ANNUAL SUPERVISION REPORT

2020

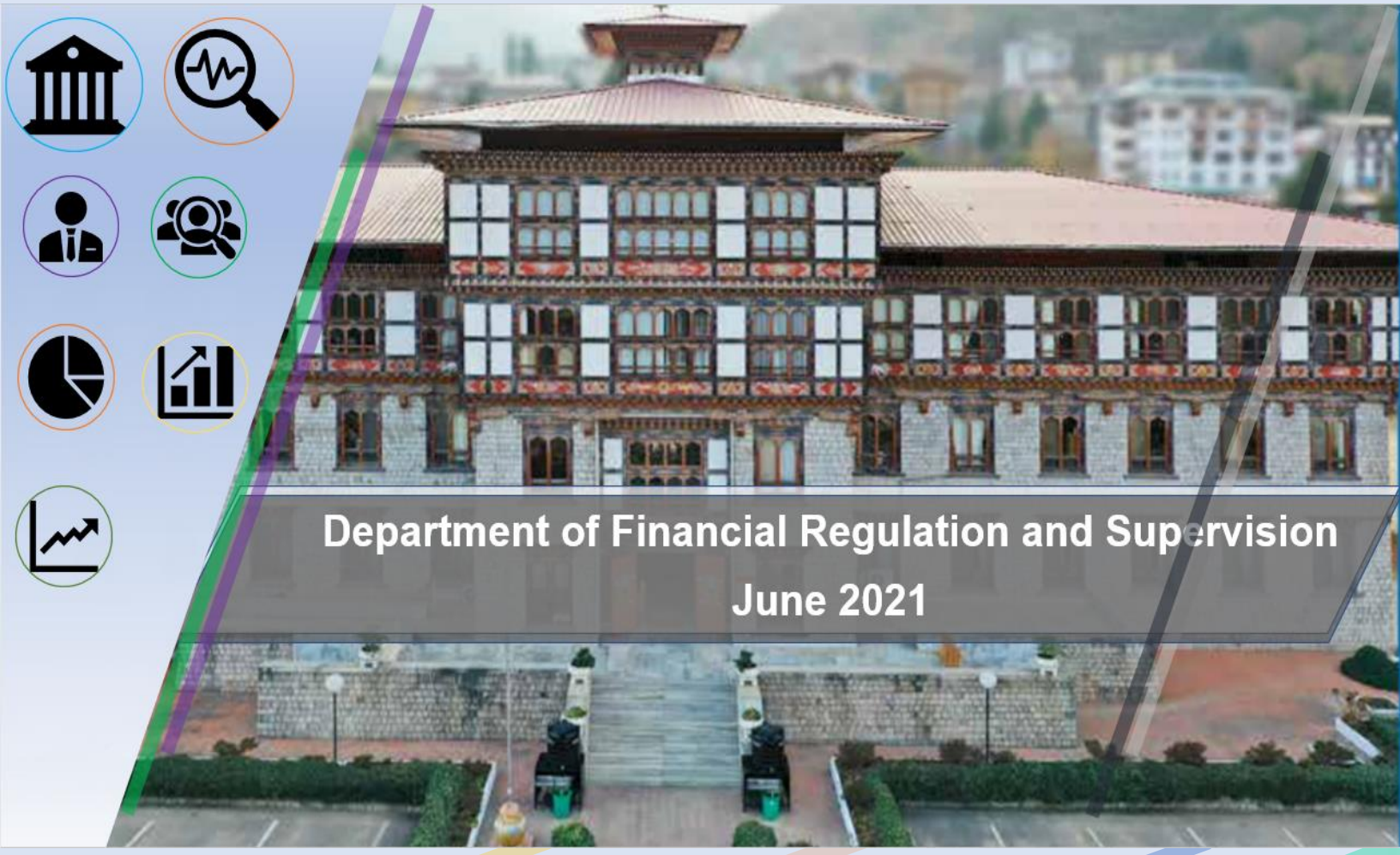

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TABLE OF CONTENT

Page Number

EXECUTIVE SUMMARY

Over the past year, COVID-19 pandemic has been plaguing every aspect of Bhutan and the Bhutanese. Against the backdrop of the pandemic, preservation and promotion of stability and soundness of the financial sector has been exacting. In pursuance of stability and soundness of the financial sector, the Royal Monetary Authority (RMA) remarkably focused on protection and promotion of the financial sector in response to the pandemic. Thus far, the combined effect of the monetary measures and the generous interest payment support (IPS) from the His Majesty has helped the financial sector to remain resilient and weather the pandemic. However, the pandemic continues to present extraordinary challenges to both financial sector and regulators.

In the backdrop of the pandemic, it is imperative to assess and understand the state of financial sector including their prudential requirements. ***This report provides information on the RMA's (i) supervisory initiatives during the year, (ii) the performance of the financial system and potential risks to the financial stability and resilience and (iii) reforms undertaken to improve the existing regulatory framework.***

Monetary Measures in Response to the COVID-19 Pandemic

One of the immediate economic impacts of COVID-19 was the disruption of business operations resulting in loss of income and employment. The decrease, or even complete loss of earnings, pose difficulties in debt repayment and place added pressure on the financial health of the sectors and the economy as a whole. The unprecedented and timely monetary measures implemented by the RMA have continued to address and mitigate the implication on the Bhutanese financial sector and serve the needs of businesses and households through this period of uncertainty.

The concerted effort in combating the adverse impact of COVID-19 pandemic has been successful. The RMA has formulated and implemented two phases of monetary measures in order to respond to the pandemic. ***The Monetary measures includes (i) deferment of loan repayment; (ii) one percent interest rate rebate (40 percent of 140,160 loan accounts amounting to Nu. 36,971 million has opted for the rebate); (iii) release of 3 percent of Cash Reserve Requirement amounting to Nu. 4,218 million for onward lending at the concessional interest rate (of which Nu. 2,591 million of loan was sanctioned in the form of soft loans as of December 2020); and (iv) interest payment support (IPS) amounting to Nu. 9,324 million (of which Nu. 1,882.5 million was born by the Financial Services Providers (FSPs)), from April to December, 2020 was provided to the 139,096 loan accounts.***

Loans sanctioned under the monetary measures, phase I and II, as of December 2020 stood at Nu. 3,624 million. ***Sectors which received the concessional loans from the financial institutions under the monetary measures are production/manufacturing, service/ tourism and trade/commerce.*** The CSI Bank has sanctioned loans of Nu. 728 million under monetary measures to the cottage and small industries.

State of Financial Sector and Associated Risks

The Department has carried out the risk assessment of the financial sector to assess the performance and key risks facing the financial sector, and the resilience of financial sector to adverse shocks. The assessment is for the period ending December 2020 and includes[1] five banks, two insurance companies and National Pension and Provident Fund (NPPF). The main findings of the risk assessment are as follows:

Liquidity and funding risk management: Liquidity position of the financial sector is expected to remain relatively stable. The financial institutions' Statutory Liquidity Ratios (SLR) are above the minimum requirements, with 32 percent for the banks and 18 percent for the non-banks. Deposit with the banks has increased by 19 percent to Nu. 165,447 million in December 2020, as compared to Nu. 138,738 million in December 2019.

Credit risk assessment: Total loans and advances have increased by 8 percent to Nu. 166,989 million in December 2020 from Nu. 154,326 million in December 2019. The non-performing loans (NPLs) of the financial sector stood at Nu. 24,397 million (15% of the total loans and advances). The loan deferment facility and interest payment support Kidu are the key factors, which prevented the further deterioration of non-performing loans.

Profitability assessment: Driven by increased loan provisioning, the profitability of the financial sector has declined. Weak profitability presents a challenge to future capital resilience as profits are an important element of capital growth. As of December 2020, financial sector made a profit after tax of Nu. 1,307 million.

***Capital risk assessment*:** The Capital Adequacy Ratio (CAR) of the financial institutions has decreased from 15 percent in 2019 to 14 percent in December 2020. The dispersion of capital levels among financial institutions remains high, and some financial institutions having entered the COVID-19 crisis with relatively lower capital levels and riskier exposures may face challenges.

Operational risk assessment: while this risk is immanent, so far, no major incident of business disruption has been reported. The FSPs' adoption of online business through the internet, mobile phone and apps, if not vigilant, exposes the FSPs to various types of risk such as cyber risk, information technology (IT) risk, employees and reputational

[1] The risk assessment includes only 8 financial institutions since these institutions are systematically important institutions in the Bhutanese financial sector.

impacts. Therefore, the financial institutions should ensure that their IT infrastructure is strong and remain vigilant to address data integrity, business continuity and cyber threats.

Insurance risk assessment: Gross premium has increased by 26 percent from Nu. 2,700 million in 2019 to Nu. 3,400 million in 2020 owing to people purchasing more life insurance covers and property insurance related to fire and motor portfolio. On the other hand, the gross claims have reduced by 58 percent from Nu. 2,500 million in 2019 to Nu. 1,000 million in 2020.

Regulatory and Supervisory Reforms

To further enhance the financial sector resilience, ***the Department (i) will be transitioning to risk-based supervisory approach from the existing compliance and performance based supervisory approach; (ii) implementation of risk-based solvency requirements for insurance sector; (iii) development of NPLs resolution framework to decongest NPLs in the financial sector; and (iv) building a resilient and credible insurance sector.***

As COVID-19 pandemic continues to pose challenges to both financial sector and regulator, the RMA will continue to ensure that its regulations and supervisory policies and tools are effective and efficient to support the economy.

This report comprises of the following chapters:

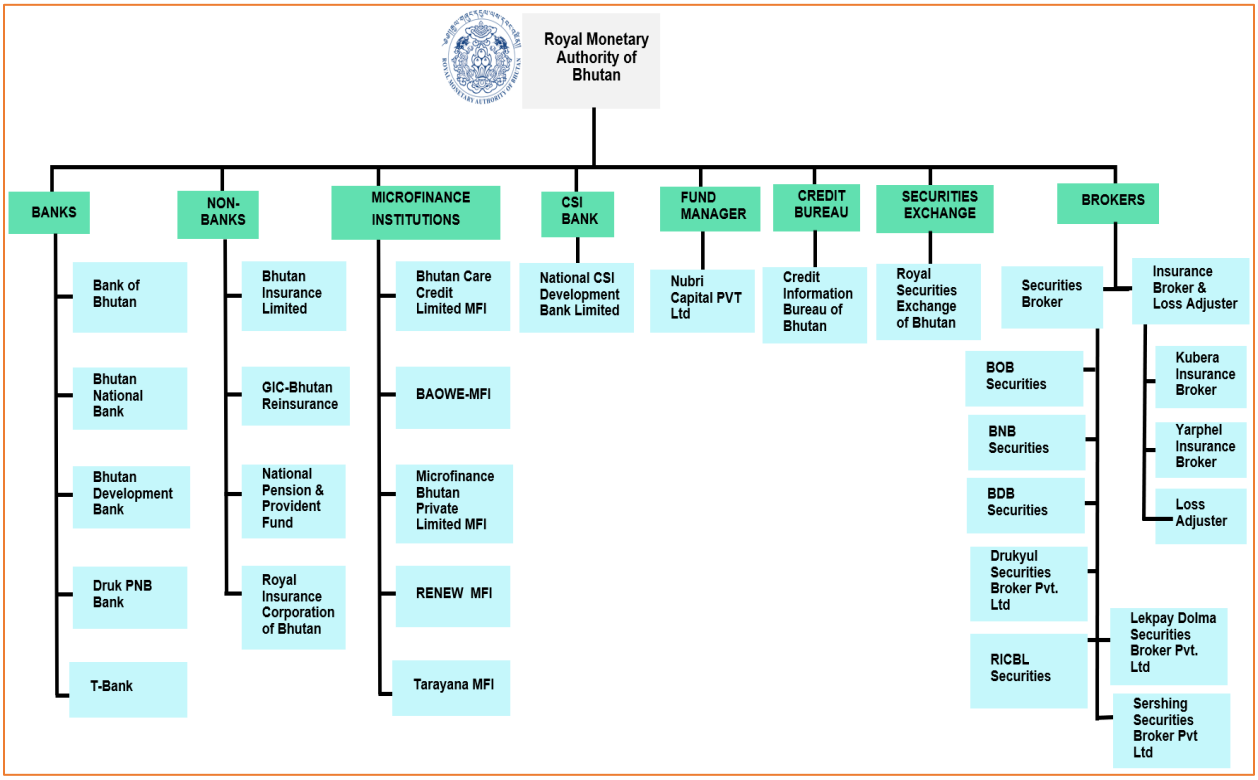
Chapter 1: Financial Sector at a Glance;
Chapter 2: Monetary Measures in Response to COVID-19 Pandemic;
Chapter 3: State of the Financial Sector and Associated Risks; and
Chapter 4: Regulatory and Supervisory Developments.

CHAPTER 1: FINANCIAL SECTOR AT A GLANCE

1.1: Structure of the Financial Sector

The Bhutanese financial sector comprises of the following[2]:

(i) Royal Monetary Authority, the central bank of Bhutan;
(ii) Five commercial banks;
(iii) Three insurance companies;
(iv) One Pension & Provident Fund;
(v) One CSI bank;
(vi) Five microfinance institutions (MFIs);
(vii) One fund management company;
(viii) One credit information bureau (CIB);
(ix) One securities exchange;
(x) One loss adjuster; and
(xi) Nine brokers (seven securities brokers and two insurance brokers).

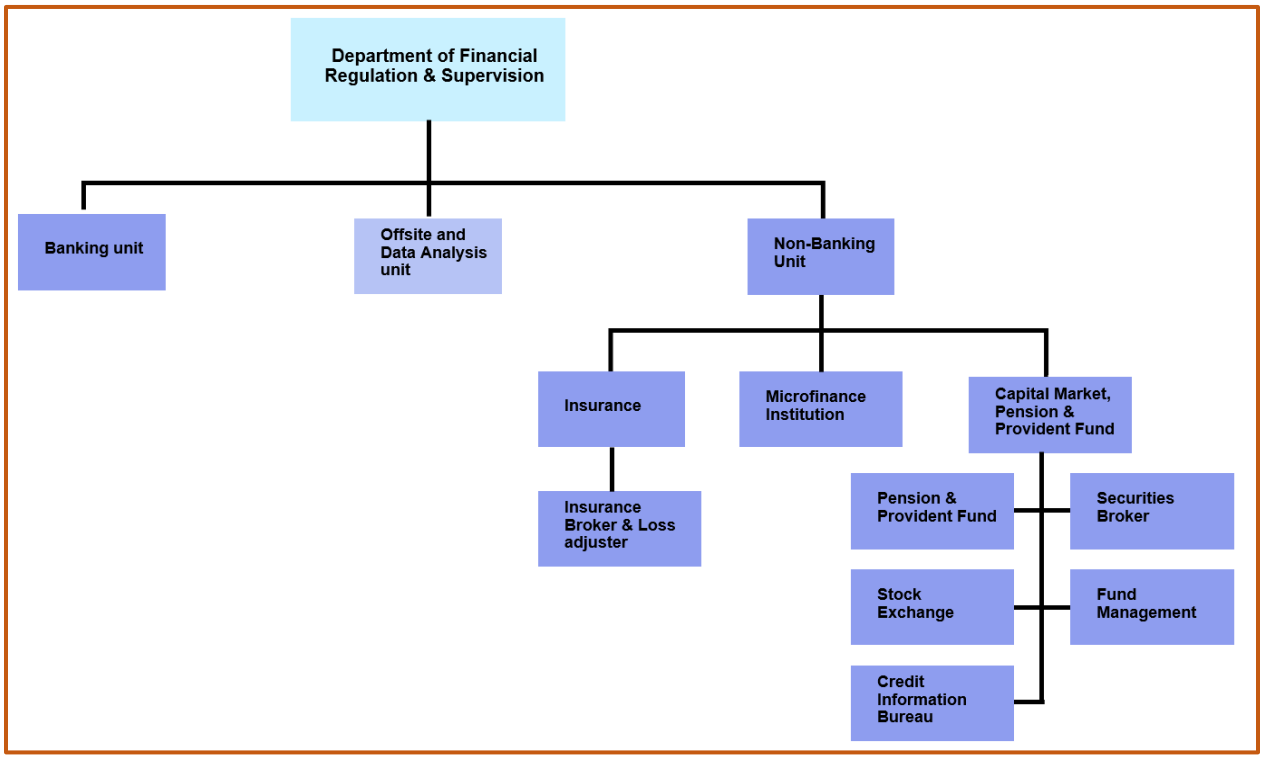


[2] Financial institutions comprise of banks, insurance companies, securities exchange and pension and provident fund
Financial service providers comprise of financial institutions, MFIs, CSI bank, fund management company, brokers and loss adjuster

1.2: Structure of Department of Financial Regulation and Supervision

The Department of Financial Regulation and Supervision is in charge of maintaining the stability and integrity of the financial system in Bhutan by formulating and applying financial regulations and prudential guidelines. Some of the primary functions of the Department of Financial Regulation and Supervision are as follows:

- Formulation and implementation of the policies and prudential regulations;
- Processing licences of financial service providers;
- Conducting onsite evaluation of the financial conditions and compliance with statutory and prudential requirements of the FSPs; and
- Conducting offsite surveillance of the FSPs.



