

ROYAL MONETARY AUTHORITY OF BHUTAN

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**BHUTANESE FINANCIAL SECTOR
PERFORMANCE REVIEW**

(June 2011 - 2012)

Financial Regulation & Supervision Department

Introduction

This report presents an objective assessment of the performance of the Bhutanese financial sector on peer group basis for the quarter ended June 2012 in comparison to the corresponding quarter of the previous year. The information contained in this report is based on the returns submitted by the financial institutions to the RMA. The observations are summarized below:

1. Business size and growth.

The total assets of the financial system¹ has slightly expanded by 1.87 percent during the period under review and stood at Nu.70.84 billion as of June 2012 compared to Nu.69.55 billion during corresponding quarter of the previous year.

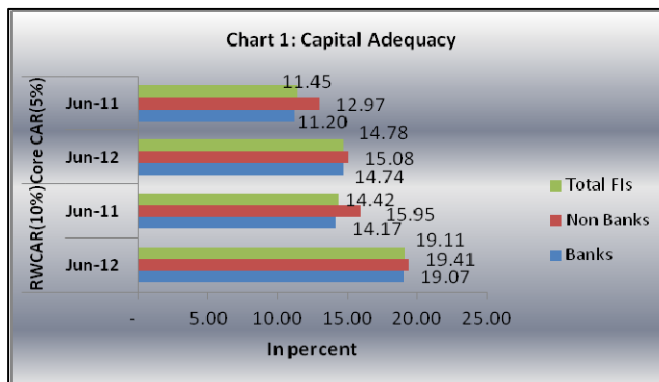
Assets of both banking system and the non-bank financial institutions (NBFIs) expanded during the second quarter, 2012. However, the total assets of the banks² grew only by 0.22 percent (from Nu. 62.69 billion to Nu. 62.83 billion) during the period under review whereas the total assets for non-banks³ (excluding NPPF) grew by 16.96 percent (From Nu. 6.85 billion to Nu. 8.02 billion). The slight increase in the total assets of the banks was mainly contributed by the increase in total loans and advances (net of provision) by 30.55 percent. For the non-banks the increase in the total assets was mainly due to increase in loans & advances and cash & bank balances by 69.94 percent and 15.65 percent respectively.

In terms of the asset composition, the banking system constitutes 88.68 percent of the total assets and the remaining 11.32 percent constitutes non-bank's assets.

Out of total liabilities of the financial sector it was observed that the capital and reserves increased by 56.20 percent (from Nu. 7.58 billion in June 2011 to Nu. 11.84 billion in June 2012). However, the deposit liabilities of banks decreased by 6.06 percent, from Nu. 50.68 billion in June 2011 to Nu. 47.61 billion in June 2012. The borrowing for non-banks has decreased by 0.24 percent during the period under review.

2. Capital & Reserves

The financial system remained satisfactory with risk weighted capital adequacy ratio (RWCR) of 19.11 percent in June 2012 against the RWCR of 14.42 percent in June, 2011. RWCR were well above the regulatory requirement –both institution wise and a systemic perspective. As shown in the table below the capital fund of



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

the financial system has increased from Nu. 7.58 billion to Nu. 11.70 billion during the period under review. The increase in the capital fund is mainly seen in banks with 60.80 percent from Nu. 6.38 billion in June 2011 to Nu. 10.26 billion in June 2012 and the increase is mainly seen in the increase in paid up capital by 30.83 percent and increase in reserves by 69.82 percent. The capital fund of non-banks has increased by 20.23 percent, contributed by 44.20 percent increase in the reserves. However, the paid up capital fund of non-banks remains unchanged during the period under review.

Particulars	Period	Banks	Non-banks	Total Fls
Capital Fund	Jun-12	10,263.02	1,439.64	11,702.68
	Jun-11	6,382.29	1,197.42	7,579.71
Risk Weighted Assets	Jun-12	53,828.04	8,037.88	61,865.92
	Jun-11	45,056.42	7,508.33	52,564.75
Tier I Capital	Jun-12	7,931.89	1,212.43	9,144.32
	Jun-11	5,044.57	973.80	6,018.37

