

Quarterly Performance Review
of the **Banking System**
September 2010



State Bank of Pakistan
Banking Surveillance Department

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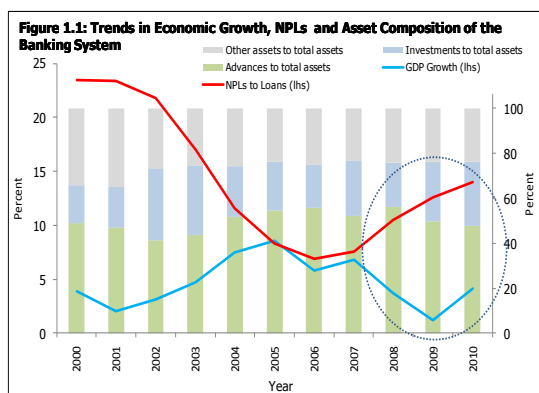
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Quarterly Performance Review of the Banking System September 2010

1. Overview



Recent unprecedented floods and torrential rains in the country to some extent intensified the effects of an already fragile macro environment as the non-performing loans (NPLs) of the banking system grew at a faster rate during Jul-Sep 2010 quarter. The asset base of the system also contracted over the quarter, conforming to an established pattern for the third calendar quarter that is marked with slow growth and the end of operating cycle of major Kharif crop-based industries.

The macro-environment is already tenuous for the last two years or so¹. A host of factors i.e. slackened economic activities, power shortages, security concerns, and higher inflation have squeezed profit margins as well as the repayment capacity of borrowers. Moreover, the fiscal situation also deteriorated and the public sector borrowed heavily from banks for budgetary support, financing needs of Public Sector Enterprises (PSEs) and commodity operations. Accordingly, there was a shift in banks' asset-mix towards credit to the public sector along with increased preference for top rated corporations- over Small and Medium

Table 1.1: Selected numbers of Balance Sheet and Profit & Loss Statement

	(billion Rupees)						
	CY04	CY07	CY08	Sep-09	CY09	Jun-10	Sep-10
Total Assets	3,043	5,172	5,628	6,105	6,516	6,782	6,626
Investments (net)	679	1,276	1,087	1,593	1,737	1,893	1,873
Advances (net)	1,574	2,688	3,173	3,119	3,240	3,231	3,167
Deposits	2,393	3,854	4,218	4,483	4,786	5,128	5,021
Equity	202	544	563	641	660	668	656
Profit Before Tax (ytd)	52	107	63	70	81	59	80
Profit After Tax (ytd)	35	73	43	42	54	36	49
Provisioning Charges (ytd)	11	60	106	64	97	30	50
Non-Performing Loans	200	218	359	422	446	460	494
Non-Performing Loans (net)	59	30	109	128	134	123	143

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

¹ The GDP growth rate for FY2009-10 remained 4.1 percent vis-à-vis the target of 3.3 and anemic 1.2 percent growth in preceding FY2008-09. However, the building pressures on fiscal account and inflation are affecting improvements in economic recovery and external account. The situation has been further aggravated by unprecedented floods and torrential rains; these floods imply lapses on some economic targets for FY2010-11 particularly GDP growth rate which is expected to remain 2 to 3 percent against the target of 4.5 percent and inflation is expected to remain 13.5 to 14.5 percent (for details please refer to the SBP's Annual Report). However, on international front, IMF in its recent World Economic Outlook of Oct-2010 has highlighted a higher-than-estimated growth during first half of 2010. Nevertheless, besides forecasting that global activity will expand by 4.8 percent during 2010 (up from 4.6 percent forecast of Jul-2010), the Fund points out that the recovery is still fragile as it is facing a number of unresolved challenges and downside risks continue to predominate.

Table 1.2: Highlights of the quarter ended Sep-10

	(in percent)						
	CY04	CY07	CY08	Sep-09	CY09	Jun-10	Sep-10
Asset Growth	19.7	18.8	8.8	0.3	15.8	5.4	(2.3)
Loans Growth	42.1	10.7	18.0	(1.8)	2.1	1.9	(2.0)
Deposit Growth	21.9	18.4	9.4	(1.7)	13.5	7.4	(2.1)
Investments Growth	(13.6)	53.1	(14.8)	13.1	59.9	5.9	(1.0)
Equity Growth	44.5	35.3	3.4	3.0	17.3	1.2	(1.9)
Capital Adequacy Ratio	10.5	12.3	12.2	14.3	14.0	13.9	13.8
Capital to Total Assets	6.7	10.5	10.0	10.5	10.1	9.9	9.9
NPLs to Loans (Gross)	11.6	7.6	10.5	12.4	12.6	12.9	14.0
Net NPLs to Net Loans	3.8	1.1	3.4	4.1	4.1	3.8	4.5
ROA (Before Tax)	1.9	2.2	1.2	1.6	1.3	1.8	1.6
ROE* (Before Tax)	30.5	22.6	11.4	15.1	13.2	17.7	16.2
Liquid Assets/ Total Deposits	46.5	45.1	37.7	42.7	44.5	45.3	44.4
Advances to Deposit Ratio	65.8	69.7	75.2	69.6	67.7	63.0	63.1

* Based on Average Equity plus Surplus on Revaluation

Note: Growth rates for Sep-09, Jun-10, and Sep-10 are on quarterly basis

Enterprises (SME) and consumer that are generally less resilient to economic slowdown and fragility in the operating environment. The heightened credit risk is reflected in a noticeable and persistent increase in NPLs - doubling over two years by the end of CY09 (see Figure 1.1 & Table 1.1).

The growth in NPLs, which decelerated during the first two quarters of CY10, grew by 7.4% during the quarter under review reaching Rs494 billion (see Table 1.1). This coupled with over-the-quarter decline in lending portfolio amplified the deterioration in infection ratios. However, since these fresh NPLs required only partial provisioning coverage, the system's baseline earning indicators remained positive (see Table 1.2).

In line with the established trend for the July-September quarter, the asset base of the banking system contracted by 2.3 percent over the quarter. The Ramadan and pre-Eid withdrawals as well as the increase in currency in circulation (CC) during the quarter led to a narrowing of the deposit base. Banks for the first time since the last quarter of CY08 reduced their holding of government paper, while lending, particularly for commodity trade, also declined. Additionally, the write-down of goodwill by a bank reduced fixed assets by 9.5 percent during the quarter. Therefore, the asset-mix further shifted towards investments as cash and interbank lending declined at an even faster rate towards the end of the quarter.

The shrinking of the asset base, particularly advances, resulted in a decline in size of the risk-weighted asset (RWA)

over the quarter. However, the higher regulatory deductions from Tier 1 capital reduced the eligible capital as well as risk-based capital adequacy ratio (CAR), which deteriorated marginally to 13.8 percent, while staying above the regulatory requirement of 10 percent (see Table 1.2).

The Ramadan and Eid related enhanced demand for currency, coupled with a slower growth in monetary aggregates and usual passive growth pattern of the third calendar quarter, led to a reduction in bank deposits, moderately straining market-based liquidity. However, the situation reversed in subsequent weeks with the replenishment of deposits forcing SBP to conduct mop ups to check excess liquidity in the market. In the wake of two consecutive raises of 50 bps each in policy rate, the yield curve gradually inched up and steepened with higher premiums for longer term maturities. The exchange rate depreciated moderately, while equity prices, after following a marginal decline recovered by the end of the quarter. The prices of these financial assets, however, showed contained volatility and owing to banks' limited risk exposures, market risk remained in check.

Going forward, the increased credit risk will remain a major challenge for banks. There is a need for banks to devise ingenious strategies for dealing with the high level of NPLs so that promising businesses, facing transitory difficulties only due to a constrained macro environment, continue to contribute in economic growth and service their obligations in an orderly manner. SBP has responded to the changed and challenging

circumstances and rationalized its regulatory requirements on loan loss recognition in respect of advances in flood-affected areas². The usual inventory build up, particularly by Kharif crop-based industries, during the last calendar quarter will create additional demand for bank credit. Although the banks are expected to remain liquid; the heightened demand for credit from the public sector will mean that the banks ability to finance additional private sector loans will be predicated upon mobilization of fresh deposits and retirement of commodity finance by government owned agencies, which continues to be extremely high. Banks will need to reduce their large portfolio of government paper and lending to the public sector agencies so as to reduce their sovereign exposure as well as to make credit available to the private sector for maintaining economic growth, and thereby enhance and diversify revenues of the banking system. Nevertheless, the aggregate earnings of the system are expected to be satisfactory, although these will continue to be concentrated in banks endowed with a wide network and competitively better placed to raise stable and relatively cheap funds. In addition, persistent macro-environment issues will pose a stiff challenge for some banks to enhance their MCR to Rs 7 billion by the end of CY10.

² Please refer to BSD Circular No. 06 of November 02, 2010.

2. Balance Sheet Analysis

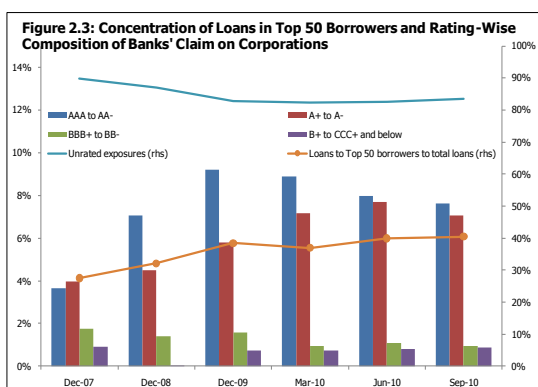
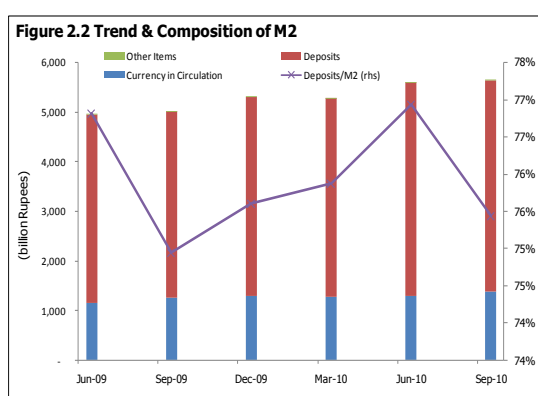
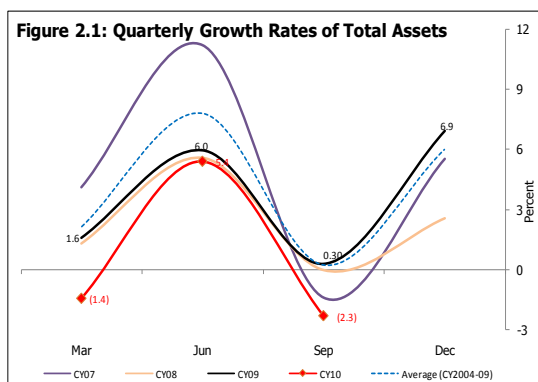


Table 2.1: Trend and Composition of Assets and Funding Structure
(Rs in Billion)

	CY06	CY07	CY08	Sep-09	CY09	Jun-10	Sep-10
Cash & Balances	596	617	654	646	708	729	672
Lending to FIs	214	191	188	180	238	292	281
Investments (net)	833	1,276	1,080	1,593	1,737	1,893	1,873
Advances (net)	2,428	2,688	3,183	3,119	3,240	3,231	3,167
Other Assets	282	401	521	567	593	638	632
Total Assets	4,353	5,172	5,627	6,105	6,516	6,782	6,626
Bills Payable	60	82	70	74	73	73	76
Borrowings	438	452	459	572	654	565	517
Deposits	3,255	3,854	4,217	4,483	4,786	5,128	5,021
Other Liabilities	197	239	317	334	344	349	355
Equity & Revaluation	402	544	563	641	660	668	656

Following the established pattern of the third calendar quarter the asset base of the banking system contracted during Sep-10 (see Figure 2.1). Besides the effects of usual end of operating cycles of a few leading borrowing industries, unprecedented floods and traditional Ramadan and pre-Eid withdrawals during August and September 2010 affected banks' deposits and credit operations. Amid a contained growth in monetary aggregates and inch up in currency in circulation, the deposits declined over the quarter and their share in M2 lowered by 1.5 percentage points to 75.4 percent (see Figure 2.2).

All the major components of assets and liabilities witnessed contraction; however, the asset-mix continued to reflect risk-averse strategy of banks' that they have been following since the latter half of CY08 when economic and business environment started to weaken and credit risk inched up while public sector emerged as a major user of bank credit. Since then asset-mix significantly shifted towards government papers, lending to and investment in bonds of PSEs and financing for commodity operations, while the lending portfolio shifted away from SME and consumer to corporate segment – especially top-rated large corporations (see Figure 2.3) that are generally more resilient to economic slowdown and fragility in the business environment.

During the quarter under review, the lending portfolio of banks registered a decline of 2.0 percent vis-à-vis a 2.1 percent decline in deposits. Moreover, banks' holding of government papers,

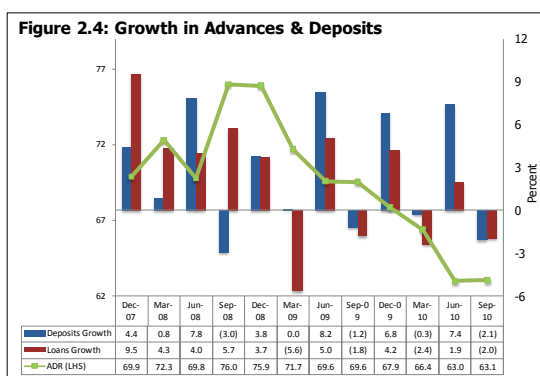


Table 2.2: Trends in Total Assets

	(billion Rupees)						
	CY05	CY06	CY07	CY08	CY09	Jun-10	Sep-10
PSCBs	724	836	1,036	1,042	1,230	1,321	1,236
LPBs	2,483	3,102	3,836	4,220	4,905	5,073	4,998
FBs	339	224	173	234	241	249	257
CBs	3,547	4,162	5,044	5,496	6,376	6,643	6,491
SBs	113	120	127	130	140	139	135
All Banks	3,660	4,282	5,171	5,627	6,516	6,782	6,626

Table 2.3: Market share by Size of Banks

	(in percent)			
	Dec-09	Mar-10	Jun-10	Sep-10
Top 5 banks	50.8	49.9	51.0	50.4
6-10 Banks	22.2	22.7	22.2	23.2
11 to 20 Banks	16.4	16.5	15.9	16.7
21 to 29 Banks	4.8	4.8	5.1	3.8
All Local Comm. Banks	94.2	94.0	94.3	94.1
Foreign Banks	3.7	3.9	3.7	3.9
Specialized Banks	2.1	2.1	2.0	2.0

