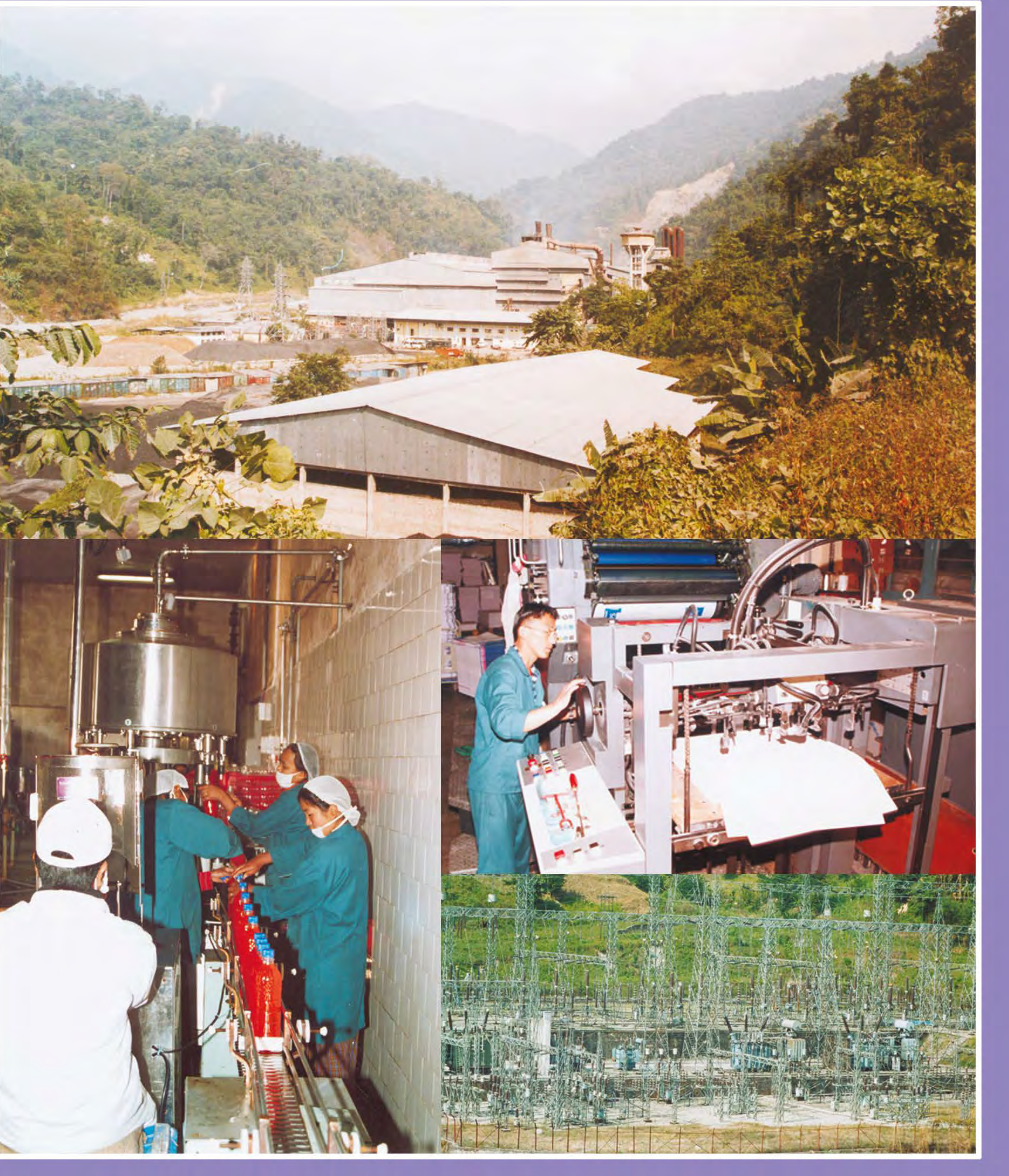
COMMERCE



A Supplementary Text for Class XII

COMMERCE

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Adviser:	Dr. Pema Thinley, Secretary, Ministry of Education (Chairman, CAPSD Board) Tshewang Tandin, Director, Department of School Education, MoE
Copyediting:	Ugyen Tshewang, Director, NPPF Karma Tshering, Registrar of Companies, MTI Klaus Dornseis, Bundes Bank Adviser to RMA Meena Subha, CCO Karma Yeshey, Joint Director, CAPSD
Research and Writing:	Omnath Baraily, Yangchenphu HSS, Thimphu Kinley Wangchuk, Chhukha HSS, Chhukha Tshering Wangmo, Chhukha HSS, Chhukha Tulasa Chhetri, Kuenga HSS, Paro
Compilation & Coordination:	Tandin Dorji, Social Studies Section, CAPSD
Design:	Jigme Lodey, Art & Publication, CAPSD
Photography:	Choezang Dupjur, Art & Publication, CAPSD
Typesetting:	Pema Choje & Karma Wangmo, Art & Publication, CAPSD

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FOREWORD

Education is the prerequisite to, and the central element of, the progress and development of a nation provided it is relevant and appropriate. Thus, our education system is moving forward and making all endeavours in fulfilling the directives issued by the Royal Government of Bhutan to make education meaningful and relevant to our children besides outlining the roles they are expected to play as the future citizens of the Country.

With the decision of the Ministry of Education to localize class XI and XII courses with Bhutan Higher Secondary Education Certificate examinations in Bhutan being conducted by the Bhutan Board of Examinations with effect from 2006, studies with Bhutanese contents will now be extended even in these classes. Therefore, the Bhutan Commerce supplementary text for class XII has been developed to acquaint the Bhutanese youth to the important features of the Bhutanese economy. The course will help our children to explore the fast growing economy of Bhutan and learn the basic concepts and principles of commerce against this backdrop.

More still, the Bhutan Commerce supplementary text will inform our children of the vibrant economic life of our country and the opportunities that lie ahead. In addition, it would also provide them with the necessary information that they will require when entering into the world of work, besides helping them to make sound decisions to become responsible and productive citizens who will be able to serve our *Tsawa Sum* with love, loyalty and dedication.

In conclusion, we hope our teachers and students will learn from this book and contribute individually and collectively towards fulfilling His Majesty's visions of a strong, prosperous and sovereign independent Bhutan for all times to come.

Trashi Delek.

Thinley Gyamtsho
MINISTER
Ministry of Education

INTRODUCTION

The Commerce syllabus for Class XII is broadly divided into six units. Bhutanese elements have been introduced as well as incorporated in the first three units through this Supplementary Text for Class XII Commerce. Since, the topics treated here are not in the main textbook, they need to be incorporated at various points in the course of the teaching learning process. Thus, it is important to refer to the syllabus time and again to confirm that all the areas are covered.

Students at this level need to have sufficient knowledge of the Companies Act in our own context. Therefore, this text provides our students with adequate exposure to the Companies Act of the Kingdom of Bhutan, 2000. Students will gain knowledge especially on the procedures of formation and incorporation of companies in Bhutan. Other topics in this text include Management Personnel. Appointment, qualification, disqualification, powers, duties, removal and remuneration of the Directors of a company have been outlined and the provisions of the Companies Act of the Kingdom of Bhutan 2000, have been fully enumerated.

Until recently our students had been studying the various financial institutions in India. However, to bring about comprehensive and practical relevance, these have been replaced with a Bhutanese flavor. The replacement details out study of financial institutions in Bhutan that includes two commercial banks, a insurance company, a development bank and a Pension Board: (i) Bank of Bhutan Limited, (ii) Bhutan National Bank Limited, (iii) Royal Insurance Corporation of Bhutan Limited, (iv) Bhutan Development Finance Corporation and (v) National Pension and Provident Fund, respectively. This will familiarize our students with various aspects of our financial institutions with special focus on their contributions to the development of the Bhutanese economy. It is therefore felt that learning becomes more meaningful and relevant to the students.

The activities in the supplementary text have been carefully designed to stimulate critical thinking in learners. Students may not find ready made answers to the questions in the text. Students also need to explore other sources for more knowledge and information.

Studying Commerce in the Bhutanese context will benefit students in a number of ways. It will give them strong foundation to pursue further studies in Commerce. If the students intend to take up employment after class XII, they will be equipped with adequate knowledge and hence, may have better stand in the job market. It will also equip our students with adequate knowledge and skills to start and operate small and medium scale business. This means that the students will have an opportunity for self employment.

Dr. Jagar Dorji
Chairperson
Social Studies Subject Committee

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UNIT ONE: CORPORATE ORGANIZATION

1. 2. Formation of Company

Introduction

In Class XI, we have studied various forms of business organization that include sole proprietorship and partnership. We now know that these forms of business organization have a number of drawbacks such as limited resources, unlimited liability, absence of continuity, limited managerial skills, etc.

The company form of business is preferred when the business activity may require pooling of resources, better technical and managerial capability, limited liability and continuous existence. Generally, large-scale operations requiring heavy investment and professional management are run in the company form of business. In Bhutan, there is an urgency for industrialization to speed up economic growth and development. To achieve this, there is a need for expansion and diversification in our industrial activity. Expansion and diversification require huge investment, and capital cost for such activities can be pooled from many individuals. This helps the small investors by way of investment opportunity as well as finances that the project promoted.

Meaning and definitions of Joint Stock Company

A Company is an artificial person created by law, having a separate legal entity, with a perpetual succession and a common seal. It is an association of individuals for the purpose of earning profit. It has a capital divided into a number of shares of which each member possesses one or more shares and which are transferable by its owners.

A Company has been defined by many renowned authors, jurists and institutions. Some of the important definitions are given below.

- "A company is an association of many persons who contribute money to a common stock and employ it for a common purpose." *- Justice Lord Lindley (Source: J.K. Mitra, 2004: 1-2)*

- "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares, ownership of which is the condition of membership."
  L.H. Haney (Source: P. Bhattacharjee, R.K. Sharma and S. K. Gupta, 1996: 2)

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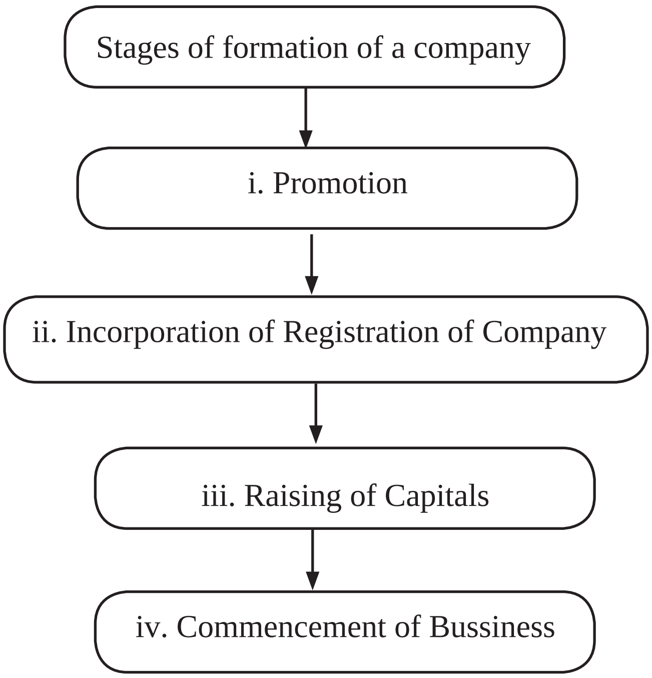
- “A company is an association of many persons who contribute money or money’s worth to common stock and employ it in some trade or business and who share the profits or losses arising there from. -*James Stephenso (Source: J.K. Mitra, 2004: 1-2)*

- “A Corporation is an artificial being, invisible, intangible and existing only in contemplation of law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it either expressly or as incidental to its very existence. -*Chief Justice Marshall (Mohan Singhal and D.D. Shah, 2000: 1)*

- According to the Companies Act of the Kingdom of Bhutan 2000, “A company means a company limited by shares incorporated and registered under this Act or an existing company incorporated by or under the Companies Act of the Kingdom of Bhutan, 1989.”

