STATE BANK OF PAKISTAN

EVOLUTION, FUNCTIONS, AND ORGANIZATION

Muhammad Farooq Arby

THE STATE BANK OF PAKISTAN

EVOLUTION, FUNCTIONS, & ORGANIZATION

Our Vision	Our Mission
To transform SBP into a modern and dynamic central bank, highly professional and efficient, fully equipped to play a meaningful role, on sustainable basis, in the economic and social development of Pakistan	To promote monetary and financial stability and foster a sound and dynamic financial system, so as to achieve sustained and equitable economic growth and prosperity in Pakistan.

Muhammad Farooq Arby

The State Bank of Pakistan: Evolution, Functions, & Organization
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CONTENTS

Foreword

This documents attempts to present, in a concise manner the historical evolution, the various functions, as well as the present organizational setup of the State Bank of Pakistan (SBP). There was a great need for such a study and I am glad that Mr. Farooq Arby, a research economist at SBP has come up with this paper by skilfully presenting different dimensions of this organization.

The employees of the Bank, current as well as new recruits, would find it extremely useful in understanding the working of the whole institution. This holistic approach will enable them to understand the multi-dimensional nature of the SBP's work and the importance of their particular sphere of work within the overall setup. I am quite confident that after reading this document the employees of the Bank would feel an enhanced sense of pride for being associated with such a dynamic and prestigious institution. Outside SBP, the general reader with interest in the financial sector and students of economics and finance would also find it an informative piece of paper on the Central Bank of the country.

In addition to Mr. Farooq Arby who is the main author and brain behind this paper a number of individuals and departments assisted in updating and finalizing this report. I would like to, in particular, acknowledge the contributions made by Kashif Hashmi of ISD, Ahmed Din of HRD, Ashfaq Ahmed of IBD, Shahzad Qazi of EDMD, Shahid Rabbani of BSD, Nizamudin Arshad of BPD and Muhammad Idrees of CMAD. The Strategic Planning Unit coordinated these efforts to provide the final blueprint.

Dr. Ishrat Husain
Governor
State Bank of Pakistan

Preface

When I received an offer letter from SBP in late 1994, I was irresolute over joining it. However, my teacher Dr. Hafiz A. Pasha, also a member of SBP's Board of Director at that time, urged me to join SBP as it was a dynamic institution and where I would have a good chance of professional growth. When I came in, naturally I was looking for some document on the institutional dynamism of the Bank and evolution of its structure. But unfortunately, I could not find any concise paper except two voluminous history books. Mr. Idrees Agha (Ex Director Research), who realized my frustration, then asked me to write a paper myself on the functions of the SBP by synthesizing the theory and practice in central banking. He was also kind enough to guide me and giving very useful suggestions which were based on his long practical experience at SBP. The present document is in fact an extended and updated version of that paper. The extension was motivated by Dr. Abdul Qayum, Senior Research Economist at PIDE who required me to write a term paper for the subject of monetary policy in my PhD coursework.

The old paper was extended in two aspects; first the functions of SBP were matched with provisions of different sections of SBP Act 1956, and second institutional changes were discussed in detail through which the SBP has evolved into one of the most prestigious organizations of the country. Although this document is still a small piece of work, yet it can serve as an orientation manual for new inductees at SBP, and a useful guide for the students of economics, business and finance. This work can be further extended by incorporating in detail the stance of monetary and credit policies in different eras of economic history of Pakistan, SBP's role in monetization of the economy, reviewing its successes or failures to achieve its objectives of growth and stability, etc.

While preparing this document in its present shape, a number of people extended their help. I wish to thank all of them. I gratefully acknowledge the officers of different departments for updating and in some cases revising the paragraphs relating to their respective departments. I owe special thanks to the Strategic Planning Unit, for providing logistic support in getting this document vetted from different departments of the Bank and making arrangements for its printing.

Muhammad Farooq Arby
February 19, 2004

THE STATE BANK OF PAKISTAN
Evolution, Functions, & Organization

Introduction

The State Bank of Pakistan is the central bank of the country. Usually the starting point for a central bank is a banking system that is already in place - the banking system necessitates the presence of a central bank. But the State Bank of Pakistan (SBP) is unique in the sense that it started its function in a newly born country, where it also had to shoulder responsibilities of developing and rehabilitating a banking system and the economy, in addition to the traditional central banking functions. Performance of the Bank since its inception in 1948, as reviewed in subsequent pages, shows that it has faced all the challenges with a great zeal and commitment. The founders of the Bank set a multi-dimensional target before it that included not only regulation of the monetary and credit system but also the growth of this system. The vision of its founders was a stable monetary system in Pakistan with fuller utilization of the country's productive resources (SBP Act, 1956).

In order to achieve the goals set before it, the State Bank of Pakistan performed all the traditional and non-traditional functions. The traditional functions, which are generally performed by central banks all over the world, are classified into two groups;

- *the primary functions*[1] including issue of notes, regulation of the financial system, lender of the last resort, and conduct of monetary policy,
- *the secondary functions* including management of public debt, management of foreign exchange, advising the Government on policy matters, anchoring payments system, and maintaining close relationships with international financial institutions.

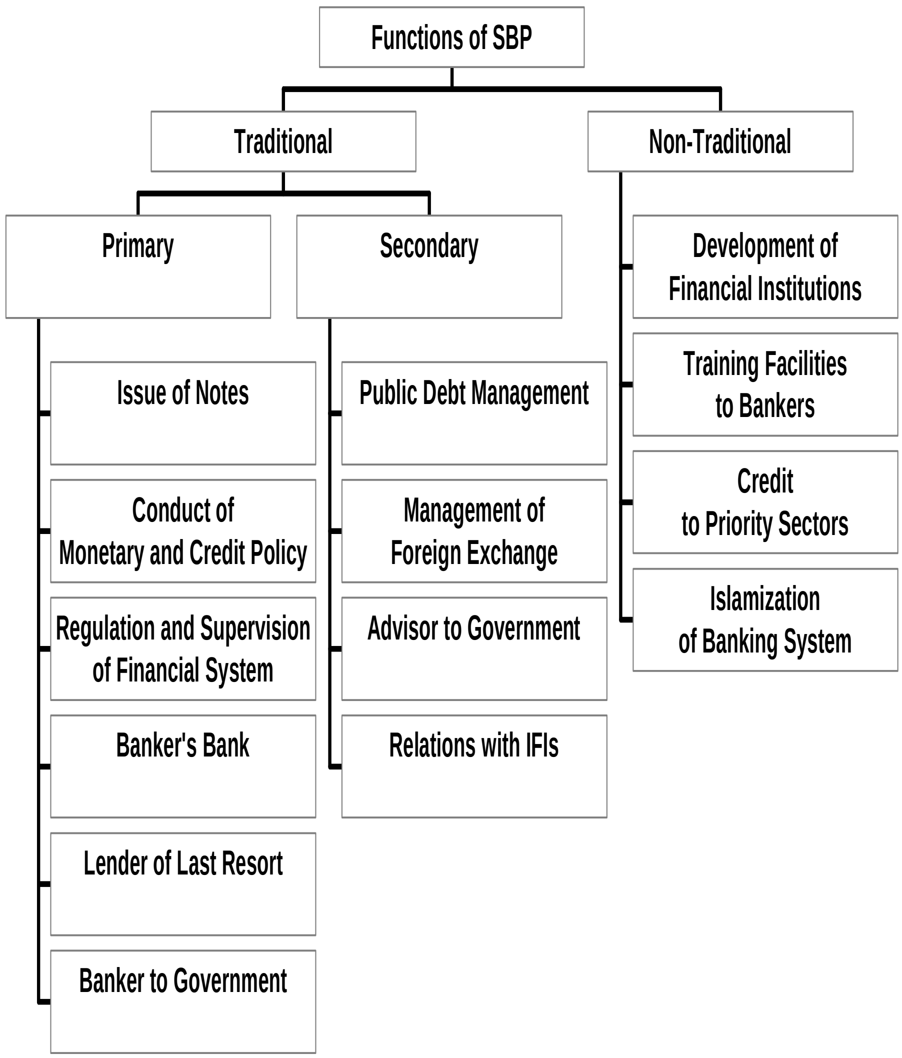
[1] There has been a considerable controversy among the economists over the question as to which function is the primary function of a central bank. According to Hawtrey (1932) the lender of last resort is the essential characteristic of a central bank, while Vera Smith (1936) regarded the monopoly in note issue as the peculiarity of a central bank. Kisch and Elkin (1932) considered that 'the essential function of a central bank is the maintenance of the stability of the monetary standard'. In the Statute of the Bank for International Settlement, on the other hand, a central bank was defined as 'the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country (Article 56 a).

The central bank operations can also be categorized into macroeconomic function and microeconomic function. The macroeconomic function is to preserve the value of the currency, that is, maintain price stability and the microeconomic function is to maintain stability in the banking system. However, in this document, we have discussed these functions in commonly used classification of primary and secondary functions.

The non-traditional or promotional functions performed by the State Bank include development of financial framework, provision of training facilities to bankers, and provision of credit to priority sectors. The State Bank has also been playing an active part in the process of Islamization of the banking system. All these functions are shown in a flow chart (**Chart 1**). In the subsequent pages, we have given a brief but comprehensive description of these functions and examined how the SBP has been performing them since its inception in 1948.

There are six sections of this document. The first and second sections give reviews of primary and secondary functions of the State Bank of Pakistan. Section 3 is on non-traditional functions. Islamization of the banking system in Pakistan is also an important function entrusted to SBP which is discussed in section 4. Section 5 outlines measures taken during 1990s and thereafter to grant autonomy to SBP in performing its functions. Finally the last section presents an account of the institutional evolution of the Bank and sketches its current structure.

Chat 1: Functions of State Bank of Pakistan



1 Primary Functions

1.1 Sole Authority to Issue Notes

One of the primary responsibilities of the State Bank is the regulation of currency in accordance with the requirements of business and the general public. For this purpose the Bank has been granted the sole right of issuing notes in the country under Section 24 of the State Bank of Pakistan Act, 1956. The overall affairs with respect to the issuing of notes are conducted through two notionally separate departments of SBP, viz., Issue Department which deals with the issue of notes, and the Banking Department which undertakes general banking business[2]. There are four issue departments one each in four provincial capitals viz., Karachi, Lahore, Peshawar and Quetta. Under section 30 of the State Bank Act, 1956 the assets of the Issue Department should at no time fall short of its liabilities, i.e., total notes issued.

Of the total amount of the assets of the Issue Department, a stipulated amount, which Government can vary from time to time, is to be kept in the form of gold coins, gold bullion, silver bullion, special drawing rights held with IMF, or approved foreign exchange. Since 1965, the Bank has been required to keep a minimum amount of Rs.1.2 billion in the shape of gold coins, gold bullion, and silver bullion or approved foreign exchange as the backing for note issue. The remainder of the assets of Issue Department should consist of rupee coins, rupee securities and the internal bills of exchange and other commercial papers as are eligible for purchase by the Bank under Section 17 (2a, 2b, & 2d) of the SBP Act, 1956. Approved Foreign Exchange includes major currencies of the world which are detailed in **Annex 1**.

The notes issued by the Bank constitute by far the largest portion of the currency in circulation in the country (See **Table 1** for volume of notes issued since 1948), the other components being one-rupee coins, two-rupee coins, and subsidiary coins[3]. The issue of one rupee and subsidiary coins is the prerogative of the Federal Government. The Bank merely looks after the management of their issue on behalf of the Government. The State Bank also issues "Commemorative (Yadgari)" notes and coins of different denominations at occasions of national importance.

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[2] Both these departments are now part of State Bank of Pakistan Banking Services Corporation (SBPBSC), a subsidiary of the Bank.

[3] One and two rupee notes also remained in circulation till 31st December 2001.

