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Study on Loan Default Pattern and Auction Cases with Special Reference to Nabil Bank Limited, Global IME Bank Limited, and NIC Asia Bank Limited, Nepal

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Abstract

Loan in banks are highly susceptible of being default during the loan period due to factors such as political instability, poor financial management and others. Among these factors, loan default not only influence the financial situation of the bank itself but also the country as a whole. This study aims to investigate the causes, consequences, and potential remedies for loan default and its process of auction in Nepal, with Global IME Bank Limited, NIC Asia Bank Limited and Nabil Bank Limited as case studies. The research employed structured questionnaires as the primary data collection tool, with responses from 103 participants and the period of study is carried over a span of a year Analysis revealed that the real estate has the highest number of loan defaults among banks and poor business management among borrowers is the primary reason for loan default. Also during the auction process, the respondents claimed that valuation disputes is the major issue. The respondents also suggested that quick legal guidelines should be followed in a step-by-step process in order to deal with auction after loan default and also they suggested that ensuring that the loan is used for the proper purpose could also be an effective method to mitigate the defaulted. The study further identified that the most significant consequence of loan default is impact to country's economy, apart from the bank financial situation.

Keywords: Loan default, Auction, Consequences of default loan, Legal and regulatory environment

1. Introduction:

Loan default patterns are behaviors and indicators suggesting a borrower may fail to meet repayment obligations, leading to defaults that can disrupt the financial system by increasing risks for lenders and reducing available credit for other borrowers (Coser, 2019). Nepal Bank Limited, established in 1937, was the country's first commercial bank, performing both commercial and central banking functions until the establishment of Nepal Rastra Bank in 1956 (Management Dynamics, 2019). While loan lending is mutually beneficial for lenders and borrowers, it carries significant credit risk, which is assessed using numerical credit scores to determine borrowers' creditworthiness (Aslam, 2024)

Financial institutions increasingly rely on data analysis to assess customer behavior and credit risk, as even minor improvements in prediction accuracy can significantly boost profitability and reduce loan defaults. While consumer credit in the U.S. reached $3.98 trillion by late 2018, risk exposure in lending remains high, with delinquency rates fluctuating, peaking at 10.1% for revolving loans during the 2009 financial crisis. (Khandani, A. et al., 2010). In 2017, 34% of Americans took personal loans primarily for purchasing cars (31%), paying off bills and debts (26%), and covering emergencies (21%), highlighting the growing demand for consumer credit. The major objective of this study is to analyze the loan default pattern and effectiveness and auction process for the recovery.

To mitigate credit risk, financial institutions analyze large data sets to identify default patterns, yet accurately predicting loan repayment behavior remains a key challenge for model validation and decision-making. The general objective of this study is to analyze the reasons and trends behind loan defaults, understand the key factors impacting loan defaults and examine how the auction process is utilized to recover the loan defaults.

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The research questions include the default pattern of 3 number of banks, the various auction process and its effectiveness for recovery of the loan and its impact on both banks and borrowers.

2. Literature Review

2.1. Background Information:

Banks play a crucial role in financial systems by mobilizing savings, facilitating investments, and managing credit risks. Originating from the Italian word "banco," banks have evolved into institutions that provide security for deposits, extend loans, and offer financial services. Loan defaults pose significant challenges, with various factors influencing repayment, such as interest rates, borrower income, and economic conditions (Singh, 2011). Golden and Walker (1993) identify the 5Cs of bad credit as key risks leading to loan defaults. Complacency occurs when lenders assume past success guarantees future repayment. Carelessness results from poor underwriting, lack of documentation, and weak loan agreements. Communication ineffectiveness arises when credit policies are unclear or not enforced. Contingencies involve underestimating potential risks, while competition refers to lenders compromising standards by imitating competitors. Banks should monitor loan repayments, avoid risky borrowers, and take quick action on defaults to minimize credit risk (Kohansal and Mansoori, 2009).

High loan default rates negatively impact both lenders and borrowers, leading to financial losses and reduced access to credit. Research highlights causes like poor credit history, economic downturns, mismanagement, and high-interest rates as key contributors to defaults. Understanding these factors can help financial institutions improve lending policies and mitigate risks. Nepal’s Credit Information Bureau (CIB) maintains a blacklist of defaulters, impacting their credit access and financial reputation (Credit Information Bureau Journal 2013). When a borrower in Nepal defaults on a loan, the lender first issues a default notice demanding repayment and warning of consequences. If the borrower responds, negotiations may take place to restructure the loan and facilitate repayment. If the default continues, the borrower may be blacklisted by the Credit Information Bureau (CIB), affecting their future credit access. There are so many serious problems related to fraud loan. Thus, this study focuses on this problem. The general objective of this study is to assess the auction process, loan default pattern and areas of loan default.