Formation of a company

Unlike sole proprietorship and partnership, formation of a company involves fulfilling legal formalities. It does not come into existence on its own until it is registered under a Company Law. The Company Act of the Kingdom of Bhutan, 2000 contains various provisions regarding the legal formalities for the setting up of a company in Bhutan. The following diagram shows the various stages of formation of a company.



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i. Promotion : Promotion is the first stage in the formation of a company. It means identification of a business opportunity or idea, analysis of its prospects and taking steps to implement it through the formation of a company. Hence, promotion means various initial steps to be taken for the formation of a company, before it actually comes into existence.

C.W Gerstenberg has defined promotion as "the discovery of business opportunities and subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom." *(P.C Tulsian and S.D Tulsian, 2002, ISC Commerce)*

Promotion involves the following stages:

- *Discovery of business opportunities:* In this stage, the promoter conceives the idea of forming a company. The promoter discovers the business opportunities, considering the availability of human and non-human resources. He or she analyses whether the idea is practical or feasible in the light of the proposed risks and profitability.

- *Detailed investigation:* This includes thorough study regarding commercial feasibility of bringing the company into existence. The promoter will have to carry out a detailed study related to market conditions (supply of raw materials and demand for the product to be manufactured), technology to be used, financial analysis that include estimated profit margin, capital requirement and the techno-commercial viability of the proposed project, etc. Sometimes the professional services of experts or consultants are used for such studies. Studies of this nature are called *Feasibility Studies* also. Entrepreneurship Promotion Centre (EPC), Ministry of Economic Affairs and Bhutan Chamber of Commerce and Industry (BCCI) may provide such services in Bhutan for small scale industries.

- *Verification of the results of investigation:* The report submitted must not be accepted without getting them verified by a separate team of neutral body of experts. Any shortcomings or mistakes in the process of investigation identified by this body of experts must be rectified.

- *Assembling of different elements of the business:* Once the reports of the investigators are verified and approved by the team of neutral experts, promoters can then go ahead with the promotion of the company. This involves gathering of original idea, property and managerial ability. It consists of selection of site, purchase or lease of land, building infrastructures, purchase of equipment and entering into contracts with technical and managerial persons. In Bhutan, one of the first activities would be submission of project reports in accordance with the Royal Government guidelines to seek project

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approval from the Ministry of Economic Affairs and clearances from other sectors like the National Environment Commission or any concerned sector Ministry.

- *Preparation of a financial plan for the proposed business:* Having gathered all the factors needed to bring the company into existence, the promoters need to proceed further with the preparation of a financial plan for the proposed company. Capital investment consists of equity contribution by the promoters as well as loans from banks and financial institutions. As part of the share capital, besides the promoters' subscription, a company can raise its capital through the issue of shares (equity or preference) and debentures. For this purpose, they have to approach banks, financial institutions and underwriters. While preparing the financial plan promoters have to keep in mind that adequate funds have to be provided for launching the enterprise as a going concern.

- *Submission of necessary documents required for incorporation:* Incorporation of a company requires filing or submitting certain documentation to the Registrar of Companies, Ministry of Economic Affairs. As per the provision laid down in the Companies Act of the Kingdom of Bhutan, 2000, the following documents have to be filed with the Registrar of the Companies.
    - (a) Articles of incorporation in the form set out in Schedule I of the Act or as near thereto as circumstances admit.
    - (b) Names and addresses of the first directors and the Chief Executive Officer (CEO).
    - (c) Consent to act as directors duly signed by the first directors in the form set up in Schedule II of the Act.
    - (d) A declaration by one or more directors that all the requirements of the Act have been complied with in respect of registration, in the form set up in Schedule III of the Act.
    - (e) Security clearance certificate of all the promoters.
    - (f) Copy of citizenship identity cards of the promoters.
    - (g) Copy of clearance/permit/approval from the relevant agencies.

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ii. Incorporation or registration of a company: On the filing of the necessary documents with the Registrar and the payment of registration fees as prescribed in Schedule IV of the Companies Act of the Kingdom of Bhutan, 2000, the Registrar will examine these documents and upon satisfaction that all requirements have been duly complied with, he shall issue a *"Certificate of Incorporation"* and enter the name of the company in the register of the companies. From the date of the incorporation mentioned in the Certificate of Incorporation, the company shall be a body corporate and comes into existence. A company can be registered as a private limited company or a public limited company and can commence business after it obtains a valid license from Ministry of Economic Affairs.

Effect of Registration: A Company comes into existence as body corporate upon issue of the *Certificate of Incorporation*. This body corporate is separate from its members (shareholders or owners). As a body corporate, a company can exercise all the powers and functions of an incorporated company having perpetual succession and common seal with limited liability of its shareholders. It can:

- carry on its business as per its object clause in the Articles of Incorporation,
- sue and be sued,
- buy, hold, sell or transfer property and assets of the company,
- execute, endorse or deal with deeds, negotiable instruments, bills of exchange or promissory note,
- enter into contract with any person.

iii. Raising of Capital: Raising of capital is also known as subscription of capital and is the third stage of the formation of a company. A private limited company does not require this stage as it is not required to invite the general public to subscribe to its shares.

A capital subscription stage is a must for public limited companies as they have to raise funds from the general public by selling its shares and securities. So, with the view to raise funds a public limited company, soon after its incorporation has to arrange a meeting to deal with the following matters:

(a) Issue of a prospectus or a statement in lieu of prospectus.
(b) Appointment of bankers for underwriting of shares.
(c) Appointment of brokers to float shares in the secondary market.
(d) Listing of shares on the stock exchange i.e. the Royal Securities Exchange of Bhutan Limited (RSEBL).

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(e) Obtaining approval for issue of prospectus from the Ministry of Economic Affairs and the Royal Securities Exchange of Bhutan Limited

A public limited company issues a prospectus in order to invite the general public to subscribe its shares. A public company cannot allot shares to the public unless the amount mentioned as minimum subscription is received. Generally, 90 per cent of the issued capital forms the minimum subscription. The restriction of "minimum subscription" is meant to ensure the formation of the company with an adequate capital.

iv. Commencement of Business: A company can start the business only after obtaining a license from the Ministry of Economic Affairs. A company shall commence business only when:

- A copy of the license is filed with the Registrar of Companies within seven days of its receipt.
- The Company has produced documentary evidence relating to purchase of property of assets and operation of account in a bank in the name of the company.

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1. 4. Incorporation

1.4.1 Mode of Incorporation

A company is said to be incorporated when it has been registered with the Registrar of the Companies. The procedure for registration of a company under the Companies Act of the Kingdom of Bhutan 2000, involves the following steps:

Step One: The first step in the registration of a company involves proposing the name of the company to the Registrar (the Registrar will not issue clearance if he or she is of the opinion that the name proposed is undesirable or is identical with, or resembles the name by which a company in existence has been previously registered).

Step Two: Once the name is cleared, the following documents should be submitted to the Registrar.

- Articles of incorporation in the form set out in schedule I of the Act or as near thereto as circumstances admit.
- Names and addresses of the first directors and the Chief Executive Officer.
- Consent to act as directors, duly signed by the first directors in the form set up in Schedule II of the Act.
- A declaration by one or more directors that all the requirements of the Act have been complied with in respect of registration, in the form set up in Schedule III of the Act.
- Security clearance certificate of all the promoters.
- Copy of citizenship identity card.
- Copy of clearance /permit/ approval from relevant agencies.

Note: *The documents listed shall be submitted along with the registration fees as prescribed in Schedule IV of the Act. Application with incomplete documents will not be accepted.*

Step Three: The Registrar will register the companies and issue a certificate of incorporation (the form set out in Schedule V of the Act) upon satisfaction that all requirements have been complied with.

(The company will come into being as a separate entity on the date mentioned in the certificate of incorporation.)

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1.4.2 Contents of the Articles of Incorporation

The Articles of Incorporation of every company shall include the following clauses:

The Name Clause: The name of the proposed company is mentioned in this clause. The name of the company must end with the word 'Limited' in the case of a public company and the words 'Private Limited' in the case of a private company. The name should not resemble the name of any existing company nor should it create the impression that the company is carrying on the business of some existing company.

The Registered Office Clause: Every company should have a registered office, the address of which should be communicated to the Registrar of companies. This helps the Registrar to communicate with the company.

The Object Clause: This clause states the object with which the company is proposed to be established. A company is not legally entitled to do any business other than that specified in its object clause. The Object clause should include:

- Main objects to be pursued after incorporation.
- Incidental objects ancillary to the attainment of the main objects.
- Other objects not included in the first two.

The Liability Clause: This clause states the nature of liability of the members of the company. For example, whether limited by shares or by guarantee –

- In case of a company limited by shares, members' liability is limited to the face value of the shares.
- In case of a company limited by guarantee, the liability clause must state the extent of liability of individual members in the event of its being wound up.

The Capital Clause: This clause states the total/authorized share capital of the company divided into shares of fixed amount. The Authorised Share Capital is the maximum limit of capital a company can raise. It can however increase or decrease its Authorised Share Capital. A company cannot collect funds exceeding the authorized capital.

The Regulations Clause: This clause specifies rules and regulations for the operation of a company. The companies are required to abide by these regulations laid down in Schedule I.

The Association/Subscriptions Clause: The names, addresses, signatures and descriptions of the signatories to the Articles are given in this clause. The clause also specifies the equity shares in numbers and percentage of each subscriber in the capital of the company. This clause

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lists the names and addresses of the first shareholders of the company and their equity contribution.

(A Private or Government Company may adopt any or all of the regulations contained in Schedule I as admissible under the Act.)

It is to be noted that, under the Companies Act of the Kingdom of Bhutan, 2000, the Memorandum of Association and the Articles of Association are not treated as separate legal documents, but rather taken as a single document called the Articles of Incorporation. The contents of Memorandum of Association and Articles of Association are clearly spelt out in the Articles of Incorporation. Thus, the Articles of Incorporation, when registered, binds the company and its members to observe all the provisions of the Articles.