1.3: Overview of the Financial Sector Performance

Bold and timely policy intervention by the RMA has helped in maintaining the stability and soundness of the Bhutanese financial sector during the COVID-19 pandemic. The following are the key financial soundness indicators as of December 2020.[3]

Figure 1.1: Aggregate Capital Adequacy Ratio for financial institutions as of December 2020, against the regulatory requirement of 10%

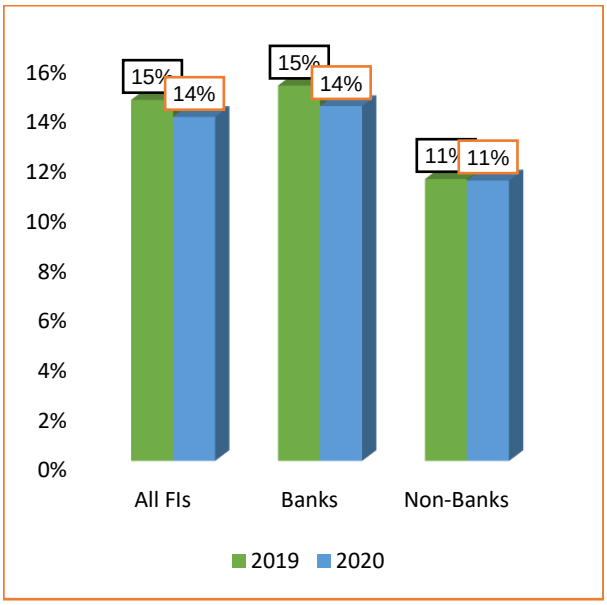


Figure 1.2: The total loan outstanding in the financial sector as of December 2020 (In Nu. Million)

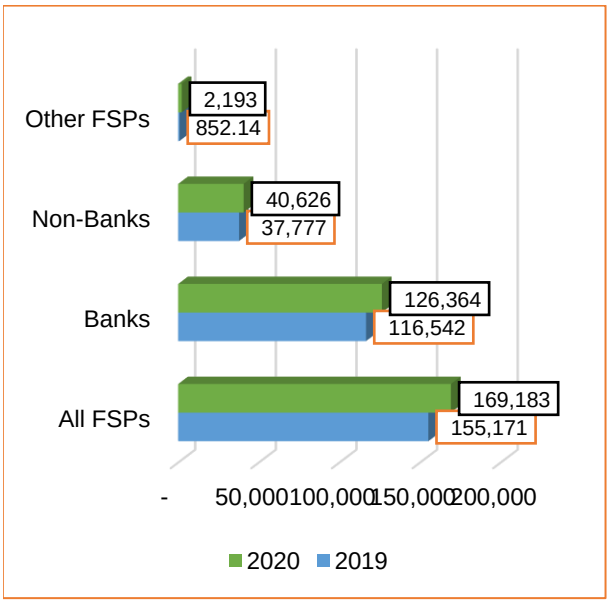


Figure 1.3: NPLs as of December 2020 (In Nu. Million)

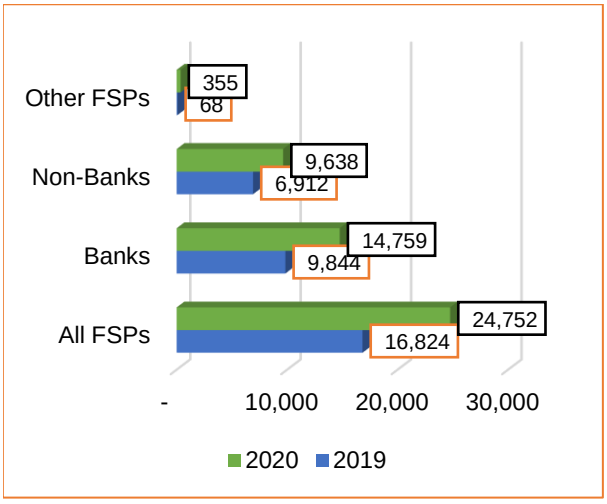
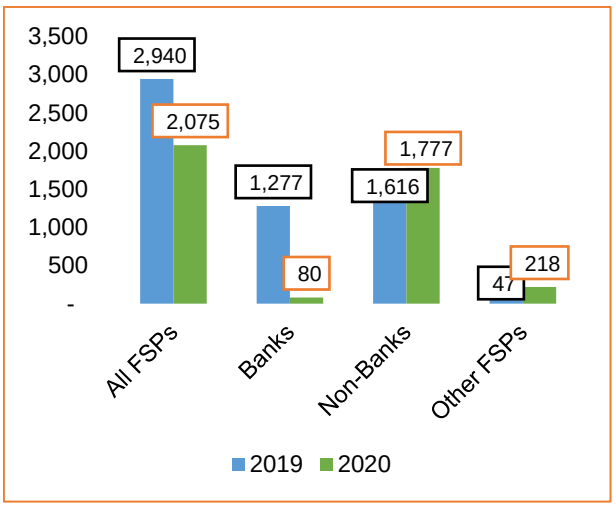


Figure 1.4: Overall profitability of the FSPs as of December 2020 (In Nu. Million)



[3] (i) excluding NPPF and Reinsurance for capital adequacy purposes and (ii) other FSPs include CSI bank, reinsurance company, MFIs for the purposes of loans, NPLs and profitability

Figure 1.5: Deposits of banks and deposit taking MFIs as of December 2020 (In Nu. Million)

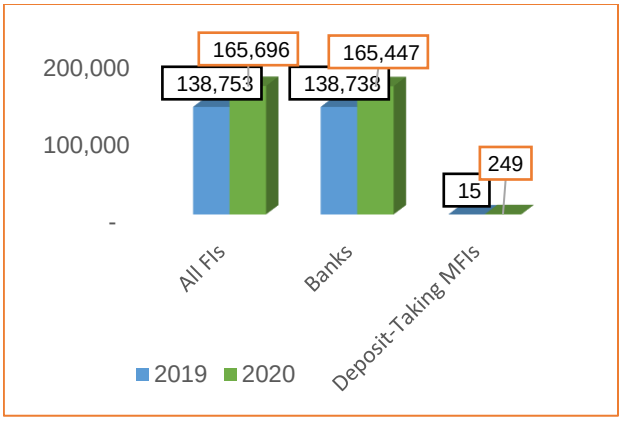


Figure 1.6: The liquidity position of the financial institutions as of December 2020 (in percentage)

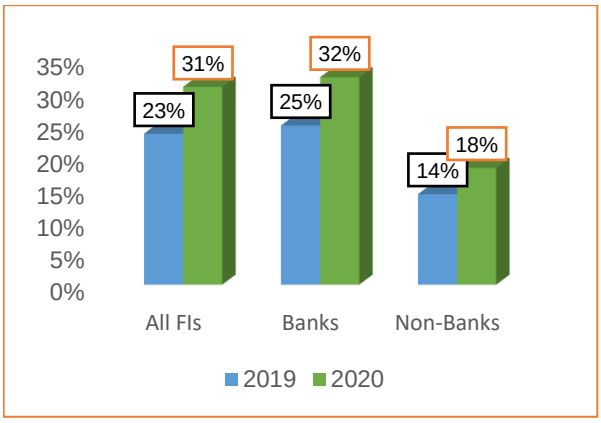


Figure 1.7: Dzongkhag wise distribution of the loans in the financial sector as of December 2020.

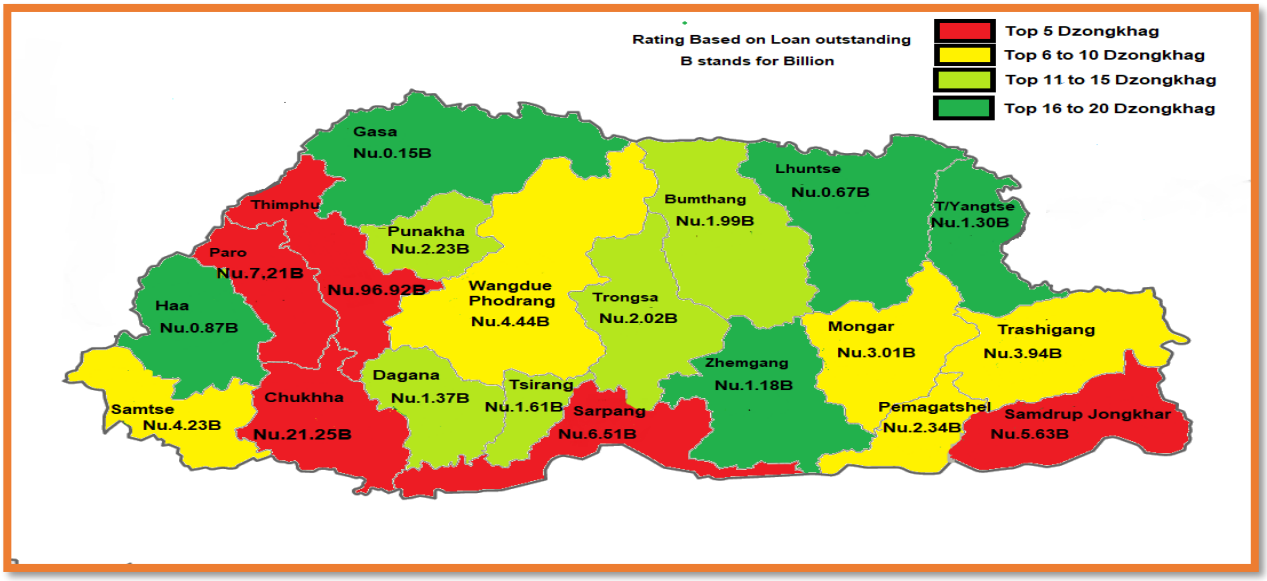
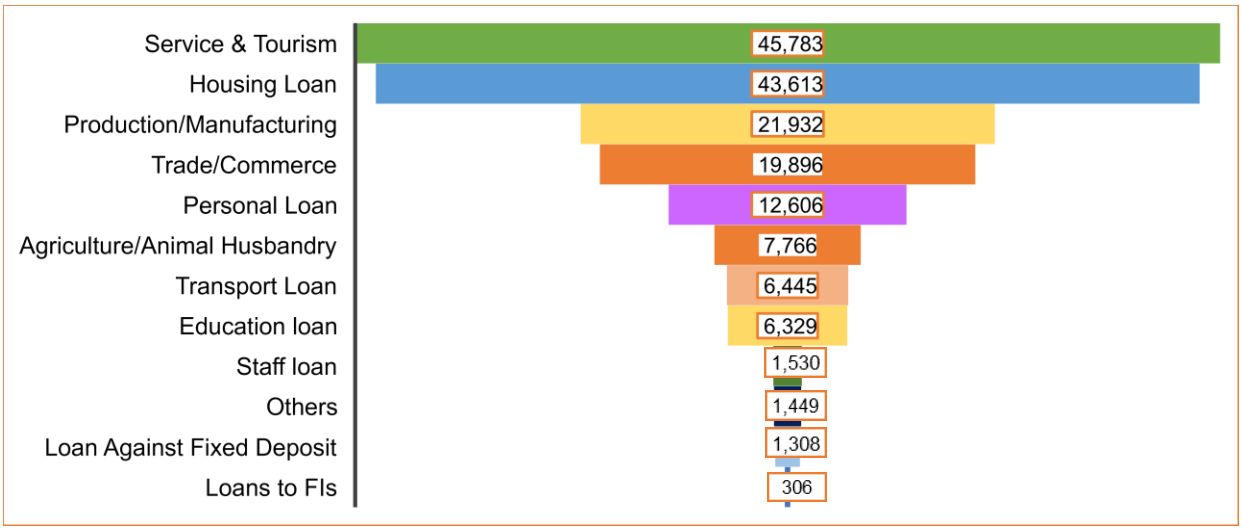


Figure 1.8: Overall loan distribution by sectors as of December 2020 (In Nu. Million).

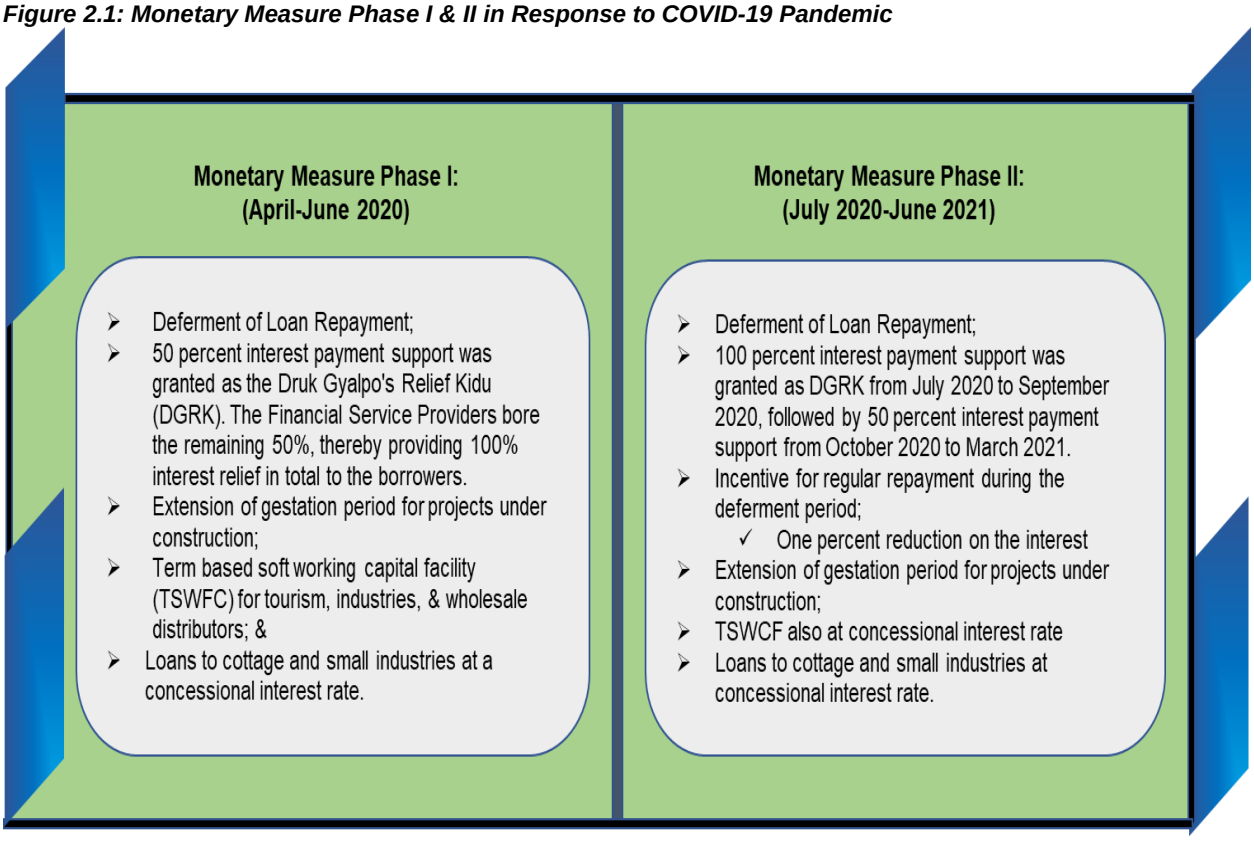


CHAPTER 2: MONETARY MEASURES IN RESPONSE TO COVID-19 PANDEMIC

2.1 Monetary Measures in Response to COVID-19 Pandemic

The COVID-19 pandemic has brought huge social disruptions and economic challenges, with inevitable impact on the Bhutanese financial sector. The RMA in collaboration with the financial service providers (FSPs) have implemented the monetary measures that are people-centred to protect the wellbeing of the people and to benefit the people who are facing economic hardship owing to the COVID-19 pandemic. These unprecedented and timely intervention through issuance of monetary measures have continued to address and mitigate the implication on the Bhutanese financial sector and serve the needs of businesses and households through this period of uncertainty. However, given the uncertainty of the scale and duration of the pandemic, the financial sector is still vulnerable and continue to face challenges posed by the pandemic.

Figure 2.1: Monetary Measure Phase I & II in Response to COVID-19 Pandemic



2.2: Implementation Status of Monetary Measures as of December 2020

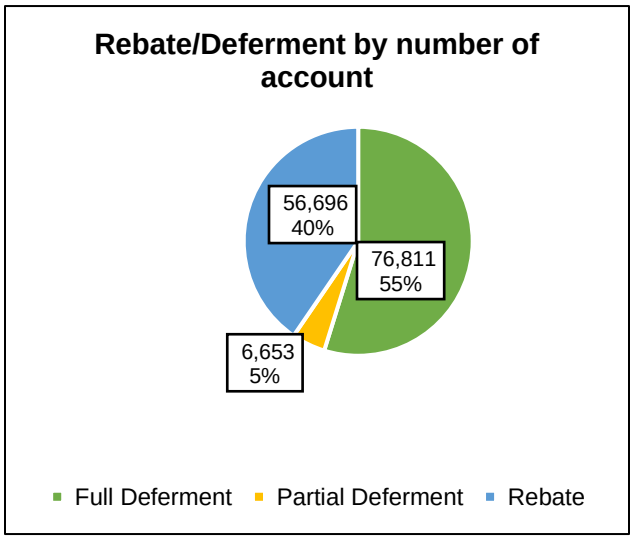
Table 2.1: Monthly Interest Payment Support from April to December 2020 (In Nu. Million) provided to the eligible borrowers (loan outstanding as of April 10, 2020).