Table 2.4: Balance Sheet Composition by Size of Banks

	(in percent)							
	Top 5 Banks	6-10 Banks	11 to 20 Banks	21-29 Banks	All Local Comm.	Foreign Banks	Specialized Banks	All Banks
	Sep-10	Sep-10	Sep-10	Sep-10	Sep-10	Sep-10	Sep-10	Sep-10
Cash & Bank	10.7	9.6	7.9	9.1	9.9	18.5	7.4	10.1
Lending to FIs	3.0	1.9	5.8	13.7	3.7	20.1	-	4.2
Investments	28.4	31.2	29.5	18.6	28.9	22.2	10.7	28.3
Advances	49.2	46.2	47.0	45.8	47.9	32.7	69.7	47.8
Other Assets	8.6	11.1	9.7	12.7	9.6	6.5	12.2	9.5
Total Assets	100	100	100	100	100	100	100	100
Bill Payables	1.0	1.2	1.3	1.7	1.2	1.5	0.3	1.1
Borrowings	4.3	7.6	12.9	6.2	6.7	6.0	61.8	7.8
Deposits	79.1	77.1	73.8	74.4	77.5	68.8	10.1	75.8
Other Liabilities	4.3	6.7	3.8	2.5	4.7	9.3	27.6	5.4
Net worth	11.3	7.4	8.1	15.2	9.9	14.4	0.3	9.9

Table 2.5: Deposits by Size of Banks

	(Percent)							
	Top 5 Banks	6-10 Banks	11 to 20 Banks	21 to 29 Banks	All Local Comm. Banks	Foreign Banks	Specialized Banks	All Banks
Market Share in Deposits	52.7	23.5	16.3	3.7	92.5	3.5	0.3	100
Composition of Deposits:								
Customers	97.1	97.3	96.8	97.6	97.1	96.5	94.5	97.1
Fixed Deposits	25.2	31.2	44.3	45.6	30.1	48.1	22.7	31.3
Saving Deposits	38.4	36.7	31.4	28.5	36.7	28.3	32.4	36.1
Current accounts - Remunerative	4.8	2.2	-	2.0	3.3	0.3	1.2	3.1
Current accounts - Non-remun.	28.2	26.1	20.1	20.8	26.3	19.4	36.3	25.8
Others	0.5	1.1	1.1	0.7	0.7	0.4	1.9	0.7
Financial Institutions	2.9	2.7	3.2	2.4	2.9	3.5	5.5	2.9
Remunerative Deposits	1.6	2.6	3.1	2.2	2.1	2.5	5.4	2.1
Non-remunerative Deposits	1.3	0.1	0.1	0.2	0.8	1.0	0.0	0.8
Total Deposits	100	100	100	100	100	100	100	100

which has been continually increasing since last quarter of CY08, also slightly came down. The asset and funding structure of the system accordingly remained over the quarter (see Figure 2.4 & Table 2.1)

Cross-Sectional Analysis & Market Structure:

Disaggregated analysis of banks revealed contraction in asset base of all banks groups except for FBs which posted a slight growth during the quarter under review (see Table 2.2). On individual basis, most of the banks observed contraction in their asset base. However, the decline was particularly conspicuous in top 5 banks, while due to strong increase in a few medium-sized banks, the market share slightly inched up (see Table 2.3). Banks' size and outreach also reflect in their asset – liability management strategies. That is, large-sized banks with extensive outreach and long presence in the market enjoy a competitive edge in mobilizing stable and economical funds. Accordingly, major part of their funding base comprises customer deposits, which are less sensitive to change in rate of return. This, enable them to invest major portion of their funds in loans and advances which are less liquid but yield returns higher than other asset classes (see Table 2.4 and 2.5). Detailed market structure along key risk indicators is available at Annexure-III.

Growth & Dynamics of Different Components of Assets and Liabilities:

Deposits base of the banking system declined by 2.1 percent (YoY growth of 12.0 percent). This decline was mainly

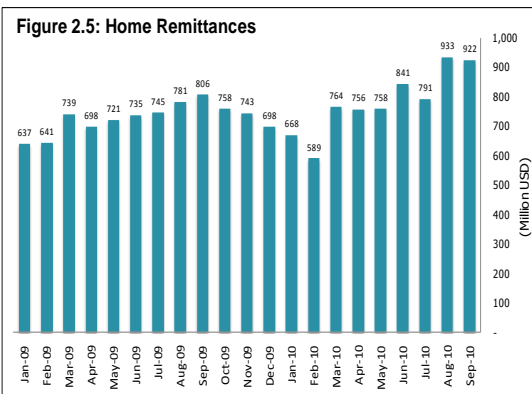
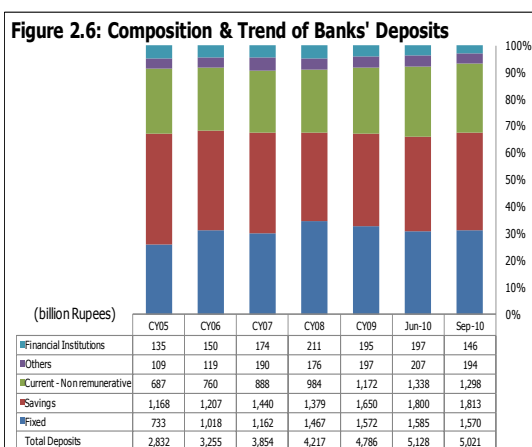


Table 2.6: Investments in CDNS Schemes

	Outstanding (billion Rs)	Growth (QoQ) %	% of Banks' Deposits
Jun-08	1,094	2.1	28.5
Sep-08	1,114	1.9	29.5
Dec-08	1,143	2.5	30.1
Mar-09	1,267	10.9	32.7
Jun-09	1,361	7.4	33.0
Sep-09	1,424	4.6	34.2
Dec-09	1,476	3.6	34.1
Mar-10	1,530	3.7	34.6
Jun-10	1,586	3.6	34.0
Sep-10	1,628	2.7	34.5

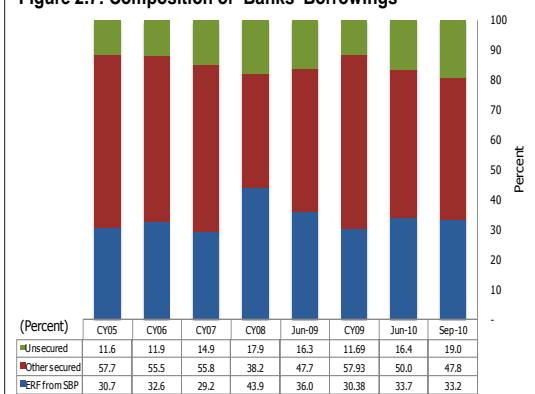
caused by contraction in interbank deposits while customer deposits also reduced, as there was a significant rise in the quantum of CC in M2 due to Ramadan and pre-Eid deposit withdrawals. However, investments in Central Directorate of National Savings' (CDNS) instruments continued growth, though at a slower pace, increasing their quantum as a percentage of banks' deposits to a 34.5 percent during the quarter (see Table 2.6). Nevertheless, an appreciable increase in home remittances, which touched highest level in Aug-10, checked the decline in deposits to some extent (see Figure 2.5).

Further analysis of deposits shows that all categories of deposits declined except Saving Accounts that marginally increased during Sep-10. However, the most obvious decrease took place in Financial Institutional Deposits that declined by 26 percent (see Figure 2.6) and corresponded to similar contraction in transitory, liquid assets i.e. cash and treasury bank balances. The individual banks however showed varying performance in mobilizing and maintaining deposits. While deposits of most of the large-sized and small-sized banks contracted, a few medium-sized banks posted strong growth in deposits base: the decline in top 5 banks' deposits was greater than the overall decline in system's deposits and was moderated by increase posted by some of the medium sized banks.



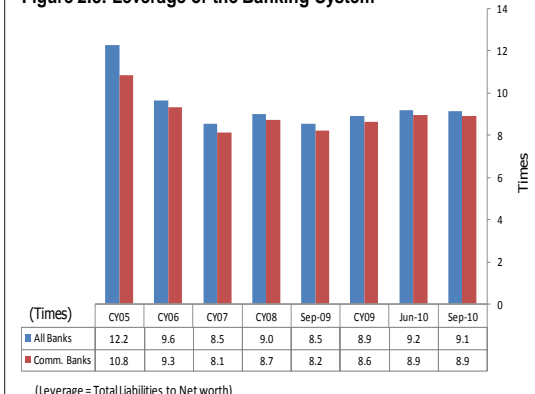
In the backdrop of contraction in banks' earnings assets and deposit base, their reliance on **borrowings** also lowered by 8.4 percent during Sep-10. This decline in

Figure 2.7: Composition of Banks' Borrowings



end-quarter balances also reflected in average share of borrowings in overall fund base i.e. average borrowings as percent of total asset lowered to 8.6 percent in Sep-10 compared to 8.8 percent in last quarter. Analysis of different components show that QoQ decline in borrowings was mainly contributed by secured borrowings, while unsecured borrowings especially, the overdrawn Nostro accounts increased. The composition of borrowings accordingly shifted towards unsecured borrowings (see Figure 2.7)

Figure 2.8: Leverage of the Banking System



The **Shareholders' equity** of the banking system slightly contracted by 2 percent during the quarter under review as one of the banks provided a significant amount in respect of intangible assets³. However, due to greater decline in asset base, leverage ratio of the system marginally lowered over the quarter (see Figure 2.8).

Table 2.7: Composition of Banks' Advances (domestic operations)

	(in percent)						
	Dec-06	Dec-07	Dec-08	Sep-09	Dec-09	Jun-10	Sep-10
Public	8.1	7.6	10.8	17.5	16.9	17.7	17.7
Private	91.9	92.4	89.2	82.5	83.1	82.3	82.3

Table 2.8: End-use of Advances (domestic operations)

	Sep-09		Dec-09		Jun-10		Sep-10	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Fixed Investment	828.2	26.0	836.0	25.0	836.8	25.0	830.6	25.3
Corporate Sector	788.5	24.8	795.2	23.8	799.5	23.9	797.1	24.2
SMEs	39.7	1.2	40.7	1.2	37.3	1.1	33.5	1.0
Trade Finance	474.9	14.9	517.0	15.5	537.9	16.1	553.6	16.8
Corporate Sector	436.5	13.7	473.0	14.2	492.9	14.8	512.0	15.6
SMEs	38.4	1.2	44.0	1.3	45.0	1.3	41.7	1.3
Working Capital*	1,523.0	47.8	1,635.4	49.0	1,637.8	49.0	1,577.5	48.0
Corporate Sector	729.0	22.9	797.3	23.9	753.4	22.6	739.8	22.5
SMEs	240.8	7.6	263.0	7.9	236.2	7.1	232.9	7.1
Agriculture	154.3	4.8	156.5	4.7	164.1	4.9	167.8	5.1
Commodity Financing	398.8	12.5	418.5	12.5	484.2	14.5	437.1	13.3
Consumer Finance	280.1	8.8	268.6	8.0	245.5	7.3	242.2	7.4
Credit Cards	34.2	1.1	31.2	0.9	28.3	0.8	26.9	0.8
Auto Loans	72.5	2.3	66.3	2.0	64.0	1.9	60.5	1.8
Consumer Durable	0.2	0.01	0.2	0.0	0.3	0.0	0.2	0.0
Mortgage Loan	62.2	2.0	61.5	1.8	57.9	1.7	53.2	1.6
Other personal Loans	111.0	3.5	109.5	3.3	95.1	2.8	101.5	3.1
Staff Loans	71.9	2.3	73.9	2.2	76.6	2.3	76.7	2.3
Housing Finance	53.2	1.7	55.0	1.6	56.1	1.7	58.4	1.8
Others	18.6	0.6	18.9	0.6	20.5	0.6	18.3	0.6
Others	7.6	0.2	8.2	0.2	6.2	0.2	8.8	0.3
Total	3,186	100	3,339	100	3,341	100	3,289	100

* Agriculture and commodity finance are added in this category for analysis in this section only.

Loans/Advances of the banking system decreased by 2.0 percent (1.4 percent on gross basis) during the quarter under review. However, this contraction mainly resulted from retirement of commodity finance that contributed more than 90 percent decline in advances as the public and private sector disposed off a part of their wheat and other commodity holdings. Lending to both private and public sectors saw a proportionate decline during the quarter, which kept their share in overall lending portfolio unchanged (see Table 2.7)⁴. Segment wise analysis shows that besides commodity finance, lending

³ The provision against intangible assets were made in half-yearly financials for Jun-10 that are subject to limited scope audit and published a month later than submission of QRC. The impact of provisions, therefore, appeared in Sep-10.

⁴ The analysis of advances in the following paragraphs is based on domestic operations.

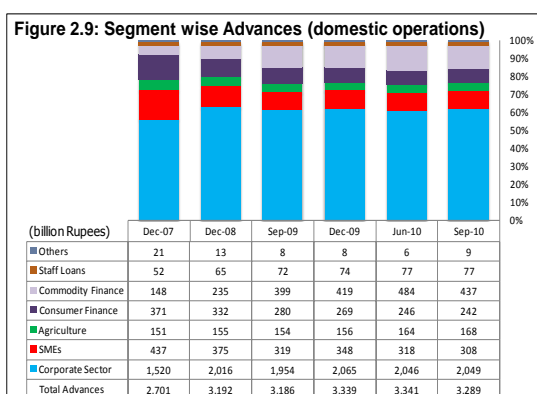
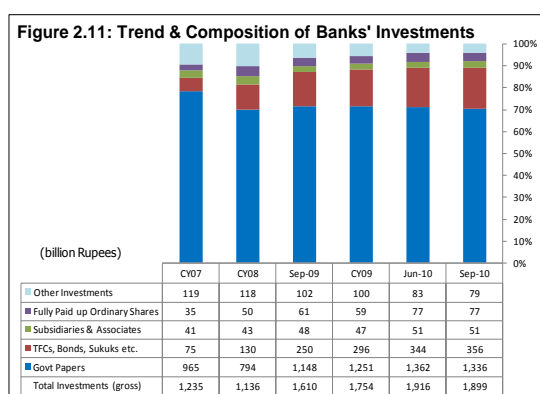
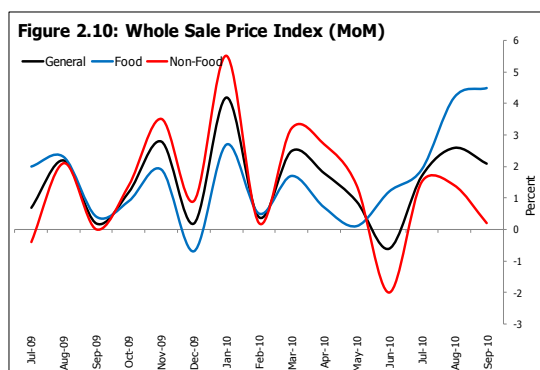


Table 2.9 : Advances by Sector of Economy (Domestic Operations)

(billion Rupees)

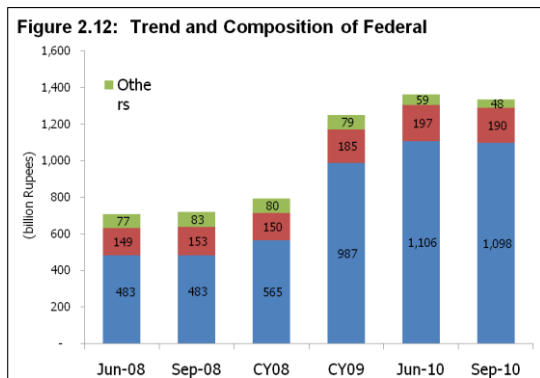
	Jun-10	Sep-10
Chemical & Pharmaceuticals	142.4	147.8
Agribusiness	203.7	211.3
Textile:	594.4	581.1
Weaving	82.5	78.1
Spinning	187.6	184.7
Composite	183.5	177.2
Other	140.8	141.1
Cement	90.7	94.1
Sugar	82.0	57.0
Shoes & Leather garments	21.2	20.5
Automobile & Transportation equipment	47.2	40.2
Financial	32.2	29.4
Insurance	1.5	1.7
Electronic & Electric Appliances	54.0	53.9
Production & Transmission of Energy	326.5	329.8
Individuals	419.6	405.9
Others	1,325.2	1,316.7
Total	3,340.6	3,289.4



to SME and Consumer also declined while Agriculture and Corporate segments witnessed a marginal increase. However, growth in corporate segment lending was mainly contributed by public sector corporations as the lending to private sector corporations came down. Accordingly, the share of corporate segment marginally increased over the quarter (see Figure 2.9).