1.4.3 Effects of Registration/Incorporation of a company

From the date of incorporation as mentioned in the Certificate of Incorporation, the company shall be a body corporate, capable forthwith of exercising all the powers and functions of an incorporated company, having perpetual succession and a common seal with limited liability of its shareholders. With such features, the company can, henceforth, carry such rights as:

- carry on its business as per its object clause in the Articles of Incorporation,
- sue and be sued;
- buy , hold, sell or transfer property and assets of the company;
- execute, endorse or deal with deeds, negotiable instruments, bills of exchange or promissory note; and
- enter into contract with any person.

A certificate of incorporation issued by the Registrar shall be the conclusive evidence that all the requirements of this Act have been complied with respect to registration and the Articles shall bind the company and the shareholders.

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Student Activity

1. If you are a promoter of a proposed Company, what steps would you take to promote a company? Enumerate the registration formality as per the Companies Act of the Kingdom of Bhutan, 2000.

2. Compare the Articles of Incorporation with the Memorandum of Association and the Articles of Association.

3. Discuss the advantages of listing the company shares on the Royal Securities Exchange of Bhutan Limited.

4. "On registration or incorporation of a company, the company obtains a legal right to enter into contract with any party."Explain this effect?

5. Visit an industrial site and write a report on the establishment history of a company. Include the following aspects in your writing:
   - type of company;
   - year of establishment;
   - mode of incorporation/registration;
   - share capital including authorized, issued , subscribed and paid up capitals.
   - Objects or business activities of the company

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UNIT TWO: MANAGEMENT PERSONNEL

2.1. Board of Directors

Introduction
We have studied that the capital of a company is raised by issuing shares. Since the shareholders are widely scattered, the actual management of the company is not in the hands of all shareholders. Most of the shareholders may lack managerial abilities too. The shareholders elect representatives to look after the day to day managerial affairs of the company. These representatives are called Directors, and collectively form the Board of Directors.

The Board of Directors is the top administrative organ of the company. The Board formulates policies and programmes and executes them through different grades of executives and staff. The Board delegates their powers to the Chief Executive Officer. The Chief Executive Officer further delegates some power to the departmental (or functional) managers.

The Companies Act of the Kingdom of Bhutan, 2000 defines the Board of Directors as *'Directors collectively acting as the Board of Directors of the Company.'*

Fig. 2.1. Board Meeting of a company in progress (Source: Bank of Bhutan Annual Report 2003)

i. Who is a Director?
The Companies Act of the Kingdom of Bhutan, 2000 defines a Director as "any person occupying the position of a director by whatever name called". This means that it is not the name by which a person is called but the position he occupies and the functions and the duties he discharges that determines whether a person is in fact a director or not.

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Although the concept of Board of Directors remains same for any registered company i.e. the Government Controlled/Owned Companies and Public Limited Companies or Private Limited Companies, there is a difference between the first two types of companies especially in terms of appointment, remunerations and removal of directors.

The Ministry of Finance may prescribe or lay down the rules and procedures for election, roles, remunerations and removals of directors for the government companies as a shareholder. In case of a conflict between the provisions of such a rule by the Ministry of Finance and the Companies Act, the provisions of the Companies Act shall prevail.

The Ministry of Economic Affairs has issued " Rules and Procedures for election of directors" effective from January 1, 2005. This rule clearly lays down the eligibility criteria, the rules and the voting procedures for election of directors of a company.

ii. Number of Directors

- Every public company shall have at least three directors and every private company shall have at least two directors.

- The subscribers to the Articles, who are individuals, shall be deemed to be the directors of the company until the directors are duly appointed in the annual general meeting.

- Unless the Articles provide for retirement of all directors at every annual general meeting, not less than one-third of the total number of directors of a public company shall retire by rotation and the remaining directors in case of such company shall, in default of and subject to any provision in Articles, also be appointed by the company in general meeting. Appointment of directors is now regulated by the "*Rules and Procedures for election of directors"* issued by the Ministry of Economic Affairs.

iii. Qualification of Directors

The Companies Act of the Kingdom of Bhutan, 2000 has not specified any academic or professional qualification of a person to become a Director. However, a person to act as a Director should have the following qualifications:

- He must be an individual having the capacity to contract. (A firm or a body corporate cannot be appointed as a director).

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- He may be nominated by a shareholder, the Royal Government or the Board of Directors of the company.

iv. Disqualification of Directors

According to Section 79 of the Companies Act of the Kingdom of Bhutan, 2000, no company shall appoint or continue the appointment of any person as Chief Executive Officer or Director who:

- is an undischarged insolvent or has at any time been declared insolvent by court;
- is or has been convicted by a court of criminal offence whether or not involving moral turpitude;
- is of unsound mind declared by the court;
- has not paid any call in respect of the shares of the company held by him;
- is a director in more than five companies.

v. Appointment of Directors_

The following procedures are followed for the appointment of Directors for various types of corporations and companies:

a) For Government corporations/companies:

The Directors of the government companies shall be appointed by the Government. The appointments shall be done on the basis of the skill, experience and knowledge of the person in the fields of commerce, finance, accounting, marketing, management and other relevant technical fields. The following rules apply to the appointment of directors for Government companies:

- The recommendations for the appointment of directors shall be made by the sector Ministry;
- The directors shall be appointed for the term of three years;
- Reappointment of retiring directors may be recommended by the sector Ministry subject to satisfactory past performance.
- Cross representation by a director on the Board of another company conducting similar activity shall be avoided;
- A representative of the Ministry of Finance by virtue of its functions, shall be included on the Board of all corporations; and
- The appointment of a director, who is independent of the Government, may be considered by the Government, based on knowledge and experience.
- A candidate shall not be appointed as a director on the Boards of more than three corporations/companies (including companies in which the Government is not the majority shareholder).

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b) For Public Ltd. Companies

Section 79(3) of the Companies Act of the Kingdom of Bhutan, 2000 lays down the rules and procedures for the selection of directors, other than retiring directors, for Public Lt. Companies. Under this section, Directors of a Public Ltd. Company shall be appointed by the company in a general meeting. Further, if the Article of Incorporation does not require the retirement of all the directors, 1/3 shall retire on rotation at every general meeting. The rules and procedures for election of directors shall be adopted by a resolution of directors and the approval of the Ministry of Economic Affairs.

Eligibility of nomination for director: A person shall be eligible for election as a director at the general meeting subject to fulfilling the following conditions:

- There is a vacancy to be filled.
- The person does not contravene section 79.
- The person is nominated by –i) the board or ii) the shareholders through a written nomination signed by at least five shareholders.
- The person consents to the nomination in writing.
- The nomination and consent is received by the company not less than seven days before the Meeting.
- Directors who have been the longest in the office shall retire first. For those persons appointed at the same day, retirement on rotation shall be determined by mutual agreement failing which retirement shall be conducted by lot.

Shareholder's entitlement to nominate candidates for election: The company shall notify all the shareholders listing the names of directors retiring on rotation and the vacancy thereof at least one month before the conduct of the Annual General Meeting.

Every shareholder listed on the register of shareholders at the time of filing the nomination shall be entitled to nominate and sign the nomination of a candidate for the post of a director at the general meeting. Where there is a joint holder of a share, then the shareholder whose name appears first in the register shall sign the nomination.

The register of shareholders shall be made available for inspection to the shareholders at the Registered Office of the Company or any other place as approved by the Registrar of Companies during the ordinary hours of business.

Proxy shareholder shall not be eligible to nominate a candidate. The rights of the proxy shareholder shall be limited to voting by poll only. The proxy holders are allowed to attend and vote in the General meeting, but a proxy so appointed shall not have any right to speak in the meeting, and shall not be entitled to vote except on a poll.

c. Form of nomination and consents.

Nominations: A nomination must (i) be in writing and (ii) set out the following information in regard to the shareholders nominating the candidate:

- The shareholder's full name as it appears in the register of shareholders/share certificate/trading note.
- The share holder's address.
- The shareholder's citizenship identity card number in case of a natural person and Certificate of Incorporation number in case of an unnatural person (company) or the RSEB code number.
- To be signed by the shareholder nominating the candidate.
- The name, address and contact details of the candidates so nominated.

Consents: A candidate so nominated shall be required to send his confirmation in writing.

Filing nomination: Nomination shall be filed and should be received by the company within seven days before the general meeting. Nomination forms and consents shall be addressed to the concerned company. Postal delay in receiving the nominations and forms shall not be the responsibility of the company.

Acceptance of nomination: The company shall notify the shareholder and the candidate in case of any irregularities and in the absence of such a notification, the same shall be deemed to be in order and hence accepted.

Voting system: Where the number of candidates is equal or lesser than the number of vacancies, *every candidate must receive more votes approving their election as a director*, which means a simple majority of votes by the shareholders present.

Where the number of candidates exceeds the number of vacancies, the Chairman shall call for a poll and every shareholder may vote in favour of the appointment of as many candidates as they approve of. *The candidates with the most votes in descending order will be selected until all vacancies are fulfilled.*

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Where the Government owns hundred percent of the shares or controls the majority of the shareholding, the Government can appoint its directors – meaning the Government is exempted from the voting procedures. In case the Government exercises this exemption, upon the maximum number of directors limit set by the Articles of Incorporation – if any, the vacancies shall be set forth on a proportionate basis on the number of directors appointed and the number of shares held by the Government. In such a case, only other shareholders will be subject to voting. Retirement could be one-third of the directors or all the directors if so noted in the Articles of Incorporation. However, if the Government decides not to exercise the above exemption, voting will be carried out for all.

The above procedures can be summarized as follows:
- The Government/Board/Shareholders nominate a candidate;
- Filing of nomination and receiving of consent to nomination from the nominated candidate;
- Acceptance of nomination by the company;
- Election by voting.

vi. Powers of Directors
a. General powers of Directors: Subject to the provisions of the Companies Act of the Kingdom of Bhutan, 2000, the Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorized to exercise and do.

However, the Board can not exercise any power or do any act or thing which is directed or required, whether by the Companies Act or by the Articles of the company or otherwise, to be exercised or done by the company in the general meeting.

The Board of Directors of a company shall exercise the following powers on behalf of the company and it shall do so only by means of resolutions passed at meetings of the Board.
- The power to make calls on shareholders in respect of money unpaid on their shares;
- The power to issue debentures;
- The power to borrow money otherwise than on debentures;
- The power to invest the funds of the company; and
- The power to make loans

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Besides the above powers mentioned there are certain other powers also which can be exercised only at the meetings of the Board. These include:

- The power to recommend the rate of dividends for the accounting period;
- The power to forfeit the shares of a defaulting member after serving a due notice;
- The power to delegate its powers to a committee of directors, the Chief Executive Officer or any principal officer of the company.

In general, the Board of Directors can also exercise the following powers:

- The Board shall have power at any time, and from time to time, to appoint a person as an additional director, provided the number of the Directors together shall not at any time exceed the maximum strength fixed for the Board by the Articles.

