NCC Bank

नेपाल क्रेडिट एण्ड कमर्स बैंक लि.

Nepal Credit & Commerce Bank Ltd.

Your Business Bank

CREDIT R!SK MANAGEMENT POLICY

2019

Nepal Credit & Commerce Bank Ltd.

Bagbazar, Kathmandu

NCC Bank
नेपाल क्रेडिट एण्ड कमर्स बैंक लि.
Nepal Credit & Commerce Bank Ltd.
Your Business Bank

The Board Meeting No. 733rd

held on 2075.11.02 (14th February, 2019)

has decided to approve, the

"Credit Risk Management Policy - 2019"

Kapil Gnawali
Company secretary
2075-11-02

Approval Sheet

Particulars	Name and Designation	Signature	Date
Prepared By	Saroj Bhandari Operation, Market and Liquidity Risk Management Department		
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Credit Risk Management Policy, 2019

1. Introduction

Credit Risk is the potentiality that a borrower or counterparty fails to meet its obligations in accordance with agreed terms willingly or unwillingly. Failure to meet obligation includes non-repayment of principal and/or interest within the agreed time frame, at the agreed rate of interest. Credit risk is the major risk that banks are exposed during the normal course of lending and credit underwriting. It results to financial losses to the bank and may ultimately lead to failure of the bank. So banks put highest priority in managing credit risk through development of robust systems and thorough internal control mechanisms.

Credit Risk Management intends to maximize bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. The effective management of credit risk is a critical component of comprehensive approach to risk management and essential to long-term success of any banking organization. Sound credit risk management involves prudently managed risk/reward relationship and controlling and minimizing credit risks across a variety of dimensions, such as quality, concentration, currency, maturity, security and type of credit facility. Bank shall manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Bank shall also consider the relationships between credit risk and other risks for effective risk management.

This Policy has been prepared in line with the Risk Management Guidelines, 2018 of the Nepal Rastra Bank. The document has outlined the Bank's initiative towards management of credit risk so that objective of the bank can be achieved optimally. It shall be the duty of all the staff members of the Bank to make themselves acquainted with the provisions incorporated in this policy and other policies referred herein.

2. Objectives

This policy has been formulated for guiding the bank to identify, access, measure, monitor, control and mitigate the credit risk. Followings are the objectives behind formulation of this policy:

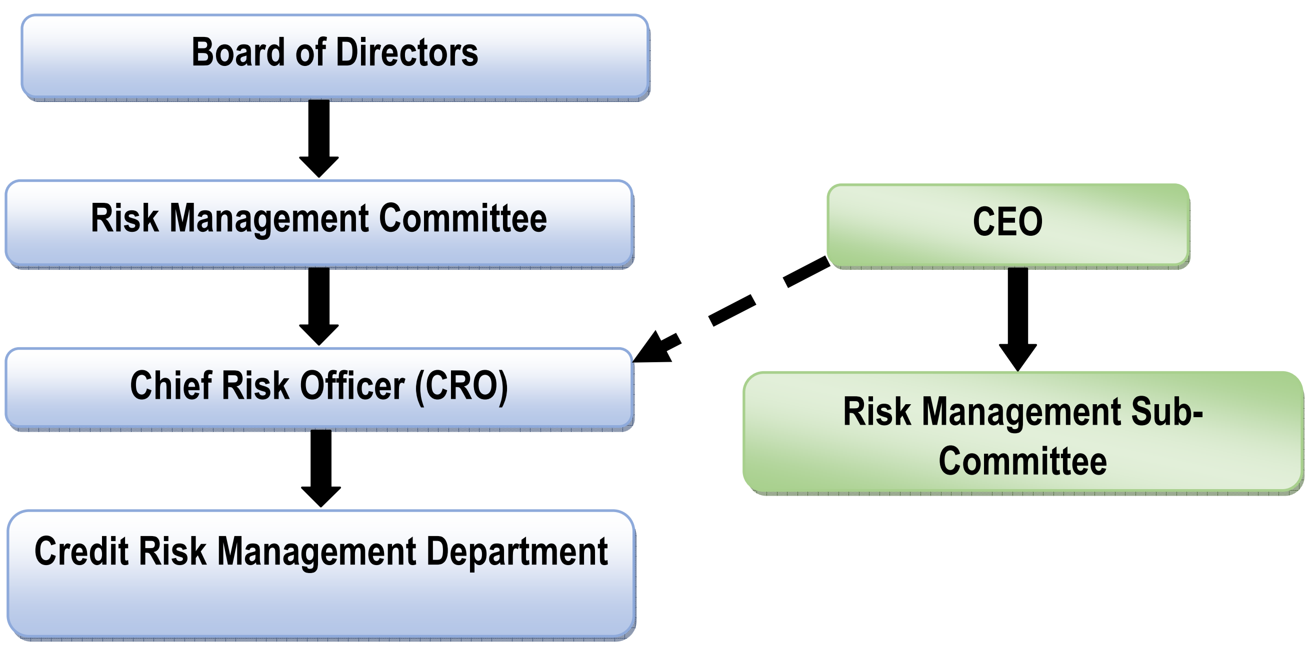
- To lay down a framework for achieving robust credit risk management procedure in alignment with regulatory requirements, best practices and the Bank's overall risk management policy;
- To ensure that the Bank has adequate systems to identify, measure, monitor and control credit risk;

