

SECOND HALF
2011

FINANCIAL STABILITY REVIEW

State Bank of Pakistan

FSR Team

Team Leader

Muhammad Javaid Ismail	javid.ismail@sbp.org.pk
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Team Members

Muhammad Shamil Akbar	muhammad.shamil@sbp.org.pk
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Dr. Moazzam Farooq	moazzam.farooq@sbp.org.pk
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Ghulam Khadija	ghulam.khadija@sbp.org.pk
----------------	--

Muhammad Sadiq Ansari	Sadiq.ansari@sbp.org.pk
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Farrukh Bashir	farrukh.bashirsatti@sbp.org.pk
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Financial Stability and State Bank of Pakistan

Under State Bank of Pakistan (SBP) Act, 1956 the SBP is *responsible for securing monetary stability and soundness of the financial system*.

Financial stability is defined as a situation in which the function of efficient financial intermediation and payment services continues without disruptions despite internal and external shocks, and financial risks are monitored and managed well such that the possibility of systemic crises is minimized. The SBP sees financial stability as an evolving process, as the financial sector adapts itself to the needs of the economy and financial globalization.

Efficient financial intermediation and access to financial services across all segments of the population is the ideal situation in which economic growth can thrive. The significance of the financial sector is even more crucial given its inter-linkages with the real sector. SBP being the leading regulator of the financial sector strives to play a facilitating role in the growth of the sector. The confidence of economic agents in the financial sector's ability to meet their financial needs in a convenient and secure manner is also important for maintaining and promoting financial stability. The SBP works closely with the Securities and Exchange Commission of Pakistan (SECP), Pakistan Banks' Association (PBA), the Federal Government, and other regulatory bodies in achieving this goal.

Ensuring financial stability also complements the other important SBP objective of securing monetary stability. It is a tall order to imagine monetary stability in the absence of financial stability. Financial Stability Report (FSR), a biannual publication provides an assessment of financial stability issues and pitches input for policy initiatives. The report gives an independent perspective and commentary on the state of financial stability by providing an objective view on the developments in the financial sector, and giving an in-depth analysis of issues relevant to the financial institutions and markets. It also endeavors to promote informed public debate on various aspects of the financial system.

State Bank of Pakistan welcomes feedback and comments on the FSR.

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The team bears the responsibility for all errors and omissions. The analysis and commentary in the report are entirely of the team and not necessarily represent views of the SBP.

Data Conventions & Coverage

The Financial Stability Review (FSR) examines performance of various components of the financial sector. The report uses two terminologies; CY for Calendar Year, and FY interchangeably for Financial Year (in case of NBFCs) and Fiscal Year (July 1 – June 30).

The review is based on the data reported in audited or unaudited accounts for each component as follows:

- Banks, Development Finance Institutions (DFIs), Microfinance banks and the insurance industry data is based on annual audited account for year ended December 31, 2011.
- Data on NBFC's including Leasing, Investment Finance Companies, Modarabas and Venture Capitals is based on annual audited accounts for financial year ended June 2011 (termed as FY11).
- Financial markets, payment system, Islamic banking -- five full fledged Islamic banks and twelve Islamic banking branches, and Mutual Funds data is based on un-audited results for period ended December, 2011.

Moreover, the analysis on banks, DFIs, Islamic banks, financial markets, and payment system covers half-yearly performance for second half of CY11; while the analysis on NBFCs and Insurance sector covers performance for a complete accounting year.

Contents

• Financial Stability: Overview and Outlook	01
• Chapter 1: Assessment of Financial Intermediation	08
• Chapter 2: Risk Analysis of the Banking Sector	15
• Chapter 3: Soundness and Resilience of the Banking Sector	27
• Chapter 4: Islamic Banking	34
• Chapter 5: Financial Markets	43
• Chapter 6: Non-Bank Financial Institutions	50
• Chapter 7: Insurance and Reinsurance Sector	63
• Chapter 8: Payment Systems	68
• Annexes	72
• Acronyms	105

Overview:

The international financial crisis is lingering on yet due to the escalating sovereign debt problems in the Euro area amid funding difficulties faced by the European banks, and increased risk aversion in the international financial markets. Pakistan, not tied in strong international financial linkages, has remained largely unaffected by this global crisis. However, the decelerated global growth, especially in the Euro area and US, has serious implications since Pakistan's GDP growth rate has also tapered due to rising trade deficit (as demand for exports have fallen), unfavorable law and order situation and persistent energy crisis.

Weak global growth and challenging local environment is impeding the economic growth....

The efforts of the government, amid the prevailing adverse macro-economic situation and political uncertainty, to channel foreign funds into the economy both by enhancing exports and arranging foreign exchange from international financial institutions (IFIs) has thus far no significant impact on the external account. The growing workers' remittances¹ is the only relief to the deteriorating current account balance.

The persistently rising budget deficit, internally, has also contributed to the overall adverse macro-economic condition. The government's demand for extra credit has resulted in crowding out of private investment. Despite the existence of twin (trade and budget) deficits, agriculture sector has recorded reasonable growth. This growth has trickled down to other sectors using agriculture produce as inputs. Similarly, large-scale manufacturing (LSM) growth has shown a marginal improvement by the end of H2-CY11. Inflation rate has also remained relatively lower compared to the past couple of years due to improvements in food supplies, although this improvement is vulnerable to projected floods in the coming year.

Asset base of the financial sector registered a growth of 15 percent during CY11 (Table 1)². This expansion, though broad based, was largely driven by the growth in banking sector. Overall operating performance of the financial sector improved over the year as ROA rose to 1.4 percent in CY11 from 0.9 percent in CY10. However, the share of financial sector in GDP (FGDP) declined marginally to 57.4 percent during CY11 due to double-digit inflation (Table-1). The improved performance indicates resilience of the financial sector, though it remains vulnerable to the risks faced by the macro-economy.

...while financial sector, though resilient, remains vulnerable to the risks facing the economy

Banking system³ remained relatively strong due to improved capital adequacy and solvency indicators, contributed by higher level of profits and equity injections made in CY11. However, risks to the banking system somewhat increased since publication of the last FSR, mainly due to the prevailing macroeconomic situation.

Banking system remains strong, though risks somewhat increased....

¹ Remittances stood at USD 13.2 billion as of end FY12.

² Data on DFIs, MFIs, Insurance, CDNS and banks is on calendar year (CY11) basis. Whereas, data on Modarabas, IFCs, Leasing Companies and Venture Capital is on financial year (FY11) basis. NBFCs include DFIs, Mutual Funds, Modarbas, IFCs, Leasing companies and Venture Capital.

³ Analysis of banks and DFIs is for the second half of 2011 (Jul-Dec), while performance of remaining institutions is for the full year.

Table 1: Assets Composition of the Financial Sector

	CY05	CY06	CY07	CY08	CY09	CY10	CY11
Assets (Rs. Billion)	5,202	6,028	7,117	7,712	8,867	9,655	11,107
Growth rate (percent)	15.1	14.5	19.4	8.4	15.0	8.9	15.0
Percent of total assets							
MFIs	0.2	0.2	0.2	0.2	0.2	0.2	0.2
NBFIs	7.6	7.8	8.0	7.6	5.3	4.4	4.7
Insurance	3.9	4.1	4.6	4.4	4.4	4.4	4.3
CDNS	18.0	16.1	14.6	14.8	16.6	17.3	17.2
Banks	70.4	71.9	72.7	73.0	73.5	73.8	73.6
Assets as percent of GDP							
MFIs	0.1	0.1	0.1	0.1	0.1	0.1	0.1
NBFIs	5.6	5.7	6.0	5.1	3.4	2.6	2.7
Insurance	2.9	3.0	3.4	3.0	2.8	2.6	2.5
CDNS	13.3	11.8	11.0	9.9	10.7	10.2	9.9
Banks	51.8	53.4	54.7	49.0	47.3	43.3	42.2
Overall assets	73.7	74.0	75.2	67.2	64.4	58.8	57.4

During H2-CY11 major contribution to the increase of 5.91 percent in asset base of the banking sector came from persistent and heightened investment in government paper. Government's inability to bring about any structural shift in correcting the twin deficit left it to rely on the banking system for funding the budget deficit. The inelastic demand for funds by the government coupled with no capital requirement against local currency sovereign debt and eligibility for statutory liquidity requirements incentivized the banks to invest even more in government securities. However, increased government exposure of banks is reducing assets diversification and curtailing their role of financial intermediation.

....as growing exposure to Federal Government Securities continues to reduce assets diversification and limit financial intermediation ...

Credit risk increased marginally during H2-CY11 as lending activity remained slow and banks managed to limit the flow of infected portfolio through restructuring/rescheduling of recoverable loans. The overall credit flows registered a first half yearly contraction in gross advances of the banking sector over a decade, an outcome of one-off settlement of inter-corporate public sector circular debt in November 2011. Consequently, public sector advances registered a decline during the period under review.

The government's policy of maintaining relatively higher support prices for major food crops contributed to the increase in share of commodity financing in overall public sector advances from 33 percent in September 2008 to 65 percent in H2-CY11. However, one-off adjustment of Rs 78 billion on account of unpaid subsidy related to public sector commodity operation only facilitated in providing a marginal cushion for further commodity financing. With the recent increase in wheat support price by Rs100/40kgs demand for funds for government's procurement needs are expected to go up even further.

.... consistently high and rising commodity finance further adding to public sector exposure...

Private sector demand for funds, though positive, remained restrained due to persistent energy shortages, poor law and order situation, and slowdown in external demand (exports). The domestic demand for private sector advances revolved around corporate working capital needs and seasonal demand for advances in the last quarter of the year. However, demand for fixed investment declined due to the already installed but underutilized industrial capacity⁴. Further, banks' contained lending to risky segments like SME and

... slowing down of loans to private sector due to both demand and supply side issues ...

⁴The State of Pakistan's Economy - Second Quarterly Report 2011 – 2012.

Consumer Finance, led to further decline in their share in overall lending portfolio.

Increasing concentration of advances to the corporate sector may pose certain risks for banks. Sensitivity analysis of group exposures show that capital adequacy of the banking system would be affected the most, in case top three private sector corporate groups default. Though the regulatory exposure limits are in place, banks should effectively manage such concentrated portfolios to avoid adverse effect on their solvency and systemic implications for the banking system.

...and rising concentration of loans to corporate sector pose additional risk

With decline in advances, accumulation of non-performing loans (NPLs) also slowed down considerably as banks added up NPLs of Rs12.4 billion during H2-CY11 against an increase of Rs 31.4 billion in H1-CY11. Nonetheless, infection ratio, with a marginal rise of 40bps to 15.7 percent in H2-CY11, remains high. Also, due to improved provisioning, particularly of top five banks, net NPLs to loan ratio came down marginally. Textile sector, with 18 percent share in aggregate loans, remained the leading user of bank credit. However, the infection ratio in textile sector, at 28 percent, was much higher than the banking sector infection ratio and remains a cause of concern.

Infection increased marginal, but overall impairment levels remain high

On the funding side, in H2-CY11, deposits registered a modest growth of 4.7 percent on account of deceleration in customer deposits. Attractive National Saving Scheme (NSS) rates and increased investment in the Investment Portfolio Securities (IPS) accounts might be the cause of this deceleration. Most of the growth in deposits came from customers' deposits in fixed and saving categories, along with an unexpected jump in financial institutions deposits. A healthy 10 percent increase in foreign currency deposits, due to 4.6 percent depreciation of Pak rupee, significantly contributed to the growth of deposits. With stagnancy in current deposits, the share of the low cost current account saving account (CASA) diluted over H2-CY11, which may increase the cost of deposits in the system in the coming months. However, zero statutory cash and liquidity requirements on long-term fixed deposits would compensate banks and allay liquidity risk in case of maturity mismatch.

Funding mainly driven by moderate deposits growth....

Banking data also revealed that the growth in deposits was mainly driven by large sized (amount exceeding Rs.10 million) deposits comprising corporate client, government, and high net worth individuals. Further, the mid sized banks (6th to 21st in assets size), which are also offering relatively better deposit rates, contributed to majority of the rise in customer deposit. This is indicative of enhanced competition in the banking sector and improved customers' confidence in these institutions.

The share of banks' borrowing from financial institutions, which generally remains within the range of 8-10 percent of their assets, witnessed an increase due to stressed short-term liquidity and sluggish deposit growth. Major portion of this enhanced borrowing comprised repo borrowing from State Bank of Pakistan (SBP) to manage short-term liquidity gap. Further, decent equity growth on account of profitability (mainly supported by FSV benefit) and fresh capital injections for meeting the prescribed capital requirements also partially supported the funding side of banks.

Incremental funds generated by banks were mainly channeled in to risk free government securities. As a result, the liquidity indicators further improved over H2-CY11. However, rising investments with restrained credit disbursements re-shaped the banking asset portfolio as reflected in decline in advances to deposits ratio (ADR) from 56.7 percent in H1-CY11 to 54 percent by H2-CY11. This situation requires diligent monitoring since continuous decline in ADR indicates the undesirable deleveraging of private sector credit. Further, continuing investments in government securities can expose banks to reinvestment risk in a declining interest rate scenario.

...most of which funneled into government securities raising re-pricing risk...

Short-term liquidity, however, remained strained, particularly in the last quarter of the year due to high and volatile overnight rates, and reflected in excessive banks' borrowing from the financial institutions. However, overall market risk facing the banks remained contained and managed, though banks need to be watchful of any adverse developments in the market to avoid losses on their exposures.

....while market liquidity pressures enhanced the interbank borrowing

The unprecedented profits further improved the overall soundness of the banking system during CY11. Banks posted before tax profit of Rs 170 billion, which was driven by large increase in net interest income on account of increased returns on growing stocks of investment in government paper. The net interest income increased by 12.4 percent during H2-CY11 due to wider net interest margins combined with steady growth in interest earning assets. The earnings were further augmented by decrease in provisions charged due to enhanced FSV benefit and increase in non-interest income from fees/commissions, dividends, and dealing in foreign exchange trading activities. Accordingly, ROA stood at 2.2 percent in H2-CY11, up from 2.1 percent in H1-CY11 (1.4 percent in CY10). Also, profits were widely shared as fewer banks incurred losses. The concentration of top 5 banks in profit accumulation also decreased to 74 percent in H2-CY11 (78 percent in H1-CY11 and 106 percent in CY10).

Record profitability improved the return indicators ...

The banking system remained reasonably well capitalized as benchmark CAR⁵ rose to 15.1 percent. With most of the increase in capital resulting from accumulation of retained earnings and equity injections, the tier-I capital ratio increased from 11.9 percent in H1-CY11 to 13 percent in H2-CY11. Further, banks flight to risk free investment in government securities under the rising credit risk environment has shrunk both the credit risk weighted assets (CRWA) and the overall risk weighted assets (RWA). As a result solvency ratios of the banking system have gone up even higher.

....and enhanced solvency, and resilience of the banking system

Though capital base has remained robust over the years, the capital at risk (Net NPL to Capital ratio) surged continuously due to persistent flow of NPLs. However, the ratio declined marginally by 17 bps to 25.6 percent during H2-CY11, which is a welcome development but, it is still high enough with a tendency to adversely affect the solvency of the banking sector.

However, rising non-performing loans continue to threaten the capital base

Another challenge faced by some banks, particularly the smaller ones, is to meet the minimum capital requirement (MCR) that is set to grow gradually to Rs10 billion by 2013. Though banks are making efforts for meeting the above requirement by reinvesting their profits, however, they still remain short of meeting the regulatory requirement. The situation is challenging as given the uncertain macroeconomic and political outlook of the country, it is getting

⁵ As per BSD circular No. 7 of 2009 banks are required to maintain a minimum CAR of 10 percent.

tougher for these banks to attract funds to further enhance their capital base.

The stress testing exercise, which now involves relatively extensive shocks, introduced recently⁶, shows that the banking sector remains reasonably resilient to withstand the exceptional but plausible shocks. While after-shock CAR of the system remains above the minimum requirement, adverse impact of the credit risk shocks due to high infection ratio keeps solvency of some banks under stress.

Islamic banking institutions (IBIs) continue to perform well and enhanced their share to around 8 percent of the banking assets. During the H2-CY11, the IBIs posted 14 percent growth in their assets, and like their conventional counterparts, a considerable portion of incremental assets was funneled into government securities. Murabaha and Ijarah continue to be the most widely used modes of financing while the ideal PLS modes lagged behind by a large margin. On average, IBIs remain more solvent and liquid though a little less profitable than the rest of the banking sector. Asset quality marginally deteriorated during H2-CY11 but remains considerably better than that of the conventional banks.

Islamic banks continue to gain systemic importance

Although government, over the last year and a half, has increased the frequency of Pakistan Ijarah Sukuk issues, however, limited liquidity management instruments, lack of a deep and liquid Islamic financial market, and absence of lender of the last resort facility for IBIs remain the key issues that need to be addressed. To this end, the SBP is working for development of a comprehensive liquidity management solution. Furthermore, profit sharing mechanism of IBIs needs standardization, for which SBP is making efforts to streamline the profit distribution.

NBFIs, after banks and CDNS, represent a major share in assets of the financial sector. However, their size in the financial sector remained small. During CY11, NBFIs' assets surged by 22.6 percent after declining for two consecutive years. This increase was mainly driven by an exceptional 29 percent growth in mutual funds over CY11 (16 percent over H2-CY11), duly supported by increase in assets of Modarabas and DFIs. However, investment finance companies (IFCs), leasing companies, and venture capital continued to endeavor for sustained existence.

Phenomenal growth in mutual funds boosted assets base of NBFIs....

In line with the overall slowdown in economy, the share of NBFIs advances in total assets decreased to 39 percent. The contraction was observed all around as financing became more risky and funding sources remained limited. The exposure of banks on NBFIs' balance sheets, their main financing source, also fell by 7 percent over FY11. In the meantime, investment increased mainly in risk free government securities, with most of this increase contributed by DFIs.

NBFIs performance⁷ improved over the year as return indicators; ROA and ROE turned positive after remaining negative for last two years. The profitability resulted from improved performance of Modarabas and leasing companies, while that of DFIs marginally deteriorated. Further, the profitability was concentrated to a few institutions in each of the NBFIs sub-sectors. Though improved profitability facilitated marginal increase in capital

....while improved performance of Modarabas and Leasing Companies enhanced overall profitability

⁶ "Guidelines on Stress Testing" issued vide BSD circular No. 1 of 2012.

⁷ Excluding mutual funds.

base of NBFIs, a number of them still failed to meet the minimum equity requirement (MER). Only DFIs exhibited healthy capital and strong solvency position but their much higher than required CAR suggest sub-optimal utilization of capital.

Exceptional performance of mutual funds on the back of money market investments was the highlight of NBFIs growth; however, they are prone to a number of risks. Tax incentives and low capital charge on banks' investments in money market funds (MMF) were the major reasons for the growth of mutual funds in CY11. However, both high concentration in MMF and expected change in the existing tax regime⁸ invite caution while analyzing the downward risk in their expected future growth trend. Further, the SBP is working on possible changes in regulatory instructions on Basel Capital Accord for Collective Investment Schemes that may affect applicable capital charge on banks' investments in mutual funds.

The continuous consolidation and deteriorating performance of some NBFIs, over the years, is making survival of various sub-sectors difficult. Particularly, overall performance of IFCs saw further deterioration during the year, amid tough competition from banks and haphazardous economic environment. With an expected merger transaction of the largest IFC (holding 36 percent share) with a bank, the IFC sector would lose substantial ground. Additionally, non-compliance of a number of firms with capital requirements kept the chances of further consolidation open, which could be non-competitive.

Some sub-sectors of NBFIs struggle for their survival

Modarabas are also challenged due to the competition they face from IBIs providing similar products. However, given the flexibility available to Modarabas to involve in financial and non-financial business, they have reasonable scope to develop indigenously customized services. Also leasing sector plays a key role in SME financing; therefore, there is a need to take appropriate measures to keep it afloat.

The **insurance sector** continued to play its role of risk dispersion and mitigation- though its penetration remained low from international perspective. The sector's assets grew by 11.7 percent during CY11 with a strong growth momentum in the life insurance sector. Rising demand of risk coverage from urban population due to growing security risks improved life insurance assets by 19.2 percent in CY11 while settlement of flood related claims led to decline in non-life insurance assets by 7.4 percent.

Insurance sector registered healthy growth and improved earnings

Despite tough macroeconomic environment, the claims ratio of both life and non-life insurance sectors declined during CY11. The profitability of the life insurance sector improved largely due to rising share of investments in government securities while the non-life insurance sector's profitability marginally declined due to rising provisioning and non-underwriting costs. Besides, insurance sector remained adequately capitalized as represented by steady capital to assets ratio.

In contrast to the favorable developments in H1-CY11, the **financial markets** witnessed a stressful condition as the macro-economy further weakened due to rising twin deficits. In addition to money market liquidity strain, adverse developments in the current account depreciated the Pak rupee by 4.6 percent while the import coverage ratio dropped as foreign exchange

Financial markets faced stress due to challenging economic environment

⁸ Federal Government has already announced measures for rationalization of tax structure as a part of the Federal budget.

reserves depleted. The equity market remained bearish as its benchmark index lost 9.2 percent coupled with a net outflow of portfolio investment. Furthermore, listings in the equity and debt market also remained low in H2-CY11.

Payment systems -- both large value and retail payments -- carried their momentum further while ensuring efficient payments and settlements. Various payment system channels exhibited sufficient resilience as they operated with minimum down time without any material disruption during H2-CY11.

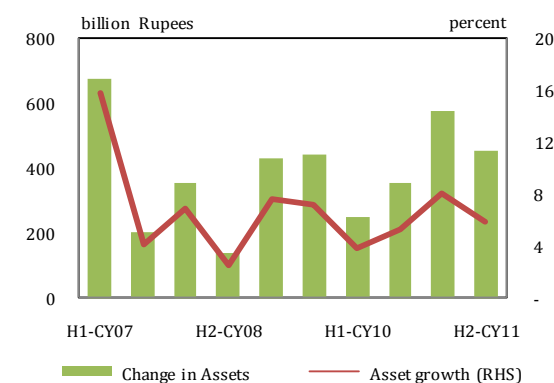
*Payment systems
remain efficient and
resilient*

Large value payment system--Pakistan Real-Time Interbank Settlement Mechanism (PRISM) successfully managed the increased level of transactions in H2-CY11, particularly in securities transactions due to stress in the liquidity conditions in the interbank market. Retail payments continue to shift to electronic modes due to increased awareness, technological advancements, and ever expanding customer base. Though paper based transactions still dominate the retail payments by value, however, due to robust increase in e-banking transactions, its share continues to shrink. Among e-banking modes, Real Time Online Banking (RTOB) emerged as the main catalyst of growth for e-banking in retail payments.

The banking sector was able to register a modest growth of 5.91 percent in H2-CY11 albeit the challenging domestic and external environment. However, advances saw a first ever half-yearly drop over a decade. The decline came from one off conversion of public sector circular debt and unpaid subsidy on account of Government commodity operation into Government securities. Private sector advances growth, though positive, remained subdued owing to high credit risk and resultant non-competitive risk-return matrix vis-à-vis public sector credit. Deposits with a sluggish increase of 4.7 percent remained the primary funding source, followed by borrowings from financial institutions. As against the recent trend of current account- saving account (CASA) driven increase in deposits, major boost to funding came from growth in fixed deposits during the period under review.

Figure 1.1

Changes in Banking Assets



The asset base of the banking sector increased on the back of banks' investment in Federal Government Securities...

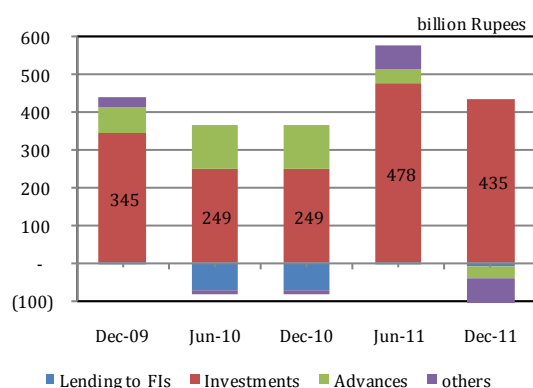
The asset base of the banking system registered a growth of Rs 456 billion (5.91 percent) in H2-CY11 (**Figure 1.1**). The key characteristic of this rise was excessive banks' investments in Government securities as Government continued to borrow from banking system to finance its budget deficit. As a result, investments surged by another 16.6 percent and their share in overall assets increased to 37.3 percent (30 percent in CY10) during the period under review.

.....while advances observed first ever dip

In stark contrast, gross advances saw a first half-yearly dip (Rs17 billion) in the last decade, due to decline in Public Sector advances. The drop came from one-off conversion of public sector inter corporate circular debt and unpaid subsidies on commodity finance through issuance of Market Treasury Bills (MTBs) and Pakistan Investment Bonds (PIBs) in November 2011 (**Figure 1.2**). Low-paced growth in private sector advances (2.3 percent) mainly resulted from seasonal demand for advances in the last quarter of the year.

Figure 1.2

Flows in Asset Components

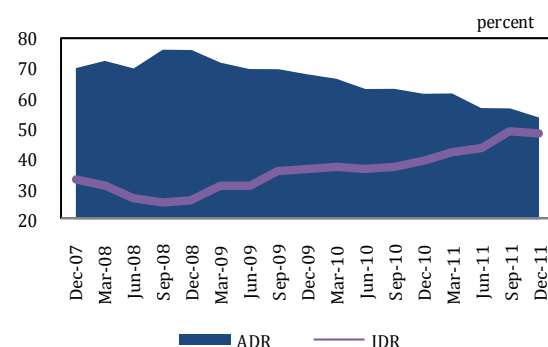


Funding was driven by slow deposit growth, borrowings, and equity

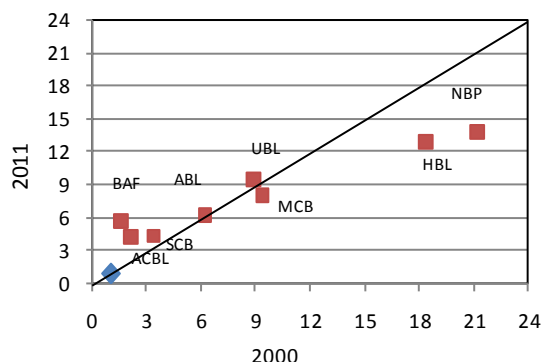
On the funding side, deposit growth decelerated during the half year under review; increase of 4.7 percent in H2-CY11 was far below the 9.43 percent increase during the first half. Further, composition of incremental customer deposits saw a shift as entire growth of Rs 279 billion came from remunerative and large-sized fixed and saving deposits. In addition, the foreign currency deposits also observed a conspicuous rise of Rs.77 billion on account of the downward pressure on Pak rupee.

Figure 1.3

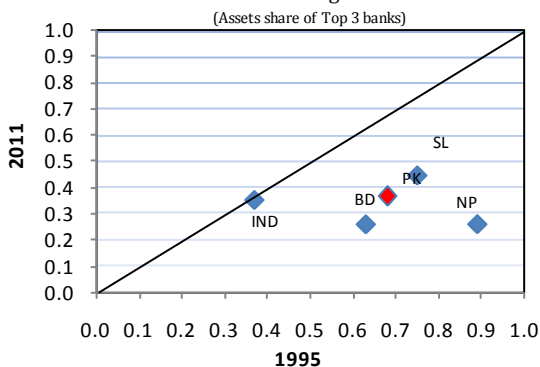
Shift in Asset Mix

**Figure 1.4**

Bank's Concentration in Pakistan

**Figure 1.5**

Bank's Concentration in SAARC Region



Borrowings from financial institutions, which contribute a small portion in overall funding structure and are transitory in nature, saw a jump of Rs.113 billion, which contributed almost 25 percent in overall increase in fund base. The major portion of this growth came from SBP repo borrowing for short-term liquidity management. The year to date profits and injections of fresh capital by a few banks augmented equity base of the system by Rs 62 billion, increasing its share in total assets by 23 bps to 9.6 percent.

The mirror image of IDR and ADR exhibits private sector credit crowding out

With massive increase in investments and continued stagnancy in advances, the composition of banking assets further tilted towards investments. And this led to increase in Investment to Deposit Ratio (IDR) to 49 percent (**Figure 1.3**), almost double the level in Sep-08. Over the past few years, banks, in wake of the rising credit risk and sluggish business environment, opted to invest heavily in government securities. As a result, the mirror imaged Advances to Deposit Ratio (ADR) significantly declined to 54 percent in Dec-11 (76.0 percent in Sep 2008).

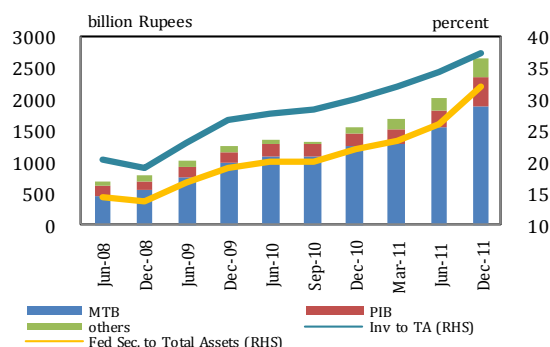
Though ADR and IDR vary across banks by size, however, ratios remained below the industry average in majority of the top ten banks, indicating the competitive edge available to these banks in raising deposits (76 percent share in total deposits) due to their extensive outreach and brand.

Concentration levels in terms of assets continue to improve

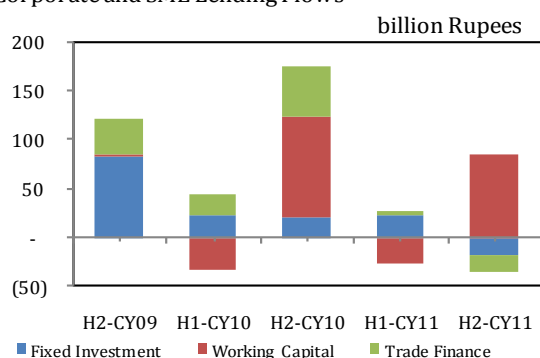
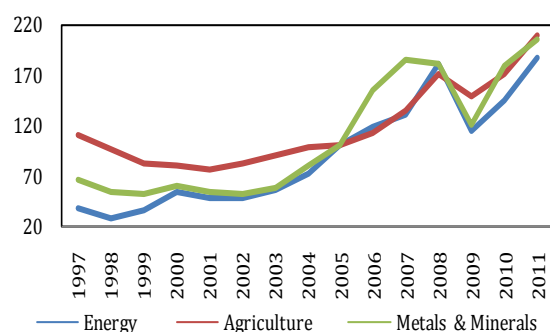
Over the years, top banks have shed their market share due to various structural and consolidation measures; the trend continued during the period under review, though at a slower pace. Analysis shows that small and medium sized banks expanded in size, thus increasing their share in assets base (**Figure 1.4**). Cross-country comparison also shows that concentration in the banking system of Pakistan has improved overtime (**Figure 1.5**).

Banks' exposure on Government continued to rise

As Government insatiate funding needs for budgetary support continued, banks' overall exposures to government reached new levels (**Figure 1.6**). Investment in treasury securities registered 32 percent growth in H2-CY11, much higher than 25 percent increase during the first half. Consequently, share of treasury securities augmented to 86 percent of the total investments and 33 percent of the total assets base.

Figure 1.6**Bank's Investments in Govt. Debt****Table 1.1: QoQ Incremental flows-Domestic Private Lending**

	billion Rupees				
	Q1	Q2	Q3	Q4	CY
CY09	(133)	(50)	(35)	145	(73)
CY10	18	(41)	(44)	236	168
CY11	39	(48)	(133)	197	55

Figure 1.7**Corporate and SME Lending Flows****Figure 1.8****World Commodity Prices Indices**

However, the overall monetary impact of the government borrowing was limited to the extent of Rs204 billion as government papers issued under settlement of circular debt was more of an accounting adjustment. The settlement envisaged issuing PIBs and MTBs (50 percent each), which led to 78 percent increase in the stock of PIBs on the books of banks. Various instruments settled also included TFCs issued by Pakistan Holding Company Limited (PHCL). As such, the share of banks investment in TFCs & PTC saw a hefty decline of 10 percentage points to 4.3 percent in H2-CY11.

In addition, the bearish behavior of capital market due to fragile macroeconomic conditions and precarious law and order situation shook the confidence of both domestic and foreign investor. With 9.2 percent fall in the KSE benchmark index, the banks investments in equities declined by 2 percent in H2-CY11.

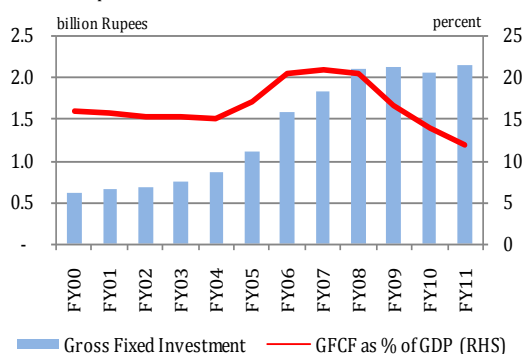
The gross lending to private sector (domestic operations) although registered a net increase of Rs 64 billion during the H2-CY11, however the increase was much lesser than the credit disbursement of Rs.188 billion (7.0 percent) in H2-CY10 and Rs.110 billion in H2-CY09. This sluggish pattern of private sector credit continued as demand dampened due to continuing energy shortages and unfavorable law and order conditions, making businesses shy away from taking new ventures and consolidate their balance sheets. On the supply side, increasing credit risk and availability of alternative risk free option also affected flow of banks' credit to private sector.

Domestic credit to private sector grew marginally...

The domestic private credit off-take usually follows a seasonal pattern with net retirements in 3rd quarter followed by an overriding credit off-take in the fourth quarter. However, a high magnitude of net retirements during Q3-CY11, as compared to the retirements in corresponding periods of last two years, kept the flow of credit to domestic private sector depressed during H2 CY11 (**Table 1.1**).

...while credit demand confined to working capital needs

The segment wise data reveals that most of credit increase came from decelerated working capital growth of Rs.85 billion (against off-take of Rs.102 billion in H2-CY10) while fixed investment and trade finance observed negative credit off-take (**Figure 1.7**). Continuously escalating global commodity

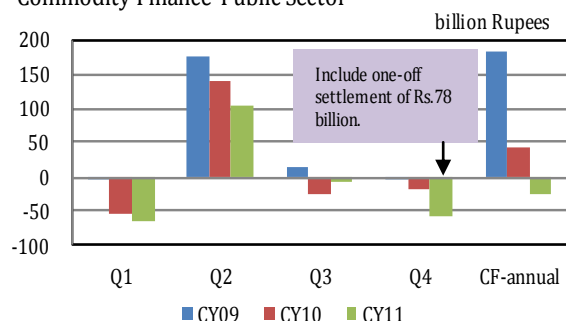
Figure 1.9**Gross Fixed Capital Formation**

prices⁹ especially the oil & raw material prices (**Figure 1.8**) and domestic inflation kept the demand for working capital finance alive. The driving factors behind the decline in credit flows for trade finance were deceleration in overall exports (specially the textile sector), owing to squeezed foreign demand in USA and Euro Zone, and domestic non-conductive economic environment. Further, retirements also came from importers whereas demand for EFS loans remained low during the period under review. However, demand for fixed investment declined due to the already installed but underutilized industrial capacity¹⁰.

The lackluster demand for fresh fixed investment financing during the last few years is also translating into a drop in Gross Fixed Capital Formation¹¹ to GDP ratio (**Figure 1.9**) which exhibits an overall tendency towards consumption led economy at the cost of potential investments. As empirical studies indicate financial stability goes side by side with economic development and stability¹², the continuation of this trend may have significant ramifications for banking and financial sector stability.

Though overall credit off-take was sluggish, sector wise credit demand varied (**Table 1.2**). An exceptional retirement (Rs.38 billion) was seen in the sugar sector in H2-CY11, much higher than the retirements (Rs.8 billion) in the same period last year. In fact, the inability of sugar mills to off-load their inventories before the start of crushing season on account of lower domestic prices kept the advances demand low in this sector. However, government purchased sugar stock to stabilize the prices, which facilitated the sugar sector settle their dues. The low credit demand in the textile sectors (spinning, weaving, finishing etc) was driven by lower raw material prices in domestic market and reduced global demand.

Cement sector also registered net retirements of Rs.0.2 billion in H2-CY11 due to squeezed construction activities in the economy. Other industries including electronics & electrical appliances and production & transmission of energy sectors also revealed negative credit demand. However, automobile & transportation sector somewhat recovered showing net credit off-take of Rs.2.8 billion in H2-CY11 against the net retirement

Figure 1.10**Commodity Finance-Public Sector****Table 1.2 Sector-wise Flow of Credit to Private Sector**

	H1-10	H2-10	H1-11	H2-11
Chemical and Pharmaceuticals	10.0	(3.2)	1.5	2.1
Textile	(53.4)	101.4	(37.5)	12.6
Cement	(4.3)	4.1	(13.7)	(0.2)
Sugar	19.5	(8.4)	48.5	(38.1)
Shoes and leather garments	0.5	0.8	2.9	5.2
Automobile and transportation equipment	(5.2)	(10.8)	3.1	2.9
Financial	(18.4)	0.5	10.3	18.7
Production and transmission of energy	34.5	15.5	29.8	(10.3)

⁹ The world commodity prices, after bottoming out in post global crisis, took a reversal again particularly in Jan-09 and exhibited a 35% rise during 2009-2011. The resurgence of prices was seen in most commodities (Energy, Agriculture, and Metal).

¹⁰ The State of Pakistan's Economy - Second Quarterly Report 2011 - 2012.

¹¹ A national account indicator of how much new value-add has been invested instead of consumed

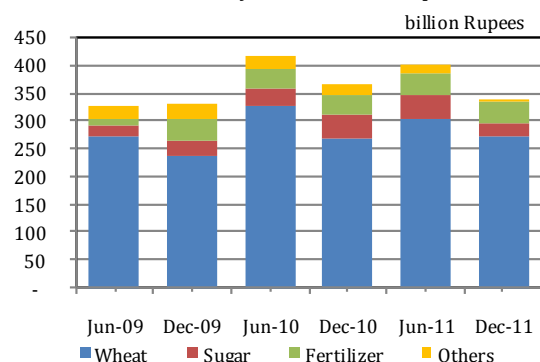
¹² Please see Levine (2011), King and Levine (1993), Pagano (1993), Roubini & Martin (1992), Khan and Senhadji (2000) and Papaioannou (2007).

of Rs.11 billion in H2-CY10. For the same reason, credit for agribusiness (recovering from dismal performance last year) and chemical & pharmaceutical also showed a positive credit demand in the period under review.

One-off settlement by the Government for commodity finance resulted in net retirements....

Figure 1.11

Public Sector Commodity Finance Break-up



In addition to settlement of inter-corporate circular debt, Government¹³ also settled Rs.78 billion¹⁴, against unpaid subsidy on account of public sector commodity operations. This led to net retirements of Rs 63 billion of commodity operations in H2-CY11 (**Figure 1.10**). Such retirements were profoundly seen in three major commodities i.e. wheat (Rs.31 billion), sugar (Rs20 billion), and rice (Rs12 billion).

...however, financing for procurement of wheat remains high

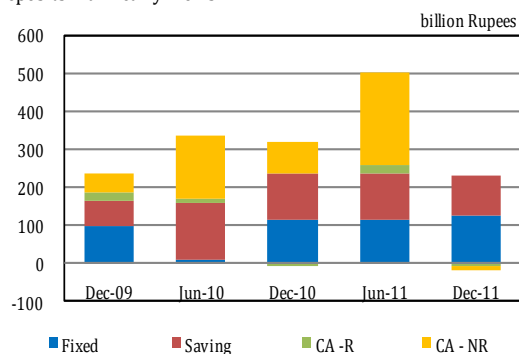
The bank-wise data reveals that major exposure on account of commodity financing to public sector is concentrated in five big banks (out of 23 commercial banks) with cumulative share of 73 percent in overall financing of Rs336 billion. The public sector financing needs revolve around the few commodities – wheat being a primary food crop of the country. As of end 2011, public sector enterprises availed Rs271 billion (81%) for wheat financing followed by Rs.41 billion (12%) for fertilizer and Rs.22 billion (7%) for sugar (**Figure 1.11**). It may be noteworthy that government borrowing for the commodity financing remained consistently high and rising during past few years owing to escalating global commodity prices and increasing wheat support price. With the increase in wheat support price by Rs100 per 40kg and decline in international wheat price, domestic financing and procurement needs are expected to increase considerably¹⁵.

Deposits registered a subdued growth

The second half of CY11 witnessed a slowdown in deposit growth compared to the same period last year (increase of Rs279 billion in H2-CY11 vis-à-vis Rs323 billion in H2-CY10). This deceleration in deposits is attributed to attractive

Figure 1.12

Deposits-Half Yearly Flows



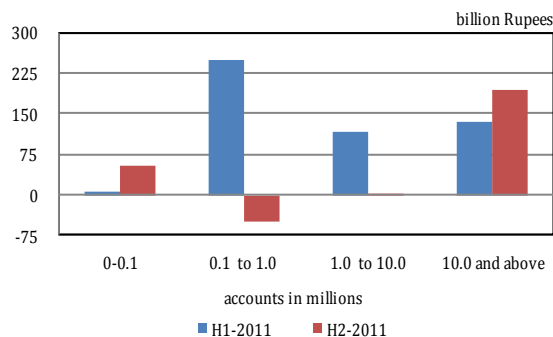
¹³ Banks have 77 percent exposure on public sector in terms of commodity finance.

¹⁴ Govt. borrowed around Rs.140 billion from commercial banks during April-October, 2011. However, in Nov-2011 govt. released on-off Rs.78 billion to procurement agencies for the settlement of accumulated subsidies.