- The Board of Directors may meet for the dispatch of business, adjourn and regulate its meetings, as it thinks fit.

- A Director may, and the secretary on the requisition of a Director shall, at any time, summon a meeting of the Board.

- The seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or of the committee of a Board authorized by it on that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may appoint for the purpose; and those two directors and the secretary or other person as aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

- The Board shall from time to time determine whether and to what extent and at what times and places and under what conditions, the accounts and the books of the company , or any of them, shall be open to the inspection of members not being directors.

b. Restriction on powers of Board: The Board of Directors of a public company shall not, except with the consent of such company in general meeting:

- Sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company;
- Remit or give time for the repayment of any debt due by a director to the company;
- Borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed the aggregate of the paid up share capital and free reserves of the company (reserves not set apart for any specific purpose).

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vii. Duties of Directors

Every director of a company, in the exercise of his powers and discharge of his duties under the provisions of this Act or under the Articles, shall act honestly and in good faith in the best interests of the company and shall exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. (Section 91 of the Companies Act of the Kingdom of Bhutan, 2000).

viii. Remuneration of Directors

a. For Government Companies/corporations

- Directors may receive reasonable amounts as sitting fees;
- Directors may receive allowances equivalent to the Chief Executive Officer (CEO) when undertaking tasks assigned by the Board;
- Directors shall not be presented with any gifts by the corporation; and
- Directors shall not be entitled to concessions on the services or products of the corporation.

b. For Other Companies

- The remuneration of the directors shall consist of a monthly payment.
- In addition to the remuneration payable to them in pursuance of the Act, directors may be paid all traveling, hotel and other expenses properly incurred by them:
    * In attending and returning from meetings of the Board of Directors or any committee thereof or general meeting of the company; or
    * In connection with the business of the company.

ix. Removal of Directors

According to section 85 of the Companies Act of the Kingdom of Bhutan 2000, a Director can be removed in the following manner:

- A company may, by ordinary resolution, remove a Director before the expiry of period of his office.
- A notice signed by a shareholder at least fifteen days before the general meeting shall be required for proposing any resolution to remove a Director under the section along with the reasons or grounds for such removal.
- On receipt of notice under sub-section (2), the company shall forthwith send a copy of the proposed resolution to the Director concerned who shall be heard on the resolution at the meeting.

2.2. Chief Executive Officer

Section Two of the Companies Act of the Kingdom of Bhutan 2000 defines a Chief Executive Officer as "a full-time manager, by whatever name called, appointed by the Board with the approval of the company in the general meeting to manage the day to day affairs of the company or as otherwise determined by the Board, or the Articles or shareholders in general meeting". It means a Chief Executive Officer is entrusted with substantial powers of management authorized or delegated by the Board of Directors. He/She may also function as a Director as well as a manager. As a Director, he/she attends the Board meetings and as a Manager, he/she manages the day to day affairs of the company.

a. Appointment of Chief Executive Officer: Section 2 of the Companies Act of the Kingdom of Bhutan 2000 emphasizes on the appointment of Chief Executive Officer in the Public Ltd. Companies. According to this section:

- Every Public Ltd. Company shall appoint a Chief Executive Officer for a term not exceeding five years with the approval of the company at the general meeting.

- A person appointed as a Chief Executive Officer shall not be appointed as a Chief Executive Officer of two companies at a time.

- A person may be recommended for the post of Chief Executive Officer in a Government owned/controlled company by the Board through the sector Ministry from among the list of eligible Civil Service candidates provided by the Royal Civil Service Commission, if the Government wishes to appoint a civil servant on deputation. A non-civil service candidate may be recommended by the Board through the sector Ministry, for appointment as Chief Executive Officer based on merit and experience, in which case the appointment shall be for a fixed contract period with clear terms and conditions for performance linked remuneration package. The civil servant's appointment as CEO shall be approved by the Government for a term of five years only subject to satisfactory past performance, based on an evaluation system recommended by the Government.

Student Activity

1. Divide the class into two groups. Discuss in each group various factors that lead to the formation of Board of Directors in a company. Present the views of each group to the class and draw the inference of the need of the Board.

2. Think about a manufacturing concern. Prepare a comprehensive organizational structure showing all the details of managerial personnel.

3. Explain any three powers of directors which can be exercised through resolutions at meetings of the Board.

4. Discuss the concept of minimum amount of qualifying shares?

5. How are the directors appointed by the Government different from that of the directors appointed under the Companies Act?

6. Distinguish between a Chief Executive Officer and a Managing Director of a company.

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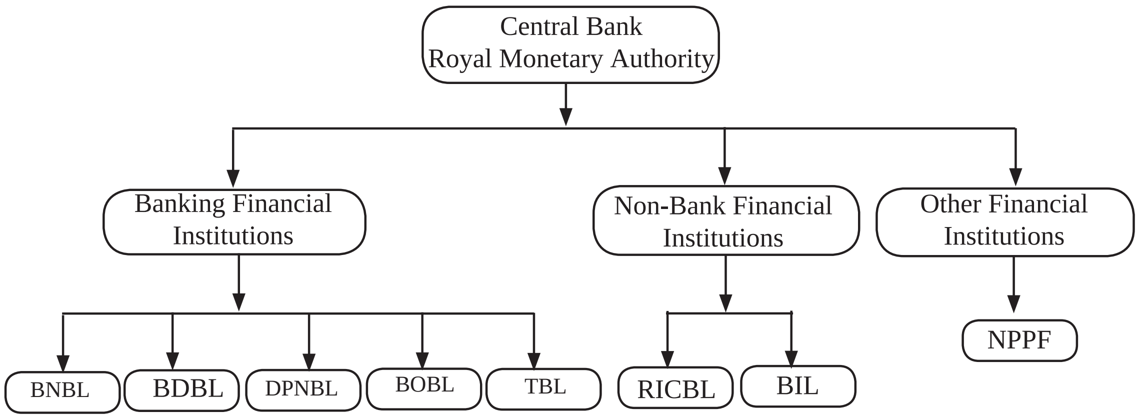
3.4. Financial institutions in Bhutan

Introduction

The financial Sector in Bhutan consists of the Central Bank, (the Royal Monetary Authority of Bhutan (RMA), two Commercial Banks, the Bank of Bhutan Limited (BOBL) and the Bhutan National Bank Limited (BNBL), two Non-bank Financial Institutions, the Royal Insurance Corporation of Bhutan Limited (RICBL) and the Bhutan Development Finance Corporation (BDFC), and two Other Financial Institutions, the National Pension and Provident Fund (NPPF) and the Royal Securities Exchange of Bhutan Limited (RSEBL).

The structure of the financial sector, which is under the supervision of the RMA, the apex institution, is shown in the diagram below.



Each of the financial institutions reflected in the diagram above is discussed below.

(Source: Annual Report 2003/2004, Royal Monetary Authority of Bhutan, January 2005.)

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THE ROYAL MONETARY AUTHORITY OF BHUTAN (RMA)

In August 1982, the RMA Act was passed by the National Assembly during its fifty-sixth session, while actual operations started from October 1983. General strategy, monetary policy, and all other important general decisions are entrusted to the Board of Directors. The Board consists of five members, i.e., the Minister of Finance and the Secretary of Finance, both of whom shall serve by virtue of their offices, the RMA's Managing Director, and two other appointed Directors. The day-to-day management is the responsibility of the Managing Director, with constant support of Deputy Managing Director I, (who is responsible for the Operations Department), and Deputy Managing Director II, (who is responsible for the Policy and Programs Department).

The basic functions of the RMA are, as is the case with virtually all other Central Banks:

- Achievement and Maintenance of Price Stability in the Medium and Longer Term;
- The Bank of Issue; The Bankers' Bank; The Government's Bank;
- The Advisor to the Government;
- The Guardian of the Country's Reserves;
- Supervision of Banks and Financial Institutions; and
- Promotion of Financial Sector Development.

In this regard, for achieving and maintaining Price Stability, a one-to-one peg between the Bhutanese Ngultrum (BTN) and the Indian Rupee (INR) has been chosen, which in view of the close economic relationships between India and Bhutan is the most appropriate Monetary Policy Target for the time being. This arrangement, however, implies that the RMA's scope for pursuing an Independent Monetary Policy is limited. As a consequence, the RMA uses, at present, Central Bank Policy Tools, such as RMA Bills, to a considerable degree for financial development, and the Cash Reserve Ratio, also for prudential purposes, and not exclusively for monetary policy purposes (i.e., the management of commercial banks' liquidity).

a) Role and Functions

In accordance with the RMA Act, 1982, *the RMA's Core Functions*, i.e., *the Central Function* and *the Subsidiary Functions*, can be summarised as follows:

- *Achievement and Maintenance of Price Stability in the Medium and Longer Term is the Central Function.*

  In view of the close economic and financial ties between Bhutan and India, an *Exchange Rate Target was chosen*, i.e., *the one-to-one Peg between the BTN and the INR*. *Monetary Policy*, which is aimed at achieving *Price Stability*, *is confined to the support of the Peg*, which involves making available sufficient INR on demand, providing at least 100% reserve backing for all BTN issued, the avoidance of a large BTN liquidity build-up, together with additional confidence-building measures for the BTN, implying, for example, credible RMA and Government policies. All the other *Subsidiary Functions*, which are also very important, and which complement the *Central Function*, are outlined below under *the Bank of Issue* and promotion of financial sector development..

- *The Bank of Issue.*
  The RMA has the sole right to issue notes and coins for the purpose of directly influencing the amount of currency in circulation outside banks, thereby providing the economy with sufficient, but if possible, non-inflationary liquidity.

- *The Bankers' Bank*
  This function includes the acceptance of deposits as prudential reserves for banks (e.g., Minimum Reserves), the willingness to discount commercial and Government paper, and the commitment to act as "lender of last resort" to banks in the case of short-term liquidity shortages. It also involves the provision of central clearance facilities for interbank transactions.

- *The Government's Bank*
  The RMA is the banker and the fiscal agent for the Government, and may be the depository of the Government. The Central Bank may also make temporary advances to the Government.

- *The Advisor to the Government*
  The RMA may advise the Government on any matter relating to its functions, powers and duties. The RMA may also be requested to advise the Government on any matter related to its functions, powers and duties, the credit conditions in the country, or any proposal, measures, and transactions relating thereto.

- *The Guardian of the Country's External Reserves*
  The RMA is the depository of the official external assets of the country, including gold and foreign currency reserves. Guarding international reserves usually implies also the responsibility for the Exchange Rate Policy (in Bhutan the external value of the BTN is declared by the Government on recommendation of the RMA's Board, while the RMA has to implement and support it), Reserve Management (with a view to the prudential management of the funds, with due regard to liquidity, safety, and

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profitability, in that order), and External Debt Management on behalf of the Ministry of Finance. In Bhutan, as in various other developing countries (e.g., in India), Reserve Management also includes the formulation, implementation, monitoring, and enforcement of Foreign Exchange Regulations.