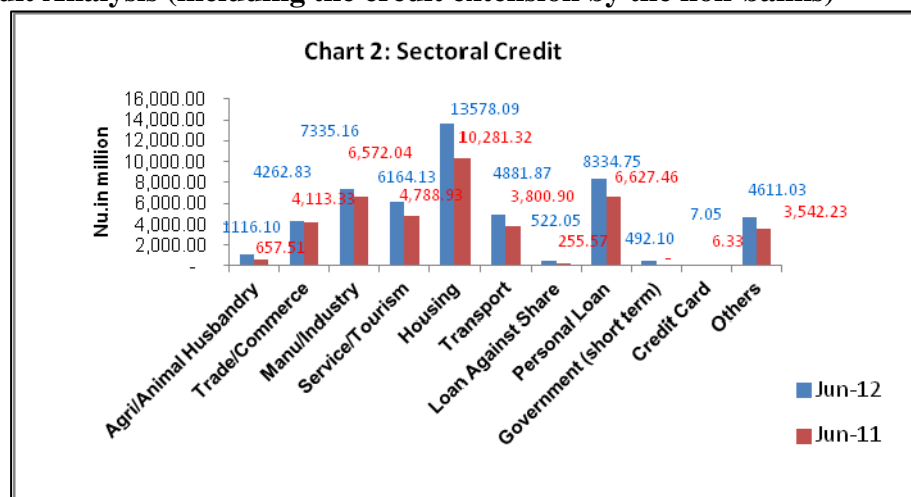
The total risk weighted assets of the financial system stood at Nu. 61.87 billion in June 2012 as compared to Nu. 52.56 billion in June 2011, out of which 87.01 percent of the risk weighted assets are within the banking sector and only 12.99 percent comprises of the non-bank's assets. The core capital ratio of the financial sector has increased to 14.78 percent from 11.45 percent during the period under review.

3. Banking

The balance sheet in the banking sector has slightly increased to Nu. 62.83 billion from Nu. 62.69 billion during the period under review indicating a growth of 0.22 percent. The composition of the balance sheet of the banks continued to be dominated by traditional balance sheet items. The deposits constituted nearly 75.78 percent of the total banking liabilities. Although the deposits constitute major liabilities, the deposit base has decreased by 6.06 percent, from Nu. 50.68 billion in June 2011 to Nu. 47.61 billion in June 2012. The capital fund and reserves constitutes 16.33 percent of total banking liabilities. The provision and current & other liabilities accounts for 5.87 percent of the total liabilities. On the asset side, the total loans and advances (net of provision) continue to form majority of the total assets of banks. The loan and advances (net of provision) constitutes 68.63 percent of the total assets followed by cash and bank balances with 27.52 percent. However, the cash and bank balances of the bank decreased from Nu. 24.60 billion to Nu. 17.29 billion during the period under review. The investment (securities and equity) which accounted for 2.01 percent of total bank's assets mostly consisted of Government and RMA securities.

a) 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 June 2012, the

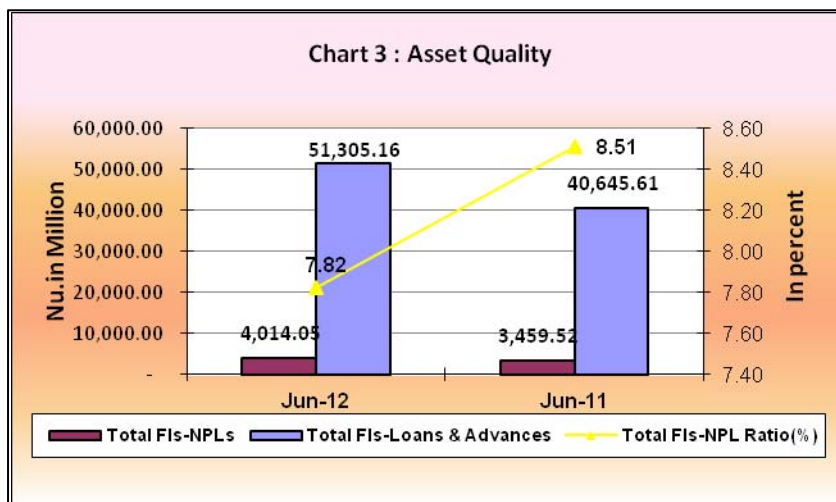


financial sector's total credit portfolio (gross) increased to Nu. 51.31 billion from Nu.40.65 billion in June 2011, or by 26.23 percent. The lending activity was attributable to the strong demand to the housing and personal sector, as a result leading the other sectoral exposures. In terms of the sectoral exposures to total loans, 26.47 percent constitutes housing loan, followed by personal and manufacturing/industry with 16.25 percent and 15.26 percent respectively. The housing sector's credit increased from Nu. 10.28 billion to Nu. 13.58 billion (31.99 percent) and credit to personal sector increased from Nu. 6.51 billion to Nu. 8.33 billion (27.91 percent) during the period under review. In the case of the sectoral growth during the period under review, the loan against share grew at 104.27 percent (from Nu. 0.25 billion to Nu. 0.52 billion) followed by agriculture/animal husbandry with 69.75 percent (from Nu. 0.66 billion to Nu. 1.12 billion).