The end-use analysis of advances indicated decline in all major end-uses except for agriculture and trade finance of corporate segment (see Table 2.8) reflecting an uptick in world commodity prices and depreciating exchange rate that pushed up the quantum of trade finance. The reduction in working capital finance to both corporate and SME mainly attributed to the reduction in exposures of sugar sector and cotton industries (see Table 2.9) that paid off their working capital borrowings before the inception of next business cycle in outgoing (Oct-Dec) quarter. Otherwise, the Wholesale Price Index (WPI) rose toward the end of quarter (see Figure 2.10) highlighting the higher valued inventories in rupee terms.

Investments of the banking system that mainly comprise government papers have significantly increased significantly since the last quarter of CY08. During the quarter under review the investment portfolio, however, declined by 1.0 percent for the first time since then as the government papers contracted by 2 percent while Bonds, TFCs & Sukuks registered moderate growth (see Figure 2.11). Banks' stock of government papers decreased as all the bids for Pakistan Investment Bonds (PIBs) auctions were



rejected during the quarter while their holding of short-term Market Treasury Bills (MTBs) also marginally declined (see Figure 2.12).

Going forward, the conventional pickup in demand for bank credit in outgoing quarter, which is marked with the Kharif crop harvest and inventory building by allied industries, is likely to expand the base of earnings assets. Given the sufficient amount of liquid assets in the form of short term government papers, banks liquidity profile is expected to remain comfortable. However, their ability to lend private sector will largely depend upon the mobilization of deposits and retirement of commodity finance, stock of which has been towards higher end and showing stagnancy for quite some time. The recent heavy floods and torrential rains that caused massive losses to human lives and economic wealth, especially in the areas which are heartland of major Kharif crops, are likely to affect credit conditions in allied industries. Moreover, financing requirements to support the rehabilitation program in flood-affected areas will further stimulate the government's needs for bank credit that is already high due to stressed fiscal balances.

3. Risk Assessment of the Banking System

3.1. Credit Risk

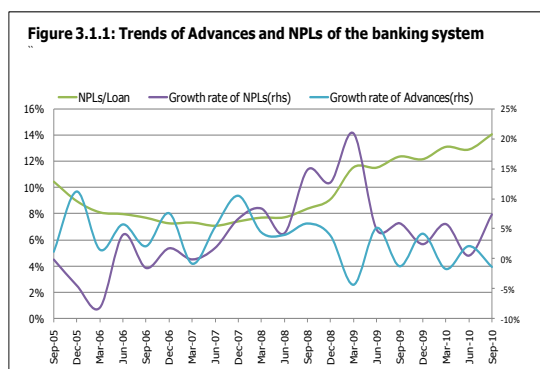


Table 3.1.1 : Concentration of Lending in the Banking System
(in percent)

	Banks			
	Top 5	Top 10	Top 20	Industry
CY 07	48.8	72.6	94.1	100
Dec-08	52.9	74.2	93.6	100
Jun-09	53.5	74.7	93.5	100
Sep-09	53.5	74.7	93.5	100
Dec-09	53.7	74.7	93.2	100
Mar-10	52.5	72.8	93.0	100
Jun-10	52.6	74.3	92.8	100
Sep-10	51.8	73.8	92.3	100

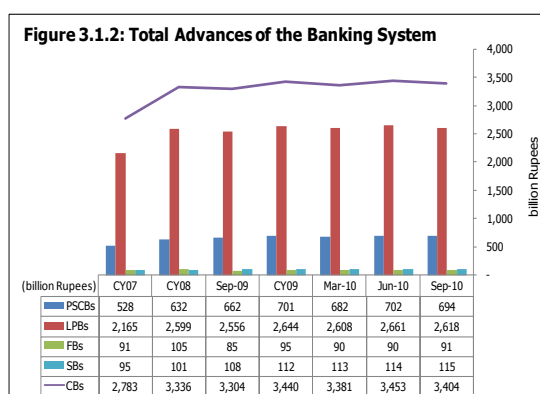


Table 3.1.2: Concentration-NPLs/Loans

	(in percent)								
	CY05	CY06	CY07	CY08	Sep-09	Dec-10	Mar-10	Jun-10	Sep-10
Top 5 Banks	8.2	6.8	6.8	9.0	10.8	10.49	11.54	11.16	12.21
Top 10 Banks	7.6	6.0	6.9	9.6	11.4	9.93	10.95	11.73	12.57
Top 20 Banks	7.6	6.2	6.7	10.1	11.9	11.69	12.63	12.52	13.43
Industry	8.3	6.9	7.2	10.5	12.4	12.15	13.09	12.89	14.04

The overall fragile economic situation and weaknesses in the operating environment coupled with devastations caused by recent unusually high floods and torrential rains during the quarter under review further aggravated the credit risk. As a result, NPLs which saw some deceleration during the last two quarter, again grew by 7.4 percent reaching Rs494 billion. Though the decline in advances is a usual event in third quarter, the contraction in advances during the quarter in conjunction with a significant increase in NPLs amplified the infection ratios (see Figure 3.1.1).

The major factors for decline in overall advances were the a)- traditional slowdown in credit during third calendar quarter, which corresponds to end of operating cycle of major borrowings industries, b)- unprecedented floods that affected credit operations, and c)- continuing risk-averse policies of banks in the face of heightened credit risk, especially by the bigger players (see Table 3.1.1). Due to subdued economic activity, banks became cautious in their lending business. This is visible in the shift in their advances-mix from consumer and SME to corporate especially the top-rated corporations (see Figure 3.1.3 & 3.1.4). On group-wise basis LPBs and PSCBs saw a decrease in advances, while SBs and FBs saw marginal growth. However, growth in the latter two groups failed to have any significant impact due to their modest share in the system (see Figure 3.1.2).

The extended outreach of large sized banks and their larger pie in loan portfolio also made them more vulnerable to the credit risk emanating from their exposures in flood-affected areas. Some of the larger banks took heavy tolls; and Sep-10 quarter saw a decline

Table 3.1.3: Composition of Banks' Advances						
(amount in billion Rupees, growth in percent)						
Period	Public Sector Loans			Private Sector Loans		
	Amount	Share	Growth	Amount	Share	Growth
Dec 07	241	8.4	15.7	2,637	91.6	13.8
Dec 08	380	11.1	58.0	3,056	88.9	16.0
Mar 09	368	11.2	(3.1)	2,918	88.8	(4.5)
Jun 09	596	17.3	62.0	2,859	82.7	(2.0)
Sep 09	591	17.3	(1.0)	2,822	82.7	(1.3)
Dec 09	617	17.4	5.0	2,938	82.6	4.0
Mar-10	551	15.8	(10.7)	2,943	84.2	0.2
Jun-10	657	18.4	19.2	2,911	81.6	(1.1)
Sep-10	653	18.6	(0.6)	2,865	81.4	(1.6)

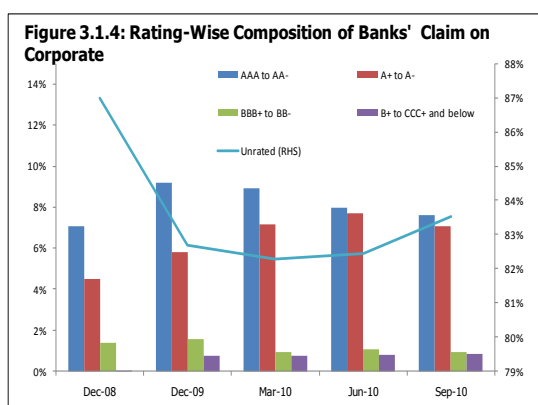
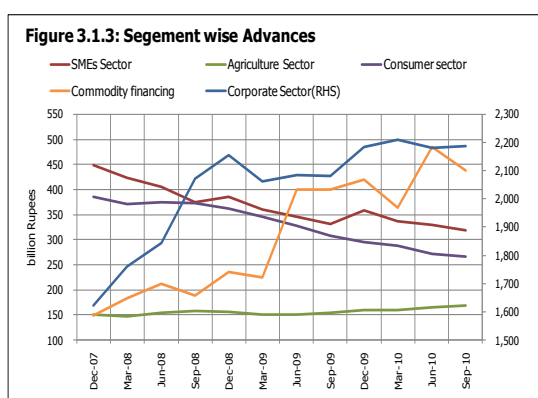
in their, otherwise growing, share of advances. The share in advances for smaller banks increased in the current quarter (see Table 3.1.1 & 3.1.2).

The contraction in advances took place in both public and private sector, mainly due to 6.5 percent decline in commodity finance over the quarter. The energy sector, however, saw some growth in lending to public sector corporations. Relative sharper decline in private sector shifted the mix towards the public sector advances by 20 bps (see Table 3.1.3).

Despite the overall decline, the Corporate and Agriculture segments still managed to show some growth in advances. The performance of both these sectors in terms of share in overall loans remained relatively stable due to their scale of production, varied activity and share in GDP. The growth in Agriculture segment was lead by a single bank holding 54 percent of agriculture portfolio (see Figure 3.1.3).

Various loan segments have shown declining trends in fresh loan acquisition due to varied reasons. The decline in commodity finance is cyclical in nature, whereas the depression in SMEs and Consumer loans resulted from low credit demand, partly due to high interest rates, high inflation and high degree of banks' preference for managing existing worthy borrowers and cautiousness for green field loans.

The breakup of advances on sector-wise basis showed growth mainly in Chemical & Pharmaceutical, Cement and Production & Transmission of Energy. The growth in Chemical and Pharmaceutical sector emanated from diversity in nature of its industries ranging from household chemicals to industrial chemicals, pesticides and Pharmaceuticals to Fertilizers. This sector has been one of the few stable sectors in the



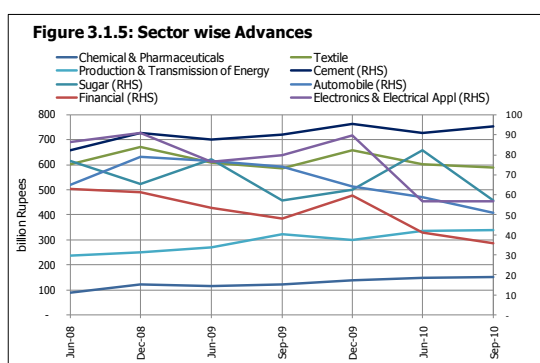
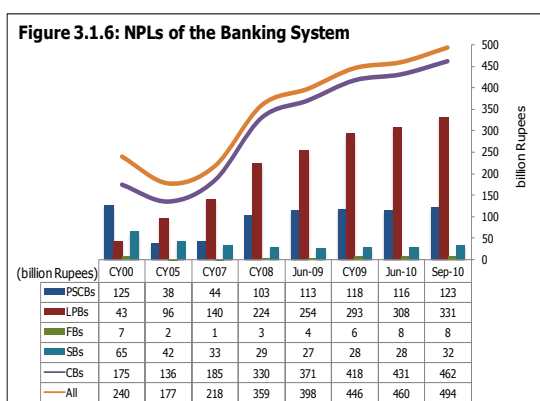


Table No. 3.1.4 NPLs to loans by end use

(amount in billion Rupees, ratio in percent)

	Sep-09			Jun-10			Sep-10		
	Loans	NPLs	Ratio	Loans	NPLs	Ratio	Loans	NPLs	Ratio
Fixed Investment	892.2	118.8	13.3	900.3	131.9	14.6	897.8	140.9	15.7
Working Capital	1,584.6	199.9	12.6	1,699.2	217.6	12.8	1,638.3	238.3	14.5
Trade Finance	489.6	56.9	11.6	557.8	59.6	10.7	572.5	61.6	10.8
Others	445.9	46.0	10.3	410.3	50.8	12.4	409.9	53.2	13.0
Total	3,412.3	421.6	12.4	3,567.6	459.8	12.9	3,518.5	494.0	14.0



Corporate Segment. The growth in production and transmission of energy was due to obvious unevenness in supply of energy with respect to its demand (see Figure 3.1.5). The Sugar and textile sectors advances declined due to close of their seasonal business cycle.

The negative growth in advances affected Fixed Investments as well as Working Capital Finance, signifying the absence of any substantial new investments. Only Trade Finance was able to post some increase over the quarter; attributable to increased forex rates and high international prices of commodities and other imported items (see Table 3.1.4).

As already discussed above and in a couple of the preceding QPRs, the environmental stresses in business ecosystem are having their toll on the performance of all kinds of borrowers; be it large corporates, SMEs or individuals and households. The resultant outcome not only lowers the demand for new borrowings. The demand for fresh loans and the repayment capacity of borrowers was largely affected by the sluggish performance of the real sectors. In the year 2009 only 19 out of 32 corporate sectors were able to post profit after tax (28 for year 2008)⁵. This slackness in productivity and profitability in the real sector actually transformed into bad assets of financial sector by a time lag.

Accordingly, the infected portfolio touched new highs in absolute value as well as in term of percentage. The NPLs grew to Rs 494 billion at a rate of 7.4 percent in the quarter (YoY growth of 17.17 percent) (see Figure 3.1.6). Recoveries against NPLs, which showed some improvements in the past quarters, remained depressed during the quarter under review.

⁵ Page No. 99. Money and Banking; SBP's Annual Report 2009-2010.

