ROYAL MONETARY AUTHORITY OF BHUTAN

༄༅། །རྒྱལ་གཞུང་དངུལ་ལས་དབང་འཛིན། །

BHUTANESE FINANCIAL SECTOR PERFORMANCE REVIEW

(December 2011 - 2012)

Financial Regulation & Supervision Department

This report presents in general the performance of the Bhutanese financial sector on peer group basis (excluding RSEBL) for the period ended Q4FY'12 in comparison to the corresponding quarter of the previous year. This report has been prepared by the Financial Regulation & Supervision Department of the Royal Monetary Authority of Bhutan (RMA) and the information contained in this report is based on the returns submitted by the financial institutions to the RMA. The observations are highlighted below:

1. Overview

The performance of the financial sector improved significantly with the continued expansion in the business, while the stability of the system was maintained. The credit growth accelerated during the year and the performance of financial institutions improved with enhanced growth in assets, healthy profitability, higher capitalization and lower risk level. The banking, non-bank and insurance sectors expanded their branch network around the country, thereby increasing access to financial services.

2. Business size and growth (Financial Sector)

As of December 2012, the total assets of the financial system[1] has expanded to Nu. 81.60 billion compared to Nu.72.23 billion in December 2011 indicating a growth of 12.94 percent. The growth has been recorded in the assets of banks[2] which have increased from Nu. 64.98 billion to Nu. 73.34 billion, and that of non-banks[3] from Nu. 7.27 billion to Nu. 8.26 billion during the period under review. However, in terms of the percentage growth of the total assets of banks and non-banks, the bank's total assets increased by 12.85 percent and non-banks increased by 13.66 percent.

The increase in the total assets of the banks was mainly contributed by bank's investment in Government securities and RMA bills. The total investment in Government securities and RMA bills increased from Nu. 1.5 billion to Nu. 4.15 billion during the period under review. The loans and advances also increased from Nu. 40.15 billion to Nu. 45.35 billion, and the Cash and bank balances increased slightly from 5.96 billion to Nu. 6.73 billion. However, the bank's balances with RMA decreased from Nu. 13.83 billion to Nu. 11.02 billion during the period under review. For non-banks although the total loans and advances forms a major part of assets (70.95 percent), the total loans and advances has slightly increased by 5.51 percent (from Nu. 5.55 billion to Nu. 5.86 billion) during the period under review. In terms of percentage growth, the cash and bank balances of non-banks increased by 49.72 percent (from Nu. 1.04 billion to Nu. 1.56 billion).

	Banks		Non Banks		Total	
ASSETS	**Dec-12**	**Dec-11**	**Dec-12**	**Dec-11**	**Dec-12**	**Dec-11**
Cash & Bank Balances	**22,254.65**	**21,887.74**	**1,562.13**	**1,043.36**	**23,816.78**	**22,931.10**
Cash & Bank Balances(Nu.)	6,733.21	5,962.47	1,559.55	1,041.73	8,292.76	7,004.21
Balances with Banks in India	1,228.81	791.05	0.04	0.04	1,228.85	791.09
Balances with Banks abroad	3,269.96	1,304.83	2.30	1.35	3,272.26	1,306.18
Balances with RMA	11,022.68	13,829.39	0.23	0.23	11,022.91	13,829.62
RGOB/RMA Securities	**4,146.00**	**1,552.14**	**0.00**	**0.00**	**4,146.00**	**1,552.14**
RMA Bills	3,001.36	498.14	0.00	0.00	3,001.36	498.14
RGOB Bills/ Bonds	1,144.65	1,054.01	0.00	0.00	1,144.65	1,054.01
Others	-	0.00	0.00	0.00	0.00	0.00
Loans & Advances (net of prov)	**45,349.31**	**40,153.67**	**5,860.51**	**5,554.33**	**51,209.82**	**45,708.00**
Equity Investments	**242.14**	**208.14**	**83.98**	**83.98**	**326.13**	**292.13**
Fixed Assets	**629.27**	**619.41**	**163.61**	**136.55**	**792.88**	**755.96**
Other Assets	**721.72**	**568.53**	**589.97**	**448.98**	**1,311.69**	**1,017.51**
Total Assets	**73,343.10**	**64,989.65**	**8,260.20**	**7,267.20**	**81,603.30**	**72,256.85**