- To ensure adequate, prioritized and focused attention from the board and senior management level on significant credit risk exposures and measures of mitigations
- To establish an appropriate reporting and monitoring tools with regard to the credit risk management;
- To ensure that a sound and uniform risk management culture is established throughout the bank.

3. Credit Risk Management Structure and Framework

Board level Risk Management Committee (RMC) of the Bank shall oversee the issues of credit risk and credit risk management practices in the Bank. There shall be a Risk Management Sub-Committee (RMSC) in management level for the overall monitoring and controlling of the credit risk. Further, bank shall have a separate Credit Risk Management Department to look the issues and monitor the credit risk. The department put continuous efforts and vision for the identification, assessment, measuring, monitoring and controlling the credit risk. It collects the issues from concerned business line and uses it for the overall development of credit risk management practice in the bank. The department ensures the effective implementation of policies and strategies related with the credit risk. The department will report to the Chief Risk Officer and shall present the credit risk issue in Risk Management Sub-Committee and Board level Risk Management Committee.

The credit risk management structure of the Bank shall be as follows:



Every staff of the bank shall takes the responsibility of controlling risk or losses while performing their duties. Bank implement the systems and procedures with the adequate risk mitigating and controlling techniques.

4. Roles and Responsibilities

Roles and responsibilities of all concerned shall be to understand in identifying, assessing, monitoring, measuring and controlling credit risks. Bank shall assigned the following responsibilities, but not limited, to following functions:

4.1 Board of Directors

Board of Directors shall be primarily responsible for ensuring in place an effective credit risk management policy at the Bank. Board of Directors is also responsible to advise and approve appropriate credit risk management strategy, define Bank's overall tolerance in relation to credit risk and overseeing the implementation status for proper functioning of the policy. Board of Directors shall ensure that bank's significant credit risk exposure is maintained at prudent levels and is consistent with future capital requirement of the bank. The Board also reviews the trends in portfolio quality and the adequacy of Bank's provision for credit losses. Board shall also review/approve/ratify the exposures exceeding the level of the authority delegated to management in periodic basis.

4.2 Risk Management Committee

Risk management committee shall be responsible to review the credit risk profile of the bank, understand the future challenges and threats and concur on areas of highest priority and related mitigation strategy. Committee shall recommend the Board for the formulation of policies and strategies in line with the provision of regulator, internal limit and appropriate practices for credit risk management. Committee shall also review the credit risk appetite, adequacy of resources being assigned to mitigate risks, result of stress testing, reinforce culture and awareness of credit risk management throughout the bank and recommend suitable control/mitigating strategy for management. The committee periodically updates the status of risks to the Board.

4.3 CEO and Senior Level Management

CEO and senior level management is primarily responsible for implementing the credit risk management policy and strategy approved by board and formulate appropriate procedures, guidelines, framework for the management of credit risk. CEO and Senior Management shall ensure that Bank has a strong control environment, formulated policies, process, system, internal control, risk mitigating strategy are in effective implementations and the staff members of the bank are well versed with banks credit risk management policy and strategies.

4.4 Risk Management Sub Committee

Risk Management Sub Committee shall ensure the implementation of the credit risk management policy and framework at working level. The committee shall ensure that the bank's activities are conducted professionally. The Committee shall check, review and ensure that the necessary resources are available to manage credit risk. Committee also ensure the adequacy and effectiveness of risk management process in the Bank. The sub-committee shall review the credit report submitted by department and give necessary instruction for management and mitigation of identified credit risk.