- *Supervision of Banks and Other Financial Institutions*
  In general, this activity, which in quite a few countries is carried out by a separate institution, involves insuring that deposit money banks and other financial institutions conduct their business on a sound prudential basis and according to the various rules and regulations in force. It also includes the licensing of financial institutions.

  In the "Small Economy Case" and/or countries at a relatively early stage of economic and institutional development (e.g., in Bhutan and the Maldives) there is a very good case for making the Central Bank also responsible for Financial Institutions' Supervision (including all Financial Institutions) on account of economies of scale and the Central Bank's Financial sector expertise. In larger developing countries, one might think at a later stage of development of creating a separate institution for Financial Institutions' Supervision, or even several separate institutions.

- *Promotion of Financial Sector Development*
  This refers to the establishment of an effective financial system, with the aid of which financial transactions necessary for the smooth functioning of the economy can be carried out with a minimum amount of cost and time involved. In this connection, the RMA has to be a facilitator of advanced clearing and transfer systems. It also implies that the necessary banking services, as, for example, deposit facilities and loan facilities, are made available. Of importance is also the establishment of a deposit insurance system and the availability of certain specialised institutions, which could be represented, for example, by an industrial development bank, an agricultural development bank, and microfinance institutions, and the facilitation of a money market, primary and secondary markets for securities, a foreign exchange market, and a capital market. In other words, the RMA should be heavily involved in Financial Sector Development, which already is the case.

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b) Monetary Policy Framework

The RMA's Monetary Policy Framework is implicit. According to the RMA Act, Section 6 b), one of the purposes of the RMA is "to promote monetary stability", which can be interpreted as the *promotion of "Price Stability".* In some Central Bank Acts, *Price Stability* is quantified, e.g., in the case of the European Central Bank, *Price Stability* is equivalent to a year-to-year rate of change of the Consumer Price Index below, but close to, 2 percent, to be maintained over the medium term. The Intermediate Target for achieving and maintaining Price Stability in Bhutan is the one-to-one peg between the INR and the BTN. In other words, an Independent Monetary Policy in Bhutan is, more or less, limited. As a consequence, Monetary Policy is confined to the support of the peg, including the following basic measures:

- Ensuring the sustainability of the exchange rate arrangement, i.e., always making available sufficient INR on demand for exchange with the BTN for payments in India and provision of at least 100 percent reserve backing for all BTN issued (elements of a Currency Board).

- Confidence-building measures for the BTN (e.g., credible RMA and Government policies).

- Sterilising any persistent growth in liquidity to forestall a possible build-up of inflationary pressures, a weakening of the balance of payments, and a contingent effect on the financial market.

  The following are the main supporting factors for the present system:

  - Close economic and financial relationships exist between India and Bhutan.

  - There is a dual currency system, with the BTN and the INR circulating freely side by side in Bhutan. This system can be described as an informal monetary (currency) union with India.

  - Inflation and interest rates in the two countries are closely related.

  - The arrangement maintains confidence and ties Bhutan to the relatively stable monetary conditions in India.

  - The peg has also clear benefits for trade with India, since there is no uncertainty about exchange rate developments between the two trading partners.

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On the basis of the above factors, *the Monetary Policy Decisions made in Bhutan are generally viewed as prudent and appropriate* (e.g., by the International Monetary Fund).

While ensuring the sustainability of the exchange rate arrangement, the Monetary Authority is also required to play an important role in *Monetary and Credit Management*, largely owing to the build-up of excess liquidity in recent years. With the elimination of *Quantitative Credit Controls*, it has developed and increasingly relied upon more *Indirect Instruments of Monetary Management*. In particular, for the purpose of liquidity management in the banking system, the RMA has resorted to *variations in Reserve Requirements*, the *sale of Central Bank Bills*, and the *sale of Foreign Exchange to banks*. Through the sale of the short-term *Central Bank Bills,* the RMA also aims to establish a modest *money market* and to set a *frame of reference for interest rates.*

According to the Act, the RMA has also at its disposal various *Liquidity Support Facilities* (e.g., discount of bills and secured loans), which, however, are not being used at present due to the relatively large surplus liquidity of commercial banks.

(Sources: RMA Booklet – Role and Functions, Monetary Policy Framework, and Organization Structure, Royal Monetary Authority of Bhutan, November 2004. Annual Report 2003/2004, Royal Monetary Authority of Bhutan, January 2005.)

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Commercial Banks

Banking Institutions in Bhutan include the two commercial banks viz., The Bank of Bhutan Limited (BOBL) and The Bhutan National Bank Limited (BNBL).

i. Bank of Bhutan Limited (BOBL)

Fig. 3.1. Bank of Bhutan Limited Head Office in Phuentsholing, (Source: BOB Annual Report 2003)

It was established in 1968 through a Royal Charter. Bank of Bhutan Limited is the oldest financial institution in Bhutan with the paid-up capital of Nu. 100 million and reserves of Nu.351.29 million (Dec. 1999).

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The Royal Government of Bhutan is the biggest shareholder (it holds about 80 per cent of the shares), while The State bank of India (SBI) holds about 20 per cent of the shares. The Authorized capital of the Bank of Bhutan is Nu. 250 million. The paid up capital and reserve as of December 2003 was Nu. 917.302 millions. The total assets stood at Nu.12, 351.433 millions in December 2003.

It operates with 26 branches (as of Dec. 2003). In 2003, the bank sanctioned loans amounting to Nu. 1047.404 millions of which major financing (67 per cent) went to trade, commerce, manufacturing and industrial sectors.
(Source: Bank of Bhutan, 36th Annual Report, 2003)

ii. Bhutan National Bank Limited (BNBL)

Being pressurized by the business community and BOBL's monopoly, the Royal Government of Bhutan finally decided with the assistance of the Asian Development Bank (ADB) to convert the Unit Trust of Bhutan (UTB), established in 1980, into a commercial bank. Hence the UTB was made a full-fledged commercial bank and renamed as Bhutan National Bank Limited (BNBL). The Bhutan National Bank Limited started in 1997. As of December 2009, there are seven branches located in Thimphu, Phuentsholing, Paro, Mongar, Gelephu, Wangduephodrang and Bumthang and two extension offices located in Samdrupjongkhar and Trashigang. The bank has a proposal to establish full fledged branches in Bumthang and Gelephu in the near future.

The BNBL has the authorized capital amounting to Nu. 200 millions and the subscribed and paid up capital of Nu. 59.5 millions. The total assets of BNBL stood at Nu. 5559.307 millions as of December 2003. The general public is the largest shareholder holding about 28.6 percent of the shares while Royal Government of Bhutan(RGOB) the second largest shareholder holds 27.2 percent of the shares. Asian Development Bank (ADB), Citibank (USA) and RICB hold 20.1 percent, 19.9 percent and 4.2 percent respectively. The BNBL's major share of loans and advances went to other large industries than small business industries like any other financial institutions. *(Source: Bhutan National Bank)*

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Functions of Commercial Banks

The commercial banks play an important role in contributing to economic development of the country. Modern commercial banks perform a number of functions and provide a number of services to the various sections of the society and to the Government itself. The functions of the commercial banks can be broadly classified into two.

- Banking or primary function, and
- Subsidiary or agency or secondary functions.

The former includes all those functions which any banking institutions should perform. Sayers explains these functions as "trading and manufacture of money" by the bank. The later type of functions mainly includes utility services provided by the bank. The functions of commercial bank have been discussed in detail below:

1. Acceptance of deposits

This is the most important function of the commercial bank. The commercial bank accepts the deposits from the people who possess the ability to save but are unable to utilize their savings properly. The bank accepts the deposits in two forms i.e., a) Demand deposits and b) Time deposits.

a) Demand Deposits

The demand deposits include saving deposit accounts and current deposit accounts.

- Saving Deposit Accounts

  This account is commonly held by individuals/households who have idle cash. But there are certain restrictions imposed on the depositors. They can withdraw any sum of money any time but they will have to maintain the minimum balance prescribed by the bank in their accounts. Withdrawal of money is restricted to twice or thrice a week. It is payable on demand and can be withdrawn either by issue of cheques or withdrawal forms. The bank also imposes restriction on the amount and a number of withdrawals during a particular period. The rate of interest is generally low in comparison to other types of deposits such as fixed or recurring deposits.

- Current Deposit Accounts

  The current deposit account is usually suitable for busy traders and business people who use them for making business payments. These deposits can be drawn upon by cheque without any restriction on the account as many times as they desire. The commercial banks provides various services to the current account holders such as

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making payments through cheques, collection of payment of cheques, issuing drafts on behalf of the account holders, etc. So, the bank does not pay any interest to the depositors. Banks, rather, levy certain service charges on the customers for the services rendered by them.

b) Time Deposits

The time deposit includes recurring deposit accounts and fixed deposit accounts.

- Recurring Deposit Accounts

  Under recurring deposit account, a depositor makes a regular deposit of a certain sum for a specified period (e.g., Nu. 2000 per month for a period of 2 years). The depositor will have to deposit the specified amount of money regularly every month till the maturity date. On maturity, the depositor will be paid in lump sum the accumulated amount deposited together with the interest payable. Hence, the depositor cannot withdraw the amount deposited before the expiry of the specified period. This account is designed to motivate the small savers to save a particular amount regularly. The rate of interest is comparatively higher than demand deposit accounts.

- Fixed Deposit Accounts

  The money is deposited for a fixed period, viz; one year, two years, three years, five years or more. For instance, if a person has deposited a sum of Nu.50, 000 in this account for a period of five years, he cannot withdraw the money before the expiry of the five year period. The interest on this deposit is higher than other deposit accounts since the bank can invest this money and earn interest as the money cannot be withdrawn by the depositor before the expiry of the specified period. The rate of interest varies with the length of time for which the deposit has been made. For example, the rate of interest on a certain sum (say, Nu. 50,000) for a period of five years will be higher than the rate of interest on the sum (say, Nu. 50,000) for a period of two years.

2. Advancing of Loans

The second important function of a commercial bank is the advancing of loans. After keeping a certain percentage of cash reserves, the balance deposits are lent out by the bank to small and large borrowers in the form of loans and advances. The borrowers of this fund are usually the government, the business houses and individuals (investors). The rate of interest charged varies on the amount, type of loan and the period for which the loan is taken. The loan facilities take the forms of cash credit, loans, overdraft facilities and discounting of the bills of exchange.

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- Cash Credit

  Cash credit is a short term borrowing. It is very useful to the Bhutanese business people. Loans are provided to the borrowers against certain collateral security. The full amount of loan is not given at a particular time. The bank opens an account in the name of the borrower and allows him/her to withdraw the amount as and when he needs as per the requirement. The bank charges interest on only actual amount used and not on the full amount of loan sanctioned. The rate of interest charged on cash credit is higher than that charged on loan.