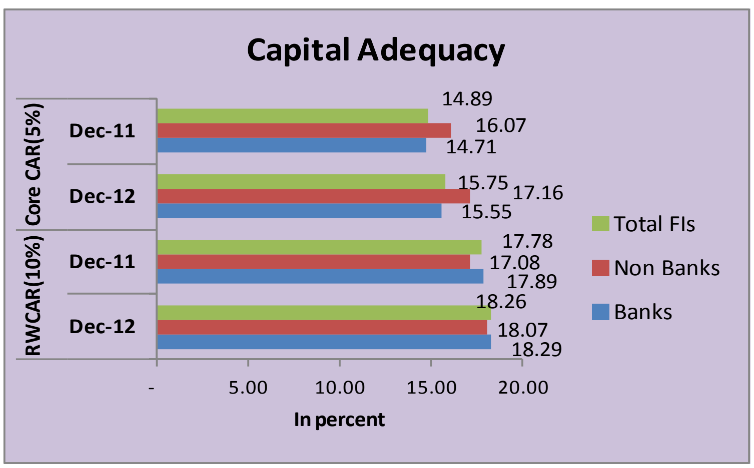
[1] The financial system comprises of BNBL, BOBL, DPNBL, Tbank, BDBL,RICBL &BIL.
[2] Banks refers to BNBL, BOBL, DPNBL, Tbank & BDBL.
[3] Non-banks refers to RICBL & BIL.

In terms of the asset composition of financial sector, the banking system constitutes 89.88 percent of the total assets and the remaining 10.12 percent constitutes non-bank's assets.

Out of total liabilities of the financial sector it was observed that the paid up capital doubled from Nu. 2.13 billion in December 2011 to Nu. 4.94 billion December 2012 (by 131 percent in terms of percentage growth). The increase in the paid up capital was mainly due to injection of fresh capital by the banks. However, the deposit liabilities of banks slightly increased by 8.56 percent, from Nu. 51.11 billion in December 2011 to Nu. 55.49 billion in December 2012. The borrowing for non-banks has decreased by 0.32 percent (from Nu. 4.59 billion to Nu. 4.57 billion) during the period under review.

LIABILITIES	Banks		Non Banks		Total	
	Dec-12	Dec-11	Dec-12	Dec-11	Dec-12	Dec-11
Paid-up Capital	4,503.41	1,795.83	440.00	340.00	4,943.41	2,135.83
Reserves	8,010.47	7,703.35	1,317.44	1,009.86	9,327.91	8,713.21
Deposit Liabilities	55,486.94	51,109.65	0.00	0.00	55,486.94	51,109.65
Borrowings	1,278.68	1,330.52	3,299.97	3,262.97	4,578.65	4,593.49
Funds/Grants	0.00	0.00	0.00	0.00	0.00	0.00
Provisions	1,252.34	1,199.30	1.96	1.41	1,254.30	1,200.71
Current & Other Liabilities	2,811.27	1,850.99	3,200.83	2,652.97	6,012.10	4,503.96
Total Liabilities	73,343.10	64,989.65	8,260.20	7,267.20	81,603.30	72,256.85