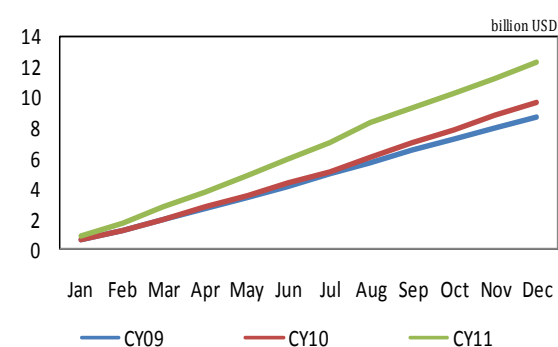
¹⁵ The public sector commodity finance for wheat procurement has increased to Rs 350 billion up from Rs 217 billion on 30th March, 2012.

Figure 1.13

Deposits Growth by Size

**Figure 1.14**

Workers' Remittances -cumulative Flows



National Saving Scheme (NSS) rate and increasing investment into Investors Portfolio Securities (IPS) account (see chapter 5). Most of the 4.7 percent increase in deposits came from remunerative deposits while non-remunerative deposits remained stagnant. Among the remunerative customer accounts, fixed and saving deposits collectively shared most of the increase in deposit base (**Figure 1.12**). In addition, financial institutions' deposits, with a surge of 34 percent, contributed 26 percent in the overall deposits growth. Due to the stagnancy in current deposits, the share of low cost Current Account – Saving Account (CASA) diluted over the half year, indicating a possibility of increase in cost of deposit for the system in coming months.

...with most of the increase contributed by the large depositors

As stated above, the fixed deposits inched up by Rs.128 billion during the period under review. However, the increase was not parallel in all maturity ladders. Almost 95 percent increase in fixed deposit was seen within the maturity ladder of 6 months to 2 years along with a relatively marginal increase in number of accounts from 0.45 million to 0.51 million. Fixed deposits with maturity of up to six months reduced by Rs.15 billion during H2-CY11. The data also reveals that overall deposit growth in H2-CY11 was mainly driven by large sized (exceeding Rs.10 million) deposits¹⁶ (**Figure 1.13**). The second best was the smaller sized deposits (Rs.0.1 million or below) which grew by Rs.52 billion.

Table 1.3: Remittance Growth in Top 20 Countries

Rank	Country				USD billion	
		2008	2009	2010	GDP 2010	Remittance to GDPL Ratio
1	India	49.98	49.47	54.03	1,727	3.13%
2	China	48.41	48.85	53.04	5,816	0.91%
3	Mexico	26.04	22.01	22.05	1,035	2.13%
4	Philippines	18.64	19.77	21.42	200	10.73%
5	France	16.60	15.87	15.63	2,671	0.59%
6	Germany	10.88	11.21	11.34	3,392	0.33%
7	Bangladesh	8.94	10.52	10.85	100	10.81%
8	Spain	11.84	10.37	10.51	1,407	0.75%
9	Belgium	10.29	10.52	10.18	469	2.17%
10	Nigeria	9.98	9.58	10.05	194	5.19%
11	Pakistan	7.04	8.72	9.69	166	5.85%
12	Korea, Rep.	10.73	8.91	8.71	1,014	0.86%
13	Vietnam	6.81	6.02	8.26	106	7.76%
14	Egypt	8.69	7.15	7.73	219	3.53%
15	Poland	10.45	8.13	7.61	469	1.62%
16	Lebanon	7.18	7.56	7.56	39	19.38%
17	UK	7.86	7.25	7.53	2,138	0.35%
18	Indonesia	6.79	6.79	6.92	707	0.98%
19	Italy	5.55	5.22	6.80	2,061	0.33%
20	Morocco	6.90	6.27	6.42	91	7.07%

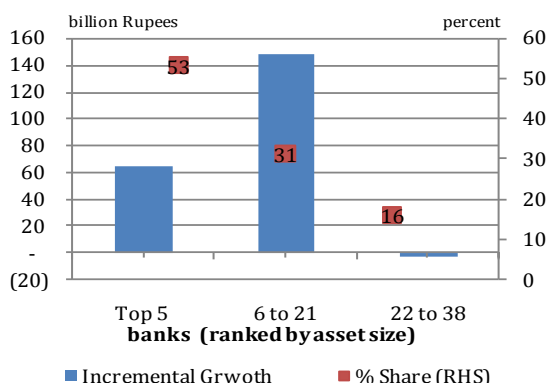
Source: World Bank

Among other factors, workers' foreign remittances (**Figure 1.14**) supported increase in banking sector deposits, thanks to joint efforts of SBP, Ministry of Finance, and Ministry of Overseas Pakistanis for developing an effective network through Pakistan Remittance Initiative (PRI). These efforts improved Pakistan's standing in global ranking in receipt of worker remittance, as World Bank's report/data reveals that in 2010 Pakistan ranked eleventh in terms of receipt of the worker remittances (**Table 1.3**). Besides strong growth in the quantum of foreign remittances, Pak rupee depreciation of 4.6 percent in H2-CY11 led to a strong growth in foreign currency deposits. Currency wise break-up of deposits show that foreign exchange deposit contributed almost 28 percent of the increase in deposits base which augmented their share in overall deposits to 13.5 percent from 12.9 percent in first half.

¹⁶ The large deposits mainly comprise corporate clients, Government or other institutional accounts.

Figure 1.15

Banks' contribution in Deposit Generation



Mid-sized banks outperformed the large banks in terms of customer deposit mobilization

During the period under review, mid-sized banks (6th to 21st in assets size representing 41 percent of the banking sector) contributed a major part in customer deposit collection and generated 70 percent of overall deposit flows of Rs.207 billion (**Figure 1.15**), while remaining deposits were mostly raised by the top five banks (53 percent share). Although the current deposit saw a marginal withdrawal in H2-CY11, the mid-sized banks managed to add fresh current deposits of Rs.36 billion. This dominating performance of mid-sized banks in mobilizing funds is an encouraging sign advocating the enhanced degree of competitiveness in the industry in terms of resource mobilization, and provision of efficient services. Further, the higher deposit generation also indicates the growing degree of customer trust on these institutions.

Liquidity strain pushed up the interbank borrowing

The share of banks' borrowing from financial institutions generally remains within the range of 8-10 percent of total liabilities and shows a transitory nature reflecting general liquidity conditions in the banking system. The period under review witnessed greater activity in these borrowings (Rs113 billion or 25 percent of liabilities increase) that was much higher than the normal threshold band. The major portion of banks' borrowing came from SBP under repo facility-generally availed to meet the short-term liquidity requirements. The stressed liquidity conditions and low deposit growth actually compelled banks to enhance borrowings from financial institutions.

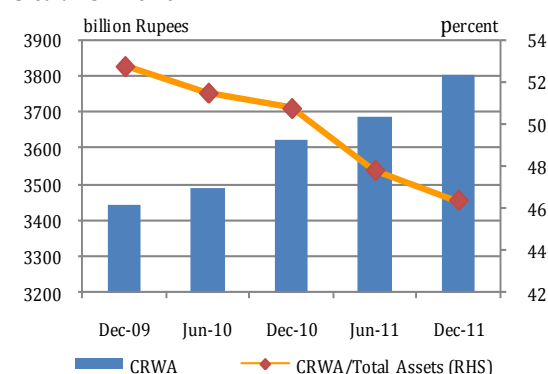
Risk profile of the banking system offered a mixed picture. Despite tighter credit conditions and insatiate craving of banks to invest in government securities, the credit risk continues to be the dominant component of the risk profile of the banking sector. Although, NPLs marginally rise and PSCBs and mid-sized LPBs appear more prone to the credit risk, yet the credit risk remains manageable due to adequate provisions. Banks' liquidity profile strengthened by accumulation of government securities while growing share of term deposits in the funding mix kept the funding risk at bay. Despite some turbulence in financial markets, the market risk in the banking sector remains contained and managed.

Credit Risk

Further tightening of credit conditions may be harmful

Figure 2.1

Credit Risk Profile



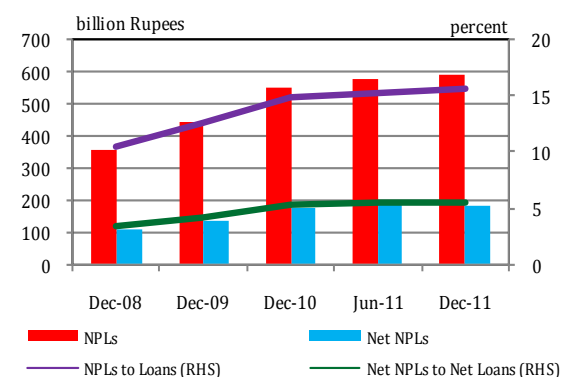
During H2-CY11, gross loans of the banking sector contracted by Rs17 billion. Besides low demand from the private sector, the credit conditions in Pakistan appear to be tightened as evident from the decreasing credit risk weighted assets (CRWA) to total assets ratio (**Figure 2.1**). Any further tightening of credit conditions could intensify the adverse feedback loop of weak macroeconomic activity, which could ultimately harm the resilience of the financial system as well. Consequently, the pass through of the recent hike in the floor on saving products by 100 basis points to the lending rates and its impact on the demand for credit requires vigilant monitoring.

Credit risk dominates the risk profile despite cautious lending

Credit risk emanating from the loan portfolio of the banks remain the most significant and immediate threat to the financial stability of the banking sector. Despite credit contraction and recent trend of banks to park bulk of their incremental funds in safer assets, the credit risk remains the dominant component in the risk profile of the banking sector and has intensified since H1-CY11. During H2-CY11, in absolute terms the credit risk weighted assets (CRWA) grew by 3 percent or Rs. 118 billion (**Figure 2.1**). However, a much robust growth in assets (6 percent) on the back of investments in government papers markedly outpaced the relatively slower growth in CRWA. As a result, ratio of CRWA to total assets further regressed by 1.4 percent, dropping to 46.35 percent by the end of December 2011. However, falling CRWA to total assets over the last few years is not an indicator of lower credit risk; rather it simply suggests a strong flight to quality amid high NPLs. Banks have tried to manage higher infections by tightening their credit standards, and significantly restricting

Figure 2.2

Trends in Non Performing Loans



their lending to riskier sectors (eg: SMEs & Consumer). At the same time, banks have liberally increased their investments in government debt.

Non performance on loans elevate marginally...

The adverse economic outlook and structural deficiencies in the economy continue to take their toll on the debt repayment capacity of the borrowers. In line with the theoretical prediction, the deterioration in economic indicators as measured by a faltering GDP growth rate has led to growth in NPLs. During H2-CY11, NPLs of the banking sector marginally increased from 15.3 to 15.7 percent, with the addition of another Rs12.4 billion to infected assets (**Figure 2.2**). Compared to a rise of Rs31.4 billion in NPLs during H1-CY11 the accumulation in NPLs is relatively lower in the half year under review. The reasons for the slowdown in the buildup of NPLs is due to rising investments in government securities and efforts made by banks to reschedule/restructure infected loans.

...with the bulk of NPLs classified in the loss category

During H2-CY11, NPLs classified as *Loss* increased by another Rs24 billion due to ageing of previously classified loans and direct additions in this category. The addition in this category was about Rs31 billion during the first half of the calendar year. While there are some signs of deceleration of NPLs in *Loss* category, turnaround in NPLs growth is still out of sight. During H2-CY11, increase in loss category was the most significant compared to all other categories which actually witnessed a decrease. Given that about 79 percent of the NPLs of the banking sector are still classified in the loss category, recovery of these infected assets requires significant efforts by banks¹⁷ (**Figure 2.3**).

... yet, adequate provisioning keeps the risks covered and credit risk remains manageable

The credit portfolio of banks appears to be adequately covered against anticipated losses. Provisions held increased by Rs17 billion during H2-CY11 corresponding to a 4 percent increase during the half year. The NPL coverage ratio (provisions to NPLs) of banks stood at 69.31 percent as of end December, 2011 up from 67.9 percent in as of end June, 2011 (**Figure**

Figure 2.3
Category-wise Break-up of NPLs

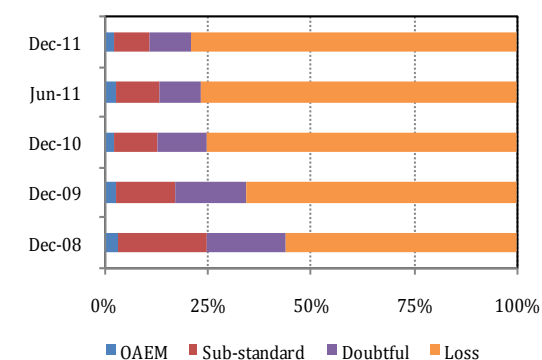
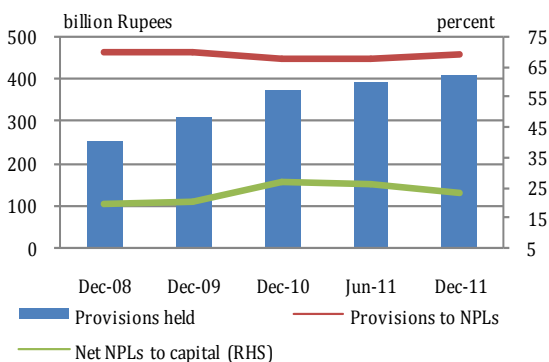


Figure 2.4
Provisions against NPLs



¹⁷ Notwithstanding lower chances of recovery, these assets would not dent banks balance sheet any further, given that banks have made suitable provisions.

2.4). SBP allow banks to avail the benefit of forced sale value (FSV) of the securities held against advances to calculate required provisions. Although, the FSV benefit decreases their provisioning requirements and improves their bottom line, yet, to mitigate the associated moral hazard, banks are not allowed to pay cash or stock dividend from the increased profitability resulting from the benefit. Had this benefit not available, banks would have needed to make additional provisions of over Rs20 billion during CY11 (Rs33 billion on cumulative basis including additional provisions required for previous years).

The stress testing results of the credit exposures suggest that severe credit shocks may bring some banks under stress, however, the CAR of the banking system as a whole remains above minimum requirements.

PSCBs and mid-sized LPBs appear more vulnerable to credit risk

During the period under review, the increase in NPLs was largely distributed as most of the banks experienced an increase in NPLs whereas, only a handful of banks managed to decrease their NPLs.

Breakup of NPLs in terms of various banking groups reveals that both Public Sector Commercial Banks (PSCBs) and mid-sized LPBs (ranked 11-20 on the basis of total assets) had significantly higher infection ratios than the industry averages suggest heightened level of vulnerabilities of these groups against credit risk (**Table 2.1 & 2.2**). At group level, the infection ratio of PSCBs marginally decreased; however, there were significant differences within-group as sharp increase in the NPLs of one of the PSCBs was clouded by a more than offsetting decrease in the NPLs of another PSCB. Specialized banks have chronically high level of NPLs; structural changes including write-offs of unrecoverable loans are needed in this group of banks to arrest the prevailing situation.

Table 2.1: Asset Quality by Bank Category

	in percent				
	Jun-11	Dec-11			
	Infection Ratio	Infection Ratio	Net Infection Ratio	Provision Coverage	Net NPLs to Capital
PSCBs	21.5	21.1	10.1	58.2	41.8
LPBs	13.2	13.8	3.9	74.6	17.1
FBs	9.0	10.4	1.2	89.3	1.9
CBs	14.8	15.3	5.1	69.9	21.6
SBs	31.1	30.1	14.9	59.1	175.0
All banks	15.3	15.7	5.4	69.3	23.1

Table 2.2: Asset Quality by Bank Size

	in percent				
	Jun-11	Dec-11			
	Infection Ratio	Infection Ratio	Net Infection Ratio	Provision Coverage	Net NPLs to Capital
Top 5 banks	12.9	12.9	2.6	81.8	10.3
6-10 banks	11.3	12.0	3.2	75.8	17.2
11-20 banks	25.6	26.2	14.8	51.0	77.0
21-30 banks	15.9	13.4	6.7	53.8	17.4
All banks	15.3	15.7	5.4	69.3	23.1

The changes in the infection ratios of banks ranked 11-20 and 21-30 during the period under review is mainly because of movement of banks from one size group to the other. The higher infection ratios of mid-sized LPBs are reflective of their limited choice in attracting quality borrowers. Primarily, it is the large sized banks that have better outreach and access to low cost deposits, which allows them to attract more creditworthy borrowers by charging lower rates (**Table 2.2**). Going forward, if the economic performance continues to be

lackluster, the infected portfolio of these groups is likely to surge further.

Textile sector's growing infection aggravates concentration risk

Among the corporate sector, the infection ratio of textile and cement sectors is much higher than overall infection ratio. The persistent energy crisis is one of the main causes of high level of NPLs in both of these sectors. The continuing energy crisis forced the cement and textile industries to operate below capacity for over half of the year, which has crippled these industries and induced default on loans. Sharp increase in the input cost, bulk of which is the energy cost, further aggravated the situation for the cement industry.

Banks have significant exposure to textile sector. With around 18 percent share in aggregate loans of the banking sector, textile sector is the leading user of bank credit (**Table 2.3**). Though banks' significantly large exposure is understandable, given the share of textile sector in GDP and exports¹⁸, yet concentration of credit to this sector may pose threat of systemic risk and thus warrants a close watch. Owing to the large exposure, even small deterioration in the asset quality of textile sector can have serious implications for the solvency of some banks. This concentration becomes more critical given that textile sector already has a significantly higher infection ratio, which has further deteriorated to 27.9 percent during the half year under review. The stress tests show that an increase in the NPL ratio equivalent to maximum quarterly increase during the last three years would wipe out Rs48 billion of the banks' capital and would lower the Capital Adequacy Ratio by 64 basis points.

Energy sector, agribusiness and financing to individuals are other segments that are amongst large users of the bank credit and need to be monitored carefully for early warning signs of a major deterioration. During the period under review the infection ratio of agribusiness surged from 7.3 percent to 11.7 percent mainly inflicted by the torrential rains and floods during 2010 and 2011. The quantum of non-performing loans actually decreased in the sugar sector, however, infection ratio deteriorated because the reduction of loans to the sector outpaced the reduction in NPLs.

Table 2.3: Credit and Infection Ratios by Sector

	Share in Loans	in percent	
		Jun-11	Dec-11
Textile	18.2	26.8	27.9
Individuals	9.0	17.2	15.9
Energy	10.0	4.5	3.9
Agribusiness	8.2	7.3	11.7
Chemical & Pharma	4.0	8.6	9.1
Sugar	2.2	11.2	14.3
Cement	2.2	23.1	23.3
Others	46.1	13.9	15.0
Total	100.0	15.3	16.2

¹⁸ The share of textiles in total exports accounted for over 55.6 percent during FY11 and its share in Large Scale Manufacturing is 32.6 percent.

Figure 2.5

Trends in SME Financing

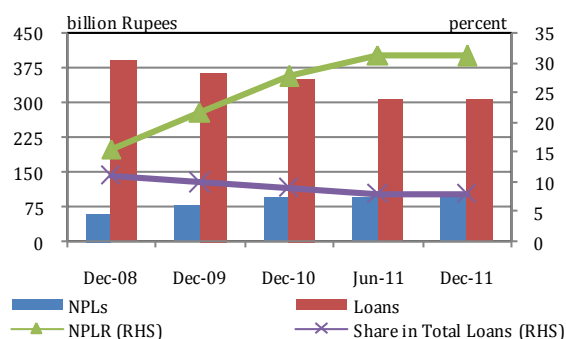


Figure 2.6

Trends in Consumer Financing

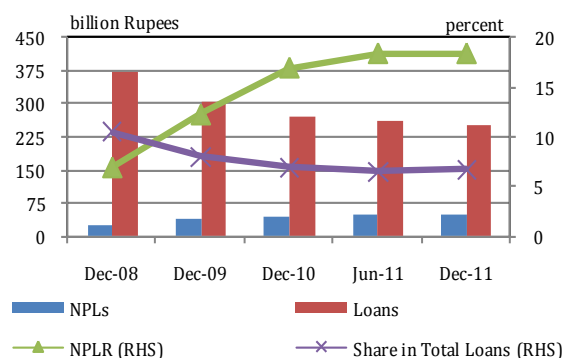


Table 2.4: NPL Ratio of Consumer Financing

(Private sector only)	in percent		
	Share	Jun-11	Dec-11
Credit cards	9.34	21.12	20.50
Auto loans	20.52	9.45	9.71
Consumer durable	0.05	15.56	72.85
Mortgage loans	24.77	26.60	28.22
Other personal loans	45.32	16.63	16.33
Total	100	18.04	18.34

SME and consumer finance don't show any significant signs of improvement...

Credit to SMEs, which was persistently receding over the last three years, showed some signs of resistance to further decline. During H2-CY11, the credit to SMEs increased by a trivial amount of Rs1.7 billion. This increase in credit to SMEs came along with half a billion rupees decline in NPLs of the segment (**Figure 2.5**). This recent check on the dwindling credit to SMEs is a healthy sign, however, the decrease in credit for fixed investment and decrease in the number of borrowers in this segment by 26,000 or 13 percent is worrisome because SMEs employ a large proportion of labor force and non-availability of credit to SMEs may trigger more defaults and may have serious economic and social repercussions.

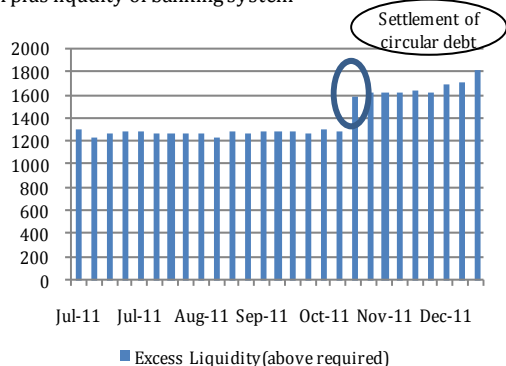
During H2-CY11, infection ratio for consumer finance inched up to 18.34 percent, prompting banks to further cut back their exposure. Consequently, the banks reduced their aggregate consumer financing by another Rs7 billion (**Figure 2.6**). The mortgage loans that makes up 25 percent of the total consumer financing suffers with infection rate of 28 percent .. The high level of default in this segment is due to the stagnant real estate prices coupled with high inflation-high interest rate conditions that make it difficult for borrowers to pay installments on variable rate loans taken during the low inflation – low interest rate times. The infection ratio in financing against consumer durables increased sharply during H2-CY11 to 73 percent and seemingly looks alarming. However, the high infection ratio is caused by a sharp reduction in the financing in this segment that decreased by almost 80 percent (**Table 2.4**). The number of borrowers availing consumer financing also decreased by over one hundred thousand or five percent during H2-CY11. Banks' growing reluctance for consumer finance, while understandable amid high infection ratios, is likely to affect the already lower level of access of households to bank credit. However, unless macroeconomic conditions improve significantly, banks are unlikely to resume interest in this segment soon.

Volume of pending litigations adds to the banks' woes

During H2-CY11, banks were able to recover Rs19 billion against the non-performing loans that constitute only 3 percent of the total non-performing portfolio of the banks. Banks are exposed to the risk of non recovery or late recovery of non-performing loans because of huge backlog of cases

Figure 2.7

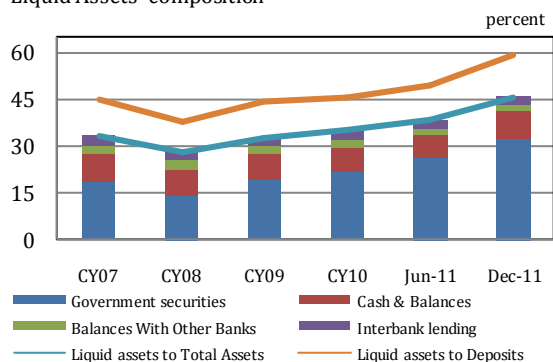
Surplus liquidity of banking system



pending with the courts that intensifies this risk. The volume of the backlog of pending cases is a lot more than the processing capacity of the concerned courts. According to the available records, over 56,000 recovery suits were pending with courts and banking tribunals during the first quarter of 2011. These cases jointly involve more than Rs200 billion of litigated amount. Over 14,000 of these cases are pending for more than 10 years. The relatively limited size and operational capacity of judiciary compared to the huge backlog of pending cases slows down the litigation process and it not only delays the recovery of the defaulted amount but also provides incentives to the borrowers to default on their commitments.

Figure 2.8

Liquid Assets' composition



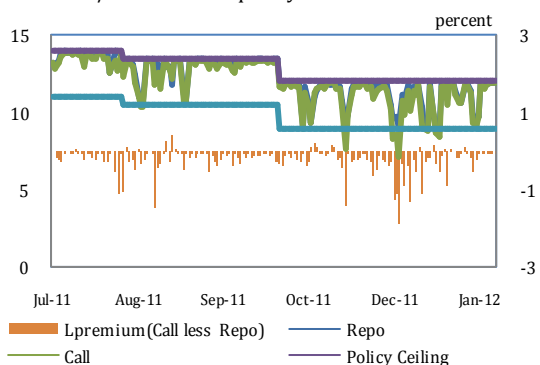
Liquidity Risk:

Statutory liquidity indicators exhibit a comfortable position on the back of rising investments...

Banks continues to exhibit comfortable liquidity position attributable to consistent flow of deposits, though at decelerated pace, into investment portfolio. During the period under review, the level of liquidity maintained by the banking system surged to 64 percent of the time and demand liabilities (TDL) up from 53 percent in Jun-11 (against statutory requirements of 24 percent), with a major increase provided by one off settlements of inter-corporate circular debt (**Figure 2.7**).

Figure 2.9

Trends in O/N rates and Liquidity Premium

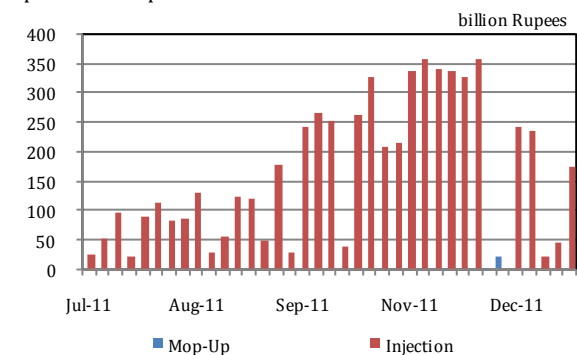


With banks' burgeoning exposure to government debt, various liquidity ratios surged over the half year; share of liquid assets in total assets increased from 38.2 to 45.5 percent (**Figure 2.8**), while liquid assets to deposits ratio reached 59.5 percent up by 10 percentage points. The improvement in liquidity condition is observable across the banking industry, as all banks had liquid assets to total assets ratio above 10 percent.

Similarly, growth in deposits and decline in advances portfolio brought about further improvement in the advances to deposits ratio (ADR); it declined to 54 percent by Dec-11, from 56.7 percent in June-11. Improved ADR though provides supports to enhanced liquidity of the system: its declining trend indicates the undesirable deleveraging of private sector credit.

Figure 2.10

Open Market Operations



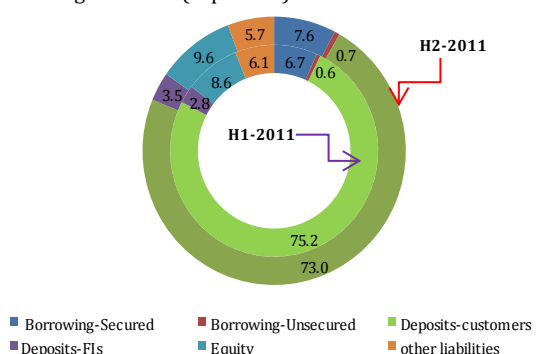
...though overnight market was strained due to uncertainty regarding cash flows

However, short-term liquidity remained somewhat strained during H2-CY11; with overnight rates remaining high and volatile (**Figure 2.9**). The higher volatility could be explained by more than anticipated Government borrowings from banking sector, continued decline in foreign financial flows, heavy oil payments and seasonal factors. This strain led SBP to make substantial net injections into the banking system (**Figure 2.10**), which is perceived as indirect monetization of fiscal deficit.

Marginal shift in funding structure...

Figure 2.11

Funding structure (in percent)

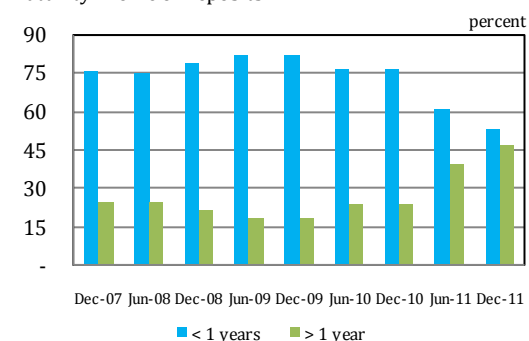


Banks' funding structure saw a marginal shift over the period under review mainly on account of surge in borrowing by 20 percent and sluggish 4.7 percent growth in deposits. As a result share of borrowing inched up to 8 percent, while the share of customer deposits declined marginally (**Figure 2.11**). Analysis of borrowing re-confirm the increased activity in repo borrowing (increase of 118 percent), to meet the short term cash requirements in relatively strained liquidity condition and low deposit growth.

Visible growth of longer tenor deposits further shifted the maturity profile....

Figure 2.12

Maturity Profile of Deposits

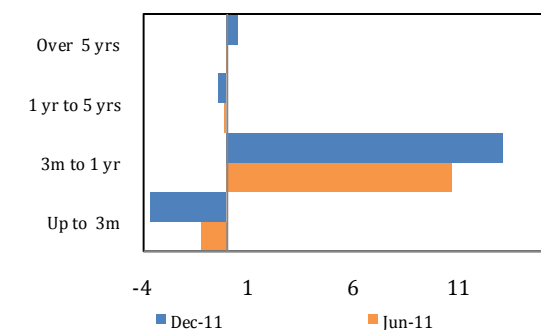


Maturity profile of the deposits continued the trend observed in the first half of the year. However, the period under review saw a shift in growth pattern of various deposit types; most of the increase was contributed by saving and fixed deposits, while current account deposits saw a negligible decline. As a result the share of deposits of one year and above sharply increased over the period to 47 percent from 39.4 percent (**Figure 2.12**). On the other hand, the share of deposits of less than one year registered further decline during the period under review, mainly on account of stagnant current deposits and SBP's revised instructions to report non-contractual deposits on the basis of their behavior¹⁹.

¹⁹ This gap is mainly attributed to banks' adjustment to place demand deposits (the non-contractual liabilities which have a significant share in total liabilities) from 3-month bucket to longer time bucket based on their expected maturity after issuance of latest instruction in BSD circular letter no. 3 of 2011.

Figure 2.13

Maturity Gap (Assets-Liabilities) as percent of Assets

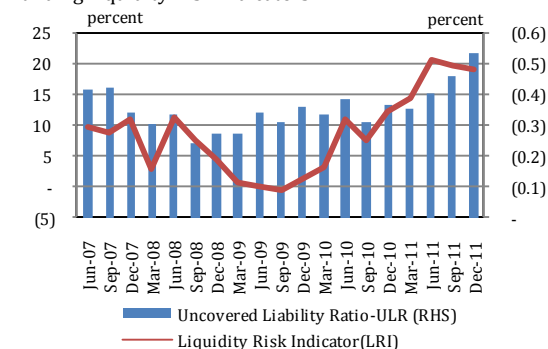


Continuing positive maturity gap in short tenor buckets: an indication of re-pricing risk

Tenor wise maturity gaps also observed some shift due to increase in short and medium term investments, in addition to changes in maturity profile of deposits. During H2-CY11, the gap between assets and liabilities increased to 13.06 percent for 3-months to 1-year time buckets (**Figure 2.13**). These shifts can be explained by substantial increase of investments in MTBs maturing within 3 months to 1 year. While the change in gaps of less than one year is a positive development in terms of short term liquidity risk management, it also reveals an increasing share of investments in banks' total assets. However, this trend can expose banks to reinvestment risk in a declining interest rate scenario.

Figure 2.14

Funding Liquidity Risk Indicators



As Government securities continue to amplify in overall investment portfolio, the Uncovered Liability Ratio (ULR), showed further improvement in overall coverage of the liabilities (**Figure 2.14**). Similarly, Liquidity Risk Indicator (LRI) which measures the short term liquidity gap calculated for 30 day horizon indicates lower funding risk on the back of changing pattern of deposit mix towards longer tenor deposits (**Figure 2.14**). Positive results of both these indicators bode well for overall comfortable liquidity position in market.

Banks exhibit resilience against liquidity shocks for 5 days and 30 days time period

Stress testing results complement overall liquidity picture in the banking industry, as banks are found resilient to different liquidity shocks including withdrawal of customer deposits, whole sale deposits and shocks to recently introduced Basel III liquidity coverage ratio (LCR). Even a shock of 20 percent fall in the value of government securities would marginally reduce the post-shock LCR to 7.21, significantly higher than the minimum required level of '1' defined under Basel III. The liquidity coverage is quite broad based as no bank has LCR below 2 after this shock.

Figure 2.15

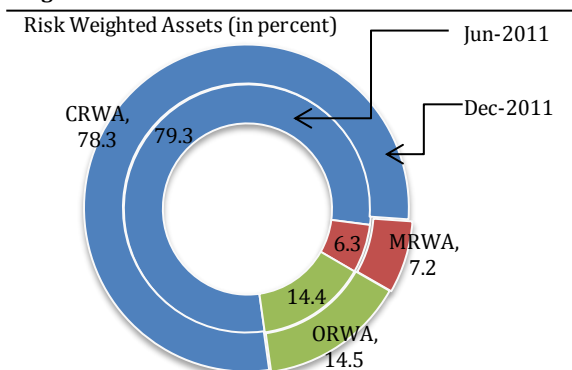


Figure 2.16

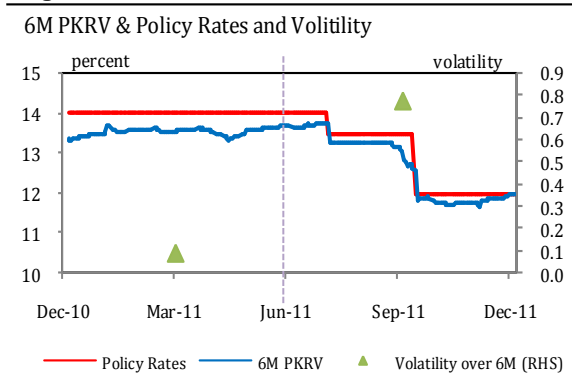
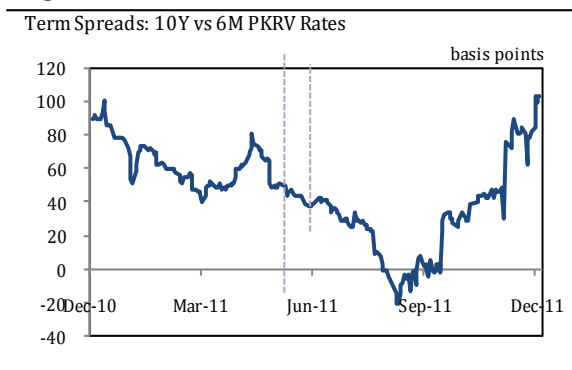


Figure 2.17



Market Risk

Market risk remains trivial under current measurement methods

The recent financial crisis highlighted the importance of market risk as a lot of variation in the asset prices was related to the market risk factors²⁰. The mounting levels of uncertainty caused by concerns over the government's fiscal worries, mounting public debt and looming negative economic growth prospects seem to have affected the market sentiments. However, despite sizeable level of volatility in the domestic financial markets during the period under review, the contribution of market risk remains trivial in the overall risk profile of banks when measured in terms of current practices of calculating risk-weighted assets²¹. Market risk weighted assets (MRWA) constitute about 7 percent of the total risk weighted assets of the banking sector and the market risk remained contained partly due to prudent limits imposed by SBP on banks for taking market related risks. The marginal increase in the proportion of MRWA was on account of disproportional increase in investments in federal government securities relative to the increase in the private sector credit (Figure 2.15).

Volatility increases in money market with a downward shift in the yield curve

During the period under review (H2-CY11), the money markets remained relatively more volatile compared to previous half year (H1-CY11). Higher volatility, an indication of the uncertainty and liquidity pressures, is a usual phenomenon when significant monetary policy announcements are expected or made and was triggered due to changes in SBP's monetary policy stance during H2-CY11. A decline in inflation and the need to boost private sector credit prompted SBP to ease the monetary policy stance; SBP responded by slashing the policy rates by 200 basis points in two episodes during H2-CY11 (Figure 2.16).

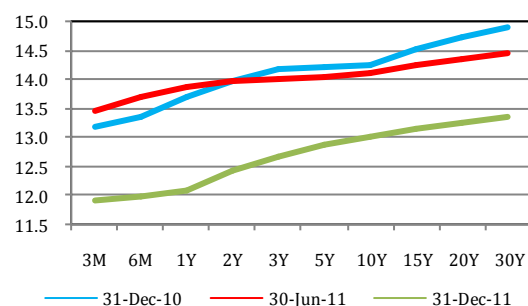
The term spread between 10 year and 6 month PKRV rates that was dwindling since May 2011 became negative in September 2011, signaling concerns of market over long term

²⁰ Berg, T. (2010), "The term structure of risk premia: new evidence from the financial crisis", European Centre Bank working paper series, No. 1165, Frankfurt.

²¹ Throughout this section, risk weighted assets (RWA) are limited to RWA under Pillar-1 of Basel II capital accord, that is, interest rate risk in banking book is explicitly excluded from the analysis.

Figure 2.18

Yield Curves



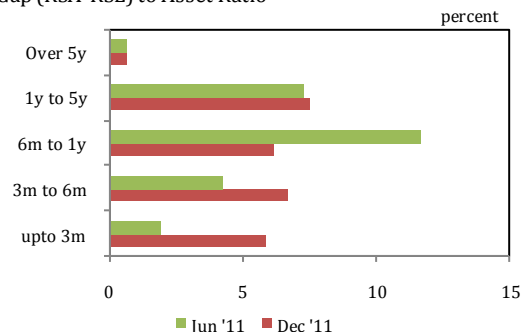
economic outlook, growth and demand for long term funding. However, the term spread started to increase in September 2011 and took off following the 150 basis points cut in policy rates in October 2011. By the end December 2011 the term spread was 103 basis points (**Figure 2.17**). Consequently, besides a downward shift, the yield curve also steepened during the review period (**Figure 2.18**). The steepening of yield curve signals short term availability of liquidity along with higher inflation expectation and an overall reassurance about long term economic outlook, growth and demand for long term funding.

.....exposing banks to yield risk

During H2-CY11, the gap in RSA and RSL varied substantially across different time buckets, with banks continuing to face yield risk. However, the sharpening of yield curve during H2-CY11 has been less material for the banks as the yield curve swiveled around 3 year maturity (**Figure 2.18**), whereas banks have most of the positive gap in up to 1 year maturity (**Figure 2.19**). The positive gap in this time bucket is reflective of the banks' increasing exposure in the short term government securities and circular debt financing.

Figure 2.19

Gap (RSA-RSL) to Asset Ratio

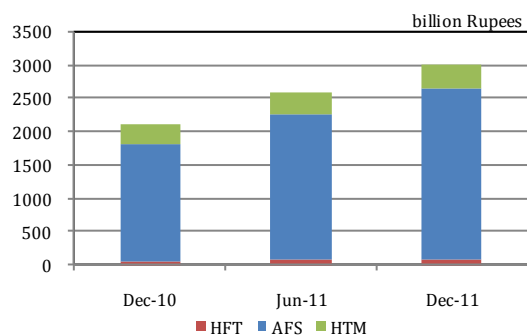


The rate sensitive gap sporadically exceeds the acceptable bounds

In banks a certain degree of gap between rate sensitive assets (RSA) and rate sensitive liabilities (RSL) is inevitable; generally a gap to asset ratio of +/- 10 percent is considered within tolerable range. During the period under review, the banks were able to effectively manage re-pricing risk as gap to asset ratio of the banking sector remained within to the acceptable limits in most of the time buckets. However, in 6-month to 1-year time bucket the gap between RSA and RSL was 11.5 percent of total assets, that is somewhat beyond the generally acceptable limits, exposing banks to a interest rate risk in decreasing interest rate scenario (**Figure 2.19**).

Figure 2.20

Classification of Investment

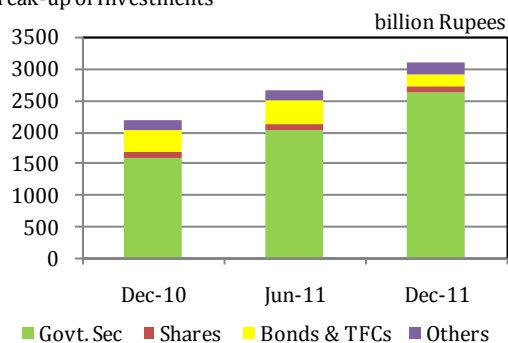


AFS classification restricts the bottom line benefiting from revaluation gains

During H2-CY11, banks continued with their strategy of classifying lion's share of their investments in the Available for Sale (AFS) category, with only small proportions in Held for Trading (HFT), Held to Maturity (HTM) and Strategic investment categories (**Figure 2.20**). As of 31st December 2011, less than 3 percent of the investment portfolio was

Figure 2.21

Break-up of Investments



classified as HFT whereas about 84 percent was held in AFS category, including substantial holdings of government securities (**Figure 2.21**). Following cut in policy rates, banks booked revaluation gains of Rs11.7 billion during CY-11. These gains were partially offset by revaluation deficit of Rs8.5 billion on shares and other investments. The revaluation gains / losses on AFS category are directly taken to the balance sheet without affecting the income statement; therefore, despite the net revaluation gains, the affect was not transferred to the income statement.

Stock market performance remained dismal....

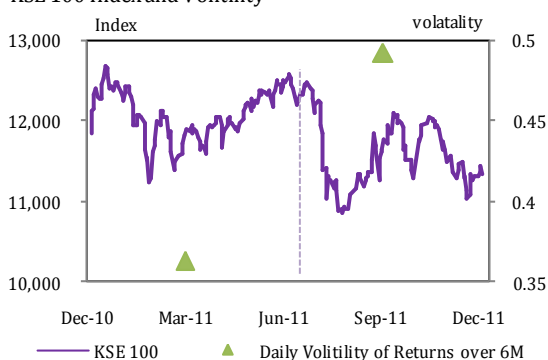
The soft rebound in equity prices that was witnessed in H1-CY11 appears to have come to an end during the period under review as during H2-CY11 the capital market functioning has deteriorated and equity prices have fallen sharply. During this period, KSE 100 index showed dismal performance. The index followed a general downward trend with some bouts of positive returns. The KSE 100 index closed at 11,347 points registering a loss of 5.6 percent during the half year and a loss of 9.2 percent during CY11 (**Figure 2.22**). During H2-CY11, the stock market volatility²² increased as compared to H1-CY11, reflecting an increase in uncertainty amongst investors.