- Loans

  A loan is a specified amount which is granted by the banker to the customer. It may be either medium or long term loans. The Loan is granted for a fixed period, say for one year, two years or more. The whole amount sanctioned is credited to the borrower. The borrower has the option either to withdraw the amount in lump sum or draw cheques against this sum up to the upper limit allowed. A loan is usually granted against the security of assets or the personal security of the borrower. The loan may be repaid either in installments or in lump sum. Interest is charged on the entire amount of loan sanctioned irrespective of whether the borrower uses the full amount or not. The rate of interest is lower than that of cash credit and the bank overdraft facilities.

- Overdraft facilities

  The bank overdraft facility is granted to the current deposit account holder of the commercial banks. It is a short period arrangement and is very popular and useful to the Bhutanese business people. This overdraft facility is given to the customer on the security of assets or on the personal security of the customer. A customer having a current deposit account is allowed to draw cheques in excess of the deposited amount to his credit and up to the amount specified by the banks. Interest is charged only on the amount overdrawn by the customer and not on the full amount granted by the bank. The rate of interest on bank overdraft is always higher than that of loans.

- Discounting Bills of Exchange

  The discounting of bills of exchange is also an important form of lending. It is a very popular type of lending to the business community in the modern economy. Discounting of bills facilitates modern business transactions in many ways. The creditor (the holder of the bills of exchange) cannot encash the bill before its maturity. Therefore, if the creditor is in need of money before the maturity of the bill, he/she can get it discounted from the commercial bank. The commercial bank purchases/ discounts these bills of exchanges at the present rate after deducting its commission from the holder of the bill.

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For example, Karma sells goods to Pema on credit. Usually he draws a bill on Pema. If Karma is in need of money before the bill expires, then Karma takes the bill to his bank and gets cash at its present worth (i.e. after deducting the commission). The bank ultimately recovers the amount from Pema on the due date of the bill.

3. Agency Functions

Both the commercial banks in Bhutan (i.e., Bank of Bhutan Limited and the Bhutan National Bank Limited) also act as the agents of their customers. In their capacity as the agents of their clients, these commercial banks provide the following agency services:

- Collection and payment of cheques and bills on behalf of the customers;
- Collection of dividends, interest, rent, etc. on behalf of the customers if so instructed;
- Payment of rent, interest, insurance premium, subscriptions, etc on behalf of the customers on request;
- Purchase and sale of shares and securities on behalf of their customers on request;
- Acting as trustees or executors, etc.; and
- Acting as correspondence on behalf of their customers for other banks and financial institutions at home and abroad.

4. General Utility Services

These functions of the commercial banks are not only to their clients but also to the general public. The general utility services provided by the BOB and the BNB include:

- Issuing circular notes, drafts, and traveler's cheques to the people;
- Receiving securities for safe custody;
- Underwriting of shares, debentures, etc.;
- Acting as referees to their customers thereby strengthening their reputation;
- Supplying useful trade information to their customers;
- Issuing of credit cards to the people for credit security, liquidity and respectability in international transaction. This facility will provide easy access to funds any time from anywhere in the world. In Bhutan, the Bhutan National Bank Limited provides this service.

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Non-Bank Financial Institutions

Unlike the banking institutions, the Non-Bank Financial Institutions do not accept deposits from the public. However they grant medium and long term loans against collaterals or securities to individuals and business houses. As already explained, they function under the strict supervision and in accordance with the regulations laid down by the Royal Monetary Authority. As of today, there are two main non-banking financial institutions in Bhutan. They play vital role in Bhutan's socio-economic development. These non-banking financial institutions mobilize and channel their capital for developmental projects and commercial undertakings. The non-banking financial institutions in Bhutan include, (i) The Royal Insurance Corporation of Bhutan Limited (RICBL) and (ii) The Bhutan Development Finance Corporation Limited (BDFCL).

i. The Royal Insurance Corporation of Bhutan Limited (RICBL)

The Royal Insurance Corporation of Bhutan Limited, commonly known as RICB is the only Insurance Company and the second largest Financial Institution in the Kingdom. The Royal Government established RICB on 7th January 1975, under the Royal Charter of the Third King, His Majesty Jigme Dorji Wangchuck with HRH Ashi Sonam Choden Wangchuck as the founding Chairperson. It was established

Fig. 3.2. Head Office of RICB in Phuntsholing (Source: Glimpses, RICB, 2000)

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primarily to meet the insurance needs of Bhutanese citizens as well as to actively participate in the economic development of the nation. The RICBL was subsequently registered in October 1991 under the Companies Act of the Kingdom of Bhutan in 1989. Later in 1992, The RICBL was licensed under the Financial Institution Act of Bhutan, 1992.

Over the years the RICBL has grown from strength to strength in keeping with the nation's march towards the goal of economic growth, self-reliance and Gross National Happiness. The Corporation's capital stood at Nu. 167.1 millions (subscribed and paid up shares at Nu. 24 millions and reserves and surpluses at Nu. 143.1 millions). The authorized capital was Nu.50 millions and the total assets stood at Nu. 2453 millions (as of December 1999).

The major share is held by the Royal Government of Bhutan (RGOB) but has been divested to the private sector. The RICBL serves with nine branch offices, one regional office and one head office providing various types of insurance services in the country. In addition, RICBL also provides different types of lending. The Credit and Investment Division of the RICBL provides small loans to small business in industries and services. However, its major part of the advances/loans goes to huge industries requiring high investments. The Corporation provided various types of loans amounting to Nu. 1211.644 millions as of December 2003.

a) Objectives of the RICBL

Ever since its inception in1975, the RICBL have been functioning with following objectives:

- Serve the policy holders to the best of RICBL's capabilities,
- participate in the economic development of the country,
- underwrite all forms of insurance,
- enlarge into re-insurance, and
- develop local expertise in project planning and implementation.*(Source: Chetri Saamdu and Dhar Samirendra Nath, 2004, page 115)*

b) Functions of the RICBL

The RICBL, being a premier financial institution in the kingdom, performs the following functions:

1) Primary Functions

Providing Insurance services to the general public. This is the primary and the most important function of the RICB. In fact the Corporation was established mainly to take up this responsibility. The various types of insurance services provided by the RICB are as follows:

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- Life Insurance

  Life insurance is usually referred to as life assurance. The Life Insurance business is one of the most important activities that the corporation had been dealing with. RICBL takes all possible steps to achieve satisfactory growth rate in life insurance sector, its pioneer activity. The life insurance policy financially covers all unforeseen circumstances of all individual units of one's family if insured. The RICBL will compensate to the insured a certain sum on the happening of a specified event in the life of insured i.e., in the event of permanent disability, the reaching of the particular age or during his/her death to his/her legal heir.

- Fire Insurance

  Fire insurance covers risk against loss or damage of properties caused by fire including lightning. Under this policy, the RICB undertakes into consideration the premium paid to compensate for any loss or damage of properties caused by fire during a given period subject to the maximum limit. It is important that fire must be accidental and not intentional.

- Marine Insurance

  Marine Insurance consists of Hull Insurance and cargo insurance. In Bhutan we are concerned with Insurance of Cargo, i.e. insurance against various risks relating to movement of merchandise and goods by various means of transport.

- Miscellaneous Insurance

  This class of insurance comprises several types of Insurance policies to cover a variety of other risks such as Motor Vehicle Insurance, Burglary Insurance, Fidelity Guarantee Insurance, Accident Insurance, Money/Cash-in-transit Insurance, Engineering Insurance etc.

2) Secondary Functions

- Advancing Loans

  The RICB also provides small loans to small, medium and large scale business through its Credit and Investment Division. During 2003, the corporation provided financial services to housing (37.70 percent), industries (22.00 per cent), Staff/RICB card/shares (11.24 per cent), construction revenue and credit (9.04 per cent), business (6.85 per cent), preferential finance (5.12 per cent), consumer (4.33 per cent), transport (3.71 per cent) and agriculture (0.01 per cent) accounting to a total loan portfolio of Nu. 1,211.644 millions as of December 2003.

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- Developing Housing Estate

  The need for dependable shelter is one of the most basic physiological requirements of humans. With need for real estate growing day to day, RICBL has played a dynamic role in financing construction activities as well as developing housing estates all over Bhutan with the primary objective of meeting the civil service personnel's housing demand. In real estate sector RICBL provides residential accommodation and has helped to overcome the shortage of accommodation to a certain extent.

  Development of housing estate by RICBL started as early as 1977 initially at Thimphu, Phuentsholing, Samtse and Samdrup Jongkhar towns. Now, this function of RICBL had been taken over by National Pension and Provident Fund (NPPF).

- Financing Micro enterprises

  The RICBL participates in the Entrepreneurship Development Programme (EDP) like any other financial institutions. It has steadily increased its credit to micro entrepreneurs, although very minimal (i.e. less than 1 percent of its total loan portfolio), through its Credit investment Division. During early 1990's, the RICB launched a scheme for providing credit facilities to small transport entrepreneurs, but it failed due to bad recovery. Hence, the RICBL started functioning like any other financial institutions in terms of providing credit to micro enterprises.

- Providing for children's education

  Children's education today is becoming a costly affair. It calls for wise planning for parents in advance. The Millennium Education Scheme introduced by the RICBL in year 2000 provides funding provisions for higher education of children in future.

ii. Bhutan Development Finance Corporation Limited (BDFCL)

Bhutan Development Finance Corporation was established on 31st January, 1988 under the Royal Charter of the Fourth King, His Majesty Jigme Singye Wangchuck a development financial institution in Bhutan to promote and accelerate the industrial and agricultural developmental activities in the country. The Corporation was later registered with the Companies Act of the Kingdom of Bhutan, 1989.

The organization is divided into two Lending Sectors. In the Industrial Lending sector, the main aim of the institution is to act as a catalyst in the rapid industrialization process of the country especially in the private sector. In the agricultural sector, its principal goal is to assist the small farmers to increase production and thus their incomes, thereby, improving their standard of living. The increase in production of food on a nation-wide basis will assist Bhutan

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become self sufficient thus fulfilling one of the major aims of the government. One of the organization's specific roles is to meet the needs of the poor rural farmers and the small-scale entrepreneurs. Its incorporation was assisted by the Asian Development Bank (ADB).

As of December 2003, its total assets stood at Nu. 1242.09 millions. The authorized share capital was at Nu. 200 millions of which Nu. 100 million is subscribed and paid up. The Royal Government and the financial institutions are the shareholders of the BDFCL. The BDFCL serves with 21 offices, one in each Dzongkhag. The Head Office of the BDFCL is located in Thimphu with a Liaison Office in Phuentsholing.

a) Sources of Fund

The sources of fund for BDFCL consist of paid up share capital, rural credit bond, reserves and surplus, an operational subsidy provided by the government and grants received from donors and other foreign agencies. The donors and the foreign agencies provide financing either as grants or concessional term loans channeled through the government mechanism. The donors and the foreign agencies financing the BDFC are:

- United Nation Capital Development Fund (UNCDF)
- Asian Development Bank (ADB)
- The International Fund for Agricultural Development Fund (IFAD)
- The Kuwait Fund for Arab Economic Development (KFAED) and
- The Swiss Industrial Development Fund (SIDF)

b) Objectives of the BDFCL

Ever since its establishment in 1988, it operates with the following directed objectives of the government.