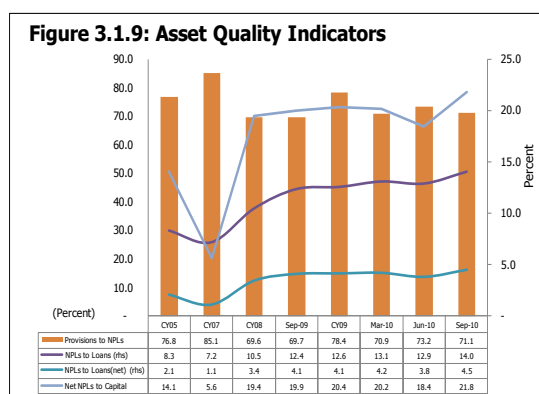
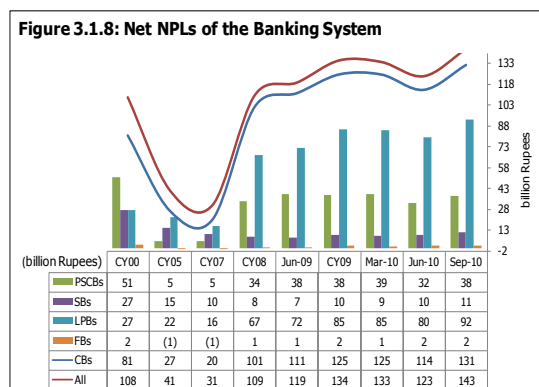
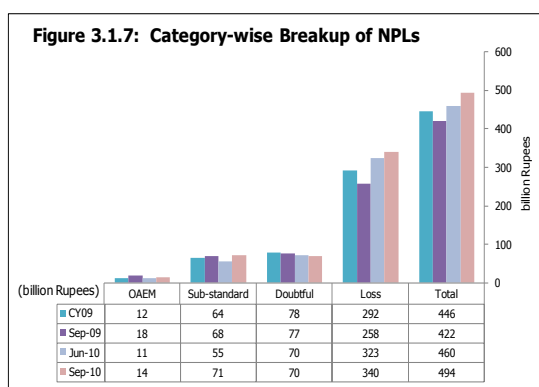


Table 3.1.5: Segment wise advances and NPLs

Items	Jun-10				Sep-10			
	Loans	Share in Loans	NPLs	Ratio	Loans	Share in Loans	NPLs	Ratio
Corporate Sector	2,179.38	61.09	289.22	13.27	2,184.54	62.09	314.23	14.38
SMEs Sector	328.51	9.21	89.01	27.09	318.00	9.04	92.03	28.94
Agriculture Sector	164.74	4.62	27.16	16.49	168.43	4.79	31.30	18.59
Consumer sector	270.23	7.57	39.79	14.73	265.67	7.55	41.74	15.71
i. Credit cards	28.90	0.81	4.60	15.93	27.45	0.78	4.90	17.84
ii. Auto loans	65.27	1.83	5.85	8.96	61.68	1.75	6.11	9.90
iii. Consumer durable	1.02	0.03	0.14	13.65	1.23	0.03	0.12	9.52
iv. Mortgage loans	73.12	2.05	13.62	18.63	67.57	1.92	14.17	20.97
v. Other personal loans	101.92	2.86	15.58	15.29	107.74	3.06	16.45	15.27
Commodity financing	484.63	13.58	3.68	0.76	437.60	12.44	3.29	0.75
Staff Loans	76.92	2.16	0.98	1.27	76.98	2.19	1.04	1.35
Others	63.19	1.77	10.00	15.83	67.28	1.91	10.37	15.42
Total	3,567.60	100.00	459.84	12.89	3,518.49	100.00	494.01	14.04

The increased credit risk in the assessment period was affected, to a great extent, by the inflow of fresh NPLs as signified by strong rise in the categories of 'OAEM' (23.8 percent) and 'Substandard' (28.9 percent). These categories act as entry points of problem loans for Agri-culture and Non-Agriculture advances, respectively. Almost all of the increase in OAEM came from a single Specialized Bank that primarily focus on agriculture finance. The slight decline in 'Doubtful' loans denotes the shifting of these NPLs to 'Loss' category which grew by 5.0 percent (see Figure 3.1.7).

The increase in fresh NPLs brought considerable increase in Net NPLs and net infection ratio because of partial provisioning requirements on 'OAEM' and 'Substandard' categories. Resultantly, the provision coverage ratio also deteriorated by 210 bps to reach 71.13 percent (73.23 percent in Jun-10). The weaker provision coverage ratio increased the risk to capital of banks as reflected in 3.33 percent increase in Net NPLs to capital ratio (see Figures 3.1.8 & 3.1.9).

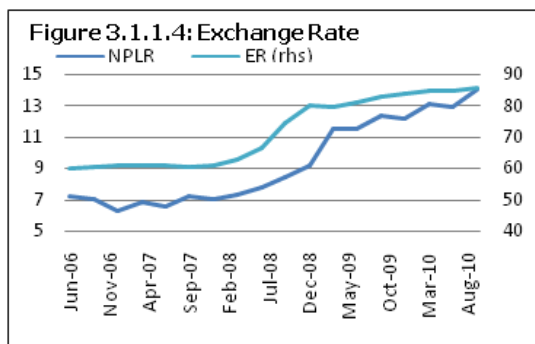
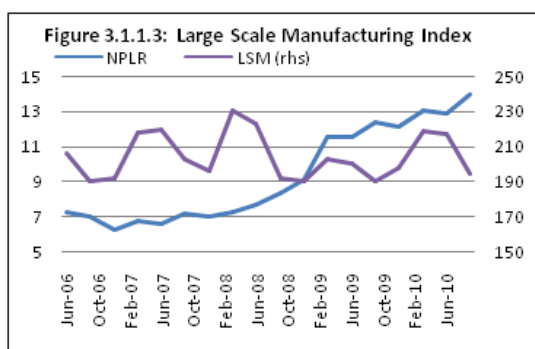
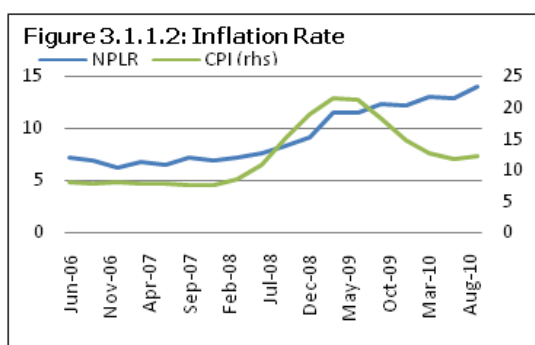
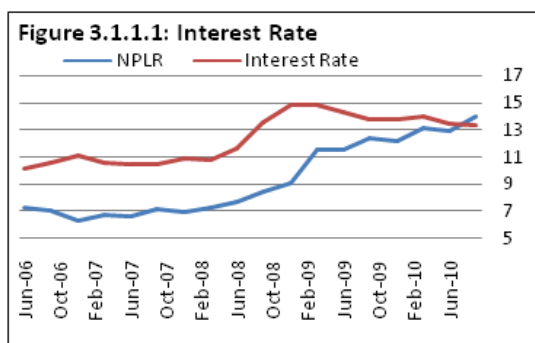
During the quarter under review SME and Consumer segment that are more vulnerable to vagaries of macro environment witnessed further contraction in lending as well as increase in NPLs. The disaggregated analysis reveals that though NPLs in SME segment are on rise in most of the banks, however increase in NPLs is more pronounced in some midsized banks. The performance of the consumer segment also remained in lackluster. Since the slackened economic activities, higher inflation rate and borrowing cost continued to strain the consumer's repayment capacity and led to further deterioration of infection ratio to 15.7 percent; banks maintained their cautious approach and consumer finance further contracted over the quarter (see Table 3.1.5 & 3.1.6).

Item	Jun-10			Sep-10		
	Loans	NPLs	NPLs to loans	Loans	NPLs	NPLs to loans
Chemical & Pharmaceuticals	146.51	9.54	6.51	151.07	11.90	7.88
Agribusiness	208.13	15.69	7.54	215.16	18.00	8.36
Textile	603.72	140.35	23.25	589.69	148.35	25.16
Cement	90.91	14.24	15.66	93.95	14.45	15.38
Sugar	81.96	12.78	15.59	57.39	12.54	21.85
Shoes & Leather garments	22.09	2.85	12.90	21.34	2.85	13.34
Automobile & Transportation equipment	58.54	11.10	18.96	50.72	11.22	22.13
Financial	41.07	6.00	14.60	35.79	6.61	18.45
Insurance	1.49	0.00	0.06	1.72	0.00	0.05
Electronic & transmission of energy	391.49	29.98	7.66	394.54	31.18	7.90
Individuals	456.29	62.42	13.68	441.49	68.40	15.49
Others	1,465.39	154.91	10.57	1,465.63	168.52	11.50
Total	3,567.60	459.84	12.89	3,518.49	494.01	14.04

The performance of Agriculture was also affected quite substantially in the review period due to floods. Keeping in view of the vulnerabilities of agriculture and SME segments, State Bank of Pakistan has encouraged the banks to restructure and reschedule loans these segments in flood affected areas⁶. It is expected that this relaxation to banks will be transferred to the borrowers and will help in easing the strains on borrowers as well as banks balance sheet and operating performance.

⁶ BSD Circular No. 06 of 2010, dated November 02, 2010.

3.1.1 Macroeconomic Stress Testing of Credit Risk



Macro stress testing of credit risk provides information based on forward looking macroeconomic perspective and financial institutions' risk exposures, on the degree of financial system's vulnerability against extreme but plausible macro shocks. In this regard, the Credit Portfolio View Model (CPV) estimates the impact of macro-economic shocks on the infection ratio of the banking sector as a proxy for bank default rate.

Banking system infection ratio surged to a new high of 14 percent during Sep-10 quarter after taking a dip in the last quarter – infection ratio was recorded at 12.9 percent for Jun-10 period, declining for the first time since the upward trend began in 2007. A high growth in the NPLs by 7.4 percent and deterioration in advances by 2 percent over the Sep-10 on account of sluggish seasonal trend enhanced the delinquency rate. However, the increase in the ratio was anticipated in view of the damages caused by July 2010 floods and consequent impact on economy in general and on banking sector in particular.

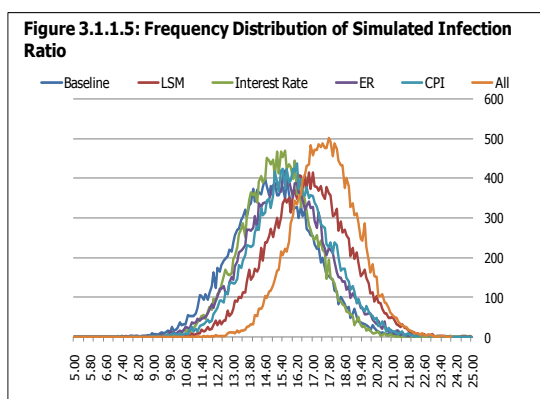
Despite the fact that recent deterioration in infection ratio was primarily driven by the worst flooding in the history of Pakistan, the already deteriorated macro-economic indicators also contributed to the heightening of the ratio (see Figures 3.1.1.1-3.1.1.4).

The domestic macroeconomic environment faces serious challenges in

Table 3.1.1.1: Simulated NPL Ratios

	Baseline	LSM	LR	ER	CPI	CPI+LR	All
Average	14.94	16.70	15.21	14.34	15.86	17.37	18.56
75 P*	16.36	18.08	16.41	14.84	17.18	18.75	19.65
90 P*	17.57	19.30	17.50	15.29	18.42	19.98	20.63
95 P*	18.33	20.02	18.12	15.56	19.15	20.71	21.24
99 P*	19.73	21.37	19.36	16.05	20.53	22.22	22.38
99.5P*	20.21	21.77	19.80	16.23	21.12	22.72	22.75

P* represents percentile, CPI=Inflation, ER=Exchange rate, LR=Interest rate, LSM=Large scale manufacturing



the period ahead as reflected in forecasted projections of macroeconomic aggregates. Nonetheless, the GDP growth is projected to be around 2.5 percent for FY11 and inflation is projected to be in the range of 13.5-14.5 percent during FY11⁷. Keeping in view above developments, the NPLs may maintain the rising trend in the Dec-10.

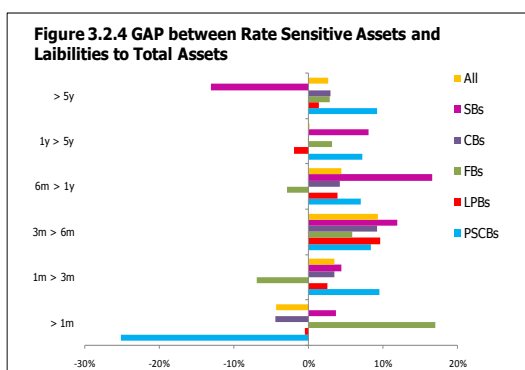
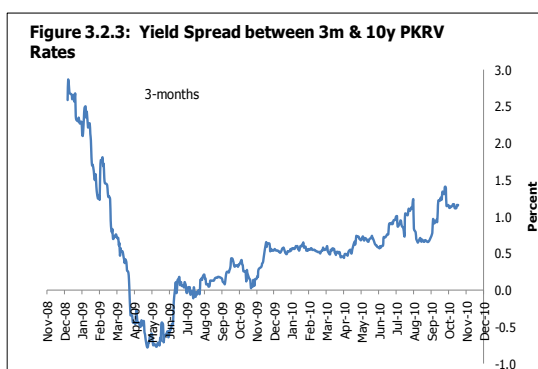
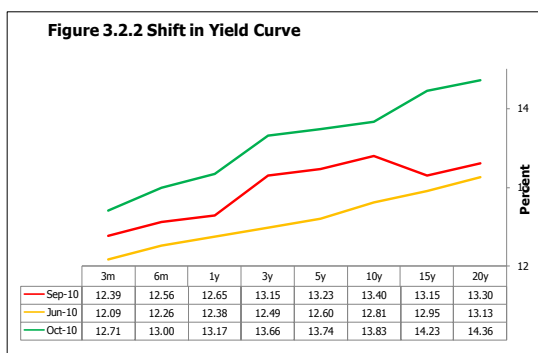
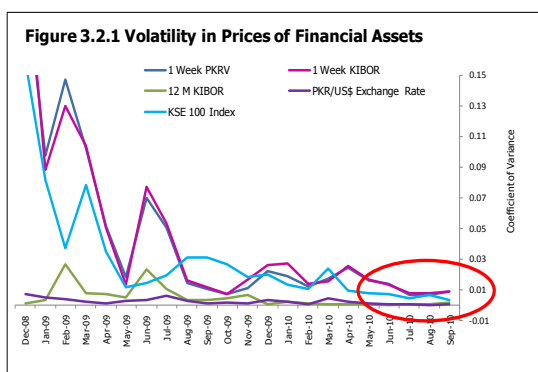
Given the following underpinnings, the CPV model is employed to obtain a forecast for infection ratio for the Dec-10 period. Further, the stress testing of credit risk faced by the banks is conducted by applying four different shocks categorized on the basis of origin of stress: LSM index (proxy for economic growth), inflation, interest rate and the exchange rate. Results from CPV model suggest that under the baseline scenario, the infection ratio for Dec-10 quarter is projected to be 14.94 percent, higher than 14 percent realized for Sep-10 period. At lower probability level of 0.5 percent, the NPL ratio is expected to reach 20.21 percent (see Table 3.1.1.1).

Under the stress scenario, the infection ratio worsens in case of an adverse single and multiple factor shocks applied to the model. For instance, an interest shock (I) will increase the NPL ratio to an average of 15.21 percent. Moreover, there is only 1 percent probability that NPL ratio may deteriorate to 19.36 percent in response to an interest rate shock. Furthermore, in an extreme case of combined shock to all macroeconomic variables, the impact on NPL ratio can range from 18.56 to a massive 22.75 in Dec-10 period.

⁷ Monetary Policy Decision (Sep 2010), SBP.