1.2 Conduct of Monetary and Credit Policies

The State Bank of Pakistan is responsible to regulate the monetary and credit system of the country in such a manner that ensures monetary stability in the economy[4]. Section 9A of SBP Act, 1956 entrusts the Central Board of the Bank to formulate and monitor monetary and credit policy by taking into account the Federal Government's targets for growth and inflation, in accordance with the recommendation of the Monetary and Fiscal Policies Co-ordination Board (MFPCB). The State Bank has a number of instruments at its disposal to regulate the volume of credit and to ensure its flow to the priority sectors.

Instruments

The Bank has been equipped with both indirect (market-oriented) and direct instruments of credit control. Indirect and market-oriented

Box 1: Main Instruments

SBP 3-day Repo Rate

SBP provides a lending facility to the scheduled banks for up to 3 days through *Reverse Repo* transactions. The interest rate charged on this facility serves as the main tool to give interest rate signals to the money market. Increase in this rate gives a signal of monetary tightening.

T-Bill Auctions

SBP 3-day repo rate influences the yield of T-bills sold through auctions The cut off yield is determined by the Auction Committee, keeping in view monetary targets, current economic and financial conditions and expected market response. The Six month T-bill is considered the most important benchmark by the money market.

Open Market Operation

SBP is conducting regular Open Market Operations (OMOs) since January 1995. Up till October 1997, OMOs were *unidirectional*, i.e. the SBP used to mop up liquidity from the market in case of excess but it refrained to inject funds in case of liquidity crunch. However, in October, 1997, it started *bi-directional* intervention; now *Repo* transactions are used to mop up liquidity and *Reverse Repo* to inject it. Decisions upon the direction and extent of OMO are taken by the OMO Committee.

Statutory Liquidity Ratio

Commercial banks are required to keep some fraction of their assets in the form of cash, Treasury Bills (T-Bills) or other approved securities. This fraction is called Statutory Liquidity Ratio. Its main objective is to ensure that banks have sufficient funds in the form of liquid assets. Currently this ratio (excluding Cash Reserve Requirement) is 15% of time and demand liabilities.

Statutory Cash Reserve Requirement (CRR)

Under this requirement, banks are required to keep a weekly average balance of 5% of their total time and demand liabilities with the SBP, subject to daily minimum balance of 4%. Recently State Bank has also issued a Master Circular of regulations on CRR.

[4] See preamble to the SBP Act, 1956.

instruments include changes in discount rate (3-day repo rate), T-bill auction rate, Open Market Operations in government securities and other eligible assets, Statutory Reserve Requirement, and Statutory Liquidity Ratio (See **Box 1**). Under the direct instruments, the Bank can prescribe credit ceilings, set credit/deposit ratio, fix margin requirements, and control the rate of return. It can also direct the banks to restrict credit for certain purposes as well as to direct the flow of credit to priority sectors. Before 1990, State Bank of Pakistan used to conduct monetary and credit policies by applying mostly direct instruments. Since the last decade, with the introduction of financial sector reforms the Bank has been using indirect measures of monetary policy.

Transition to Indirect Instruments

A number of policy changes have been made since 1990-91 to move towards indirect and market-based monetary management. As a major step in this direction, the prescription of credit ceilings, as an instrument of credit control, was abolished in August, 1992 and was replaced by a system which required the commercial banks to extend credit to the private sector within limits worked out on quarterly basis in relation to a Credit/Deposit Ratio[5]. Thereafter the Credit/Deposit Ratio (CDR) was liberalized gradually. It was abolished completely w.e.f. October, 1995. Now the monetary management is carried out through changes in discount rate, T-bill auction rate, open market operations, and reserve requirement (See **Table 2.1** & **Table 2.2** for changes in CRR & SLR).

Another important step towards market-based monetary management was effective March 26, 1995 when the State Bank removed the cap on lending rates of Banks and NBFIs other than that applicable to special financing schemes. Subsequently the floor on the lending rates was also removed. Similarly, restrictions on deposit rates have also been removed effective from 1998. Accordingly, banks and other financial institutions are now free to set their lending and deposit rates keeping in view the demand and supply conditions in the market. Directed and mandatory credits have been phased out.

SBP is conducting regular Open Market Operations (OMOs) since January 1995. The State Bank of Pakistan is using Market Treasury Bills (MTBs) both on an outright basis as well as under Repo contracts (generally for the short term maturities) to control liquidity through Open Market Operations.

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[5] Pakistan: Financial Sector Assessment, 1990-2000, SBP

1.3 Regulation and Supervision of the Financial System

Another principal task of the Bank is to safeguard the soundness of the financial system. To perform this crucial role effectively and efficiently, State Bank of Pakistan has been given vast powers under the State Bank of Pakistan Act, 1956, Banking Companies Ordinance, 1962, Banks Nationalization (Amendment) Act, 1974 and Microfinance Institutions Ordinance 2001 to regulate and supervise the activities of Banks, Development Finance Institutions and Microfinance Banks. These laws have been subject to amendments over time to meet changing circumstances. During the year 1997 some major amendments were made in the banking laws, which gave autonomy to the State Bank in the area of banking supervision. Under Section 40-A of the said ordinance it is the responsibility of State Bank to systematically monitor the performance of every banking company to ensure its compliance with the statutory criteria, and banking rules & regulations (See **Section 5** on Autonomy of the SBP).

The financial sector in Pakistan comprises of Commercial Banks, Specialized banks, Development Finance Institutions, Microfinance Banks, Non-banking Finance Companies (NBFCs) (leasing companies, investment Banks, discount Houses, housing finance companies, venture capital companies, mutual funds, etc.), Modarabas, Stock Exchange and Insurance Companies. Under the prevalent legislative structure the supervisory responsibilities in case of Banks, Development Finance Institutions (DFIs), and Microfinance Banks (MFBs) fall within legal ambit of the State Bank of Pakistan while the rest of the financial institutions are monitored by Securities and Exchange Commission of Pakistan.

As of December 31, 2003 there are 40 scheduled banks, 2 MFBs, and 6 DFIs, operating in Pakistan whose activities are regulated and supervised by State Bank of Pakistan. The commercial banks comprise of 4 public sector banks, 19 private sector banks (including 1 Islamic Bank), and 14 foreign banks. In addition there are 3 specialized banks. (See **Annex 2** for the detailed list).

Off-site & On-site monitoring

The Bank monitors the banking activities through a combination of off-site monitoring and on-site inspection. Off-site surveillance is conducted by the State Bank through various periodical returns received from banks and DFIs. On the other hand, on-site inspection is undertaken on the premises of the concerned banks. The purpose of inspection is to check the assets and liabilities as they appear on the books, to evaluate the quality of the assets, to determine compliance with laws, regulations, directives and policy guidelines provided by the State Bank, to judge the soundness of operations and the prudence of lending and investment policies, to appraise the quality of the management and to attempt an estimate of the overall position of the bank. The State Bank can give directions to commercial banks pertaining to any matter concerning their business, and can call for any information in respect of their transactions.

During the decade of 1990s, the Bank undertook a number of measures to strengthen its supervisory and regulatory capabilities. In 1997, services of an international consultant were acquired by the Bank[6] to undertake an in-depth review of the banking supervisory system and monitoring techniques. The consultants recommended risk-based inspection of financial institutions and CAMELS (Capital, Asset quality, Management soundness, Earnings, Liquidity & Sensitivity to other risks) system of off-site surveillance. The training of Bank officials (both in the country and abroad) and up-gradation of information technology system is a continuing process for effective implementation of the consultant's recommendations.

To ensure a cohesive and proactive monitoring of the risks the banks/DFIs are exposed to and to further strengthen the existing supervisory mechanism, State Bank of Pakistan has introduced in 2004 a framework, called Institutional Risk Assessment Framework (IRAF), on which the banks/DFIs will henceforth be monitored. The new framework envisages a collaborative and seamless supervisory focus amongst the various supervisory departments within the SBP. The framework, being technology driven, would ensure swift flow of information leading to more efficient and effective banking supervision and continuous monitoring, integrating on-site inspection, off-site surveillance and current market information.

Prudential Regulations

In order to safeguard the interest of depositors and to ensure the safety and soundness of the banks/DFIs, the State Bank has issued Prudential Regulations. These Prudential Regulations present a prudent operating framework for the banks/DFIs. The regulations incorporate the spirit and essence of Bank of International Settlement (BIS) regulations and are constantly watched for possible improvement so that their enforcement yields the best possible results to promote the overall objectives of financial sector supervision.

The State Bank has devised separate Prudential Regulations for different areas viz. Corporate and Commercial Banking, Small and Medium Enterprise Financing, Consumer Financing and Micro Financing while those for Agriculture Financing

[6] Such services were financed by the World Bank under Financial Sector Deepening and Intermediation Project (FSDIP).

are being framed. This way each set of regulations serves the relevant area in the best possible way. A brief introduction to these is given below:

Prudential Regulations for Corporate and Commercial Banking
The Prudential Regulations for Corporate and Commercial Banking govern operations of the financial institutions in respect of their dealing with the corporate entities. The regulations focus on Credit Risk Management, Corporate Governance, Anti Money Laundering and Operations.

The regulations on Credit Risk cover per party exposure limits of the bank/DFIs for fund-based and non-fund based facilities, Limit for clean advances, investment in shares/Term Finance Certificates (TFCs), provisioning requirements for stuck-up assets, exposure to NBFC and Margin requirements etc. The regulations on Corporate Governance put in place exhaustive criteria for management and the Board of Directors (BOD) to ensure Good Governance in all respective areas. Similarly, the regulations on Anti Money Laundering and Operations cover eliminating criminal use of banking channels for the purpose of money laundering, and restricting window dressing & wrong use of suspense account respectively.

Prudential Regulations for Consumer Financing
Regulations for Consumer Financing have been devised to encourage the banks to diversify their loan portfolio through creation of new products and to ensure that banks undertake Consumer Financing in a prudent manner. Consumer Financing cover any financing allowed to individuals for meeting their personal, family or household needs and include credit cards, Auto Loans, Housing Finance and other consumer financing.

The Regulations require strengthening of risk-management processes of the banks/DFIs through establishing comprehensive credit risk management systems appropriate to their type, scope, sophistication and scale of operations. The BOD of the banks/DFIs has been required to establish policies, procedures and practices to define risks, stipulate responsibilities, specify security requirements, design internal controls and then ensure strict compliance with them. They also cover different consumer products through separate rules so that each product is dealt with while keeping in view their specific nature.

Prudential Regulations for SME Financing
The Prudential Regulations for Small and Medium Enterprises (SMEs) facilitate and encourage the flow of bank credit to the SME sector, keeping in view their important role in the economic development. Its features are;

- Shift from collateral based lending to cash flow based lending

- Maximum limit of clean financing against personal guarantees increased to Rs. 3 million for SMEs. This is greater than that for consumer as well as the corporate clean financing.
- The requirement for banks/DFIs to obtain copy of accounts has been relaxed for exposures of up to Rs.10 million.

Through the Prudential Regulations for SMEs, the State Bank of Pakistan has provided guidelines to the banks/DFIs for effective reach out to the SME sector. Presently most of the SMEs in Pakistan lack sophistication to have reliable and sufficient data and financial information, thus the banks/DFIs have been advised to come up with the minimum information requirements and standardized formats to facilitate SMEs. Close coordination of officials of the banks/DFIs and SMEs has been stressed in these regulations. The regulations are aimed at encouraging banks/DFIs to develop new financing techniques and innovative products to meet the requirements of SMEs and develop effective risk and resource management systems.

Prudential Regulations for Micro Finance Banks

The Bank has issued Prudential Regulations for Microfinance Banks and institutions, which are licensed by it. Some of the main points of these regulations are given below;

- No Microfinance Bank/Institutions (MFBs/MFIs) shall commence business unless it has a minimum paid-up capital as prescribed in MFIs Ordinance 2001. It shall also maintain equity equivalent to at least 15% of its risk-weighted assets.
- The MFB/MFI shall maintain a cash reserve equivalent to not less than 5% of its time and demand liabilities in a current account opened with the State Bank or its agent. In addition to cash reserve it shall also maintain liquidity equivalent to at least 10% of its time and demand liabilities in the form of liquid assets i.e. cash, gold and unencumbered approved securities.
- The MFB/MFI shall not extend loans exceeding Rs.100,000/- to a single borrower.
- The outstanding principal of the loans and advances, payments against which are overdue for 30 days or more shall be classified as Non-Performing Loans (NPLs).

