

EXTERNAL CONSULTATIONS & STAKEHOLDERS INVOLVEMENT

As the central bank of the country and the regulator of the banking sector, State Bank of Pakistan has the basic responsibility for formulation and implementation of the monetary policy, availability of credit and liquidity in the financial system and stability of the exchange rate regime. It is essential that the overall policy framework is based on premises and rationale, well understood by all the stakeholders where all their legitimate concerns and issues are given due weightage to promote ownership and operational transparency. Toward this end, State Bank has opted extensively for formal interactions with significant stakeholders where a regular and structured exchange of views and information could provide immediate and visible value addition in terms of policy alignment and proactive regulatory response to emerging issues and developments. The ongoing efforts in this regard include the following forums:

Pakistan Banks Association (PBA): Pakistan Banks Association (PBA) is a forum of Banks operating in Pakistan for discussion and resolution of matters of common interest. State Bank of Pakistan being the regulator of the banks although has remained in close coordination with the banks, the need was felt for formalized and for continuous consultation with the industry to include the stakeholders in the decision making process for considered and effective policy decisions. It was therefore decided by the Governor to hold quarterly meetings with the Executive Committee of Pakistan Banks Association so as to discuss and resolve current issues and obtain feed back on matters of conflict on this forum. The first meeting of the executive committee of Pakistan Banks Association with the Governor was held on December 6, 2000. From then onwards quarterly meetings are being held wherein various issues are discussed and resolved/settled. The main issues tackled in the above meetings were:

1. Minimum Capital Requirements for Banks.
2. Recovery of exorbitant service charges from general public and maintaining of minimum balance requirements
3. Office / business hours for evening banking
4. Issue relating to credit cards
5. Role of external auditors
6. Online reporting to CIB for loans exceeding Rs.500,000
7. Issuance of redeemable capital in the form of TFCs in accordance with Section 120 of Companies Ordinance, 1984
8. Prudential Regulations for corporate / commercial banking, consumer financing and Small & Medium Enterprises (SMEs)
9. Taxation issues
10. Restructuring of Non Bank Financial Institutions
11. Maintenance of Statutory Liquidity Requirements
12. Rupee Traveler's Cheques
13. Financing of Information Technology projects
14. SWAP Window
15. Forward cover on Import Loans
16. Cap on F.E.25 Deposits
17. Jumbo Issues to Improve Secondary Market
18. RTGS
19. Restructuring of Sick Project Facilities – CIRSU
20. IAS 39
21. Using KIBOR/KIBID as Benchmark for Banks' Customers Lending Rates
22. Abridged Version of Accounts
23. Threshold Point for Leasing Business
24. Operational Reforms –Recovery of NPLs through Legal Recourse

25. Restructuring of Advances and Revaluation of Fixed Assets
26. Formation of Working Group on WTO Matters related to the Banking Sector
27. Separate Schedule for Financial Services.
28. Cash Management.
29. Fit & Proper Test.
30. Lending & Prime Rates as Bench Mark.
31. Textile Vision 2005
32. PEFG Collateral not being accepted by the banks.
33. Cap on PIB Holdings of Banks to Develop Secondary Market.
34. Lending Rate for commodity operations.
35. Derivatives.
36. Prohibition of Service Charges / Penalties on PLS Accounts.
37. Collection of Utility Bills By Banks.
38. Profit Rates on Deposits.
39. Criteria for enlistment of Professional Valuers.

National Credit Consultative Council (NCCC): The NCCC was constituted by the Federal Government in 1972 to work under the supervision of the State Bank of Pakistan. It is represented by all the stakeholders in the economy including Government, State Bank, Commercial Banks, representatives of chambers of commerce, agriculture, and various other bodies. Initially, the Council was mandated to prepare, approve and monitor Credit Plan. However, during recent time when all the credit controls and other restrictions have progressively been removed from the system, to make it work in alignment with the market forces, the role of NCCC has changed from a regulatory or planning body to purely a consultative body, which meets twice a year under the chairmanship of Governor, State Bank. The credit plan which is a financial program, according to which monetary policy is implemented, is discussed in the NCCC in its annual meeting and suggestions and recommendations of all the stakeholders are taken into consideration in monetary policy formulation. The second meeting is held to review the 6-monthly developments in monetary, credit and related areas and suggests ways and means to improve the delivery of credit for higher rate of growth in the economy. The forum also suggests changes or improvements in the monetary policy for the remaining part of the year if developments so warrant. Over the years, NCCC has been contributing quite effectively to the process of monetary policy formulation, credit to private sector and economic growth.