4.5 Chief Risk Officer (CRO)

Chief Risk Officer (CRO) shall be responsible for overall monitoring of the credit risk activities of the Bank. CRO shall support the CEO, Risk Management Committee and Board for implementation, review and approval of risk governance framework of the Bank. CRO shall ensure the establishment of early warning or trigger system for breaches of the bank's risk and risk appetite or limits of various sectors. CRO monitor the credit risk-taking activities and credit risk exposures are in line with the board-approved risk appetite, risk limit and capital planning. CRO shall report to the Risk Management Committee and shall update to CEO on credit risk profile of the bank and all credit risk-mitigating activities of the Bank.

4.6 Credit Risk Management Department (CRMD)

Bank has an independent Credit Risk Management Department (CRMD) which is independent from risk taking unit. Primary responsibility of the Credit Risk Management Department is to disseminate and implement the credit risk management policies, strategy, procedures, guidelines and framework in the bank. Followings are the major responsibilities of the CRMD:

- Disseminate and implement the credit risk management policies, strategy, procedures, guidelines and framework of the bank.
- Report all issues and status of the credit risk profile of the bank to the CRO and Risk Management Sub-Committee (RMSC).

- Identify, access, measure, monitor and report the credit risk.
- Review the credit issues ensuring that the Bank's credit portfolio remains healthy and any early warning signals in the credit portfolio is timely tracked and well managed.
- Review the existing system, procedures required changes/improvements of a particular business segment and recommend to the management for any improvements.
- Track/monitor the regulatory changes and macro/micro economic events which has potential to increase risk or risk profile
- Establish and prepare early warning or trigger signals for breaches of the Bank's risk appetite and tolerance limit,
- Prepare hot list / negative list / watch list (list having negative market information, negative account performance, suspicious activities and other information for which bank may not willing to provide the credit facility)
- Co-ordinate on the preparation of policy papers, product papers and timely review of these papers
- Review of the credit files, identify deviation and risk indicators, give constructive feedbacks, identify probable risk areas and suggest for mitigating such risk indicators.
- Review industry and portfolio on regular basis and recommend concerned authority for the diversification / narrow down the exposure on certain portfolio.

4.7 Executives / Departments / Branches

Executives / Departments and Branches are responsible to ensure the implementation of risk parameters and principles as per the product, policies and procedures. Executives / Departments and Branches shall report the issues and incidents to the risk management department. Executives / Departments and Branches shall maintain zero level of non-compliance and ensure the prudent / ethical banking on the day to day functionality maintaining the well practice of risk culture and risk understanding.

5. Credit Granting Process

Bank shall have well defined credit granting process. There shall be different functional department for initiating the credit proposal to final disbursement. Following process shall effectively implemented while granting the credit proposal

5.1 Credit File Assessment

Credit file assessment shall be done by the employee at first line of defense. Respective relationship officer / manager shall primarily access the credit file according to the procedures, methodology and guidelines depicted in Bank's credit policy guidelines, product paper and other governing document. He/she shall collect all the information and document relevant and required for credit file assessment. There shall be the practice of collecting information/document from customer according to the risk profile of the customer and mentioning the relevant information in credit proposal document (CAM).

5.2 Credit Review

Basically, the first risk officer of the bank is the initiator of the file in the credit line, who is the first person to take up risk assets. Branch manager at branch level to head of department at corporate level shall review the credit file and ensure that all information/document has been collected by staff responsible for credit assessment, all required and relevant information has been mentioned in the CAM, properly access the risk profile of the customer with proper scoring model, propose the necessary amount of credit facility applying risk based pricing model. There shall be independent Credit Risk Management Department to review the credit file forwarded by branches / department. The department shall review and analyze the credit proposal minutely, identify the possible credit risk indicator and suggest to mitigate/manage such credit risk indicator before implementing the credit proposal. The department shall have authority to decline the credit file incase identified credit risk is beyond acceptable level or may forward for further decision indicating the risk observations.

5.3 Credit Approval

There shall be the defined delegated credit approval authority. Board shall delegate the credit approving authority to CEO and CEO may further delegate the assigned authority down the line. The approving authority shall review the initial assessment, reviewer comments/remarks before approving the credit proposal. He/she can also provide condition to be fulfilled within specified time while approving the credit proposal. The ultimate responsibility lies within the approving authority to ensure that credit proposals are adequately assessed and reviewed by concerned authority and the risk profile of the proposal is within the risk appetite and risk tolerance level of the Bank.