2.2. History of Banking in Nepal

The banking system in Nepal has evolved over different phases, beginning with informal moneylenders and the introduction of coins by historical rulers. The first formal institution, Tejarath Adda, was established in 1880 but lacked full banking functions. Nepal Bank Limited (NBL) was founded in 1937 as the first commercial bank, later followed by Rastriya Banijya Bank and the Nepal Rastra Bank (NRB) in 1956, which regulated the banking sector. The 1980s marked a shift towards economic liberalization, allowing the entry of joint-venture and private banks. The NRB Act of 2002 granted the central bank more autonomy, leading to regulatory reforms, including the Bank and Financial Institution Act (BAFIA) of 2006, which categorized financial institutions into different groups (BAFIA, 2006).

2.3. Most Recent Development:

Nepal initiated financial sector reforms in 1984, with the most recent efforts driven by concerns over system vulnerability, leading to the Financial Sector Strategy Paper (FSSP) in 2000, supported by the World Bank. The reform was implemented in two phases: The Financial Sector Technical Assistance Project (FSTAP) and the Financial Sector Restructuring Project (FSRP), focusing on NRB reengineering, commercial bank reforms, and capacity building. As of mid-January 2025- after the merger policy, NRB had licensed 20 commercial banks, 17 development banks, 17 finance companies operating in Nepal

Between 1956 and 2009, Nepal's financial sector expanded from a single commercial bank, Nepal Bank Limited (NBL), to 237 banks and financial institutions, including 25 commercial banks, 60 development banks, and 71 finance companies. This growth resulted from significant financial reforms and liberalization policies that encouraged private and joint-venture participation (Bhattarai, 2014).

2.4. Infrastructure Development, Economic Growth in Nepal and effect of credit risk on performance of Nepalese Commercial Banks:

Infrastructure development in Nepal plays a crucial role in driving economic growth by enhancing efficiency, competitiveness, and market access; studies have found a positive and significant relationship between infrastructure development and long-term economic growth in the country (Dhungel, 2020). Infrastructure development is crucial for economic growth, as it enhances connectivity, reduces costs, and improves market access. However, Nepaasuul faces challenges in fully developing its infrastructure, impacting its economic performance. Addressing these challenges requires effective policies and investments to harness the potential of infrastructure in driving economic growth (Munnel & Cook, 1990). A bank plagued with a high stock of NPLs is likely to focus on internal consolidation and improving asset quality rather than providing new credit (Leon and Tracey 2011).

As of mid-July 2024, Nepalese commercial banks reduced their average non-performing loan (NPL) ratio to 3.76%, down from 3.89% in mid-April, reflecting improved loan recovery efforts.(NRB Monetary Policy 2024) To support banks amid credit risk challenges, Nepal Rastra Bank (NRB) implemented measures such as lowering the loan loss provisioning requirement for 'good' loans from 1.25% to 1.10% and allowing certain reserves to count as Tier 2 capital, thereby easing capital pressures and enhancing lending capacity. These interventions have bolstered banks' capital adequacy ratios, positioning them to better manage credit risks and contribute to financial stability.

Table 1. Comparison of Non-Performing loans (NPLs) of 3 number of banks:

SN	Name of the Bank	FY 2081/82	FY 2080/81
1	Global IME Bank Ltd	4.86%	4.68%
2	Nabil Bank Ltd	4.93%	3.8%
3	NIC Asia Bank Ltd	4.61%	1.19%

Source: NRB

Non-performing loans (NPLs) serve as a critical indicator of economic health. High NPL ratios can erode bank profitability, necessitating increased provisions and reducing interest income, thereby limiting banks' capacity to lend to the real economy. This reduction in lending can lead to lower productivity and slower economic growth, as businesses and consumers face diminished access to credit. Moreover, elevated NPL levels can undermine confidence in the financial system, potentially leading to capital outflows and currency depreciation. Addressing NPLs requires effective policies and frameworks to manage and resolve these loans, ensuring financial stability and supporting sustainable economic growth. (Economic Governance Support Unit, March 2021).