- To provide micro-credit to all the rural farmers so that they can increase their production and thereby increase their household income in the agricultural sector.
- To provide much needed capital to the small and medium business entrepreneurs who are neglected by commercial banks due to lack of collateral securities.
- To provide consultancy and advisory services to business enterprises.
- To mobilize external and internal capital resources for investment in the industrial and agricultural sector.
- To engage primarily in the promotion of industrial and agricultural activities in the Kingdom so as to boost their growth.
- To provide continuous human resource management and training through both internal and external means to the employees of the organization.

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c) Functions of the BDFCL

BDFCL, as a development finance institution performs a number of functions. Some of the functions of the BDFC are stated below.

1. Advancing of loans

The main purpose of BDFCL as a development bank is to provide credit to small and medium scale industries and agricultural activities in the Kingdom. The organization is divided into two Lending Sectors viz.(i) Industrial and (ii) Agricultural Lending Sectors.

- Industrial Lending Sector

  The BDFCL provides concessional loans to small and medium scale industries, especially, in the private sector to accelerate industrialization in the country. In addition to the financial support, the Corporation also provides technical and advisory assistance to the enterprises and mobilizes external and internal capital for investment in enterprises. In 2003 the total loans disbursed by the BDFCL to small and medium industries amounted to Nu. 288.71 millions. As of December 2003, cumulative number of clients assisted by the BDFC under Industrial Lending was 2,703.

- Agricultural Lending Sector

  BDFCL's principal goal is to assist the small farmers to increase production and increase their incomes, thereby improving their living standard. Usually, the rural farmers find it very difficult to get credit facilities from the commercial banks. Farmers cannot fulfill the high collateral requirement as well as the conditions imposed by the commercial banks. The banks do not want to venture into rural lending due to the high costs in administration of these loans. Therefore, farmers become easy victims of unscrupulous money lenders who charge high interest on indigenous loans. In such situations, the BDFCL makes funds available to rural farmers on easy terms and low interest rates. The rural populace which now constitutes around 79 per cent of the total population is increasingly taking advantage of the credit provided by the BDFCL.

  As of December 2003, the total loans provided by BDFC to rural farmers amounted to Nu.195.93 millions whereas the cumulative number of clients assisted by the BDFC under Agricultural Lending stood at 55,961.

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2. Promotional Functions

While advancing of loans is the primary function of the BDFCL, it also provides number of services for the promotion of micro enterprises. To achieve this objective, the BDFCL established a full-fledged Entrepreneurship Development Programme (EDP) cell for enhancing the development of small business in Bhutan. The main activities of the cell are to:

- liaison with the Ministry of Economic Affairs (MoEA) and other agencies to access to potential entrepreneurs,
- assist in preparing proposal for financing by the BDFC,
- conduct appraisal of the projects,
- provide assistance and consultation for entrepreneurs, and
- sponsor 20 entrepreneurs each year and provide support up to Nu. 2 millions to each selected entrepreneur.

d) Evaluation of the workings of the BDFCL

i. Strengths of BDFCL

BDFCL's strengths are summarized as follows:

- Farmer friendly loan Scheme

  BDFCL is the only development financial institution with a rural focus. Its loan schemes are revised from time to time to make it farmer friendly and achieve increased outreach and accessibility of loans. The rural farmers were earlier neglected by the existing commercial institutions due to high collateral requirement and abnormally high interest rate charges. BDFC's strength lies in the fact that its lending is based on project viability and cash flow basis rather than collateral based.

- Support from International Agencies and Donors

  BDFCL is the only institution directly supported by international agencies and donors with funds that are either free of cost or as soft loans. This has enabled the organization to have ready access to both international and domestic markets for its resource mobilization through the support of the government and is able to obtain funds at much lower cost than its commercial competitors.

- Exemption from duty and taxes
  Plant and equipment purchased through loans from BDFCL are exempted from any form of duty and taxes from the government.

- Efficient Human Resources
  Owing to its governmental connection, the organization has been able to tap technical assistance in the form of training, scholarship and equipment facilities provided by international agencies. It has ready access to experts from outside the country also.
- Transparency and Decentralization in Management and Operation
  One of the greatest advantages of the Corporation is its transparency in both its management and operation systems. The present management has provided its employees and staff with clear delineation of powers in the day to day running affairs of the corporation. The District Credit Officers (DCOs) are fully empowered to take decisions regarding credit activities in the villages of the districts.

e) Challenges of the BDFCL

1. Low loan recovery

In spite of the continuous effort by the management to enhance the effectiveness and efficiency of the operations, the single biggest problem is the very low loan recovery especially in the agricultural sector where the recovery rate has now just reached around 65 per cent. The low recovery has been attributed by many factors, the following being the main ones:

- Lack of proper feasibility studies and monitoring of loans by the staff and concerned sector heads of the government.
- Weak extension services and low literacy rate of most clients.
- Lack of credit and financial discipline of clients. Most farmers regard the credit as free money from the government.
- Abuse and misappropriation of funds by the staff, local public representatives such as village head persons (Gups), district officials and sector agencies of the government.
- Lack of support, initiative and action by local district judicial courts to settle cases regarding the defaulters.
- Lack of co-operation from local public representatives and among the villagers themselves in effectively dealing with loan defaulters.
- Lack of proper accountability and responsibility by the chairperson of the District Loan Committee when disbursing loans to the farmer clients.

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2. High Credit Administration Cost

The Corporation also faces with the difficulty of high cost of administering the credit especially in the rural areas due to the natural and physical constraints to development as mentioned earlier.

3. Lack of Collateral

This difficulty includes the lack of collateral which the corporation is not permitted to execute with the rural population for their loans. This makes it difficult for the Corporation to recover the loans from the farmers at the time when they fail to repay the loans on the due date.

4. Low turnover of the funds

Another difficulty faced by the BDFC is the low turnover or recycling of the funds as most loan repayments are made by farmers on an annual basis.

5. Lack of well trained and educated work force

The Corporation lacks well trained and educated work force in the organization that is able to provide proper feasibility and good appraisal of loans. This drawback on the part of the workforce lowers smooth functioning of the Corporation.

The organization also faces the additional difficulty of recruiting people who are willing to take up posts in the remote dzongkhags.

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Other Financial Institutions

There are two institutions, viz. National Pension and Provident Fund (NPPF) and the Royal Securities Exchange of Bhutan Limitted (RSEBL). In this section we will deal only with NPPF as RSEBL had been discussed in detail in Class XI Commerce Supplementary text.

National Pension and Provident Fund (NPPF)

The retirement security is an integral part of social development. As the nation sets its millennium goal with Gross National Happiness at the backdrop, the retirement income for old age security assumed a greater importance.

Fig. 3.3. NPPF investment in real estate.

At present, Bhutan's old age securities to a large extent rely exclusively on traditional family support which is referred as *informal arrangement*. Until June 2002, the gratuity (established in 1962) and the Government Employees Provident Fund (GEPF established in 1976) were the only two *formal retirement schemes* instituted for the public sector employees- civil service, government owned corporations and the Armed Forces. The retirement benefits from these two schemes though *limited to lump-sum* played a vital role in shaping old age security in Bhutan.

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But a greater demand for retirement security was felt in the process of economic development and social disintegration because lump-sum provision from the two formal schemes:

- attributed to a minimal benefit;
- supply short-term income; and
- failed to guarantee a life long income during old age.

As a result, on July 1, 2002 the Royal Government introduced the National Pension and Provident Fund Plan replacing the Government Employees Provident Fund (GEPF) to provide more predictable and adequate income for old age consumptions.

The National Pension and Provident Fund (NPPF) is an autonomous entity, established in March 2000 to manage and administer the National Pension and Provident Fund Plan (NPPFP). The National Pension and Provident Fund is operating under the direction and supervision of the Board of Directors called the "National Pension Board (NPB)" consisting of members from various stakeholders.

a) Main objectives of the National Pension and Provident Fund Plan.

The basic purpose of the existing plan is to assure and promote a meaningful protection against the hazard of old age, disability and death of a member resulting in loss of income or financial burden. It envisages with threefold objectives:

- *to enhance and promote the retirement security of the retirees;*
- *to achieve greater adequacy of living standard during old age; and*
- *to promote the high integrity in the workforce through sustainable old age security provision that promote the **Value of Gross National Happiness.***

In addition to the above objectives, the NPPF also aims fulfilling other important objectives such as:

1. Investment in the housing and education programmes through *Member Housing and Education Loan Schemes*;

2. Widening the macro-economic base of the country:
    - *maintaining savings schemes for old age* that affects the income distribution and inter alia, permit the maintenance of consumption levels for people during inactive phases of their lives; and
    - *mobilizing savings and investments through loans to the Royal Government and the public limited companies* that enhance productivity and improvement in financial innovation.

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b) Current members of the Pension and Provident Fund Plan

The current retirement plan envisages covering the entire salaried workforce in the country including private sectors. However, at present, the statute covers civil servants, employees of government owned corporations, financial institutions, joint sector companies and the Armed Forces constituting about 5 percent of the population and 7 percent of the labour forces.

c) Various Pension and Provident Fund Plans

Under the National Pension and Provident Fund, the Pension and Provident Fund Plan is classified into two:

1. *National Pension and Provident Fund Plan (NPPFP)*

   The members are the employees of civil service, government owned corporations, financial institutions and joint sector companies and the Rules and Regulations for this plan is laid down in the National Pension and Provident Fund Plan.

2. *Armed Forces Pension and Provident Fund Scheme (AFPPFS)*

   It covers the members of the Armed Forces and the Rules and Regulations for this scheme is laid down in the Armed Forces Pension and Provident Fund Scheme.*(The subsequent discussion focuses only on the National Pension and Provident Plan)*

d) National Pension and Provident Fund Plan

The National Pension and Provident Fund Plan comprises of two different tiers:

- **National Pension Plan as Tier 1**: It is a Defined Benefit (DB) plan under which *monthly pensions* are paid to the *members upon superannuation, permanent disability and death to the surviving family members*.

- **Provident Fund Plan as Tier 2**: It is a Defined Contribution plan under which a *lump-sum benefit* equivalent to accumulated contributions made to the Member's Provident Fund Account with investment returns are paid to the members on retirement and to the nominee (s) on the death of a member while in service.

e) Contributions to the National Pension and Provident Fund Plan

Currently, the employees contribute a minimum of 11 percent of the monthly basic salary with matching contributions from the employer making a total contribution of 22 percent to the National Pension and Provident Fund Plan. This provision is applicable to all the civil servants, the employees of corporate and financial institutions.

