Best Finance Company Limited

Basel II Disclosure (1st Quarter of FY 2083-84)

As per Capital Adequacy Framework 2007 (Updated 2008)

A. Tier 1 capital and a breakdown of its component

(Figures in 000)

SN	Particular	Current Period (Quarter)	Previous Period (Quarter)
	Core Capital (Tier 1) (a+b+c+d+e+f)	**726,599**	**708,402**
a	Paid up Equity Share Capital	890,424	890,424
b	Share Premium	14,948	14,948
c	Statutory General Reserves	259,277	254,991
d	Retained Earnings	(463,111)	(525,369)
e	Un-audited current year cumulative profit/(loss)	21,432	69,779
f	Capital Adjustment Reserve	3,629	3,629
g	Less: Investment in equity of institutions in excess of limits	-	-
h	Less: Other Deduction	-	-

B. Tier 1 capital and a breakdown of its component

(Figures in 000)

SN	Particular	Current Period (Quarter)	Previous Period (Quarter)
	Supplementary Capital (Tier 2) (a+b+c)	**132,519**	**94,271**
a.	General loan loss provision	65,955	54,705
b.	Other Reserves	-	-
c.	Accrued Interest Receivable on pass loan included in Regulatory Reserve	13,561	6,891
d.	Interest Capitalized Reserve included in Regulatory Reserve	2,888	2,538
e.	Regulatory reserve for nonbanking assets recorded within the last 24 months.	50,115	30,137

C. Detailed information about the Subordinated Term Debts with information on the outstanding amount, maturity, amount raised during the year and amount eligible to be reckoned as capital funds.

There are no Subordinated Term Debts Issued by Finance.

D. Deductions from Capital

There are not any deductions from Capital.

E. Total Qualifying Capital

(Figure in 000)

SN	Particular	Current Period (Quarter)	Previous Period (Quarter)
a	Tier 1 Capital as per A	726,599	708,402
b	Tier 2 Capital as per B	132,519	94,271
	Total Qualifying Capital (a+b)	**859,118**	**802,673**

F. Capital Adequacy Ratio

(In %)

SN	Particular	Current Period (Quarter)	Previous Period (Quarter)
a.	Tier 1 Capital to Total Risk Weighted Exposures (After Bank's adjustments of Pillar II)	13.73%	13.73%
b.	Tier 1 and Tier 2 Capital to Total Risk Weighted Exposures (After Bank's adjustments of Pillar II)	16.23%	15.56%

G. Risk Weighted Exposures for Credit Risk, Market Risk and Operational Risk

(Figure in 000)

SN	Risk Weighted Exposure	Current Period (Quarter)	Previous Period (Quarter)
a	Risk Weighted Exposure for Credit Risk	4,879,146	4,713,123
b	Risk Weighted Exposure for Operational Risk	264,063	284,651
c	Risk Weighted Exposure for Market Risk		
d	**Total Risk Weighted Exposures (Before adjustments of Pillar II) (a+b+c).**	**5,143,209**	**4,997,774**
	Adjustments under Pillar II		
SRP 6.4a (7)	Add RWE equivalent to reciprocal of capital charge of 3 % of gross income.	46,708	62,247
SRP 6.4a (9)	Overall risk management policies and procedures are not satisfactory. Add 4% of RWE	102,864	99,955
SRP 6.4a (10)	Desired level of disclosure requirement has not been achieved. Add 1% of RWE		
e	**Total Adjustments under pillar II (SRP 6.4a(7)+SRP 6.4a (9)+SRP 6.4a (10))**	**149,572**	**162,202**

Total Risk Weighted Exposures (After Bank's adjustments of Pillar II) (d+e)	**5,292,781**	**5,159,976**

H. Risk Weighted Exposures under each of 18 categories of Credit Risk

(Figure in 000)