3. Capital & Reserves.



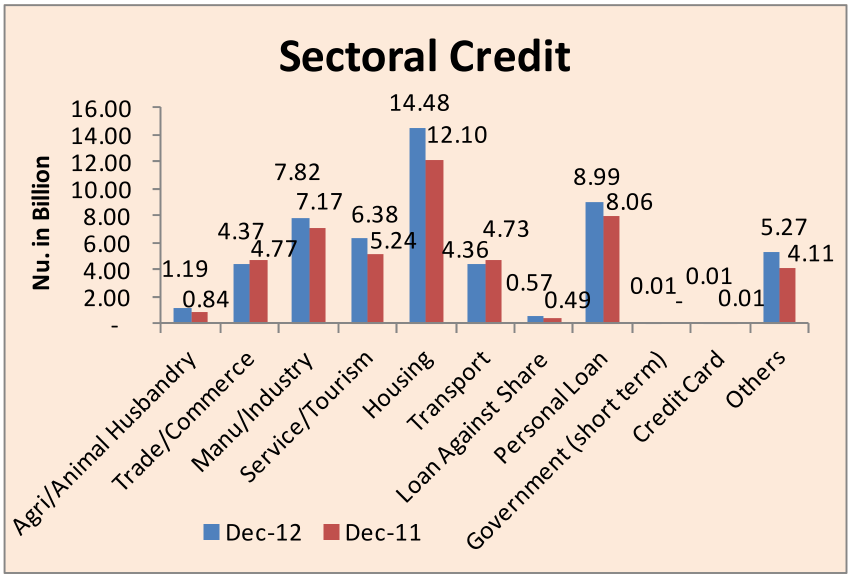
The financial system remained satisfactory with risk weighted capital adequacy ratio (RWCAR) of 18.26 percent in December 2012 against the RWCAR of 17.78 percent in December, 2011. RWCAR were well above the regulatory requirement –both institution wise and a systemic perspective. The total risk weighted assets of the financial sector increased from Nu. 61.01 billion in 2011 to Nu. 78.14 billion in December 2012. As against the bank's risk weighted assets of Nu. 68.42 billion in December 2012, the paid up capital increased by two fold from Nu. 1.79 billion to Nu. 4.50 billion with the injection of the equity capital during the period under review. Similarly, the reserves and surplus of the banks slightly increased from Nu. 7.7 billion to Nu. 8.01 billion. The RWCAR of banks increased from 17.89 percent to 18.29 percent during the period under review.

The RWCAR of non-banks also increased from 17.08 percent to 18.07 percent. The total risk weighted assets of the non-banks increased from Nu. 7.90 billion to Nu. 9.72 billion. Similarly, the capital fund of non-banks increased from Nu. 1.35 billion to Nu.

1.76 billion and the increase was mainly attributed to increase in the reserves and surplus by 30.46 percent (from Nu. 1.01 billion to Nu. 1.32 billion).

The core capital ratio of the financial sector has increased to 15.75 percent from 14.89 percent during the period under review.

4. Sectoral Credit Analysis (including the credit extension by the non-banks)

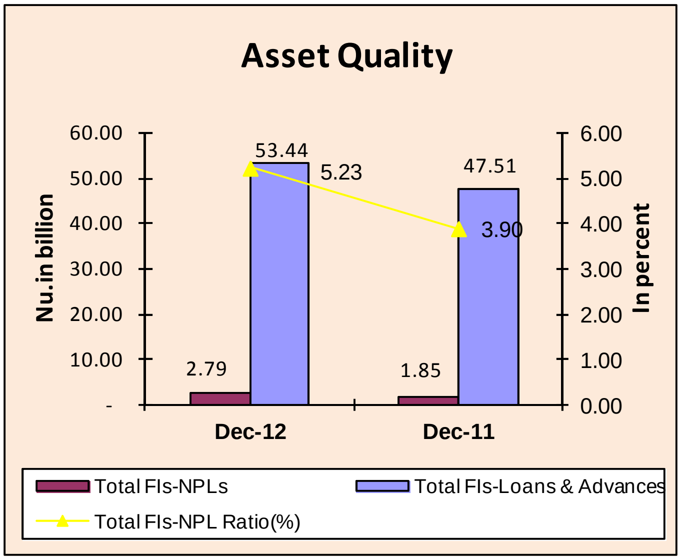


The banking system continued to play an active role in providing financing to both the household and corporate/private sectors. During the period ended December, 2012 the financial sectors total lending (gross) to the economy reached to Nu. 53.44 billion from Nu.47.51 billion in December, 2011 or an increase by 12.48 percent. The growth in the lending activity was always attributable to strong demand towards the housing and personal sector, as a result leading the other sectoral exposures. The Housing loan increased from Nu. 12.10 billion to Nu. 14.47 billion (Growth of 19.59 percent) and personal loans increased from Nu. 8.05 billion to Nu. 8.99 billion (Growth of 11.63 percent) during the period under review.

In terms of the sectoral exposures to total loans and advances, housing sector credit continued to lead the sectoral credit concentration with Nu. 14.47 billion (27.09 percent to total loans), followed by personal loan and manufacturing & industry loan with Nu. 8.99 billion (16.83 percent) and Nu. 7.82 billion (14.63 percent) respectively. However, in terms of growth by sector, loans to agriculture sector experienced the highest sectoral growth of 41.59 percent (from Nu. 0.84 billion to Nu. 1.19 billion), followed by the loans to others sector with a growth of 28.29 percent (from Nu. 4.11 billion to Nu. 5.27 billion).