Majority of credit are provided by the banks. Out of total credit, 88.57 percent (Nu. 45.44 billion) are provided by banks and remaining 11.43 percent (Nu. 5.86 billion) are credit provided by non-banks.

b) 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 deteriorated by 16.03 percent. As against the total loans of Nu. 51.31 billion within the financial sector, the NPL increased from Nu. 3.46 billion in June 2011 to Nu. 4.01 billion in June 2012. Although there is

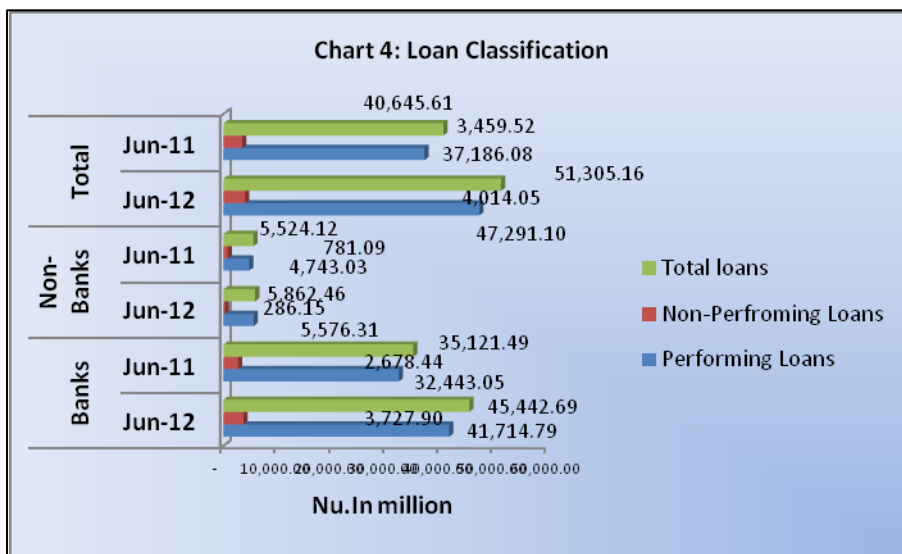


increase in the NPL for financial sector, the NPL to total loans and advances ratio decreased from 8.51 percent to 7.82 percent during the period under review. The decrease in the NPL to total loans and advances ratio is mainly due to increase in total loans and advances by 26.23 percent as against the deterioration in the NPL by 16.03 percent. Doubtful and loss assets comprised over 50 percent (22.30 percent doubtful and 35.84 percent loss) of the stock of NPLs indicating preponderance of sticky advances, and the remaining 41.86 percent comprised of substandard assets.

Meanwhile, the percentage of provision as a percentage of NPLs provided for impaired loans has decreased from 68.02 percent in June 2011 to 55.86 percent in June 2012. The decrease in the ratio is mainly due to the composition of 41.86 percent of impaired loans into the substandard assets as of June 2012 as against the composition of 35.77 percent of impaired loans into the substandard assets as of June 2011 (classification of NPL into the recent buckets of NPL categorization which requires minimal provision requirement).

