



Completion Report

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Technical Assistance Number: 8076
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Bhutan: Strengthening Royal Monetary Authority's Regulatory Capacity for Nonbank Financial Institutions

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TA No., Country and Name		Amount Approved: US\$525,000	
TA 8076-BHU: Strengthening Royal Monetary Authority's Regulatory Capacity for Nonbank Financial Institutions		Revised Amount: US\$525,000	
Executing Agency: Royal Monetary Authority of Bhutan	Source of Funding: Japan Fund for Poverty Reduction	Amount Undisbursed: US\$72,972.55	Amount Utilized: US\$452,027.45
TA Approval Date: 11 May 2012	TA Signing Date: 7 Jun 2012	Fielding of First Consultant: 19 Jul 2012	TA Completion Date Original: 31 May 2013 Revised: 31 Oct 2013 Account Closing Date Original: 31 May 2013 Actual: 30 Sep 2014
<p>Description. On 11 May 2012, the Asian Development Bank (ADB) approved Technical Assistance (TA): 8076-BHU: Strengthening RMA's Regulatory Capacity for Non-Bank Financial Institutions in the amount of \$525,000 financed by the Japan Fund for Poverty Reduction (JFPR) and administered by ADB. The TA was approved on the request of the Government of Bhutan to provide an additional TA to strengthen the regulatory and supervisory capacity of the Royal Monetary Authority of Bhutan (RMA) following two previous grants provided by ADB in 2003 and 1999.¹ The request was in line with government's efforts to enhance resource mobilization and outreach capacity of the financial sector, as well as to promote economic and financial governance, in accordance with the government's Tenth Five-Year Plan 2008–2013. The TA was designed to address the: (i) lack of enabling regulatory and supervisory framework on non-bank financial institutions (NBFIs) covering insurance, pension, securities, and microfinance subsectors; and (ii) the limited regulatory capacity and training needs of RMA supervisors and staff of NBFIs in Bhutan.</p> <p>Expected Impact, Outcome and Outputs. The expected impact of the TA was improved overall functioning of the financial sector in Bhutan. The outcome was enhanced efficiency and effectiveness of the financial sector supervisory and regulatory system for NBFIs. There were two outputs, namely: (i) improved RMA regulatory and supervisory role and (ii) enhanced capacity of financial sector.</p> <p>Delivery of Inputs and Conduct of Activities. The TA was originally planned for a 12-month implementation period, from May 2012 to May 2013. The TA became effective on 7 June 2012. To achieve the planned outcome, the TA provisioned for the recruitment of five international consultants and one national consultant, as follows: (i) one insurance supervision expert focused on strengthening the regulatory capacity for supervising the insurance industry, (ii) one pension supervision expert focused on strengthening the regulatory capacity for supervising the pension industry, (iii) one capital market supervision expert with emphasis on strengthening regulatory capacity for supervising the capital market, (iv) one microfinance supervision expert focused on strengthening the regulatory capacity for supervising the microfinance industry, (v) one NBFI supervision expert focused on off-site supervision and regulatory policy, and (vi) one national NBFI supervision expert to support all the international consultants.</p> <p>Under the TA approval, each of the international consultants had an initial duration engagement of 2.5 person-months equivalent to 55 working days, which the RMA (as regulator of NBFIs) clarified with ADB as insufficient to deliver their terms of reference. A minor change in implementation was approved by ADB after TA effectiveness to: (i) increase the inputs of consultants to 75 working days, intermittently (i.e. 50 days field inputs and 25 days home inputs) with more focus on training in the field; and (ii) recruitment of additional national consultant. Except for the insurance expert and national consultant who both commenced their engagements in July 2012, the fielding of four other international consultants were delayed due to conflict in schedules and overlapping of work with other contracts, and were only available to start between April 2013 and August 2013 on a full-time basis. There was one extension of completion date from 31 May 2013 to 31 October 2013 to enable completion of consultants' tasks. During implementation, each of the consultants efficiently used their field inputs allowing two travels to Bhutan to conduct the capacity building activities, as outlined under their terms of reference. Taking into consideration the quality of report submissions, trainings, and extensive consultations done with RMA and stakeholders, individual performance ratings of the consultants were satisfactory.</p> <p>The RMA took ownership of the TA and closely coordinated with the consultants during its implementation. The RMA provided adequate counterpart support facilities and staff during TA implementation. TA financing and utilization was appropriate to meet the planned activities and inputs, including the procurement of around \$28,000 worth of information technology equipment (laptops, printers, telephones, etc.) by the RMA to support the technology requirements of its expanding office with the recruitment of additional staff for supervision of the NBFIs. A certificate of turnover of TA equipment to the RMA (as the executing agency for the TA) was confirmed and signed by ADB on 22 September 2014 prior to TA closing.² ADB held three missions consisting of: (i) a fact-finding mission in 2011, (ii) an inception mission in 2012, and (iii) a review mission in 2013. Overall, the performance of the RMA and ADB were satisfactory.</p>			

¹ ADB. 2003. *Technical Assistance to the Kingdom of Bhutan for Strengthening the Capacity of the Royal Monetary and Royal Securities of Exchange of Bhutan*. Manila, and ADB. 1999. *Technical Assistance to the Kingdom of Bhutan for Strengthening the Banking Supervision Function of the Royal Monetary Authority of Bhutan*. Manila.

