Macro-prudential rules and regulations

RESTRICTION ON DISTRIBUTION OF PROFIT

[Draft]
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Part 1. Introduction

1.1 Short title

1.1.1. Restrictions on distribution of profit

1.2 Authorization

1.2.1. The Royal Monetary Authority is authorized to issue regulations under Article 8 (a) of the “Royal Monetary Authority Act of Bhutan 2010” in relation to prudential matters to be complied with by all Banks and ‘Other Financial Institutions’ (collectively ‘Banks’), or other persons as the regulation may specify.

1.3 Application

1.3.1. This regulation is applicable to all Banks and OFIs which are licensed by RMA to perform their Banking/non-Banking functions in Bhutan.

1.4 Definitions

1.4.1. Terms used within this regulation are as defined below, or as reasonably implied by contextual usage:

i. Bank has the same meaning as in the Financial Services Act of Bhutan 2011.

ii. Non-Bank financial institution has the same meaning as in Financial Services Act of Bhutan 2011.

iii. Amount available for distribution is net profit after tax and other provisions, as per the Accounting standards.

iv. Capital Adequacy ratio (CAR) refers to the ratio of the financial institutions total capital fund to its risk-weighted assets plus risk weighted off balance sheet items as given by Section 6.4 (a) of the Prudential Regulations 2002.

v. The capital fund refers to sum of Tier 1 capital and Tier 2 capital (only to the extent of 100% of the Tier 1 capital), as defined by Section 6.3 of the Prudential Regulations 2002.

vi. Non-performing loans (NPL) are as defined by the RMA in Section 9.5 of the Prudential Regulations 2002 (amended 22 July 2010).

vii. Net NPLs refers to the non-performing loans of the Bank as defined above, net of specific provisions.

viii. Specific Provisions refer to loan loss provisions made against Substandard, Doubtful, and Loss, as specified by Section 9.7.3 of the Prudential Regulations 2002. The amount of provisions are to be in line with point 2 (“Asset Class and Provisioning”) specified by the RMA in its directive dated November 9, 2012 with the subject line: "Revision of Prudential Norms" or as it may specify from time to time.

ix. Net loans and advances refer to the stocks of loans and advances on the Bank’s balance sheet, net of provisions.
x. **Net NPL ratio** refers to the ratio of net non-performing loans to net loans and advances, as defined above.

xi. **Dividend payout** ratio refers to the ratio of total eligible dividend to net profit.

xii. **Net profit/ Profit after Tax** shall be defined as gross operating income minus operating expenses plus net profit/loss on sale of assets plus net profit/loss on sale of investment plus provision written back minus bad debt written off minus provisions.

xiii. **Other Financial Institutions (OFIs)** refers to all financial institutions except Banks over which RMA can exercise and perform the powers, duties and functions conferred upon the Authority by or under the Royal Monetary Authority Act of Bhutan, 2010.

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### Part 2. Statement of policy

#### 2.1 Purpose

2.1.1. This regulation is intended to ensure that each Bank adheres to safety and prudential regulations and other provisioning while considering dividend distribution to the shareholders.

2.1.2. The Royal Monetary Authority of Bhutan (RMA) duly recognizes the importance of distribution of profit in any financial institution and at the same time RMA also attaches more importance to the safety of the financial institution so that financial strength is not jeopardized / diluted and the interests of the small deposit holders are duly protected. Hence it is important that all safety and prudential regulations and other provisioning are adhered to while considering dividend distribution to the shareholders.

#### 2.2 Scope

2.2.1. This regulation is applicable to all Banks and other financial institutions which are licensed by the RMA to perform their Banking / non-Banking functions in Bhutan.

#### 2.3 Responsibility

2.3.1. It is the responsibility of the Board of Directors of each Bank and deposit taking institutions to establish policies and procedures to ensure that the dividend is distributed in full compliance with the provisions set forth in this regulation.