Majority of credit are provided by the banks. Out of total credit of Nu. 53.44 billion, 88.75 percent (Nu. 47.43 billion) are provided by banks and remaining 11.25 percent (Nu. 6.01 billion) are credit provided by non-banks. The total loans and advances provided by the banks increased to Nu. 47.43 billion from Nu. 41.83 billion indicating a growth of 13.39 percent. Similarly, the total loans and advances of non-banks increased by 5.76 percent, from Nu. 5.69 billion to Nu. 6.01 billion during the period under review.

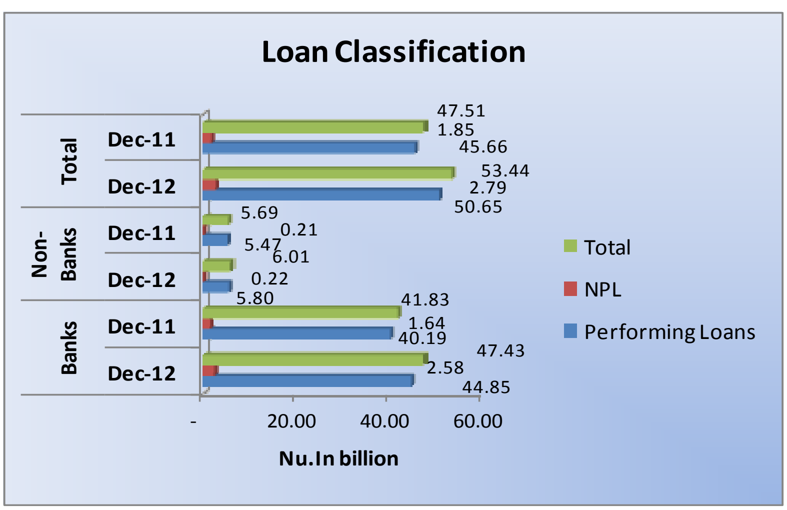
5. Credit Quality (Loans and Advances including the non-banks)



Asset quality continued to pose some concerns as the Non Performing Loans (NPL) of the financial sector grew from Nu. 1.85 billion in December 2011 to Nu. 2.79 billion in December 2012 indicating a deterioration of 50.87 percent. As against the total loans of Nu. 53.44 billion (gross), the NPL to total loans ratio stood at 5.23 percent as compared to 3.90 percent during the period under review. For the period ended December 2012, the NPL grew at more than 50 percent as against the growth in the total loans and advances by 12.48 percent. Doubtful and loss assets comprised over 72.02 percent (27.38 percent doubtful and 44.64 percent loss) of the stock of NPLs indicating preponderance of sticky advances, and the remaining 27.98 percent comprised of substandard assets.

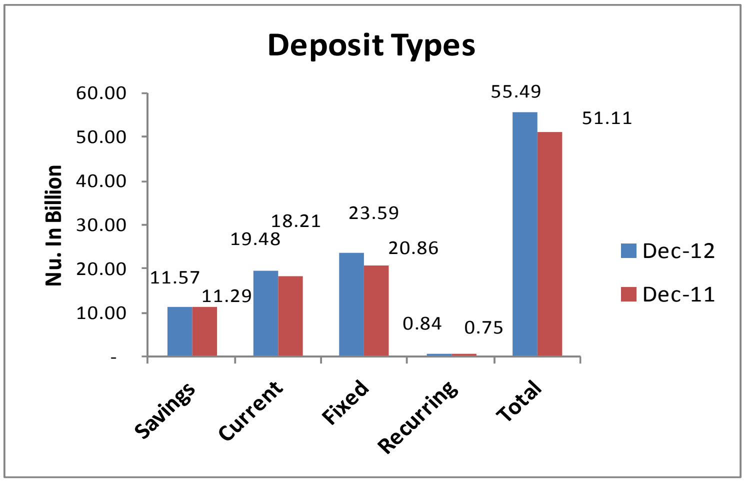
Meanwhile, the percentage of provision as a percentage of NPLs provided for impaired loans has decreased from 85.59 percent in December 2011 to 69.84 percent in December 2012. The decrease in the ratio was due to the increase in NPL by Nu. 0.94 billion during the period under review. The NPL of the banks increased from Nu. 1.64 billion to Nu. 2.58 billion as against the increase in the total loans from Nu. 41.83 billion to Nu. 47.43 billion during the period under review. The gross NPL to total loans ratio of banks stood at 5.44 percent as compared to 3.92 percent during the period under review. However, the NPL for non-banks slightly increased from Nu. 0.21 billion to Nu. 0.22 billion as against the increase in the total loans to Nu. 6.01 billion from Nu. 5.69 billion (5.77 percent). The NPL ratio of non-banks stood at 3.58 percent as compared to 3.74 percent during the period under review.