2.5. Legal Framework for Banking Offence in Nepal:

In Nepal, banks and financial institutions are regulated under the Banking Offence and Punishment Act 2064, which criminalizes unauthorized activities such as opening accounts with false documents, issuing unauthorized checks, and misusing electronic payment methods.

a. Nepal Rastra Bank Act, 2058 BS (2002 AD):

Section 95 of the Nepal Rastra Bank Act, 2058 (2002) criminalizes unauthorized financial activities, interest rate violations, dealing with counterfeit currency, unlicensed transactions, and obstruction of clearing and settlement processes, with non-compliance also constituting an offense.

b. Banks and Financial Institutions Act, 2073 BS (2017 AD):

The Bank and Financial Institution Act, 2073 (BAFIA) of Nepal outlines various banking offenses to ensure integrity, transparency, and accountability in the financial sector. It criminalizes acts such as misuse of authority by officials, submission of false financial statements or documents, non-compliance with Nepal Rastra Bank (NRB) directives, engaging in unauthorized banking activities without a license, and obstructing regulatory inspections. The Act empowers NRB to investigate and take action, including imposing fines, suspending licenses, or recommending prosecution. Penalties range from monetary fines to imprisonment, depending on the nature and severity of the offense.

c. Criminal Offence in Banking Offence and Punishment Act, 2064 BS:

The scope of the Banking Offense and Punishment Act, 2008 in Nepal includes offenses such as opening fictitious accounts, unauthorized withdrawals, misuse of electronic banking, providing unauthorized loans, misuse of credit, and misusing banking resources. It criminalizes alterations in ledgers by forgery, deceptive transactions with financial institutions, false asset valuations, irregular financial activities, illegal Dhukuti transactions, and any banking transactions by cooperatives without permission from Nepal Rastra Bank. These actions are subject to criminal penalties including fines and imprisonment.

Limitation:

The Banking Offence and Punishment Act, 2008, criminalizes various banking offenses in Nepal, including unauthorized financial activities, misuse of electronic banking, and fraudulent loan practices. The Act establishes a framework for investigation and prosecution of such offenses, specifying procedures, limitations, and punishments to uphold the integrity of the banking system.

2.6. Recent conditions of banks due to non-performing loans:

The non-performing loans (NPLs) of Nepal's commercial banks is 3.89% as per the latest statistics published by Nepal Rastra Bank for Chaitra end 2080, driven by bad debts from the economic slowdown, leading to more individuals being blacklisted and a rise in banking fraud cases.

2.7. Causes of Non-Performing Loans across the globe

i. **Bank Specific Factors**:

- Cost efficiency, high interest rates, leverage ratios, and undiversified environments lead to impaired loans in countries like the US, Turkey, Greece, and Guyana.
- Ownership structures and capital regulation also contribute to NPLs in various banking systems.

ii. Macroeconomic Factors:

- Macroeconomic factors such as GDP, exchange rates, unemployment, inflation, and economic growth significantly affect NPLs in countries like Sub-Saharan Africa, Greece, Tunisia, and Nepal.
- In Nepal, NPLs are also influenced by GDP, interest rates, inflation, and issues like political pressure and economic slowdowns.

iii. Regulatory Perspective:

- Regulatory agencies like Nepal Rastra Bank (NRB) monitor and regulate NPLs, aiming for financial stability through proper risk management.
- NRB focuses on ensuring capital adequacy and sound financial practices while managing credit risks.
- Understanding regulators' views on NPL causes is essential for improving financial institutions and promoting national economic stability.

3.Methodology

3.1. Tools used:

Tools like survey of the banks, in-depth interviews, focus group discussions, and questionnaire survey were used for the collection of primary data. Moreover, secondary data were collected from a variety of published and unpublished documents, thesis, books, journals and client's documents. The study conducted during the period from January 2024 to December 2024.

This is case study research in which on-going loan default pattern and its auction process of three major banks of the country is considered. The standard causes of how and why non-performing loan occurs, its consequences, and possible remedial measures are reviewed for further study. The study area of all studied banks is all located in Kathmandu valley.

3.1.1. Study area:

The study area of banks that was under observation is all located in Kathmandu valley only with exclusions of rural perspective from other stakeholders such as opinions of regulatory authority and borrowers.