1.4 Bankers' Bank

The Bank also functions as the bankers' bank. Banks are classified as scheduled and non-scheduled. The Bank maintains an updated list of all scheduled banks at its various offices. These banks are entitled to certain facilities from the State Bank and in return they have some obligations to it. State Bank provides the following three important services to the scheduled banks;

a. It keeps the deposits of commercial banks, which primarily constitute the *statutory reserves of scheduled banks*. Scheduled banks are required to keep with the State Bank certain percentage of their demand and time liabilities under Section 36 of SBP Act, 1956. Normally, the statutory reserves are kept with the Bank free of any return. However, the Bank can offer some interest on certain fraction of these reserves. Scheduled banks also keep a certain amount of excess reserves with the Bank, which not only facilitate inter-bank payments but also provide buffer for statutory reserves in case of fluctuations in banks demand and time liabilities.

b. The State Bank also provides extensive *remittances facilities* to banks at a concessional rate under the Remittance Facilities Scheme introduced since 1948. This facility helps the flow of funds smoothly and efficiently between various centres in the country. The Bank provides this facility through the media of its own offices, the branches of National Bank of Pakistan acting as its agents, and treasuries and sub-treasuries holding permanent currency chests at places where the State Bank has no office. Telegraphic Transfers (T.T.), Mail Transfers (M.T.), Demand Draft (D.D.) and Government Draft (G.D.) are the principal instruments used for remittances.

c. In order to streamline payments through the financial system, the Bank also manages the operations of clearing houses. In the five major cities, the functions of SBP clearing house has been handed over to a private agency namely National Institutional Facilitation Technologies Private Limited (NIFT) to the extent of sorting of payments instruments and preparing clearing schedules. Presently NIFT covers 80 percent of clearing services. However, the settlement of accounts is still undertaken at SBP. In other financial centres of the country, the Bank performs all the functions of the clearing house which are now managed by SBPBSC.

1.5 Lender of the Last Resort

One of the important characteristics of a central bank is its being the lender of the last resort. The State Bank provides loan and re-discount facilities to scheduled banks in times of dire need when they find no other source of funds. These facilities are ordinarily provided by the Bank against government securities, trade bills, agriculture bill, etc. These loans are essentially short-term in nature and are advanced to enable the banks to meet their temporary requirements of funds arising out of seasonal expansion in trade, commerce, agricultural operations, and other economic activities. These operations are carried out in accordance with the provisions of Section 17 of the State Bank of Pakistan Act, 1956. Notwithstanding any limitations contained in different sub-clauses of the Section 17, the Section 18 of the act gives the Bank the power of direct discount for undertaking this function.

In order to bring flexibility in accommodating short term liquidity requirements of financial institutions and to implement market oriented monetary policy, a 3-Day Repo facility was introduced by the State Bank of Pakistan with effect from 1st February, 1992, and the earlier arrangement of re-discount was discontinued effective from February 15, 1992. Against the 3-day repo facility, funds are allowed by accepting Market Treasury Bills/ Federal Investment Bonds/ Pakistan Investment Bonds.

1.6 Banker to Government

The State Bank conducts the banking business of Federal and Provincial Government and some government agencies. These functions performed by the Bank are akin to those ordinarily performed by commercial banks for their customers. The Bank provides the following services to the governments:

a. It accepts the deposits of cash, cheques and drafts by the Government and undertakes the collection of cheques and drafts drawn on other banks. The Bank transfers government funds from one account to another or from one centre to another as advised by them. The statutory provisions for this function were made first in the State Bank of Pakistan Order, 1948 and then in the SBP Act, 1956. *Federal and Provincial governments keep their deposits with the Bank free of interest. In turn, the Bank does not charge any commission to the governments for the banking services rendered to them*.

b. The Federal and Provincial governments can obtain advances from the Bank subject to mutual agreements in respect of the terms and conditions for such advances. The Bank makes ways and means advances to the Federal as well as to the Provincial governments without any collateral security. However, some times loans are also granted to the Provincial governments against the collateral of Federal Government securities.

c. On behalf of Federal, Provincial or Local governments the Bank also undertakes sale/purchase of gold, silver, approved foreign exchange, securities or shares in any company, collection of return on these shares/securities, transaction of SDR, etc. (Section 17(13) of the act).

2 Secondary Functions

2.1 Public Debt Management

The Bank is responsible for the management of government debt under sub-section 13(e) of section 17, and section 21 of the SBP Act, 1956. The Public Debt Act 1944 also defines the responsibilities of SBP for public debt management. The following actions are involved in this regard:

- Subscribing Federal and Provincial governments' securities at the time of their issue
- Sale/purchase of such securities in the Money Market (through auction, OMO or discount window)
- Payments of interest to holders of public debt instruments

In order to efficiently manage the public debt, a department namely, Securities Department was set up in December, 1990 for the business of government securities[7]. This department was subsequently merged with foreign exchange dealing room and a new department Exchange & Debt Management Department (EDMD) was created in February, 2000.

For the auction of Treasury Bills and government bonds, a primary dealer system is developed. The securities are offered for sale on fortnightly basis in case of Market Treasury Bills (MTBs) and on quarterly basis in case of Pakistan Investment Bonds (PIBs) to primary dealers[8]. Primary dealers are then allowed to undertake the business of government securities in secondary market[9].

The State Bank undertakes draws of prize bonds along with their sale/purchase. It also carries out the sale, purchase and interest payments on some of the saving schemes, however the overall management of prize bonds and saving schemes lies

[7] Before 1991 government securities were offered on Tap. Tap remained open for subscription throughout the year on weekly basis. In March 1991 this system was discontinued with the introduction of an auctioning system.

[8] For the year 2003-04, the primary dealers were American Express Bank HBL, Standard Chartered Bank, UBL, ABN Amro Bank, NBP, Citibank, Union Bank, Pak Oman Investment Company Limited, Bank Alfalah Limited, Jahangir Siddiqui & Co Limited (EDMD Circular No. 11 August 07, 2003)

[9] Secondary market consists of SBP, primary dealers, banks other than primary dealers, non-bank financial institutions, financial brokerage houses, different financial funds, individuals, etc.

with the Central Directorate of National Savings. The State Bank is entitled to receive commission on the transactions of government savings certificates. The State Bank also has an advisory role with regard to government loans, terms and timings for their floatation.

2.2 Management of Foreign Exchange

Being responsible for maintaining the external value of the currency, the State Bank of Pakistan assumed the charge of management and administration of the exchange system of the country in line with the Foreign Exchange Regulation Act, 1947 which was originally enacted by the British Government and subsequently adopted by Pakistan. As an agent to the Government, the Bank has been authorized to purchase and sell gold, silver or foreign exchange and transactions of special drawing rights with the International Monetary Fund under sub-sections 3(a) and 13(a,f) of section 17, and section 23 of the SBP Act, 1956.

Exchange Rate Regimes

The Bank is responsible to keep the exchange rate of the rupee at an appropriate level and prevent it from wide fluctuations in order to maintain competitiveness of our exports and maintain stability in the foreign exchange market. Various exchange policies have been adopted at different times for this purpose keeping in view the circumstances. With the collapse of Bretton-Woods arrangements in early 1970s and adoption of floating exchange rate regime by major trading countries of the world, Pakistan did not float the rupee but linked it to US Dollar to avoid the adverse impact of appreciating Pound Sterling to which rupee remained linked up to September, 1971. This link continued till January 7, 1982. However, with a view to reducing the ill effects of an appreciating US Dollar, in terms of major currencies of the world during early 1980s on our export competitiveness in the international markets, it was decided to adopt the managed floating exchange rate system with effect from January 8, 1982. Under this system the value of the rupee was determined on daily basis, with reference to a basket of currencies of Pakistan’s major trading partners and competitors. Adjustments were made in the value of rupee as and when the circumstances so warranted.

After nuclear detonation by Pakistan in 1998, a two tier exchange rate system was introduced temporarily, under which official exchange rate was fixed at Rs. 46 per US dollar and only certain percentage of exchange requirements of the economic agents were available at official rate, the rest of the requirements were to be met from inter-bank market at market rate. This policy significantly reduced the pressure on official reserves and prevented the economy to some extent from adverse implications of sanctions imposed on Pakistan due to nuclear explosion. The exchange rate was unified w.e.f. May 19, 1999 with the introduction of market based floating exchange rate system. However, there still remained an unofficial ceiling on the Rupee/Dollar parity until June 2000. During FY01, as a part of stabilization program, the Rupee band was dismantled in July 2000, and the monetary policy was used to quell market pressures and smooth out volatility.

As the custodian of country's external reserves, State Bank is also responsible for the management of the foreign exchange reserves. The task relating to the management of foreign exchange reserves is being performed by an investment committee. The committee after taking into consideration the overall level of reserves, maturities and payment obligations, make investment of surplus funds in such a manner that ensures liquidity of funds and maximizes earnings. These reserves are also being used for intervention in the foreign exchange market. For this purpose a Foreign Exchange Dealing Room was set up at the Central Directorate and services of a forex expert had been acquired[10].

While the foreign exchange reserves continue to grow substantially, SBP has adopted a new investment strategy for its foreign exchange reserves management. SBP has hired the services of Investment Consultant Firm M/s Mercer to advice and build capacity in this respect. In an attempt to diversify the composition of reserves, SBP for the first time, invested reserves in the commercial market, choosing five-year Islamic Bond worth of US$ 25 million.

The overall objective of this management strategy, in order of priority, is to ensure safety (preservation of capital), liquidity and maximum return on these reserves within the above constraints. The management strategy entails both, the development of in-house capacity and the partial outsourcing of reserve management to reputable foreign investment companies. The following are the salient features of the reserve management strategy:

Since the overall objectives are by definition conflicting, the optimal strategy is to strike a balance among them through dividing the overall portfolio into three sub-portfolio buckets including cash portfolio, liquidity portfolio and long-term portfolio. Given the level of reserves at the time of finalizing the strategy, the three portfolios had the fund allocation of US$ 3 billion, US$ 4 billion and US$ 2 billion respectively. The SBP has decided to award $3.2 billion out of the total US$ 6 billion allocated currently for the liquidity portfolio and the long-term

[10] The dealing room was subsequently merged with Securities Department and new department Exchange & Debt Management Department was established.

investment portfolio, to nine international fund managers. Any increment to the reserves, thereafter, would be allocated to the cash portfolio.

- Apart from short-term placements, the portion of reserves will also be invested in fixed income instruments.
- Their would be a maximum duration limit of long-term portfolio.
- The overall portfolio rating would be at least ‘AA’ while rating of any single instrument would not be below investment grade. The investment in equities is not permitted.
- The bank will appoint fund managers and the funds will be distributed among the external fund mangers according to their areas of expertise.
- Similarly, custodian banks may be appointed out of top highest-rated banks offering custodial services.
- All the matters pertaining to foreign exchange reserve position would be monitored and reviewed regularly.

Development of Forex Market

As a part of market based economic policies stance, the process of liberalization of exchange and payments regime has been started since 1991. A number of reforms have been undertaken since then including (a) permission to residents for opening foreign currency deposits, (b) granting license to Pakistani nationals and resident companies/firms to work as authorized money changers on payment of prescribed fee, (c) permission for opening of a ‘Special Convertible Rupee Account’ by non-residents for purchase of shares quoted on the Stock Exchange, (d) permission to investment banks to raise foreign currency funds from abroad through issue of certificate of investment, (e) liberalization of rules relating to investment in government securities, including NIT Units, by non-resident Pakistanis on repatriable basis, (f) permission to authorized Dealers for import and export of foreign currency notes and coins, (g) establishment of exchange companies, (h) relaxation in respect of trade-related remittances, and (i) adoption of measures to deepen forex markets/treasury operation etc.