5.4 Credit Disbursement

There shall be the separate department for limit insertion of the approved credit proposal. Further, respective branches or departments shall disburse the loan to the borrower in individual case basis. Before limit inserting and disbursing the credit facility to the borrower, the department shall ensure that all terms and conditions mentioned in the credit proposal are addressed. Responsible staff for limit insertion and disbursement shall instruct the respective RO/RM to comply/address all the terms and condition mentioned by reviewing and approving authority. The department shall keep the record of all pending approval terms and condition and follow up with the initiator of the credit proposal whether all are addressed in specified time.

5.5 Credit Administration

Bank shall have effective credit administration function for maintaining the safety and soundness credit activities in the Bank. At branch/department level, respective BM/RO/RM shall responsible for maintaining credit files and ensuring they are kept up to date and follow-up on necessary actions such as renewal notices, updating information, insurance renew, site visit etc. The procedures for credit file maintenance and administration shall be as depicted in the Credit Administration Manual.

6. Internal Credit Risk Rating

Bank shall have Internal Credit Risk Rating System. The system shall be applied to measure the degree of credit risk in the different credit exposure. This system shall be designed to get accurate determination of the overall characteristics of the credit portfolio, concentrations, problem credits and the adequacy of loan loss provisions. Consistency and accuracy of the credit risk rating system shall be examined periodically by the credit risk management department. All credit approving channel shall review and access the risk rating score independently and prudently. The system shall have at least following parameters:

- Covers a broad range of the bank's credit exposure, including off-balance sheet exposures;
- Covers both performing and non-performing assets;

- Several grades covering exposures, with the lowest rating accorded to those where losses are expected;
- There shall be several grades for performing loan on the basis of its merit and according to the nature of underlying security.
- Regulatory classifications (performing, watch list, restructured & rescheduled, substandard, doubtful & bad) should be incorporated within the risk rating systems;
- The internal credit risk rating system is subject to review periodically.

7. Credit Risk Categorization

Bank shall primarily use the Basel III norms to categorize the credit risk for risk assessment. Credit risk on individual basis as well as group basis shall be segregated on micro level. The category of credit risk as per Basel III norms are as below:

- Claims on Government & Central Bank
- Claims on Other Officials Entities
- Claims on Banks
- Claims on Corporate & Securities Firms
- Claims on Regulatory Retail Portfolios
- Claims secured by Residential Properties
- Claims secured by Commercial Real Estate
- Past due claims
- High risk claims
- Other assets
- Off Balance Sheet items

8. Credit Concentration

Bank shall reviews the credit concentration on periodical basis under regulatory requirements as well as under Risk Appetite and Tolerance Limit of the Bank. Any deviation found or risk identified shall be adjusted on the economic capital calculation. Credit concentration risk assessed shall be on the following way:

- Single Obligor Limit, Group Exposure
- Deprived sector exposure

- Productive sector exposure
- Real Estate, Margin Lending, Personal Lending
- Client Concentration
- Product Concentration
- Sector Concentration
- Geographical Regions and many more as deemed necessary

9. Estimating Credit Losses

Periodical credit loss assessment shall be done based upon the prevailing credit portfolios and credit performance. This enables the management and board to assess and put proactive measures on controlling credit losses. Bank shall develop separate mechanism for determining the credit losses in different categories. Bank shall use following tools for credit loss estimation.

i. **Probability of Default (PD)**: The likelihood that the borrower fails to make full and timely repayment of its financial obligations. PD shall be derived based on our experience on the various sectors that the credit is exposed, In case bank identifies any early warning signals through PD, bank shall take remedial actions before becoming chronic default problem. Regular observation of concentration level of portfolio in specific sector shall be made to better assess exposure risk in those sector.

ii. **Exposure at Default (EAD)**: The expected value of the loan at the time of default. Default value can be used on provisioning and managing credit. It makes the bank to measure the risk of losses on credit.

iii. **Loss Given Default (LGD)**: The amount of the loss in the event of default, expressed as a percentage of the exposure at default (EAD). It is the value of losses out of default portfolio. The LGD is based on the difference between the contractual cash flows dues and those that the lender would expect to receive, including from the realization of any security, underlying the credit. Since LGD largely depend on the macro economic factors, the same needs to be revisited in fixed time intervals.

iv. **Recovery Rate (RR):** The proportion of the EAD the bank recovers. It gives the value and ratio of exposures that the default loan can be recovered on the business course.