Months	DGRKF	FSPs	Total
April	626	626	1,252
May	640	640	1,279
June	617	617	1,234
July	1,255	-	1,255
August	1,247	-	1,247
September	1,239	-	1,239
October	618	-	618
November	595	-	595
December	607	-	607
Total	**7,442**	**1,882**	**9,324**

i. April - June: DGRKF (50%) & FSPs (50%)
ii. July - Sept: DGRKF (100%)
iii. Oct - Dec 2020: DGRKF (50%) & borrowers (50%)

*DGRKF - Druk Gyalpo's Relief Kidu Fund

Figure 2.1: Overview of deferment of loans repayment & one percent rebate to borrowers who pays regular repayment of loans.



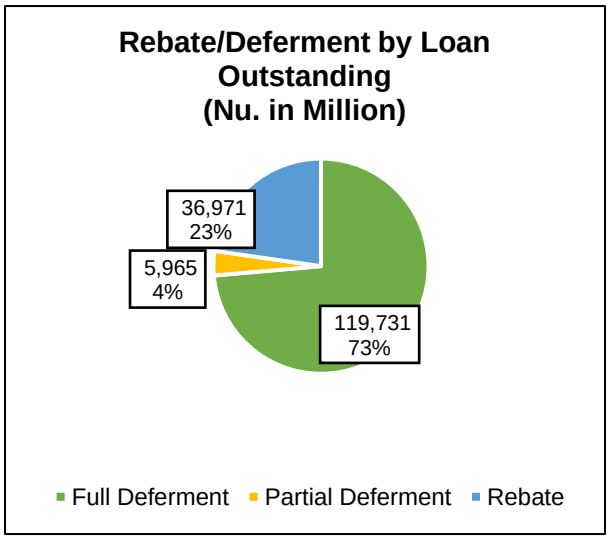
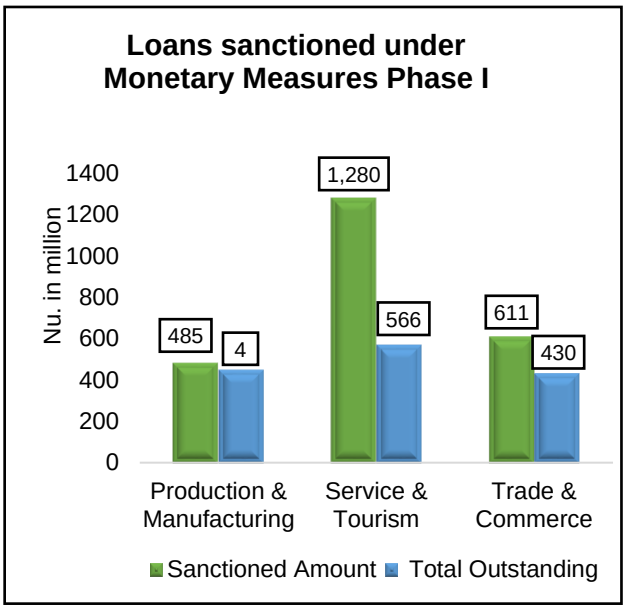
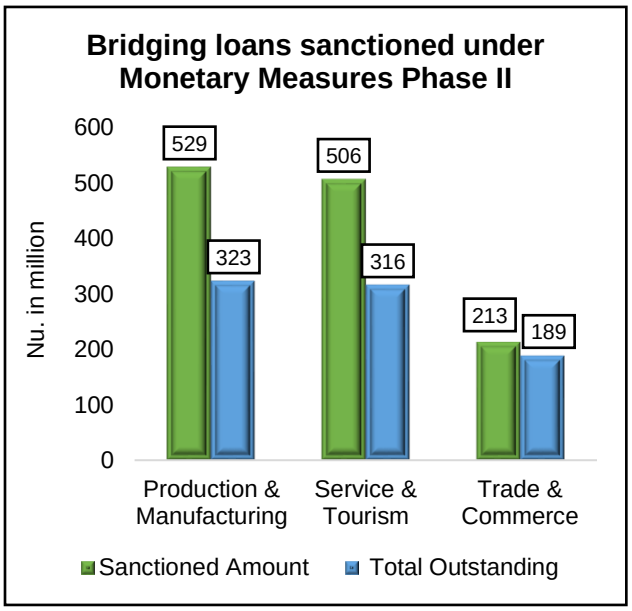


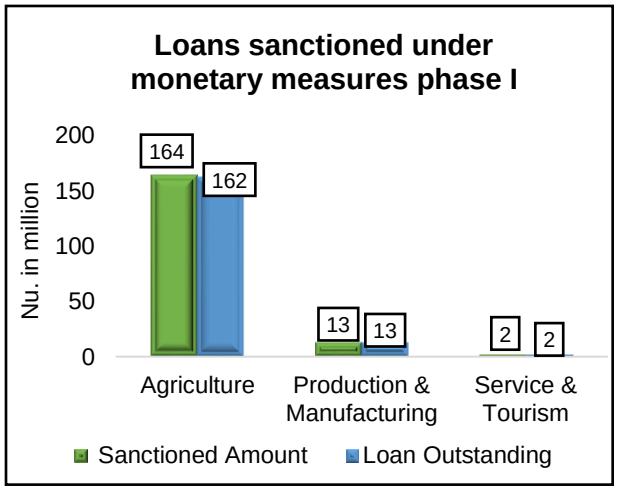
***Figure 2.2**: Loans sanctioned at a concessional interest rate by the financial institutions under the monetary measures through the release of CRR amounting to Nu. 4.2 billion*

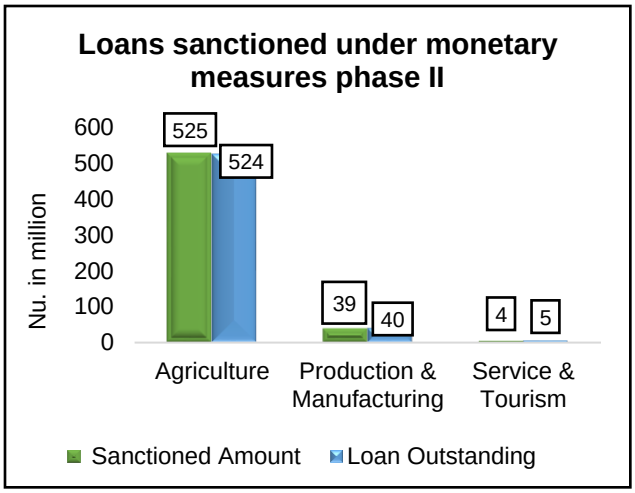




The total sanction amount includes the loans financed by NPPF & BIL at a concessional interest rate (Nu.1,056.18 million) which is not from the CRR.

Figure 2.3: Loans sanctioned at a concessional interest by CSI bank under the monetary measures





- In order to ensure that the cottage and small industries have access to loans during the COVID-19 pandemic, the CSI bank sanctioned loans at a concessional interest rate:
    - Nu. 728 million of micro loans at 2 percent interest rate was sanctioned as of December 2020.
    - Nu. 19 million of working capital loan at 4 percent was sanction as of December 2020.

CHAPTER 3: STATE OF FINANCIAL SECTOR AND ASSOCIATED RISKS

3.1 Background

The RMA has carried out the risk assessment of the financial sector to measure the impact of COVID-19 pandemic. The assessment report outlines the RMA's assessment of the performance and key risks facing the financial sector, the resilience of financial sector to adverse shocks, and recommendations to ensure financial stability. ***The assessment is for the period ending fourth quarter, 2020 and includes five banks, two insurance companies and National Pension and Provident Fund.***

Table 3.1: Core indicator of the financial sector

Indicators	Dec-19	Dec-20
Capital		
RWCAR (12.5%)	14.22%	13.82%
Core CAR (7.5%)	11.35%	10.75%
Leverage Ratio (5%)	7.56%	6.68%
Asset Quality		
Gross NPL Ratio	10.86%	14.61%
Single Largest Borrower	16.93%	16.70%
Provision to NPL	68.57%	54.75%
NPL	Nu. 16.76b	Nu. 24.40b
Loan	Nu. 154.33b	Nu. 166.99b
Earning		
Return on Asset (RoA)	1.06%	0.92%
Return on Equity (RoE)	9.14%	8.73%
Profit After Tax (PAT)	Nu. 1.55b	Nu. 1.83b
Liquidity		
Loans to Deposits ratio	92.03%	78.40%
Statutory Liquidity Requirement ratio	23.32%	30.67%
Liquidity Position	Nu. 7.49b	Nu. 22.86b
Statutory Liquidity Requirement	Nu. 31.17b	Nu. 36.91b

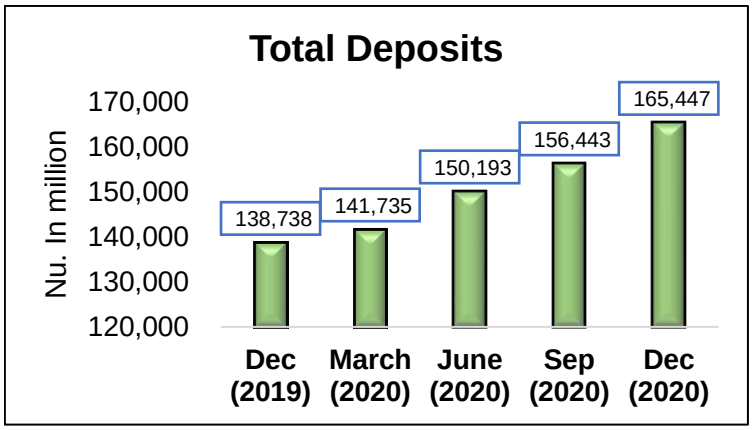
3.2 Liquidity and Funding Risk Assessment

(i) The Liquidity Position of the financial sector is expected to remain relatively stable with the implementation of Domestic Liquidity Management Framework to help financial institution with liquidity support. The domestic financial system has already played a significant role in supporting liquidity needs of businesses so far in this pandemic. Deposit structure has remained stable and largely unaffected since December 2019.

(ii) Deposits has Remained Stable and Unaffected[4]

The total deposits in the banking sector as reflected in figure 3.1 has increased from Nu. 150,193 million in June 2020 to Nu. 156,443 million in September 2020 and further to Nu. 165,447 million in December 2020. The total deposits have increased by 19 percent from December 2019 to December 2020 (from Nu 138,738 million to Nu. 165,447 million).

Figure 3.1: Deposit composition in the banking sector



Banking sector has entered the COVID-19 pandemic with a continued focus on deposit in their liability structure. Since the outbreak of the pandemic, funding structure in terms of deposits have been stable and volumes have been largely unaffected.

In terms of deposit composition, the retail deposit as of December 2020 has increased to Nu. 97,393 million *(59 percent of total deposits)* as compared to Nu. 89,683 million in September 2020 and corporate deposits as of December 2020 has also increased to Nu. 68,053 million *(41 percent of total deposits)* as compared to Nu. 66,760 million in September 2020.

Table 3.2: Quarterly retail and corporate deposit trend (In Nu. Million)

Deposits Type	Dec (2019)	March (2020)	June (2020)	Sep (2020)	Dec (2020)
Corporate Deposits	66,449	67,143	68,323	66,760	68,053
Retail Deposits	72,288	74,592	81,870	89,683	97,393
Total Deposits	138,738	141,735	150,193	156,443	165,447

The table 3.2 shows the deposit by account type for the period ended December 2020. 48 percent of total deposits as of December 2020 are in the form of time deposits (46 percent in fixed deposits and 2 percent in recurring deposits) indicating stable deposits in the banking sector. Remaining 52 percent of total deposits are in the form of demand deposits (31 percent in saving deposits and 21 percent in current deposits) which may be volatile in nature as this type of deposits can be withdrawn at any time.

[4] Total deposits comprise of bank deposits and excludes the deposits of deposit taking MFIs

Table 3.3: Deposits by account type as of December 2020 (In Nu. Million)

Deposit Type	Dec (2019)	March (2020)	June (2020)	Sep (2020)	Dec (2020)
Current Deposits	26,638	30,934	29,597	32,888	34,435
Savings Deposits	36,630	38,640	46,496	49,021	51,473
Fixed Deposits	73,161	69,700	71,284	71,424	76,118
Recurring Deposits	2,310	2,460	2,815	3,109	3,421
Total	**138,738**	**141,735**	**150,193**	**156,443**	**165,447**

(iii) Financial Sector Continues to Maintain SLR above the Regulatory Requirement

Financial institution's statutory liquidity ratio (SLR) as of December 2020 are above the minimum regulatory requirement of 20 percent for banks and 10 percent for non-banks. Stable liquidity position has enabled the financial institutions to meet demand for new loans and committed funds.

(iv) Liquidity Position of the Financial Sector is Expected to Remain Relatively Stable in Medium-term

Ensuring an undisrupted flow of liquidity in the economy at all times is important to revitalize the economy and promote lending to productive sectors. Currently, one of the key challenges faced by the banking sector is the variation in liquidity holdings amongst banks, in particular due to its varying size and coverage. In order to promote easy access to liquidity in the financial sector, the RMA formulated a Forward-Looking Domestic Liquidity Management Framework (DLMF). The main objectives of this Framework are (i) to ensure and provide undisrupted and optimal level of liquidity in the financial system (ii) to encourage financial institutions to proactively carry out their liquidity management function based on the need and priority of the economy and (iii) to support the development of interbank lending operations and also develop the domestic money market.

3.3 Credit Risk Assessment

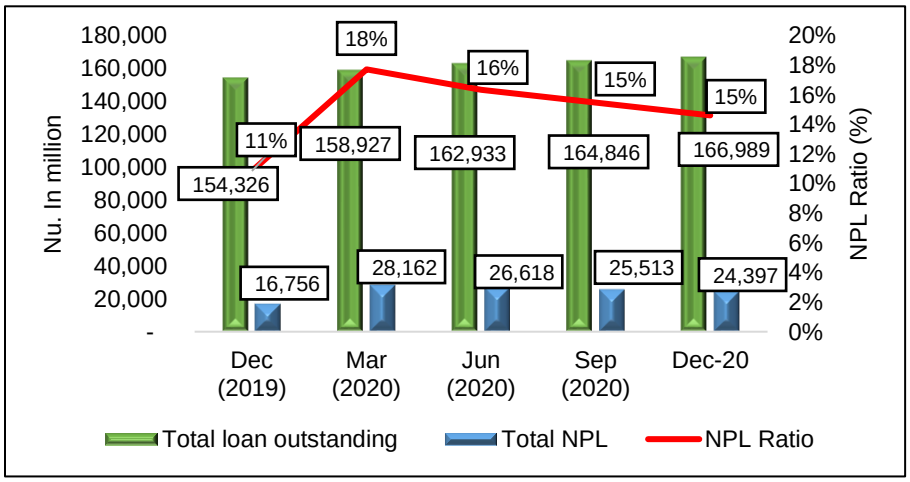
(i) Loan Outstanding and NPL Trend in the Financial Sector

Total loans and advances have increased by 8 percent during the year 2019 to 2020 (from Nu. 154,326 million in 2019 to Nu. 166,989 million in 2020). NPLs in the financial sector has decreased in December 2020 compared to previous quarters of 2020 as a result of exceptional levels of policy support, the role of loan deferment facility and interest

payment support Kidu (also loan follow-up and recovery initiative undertaken by the financial institutions).

As reflected in figure 3.2, NPLs in the financial sector has decreased from Nu. 25,513 million in September 2020 to Nu. 24,397 million in December 2020. The NPLs of most of the financial institutions has decreased. The loan deferment facility and interest payment support Kidu have been a key feature of the financial system response to the crisis, providing temporary relief from loan repayments for affected borrowers. This system-wide response, undertaken for almost all loan portfolios provided relief regardless of whether the income-shock was short-term or potentially more permanent.

Figure 3.2: Loans and NPL



While NPLs ratio stood at 15 percent in December 2020, NPLs could rise significantly if the pandemic's economic effects prove to be acute and persistent in the medium to long term. The asset quality is expected to be a key challenge for financial institutions going forward. As loan deferment facility expires, there will be borrowers who cannot return to full repayments and will require supports to address the specific issues they are experiencing. It is likely that most of the distressed loans may seek repayment extension beyond June 2021 impacting the cash flow of financial institutions and their ability to extend new loans in the economy.

(ii) Loan Classification Movements

The key indicator of changes in the credit quality is how much of it has been moved to a worse loan bucket/category as this indicates whether the loan book has undergone a significant increase in terms of credit risk. The table 3.4 shows the bucket wise loan comparison in the financial sector from December 2019 to December 2020.