² Certificate of turnover of TA equipment to the RMA is available upon request.

Evaluation of Outputs and Achievement of Outcome. During the implementation period, consultants delivered key outputs, which included: (i) the drafting of new regulations pertaining to insurance, pension, securities, and microfinance sectors; (ii) preparation of supervisory methodologies to support RMA oversight functions; (iii) preparation of standard templates and procedures by which NBFIs will collect and report financial information; (iv) training of RMA staff in applying the supervisory methodologies and enforcing regulations; and (v) training staff from NBFIs to ensure effective compliance with the new rules and regulations and staff from finance sector entities to ensure update with the new regulations. More specifically, the TA supported (i) the review and revisions to existing Insurance Regulations of 2006; (ii) drafting of at least 10 new regulations aimed at increasing financial services and access to finance; (iii) preparation of onsite and offsite manuals and reporting formats; (iv) training of RMA staff on supervision and enforcement; and (v) training of 66 staff from NBFIs and other financial sector entities (i.e. 50 NBFI staff and 16 banks staff) on the new regulations. Refer to Appendix 1 for more details on the key outputs under the TA.

Overall, the TA substantially delivered the outputs and achieved the expected outcome of enhanced efficiency and effectiveness of the financial sector supervisory and regulatory system for NBFIs. In line with the performance targets under the TA's design and monitoring framework, the TA has resulted with the RMA: (i) conducting onsite inspection of NBFIs on an annual basis supplemented by quarterly offsite reports using customized reporting templates, guidance notes, and methodologies (as applicable) prepared by the consultants; (ii) assigning the functions of an apex microfinance institution to Bhutan Development Bank Limited providing a lead role to support micro, small, and medium scale enterprises; (iii) licensing of at least one securities broker in 2015 and has received three more applications for review; and (iv) approving two pension scheme managers, one fund manager and two more fund managers currently under review. More importantly, the TA has substantially contributed to the broader design of two larger ADB policy based interventions to strengthen the economic management in Bhutan to support financial sector development.³

Overall Assessment and Rating. The TA is rated as successful. The TA has contributed significantly to the improved overall functioning of the financial sector in Bhutan by providing enabling capacity of the RMA to put in place regulatory and supervisory frameworks for NBFIs. Substantial improvements to RMA's monitoring and enforcement of NBFIs include: (i) quarterly financial information are collected from insurance companies to assess financial viability; (ii) onsite inspection of the National Pension and Provident Fund (NPPF) is now conducted every year; (iii) policies were formulated for the development of an active market for equities and corporate bonds; (iv) onsite inspection of securities brokers are formally in place; (v) offsite monitoring of securities exchange and brokers are regularly conducted using inspection manual and reporting formats developed under the TA; and (vi) a legal framework for microfinance and regulations for microloan institutions are now effective, with RMA receiving applications for registration from interested parties for assessment. Additionally, RMA has been receiving enquiries from agencies and applications from entities engaged in micro lending to register as microloan institutions.

Major Lessons. TA administration can become complex and cumbersome with the recruitment of a number of individual consultants, as was the case under this TA. Given the required number of consultants and numerous outputs to be delivered under the TA, hiring under a firm selection process would have reduced the administrative complexity of handling individual consultants for better coordination and monitoring of TA outputs. Also, the RMA would have benefited more if the outputs were seamlessly integrated that would help determine gaps, future interventions, and strategy to further develop and strengthen the capacity building of NBFIs. Also, any future TA support of this nature covering too many financial subsectors should have needs assessments undertaken at the initial stages of the TA design to determine priorities and specific deliverables for better monitoring of TA outputs. This should include well considered indicators and targets for the outputs and outcome in the design and monitoring framework with clearly defined data source and collection approach, and a mechanism for monitoring the indicators.

Recommendations and Follow-Up Actions. The achievements under the TA contribute towards initial sustainability of ADB support and improved overall functioning of the financial sector in Bhutan. Notwithstanding progress, measures to strengthen regulation and supervision of the NBFIs should include institutional strengthening through improved corporate governance and a move from compliance-based to a risk-based supervision. However, measures to develop the capital market were addressed in a subsequent ADB TA,⁴ which supported the government in the formulation of a capital market master plan and regulatory framework for the establishment of a domestic credit rating agency that are crucial to Bhutan's overall financial sector development. Refer to Appendix 2 for the list of new NBFI regulations supported under the TA.

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³ ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Grant to the Kingdom of Bhutan for the Strengthening Economic Management Program*. Manila, and ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan, Grant, and Technical Assistance Grant to the Kingdom of Bhutan for the Strengthening Economic Management Program II*. Manila.

⁴ ADB. 2012. *Technical Assistance to the Kingdom of Bhutan for Capital Market Development*. Manila.