10. Credit Risk Events

Bank shall identify and access various credit risk events on credit administration and management. Same shall be recorded and analyzed to identify the probable risk. Credit risk events shall be identified through analyzing financial and other information, pre-approval assessment, post approval assessment, risk appetite and tolerance measurement and many more. Bank shall have practice of collecting risk events and assess the credit risk through risk department, risk committee and board.

11. Consideration on Credit Proposal

Bank shall have well defined Credit Appraisal Memo (CAM) for each type of loan product. The information to be included in such CAM shall be provided in the format of CAM. However, at least following information shall be considered in the credit proposal:

- Purpose of credit and source of repayment
- Risk profile of the customer using internal credit risk rating system
- Analysis of borrower's repayment history, current and future repayment capacity, historical financial trends, future cash flow projection, account performance and relationship
- Borrower's business background, business expertise, condition of the borrower's economic sector and its position within the sector
- Net worth of borrower and the personal guarantors
- The proposed terms, conditions, covenants of the agreement and justification for the proposal
- Collateral and sensitivity to economic and market developments
- Adequacy, enforceability and liquidity status of collateral and practical aspects of their mobilization.
- Other relevant information as required by Credit Policy Guidelines (CPG), Product Paper and NRB Directives.

12. Risk Assessment in Individual Credit Facility

Credit Risk Management Department shall review the individual credit file for the identification and assessment of the probable credit risk. Department shall not solely depend on information provided in CAM. Risk Officer / Manager shall review at least following copy of documents before recommending credit proposals:

- Document of Incorporation
- License Certificate

- Board minute / resolution / decision to avail loan from borrower
- Copy of latest share register book
- Summary copy of Initial Environmental Examination (IEE) / Environmental Impact Assessment (EIA) Report, as applicable
- Tax Clearance Certificate / Tax Paid Receipt
- Income Source Verification Certificate/Document
- Business / Collateral Inspection and Site Visit Report
- Net Working Capital Reports (Net Current Assets)
- Valuation Report
- CIC of borrower, guarantor and related party
- Legality of real estate security viz. Land ownership document, Four Boundary Certificate etc.
- Bank / Loan statement if applicable
- Repayment history as per CBS record.

13. Risk Measurement

Risk Management process include risk measurement of the identified risk associated with material products, activities, processes and systems. Bank shall follow the steps outlined below for measuring credit risk.

- Credit risk shall be measured according to the norms specified by Basel III. Such risk category shall be reviewed on regular basis.
- Internal Risk Rating System shall be used to measure the credit risk exposure of individual and total portfolios credit.

Branch Credit Risk Scoring Model

Bank shall develop and implement the Branch Credit Risk Scoring Model to identify the credit risk associated with branches through well-defined risk parameters, measure it through well-defined risk severity and weight, monitor it through continuous review, manage & control it through using various mitigating tools and report it to senior management. Credit Risk assessment of the branches shall be conducted on following broad category:

S. No	Score / Parameters	0	1	2	3	4	5
1	NPA %	0	=<0.5	< = 1.0	< = 1.5	< = 2	> 2
2	Interest overdue to Total Loan %	0	=<0.5	< = 1.0	< = 1.5	< = 2	>2
3	Past due Account to Total Account %	0	< = 7	< = 10	< = 13	< = 15	< 15
4	Expired Accounts to Total loan Account%	0	< = 2	< = 4	< = 7	< = 10	> 10
5	No of Insurance Expired	0					> 0
6	Drawing Power Expired/Business Inspection Due	0			< = 10		> 10
7	Margin Call A/c to Total Margin Loan Account %	0			< = 20		> 20
8	Revaluation Pending Account/ Revolving Account %	0	<=5	<=10	<=15	<=20	<20

The risk level of the individual branch shall be calculated using following formula:

Total Credit Risk = Total Risk Score / 8

According to the risk assessment and total calculated risk scores, branches will be categorized in to following category according to the following risk weighted exposures:

S.N.	Risk Weight Exposures	Risk Category
1	0	(Virtually) No Risk
2	Up to 1.0	Inherent Risk
3	1.0 to 2	Low Risk
4	2.0 to 3.5	Medium Risk
5	3.5 to 4.5	High Risk
6	Above 4.5	Very High Risk

At least in every quarter Credit Risk Management Department shall calculate the credit risk score and risk level of the each branch. The movement of risk score and risk level shall be analyzed and control measures shall be implemented to mitigate the identified risk areas.

The above stated risk measurement module and parameter used thereon shall be reviewed periodically and accordingly updated in the policy.