SN	Particular	Current Period (Quarter)	Previous Period (Quarter)
a.	Claims on Govt. and Central Bank		
b.	Claims on other Financial Entities		
c.	Claims on Banks	43,839	27,195
d.	Claims on Corporate and Securities Firm	566,345	553,511
e.	Claims on Regulatory Retail Portfolio	1,077,017	1,109,044
f.	Claims secured by Residential Properties	704,911	669,215
g.	Claims secured by Commercial Real Estate		
h.	Past due Claims	419,165	348,633
i.	High Risk Claims	1,033,292	936,579
j.	Other Assets	972,649	1,013,839
k.	Off balance sheet items	61,930	55,107
	Total	**4,879,146**	**4,713,123**

I. Total Risk Weight Exposure Calculation Table (Relevant items only) For current period (Quarter)

(Figure in 000)

A. Balance Sheet Exposures	Book Value	Specific Provision	Eligible CRM	Net Value	Risk Weight	Risk Weighted Exposures
	A	B	C	d=a-b-c	e	f=d*e
Cash Balance	31,610			31,610	0%	-
Balance with Nepal Rastra Bank	500,687			500,687	0%	-
Investment in Nepalese Government Securities	315,000			315,000	0%	-
All Claims on Government of Nepal	4,015			4,015	0%	-
Investment in Nepal Rastra Bank securities	300,000			300,000	0%	-
All claims on Nepal Rastra Bank	1,200,000			1,200,000	0%	-
Claims on domestic banks that meet capital adequacy requirements	219,193			219,193	20%	43,839
Claims on domestic banks that do not meet capital adequacy requirements				-	100%	-
Claims on Domestic Corporates (Unrated)	566,345			566,345	100%	566,345
Regulatory Retail Portfolio (Not Overdue)	1,332,504		20,598	1,311,906	75%	983,930
Claims fulfilling all criterion of regularity retail except granularity	127,737		34,650	93,087	100%	93,087
Claims secured by residential properties	956,792			956,792	60%	574,075
Claims secured by residential properties (Overdue)	170,861	40,025		130,836	100%	130,836
Past due claims (except for claims secured by residential properties)	509,590	230,147		279,443	150%	419,165
High Risk claims	688,861			688,861	150%	1,033,292
Lending Against Shares	117,162			117,162	100%	117,162
Personal Hire purchase/Personal Auto Loans	148,767			148,767	100%	148,767
Investments in equity and other capital instruments of institutions listed in stock exchange	64,149			64,149	100%	64,149
Investments in equity and other capital instruments of institutions not listed in the stock exchange	4,316			4,316	150%	6,474

Staff Loan secured by residential properties	16,555			16,555	50%	8,278
Interest Receivable/claim on government securities	8,979			8,979	0%	-
Loans not exceeding Rs. 30 million to SME's that fulfill the criteria				-	60%	-
Other Assets	627,819			627,819	100%	627,819
TOTAL (A)	**7,910,942**	**270,172**	**55,248**	**7,585,522**		**4,817,216**
B. Off Balance Sheet Exposures	**Book Value**	**Specific Provision**	**Eligible CRM**	**Net Value**	**Risk Weight**	**Risk Weighted Exposures**
	A	B	c	d=a-b-c	E	f=d*e
Bid Bond, Performance Bond and Counter guarantee domestic counterparty	3,188			3,188	40%	1,275
Irrevocable Credit commitments (short term)	203,340			203,340	20%	40,668
Other Contingent Liabilities	19,987			19,987	100%	19,987
TOTAL (B)	**226,515**			**226,515**		**61,930**
Total RWE for credit Risk Before Adjustment (A)+(B)	**8,137,457**	**270,172**	**55,248**	**7,812,037**		**4,879,146**
Adjustments under Pillar II						
Answer the question SRP 6.4a (3) in SRP sheet						
Answer the question SRP 6.4a (4) in SRP sheet						
Total RWE for Credit Risk after Bank's adjustments under Pillar II	**8,137,457**	**270,172**	**55,248**	**7,812,037**		**4,879,146**

J. Amount of NPA's (Both Gross and Net)

(Figure in 000)

S. N	Loan Classification	Current Period (Quarter)		Previous Period (Quarter)	
		Gross NPA	Net NPA	Gross NPA	Net NPA
a	Restructure/Reschedule Loan	-	-	-	-
b	Substandard Loan	141,738	106,345	174,483	129,709
c	Doubtful Loan	92,001	46,923	80,583	40,833
d	Loss Loan	196,046	6,344	222,217	6,695