Table 3.4: Financial institution's loan classification category (In Nu. Million)

Loan Status	Loan category	Dec (2019)	March (2020)	June (2020)	Sep (2020)	Dec (2020)
Regular loans	1. Standard (0 to 30 days)	122,852	113,837	120,355	126,749	128,151
	2. Watch (31 to 90 days)	14,710	16,928	15,919	12,584	14,442
NPLs	3. Sub-standard (91 to 180 days)	2,548	11,812	10,612	8,089	8,863
	4. Doubtful (181 to 365 days)	2,794	2,103	2,061	3,372	1,911
	5. Loss (more than 365 days)	11,415	14,247	13,986	14,051	13,623

- In the financial sector, the loans under Sub-standard category (NPLs) have decreased from Nu. 10,612 million in June 2020 to Nu. 8,089 million in December 2020. Loans under Doubtful and Loss category has also decreased from June 2020 to December 2020.

- The loans under Standard category have increased from Nu. 120,355 million in June 2020 to Nu. 128,151 million in December 2020.

The loan classification status of financial sector as of December 2020 is reflected in table 3.5.

Table 3.5: Financial Institutions' loan composition as of December 2020 (In Nu. Million)

Loan category	All FIs	Banks	Non-Banks
Standard (0 to 30 days)	128,151	100,522	27,629
Watch (31 to 90 days)	14,442	11,083	3,359
Sub-standard (91 to 180 days)	8,863	5,144	3,719
Doubtful (181 to 365 days)	1,911	1,193	718
Loss (more than 365 days)	13,623	8,423	5,200
(1) Total loans	166,989	126,364	40,626
(2) NPL ratio (%)	15%	12%	24%

(iii) Sectoral Loan Classification Status of Financial Sector as of December 2020

Financial sector's loan composition is expected to determine the extent to which they will be affected by the pandemic. Some sectors are expected to be hit harder than others, though predictions on the intensity of the impact on different sectors are difficult. The table 3.6 shows the sectoral loan classification status as of December 2020:

Table 3.6: Sectoral loan classification status as of December 2020

Sectors	(A) Sectoral Loans and NPL (Nu. In million)							(B) Percentage Holding	
	Standard (0 to 30 days overdue)	Watch (31 to 90 days overdue)	Sub-standard (91 to 180 days overdue)	Doubtful (181 to 365 days overdue)	Loss (more than 365 days overdue)	(A.1) Total Loan O/S	(A.2) NPLS	(B.1) Setoral loan % against total loans	(B.2) NPL % against respective sector
Agriculture/Animal Husbandry	4,827	327	323	213	690	6,380	1,226	4%	19%
Production/Manufacturing	14,508	2,195	2,680	54	2,054	21,490	4,787	13%	22%
Tourism Related	18,012	2,370	1,212	74	918	22,585	2,204	14%	10%
Contract (construction based)	1,932	1,063	823	269	2,475	6,562	3,567	4%	54%
Others: Service	13,573	1,555	581	209	706	16,624	1,496	10%	9%
Trade/Commerce	12,892	2,127	1,375	279	3,128	19,801	4,782	12%	24%
Loans to FIs	306	-	-	-	-	306	-	0%	0%
Home loans	7,589	646	192	90	531	9,048	813	5%	9%
Commercial Housing loans	30,167	2,408	465	205	1,309	34,554	1,979	21%	6%
Commercial Transport	3,051	726	665	304	534	5,279	1,502	3%	28%
Non-commercial Transport	864	140	63	19	78	1,165	161	1%	14%
Personal Loan	10,544	532	303	72	1,131	12,583	1,507	8%	12%
Staff loan	1,433	65	17	5	10	1,530	31	1%	2%
Education loan	6,024	147	74	54	30	6,329	158	4%	2%
Loan Against Fixed Deposit	1,269	23	16	-	1	1,308	17	1%	1%
Loans to Government	-	-	-	-	-	-	-	0%	
Others	1,158	120	73	65	29	1,445	167	1%	12%
Total	**128,151**	**14,442**	**8,863**	**1,911**	**13,623**	**166,989**	**24,397**	**100%**	**15%**
(Hardest-hit sectors by the pandemic: (1) Tourism related (2) Manufacturing (3) Trade (4) Commercial Transport and (5) Commercial Housing)									

The following are the sectors most at risk posed by COVID-19 pandemic:

(a) Tourism related loans: with exposure of 14 percent of total loans in the financial sector as of December 2020.

(b) Manufacturing/Production sector loans: with exposure of 13 percent of total loans in the financial sector as of December 2020.

(c) Trade/Commerce sector loans: with exposure of 12 percent of total loans in the financial sector as of December 2020.

(d) Commercial Transport loans: with 3 percent of total loans in financial sector as of December 2020.

(e) Commercial Housing loans: with a share of 21 percent of total loans in financial sector as of December 2020.

Sectors that are most at risk are those more exposed to the COVID-19 pandemic and those impacted by supply chain disruptions.

The total loan exposure of financial institutions towards the most-hit sectors makes around 62 percent of total loans as of December 2020 amounting to Nu. 103,553 million.

As of December 2020, 85 percent of total loans are regular loans (standard and watch category) amounting to Nu. 141,940 million and remaining 15 percent are NPLs (sub-standard, doubtful and loss bucket) amounting to Nu. 24,397 million.

Out of regular loans of Nu. 141,940 million, 62 percent are the. loans towards the most-hit sectors (tourism, production/manufacturing, trade/commerce, commercial transport and commercial housing loans) amounting to Nu. 88,002 million.

Out of the total tourism sector loans of Nu.22,585 million, 10 percent were NPLs amounting to Nu.2,258 million as of December 2020. In the worst-case scenario, the entire tourism portfolio of Nu.22,585 million could be at risk of becoming NPL.

The pace of recovery in the manufacturing sector depends on how quickly the industries can resume production at normal levels and how severely the pandemic has disrupted supply chains including the availability of labour. Total loans to the manufacturing sector stood at Nu.21,490 million as of December 2020, out of which, Nu.4,787 million or 22 percent were NPLs.

The NPLs in Personal loans, particularly consumer loans that were given to private sector employees may likely to increase as a result of job losses.

The table 3.7 shows the financial sector's sectoral loan outstanding and exposure towards the most-hit sectors as of December 2020. The total loan outstanding as of December 2020 amounted to Nu. 166,989 million, of which 75 percent are provided by the banking sector and remaining 25 percent by the non-banks.

Table 3.7: Financial institutions' loan composition as of December 2020 (In Nu. Million)

Sectors	All FIs	Banks	Non-Banks
Agriculture/Animal Husbandry	6,380	6,326	54
Production/Manufacturing	21,490	15,381	6,109
Tourism Related	22,585	20,430	2,155
Contract (construction based)	6,562	2,677	3,884
Others: Service	16,624	8,298	8,326
Trade/Commerce	19,801	15,477	4,324
Loans to FIs	306	22	284
Home loans	9,048	8,526	522
Commercial Housing loans	34,554	28,762	5,792
Commercial Transport	5,279	4,322	958
Non-commercial Transport	1,165	914	251
Personal Loan	12,583	10,530	2,052
Staff loan	1,530	1,103	426
Education loan	6,329	1,201	5,127
Loan Against Fixed Deposit	1,308	1,308	-
Loans to Government	-	-	-
Others	1,445	1,085	360
Total	**166,989**	**126,364**	**40,626**
Exposure to most-hit sectors (%)	**62%**	**67%**	**48%**

In the financial sector, the highest loan outstanding can be seen under commercial housing loan with Nu. 34,554 million or 21 percent of total loans followed by tourism related loans with Nu. 22,585 million or 14 percent of total loans and production/manufacturing loans with Nu. 21,490 million or 13 percent of total loans as of December 2020.

Financial institutions with high exposure to most-hit sectors by COVID-19 could be vulnerable post June 2021 if COVID-19 pandemic continues.

Table 3.8: Sectoral NPL composition in the financial sector as of December 2020 (In Nu. Million))

Sectors	All FIs	Banks	Non-Banks
Agriculture/Animal Husbandry	1,226	1,225	1
Production/Manufacturing	4,787	3,348	1,440
Tourism Related	2,204	1,289	914
Contract (construction based)	3,567	959	2,608
Others: Service	1,496	890	607
Trade/Commerce	4,782	3,105	1,677
Loans to FIs	-	-	-
Home loans	813	781	32
Commercial Housing loans	1,979	1,035	944
Commercial Transport	1,502	1,132	371
Non-commercial Transport	161	96	64
Personal Loan	1,507	705	801
Staff loan	31	11	21
Education loan	158	120	37
Loan Against Fixed Deposit	17	17	-
Loans to Government	-	-	-
Others	167	46	121
Total	**24,397**	**14,759**	**9,638**
NPL ratio	**15%**	**12%**	**24%**

In the financial sector, the highest NPL can be seen under production/manufacturing and trade/commerce sectors with Nu. 4,787 million and Nu. 4,782 million respectively followed by contract (construction based) loans with Nu. 3,567 million as of December 2020.

3.4 Profitability Assessment

(i) The profitability of the financial sector has declined since the onset of the pandemic, driven by increased loan impairment. Weak profitability presents a challenge to future capital resilience as profits are an important element of capital growth. Most of the financial institutions suffered losses during the first three quarters of 2020. However, as of December 2020, financial sector made a profit of Nu. 1,307 million, mainly on account of decrease in NPLs from September 2020 to December 2020.

(ii) The COVID-19 pandemic is expected to have significantly adverse impact on profitability. The profitability of the financial sector has declined sharply since the onset of the pandemic, driven by increase in NPLs. Weak profitability presents a challenge to future capital resilience as profits are an important element of capital growth. However, as of December 2020, most of the financial institutions have made profit mainly on

account of decrease in NPLs from June to September and further decrease in December 2020. The table 3.9 shows the financial institution's profitability in 2020:

Table 3.9: Financial institutions' profitability in 2020 (In Nu. Million)

Particulars	Period	All FIs	Banks	Non-Banks
(1) Profit before tax	December, 2019	3,494	1,838	1,656
	March, 2020	5	(1,910)	1,915
	June, 2020	(622)	(2,628)	2,006
	September, 2020	(1,084)	(1,712)	628
	December, 2020	1,730	(45)	1,776
(2) Additional provision charged	December, 2019	3,015	2,063	952
	March, 2020	2,933	2,428	504
	June, 2020	3,519	3,104	415
	September, 2020	3,607	2,717	890
	December, 2020	2,366	1,854	512

(iii) The loan deferment facility and interest payment support Kidu has helped financial institutions to prevent from further build-up of NPLs and huge negative net interest income (difference between interest income and interest expenses). Without these stimulus package, COVID-19 pandemic might have caused a decline in financial institutions' interest income, and potentially impacting the capital and earning of financial institutions. The table 3.10 shows the financial institution's profitability status as of December 2020.

Table 3.10: Financial sector's profit as of December 2020 (In Nu. Million)

Particulars	All FIs	Banks	Non-Banks
Interest Income (A)	15,376	11,694	3,682
Interest expenses (B)	9,501	7,823	1,678
Net Interest Margin (C) = (A) -(B)	5,875	3,871	2,004
Operating Income (D)	1,767	981	786
Operating Expenses (E)	3,733	3,252	482
Net Income (F)= (C) + (D) - (E)	3,908	1,600	2,308
Additional provision charged	1,980	1,396	585
Profit before tax (after adjusting provision)	1,928	205	1,723
Profit after tax	1,307	100	1,206

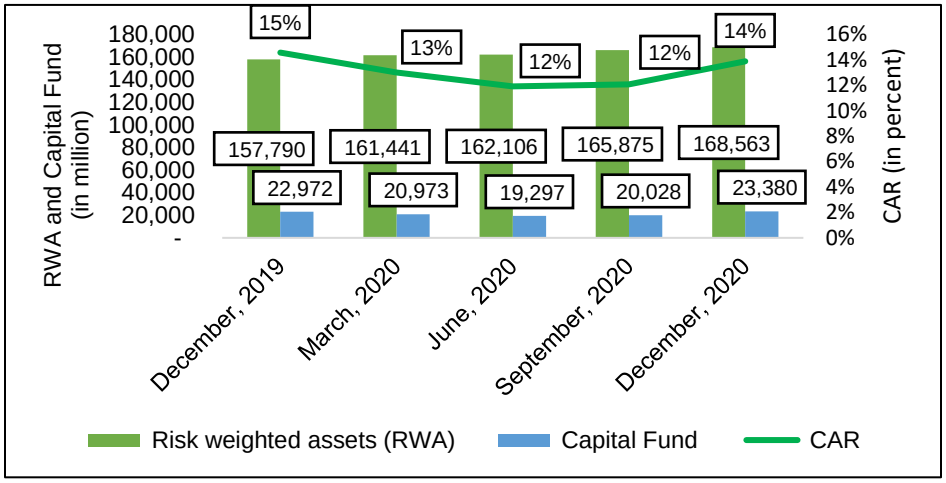
The financial sector made a profit of Nu. 1,307 million (after tax) as of December 2020. If the current economic conditions persist over the medium term and borrowers are not able to repay their loans, the financial institutions would be under pressure and need to recognize the losses on the loans by writing down the value of their capital.

3.5 Capital Risk Assessment

(i) Capital Adequacy Analysis

Financial sector entered the COVID-19 pandemic with the capital adequacy ratio (CAR) of 15 percent as of December 2019 including the requirement of capital conservation buffer (CCB)[5] of 2.5 percent which will allow the financial sector to cover potential credit losses. As reflected in figure 3.3, the CAR of financial sector as of December 2020 reached at 14 percent (against the minimum requirement of 10 percent) as compared to 12 percent in September 2020. The decrease in NPLs in most financial institutions from September to December 2020 has led to the improvement in the CAR as of December 2020.

Figure 3.3: Risk-weighted assets and capital adequacy ratios in the financial sector



Capital buffers built prior to the pandemic and the regulatory relief provided by the RMA has allowed financial institutions to increase their lending to the economy, particularly to those sectors most in need of liquidity, and help financial institutions to withstand the impact of forthcoming expected credit risk losses stemming from the crisis. The CCB release makes available Nu. 2,600 million of capital across the financial sector, with the potential to support additional lending between Nu. 20,000 million to Nu. 25,000 million. However, the dispersion of capital levels among financial institutions remains high, and some financial institutions having entered the COVID-19 crisis with relatively lower capital levels and riskier exposures may face challenges.

[5]CCB ensures that financial institutions build up capital buffers outside periods of stress which can be drawn down as losses are incurred in order to avoid breaches of minimum capital requirements:

3.6 Operational Risk Assessment

With the outbreak of the COVID-19 pandemic and unprecedented containment measures introduced, the most urgent concern of the financial institutions was to ensure to operate unimpeded and provide their essential services. Most of the financial institutions have switched their business to online through the internet, mobile phone and apps exposing to various types of risk such as cyber risk (fraud, remote working), information technology (IT) risk, employees and reputational impacts.

So far, critical functions of financial institutions have continued to operate largely unaffected, as part of their business continuity plans. No major incident of business disruption attributable to the pandemic has been reported. Nonetheless, digitalization of financial services and the use of IT solutions might considerably contribute to alleviation of the pressure and the impact of the pandemic on financial institutions' operations. Therefore, financial institutions should ensure that their IT infrastructure is strong and remain vigilant to address data integrity, business continuity and to address cyber threats.

3.7 Insurance Risk Assessment

(i) Gross Premium has increased by 26 percent from Nu. 2,700 million in 2019 to Nu. 3,400 million in 2020 owing to people purchasing more life insurance and property insurance related to fire and motor portfolio.
(ii) Gross Claims has reduced by 58 percent from Nu. 2,500 million in 2019 to Nu. 1,000 million in 2020. The decrease in the claims is mainly due to the fact that there were less economic activities during the pandemic which directly led to minimum risk exposure both at the individual and business fronts. Especially, the imposition of 2 national lockdown and much stringent vehicle movements within the districts had a direct impact on reduction of motor vehicle accidents in the country.
(iii) The outward reinsurance ceding by the 2 insurance companies in fact increased by 7 percent from Nu. 580 million in 2019 to Nu, 622 million in 2020 since there was an increase in the gross premium.
(iv) The total number of policies underwritten by the 2 insurance companies also increased as follows;

Table 3.11: Total policies underwritten and claims settled

Insurance Companies	2019 (Before COVID-19)		2020 (During COVID-19)	
	Life	Non-Life	Life	Non-Life
Total Policies Underwritten (Numbers)	125,276	84,777	212,124	72,854
			69% increased	14% decreased
Total Claims Settled (Numbers)	8,476	2,203	11,836	1,766
			40% increased	20% decreased

3.8 Measuring Financial System Resilience: Stress-test

The COVID-19 pandemic will continue to have material adverse effects on Bhutanese economy. Due to exceptional levels of policy support, the role of loan deferment facility and the interest payment support Kidu, the pandemic has only had a modest impact on financial sector's reported key capital ratios, NPL ratio and profitability so far in 2020. Nonetheless, financial institutions remain exposed to the economic effects of the pandemic, with uncertainty remaining over the macro-financial outlook, borrowers' repayment capacity, and opportunities for income generation through new lending.