3.1.2. Sample Size

The research has target of 200 respondents for questionnaire survey. Purposive sampling method, a non-probability sampling technique was adopted for this purpose with a view to gather the views of the respondents where researchers deliberately select participants based on their specific characteristics or knowledge relevant to the study's objectives., appropriate for the research objective. Therefore, in our research we have adopted the sample size as 103.

4. Results and discussion

4.1. Results

4.1.1. Professional status of the respondent and their experience:

Out of the surveyed candidates highest number of respondents were from Global IME Bank Limited. The survey respondents predominantly consisted of Branch Managers (46%) and Loan Officers (38%), with smaller representations from General Clerks (15%) and Tellers (1%). The survey indicates that the majority of respondents hold positions as Branch Managers (46%) and Loan Officers (38%), with a significant portion having over 20 years of experience in the banking sector. This suggests a workforce with substantial experience, predominantly in managerial and loan-related roles.

4.1.2. Approximate percentage of nonperforming loan in respective banks:

The majority of non-performing loans (NPLs) are concentrated in the higher percentage ranges, with 51% of the respondent voted that the NPL's in their bank falls between 2% and 5%, and 3% of them said that NPL exceeded 10%, highlighting significant potential risks for stakeholders.

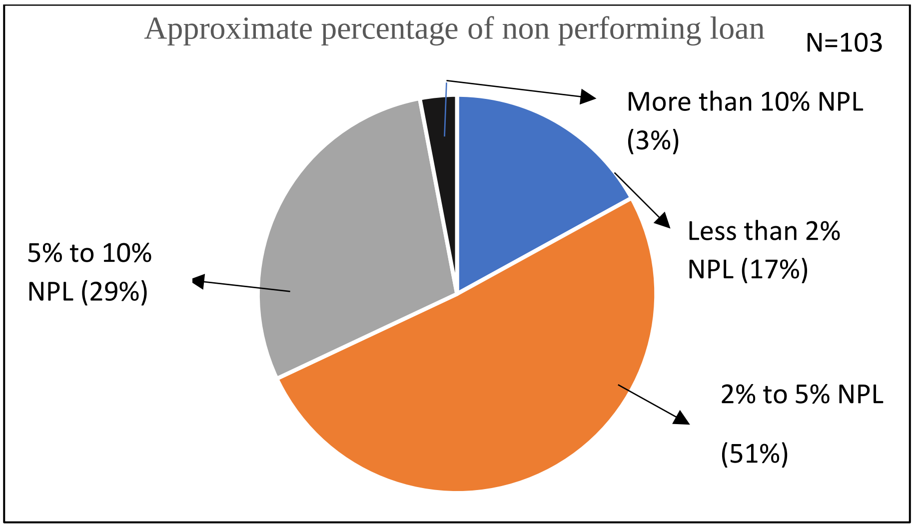

Figure 1. Pie chart representing the percentage of non-performing loan (Field Study, 2025)

4.1.3. Sectors which exhibit highest loan default rates:

A survey revealed that 33% of respondents responded that real estate exhibit the highest loan default rates while agriculture holds the least percentage of loan default.

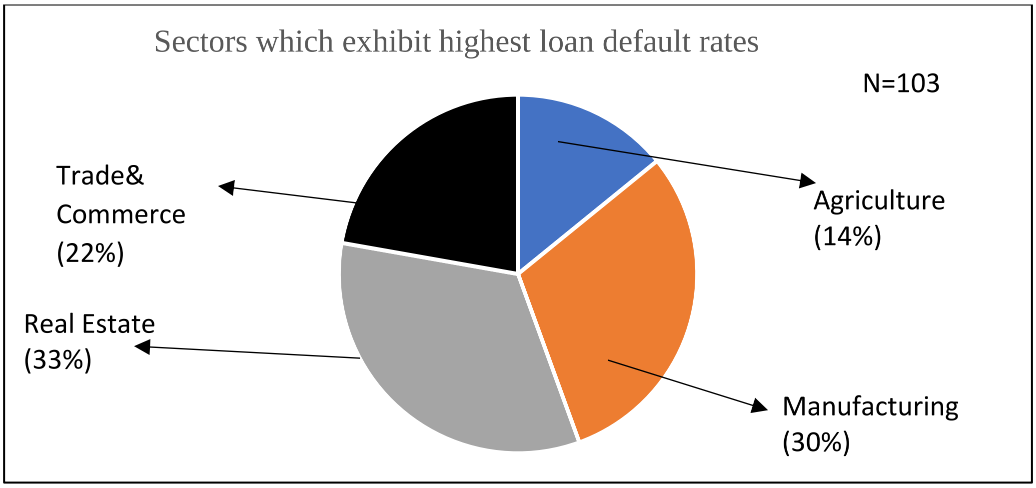

Figure 2. Pie chart representing sectors which exhibit highest loan default rates (Field Study 2025)

4.1.4. Primary reason for loan default among borrowers:

A survey of 103 banking sector participants revealed that 38% of loan defaults were due to poor business management, 16% to economic downturns, 27% to natural disasters, and 18% to political instability, highlighting that loan defaults often result from a mix of internal mismanagement and external challenges.