6,344

K. NPA Ratios

(in %)

S. N		Current Period (Quarter)	Previous Period (Quarter)
a	Gross NPA to Gross Advances	9.30%	10.70%
b	Net NPA to Total Loan & Advances	3.45%	3.97%

L. Movement of Non-Performing Assets

(Figure in 000)

S. N	Loan Classification	Previous Period (Quarter)	Movement in – or + (Net)	Current Period (Quarter)
a	Restructure/Reschedule Loan	-	-	-
b	Substandard Loan	174,483	(32,745)	141,738
c	Doubtful Loan	80,583	11,418	92,001
D	Loss Loan	222,217	(26,171)	196,046

M. Write off of Loan and Interest Suspense

There is no loan written off in current period.

N. Movement in Loan Loss Provision and Interest Suspense

(Figure in 000)

S. N	Loan Classification	Previous Period (Quarter)	Movement in - or + (Net)	Current Period (Quarter)
a	Loan Loss Provision*(NRB Adj)	354,752	(18,624)	336,128
b	Interest Suspense	78,182	8,604	86,786

O. Segregation of investment portfolio into Held for trading, Held to maturity and Available for sale category

(Figure in 000)

SN	Investment Category	Current Period (Quarter)	Previous Period (Quarter)
a	Held for Trading	-	-
b	Held to Maturity	1,185,000	1,965,000
c	Available for sale*	68,465	65,965

**** At cost***

P. Summary of the finance's internal approach to assess the adequacy of its capital to support current and future activities, if applicable:

Best Finance Company Limited adopts healthy risk management framework. The company follows Internal Capital Adequacy Assessment Process (ICAAP) and Risk Management Guideline while taking decision on any business. It has always taken note of ICAAP and has taken steps accordingly in ensuring soundness of capital position and sustainability of the business. The company policies and procedures are approved by the Board of Directors and these documents provide guidance on independent identification, measurement and management of risks across various businesses.

Finance's different committees like Audit Committee, Risk Management Committee review the business and risks periodically and take account of stress test results, scenario analysis so as to align risk, return and capital in sustainable manner.

Basel II disclosures have been complied with, addressing the risks and adopting measures to minimize their impact. Increasing complexities in risks, vulnerabilities of businesses and fast changing world with intense competition pose a threat to sustainability. In order to address the varieties of risk that keeps coming out of business operations, company has identified different risks and adopted different measures to minimize them.

Capital planning is an integral part of the finance's medium-term strategic planning and annual budget formulation process. Total risk weighted exposures for the projected level of business operations is calculated, the required capital level is projected and a plan is formulated to retain the required capital.

Q. Risk Management Framework

Best Finance manages risk through an integrated risk management framework of the Finance. It is built upon the principles of the Basel Committee on Banking Supervision and follows the Risk Management Guideline issued by Nepal Rastra Finance

Components in Risk Management Framework

The Finance's Risk Management Framework has the following components:

1. Board and Senior Management Oversight

Board level control has been exercised on the management of risk across the Finance. There is a presence of clear, effective, and robust structure with well-defined transparent and consistent

lines of responsibilities. Board level committees like Audit, Risk, AML Committee meet regularly to review the risk profile and take decisions accordingly.

2. Policies and Procedures:

The Finance has implemented policies/procedures to ensure that risk management practices and process are effective at all levels and execution of sound risk management process to actively identify, measure, control, monitor and report risk inherent in all products activities, process, systems, and exposure.

3. Risk Management Function

There are guidelines on key responsibilities and escalation and risk reporting model in the Finance. Risk Management Committee (RMC) reports to the Board of the Finance for key risk areas periodically

4. Appropriate Management Information System

A sound and effective management information system (MIS) is crucial for the Finance's credit management. Information generated by MIS helps Senior Management/Board to take decisions regarding risks, credit portfolio decisions, and estimate capital requirements on a meaningful and timely basis. The Finance has an effective MIS that helps senior management/board to make decisions regarding credit risk management.