2.3.2. The Board of the Bank and OFIs should take into account the interests of all stakeholders and the following aspects while deciding on the proposals for declaring dividend:

   i. The Bank satisfies all prescriptions mentioned in this regulation;
   
   ii. The annual inspection findings of the RMA having bearing on net profits;
   
   iii. The auditors’ qualifications pertaining to the statement of accounts;
   
   iv. The Bank’s long term growth plans;
   
   v. The amount actually distributed as “dividend” does not differ from the amount as approved by RMA.
vi. After the distribution of dividends, all stakeholders are duly informed, either by way of press communiqué or a note available in the website of the Bank / financial institution or individual letter.

2.3.3. The Bank / other financial institution shall distribute the eligible dividend thus arrived, only after obtaining necessary approval from the RMA.

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### Part 3. Implementation and specific requirements

#### 3.1 Eligibility criteria for declaration of dividend

3.1.1. Only those Banks and OFIs, which comply with the following minimum prudential requirements, would be eligible to declare dividends:

i. The Bank should have:
   a. CAR of at least 10% for preceding two completed years and the accounting year for which it proposes to declare dividend
   b. Net NPA of less than 7%

   **In case any bank does not meet the above CAR norm, but is having CAR more than 10% for the accounting year for which it proposes to declare dividend, it would be eligible to declare dividends only if Net NPA is less than 5% as given in the annexure 1.**

ii. The Bank should comply with the provisions of Sections 82, 83, 84, 85, 86, 87, 88, 89, 90, and 247 of The Financial Services Act of Bhutan 2011.

iii. The Bank should comply with the provisions of Sections 12.2 and 12.3 of the Prudential Regulations, 2002 (amended on September 16, 2006).

iv. The proposed dividend should be payable out of the accounting years profit for which dividend distributions is being considered.

v. The total amount of dividend (inclusive of interim dividend) distributable in a year shall not exceed 40% of the net profit of the accounting year.

vi. The RMA should not have placed any explicit restrictions on the Bank regarding declaration of dividends.

vii. The Bank should have obtained all necessary approval from its Board before submitting the requests to RMA for declaration of dividends.

3.1.2. The RMA shall not entertain any application for a higher dividend payout ratio than the one for which the Banks qualify as given in the annexure.

3.1.3. The RMA shall review the entire prescriptions of distribution of profit, once in a year, in the light of the evolving macro-economic and financial sector development.
3.2 **Quantum of dividend payable**

3.2.1. Banks, which fulfil the eligibility criteria set out in Section 3.1 of this regulation, may declare and pay dividends, subject to the following:

i. The dividend payout ratio shall not exceed 40% of the net profits of the accounting year for which Bank proposes to declare dividend and it shall be as per the norm furnished in Annexure-I of this regulation.

ii. In case the profit for the relevant period includes any extra-ordinary profits/income, the payout ratio shall be computed after excluding such extra-ordinary items for reckoning compliance with the prudential payout ratio.

iii. The auditor (s) should not have mentioned any qualification in the audited report, which has a bearing on the net profit figures for the year in which the dividend is being considered. If so, net profit should be adjusted to this effect, so that funds available for distribution should be free from any such qualification.

3.3 **General**

3.3.1. The Bank / financial institution shall publish the dividends payable, as approved by RMA, to all stakeholders within 30 days of approval by RMA.

3.4 **Reporting requirements**

3.4.1. All Banks declaring dividends should report details of dividend declared during the accounting year as per the performa furnished in Annex 2. The report should be furnished within a fortnight after declaration of dividends.

3.4.2. The Banks/OFIs must submit a status report on compliance with other macro-prudential regulations to RMA when request for dividend distribution approval is made to RMA.

3.4.3. In event of non-compliance of any macro-prudential regulation in force as indicated in the status report, the bank shall submit an action plan for compliance along with the status report.

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**Part 4. Corrective measures**

4.1 **Corrective measures and sanctions**

4.1.1. In alignment with extant statutory provisions, the corrective measures and sanctions may include, but are not limited to any of the following:

i. Issue of a formal warning to the Bank;

ii. Written agreements with Banks/OFIs for undertaking remedial measures, including those limiting the operations of the institution engaged in financial services;

iii. Suspend access to credit facilities of the RMA;
iv. Suspend temporarily or permanently officers or directors from duties in the financial institutions;

v. Revoke the license to operate.