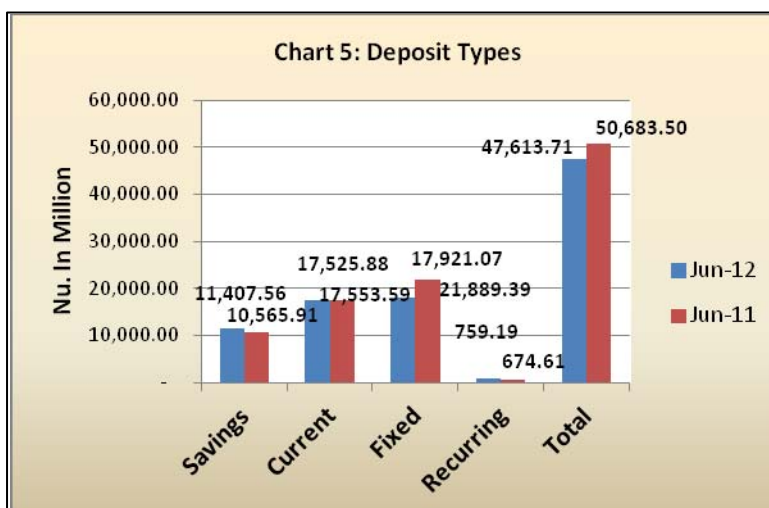
c) Consolidated Loan Classification of the FIs

Analysis on asset classification confirms that around 92.18 percent of total loans disbursed by the financial sector are performing loans. Out of the total loans of Nu. 45.44 billion of banks, 91.80 percent are performing and remaining 8.20 percent are non-performing. The NPL for banks increased by 39.18 percent, from Nu. 2.68 billion in June 2011 to Nu. 3.73 billion in June 2012. Similarly, 95.12 percent of the total loans and advances (Nu.5.86 billion) of the non banks are performing loans and the remaining 4.88 percent is non-performing loans. The NPL of non-banks has also decreased from Nu. .78 billion to Nu. .28 billion during the period during review.



d) Deposits

The total deposit base of the banking sector (including Bhutan Development Bank Ltd.) decreased by 6.06 percent, from Nu. 50.68 billion in June 2011 to Nu. 47.61 billion in June 2012. The decrease in the overall deposit base is mainly due to significant decrease in the time deposits (Fixed and Recurring) by 17.21 percent, from Nu. 22.56 billion to Nu. 18.68 billion during the period under review. However, the share



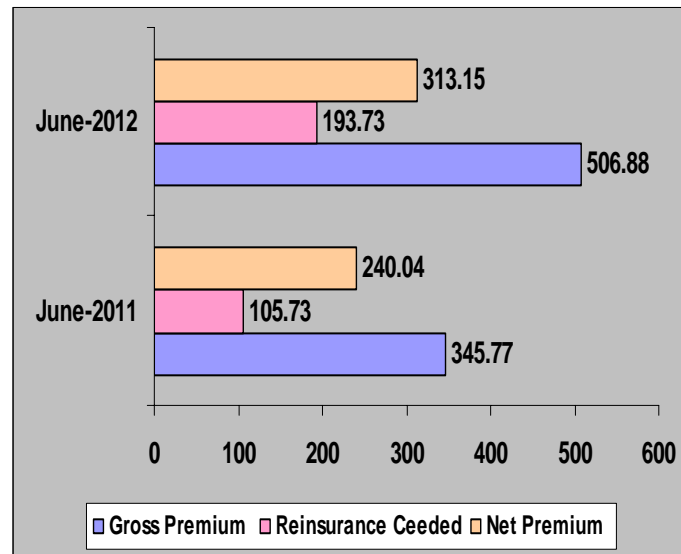
of CASA product (Current and Saving) grew slightly by Nu. 2.89 percent (from Nu. 28.12 billion to Nu. 28.93 billion). In terms of customer holdings, corporate deposits accounts for 53.20 percent (Nu. 25.33 billion) of the total deposits and remaining 46.80 percent (Nu. 22.28 billion) constitutes retail 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 60.77 percent and time deposits (fixed and recurring) comprised of 39.23 percent.

4. Insurance

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 provides not only insurance services but it also give out retail loans and advances.

1. **General Business (Non-life):** During the period June'11-June 2012,

Bhutanese insurance industry experienced serious events such as earthquakes and heavy machineries claims. Despite these events, General Business registered a significant growth of 46.60 percent in Gross direct premium written during the second quarter of 2012. Gross written premium as of June 2012 was Nu.506.88 million with 24,868 policy holders as against Nu.345.77 million with 14,397 policy holders a year ago . However, of about 35.12 percent has been ceded to reinsurance companies.



2. **Life Insurance:** No. of life policy holders increased by almost 90 percent to 17,441 in June 2012. Consequently, Gross direct Premium written for life business has grown to Nu.321.16 million in June 2012 from Nu.227.03 million in June 2011.