5. Effective Internal Control and Limits

To monitor the risks with the risk appetite of the Finance, approved risk limits are in place. Internal controls are embedded in day-to-day business and are designed to ensure, to the extent possible, that the banking activities are efficient and effective, information is reliable, timely, and complete and the Finance is compliant with applicable laws and regulations.

6. Risk Appetite and Risk Tolerance

In line with the Risk Appetite Statement and Risk Tolerance metric, the responsibility matrix has been developed for various risk areas and trigger level monitoring. The risk appetite statement considers risk capacity, financial position, and strength of its core earnings. Risk appetite is set and approved by the Board and is overseen on an ongoing basis.

The Finance has also set a risk tolerance level for different risk aspects. Such trigger levels set the risk appetite of the Finance and the amount of uncertainty that the Finance is willing to take. Risk Tolerance levels are defined in quantitative aspects which also work as Key Risk Indicators which shall trigger remedial measures in case such indicators are crossed.

7. Risk Culture

Risk culture covers awareness, attitude, and behavior of staff towards risk and risk management. The Finance promotes a strong risk culture that supports the appropriate standard for professional and responsible behavior. The Finance has defined three lines of defense towards fostering risk culture across the organization: first (Branch/Strategic Business Units), second (Risk Units), and third (Internal Audit).

8. Training

Training has been provided internally and externally as per the need to enhance skill and knowledge in the area of risk management for the officials of the Finance.

The internal audit of the Finance is independent of the management and directly reports to the Audit Committee, a board-level committee.

9. Board Level Committees

For effective management and active oversight of risk, the Finance's board of directors has constituted four board-level committees for oversight in specific risk areas. Each committee has its own standard operating guideline which defines objectives, responsibilities, and operating procedures of the committee. Brief description of the committees is given below:

i. Risk Management Committee is a board-level committee, which also includes members from risk divisions of the Finance. This is where overall risk management including the performance of the Finance is discussed in detail to assess the solvency of the Finance and necessary instructions are issued to concerned division and recommendations are made to the Board for necessary deliberation and implementation.

ii. Audit Committee is constituted and its functions comply with the regulatory provisions of NRB Unified Directives and the provisions of Sections 164 and 165 of Company Act 2063. The Committee's role is extensive and strongly supports the board in dealing with aspects of good corporate governance, internal control, risk management, financial reporting, legal and regulatory compliance, and ethical conduct of business.

iii. Anti-Money Laundering (AML) Committee is constituted in line with the provision of directives of the Nepal Rastra Finance. The Committee oversees the implementation of Assets (Money) Laundering Prevention Act, 2064, Assets (Money) Laundering Prevention Rules, 2073, NRB Unified Directives, and other legal and regulatory requirements related to prevention of money laundering. The Committee oversees risk arising from non-compliance with AML policies and procedures based on national and international best practices.

iv. Committee relating to Staff Services and Facilities is constituted in line with the provision of directives of the Nepal Rastra Finance. The Committee's roles and responsibilities are extensive and the Committee strongly supports the board in formulating policies, guidelines, and rules relating to human resource function. The Committee functions and discharges its duties and responsibilities in compliance with regulatory requirements.

10. Credit Risk Management

Banking business in Nepal is exposed to credit risk to a much larger extent and the Finance's business is also concentrated around its credit risk exposure. The bulk of the earnings is generated from credit-related business, be it in the form of interest income, fee income, or forex income. The Finance operates in a dynamic economic environment where the margin between performing assets and non-performing assets can often be very thin. Therefore, it is always a major threat that any of the Finance's credit exposure may experience default.

The Finance's objective in credit risk management is to minimize the risk and maximize the risk-adjusted rate of return by onboarding and maintaining credit exposure within the acceptable

parameters. The Finance seeks to achieve this objective through effective implementation of its Credit Policy and its Investment Policy within its overall risk management structure. These policy documents guide on the do's and the don'ts in business generation. Any generation of risk assets and their impact on long term value generation is well deliberated in every credit proposal. Risks and returns are properly weighed and risk mitigating measures are explicitly spelled out. Risk division does not have any business level targets, nor has any incentive for growth in business. The division oversees global, macro, micro, and unit-level risk that arise out of daily business operation as well as out of changes in market conditions that affect particular borrowing customers/counterparties.