Before 1990s - when the process of liberalization started - all transactions in foreign exchange were to be conducted at specified rates through authorized dealers. All foreign exchange receipts on account of exports and services were required to be declared and surrendered to the authorized dealers who, in turn, passed them on to the State Bank. However, now the Bank has done away with the surrender requirement; and the commercial banks and other authorized dealers have been made free to hold and undertake transaction in foreign currencies.

A new foreign currency accounts scheme has been introduced under which banks keep the funds with them and pay return keeping in view their earnings and cost of funds. The funds under this scheme have been allowed to be used for financing of trade-related activities. The traders, particularly the exporters, can now avail foreign currency loans at cheaper rates.

Exchange companies have been established to carry out sale/purchase, export/import and remittances of foreign currencies. They have been allowed to make remittances on account of dividend, royalty and franchise fee etc., subject to an NOC from the designated authorised dealer. Formulation of exchange companies would help in unification of exchange rates. Presently, it has given a corporate culture to money changing/remittances business in the country. Home remittances are also being routed through these companies, which have been brought in the reporting ambit.

2.3 Advisor to Government

The State Bank of Pakistan, also acts as an advisor to the Government on financial and economic matters particularly with reference to their monetary aspects. The Bank counsels the Government on loan operations and advises it with regard to the timings, terms and conditions and rate of return on these loans. The advice is also tendered on matters like agricultural credit, cooperative credit, industrial finance, exchange regulations, banking and credit control, mobilization of savings, financial aspects of planning and development and similar other economic issues. State Bank of Pakistan also tenders advice to the Government on debt management issues. The advisory role of the Bank has been made mandatory in accordance with the Section 9A(d,e) of the SBP Act 1956.

Monetary and Fiscal Policies Coordination Board (MFPCB)

The State Bank also participates in economic policy making as a member of various government agencies and committees. In order to coordinate fiscal, monetary, foreign trade and exchange rate policies, a “Monetary and Fiscal Coordination Board” has been set up under Section 9B of the SBP Act 1956 with the Finance Minister as its Chairman and Federal Minister or secretary for Commerce, Deputy Chairman Planning Commission, Governor State Bank of Pakistan and Secretary of Finance, as its members. The Board is responsible for ensuring consistency among macro targets and to determine, in consultation with the Federal Government, the limits of credit to be extended to the Federal and Provincial governments and review, on a quarterly basis, Government’s borrowings in relation to pre-determined or revised targets. The Bank is required to place before the Board its assessment regarding the impact of economic policies on monetary aggregates and recommendations for fixing the safe limits of monetary expansion and Government borrowings.

In carrying out its assigned functions of coordinating fiscal, monetary and exchange rate policies and for ensuring consistency among macroeconomic targets of growth, inflation, fiscal, monetary and external accounts, the Coordination Board shall not take any measure that would adversely affect the autonomy of the State Bank of Pakistan as provided in the SBP Act.

Reports on the State of the Economy

The Bank submits its review of the economy to the Parliament through its annual and quarterly reports. The advisory function of the State Bank has been assigned to it by sub-sections (d), (e) and (f) of Section 9A of the SBP Act, 1956 which enjoins the Central Board of the State Bank to (i) tender advice to the Federal Government on the interaction of monetary policy with fiscal and exchange rate policy; (ii) analyse and advice the Federal Government on the impact of various policies on the state of the economy; and (iii) submit a quarterly report to the Majlis-e-Shoora (Parliament) on the state of the economy with special reference to economic growth, money supply, credit, balance of payments and price developments.

2.4 Relationships with International Financial Institutions

Pakistan is the member of International Monetary Fund. The State Bank of Pakistan deals with the IMF on behalf of the Government of Pakistan (sub-sections 13(f) and 15 of Section 17 of the act). As a member of the Fund, the Government accepted the obligations of Article-VIII, Sections 2, 3 and 4 of the IMF Articles of Agreement w.e.f. July 1, 1994. As a result of which Pak-rupee was made convertible on current international transactions. The Governor State Bank accompanies the Minister of Finance in annual general meeting of the IMF and World Bank. The Bank officials also participate in negotiations with IMF missions in Pakistan and at IMF Head Office.

The State Bank of Pakistan also deals with other international financial organizations including Bank for International Settlement, the World Bank, Central Banks of foreign countries, etc. Almost all the agreements of Provincial and Federal Government with International Financial Institutions (IFIs) are executed through the State Bank of Pakistan.

3 Non-traditional Functions

Responsibilities of the State Bank of Pakistan go well beyond the conventional functions that have been discussed above. The scope of Bank's operations has been widened considerably by including the economic growth objective in its statute under the State Bank of Pakistan Act, 1956. In fact, the Bank has been involved in developmental and promotional activities even before the enactment of SBP Act, 1956. The Bank's participation in the development process has been in the form of rehabilitation of banking system in Pakistan, development of new financial institutions and debt instruments to promote financial intermediation, establishment of Development Finance Institutions (DFIs), directing the use of credit according to development priorities, providing subsidized credit, and development of capital market.

3.1 Development of the Banking System

The most significant contribution made by the State Bank of Pakistan towards facilitating and fostering economic development in Pakistan was the rehabilitation of the banking system in Pakistan. At the time of independence the commercial banking system in Pakistan had virtually collapsed with the closure of large number of bank offices which were run and managed by non-Muslims who migrated en-mass to India. Also there was no independent monetary authority, and the Government of Pakistan had to resort to the Reserve Bank of India for its currency and monetary affairs. Thus a tremendous task before the State Bank was to strengthen its own institution as a central bank besides overall development of banking industry in the country.

Commercial banking

For promotion of overall banking services in the country the Bank initiated a scheme for setting up the National Bank of Pakistan with a broader outlook and a bold branch expansion programme in 1949. A year later, it was decided to reserve internal banking for Pakistani banks and allow the foreign banks to open new offices only in port towns or in other large cities where substantial trade was carried on with foreign countries.

This policy gave a powerful fillip to Pakistani enterprise in the field and there was a remarkable growth in the number of offices of Pakistani scheduled banks in early days of the state of Pakistan. In recent years (1990s), as a move towards financial sector liberalization, private sector has been encouraged to enter into the banking industry. Foreign banks have also been allowed to expand their branch network across the country. This policy has promoted healthy competition among banking companies, and has significantly improved the quality of banking services in Pakistan.

Micro Finance

In order to expand the banking services at grass root level and to enable the financial sector to play its role in poverty alleviation, the State Bank of Pakistan is also promoting micro banking in the country. It has facilitated two micro finance banks namely Khushali Bank and the First Micro Finance Bank (FMFB) Limited. Khushhali Bank is in public sector and FMFB is set up in private sector. Contrary to the requirement of paid up capital of Rs 1 billion for commercial banks, SBP has fixed a reduced limit of minimum paid up capital for microfinance banks. In order to commence business the MFB/MFI shall have a minimum paid up capital of Rs.500 million, Rs.250 million and Rs.100 million respectively for countrywide, specific province-wide and specific district-wide operations.

A set of prudential regulations[11] has also been issued to keep the activities of these banks within the norms of banking business and to safeguard the interest of their clients. The Micro Finance Bank can also engage in mobile banking within their area of business so that banking facilities can be spread to the grass root level.

Promotion of Islamic Banking

In order to meet the latent demand for Shariah compliant solutions of various financial needs of masses, State bank of Pakistan is playing a leading role in the promotion of Islamic Banking in Pakistan. Conferences, workshops, seminars and presentations are being conducted to create public awareness and develop better coordination among various stakeholders of Islamic banking.

[11] See section 1.3 for some points of the prudential regulation for micro finance.

3.2 Training Facilities to Bankers

Keeping in view an acute shortage of trained bankers at the time of the independence, the State Bank introduced "Bank Officers Training Scheme" within one month of its establishment. On July 2 1948, the Central Board of Directors of the Bank approved a comprehensive scheme for university graduates especially with mathematics, economics and commerce backgrounds. For clerks, State Bank introduced departmental examinations system in 1950 to enhance the capabilities of the existing staff in the banking industry.

Institute of Bankers Pakistan

On the initiative of the Bank's Governor, the Institute for Bankers Pakistan (IBP) was established for conducting examinations in prescribed banking courses for augmenting the strength of qualified banking staff in the country. The Institute started functioning from September 17, 1951. The Governor was elected the first president of the council of the Institute of Bankers Pakistan. The Institute contributed significantly towards the improvement of operational efficiency of commercial banking system and providing better facilities for training and education in banking. All the branches of SBP (BSC) have local offices of the Institute which organize seminars and short courses on current and important issues in banking industry of Pakistan. The institute also conducts annual essay competition on various economic issues and awards prizes to the four best essays.

Training Department/Division

State Bank also strengthened its training area. Training courses on central and commercial banking for both domestic and international participants were designed. Under the domestic training programme, the in-service training schemes have always remained on high priority in the training strategy of the Bank. During 1981-82, two Training Units were established - one each at Karachi and Lahore to cater to the training needs of the Bank's staff of different categories attached to various offices. The Training Department of the Bank also tries to secure training placements for Bank officials in different training institutions both at home and abroad like NIPA, PIDE, IMF, ADB, IDB, World Bank, etc. Recently Training Department has been merged with Human Resource Department in order to make human resource managements more efficient at SBP.

NIBAF

In 1997, with the abolition of Pakistan Banking Council, the State Bank assumed the charge of National Institute of Banking and Finance (NIBAF), Islamabad. At NIBAF excellent training facilities are available for participants on commercial banking, central banking and other areas related with the financial sector. The NIBAF was converted into an independent subsidiary of SBP in 2003 under a fulltime Managing Director. It operates two campuses – one at Islamabad and the other at Karachi (North Nazimabad). In pursuance of the Bank's objective to promote technical cooperation among developing countries, international training courses for the benefit of bankers from Afro-Asian, Latin American, Commonwealth and Central Asian States are also organized each year at NIBAF.

Training on Islamic Banking

The NIBAF has also designed a module on Islamic banking and finance in its training courses designed for State Bank's officers. Courses of the Institute of Bankers, Pakistan have been revised to include topics on Islamic economics, banking and finance.

SEANZA Courses

The Bank also hosted the 5th and 20th SEANZA Central Banking Courses held at Karachi during January-March, 1964 and October-November, 1994 respectively. The former was attended by 23 participants and the latter was attended by 29 participants from 17 countries. Formed in 1956, SEANZA is a group of 17 central banks in South East Asia Region comprising Australia, Bangladesh, China, India, Indonesia, Iran, Japan, Korea, Malaysia, Nepal, New Zealand, Pakistan, Papua New Guinea, Philippines, Singapore, Sri Lanka and Thailand. State Bank of Pakistan is one of its five founding members.

Scholarships for PhD

The Bank has also started scholarships for PhD in economics and finance in order to meet its needs for professionally qualified personnel in these fields. These scholarships are available to those candidates who are able to get admissions in top ranked universities of the world. For domestic candidates, one scholarship is also available for PhD student of Pakistan Institute of Development Economics (PIDE).

Training for Rural Finance

Recently the SBP has launched a unique training program for not only bankers involved in rural and agricultural credit but also farmers and other potential clients of rural financial service providers. Such trainings are held at different offices of SBP (BSC). The objective of such training programs is creating awareness among the farming community and sharing of knowledge and experience with stakeholders.

The participants of these training courses include local/ regional nominees, preferably mobile credit officers/agricultural credit officers from Zarai Taraqiati Bank Ltd., five big commercial banks, provincial co-operative banks, domestic private banks, chambers of agriculture, farmers association / abadgars / growers association and SBP (BSC) officers of Local Credit Advisory Committees.

Library Services

In order to cater to information needs of the bankers, researchers, students and general public, a main library was setup in 1949 at Central Directorate of State Bank of Pakistan, Karachi. The library has a rich collection of books, technical reports, Government documents, periodicals and magazines mainly relating to the subjects of economics, banking, finance, management, commerce, etc. Besides, sufficient reading material on Islam (in English, Urdu, Arabic, and Persian languages) and literary works in national and regional languages are also available in the library. Over the years, the library has grown into one of the biggest and well-stocked libraries of the country on these subjects. The library facilities have been so designed that the latest as well as archival materials on the subjects related to economics, banking, finance and allied subjects are within easy access of the readers.