6. Consolidated Loan Classification of the FIs.



The review on asset classification confirms that around 94.77 percent of total loans disbursed by the financial sector are performing loans and remaining 5.23 percent are non-performing loans. Of the total loans of Nu. 47.43 billion of banks, 94.56 percent are performing loans and only 5.44 percent are non-performing. Similarly, 96.42 percent of the total loan outstanding (Nu.5.79 billion) of the non-banks are performing loans and the remaining 3.58 percent are non-performing loans.

7. Deposits.



The total deposit base of the banking sector increased slightly by 8.56 percent, from Nu. 51.11 billion to Nu. 55.49 billion during the period under review. The demand deposits which comprises of saving account and current account grew only by 5.26 percent, from Nu. 29.50 billion in December 2011 to Nu. 31.05 billion in December 2012. The time deposits which comprises of fixed and recurring account grew by 13.07 percent, from Nu. 21.61 billion to Nu. 24.43 billion during the period under review.

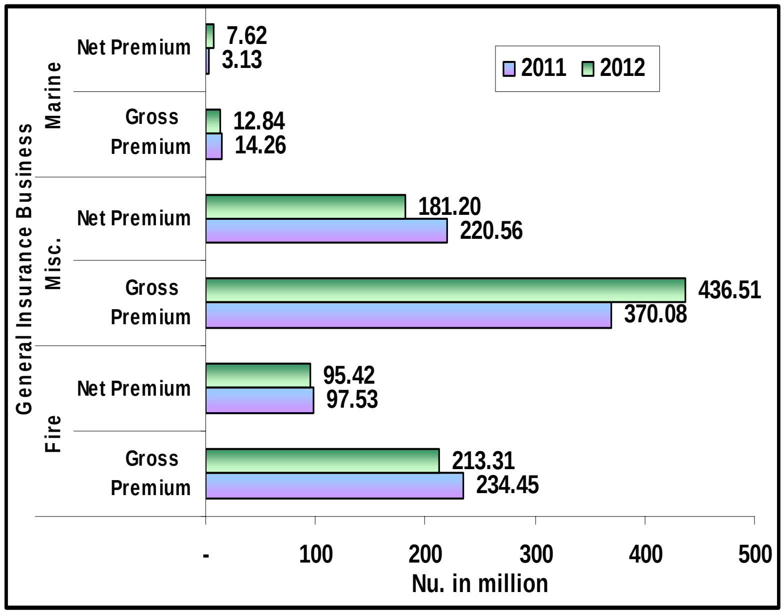
In terms of customer holdings, corporate deposits accounts for 59.47 percent (Nu. 33 billion) of the total deposits and remaining 40.53 percent (Nu. 22.49 billion) constitutes retail deposits. In other words, corporate deposits continued to dominate the deposit holding pattern of the financial institutions. As a share of total deposits, demand deposits (current and saving) accounted for 55.97 percent and time deposits (fixed and recurring) comprised of 44.03 percent.

8. THE INSURANCE INDUSTRY OF BHUTAN (December 2011- December 2012)

Bhutanese insurance industry, which comprises of Royal Insurance Corporation of Bhutan (established in 1976) and a newly opened general insurance company, Bhutan Insurance limited (established in 2009) is unique in itself because both the insurance companies not only provides insurance services but it also give out retail loans and advances and manages provident fund of private companies. The Royal Insurance Corporation of Bhutan (RICBL) was established under the Royal Charter of His Majesty the King Jigme Singye Wangchuk in 1975. It was incorporated under the Companies Act of Bhutan 1989 and subsequently registered under the Financial Institution Act of Bhutan 1992. RICBL was mandated to undertake all types of insurance business (life and general) emanating within Bhutan and also to finance various commercial undertakings and development projects. RICBL initially started its business with paid-up capital of Nu.1 million, which is presently at Nu.200 million. Bhutan Insurance Ltd. is a general insurance company with an initial paid-up capital of Nu.100 million.