....while modest equity positions insulate banks from swings in stock prices

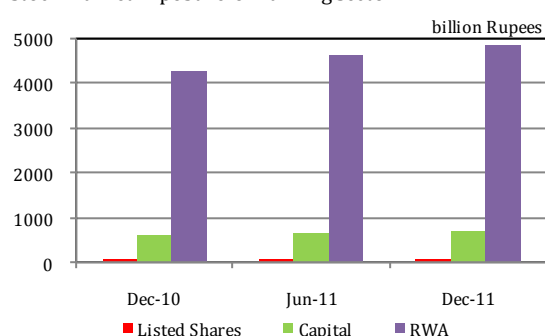
SBP has strict limits on the banks' exposure to the stock market. Banks are required to limit their stock market exposures to maximum of 20 percent of their own equity. Consequently banks' exposure to the stock market remains trivial. At the end of H2-CY11, banks had Rs91 billion in the stock market which constitutes a meager 1.5 percent of their total asset base and 3.2 percent of their investment portfolio (**Figure 2.23**). This relatively small exposure means that even big swings in the equity prices are not going to affect banks' profitability or solvency. Therefore, despite sharp decrease in equity prices, banks were able to weather the revaluation losses of Rs5.5 billion incurred on their stock market investments. Due to the limited exposure to stock market, banks can absorb even more severe decline in the stock prices; sensitivity analysis shows that if the prices of all listed shares drop by 50%, the CAR of the banks will decrease by only 76 basis points (see Chapter 3 for details).

Figure 2.22

KSE 100 Index and Volatility

**Figure 2.23**

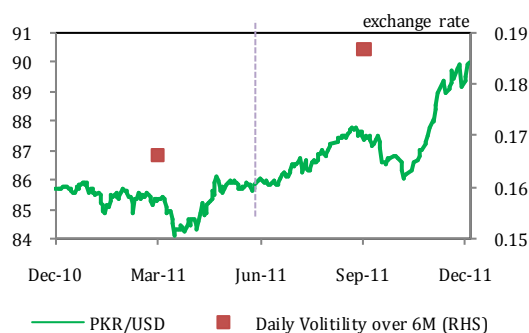
Stock Market Exposure of Banking Sector



²² Volatility is calculated as daily standard deviation of KSE 100 Index returns over six- month period.

Figure 2.24

Evolution of PKR/USD Exchange Rates



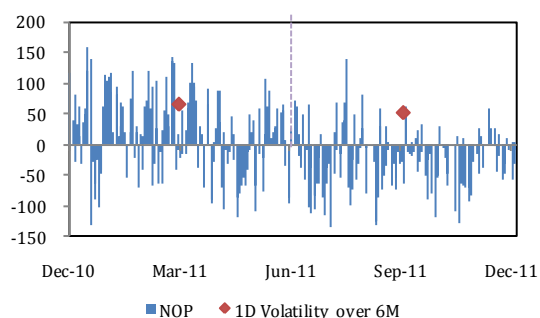
Other than the direct hit to the banks' health, a fall in equity prices also reduces the value of collateral which borrowers use against their borrowings, thereby diminishing the borrowers' ability to obtain loans and thus adding to the pro-cyclical pressures. For Pakistani banks, the effect of lost collateral value is, however, expected to remain small as the total volume of loans obtained from the banking system against shares as collateral was about Rs25 billion or less than 1 percent of the total loan portfolio.

Healthy home remittances contained depreciation of PKR and NOP remains within manageable bounds

During the period under review, Pakistan received a record USD 6.3 billion in home remittances, registering an improvement of 7 percent over the first half of 2011. Despite this positive development, PKR depreciated against USD closing at Rs/\$ 89.97²³ on December 30, 2011, thus shedding 3.98 rupees against USD during H2-CY11 and 4.26 rupees since beginning of CY11. The volatility of exchange rate during H2-CY11 was more than that during the first half of CY11 reflecting mounting concerns over growing economic challenges (**Figure 2.24**).

Figure 2.25

NOP of All Banks



During the period under review, overall Net Open Position (NOP) of banks remained within the manageable bounds of +/- US\$ 150 million or less than 2 percent of bank's capital. The volatility of NOP during the period was slightly more than that during H2-CY10; however, deviations from square position were mostly on the short side (**Figure 2.25**). Given, the depreciation of PKR against USD and other major currencies, banks on average would stand to lose from short open positions.

²³ Average of bid and offer exchange rates.

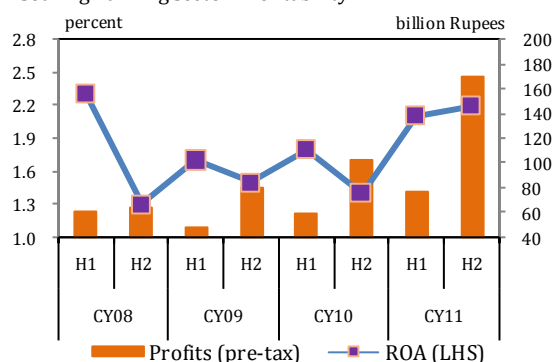
The banking sector posted its highest ever annual profit of Rs 169.9 billion (pre-tax) in CY11 on the back of increasing share of returns on government securities and lower provisions on classified loans. The CAR of the banking sector, which was already well above the regulatory requirements; increased further to 15.1 percent in H2-CY11, up by 100 bps from H1-CY11. The robust profits, fresh equity injections and decreasing RWA due to risk averse behavior of banks strengthened the solvency profile of the banking sector. However, depressed global and domestic conditions have made it challenging for some banks to meet the growing minimum capital requirements. The stress tests results for the H2-CY11 show that banking system is well poised to withstand historical as well as hypothetical credit, market and liquidity risks shock, though severe credit shocks may bring some banks under stress.

Profitability

Healthy returns on investments in government securities boosted banking sector profitability to its highest level

Figure 3.1

Soaring Banking Sector Profitability

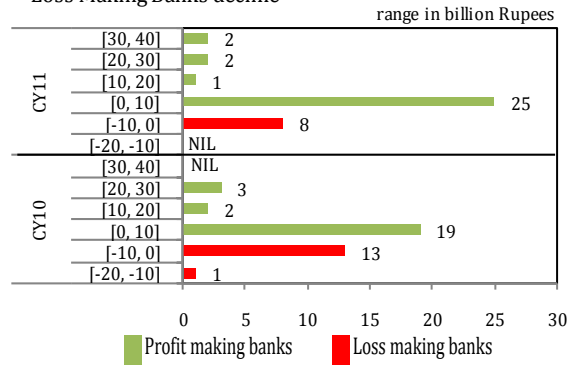


The banking sector earnings continued to accumulate in the second half of 2011 on the back of healthy returns on growing stocks of risk free government securities held by the banks. In addition, the lower provisions due to enhanced FSV benefit contributed towards buildup of profitability levels²⁴. Accordingly, the pre-tax profits soared up by 67.1 percent YoY to historically highest level of Rs169.9 billion during CY11 (**Figure 3.1**). The key return indicators surged to levels previously achieved in 2007; Return on Assets (ROA increased to 2.2 percent in H2-CY11, up from 1.4 percent in 2010).

Industry outlook strengthens as profitability concentration further declined among the banks

Figure 3.2

Loss Making Banks decline



Though the banks' investments in government securities are not considered as productive as lending to businesses and households, it has nevertheless provided an avenue for the banks for risk-free earnings and enabled them to post profits even in weak economic environment. The improvement in profitability was observed across all category of banks; only 8 banks faced losses as against 14 banks in CY10 (**Figure 3.2**). Further, share of top 5 banks in total profitability reduced to 74.7 percent which last year accounted for 106 percent in overall earnings. Analysis of banks in terms of return indicators reconfirms that on average top 5 banks continue to enjoy higher returns, compared to industry average, on the basis of competitive edge available to these banks. The return indicators of medium and small sized banks improved

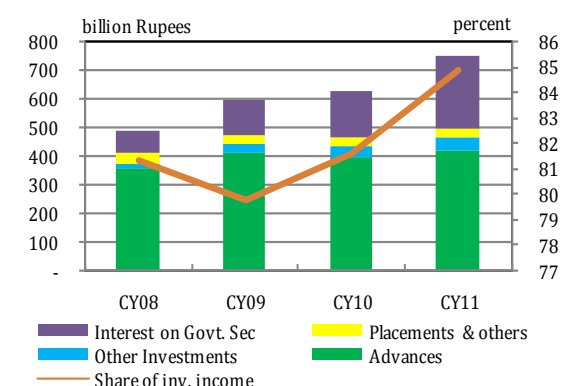
²⁴ The enhanced FSV benefits were allowed in the BSD Circular 1 of 2011 – October 2011.

Table 3.1: Concentration of Earnings

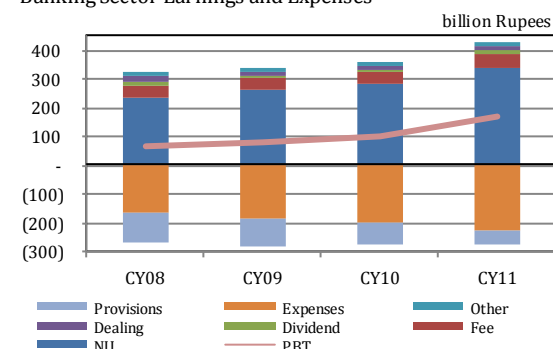
CY11	Share	ROA	ROE	share in percent		
				AU	PM	NIM
Top 5	74.7	3.2	30.1	10.9	29.2	6.3
Top 6 to 10	14.7	1.4	19.0	10.9	12.7	4.9
Top 11 to 20	8.3	0.8	9.6	10.6	7.4	3.0
Top 21 to 30	1.4	0.6	4.2	10.4	5.6	4.1
Public Sector	17.8	1.9	18.4	10.0	19.4	4.2
Local Private	76.8	2.2	24.1	11.0	19.9	5.4
Foreign	3.3	2.2	14.1	11.4	19.6	5.9
Specialized	2.1	2.4	43.2	10.6	22.6	5.5
All Banks	100.0	2.1	22.6	10.8	19.9	5.2

Figure 3.3

Interest Income on Government Securities hikes

**Figure 3.4**

Banking Sector Earnings and Expenses



marginally over the half year as most of the increase in advances took place in this category (**Table 3.1**).

Interest income rose sharply on investment yields

The Net Interest Income (NII) of the banking sector witnessed a healthy growth of 20.4 percent during CY11 backed by marked improvement in the interest income on investments; which surged by 52.9 percent during 2011.

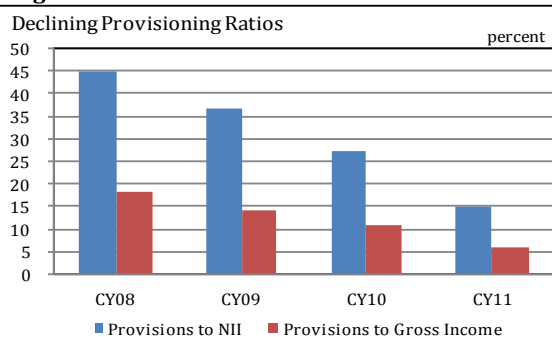
Though interest income from advances remains the major contributing factor in the interest income however, further increase in the stock of investments boosted the share of investment income to 40 percent from 31 percent in 2010. Within the investment income, return on government securities accounted for 84.8 percent share of interest earned during CY11 against 81.5 percent in the previous year (**Figure 3.3**). Interestingly, the concentration of interest income on government securities continued to rise despite slashing of policy rate by 200 bps in H2-CY11.

To cater the ever-increasing budgetary needs of the government, banks resorted to excessive repo borrowings in addition to mobilization of saving and fixed term deposits during H2-CY11. As a result, interest expense jumped by 27.4 percent during the period under review as against full year increase of 20.2 percent.

In addition to the NII, the non-interest income also improved by 11.2 percent (YoY) to add to the rising banks' profitability. Much of the improvement in the non-interest income was registered in the second half CY11; as it increased by 12.1 percent compared to 8.9 percent in the first half (**Figure 3.4**). The improvement was attributed towards increased fee/commission income, dividends and dealing in foreign exchange trading related activities. The general expenses of banking sector augmented by 14.2 percent during CY11 as cost of doing business increased in terms of rising salaries and associated expenses.

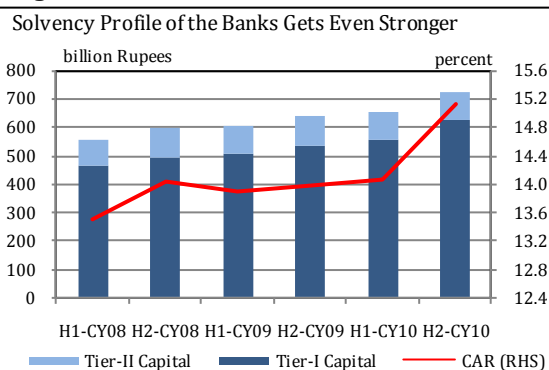
Lower provisioning expenses also contributed towards accumulation of profits

During 2005-2007, the benefit of forced sale value of collateral against NPLs was withdrawn to build up sufficient loan loss provisions keeping in view the healthy growth and performance of the banks. This counter cyclical measure provided regulator the leverage to utilize it in the period of economic slowdown. The FSV

Figure 3.5

benefit was enhanced in phases, with last enhancement allowed in second half of 2011. The rationalization of provisions through enhanced FSV benefit supported the buildup of banking profits during the year, with much of the improvement taking place in the H2-CY11.

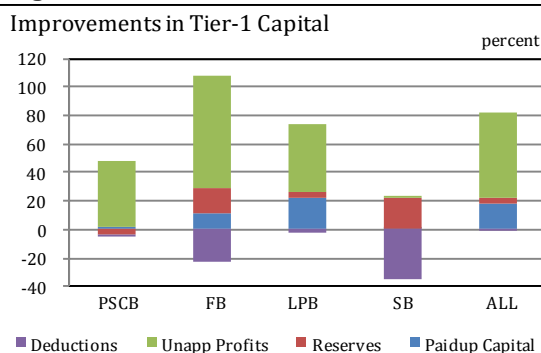
During CY11, the banks availed the FSV benefit of over Rs20 billion – a rise of 75 percent over the previous year, which led to decline in provision expense by Rs 27 billion over the year **(Figure 3.5)**. However, in order to incentivize the banks to focus on managing the credit risk and recovery of infected portfolio, banks were barred from distribution of dividends against additional income from FSV benefit.

Figure 3.6

Solvency Profile of the banking System

Higher profitability and fresh capital injections strengthened the solvency ratios

Driven by high profitability, fresh capital injections and slow growth in risk weighted assets, the solvency of the banking sector further strengthened in H2-CY11. The benchmark CAR of the banking sector improved significantly by 110 bps to 15.1 percent in H2-CY11 while Teir-1 CAR surged to 13 percent **(Figure 3.6)**.

Figure 3.7

Much of the improvements in the capital structure occurred in the core capital attributable to fresh capital injections by some medium and small sized banks as well as accumulation of rising volume of inappropriate profits. As a result, the share of Tier-1 in total capital further strengthened to 85.9 percent during second half as against 84.8 percent in the first half. Similarly, most of the banks experienced improvements in their Tier-1 capital with the exception of specialized banks **(Figure 3.7)**.

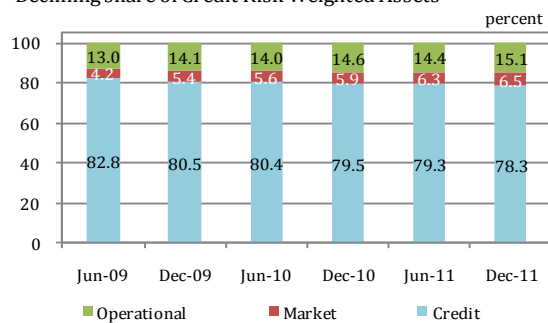
Table 3.2: Bank Category-Wise Solvency Ratios - CY11

	in percent					
	Capital to RWA		Tier 1 to RWA		Capital to Assets	
	H1	H2	H1	H2	H1	H2
Top 5	15.5	16.2	13.0	13.8	9.1	9.4
6 to 10	11.9	12.5	9.0	9.6	6.7	6.8
11 to 20	10.8	13.6	9.9	12.1	7.8	7.9
21 to 30	21.9	21.9	22.0	22.2	13.2	13.4
PSCB	12.8	16.5	10.8	14.4	9.0	9.3
LPB	14.1	14.4	12.0	12.3	8.2	8.5
FB	25.2	31.3	25.0	31.1	15.2	16.4
SB	8.0	8.9	2.0	3.4	2.0	7.5
Industry	14.1	15.1	11.9	13.0	8.5	8.9

Concentration analysis of solvency ratios show that CAR of Top 5 banks further strengthened to 16.3 percent while it improved to 31.3 percent for foreign banks (FB). In addition, improvements in core capital significantly enhanced the Tier-1 to RWA ratio. The performance of the small sized bank improved over the half year; however, abnormal losses faced by one of the small banks overshadowed the performance of small sized banks, which led to marginal increase in their Teir-1 CAR. Moreover, the leverage indicator of capital to assets ratio also improved considerably in H2-CY11 to 8.9 percent for the banking sector **(Table 3.2)**.

Figure 3.8

Declining share of Credit Risk Weighted Assets

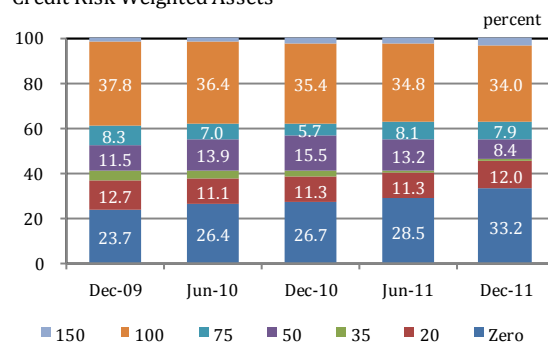


Banks' business preferences and rising credit risk lead to the declining share of CRWA...

During the period under review, the capital base of banks surged by 10.7 percent, while risk weighted assets saw a subdued growth of 2.9 percent due to banks' preference towards safer ventures amid growing credit risk on private sector lending. Accordingly, share of credit risk weighted assets that were consistently declining over the last three years, further declined to 78.3 percent in H2-CY11 (**Figure 3.8**). The share of market risk weighted assets surged to 6.5, up from 4.2 percent in Jun-09 as the interest rate risk charge increased on banks' growing stock of investment. Similarly, the share of operational risk weighted assets augmented to 15.1 percent in H2-CY11 attributable mainly to high profitability of the banking system²⁵.

Figure 3.9

Credit Risk Weighted Assets

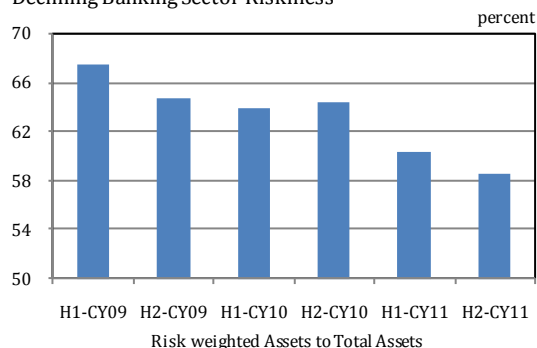


.....with the banks' risk appetite further decreased

The risk-averse behavior of the banking system is elaborately highlighted in the distribution of credit risk weighted assets that not only include advances but also include some components of investments. The share of zero risk weighted assets in the total credit risk weighted assets (CRWA) further increased to 33.1 percent in the second half as against 28.5 percent in the first half of CY11. On the other hand share of assets having 100 percent risk weight continue to decline. Meanwhile, share of assets with 150 percent risk weight edged up to 3.1 percent in the second half compared to 2.5 percent in H1-CY11 on account of increased classified portfolio²⁶ (**Figure 3.9**). Similarly, the share of risk weighted assets to total assets – a measure of overall banking sector riskiness also shows a declining trend (**Figure 3.10**).

Figure 3.10

Declining Banking Sector Riskiness



Despite stronger solvency indicators, rising level of NPLs still pose threat to the capital base

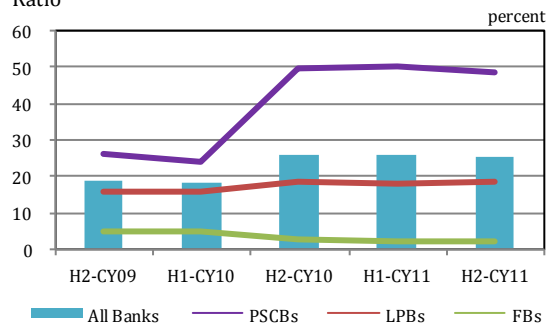
Though capital base has remained robust over the years owing to regulatory requirements and improved profitability, the capital at risk (Net NPL to Capital ratio) has also surged since CY10 - more profoundly in the public sector banks and still prevailing in the CY11. The ratio declined marginally by 17 bps to 25.6 percent during H2-CY11, which is a welcome development but, it is still

²⁵ Most of the banks in Pakistan use Basic Indicator Approach (BIA) to measure operational risk charge. Under the BIA, operational risk charge is calculated by taking the average of last three years of positive annual gross income of the banks times 15 percent.

²⁶ In terms of Basel requirements, overdue loans where specific provisions are less than 20 percent of the outstanding amount are assigned 150 percent risk weight.

Figure 3.11

Growing concern of consistently high Net NPL to Capital Ratio

**Table 3.3 Distribution of Banks by CAR**

	in percent			
	Total	less than 10	10 to 15	Over 15
H2-CY08	40	9	10	21
H1-CY09	40	7	12	21
H2-CY09	40	6	15	19
H1-CY10	40	6	15	19
H2-CY10	38	6	12	20
H1-CY11	38	5	12	21
H2-CY11	38	5	10	23

Box A: Credit Risk Sensitivity Shocks

C1: 10% of performing loans become non-performing, 50% of substandard loans downgrade to doubtful, 50% of doubtful to loss.

C2: All NPLs under substandard downgrade to doubtful and all doubtful downgrade to loss.

C3: Default of top 3 borrowers of the banks.

C4: Default of top 3 borrowing Groups of the banks.

C5: Increase in provisions against NPLs equivalent to 50% of Net NPLs.

C6: Increase in NPLs to Loans Ratio equivalent to the maximum quarterly increase in NPLs to Loans Ratio of the individual banks during the last 5 years.

C7: Increase in NPLs of all banks by 21% which is equivalent to the maximum quarterly increase in NPLs of the banking system during the last 5 years (Mar-09).

C8: Increase in NPLs to Loans Ratio of Textile Sector of the banks equivalent to the maximum quarterly increase in these banks during the last 3 years.

C9: Increase in NPLs to Loans Ratio of Consumer Sector of the banks equivalent to the maximum quarterly increase in these banks during the last 3 years.

high enough with a tendency to adversely affect the solvency of the banking sector (**Figure 3.11**).

Besides a higher net NPL to capital ratio, some banks lag behind in meeting regulatory capital requirements. A total of 12 banks fell short of MCR (minimum capital requirements) of Rs8 billion (as of Dec-11). With the prevailing level of unfavorable geo-political developments and the country's economic and structural issues, it is becoming increasingly challenging for banks to convince their foreign and domestic shareholders to further enhance the capital base of the banks.

In addition to MCR, banks are required to meet minimum CAR requirements of 10 percent which most of the banks meet quite comfortably. As of end Dec-11, only five banks with a market share of 3.6 percent remained short of minimum CAR (**Table 3.3**). These include two specialized banks, which are undergoing restructuring and three small private sector banks that represent 3.4 percent market share. This indicates a limited risk posed by such banks to the system as a whole.

Stress Testing of the Banking System

Improved solvency further enhanced the resilience of the banking system to severe stress shocks

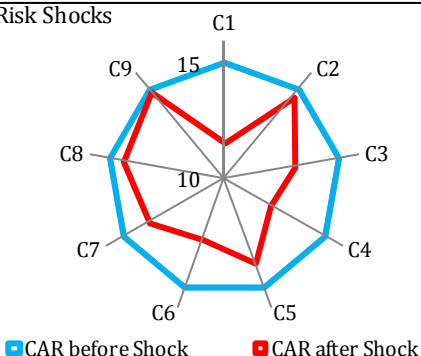
With an industry CAR of 15.1 percent - much above the regulatory requirements, even the severe stress shocks did not affect much of the banking sector with the exception of some banks. The single factor sensitivity stress shocks on the credit, market, liquidity and contagion risk profile of the banking sector reaffirms that with the exception of a few banks, system is satisfactorily placed to withstand the stress²⁷.

The banking system remained solvent even in face of severe credit risk shocks. The sensitivity based credit risk shock of downgrading of the loan classification affected banks adversely as it depleted the CAR by 350 bps to 11.6 percent (*shock C1 of Box A*). The credit shock related to concentration of loans to large borrowers and borrowing groups (shocks C3 and C4) show that CAR of the banking system deteriorated by 200bps and 280 bps respectively, showing high degree of concentration risk (**Figure 3.12**). Particularly, in the increasing credit risk scenario, banks' lending is mostly directed to large corporates. This increasing loan

²⁷ For number of banks failing stress scenarios, see Annexure 1.15.

Figure 3.12

Credit Risk Shocks

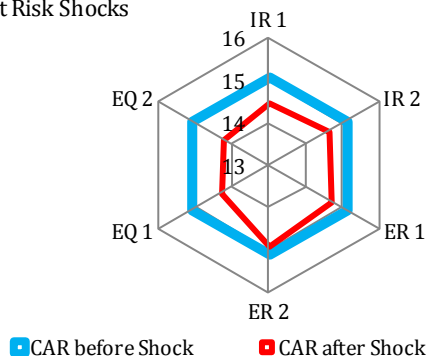


concentration to large corporate groups, when lending to SMEs and consumers is diminishing, needs to be effectively monitored to avoid any systemic implications. Similarly, in line with the easing trend of NPLs, the shock (C6) that takes the highest quarterly bank-wise NPL ratio also deteriorates the post-shock CAR significantly by 230bps.

In case of market risk that constitutes only 6.5 percent of banking sectors' risk profile, the market risk sensitivity stress shocks did not affected the banks' solvency profile as much as the credit risk shocks. The interest rate and equity price shocks have varying impact on CAR between 40 to 85 bps, while the exchange rate shocks had negligible impact on the CAR (**Figure 3.13**).

Figure 3.13

Market Risk Shocks



In addition to the conventional credit, market and liquidity shocks, the regulatory stress and inter-bank contagion shocks were also applied on the banks' portfolio and banks were found to survive in these stress events. Similarly, the liquidity shocks that consider sudden withdrawal of bank deposits and applying 20 percent haircut on the liquid assets (government securities) held with the banks to create stress on the liquidity coverage ratio also revealed the healthy liquidity profile even in stress environment.

Macroeconomic stress tests reveal worsening of macroeconomic outlook and further deterioration of the NPLR.

Box B: Market Risk Sensitivity Shocks

IR1: Parallel upward shift in the yield curve - increase in interest rates by 300 basis points along all the maturities.

IR2: Upward shift coupled with steepening of the yield curve by increasing the interest rates along 3m, 6m, 1y, 3y, 5y and 10years maturities equivalent to the maximum quarterly increase experienced during the last 3 years (July-08).

ER1: Depreciation of Pak Rupee exchange rate by 30%.

ER2: Depreciation of Pak Rupee exchange rate by 14.5% equivalent to the quarterly high depreciation of rupee against dollar experienced during the last 3 years.

EQ1: Fall in general equity prices by 41.4%

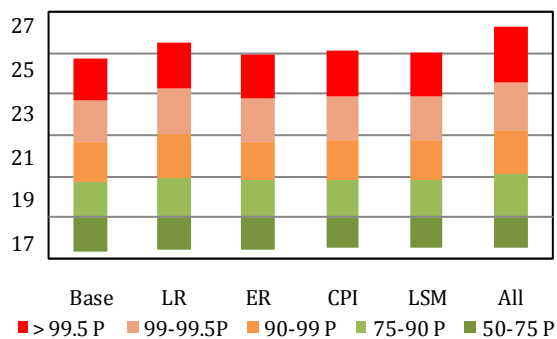
EQ2: Fall in general equity prices by 50%.

In addition to sensitivity based stress testing, the scenario or the macroeconomic stress testing of the credit risk also did not severely affected the banking sector performance on aggregate basis. Under the scenario analysis, the short-run (6 months) forecasts of macroeconomic indicators tends to worse-off and likewise the expected NPLR under the baseline case projected for H1-CY12 also deteriorated to 16.4 percent – an increase of 20bps over the NPLR of H2-CY11. However, it remained far below the critical infection ratio of 56.25 percent.

Under various scenarios of applying shocks to macroeconomic variables, the NPLR remained in the range of 16.6 to 27.7 percent at different percentile levels (**Figure 3.14**). For instance, the exchange rate shock did not severely affect the NPLR due to its weak relationship with infection ratio. While, the shocks applied to inflation and Large Scale manufacturing Index (LSM) did affect the NPLR under stress scenarios. Under the LSM shock, the average NPLR deteriorated to 17.2 percent (50th percentile) and

Figure 3.14

Simulated NPLR at Percentiles

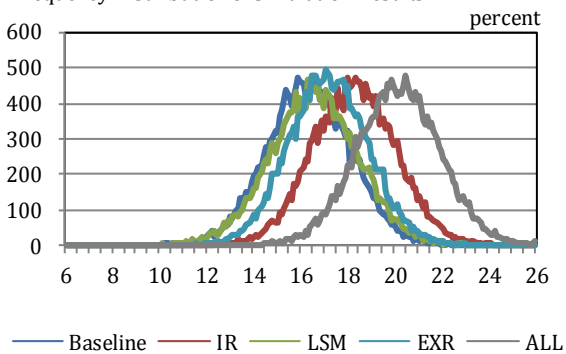


in worst case scenario (All), it further deteriorated to 21.7 percent at 99.5 percentile.

The simulations of various macroeconomic shocks also highlight the worsening trend of the NPLR under different scenarios. If all macroeconomic shocks are applied simultaneously, the resulting stressed simulations will significantly deviate from the baseline (no shock) scenario (**Figure 3.15**).

Figure 3.15

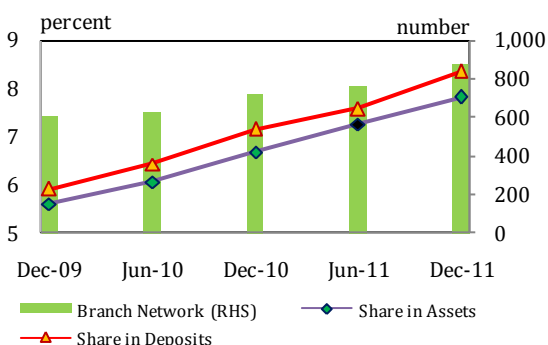
Frequency Distribution of Simulation Results



Islamic Banking is gaining systemic importance. As of 31-Dec-2011, total assets of Islamic banking institutions (IBIs) exceed those of 5th largest bank and are more than 4 times of the total assets DFIs. Similarly in terms of deposits, IBIs rank ahead of the 4th largest bank. Double digit growth rates persists, with substantial portion of the addition to assets channeled towards government securities, however, growth in financing remained subdued. On average, IBIs are more solvent and liquid though a little less profitable than rest of the banking sector. Asset quality marginally deteriorated during the period under review but still remains considerably better than that of conventional banks. Due to reliance on mark-up based, lease & mortgage type financing reputational risk remain high in IBIs that can pose significant challenge to the future growth prospects of the industry.

Figure 4.1

Share and Network of Islamic Banking



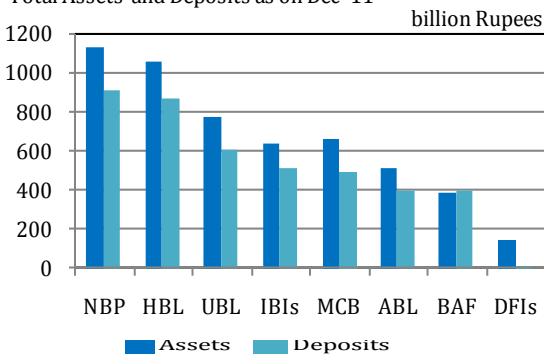
Boom continues despite diminishing base effect...

From modest beginnings in 2002, Islamic banking now accounts for 7.8 percent of the assets and 8.3 percent of the deposits of the banking sector (**Figure 4.1**). Despite diminishing base effect, the decade long strong growth of Islamic banking remained robust during the period under review as the assets and deposits of Islamic Banking Institutions (IBIs) surged by 14 and 15 percent respectively during H2-CY11 while registering year on year growth of 34 percent each. This compares well to the 10 percent growth in the global Islamic finance industry²⁸. With Rs641 billion of total assets and Rs521 billion in deposits, total assets of IBIs were approaching those of the fourth largest bank and deposits surpassed those of the fourth largest banks by the end of H2-CY11 (**Figure 4.2**).

...and so does the risk aversion

Figure 4.2

Total Assets and Deposits as on Dec-11



Due to the muted demand for bank credit from the private sector and banks' lowered risk appetite considering the opportunity to lend to the government at attractive rates, the trend of funneling new deposits to the safer havens of investment in sovereign securities continued during the period under review albeit to a lesser extent compared to the previous half year. New issuance of Government of Pakistan Ijara Sukuk in December 2011 enabled IBIs to channel another Rs30.7 billion or 38 percent of their incremental assets towards investment in government securities. On the other hand, growth in financing remained subdued with net financing increasing by a meager 6 percent (4.6 percent in H1-CY11) compared to 19 percent (46.6 percent during H1-CY11) growth in net investments during H2-CY11 (**Table 4.1**).

²⁸ Global Islamic Finance Report, 2011.

Table 4.1: Growth of Islamic Banking

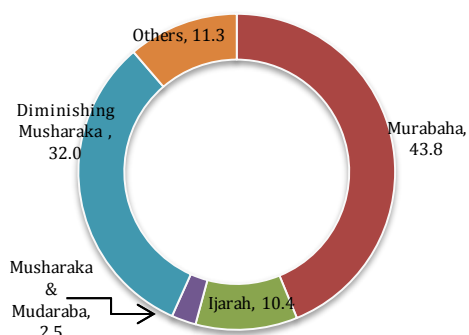
	billion Rupees					All Banks Dec-11
	Dec-09	Jun-10	Dec-10	Jun-11	Dec-11	
Total Assets	366.3	411.1	477.0	560.5	641.0	8,170.8
Investments (net)	72.2	78.0	157.8	231.3	274.3	3,054.9
Financing (net)	153.5	157.5	180.4	188.6	200.2	3,349.2
Deposits	282.6	329.8	390.1	452.1	521.0	6,243.6
	percent change					
	Dec-09	Jun-10	Dec-10	Jun-11	Dec-11	
Total Assets	17.0	12.2	16.0	17.5	14.4	5.9
Investments (net)	34.9	8.0	102.3	46.6	18.6	16.6
Financing (net)	9.4	2.6	14.5	4.6	6.2	(1.0)
Deposits	18.7	16.7	18.3	15.9	15.2	4.7

The slow growth in financing portfolio is however understandable given the significantly lower demand from the private sector caused largely by the continued energy crisis, and uncertain business and economic conditions. As the issues like energy crisis are likely to take some time in their resolution, any major boost in demand for credit from private sector is unlikely in the near future. The government has plans to issue additional Ijarah sukuk of Rs75 billion in H1-2012²⁹ and thus IBIs would have adequate supply of additional government securities to invest in commercially attractive sovereign securities.

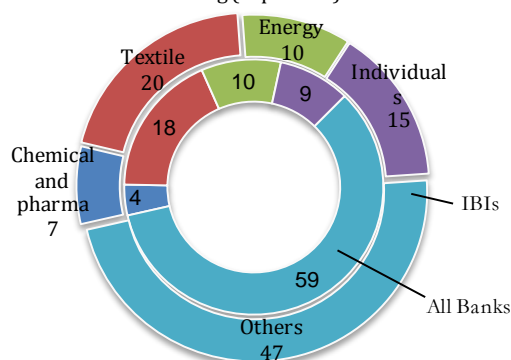
Trade based modes like Murabaha remain the dominant mode of financing...

Figure 4.3

Financing Mix (in percent)

**Figure 4.4**

Concentration of Financing (in percent)



As elsewhere³⁰, the trade based modes of financing have dominance in IBIs financing portfolio in Pakistan. This trend continues during the period under review with 89 percent of the financing under Murabaha, Diminishing Muharakah or Ijarah (**Figure 4.3**). Although, most of the Shariah advisors' reports have been emphasizing the need for Islamic Banks to switch to the profit and loss sharing (PLS) modes of financing, however, issues like moral hazard, weak contract enforcement mechanism and low demand of such products from reputed businesses and individuals will have to be addressed to see any significant improvement in such modes of financing. Encouragingly, Musharaka based transactions with reputed corporate clients having well established verifiable cash flows and good corporate governance practices and track record has started taking place, which may gradually improve the comfort level of bankers and business community in participatory modes of financing and thus may translate into gradual buildup and improvement of such financing in IBIs' financing portfolio over medium to long term.

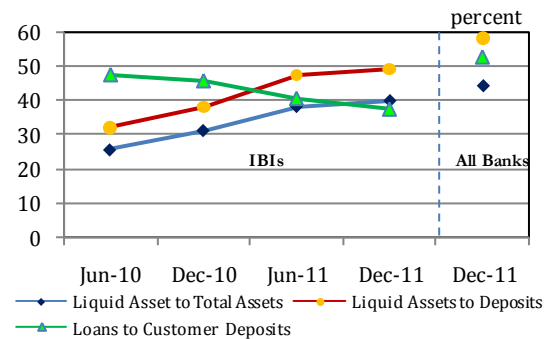
A major portion of IBIs financing representing 73 percent of the total financing portfolio goes to the corporate sector whereas SMEs share remains a meager 5 percent. Most of the corporate financing was extended to energy, electronics, Agribusiness, Textile, and chemicals sectors (**Figure 4.4**). Substantial portion of the finance representing 45 percent of the increase was extended to various sectors for meeting their working capital needs. Salam and Istisna saw a joint increase of 33% for meeting the trade finance related needs of textile, agribusiness and electronics sectors.

²⁹ Government exceeded this target and by the end of June 2012 issued about Rs116.5 billion of Ijarah Sukuk

³⁰ See for example, Chong, B. S. and M. Liu (2009) "Islamic banking: Interest-free or interest-based?", Pacific-Basin Finance Journal and F. Khan(2010) "How Islamic' is Islamic Banking?", Journal of Economic Behavior and Organization

Figure 4.5

Liquidity Ratios



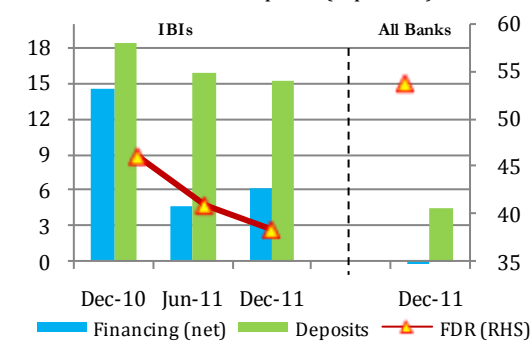
Segment analysis shows that Agriculture financing still remains the neglected area and represents only 0.1 percent share in overall financing. SBP cognizant of the need for enhancing Islamic mode based agri-finance is encouraging IBIs to increase their penetration in smaller towns and semi urban areas. Further, the recently issued standard Salam based product³¹ is also likely to facilitate IBIs in improving their agri-finance portfolio.

IBIs maintain comfortable level of liquidity as FDR further slides...

As a result of low credit demand from the private sector and continued borrowing by the government at attractive rates, IBI's incremental lending to the private sector remained muted, despite sufficient availability of funds. Consequently, liquidity ratios continued to improve during H2-CY11, with liquid asset to total assets and liquid assets to deposits ratios reaching 40 percent and 49.3 percent respectively at the end of H2-CY11, thereby approaching the liquidity indicators of the rest of the banking sector (**Figure 4.5**). During H2-CY11, Financing-to-Deposit ratio (FDR) of IBIs further plunged to 37.8 percent, compared to 52.7 percent for the entire banking sector (**Figure 4.6**).

Figure 4.6

Growth in Advances and Deposits (in percent)



On the liquidity front, last year and a half has seen relatively frequent issues of large sized shariah compliant low-risk Government of Pakistan Ijarah sukuks. However, limited liquidity management instruments, lack of a deep and liquid Islamic financial market and absence of lender of last resort facility for IBIs remain key issues that need to be addressed on priority basis. To this end SBP is working for development of a comprehensive liquidity management solution that might include i) development of Islamic interbank money market; ii) development of Islamic Interbank Offered Rate (IIBOR) for use as a benchmark for pricing of Islamic finance products; iii) transformation of a sizeable portion of conventional sovereign debt in the books of central bank into Shariah compliant debt, iv) allowing IBIs to place surplus liquidity with the central bank to be remunerated based on the central bank's earnings on Shariah complaint assets and investment portfolio, and v) lender of last resort facility for IBIs.

³¹ AC&MFD Circular No. 03 of 2011, Oct 18, 2011.