Agriculture Credit Advisory Committee (ACAC): ACAC was constituted in 1972 to assess the credit requirements of agriculture sector and assists NCCC in formulation of the Annual Credit Plan. While the role of NCCC has changed from credit planning to that essentially of a consultative nature, the ACAC is still performing the function of an advisory body to improve credit disbursement and recovery of agriculture credit in addition to suggesting measures for strengthening the institutional framework of agriculture credit. The role of ACAC is rather more important as mandatory agriculture credit schemes are still in vogue for major commercial banks since agriculture is still considered an under-developed but priority sector for credit.

State Bank of Pakistan has revamped the supervised agriculture credit scheme by expanding the scope and coverage of agriculture credit by giving incentives to make it attractive for the banks to lend to the farming community. Under the process, the entire value chain of agriculture activities from inputs, equipment, machinery and implements, production, storage, processing, transportation, marketing to distribution has become eligible. State Bank of Pakistan has removed hurdles, both technical and procedural, to enhance credit expansion in this area. All the procedures, documentation and eligibility criteria have been streamlined and standardized by clearly defining the role of each stakeholder in this process. The credit limits, eligible securities for collaterals and other requirements have been updated

recently. To educate the farming community about the facilities available and to the banking community on the scope of growth in this area, State Bank has formalized dissemination of information to this sector by consolidating and simplifying all the circulars covering the area and publishing and distributing this information through simple and comprehensive brochures in local languages and through conducting training and coordination among all the stake holders.

Local Credit Advisory Committees: In order to address the credit and other related problems in general, and the agriculture credit problems faced by the farmers, State Bank has established Credit Advisory Committees and Agricultural Sub-Committees at its 16 SBP BSC offices (Karachi, Islamabad, Rawalpindi, Lahore, Peshawar, Quetta, Faisalabad, Hyderabad, Multan, Sialkot, Sukkur, D.I. Khan, Bahawalpur, Muzafarabad and Gujranwala). The committees are represented by chambers and farmers' associations, regional heads of all the banks, and State Bank of Pakistan. All banks are directed to appoint competent regional and zonal managers with delegated powers to take the appropriate decisions in resolution of problems, on the spot.

Actions taken during the last 2-3 years for a complete overhaul of the agriculture credit scheme have paid dividends. During the year 2002-03, overall disbursements in the agriculture sector were Rs 59 billion, 7% higher than the disbursements a year before. Five major commercial banks, which are part of the mandatory credit scheme, have disbursed an amount of Rs 23 billion, 16% higher than the credit disbursements during the year 2001-02. It is encouraging that the share of commercial banks in agriculture credit is increasing and the commercial banks' aggregate disbursements have surpassed the mandatory credit targets for the first time. The domestic private banks have also started contributing to the credit needs of the agriculture sector.

Advisory Group on Financial Sector: The Advisory Group on Financial System is a consultative body of external stakeholders. The Group was formed as an outcome of the ideas generated by the successful conclusion of the Conference on Financial System held on 18 June 2002¹. The Group advises the State Bank of Pakistan on the specific issues facing the financial sector or emerging issues likely to affect the working of the financial system. Furthermore, the Group suggests ways to strengthen and improve the regulatory, supervisory, surveillance and enforcement capabilities of SBP. The Group is also entrusted to provide input to all assessments of the financial sector and comment on the quality and coverage of the SBP research publications. Finally, the Advisory Group is expected to provide consistent market feedback to SBP on the effects of policies and regulations introduced.