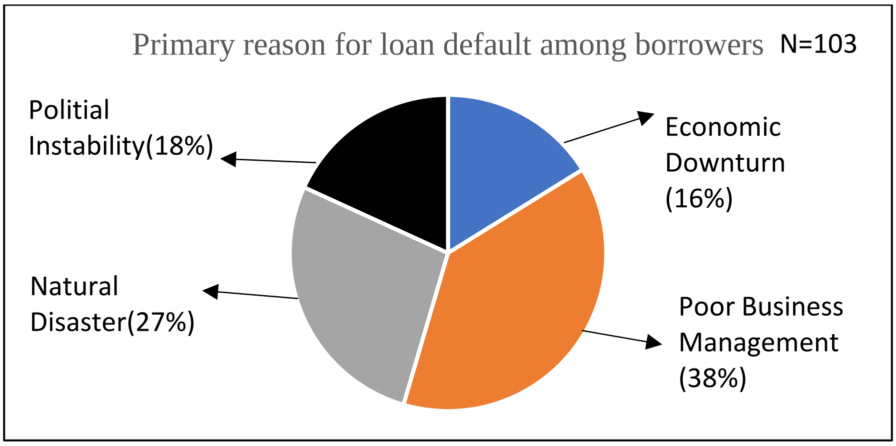

Figure 3. Pie chart showing the primary reason for loan default among borrowers (Field Study 2025)

4.1.5. Steps undertaken before undergoing auction process:

A survey of banking professionals revealed that 34% initiate loan default procedures by restructuring or rescheduling loans, 33% issue default notices, 18% engage in mediation, and 14% proceed directly to auctions.

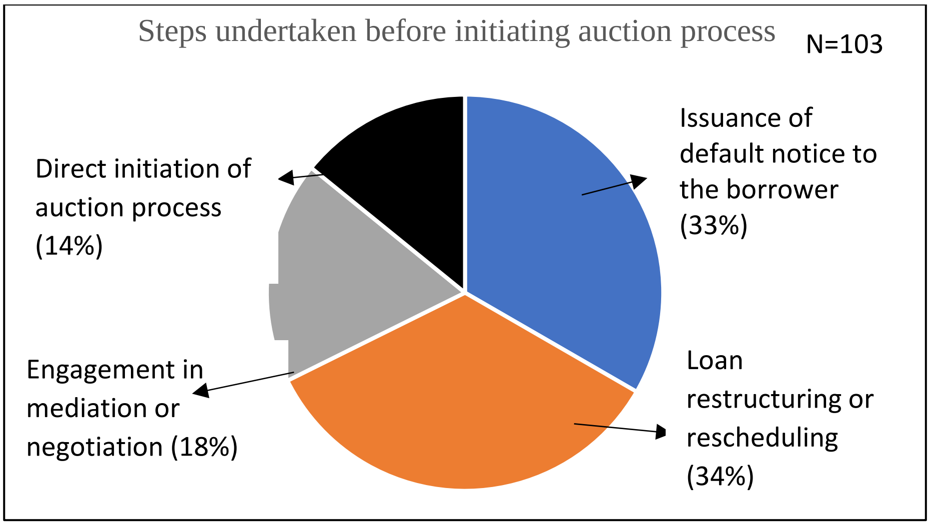

Figure 4. Pie chart showing the first step undertaken before initiating an auction process (Field Study 2025)

4.2. Determination of reserve price for auctioned properties:

In determining auction prices for properties, 20% of respondents prioritize the outstanding loan amount, while 22% rely on independent property valuations, 42% on market value assessments, and 14% consider all these factors.