As the slowdown of economy due to COVID-19 pandemic may result in higher NPLs and erosion of capital, vulnerability of the financial sector to credit risk (towards the most-hit sectors by the pandemic) has been assessed through the impact on capital under different hypothetical scenarios/shocks. The objective of stress tests is to improve the understanding of risks to financial stability and assess the resilience of financial system to a plausible but severe worsening in the economic outlook. The stress tests show if financial institutions can withstand a broad range of economic scenarios while retaining sufficient capital to keep on lending.

(i) Stress-test Scenarios and Assumptions

Two different scenarios have been used to assess the resilience of the financial sector under the assumption that the cumulative NPLs associated with the outbreak of COVID-19 pandemic would need to be around as twice as the NPLs before the outbreak of COVID-19 pandemic. NPLs increases during severe economic downturns as weakness

in economic activity and rising level of unemployment increase the likelihood that borrowers are unable to meet their financial obligations, eventually reaching the point of defaults. Rising NPLs reduces a financial institution's profitability and during severe economic downturns, can be significant enough to erode a financial institution's capital levels.

The following scenario has been developed taking into consideration the current slowdown in economic activities (macro-economic outlook) and uncertainty posed by the COVID-19 pandemic: The stress-test also takes into consideration that the existing monetary measures will end by June 2021 and no further monetary measures (deferment facility as well as interest payment support Kidu) will be extended.

(a) The first adverse scenario (S1) simulates mild increase of NPLs in 2021 followed by decrease in NPLs in 2022 as gradual recovery is expected to start in the year 2022.

(b) The second adverse scenario (S2) simulates a severe increase of NPLs in 2021 followed by decrease in NPLs in 2022 as gradual recovery is expected to start in the year 2022. The assumption used for stress-test are shown in table 3.12

Table 3.12: Stress-test assumption

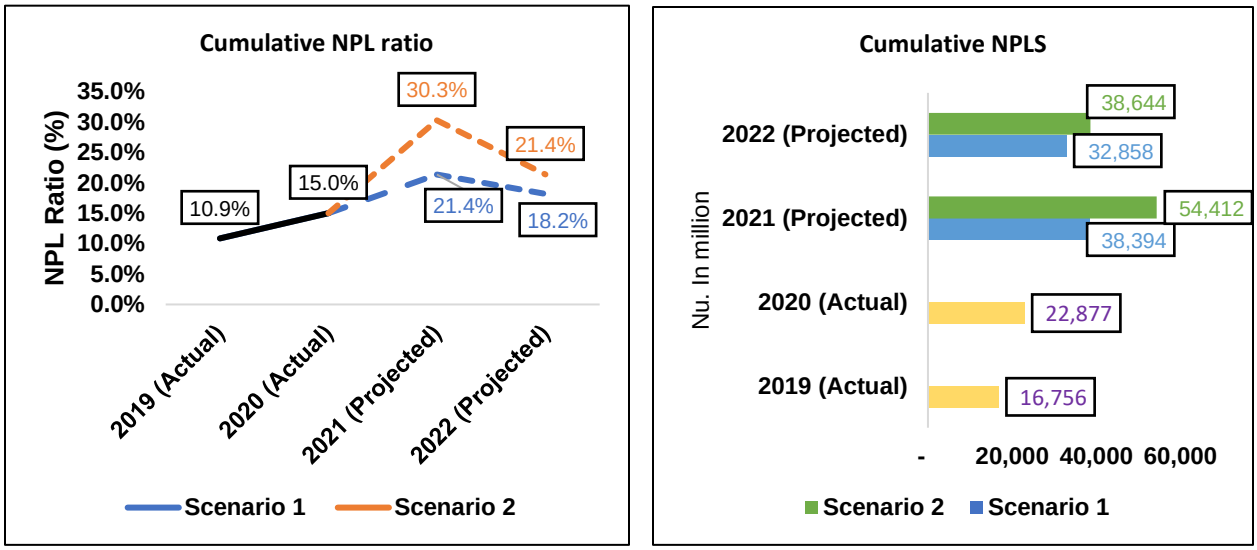
Key assumption	Scenario 1 (S1)	Scenario 2 (S2)
Increase in NPLs i. increase in NPLs towards most hit-sectors by the pandemic	i. **increase in NPLs:** - Manufacturing: 20% in 2021 and 10% in 2022 - Tourism related: 20% both in 2021 and 2022 - Trade: 20% in 2021 and 10% in 2022 - Commercial Housing: 10% in 2021 and 5% in 2022 - Commercial Transport: 20% in 2021 and 10% in 2022	i. **increase in NPLs:** - Manufacturing: 30% in 2021 and 15% in 2022 - Tourism related: 60% in 2021 and 30% in 2022 - Trade: 30% in 2021 and 15% in 2022 - Commercial Housing: 20% in 2021 and 10% in 2022 - Commercial Transport: 30% in 2021 and 15% in 2022
ii. Provision requirement for NPLs	ii. 20%	ii. 20%

(ii) Stress-test Results:

(a) Expected NPL Ratio in the Financial Sector

The stress-test result's estimation of the financial sector's increase in NPLs are as follows, although the NPLs estimation for individual financial institution varied with differences in the composition of their loan portfolios:

Figure 3.4: Expected NPLs in the financial sector



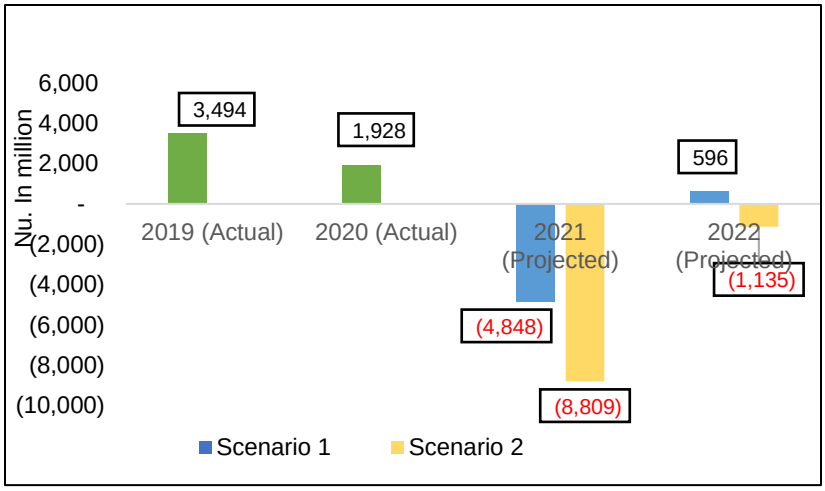
(i) Under scenario 1, the financial sector is expected to have a new NPLs of Nu. 15,517 million for the period ending 2021 and Nu. 9,981 million for the period ending 2022, taking the total cumulative NPLs to Nu. 38,394 million in 2021 and Nu. 32,858 million in 2022. The cumulative NPL ratio in 2021 will stand at 21.4 percent in 2021 and 18.2 percent in 2022 as compared to 15 percent as of December 2020.

(ii) Under scenario 2, the financial sector is expected to have a new NPLs of Nu. 31,535 million for the period ending 2021 and Nu. 15,767 million for the period ending 2022, taking the total cumulative NPLs to Nu. 54,412 million in 2021 and Nu. 38,644 million in 2022. The cumulative NPL ratio in 2021 will stand at 30.3 percent in 2021 and 21.4 percent in 2022 as compared to 15 percent as of December 2020.

(b) Expected Losses in the Financial Sector

Financial sector could face significant losses as a result of the economic shock associated with the outbreak of Covid-19. The figure 3.5 shows the potential expected losses in the financial sector under two different scenarios. The decline in profitability is primarily driven by the emergence of significant credit losses on financial institutions' loan portfolios.

Figure 3.5: Expected losses in the financial sector



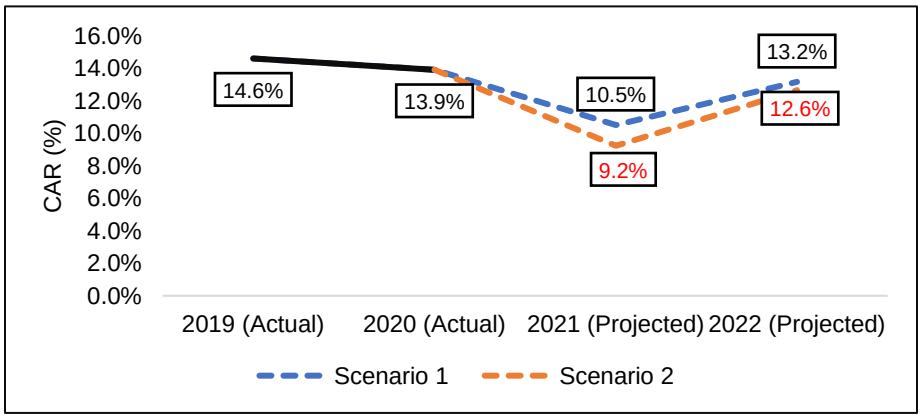
(i) Under scenario 1, the financial sector is expected to incur a total loss of Nu. 4,848 million for the period ending 2021 mainly on account of additional provisions required resulting from the increase in NPLs. However, financial sector is expected to make a profit of Nu. 596 million for the period ending 2022.

(ii) Under scenario 2, the financial sector is expected to incur a total loss of Nu. 8,809 million for the period ending 2021 mainly on account of additional provisions required resulting from the increase in NPLs. Financial sector is also expected to incur loss of Nu. 1,135 million for the period ending 2022.

(c) Stability Concerns: Impact on Capital Adequacy Ratio (CAR) of Financial Sector

Financial institutions have been playing crucial role in supplying credit to the economy. However, financial sector may incur losses if businesses struggle to weather the disruption related to the outbreak of Covid-19. Given the overall uncertainty of the crisis, it is important that the financial sector remains resilient. The figure 3.6 shows the impact of CAR under two different scenarios. The financial sector's fall in its aggregate CAR is driven by a combination of lower earnings and significant increase in NPLs, as a result, the financial sector may experience capital decline ranging from Nu. 4,000 million to Nu. 6,000 million.

Figure 3.6: Impact on CAR of the financial sector



(i) Under scenario 1, the CAR of the financial sector is expected to stand at 10.5 percent for the period ending 2021 and 13.2 percent for the period ending 2022 compared to

13.3 percent as of December 2020. At the institution level, three financial institutions will not able to meet the minimum CAR requirement of 10 percent.

(ii) Under scenario 2, the CAR of the financial sector is expected to stand at 9.2 percent for the period ending 2021 and 12.6 percent for the period ending 2022.

3.9 Recommendations

In view of the ongoing pandemic and based on the outcomes of risk assessment exercise and stress-test conducted by the RMA and financial institutions, the financial institutions are hereby required to take the following policy actions:

(i) No Dividend Payout for the year 2020:

a) In view of the uncertainty posed by the COVID-19 pandemic, it is imperative that financial institutions continue to conserve capital to support economy and absorb losses.

b) In order to strengthen the financial institution's balance sheet and support lending to the economy, financial institutions shall not make any dividend payment for the year ending 2020.

(ii) Capital Management and Recovery Planning:

a) Given the ongoing monetary support measures, the full effect of the COVID-19-related economic shock on the financial sector may not have fully materialized yet.

b) This persisting uncertainty calls for financial institutions to continue conducting stress-test and various scenarios analyses to assess the capital resilience and provide useful and timely information to their board for appropriate policy direction.

c) Based on the outcome of stress-test, financial institutions are required to come up with capital management and capital recovery plan.

(iii) Enhance Credit Risk Management Practices:

a) While financial institutions have faced difficulties over the years, the major cause of risk continues to be credit risk as a result of poor credit risk management practices.

b) The impact of the COVID-19 pandemic on asset quality is expected to be a key challenge going forward amid the prospective macroeconomic deterioration.

c) Financial institutions should therefore remain cautious on your credit risk outlook and focus on enhancing the adequacy of credit risk management strategy with a view to fostering timely identification, measurement, efficient monitoring and controlling.

d) Financial institutions should take proactive measures to assess and manage risk by (i) engaging with borrowers more directly on their recovery prospects and (ii) assess

the quality of loan portfolios to identify the sectors that are affected by the pandemic. All these will enable financial institutions to identify loans with higher credit risk and understand if any interventions are needed.

(iv) Improve Overall Risk Management Framework and Practices:

a) Financial institutions are also required to improve their overall risk management framework (risk identification, measurement, monitoring and controlling) and practices commensurate to its risk profile to ensure stability and to take into account the unique characteristics of this crisis.

b) With the implementation of risk-based supervision, RMA will focus on the financial institution's risk management framework and control functions.

(v) Operational Resilience:

Financial institutions kept their businesses running during the COVID-19 pandemic, with no major incident of business disruption attributable to the pandemic reported. However, as financial institutions are exposed to various types of risk such as cyber risk (fraud), information technology (IT) risk and employees (remote working), financial institutions are required to ensure that appropriate technologies and adequate resources are in place to address data integrity, business continuity and increasingly sophisticated cyber threats.

3.10: Capital Market

Royal Securities Exchange of Bhutan, owned by four financial institutions (BoBL, BNBL, RICBL, & BDBL), has a total number of 72,017 shareholder's account in central depository with 49,021 shareholders as of December 2020.

As of December 2020, there were seven registered securities brokers, four brokers owned by the Financial Institutions and three are the private brokerage firms

(i) Market Capitalization

The total market capitalization as of December 2020 stood at Nu. 47,450 million with 20 listed companies on the Exchange as compared to the market capitalization of Nu.51,412 million with 22 listed company in December 2019. The decrease in the market capitalization is mainly due to the fluctuation of share prices and delisting of two companies from the Exchange in 2020.

II. Overall Securities Trading in the Exchange (primary and secondary markets)

a. Equity

As of December 2020, the overall trading volume was 99,550,405 shares amounting to Nu.1,689 million as compared to the overall trading volume of 67,061,207 shares worth Nu. 1,570 million in 2019. The increase in overall trading volume is contributed by the right shares floated by GIC-Bhutan Reinsurance with 60,000,000 number of scripts worth Nu.600,000,000 and bonus issue of 14,002,022 shares worth Nu.226.59 million by Druk PNB Bank Ltd. followed by the buy-back of 865,703 shares by Druk Wang Alloys Limited.

b. Bonds

The total outstanding bonds registered in the central Depository of the Exchange amounted to Nu. 6,980 million with 13 bonds listed on the Exchange and 3 bonds under custodial service as of December 2020. The total outstanding bonds has decreased as compared to Nu. 8,650 million as of December 2019 due to the redemption of DAC (Druk Air Corporation) BOND-1, BOND-II and BOND-III worth Nu. 2,160 million in 2020. The total unit of bonds traded in the Exchange as of December 2020 was 21,200 units traded at Nu. 1000 per unit.

c. Commercial Paper

During the year 2020, Druk Green Power Corporation Ltd. issued two commercial papers, (short-term debt instrument issued at discount rate) worth Nu. 1.2 billion at a discount rate of 4 percent each for 138 days and 119 days.

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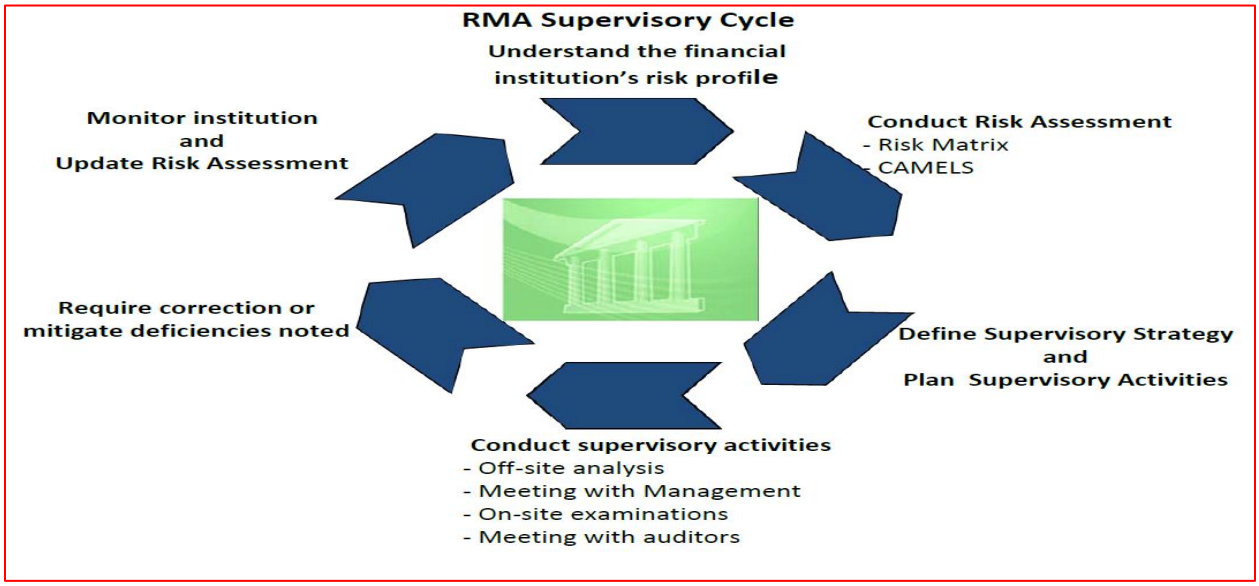
CHAPTER 4: REGULATORY & SUPERVISORY DEVELOPMENTS

4.1: Risk-based Supervisory Approach

The RMA has adopted a Risk-Based Supervisory (RBS) framework in 2019 for the supervision of financial institutions (FIs). With RBS, the RMA seeks to employ a forward-looking supervisory approach where control weaknesses or other risk management conditions or problems are assessed early, and when necessary, corrected, in order to prevent or mitigateserious problems to an institution's financial condition in the future. With the adoption of RBS framework, the RMA is bringing its supervisory practices closer to the recommendations of the Basel Committee for Banking Supervision (BCBS). The main objective of the RBS is to evaluate the safety and soundness of the financial institution by assessing its risk management systems, financial condition, and compliance with applicable laws and regulations, while focusing on the institution's highest risks. The risk-based supervision process will seek to strike an appropriate balance between evaluating



the condition of an institution at a certain point in time and evaluating the soundness of the institution's processes for managing risk in all phases of the economic cycle.