14. Risk Monitoring, Control and Mitigation

Bank shall have the appropriate monitoring and reporting mechanism in place at the Board, Senior Management and business line levels to support the proactive management of credit risk. Once credit risk is identified, assessed and measured, and the Bank decides to take the risks, these risks shall be controlled with a strong control environment through policies, processes, systems, internal controls, risk mitigations and / or transfer activities. Bank shall periodically review the risk limitation and control strategies and adjust the credit risk profiles accordingly using appropriate strategies, in light of the overall risk appetite and profile. Those risks that cannot be controlled, bank decides whether to accept these risks, reduce the level of business activity involved or withdraw from this activity completely.

Bank shall use following monitoring, control and mitigation tools to manage the credit risk:

14.1 Credit Culture and organizational structure

Bank shall have prudent risk culture along with well-defined credit values, beliefs, practices and management's attitudes. This will develop the lending environment and determine the lending behavior acceptable to the bank. Bank shall have the culture of regularly reviewing credit practices with bank's risk appetite and credit policy. Management shall place high importance on quality of credit. Bank shall have the culture of reward and penalty for the staff involved in credit process for their vigilance and negligence.

Bank shall have credit risk management function independent of the risk-taking unit. The unit shall have the power of challenge and escalate its concern to senior management, in relation to development of the credit risk management framework. There shall be segregation of duties regarding credit-related function. Bank shall have well defined organization structure for credit risk management.

14.2 Policies, Procedures, Strategies, Guidelines, Manuals, Framework and Product Paper

Bank shall have Credit Policy Guidelines (CPG) to regulate and guide the overall functioning related with the credit and credit risk handling. This will be the guiding document for credit assessment, judgment, selection and managing the credit proposals and approvals. This policy guidelines shall include the information and documentation needed to approve new loan, renew existing loan and/or change the terms and condition previously approved credits. For each type of loan facility, bank shall have separate Product Paper which clearly define the credit eligibility, estimating amount of credit, nature of credit, terms of credit, collateral required, maximum loan to value and many more credit terms.

Bank shall have a well-defined Risk Appetite and Tolerance Limit Policy which shall clearly define the maximum limit of credit exposure in particular individual, group, sector and product. This will be the guiding document for overall credit risk assessment of the bank. Further, bank shall have Internal Credit Risk Rating Policy which will be used to rating the credibility of the borrower. This will enable a Bank to comprehensive assessment of the true risk profile of the borrower or counterparty.

Bank shall have Credit Administration Manual which clearly define the credit working procedure and credit monitoring procedure, Credit Risk Management Guidelines which provide clear understanding of basic need of documents and information on credit management and Credit Scoring Module which is used to identify the credit risk exposure of the bank.

Credit officer/manager and all staff members of credit approving chain shall understand the provision of all credit related strategy, policy, procedures, guidelines, manual, framework, product paper. Credit officer/manager shall be familiar with the borrower/counterparty and be confident that they are dealing with an individual or organization of sound repute and creditworthiness.

14.3 Authority Delegation

Bank shall have well defined authorities for credit sanctioning, approvals and changes in credit terms. Board shall delegate such credit sanctioning authorities to CEO and CEO may further delegate the assigned authority down the line. The authority shall be delegated to the staff according to their experience, ability and personal character and thus shall not be merely given to a person in a particular post/role. The lending authority shall be determined according to the credit products, credit risk, credit nature, security and other regulatory differentiations. Centralized Credit Operation Department shall execute the lending only after ensuring whether credit approvals are received from due approving authority or not. Such delegated authority shall be reviewed periodically.

14.4 Credit Limits and Indicators

For the diversification of risks and limit concentration risk, bank shall establish credit limits covering on-balance sheet and off-balance sheet credit exposures for single counterparties and group of connected counterparties. Bank shall set the credit limits on exposure to specific activities or type of product, specific industries and/or economic sector, types of collateral, geographic regions etc. and all regulatory parameters set by NRB. The limit shall be determined based on the credit strength of the counterparty, genuine requirement of credit, economic condition, bank's risk appetite and capital fund position. The limit shall be periodically reviewed and updated. Bank shall consider the results of stress testing in the overall limit setting and monitoring process. Further, industry and portfolio review shall be done on regular basis and credit limits shall be updated accordingly.