5. Royal Securities Exchange of Bhutan Limited (RSEBL)

The Royal Securities Exchange of Bhutan Ltd (RSEBL) was established in 1993 by the Royal Government of Bhutan (RGOB) under the Technical Assistance from the Asian Development Bank as non-profit making organization. It was incorporated under the Companies Act of the Kingdom of Bhutan and regulated by both the Financial Institutions Act and the Companies Act. The Exchange is owned by Four Brokerage Firms (BOB Securities Ltd., BNB Securities Ltd., Drook Securities and RICB Securities Ltd.)

There are 22 companies listed on the RSEBL, out of which 2 companies have been de-listed. During the period as of 30th June 2012 the market capitalization of 20 listed companies has increased significantly by 30.21 percent to Nu. 15.17 billion from Nu.11.65 billion as compared to 2011.

State Trading Corporation of Bhutan Limited (STCBL) issued 300,004 bonus shares at Nu.100 per share increasing the paid-up capital of STCBL to Nu. 90,000,700 on 18th April 2012 from Nu.60, 000,300. Druk PN Bank Ltd (DPNBL) made its rights issue of 1,500,000 shares at Nu.100 per share increasing the total paid-up capital of DPNBL from Nu.300 million to Nu.434.52 million on 17th April 2012.

The transaction in the secondary market has decreased significantly by 203,215 shares as of 30th June 2012 when compared to 30th June 2011. A total of 80,604 shares of ten companies have been traded in the secondary market amounting to Nu.29.49 million as of 30th June, 2012 as compared to 283,819 shares worth Nu.104.64 million as of 30th June 2011.

During the period the Central Depository of the RSEBL facilitated the coupon payment of Druk Air Corporate bonds worth Nu.66.34 million. According to the record of the Central Depository as the share registry the number of shareholders has decreased to 47,938 as of 30th June 2012 from 48,496 as of 30th June 2011.

During the first two quarters of 2012, the RMA on behalf of the RGOB through the exchange, issued series of treasury bills: 90 days Treasury Bills amounting to Nu. 800.00 million at the discount rate of 5% per annum. 30 days Treasury Bills worth Nu.1 billion at discount rate of 3% per annum. 14 days Treasury Bills worth Nu.1.8 billion at the discount rate of 5% per annum and 30 days Treasury Bills worth Nu. 800 million at the discount rate of 5% per annum.

One major activity during the period was the installation of Integrated Systems at RSEBL. On 23rd April 2012 RSEBL, moved its securities market to a new and enhanced trading system.

6. Pension Fund

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.4, 520.87 million to Nu.5, 585.45 million indicating a growth of 23.54% from the previous year.

The increase is mainly due to the following reasons:

Increased in pension fund by Nu.1064.58 million during the year

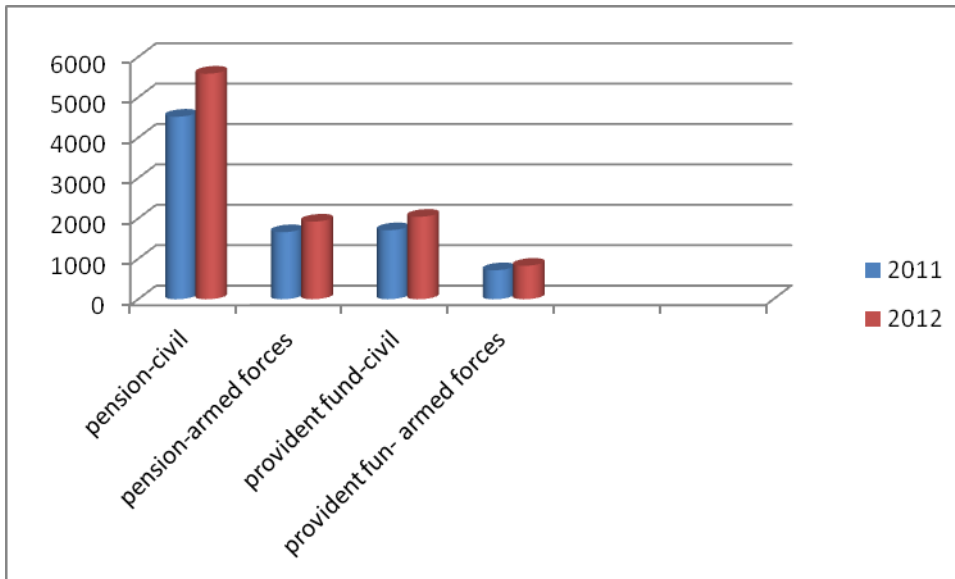
Increase in civil service employees

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. 1,659.36 million to Nu.1,922.94 million indicating a growth of 15.88% from the previous year.