The first meeting of the Group was held on 8th January 2003 at State Bank of Pakistan, Karachi with Governor, in the chair. The Governor put forward a number of issues to seek recommendations of the Group. Firstly, the Governor expressed the need for revising and updating the set of prudential regulations with a forward-looking approach, which also required a move away from regulations having micro management implications. Secondly, sustainability issue of foreign exchange inflows from the cost side of their accumulation at the central bank was discussed at length and the Governor proposed to review different options for efficient FX reserves management. The Governor also urged the banks to come up with prime rate and look for investment opportunities in the housing finance sector.

The group also discussed development of secondary market of PIBs. It was agreed that the buy-and-hold strategy of the banks had undermined the basic purpose of launching PIBs and the system of PDs. The group recommended that the system of Primary Dealers be restructured so as to make

¹ During the conference, draft version of "Pakistan: Financial Sector Assessment 1990-2000" was discussed. After incorporating suggestions of stakeholders, the report was finally published in October 2002.

investment banks/brokerage houses potentially eligible toward assuming an effective market-making role for promotion of the secondary market². The Governor also shared with the participants worries expressed by the Leasing Association of Pakistan and SECP over entry of commercial banks into the leasing business. The Group agreed on the need for the leasing companies to explore new products and sectors like SME and agriculture besides reaching out to the businesses in smaller cities.

The group felt that a major issue faced by the public was that of soiled currency notes. At the recommendation of the group, a Task Force was set up under the chair of Deputy Governor (Banking) to streamline the issues related to issuance, sorting and replacement of currency notes. The Task Force members include Presidents of HBL, NBP, Mr. S. Naseem Ahmad and the concerned Executive Director from SBP.

The Group also deliberated on the valuation differential between CIRC and the banks, and pressure for wage increase higher than the rate of inflation that would also increase the pension liability of financial institutions. The Group also recommended that possibility of outsourcing management of pension funds to specialists be explored as larger pool thus made available could be better deployed by the fund managers for maximum returns.

Advisory Group on Housing Finance: At the policy level, a certain degree of lacking in direction has been one of the major impediments in institution of a market based housing finance system. Therefore, in order to provide an institutional arrangement and direction for reforms in housing finance, a standing Advisory Group was constituted at SBP, under the Chairmanship of a member of SBP's Board of Directors. The group comprises of seasoned bankers and housing finance and capital market experts, entrusted with the responsibility of implementing the recommendations of the Housing Finance Conference held in December 2002 and to take up practical problems faced in the course of implementation. The Advisory Group, has been assigned the task of sequencing of the Reform Agenda required for the promotion and development of a sustainable market-based housing finance system in the country with a focus to:

- ◆ Propose and help implement specific issues being faced by the housing sector or issues likely to affect the development of a market-based housing finance sector through SBP & MOF.
- ◆ Convene sub-groups of experts to study and make recommendations on the issues identified by the Advisory Group or by the State Bank.
- ◆ Provide input into all assessments/reports on the Housing Sector in Pakistan, in terms of sources of data and quality, approach and analytical framework.
- ◆ Suggest specific ways in which the State Bank of Pakistan can facilitate development of the housing finance sector, including recommendations on policy and regulatory framework.
- ◆ Provide consistent market feedback to the State Bank of Pakistan on the effects of the policies and regulations introduced by it as related to the Housing Finance sector.

As a first step, the Advisory Group was successful in putting forward a convincing case to the Government on the need to provide fiscal incentives to the housing sector, for liberalizing credit regime impacting housing finance, broadening the scope of Credit Information Bureau at SBP, establishing Credit Information Bureau in the private sector for consumer loans, rationalizing stamp duties, registration fee and property taxes and ascertaining enforcement of Recovery Procedure in case

² Criteria for Primary Dealers was subsequently revised vide EDMD Circular No.11 resulting in appointment of 11 PDs effective from 7th August 2003.

of default by mortgagors. In the light of the Recommendations of the Advisory Group, Federal Government has announced a number of fiscal incentives in the Federal Budget 2003-04, which are as under:

- a. Tax credit on borrowing cost of housing loans from financial institutions has been enhanced to Rs. 500,000/- or 40% of the income of the mortgagor, whichever is less.
- b. The limit of property income for withholding tax has been raised to Rs.200,000/-.
- c. The rate of withholding tax on property income has been reduced to 5%.
- d. Profit or interest on mortgage of property or other capital charge has been allowed as deducted for the purposes of income tax.
- e. CED on wires and cables has been withdrawn and excise duty on cement has been reduced by 25% to reduce cost of construction.
- f. Banks have been allowed to deduct up to 3% of the income arising out of consumer loans for creation of a reserve to off-set bad debts in this segment.

Moreover, keeping in view the recommendations made by of the Advisory Group, SBP has further liberalized the credit regime for housing loans, the details of which are as under:

- The limit of bank exposure to housing finance has been enhanced from 5% to 10% of their net advances.
- The maximum per party limit has been increased from Rs. 5 million to Rs. 7.5 million
- The cap on debt-equity ratio for housing loans has been increased from 70:30 to 80:20
- The maximum loan tenure for housing finance has been increased from 15 years to 20 years.

For the purposes of evaluating the status of implementation of recommendation of the Advisory Group on Housing Finance as also to streamline Housing Finance Data, SBP has devised a Quarterly Report on Housing Finance for review of progress in the area.

High rates of duties and fees still remain a major impediment in property transactions and the provincial governments have not so far rationalized the same on conveyance deeds, contrary to the covenants of National Housing Policy 2001 and supporting recommendations of the Advisory Group on Housing Finance to this end. However, the rates of stamp duties and registration fee for mortgage deeds have been brought down in the provinces of Sindh and Punjab. In order to facilitate resolution of the issues requiring indulgence of the provincial governments, the Advisory Group has taken the following steps:

- Seminars on Housing Finance were held in the four Provinces. As issues relating to documentation and recovery of housing loans require legislative and administrative actions by the provincial governments, the seminars were aimed at creating awareness amongst officials of provincial governments. These seminars in the four provincial capitals were proposed with active participation of the relevant officials of the provincial/local governments and other local stakeholders.

- A detailed examination of the existing structure of property documentation is being conducted to simplify/standardize property documentation.
- In order to expedite and streamline housing finance issues requiring implementation by provincial governments, four Focus Groups in the provinces have been formulated. The Focus Groups would help in creating awareness at the provincial level, besides creating sub-groups in association with local stakeholders.

As a majority of bankers is not fully aware of all the aspects of the Criminal Law (Amendment) Ordinance 2002, the Advisory Group would help in organizing seminars, in association with PBA, for creating awareness amongst bankers and police personnel. Moreover, Advisory Group would seek cooperation and assistance of IG police of the four provinces to simplify the SOP (Standard Operating Procedure) for registration of FIRs as related to post dated cheques.

As a follow-up measure on implementation of Financial Institutions (Recovery of Finances) Ordinance 2001, the Advisory Group would approach the Honorable Chief Justices of Supreme and High Courts and request them to issue instructions to law enforcement agencies, courts and registrars on the newly promulgated recovery laws and instituting training for speedy resolution of property disputes.

In future, the Advisory Group, in addition to ascertaining follow-up on its recommendations, would also suggest ways and means for extending financing by banks to 'developers', besides liaising with international development agencies such as World Bank and International Finance Corporation on Credit Enhancement of Mortgage Backed Securities, Credit Lines to Banks, Partial Credit Risk Guarantees, and Conducting Seminars and Trainings for Housing Finance.

Financial Market Association (FMA): FMA is a non-commercial and not for profit organization based on mutual recognition of professionalism by traders of financial instruments with the objective of development of inter-bank market. FMA is an unincorporated association of treasurers and dealers in the inter-bank market with about 300 members who elect its governing body, annually.