14.5 Early Warning Signals (EWS) / Credit Quality Indicators (CQI)

Bank shall develop credit risk indicators for identifying the Early Warning Signals (EWS) or Credit Quality Indicators (CQI) of deteriorating credit quality. Bank shall list out the possible early warning signals, review it and prepare report on periodical basis. Financial position and business conditions, conduct of accounts, loan covenants and collateral valuation etc. shall be used as the basis of determining indicators for credit risk identification. Some of the credit risk indicators and early warning signals are summarized in **Annexure - 1**

14.6 Managing Problem Credit and Recovery Process

Bank shall develop Non-Performing Assets (NPA)-Non-Banking Assets (NBA) management, recovery and sales manuals for identifying and making remedial measures of the problematic credits. Such manual shall clearly define the proactive efforts, negotiation and follow-up, remedial actions, review collateral & security, reporting and selling procedures. Bank shall have effective process and procedures in place for the early implementation of remedial actions on deteriorating credits and management of problem loans. Problematic loan shall be managed under defined remedial process which may be done through specialized recovery unit. Bank shall have loan write-off policy which clearly define the condition, approving level, information to board and other process for loan write off.

14.7 Credit Administration

Bank shall have effective credit administration function for maintaining the safety and soundness of credit activities in the bank. Business function along with credit administration support team shall ensure that the credit is properly maintained. Credit Administration function shall ensure the completeness of document in accordance with approved terms and conditions before implementing the facility. Bank shall have separate Credit Administration Manual for defining the process of credit operation, documentation, disbursement and account maintenance, credit monitoring, review and reporting, renewal, repayment and settlements, custodian and file protection, compliance, securities release etc.

14.8 Exception Monitoring

Bank shall have exception monitoring system which is the key measures on identifying and controlling the credit risk. Business unit, departments, credit administrations and other controlling unit shall review the exception report on daily basis. Such exception shall be obtained from CBS, utility software or from other regular reporting. Exception reporting shall be reviewed for over-dues, expiry, insurance expiry, no limits, drawing power expiry, valuation dues, SOL exceeded, sector exceeded etc.

14.9 Stress Testing

Bank shall conduct the stress testing on regular basis to monitor the credit risk trend and indication. Stress testing is a tool to analyze what could potentially go wrong with individual credits and the overall credit portfolio if conditions/environment, in which borrowers operate, change significantly. Bank shall use credit shocks and other relevant scenario proactively to manage the credit risk. Report on credit shocks and stress testing shall be regularly reviewed by senior management. The result of stress testing shall be considered in the overall limit setting and monitoring process.

14.10 Management Information System

Bank shall have Management Information System Policy/Guidelines which clearly defines the scope and information that shall be reported and reviewed by the management. This will enables the board and all levels of management to fulfill their respective roles. The adequacy and scope of information shall be reviewed on a periodic basis at least annually by business line managers, risk management function, senior management and the board to ensure that it is sufficient to the complexity of the business.

14.11 Credit Provisioning Process

Bank shall have a policy for credit provisioning and loss methodology. Bank shall timely identify the troubled exposures and determine loss provisioning. Bank shall follow the parameters of NRB Directives for credit provisioning process. However, development in the current scenario shall also be considered while provisioning the credit facility. Bank shall also consider result of collective impairment test and individual impairment test for credit provisioning. For testing the individual impairment, bank shall develop and test various objective evidence such as significant adverse financial ratios, significant adverse future outlook, statutory indicators, default / delinquency in interest / principal, breach of contract, collateral management, economic or legal condition, probability of borrower bankruptcy or financial reorganization and many more. For testing collective impairment test bank shall develop the module to identify the Probability of Default (PD) and Loss Given Default (LGD) which is ultimately used to identify the collective impairment. Bank shall consider both NRB Directives and impairment test module to determine the credit provision and accordingly credit provisioning shall be done.

15. Credit Risk Management Model

The bank shall follow below mentioned three line of defense approach as a credit risk management model:

Line of Defense	Responsible Unit
First Line	Business / Functional units
Second Line	Compliance/ Risk Function
Third Line	Internal Audit

First Line: The first line of defense is the Bank's Business and Functional Units. This include front-line employees who are responsible for credit file preparation, conduct business site visit and deal with the customer. Employee at first line of defense have primary responsibility for all credit process and risk management. They are also responsible for implementing corrective actions to address process and control deficiencies.

Second Line: The second line of defense is the Bank's Compliance and Risk Functions that provide independent oversight of the risk management activities of the first line of defense. The responsibilities of second-line defense include reviewing risk reports and validating compliance according to the requirements of risk management framework. Second line of defense is responsible for establishing policy and process for risk management, provide guidance and coordination among all functions, liaison between third line of defense and first line of defense, oversight over risk areas and bank's objectives.