The State Bank library has been financed adequately through annual budget as well as special grants for procurement of books and periodical literature. All out efforts are made to ensure the availability of standard reading material in the library. Besides purchases, the library receives publications of central banks, United Nations, IMF, the World Bank, ADB, etc., and others international organizations like OPEC, OECD, Islamic Development Bank, Bank for International Settlements, etc., local public/private sector banks, financial & industrial institutions, government's departments and research organizations on complimentary or exchange basis.

In addition to a large collection of books, journals and other documents, the library is also maintaining clipping files on about 180 subjects relating to economics, banking, commerce, finance, politics, etc., since 1951. Interesting news items, features, articles, policy statements issued by the Government functionaries, speeches / addresses of presidents and prime ministers, etc. appearing in the national dailies are regularly clipped and maintained properly in the relevant files, which serve as valuable sources of information to those who are interested in historical research on issues relating to these subjects.

The SBP Library is open to scholars, students and others who wish to avail its facilities. A Friends of SBP Library Program provides access for outsiders to our Library resources.

3.3 Development of Specialized Financial Institutions

The State Bank has actively participated in setting up a number of specialized credit institutions designed to meet the long and medium-term financing needs of various sectors of the economy. These institutions include Pakistan Industrial Credit and Investment Corporation of Pakistan (PICIC), Industrial Development Bank of Pakistan (IDBP), National Development Finance Corporation (NDFC), Agricultural Development Bank of Pakistan[12] (ADBP), Federal Bank for Co-operatives (FBC) and House Building Finance Corporation (HBFC). These institutions were established to provide credit to industrial, agricultural and other sectors. The Bank also subscribed to the share capital of the People's Finance Corporation - renamed subsequently as Small Business Finance Corporation (merged in to the present Small and Medium Enterprise Bank), the Equity Participation Fund and Banker's Equity. These institutions were designed to provide finance to small businesses and the major sectors of the economy.

3.4 Credit to Priority Sectors

The Bank has also introduced various credit schemes to channel resources towards priority sectors like export finance scheme, mandatory credit for agriculture, small business and small industries, etc. Before 1990s, mandatory and concessionary credit to priority sectors remained about 50 per cent of the total private sector credit. However, with the start of liberalization process in the financial sector, its share is declining as a result of deliberate policy stance. The underlying objectives are to increase efficiency in all the sectors of the economy and to let the market forces decide the proper allocation of resources.

Credit for Agriculture

The Agriculture Credit Scheme was introduced in 1972 by the SBP under SBP Act 1956 read with Loan For Agricultural Purposes Act 1973. Later on, to increase the involvement of commercial banks, the scheme was reviewed and re-named as “Supervised Agricultural Credit Scheme” in 1986. The spirit of the scheme was to provide maximum credit availability through banking credit to small farmers, having cultivable land up to Subsistence Level. The Supervised Agricultural Credit Scheme was once again entirely revamped in 2001, which included a complete value chain of farm & non-farm activities, like production, transportation, packing, polishing, grading, crating, godowns, cold storage, silos, steel / metal capsules, along with forestry, poultry, fisheries (inland & marine), livestock, dairy products, fruits, vegetables, floriculture, sericulture, apiculture, marketing & exports.

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12 Now Zarai Tarqiati Bank Limited.

In order to enhance the volume and scope of Agricultural Credit, SBP during the last few years included 150 new items in the list of items eligible for Agricultural Credit, established Local Credit Advisory Committees at each SBP (BSC) office, inducted 14 new Domestic Private Commercial Banks into the scheme, issued Master / Comprehensive Circular on the Agricultural Loans Schemes, standardized and simplified loan documents, withdrew the Territorial Jurisdiction, published brochures on Agricultural Loans Scheme & Revolving Credit Scheme in English, Urdu and other regional languages. Besides these efforts SBP recently, with the consensus of all banks, introduced the Revolving Credit Scheme. It provides, sanction of limit for 3 years with one time documentation, automatic renewal, partial repayments, multiple operation as per needs of the farmers, no frequent visits of revenue department and attracting mark-up only on such amounts which are actually withdrawn and utilized on daily product basis.

Export Finance Scheme

For the purpose of exports growth, State Bank introduced its Export Finance Scheme (EFS) in 1973, enabling banks to seek reimbursement from State Bank against financing facilities provided to exporters of non-traditional and newly emerging export items. In 1977 the scope of the scheme was enlarged and financing was made available for all manufacturing goods. It was moreover, split into two parts, Part I in terms of which financing facilities are provided on transaction bases and Part II which caters to the financing requirements on performance basis. The Scheme was subsequently revised in 1998[13], wherein the banks were advised to consider more favourably, the financing requests under the scheme from small and medium exporters / indirect exporters. With a view to simplify the procedure and eliminate excessive documents required under Part I of the Scheme, its instructions were revised in September 2001. The Scheme has played an effective role in promoting exports from Pakistan (See **Table 3.1** and **Table 3.2** for year wise over all outstanding and gross disbursement position of refinance viz-a-viz total exports, from June 1996 onwards).

Up to June 1981 financing facilities under the scheme was available for 90 days as per the prevailing provision of SBP Act, 1956. However the facilities so availed could be rolled over for another period of 90 days thus finance was available to an exporter for 180 days. The period of financing / refinancing after necessary modification in SBP Act 1956 was extended to 150 days. At present the financing is available for 180 days both under Part I and II. However, in the case of exporters of carpets an additional period of 90 days is available on post shipment stage if shipment is made within 180 days. For the convenience of the exporters

[13] Vide BPRD Circular No. 44 of 1998

and banks State Bank has also separately circulated a list of items, which are ineligible for financing under the Scheme. In addition to this certain non-traditional export items (mostly intangible) have also been specifically approved as eligible for financing under the Scheme.

The rate of return on finance/refinance has been under revision from time to time. Initially the rate of interest on finance was 7% p.a. whereas the refinance rate was 4% with the spread of 3% for the commercial banks. The end users' rate reached to highest level of 13% in November, 1994 with a banks' spread of 3%. However since its linkage to the weighted average yields on 6 months T-bills, and fixation on monthly basis, its movement has been rationalized and exporters can also foresee the rate at which funds shall be available to them under EFS. For the present the banks have been provided a spread of 1.5% on their financing under EFS. Since August 2003 the end users' rates under EFS have been fixed at 3%. The State Bank has also put in place a fine regime under the scheme in terms of which the exporters who fail to meet their commitments may be subject to fine.

In addition to Export Finance Scheme, the State Bank has also been striving to channelise funds to the industrial sector and for the purpose it has designed different scheme, most of which have been discontinued as they outlived their utility. However one such scheme, Scheme for Financing Locally Manufactured Machinery is presently under review. During the period that this scheme was operational, it was widely used by industrialist for seeking financial assistance for setting up new projects.

4 Islamisation of the Banking System

The State Bank has also been involved in the process of Islamisation of the economy in general and the banking system in particular. The State Bank had been making efforts since its inception to evolve and introduce a financial system based on the norms of the Shariah. While inaugurating the State Bank of Pakistan, the Father of the Nation, Quaid-e-Azam Muhammad Ali Jinnah, and later on the first Governor of the Bank, late Zahid Hussain, gave a direction to make efforts to build the economic and financial system of the country on the lines dictated by Islam. However, the work could not be started forthwith as the experts in Islamic jurisprudence and the modern economics both were not available.

A unit was created in the Research Department of the Bank in late 1950s that was subsequently developed into a full-fledged Division, to undertake research work on economic system of Islam. Considerable amount of research work was undertaken in Islamic Economics Division (I.E.D) of the Bank during 1960s and 1970s. This particularly included the nature and connotation of 'Riba', the Shari'e position of present day interest based financial system, various alternatives to interest and the fiscal system of Islam. Similarly in 2001 an Islamic Banking Division was established in Banking Policy Department to deal with the regulatory and supervisory issues in Islamic Banking. To meet the challenges of developing a dynamic, responsive and viable Islamic banking system, a new Islamic Banking Department has been established in the Bank in September, 2003 through the merger of Islamic Economic Division and Islamic Banking Division.

4.1 Secretariat of Council of Islamic Ideology

The Islamic Economic Division of the Bank served as a secretariat to the Council of Islamic Ideology (C.I.I.) in late 1970s when the President of Pakistan asked the Council to prepare a blueprint for the establishment of an interest-free economic system compatible with the Shariah. Various reports of the C.I.I. formed the genesis for changes in the banking system that were introduced in later years. The Banking Control Department of the Bank, under guidance of the Ministry of Finance and in collaboration with the Pakistan Banking Council, issued directives to the banks for transformation of the conventional banking system into the non-interest based system. The process started in 1979 and reached its culmination in 1985. As of 1st April, 1985, all banking companies were required to provide finance to all entities, including individuals, only under the identified interest free modes. As of 1st July, 1985, no banking company could accept any interest bearing deposits. The Islamization programme, however, did not apply to foreign branches of Pakistani commercial banks as well as foreign currency accounts/ foreign currency dominated loans kept in Pakistan.

The financing procedure based on 'mark-up' adopted by banks in 1985 was, however, declared un-Islamic by the Federal Shariat Court (FSC) in November 1991. The FSC declared that various provisions of the laws held repugnant to the injunctions of Islam would cease to have effect as of July 1, 1992. However, the Government and one commercial bank filed an appeal in the Shariat Appellate Bench of Supreme Court due to which the FSC judgment remained suspended for a long time. The Supreme Court's Shariat Appellate Bench delivered its judgment on December 23, 1999 with the directions that laws involving interest would cease to have effect finally by June 30, 2001, which date was further extended to June 30, 2002. The supreme court of Pakistan directed that the present financial system had to be subjected to radical changes to bring it into conformity with the Shariah. It also directed the Government to set up, within specified time frame, a commission for transformation of the financial system and two task forces to plan and implement the process of the transformation. The Court indicated some measures, which needed to be taken, and the infrastructure and legal framework to be provided in order to have an economy conforming to the injunctions of Islam.

4.2 Commission for Transformation of Financial System

The Commission for Transformation of Financial System (CTFS) was constituted by the Government in January 2000 in the State Bank of Pakistan under the Chairmanship of Mr. I.A. Hanfi, a former Governor State Bank of Pakistan. A Task Force was set up in the Ministry of Finance to suggest the ways to eliminate interest from Government financial transactions. Another Task Force was set up in the Ministry of Law to suggest amendments in legal framework to implement the Court's Judgment. The CTFS constituted a committee for Development of Financial Instruments and Standardized Documents in the State Bank to prepare model agreements and financial instruments for new system. The committee submitted its report to the commission in May 2001. The CTFS submitted 2 reports one in October 2000 and other in August 2001, which identified a number of prior actions needed to be taken to prepare the ground for transformation of the financial system.

However, on a Review petition filed by the United Bank Limited, Shariat Bench of the Supreme Court set aside the previous verdicts on Riba, i.e. judgment by the Federal Shariat Court dated November 14, 1991 and the verdict by the SAB dated December 23, 1999 in its short judgment dated June 24, 2002 and remanded the case back to Federal Shariat Court for hearing afresh and decide the unresolved issues discussed in both the above mentioned judgments. Consequently, the CTFS was also dissolved in June 2002.

4.3 Measures for Transformation of Financial System

The State Bank issued detailed criteria in December 2001 for establishment of full-fledged Islamic commercial banks in the private sector. Al Meezan Investment Bank received the first Islamic commercial banking license from SBP in January 2002 and the Meezan Bank Limited (MBL) started commercial operations in March, 2002 as a model Islamic bank in Pakistan and has also acquired the business of 'Societe Generalé Bank's branches operating in Pakistan. As of December 31, 2003 it has a network of 10 branches in different cities.

In order to allow existing banks to open subsidiaries for Islamic banking, an amendment in section 23 of Banking Companies Ordinance, 1962 was made on 6th November, 2002.