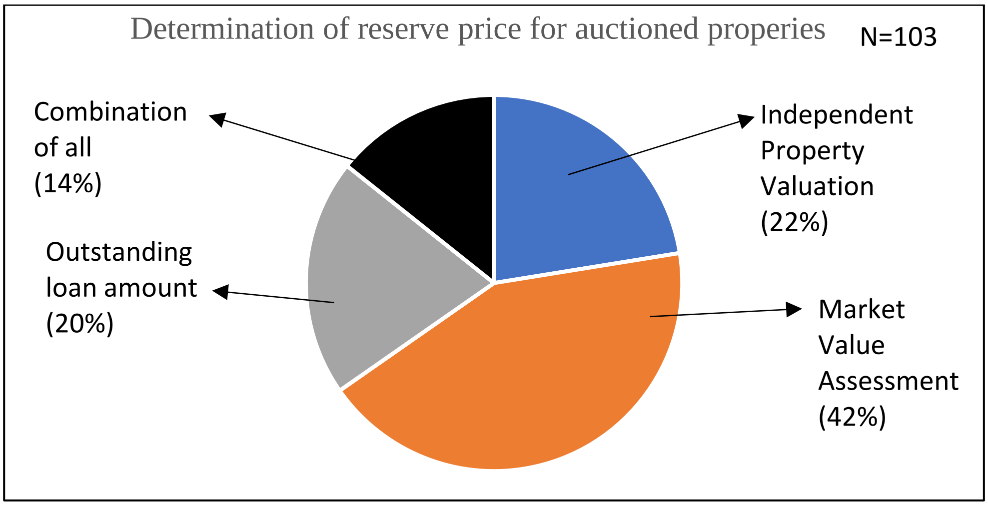

Figure 5. Pie chart showing determination of reserve price for auctioned properties (Field Study 2025)

The survey also reveals that 37% of respondents identified a lack of interested buyers as the primary challenge during the auction process, followed by 26% citing valuation disputes, 24% pointing to legal complications, and 12% mentioning lengthy procedural requirements. Upon asking with the respondents whether they are aware of the directive provided by Nepal Rastra Bank for collateral auction, 86% percent of them responded that they are well known about it, whereas, 13% of them were unaware of any such directive, possibly due to the fact that they might be novice or inexperienced to the banking field.

4.3. Subsequent actions taken where the auction does not cover the outstanding loan amount:

According to a survey, 43% of respondents in Nepal opt to write off the remaining debt when borrowers fail to repay the full loan amount, while 30% pursue legal action and 26% engage in negotiations with the borrower. The below diagraph shows the effect of loan default on bank itself.

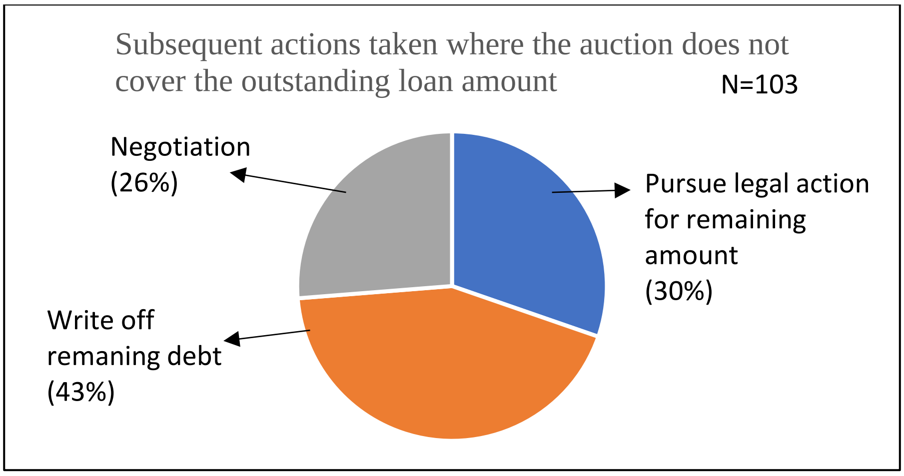

Figure 6. Pie chart showing actions taken where the auction does not cover the outstanding loan amount (Field Study 2025)

4.3.3. Effect of loan Default:

Out of the surveyed people, 28% chose to reduction in profit, 53% of the respondent chose increased operational cost and 19% said that it would impact other borrowers. Out of the surveyed people, 20% chose to early detection, 55% of the respondent chose streamlining process and 25% said that flexible payment options as the remedy.