During the year ended 31st December 2012, the Bhutanese Insurance industry continued to play its role of providing insurance to the general public and contribute towards mobilization of financial resources for sustainable economic development of the country. This report outlines the performance of the industry for the year 2012. The insurance market performed satisfactorily with regard to market growth, introduction of new policies, profitability etc.

(a)General Business Claim experience (Non-life):



The market grew by 8.70 percent in gross premium written of general business to Nu.923.04 million in December 2012 as compared to Nu.849.17 million in the previous year. The growth was mainly driven by significant recorded growth of 16.51 percent in miscellaneous class of business which includes motor insurance and others. The premium written from fire and marine insurance has however decreased during the period. This could be due to the spill-over impact of RMA's March 8, 2012's directive to restrict housing credit, which in turn reduced the no. of building insured in 2012. The retention capacity or limit has decreased as indicated by a fall in net premium despite an increase in gross premium. Although, the Bhutanese insurance industry however did not experienced any serious events, heavy machineries claims however continues to dominate the claims paid by the general insurance companies. Net claims paid by the insurance industry on general business have increased by 14.20 percent. Claim ratio of general insurance has increased to 28.67 percent from 27.29 percent, mainly due to increase claims mainly from heavy machineries despite an increase in premium written. However, the increase in claims payments is compatible with increase in business volume during the year under review.

(b)Life Insurance

Gross direct premium written for life business has grown to Nu.304.93 million in December 2012 from Nu.222.18 million in December 2011. This was mainly due to launching of new life products in 2012 and methods and systems by which the products are distributed have expanded like setting up of several micro offices. Therefore, the first year premium constitutes about 58 percent of gross premium for the year. All the premiums are retained by the insurance company. Total claims paid (by death/maturity/survival benefits & surrender) during the year amounts to 57.87 million. Therefore, net claim ratio of life insurance increased to 13.15 percent from 12.23 a year ago. However, the gross expense to net premium or combined ratio remains comfortable at 35 percent.

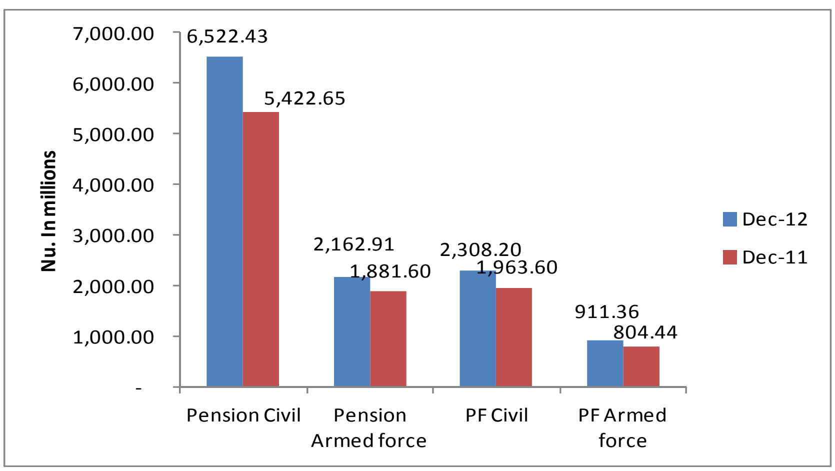
9. National Pension and Provident Fund Bureau

Pension and Provident Fund - Civil and Armed Forces

NPPF is the government pension fund service provider in the country; the plan covers from retirement benefits, survivors' benefits to permanent disability benefit for its members. It covers the civil service and Government corporations which are designed on a Pay-As-You-Go partially funded system. From the total contributions by the members, 11 percent to provident fund and 11 to pension fund every month. As the pension fund is indexed to the Average Civil Service Salary Index, the benefit level increases with every increase in civil service salary. During the period under review the pension fund size for civil has increased from Nu.5, 422.65 million to Nu.6, 522.43 million indicating a growth of 20.28 % from the previous year.
The increase is mainly due to the following reasons:

(i) Increased in pension fund by Nu.1099.78 million during the period
(ii) Increase in number civil service employees

Besides the civil pension, the NPPF also manages the Armed Forces pension scheme. The Armed Forces scheme covers the Royal Bhutan Army, Royal Body Guard and Royal Bhutan Police. The Armed Forces scheme is designed differently from the civil pension scheme in view of the different retirement age. For instance the service condition of the Armed Forces requires their personnel to retire at the age of 45 years whereas it is 56 years for the civil although it is also financed on a Pay-As-You-Go partially funded system. During the period pension fund for armed force has increase from Nu. 1,881.61 million to Nu.2,162.91 million indicating a growth of 14.95% from the previous year.