In case of a multiple shock to all macroeconomic variables in the CPV model, there is much deviation from the baseline scenario (see Figure 3.1.1.5). The projected increase in infection ratio will negatively affect both the profitability and solvency of the banking system.

3.2. Market Risk



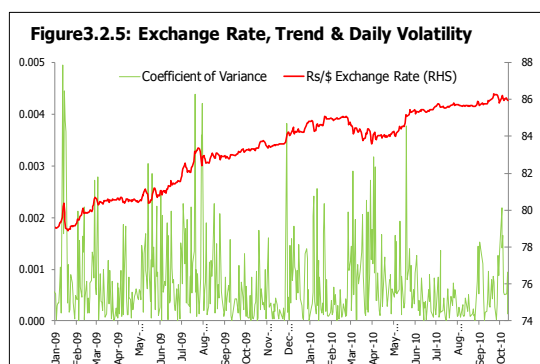
Market risk profile of the banking system continued to remain contained mainly on account of limited market risk exposures of banks as they mainly focus on traditional banking i.e. deposit-lending operations⁸. During the quarter under review, the volatilities in the prices of financial assets, though with slight inch up generally remained in low bounds (see Figure 3.2.1). Despite two consecutive policy rate increases during the quarter and gradual depreciation of exchange rate, the contained risk exposures kept the market-risk profile under check.

Interest rate risk marginally increased during the quarter. Due to adjustments in the policy rate by 100 bps, the yield curve experienced an upward shift during the quarter (see Figure 3.2.2). A greater increase in the longer-term maturities, mainly post quarter, steepened yield curve. PKRV rates of 3months and 10 year maturities increased by around 30 and 60 basis points respectively during the quarter. The spread between the both continued to widen in post quarter period (see Figure 3.2.3) creating incentives for long-term investments that bode well for economic growth.

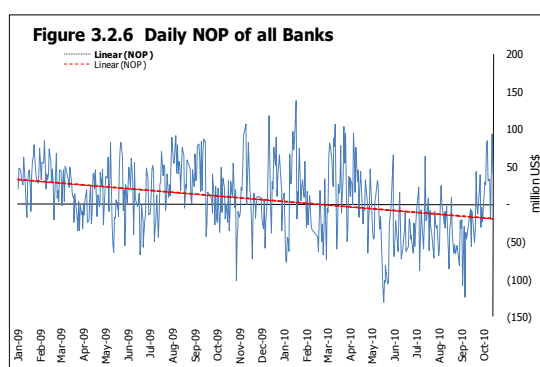
The yield curve that remained comparatively flat since CY09 - spread between the 3-months and 10 years PKRV even dropped into negative in the second quarter of CY09, discouraged long-term positions. This phenomenon also show up in banks' lower maturity gaps in longer term buckets (see Figure 3.2.4) as banks focus on shorter term assets and had little incentive to raise longer term liabilities.

⁸ Market risk historically accounts for around 4 percent of the banking system's overall risk-based capital requirements.

These lower gap positions kept interest rate exposure of the banking system in check. Therefore, in the present scenario when the interest rate increase in the longer term maturities is more pronounced, the banks booked lower revaluation deficits.



Detailed analysis reveals that most of mismatches are in up to one year maturities and hence the banks are largely running interest rate exposure up to one year. This can be explained by the fact that most of the assets of the banks are linked with KIBOR and are repriced with-in one year, and majority of the deposits which represent a significant share of liabilities are placed in the shorter repricing bucket. This signifies lower balance sheet duration of the banking system hence lower interest rate risk. Group wise, the significant mismatches in the PSCBs and SBs are largely attributable to the tendency of these banks to place deposits with non-contractual maturities in the shorter-time band. Nevertheless, the interest rate exposures of these banks are contained due to lower duration gap.



On **exchange rate** front, though the volatility in the rupee value remained low, the rupee gradually lost its value against major currencies during the quarter. Despite record growth in remittances during the quarter, the inflationary pressures and expectations for high demand for the imports largely shaped the trends in the rupee value against foreign currencies. Rupee dollar exchange rate gradually depreciated to 86.3 increasing by 82 paise by the end of the quarter (see Figure 3.2.5).

Healthy flow of remittances has fed the foreign exchange holdings of banks and

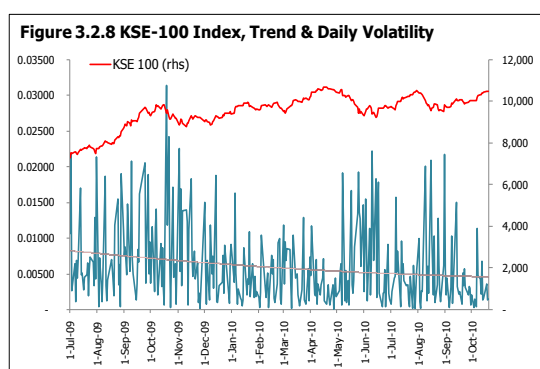
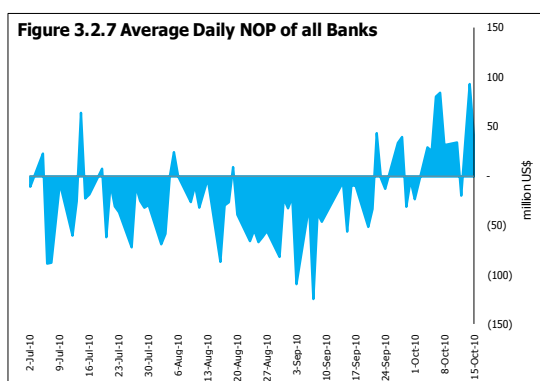
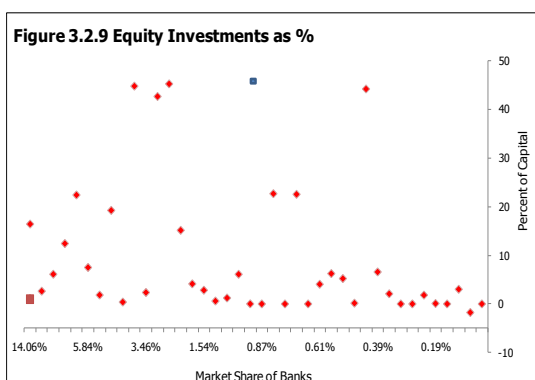


Table 3.2.1: Investments in Shares by the Banking System

(billion Rupees)				
	Jun-10		Sep-10	
	Amount	% of Capital	Amount	% of Capital
Top 5	41.1	11.3	42.2	11.2
Banks 6-10	11.7	10.4	10.4	9.2
Banks 11-20	20.4	17.3	21.1	23.5
Banks 21-29	2.1	5.4	1.8	4.8
All Local Banks	75.3	11.9	75.62	12.23
Foreign Banks	0.1	0.2	0.1	0.2
All Commercial Banks	75.4	11.3	75.68	11.55
Specialized Banks	1.4	.*	1.49	353.5
ALL BANKS	76.8	11.5	77.2	11.8



the banking system largely carried short position in foreign currency during the quarter under review and previous quarter. (see Figure 3.2.6 & 3.2.7). Post quarter the system managed to stay long, which means significant reductions in the foreign exchange risk as banks would actually gain with any further depreciation.

Equity price risk of the banking system remained well contained. During the quarter under review, the equity prices experienced greater volatility and equity prices witnessed a net increase. KSE-100 index after following a decline during the month of August inched up by 3 percent by end September 2010, and the rising trend continued in post quarter weeks (6 percent rise in Oct-10) (see Figure 3.2.8). With increase in equity prices, banks booked net surplus on revaluation of their equity portfolio as against the deficit in Jun-10 (revaluation surplus of Rs19.3 million in Sep-10 vis-à-vis deficit of Rs1,637 million).

In response to the general increase in the equity prices in the recent months, the banks investments in equities marginally increased (see Table 3.2.1) though their balance sheet footing contracted over assesment period. Group wise position shows that small local banks have largely shed their equity exposures and medium-sized banks (ranked 11-20 by size of total assets) increased their equity exposure. Bank wise analysis revealed that a few banks are carrying significant equity exposure as a percentage of their capital. Of the total 40 banks, 11 banks are carrying equity exposure greater than the industry average of 11.8 percent (see Figure 3.2.9).

Table 3.2.2: Impact of Market Risk Shocks

	Number of Banks with CAR			CAR (Capital Adequacy Ratio)	
	< 0%	0% - 10%	10%<		
Pre-Shock	3	4	33	13.85	
Shocks:				% point change in CAR	Adjusted CAR after Shock
IR-1	3	7	30	-0.75	13.10
IR-2	3	5	32	-0.55	13.30
ER-1	3	7	30	0.82	14.67
ER-2	3	4	33	-0.17	13.68
EQ-1	3	5	32	-0.23	13.62
EQ-2	3	6	31	-0.39	13.46

The stress test results show that generally the banking system is resilient towards moderate level of shocks to the prices of financial assets. Under a list of shocks to the interest rate, exchange rate and equity prices, the maximum reduction in CAR would be less than a percentage point (see Table 3.2.2) implying that after shock CAR will remain fairly above the required level.

3.2.1 Analysis of Banks' Financial Derivative Business⁹

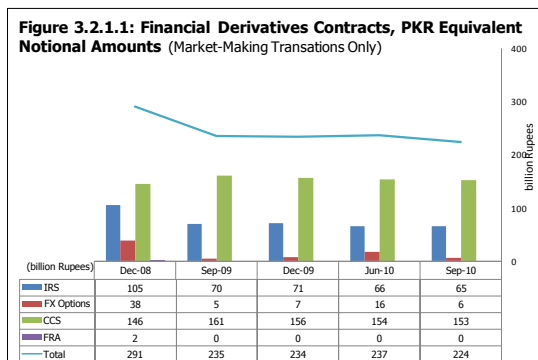
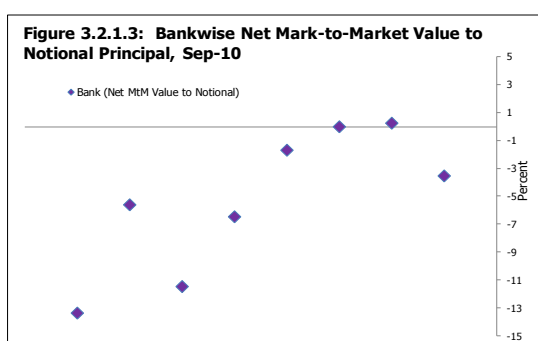
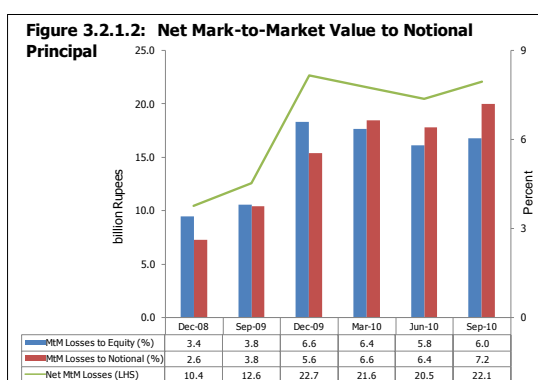


Table 3.2.1.1: Number of Derivative Contracts

Contracts	Dec-08	Jun-09	Sep-09	Dec-09	Jun-10	Sep-10
IRS	79	75	64	57	50	43
FX Options	113	249	38	193	298	26
CCS	228	255	263	257	256	256
FRA	8	-	-	-	-	-
Total	428	579	365	507	604	325



After experiencing a slight growth in last quarter, the volume of banks' financial derivative business again contracted during Jul-Sep 2010 quarter (see Figure 3.2.1.1). Though all types of contracts witnessed reduction, the decline in FX Option was particularly conspicuous, and the already a meager share of these contracts in overall derivative portfolio further plummeted while Forward Rate Agreement (FRA) contracts again did not witness any activity during the quarter (see Figure 3.2.11).

In tandem with decline in value of derivative portfolio, the number of outstanding derivatives contracts also experienced a decline (see Table 3.2.1.1). This decline was also largely contributed by FX Options which are generally small denomination contracts, while the number of Cross Currency Swaps remained the same (see Table 3.2.1.1).

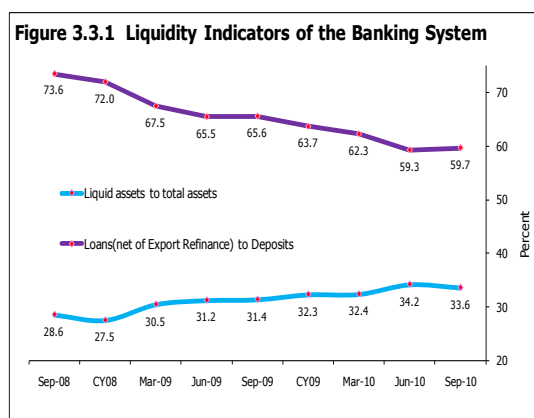
Mark-to-market (MtM) position of derivative contracts that also represents the level of their risk witnessed some deterioration during the quarter under review (see Figure 3.2.1.2). The aggregate Net MtM losses increased by Rs1.6 billion (7.8 percent), and risk position of banks dealing in derivative business somewhat worsened in terms of both equity of banks and notional amount of derivative contracts (see Figure 3.2.1.2). Bank-wise analysis shows that

⁹ The analysis is based on the information of eight banks, including five Authorized Derivative Dealers, which are engaged in derivative business. For details in respect of background of derivative business in Pakistan, regulatory framework, and the features of permissible types of derivatives contracts; please refer to the Quarterly Performance Review of the Banking System for June 2009 quarter.

out of eight banks involved in derivative business, six banks are carrying net MtM losses - two banks are having losses higher than 10 percent of the notional amount of their derivative contracts (see Figure 3.2.1.3).

3.3. Liquidity Risk

The banking system continued to exhibit comfortable liquidity conditions at the back of healthy deposit and equity base build over the last decade.¹⁰ This has been partly supported by rising remittances and continued equity injections and ploughing back of profits for meeting the strengthened regulatory minimum capital requirements. Further, in the recent quarters, risk-averse approach of banks provided additional liquidity through build up of liquid, risk-free investments as the lending portfolio followed a passive growth pattern over these quarters.