The Finance's credit functions are broadly categorized Corporate, SME, and Retail credit. Credit Risk Division is manned with a separate set of skills for analyzing risks in these different credit functions. Besides, the Finance has a system to check and analysis the health of credit portfolio minutely at each borrowing unit level irrespective of the size of the exposure on a defined periodic manner.

The Finance makes a credit extension decision by assessing each business proposal thoroughly. It also ensures that the inherent credit risks that are associated with the business are addressed appropriately through coverage of better safety margin, additional collateral back up, and lower exposure to keep the business at low leverage.

There is a separate Credit Administration Department, which prepares security documents and retains custody of the same. CAD Department is also independent of business division and it ensures, on an ongoing basis, on the safety and going concern of the borrowers, through post-relationship assessment. A periodic review of all accounts under credit exposure is one of the prudent practices that the Finance follows to take necessary steps to avert/minimize the risk. Quarterly on-site inspection of the borrowers and suggestion for timely corrective actions itself help protect borrowers as well. Besides, in case any borrower faces difficulties and poses a risk to the Finance in terms of fall in the value of assets, the Finance sets aside adequate loan loss provision. Any business decision for credit exposure is taken only if it is vetted and approved by the credit risk division.

Finance has standardized Product Papers that stipulate proper governance and procedure for all credit relationships. Similarly, periodic monitoring of business and annual review of credit relationships provides the Finance a fair idea on whether or not to continue the relationship. Besides, a periodic review of the same by the Internal Audit Department or Statutory Audit also assists in identifying the status of exposure/relationship in line with guiding documents of the Finance. Any weaknesses on the part of the business of borrower and the relationship strength are independently assessed by Internal Audit and the advice is taken positively for necessary changes.

Within the Credit Risk Management, processes are well defined where checking, control, and independence of the credit extension, risk assessment, review, monitoring, and exposure accounting is fully complied with.

All such actions and processes are properly recorded, reported, and discussed. These reports on need basis and a defined frequency are put to the oversight of Senior Management, Risk Management Committee, and the Board. Internal Audit Department of the Finance too takes up the matter on credit observations and discusses the same at Audit Committee.

11. Operational Risk Management

Operational risk can be caused by both internal and external sources, such as fraud, business interruptions, system failures, damage to physical infrastructure, failure in execution and service delivery, inherent risks in products. The risk can occur in any business function or the business supporting functions. The effect of failure in any of the resources can have concurrent impacts across the company. Effective operational risk management system aims to minimizing losses and customer dissatisfaction due to failure in process, focusing on flows in product and their design that can expose the company to losses due to fraud analyzing the impact continuity in the company's operations. The Finance company has introduced an "Operational Risk management policy all branches covering all transaction on daily basis to minimize the operational risk. The Risk Management Department is assigned with the responsibility to undertake actions related to operational risk management of the company.

12. Market Risk Management

The Company recognizes market risk as the possibility for loss of earnings or economic value to the Company caused due to adverse changes in the market level of interest rates or prices of securities (equity), foreign exchange rates and volatilities of those prices. The company has an Asset Liability Management Committee (ALCO) which meets periodically to discuss product pricing for deposits and advances and maturity profiles of assets and liabilities, articulating interest rate, view of company, funding policy, transfer pricing policy and balance sheet management. Market risk comprises three types of risk: foreign exchange rates (currency risk), market interest rates (interest rate risk), and market prices (price risk).

13. Liquidity Risk Management

Liquidity ratios are accessed and communicated to ALCO members on periodic basis. As such, actions with regards to asset liability management, if any warranted from liquidity perspective, is promptly initiated. Compliance to mandatory liquidity ratios is maintained at all times. Quarterly Stress Test results also include scenario analysis on liquidity ratios. Management oversight on liquidity risk management is ensured through discussion on the Stress Test results at management level (ALCO), Risk Management Committee, and the meeting of Board of Directors.

14. Compliance Risk Management

The company has separate division to oversee operation risk including Compliance of KYC and AML. The division has adequate access to the daily report, operational processes and right to recommend the changes in the system and procedure.

15. Internal audit

Internal audit of the finance is independent from the management and directly reports to Audit Committee.