Till December 2012, the NPPF has made a total payment of Nu.12.66 million to 3494 beneficiaries which comprised of 1,495 normal pensioners, 529 early pensioners, and 6 disabled, 343 surviving spouse, 1082 surviving children, 35 orphans and 4 dependent parents. Provident Fund provides the benefits in lump – sum to the retirees on superannuation and to the nominees in case of their death. In December 2012, the total Provident Fund of the Civil has increase from Nu.1, 963.69 million to Nu. 2,308.20 million and Armed Forces from Nu.804.44 million to Nu.911.36 million.

Financial profitability
During the period under review, NPPF generated gross revenue of Nu. 449.86 million compared to Nu.346.16 million in the previous year, thereby experiencing growth of 29.95 percent.

(a) Income from Investments
The income from investment during December 2012 was mainly due to the following reasons:

(i) Cash, Deposit and Bonds has increased from Nu.2, 469.57 million in December 2011 to Nu. 3, 518.24 million in December 2012

(ii) Loan has increased from Nu.8, 157.31 million in December 2011 to Nu. 8,759.52 million in December 2012.

(iii) Dividend income as increased from Nu. 942.49 in December 2011 to Nu. 1176.20 million in December 2012.

(b) Rental Income
The rental income has increased from Nu.245.53 million in December 2011 to Nu. 255.55 million in December 2012.
Total investments of NPPF as increased from Nu. 11,815.04 million in December 2011 to Nu. 13,709.52 million in December 2012.

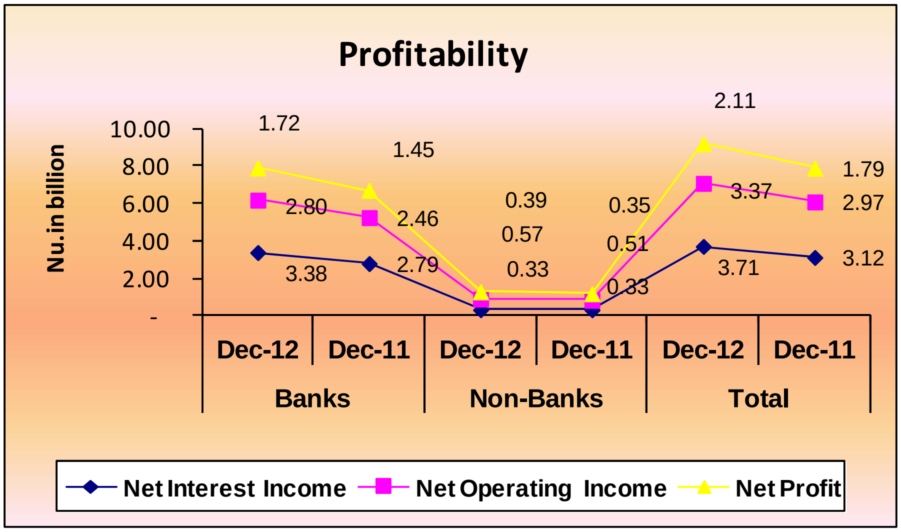
Member – Housing and Education Loan

NPPF receives monthly inflow of fund from its members and invest those funds in the marketable securities and lending to sectors as approved by the RMA.NPPF provides Education and Housing Loan for its members.
Housing loan during the period increased from Nu.1, 950.93 million in December 2011 to Nu.2, 427.74 million in December 2012.
Education loan has been popular amongst its members as all the members are eligible to utilize the services by pledging Provident Fund balances as collateral for the loan. The Education loan decreased from Nu. 1,965.49 million in December 2011 to Nu.1,798.38 million in December 2012.
Given the limited investment avenues and also to provide an incentive to the employees, NPPF started a staff vehicle loan as approved by the Board. As the repayment is tied up to its salary. The risk factor is considered very low. A total amount of Nu. 8.91 million has been disbursed till December 2012 to the staff of NPPF to purchase vehicle for personal use.