SBP issued BPD Circular No. 1 dated 1st January, 2003 outlining its policies for promotion of Islamic banking, which includes criteria for:

- Establishment of Islamic commercial banks in private sector
- Setting up of Islamic banking subsidiaries by existing commercial Banks
- Opening of stand-alone branches for Islamic banking by existing commercial banks

Accordingly five existing commercial banks (Muslim Commercial Bank, Bank Alfalah, Bank of Khyber, Habib Bank AG Zurich and Habib Bank Limited) were allowed to open 9 Islamic Banking Branches (IBBs), out of which eight branches of four banks have already started their operations.

The State Bank has also taken a number of other measures to play its role for Islamization of the banking industry as mentioned below;

a. A Shariah Board has been formed in the Bank, which consists of two renowned Shariah scholars, an accountant, a lawyer and a banker. The Shariah Board will guide the Bank in various Islamic banking issues.

b. Islamic banks have been allowed to maintain statutory liquidity under section 29 of BCO, 1962 in the form of current account with SBP to the extent of 40% of Statutory Liquidity Requirement for other banks (which is presently 15% and works out to 6% of time and demand liabilities) till the issuance of Islamic bonds by the Government or other similar non-interest bearing GOP securities.

c. Similarly they have also been allowed to maintain Special Cash Reserve (SCR) on FE-25 deposits in current account with State Bank in local currency to the extent of 40% of SCR for other banks in order to avoid interest payments on SCR.

d. An Islamic Export Refinance Scheme has been formulated by SBP to facilitate the Islamic Banks/ IBBs in providing a Shariah compliant export financing to the exporters.

e. A committee has been constituted with Institute of Chartered Accountants Pakistan (ICAP) in which SBP is also represented, for development of accounting standards for Islamic modes of financing. The committee is reviewing the accounting standards prepared by Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) with a view to adapt them to our circumstances and if considered necessary to propose new accounting standards. The committee has prepared the standard on Murabaha and is now working on the Ijara and Musharika standards.

f. State Bank of Pakistan has become a founding full member of Islamic Financial Services Board (IFSB) established in Malaysia on 3rd November, 2002. This Board will work for promotion and development of a prudent and transparent Islamic financial services industry through introducing international standards consistent with Shariah principles.

g. Islamic Banking Department is also working in close coordination with other international organizations like AAOIFI, Bahrain Monetary Authority (BMA) and Bank Negara Malaysia (BNM) etc. to promote Islamic banking and learn from their international experience.

h. To develop a system for Shariah Compliance Audit of Islamic Banks/IBBs a chartered accountant firm has been granted a contract which covers, Shariah audit of Meezan Bank, preparation of a Shariah Compliance Inspection Manual for future use of SBP and training of a few of SBP inspection staff.

i. Shariah compliant Islamic Ijara Sukuk for Government borrowings and as an avenue of investment for SLR purposed by Islamic banks is being developed in line with the experience of Ijara Sukuk issued by Bahrain Monetary Agency and Bank Negara Malaysia.

5 Autonomy of the State Bank

Independence of a central bank in conduct of its policies for achieving stipulated targets has become a significant decree of present economic wisdom. There is a world wide movement of granting independence to central banks. Pakistan is not an exception. During the decade of 1990s, a number of measures have been taken to enable the State Bank of Pakistan to execute its functions independently.

The legal documents governing financial system of Pakistan, viz., SBP Act, 1956, Banking Companies Ordinance, 1962 and Banks Nationalization Act, 1974 have been subject to a number of changes to give exclusive authority to the State Bank for regulating the banking sector, conducting an independent monetary policy and setting limit on Government borrowings from the Bank. A bill, passed in February 1994, amended the State Bank of Pakistan Act, 1956, in terms of which monetary policy was made the sole responsibility of the State Bank of Pakistan. More specifically, the Central Board of the Bank was given larger responsibility to regulate and supervise monetary and credit system keeping in view the national policy objectives of the Government.

On January 21, 1997, the State Bank of Pakistan Act was further amended to strengthen autonomy of the Bank. According to amended Section 9-A of the Act, the Central Board would, in order to secure monetary stability and soundness of the financial system, formulate and monitor credit policy. In doing so the Bank would take into account the Federal Government's targets for growth, inflation and expected changes in net foreign assets of the banking system and would ensure that monetary and credit policy is conducted in a manner which was consistent with these targets. The Board would also determine and enforce, in addition to the overall expansion of liquidity, the limit of credit to be extended by the State Bank to the Federal Government, Provincial governments and other agencies of the Federal and Provincial governments for all purposes. It would also estimate the credit requirements of the private sector and would intimate the same to the Monetary and Fiscal Policies Co-ordination Board (MFPCB). More importantly, it would submit a quarterly report to the parliament on the state of the economy with special reference to economic growth, money supply and credit, balance of payments and price developments.

In terms of the amended Section 9-B, which describes functions of the MFPCB, it would now determine the extent of Government borrowing from commercial banks taking into account the credit requirements of the private sector and liquidity expansion as determined by the Central Board. Amended Section 46-B prescribes that no governmental or quasi governmental body or agency shall issue any directive, directly or indirectly, to any banking company or any other financial institution regulated by the Bank which is inconsistent with the policies, regulations and directives issued by the Bank pursuant to this Act, the Banking Companies Ordinance, 1962 or any other law in force.

Several supportive amendments have also been made in the Banks Nationalization Act 1974 and the Banking Companies Ordinance, 1962. In terms of these amendments, the Pakistan Banking Council has been abolished, thereby making State Bank the sole agency to supervise and regulate the activities of nationalized commercial banks. The State Bank has also been given powers to institutionalize the management of banks. The chairman of a bank, who would preside over the meetings of the Board, and the president of the bank, who would be its chief executive, would be separate persons. The general direction and superintendence of the affairs and business of a bank and overall policy making in respect of its operations shall vest in its Board. The chief executive will head the operations of the bank and shall act in accordance with the policies, criteria and guidelines determined by the Board. The Government would appoint the chief executive and the members of the Board of Directors of a nationalized bank, which would now be tenured positions, from the list of duly qualified bankers to be provided by the State Bank.

The Government would appoint and remove these professionals in consultation with the State Bank. Section 41-D has been added in the Banking Companies Ordinance, 1962 which states that the State Bank may direct prosecution of a director or chief executive etc. who, in its opinion, has knowingly acted in a manner causing loss of depositors' money or of the income of the bank. It has been explained that for the purpose of this section a director or chief executive etc. would be deemed to have acted knowingly if he has departed from established banking practices or circumvented the regulations/restrictions laid down by the State Bank.

The SBP Act has been given Constitutional protection in 2003 by including it in the Sixth Schedule of the Constitution. The Governor is appointed and removed (under conditions laid down in the Act) by the President of Pakistan.

6 Organization of the State Bank

In 1948 when the Bank started its operations, it had only four departments in the Central Directorate and three small branch offices located at Karachi, Lahore and Dacca. It had the benefit of the services of only eight experienced officers who opted for service in SBP from the Reserve Bank of India. The shortage of trained personnel was even more acute for conducting the supervisory role of a central bank. However, with the passage of time the State Bank of Pakistan not only expanded its branch network across the country, it also strengthened its management by harvesting highly qualified and trained personnel and introducing modern information technology.

In order to discharge its functions effectively, the organization of the State Bank has been subject to a number of changes from time to time. A process of setting up new departments, merging others, establishing local offices has been continued since its inception. The present structure of the Bank reflects its maturity, strength and ceaseless efforts by forerunners during the last half century. An account of its present structure is given below.

6.1 Board of Directors

The general superintendence and direction of the affairs and business of the Bank have been entrusted to the Central Board of Directors consisting of the Governor (Chairman), Secretary Finance Division, Government of Pakistan, and seven directors, including one director from each province, to be nominated by the Federal Government ensuring representation to agriculture, banking and industrial sectors. The Board exercises all the powers and does all acts and things that may be exercised or done by the Bank and are not, by the SBP Act, 1956, expressly directed or required to be done by the Bank in general meeting or in annual general meeting. All decisions of the Central Board are taken by majority of members present and voting. In case of equality of votes, the Governor may exercise a casting vote. Deputy Governors of the Bank may also attend the meeting of the Board, if required, but they do not have the right to vote.

6.2 Management

The management of the Bank consists of a Governor, one or more Deputy Governors, Executive Directors, Economic Advisor, and Directors of various departments. The Governor is the Chief Executive Officer and directs and controls the whole affairs of the Bank on behalf the Central Board (see **Annex 3** for names of SBP Governors since its inception). The President of Pakistan appoints the Governor for a term of three years. A Governor is eligible for re-appointment for another term of three years. The Federal Government appoints Deputy Governors for such a period (not exceeding five years) and on such salary and such terms and conditions of service as it may determine. Presently the Bank is benefiting from the services of two Deputy Governors (DGs). Deputy Governors are assisted by Executive Directors (ED) and Economic Advisor. Each ED and EA looks after the affairs of one or more department(s). Each department is headed by a Director. A sketch of the Bank management is given in **Chart 2**.

6.3 Departments

The organization of the Bank has been divided into sixteen departments. A brief description of these departments is given below.

Accounts Department

Provides effective & efficient accounting services & information for planning, control and decision-making regarding annual budget and balance sheet of the Bank. It also undertakes sale and purchase of foreign currencies and acts as custodian of Pakistan's reserves of approved foreign exchange.

Agricultural Credit Department (ACD)

ACD coordinates the operations of the Bank in connection with agricultural credit and its relations with the provincial co-operative banks and any other organizations engaged in the business of agricultural credit.

Banking Inspection Department (BID)

BID achieves the regulatory goals of State Bank of Pakistan, i.e., ensuring the safety and soundness of the financial system and safeguards the interests of the depositors. In order to assess a financial institution, BID conducts regular *on-site* inspection of all scheduled banks inclusive of the foreign banks & DFIs.

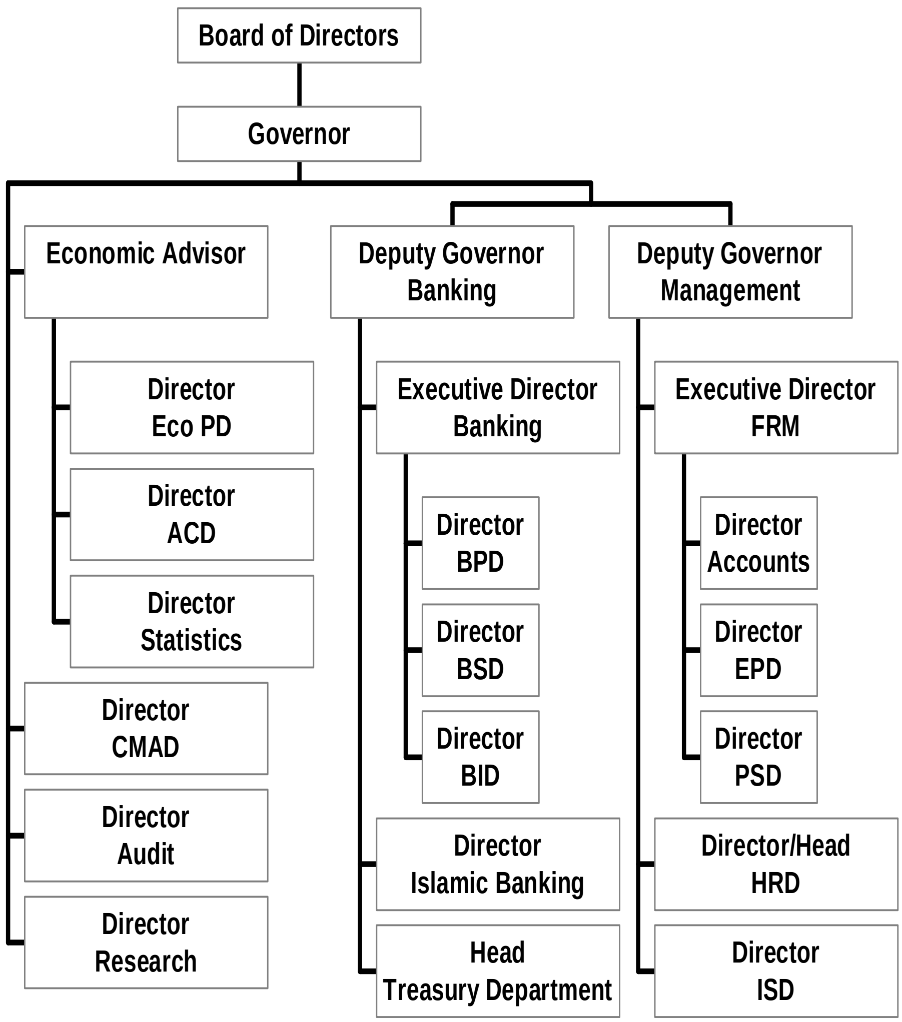
Banking Policy Department

BPD reviews and formulates proactive policy framework for Banks/ NBFIs concerning diligent licensing, proposals for mergers/acquisition, privatization matters, management of the banks and conducting special studies for improvement in the banking sector with a view to safe guard the depositor's interest.