Most of the inter-bank financial markets around the world have similar bodies in their respective countries. FMA functions on a similar pattern and is affiliated with a global body known as Association Cambiste International (ACI) based in Paris. FMA's mandate is to organize educational, professional and entertainment activities. Some of the achievement of FMAP is as follows:

- Introduced Master Repo agreement with assistance of SBP
- Introduced KIBOR regime
- Introduced marked to market rates calculations for inter-bank transactions to mitigate market risk
- Introduced dealers code of Conduct with assistance of SBP
- Organized seminars on foreign exchange and money market operations
- Commissioned an operational / trading guideline on commercial paper for Pakistan Banks association

Currently, FMA is working with SBP for introduction of interest rate derivatives in Pakistan. FMA, on behalf of its members also verifies and monitors adherence to the acceptable professional standards by inter-bank brokerage houses to in conduct of their money market brokerage business.

Forex Association of Pakistan: State Bank, as a matter of policy on external consultation and involvement of stakeholders, often interacts with the Forex Association and their Representatives.

While formulating rules and regulations covering Exchange Companies, representatives of Money Changers Association were taken on the Committee and regular meetings were held to obtain feedback in formulation of governing rules & regulations. Moreover, in order to achieve exchange rate stability, representatives of the Association are frequently advised to attend related meetings at the State Bank. Such direct consultations help SBP in obtaining first hand knowledge of market issues/problems and to get feed back on demand and supply of cash foreign currencies in the market. Feedback is also given on the expectations and future trend of rates of dollar vis-à-vis Pak-Rupee. Useful discussions are held to cope with the situations, which may not be in the best interest of the economy at large. Often, on the advice of the State Bank, this segment of the market acts quite proactive to keep the rates within the limits in the best interest of the country. This process of consultation and involvement, creates a sense of ownership in the decisions made by the Central Bank.

SECP Coordination Meetings: State Bank of Pakistan and SECP being the regulatory bodies in the financial sector, though having different jurisdictions, essentially have a common agenda and purpose in the larger context. A need was felt for a closer coordination with each other so that on the one hand there may be good supervision of the financial as well as non-bank financial institutions and on the other hand any breach of other's regulatory jurisdiction may be avoided. The close coordination was also necessary to eliminate chances of regulatory arbitrage. With this purpose a decision was taken to hold coordination meetings with regular intervals. First meeting between SBP & SECP was held on 15th January 2001 and has been a regular feature thereafter on quarterly basis or earlier as and when considered necessary.

These meetings have proved to be very useful and have enabled close cooperation in taking decisions on different regulatory issues of common concern. The main issues on which these meetings have contributed significantly as also for devising related policies and mechanism for monitoring of the financial sector are:

1. Regulatory issues related to Investment Banks.
2. Minimum Capital requirement of NBFIs.
3. Leasing Business by Banks.
4. Regulatory issues related to Leasing Companies and Modarbas
5. Coordination on Panel of Auditors.
6. Issuance of TFCs by banks.
7. Regulation of PEFGA.
8. Restructuring of NBFIs.
9. Transfers of NBFIs to SECP.
10. Information about Foreign Portfolio investments.
11. Dissemination of Credit Ratings by Credit Rating Companies.
12. Requirement of Ijara (Leasing) for operation of an Islamic Bank.
13. Sale of Sponsor shares by sponsor directors.
14. Guidelines on issuance of Commercial Papers by Banks/DFIs
15. Guidelines for Banks/DFIs to participate in Asset Backed Securitization transactions.
16. Margin Financing against shares by Banks/DFIs.
17. Illegal Brokerage companies and action there against
18. Financial Market Association of Pakistsan.

In addition to the above the meeting have also addressed a large number of minor issues of mutual concern.

ICAP Coordination Meetings: Regular and structured interactions between the regulators and external auditors are important as both have the complementary concerns with regard to the financial soundness of the financial institutions. The Basel Committee on Banking Supervision and the International Auditing Practices Committee share the view that greater mutual understanding and, where appropriate, communication would improve the effectiveness of bank audit and supervision to the benefit of both disciplines. Keeping this in view, the State Bank has taken steps to strengthen coordination with the external auditors of individual banks as well as with the Institute of Chartered Accountants of Pakistan (ICAP) being the representative body of the profession.