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**Part 5. Effective date**

**5.1 Effective date**

5.1.1. The above guidelines will be applicable to the dividends declared for the accounting year ended ....... onwards as per RMA circular.
Annexure.1  Norms for dividend payout ratio

Matrix of criteria for maximum permissible range of Dividend Payout ratio

<table>
<thead>
<tr>
<th>Net NPL Ratio</th>
<th>Up to 3%</th>
<th>More than 3% but less than 5%</th>
<th>More than 5% but less than 7%</th>
<th>More than 7%</th>
</tr>
</thead>
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<tr>
<td>Minimum Capital Adequacy of 10% in past 3 years</td>
<td>Maximum Dividend Payout Ratio</td>
<td>Up to 40%</td>
<td>Up to 35%</td>
<td>Up to 25%</td>
</tr>
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Notes: Banks should have a Capital Adequacy Ratio of at least 10% for the preceding two years and the accounting year for which it proposes to declare dividend and Net NPL of 3% or less in the accounting year for which dividend is being declared to be eligible to pay dividend payout ratio at the rate of 40%.

In case any Bank does not meet the above capital adequacy norm, but is having capital adequacy ratio of more than 10% for the accounting year for which it proposes to declare dividend, it would be eligible to declare dividends up to 15% only if Net NPA is less than 5%.
**Annexure.2  Reporting Format for Banks declaring dividend**

Details of dividend declared during the financial year beginning on DD/MM/YYYY.

Name of the Bank:

<table>
<thead>
<tr>
<th>Accounting Period*</th>
<th>Net profit for the accounting period (Nu. In Crore)</th>
<th>Rate of dividend</th>
<th>Amount of dividend (excluding dividend tax) (Nu. Crore)</th>
<th>Payout ratio</th>
</tr>
</thead>
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*quarter or half year or year ended ----- as the case may be
Annexure.3  Rationale of using multiple indicator to declare dividend

Factors determining dividend declaration:

1. The basic principle behind dividend declaration is that the profit is actually available in the books of the Banks and any unrealized profit of the future is not accounted as profit today and distributed to the shareholders. In addition, adequate provisioning is made as per the guidelines of the RMA so that existing and loyal customers of Banks do not suffer due to the deterioration in the financial health condition of Banks post declaration of dividends.

2. Hence, dividend declaration should be based on a few parameters which clearly portray the health of the Banks / other financial institutions. Any Bank / other financial institution which are showing a clear sign of deterioration of financial soundness indicators should not be allowed to declare dividends as this will completely dilute the confidence of deposit holders and also other stake holders. Furthermore, if the financial health of one or more Banks /financial institutions deteriorates, then this will pave the way for systemic instability. That is why more attention needs to be paid in maintaining and nurturing the health of the Banks. In this context, prudent distribution of dividends as explained in the regulation assumes more significance.

Rationale of having two parameters:

1. The main indicator which depicts the health of a Bank is capital to risk weighted asset ratio. In all analysis, including that of credit rating, this ratio assumes more importance than any other financial health parameters. Accordingly this parameter assumes more importance in dividend declaration also.

2. It is important to recognize that the CAR does not deteriorate overnight and it takes time for the impact to be felt on CAR. Hence, we need one more parameter, which also depicts the health of the Bank and which is observable on a high frequency time scale. Thus, we need two parameters which are the central fulcrum of health record of the Banks. Based on the experience of other countries, the signaling parameter is non-performing loan ratio (NPL). Hence, it is optimal to base the dividend declaration policy based on NPL and CAR.

3. While CAR explains the solvency of the Banks, NPL ratio explain the development under non-performing loan ratio which is monitored on a high frequency basis by Banks. Changes in the values of NPL ratios have significant impact on CAR ratios. Furthermore, selection of two parameters give added flexibility to both RMA and Banks in dividend declaration initiatives. As explained earlier, once the NPL ratio deteriorates, this erodes the flexibility of giving more dividends and funds available for dividend distribution comes down. This has long lasting effect on shareholders. In order to rectify the situation all stakeholders have to take actions to arrest higher NPL ratios, which will positively contribute in strengthening the CAR ratios. Thus these two ratios will give added flexibility to RMA and Banks than any single parameter.