Table 4.2: Asset Quality

	In percent			
	IBIs		All Banks	
	Dec-10	Jun-11	Dec-11	Dec-11
NPF to Financing	7.3	7.5	7.6	15.7
Net NPF to Financing	3.2	3.2	2.9	5.4
Provisions to NPFs	58.6	60.0	63.0	69.3
Net NPFs to Total Capital	12.3	11.6	10.5	23.1

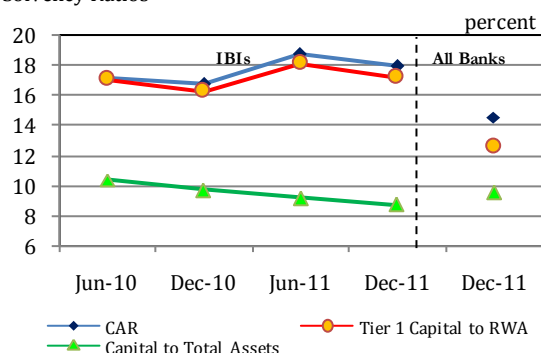
	IBIs		IBBs	
	Jun-11	Dec-11	Jun-11	Dec-11
NPF to Financing	9.6	9.0	4.1	4.9
Net NPF to Financing	3.7	3.0	2.2	2.9
Provisions to NPFs	63.4	68.9	46.7	42.6
Net NPFs to Total Capital	12.0	10.3	10.6	10.9

NPFs (billion Rs.)	11.7	11.8	2.1	3.0
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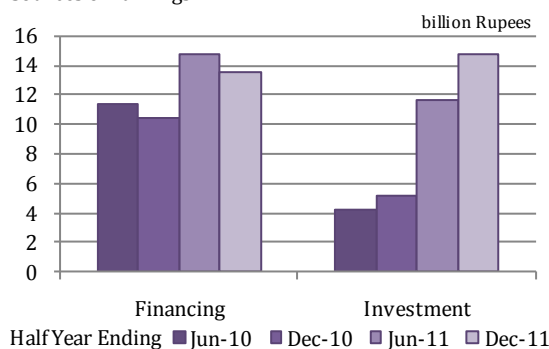
IBIs=Islamic Banks, IBBs = Islamic Banking Branches, IBIs = IBs+IBBs

Figure 4.7

Solvency Ratios

**Figure 4.8**

Sources of Earnings



Asset quality marginally deteriorates...

The Non Performing Financing (NPFs) of IBIs continued to pile up and the infection ratios marginally deteriorated during the period under review (**Table 4.2**). During H2-CY11, IBIs accumulated another Rs1.1 billion in NPFs (Rs3 billion during H2-CY10), with most of the increase contributed by Islamic Banking Branches (IBBs). However, asset quality indicators remained relatively better than those of conventional banks reflecting their ability to better manage credit risk..

... but damage is contained and adequate cushion is available to absorb unanticipated losses

Almost 69 percent of the NPFs of IBIs are in the loss category and are therefore adequately provided for. The provisions coverage ratio further improved to 63 percent and capital at risk (Net NPFs to Total Capital) of IBIs dropped by 110 bps to 10.5 percent (Net NPLs to Total Capital of conventional banks is in the north of 20 percent) over the review period (**Table 4.2**). The solvency of the IBIs saw a decline with CAR declining by 78 bps to 17.95 percent as of H2-CY11, mainly due to increase in credit risk weighted assets (**Figure 4.7**). The CAR well above the benchmark rate suggests (a) relatively low leveraging of capital by IBIs, (b) significantly larger investment in low risk government securities and well rated corporates, and (c) availability of sufficient cushions with IBIs to absorb unanticipated losses.

The shift to investment in government securities pays off as profitability is maintained despite increase in NPLs...

IBIs witnessed healthy growth in earnings at the back of improved income from investments in high yielding sukuks, lower provisions against NPF and improved dividend income (**Figure 4.8**). As a result, profit before tax quadrupled over the year to Rs10.6 billion, which supported the ROA and ROE of the IBIs. The efficiency of IBIs' use of resources did not change much during the period under review as operating expenses to gross income ratio decreased marginally to 60.4 percent during H2-CY11 from 60.9 percent during H1-CY11 (**Table 4.3**).

Table 4.3: Earnings

	In percent			
	IBIs			All Banks
	Dec-10	Jun-11	Dec-11	Dec-11
Return on Assets	0.6	2.0	1.9	2.2
Return on Equity	5.9	20.7	20.8	23.4
Operating Expenses to Gross Income	72.6	60.9	60.4	62.3

Profit before tax is used in all calculations

Profit and Loss distribution mechanism still needs to be streamlined

IBIs are contractually obliged to share profits and losses with the PLS depositors. However, their profit and loss computation and distribution policies and practices lack standardization. Taking cognizance of this reputational risk, the SBP is in the process of developing a standardized framework in consultation with the industry which is likely to be introduced and enforced during H2-CY12. The standardized framework is expected to improve transparency in the profit computation and distribution policies and practices and thus would improve public confidence in Islamic banking generally and profit distribution mechanism particularly.

Box 4.1

Business Model, Stability, Asset Quality and Efficiency of Conventional and Islamic Banking Institutions in Pakistan³²

The proponents of Islamic finance argue that financial intermediation based on Islamic principles would bring in greater stability in domestic economy, financial markets and even in international economy. [Siddiqi (2006); Zaher and Hassan (2001); Nigel (1998); El-Gamal (2000)]. There is, however, a general lack of academic studies to empirically test this hypothesis. Employing z-scores to test the relative strength of banks in 18 countries from 1993-2004, Čihák and Hesse (2010) find that small Islamic banks are financially stronger than small and large commercial banks, whereas, large Islamic banks are weaker than large commercial banks. They attribute their findings to the issues of credit risk management, in large Islamic banks, related to financing based on Profit and Loss Sharing (PLS) arrangements. However, PLS based financing form a very small part of the overall credit portfolio of Islamic banks. In a broader study covering 141 countries over the period 1995-2007, Beck, Demirgüç-Kunt et al. (2010) compare the business model, efficiency, asset quality and stability of the Islamic banks and conventional banks employing a group of indicators from their balance sheets and income statements. They note that Islamic banks are better capitalized but they do not find significant differences between the business model, efficiency, asset quality or stability of Islamic and conventional banks. Using loan level data of Pakistan banking sector from 2006 to 2008, Baele, Farooq et al. (2010) find that as compared to conventional loans, on average Islamic loans are less likely to default. These papers suggest that the structure of banking sector and the size and organization of Islamic banks may influence the health of Islamic banks.

In this study we investigate how in Pakistan, Islamic banking in practice is different from conventional banking in terms of business orientation, efficiency, asset quality and stability where both types of banking systems coexist. Our findings suggest that there is a significant difference in business model of Islamic and conventional banking institutions, measured by non-deposit funding to total funding and gross loans to total assets ratios. In profitability (return on assets) and asset quality comparison, Islamic banking institutions (IBIs), comprising exclusive Islamic banks (IBs) and Islamic banking branches (IBBs) of dual banks, perform better than conventional banking institutions (CBIs) that include exclusive conventional banks (CBs) and conventional banking branches (CBBs) of dual banks.

Data and Methodology

For this study we use the quarterly data of individual banks which they submit to the SBP for regulatory purpose, therefore, it is more precise, and standardized and comprehensive than those used in other studies. The dataset contains detailed information on the balance sheet and income statement of the banks. It provides us enough information to construct the indicators of business model, efficiency, asset quality and stability for comparison of the Islamic banking and conventional banking.

In Pakistan conventional and Islamic banks coexist with some full-ledged Islamic banks, some full-fledged conventional banks and some bank that are engaged in both Islamic and conventional operations as the regulatory framework of the country has the provision for conventional banks to open standalone Islamic branches. Our dataset, therefore, allows us to decipher how Islamic and conventional operations within same bank differ in terms of their business model, efficiency, asset quality, profitability and stability. The dataset

Table 1: Descriptive Statistics: All Banks

	Obs	Mean	Std. Dev.	IBIs	Conv. banks
Non Interest Income to Total Income	1417	17.73	13.30	9.84	20.23***
Non-Deposit Funding to Total Funding	1423	22.46	24.87	16.03	24.51***
Gross Loans to Total Assets	1423	52.61	22.23	49.68	51.23
Z-SCORE	1423	15.55	18.94	19.56	14.16***
Return on Assets	1423	0.53	1.58	1.08	0.32***
Capital-Asset Ratio	1423	9.88	45.47	19.47	5.85***
NPLs to total Loans	1367	13.89	22.24	1.61	23.52***
Provisioning to gross Loans	1369	9.92	18.34	0.78	8.04***
Cost Income Ratio	1417	87.73	52.92	90.67	85.38
Operating Cost to Total Cost	1389	47.14	20.08	42.91	46.55***
Bank Level Controls					
Size	1423	10.00	1.91	7.99	10.61***
Non-Loan Earning Assets to Total Assets	1423	52.19	18.99	44.16	54.42***
Fixed Assets to Total Assets	1423	2.98	3.93	3.43	2.75***

***, **, * significant at 1%, 5% and 10% respectively

³² This section is based on Farooq, Moazzam and Sajjad Zaheer (2012), "Business Model, Stability, Asset Quality and Efficiency of Conventional and Islamic Banking Institutions: Evidence from an Emerging Economy", Working Paper.

covers accounts of 23 conventional banks (CBs), 5 exclusive Islamic banks (IBs) and 12 dual banks with both Islamic as well as conventional operations for 32 quarters starting from June 2002 to March 2010. Following the convention in Pakistan, we name the Islamic branches of dual banks as Islamic banking branches (IBBs) and their conventional branches as conventional banking branches (CBBs). Both IBBs and exclusive Islamic banks (IBs) form the Islamic banking institutions (IBIs). **Table 1** shows descriptive statistics of the main variables for IBIs and conventional banks.

For business model we compare asset portfolio of Islamic and conventional banks using loan³³ to total assets ratio. In our sample, gross loans to assets ratio is on average 53 percent with standard deviation of 22 percent. This ratio for IBIs is lower than that for conventional banks; however, the difference between the two is not significant.

As expected, IBIs rely less on non-deposit funding due to limited market based funding options, which is evident from their lower non-deposit funding to total funding ratio as compared to that of conventional banks. Moreover, average of non-interest/markup income to total income for IBIs is 9.84 percent against industry's figure of 17.73 owing to their relatively new presence and smaller size and network on average. We use Z-scores to compare the stability of the Islamic banks and conventional banks. Z-score is an increasingly used measure of bank soundness. Bank insolvency is defined as a state where $(CAR + ROA) \leq 0$, with CAR being the bank's capital-asset ratio and ROA its return on assets, or equally when losses exceed equity (Roy, 1952; Hannan and Henwick, 1988; Boyd, Graham and Hewitt, 1993; and De Nicolo, 2000). Z-score is constructed as the sum of the mean rate of return on assets (μ) and the mean equity-to-assets ratio (k) divided by the standard deviation of the return on assets (σ) i.e. $z\text{-score} = \frac{\mu + k}{\sigma}$. It measures the risk of insolvency or distance to default.

The sample data shows that Z-score of Islamic banks is on average higher than that of conventional banks, meaning that IBIs are on average more stable than their conventional counterparts. Both better capitalization³⁴ and higher returns on assets (ROA) contribute to the stability of the IBIs over conventional banks. We use non-performing loans (NPLs) to gross loans and provisioning to gross loans to compare the asset qualities of both the banking systems. NPLs and provisioning of IBIs are lower than those of conventional banking institutions, indicating a better asset quality. The indicators of efficiency show that on average cost-income ratio of IBIs is higher than that of the conventional banks, although their overheads, as measured by operating cost to total cost, are lower. The correlation between variables did not pose any estimation challenge and the correlation matrix is not reported here.

Econometric Specification

To evaluate difference in various banking indicators of business model, efficiency, asset quality, and stability across both bank types in our data, we estimate the following regressions:

$$M_{it} = \alpha + \beta I_i + \gamma_1 B_{it} + \gamma_2 T_t + \varepsilon_{i,t} \quad (1)$$

Where M is one of the measures corresponding to business model, asset quality, stability and efficiency of bank in quarter t. I is the dummy for Islamic banking institutions, which includes both IBBs and IBs. B is time changing bank characteristics and T represents time fixed effects. To compare Islamic banking operations with conventional banking operations within same bank we use bank fixed effects.

We first estimate the equation (1) with an intercept and dummy for IBIs without any covariates, for the whole sample. We then progressively control the results for an array of bank-level time variant features which might affect the differences across bank due to bank type. Our control variables include bank's size, proxied by log of assets, as larger banks may be more efficient due to economies of scale, could have more access to wholesale funding and might generate more fee based income. There is however no definite relationship between bank size and stability (Beck, Demirgüç-Kunt et al. (2010). Most of the Islamic banks in Pakistan are in small to medium size bank categories, whereas to tap the market few big conventional banks also introduced Islamic banking

³³ For IBIs the term 'loan' refers to any type of financing provided using Islamic modes of financing and markup refers to the profit earned on the sale of or leasing out an asset.

³⁴ IBIs are relatively younger than conventional banks, therefore, overall leveraging of their capital is lower than that of conventional banks.

operations through IBBs. We also include fixed assets to total assets ratio and non-loan earning assets to total assets ratio to control for the opportunity cost of having unproductive assets and non-lending business respectively. Moreover, we also split the dummy for IBIs into dummy for Islamic banks (IBs) and Islamic banking branches (IBBs), to see the corresponding difference from CBIs. To remove the outliers data is winsorized for all variables at the 1st and 99th percentiles. For robustness all specifications are also estimated with original data without winsorizing it, the results remain robust to this alternative treatment and are not reported here.

Results:

Table 2, shows results of specification (1) for various indicators of stability and asset quality of Islamic and conventional banking operations. According to the results, there is a significant difference between stability and asset quality of the IBIs and CBIs. IBIs fare better than CBIs in non-performing loans and provisioning to gross loans. Findings about asset quality of the banks are also endorsed by the study of Baele, Farooq et al. (2010) that employs loan level data from Pakistan from 2006 to 2008. Provisioning to gross loans ratio is significantly lower for IBIs owing to the lower level of non-performing loans. Return on assets of IBIs is also statistically and economically higher than that of CBIs. Similarly, asset quality indicators of IBIs depict better position than that of CBIs. Differences in both of these indicators across IBIs and conventional banks are economically relevant as well.

Table 2 Results of Specification (1) for Stability and Asset Quality					
	Stability			Asset Quality	
	Z-Score	ROA	CAR	Provisions to Gross Loans	NPLs to Gross Loans
C	17.69	-2.65**	11.51	30.59**	48.61**
Islamic	2.06	7.12***	57.40	-37.72**	-56.68*
Size	-1.17	0.27***	-0.13	-3.07**	-4.24**
Fixed Assets to Total Asset	0.02	-0.06*	0.84	0.18	0.73**
Non-loan Earning Assets to Total Earning Assets	0.17	0.00	-0.11	0.26**	0.22*
Islamic * size	0.08	-0.67***	-5.49	2.64*	4.14**

***, **, * significant at 1%, 5% and 10% respectively

Results of specification (1) for various indicators of business model and efficiency are presented in **Table 3**. The results show significant differences between IBIs and CBIs on various measures of business model and efficiency. Non-interest/markup income of IBIs is significantly lower than those of conventional banks and, IBIs rely less on non-deposit sources for their funding needs than their conventional counterparts do, indicating differences in the business models of IBIs and CBIs. The proportion of financing in total assets of IBIs and CBIs also differ, however this difference is not statistically significant.

The IBIs however appear to be relatively less efficient as exhibited by their higher operating cost to total cost ratio that originates from redundancies in their contracts. Apriori this is an expected result due to the presence of relatively younger IBIs with higher establishment related costs in the initial years and a need to spend more to gain attraction and compete with the relatively mature conventional banks with established brands, clientele and systems. Another reason for this difference could be relative strength of conventional banks to harness efficiency from economies of scale and scope that might not be available to relatively younger Islamic banks³⁵.

The data also provide us the opportunity to use bank fixed effects, since we have some banks which are doing Islamic and conventional banking simultaneously. The unreported results show a significant difference between IBBs and CBBs in some indicators of stability, asset quality and efficiency but no difference between the business orientation of IBBs and CBBs.

³⁵ Farooq, M. (2011), "Literature Survey and Anatomy of Islamic Banking", Working Paper.

Conclusion:

In this section we investigate how Islamic banking institutions are different from conventional banking institutions in terms of business orientation, efficiency, asset quality and stability in Pakistan. The results suggest that, once we control for bank level characteristics, there is significant difference in business model of Islamic and conventional banks. Also, Islamic banking institutions (IBIs) performed better than conventional banking profitability and asset quality during the last decade. Specifically, non-performing loans and provisioning to gross loans ratios of IBIs are lower than the same indicators of conventional banks. Islamic bank also rely less on non-deposit funding suggesting that they

are more involve in core banking business. However, their asset portfolio shows that they have lower loans to total asset ratio than that of conventional banks. On the other hand, we do not find any significant difference in efficiency between Islamic and conventional banking in our main specification.

Table 3 Results of Specification (1) for Business Model and Efficiency

	Business Model			Efficiency	
	Non-interest Income to Total Income	Non Deposit Funding to Total Funding	Gross Loans to total assets	Cost to Income	Ops. Cost to Total Cost
C	13.70	128.82***	127.29***	150.48***	21.92
Islamic	-20.76*	-82.71***	-36.34	-35.86	43.53**
Size	0.22	-8.08***	-2.52	-8.92***	0.48
Fixed Assets to Total Asset	-0.10	0.22	-0.59	2.86***	1.45***
Non-loan Earning Assets to Total Earning Assets	0.07*	-0.35*	-0.85	0.42**	0.27***
Islamic*Size	1.68	6.38***	2.83	2.66	-4.23**

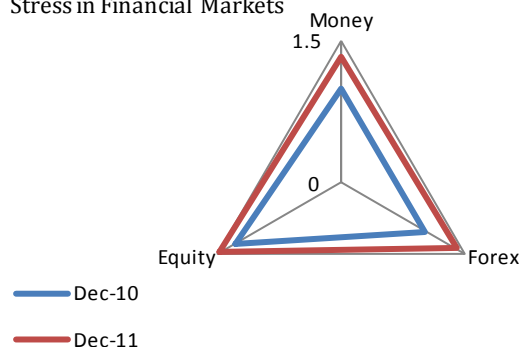
***, **, * significant at 1%, 5% and 10% respectively

The second half of 2011 represents a stressful condition of the domestic financial markets as the macro-economy further weakens due to rising twin deficits. The money market liquidity showed stress as the central bank injected substantial liquidity in the banking system and yet the banks still providing the government an avenue to monetize its deficit. Similarly, adverse developments in the current account depreciated the USD/PKR parity by 4.6 percent while the import coverage ratio dropped as foreign exchange reserves depleted. Similarly, the equity market remained bearish as its benchmark index lost 9.2 percent and portfolio investment observed net outflow. Further, in line with general economic environment, listings in the equity and debt market remained low in H2CY11.

Financial markets remained under stress as economy further drowned into twin deficit.

Figure 5.1

Stress in Financial Markets



The key indicators of the financial markets exhibited a rising degree of pressure as soaring fiscal and current account deficits further dampened the economic growth. The stressed money market, depreciating exchange rate and bearish equity market contributed to strains in the financial markets (**Figure 5.1**).

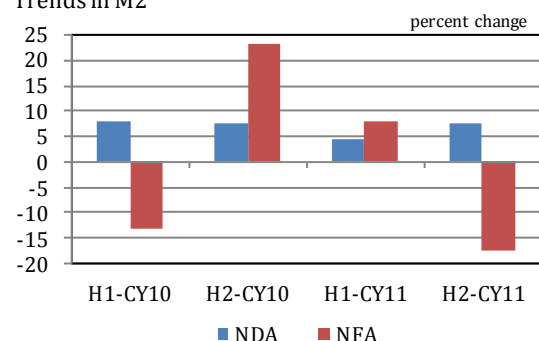
Despite monetary easing by 200 bps to 12 percent in H2-CY11, the short-term interest rate volatility remained high due to unpredictable yet persistent government borrowing from the banking system³⁶. Similarly, the uncertain financial inflows and widening of external account deficit in H2-CY11 also posed pressure on the USD/PKR exchange rate that depreciated by 4.6 percent during the period. Moreover, the uncertain political and social landscape coupled with unfavorable economic circumstances adversely affected the equity markets as the KSE-100 index which depleted by 9.2 percent during H2-CY11.

Liquidity stress in the money market further exacerbated in the last quarter....

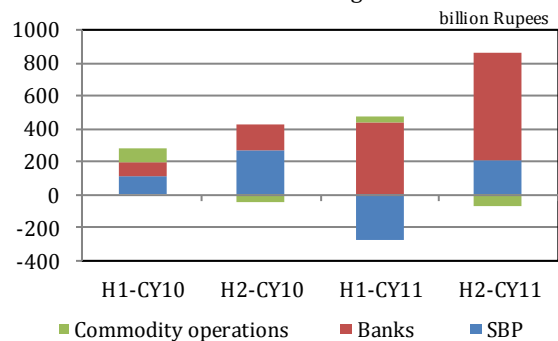
The developments in the financial markets also reflected in the skewed trend of the M2 growth (**Figure 5.2**). The mild liquidity strain that was felt in first half of 2011 and was largely contained by the Net Foreign Assets (NFA) reversed in the second half of CY11. Despite an increasing influx of remittances, the external account deficit increased mainly due to increasing oil import bill and

Figure 5.2

Trends in M2



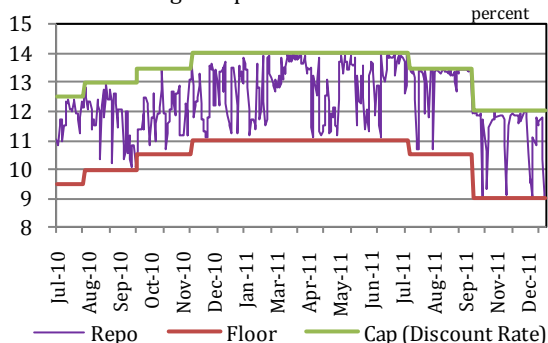
³⁶ The surge in government borrowings in second half was also due to partial settlement of the circular debt of Rs390.7 billion.

Figure 5.3**Pattern of Government Borrowings**

fertilizer imports, decline in portfolio investments and uncertainty regarding other financial inflows. As a result, the NFA declined drastically by 18 percent during H2-CY11 making the liquidity management a challenging proposition.

Similarly, in contrast to the first half, the second half of 2011 witnessed revival of monetization of fiscal deficit, in addition to continued government borrowing from the commercial banks. As a result, the Net Domestic Assets (NDA) grew by 9 percent as banks catered to increasing borrowing needs of the government (**Figure 5.3**).

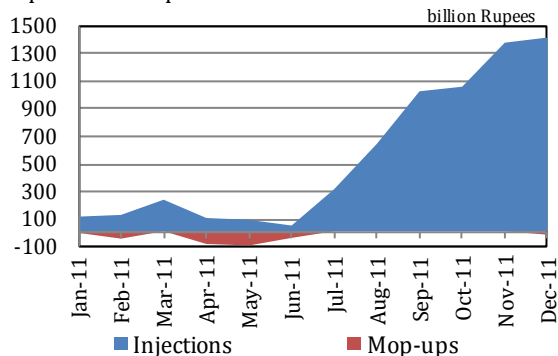
In wake of the above and rising Government's demand for credit, market liquidity remained stressed in the last quarter of CY11. Further, sluggish 4.6 percent growth in banks' deposits during second half as against 9.5 percent in the first half was not sufficient to meet the persistent public sector demand, let alone the private sector borrowers³⁷. Consequently, the short term overnight repo rates not only became more volatile but also remained largely close to the discount rate, particularly in the 4th quarter of CY11, reflecting the increased liquidity demand (**Figure 5.4**).

Figure 5.4**Trend of overnight Repo Rates**

Central bank increased liquidity through substantial open market operations (OMOs)

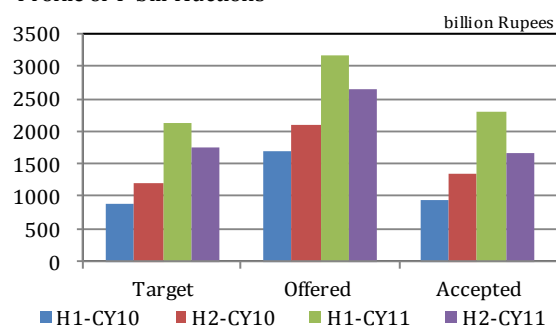
These liquidity shortages led banks increasingly approach the SBP discount window. To overcome the liquidity pressures, the central bank increased injection through frequent OMOs (**Figure 5.5**). However, as most of the bank funding continue to be channelized into Government securities, regular liquidity injection into the banking system tantamount to indirect monetization of debt.

Demand for longer tenor T-Bills remained high in expectation of cut in the policy rate...

Figure 5.5**Open Market Operations**

Analysis of the primary auctions of government securities reveals obvious trend; that banks' continued increased participation in T-bill auctions during the period under review. Owing to increasing credit risk, banks prefer to place the loanable pool of funds in risk-free government securities at relatively attractive interest rates. Hence, not only did the banks participate in high yielding and yet risk free short term government bills. Banks eagerness to invest in T-bills was visible from high offer ratio (i.e. ratio of offered amount

³⁷ The stock of bank deposits increased by Rs273 billion during the second half while the public sector lending increased to Rs654 billion.

Figure 5.6**Profile of T-bill Auctions**

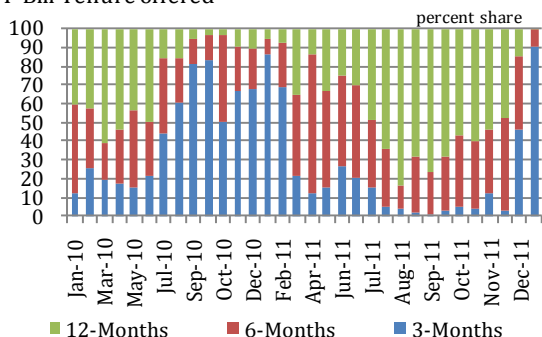
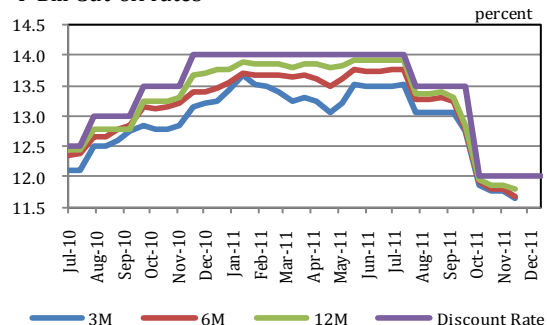
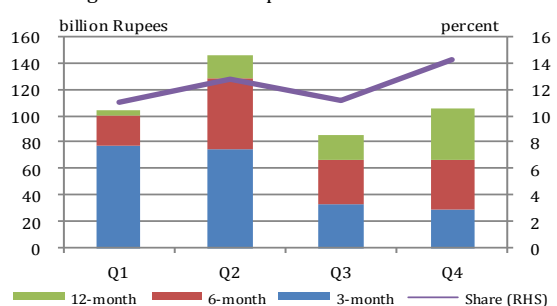
to target amount) of 150 percent during the period, though the acceptance ratio (i.e. ratio of accepted amount to target amount) remained stagnant to 100 percent (**Figure 5.6**).

Banks' preference to invest in longer-tenor T-bills started to emerge as policy rate was slashed by 50 bps in July 2011. The participation in 12-month T-bills remained above 60 percent of the total amount offered during most of the H2-CY11 due to expectations of a further cut in policy rate. The expectations further strengthened after a 150 bps discount rate cut in October 2011, consistent with the declining inflation rate (**Figure 5.7**). However, banks appetite for the government papers actually dried up by end of the year as bids made were far below the target and the government was unable to rollover the maturing T-bills. Eventually, the accepted T-bills (Rs1,690 billion) fell short of the government target of Rs1,775 billion in H2CY11.

The cut-off rates reveal the preferences of the borrowers and lenders. Consistent with the offering pattern, the 12-month cut-off rate remained close to the discount rate and rather less volatile than the 3-month rate. With the gradual cut in discount rate, the T-bills rate also followed the same path while the 3-month rate was more responsive to rate cuts as banks opted for longer maturities (**Figure 5.8**).

The share of NCBs increased in overall participation

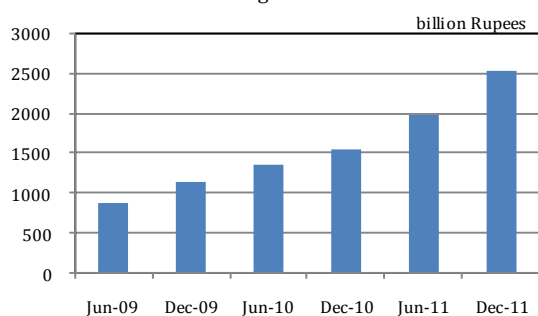
In addition to banks and other financial institutions, households and businesses also participate in the MTB / PIB auctions through Investor Portfolio Securities (IPS) accounts maintained with banks. The measure aims at diversifying investors' base in government auctions, along with instilling competition in the bidding process and encouraging small investors to invest in government securities. Under this approach, banks submit non-competitive bids (NCB)³⁸ on behalf of interested investors for consideration in the auctions. As a result, participation of institutions and individuals in T-bills auctions increased over the year. During CY11, the share of NCBs accepted towards total acceptance has increased from 11.1 percent during Q1-CY11 to 14.3 percent in Q4-CY11 (**Figure 5.9**).

Figure 5.7**T-Bill Tenure offered****Figure 5.8****T-Bill Cut-off rates****Figure 5.9****Growing share of Non-Competitive Bids in CY11**

³⁸ SBP increased the ratio of Non- Competitive Bids (NCB) from 10 percent in Jul FY03 to 15 percent in July FY10.

Figure 5.10

Stock of T-bills outstanding

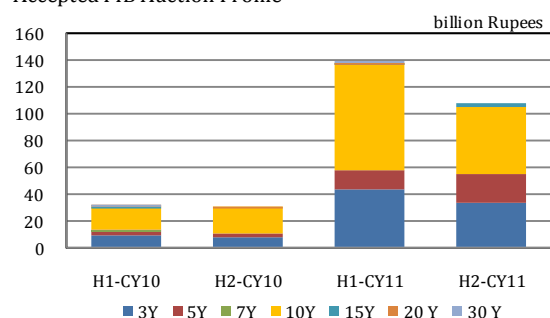


Increasing investments in T-Bills squeezed the flow of banks' credit to private sector

With increasing investment of commercial banks in government securities, the maturing amount of T-bills has been growing by more than 60 percent per year since FY09 (**Figure 5.10**). Against required rollover of Rs 1.5 trillion T-bills in CY10, the amount increased to Rs 2.5 trillion in CY11. The sharp rise has implications not just for the fiscal account, but also for the private sector as higher rollovers served to squeeze the available liquidity for the private sector.

Figure 5.11

Accepted PIB Auction Profile

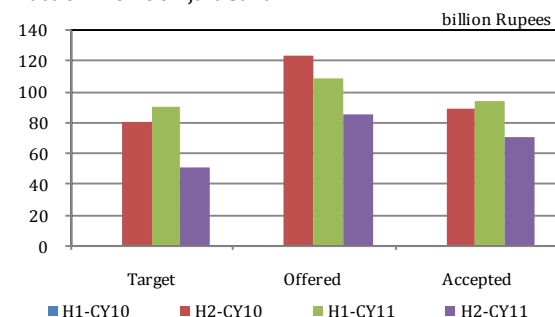


Banks' interest in PIBs off-set by rate cut and liquidity constraints

The regular auction profile of the PIBs exhibited declining trend of banks' investment in longer term maturities (**Figure 5.11**). Furthermore, the PIB auction offerings also reduced significantly in the second half of 2011 reflecting banks' concern for liquidity management and rate cuts.³⁹

Figure 5.12

Auction Profile of Ijara Sukuk

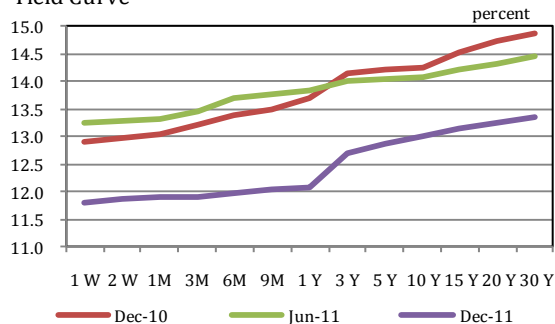


In terms of Islamic money market instruments, the floatation of a GoP Ijara Sukuk offering in H2-CY11 provided much needed investment instrument for the Islamic banks (**Figure 5.12**). The Government issued Ijara Sukuk of Rs 70 billion far in excess of the target of Rs 50 billion. Not only it helped government in generating funds for itself but it also helped the Islamic banks to invest excess liquidity and earn risk free return and improve their stability outlook.

Monetary stance shifted the yield curve downwards with steepening over medium to long term horizon.

Figure 5.13

Yield Curve

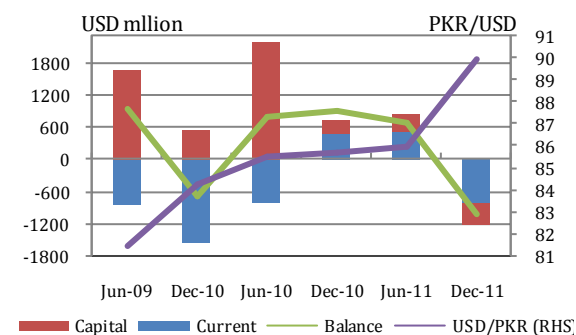


The 200 bps reduction in the discount rate impacted the overall interest rates as the Yield Curve shifted downwards. The short-term rates in expectations of the further rate cut flattened by end Dec-11 (**Figure 5.13**). While medium and long term part of the Yield curve steepened due to inflationary expectations and overall economic situation. Additionally, the government converted the inter circular corporate circular debt and subsidies on commodity finance through issuance of Government securities to the tune of Rs 391 billion including issuance of 50 percent PIBs of 5 year maturity. This increased supply of long-term government securities apparently declined banks' demand for additional securities, resulting in increase of the secondary market yields on these securities and steepening of the yield curve.

³⁹ The banks offered Rs232 billion for a target of Rs95 billion in the first half 2011 out of which Rs137 billion were accepted. Meanwhile, for a target of similar Rs95 billion, the banks offered Rs170 billion out of which Rs107 billion were accepted.

Figure 5.14

Developments in External Account

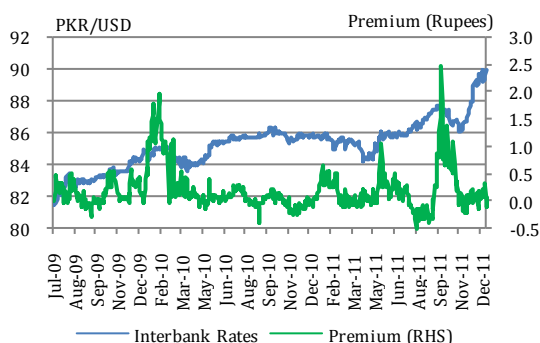


Stress prevailed in the foreign exchange market and on the domestic currency as external account deteriorated.

While central bank's operations kept the liquidity stress in the money market under check, the foreign exchange market faced stresses of its own –partially due to exogenous factors like rising international fuel and commodity prices, international investors' risk appetite, and uncertainties surrounding global economic recovery. In addition domestic business affected by prevailing energy shortages, and law and order situation also hampered exports that decelerated by 9.1 percent during H2-CY11 while imports increased by 9.3 percent (**Figure 5.14**).

Figure 5.15

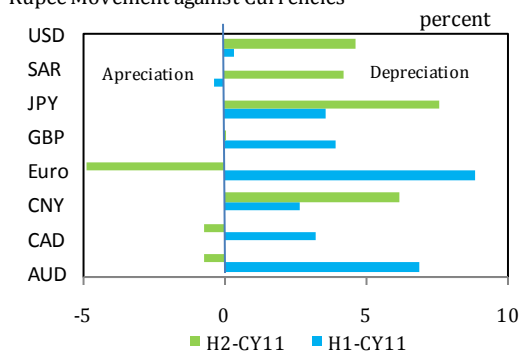
Exchange Rate and KERB Market Premium



As a result, the current account deficit surged to USD 2.3 billion in H2-CY11 against surplus in the corresponding period of the last year. The financial account flows also presented dismal picture. Foreign Direct Investment (FDI) declined by 36 percent, while foreign portfolio investment (FPI) turned negative. The developments in external account resulted in exerting pressure on the value of Pak rupee that depreciated by 4.62 percent against US Dollar in H2-2011, compared to marginal depreciation of 0.38 percent in the first half. Much of the depreciation took place in last two months of H2 on account of rising oil import payments.

Figure 5.16

Rupee Movement against Currencies

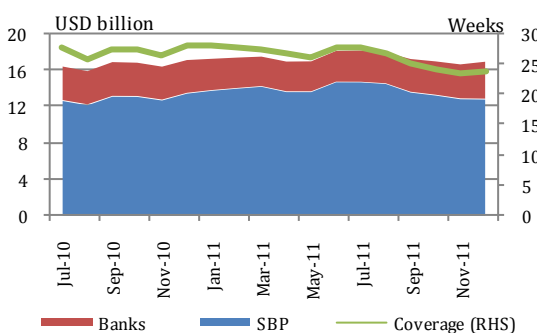


With the depreciation of Pak Rupee, the maximum KERB market premium (difference between exchange companies /market and interbank exchange rates) was Rs2.46 per US Dollar during H2-CY11 (**Figure 5.15**). This also led to a buying spree among the speculators in anticipation of further depreciation.

In addition to depreciation against the USD, Pak Rupee also depreciated against all other major currencies except Euro (**Figure 5.16**). As a result the NEER (Nominal Effective Exchange Rate) depreciated by 0.7 percent. However, the inflation adjusted Real Effective Exchange rate (REER) appreciated by 3 percent indicating a likely reduction in country's external competitiveness.

Figure 5.17

Foreign Exchange Reserves and Import Coverage



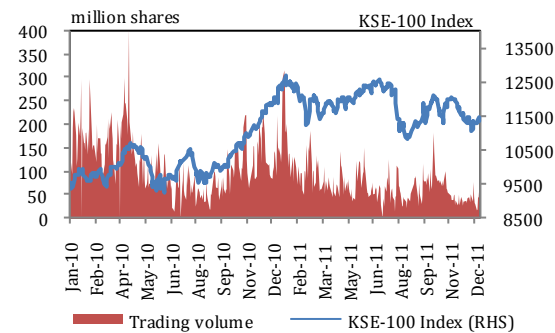
External account deficit kept pressure on FX reserves and on import coverage ratio

The external account deficit also depleted reserves held by the central bank by USD 1.9 billion in H2-CY11 as against an improvement of USD 1.2 billion in the first half. Accordingly, the import coverage also reduced to 24 weeks of import in H2 against 28 weeks in the H1 (**Figure 5.17**).

Downward pressure on Pak Rupee also led to an increase in the foreign currency deposits (FCD), held by commercial banks, by US

Figure 5.18

KSE-100 Index and Trading Volumes

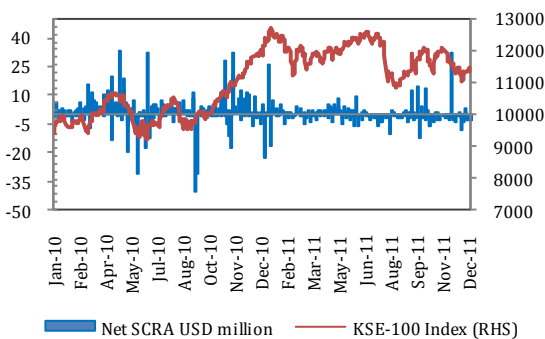
**Table 5.1: Profile of Capital Market**

	2009	2010	2011
Listed Companies	651	644	638
Listed Capital	814.5	919.2	1,048.4
Capitalization	2,705.9	3,268.9	2,945.8
GDP Ratio	23.6	23.7	17.9
KSE-100	9386.9	12022.5	11347.7
New Companies	4	6	4
New Equity Capital	8.8	33.4	16.0
New Debt	1	4	6
New Debt Capital	3.0	5.7	14.8

Listed Capital, Capitalization, New Equity Capital and New Debt Capital are in Rs. Billions. GDP Ratio in percent and Equity volume in million shares

Figure 5.19

Net SCRA Flows and KSE Performance



Dollar 690 million. Though, a considerable rise in the FCD may highlight the risk of dollarization of the economy, however, with maximum FCD⁴⁰ limits placed on a Commercial Bank, the risk remain contained. On the positive side, increase in deposits provided funds to the banks for financing trade, thereby limiting pressure on the Pak Rupee and reserves.

Equity indices severely affected by fragile macro-economy and prevailing political environment

Similar to the money and FX market, the equity and capital markets also faced stresses during H2-CY11. The benchmark KSE-100 index depleted by 9.2 percent to 11,347 points on account of weak macroeconomic fundamentals and political issues both locally and internationally (**Table 5.1**). In addition, the prevailing law and order situation also repulsed the foreign investors and the KSE witnessed foreign portfolio investment outflows.

Though healthy financial performance of leading corporate was expected to revive the market outlook and activity as measured by the turnover, uncertainties in the international relations kept the market in the bearish sentiment. The average turnover further decreased to 58 million shares per day in H2CY11 as against 97 million in the first half (**Figure 5.18**).

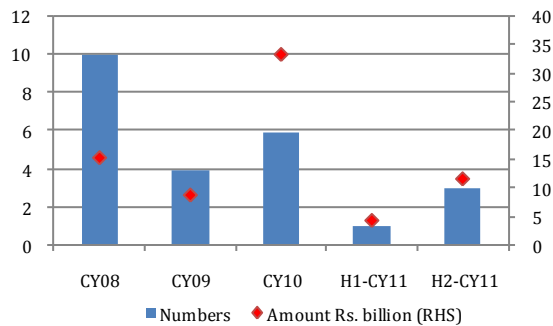
The portfolio investment measured by Special Convertible Rupee Account (SCRA) also witnessed limited market participation throughout the second half (**Figure 5.19**). Actually, portfolio investment is generally short-lived and in volatile markets, the investors book gains and flee as soon as reasonable profits accumulate. The local investors following the herd behavior also led to panic selling in some instances and add to deterioration in the equity indices. Similarly, in wake of the uncertainties facing the economy, the SCRA witnessed a net outflow of USD 209 million during H2-CY11 compared to a net inflow of USD 237 million in FY11. Most of the outflows were limited to equity securities due to bearish stock market. The equity market failed to pick up albeit positive corporate results; while declining outflow of FPI further contributed to downtrend.