State Bank has the statutory responsibility to maintain a panel of auditors for banks. In order to ensure the quality of audits and credibility of annual accounts of the banks, a stringent criterion has been laid down in consultation with ICAP for placing chartered accountancy firms on the said panel. The credentials of all applicants for placement on the panel are verified by the ICAP. Furthermore, an institutional arrangement has been made to hold regular meetings with ICAP on quarterly basis to discuss issues relating to the audit and accounts of banks. Both the bodies invite representations from each other on various committees constituted to deliberate on auditing and accounting issues pertaining to banking sector.

In order to promote coordination and sharing of information between the external auditors of banks and SBP inspectors, the ICAP and the State Bank have jointly decided that the SBP's inspection teams will hold meetings with the external auditors of banks before the commencement of each inspection, during which the auditors will share their audit findings with the inspectors. Similarly, the SBP inspection teams on conclusion of the inspection will also share their concerns about the financial health of the banks with the auditors. This coordination with the ICAP and sharing of information with the auditors will add value to the supervisory oversight of the State Bank.

Apart from the formalized arrangements for interactions with the stakeholders, a significant degree of input is obtained by the central bank through unstructured deliberations on issues, concerns and solutions having direct bearings on all the facets of the economy at large. Such interactions and feedback not only provides essential inputs to the policy formulation process contributed to by the State Bank but also raises the comfort level of various stakeholders vis-à-vis the process and that related decisions are not being taken in isolation at the State Bank or the Governmental level.

Pakistan Federation of Chambers of Commerce and Industry: Being the representative body on country wide basis, due importance and consideration is given to the suggestions/proposals coming out of this forum with regard to various problems being faced by exporters, importers, manufacturers and traders. Related interactions provide essential information on trade flows and directions as well as import/export policies of other countries and the competitive position of the local players in the global context. SBP remains conscious of leveraging its policy framework for increased economic activity and cross border trade and removing or reducing the impediments while also disseminating related rationale so that the business community gains the necessary information and context to work out their individual costs and strategies to compete in the local and international business environment. Toward this end, consultations with the Federation prior to issuance of FE Circulars, has become a regular feature. Every opportunity is provided at the State Bank, at the highest level, to the chambers to put forward their viewpoint, concerns and issues for appropriate resolution within the defined monetary and fiscal policy framework.

Trade Bodies: A large number of trade bodies exist in the country such as Bed-ware Association, Towel Manufacturers Association, Ready-made Garment Association etc. While these bodies /association are represented by their members in various meetings particularly in the Credit Advisory Committees, State Bank on its part endeavors to resolve their genuine problems with regard to availability of credit, export finance and matters arising out of the regulatory framework.

Export Bodies and Associations: The sectors producing goods and services for exports have always been an area of focus of the government and the State Bank. Historically, a number of government-sponsored schemes for promotion of exports were devised and implemented through the State Bank. The process of consultations and interactions with the representative bodies and associations remains a regular feature at all levels at the State Bank. While such bodies are encouraged to provide feedback on policies and apprise the policy makers on evolving cost structures and their own competitive positions, the Governor State Bank also makes it a point to attend, to the extent possible, all forums for related interactions with stakeholders.

Academia: The positive contribution of the academics in areas of a central bank's core functions and responsibilities is not only a welcome tool in establishing the rationale and relevance of stated policies and objectives but may provide guidance and awareness of alternate dimensions. State Bank not only seeks active inputs from the academia on issues of significance but continuously monitors alternate viewpoints emanating out assessments and concerns voiced. As a matter of policy, State Bank takes every opportunity to disseminate information, facts and basis for particular policy decisions and the envisaged / anticipated impact in the short and longer terms, to enable informed external judgements. Ongoing interactions with the academia enable State Bank to identify the set of data and information to be disseminated proactively to facilitate exhaustive academic treatment and ensuing value addition to the workings of the central bank.