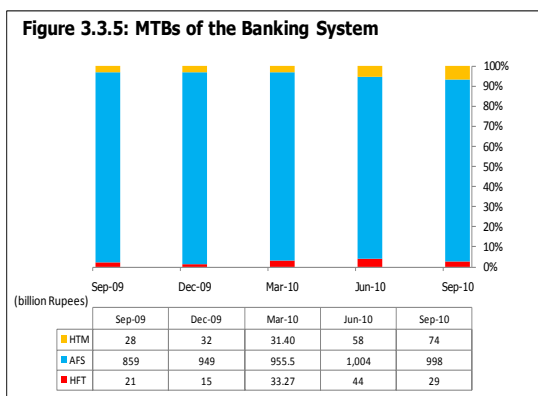
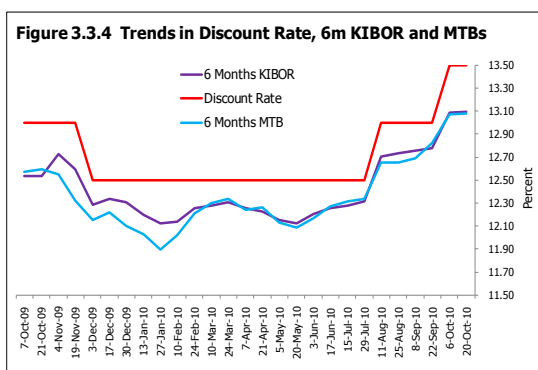
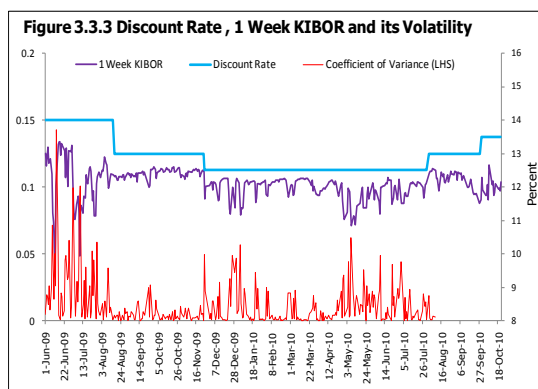
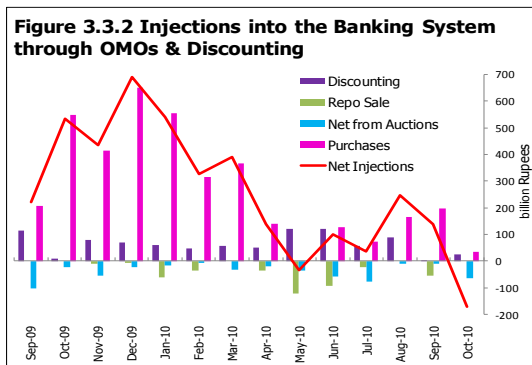


During the quarter under review, liquidity of the banking system remained comfortable owing to favorable base effect amidst tighter monetary policy stance aimed at curbing the inflationary pressures¹¹ and increasing pressures on credit risk front. The funding liquidity experienced some contraction during the quarter owing to usual seasonal trend and liquidity pressures resulting from Ramadan/Eid related withdrawals and the general slowdown in the economic activity. However, level of asset-based liquidity provided enough support to the liquidity of the system, while market-based liquidity indicators also witnessed easing in post quarter weeks.

The key liquidity indicators, which have been showing significant improvement since the liquidity stress of Dec-08, experienced some contraction (see Figure 3.3.1). The key funding source i.e. deposits, mainly following the seasonal

¹⁰ Over the last six years deposits and equity have shown average growth of 24 and 53 percent respectively and mostly remained in double digit during most of these years.

¹¹ - policy rate was increased twice by total of 100 bps during the quarter under review.

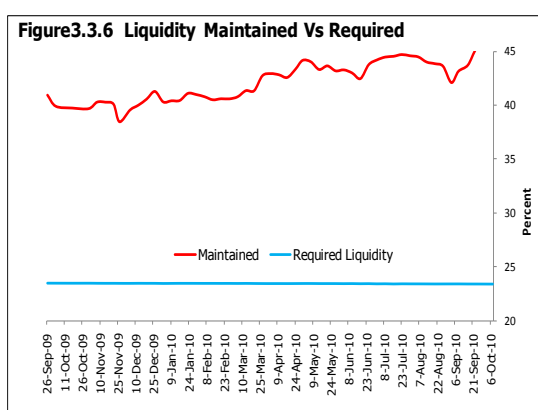


trend, experienced a decline of 2.1% over the quarter. Loans to deposit ratio of the banking system witnessed a marginal increase owing to comparatively less decrease in advances (1.4%). Since deposit withdrawals were accompanied by a significant decline in cash and treasury bank balances, the liquid assets to total asset ratio also experienced a marginal decline, first time after CY08.

Though not significant, this contraction in the liquidity is also reflected in the volume of short term liquidity support provided by the SBP, which increased during the quarter (see Figure 3.3.2). However, when compared with Dec-09 and Mar-10 quarters, the level of net injections into the banking system were significantly low during quarter under review (Sep-10: Rs420 billion, Mar-10: Rs1.2 trillion, Dec-09: Rs1.7 trillion). Post quarter, the system was enjoying excess liquidity and there have been net mop ups from the market.

Interbank rates, an indicator of market based liquidity, witnessed some softening by the end Sep-10, despite a twice increase in the policy rate. Post quarter, the eased off liquidity was well indicated in the decreasing market interest rates (1-week KIBOR), the same can fairly be explained by the net mop-ups from in OMOs in that period. Similarly, the 1 week KIBOR at times witnessed a decline of around 50bps in October, 2010. Resultantly, the spread between the policy rate and the interbank rates widened significantly indicating improved market based liquidity (see Figure 3.3.3).

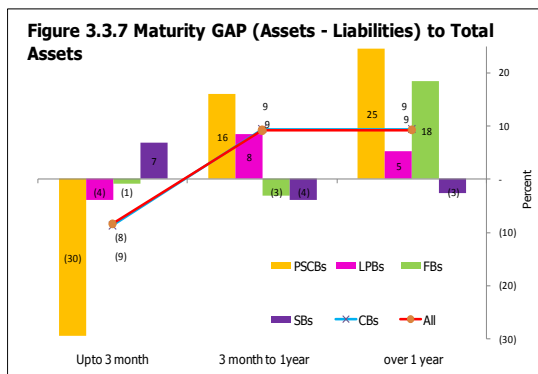
Risk free rates (MTB rates) remained very close to the interbank rates since the start of the CY10 (see Figure 3.3.4), which



greatly attracted the funds away from the risky assets i.e. advance to the risk free assets i.e. the government securities. This phenomenon is also reflected in the rising share of investments in the banks' books. However, in line with overall decrease in the asset base, investments declined, by 1 percent during the quarter. The MTBs experienced even a lower decline (QoQ: - 0.7 percent), thus raising its share in the balance sheet to 16.6 percent (Jun-10:16.3 percent). This increased preference of banks to lock more of their funds in government securities provides a dual benefit: a) improved liquidity at optimum returns and b) less risky assets which improved CAR of the system. However, this trend may not be appreciating in broader context for it crowds out the private sectors' share and may not be a sustainable avenue.

Category wise holding of government securities showed preference of banks to generally place their investments in Held for Trading (HFT) and Available for Sale (AFS) categories, which added to their asset based liquidity. Of the total investment in government securities more than 80 percent were held in MTBs including around 90 percent held in these two categories (see Figure 3.3.6).

The liquidity preference of the banks has been feeding into the excess liquidity reserves maintained by the banking system. During the quarter under review, the level of liquidity maintained by the banking system as against the required level remained at historically high levels (see Figure 3.3.5). Analysis of the maturity profile of assets and liabilities reveal that the banking system is experiencing negative gap in the three-



month maturity band (see Figure 3.3.7). This GAP resulted from a placement of huge percentage of non-contractual deposit (current and saving) in short term bucket which substantially increased liabilities in short term buckets. Group wise, PSCBs show significantly large gap, which largely attributes to placement of their non-contractual deposits in short-time bucket. For the longer-term maturities, the gap generally stayed positive.

Liquidity stress tests give an estimate of resilience of the banking system towards liquidity shocks. Results of liquidity stress tests exhibit fair resilience of the system towards moderate liquidity shocks of deposit withdrawal for consecutive three days. After 4 and 5 days of consecutive withdrawals 2 and 4 banks would become illiquid, respectively (see Table 3.3.1).

Table 3.3.1 Summary of Stress Test Results

Quarter ended:	Number of Banks Becoming Illiquid after Shock				
	1 day	2 days	3 days	4 days	5 days
Sep-10	0	0	0	2	4
Jun-10	0	0	0	3	4
Mar-10	0	0	0	2	5
Dec-09	0	0	0	2	5
Sep-09	0	0	0	3	6

Summing up, the funding liquidity of the banking system experienced some contraction in September 2010 quarter mainly on account of seasonal Ramadan/Eid withdrawals. However, funding liquidity risk has improved as reflected in post quarter signals of improved liquidity indicators.

4. Financial Soundness of the Banking System

4.1 Profitability

The banking system registered growth in profits over the corresponding quarter of Sep-09 owing to improved net interest income and lower loan-loss provisioning charges. However, prevailing challenging environmental factors and banks' increased preference for low-return, risk-free assets continue to exert pressure on banks' profitability as key return indicators i.e. ROA and ROE contracted over the quarter under review (see Table 4.1.1 and 4.1.2).

The profitability in terms of volume improved across all the banking groups except for SBs. Disaggregated analysis shows that the performance of top 5 banks remains the key support to the overall profitability of the banking system (see Table 4.1.3).

Analysis of sources of net interest income show that earning from loans & advances and investments improved net interest /mark-up income during the quarter (see Figure 4.1.1). Investment though declined towards the end of quarter; however, higher investment volumes (mainly in Government papers) build over last couple of years along with rising return, increased their share in mark-up income. Whereas, due to stagnant growth in advances and increased NPLs share of income from loans and advances decreased (see Table 4.1.4). On the expense side, deposits remained the key source of interest/mark-up expense (81.6 percent).

Table 4.1.1: Profitability of The Banking System

(billion Rupees)								
	CY05	CY06	CY07	CY08	Sep-09	CY09	Jun-10	Sep-10
<i>Profit before tax</i>								
PSCBs	22.8	31.5	33.2	6.6	12.3	16.8	11.3	15.2
LPBs	60.5	85.6	69.5	52.5	55.5	60.5	45.0	62.0
FBs	11.6	6.3	2.4	0.0	0.1	(0.9)	0.7	1.5
CBs	94.9	123.5	105.2	59.0	67.9	76.5	57.0	78.7
SBs	(1.1)	0.1	1.7	4.2	2.2	4.2	1.7	1.6
All Banks	93.8	123.6	106.9	63.2	70.1	80.7	58.7	80.3
<i>Profit after tax</i>								
PSCBs	15.5	21.2	23.9	5.6	8.1	14.4	7.5	10.6
LPBs	41.1	59.1	47.3	34.7	34.1	39.3	27.6	37.7
FBs	8.0	4.3	1.1	0.6	(0.2)	(0.8)	0.4	0.9
CBs	64.6	84.6	72.2	41.0	41.9	52.8	35.6	49.1
SBs	(1.3)	(0.5)	0.9	2.3	0.3	1.6	0.3	(0.1)
All Banks	63.3	84.1	73.1	43.3	42.2	54.4	35.9	49.0

Table 4.1.2: Profitability Indicators

(in percent)								
	CY05	CY06	CY07	CY08	Sep-09	CY09	Jun-10	Sep-10
<i>Before Tax ROA</i>								
PSCBs	3.3	4.0	3.5	0.6	1.5	1.5	1.8	1.6
LPBs	2.7	3.1	2.0	1.3	1.7	1.3	1.8	1.7
FBs	3.6	3.2	1.5	0.0	0.1	(0.3)	0.6	0.3
CBs	2.9	3.2	2.3	1.1	1.6	1.3	1.8	1.6
SBs	(1.0)	(1.3)	1.4	3.2	1.3	3.1	2.6	1.7
All Banks	2.8	3.1	2.2	1.2	1.6	1.3	1.8	1.6
<i>Before Tax ROE (based on Equity plus Surplus on Revaluation)</i>								
PSCBs	30.7	32.4	27.2	5.2	12.8	13.3	16.8	15.1
LPBs	40.1	36.2	20.4	12.9	16.4	13.2	18.2	16.8
FBs	38.9	30.0	13.1	0.0	0.4	(2.4)	3.8	2.7
CBs	37.2	34.7	21.8	10.6	14.7	12.4	17.1	15.8
SBs	-	-	-	-	-	-	-	-
All Banks	38.2	35.2	22.6	11.4	15.1	13.2	17.7	16.2

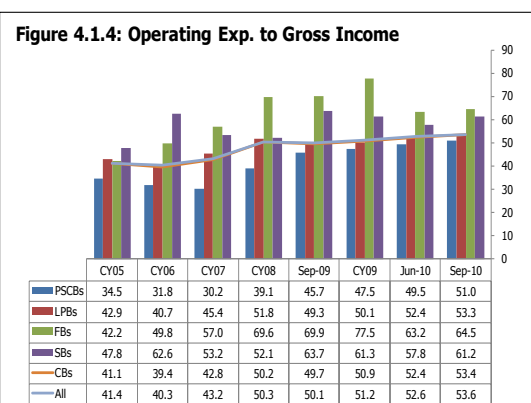
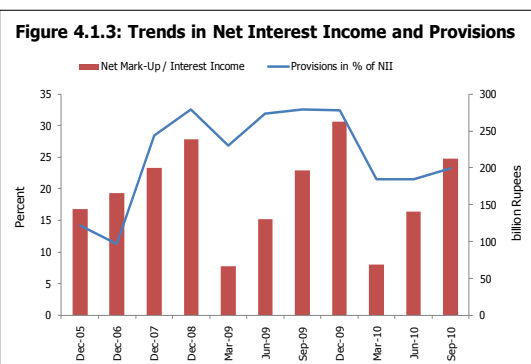
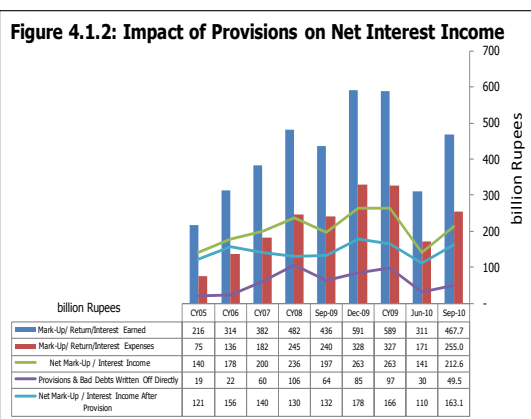
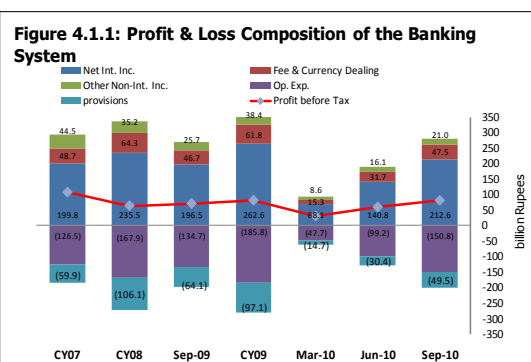
Data for CY07 has been restated due to introduction of Basel II.