⁴⁰ In terms of Regulation O-5 of the Prudential Regulation for Corporate Commercial Banking, Foreign Currency deposits should not at any point exceed twenty percent of the local currency deposits of the banks at the close of business on the last working day of the preceding quarter.

Listings in Equity and debt market remained low

Figure 5.20

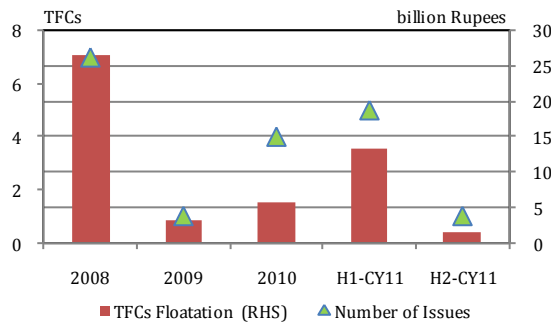
Equity Listings in KSE



The listings in the equity market though revived in H2-CY11 but still remain small in number and value. A total of 3 companies were listed that augmented the listed capital by Rs11.6 billion (**Figure 5.20**). However, the corporate debt market remained quite inactive in terms of listing during the period under review. Only one instrument worth Rs1.5 billion was listed in the debt market in H2-CY11 against listing of five instruments worth Rs13.2 billion in the first half (**Figure 5.21**). Generally, the corporate that require long-term debt for project finance tend to borrow from the corporate debt market. However, under the prevailing economic scenario and sluggish business activity, majority of the corporates borrowed from banking sources for their working capital needs only.

Figure 5.21

Corporate Debt Market Performance



NBFIs asset base surged by 22.6 percent at the back of phenomenal growth in mutual funds industry while some of the NBF sub-sector struggled for survival. Borrowing remains the major funding source for NBFIs, which in wake of challenging environment, continues to shrink. Improved performance of Modarbas and leasing boosted overall profitability of the system, which marginally improved the capital base of NBFIs. However, a number of NBFIs still fail to meet the minimum equity requirement (MER) which keeps the option of further consolidation of NBFIs open.

Overview⁴²

NBFIs asset base surged at the back of phenomenal growth in Mutual funds industry.

After declining for two consecutive years, NBFIs' assets surged by 22.6 percent, during the year under review (**Table 6.1**). This increase was mainly driven by a phenomenal 29 percent growth in mutual funds over the year (16 percent over the half year), duly supported by increase in assets of Modarabas and DFIs by 8 percent and 10 percent respectively. On the other hand, Investment Finance Companies (IFCs), leasing companies and venture capital continued to struggle for existence (**Figure 6.1**). Despite healthy growth, the overall size of NBFIs in the financial sector remains small; with assets of Rs 517.4 billion, NBFIs represent 2.7 percent of GDP⁴³ of the country.

Mutual funds sector, which experienced a major setback after imposition of floor on KSE-100 index in FY09, managed to recover the lost value in FY-11 on the back of increased investments in money market funds. As a result mutual funds now constitute 56 percent of the assets of NBFIs (**Table 6.1**). Growing fiscal deficit and tax arbitrage on investment in mutual funds proved major factors behind the growth of mutual fund industry. All other sectors saw contraction in their respective shares, with major drop in leasing and IFCs. Moderate increase in the asset base of DFIs and Modarabas was overshadowed by healthy growth in mutual fund, which lead to marginal drop in their share in the asset base of NBFIs.

...while other subsector of the NBFIs struggle for survival.

The sector, though has seen continuous consolidation over the years, the trend is making survival of some sub-sectors difficult.

Figure 6.1

Growth Trend in Non-bank Finance Sector

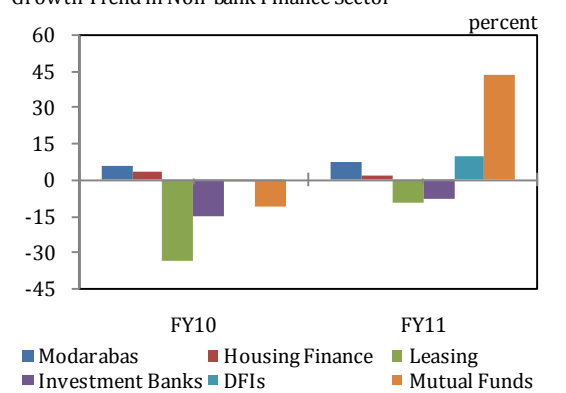


Table 6.1: Profile of NBFIs

	FY04	FY08	FY09	FY10	FY 11
Assets (Rs. Billion)	318.1	585.6	470.1	421.9	517.4
Growth rate	22.7	3.28	-19.72	-10.25	22.62
Share in Assets (percent)					
Mutual Funds	32.4	58.5	47.9	47.6	55.7
DFIs	29.8	14.5	24.2	26.8	24.1
Leasing	14.1	11	11.9	8.8	6.5
Investment Finance	11.2	7.4	6.6	6.2	4.7
Modarabas	5.7	5.1	4.9	5.8	5.1
Housing Finance	6.1	3.1	4	4.6	3.8
Venture Capital	0.3	0.3	0.5	0.3	0.2

Source: Annual Accounts of NBFIs and MUFAP

DFIs and Mutual funds data is as of December 2011

*Assets of HBFC, a DFI engaged in providing housing finance, have been included in the Housing Finance category however for analysis purpose we have included HBFC under DFI category.

⁴¹ Non-Bank Financial Institutions (NBFIs) include Non-Bank Finance Companies (NBFCs), Modarabas and Development Finance Institutions (DFIs) where NBFCs include Investment Finance Cos.(IFCs), Leasing Cos., Mutual Funds, Venture Capital Cos.(VCCs). and Housing Finance Cos.

⁴² The analysis of NBFCs and Modarabas is based on Annual Statements as of June 30, 2011, whereas DFIs' and Mutual Funds data is as of December 31, 2011.

⁴³ Average GDP at market price.

Table 6.2: Number of NBFIs

	FY08	FY09	FY10	FY11
DHs	1	0	0	0
VCCs	4	3	4	3
HFCs	2	1	1	1
DFIs	6	8	8	8
IFCs	11	9	8	7
Leasing	12	11	9	9
Modarabas	27	27	26	26
M. Funds*	95	102	135	144
Total	158	161	191	198

Source: SECP and MUFAP and for analysis purpose, 7 IFCs are used for FY10 analysis as 1 IFC is under winding up.

Table 6.3 Key Performance Indicators of NBFIs*

	percent (unless mentioned otherwise)			
	FY08	FY 09	FY 10	FY 11
Capital to Assets	35.2	35.9	36.2	35.4
Advances to Assets**	52.5	47.7	41.4	38.7
Investments to Assets**	28.6	34.0	39.2	46.8
Earning Assets to Total Assets**	82.6	85.6	80.7	85.5
Debt to Equity Ratio (Times)	2	2.1	1.8	1.8
Borrowings to Liabilities**	61.1	58.1	60.0	66.7
Deposits to Liabilities**	25.2	28.7	27.8	21.5
Income to Expense	111.3	92.5	102.5	112.9
Return on Average Assets (after tax)	0.9	-1.6	-0.1	0.6
Return on Average Equity (after tax)	3	-5.1	-0.3	1.7

*Excluding Mutual Funds and Venture Capital

** Modarabas are not included for these ratios

Excluding mutual funds, number of NBFIs stood at 54 in FY11, down from 56 in FY10. Among the sub sectors, IFCs performance saw further deterioration during the year, amid their inability to generate fresh funds to do business, though competition from banks and challenging economic environment. With expected merger transaction of largest IFC(holding 36 percent share), the sector is expected to lose substantial ground. With already small number of firms, further deterioration of performance and closure/consolidation of NBFIs, particularly IFCs and leasing companies, will further decline the role of NBFIs sector and need urgent measures to make this sector sustainable **(Table 6.2)**.

In line with the overall slow down in business and economy, the share of advances in total assets⁴⁴ decreased to 38.7 percent **(Table 6.3)**. The contraction, was observed all around as financing became more risky and funding sources remain limited. The exposure of banks on NBFIs, their main financing source, declined by 6 percent over the year. In the meantime, investment mainly in risk free securities increased as institution opted flight to safe haven. DFIs, with 27 percent increase in investments provided boost to 23 percent increase in overall investments.

Borrowing remains the major funding source for NBFIs

On the funding side, NBFIs reliance on borrowing from financial institutions increased with a concomitant drop in deposits. Borrowing saw a substantial surge over the year, which enhanced its share in total liabilities to 67 percent in FY11, up from 60 percent in FY10. Most of the borrowing was concentrated in DFIs, while the drop in deposits is observed all around. Particularly the leasing companies not only shed their borrowings but also their deposits and utilized their recoveries from leases for filling up the funding gap **(Table 6.3)**.

Improved performance of Modarabas and leasing boosted profitability of the system

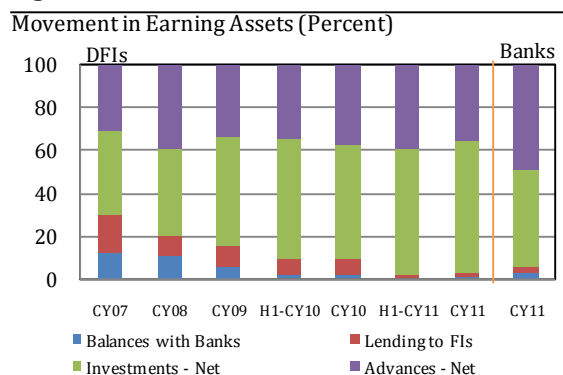
NBFIs posted profit after tax of Rs 1.3 billion against losses booked during FY09 and FY10. As a result, the ROA and ROE of NBFIs turned positive in FY11. Decrease in provisions across the NBFIs remains the key factor in improving the performance, in addition to overall risk averse attitude. The profitability of the sectors resulted from improved performance of Modarabas and leasing companies, while profitability of DFIs remained below the level achieved in FY10. Further analysis show that profitability is mainly attributed to a few institutions in each of the sub-sector and exit of any of these institutions will significantly decrease share of NBFIs sector in the financial system and adversely impact the performances of the specific sub-sector. Improved profitability, marginally improved the capital base of NBFIs, however, a number of NBFIs still fail to meet the minimum equity requirement(MER).

⁴⁴ Excluding Mutual funds and Modarabas

Development Finance Institutions (DFIs)⁴⁵

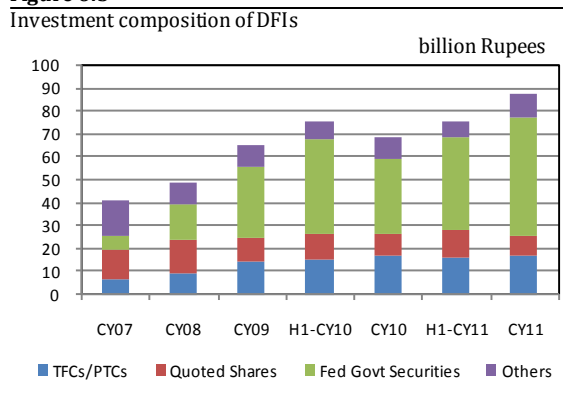
Strong lopsided growth in investments provided boost to assets base of DFIs.

Figure 6.2



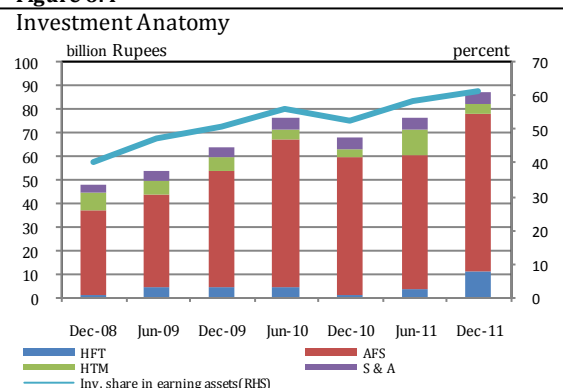
The asset base of DFIs, which remained stagnant for last couple of years, saw a modest growth of 7 percent during the half year under review. Like banks, increase came from rising investment portfolio, which now constitutes 57 percent of the asset base and 62 percent of the earning assets. Institution wise analysis shows that increase in assets and investment was contributed by a few DFIs. Advances, on the other hand, saw a contraction of 1.8 percent, which decreased their share in asset base to 32 percent (**Figure 6.2**). Lending to financial institution which almost dried up during the first half of the year, saw improved activity; with most of the increase taking place in last quarter of the year.

Figure 6.3



Investments surged by 15.5 percent over the half year due to 28 percent increase in short term government securities. As a result, the share of Federal Government securities increased to 59.4 percent of total investments (**Figure 6.3**). However this growth was not broad based, as increase was driven by a couple of DFIs. With deterioration of capital market⁴⁶, DFIs shed their investment in shares, mutual funds etc. by 9 percent. The value of investments in subsidiaries and associates (S&A), which mainly constitute Mutual Funds, Leasing and Takaful, further declined due to continuing losses particularly in the later two segments (see later section of this chapter).

Figure 6.4



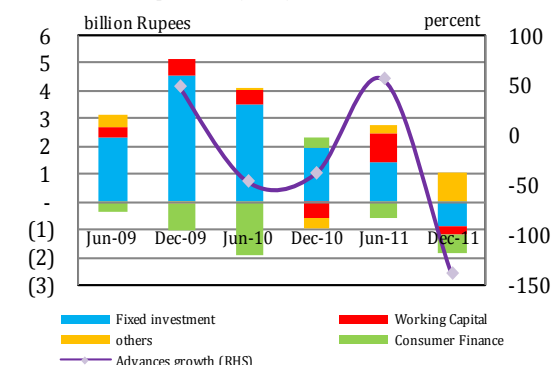
Due to stressed money market, DFIs opted to enhance their asset based liquidity. Accordingly, their holding of AFS and HFT securities further increased and count for 76.8 percent and 12.9 percent of DFIs investment portfolio respectively in H2-CY11 (**Figure 6.4**).

⁴⁵ DFIs include House Building Finance Company Limited(HBFCL); a DFI engaged in providing housing finance

⁴⁶ See chapter 5 Financial Markets.

Figure 6.5

Advances Composition (flow)

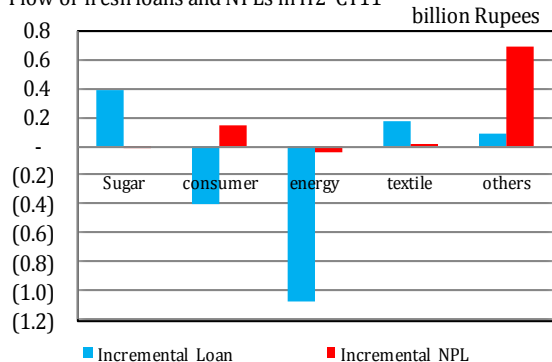


...while advances saw all around decline

Amid increased risk aversion, DFIs shed their lending portfolio during H2-CY11. Breakup of incremental advances⁴⁷ reveals decline in all categories of advances with major drop in corporate advances in fixed investment category. Consumer finance, the second largest segments in DFIs loan portfolio, further decreased its shares due to 5.3 percent decline in mortgage financing (**Figure 6.5**). Only positive development during the half year remains the increase in commodity finance, where couple of DFIs started taking exposure. Sector-wise analysis show healthy growth in advances to sugar and electronics & appliances sector, with marginal increases in Textile and Chemicals. However, significant reduction particularly in energy and transportation sector led to overall decline in the advances of DFIs during H2-CY11 (**Figure 6.6**).

Figure 6.6

Flow of fresh loans and NPLs in H2-CY11

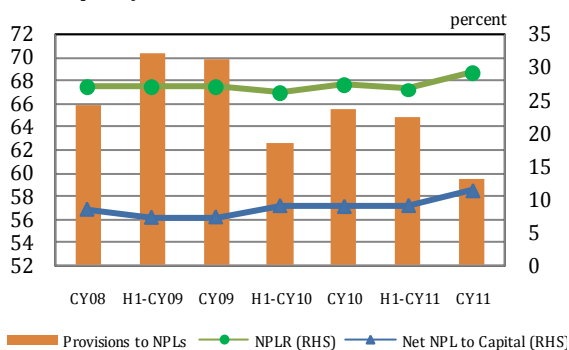


Asset quality indicators deteriorate due to rise in NPLs, amid fall in advances

With a smaller loan portfolio and due to sluggish growth over the last couple of years, the credit risk of DFIs, on aggregate basis, kept a contained profile. However, the asset quality saw deterioration, during the half year under review, leading to worsening of credit risk indicator. NPLR increased to 29.34 percent (highest in last three years) on the back of 8 percent growth in NPLs and overall contraction in advances. Excluding, housing finance company, NPLR increased to 20 percent; a rise of one percentage point over H1-2011, conspicuously indicating that rising NPL in special mortgage finance institution contributed to rising overall infection of DFIs.

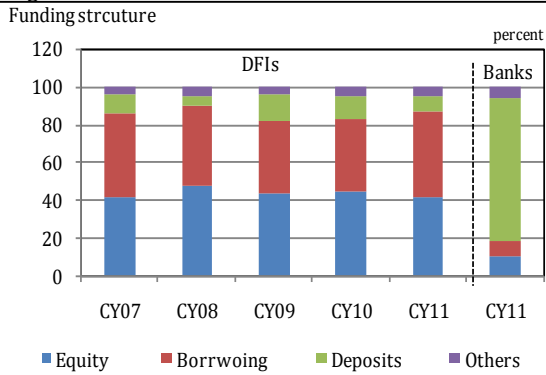
Figure 6.7

Asset quality of DFIs



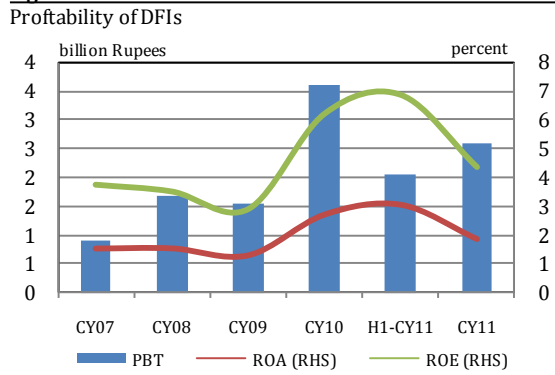
Major chunk of NPLs fall under loss category (requiring higher provisions), which saw further increase of 14.4 percent during H2-CY11. Provisions coverage ratio, however, deteriorated to 59.4 percent due to lower provisions charge on account of enhanced FSV benefit. Corresponding increase in Net NPLs led to increase in Capital impairment ratio (Net NPLs to capital) ratio to 11.3 percent (**Figure 6.7**).

⁴⁷ Sectoral and segment based analysis of advances in this section is based on Un-audited quarterly data.

Figure 6.8

Funding structure remained heavily reliant on equity and costly borrowings

Funding structure of DFIs remained reliant on capital and borrowings which jointly fund 86 percent assets of DFIs (**Figure 6.8**). Equity usually remained the mainstay of the funding structure of DFIs, however, during the half year under review, borrowing saw a substantial jump particularly in secured repo borrowing, which increased by 58 percent. This increase like overall increase in assets was quite lop sided and limited to a few DFIs.

Figure 6.9

Operating performance of DFIs weakened during H2-CY11

Operating performance weakened during second half of 2011 as pretax profit declined by 74 percent compared to the first half. While net interest income increased by 12.4 percent, the gain was offset by increase in provisions charge, losses in dealing in foreign currencies and surge in other expenses. Accordingly, the ROA dipped to 1.9 percent in H2-CY11, from 3.1 percent in the first half (**Figure 6.9**). Again decline in profits resulted from a lop-sided performance of a couple of DFIs, a persistent feature of the sector.

Solvency though strong but excessive suggesting ineffective utilization of capital

Solvency of DFIs remained quite strong. Due to stangnancy in risk based activity, overall structure of RWA assest and capital remained stable over the half year. As a result CAR, with a marginal increase of 20 bps, remained steady at 56.9 percent (**Figure 6.10**). This development, consistent with overall change in asset mix of the DFIs, should be seen with caution as very high CAR is mainly driven by strong capital with low investment in risky assets, indicating less than optimum utilization of capital. Such a high CAR coupled with low leverage of the sector, highlights the need for DFIs to broaden and diversify their exposures.

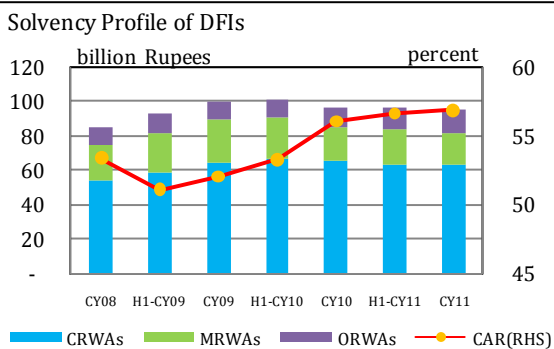
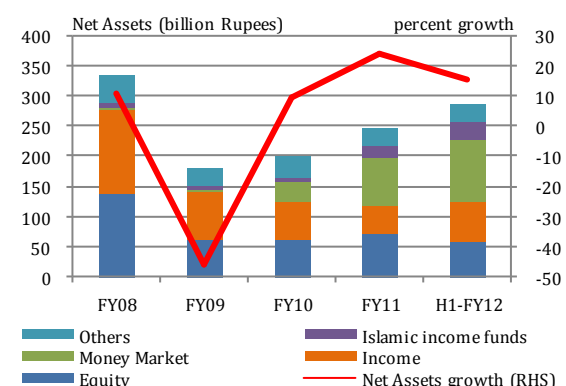
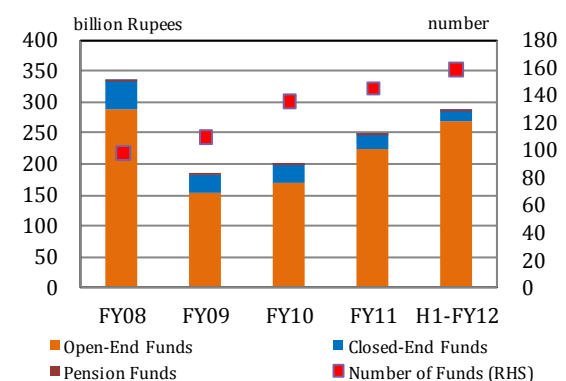
Figure 6.10

Figure 6.11

Profile of Mutual Funds Industry

**Figure 6.12**

Performance of Mutual Funds



Mutual Funds

Structural shift seen both in funding structure and investment strategy

Mutual fund industry has undergone major structural shift in the last decade due to changing market dynamics and economic conditions. In terms of funding structure, open end funds now lead the market compared to close end funds. In terms of investment strategy, industry once driven by equity funds, shifted to money market and income funds; amid increased safe haven demand in line with overall risk averse environment. With the increasing demand for Islamic financial products, Islamic funds have gained substantial share over the last 3 years.

Net assets surged at the back of growing investment in open end funds ...

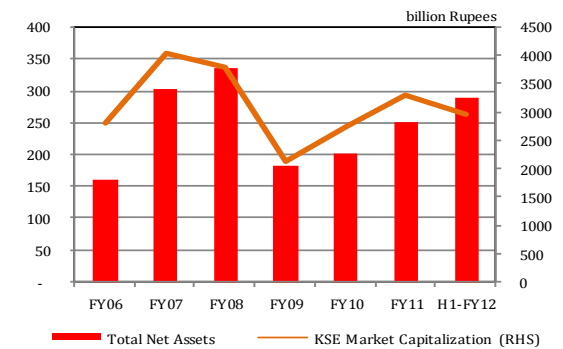
Although mutual fund sector experienced major setback after imposition of floor on KSE-100 index in first half of FY-09, yet it managed to substantially recover the lost value in FY-11. Over the half year under review, net assets of the mutual fund industry expanded by 15.7 percent (24 percent in first half) to reach Rs 288 billion (**Figure 6.11**). Among the mutual fund categories, open end funds grew by 20 percent during second half of CY11, while close end funds diminished by 22.7 percent. Number of Mutual funds increased to 144 (**Figure 6.12**).

....while in terms of investment strategy, MMFs outpaced all other instruments available

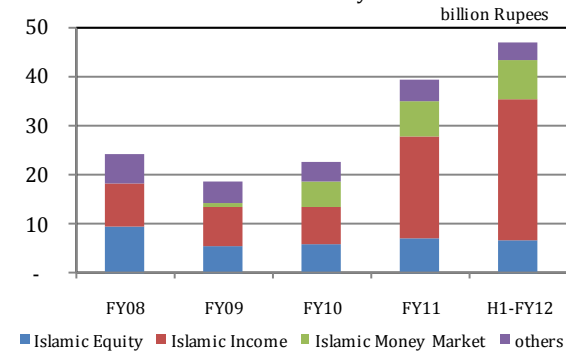
Money market funds (MMF) continued to attract more funds due to their risk free competitive return with safety of capital. With a 33 percent growth over the half year, MMFs remained the main growth driver for the industry. Similarly, income funds, with an investment mix of government securities, debt instruments of financial institutions and banks deposits, posted a phenomenal 35 percent growth. As a result, the share of MMF and income funds surged to 39 and 32 percent respectively of the total net assets. In contrast, equity funds and close end funds continued on the contraction path both in terms of value and overall share due to jittery stock market (**Figure 6.13**). The net assets of equity funds saw a decline of 5.21 percent as KSE-100 index lost 9.2 percent during H2-CY-11, decreasing its overall share to 23 percent of total net assets (92 percent in 2002 and 54 percent in 2007).

Figure 6.13

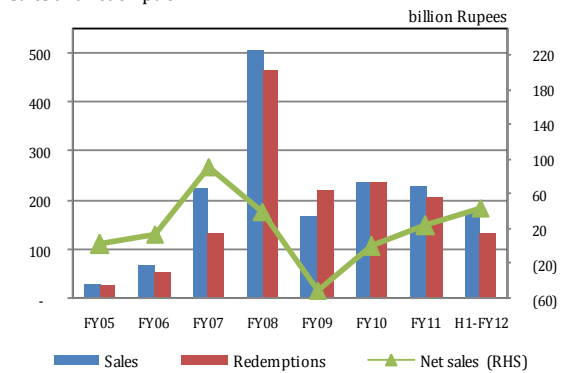
Mutual funds and equity market

**Figure 6.14**

Profile of Islamic Mutual Fund Industry

**Figure 6.15**

Sales and redemption



Islamic Mutual funds continue to capture a considerable share of mutual fund industry on the back of growth in Islamic income funds

With the growing demand for shariah compliant products, the offering of Islamic Mutual Funds (IMFs) is also increasing, though pattern remains more or less in line with the industry trend. The net assets of IMFs surged to Rs 47 billion at 31st December, 2011 from less than a billion rupees in 2003, representing Compound Annual Growth Rate (CAGR) of 48 percent. The IMFs have seen increased diversity over time. Starting from equity funds in 2002, their pool now contains all categories including, income, money market, balanced, capital protected and pension funds. As of the end H2-CY11, the net assets of IMFs represent 17 percent of the overall market, with major concentration in Islamic income fund (10 percent) followed by Islamic money market funds (3 percent) and Islamic equity funds (2 percent). A full year growth of 62 percent in net assets of IMFs compares well with 7.6 percent growth in the Islamic fund industry globally⁴⁸ (Figure 6.14).

Although Islamic mutual funds are exhibiting healthy growth, SECP is working for improving cohesion in policy and framework. In this regard, a specialized unit is being set up at the SECP to review the existing and proposed Islamic products to cater to investors' needs⁴⁹.

Sales and redemption of the mutual funds over the last 6 years show that mutual funds have generally seen net sales except for net redemptions in 2008 due to liquidity crunch faced by the mutual funds in the aftermath of freezing of stock exchanges. The trend continued in the period under review as industry attracted Rs 24 billion of new investment in FY-11 on the back of major investment in Money market funds (Rs 34.2 billion) and pension funds (Rs 10 billion). All the other funds experienced net redemption (Figure 6.15). Favourable environment in money market funds on the back of Government demand and investors' risk averse sentiment is a major factor behind growth of mutual fund industry.

⁴⁸ Islamic Funds & Investment Report 2011, Ernst & Young.

⁴⁹ Securities and Exchange Commission of Pakistan (SECP) Annual Report, 2011.

Banking industry remains the major player in Mutual fund industry due to tax advantage...

On the funding side, the growing interest of banks in mutual funds due to tax incentive⁵⁰ and low capital charge proved a major impetus behind the growth of mutual fund industry in 2011. As a result, the banks' investment in Mutual funds grew to 33 percent of the total size of fund industry. However, this development should be seen with caution as mutual funds industry needs diversity of investors for sustainable development in the long run.

Further, in the absence of any specific instruction to categorize mutual fund investments, banks' growing exposure to mutual funds attracts less risk weight as banks prefer to place these investments on the banking book. This approach ignores the market risk component of mutual fund portfolio for capital adequacy purpose. Going forward, any change in regulatory instructions on Basel capital accord for Collective Investment Schemes like 'look through approach'⁵¹ may impact applicable capital charge on mutual funds investments. In the absence of any tax and capital advantage, banks may pull off their investments from mutual funds and devise other investment strategies for enhancing returns.

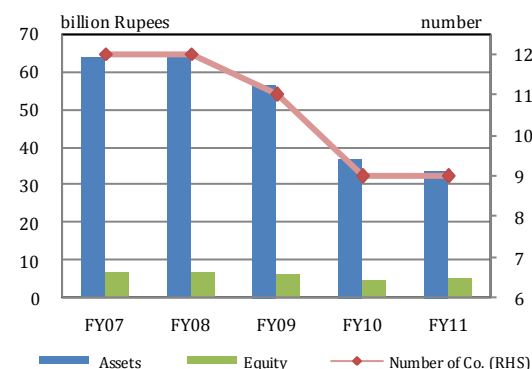
Although growth in mutual funds is a positive development but growth is concentrated both in terms of funding and investment strategy. With the proposed changes in tax regime and expected changes in regulatory framework for banks, regulators and fund managers need to give due consideration to these developments while devising overall future strategy for the industry. Particularly the Asset Management Companies (AMCs) will have to revisit their approaches and offer new products and avenues for investment to cater to the diverse class of investors.

⁵⁰ The income of banks is presently taxed as per the corporate tax rates i.e., @35% of income before tax. However, the income generated by banks from investment in mutual funds was taxed at 10%. Finance bill 2012 has proposed gradual elimination of this tax incentive over the next two years.

⁵¹ Under look through approach, banks are required to calculate capital charge on their mutual fund investments as if the underlying exposure/asset class is held by the banks themselves.

Figure 6.16

Profile of Leasing sector



Leasing

Marginal improvement in performance with shrinking assets base and high concentration

The performance of the leasing sector marginally improved in FY-11 in the backdrop of challenging business, economic and social environment. The sector posted profits, after making substantial losses in last two years, on the back of expense control and lower provisions charge. As a result, return indicators turned positive. However, due to on going consolidation, shrinking funding resources and competition from commercial banks and other NBFIs, the sector shed 9.5 percent of assets base. Overall sector continued to be dominated by few companies

During FY11, industry continued consolidation as assets of the sector shrank further (**Figure 6.16**). Most of the decline was contributed by 8 percent reduction in advances and 22 percent in investments. Though lease finance remained the major financing activity representing 74 of the total assets, however, it observed a drop of 6.7 percent over the year. Analysis of lease finance show that major focus of the sector remained on car financing followed by manufacturing. Sector-wise composition shows that leases are quite diversified, with major concentration in textiles, sugar and individuals. Given high non-performing loans, focus of the sector has remained on limiting the credit risk, improving recoveries and restructuring activity; as a result provisions charge for FY11 remained 26 percent lower than the previous year.

Funding constraint remained the key issue facing leasing industry...

Funding constraints remained the key issue facing the leasing sector. As borrowings dropped by 18 percent, leasing companies utilized the lease rentals for repayment of borrowed funds. Similarly the deposits of the leasing sector saw a decline of 14 percent. Though decline in funding mobilization was a sector wide phenomenon, it was more pronounced for companies facing financial stress.

...yet sector posted earnings

During the year under review, leasing sector posted profit after tax of Rs 64.6 million (**Table 6.4**). Due to decline in lease finance activity, lease income saw a marginal drop, however, substantial drop in financial charges and allowances for lease losses provided boost to the net earning of the leasing sector. As a result expense to income ratios declined while return indicators turned positive; ROA improved to 0.2 percent in FY11 from negative 1 percent in FY10 and ROE improved to 1.4 percent from negative 7.5 percent a year earlier (**Figure 6.17**). Also 5 out of 9 firms posted profits and most of the loss making firms curtailed their losses.

Table 6.4 : Leasing sector performance indicators

	amount in million Rupees, ratio in percent				
	FY07	FY08	FY09	FY10	FY11
Profit after tax	303	551	(1,522)	(336)	65
Income from lease operations	4,349	4,518	4,346	3,501	3,447
Income from investment	24	47	(24)	26	2
Expense	786	884	1,189	5,053	3,724
Expense to income	91.8	90.3	174.7	107.8	88.7
Financial expense to income	86.8	83.0	175.0	64.7	53.5

Figure 6.17

Profitability indicators of Leasing sector

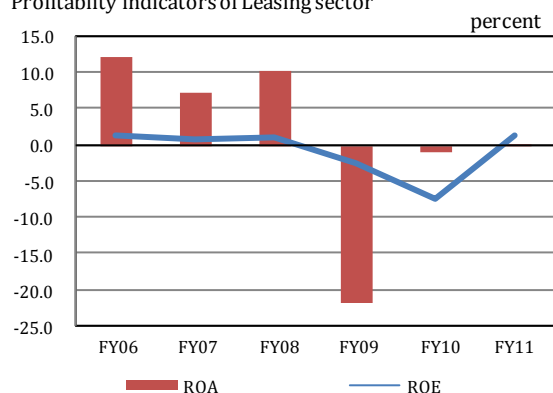
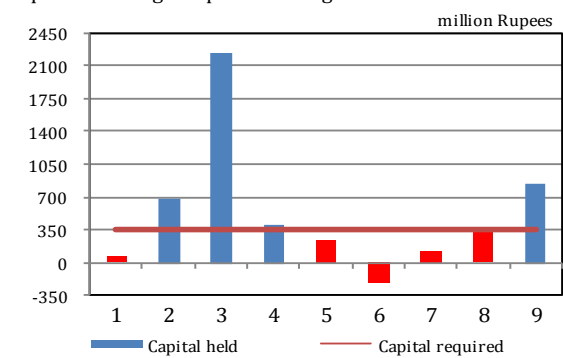


Figure 6.18

Capital of leasing companies during FY11

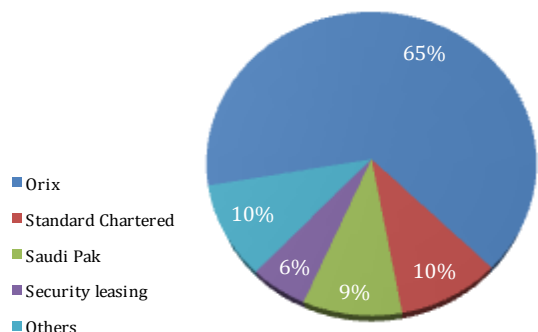


This improved performance resulted in marginal strengthening of solvency profile due to buildup of statutory reserves. However, majority of the firms remained undercapitalized with 5 of the 9 companies were non-compliant with the Minimum Equity Requirement(MER) set forth by SECP⁵² (**Figure 6.18**) . Keeping in view the challenging economic environment, SECP has allowed the leasing sector to meet minimum equity requirements of Rs700 million by 2013 (previously required to be meet by 2011).

Leasing sector continued to shrink due to a host of challenges. Sector though exhibited improved performance during the year, however, its performance remained lopsided in favour of few firms with major concentration of industry assets (**Figure 6.19**). Additionally, non-compliance of a number of firms with MER kept the chances of further consolidation open, which will further reduce the number of firms in the industry . Keeping in view the role of leasing sector in SME financing, serious efforts are needed to keep the leasing sector afloat. Leasing companies should focus on diversifying their funding, product and customer base to take benefit of their niche⁵³. On the other hand regulator needs to take measures for facilitating the growth of sector. To this end, SECP has proposed amendments in NBFC Regulations 2008 to allow shorter lease contracts for leasing companies, which is expected to enhance business prospects of the leasing industry⁵⁴.

Figure 6.19

Asset concentration in Leasing sector during FY11



⁵² Non-Banking Finance Companies and Notified Entities Regulations, 2008 (amendment vide SRO 764, Dated September 2nd 2009) require fresh licensed leasing companies to hold Rs700 million capital while existing companies to maintain Rs350 million by June 30,2011 , Rs500 million by June 30,2012 and Rs700 million by June 30,2013).

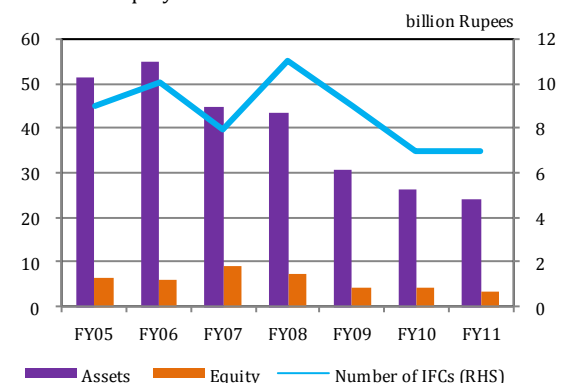
⁵³ In FY-11, Orix has issued TFCs of Rs4.3 billion to financial institutions, corporate and trusts.

⁵⁴ Annual Report 2011-Securities & Exchange Commission of Pakistan.

Investment Finance Companies

Figure 6.20

Assets and Equity IFCs



IFCs in Pakistan are facing severe competition from commercial banks. They were doing well till late 80's however, after initiation of financial sector reforms in early 90s and entry of new banks in the market, competition in banking sector heightened. This forced banks to explore new business avenues other than traditional intermediary role. Given the leverage available in the legal framework⁵⁵ of Banking Companies, some banks entered in investment advisory business, project finance and underwriting ventures. Further, some banking groups opted to merge group IFCs with banks to meet capital requirements, which also enhanced banks' capacities in investment finance services and at the same time made it quite challenging for the remaining IFCs to compete with banks.

Sector faced continuous shrinkage in terms of number of operative institutions resulting in declining asset base....

Above trend continues, as number of IFCs came down substantially from 12 in FY03 to 7 in FY11⁵⁶. During the period under review, performance of Investment Finance Companies further deteriorated, as asset base of IFCs declined by 8.2 percent to Rs 24 billion (Figure 6.20). This contraction was mainly contributed by decline in asset base of 3 IFCs on account of reduction in advances. On the funding side IFCs reliance remained on borrowing from financial institutions which increased by 23 percent over the year. Most of these funds were used to enhance investment activity of the IFCs as well as to manage shortfall in funding resulting from 20 percent decline in deposits.

...and murky performance and solvency picture

Performance indicators also show dismal picture (Figure 6.21). Due to curtailed financing activity gross revenues declined by 11 percent over the year. Overall expenses also observed substantial drop due to decrease in deposit and administrative cost control measures. As a result, IFCs managed to limit the overall losses for the year to Rs 689 million compared to losses of Rs 1.8 billion in FY10 (Figure 6.22).

Although paid-up capital of IFCs improved after FY08 in line with the increase in the minimum equity requirements (MER), continuous accumulation of losses over the last three years led to substantial decline in equity of the IFCs. As of end FY11, four institutions failed to meet the minimum equity requirement of Rs500 million (Figure 6.23). Small capital base with limited capacity to absorb shocks is a major impediment in the growth of this sector.

Figure 6.21

Profitability Indicators and Asset growth

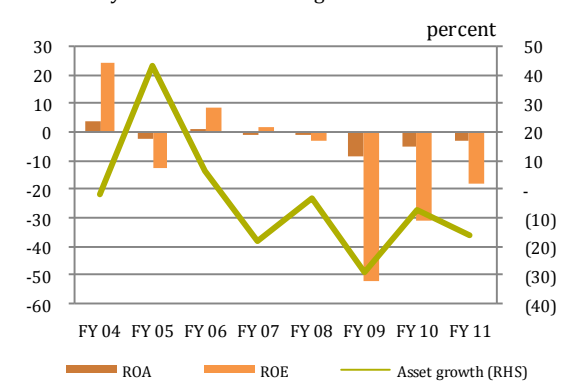
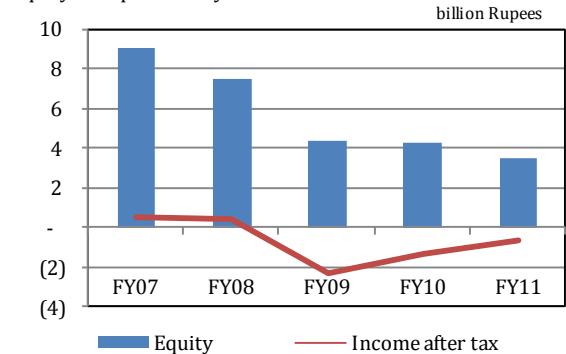


Figure 6.22

Equity and profitability

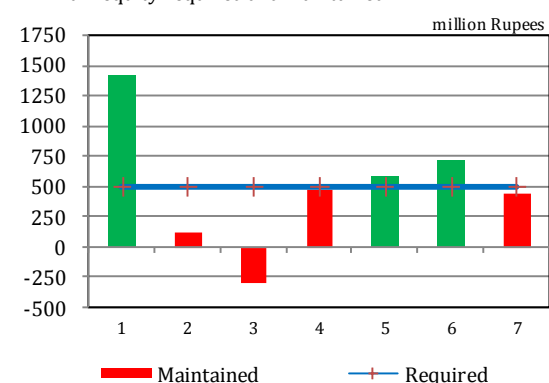


⁵⁵ Banking Companies Ordinance, 1962

⁵⁶ Innovative Housing Finance which was operational till 2010 went into liquidation, which led to decline in number of IFCs to 7. Number of IFCs is expected to decrease further as a major IFC holding 36 percent share of industry is contemplating with a commercial bank.