Gross Non- performing Loans

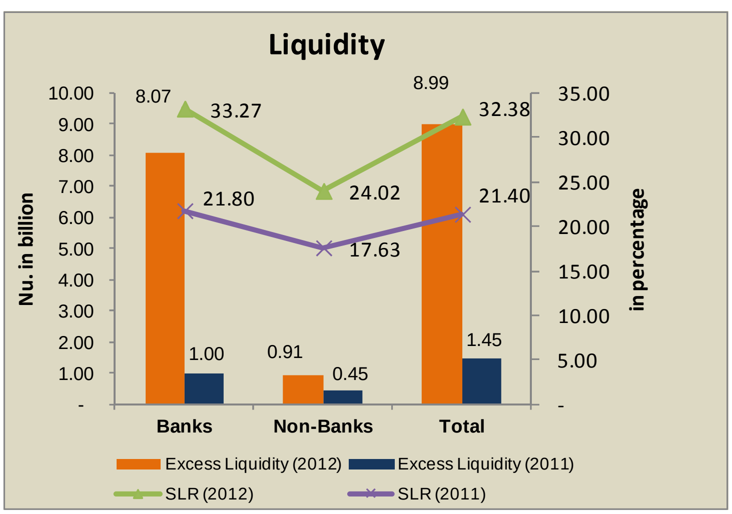
NPL ratio measures the percentage of non- performing loans, which are loan repayment in arrears by 90 days or more to the total loan portfolio. The NPL is a concern to the institution as these loans have the highest potential for ultimately becoming write – offs and therefore affect the overall performance of the institution.
NPPF loan portfolio includes manufacturing/industry, service and tourism, housing, education, institutional loans, short -term loan to RGoB and pension loan. As of December 2012, the total loan outstanding stood at Nu.8,432.15 million with total NPL of Nu 192.20 million. The gross non-performing loan ratio stands at 2.27 percent compared to 1.23 percent in the previous year.

10. Profitability.



During the period ended December 2012, the net profit of the financial sector has increased when compared to the corresponding quarter of the previous year. The net profit stood at Nu.2.11 billion in December 2012 as compared to a net profit of Nu. 1.79 billion in December 2011, indicating a growth of 17.66 percent. Although the profit grew by 17.66 percent, the profit after tax of banks increased by 18.74 percent, from Nu. 1.45 billion to Nu. 1.72 billion during the period under review. The profit after tax for non-banks also increased slightly from Nu. 0.34 billion to Nu. 0.39 billion during the period under review indicating a growth of 13.16 percent. The net interest income of banks increased by 21.08 percent (by Nu. 0.58 billion) and net operating income by 13.85 percent from Nu. 2.45 billion to Nu. 2.79 billion. The net interest income of non-banks slightly decreased by 0.19 percent. However, the net operating income increased by 12.11 percent (from Nu. 0.51 billion to Nu. 0.57 billion).

11. Liquidity.



On the liquidity front, the excess liquidity of the financial sector has substantially increased to Nu.8.98 billion in December 2012 from Nu.1.45 billion in December 2011 indicating a growth of 519.04 percent. The increase in liquidity is mainly due to increase in the quick assets from Nu. 13.14 billion to Nu. 21.80 billion (cash & bank balance by 3.86 percent from Nu. 22.93 billion to Nu. 23.82 billion, and RGOB/RMA securities increased by 167.11 percent, from Nu. 1.55 billion to Nu. 4.15 billion) during the period under review. The statutory liquidity requirement (SLR) of the banks stood at 33.27 percent as compared to 21.80 percent during the period under review and the increase in the ratio is mainly due to increase in the quick assets by 67.29 percent from Nu. 12.09 billion to Nu.

20.24 billion. Similarly, the statutory liquidity position of non-banks stood at 24.02 percent as compared to 17.63 percent with an slight increase in quick assets from Nu. 1.04 billion to Nu. 1.56 billion during the period under review. The SLR position of both banks and non-banks is above the minimum prudential requirement of 20 percent and 10 percent respectively.