Banking Supervision Department

Banking Supervision Department ensures enforcement of regulatory and supervisory policies, monitors risk profiles, and evaluates operating performance of individual banks and DFIs as also of the overall banking system. It also ensures that banks and DFIs are adequately capitalized and have policies and systems in

Chart 2: Organization of the State Bank of Pakistan



place to assess various risks. Furthermore, the Department is also responsible for regulation and supervision of MicroFinance Banks (MFBs) to ensure their soundness and stability. BSD also provides online collection & dissemination of credit related information to financial institutions.

Economic Policy Department
Prepares monetary survey, credit plans, working papers for National Credit Consultative Council (NCCC) and M&FCB meetings, keeps constant watch and analyses developments in the financial markets and matters relating to Pakistan's relationship with IFIs.

Exchange & Debt Management Dept.
Its function is effective and efficient execution of monetary and exchange rate policies through money market and foreign exchange operations. It also performs domestic debt management function.

Exchange Policy Department
Its functions include formulation and regulation of policies relating to foreign exchange matters.

Islamic Banking Department
IBD has been set up recently with the objective of promoting and regulating Islamic banking in the country. Its vision is "Make Islamic Banking the banking of first choice for the providers and users of financial services". All maters relating to Islamic banking in the country are taken care of by this department.

Payment System Department
It is set up recently to implement Real Time Gross Settlement (RTGS) project, and to oversee the existing payment and settlement system in place and develop a strategy with the banking industry for improvement in the banking system.

Research Department
Makes objective analyses of economic developments; explore inter-linkages between macroeconomic policies; and examine their relationships with overall economic growth, with a view to initiating informed public debates on national issues, and guiding formulation of sound economic policies. It also prepares annual and quarterly reports on the status of economy.

Statistics Department
The Department is responsible for collection, compilation, dissemination and publication of statistics on economic, financial and monetary aspects most pertinent to the central banking.

Human Resources Department
Its objective is excellence at acquiring, developing and retaining the right talent for SBP by continuous innovation & improvement of the HR policies & procedures, providing effective facilitation and advisory services to line departments and efficient and timely delivery of HR services.

Audit Department
It provides independent appraisal of all the activities of SBP aiming to add value, improve operational efficiency, risk management & internal control systems.

Information Systems Department
It is responsible for oversight and management of the technology operations, development and implementation, including all corporate systems, LANs, WANs, databases, websites, system administration and desktop support for the SBP.

Corporate & Media Affairs Department
This department is entrusted to arrange Central Board meetings. It takes care of all the affairs related with Board of the Bank, acts as spokesman of the Bank for media and other external stakeholders, and manages publications of the State Bank of Pakistan (See **Annex 4** for list of regular and periodic publications available to the public).

6.4 Information Technology

The ultimate goal of computerization is a gradual transformation towards paperless environment (through the use of Intranet/internet exchange server) and to leverage technology to achieve operational excellence. The Information Strategy Plan under the World Bank assistance has commenced with effect from 18th September 2000, with the award of the contract to M/s. Hyundai Information Technology Company, Korea and its Consortium Partners. The project cost was US$15.89 million foreign currency component and Rs 38.9 million in local currency component. The objectives of the project are;

- To automate the existing manual systems (Banking Operations)
- To develop a local and wide area networks, connecting various departments and offices across the country.
- To establish an Enterprise Resource Planning system.
- To design and implement a Data Warehouse wherein the data is stored, retrieved, upgraded and extracted for analytical purposes.
- To develop a Management Information System

There are three components of software solution under this project;

- Banking Globus
- ERP – Oracle Applications
- Data Warehouse

Globus is meant for automating the retail banking and treasury operations and Oracle ERP is for Banks internal operations. Data Warehouse will provide comprehensive and high integrity data in a form suitable for decision support to end users and decision makers throughout the organization.

Globus Software Applications

Under the ongoing technology up-gradation project, Globus banking system has currently been installed at SBP(BSC), Karachi, Islamabad and Rawalpindi offices. For implementation of Globus, the User Acceptance Testing (UAT) for foreign exchange, government securities, and deposit banking and Government Banking (covering 90 percent treasury products) were conducted in South Africa in November 2001. For this purpose, a team of important users from SBP was flown to South Africa. The second phase of the UAT was conducted in Karachi during January 14-31, 2002, covering UAT for the remaining 10 percent treasury products and retail products as well as the re-testing of the incidences reported in South Africa.

In February 2002, the mock banking exercise was conducted to familiarize SBP users and management with Globus banking system in real time banking environment. This exercise enabled application users to understand issues involved in the real time banking. The strategy of implementation was revised and SBP decided to implement the system in phases and first phase covering Teller, Deposit Banking and Government Banking was started in August, 2002. In October, 2002 Government Securities and General Banking along with Forex was implemented. In March, 2003 Export refinance was implemented. During September to October, 2003 the various functionalities working satisfactorily in Karachi including Deposit Banking, Government Banking, Teller, Export Refinance was rolled-out in Islamabad and Rawalpindi offices. The last phase covering Issue Department, Prize Bonds and National Savings Certificates is in progress and UAT of some of these products has been conducted and remaining ones are in progress.

Oracle Enterprise Resource Planning Software

The ongoing challenge of operating more efficiently and doing more with less is forcing organizations to streamline and improve their business processes. In recent years, the State Bank of Pakistan (SBP) has enhanced its focus on internal operational efficiency and information management capabilities.

The new system is designed taking into account the mission critical nature of State Bank of Pakistan's operations with full consideration given to security and the necessary system access controls. The ERP system is in use by the Accounts department, Procurement Division and Human Resource Department of SBP since July 2002, and accounts' closing for 2002-03 was done using this system. Through different modules of Oracle Financials (GL, FA, AP) and Oracle Distribution (PO, INV), SBP has introduced an online process that ensures quick and efficient procurement cycle. It provides better management, better customer service and integration of different working areas of SBP. It has also helped in discarding manual registers, manual vouchers and manual reporting.

The Oracle HRMS modules being used are Recruitment, Employee Information & Assignments, Leave Management, Policies Maintenance – Work Structure and Compensation & Benefit (Non-Payroll) is implemented and its implementation has improved the department's operations. Specifically the recruitment functionality automated by Oracle reduced the application processing time from 120 days to 30 days. The payroll application is being transformed from a Cobol based software application to an Oracle base applications with linkages to Oracle ERP. The new payroll application comprises of four modules i.e. Salary, Advances, Pension and Provident Fund / General Provident Fund.

Data Warehouse Application

Most business organizations today consider the acquisition, organization and analysis of data to be a core requirement in support of their primary strategic goals. For a Central Bank, however, the primary strategic goal is the acquisition, organization and analysis of data. Without this, it would not be possible for a Central Bank to perform its primary function of supporting and regulating a healthy financial environment, conducive to the growth and financial prosperity of its citizens and the country as a whole.

Central Banks have always had a requirement for a coherent, robust and extensible information system capable of handling and analyzing large quantities of data. An Enterprise Data Warehouse (EDW) is the core tool for achieving this goal. All the subject areas except Banking area are in their user acceptance testing phase and the project will be completed soon.

Current Status of IT Infrastructure

All offices of the State Bank in Karachi have access to the Internet, email and business applications utilizing a network infrastructure of more then 2500 nodes. At present 1360 email accounts are in use by the employees of the SBP. Press Building and the Boulton Market Offices are connected to the SBP office through S-Band 256Kbps radio links whereas the North Nazimabad Office is connected via the same media at 128Kbps.

For the remote sides outside Karachi, the primary media to the two hub sites - Lahore and Islamabad - is DXX. This is based on a copper last mile connect to the exchange from all sites beyond which the signal is carried on NTC's redundant fiber backbones across the country. The links from Karachi to Lahore and Karachi to Islamabad are point to point. The WAN connectivity backup of the sites outside of Karachi is via always-on VSAT links that operate in a load-sharing fashion with DXX under normal circumstances. In the event of a DXX failure, the VSAT bandwidths are automatically reserved for mission critical business applications.

The project has established 2 IT labs at NIBAF and an additional 2 IT labs at Rawalpindi and Lahore offices. The project team has also trained 1332 officers in basic Microsoft office automation software products across Karachi, Lahore, Islamabad, Rawalpindi and Peshawar.

6.5 Subsidiaries

Two subsidiaries of the Bank have been established in recent years; one is National Institute of Banking and Finance (NIBAF) and the other is State Bank of Pakistan Banking Services Corporation, each headed by a Managing Director.

All the sixteen local offices of SBP have been made part of SBP-BSC. These are now branches of SBP (BSC) located two at Karachi and one each at Hyderabad, Sukkur, Quetta, Peshawar, D.I. Khan, Muzaffarabad, Bahawalpur, Multan, Faisalabad, Lahore, Gujranwala, Sialkot, Rawalpindi and Islamabad. (See **Box 2** for some detail about SBP BSC).

Box 2: SBP Banking Services Corporation

State Bank of Pakistan Banking Services Corporation, as a subsidiary of the State Bank (SBP), was set up through an ordinance on December 29, 2001.

The Corporation is responsible to carry out retail business i.e. certain statutory and administrative functions and activities on behalf of SBP, as transferred or delegated by SBP under the provisions of the Ordinance mainly including:

- currency management (i.e. receipt, supply and exchange of bank notes and coins)
- disbursing of loans and advances to the government, banks, financial institutions and local authorities
- facilitating in inter-bank settlement system
- dealing in prize bonds and other savings instruments of the government
- collecting revenue and making payments for and on behalf of government, local bodies, authorities, companies, banks and other financial institutions, and maintaining their accounts
- operational work relating to management of debt and foreign exchange

These functions and related assets, liabilities and employees were transferred to the Corporation with effect from January 2, 2002 in accordance with the provisions of Transfer Order dated December 29, 2001. The transfer order was approved by the Governor of the Bank under section 15 of the Ordinance.

The powers to manage the affairs and business of the SBPBSC have been vested in the Board of Directors which consists of all the members of the Central Board of the SBP and a Managing Director. The Governor SBP is the chairman of the Board and the MD is the chief executive officer of the subsidiary.

The State Bank of Pakistan has powers to give instructions to SBPBSC or assign any duty or function to perform. However, the subsidiary can not be given any function related to (i) formulation and monitoring of monetary and credit policies, (ii) regulation and supervision of the financial sector, (iii) foreign exchange regime and exchange rate policy, and (iv) payment and settlement system.

Table 1: Issue of Currency Notes by SBP

(Million rupees)

	Currency Issued by Issue Department	Currency held by Banking Department	Currency in Circulation
July 2, 1948	542.3	21.5	520.8
June 30, 1949	1,739.5	57.6	1,682.0
June 30, 1958	3,465.5	92.2	3,373.3
June 30, 1968	5,880.0	125.6	5,754.4
June 30, 1978	19,605.1	370.4	19,234.7
June 30, 1988	91,205.8	208.6	90,997.2
June 30, 1998	289,997.8	153.4	289,844.4
June 30, 2003	522,891.1	214.2	522,676.9

Source: Balance sheet of Issue Department of SBP.