Third Line: The third line of defense is audit function of the Bank who is independent. The audit function regularly review the first and second line of defense activities and results, including the risk governance functions, to ensure that the risk management arrangements and structures of the Bank are appropriate and are discharging their roles and responsibilities completely and accurately. The results of reviews of these audit functions need to be effectively communicated to the management and board of directors in order to take appropriate action to maintain and enhance the risk management culture of the Bank.

16. Disclosure Requirement

Annual report of the bank shall make a full disclosure of approaches followed by the bank for identification, assessing, monitoring, measuring and controlling credit risks. Disclosure shall include methods applied by bank to determine credit risk, credit risk mitigating tools used, collateral and other credit enhancement practices, methods of determining credit quality of financial assets and other relevant information.

17. Implementation, Review and Updates

This Policy will be effective upon the approval of BoD. This Credit Risk Management Policy shall be reviewed at least annually. The review shall include identification of current risk exposure, emerging risk trends, control measurements and response to changes on organizational environment, business circumstances, legal conditions or technical environment.

<u>Annexure – 1</u>

Key Risk Indicators / Early Warning Signals for Credit Risk

A. Branch Activity Indicator

- Increasing numbers of expired insurance
- Increasing numbers of expired drawing powers or deficit drawing power
- Increasing numbers of business inspections due
- Increasing numbers of revaluations due
- Increasing portfolios on high risk grade as per internal credit risk rating
- Increasing NPAs
- Reporting of MIS is not on time and not complete
- Repeated errors on reporting
- Errors on loan recording on CBS like: interest mistake, penal calculation errors, schedule errors
- Increasing cases of loan accounts not having complete information
- Increasing number of account overdrawing and limit breach
- Increasing numbers of loan account having missing documents
- Increasing numbers of compliance failures
- Not adhering terms and conditions of approved loans
- Increasing numbers of unsatisfactory account turnover of revolving loan accounts
- Internal audit remarks on the credit related issues and many more…..

B. Client Behavior Indicator

- Customer not interested to come into bank's contact or not in contact for long time
- Decreasing sales and increasing receivables of the customer
- Increasing default frequency and default amount
- Analyzing the financial statements that revels the potential financial related problems
- Increasing poor liquidity, increasing financial leverage, lowering debt service coverage ratio and weaker profitability positions
- Deteriorating customer's cash position
- Sharp increment on customer's receivable position and increasing collection period
- Stale inventory, inappropriate inventory mix, stock report and inspection report mismatch
- Rapidly changing concentrations in fixed assets

- Diversion of short-term funds for long-term use.
- Building up of unproductive assets.
- Evidence of misuse of funds
- Changes in management, ownership, or key personnel
- Inability to meet commitments on schedule
- Fragmented operations
- Routing transactions to other banks
- Major breakdown in plant and machinery
- Delay in reacting to declining markets or economic conditions
- Any erosion in the value of securities / negligence noticed on the part of the borrower to keep securities in order
- Excessive growth that strains the capacity of the owner to manage and control
- Labor problems in business of the borrower
- Change in the nature of the company's business
- Loss of key product lines, franchises, distribution rights, or supply sources
- Loss of any major and financially sound customers
- Transfer of assets to other companies or individuals
- Frequent turnover of internal accountant, bookkeeper, or Chief Financial Officer
- Sudden death / illness of partner / director.
- Disputes among partners / directors.
- Frequent reconstitution of the firm/board.
- Heavy reliance on short-term debt
- Poor turnover in an account indicates that either sale proceeds are being routed through the other bank or have, in fact, been dropped.
- Frequent invocation of bank guarantees (BGs) and non-payment within a reasonable period and non-payment of Letter of Credit liabilities within a reasonable period.
- Excessive or unanticipated STL renewals
- Frequent returns of Bills for collection and many more…..

C. Market Indicator

- Frequent negative news of customer on newspaper and other public information
- Unfavorable changes in Government policies as regards imports, export, price mechanism, minimum wages etc.
- Recession effect in the industry and many more……

Board of Directors:

S.N.	Name	Position	Signature
1.	Mr. Upendra Keshari Neupane	Chairman	
2.	Mr. Iman Singh Lama	Director	
3.	Mr. Chandra Prasad Bastola	Director	
4.	Mr. Madhav Prasad Bhatta	Director	
5.	Mr. Krishna Shrestha	Director	
6.	Dr. Kailash Patendra Amatya	Director	