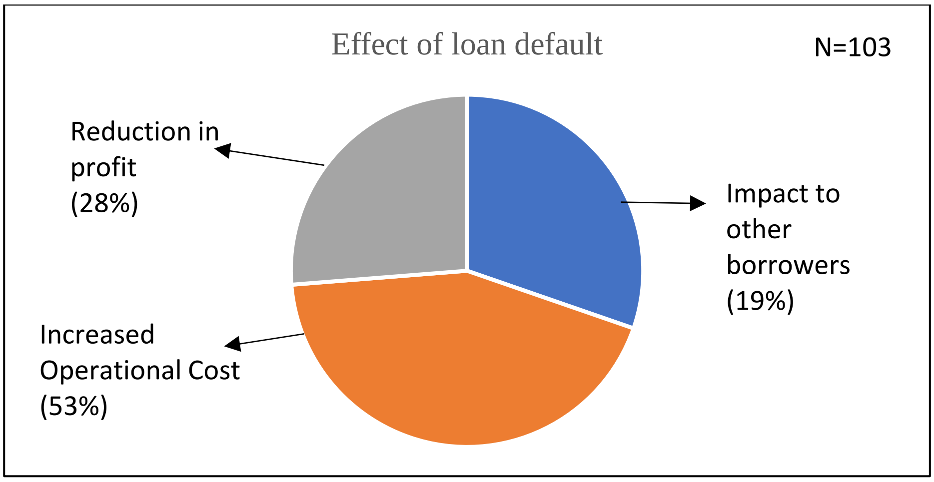

Figure 7. Pie chart showing Effect of loan (Field study, 2025)

4.4. Qualitative Findings

4.4.1. Findings from focus group discussions

Key causes of loan defaults include financial instability, economic factors, and poor credit assessment. Challenges in the auction process involve lengthy legal procedures, low buyer interest, and transparency issues. The impact on stakeholders includes borrower stress, lender losses, and participant frustration. Proposed improvements focus on enhanced risk assessment, streamlined legal frameworks, market awareness, and support mechanisms for borrowers. The respondents of FGD includes key bank staff such as loan officers, CEO's and other auction related legal staff.

4.4.2. Findings from in-depth interview

Key causes of loan defaults include borrower-specific factors, sector risks, and macroeconomic challenges. Flaws in the auction process involve prolonged recovery times, poor market engagement, and transparency issues. Stakeholders are impacted by borrower stigma, rising NPAs for lenders, and frustration for bidders. Suggestions for improvement include strengthening loan monitoring, simplifying the auction process, and fostering a collaborative approach with digital platforms and AI integration. In in-depth interview, we interviewed specific bank staff such as branch manager, credit administration department head and loan HOD, regarding the peculiar reasons for loan defaults and procedure later after it.

4.5. Findings from field observation:

The field survey found that geographical and demographic factors contribute to loan defaults, with rural borrowers facing weather-related risks and urban borrowers dealing with economic challenges. The auction process faced issues such as lack of preparation, insufficient marketing, unclear terms, and bureaucratic delays. Borrowers were often unaware of default implications, while lenders struggled with legal complexities. Improvements suggested include enhancing transparency, streamlining processes, better property readiness, and educating borrowers on early intervention and negotiation. These observations suggest a need for greater efficiency, transparency, and fairness in both the loan default and auction process, as well as stronger communication with borrowers to mitigate defaults before they escalate to auctions.

5. Conclusion

- The study analyzed loan default patterns in three major banks, showing that loan defaults are primarily attributed to poor business management (37.9%), economic downturns (27.2%), natural disasters (18.4%), and political instability (16.5%), indicating that both internal mismanagement and external challenges significantly contribute to loan defaults.
- The study also revealed that real estate has the highest percentage of loan defaults, followed by manufacturing, trade and commerce, with agriculture having the least. The majority of respondents (51%) indicated that non-performing loans typically fall between 2% to 5%, and 92% of them confirmed that their banks follow standardized procedures for auctioning collateral. The initial step before auction, according to respondents, was mainly restructuring or rescheduling loans (34%).
- Market value assessments were considered the primary factor in determining auction prices. Lack of buyer interest was identified as a major challenge in the auction process. The impact of loan defaults was mainly felt through increased operational costs (53%), with profit reduction cited by 28%. To mitigate defaults, respondents suggested streamlining loan processes (55%), early detection (20%), and offering flexible payment options (25%).
- The study recommends that financial institutions implement monitoring systems to track borrowers' financial health and adopt tailored risk assessment models.

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