OUTLINE OF KEY CONSULTANTS' OUTPUTS ACHIEVED UNDER THE TECHNICAL ASSISTANCE

1. **Insurance regulation and supervision.** The consultant: (i) developed a supervisory framework in assessing the financial viability of insurance companies using benchmarks, such as liquidity profile, solvency, asset quality, capital adequacy, earnings and management capacity; (ii) prepared five onsite inspection manual segments on structure of an insurance entity, general insurance underwriting, life insurance underwriting, claims and investments; (iii) appraised and updated standardized offsite reporting templates for insurance companies, incorporating key performance ratios in the reports; (iv) conducted a total of 20 trainings to Royal Monetary Authority (RMA) staff on insurance regulation and supervision; and (v) actual on-site inspections of two insurance companies i.e. Royal Insurance Company of Bhutan Limited (RICBL) and Bhutan Insurance Limited (BIL).
2. **Pension regulation and supervision.** The consultant (i) drafted pensions and provident fund regulation, modelled on the chapter for insurance; (ii) prepared a number of operational rules covering actuarial valuation methodology, requirements for actuarial valuation reports, requirements for investment policy and procedures, fit and proper tests for those acting a fiduciary capacity, and intermediaries; (iii) developed a pension supervisory framework; (iv) prepared a pension manual including guidance notes on onsite and offsite examinations and standardized reporting formats for the pension and provident funds; (v) developed extensive training course in onsite examination procedures and hands-on training conducting multi-day examination of the National Pension and Provident Fund; and (vi) held a stakeholder discussion forum with industry participants (i.e. PFF, RICBL, BIL, and Nubri Capital) on policy and operational matters.
3. **Capital market regulation and supervision.** The consultant (i) provided a report on legal and regulatory framework of the capital markets in Bhutan, the gaps and impediments to capital market development, and recommendations to existing capital markets-related acts (e.g. Financial Services Act 2011 and Companies Act, 2000), RMA regulations, and Royal Securities Exchange of Bhutan (RSEB) rules to move these toward international standards within the Bhutanese environment; (ii) developed training materials and programs for the training of RMA staff in Financial Regulatory and Supervisory Department (FRSD) on topics including IOSCO principles of securities regulation, performing on-site inspections for brokerage firms, inspection of exchange and depository, inspection manual for securities brokerage firms, writing the inspection report and risk-based supervision training; (iii) provided hands-on training of FRSD staff on two practical on-site inspections for RSEB and a brokerage firm; and (iv) delivered training sessions for RSEB and four brokerage firms on compliance for capital markets.
4. **Nonbank/reinsurance regulation and supervision.** The consultant (i) reviewed the insurance regulation and drafted reinsurance regulation; (ii) developed onsite and offsite manuals and guidance notes for all insurance sectors containing specific aspects for the monitoring of reinsurance; (iii) conducted three specific training sessions for RMA supervision staff on the manuals and on topics specific to reinsurance; (iv) conducted stakeholder discussions with insurance companies on the proposed regulation for enforcement; and (v) developed reporting form for statistics obtained from insurance and reinsurance business for offsite monitoring and trained staff on computation and analysis of financial data and ratios obtained.
5. **Microfinance regulation and supervision.** The consultant (i) drafted regulations for the establishment of microloan institution and non-deposit taking and deposit taking microfinance

and (ii) prepared onsite and offsite manual and provided training of RMA staff on the supervision of microfinance institutions. The regulation for establishment of microloan institutions has already been adopted while regulation for deposit taking microfinance institutions will be adopted before September 2016.

LIST OF NEW NBFI REGULATIONS SUPPORTED UNDER THE TECHNICAL ASSISTANCE

NBFI Regulation	Status
1. Investment Guidelines for Insurance Business 2015	Implemented in February 2015
2. Investment Advisor and Management Company Regulations	Implemented in September 2014
3. Deposit-Taking Micro Finance Regulations	Presented to RMA Board for approval in 2014 but has been deferred til further notice
4. Non-deposit Taking Micro Finance Regulations	Presented to RMA Board for approval in 2014 but has been deferred til further notice
5. Microloan Institutions Regulations 2014	Implemented in September 2014
6. Insurance Regulation (revised)	The TA reviewed the existing Insurance Regulations of 2006 with proposed recommendations and revisions to be finalized by the RMA for approval.
7. Reinsurance Regulations	Pending for RMA approval ^a
8. Pension Manual	Pending for RMA approval
9. Pension Procedures Manual and Guidelines	Pending for RMA approval
10. Fund Valuation Rules	Pending for RMA approval
11. Fund Investment Rules	Pending for RMA approval
12. Central Depository Regulations	Pending for RMA approval
13. Clearing and Settlement Regulations	Pending for RMA approval
14. Securities Exchange Regulation	Pending for RMA approval

NBFI = non-bank financial institutions, RMA = Royal Monetary Authority, TA = technical assistance.

^a The RMA has indicated that these regulations remain in draft form and pending for approval and implementation. However, the delay is mainly as a result of lack of capacity and shortage of staff in the Financial Regulatory and Supervisory Department of the RMA.