Figure 6.23

Minimum equity required and maintained



Going forward, existing IFCs need to realign their business strategies with the financing needs of the economy. In the face of large potential of debt and equity market development in the economy, SECP is striving hard to revive this sector. To encourage investment banks to enhance scope of non-fund based services, SECP has allowed investment banks to undertake brokerage business from their own platforms instead of establishing a separate company⁵⁷. Apart from these incentives, both regulators and market participants need to devise a sustainable business model for IFCs if these specialized institutions are to remain commercially viable in an increasingly competitive financial sector.

Modarabas

Sector is among the one of the three NBFIs showing growth in current period despite facing competition from Islamic banks

Modaraba companies⁵⁸ perform sharia-compliant business under the provisions of *Modaraba Companies and Modaraba (floatation & Control) Ordinance' 1980 (the Modaraba Ordinance)*. The legal framework provided them flexibility to involve in financial and non-financial business; a comparative advantage over banks. However, islamic banks with similarity in product offering remains their major competitor.

Currently there are 26 Modaraba companies out of which 23 are in financial services, 2 in manufacturing/trading and one is equity Modaraba⁵⁹. In terms of number, modaraba sector is the second largest sector after mutual funds; however the size of the modaraba sector, in term of its share in total NBF assets is relatively small and stands at 5.6 percent at end FY11 (**Figure 6.24**).

Modaraba is one of the three NBFIs sub-sector which registered growth in FY11. During the period under review, Modaraba sector registered growth of 7.6 percent. This growth though commendable in the highly competitive and difficult economic environment, was mainly contributed by top ten Modarabas representing 84 percent of total assets. Concentration in Modaraba Companies is also an indication of widespread fragmentation as is evident from large number of small and weak entities, with limited market share (**Table 6.5**).

Major funding source of modarabas include floatation of modaraba in the form of equity Musharaka certificates and financing facilities from banks and other financial institutions in the form of various Islamic financing arrangements. These funds were largely utilized in the form of shariah compliant financing agreements, namely

Figure 6.24

Profile of Modaraba sector

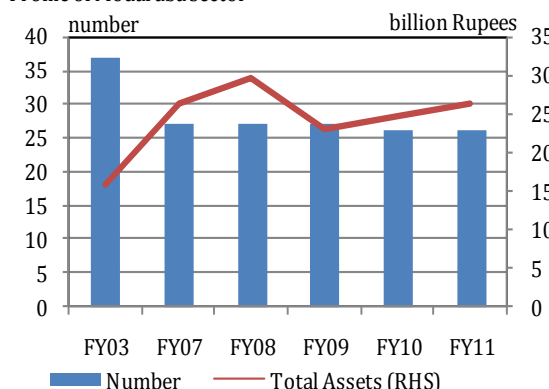


Table 6.5: Concentration in Modaraba business

	in percent			
	FY08	FY09	FY10	FY11
Top 3	42.0	42.3	45.0	42.5
Top 5	64.0	65.8	63.0	61.0
Top 10	86.0	83.3	83.0	84.0
Rest of firms	14.0	16.7	17.0	16.0

⁵⁷ Amendment made in Non-Banking Finance Companies (Establishment and Regulation) Rules 2003 through S.R.O. 271(I)/2010 dated April 21, 2010

⁵⁸ Modaraba industry structure consist of modaraba management companies which float Modarabas. There are two types of Modarabas ; (i) Multipurpose (ii) Specific purpose. Currently all modarabas are listed on stock exchange.

⁵⁹ NBF & Modaraba year book 2011

Ijarah, Musharika, Murabaha, with ijarah being major financing mode. Industry has exposure to wide variety of sectors ranging from food and beverages, construction, sugar, chemical and textile sector.

Performance of the sector improved on the back of lease finance income

Performance of the Modarabas further improved over the year. The performance of the sector in terms of profitability was best among the financial institutions after banking sector. The profit after tax jumped to Rs 1.1 billion in FY11 from Rs 0.78 billion in FY10. Income from lease finance formed the major part of income of Modarabas. As a result, ROA and ROE improved to 4.4 percent and 9.4 percent in FY-11 (**Table 6.6**). Earnings of the sector were broad based as 21 modarabas posted profit. Size wise analysis show that top ten Modarabas augmented the overall profitability, with most of them owned by strong groups involved in banking and finance, and manufacturing.

Going forward, major challenge faced by Modaraba sector is from Islamic banking institutions providing similar products. To increase their customers, they need to focus on customized services and build their niche. To sustain in long term, Modaraba industry strongly need to focus on those segments which are still untapped by banks including SME, agriculture, real estate and small infrastructure projects. The sector needs serious efforts towards improving and strengthening governance framework. For which industry driven steps with active involvement of regulator is needed.

Venture Capital

Private equity/venture capital accounts for a nominal share of 0.2 percent in overall NBFCs market. Venture capitalists provide funds to new projects with high potential of growth and exit after five to seven years. Due to the high risk nature of start up businesses, venture capitalists desire commensurate returns along with management control and strategic interest holding. To develop entrepreneurship in country, SECP is revisiting the regulatory framework for private equity to make it conducive for both investors and entrepreneurs. The relative size of sector is negligible comprising three institutions; out of those, one is effectively inactive for the last three years. The financial position of sector is given in **Table 6.7**.

Table 6.6: Performance Indicators of Modarabas

	billion Rupees			
	FY08	FY09	FY10	FY11
Profit after tax	0.8	-0.1	0.8	1.1
Income	5.5	6.9	7.9	8.8
Expenses	1.8	6.5	7.1	7.6
ROA (percent)	3.6	-0.6	3.3	4.4
ROE (percent)	8.7	-1.4	7.0	9.4

Source: Annual Audited Reports

Table 6.7: Profile of Venture Capital

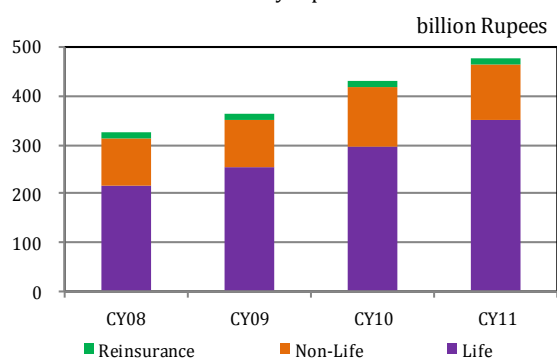
	million Rupees			
	FY08	FY09	FY10	FY11
Equity	1,714	2,497	1,028	961
Liabilities	267	66	65	77
Income	-2,403	823	134	14
Expense	91	85	1,620	72
Assets	1,981	2,563	1,093	1,038

The insurance and reinsurance sector witnessed 11.1 percent growth in asset base during CY11. The performance of life insurance industry, both in terms of asset and premium accumulation played a major role in improving the overall performance of the sector, while the non-life segment witnessed deterioration in asset-base due to settlement of floods related outstanding claims. The period under review was also significant for the insurance industry as it witnessed decline in the claims and expense ratios for both life and non-life segments which contributed towards improving the overall profitability. Besides the positive developments in the insurance sector, it still lags behind in terms of density and penetration when compared with regional countries.

Insurance sector posted reasonable growth despite sluggish macroeconomic environment...

Figure 7.1

Size of the insurance industry expands

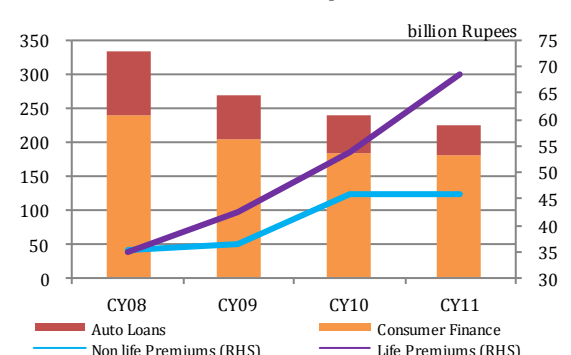


The asset base of the insurance and reinsurance sector witnessed a double-digit growth of 11.1 percent during CY11 mainly attributable to a 19.2 percent surge in the life insurance sector assets. The life insurance industry successfully attracted prospective policyholders by proactive marketing campaigns, expansion of agent services and offering innovative life products. Furthermore, the growing inclination of the urban population towards risk coverage in the wake of rising security and social concerns also boosted the demand for life insurance and overall asset base of the sector.

In contrast, the asset base of non-life industry reduced by 7.4 percent as the non-life companies were able to resolve their outstanding flood related claims that were incurred in CY10. While the reinsurance industry – that constitutes only one non-life reinsurance company posted a marginal growth of 2.7 percent in its asset-base as the domestic non-life business remained subdued during CY11 (**Figure 7.1**).

Figure 7.2

Consumer finance and insurance premiums

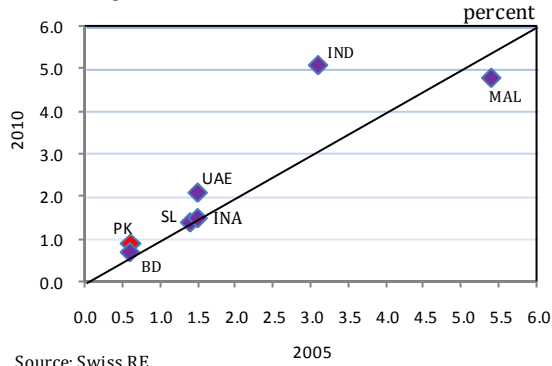


Despite a recent dip in non-life industry assets, the consistently high growth rates in the asset base of the insurance and reinsurance sector during the last few years have also accentuated the ability of the sector to withstand sluggish macroeconomic environment. In fact, even the rising inflation levels did not affect the growth pattern of life premiums. However, the trend of the non-life premiums seem to be positively correlated with the banking business in general and consumer finance business in particular (**Figure 7.2**)⁶⁰.

⁶⁰ In addition to the reduction in the banks' consumer finance business, other sectors such as the leasing sector also witnessed a drastic reduction in its auto lease.

Figure 7.3

Insurance penetration in selected countries



....though penetration and density remained low

Though the domestic insurance industry has grown at a healthy pace, an international comparison shows that the country is not only lagging behind in terms of density and penetration of the insurance industry but the Pakistan's standing among the regional countries remained low in recent years⁶¹. Of 88 countries, Pakistan is consistently ranked lower (86th) with the insurance penetration ratio of 0.7 percent. Similarly, the country ranks almost at the bottom of the sample (87th) in terms of insurance density⁶². Even the less developed regional countries have better penetration and density ratios (**Figure 7.3**). On the positive side, the inflation adjusted premium growth rates of the Pakistan's life insurance industry are comparable with that of the emerging market economies. However, the real premium growth of non-life insurance industry lags behind significantly (**Table 7.1**).

Table 7.1: Real Premium Growth in 2010

	in percent		
	Life	Non Life	Total
Advanced	1.8	1	1.4
Emerging	13	8.5	11
Pakistan*	13	-4.1	2.6
World	3.2	2.1	2.7

Source: Sigma /Swiss Re 02/2011

* SBP calculations

The measures of insurance density and penetration being very low in international perspective indicate the insurance service providers performing below their potential. For increasing penetration, the insurance service providers need to broaden their products and services, and enhance their outreach to new areas for effectively bringing the untapped segments into their insurance net.

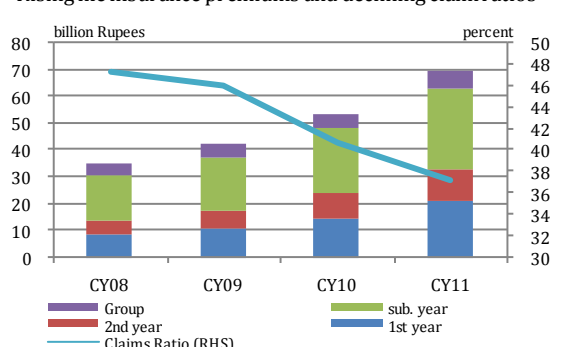
Life Insurance

Growth in life insurance driven by higher premiums

During CY11, the gross life insurance premiums witnessed a robust increase of 27 percent (YoY). Importantly, the family takaful business, that now represents 5 percent of life insurance (2.5 percent in 2010), also grew by 75.8 percent during the same period thanks to growing awareness of shariah compliant insurance services among the prospective policyholders. With the entry of new companies in the life and family takaful business in recent years, the industry asset and premium concentration ratios have improved significantly, with private companies successful in enhancing their business and profitability. In addition, the recent growth momentum in the premiums and rising investment income feeding into improved profitability of the life insurance industry

Figure 7.4

Rising life insurance premiums and declining claim ratios

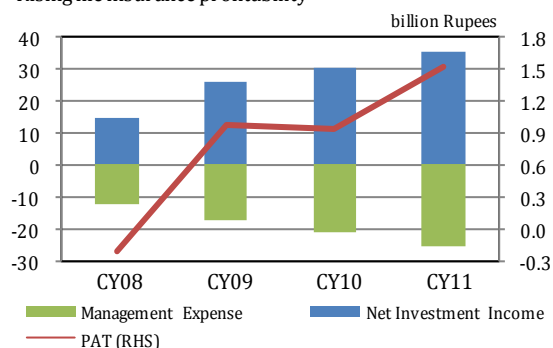


⁶¹ The insurance penetration is the ratio of the insurance premiums to GDP while insurance density is the ratio of insurance premiums to population.

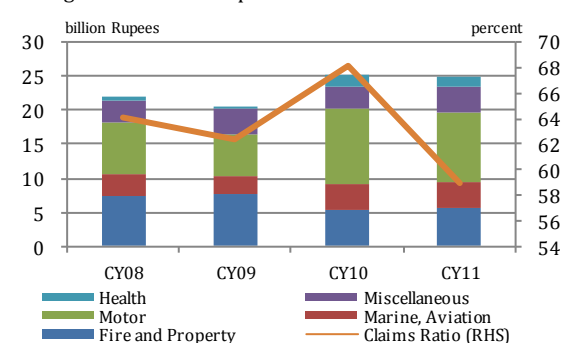
⁶² Source: Sigma / Swiss Re – World Insurance in 2010. No. 2/2011

Figure 7.5

Rising life insurance profitability

**Figure 7.6**

Marginal decline in net premiums of non-life sector



may also encourage companies to venture into and offer (conventional and Islamic) new products⁶³.

A positive and encouraging feature of the rising gross premiums is the share of new business (1st year premiums) and the retention of the policy by the insured (subsequent years). Besides 44.5 percent improvements in the first year premiums, its share in total gross premium improved to 30 percent up from 26.8 percent a year earlier. Similarly, the subsequent premiums grew by 23.8 percent during CY11 (**Figure 7.4**).

On the flip side, life insurance saw a considerable decline in the claims ratio. Much of the reduction in the claims ratio has been on account of increasing reinsurance coverage that substantially reduced the claims expense borne by the companies. This coupled with stronger growth in premiums and rising share of outstanding (unsettled) claims in gross claims has brought down the claims ratio to 37.1 percent in CY11.

Increasing stock of government securities surged the profitability of the life insurance.

Besides the banking sector, the life insurance companies are the largest investors in government securities and likewise the higher return on investments remained instrumental in improving the industry's earnings profile. As a result the profit after tax of the life insurance companies surged to Rs1.5 billion in CY11 from Rs0.9 billion a year earlier (**Figure 7.5**) and ROA improved to 0.4 percent.

Companies' analysis show that the conventional business continues to earn positive returns whereas, the two family Takaful companies incurred losses of about Rs100 million during CY11 on account of heavy investments on expansion of their operations and improving physical infrastructure activities.

Soundness indicators of Life insurance remained stable

Improved profitability and entry of new life insurance entities have enhanced the overall equity of the sector. As a result the capital to asset ratio of the insurance industry remained steady at 2.2 percent in CY11, down marginally by 6 bps from 2010. Majority of the life insurance companies complied with the minimum paid-up capital requirement specified by the SECP; however, in the absence of any solvency measure, the leverage of the life insurance seems high. To

Table 7.2: Soundness indicators of Life Insurance

	in percent			
	CY08	CY09	CY10	CY11
Capital to Assets	1.8	1.9	2.2	2.1
Claims Ratio	47.3	46	40.7	37.1
Expense Ratio	36.7	41.8	40.5	38.5
Combined Ratio	84.1	87.8	81.2	75.6
Premium Retention	96.9	97.1	97.6	96.9
Return on Investment	9	13	13.4	13.2
Return on Assets	-0.1	0.4	0.3	0.4

⁶³ The asset concentration of SLIC (State Life Insurance Corporation) in life insurance declined from 93 percent in 2005 to 84 percent in 2011. Similarly, the gross premium concentration also witnessed a gradual decline from 95 percent in 2005 to 64 percent in 2011.

this end, the SECP has been working on revising the existing solvency requirements⁶⁴ (Table 7.2).

The enhanced reinsurance coverage, being pursued by the life insurance companies, led to a decline in the premiums retention ratio during CY11, which consequently contributed towards lower claims ratio. The return on investments (ROI) remained healthy at 13.2 percent, though it observed a marginal dip of 17 bps on account of impairment charges on investments (other than government securities).

Nonlife Insurance

Decline in motor underwriting lowered the non-life premiums

The non-life industry witnessed a marginal deterioration in its gross premiums by 0.2 percent in CY11. Much of the decline occurred on account of slowdown in the motor insurance business that declined by 7.5 percent (YoY). As motor insurance constitutes almost 42 percent of total non-life business, factors such as reduction in auto loans extended by banks and leasing companies and the rising premium cost decreased the premiums of the non-life during CY11 (Figure 7.6).

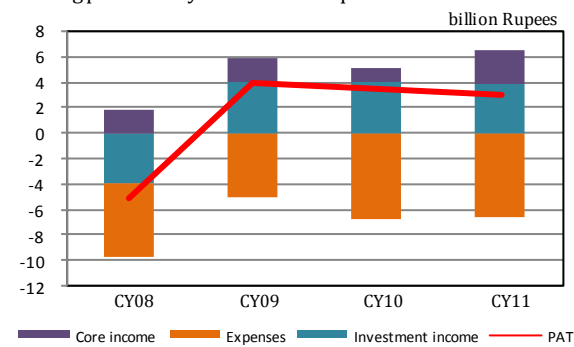
Similarly, the claims expense of the non-life sector also reduced by 16.9 percent on account of higher reinsurance, resulting in a steep decline in the claims ratio to 59 percent in CY11 compared to 68.1 percent last year. Takaful companies, though improved their share in the non-life business remained plagued with high claims ratio. The takaful claims ratio came down by almost 9 percentage points to 84 percent during CY11, however, it is still high and well above the industry average.

Increased provisioning and non-underwriting expenses lowered non-life profitability

The profitability of the non-life companies declined on account of rising provisioning and non-underwriting costs. However, healthy growth in core income represented by improved underwriting income and decline in claims kept the decline in the profitability under check. As a result, the PAT of the non-life industry came down by 15 percent to Rs 3.1 billion, while the ROA edged down to 2.7 percent in CY11 from 3 percent a year earlier (Figure 7.7).

Figure 7.7

Rising profitability of Nonlife Companies



⁶⁴ SECP has revised the solvency requirements vide its Notification on Amendments in Solvency Rules 2012 <http://www.secp.gov.pk/notification/pdf/2012/Amendments-Requirements-Solvency-Rules2012.pdf>

Table 7.3: Soundness of Non-Life Insurance Companies

	in percent			
	CY08	CY09	CY10	CY11
Capital to Assets	57.6	57.8	47.9	52.8
Claims Ratio	64.1	62.4	68.1	58.9
Expense Ratio	24.8	23.5	27.1	27.1
Combined Ratio	88.8	85.9	95.2	86
Premium Retention	64.7	59.4	54.8	52.7
Return on Investment	-8	7.4	6.6	6.8
Return on Assets	-5.4	4.1	3	2.7

Among the other soundness indicators, the capital to assets ratio observed improvement on account of 7.4 percent decline in the assets. Similarly, with the decline in claims ratio and a rather stagnant underwriting, expense ratio has also managed to improve the combined ratio – though still very high in comparison to life insurance industry **(Table 7.3)**⁶⁵. The premium retention in non-life continue to decline as non-life companies are required to compulsory reinsure at least 35 percent⁶⁶ of its surplus business from the local non-life reinsurer⁶⁷. Though, low retention seems to affect the underwriting income however, in a constraining business environment and security concerns, it also turned out to be a positive development as most of the decline in the claims resulted from risk transfer.

Reinsurance

Rising investment income improved the profitability of reinsurance

The country has one public sector reinsurer that caters to the need of the non-life insurance companies. The asset base of the reinsurance improved marginally by 2.7 percent while investments surged by 24 percent during CY11 **(Table 7.4)**. In terms of underwriting business, the gross premium grew by 4.5 percent as non-life insurance companies were required to reinsure their business to hedge the claims expense.

The net claims also recorded an increase of 17.6 percent as it resorted to maintain high premium retention on the back of its strong equity. With improved returns on its investments, the profitability improved by 60 percent during CY11.

Table 7.4: Profile of Reinsurance

	billion Rupees			
	CY08	CY09	CY10	CY11
Equity	7.3	6.8	6.4	6.4
Investments	5.5	5.5	4.7	5.8
Gross Premiums	4.6	5.8	6.6	6.9
Net. Premiums	1.9	2.2	2.9	3.5
Net Claims	1	0.9	1.7	2
Expenses	0.3	0.2	0.3	0.4
Profits	0.9	0.3	0.5	0.8
Assets	12.5	12.4	12.5	12.9

⁶⁵ Combined ratio is the sum of claims ratio and management / underwriting expense ratio.

⁶⁶ According to Par VI, section 42 of the Insurance Ordinance 2000 of the SECP, every non-life insurance company is required to offer PRCL (Pakistan Reinsurance Company) the right of first refusal to reinsurance not less than 35 percent of its surplus business.

⁶⁷ Surplus business in insurance is the business against which company does not maintain reserves to pay for its losses.

During the period under review (July-December 2011), the payment systems continued to ensure efficient payments and settlements. Various payment system channels exhibited sufficient resilience as they operated with minimum down time without any material disruption during H2-CY11. Large Value payment system-PRISM successfully managed increased transactions, particularly in securities due to stress in the liquidity conditions in the interbank market. Similarly, volumes and transaction value for retail payments also increased during the period. Though paper based transactions dominate the retail payments in terms of value, due to robust increase in e-banking transactions, its share continues to shrink. Among e-banking channels, Real Time Online Banking emerged as the main catalyst of growth.

Efficient functioning of payment systems complemented the banking sector growth

Table 8.1: Profile of Payment System Mechanisms

Mechanism	H1-CY11		H2-CY11	
	Volume	Value	Volume	Value
Volume in thousands and value in trillion Rupees				
PRISM	175.4	44.8	176.1	55.6
Volume in millions and value in billion Rupees				
Retail Payments	302.8	59825.1	309.8	60367.3
Paper based	176.8	47,789.1	177.6	47,757.7
E-transactions	126.0	12,036.0	132.2	12,609.6

With advances in the IT infrastructure in the country, the financial sector in general and the banking sector in particular greatly benefitted from improving services and expanding coverage. With efficient payment systems infrastructure, not only banks enhanced penetration in the urban areas, the traditional banking practices also significantly changed from conventional paper-based to electronic modes. Similarly, the efficient flow of funds in the interbank market led to reliable and smooth payment systems operations compliant with the both domestic prudential and international standards of Basel Core Principle (BCP) that aimed at improving efficiency and mitigating associated risks and ensuring stability of the financial system⁶⁸.

The payment system of the country came a long way from traditional paper-based mechanism to a more sophisticated technology driven real-time online transaction based systems capable of handling large value payments between the financial institutions. Keeping in view the systemic importance of the large value payments, the Pakistan Real-time Interbank Settlement Mechanism (PRISM) was launched in CY08 to facilitate inter-bank as well as transactions involving the central bank. The PRISM transactions included securities settlements, large value cheque clearing and interbank transfers.

In addition to the PRISM, the payment system also constitutes conventional channel of retail payments and emerging E-transaction systems. During the period under review, overall payments settlements improved both in terms of volumes and

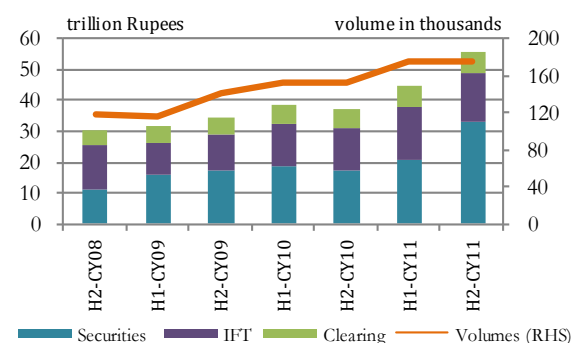
⁶⁸ There are various international standards and measures for ensuring the prudent operations of payment systems including Basel Core Principles (BCP). These include core principle – VII dealing with operational risk, core principle – VIII dealing with efficiency and core principle – IX dealing with access criteria.

value. During H2-CY11, transaction value in PRISM boosted by 24 percent on half-yearly basis while the retail and e-transaction values managed 0.9 and 4.8 percent growth respectively (**Table 8.1**).

PRISM continued to support the growing needs of securities settlements.

Figure 8.1

Profile of PRISM

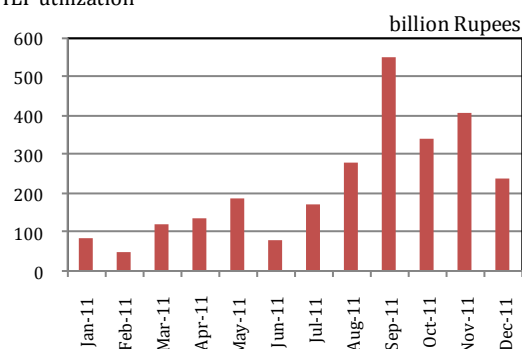


During H2-CY11, the value of PRISM transaction surpassed Rs55.6 trillion which is 2.7 times of the GDP of the country. Similarly, the transaction volumes also improved 2 percent during the period. The most significant factor that contributed towards growth in the settlements values and volume under PRISM was the rising degree of stress in the liquidity conditions in the interbank market during the second half of CY11.

Banks' need for funds have largely been met by securities settlement (collateralization) in exchange for short-term liquidity from the interbank market and from the discount window of the central bank. Other PRISM components including interbank funds transfers and retail cheque clearing witnessed a reduction in transaction values during the period. Much of the reduction in clearing resulted from increasing online funds transfer facilities offered by banks (**Figure 8.1**).

Figure 8.2

ILF utilization



Due to liquidity stress in the interbank market, banks/DFIs participating in the PRISM considerably increased use of the Intraday Liquidity Facility (ILF)⁶⁹. Consequently, the ILF enhanced substantially by 198 percent during the second half of CY11 as banks were not able to readily settle their liabilities and therefore were provided intraday limits to settle transactions and to avoid queues and gridlocks⁷⁰ in the PRISM (**Figure 8.2**). Similarly, the ratio of ILF utilization to PRISM transactions also increased from 1.5 percent in the first half CY11 to 3.7 percent in the second half.

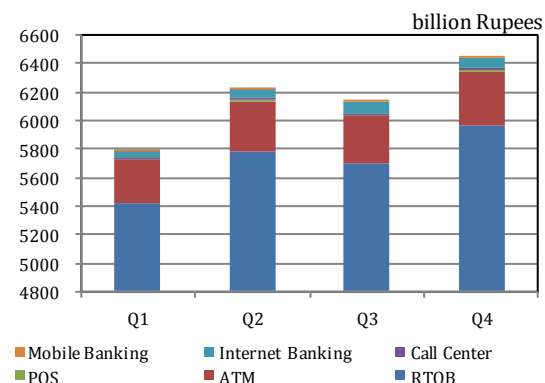
An efficient and reliable payment system serves as the catalyst for growth in the financial system. The PRISM contributed significantly towards improving the efficiency of payments and securities settlements and minimizing the cost and time of interbank transfers and clearing. During H2-CY11, the PRISM availability and performance remained very high; its availability, on average improved to 99.6 percent of the total operational time.

⁶⁹ The ILF provides very short-term liquidity facility to the banks to ensure smooth functioning of the PRISM. In absence of the ILF, the PRISM transactions do not complete and pose settlement risk.

⁷⁰ PRISM transactions are based on FIFO (First in First out). If any transaction is not complete, the PRISM will keep the pending transaction in form of queues. Gridlock occurs when there are large unsettled transactions in the queue.

Figure 8.3

Trends in E-Banking transactions during CY11

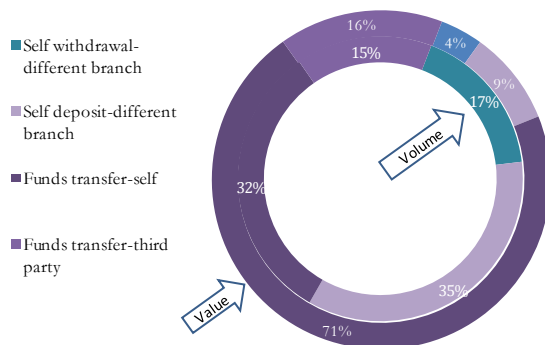


Retail payments system witness a gradual shift towards electronic modes

The retail payment system that link banks with its customers (households and businesses) solely rely on paper-based and electronic modes of payments. Though paper-based transactions still dominate the retail payments with a share of 79.1 percent in value and 57.3 percent in volumes, the share of e-banking transactions continues to grow steadily. with the rapid penetration of internet and mobile phones services. During H2-CY11, the share of electronic modes including RTOB, Automatic Teller Machine (ATM), Point of Sale (POS), Mobile banking and other services improved marginally by 80 bps to 20.9 percent in terms of transaction value. With more banks offering internet / e-banking and mobile banking based products, the share of electronic banking is expected to further improve in the future.

Figure 8.4

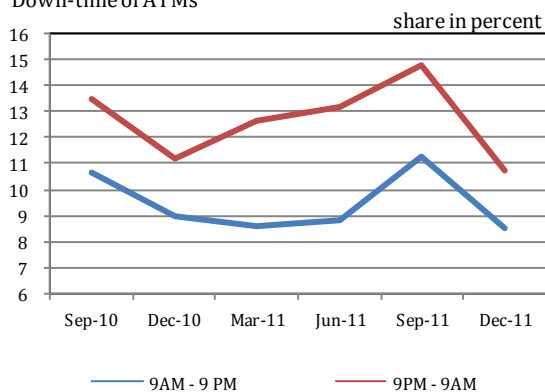
Composition of RTOBs during H2-CY11



Within the electronic banking segment, the RTOB dominated with a share of 92.5 percent in terms of transaction value during H2CY11 (**Figure 8.3**). The RTOB largely constituted large online bank deposits and withdrawals that are drawn in the same bank substituting the conventional clearing and telegraphic and mail transfers (**Figure 8.4**). With an increase in the number of online bank branches to 8905 representing a share of 89.5 percent in total branches network, the RTOB literally created a surge in the efficient and quick online customer clearing and transfer payments.

Figure 8.5

Down-time of ATMs

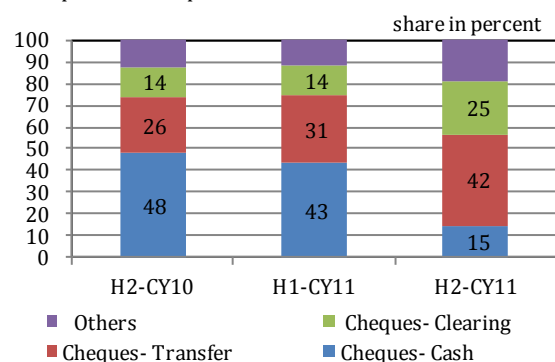


The ATM services are perhaps the most visible and prominent developments of e-banking witnessed in the country. In fact, the ATM services have also become the one leading factor considered by the prospective bank account holder while selecting the bank. Since the introduction of ATM services since early 90s, banks have substantially enhanced their network, to 5409 ATMs by end December, 2011, which provide cash and other services to bank customers, in addition to limited number of machines offering cash deposits services. In terms of value, the ATM transactions account for 5.9 percent of E-banking transactions while in terms of volume, ATM transactions 59.8 percent share. During H2-CY11, ATM transactions value improved by 10.8 percent while the ATM usage augmented by 4.2 percent.

Like PRISM, efficiency of the ATM network also improved during Q4-CY11 (**Figure 8.5**). Historically, the ATM down-time has been lower during the business hours because of proper system maintenance and replenishment of cash in the ATM by the banks. Over the period under review the down time saw a sudden jump in the first half, however, with the resolution of technology related

Figure 8.6

Composition of Paper Based Transactions



issues, the down time substantially improved over the last quarter of the year.

In addition to the developments in the RTOB and ATM, the fast-growing E-banking was boosted by increasing use of branches banking, particularly the internet banking and mobile phone banking. During H2-CY11, the internet banking witnessed an increasing trend in its usage and transaction value as its users became confident of the online security measures taken by banks. In terms of value, the internet banking grew by 5.0 percent while its usage also improved by 1.8 percent.

Pakistan ranks highly in promotion of branchless banking.

Similarly, the mobile phone banking transactions also witnessed a 36.2 percent growth in transaction values. However, the volume of mobile phone banking transactions dropped marginally by 1.9 percent on account of rising security concerns on mobile phones and relatively cheaper internet banking services offered by the banks. Further, World Economic Forum study rated, Pakistan highly on providing mobile financial services in its banking sector⁷¹ and is regarded as one of the fastest developing countries for branchless banking in the world⁷².

Despite technological advancements paper based system dominates

The conventional paper based transactions still lead on account of low level of financial literacy and non-availability of adequate I.T infrastructure in less developed parts of the country. For paper based transactions, settlement of transaction through cheques (clearing, transfers and withdrawal) dominate the customer – bank payment channel. During H2-CY11, a significant change has been observed in paper based transaction as the share of cheques (clearing, transfers and withdrawal) dropped to 81 percent during H2-CY11 (**Figure 8.6**).

⁷¹ The Mobile Financial Services Development Report 2011- World Economic Forum.

⁷² <http://www.cgap.org/p/site/c/template.rc/1.9.55438/>

Annexes

List of Annexes

1. Statistics of the Banking System	75
Table 1.1: Key variables of Balance Sheet and Profit & Loss Statement	76
Table 1.2: Growth Rates of Key Variables and Key Financial Soundness Indicators (FSIs)	76
Table 1.3: Group wise Balance Sheets and Income Statements.....	77
Table 1.4: Financial Soundness Indicators*	78
Table 1.5: Banks' Group-wise Key Variables.....	80
Table 1.6: Concentration in the Banking System	82
Asset Quality:	83
Table 1.7: Asset Quality Indicators	83
Table 1.8: Segment-wise Advances and Non Performing Loans (NPLs)*	84
Table 1.9: Sector-wise Advances and Non Performing Loans (NPLs)*	84
Soundness & Resilience:	85
Table 1.10: Category-wise Profitability.....	85
Table 1.11: Category-wise Profitability Indicators.....	85
Table 1.12: Break-up of Mark-up/Return/Interest Earned	86
Table 1.13: Distribution of Banks by Capital Adequacy Ratio (CAR).....	86
Table 1.14: Capital Structure and Capital Adequacy of Banks and DFIS.....	87
Table 1.15: Stress Testing Results	88
Table 1.16: List of Banks.....	89
2. Islamic Banking.....	90
Table 2.1: Group-wise Balance Sheets and Income Statements of Islamic Banks/Branches	91
Table 2.2: Financial Soundness Indicators of Islamic Banking*	92

Table 2.3: List of Islamic Banks and Conventional Banks with Islamic Banking Branches	93
3. Non-Banking Financial Institutions	94
Table 3.1: Balance Sheets and Income Statements of DFIs	95
Table 3.2: Financial Soundness Indicators of DFIs	96
Table 3.3: List of DFIs	97
Table 3.4: NBFC's category-wise key variables	98
Table 3.5: List of Non-Banking Finance Companies	99
4. Insurance Sector	101
Table 4.1: Insurance Sector: Category-wise key variables	102
Table 4.2: List of Insurance Companies	103
Table 4.2: List of Insurance Companies	103

Note: Statistics for CY10 and CY11 are based on audited results, unless mentioned otherwise.

1. Statistics of the Banking System

Table 1.1: Key variables of Balance Sheet and Profit & Loss Statement

	billion Rupees										
	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11	CY11
Total Assets	2,223	2,542	3043	3660	4,353	5,172	5,628	6,516	7,117	7,715	8,171
Investments (net)	701	787	679	800	833	1,276	1,087	1,737	2,157	2,620	3,055
Advances (net)	921	1,108	1574	1991	2,428	2,688	3,173	3,240	3,358	3,383	3,349
Deposits	1,678	1,964	2393	2832	3,255	3,854	4,218	4,786	5,451	5,965	6,244
Equity	107	140	202	292	402	544	563	660	695	723	784
Profit Before Tax (ytd)	19	44	52	94	124	107	63	81	105	77	170
Profit After Tax (ytd)	3	25	35	63	84	73	43	54	65	51	112
Provisioning Charges (ytd)	22	18	11	19	22	60	106	97	75	30	50
Non-Performing Loans	232	211	200	177	177	218	359	446	556	579	592
Non-Performing Loans (net)	91	76	59	41	39	30	109	134	185	186	182

Note: Statistics for Jun-11 are based on un-audited accounts submitted by banks.

The statistics of profits and provision charges are on year-to-date (ytd) basis.

Table 1.2: Growth Rates of Key Variables and Key Financial Soundness Indicators (FSIs)

	Percent									
	CY04	CY07	CY08	CY08	CY09	CY10	Jun-11	CY11		
Growth Rates	YoY	YoY	YoY	YoY	YoY	YoY	HY	YoY	HY	YoY
Assets	19.7	18.8	8.8	8.8	15.8	9.2	8.4	13.7	5.9	14.8
Loans (Net)	42.1	10.7	18.0	18.3	2.1	3.7	0.8	4.7	(1.0)	(0.3)
Deposits	21.9	18.4	9.4	9.4	13.5	13.9	9.4	16.3	4.7	14.5
Investments (Net)	(13.6)	53.1	(14.8)	(15.4)	59.9	24.2	21.5	38.4	16.6	41.6
Equity	44.5	35.3	3.4	3.4	17.3	5.2	4.0	8.1	8.6	12.9
KEY FSIs:	CY04	CY07	CY08	CY08	CY09	CY10	Jun-11	CY11		
Capital Adequacy Ratio	10.5	12.3	12.2	12.3	14.0	13.9	14.1	15.1		
Capital to Total Assets	6.7	10.5	10.0	10.0	10.1	9.8	9.4	9.6		
NPLs to Loans (Gross)	11.6	7.6	10.5	10.5	12.6	14.9	15.3	15.7		
Net NPLs to Net Loans	3.8	1.1	3.4	3.4	4.1	5.5	5.5	5.4		
ROA (Before Tax)	1.9	2.2	1.2	1.2	1.3	1.5	2.1	2.2		
ROE^ (Before Tax)	30.5	22.6	11.4	11.4	13.2	15.5	21.8	23.0		
Liquid Assets/ Total Deposits	46.5	45.1	37.7	38.2	44.5	36.1	49.5	45.5		
Advances to Deposit Ratio	65.8	69.7	75.2	75.5	67.7	61.6	56.7	53.6		

^ Based on Average Equity plus Surplus on Revaluation.

Note: Growth rates for Jun-11 are based on un-audited quarterly results.

Table 1.3: Group wise Balance Sheets and Income Statements
(December 31, 2011)

							million Rupees	
Financial Position	PSCB	LPB	FB	CB	SB	All Banks	Absolute change Half Yearly*	Year on Year
ASSETS								
Cash & Balances With Treasury Banks	153,807	505,803	38,476	698,086	3,878	701,963	116,426	107,655
Balances With Other Banks	33,521	125,722	4,428	163,672	13,365	177,037	12,702	(2,808)
Lending To Financial Institutions	66,140	122,836	18,354	207,330	876	208,205	(7,519)	(6,559)
Investments - Net	479,609	2,442,332	113,382	3,035,323	19,546	3,054,869	434,620	897,713
Advances - Net	689,423	2,499,799	66,411	3,255,634	93,585	3,349,219	(34,238)	(9,006)
Other Assets	85,114	258,739	6,831	350,685	12,514	363,198	(73,164)	55,411
Operating Fixed Assets	33,167	197,875	2,149	233,190	5,075	238,266	9,805	14,071
Deferred Tax Assets	22,077	50,364	5,243	77,684	331	78,016	(2,458)	(2,719)
TOTAL ASSETS	1,562,858	6,203,471	255,274	8,021,604	149,169	8,170,773	456,173	1,053,758
LIABILITIES								
Bills Payable	10,375	70,476	3,985	84,837	424	85,261	4,078	10,071
Borrowings From Financial Institution	74,791	501,115	21,464	597,370	77,881	675,251	113,231	136,817
Deposits And Other Accounts	1,248,199	4,810,209	167,870	6,226,278	17,327	6,243,606	278,762	792,626
Sub-ordinated Loans	-	54,323	-	54,323	3,405	57,728	663	3,234
Liabilities Against Assets Subject To Finance Lease	84	7	9	100	14	114	(39)	(51)
Other Liabilities	63,225	178,771	19,415	261,411	42,127	303,539	(11,110)	12,832
Deferred Tax Liabilities	12	20,906	-	20,917	-	20,917	8,748	8,573
TOTAL LIABILITIES	1,396,686	5,635,806	212,744	7,245,236	141,179	7,386,415	394,334	964,102
NET ASSETS	166,172	567,665	42,530	776,368	7,990	784,358	61,840	89,656
NET ASSETS REPRESENTED BY:								
Share Capital	41,414	309,306	38,720	389,440	15,508	404,948	30,458	46,832
Reserves	45,415	123,013	149	168,577	9,374	177,951	(3,614)	4,662
Unappropriated Profit	55,921	89,039	3,818	148,778	(21,543)	127,235	28,464	33,583
Share Holders' Equity	142,751	521,358	42,687	706,796	3,338	710,134	55,309	85,077
Surplus/Deficit On Revaluation Of Assets	23,422	46,307	(157)	69,572	4,652	74,224	6,531	4,578
TOTAL	166,172	567,665	42,530	776,368	7,990	784,358	61,840	89,655
PROFIT AND LOSS STATEMENT								
Mark-Up/ Return/Interest Earned	128,580	582,956	24,028	735,564	12,152	747,716	123,019	
Mark-Up/ Return/Interest Expenses	77,559	310,871	12,183	400,612	5,189	405,802	65,782	
Net Mark-Up / Interest Income	51,021	272,086	11,844	334,951	6,963	341,914	57,237	
Provisions & Bad Debts Written Off Directly/(Reversal)	7,518	40,629	1,305	49,452	578	50,030	(25,257)	
Net Mark-Up / Interest Income After Provision	43,503	231,456	10,540	285,499	6,385	291,884	82,494	
Fees, Commission & Brokerage Income	10,576	35,093	1,800	47,469	57	47,527	3,221	
Dividend Income	2,338	9,555	-	11,893	147	12,040	5,253	
Income From Dealing In Foreign Currencies	3,370	17,058	4,366	24,794	1	24,795	4,636	
Other Incomes	6,249	15,644	(1,615)	20,278	3,183	23,461	(1,793)	
Total Non - Markup / Interest Income	22,533	77,350	4,552	104,434	3,388	107,822	11,316	
Administrative Expenses	36,655	169,830	9,634	216,118	6,078	222,196	26,977	
Other Expenses	22	7,526	96	7,644	177	7,821	2,255	
Total Non-Markup/Interest Expenses	36,676	177,355	9,730	223,762	6,255	230,017	29,232	
Profit Before Tax and Extra Ordinary Items	29,359	131,451	5,361	166,172	3,518	169,690	64,578	
Extra ordinary/unusual Expense/(Gains)	-	-	(239)	(239)	-	(239.14)	(661.37)	
PROFIT/ (LOSS) BEFORE TAXATION	29,359	131,451	5,601	166,411	3,518	169,929	65,239	
Less: Taxation	9,526	45,735	1,940	57,201	1,130	58,331	18,710	
PROFIT/ (LOSS) AFTER TAX	19,833	85,716	3,660	109,210	2,388	111,598	46,529	

Based on un-audited results.