As a pilot program of the RBS, the RMA conducted the pilot RBS for two financial institutions in 2020 and gradually plans to transit to RBS for all the financial institutions. The introduction of RBS would require the institutions to reorient their organizational set up towards RBS and put in place an efficient risk management architecture, adopt risk focused internal audit, strengthen the management information system, and set up risk functions. As part of putting in place an institutional mechanism in institutions for moving

over to RBS, RMA also issued the risk management guidelines (RMG) in 2019. A financial institution shall implement a risk management framework proportionate to its size, activities, and complexity. Financial institutions were also required to self-assess their risk management framework to achieve compliance with this RMG 2019.

4.2: Risk-Based Solvency Requirements

The RMA issued Risk-Based Solvency Requirements (RBC/risk-based solvency requirements) as part of the Insurance and Reinsurance Companies Rules and Regulations 2018. Risk-Based Capital (RBC) is a method of measuring the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. The RBC limits the amount of risk insurance companies can take. It requires a company with a higher amount of risk to hold a higher amount of capital. The purpose of the formula is to establish a minimum capital requirement based on the types of risks to which a company is exposed. The risk factors for the RBC formulas focus on two major risks: 1) Insurance Risk; 2) Investment Risk.
The RBC regime was created to provide a capital adequacy standard that is related to risk, raises a safety net for insurers, and provides regulatory authority for timely action. Under the RBC system, RMA has the authority and statutory mandate to take preventive and corrective measures for early regulatory intervention depending on the capital deficiency indicated by the RBC result.

4.3 Non-Performing Loans (NPLs) Resolution Framework

The COVID-19 pandemic has made an adverse impact on the economy and resulted in reduced/loss of household incomes. This has posed difficulty in meeting loan repayment obligations due to supply-chain disruption and decreased in aggregate demand from unemployment or reduced economic activity. Therefore, increasing the risk of rising NPLs which will lead to a credit crunch in the economy as the financial institutions will be reluctant to lend any further.

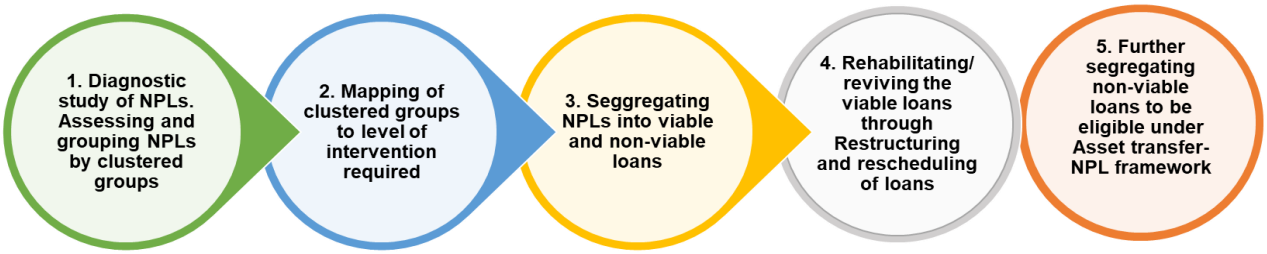
In response, the Royal Government of Bhutan and Royal Monetary Authority issued two phases of Fiscal and Monetary Measures with interest waiver support as ‘Kidu” from His Majesty the Druk Gyalpo. Within this momentary relief provided, the RMA has designed a comprehensive NPL resolution framework involving different levels of stakeholders at various levels to provide relief to both borrowers and financial institutions while providing opportunity for smooth credit flow in the economy.

As of 31st March 2020, before the intervention, total loans stood at Nu.158,927 million, out of which, 18 percent or Nu.28,883 million were non-performing loans (NPLs) i.e., loans with payments that were overdue by 91 days or more. Through the support of

interest payment and loan deferment facilities, the total NPLs have been brought down to Nu. 24,393 million at 15 percent NPL ratio as on 31st December 2020.

Within the momentary relief provided by the fiscal and monetary measures, in line with Part V of Press Release from Prime Minister's Office: Comprehensive National Response to the challenges of the COVID-19 Pandemic Phase-II, the RGoB and RMA has formed a National NPL resolution strategy with cluster-based approach and committee interventions as follows:

NPL Resolution Framework- Short-Medium term Strategy



Role of Committees in the NPL Resolution Framework

INTER-FINANCIAL INSTITUTION COMMITTEE	CEO LEVEL COMMITTEE	HIGH LEVEL COMMITTEE
• Comprised of Legal Representatives from Financial Institutions and RMA • Led by Chief General Counsel, RMA • Review of NPLs (case by case) • Fact finding and grouping of NPLs into clustered groups • Mapping of these groups to level of intervention required e.g: Whether Financial Institutions can resolve it or High level authority to intervene.	• Represented by the CEOs of financial Institutions • Led by Deputy Governor, RMA • Review cases submitted by Inter-Financial Institution Committee • Segregate NPLs into viable and non-viable loans • Rehabilitate/revive viable loans through restructuring and rescheduling of loans • Based on 'Guidelines for segregation of NPL into viable and non-viable loans' • Foreclose Non-viable loans	• National Level Committee with representatives from Royal Government of Bhutan, Supreme Court of Bhutan, National Land Commission and Royal Monetary Authority • Formed through Executive Order from the Lhengye Zhungtshog • Led by Hon'ble Finance Minister • Park NPLs as per 'Guidelines for Asset Transfer NPL framework 2020 ' and freezing of interests for NPLs parked. • Provide guidance and decision on NPL cases beyond Financial Institution's level

Since the presentation of early findings in September 2020[6] which had focused on a cluster-based diagnostic study of the top 20 NPLs, the following have been undertaken by the RMA and the three-tier committee – the Inter-Financial Institution Committee (IFIC)

[6] Working Paper on Non-Performing Loans (September 2020)

at the working level, CEO Level Committee at the financial sector level and High Level Committee at the national level:

(i) Institution of an NPL Asset Transfer Framework

The NPL Asset Transfer Framework aims to de-congest the balance sheet of the financial institutions by temporarily transferring all eligible NPLs as “asset pending foreclosure”. This will subsequently enhance the capital position of the financial institutions allowing them to provide new loans. It also aims at providing relief to borrowers through freezing of interest and allowing revival and rehabilitation of viable loans.

The NPLs Asset Transfer Framework is enabled through the following three guidelines:

A. Guidelines on Segregation of NPLs into Viable and Non-viable loans

The RMA will issue a guideline on segregation of NPLs into viable and non-viable loans to provide the FSPs with principles for identifying viable loans which can be revived/rehabilitated.

Viable loans are those loans where the borrower may be facing a temporary financial difficulty from loss of or reduction in income and the FSPs see prospects of the NPL becoming regular after rehabilitating / reviving the loan. The process of rehabilitation will involve bilateral engagements between the borrower and the FSP to jointly explore and implement corrective actions to revive the borrower’s business or earning capacity. The guideline provides the following facilities to rehabilitate the loan:

- **Restructuring:** Changing the structure of the loan – by reducing the interest rate, re-working the repayment schedule, providing gestation period before repayment starts etc.
- **Rescheduling:** Increase the loan tenure to reduce equated monthly payments to ease servicing of the loan.
- **Renewal:** Renewal of overdraft and working capital duration to enable the borrower to carry forward overdraft and working capital loans.
- **Enhancement of loan** (additional loan): sanctioning additional loans to improve the liquidity of the borrower for carrying out the business activity.

B. Guidelines on the Transfer of Non-Performing Loan Asset, 2020

The guideline on the transfer of the NPL Asset, 2020 was issued by the RMA in October 2020 to decongest the balance sheet of the financial institutions through an

unconventional regulatory arrangement given the pandemic whereby the NPLs will be removed from the loans and transferred to a new category of assets called 'asset pending foreclosure'. Subsequently, the loan loss provisions kept against these NPLs will be released into regulatory capital, thereby enabling creation of new loans with the ultimate objective of improving the real economy. It also aims at providing relief to the borrowers from existing debt burden to enable them to revive and rehabilitate.

NPLs that are beyond the scope of recovery by FIs such as absconded, untraceable, deceased, imprisoned, loans under enforcement, unable to auction the pledged collateral and NPLs which have been in loss category for more than two years are eligible for the transfer.

To ensure equity and transparency, the transfer process is implemented through three tiered interventions through constitution of three level committees namely the Inter Financial Institution Committee (comprising of legal and credit heads of FIs with representation from RMA Legal and technical team); CEO Level Committee (comprising of CEOs of FIs chaired by the Deputy Governor II); and the High Level Committee chaired by the Hon'ble Finance Minister.

The NPLs are transferred for a maximum period of three years from the date of transfer after which the loans, if not recovered within the period, are foreclosed / written off in line with the Guidelines on Foreclosure and Write off of NPLs.

C. Guidelines on Foreclosure and Write off of NPLs

The guidelines on foreclosure and write off of NPLs will be issued by the RMA to provide broad uniform guidelines to the FSPs for foreclosing and writing off of NPLs in a timely manner with the objective to decongest its books of accounts.

Foreclosure refers to a legal process by which an FSP attempts to recover or liquidate the loan balance outstanding from a defaulting borrower, either through court order or through out-of-court settlement.

- Pre Litigation Foreclosure: When a loan account becomes or is likely to become Non-Performing, the FSP follows-up and negotiates with borrowers such as granting time extension or rehabilitating or restructuring the NPLs.
- Foreclosure through court: When an FSP does not foresee any viability in the pre-litigation foreclosure, recovery proceedings are initiated in the court of law for the foreclosure of NPL.
- Post Litigation Foreclosure: This pertains to strict implementation of the judgment of court including taking over of the loan security with subsequent freezing of interest. If the proceeds from the sale of security is insufficient to liquidate the loan outstanding, FSP can either file for recovery suit or write off the balance loan outstanding.

Write off refers to removing bad debts from the balance sheet of the FSPs after all measures and legal efforts to recover the debt have been fully exhausted. A write-off does not mean that the FSPs are forfeiting their legal right to claim its dues, unless the court has ordered otherwise.

NPLs that are beyond the scope of recovery of FSPs are required to be written off, with prior approval of its Board of Directors, and includes, inter alia, NPLs that has been transferred to Asset Pending Foreclosure under the NPL Asset Transfer Framework. All NPLs written-off are expensed out through Profit and Loss/ Income Statement of the FSPs with adjustment against the provisions and interest-in-suspense kept aside for the same.

4.4 Building a Resilient and Credible Insurance Sector

In the wake of COVID-19 pandemic, the insurance sector in Bhutan has played multifaceted roles to offset the negative effects to the economy. Moving forward, the insurance sector has greater role to play in terms of building resilience and protection net to support the various economic activities which will revitalize the economy. The National Insurance Strategy (NIS) is a value based dynamic document which besides developing the insurance sector will also enable RMA to continue to meet its long-term operational objectives, that is, to ensure the stability and integrity of the financial system. NIS endeavors towards maximizing the goal of Gross National Happiness and ultimately foster the promise of the creation of a 'Harmonious Society' through the creation of inclusive insurance that aims to protect both lives and livelihood. At the NIS's core, it has six fundamental values of Competition, Responsibility, Excellence, Accountability, Transparency and Empathy. The strategy is developed for a period of 3 years initially from July 2021 till July 2024. The summary of the strategy are as follows:

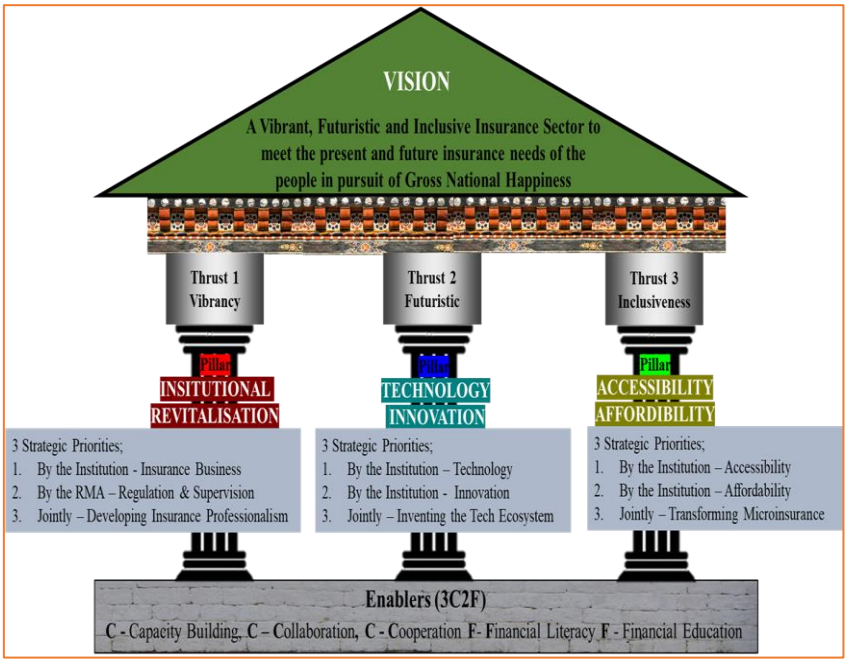
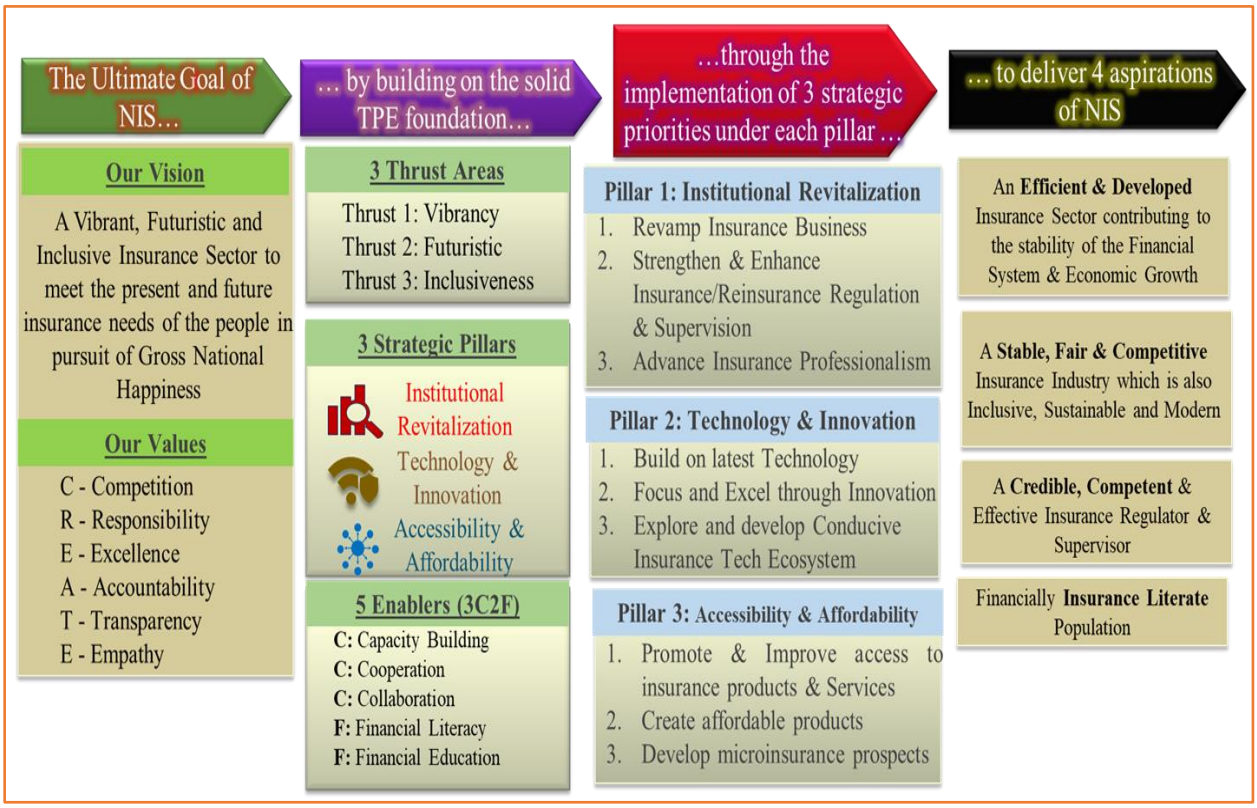


Figure 4.2: The chart expresses the ultimate goals and aspirations the NIS is expected to achieve.