Table 4.1.3: Concentration of Earnings and Profitability

						(in percent)			
		ROA (Before Tax)		ROE (Before Tax)		ROA (After Tax)		ROE (After Tax)	
Top 5 banks		3.0		27.8		2.0		18.0	
Top 5 to 10 banks		0.8		10.1		0.5		6.5	
Top 11 to 20 banks		(0.4)		(3.7)		(0.3)		(3.5)	
21-29 banks		(2.2)		(14.0)		(1.8)		(11.5)	
All 29 banks		1.7		16.4		1.0		10.3	
FBs		0.7		3.9		0.4		2.5	
SBs		1.3		41.6		0.1		3.8	
All Banks		1.6		16.2		1.0		9.9	

Table 4.1.4: Mark-up / Return / Interest Earned

(billion Rupees)												
Items	Dec-07		Sep-09		Dec-09		Mar-10		Jun-10		Sep-10	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans & advances	273.8	71.3	311.2	71.4	412.1	69.7	100.1	65.3	203.0	65.2	300.6	64.3
Investments	80.6	21.0	102.0	23.4	148.4	25.1	45.9	30.0	93.5	30.0	143.9	30.8
Deposits, repo and others	29.8	7.7	22.9	5.2	30.6	5.2	7.1	4.7	15.0	4.8	23.1	4.9
Total	384.1	100	436.1	100	591.1	100	153.2	100	311.5	100	467.7	100



After some let up in the last quarter, provision charges increased again during Sep-10. This increase mainly occurred in sub-standard category, requiring partial provisioning, and Loss category as NPLs in Doubtful category loans downgraded to Loss category (see Figure 4.1.2). Therefore, provision charges increased at 63.1 percent over the quarter vis-à-vis proportionate growth rate of 50 percent, thereby slightly dampening the earnings. However, year to date charges remained lower than corresponding period of last year mainly due to FSV benefit in respect of collateral that was introduced in last year and banks gradually streamlined their credit administration processes to take the benefit in provisioning. Accordingly, the provisions as a percentage of net interest income saw a substantial decline of 10 percentage points on YoY basis (see Figure 4.1.3).

On aggregate basis, non-interest income declined by 5.4 percent on YoY basis. All components of non-interest income, except fee and commission income, witnessed negative growth. Detailed analysis highlights that overall decline mainly resulted from dividend income and other income (including trading gains/losses). Consequently, share of non-interest income in gross income squeezed further by 1 percentage point to 24.4 percent (see Figure 4.1.1).

Persistent increase in administrative and other business related expenses, due to inflationary pressures, affected the cost to income ratio (operating expenses as a percentage of gross income) which inched

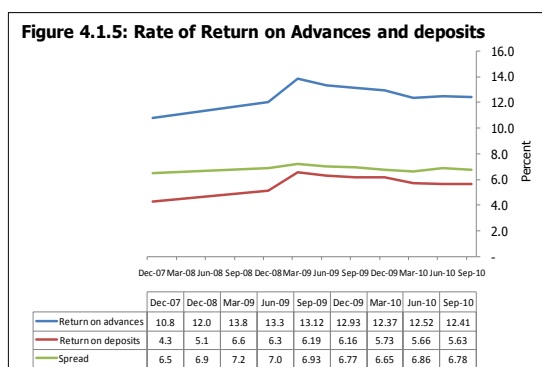


Table 4.1.5: Sources of change in Net Income (on advances and deposits)

(billion Rupees)						
	Interest Income Rate Variance	Interest Income Volume Variance	Deposit Rate Rate Variance	Deposit Rate Volume Variance	Total Variance	Net Income (Int. Earned - Deposit Exp)
Sep-08	8.4	38.1	(13.2)	(16.7)	16.5	108.3
Sep-09	37.0	22.0	(45.7)	(13.4)	(0.04)	108.2
Sep-10	(17.9)	7.3	20.7	(25.9)	(15.7)	92.5

up by 1 percentage points (see Figure 4.1.4).

Volume of net advances and deposits contracted during the quarter under review and the share of top five banks in net advances and deposits decreased further to 51.9 percent and 52.7 percent, respectively. Since these banks due to their wider outreach and brand recognition enjoy lowest cost of deposits, the spread between return on advances and deposit declined by 8bps, as there was relatively higher decrease in return on advances compared to return paid on deposits (see Figure 4.1.5).

Factors for the decline in spread were also reflected in changes in net interest income (interest earned on advances less interest paid on deposits). YoY decrease in return on advances was the main contributor for reduction in net income. Similarly, 12 percent increase in deposit base led to higher total pay out to depositors (see Table 4.1.5).

Table 4.1.6: Percentage Breakdown of Banking System's Total Assets (TA) by ROA

	CY07		CY08		Sep-09		CY09		Jun-10		Sep-10	
ROA	No. of Banks	Share in TA	No. of Banks	Share in TA	No. of Banks	Share in TA	No. of Banks	Share in TA	No. of Banks	Share in TA	No. of Banks	Share in TA
0 and below	10	8.5	16	14.5	20	13.3	18	12.7	17	15.7	17	14.8
0 to 0.5	2	2.4	3	10.2	3	6.6	8	21.6	5	2.8	3	1.4
0.5 to 1	4	1.9	5	8.2	4	11.2	4	5.3	2	9.8	4	10.8
1.0 to 1.5	10	34.9	4	5.7	4	8.8	3	17.0	2	0.6	6	10.7
1.5 and Over	13	52.3	12	61.5	9	60.0	7	43.4	14	71.2	10	62.2

ROA of the system decreased over the quarter, underscoring the slowdown in advances, increase in NPLs and decline in non-interest income. Breakdown of ROA (before tax) by assets and number of banks highlight decrease in number of banks' with ROA above 1.5 percent, mainly due to decline in ROA of some medium-sized banks. Majority of the high ROA banks also observed slight deterioration in return. Number of banks with ROA below zero remains unchanged, while a few small banks were able to improve their ROA by means of cost cuttings and improved operating efficiencies (see Table 4.1.6).

Table 4.2.1: Capital Adequacy Indicators

	CY07	CY08	Jun-09	Sep-09	CY-09	Mar-10	Jun-10	Sep-10
Capital Adequacy Ratio (CAR)								
PSCBs	17.8	13.2	14.5	15.6	15.1	13.7	13.9	12.5
LPBs	12.7	12.1	13.3	14.2	13.9	13.8	14.0	14.1
FBs	13.5	21.8	23.7	23.8	23.0	22.4	22.7	23.9
CBs	13.7	12.7	14.0	17.9	14.5	14.1	14.3	14.1
SBs	(6.2)	(4.9)	(3.4)	(5.0)	(1.5)	(0.5)	(1.4)	2.2
All banks	13.2	12.3	13.5	14.3	14.0	14.6	13.9	13.8
Tier 1 Capital to RWA								
PSCBs	13.0	11.0	12.0	12.8	12.6	11.6	11.9	10.4
LPBs	10.5	10.2	11.2	11.8	11.4	11.4	11.6	11.8
FBs	12.9	21.3	23.1	23.3	22.5	22.0	22.3	23.5
CBs	11.1	10.8	11.8	12.4	12.0	11.8	12.1	11.9
SBs	(11.9)	(10.1)	(7.4)	(8.2)	(5.8)	(5.3)	(5.5)	(3.4)
All banks	10.5	10.2	11.3	11.9	11.6	11.4	11.6	11.6
Capital to Total Assets								
PSCBs	13.7	10.7	10.9	11.9	11.3	11.1	11.3	11.1
LPBs	10.2	10.0	10.2	10.3	9.9	10.2	9.8	9.6
FBs	11.2	14.5	14.8	14.8	14.8	14.0	14.6	14.4
CBs	10.9	10.3	10.5	10.8	10.4	10.5	10.0	10.1
SBs	(5.5)	(3.2)	(2.5)	(3.4)	(1.7)	(0.9)	(1.2)	0.3
All banks	10.5	10.0	10.2	10.5	10.1	10.3	9.8	9.9

Table 4.2.2: Category-Wise Solvency Ratios for Sep-10

	Capital to RWA		Tier 1 to RWA		Capital to Assets	
	Jun-10	Sep-10	Jun-10	Sep-10	Jun-10	Sep-10
Top 5	15.3	16.3	12.5	13.4	10.5	11.3
6 to 10	11.1	8.8	8.4	6.2	7.5	7.4
11 to 20	11.6	13.4	10.9	12.1	10.1	9.1
21 to 29	22.9	14.4	22.7	14.7	15.1	11.7
All 29	14	14.0	11.7	11.7	9.9	10.0
FBs	22.7	23.9	22.3	23.6	14.6	14.4
SBs	(1.4)	2.2	(5.5)	(3.4)	(1.2)	0.3
Industry	13.9	13.8	11.6	11.5	9.8	9.9

Table 4.2.3: Concentration Analysis of Solvency Indicators

	(In percent)			
	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Capital to Risk Weighted Assets				
Sep-09	15.6	14.5	14.3	14.3
Jun-10	15.3	14.1	13.6	13.9
Sep-10	16.3	14.1	13.9	13.8
Tier 1 Capital to RWA				
Sep-09	12.5	11.7	11.7	11.9
Jun-10	12.5	11.4	11.5	11.6
Sep-10	13.4	11.3	11.5	11.5
Net Worth to Total Assets				
Sep-09	11.1	10.3	10.4	10.5
Jun-10	10.5	9.6	9.8	9.8
Sep-10	11.3	10.0	9.8	9.9

4.2 Solvency¹²

The baseline solvency indicators ¹³ of the banking system witnessed slight deterioration during the quarter under review mainly due to heightened credit risk, which was further intensified by recent unprecedented floods. Resultant decrease in capital base and RWA lead to marginal decrease of 10 bps in CAR to 13.8 percent over the quarter (see Table 4.2.1).

The capital adequacy indicators saw a marginal improvement for all the banking groups except PSCBs. Increase in capital base of large sized banks marginally improved CAR of the LPBs. Though the CAR of the FBs improved significantly, however due to their small market share, it had negligible effect on overall capital adequacy indicators of the system (see Table 4.2.2).

Concentration analysis show that reduction in RWAs coupled with an increase in the capital base of top 5 banks increased the CAR significantly to 16.3 percent over the assessment period. However, the effects of loan losses and impairment of intangibles assets were pronounced in other medium (6-10) and small sized banks which witnessed reduction in their overall CAR as well as the core capital to RWA ratio. Similarly, the Capital to Assets ratio also witnessed increasing trend for top 5 banks due to decline in their assets on account of cyclical slowdown in the quarter. However, smaller banks faced lowering in

¹² The above discussion is based on the CAR calculations on Basel-II framework. Except for three SBs which are reporting on Basel-I reporting formats, all other banks have reported on Basel II. These three banks hold 0.4 percent of the banking systems assets.

¹³ Capital to risk weighted assets, Tier 1 to RWA and capital to total assets

their capital to total assets ratio (see Table 4.2.3)

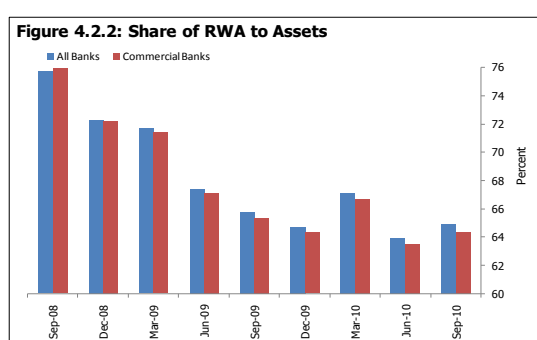
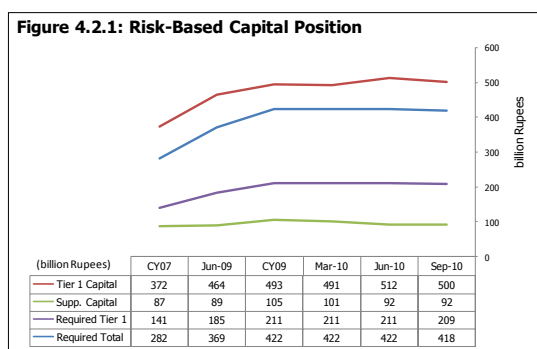


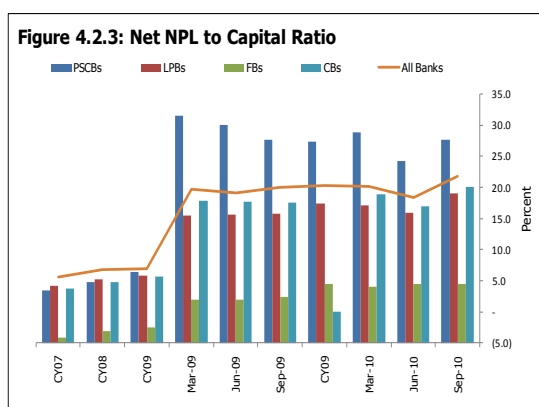
Table 4.2.4: Risk Weighted Assets

	(amount in billion rupees, share in percent)					
	Sep-09		Jun-10		Sep-10	
	Amount	Share	Amount	Share	Amount	Share
CRWA	3,286.0	81.8	3,490.7	80.4	3,436.9	80.0
MRWA	195.0	4.8	243.6	5.6	253.9	5.9
ORWA	535.0	13.3	604.9	14.0	606.8	14.1
Total (RWA)	4,016.0	100	4,339.2	100	4,297.6	100

Analysis of the components of the CAR shows that the total capital of the banks depleted by 1.31 percent in Sep-10. The Tier-1 capital depleted on account of deductions for uncovered classified loans and increase in the deficit on revaluation by 53 percent. A disaggregate analysis of the core capital highlights 2.1 percent increase in paid up capital on account of capital injections for meeting MCR and 16.9 percent decline in accumulated profits. Since the banks have been holding a higher proportion of Tier-1 capital in the total capital base (84 percent), the banks have been able to absorb the rising trend of delinquencies. Furthermore, the Tier 2 capital remained stable at the preceding quarter's level (Figure 4.2.1).

The RWA also showed a declining trend in Sep-10 quarter on account of 1.5 percent decline in Credit Risk weighted Assets (CRWA) as the advances declined over the quarter. Consequently, CRWA, which constitutes 80.4 percent of total risk weighted assets in Jun-10 quarter, saw a marginal decline to 80 percent in Sep-10 (see Table 4.2.4). However, an increase in capital charge for interest rate, equity and foreign exchange exposures enhanced the market risk weighted assets by 4.2 percent during the quarter. However, due to more than proportionate decline in total assets, RWA to total assets ratio, an indicator of banks' risk preference increased in Sep-10 quarter (see Figure 4.2.2).

The credit risk accounts for bulk of the risk affecting the solvency indicators of

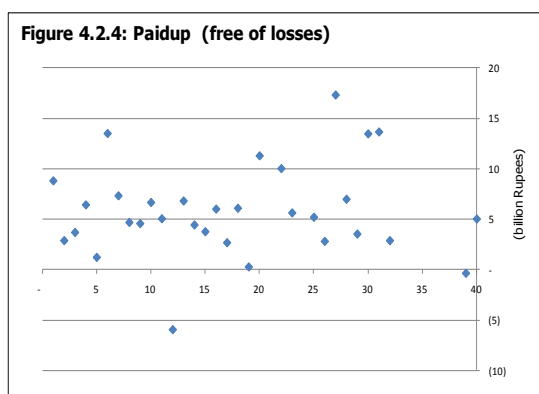


the banks; the gradual increase in the Net NPL to Capital ratios signify the impairment risk to banks' net worth from deteriorating asset quality. Since the emergence of ongoing economic slowdown and high credit risk settings, the ratio has significantly worsened since CY07. During the quarter under review, the ratio witnessed further deterioration as the influx of new NPLs that require partial provisioning coverage coincided with the contraction in capital base of the system and the ratio rose to 21.8 percent (see Figure 4.2.3).

