1.1** The main objective of requiring each financial institution to appoint a Compliance Officer is to check the level of compliance of laws, regulations and rules within the institution and to streamline the present reporting system to the RMA. The concerned institution may appoint a senior officer holding a designation of no less than that of a Deputy General Manager from the Head Office. While the Compliance Officer may report to the Managing Director/Audit Committee on areas requiring compliance at intervals as may be specified by the institution, the issues pertaining to non-compliance should be reported to the RMA on a quarterly basis.

In addition to his/her normal discharge of duties and responsibilities, the Compliance Officer shall also be responsible for:

- (i) implementing and complying with all matters relating to RGOB circulars, prudential regulation and directives issued by the Royal Monetary Authority from time to time;
- (ii) acting as a focal point of contact between the financial institution concerned and the RMA;
- (iii) instituting a system whereby he/she can collect any information requested by the RMA from various divisions/department of the respective financial institution;
- (iv) monitoring and confirming from the officer-in-charge of the respective division/department with regard to effective compliance of legislations, regulations, directives and circulars on an on-going basis;
- (v) undertaking measures when necessary to reflect the institution's compliance to Sl. No. (iv) above on an on-going basis;
- (vi) collecting and compiling all information relating to RMA returns, and then submitting to the RMA;
- (vii) checking the correctness and promptness of the reports being submitted to the RMA; and
- (viii) dealing with any queries or problems concerning the RMA returns and compliance with the prudential norms.

**22.2** Any change in the appointment of the Compliance Officer shall be only upon the prior approval of the Financial Regulation and Supervision Department of the RMA.<sup>29</sup>

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<sup>29</sup> Amended on March 29, 2010