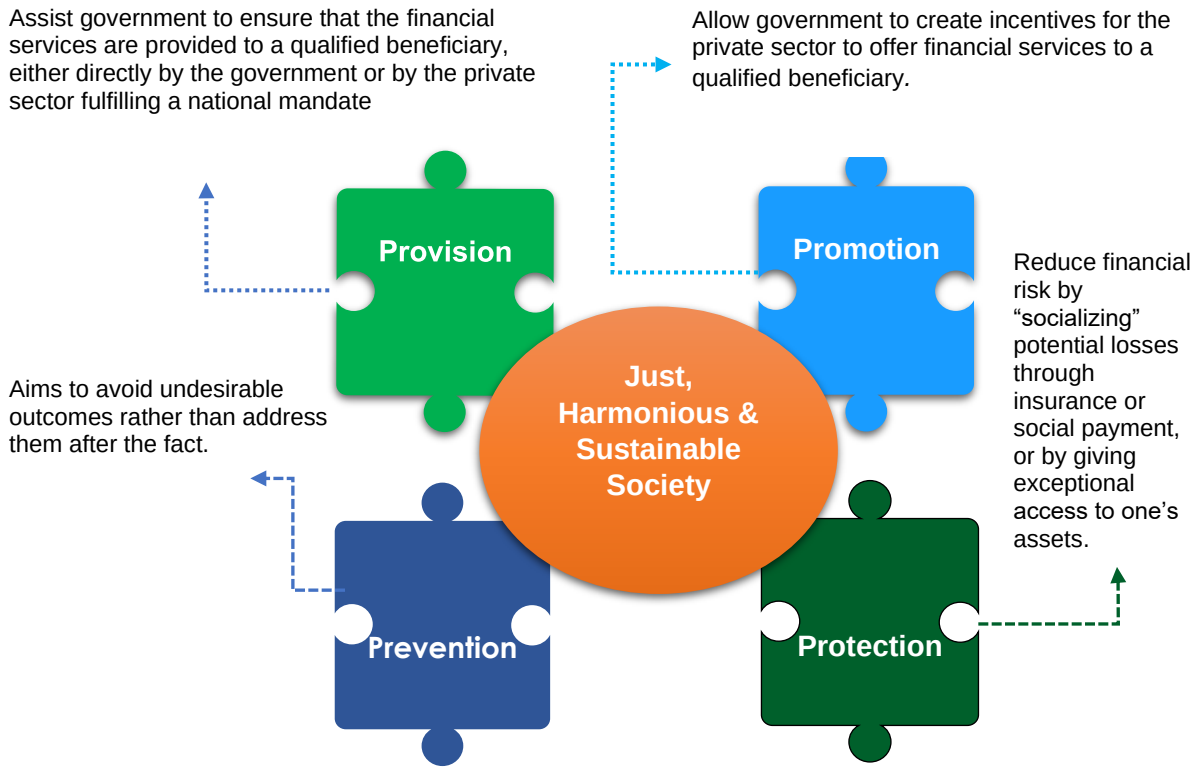


4.5 Green Finance

As the world is grappling with the impact of global warming, and more so, that the developing countries, like Bhutan, are more vulnerable to both visible and invisible effects of the climate change. Therefore, in order to promote and support the flow of finance towards the development and implementation of sustainable business models, investments, trade, economics, environment and social projects, the RMA has designed a Green Finance Roadmap. The Green Finance Roadmap envisages a robust and resilient financial sector that can deliver both investable returns and environmentally positive outcomes.

The roadmap is developed based on the four key principles of inclusive green finance policy adopted and agreed by the member countries of the Alliance for Financial Inclusion (AFI). Thus, this roadmap seeks an effective approach towards fulfillment of the overarching objective of “just, fair and harmonious society” as envisioned by His Majesty.

Figure 4.3: Framework of Inclusive Green Finance. Source: Inclusive Green Finance



The RMA will continue its effort of prioritizing and promoting Green Finance through the following activities:

- Development and adoption of green taxonomy;
- Assisting the financial institutions in targeted lending using the fund mobilized through green finance funding sources and credit lines;
- Facilitate the design of innovative green finance instrument;
- Create an enabling environment for the Financial Service Providers to smoothly adopt the ESRM framework

4.6 International Financial Reporting Standards

The Royal Monetary Authority of Bhutan has commenced aligning its prudential regulation requirements with standards and practices that are widely accepted internationally to promote fairness, transparency, and accountability in the financial sector. In this light, the RMA will be issuing guidelines governing the adoption of the International Financial Reporting Standards 9 (IFRS 9). This is aimed at ensuring consistency of application and comparability of financial reports across the financial sector. The areas covered are as following;

1. Issuance of guidelines governing the adoption of the International Financial Reporting Standards 9 (IFRS 9) including Expected Credit Loss model;

2. Harmonizing the RMA's existing Prudential Regulation 2017 (PR 2017) and International Financial Reporting Standards 9 (IFRS 9);

3. Develop Expected Credit Loss model and the regulatory reporting based on the International Financial Reporting Standards; and

4. Develop and conduct capacity building training programs for supervisors and financial sector for implementation of IFRS 9 in collaboration with Financial Institution Training Institute (FITI).

Box 1: Deposit Composition of Banks and Deposit-taking Microfinance Institutions as of December 2020

As of December 2020, the banks and deposit-taking MFIs witnessed a total deposit of Nu. 165,696 million with 970,766 deposit accounts. Of the total deposits of Nu. 165,696 billion, Nu. 165,447 million comprises of deposits from the banking sector and remaining deposits of Nu.249 million are from the deposit-taking MFIs.

Figure 5.1: Deposit Details as of December 2020 segregated into four categories of deposits

Figure 5.1.1: Based on number of deposits accounts

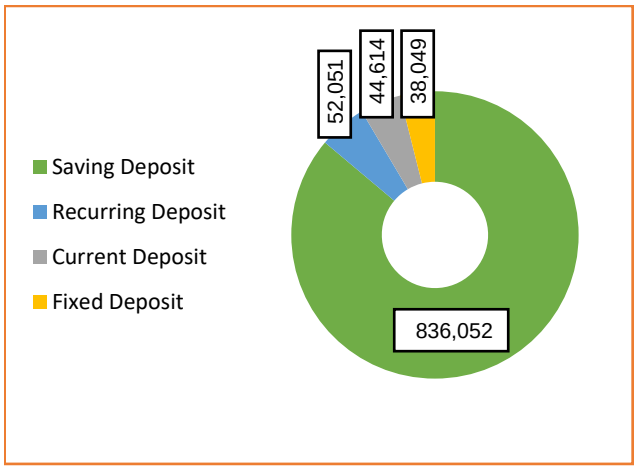


Figure 5.1.2: Based on number of deposits amount (Nu. In million)

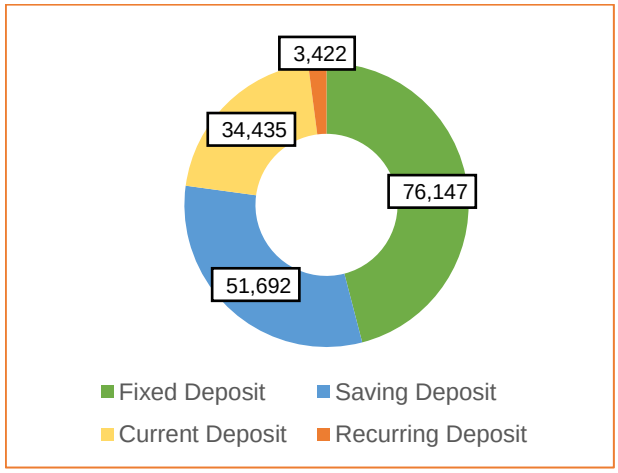
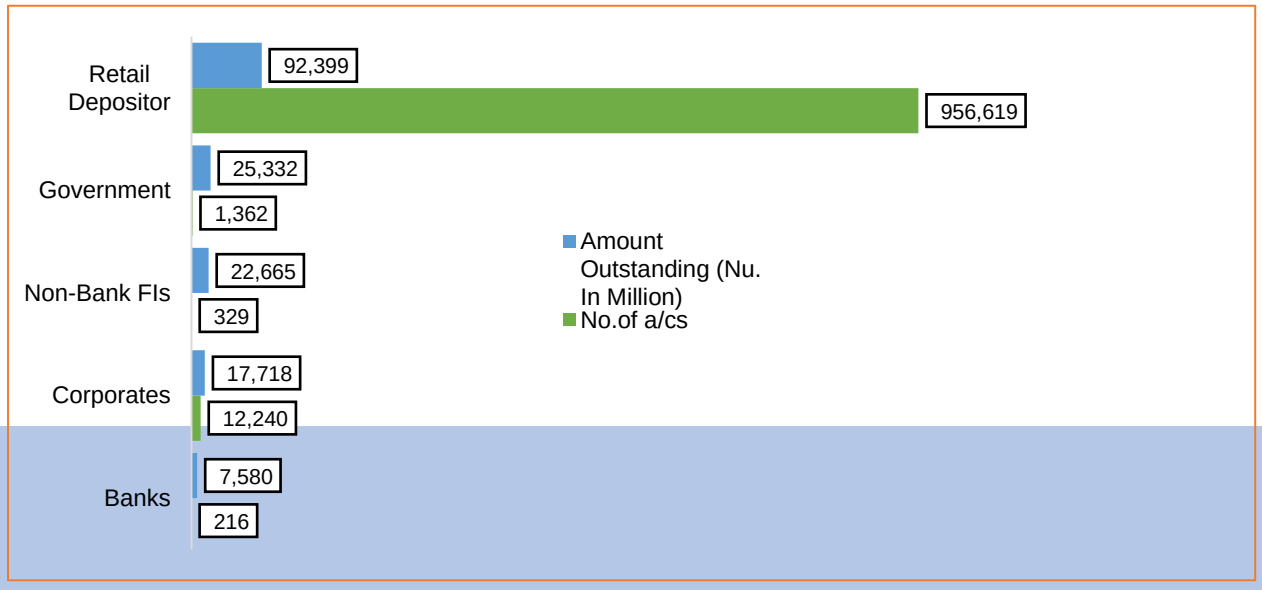


Figure 5.2: Share of deposits by depositor's type



Box 2: New Loans- *Loans sanctioned from 11 April - 31 December 2020 (exclusive of loans sanctioned under monetary measures)*

Between 11th April 2020 to 31st December 2020, the financial service providers have new loans amounting to Nu. 13,607.5 million to 14,807 loan accounts.

Figure 5.3: Sector-wise new loans from April to December 2020:

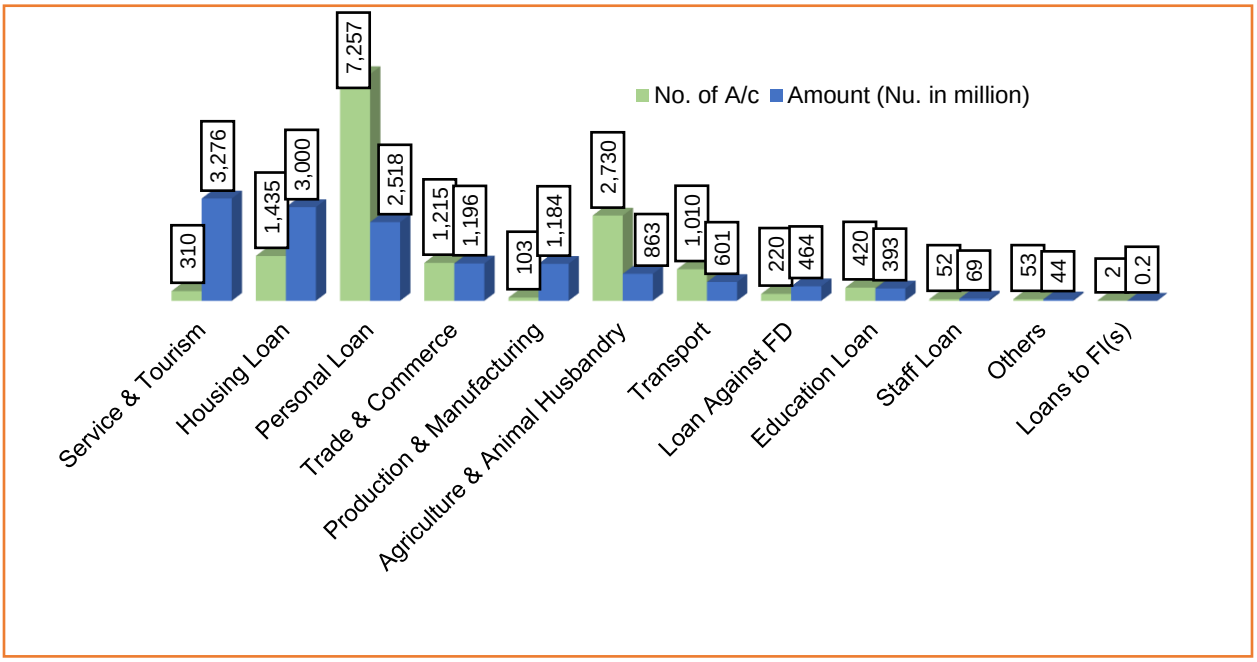
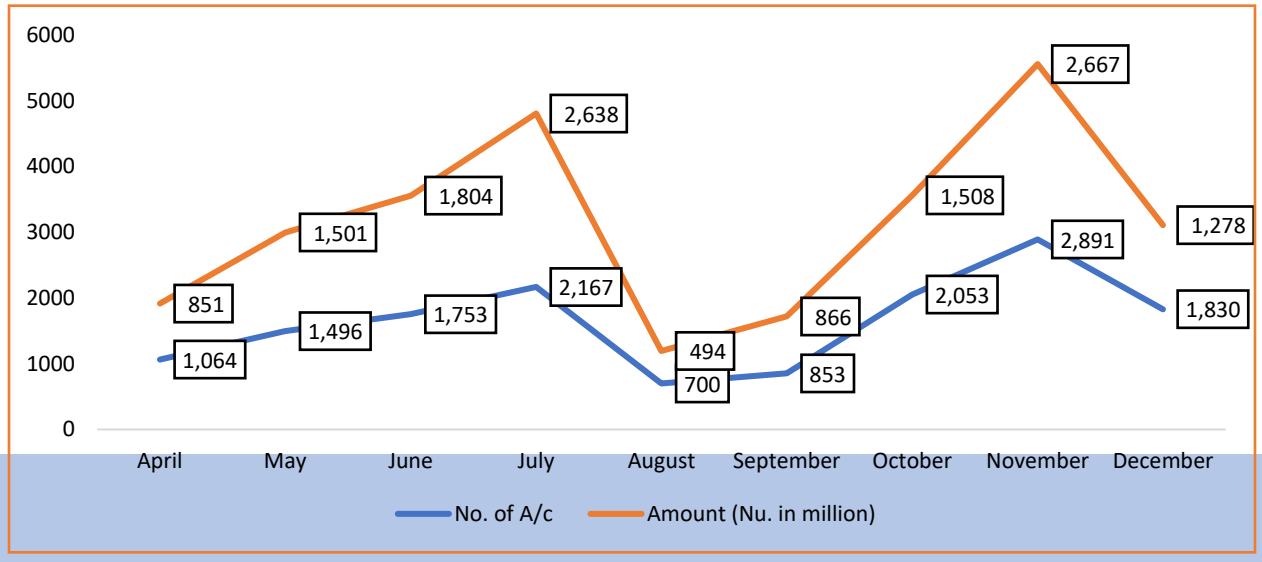


Figure 5.4: Monthly new loans trends



Box 3: Exposure to Hotel Loans as of December 2020

The loan to tourism sector stood at Nu. 1,819 million as of December 2020. The tourism sector is one of the most hit sector by the COVID-19 pandemic, and financial institutions with high exposure to tourism sector might be vulnerable if the pandemic continues and if there are no further regulatory intervention in place.