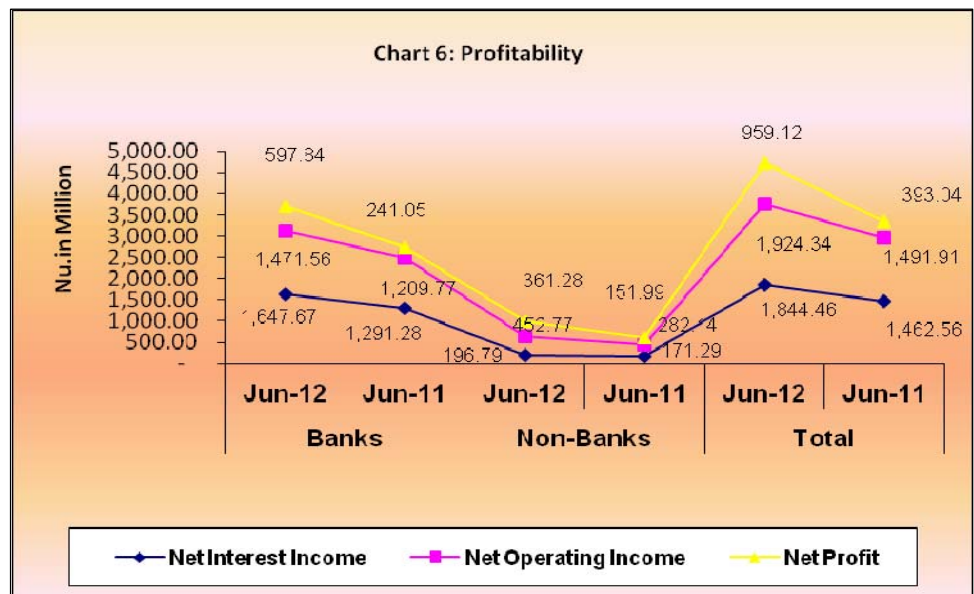
The NPPF has made a total payment of Nu.10.54 million to 3094 beneficiaries which comprised of 1,317 normal pensioners, 458 early pensioners, and 6 disabled, 292 surviving spouse, 986 surviving children, 31 orphans and 4 dependent parents during the period under review.

Provident Fund provides the benefits in lump – sum to the retirees on superannuation and to the nominees in case of their death. The total Provident Fund of the Civil has increased from Nu.1708.62 million to Nu. 2041.14 million and Armed Forces from Nu.717.09 million to Nu.827.47 million during the period under review.



7. Profitability

During the quarter under review, the financial institutions incurred a profit of Nu. 0.95 billion as compared to the profit of Nu. 0.39 billion in June 2011, indicating a growth of 144.03 percent. The profit after tax of both banks and non-banks grew by 148.01 percent



and 137.70 percent respectively. The profit after tax of banks increased from Nu. 0.24 billion to Nu. 0.60 billion and the profit for non-banks increased from Nu. 0.15 billion to Nu. 0.36 billion during the period under review. The net interest income of banks increased by 27.60 percent (by Nu. 0.36 billion) and net operating income for banks increased from Nu. 1.21 billion in June 2011 to Nu. 1.47 billion (by 21.64 percent) in June 2012. Similarly the net interest income of non-banks increased by 14.89 percent (by Nu. 0.02 billion).

8. Liquidity

On the liquidity front, the financial sector has an excess of Nu.4.52 billion in June 2012 as against a shortfall of Nu. 0.91 billion in June 2011. The statutory liquidity requirement of the banks stood at 27.48 percent (7.48 percent above the regulatory requirement of 20 percent) in June 2012 as compared to 17.99 percent in June, 2011. The increase is due to increase in the quick assets of the banks by 42.58 percent (from Nu. 10.13 billion to Nu. 14.44 billion). Similarly, the non-banks' SLR

position stood at 19.07 percent, 9.07 percent above the minimum prudential requirement of 10 percent as compared to 13.91 percent in June 2011. The quick assets of non-banks has increased by 59.43 percent (from Nu. 0.78 billion to Nu. 1.25 billion).