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f) Crediting of contributions to National Pension and Provident Fund Plan Account
Out of the total contributions rate of 22 percent, 16 percent of monthly basic salary is allocated to finance Defined Benefit (DB) Plan and the balance of 6% to Member's Provident Fund Account.

g) Pension Benefits under the National Pension Plan, Tier 1:
Benefits under this plan provide monthly:

1. ***Retirement* pension** to the members until death;

2. ***Disability benefit*** on member's permanent disability until recovery or attaining minimum civil service retirement age or death whichever is earlier;

3. ***Survivors Benefits*** on the death of a member:
   - ***Spousal benefits*** on attaining age 50 until remarriage or death whichever is earlier
   - ***Children benefits*** under age 18 years
   - ***Orphan benefits*** under age 18 years
   - ***Dependent parent benefits*** on attaining minimum civil service retirement age until death.

1. Member Retirement Pension
Pension to members are paid on retirement from service on attaining minimum civil service retirement age (currently 56 years) and has contributed a minimum of 120 months to National Pension and Provident Fund Plan. The calculations for retirement and early retirement are done as follows:

i) Methodology for Computation of Retirement Pension
The retirement pension is computed based on the pension point earned multiplied by 60 percent of Average Civil Service Salary Index (refer Box 1 for ACSSI computation) of the previous financial year divided by the full working period. The formula to determine pension is as under:

$$\textit{Member Pension} = \frac{\textit{Total Pension Points X 60\% of Average Civil Service Salary Index}}{\textit{Full working period}}$$

(Full working periods are predetermined in the National Pension and Provident Fund Plan Rules and Regulations. Currently, on the date of commencement of the pension plan, it is taken as 30 years and shall increase by 2 months each year thereafter).

Box 1. Definition of Average Civil Service Salary Index (ACSSI)

Theoretically, **ACSSI** is defined as follows:
For the period of twelve months ending on June 30 of each year, the total civil service monthly salary paid to civil servants who are members of the National Pension & Provident Fund Plan are added up resulting in **total civil servants salary.** The numbers of civil servants actually worked in the same twelve months period are all added up resulting in **total service.** The total civil servants salary is divided by the total service resulting in **Average Civil Service Salary Index (ACSSI).**

$$\text{ACSSI} = \frac{\text{Total civil servants salary}}{\text{Total service}}$$

Pension Point (s) in time period t is a ratio of annual basic salary of a member in time period *t* and the Average Civil Service Salary Index (ACSSI) of the same year

Box 2. Illustration on Pension Points

An employee of civil service joined the NPPFP on July 1, 2005 in the beginning of financial year 2005-2006 with a monthly basic salary of Nu. 10,000. As of June 30, 2006, after one of year of contribution, he earned a total basic salary of Nu. 120,000. Assume the annual ACCSI during the financial year 2005-2006 determined by the National Pension Board of Nu. 83,000. Then,

$$\text{Pension Points}_{\text{2005-2006}} = \frac{\text{Annual Basic Salary}_{\text{2005-2006}}}{\text{ACSSI}_{\text{2005-2006}}}$$

$$= \frac{120{,}000}{83{,}000} = 1.4458$$

Suppose if he/she earned the same points during the contributory period of 5 years then, the total pension points after 5 years is sum of the yearly pension points:

$$= 1.4458+1.4458+1.4458+1.4458+1.4458$$
$$= 7.2290 \text{ pension points}$$

Total pension points are cumulative of the pension points earned every year of contributory period to the National Pension & Provident Fund Plan.

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ii) Early Retirement Pension

Members may retire from service before attaining minimum civil service retirement age. But such members are eligible for pension *within or prior to 5 years* of attaining minimum civil service retirement age with a reduced pension points at the rate of ½ of 1% (i.e. 0.5% per month or 6% per year) for every month the age falls short of the minimum civil service retirement age.

Box 3. Illustration on Early Retirement Pension

A member who was born in January 1, 1956 voluntarily retired from civil service on December 31, 2005 at the age of 49 years with a total pension points of 40.5050. Since he is eligible for pension only on attaining minimum civil service retirement age (56 years) in January 2012 he opted for early pension. In such a case, early pension is payable only at the age of 51 years i.e.5 years prior to 56 years which is due in January 2007. Then, the retirement age fall short of 56 years in January 2007 is 5 years i.e. {(56 -51=5 years) 5 x 12 =60 months)}. His pension at the age of 51 years is computed as under:

Total months fall short of 56 years = 60 months

Reduction factor = ½ of 1% months fall short of 56 years = (0.005 x 60) = 30%

Total Pension Points	=	40.5050
Reduced pension points	=	(40.5050 x 30%) = 12.1515
Net pension points	=	40.5050-12.1515 = **28.3535**

$$\text{Pension in January 2007} = \frac{\text{Net Pension Points x 60\% ofAverage Civil Service Salary Index}}{\text{Full working period}}$$

$$= \frac{(28.3535 \text{ x } 60\% \text{ x } 7000)}{31}$$

= **Nu. 3,841 per month** payable during financial year 2006-2007.

Assumptions: Annual ACSSI for the previous year financial year i.e. 2005-2006 was 84,000 i.e. 7000 per month and Full working period during pension commencement in Jan. 2007 = 31 years

The members shall not be entitled for pension if they retired from service with contribution less than 120 months. But if contributions are more than 12 months (1 year) they are entitled to refund of contributions with interest made to the Tier 1. However, if contributions are less than 12 months they are not entitled any refund of contributions made to the Tier 1.

2. Permanent Disability benefits

Permanently disabled member who has contributed a minimum of 36 monthly contributions (3 years) to the Tier 1 shall be entitled to disability benefit of 30% of ACSSI of the previous financial year from the date of disability until the attainment of minimum civil service retirement age, recovery or death whichever is earlier.

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Box 4. Illustration on Disability Benefit

An employee who worked for 3 years with Agency A and contributed to NPPFP of 36 months became permanent disability on December 31, 2004. The Medical Committee of Doctors has certified that a member is eligible for permanent disability benefit in accordance with disability definition of the NPPFP Rules and Regulations. Then, a member is entitled to disability benefit of 30% of ACSSI for the financial year 2003-2004. For instance, if annual ACCSI for the financial year 2003-2004 was Nu. 82,474 then, the disability benefit is 30% of Nu. 82,474 = Nu. 24,742 i.e. Nu. 2,062 per month payable during the financial year 2004-2005.

3. Survivors benefits

Survivor benefits can be paid to:

a. Legally married spouse and legitimate children on the death of a member and has contributed a minimum of 36 monthly contributions by the deceased member to the Tier 1 before such contingency:
   - **Spouse who is age 50 or older** shall be entitled 50 percent of member's pension or 30 percent of ACSSI of the previous financial year whichever is higher until remarriage or death.
   - **Children under age 18 years** shall be entitled 10 percent of ACSSI of the previous financial year per child to a maximum of three children at a time.
   - **Orphans under age 18 years** shall be entitled 15% of ACSSI of the previous year per orphan to a maximum of three orphans at a time.

b. One of the dependent parents (whether biological or legally adopted parent) on the *death of a member who was not married at all* and has contributed a minimum of 120 monthly contributions (10 years) to the Tier 1 by the deceased member before such contingency:
   - Dependent parent on attaining minimum civil service retirement age shall be entitled 50 percent of member's pension or 30% of ACSSI of the previous financial year whichever is higher.

h) Benefits under Provident Fund Plan (Tier 2)

Benefits under this plan provide the *lump-sum benefit* as under:

- Accumulated contribution to member's Provident Fund Account; and
- Investment returns (interest).

In case of death, the nominees shall receive this benefit.

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(The Armed Forces Pension and Provident Fund Scheme Rules and Regulations approved by the Royal Government provide similar retirement benefits to the members of the Armed Forces).

i) Achievements and challenges of the National Pension and Provident Fund (NPPF)

The Royal Government established the NPPF to administer and manage the National Pension & Provident Fund Plan. Soon after its establishment, on July 3, 2000, the NPPF took over the Government Employees Provident Fund operations from the Royal Insurance Corporation of Bhutan (RICB). Since then the assets increased significantly. This favourable growth of assets attributed mainly to three factors:

- Growth of new members and positive contribution to pay out ratio- less *outflow of funds* compared to the *inflow of funds* due to smaller number of beneficiaries relative to contributors;
- The positive performance of pension fund investments; and
- Savings in the operational and administrative expenses resulted from efficient management of fund.

The NPPF contributes in the *savings and investments* of the economy. Retirement scheme is a deferred-savings for future consumptions which makes the retirees to consume through time. The NPPF is helping people to save in two forms-

- *Savings from their monthly income.* Today, the members are mandated to save 22 percent of their monthly income to the pension and provident fund plan.
- *Savings in the form of housing construction and investment in education.* The current members are accessible with two kinds of loan schemes- Member Housing Loan for investment in the housing and Member Education Loan for education of their children.

The NPPF as the custodian of pension and provident fund, its fiduciary responsibility is to generate adequate returns to the members and to maintain long-term financial sustainability of the plan. The NPPF also invests on *real estate* to provide decent accommodation to the members while to some extent it has eased the acute housing problems.

Today, with its hugh asset size, the NPPF has become the largest institutional investor in the country. But under-developed capital markets and shallow financial sectors are the major obstacles for the investment of funds. A substantial fund is deposited at low returns with the two commercial banks - Bank of Bhutan and Bhutan National Bank.

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The NPPF is constantly pursuing for the mandate that would permit it to directly invest in *industrial projects* and explore new investment avenues in order to maximize returns and continue the growth of its asset relative to benefit payments. At the same time, the NPPF is emphasizing on its goal to deliver efficient and quality services to the beneficiaries.

In summary, there are three major challenges that the NPPF has to work against constantly over the years. They are:

- Given the huge asset size coupled with limited investment outlets in the domestic market, the NPPF has a challenging task of enhancing returns on its investments; and
- Continue assessment of the plan to maintain long-term financial sustainability; and
- Deliver efficient and quality services to the members through skilled and efficient workforce.

Student Activity

1. The Financial Institutions in Bhutan are broadly classified into Commercial Banks, Non-Bank Financial Institutions and other Financial Institutions. From what you have studied in this chapter, discuss how Banking Institutions differ from Non-Banking Institutions.
2. The Royal Monetary Authority (RMA) is often referred to as the 'Captain' of the financial Institutions in Bhutan. It supervises the functioning of the different financial institutions. What would happen to the working of these FIs if there was no RMA as a regulating body?
3. Discuss in pairs and make a list of strengths and challenges of our two commercial banks.
4. In1997, the RGOB converted the Unit Trust of Bhutan into a commercial bank and renamed it as Bhutan National Bank. What could be the possible reason for that?
5. The BDFC, being the only financial institution with rural focus in Bhutan is faced with a number of problems and challenges. Discuss in a group of two or three and make a list of suggestions to overcome these difficulties and present it to the whole class.
6. In what different ways do you think that the financial institutions in Bhutan can contribute towards the private sector development in Bhutan?
7. Divide the class into two groups and discuss whether the "National Pension and Provident Fund Scheme which comprises of two important retirement benefits-pension and provident fund schemes can provide a better old age security than the Government Employee Provident Fund (GEPF)". Present the findings to the class in the form of a debate.
8. Evaluate the loan schemes granted by the following financial institutions for construction of houses: RICB, BDFC, NPPF, BOB and BNB

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