Table 2.1: Changes in Liquidity Ratio

Liquidity Ratio	
Effective from	**Ratio (%)@**
01.07.1948	20
01.09.1967	25
06.06.1972	30
16.08.1973	*35
13.08.1992	*40
19.12.1992	*45
27.10.1993	*35
01.03.1994	*30
28.05.1997	*25
02.01.1998	*23
22.06.1998	****18.75 & 20
19.05.1999	***16.5
12.07.1999	*20
07.10.2000	**22
16.12.2000	*20

@ Percentage of demand and time liabilities unless specified otherwise

* Including 5 % Cash Reserve Requirement

** Including 7 % Cash Reserve Requirement

*** including 3.5% Cash Reserve Requirement

**** including 3.75 & 5% of Local & Foreign Currency Cash Reserve Requirement

Table 2.2: Changes in Cash Reserve Requirement

Reserve Requirement	
Effective from	**Ratio (%)[@]**
01.07.1948	5% of demand and 2% of time liabilities
25.07.1963	5
01.08.1965	6.25
01.05.1965	7.5
21.08.1965	6.25
17.09.1965	5
16.06.1967	6.25
19.01.1968	5
01.01.1991	5%
28.07.1997	5 % Weekly Average subject to daily minimum of 4 %
22.06.1998	3.75% of Rupee TDL & 5 % of Foreign Currency TDL
05.09.1998	5 % Weekly Average subject to daily minimum of 4 %
19.05.1999	3.5 % Weekly Average subject to daily minimum of 2.5 %
12.07.1999	5 % Weekly Average subject to daily minimum of 4 %
07.10.2000	7 % Weekly Average subject to daily minimum of 6 %
16.12.2000	5 % Weekly Average subject to daily minimum of 4 %
30.12.2001	5 % Weekly Average subject to daily minimum of 3 %
06.01.2001	5 % Weekly Average subject to daily minimum of 4 %

@ Percentage of demand and time liabilities unless specified otherwise

Table 3.1: Export Refinance: Outstanding Position

(Rs. in billions)

Outstanding	Refinance			Total Exports	% Age
Period	**Part-I**	**Part-II**	**Total**		
30/06/96	12.8	18.4	31.2	294.7	10.6%
30/06/97	15.5	22.4	37.9	325.3	11.7%
30/06/98	22.5	31.1	53.6	373.1	14.4%
30/06/99	40.4	40.6	81.0	390.3	20.8%
30/06/00	27.9	47.2	75.1	443.7	16.9%
30/06/01	30.5	45.0	75.2	539.1	13.9%
30/06/02	17.0	43.0	60.0	560.9	10.7%
30/06/03	15.3	41.4	57.0	644.8	8.8%

Table 3.2: Export Refinance: Gross Disbursement

(Rs. in billions)

Gross Disbursement	Refinance			Total Exports	%Age
Period	**Part-I**	**Part-II**	**Total**		
30/06/96	40.9	57.7	98.6	294.7	33.5%
30/06/97	46.9	66.2	113.1	325.3	34.8%
30/06/98	68.1	82.6	150.7	373.1	40.4%
30/06/99	96.7	114.4	211.1	390.3	54.1%
30/06/00	91.8	119.4	211.2	443.7	47.6%
30/06/01	77.7	131.4	209.1	539.1	38.8%
30/06/02	49.0	178.0	227.0	560.9	40.5%
30/06/03	42.0	107.3	149.3	644.8	23.2%

Annexure 1: List of Currencies declared Approved Foreign Exchange in terms of section 19 of SBP Act

1. Italian Lira
2. Canadian Dollar
3. Belgian Francs
4. Dutch Guilders
5. Swiss Francs
6. Labanese pound
7. Czechoslovakia Crown
8. Netherlander Guilders
9. U.S. Dollar
10. U.K. Pound Sterling
11. India Rupee
12. German Mark
13. French Francs
14. Iranian Rial
15. Turkish Lira
16. Japanese Yen
17. Denmark Krone
18. Norway Krone
19. Sweden Krone
20. Austria Shilling
21. U.A.E. Dirham
22. Oman (Muscat) Riyal
23. Kuwaiti Dinar
24. Qatar Riyal
25. Bahrain Dinar
26. Bangladesh Taka
27. Nepalese Rupee
28. Srilankan Rupee
29. Euro
30. Yuan

<u>Monetary Units of Accounts</u>

1. Islamic Dinar
2. Asian Monetary Unit
3. European Monetary Unit
4. Special Drawing Rights

Annex 2: List of Scheduled Banks/DFIs (As of March 31, 2004)

I. Public Sector Banks

1. First Women Bank Limited
2. National Bank of Pakistan
3. The Bank of Khyber
4. The Bank of Punjab

II. Private Sector Banks

5. Habib Bank Limited
6. Allied Bank of Pakistan
7. Muslim Commercial Bank Limited
8. United Bank Limited
9. Askari Commercial Bank
10. Bank Al Falah Limited
11. Bolan Bank Limited
12. Bank Al-Habib Limited
13. Faysal Bank Limited
14. KASB Bank Limited
15. Meezan Bank Limited
16. Metropolitan Bank Limited
17. Prime Commercial Bank Limited
18. PICIC Commercial Bank Limited
19. Saudi-Pak Commercial Bank Limited
20. Soneri Bank Limited
21. Union Bank Limited
22. MashreqBank Pakistan Limited
23. NDLC-IFIC Bank

III. Specialized Banks

24. Industrial Development Bank of Pakistan
25. Punjab Provincial Cooperative Bank Ltd.
26. Zarai Tarqiati Bank Limited

IV. Foreign Banks

27. ABN Amro Bank N.V.
28. Al-Baraka Islamic Bank B.S.C. (E.C.)

29. American Express Bank Limited
30. Bank of Tokyo Mitsubishi Limited
31. Bank of Ceylon
32. Credit Agricole Indosuez (The Global French Bank)
33. Citibank N.A.
34. Deutsche Bank A.G.
35. Doha Bank
36. Habib Bank A.G. Zurich
37. Hong Kong & Shanghai Banking Corporation Limited
38. Oman International Bank S.O.A.G.
39. Rupali Bank Limited
40. Standard Chartered Bank

V. Micro Finance Banks

41. Khushhali Bank
42. The First Micro Finance Bank Limited

VI. Development Finance Institutions

43. Pakistan Industrial Credit & Investment Corporation Limited
44. Pak Kuwait Investment Company (pvt) Limited
45. Pak Libya Holding Company (pvt) Limited
46. Pak Oman Investment Company (pvt) Limited
47. Saudi Pak Industrial & Agricultural Investment Company (pvt) Limited
48. SME Bank Limited

Annex 3: Governors of the State Bank of Pakistan

Mr. Zahid Hussain	10-06-1948	to	19-07-1953
Mr. Abdul Qadir	20-07-1953	to	19-07-1960
Mr. S.A. Hasnie	20-07-1960	to	19-07-1967
Mr. Mahbubur Raschid	20-07-1967	to	01-07-1971
Mr. S.U. Durrani	01-07-1971	to	22-12-1971
Mr. Ghulam Ishaq Khan	22-12-1971	to	30-11-1975
Mr. S. Osman Ali	01-12-1975	to	01-07-1978
Mr. A.G.N. Kazi	15-07-1978	to	09-07-1986
Mr. V.A. Jafarey	10-07-1986	to	16-08-1988
Mr. I.A. Hanfi	17-08-1988 01-09-1990	to to	02-09-1989 & 30-06-1993
Mr. Kassim Parekh	05-09-1989	to	30-08-1990
Dr. Muhammad Yaqub	25-07-1993	to	25-11-1999
Dr. Ishrat Husain	02-12-1999	to	date

Annex 4: Regular and Periodic Publications available to the public

1. Annual Report: Review of the Economy
2. Annual Report: Performance Review
3. Balance sheet Analysis of Joint Stock Companies (Annual)
4. Banking Statistics of Pakistan (Annual)
5. Banking System Review (Annual)
6. Equity Yield on Ordinary Shares (Annual)
7. Export Receipts (Monthly and Annual)
8. Foreign Exchange Liabilities & Assets and Foreign Investment in Pakistan (Annual)
9. Index Numbers of Stock Exchange Securities (Annual)
10. Monetary Policy Statement (Half yearly)
11. Pakistan Balance of Payments (Annual)
12. Pakistan: Financial Sector Assessment (Annual)
13. Quarterly Performance Review of the Banking System
14. Statistical Bulletin (Monthly)
15. Statistics on Scheduled Banks in Pakistan (Half Yearly)
16. The State of Pakistan's Economy (Quarterly)
17. Weekly Statement of Affairs

Acronyms

Departments

BID	Banking Inspection Department
BPD	Banking Policy Department
BSD	Banking Supervision Department
CMAD	Corporate & Media Affairs Department
EcoPD	Economic Policy Department
EDMD	Exchange & Debt Management Department
EPD	Exchange Policy Department
HRD	Human Resources Department
IBD	Islamic Banking Department
ISD	Information Systems Department
PSD	Payment System Department

Others

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutoins
ADB	Asian Developmental Bank
ADBP	Agricultural Development Bank of Pakistan
BCO	Banking Companies Ordinance
BMA	Bahrain Monetary Authority
BNM	Bank Negara Malaysia
BOD	Board of Directors
BoP	Balance of Payment
BSD Circular	Banking Supervision Department Circular
CDR	Credit / Deposit Ratio
CIB	Credit Information Bureau
CII	Council of Islamic Ideology
CRR	Cash Reserve Requirement
CTFS	Commission for Transformation of Financial System
DD	Demand Draft
DFIs	Development Financial Institutions
DGs	Deputy Governors
EDs	Executive Directors
EDW	Enterprise Data Ware Housing]
EFS	Export Finance Scheme
ERP	Enterprise Resource Planning
F.E. Circular	Foreign Exchange Circular
FBC	Federal Bank for Cooperatives
FE	Foreign Exchange

FEA	Foreign Exchange Advisor
FSC	Federal Shariat Court
GD	Government Draft
HRMS	Human Resource Management System
IBBs	Islamic Banking Branches
ICAP	Institute of Chartered Accountants of Pakistan
IDB	Islamic Development Bank
IDBP	Industrial Development Bank of Pakistan
IED	Islamic Economics division
IFIs	International Financial Institutions
IFSB	Islamic Financial Services Board
IRAF	Institutional Risk Assessment Framework
IT	Information Technology
DCR-VIS	Duff and Phelps Credit Rating – Vital Information Services. A credit rating company.
KASB Bank	Khadim Ali Shah Bukhari Bank
Kbps	Kilobytes per seconds
KYC	Know Your Customer
LAN	Local Area Network
MBL	Meezan Bank Ltd.
MFBs	Micro Finance Banks
FMFB	First Micro Finance Bank
MFIs	Micro Finance Institutions
MFPCB	Monetary and Fiscal Policy Coordination Board
MIB	Meezan Investment Bank
MT	Mail Transfer
MTBs	Marketable Treasury Bills
NBFCs	Non-Bank Finance Companies
NBFIs	Non-Bank Finance Institutions
NCCC	National Credit Consultative Council
NDFC	National Development Finance Corporation
NIBAF	National Institute of Banking and Finance
NIFT	National Institutional Facilitation Technologies (Pvt.) Ltd.
NIPA	National Institute of Public Administration
NIT Units	National Investment Trust Units
OMO	Open Market Operation
PIB	Pakistan Investment Bonds
PICIC	Pakistan Industrial Credit and Investment Corporation
PIDE	Pakistan Institute of Developmental Economics
RTGS	Real Time Gross Settlement
SAB	Shariat Appellate Bench

SBP	State Bank of Pakistan
SBP(BSC)	State Bank of Pakistan Banking Services Corporation
SCR	Special Cash Reserve
SEANZA	South East Asia, New Zealand & Australian Association of Central Bankers
SLR	Statutory Liquidity Requirement
SMEs	Small and Medium Enterprises
TFCs	Term Finance Certificates
UAT	User Acceptance Test
w.e.f.	with effect from
WAN	Wide Area Network
WB	World Bank
ZTBL	Zarai Taraqiyati Bank Limited

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