Table 1.4: Financial Soundness Indicators*

Indicators	Percent						
	2006	2007	2008	2009	2010	Jun-11	2011
CAPITAL ADEQUACY							
Risk Weighted CAR**							
Public Sector Commercial Banks	15.2	16.1	13.4	15.1	14.7	12.8	16.5
Local Private Banks	12.7	11.8	11.9	13.9	13.6	14.1	14.4
Foreign Banks	15.0	14.6	21.8	23.0	23.8	25.2	31.3
Commercial Banks	13.3	12.8	12.6	14.5	14.1	14.2	15.3
Specialized Banks	-8.3	-6.2	-4.9	-1.5	4.7	8.0	8.9
All Banks	12.7	12.3	12.2	14.0	13.9	14.1	15.1
Tier 1 Capital to RWA							
Public Sector Commercial Banks	11.1	12.2	10.9	12.6	12.2	10.8	14.4
Local Private Banks	10.4	9.9	10.0	11.4	11.4	12.0	12.3
Foreign Banks	14.3	14.0	21.3	22.5	23.5	25.0	31.1
Commercial Banks	10.8	10.5	10.6	12.0	12.0	12.2	13.3
Specialized Banks	-13.3	-12.5	-10.1	-5.8	-0.9	2.0	3.4
All Banks	10.0	10.0	10.1	11.6	11.6	11.9	13.0
Capital to Total Assets							
Public Sector Commercial Banks	12.2	13.7	10.7	11.3	11.7	10.5	10.6
Local Private Banks	9.2	10.2	10.0	9.9	9.3	8.9	9.2
Foreign Banks	10.1	11.2	14.5	14.8	14.8	15.1	16.7
Commercial Banks	9.9	10.9	10.3	10.4	9.9	9.4	9.7
Specialized Banks	-8.0	-5.4	-3.2	-1.7	1.2	5.7	5.4
All Banks	9.4	10.5	10.0	10.1	9.8	9.4	9.6
ASSET QUALITY							
NPLs to Total Loans							
Public Sector Commercial Banks	9.0	8.4	16.3	16.9	22.9	21.5	21.1
Local Private Banks	5.2	6.5	8.7	11.1	12.5	13.2	13.8
Foreign Banks	1.0	1.6	2.9	6.7	9.5	9.0	10.4
Commercial Banks	5.7	6.7	9.9	12.1	14.5	14.8	15.3
Specialized Banks	39.1	34.3	28.8	25.5	28.7	31.1	30.1
All Banks	6.9	7.6	10.5	12.6	14.9	15.3	15.7
Provision to NPLs							
Public Sector Commercial Banks	84.5	89.0	66.9	67.8	52.4	53.8	58.2
Local Private Banks	78.7	88.5	70.2	71.0	73.2	74.7	74.6
Foreign Banks	191.7	157.0	81.9	75.2	86.6	88.8	89.3
Commercial Banks	81.5	89.1	69.3	70.1	66.9	68.5	69.9
Specialized Banks	64.1	68.6	72.4	65.7	63.4	59.2	59.1
All Banks	77.8	86.1	69.6	69.9	66.7	67.9	69.3
Net NPLs to Net Loans							
Public Sector Commercial Banks	1.5	1.0	6.1	6.1	12.4	11.2	10.1
Local Private Banks	1.1	0.8	2.7	3.5	3.7	3.7	3.9
Foreign Banks	-1.0	-0.9	0.5	1.8	1.4	1.1	1.2
Commercial Banks	1.1	0.8	3.3	4.0	5.3	5.2	5.1
Specialized Banks	18.7	14.0	10.0	10.5	12.8	15.5	14.9
All Banks	1.6	1.1	3.4	4.1	5.5	5.5	5.4
Net NPLs to Capital							
Public Sector Commercial Banks	6.4	3.4	30.3	27.4	48.8	50.2	41.8
Local Private Banks	7.1	4.1	15.9	17.4	18.9	17.9	17.1
Foreign Banks	-5.1	-4.1	1.6	4.4	2.6	2.0	1.9
Commercial Banks	6.2	3.7	17.9	18.8	25.0	24.0	21.6
Specialized Banks					2.0	-	3.0
All Banks	9.7	5.6	19.4	20.4	26.7	25.7	23.1
EARNINGS							
Return on Assets (Before Tax)							
Public Sector Commercial Banks	4.0	3.5	0.6	1.5	1.8	1.8	2.0
Local Private Banks	3.1	2.0	1.3	1.3	1.5	2.2	2.3
Foreign Banks	3.2	1.5	0.0	-0.3	0.9	2.2	2.3
Commercial Banks	3.2	2.3	1.1	1.3	1.5	2.1	2.2
Specialized Banks	-1.3	1.4	3.2	3.1	2.0	1.1	2.4
All Banks	3.1	2.2	1.2	1.3	1.5	2.1	2.2

Financial Soundness Indicators* cont'd:

Indicators	Percent						
	2006	2007	2008	2009	2010	Jun-11	2011
Return on Assets (After Tax)							
Public Sector Commercial Banks	2.7	2.5	0.5	1.3	1.3	1.2	1.4
Local Private Banks	2.1	1.4	0.9	0.9	0.9	1.4	1.5
Foreign Banks	2.1	0.7	0.3	(0.3)	0.4	1.6	1.5
Commercial Banks	2.2	1.6	0.8	0.9	0.9	1.4	1.5
Specialized Banks	(1.8)	0.7	1.8	1.2	1.2	1.1	1.6
All Banks	2.1	1.5	0.8	0.9	1.0	1.4	1.5
ROE (Avg. Equity & Surplus) (Before Tax)							
Public Sector Commercial Banks	32.4	27.2	5.2	13.3	15.2	16.6	18.0
Local Private Banks	36.2	20.4	12.9	13.2	15.6	23.8	24.7
Foreign Banks	30.0	13.1	0.0	(2.4)	5.8	14.8	14.5
Commercial Banks	34.7	21.8	10.6	12.4	15.0	21.8	22.7
Specialized Banks	-	-	-	-	2.0	-	3.0
All Banks	35.2	22.6	11.4	13.2	15.5	21.8	23.0
ROE (Avg. Equity & Surplus) (After Tax)							
Public Sector Commercial Banks	21.7	19.5	4.4	11.4	11.2	11.0	12.2
Local Private Banks	25.0	13.8	8.5	8.6	9.3	15.4	16.1
Foreign Banks	20.4	6.0	2.2	(2.3)	2.7	10.9	9.5
Commercial Banks	23.7	15.0	7.3	8.6	9.4	14.2	14.9
Specialized Banks	-	-	-	-	2.0	-	3.0
All Banks	23.8	15.4	7.8	8.9	9.6	14.3	15.1
NII/Gross Income							
Public Sector Commercial Banks	69.5	65.9	65.4	63.0	69.1	70.2	69.4
Local Private Banks	73.5	70.7	73.2	75.9	77.2	77.5	77.9
Foreign Banks	65.8	59.1	61.3	64.8	67.6	72.9	72.2
Commercial Banks	72.1	69.2	71.2	73.3	75.4	76.2	76.2
Specialized Banks	40.1	42.8	46.6	44.7	51.0	64.6	67.3
All Banks	70.9	68.2	70.3	72.4	74.7	75.9	76.0
Cost / Income Ratio							
Public Sector Commercial Banks	31.8	30.2	39.1	47.5	49.1	49.2	49.9
Local Private Banks	40.7	45.4	51.6	50.1	52.5	50.2	50.8
Foreign Banks	49.8	57.0	69.6	77.5	65.2	62.2	59.3
Commercial Banks	39.4	42.8	50.0	50.9	52.4	50.5	50.9
Specialized Banks	62.6	53.2	52.1	61.3	61.3	69.8	60.4
All Banks	40.3	43.2	50.1	51.2	52.7	51.0	51.1
LIQUIDITY							
Liquid Assets/Total Assets							
Public Sector Commercial Banks	33.9	37.0	30.6	31.1	34.6	29.9	40.9
Local Private Banks	31.1	32.5	26.8	32.3	35.7	39.6	46.2
Foreign Banks	41.0	41.6	45.2	55.0	64.6	65.2	68.6
Commercial Banks	32.2	33.8	28.3	32.9	36.4	38.5	45.9
Specialized Banks	23.0	27.9	24.5	19.8	19.6	22.4	23.5
All Banks	31.9	33.6	28.2	32.7	36.1	38.2	45.5
Liquid Assets/Total Deposits							
Public Sector Commercial Banks	42.6	47.1	38.9	40.1	43.5	37.1	51.3
Local Private Banks	40.6	42.9	35.0	43.4	45.8	50.4	59.5
Foreign Banks	61.1	61.1	71.6	82.4	96.4	95.3	104.3
Commercial Banks	42.0	44.3	37.1	44.0	46.8	49.1	59.1
Specialized Banks	205.4	247.7	229.4	167.1	149.4	181.2	202.0
All Banks	42.7	45.1	37.7	44.5	47.1	49.5	59.5
Advances/Deposits							
Public Sector Commercial Banks	64.6	60.0	68.4	65.2	58.0	58.1	55.2
Local Private Banks	74.5	70.1	75.1	66.6	61.3	55.1	52.0
Foreign Banks	80.1	75.2	68.9	56.1	42.0	40.8	39.6
Commercial Banks	72.7	73.8	73.6	66.0	60.1	55.3	52.3
Specialized Banks	528.4	507.3	577.0	560.8	491.5	517.8	540.1
All Banks	74.6	69.7	75.2	67.7	61.6	56.7	53.6

* Source: FSIs are prepared on the basis of annual audited accounts except for end Jun -11 which are based on unaudited Quarterly Report of Condition (QRC) submitted by banks.

** Data of IDBP, PPCBL, and SME is based on Basel I.

Table 1.5: Banks' Group-wise Key Variables

All Banks

	billion Rupees										
	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Paid up Capital	67	78	98	106	168	248	281	325	358	374	405
Equity	106.81	140.08	202	292	402	544	563	660	695	723	784
Deposits	1,678.40	1,963.59	2,393	2,832	3,255	3,854	4,218	4,786	5,451	5,965	6,244
Liabilities	2,116.25	2,402.19	2,841	3,367	3,951	4,627	5,065	5,856	6,422	6,992	7,386
Advances (net of Provision)	921.27	1,107.65	1,574	1,991	2,428	2,688	3,173	3,240	3,358	3,383	3,349
Investments (net of Provisions)	701.01	786.65	679	800	833	1,276	1,087	1,737	2,157	2,620	3,055
Assets	2,223.06	2,542.28	3,043	3,660	4,353	5,172	5,628	6,516	7,117	7,715	8,171
Income	181	167	168	271	385	475	582	690	721	413	856
Expense	162.10	123.43	116	177	262	368	519	609	617	336	686
Profit before tax	19	44	52	94	124	107	63	81	105	77	170
Profit after tax	3	25	35	63	84	73	43	54	65	51	112

* Un-audited results.

Public Sector Commercial Banks

	million Rupees										
	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Paid up Capital	18,113	18,536	7,945	9,773	12,278	16,671	18,544	21,339	34,030	37,394	41,414
Equity	49,166	58,862	56,856	92,712	102,043	142,270	111,986	139,219	159,790	153,546	166,172
Deposits	721,899	799,359	544,817	578,060	665,642	812,856	819,683	952,373	1,087,506	1,183,100	1,248,199
Liabilities	828,402	900,571	596,167	631,739	734,145	893,622	930,324	1,090,831	1,205,801	1,315,176	1,396,686
Advances (net of Provision)	319,684	365,187	270,884	345,514	429,716	487,362	560,666	620,596	630,704	687,759	689,423
Investments (net of Provisions)	303,759	346,246	176,159	188,088	179,883	296,670	204,784	297,689	383,310	396,274	479,609
Assets	877,568	959,434	653,023	724,450	836,189	1,035,892	1,042,310	1,230,050	1,365,591	1,468,723	1,562,858
Income	29,083	57,346	34,660	52,968	73,519	90,970	103,421	119,979	131,722	72,172	151,113
Expense	55,372	41,205	20,437	30,328	41,961	57,748	96,855	103,218	108,949	59,532	121,753
Profit before tax	10,909	16,141	14,223	22,640	31,558	33,222	6,566	16,762	22,773	12,640	29,359
Profit after tax	4,768	9,365	7,952	15,379	21,192	23,851	5,644	14,372	16,798	8,433	19,833

* Un-audited results.

Local Private Banks

	million Rupees										
	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Paid up Capital	24,119	30,232	58,130	59,376	124,252	199,547	214,571	253,015	274,587	286,639	309,306
Equity	50,638	64,273	128,308	176,569	287,882	389,726	421,074	487,719	498,613	523,717	567,665
Deposits	757,403	953,507	1,603,996	1,992,987	2,425,781	2,909,310	3,236,220	3,655,994	4,188,181	4,595,919	4,810,209
Liabilities	916,818	1,147,357	1,851,966	2,306,329	2,886,107	3,446,053	3,799,764	4,417,543	4,875,191	5,331,805	5,635,806
Advances (net of Provision)	395,810	554,722	1,080,089	1,413,072	1,807,163	2,039,623	2,429,934	2,435,792	2,568,695	2,534,501	2,499,799
Investments (net of Provisions)	334,395	389,798	465,459	523,376	598,435	936,764	847,045	1,373,082	1,679,542	2,115,413	2,442,332
Assets	967,456	1,211,630	1,980,274	2,482,898	3,173,989	3,835,779	4,220,838	4,905,262	5,373,804	5,855,523	6,203,471
Income	29,083	76,326	105,596	177,860	273,918	348,149	437,498	524,275	547,425	318,073	660,306
Expense	64,818	52,481	74,523	117,198	187,158	278,615	385,022	463,734	470,401	257,186	528,855
Profit before tax	11,892	23,845	31,073	60,662	86,760	69,530	52,477	60,541	77,024	60,887	131,451
Profit after tax	6,368	14,813	21,782	41,188	59,490	47,263	34,704	39,265	45,646	39,289	85,716

* Un-audited results.

Foreign Banks

	million Rupees										
	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Paid up Capital	21,482	20,058	20,053	23,111	17,469	17,085	32,130	34,885	33,992	34,949	38,720
Equity	29,632	26,889	27,184	32,202	22,686	19,373	33,971	35,739	34,508	36,968	42,530
Deposits	182,753	193,845	226,976	244,955	150,093	117,561	147,938	160,936	156,331	167,910	167,870
Liabilities	249,946	244,659	276,711	307,176	201,081	153,339	200,590	205,297	198,746	208,326	212,744
Advances (net of Provision)	131,604	123,762	159,172	168,439	120,223	88,455	101,921	90,325	65,628	68,438	66,411
Investments (net of Provisions)	57,323	43,844	30,949	67,383	38,477	26,427	22,593	52,373	79,809	87,888	113,382
Assets	279,578	271,548	303,896	339,378	223,783	172,711	234,562	241,037	233,253	245,294	255,274
Income	24,413	18,724	17,872	30,300	24,107	20,169	24,005	27,741	25,147	13,893	28,579
Expense	17,795	11,653	10,659	18,741	17,784	17,733	23,998	28,591	23,100	11,256	22,979
Profit before tax	6,618	7,071	7,212	11,559	6,323	2,435	7	(850)	2,046	2,637	5,601
Profit after tax	4,156	4,180	5,816	8,035	4,288	1,122	651	(809)	960	1,943	3,660

* Un-audited results.

Specialized Banks

	million Rupees										
	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Paid up Capital	3,500	9,243	12,185	13,946	14,452	14,849	15,506	15,507	15,507	15,508	15,508
Equity	(22,626)	(9,942)	(9,971)	(9,106)	(10,214)	(6,931)	(4,163)	(2,424)	1,791	8,286	7,990
Deposits	16,344	16,878	17,356	15,861	13,491	14,320	13,883	16,588	18,962	17,915	17,327
Liabilities	121,082	109,607	115,755	121,961	129,173	134,125	134,332	142,414	142,577	136,774	141,179
Advances (net of Provision)	74,173	63,977	64,303	63,554	70,617	72,647	80,114	93,031	93,197	92,759	93,585
Investments (net of Provisions)	5,534	6,764	6,890	21,380	16,581	15,926	12,147	13,819	14,495	20,675	19,546
Assets	98,456	99,666	105,784	112,855	118,959	127,193	130,178	139,990	144,367	145,060	149,169
Income	13,685	14,785	9,896	9,531	13,944	15,943	17,039	17,612	16,909	8,834	15,540
Expense	24,112	18,088	10,256	10,626	14,710	14,272	12,888	13,392	14,063	7,692	12,022
Profit before tax	(10,428)	(3,302)	(360)	(1,095)	(766)	1,671	4,151	4,220	2,846	1,142	3,518
Profit after tax	(12,366)	(3,677)	(871)	(1,300)	(1,075)	875	2,317	1,617	1,665	1,159	2,388

* Un-audited results.

Table 1.6: Concentration in the Banking System
(December 31, 2011)

							Percent
Indicators	Top 5 Banks	6-10 Banks	11-20 Banks	21-28 Banks	FBs	SBs	Industry
Asset							
Share of Total Assets	50.9	22.6	18.1	3.5	3.1	1.8	100
Share of Total Investments	49.9	23.6	18.7	3.5	3.7	0.6	100
<i>of which investment in Government Securities</i>	83.6	91.8	83.9	87.9	99.9	91.7	86
Advances*							
Advances:public*	70.8	17.7	8.4	2.8	0.2	0.1	100
Advances:private*	48.8	22.1	20.5	2.9	2.2	3.5	100
Sectoral Distribution of Loans*							
Corporate Sector	49.5	23.2	21.5	3.1	2.4	0.2	100
SMEs	45.9	18.7	30.9	1.1	0.2	3.2	100
Agriculture	30.6	9.1	5.2	0.0	0.0	55.0	100
Consumer Finance	57.0	22.5	11.8	5.9	2.7	0.0	100
Commodity Financing	66.6	21.3	9.5	2.6	0.0	0.0	100
Staff Loans	56.0	19.6	14.1	3.1	3.0	4.1	100
Others	85.0	8.1	1.3	0.3	5.1	0.3	100
Total	51.8	21.5	18.8	2.9	2.0	3.1	100
NPLs / Gross Loans	12.9	12.0	27.0	9.1	10.4	30.1	15.7
Net NPLs / Capital	10.3	17.2	87.4	10.7	1.9	175.0	23.1
Liabilities							
Share of Total Deposits	53.0	23.2	17.6	3.3	2.7	0.3	100
Customer Fixed Deposits	45.2	23.0	23.5	4.2	3.9	0.2	100
Customer CASA	56.1	23.6	14.9	2.9	2.2	0.3	100
Customer Deposits others	39.5	28.5	28.4	1.5	1.4	0.7	100
Financial Institutions Remunerative Deposits	48.3	25.3	21.1	4.1	0.8	0.4	100
Financial Institutions Non-Remunerative Deposits	95.0	1.9	1.0	0.3	1.8	0.0	100
Capital Adequacy							
Capital/RWA (Capital Adequacy Ratio)	16.2	12.5	11.3	29.3	31.3	8.9	15.1
Tier 1 Capital / RWA	13.8	9.6	10.4	29.6	31.1	3.4	13.0
Net Worth / Total Assets	10.7	7.4	7.2	16.0	16.7	5.4	9.6
Share of Risk Weighted Assets	52.8	20.6	18.3	3.0	2.8	2.6	100
Earning & Profitability							
Profit/Loss (Before Tax)	75.8	14.7	2.5	1.7	3.3	2.1	100
Net Interest Income / Gross Income	78.1	77.4	62.3	83.1	72.2	67.3	76.0
Non-Interest Expense / Gross Income	21.9	22.6	37.7	16.9	27.8	32.7	24.0
Provision Expense to Gross Income	11.4	14.0	8.7	0.8	8.0	5.6	11.1
Liquidity							
Liquid Assets / Total Assets	45.0	47.2	42.8	46.1	68.6	23.5	45.5
Liquid Assets / Total Deposits	56.6	60.2	57.5	63.5	104.3	202.0	59.5
Advances to deposits ratio	52.5	51.3	55.2	49.9	39.6	540.1	53.6

* Based on un-audited results.

Asset Quality:

Table 1.7: Asset Quality Indicators

Break up of NPLs by Classification

	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
OAEM	14,980	6,890	12,660	8,999	11,558	12,152	14,141	16,686	15,521
Sub Standard	13,853	17,405	17,718	36,520	78,503	63,905	53,030	60,464	50,262
Doubtful	15,103	12,206	17,429	24,248	67,877	77,809	68,665	58,963	58,346
Loss	155,817	140,814	128,959	148,233	201,301	292,138	420,132	443,084	467,450
Total	199,753	177,315	176,766	217,999	359,238	446,005	555,968	579,197	591,579

* Un-audited results.

Group-wise Break up of Advances

	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
PSCBs	301,794	378,514	465,065	526,566	629,389	700,902	716,562	777,606	786,264
LPBs	1,152,352	1,486,297	1,881,906	2,163,480	2,587,530	2,643,594	2,826,985	2,811,008	2,785,927
FBs	161,749	171,466	122,626	90,666	104,440	95,113	71,495	74,385	73,215
CBs	1,615,896	2,036,277	2,469,597	2,780,712	3,321,360	3,439,608	3,615,042	3,662,999	3,645,407
SBs	99,165	90,567	94,459	94,974	101,189	111,723	113,961	113,683	113,828
Industry	1,715,060	2,126,844	2,564,055	2,875,686	3,422,549	3,551,331	3,729,003	3,776,682	3,759,235

* Un-audited results.

Group-wise Break up of Non Performing Loans (NPLs)

	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
PSCBs	40,141	38,018	41,841	44,054	102,656	118,400	163,786	166,915	166,289
LPBs	103,401	95,672	96,475	139,997	224,395	292,780	352,672	370,244	383,437
FBs	2,530	2,074	1,253	1,409	3,077	6,369	6,774	6,701	7,623
CBs	146,072	135,765	139,568	185,460	330,128	417,549	523,232	543,860	557,349
SBs	53,682	41,668	37,198	32,538	29,110	28,456	32,736	35,337	34,230
Industry	199,754	177,433	176,766	217,998	359,238	446,005	555,968	579,197	591,579

* Un-audited results.

Group-wise Provisions

	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
PSCBs	30,911	32,999	35,349	39,204	68,723	80,305	85,858	89,848	96,840
LPBs	72,263	73,225	76,080	123,855	157,598	207,803	258,289	276,507	286,128
FBs	2,577	3,027	2,403	2,211	2,519	4,788	5,867	5,947	6,804
CBs	105,751	109,252	113,831	165,271	228,839	292,896	350,014	372,302	389,773
SBs	34,862	27,012	23,841	22,332	21,075	18,692	20,764	20,924	20,244
Industry	140,613	136,264	137,672	187,603	249,914	311,588	370,778	393,226	410,016

* Un-audited results.

Group-wise Advances (net of provisions)

	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
PSCBs	270,884	345,514	429,716	487,362	560,666	620,596	630,704	687,759	689,423
LPBs	1,080,089	1,413,072	1,807,163	2,039,623	2,429,934	2,435,792	2,568,695	2,534,501	2,499,799
FBs	159,172	168,439	120,223	88,455	101,922	90,325	65,628	68,438	66,411
CBs	1,510,144	1,927,026	2,357,102	2,615,440	3,092,522	3,146,713	3,265,028	3,290,698	3,255,634
SBs	64,303	63,554	70,617	72,647	80,114	93,031	93,197	92,759	93,585
Industry	1,574,447	1,990,580	2,427,719	2,688,087	3,172,636	3,239,744	3,358,225	3,383,457	3,349,219

* Un-audited results.

Group-wise Non Performing Loans-NPLs (net of provisions)

	CY04	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
PSCBs	9,230	5,019	6,492	4,850	33,934	38,095	77,928	77,067	69,448
LPBs	31,138	22,447	20,395	16,142	66,797	84,977	94,382	93,737	97,309
FBs	(47)	(952)	(1,150)	(803)	558	1,581	907	754	819
CBs	40,321	26,513	25,737	20,189	101,289	124,653	173,218	171,558	167,576
SBs	18,820	14,655	13,356	10,206	8,035	9,764	11,972	14,414	13,987
Industry	59,141	41,169	39,094	30,395	109,324	134,417	185,190	185,972	181,563

* Un-audited results.

Table 1.8: Segment-wise Advances and Non Performing Loans (NPLs)*

amount in million Rupees, ratio in percent

	Dec-10			Sep-11			Dec-11		
	Advances	NPLs	Infection Ratio	Advances	NPLs	Infection Ratio	Advances	NPLs	Infection Ratio
Corporate Sector	2,329,440	357,717	15.4	2,345,911	415,502	17.7	2,419,390	414,240	17.1
SMEs Sector	346,986	97,205	28.0	277,613	97,789	35.2	303,685	95,501	31.4
Agriculture Sector	169,315	30,359	17.9	174,693	35,964	20.6	176,860	34,105	19.3
Consumer sector	259,625	43,879	16.9	244,450	45,568	18.6	242,235	44,965	18.6
<i>i. Credit cards</i>	26,244	5,114	19.5	23,935	4,777	20.0	23,406	4,822	20.6
<i>ii. Auto loans</i>	57,341	5,839	10.2	48,383	5,166	10.7	46,785	4,868	10.4
<i>iii. Consumer durable</i>	1,003	109	10.8	609	104	17.0	126	100	79.1
<i>iv. Mortgage loans</i>	65,330	15,506	23.7	58,694	16,626	28.3	57,774	16,534	28.6
<i>v. Other personal loans</i>	109,707	17,311	15.8	112,828	18,895	16.7	114,144	18,642	16.3
Commodity financing	457,247	5,907	1.3	467,965	5,051	1.1	437,555	4,883	1.1
Staff Loans	77,535	1,293	1.7	75,415	1,356	1.8	75,771	1,395	1.8
Others	74,164	11,410	15.4	80,488	11,989	14.9	90,652	12,056	13.3
Total	3,714,312	547,770	14.7	3,666,535	613,219	16.7	3,746,149	607,145	16.2

* Un-audited results.

Table 1.9: Sector-wise Advances and Non Performing Loans (NPLs)*

amount in million Rupees, ratio in percent

	Dec-10			Sep-11			Dec-11		
	Advances	NPLs	Infection Ratio	Advances	NPLs	Infection Ratio	Advances	NPLs	Infection Ratio
Agribusiness	220,907	14,511	6.6	324,933	38,442	11.8	312,087	36,504	11.7
Automobile/Transportation	47,709	10,987	23.0	50,380	11,081	22.0	53,727	10,928	20.3
Cement	94,983	17,570	18.5	82,872	18,897	22.8	81,119	18,804	23.2
Chemical & Pharmaceuticals	143,357	11,396	7.9	137,823	13,531	9.8	146,899	13,821	9.4
Electronics	61,619	23,730	38.5	56,949	29,121	51.1	60,347	30,358	50.3
Financial	41,548	7,907	19.0	58,339	8,382	14.4	70,533	8,424	11.9
Individuals	446,106	71,784	16.1	339,266	54,141	16.0	336,181	53,521	15.9
Insurance	1,470	1	0.1	1,087	1	0.1	508	1	0.2
Others	1,504,600	188,026	12.5	1,501,109	218,315	14.5	1,519,573	210,332	13.8
Production/Transmission of Energy	350,434	13,283	3.8	396,337	16,835	4.2	369,929	14,934	4.0
Shoes & Leather garments	22,850	2,859	12.5	24,872	3,068	12.3	30,930	3,128	10.1
Sugar	73,565	14,245	19.4	94,968	12,975	13.7	84,022	12,233	14.6
Textile	705,164	171,472	24.3	597,600	188,431	31.5	680,293	194,158	28.5
Total	3,714,312	547,770	14.7	3,666,535	613,219	16.7	3,746,149	607,145	16.2

* Un-audited results.

Soundness & Resilience:

Table 1.10: Category-wise Profitability

	billion Rupees							
	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Profit Before Tax								
PSCBs	22.8	31.5	33.2	6.6	16.8	22.8	12.6	29.4
LPBs	60.5	85.6	69.5	52.5	60.5	77.0	60.9	131.5
FBs	11.6	6.3	2.4	0.0	(0.9)	2.0	2.6	5.6
CBs	94.9	123.5	105.2	59.0	76.5	101.8	76.2	166.4
SBs	(1.1)	0.1	1.7	4.2	4.2	2.8	1.1	3.5
All Banks	93.8	123.6	106.9	63.2	80.7	104.7	77.3	169.9
Profit After Tax								
PSCBs	15.5	21.2	23.9	5.6	14.4	16.8	8.4	19.8
LPBs	41.1	59.1	47.3	34.7	39.3	45.6	39.3	85.7
FBs	8.0	4.3	1.1	0.6	(0.8)	1.0	1.9	3.7
CBs	64.6	84.6	72.2	41.0	52.8	63.4	49.7	109.2
SBs	(1.3)	(0.5)	0.9	2.3	1.6	1.7	1.2	2.4
All Banks	63.3	84.1	73.1	43.3	54.4	65.1	50.8	111.6

* Un-audited results.

Table 1.11: Category-wise Profitability Indicators

	Percent							
	CY05	CY06	CY07	CY08	CY09	CY10	Jun-11*	CY11
Before Tax ROA								
PSCBs	3.3	4.0	3.5	0.6	1.5	1.8	1.8	2.0
LPBs	2.7	3.1	2.0	1.3	1.3	1.5	2.2	2.3
FBs	3.6	3.2	1.5	0.0	-0.3	0.9	2.2	2.3
CBs	2.9	3.2	2.3	1.1	1.3	1.5	2.1	2.2
SBs	-1.0	-1.3	1.4	3.2	3.1	2.0	1.1	2.4
All Banks	2.8	3.1	2.2	1.2	1.3	1.5	2.1	2.2
Before Tax ROE (based on Equity plus Surplus on Revaluation)								
PSCBs	30.7	32.4	27.2	5.2	13.3	15.2	16.6	18.0
LPBs	40.1	36.2	20.4	12.9	13.2	15.6	23.8	24.7
FBs	38.9	30.0	13.1	0.0	-2.4	5.8	14.8	14.5
CBs	37.2	34.7	21.8	10.6	12.4	15.0	21.8	22.7
SBs	-	-	-	-	-	-	-	-
All Banks	38.2	35.2	22.6	11.4	13.2	15.5	21.8	23.0

* Un-audited results.

Table 1.12: Break-up of Mark-up/Return/Interest Earned

Items	CY10		Mar-11*		Jun-11*		Sep-11*		CY11	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans & advances	398.9	63.9	107.1	60.3	214.1	59.5	312.2	57.5	423.5	56.6
Investments	196.3	31.4	63	35.6	131.6	36.6	210.2	38.7	297.8	39.8
Deposits, repo and others	29.4	4.7	7.3	4.1	14.3	4.0	20.2	3.7	26.4	3.5
Total	624.7	100.0	177.6	100	359.9	100.0	542.7	100.0	747.7	100.0

* Un-audited results.

Table 1.13: Distribution of Banks by Capital Adequacy Ratio (CAR)

	CY05	CY06	CY07	CY08	CY09	CY10	Mar-11*	Jun-11*	Sep-11*	CY11
Less than 10	9	7	9	9	6	5	6	5	5	5
10 to 15	13	15	12	10	15	12	13	12	8	10
Over 15	17	17	18	21	19	21	19	21	25	23
Total	39	39	39	40	40	38	38	38**	38	38

* Un-audited results.

**While amalgamation of MyBank with and into Summit bank Ltd came into effect on Jun 29, 2011, both banks reported their results for Jun-11 quarter separately.

Table 1.14: Capital Structure and Capital Adequacy of Banks and DFIS
(December 31, 2011)

million Rupees

	All Banks and DFIs	PSCBs	LPB	FB	SB	All Banks	DFIs
Equity							
1.1 Fully Paid-up Capital/Capital Deposited with SBP	494,974	41,414	353,898	38,720	15,508	449,540	48,627
1.2 Balance in Share Premium Account	(35,060)	17,000	(52,060)	-	-	(35,060)	-
1.3 Reserve for issue of Bonus shares	38	38	-	-	-	38	-
General Reserves as disclosed on the Balance Sheet (including statutory reserve)	151,195	20,519	112,330	149	10,956	143,954	7,241
1.5 Un-appropriated/Unremitted profits (net of accumulated losses, if any)	128,865	55,921	88,303	3,818	(21,894)	126,147	2,533
1.6 Sub-Total (1.1 to 1.5)	740,011	134,892	502,471	42,687	4,569	684,619	58,401
Deductions							
1.7 Goodwill	41,770	1,132	40,266	342	0	41,740	30
1.8 Shortfall in Provisions required against Classified assets	7,149	3,717	2,997	436	-	7,149	-
1.9 Deficit on account of revaluation of AFS investment	1,749	570	127	247	234	1,179	570
1.10 Any increase in equity capital resulting from a securitization transaction	7	-	7	-	-	7	-
1.11 Investments in TFCs of other banks	1,573	-	16	-	-	16	1,557
1.12 Other Deductions	14,176	2,727	9,789	-	103	12,667	1,557
1.13 Sub-Total (1.7 to 1.12)	66,546	8,172	53,298	1,025	337	62,759	3,714
1.14 Total Eligible Tier 1 capital(1.6 less 1.13)	673,465	126,720	449,173	41,662	4,232	621,860	54,687
Supplementary Capital							
2.1 Freely available General Provisions or reserves for loan losses-up to maximum of 1.25% of Risk Weighted Assets	13,132	3,081	8,171	310	1,389	12,952	180
2.2 Revaluation reserves eligible upto 45%	40,324	11,893	25,056	6	2,454	39,409	916
2.3 Foreign Exchange Translation Reserves	24,267	6,051	18,216	-	-	24,267	-
2.4 Undisclosed reserves	-	-	-	-	-	-	-
2.5 Subordinated debt-up to maximum of 50% of total equity	38,326	-	35,121	-	3,204	38,326	-
2.6 Total Tier 2 Supplementary Capital(2.1 to 2.5)	115,953	21,025	86,469	316	7,047	114,954	1,097
Deductions							
2.7 Other deductions	14,176	2,727	9,789	-	103	12,667	1,557
2.8 Total Deductions	14,176	2,727	9,789	-	103	12,667	1,557
2.9 Total eligible tier 2 capital	101,777	18,298	76,680	316	6,944	102,286	(460)
2.10 Eligible tier 3							
Total Supplementary Capital eligible for MCR(maximum upto 100% of Total Equity)	101,777	18,298	76,680	316	6,944	102,239	(460)
2.13 TOTAL CAPITAL (1.14 plus 2.9)	778,253	145,018	525,853	41,978	11,177	724,099	54,227
Risk Weighted Amounts							
3.1 Total Credit Risk Weighted Assets	3,811,998	714,508	2,826,404	102,121	105,626	3,748,660	63,921
3.2 Total Market Risk Weighted Assets	331,660	44,862	263,860	4,570	28	313,320	18,378
3.3 Total Operational Risk Assets	735,598	120,985	554,826	27,458	19,468	722,737	12,934
3.4 Total Risk Weighted Amount	4,879,949	880,355	3,645,090	134,149	125,122	4,784,716	95,233
Capital Adequacy Ratios							
4.1 Credit Risk Capital Adequacy Ratio	20.4%	20.3%	18.6%	41.1%	10.6%	19.3%	84.8%
4.2 Tier 1 capital to Total Risk Weighted Amount	13.8%	14.4%	12.3%	31.1%	3.4%	13.0%	57.4%
4.3 Total Capital Adequacy Ratio	15.9%	16.5%	14.4%	31.3%	8.9%	15.1%	56.9%
Other Deductibles from Tier 1 and Tier 2 Capital							
5.1 Investments in equity and other regulatory capital of majority owned securities or other financial subsidiaries not consolidated in the balance sheet	21,757	3,567	17,125	-	205	20,897	860
5.2 Significant minority investments in banking, securities and other financial entities	5,319	1,888	1,369	-	-	3,257	2,062
5.3 Equity holdings (majority or significant minority) in an insurance subsidiary(para 1.1 scope of Application)	552	-	361	-	-	361	191
5.4 Significant minority and majority investments in commercial entities exceeding 15% of Banks Capital	724	-	724	-	-	724	-
5.5 Securitization exposure subject to deduction (para 4.3.1 of instructions)							
5.6 Others	96	-	96	-	-	96	-
5.7 Total Deductible Items to be deducted 50% from Tier 1 capital and 50% from Tier 2 capital (5.1 to 5.6)	28,448	5,454	19,675	-	205	25,335	3,113

Table 1.15: Stress Testing Results
(December 31, 2011)

		Number of banks with CAR		
	Shock Details	< 0%	0% - 10%	> 10%
	Pre-Shock Position	1	4	33
Credit Risk Shocks		< 0%	0% - 10%	> 10%
C-1	10% of performing loans become non-performing, 50% of substandard loans downgrade to doubtful, 50% of doubtful to loss.	2	9	27
C-2	All NPLs under substandard downgrade to doubtful and all doubtful downgrade to loss.	2	3	33
C-3	Default of top 3 borrowers of the banks.	3	3	32
C-4	Default of top 3 borrowing groups of the banks.	3	4	31
C-5	Increase in provisions against NPLs equivalent to 50% of Net NPLs.	2	4	32
C-6	Increase in NPLs to Loans Ratio equivalent to the maximum quarterly increase in NPLs to Loans Ratio of the individual banks during the last 5 years.	2	4	32
C-7	Increase in NPLs of all banks by 21% which is equivalent to the maximum quarterly increase in NPLs of the banking system during the last 5 years (Mar-09).	2	3	33
C-8	Increase in NPLs to Loans Ratio of Textile Sector of the banks equivalent to the maximum quarterly increase in these banks during the last 3 years.	2	4	32
		NPLR	Critical NPLR	Difference
C-9	Increase in NPLs to Loans Ratio of Consumer Sector of the banks equivalent to the maximum quarterly increase in these banks during the last 3 years.	16.2	56.3	40.0
Market Shocks				
IR-1	Parallel upward shift in the yield curve - increase in interest rates by 300 basis points along all the maturities.	2	4	32
IR-2	Upward shift coupled with steepening of the yield curve by increasing the interest rates along 3m, 6m, 1y, 3y, 5y and 10y maturities equivalent to the maximum quarterly increase experienced during the last 3 years (Julv-08).	2	4	32
IR-3	Downward Shift plus flattening of the yield curve by decreasing the interest rates along 3m, 6m, 1y, 3y, 5y and 10y maturities equivalent to the maximum quarterly increase experienced during the last 3 years (April-09).	1	5	32
ER-1	Depreciation of Pak Rupee exchange rate by 30%.	2	4	32
ER-2	Depreciation of Pak Rupee exchange rate equivalent to the quarterly highest depreciation of rupee against dollar experienced during the last 3 years (14.5% during May08-Aug08).	2	3	33
ER-3	Appreciation of Pak Rupee exchange rate equivalent to the quarterly highest appreciation of rupee against dollar experienced during the last 3 years (3.2% during Oct08-Jan09).	1	4	33
EQ-1	Fall in general equity prices (41.1% during Oct08-Jan09).	2	4	32
EQ-2	Fall in general equity prices by 50%.	2	4	32
Combined Credit & Market Shocks				
COMB-1	Increase in NPLs equivalent to historically high quarterly increase in NPLs to Loan Ratio (Shock C-3) and upward shift plus steepening of the yield curve (Shock IR-2) and fall in equity prices (Shock- EO-1)	3	6	29
COMB-2	10% of performing loans moving to substandard, 50% of substandard to doubtful, 50% of doubtful to loss (Shock- C-1), parallel upward shift in the yield curve by 3% (Shock IR-1) and fall in equity prices by 50% (Shock- EO-2)	2	15	21
Liquidity Shocks		No. of Banks with no liquidity after		
		3 Days	4 Days	5 Days
L-1	Withdrawal of customer deposits by 2%, 5%, 10%, 10% and 10% for five consecutive days respectively.	0	0	0
		1 Day	2 Days	3 Days
L-2	Withdrawal of Wholesale Deposits and Unsecured Borrowings by 25%, 50%, and 100% for three consecutive days respectively.	0	0	0

* Stress test shocks for various factors have been redefined on historical data/events basis. Therefore stress test shocks, stated above, vary from those reported in previous compendiums.