Figure 5.5: Hotels Data at a glance

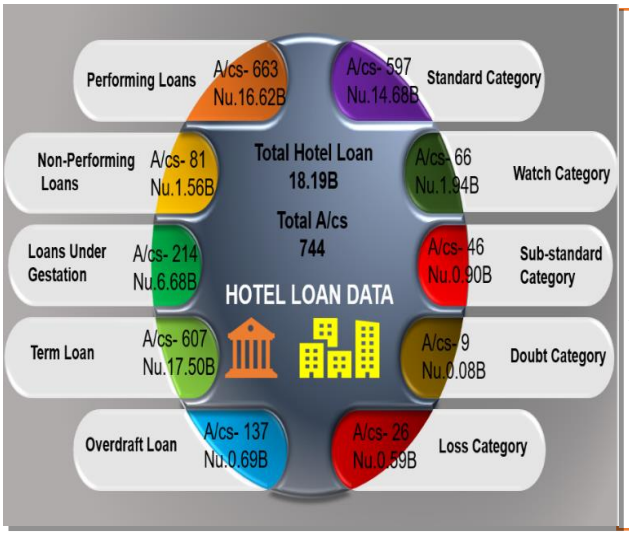


Figure 5.6: Hotels Data- by hotel type

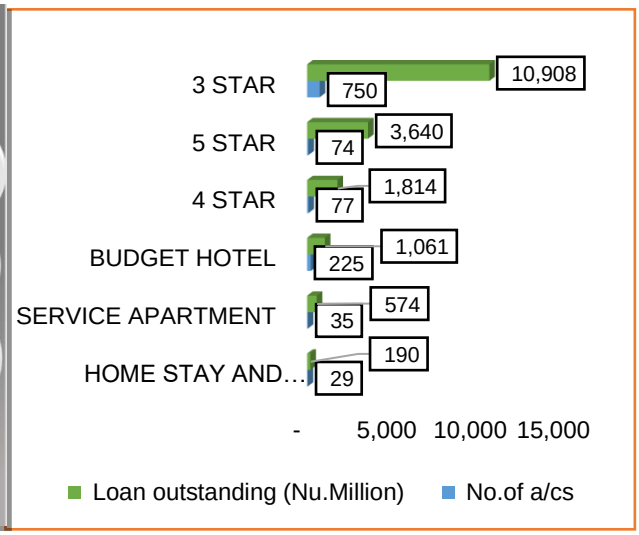
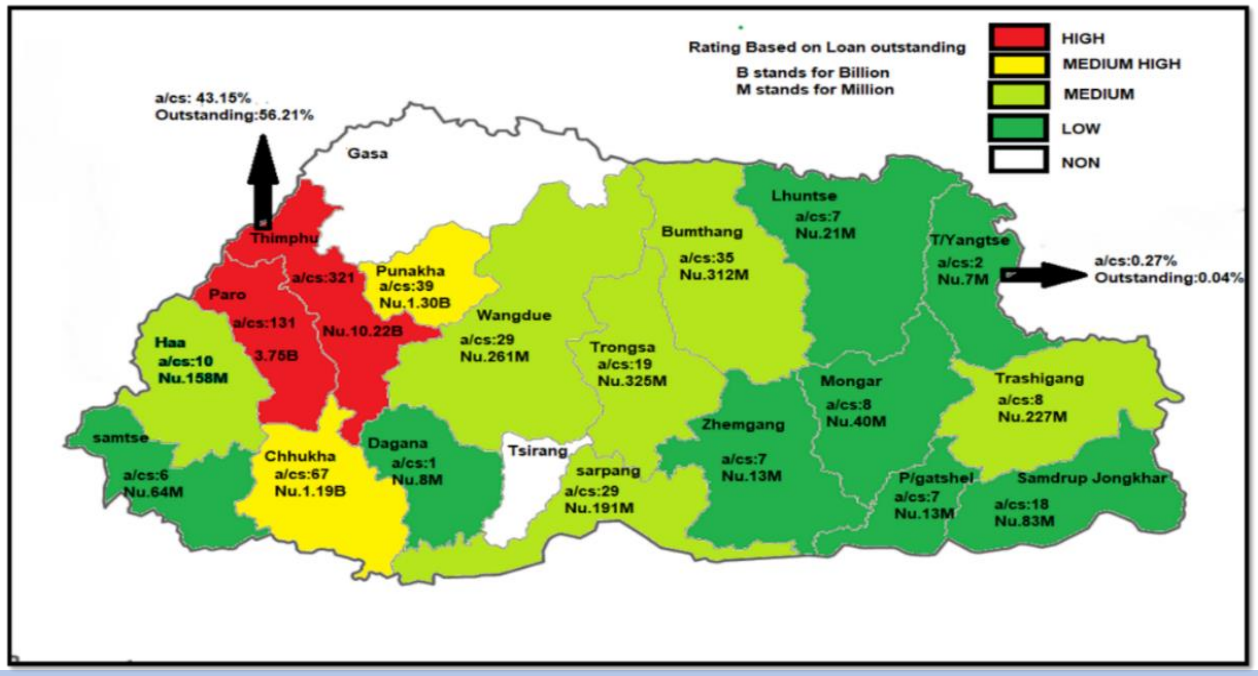


Figure 5.7: Hotels Data- by Dzongkhag



Box 4: Exposure to Restaurant Loans as of December 2020

Similar to exposure to hotel loans, the FSPs' also have moderate exposure to restaurant loans. Restaurant loans include loans to the restaurants which caters to tourists as well as to local consumers. The sector is also one of the hard-hit sector by the COVID-19 pandemic.

Figure 5.8: Restaurants Data- by Slab

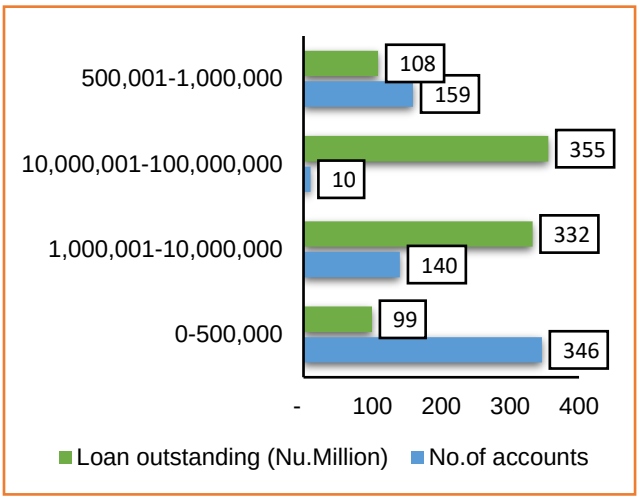


Figure 5.9: Restaurants Data- by Loan status

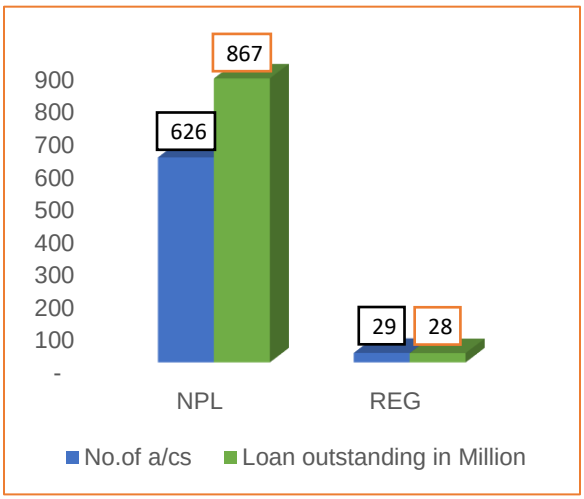
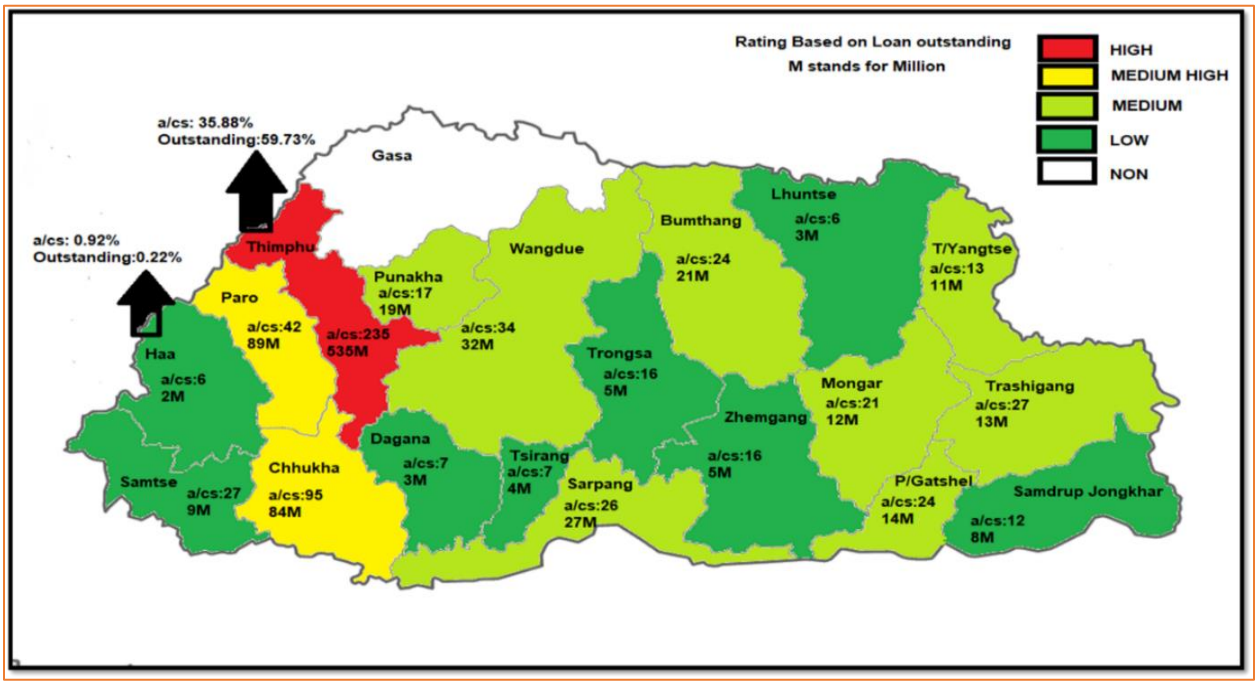


Figure 5.10: Restaurants Data- by Dzongkhag



Box.5 Financial Sector's Exposure to Housing Loans (Includes staff incentive home loan)

The loans towards the housing sector constitutes of 27 percent of the total loan portfolio of FSPs for the period ending December 2020 amounting to Nu. 44,984.6 million. Out of the total housing loans of Nu. 44,984.6 million, commercial housing loans stood at Nu. 33,208.9 million and home loans stood at Nu. 11,775.8 million

Figure 5.11 FSP's exposure to housing loans disaggregated into home and commercial housing loans

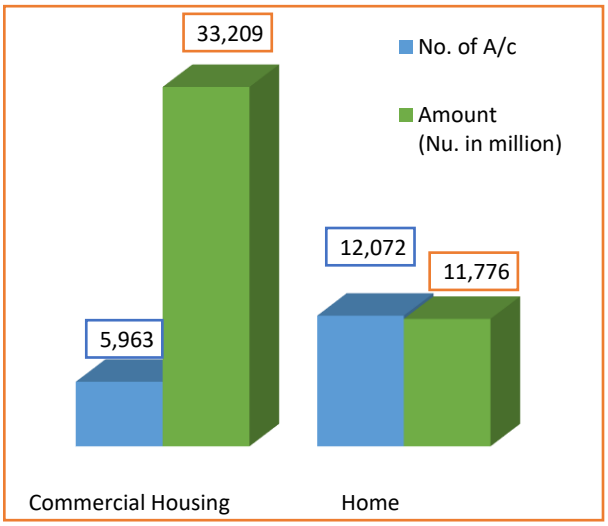


Figure 5.12: Non-performing housing loans disaggregated into home and commercial housing NPL

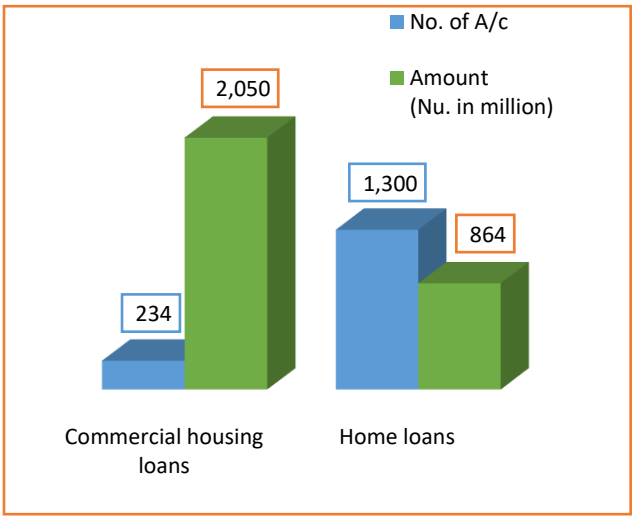
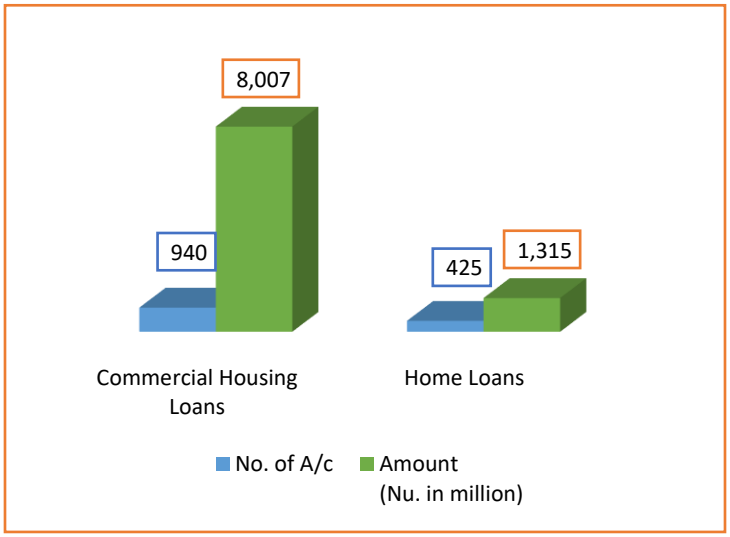
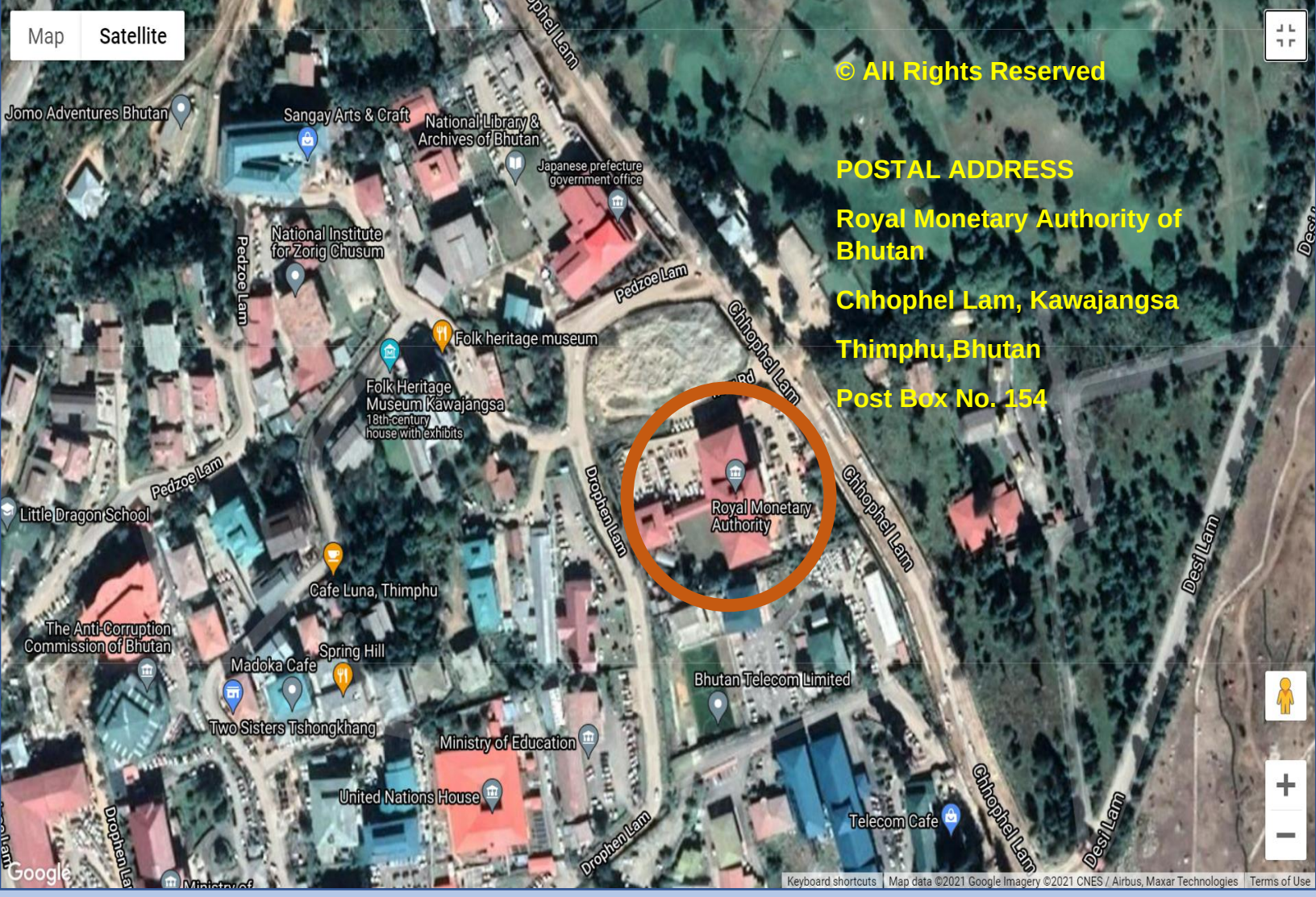


Figure 5.13: Housing loans under gestation period segregated into home and commercial housing loans under gestation





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