Table 1.16: List of Banks

2009	2010	Jun-11	2011
A. Public Sector Com. Banks (4)	A. Public Sector Com. Banks (5)	A. Public Sector Com. Banks (5)	A. Public Sector Com. Banks (5)
First Women Bank Ltd.	First Women Bank Ltd.	First Women Bank Ltd.	First Women Bank Ltd.
National Bank of Pakistan	National Bank of Pakistan	National Bank of Pakistan	National Bank of Pakistan
The Bank of Khyber	Sindh Bank Ltd.	Sindh Bank Ltd.	Sindh Bank Ltd.
The Bank of Punjab	The Bank of Khyber	The Bank of Khyber	The Bank of Khyber
	<i>The Bank of Punjab</i>	<i>The Bank of Punjab</i>	<i>The Bank of Punjab</i>
B. Local Private Banks (25)	B. Local Private Banks (23)	B. Local Private Banks (22)	B. Local Private Banks (22)
Allied Bank Ltd.	<i>AlBaraka Bank (Pakistan) Ltd.*</i>	<i>AlBaraka Bank (Pakistan) Ltd.*</i>	<i>AlBaraka Bank (Pakistan) Ltd.*</i>
Askari Bank Ltd.	Allied Bank Ltd.	Allied Bank Ltd.	Allied Bank Ltd.
<i>Atlas Bank Ltd***</i>	Askari Bank Ltd.	Askari Bank Ltd.	Askari Bank Ltd.
Bank AL Habib Ltd.	Bank AL Habib Ltd.	Bank AL Habib Ltd.	Bank AL Habib Ltd.
Bank Alfalah Ltd.	Bank Alfalah Ltd.	Bank Alfalah Ltd.	Bank Alfalah Ltd.
BankIslami Pakistan Ltd.	BankIslami Pakistan Ltd.	BankIslami Pakistan Ltd.	BankIslami Pakistan Ltd.
<i>Dawood Islamic Bank Ltd. ^</i>	<i>Dawood Islamic Bank Ltd. ^</i>	<i>Dawood Islamic Bank Ltd. ^</i>	<i>Burj Bank Ltd. ^</i>
<i>Emirates Global Islamic Bank Ltd.*</i>	<i>Faysal Bank Ltd.**</i>	<i>Dubai Islamic Bank Pakistan Ltd.</i>	<i>Dubai Islamic Bank Pakistan Ltd.</i>
Faysal Bank Ltd.	Habib Bank Ltd.	Faysal Bank Ltd.**	Faysal Bank Ltd.**
Habib Bank Ltd.	Habib Metropolitan Bank Ltd.	Habib Bank Ltd.	Habib Bank Ltd.
Habib Metropolitan Bank Ltd.	JS Bank Ltd.	Habib Metropolitan Bank Ltd.	Habib Metropolitan Bank Ltd.
JS Bank Ltd.	KASB Bank Ltd.	JS Bank Ltd.	JS Bank Ltd.
KASB Bank Ltd.	MCB Bank Ltd.	KASB Bank Ltd.	KASB Bank Ltd.
MCB Bank Ltd.	Meezan Bank Ltd.	MCB Bank Ltd.	MCB Bank Ltd.
Meezan Bank Ltd.	<i>Mybank Ltd. ^</i>	Meezan Bank Ltd.	Meezan Bank Ltd.
Mybank Ltd.	NIB Bank Ltd.	NIB Bank Ltd.	NIB Bank Ltd.
NIB Bank Ltd.	SAMBA Bank Ltd.	SAMBA Bank Ltd.	SAMBA Bank Ltd.
SAMBA Bank Ltd.	Silk Bank Ltd.	Silk Bank Ltd.	Silk Bank Ltd.
Silk Bank Ltd.	Soneri Bank Ltd.	Soneri Bank Ltd.	Soneri Bank Ltd.
Soneri Bank Ltd.	Standard Chartered Bank (Pakistan) Ltd.	Standard Chartered Bank (Pakistan) Ltd.	Standard Chartered Bank (Pakistan) Ltd.
Standard Chartered Bank (Pakistan) Ltd.	United Bank Ltd.	Summit Bank Ltd (formerly Arif Habib Bank)***	Summit Bank Ltd (formerly Arif Habib Bank)***
<i>The Royal Bank of Scotland Ltd.</i>	Dubai Islamic Bank Pakistan Ltd.	United Bank Ltd.	United Bank Ltd.
United Bank Ltd.	Summit Bank Ltd (formerly Arif Habib Bank)***		
Dubai Islamic Bank Pakistan Ltd.			
Arif Habib Bank Ltd.			
C. Foreign Banks (7)	C. Foreign Banks (6)	C. Foreign Banks (6)	C. Foreign Banks (7)
<i>Albaraka Islamic Bank B.S.C.</i>	Bank of Tokyo - Mitsubishi UFJ, Ltd.	Bank of Tokyo - Mitsubishi UFJ, Ltd.	Bank of Tokyo - Mitsubishi UFJ, Ltd.
Bank of Tokyo - Mitsubishi UFJ, Ltd.	Deutsche Bank AG	Barclays Bank PLC	Barclays Bank PLC
Deutsche Bank AG	Citibank N.A.	Citibank N.A.	Citibank N.A.
Citibank N.A.	Oman International Bank S.A.O.G.	Deutsche Bank AG	Deutsche Bank AG
Oman International Bank S.A.O.G.	Barclays Bank PLC	HSBC Bank Middle East Ltd.	HSBC Bank Middle East Ltd.
Barclays Bank PLC	HSBC Bank Middle East Ltd.	Oman International Bank S.A.O.G.	Industrial and Commercial Bank of China Ltd ^
HSBC Bank Middle East Ltd.			Oman International Bank S.A.O.G.
D. Specialized Banks (4)	D. Specialized Banks (4)	D. Specialized Banks (4)	D. Specialized Banks (4)
Industrial Development Bank of Pakistan	Industrial Development Bank of Pakistan	Industrial Development Bank of Pakistan	Industrial Development Bank of Pakistan
Punjab Provincial Co-operative Bank Ltd.	Punjab Provincial Co-operative Bank Ltd.	Punjab Provincial Co-operative Bank Ltd.	Punjab Provincial Co-operative Bank Ltd.
SME Bank Ltd.	SME Bank Ltd.	SME Bank Ltd.	SME Bank Ltd.
Zarai Taraqiati Bank Ltd.	Zarai Taraqiati Bank Ltd.	Zarai Taraqiati Bank Ltd.	Zarai Taraqiati Bank Ltd.
All Commercial Banks (36)	All Commercial Banks (34)	All Commercial Banks (33)	All Commercial Banks (34)
Include A + B + C	Include A + B + C	Include A + B + C	Include A + B + C
All Banks (40)	All Banks (38)	All Banks (37)	All Banks (38)
Include A + B + C + D	Include A + B + C + D	Include A + B + C + D	Include A + B + C + D

* Descheduling of Albaraka Islamic Bank Pakistan Operations and merger into Emirates Global Islamic Bank Limited with effect from October 29, 2010. Subsequent upon its merger, name has been changed from "Emirates Global

** Royal Bank of Scotland Limited (RBS Pakistan) Amalgamated with and into Faysal Bank Limited on December 29, 2010.

***De-scheduling of Atlas Bank Limited with effect from the close of business on December 31, 2010, on account of its merger with and into Summit Bank Limited.

* Name has been changed to "Summit Bank Limited" vide BPRD notification dated August 16, 2010.

SBP declared "Sindh Bank Limited" as a scheduled bank with effect from December 24, 2010.

[^] Descheduling and amalgamation of Mybank Limited (MBL) with and into Summit Bank Limited with effect from Jun 29, 2011.

[^] Name of Dawood Islamic Bank changed to Burj Bank Limited with effect from July 11, 2011.

^{^^} Scheduling of Industrial and Commercial Bank of China Limited took place vide No. BPRD (LD-06)/602-ICBC/2011/10416 dated August 16, 2011.

2. Islamic Banking

Table 2.1: Group-wise Balance Sheets and Income Statements of Islamic Banks/Branches
(December 31, 2011)

million Rupees

Financial Position	Islamic Banks	Islamic Banking Branches	Islamic Banking	Absolute change	
ASSETS				Half Yearly	Year on Year
Cash & Balances With Treasury Banks	30,081	17,982	48,064	8,659	11,934
Balances With Other Banks	13,807	9,756	23,563	4,192	(3,643)
Due from Financial Institutions	12,327	1,500	13,827	(5,329)	(5,528)
Investments - Net	168,656	105,705	274,361	43,083	116,598
Financing - Net	140,727	71,069	211,796	23,184	25,573
Operating Fixed Assets	10,865	4,064	14,929	1,214	4,480
Deferred Tax Assets	2,878	32	2,910	529	(8,312)
Other Assets	28,417	22,572	50,989	4,428	22,907
TOTAL ASSETS	407,758	232,681	640,439	79,962	164,008
LIABILITIES					
Bills Payable	4,137	1,142	5,280	(432)	1,143
Due to Financial Institution	14,118	13,293	27,410	3,448	9,102
Deposits And Other Accounts	340,990	180,008	520,999	68,871	130,936
Sub-ordinated Loans	-	-	-	-	-
Liabilities Against Assets Subject To Finance Lease	5	-	5	(6)	(14)
Deferred Tax Liabilities	-	12	12	7	(5,479)
Other Liabilities	10,845	19,604	30,449	3,270	(8,560)
TOTAL LIABILITIES	370,095	214,059	584,154	75,159	154,308
NET ASSETS	37,662	18,622	56,284	4,803	9,700
NET ASSETS REPRESENTED BY: -					
Share Capital	35,665	8,873	44,538	(627)	44,538
Reserves	2,333	10	2,344	1,920	(37,796)
Unappropriated Profit	(983)	8,830	7,847	3,074	6,393
Share Holders' Equity	37,015	17,714	54,728	4,367	51,851
Surplus/Deficit On Revaluation Of Assets	648	908	1,556	436	(42,915)
TOTAL	37,662	18,622	56,284	4,803	54,171
PROFIT AND LOSS STATEMENT	Islamic Banks	Islamic Banking Branches	Islamic Banking	Absolute change	
				YoY	
Mark-Up Income	37,242	21,207	58,449		22,109
Mark-Up Expenses	20,370	12,190	32,559		12,435
Net Mark-Up	16,873	9,017	25,889		9,673
Provisions & Bad Debts Written Off Directly/(Reversals)	1,445	415	1,861		(1,603)
Net Mark-Up After Provision	15,427	8,601	24,028		11,276
Fees, Commission & Brokerage Income	1,345	928	2,273		649
Dividend Income	1,051	71	1,122		748
Income From Dealing In Foreign Currencies	975	102	1,076		(732)
Other Income	489	550	1,039		389
Total Non - Markup	3,859	1,651	5,509		1,054
Administrative Expenses	19,286	10,252	29,538		12,330
Other Expenses	13,584	5,122	18,706		4,000
Total Non-Markup	288	219	507		218
Profit before Tax and Extra ordinary Items	13,872	5,341	19,213		4,218
Profit before Tax and Extra ordinary Items	5,414	4,911	10,325		8,112
Extra ordinary/unusual Items -- Gain/(Loss)	-	-	-		-
PROFIT/ (LOSS) BEFORE TAXATION	5,414	4,911	10,325		8,112
Less: Taxation	1,300	94	1,394		665
PROFIT/ (LOSS) AFTER TAX	4,114	4,817	8,931		7,447

*Based on audited results of Islamic banks, while results of Islamic banking branches are based on un-audited data.

Table 2.2: Financial Soundness Indicators of Islamic Banking*

	Jun-10	Sep-10	CY10	Mar-11	Jun-11	Sep-11	Percent CY11
Asset Quality							
NPLs to Total Loans	6.5	8.4	8.1	8.0	7.5	8.4	8.0
Net NPLs to Net Loans	2.8	4.1	3.4	3.4	3.2	3.3	2.9
Provision to NPLs	58.8	54.1	59.9	58.7	60.0	62.4	65.8
Earnings							
ROA before Tax	0.9	0.6	0.3	1.8	2.0	2.0	1.8
ROA after Tax	0.8	0.6	0.3	1.4	1.6	1.7	1.4
ROE before Tax	8.2	5.5	3.1	18.3	20.7	21.3	18.7
ROE after Tax	6.9	5.3	3.2	15.0	16.5	17.6	15.0
Net Interest Income to Gross Income	80.7	80.0	77.4	80.8	82.6	81.9	82.0
Non Interest Income to Gross Income	19.3	20.0	22.6	19.2	17.4	18.1	18.0
Operating Expense to Gross Income	71.8	73.9	75.9	62.3	60.9	58.6	63.0
Liquidity							
Loans to Deposits	47.8	45.2	46.9	45.1	41.7	38.3	39.6

* Statistics for CY10 and CY11 are based on audited results of islamic banks, while statistics for islamic banking branches are based on un-audited results.

Meanwhile, statistics for Mar, Jun and Sep are based on un-audited quarterly results, both of islamic banks and branches.

Table 2.3: List of Islamic Banks and Conventional Banks with Islamic Banking Branches

As of June 30, 2011		As of December 31, 2011	
Islamic Banks		Islamic Banks	
1	AlBaraka Bank (Pakistan) Ltd	1	AlBaraka Bank (Pakistan) Ltd
2	BankIslami Pakistan Ltd	2	BankIslami Pakistan Ltd
3	Dawood Islamic Bank Ltd	3	Burj Bank Ltd
4	Dubai Islamic Bank Pakistan Ltd	4	Dubai Islamic Bank Pakistan Ltd
5	Meezan Bank Ltd	5	Meezan Bank Ltd
Conventional Banks having Islamic Banking Branches		Conventional Banks having Islamic Banking Branches	
1	Askari Bank Ltd	1	Askari Bank Ltd
2	Bank Al Habib Ltd	2	Bank Al Habib Ltd
3	Bank Alfalah Ltd	3	Bank Alfalah Ltd
4	Faysal Bank Ltd	4	Faysal Bank Ltd
5	Habib Bank Ltd	5	Habib Bank Ltd
6	Habib Metropolitan Bank	6	Habib Metropolitan Bank
7	MCB Bank Ltd	7	MCB Bank Ltd
8	National Bank of Pakistan	8	National Bank of Pakistan
9	Soneri Bank Ltd	9	Soneri Bank Ltd
10	Standard Chartered Bank	10	Standard Chartered Bank
11	The Bank of Khyber	11	The Bank of Khyber
12	United Bank Ltd	12	United Bank Ltd
Grand Total 17 (5+12)		Grand Total 17 (5+12)	

3. Non-Banking Financial Institutions

Table 3.1: Balance Sheets and Income Statements of DFIs
(December 31, 2011)

million Rupees							
Financial Position	CY07	CY08	CY09	CY10	Jun-11*	CY11	Absolute change Half Yearly Year on Year
ASSETS							
Cash & Balances With Treasury Banks	637	701	1,716	1,740	1,766	2,341	575 601
Balances With Other Banks	12,508	10,905	6,713	2,866	758	1,423	665 (1,443)
Lending To Financial Institutions	19,864	8,245	12,085	8,720	2,253	2,909	656 (5,811)
Investments - Net	41,389	38,536	62,102	64,115	72,055	81,379	9,324 17,264
Advances - Net	33,392	36,673	41,416	45,234	47,394	46,547	(846) 1,313
Operating Fixed Assets	2,969	2,918	3,098	2,974	2,944	2,930	(14) (44)
Deferred Tax Assets	545	790	1,277	1,098	1,193	1,193	0 95
Other Assets	5,029	4,522	3,786	5,500	5,951	5,103	(848) (398)
TOTAL ASSETS	116,332	103,290	132,193	132,248	134,312	143,825	9,513 11,577
LIABILITIES							
Bills Payable	-	-	-	-	-	-	- -
Borrowings From Financial Institution	51,664	43,838	51,522	50,306	51,789	64,885	13,096 14,579
Deposits And Other Accounts	11,868	5,881	18,074	15,856	15,841	12,074	(3,767) (3,783)
Sub-ordinated Loans	-	-	-	-	-	-	- -
Liabilities Against Assets Subject To Finance Lease	38	36	30	15	12	19	7 4
Deferred Tax Liabilities	564	-	2	637	76	669	594 33
Other Liabilities	4,552	4,841	5,814	6,757	7,167	6,899	(268) 142
TOTAL LIABILITIES	68,686	54,595	75,442	73,571	74,884	84,546	9,661 10,975
NET ASSETS	47,646	48,695	56,751	58,677	59,428	59,279	(149) 602
NET ASSETS REPRESENTED BY: -							
Share Capital	31,993	42,750	47,269	48,343	48,409	48,409	- 66
Reserves	11,159	11,610	7,250	7,272	6,930	7,454	523 181
Unappropriated Profit	1,522	(5,008)	342	2,116	3,064	2,513	(551) 396
Share Holders' Equity	44,673	49,352	54,860	57,732	58,403	58,375	(28) 643
Surplus/Deficit On Revaluation Of Assets	2,973	(657)	1,891	945	1,025	904	(121) (41)
TOTAL	47,646	48,695	56,751	58,677	59,428	59,279	(149) 602
OPERATING POSITION							
Mark-Up/ Return/Interest Earned	7,315	10,350	12,592	13,942	7,190	15,202	1,260
Mark-Up/ Return/Interest Expenses	4,538	5,873	6,720	7,318	3,814	8,030	713
Net Mark-Up / Interest Income	2,777	4,478	5,872	6,625	3,376	7,172	547
Provisions & Bad Debts Written Off Directly/(Reversals)	2,863	6,159	3,133	1,238	342	941	(298)
Net Mark-Up / Interest Income After Provision	(86)	(1,681)	2,739	5,386	3,035	6,231	845
Fees, Commission & Brokerage Income	79	123	191	148	42	124	(24)
Dividend Income	391	669	423	484	228	854	370
Income From Dealing In Foreign Currencies	(45)	560	20	(483)	2	(160)	323
Other Income	3,010	6,412	844	1,194	235	534	(660)
Total Non - Markup / Interest Income	3,434	7,763	1,479	1,343	507	1,352	9
Administrative Expenses	3,349	6,082	4,217	6,729	3,542	7,583	853
Other Expenses	2,330	2,413	2,647	2,977	1,425	3,102	125
Total Non-Markup/Interest Expenses	102	2,022	62	166	76	1,905	1,738
Profit before Tax and Extra ordinary Items	2,432	4,435	2,709	3,144	1,501	5,007	1,863
Extra ordinary/unusual Items -- Gain/(Loss)	917	1,647	1,508	3,586	2,041	2,576	(1,010)
Profit/ (Loss) Before Taxation	895	1,696	1,533	3,586	2,041	2,576	(1,010)
Less: Taxation	1,020	886	630	1,452	883	1,690	238
Profit/ (Loss) after Taxation	(125)	810	904	2,134	1,158	886	(1,248)

* Un-audited results.

Table 3.2: Financial Soundness Indicators of DFIs

					Percent
	CY08	CY09	CY10	Jun-11*	CY11
Capital					
Total Capital to Total RWA	53.4	52.5	54.4	56.7	56.9
Tier 1 Capital to Total RWA	53.3	52.4	54.9	57.2	57.2
Capital to Total Assets	47.1	42.9	44.4	44.2	41.2
Asset Quality					
NPLs to Total Loans	27.0	27.1	27.5	26.7	29.3
Net NPLs to Net Loans	11.2	10.1	11.6	11.4	14.4
Provision to NPLs	65.9	69.8	65.4	64.7	59.4
Net NPLs to Capital	8.4	7.4	8.9	9.1	11.3
Earnings					
ROA before Tax	1.5	1.3	2.7	3.1	1.9
ROA after Tax	0.7	0.8	1.6	1.7	0.6
ROE before Tax	3.4	2.9	6.2	6.9	4.4
ROE after Tax	1.6	1.7	3.7	3.9	1.5
Net Interest Income to Gross Income	34.8	79.9	83.1	86.9	84.1
Operating Expense to Gross Income	22.7	36.9	39.5	38.7	58.7
Liquidity					
Loans to Deposits	622.9	229.2	285.3	299.2	385.5
Liquid Assets/Total Assets	31.2	35.9	32.6	33.5	40.3
Liquid Assets/Total Deposits	547.3	262.4	271.6	284.3	480.6

* Un-audited results.

Table 3.3: List of DFLs

As of June 30, 2011	As of December 31, 2011
1. House Building Finance Company Limited	1. House Building Finance Company Limited
2. PAIR Investment Company Limited	2. PAIR Investment Company Limited
3. Pak Brunei investment Company Limited	3. Pak Brunei investment Company Limited
4. Pak Libya Holding Company Limited	4. Pak Libya Holding Company Limited
5. Pak Oman Investment Company Limited	5. Pak Oman Investment Company Limited
6. Pak-China Investment Company Limited	6. Pak-China Investment Company Limited
7. Pakistan Kuwait Investment Company Limited	7. Pakistan Kuwait Investment Company Limited
8. Saudi Pak Industrial & Agricultural Investment Company Limited	8. Saudi Pak Industrial & Agricultural Investment Company Limited

Table 3.4: NBFC's category-wise key variables

Investment Banks

	million Rupees										
	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10*	FY11*
Equity	2,796	4,112	4,811	6,236	6,659	5,921	9,038	7,482	4,349	4,286	3,501
Deposits	11,208	11,062	12,810	12,263	19,907	25,024	15,204	12,593	8,869	6,472	5,199
Liabilities	25,211	22,916	31,258	29,338	44,382	48,606	35,550	35,896	26,526	22,007	20,640
Advances	12,513	10,058	10,715	13,535	21,274	22,502	18,537	18,721	14,181	7,852	4,432
Investments	11,557	11,333	19,888	17,386	20,931	24,088	20,854	17,070	11,196	9,270	10,085
Assets	28,007	27,028	36,069	35,568	51,041	54,527	44,588	43,378	30,875	26,294	24,140
Income	2,808	4,770	4,699	3,690	4,598	6,441	4,662	5,201	2,835	2,767	2,462
Expense	3,641	4,403	3,959	2,051	4,302	5,058	4,278	4,695	4,953	4,563	2,961

* Statistics for FY10 and FY11 comprised of seven investment banks as one Investment bank is under winding-up process.

Leasing Companies

	million Rupees										
	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Paid up Capital	3,173	3,879	3,713	3,554	4,683	5,104	5,259	6,467	7,666	4,277	4,277
Equity	2,796	4,112	4,811	6,236	6,659	5,921	9,038	7,482	4,349	4,582	4,799
Deposits	11,208	11,062	12,810	12,263	19,907	25,024	15,204	12,593	8,869	13,290	11,481
Liabilities	25,211	22,916	31,258	29,338	44,382	48,606	35,550	35,896	26,526	32,406	28,674
Advances	12,513	10,058	10,715	13,535	21,274	22,502	18,537	18,721	14,181	29,285	26,934
Investments	11,557	11,333	19,888	17,386	20,931	24,088	20,854	17,070	11,196	3,635	2,799
Assets	28,007	27,028	36,069	35,568	51,041	54,527	44,588	43,378	30,875	36,989	33,473
Income	2,808	4,770	4,699	3,690	4,598	6,441	4,662	5,201	2,835	4,686	4,198
Expense	3,641	4,403	3,959	2,051	4,302	5,058	4,278	4,695	4,953	5,053	3,724

Modarabas

	million Rupees										
	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Paid up Capital	7,467	8,616	8,187	8,081	7,912	7,547	7,193	7,828	8,529	8,439	8,746
Equity	6,671	7,727	7,983	8,652	9,965	10,326	11,148	11,845	10,839	11,489	12,422
Liabilities	8,833	9,785	7,990	9,471	11,607	13,602	15,191	17,805	12,248	13,000	13,921
Assets	15,504	17,512	15,973	18,026	21,572	23,927	26,339	29,643	23,087	24,489	26,343

Table 3.5: List of Non-Banking Finance Companies

Investment Banks

As of June 30, 2010	As of June 30, 2011
1 Escort Investment Bank Limited	1 Escort Investment Bank Limited
2 First Credit and Investment Bank	2 First Credit and Investment Bank
3 First Dawood Investment Bank Limited	3 First Dawood Investment Bank Limited
4 IGI Investment Bank Limited	4 IGI Investment Bank Limited
5 Innovative Investment Bank Limited (Winding up filed in Sep., 2010)	5 Invest Capital Investment Bank Limited
6 Invest Capital Investment Bank Limited	6 Security Investment Bank Limited
7 Security Investment Bank Limited	7 Trust Investment Bank Limited
8 Trust Investment Bank Limited	

Leasing Companies

As of June 30, 2010	As of June 30, 2011
1 Grays Leasing Limited	1 Grays Leasing Limited
2 NBP Leasing Limited	2 NBP Leasing Limited
3 Orix Leasing Pakistan Limited	3 Orix Leasing Pakistan Limited
4 Pak Gulf Leasing Limited	4 Pak Gulf Leasing Limited
5 Saudi Pak Leasing Limited	5 Saudi Pak Leasing Limited
6 Security Leasing Corporation Limited	6 Security Leasing Corporation Limited
7 Sigma Leasing Corporation Limited	7 Sigma Leasing Corporation Limited
8 SME Leasing Limited	8 SME Leasing Limited
9 Standard Chartered Leasing Limited	9 Standard Chartered Leasing Limited

Modarabas

As of June 30, 2010	As of June 30, 2011
1 Al -Noor Modaraba	1 Al -Noor Modaraba
2 Allied Rental Modaraba	2 Allied Rental Modaraba
3 B.F. Modaraba	3 B.F. Modaraba
4 BRR Guardian Modaraba	4 BRR Guardian Modaraba
5 Crescent Standard Modaraba	5 Crescent Standard Modaraba
6 Elite Capital Modaraba	6 Elite Capital Modaraba
7 Equity Modaraba	7 Equity Modaraba
8 Fidelity Leasing Modaraba	8 Fidelity Leasing Modaraba
9 First Constellation Modaraba	9 First Constellation Modaraba
10 First Pak Modaraba	10 First Pak Modaraba
11 First Treet Manufacturing Modaraba	11 First Treet Manufacturing Modaraba
12 Habib Bank Modaraba	12 Habib Bank Modaraba
13 Habib Modaraba	13 Habib Modaraba
14 IBL Modaraba	14 IBL Modaraba
15 Imrooz Modaraba	15 Imrooz Modaraba
16 KASB Modaraba	16 KASB Modaraba
17 Modaraba Al-Mali	17 Modaraba Al-Mali
18 National Bank Modaraba	18 National Bank Modaraba
19 Paramount Modaraba	19 Paramount Modaraba
20 Prudential Modaraba	20 Prudential Modaraba
21 Punjab Modaraba	21 Punjab Modaraba
22 Standard Chartered Modaraba	22 Standard Chartered Modaraba
23 Tri-Star Modaraba 1st	23 Tri-Star Modaraba 1st
24 Trust Modaraba	24 Trust Modaraba
25 UDL Modaraba	25 UDL Modaraba
26 Unicap Modaraba	26 Unicap Modaraba

4. Insurance Sector

Table 4.1: Insurance Sector: Category-wise key variables

Non-Life Insurance Business

	million Rupees								
	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	CY11
Paid-up capital	5,965	7,101	7,734	8,807	10,245	11,827	13,909	13,347	14,601
Investments	14,605	16,402	22,528	34,419	69,677	60,195	63,122	59,268	56,821
Gross Premium	19,571	22,052	27,712	33,250	38,196	41,707	43,441	45,813	45,717
Net Premium	9,740	11,749	15,931	20,403	23,076	26,293	25,298	25,491	24,743
Net Claims Incurred	5,266	6,565	9,017	11,807	17,378	26,297	21,283	17,162	14,640
Net Profit after tax	2,642	3,358	5,863	16,819	56,153	(4,089)	5,995	3,605	3,066
Total Assets	37,013	44,041	53,753	74,334	121,771	114,497	123,654	121,856	112,883

Life Insurance Business

	million Rupees								
	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	CY11
Paid-up capital	2,202	2,317	2,362	2,748	2,847	3,391	4,467	5,895	5,895
Investments	87,125	99,026	109,581	129,084	154,675	165,319	199,364	227,547	269,330
Gross premium	13,029	14,682	18,552	22,571	27,692	34,861	41,943	53,831	69,936
Net premium	12,662	14,236	17,964	21,848	26,818	33,786	40,771	52,531	66,274
Gross claims incurred	6,687	7,887	8,818	10,994	13,353	16,737	19,774	21,214	20,469
Net profit (after tax)	395	320	393	657	1,679	(137)	1,068	940	1,519
Total assets	108,036	123,899	142,329	164,605	191,746	213,959	228,581	292,810	348,993

Reinsurance Business

	million Rupees								
	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	CY11
Paid up Capital	450	450	450	450	540	3,000	3,000	3,000	3,000
Investments	1,886	2,719	2,873	3,588	6,412	5,459	5,481	4,674	5,793
Gross Premium	4,697	5,241	4,160	4,499	4,731	4,555	5,839	6,552	6,893
Net Premium	1,447	2,289	2,005	1,415	1,695	1,896	2,170	2,940	3,535
Net Claims incurred	1,011	1,329	823	777	931	962	904	1,688	2,018
Net Profit after tax	333	325	594	672	3,727	886	269	526	844
Total Assets	6,232	6,613	5,634	6,464	10,447	12,528	12,372	12,535	12,878

Table 4.2: List of Insurance Companies

Non-Life Insurance

As on 2010	As on 2011
1 ACE Insurance Limited	1 ACE Insurance Limited
2 Adamjee Insurance Company Limited	2 Adamjee Insurance Company Limited
3 Allianz EFU Health Insurance Limited	3 Allianz EFU Health Insurance Limited
4 Alfalah Insurance	4 Alfalah Insurance
5 Alpha Insurance Company Limited	5 Alpha Insurance Company Limited
6 Asia Insurance Company Limited	6 Asia Insurance Company Limited
7 Askari General Insurance	7 Askari General Insurance
8 Atlas Insurance Limited	8 Atlas Insurance Limited
9 Capital Insurance Company Limited	9 Capital Insurance Company Limited
10 Central Insurance Company Limited	10 Central Insurance Company Limited
11 Century Insurance Company Limited	11 Century Insurance Company Limited
12 Continental Insurance Company Limited	12 Continental Insurance Company Limited
13 East West Insurance Company Limited	13 East West Insurance Company Limited
14 EFU General Insurance Limited	14 EFU General Insurance Limited
15 Habib Insurance Company limited	15 Habib Insurance Company limited
16 IGI Insurance Limited	16 IGI Insurance Limited
17 National Insurance Company Limited	17 National Insurance Company Limited
18 New Hampshire Insurance Company	18 New Hampshire Insurance Company
19 New Jubilee Insurance Company Limited	19 New Jubilee Insurance Company Limited
20 PICIC Insurance Limited	20 PICIC Insurance Limited
21 Premier Insurance Limited	21 Premier Insurance Limited
22 Reliance Insurance Company Limited	22 Reliance Insurance Company Limited
23 Saudi Pak Insurance Company Limited	23 Saudi Pak Insurance Company Limited
24 Security General Insurance Company Limited	24 Security General Insurance Company Limited
25 Shaheen Insurance Company Limited	25 Shaheen Insurance Company Limited
26 Silver Star Insurance Company Limited	26 Silver Star Insurance Company Limited
27 The Asian Mutual Insurance Company (Guarantee) Limited	27 The Asian Mutual Insurance Company (Guarantee) Limited
28 The Cooperative Insurance Society of Pakistan	28 The Cooperative Insurance Society of Pakistan
29 The Crescent Star Insurance Company Limited	29 The Crescent Star Insurance Company Limited
30 The Pakistan General Insurance Company Limited	30 The Pakistan General Insurance Company Limited
31 The United Insurance Company of Pakistan Limited	31 The United Insurance Company of Pakistan Limited
32 The Universal Insurance Company Limited	32 The Universal Insurance Company Limited
33 TPL Direct Insurance Limited	33 TPL Direct Insurance Limited
34 UBL Insurers Limited	34 UBL Insurers Limited

Non-Life Takaful Companies

As on 2010	As on 2011
1 Pak Kuwait Takaful Company Limited	1 Pak Kuwait Takaful Company Limited
2 Pak Qatar General Takaful Limited	2 Pak Qatar General Takaful Limited
3 Takaful Pakistan Limited	3 Takaful Pakistan Limited

Life Insurance

As on 2010	As on 2011
1 Adamjee Life Assurance Company Limited	1 Adamjee Life Assurance Company Limited
2 American Life insurance Company (Pakistan) Limited	2 American Life insurance Company (Pakistan) Limited
3 Asia Care Health & Life Insurance Company Limited	3 Asia Care Health & Life Insurance Company Limited
4 East West Life Assurance Company Limited	4 East West Life Assurance Company Limited
5 EFU Life Assurance Limited	5 EFU Life Assurance Limited
6 New Jublee Life Insurance Company limited	6 New Jublee Life Insurance Company limited
7 State Life Insurance Corporation of Pakistan	7 State Life Insurance Corporation of Pakistan

Life Takaful Companies

As on 2010	As on 2011
1 Dawood Family Takaful Limited	1 Dawood Family Takaful Limited
2 Pak Qatar Family Takaful Limited	2 Pak Qatar Family Takaful Limited

Reinsurance

As on 2010	As on 2011
1 Pakistan Reinsurance Company Limited	1 Pakistan Reinsurance Company Limited

Acronyms

ADB	Asian Development Bank	DNS	Deferred Net Settlement Systems
ADR	Advances to Deposit Ratio	DPCO	Debt Policy Co-ordination Office
Ads	Authorized Dealers	DSC	Defense Saving Certificates
AFS	Available-For-Sale	DVF	Delivery Vs. Free
AGD	Accumulated Gross Disbursements	DVP	Delivery Vs. Payment
AHFL	Asian Housing Finance Limited	DW	Discount Window
AIG	American International Group, Inc	EA	Emerging Asia
ALM	Asset Liability Management	e-banking	Electronic Banking
AMC	Asset Management Companies	E-bond	Electronic Bond
AML	Anti Money Laundering	ECB	European Commercial Bank
AMZVL	AMZ Ventures	EFS	Export Finance Schemes
ASEAN	Southeast Asian Nations	EPS	Earnings per Share
ATM	Automated-Teller Machines	EWS	Early Warning System
BCBS	Basel Committee Of Banking Supervision	FCA	Foreign Currency Account
BIS	Bank Of International Settlement	FDI	Foreign Direct Investments
BOP	Balance of Payment	FIFO	First In First Out
BPRD	Banking Policy and Regulation Department	FMAP	Financial Market Association Of Pakistan
bps	Basis Points	FPI	Foreign Portfolio Investments
BRRGM	B.R.R. Guardian Modaraba	FRA	Forward Rate Agreement
BSC	Banking Services Corporation	FRDL	Fiscal Responsibility and Debt Limitation Act
BSCs	Behbood Savings Certificates	FSB	Financial Stability Board
BSD	Banking Surveillance Department	FSR	Financial Stability Report
CAD	Current Account Deficit	FSV	Forced Sale Value
CAELS	Capital Adequacy Asset Quality Earnings	FY	Fiscal Year
CAMELS	Capital, Assets, Management, Earnings, Liquidity and Sensitivity	GDP	Gross Domestic Product
CAR	Capital Adequacy Ratio	GFC	Global Financial Crisis
CASA	Current Account Saving Account	GoP	Government Of Pakistan
CBs	Commercial Banks	GPF	General Provident Fund
CDC	Central Depository Company	HBFC	House Building Finance Corporation Limited
CDD	Customer Due Diligence	HFT	Held-For-Trading
CDNS	Central Directorate of National Savings	HHI	Herfindahl Index
CDR	Currency to Deposits Ratio	IBD	Islamic Banking Department
CDS	Credit Default Swaps	IBIs	Islamic Banking Institutions
CDS	Central Depository System	IDB	Industrial Development Bank
CFS	Continuous Funding System	IDR	Investments to Deposit Ratio
CIB	Credit Information Bureau	IFCs	Investment Finance Companies
CIC	Currency in circulation	IFIs	International Financial Institutions
CoDs	Certificate of Deposits	IFT	Interbank Fund Transfers
COFI	Cost of Financial Intermediation	ILF	Intra-Day Liquidity Facility
CoIs	Certificate of Investments	IMF	International Monetary Fund
CPI	Consumer Price Index	IPO	Initial Public Offering
CPI	Consumer Price Index	IPS	Investment Portfolio Securities
CPSS	Committee Of Payment And Settlement	IRS	Interest Rate Swap
CRR	Cash Reserve Requirement	IT	Information Technology
CRWA	Credit Risk Weighted Assets	KDA	Khass Deposit Accounts
CSF	Coalition Support Fund	KDS	Khass Deposit Certificates
CSF	Competitiveness Support Fund	KIBOR	Karachi Inter-Bank Offer Rate
CY	Calendar Year	KONIA	Karachi Overnight Index Average
DCMC	Debt Capital Market Committee	KSE	Karachi Stock Exchange
DFIs	Development Finance Institutions	KYC	Know Your Customer
		LHS	Left Hand Side

DMMD	Domestic Markets & Monetary Management	PE&VCF	Private Equity and Venture Capital Fund
LIBOR	London Inter-Bank Rate	PEPCO	Pakistan Electric Power Company
LICs	Life Insurance Companies	PIB	Pakistan Investment Bond
LMM	Locally Manufactured Machinery	PIIC	Pak-Iran Investment Company Ltd.
LoLR	Lender of Last Resort	PKIC	Pakistan Kuwait Investment Company (Pvt)
LPBs	Local Private Banks	PKR	Pakistani Rupee
LSM	Large Scale Manufacturing	PKRV	Pakistan Revaluation Rate
M&As	Mergers and Acquisitions	PLA	Personal ledger Accounts
MCR	Minimum Paid-Up Capital Requirement	PLHC	Pak-Libya Holding Company (Pvt) Ltd.
MER	Minimum Equity Requirements	PLS	Profit-Loss Sharing
MICR	Magnetic Ink Character Recognition	POIC	Pak Oman Investment Company
MMA	Mahana Amdani Accounts	POL	Pakistan Oilfields Limited
MNSB	Multilateral Net Settlement Batches	POS	Point Of Sale
MoF	Ministry Of Finance	PPEML	Pakistan Private Equity Management Ltd
MPS	Monetary Policy Statement	PPTFC	Privately Placed Term Finance Certificates
MRTBs	Market Related Treasury Bills	PRCL	Pakistan Reinsurance Company Limited
MRWA	Market Risk Weighted Assets	PRISM	Pakistan Real-Time Interbank Settlement
MTBs	Market Treasury Bills	PSC	Private Sector Credit
MUFAP	Mutual Funds Association of Pakistan	PSCBs	Public Sector Commercial Banks
NAV	Net Asset Value	PSEFT	Payment Systems And Electronic Fund
NBFC	Non-banking Finance Companies	PSEs	Public Sector Enterprises
NBFIs	Non-Bank Financial Institutions	RDNS	Regional Directorate of National Savings
NBP	National Bank of Pakistan	REER	Real Effective Exchange Rate
NCB	Non-Competitive Bids	REPO	Repurchase Agreement
NCCPL	National Clearing Company of Pakistan Ltd.	RHS	Right Hand Side
NCS	National Coinsurance Scheme	RIC	Regular Income Certificates
NCSS	National Clearing And Settlement System	ROA	Return on Assets
NDA	Net Domestic Assets	ROE	Return on Equity
NDLC	National Developing Leasing Corporation	RSA	Rate Sensitive Assets
NEER	Nominal Effective Exchange Rate	RSL	Rate Sensitive Liabilities
NFA	Net Foreign Assets	RTGS	Real-Time Gross Settlement
NGOs	Non-Governmental Organization	RTOB	Real Time Online Banking
NICL	National Insurance Company Limited	RWA	Risk Weighted Assets
NIFT	National Institutional Facilitation Technologies (Pvt.) Limited	S&DHW	Statistics & Data Warehouse Department
NII	Net Interest Income	SA	Savings Accounts
NIM	Net Interest Margin	SBs	Specialized Banks
NIT	National Investment Trust Ltd	SBA	Stand-by Arrangement
NOP	Net Open Position	SBP	State Bank of Pakistan
NR	Non-Remunerative	SCRA	Special Convertible Rupee Account
NPLs	Non-Performing Loans	SDA	Special Drawing Accounts
NPLR	Non-Performing Loan Ratio	SDRs	Special Drawing Rights
NSB	National Savings Bond	SECP	Securities Exchange Commission of Pakistan
NSS	National Savings Schemes	SGS	Singapore Government Securities
NTN	National Tax Number	SLIC	State Life Insurance Corporation
O/N	Overnight	SLR	Statutory Liquidity Requirement
OAEM	Other Assets Especially Mentioned	SME	Small And Medium Enterprises
OMOs	Open Market Operations	SPIAIC	Saudi Pak Industrial and Agricultural
OSD	Off-Site Supervision and Support Department	SSAs	Special Savings Accounts
OTC	Over the Counter	SSC	Special Savings Certificates
PBA	Pensioners' Benefit Account	SSS	Small Savings Schemes
PBIC	Pak Brunei Investment company Ltd	STD	Short-Term Debt And Liabilities
PCIC	Pak China Investment Company Ltd.	SWIFT	Society For Worldwide Interbank Financial

T-Bill	Treasury Bills
TDL	Time And Demand Liabilities
TFC	Term Finance Certificates
TMTV	TMT Ventures
TRGPL	TRG Pakistan Limited
TSA	Treasury Single Account
UAE	United Arab Emirates
USD	US Dollar
VC	Venture Capital
WADR	Weighted Average Deposits Rate
WALR	Weighted Average Lending Rate
WAPDA	Water and Power Development Authority
WEO	World Economic Outlook
YoY	Year on Year