Table 4.2.5: Distribution of Banks by CAR

	(In percent)			
	Total	less than 10	10 to 15	Over 15
Sep-08	40	13	7	20
CY08	40	9	10	21
Mar-09	40	5	13	22
Jun-09	40	7	12	21
Sep-09	40	6	13	21
CY09	40	6	15	19
Mar-10	40	6	13	21
Jun-10	40	6	15	19
Sep-10	40	6	14	20

The overall trend of capital adequacy for the commercial banks improved marginally in the Sep-10 as reflected in the distribution of CAR (see Table 4.2.5). The numbers of non-compliant banks have remained consistent since Sep-09, representing public sector banks and banks in the process of either mergers/reorganization or injection of additional equity.



In order to strengthen the capital base of the banking system and enhance its stability, SBP initiated a policy of gradual increase in MCR. The enhanced MCR levels also reveal challenging times for banks. Out of 40 banks, the MCR of 16 entities (excluding foreign banks¹⁴) fall short of regulatory requirement of Rs6 billion (see Figure 4.2.4). Of these banks, 6 are public sector banks which are under restructuring, while 3 other banks are in the process of merger, thus leaves only 7 non-compliant banks with which SBP is actively engaged for meeting MCR.

¹⁴ The Foreign Banks having 5 or less branches are required to raise the assigned capital to Rs. 3 billion by 31 December 2010. Similarly, Foreign Banks with more than 6 and less than 20 branches are required to raise the assigned capital to Rs. 6 billion by 31 Dec 2010. Source: BSD Circular 19/2008.

Though, over the years increase in MCR remained one of the key factors in ensuring solvency of the system, increasing credit risk and slow economic recovery could make it quite challenging for the banks to enhance MCR to Rs 7 billion by end 2010.

5. Performance of Islamic Banking

Table 5.1: Islamic Banking Growth over quarters

	(in percent)			
	Sep-09	Mar-10	Jun-10	Sep-10
Financing	(4.7)	1.5	1.1	(3.0)
Investment	20.8	0.9	7.0	3.4
Asset	3.3	1.3	10.7	3.2
Equity	3.1	0.8	1.5	1.6
Share of Islamic Banking in Assets of Banking Industry	5.3	5.8	6.1	6.4
Deposits	2.8	2.3	14.1	2.6
	(in numbers)			
Islamic Banks (IBs)	6	6	6	6
Banks having Islamic Banking Divisions	13	13	13	13
Total Islamic Banking Network	550	654	667	703
of which Islamic Banking Divisions' Branches	144	176	188	202

Table 5.2: Islamic Banking at a Glance over quarters

	(Billion Rupees, Share in percent)							
	Sep-09	Share	Mar-10	Share	Jun-10	Share	Sep-10	Share
Financing	133.7	41.4	155.8	42.0	157.5	38.3	152.8	36.0
Investments	64.7	20.0	72.9	19.6	78.0	19.0	80.7	19.0
Cash, bank balance, placements	92.5	28.6	104.4	28.1	122.5	29.8	129.5	30.5
Other assets	32.3	10.0	38.0	10.2	53.0	12.9	61.1	14.4
Total Assets	323.2	100.0	371.2	100.0	411.1	100.0	424.1	100.0
Deposits	244.8	86.4	289.1	87.9	329.8	89.6	338.2	91.8
Due to FIs	14.1	5.0	17.4	5.3	15.1	4.1	14.2	3.8
Other liabilities	24.3	8.6	19.0	5.8	18.3	5.0	22.4	6.1
Total Liabilities	283.2	100.0	328.9	100.0	368.2	100.0	380.6	100.0
Capital & other funds	40.1	12.4	42.2	11.4	42.8	10.4	43.5	10.3

Figure 5.1: Composition of Deposits

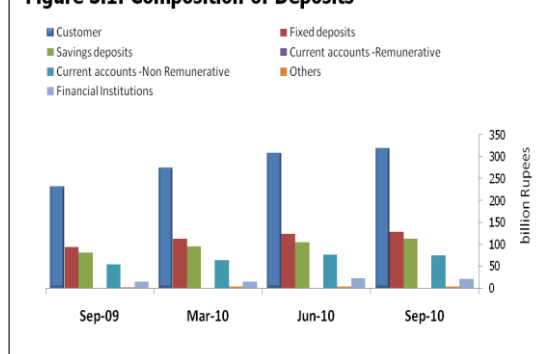
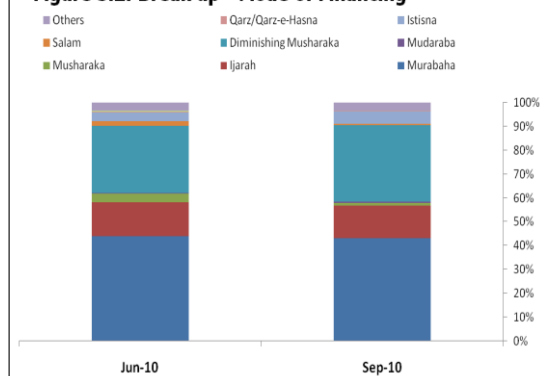


Figure 5.2: Break up - Mode of Financing



Even in the face of tenuous economic environment and heightened credit risk, Islamic Banking continued to grow, though there was some decline in overall performance indicators (see Table 5.1). The share of Islamic banking increased by another 30 bps to 6.4 percent, as there was 3.2 percent growth in its assets compared to a decline in asset base of conventional banks. The branch network of Islamic Banking also increased by 5.4 percent - most of the increase was contributed by Islamic Banking Divisions' of conventional banks (YoY growth 27.8 percent).

The balance sheet analysis of Islamic banking shows increase in most of the key components except financing (see Table 5.2). Investments remained subdued during the quarter under review, as there were no new issues of Islamic instruments. As result, cash and bank balances increase their share in total assets by three quarters of a percentage point. However, post quarter tender for Government of Pakistan Ijarah Sukuk (GIS) amounting to Rs 80 billion are expected to further facilitate the Islamic banks in asset-liability management. Other assets continued to increase in Sep-10 (15.2 percent) also as some institutions reported advance payments for acquisition of Ijara assets in other assets in lieu of advances (See Box 5.1).

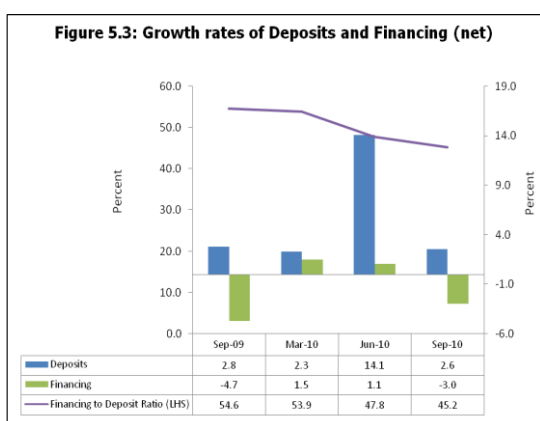
Funding structure also showed growth during the quarter under review as deposits marginally increased by 2.5 percent. However, the YoY growth of deposits continued to remain impressive i.e 38.1 percent (see Figure 5.1). The

Table 5.3: Segmentwise Breakup of Financing

(amount in billion Rupees, share in percent)				
	Jun-10		Sep-10	
	Financing	Share	Financing	Share
Corporate Sector	100.7	61.5	101.6	63.5
SMEs	11.0	6.7	10.7	6.7
Agriculture	0.0	0.0	0.0	0.0
Consumer Finance:	32.0	19.5	29.1	18.1
Credit Cards	0.0	0.0	0.0	0.0
Auto Loans	14.4	8.8	14.7	9.2
Consumer Durable	0.0	0.0	0.0	0.0
Mortgage Loan	17.1	10.4	13.8	8.6
Other personal Loans	0.5	0.3	0.5	0.3
Commodity Financing	16.4	10.0	14.8	9.3
Staff Loans	3.1	1.9	3.2	2.0
Others	0.5	0.3	0.6	0.4
Total	163.8	100.0	160.1	100.0

Table 5.4: Comparative Position on Concentration of Funds

Items	Jun-10		Sep-10	
	Financing	Share	Financing	Share
Chemical and Pharmaceuticals	15	9.0	16	9.9
Agribusiness	2	1.1	2	0.9
Textile	30	18.1	29	17.9
Cement	6	3.4	6	3.6
Sugar	6	3.5	4	2.3
Shoes and leather garments	2	1.1	2	1.2
Automobile and transportation	3	1.8	3	2.0
Financial	2	1.3	2	1.0
Insurance	0	0.0	0	0.0
Electronics and electric appliances	1	0.9	2	1.0
Production and transmission of energy	8	4.8	10	6.4
Individuals	31	18.9	30	18.8
Others	59	36.0	56	35.0
Total	163.8	100.0	160.1	100.0



break-up of financing show that apart from Istisna and Diminishing Musharka, all major components of Islamic financing declined over the quarter (see Figure 5.2). Similarly, segment-wise analysis portrays decline across all segments except Corporate (see Table 5.3). The decline of Rs3.3 billion in Mortgage Loans was instrumental in the decrease of Consumer Finance as well as over all finance. Sector-wise, Production and Transmission of Energy and Chemical and Pharmaceuticals increased by Rs2 billion and Rs1 billion, respectively (see Table 5.4). The liquidity position of Islamic banking remained stable in Sep-10 as the sector exhibited some improvement in overall liquidity indicators. Marginal growth in deposits coupled with decrease in Financing, led to decline in financing to deposit ratio during the quarter under review (see Figure 5.3).

The asset quality deteriorated as the NPFs increased to Rs 13.5 billion (27.3 percent increase) by end Sep-10. Category-wise analysis of NPFs indicates increase in Substandard and Loss categories (see Figure 5.4). Substantial increase in fresh NPFs resulted in smaller increase in provisions, therefore Net NPFs increased by Rs 1.8 billion (increase of about 40 percent). Accordingly, the infection ratios observed deterioration; Net NPFs to Financing ratio inched up to 4.1 percent and impairment ratio to 14.3 percent, while provisions coverage ratio declined over the quarter (see table 5.5). Nevertheless, Islamic Banks show lower infection as compared with conventional banks.

Islamic banking remained profitable despite increased credit risk. Though quarter observed increase in net mark up

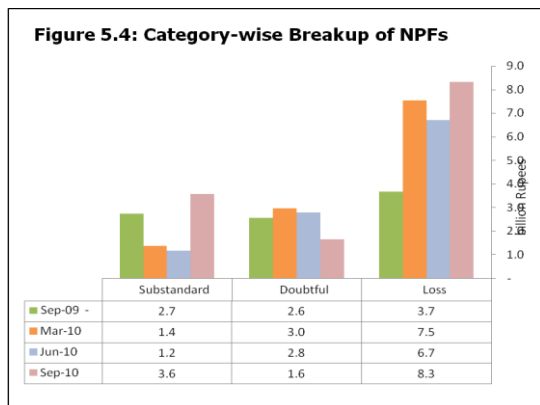


Table 5.5: Asset Quality

Indicator	Sep-09	Mar-10	Jun-10	Sep-10
	(Billion Rupees)			
Non-performing Financials	8.9	11.9	10.6	13.5
Provisions held	4.9	5.9	6.3	7.3
Net NPFs	4.0	5.9	4.4	6.2
	(in percent)			
NPFs to total financing	6.5	7.3	6.5	8.4
Net NPFs to net financing	3.0	3.8	2.8	4.1
Provision to NPFs	55.0	50.0	58.8	54.1
Net NPFs to Capital	10.0	14.1	10.2	14.3

Table 5.6: Income Statement

	Sep-09	Mar-10	Jun-10	Sep-10
	(billion Rupees)			
Markup Income	23.1	9.0	18.4	28.0
Markup Expense	12.6	4.8	10.0	15.5
Net Markup Income	10.4	4.2	8.4	12.5
Provision Expense	2.6	0.7	1.2	2.3
Non Markup Income	2.8	1.0	2.0	3.1
Operating Expense	8.9	3.7	7.5	11.5
Profit Before Tax	1.7	0.8	1.7	1.8
Tax	0.2	0.1	0.3	0.1
Profit After Tax	1.5	0.7	1.5	1.7
Equity	40.1	42.2	42.8	43.5
	(in percent)			
Net Markup Income to total assets	4.7	4.6	4.4	4.2
Non Markup Income to total assets	1.2	1.1	1.0	1.1
Operating Expense to Gross Income	67.2	70.2	71.8	73.9
ROA (after tax)	0.7	0.8	0.8	0.6

and non-mark up income, however, their growth remained lower than one observed in corresponding quarter of last year. Further, year to date provision expense almost doubled in Sep-10 quarter (see Table 5.6). Consequently, most of the earnings ratios observed decline; ROA declined by 20 bps to 0.6 percent. One factor that might have been affecting the performance of Islamic banking during the last few quarters is the first ever merger of two Islamic banks in Pakistan that completed in October 2010. The overall earnings of the Islamic banking however, remained skewed as IBBs contributed all the profits while the aggregate earnings of IBs remained in red.

Box 5.1: Islamic Financial Accounting Standard for Ijarah (IFAS-2) – Impact on balance sheet:

Disclosure and transparency is a key component of an effective Corporate Governance regime. Disclosure is usually based on the International Accounting Standards, the local legal and regulatory requirements and the nature of the institution. With the growth and increasing share of Islamic Financial Institutions, focus on addressing disclosure issues related to Islamic Finance has increased many folds over the last decade. In this regard, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) prepares accounting, auditing, governance, ethics and Shari'ah standards for Islamic financial institutions and the industry. These standards are being adopted by various jurisdictions after clearance by the local regulatory authorities.

In Pakistan, State Bank of Pakistan encourages IBIs to use AAOIFI Accounting Standards. However, they are required to follow financial reporting standards for Islamic modes of financing as adopted by the Securities and Exchange Commission of Pakistan (SECP) under the Companies Ordinance, 1984¹. SECP has so far adopted two Islamic Financial Accounting Standards; IFAS-1 for Murabaha and IFAS-2 on Ijarah. Application of these standards has varying impact on the balance sheet.

IFAS-2 on Ijarah was adopted by the SECP in 2007. However, keeping in view the issues faced by the Islamic banks, implementation of IFAS-2 was made effective from 1st January, 2009. In terms of the standard, until assets to be leased are delivered to the Musta'jir (lessee), no lease rental becomes due and payable (i.e. Ijarah cannot be recorded until the subjected asset is delivered to the lessee.) As a result, the banks record the advance payment against the leased assets in "other assets" in the balance sheet. The outcome is rapid increase in other assets of the IBIs.

Analysis of the financial statement for the last three quarters of the CY10 shows that other assets have increased by 114 percent. Corollary to that is delayed recognition of Ijarah as financing in the balance sheet. Another important aspect is that banks may have disbursed larger funds for financing during the quarter, however, due to accounting treatment, the balance sheet may show decline in financing. For example, during the Sep-10 quarter, financing for Islamic banks decreased by 3 percent, while the other assets increased by 19 percent, a part of which is result of recognition of advance against Ijarah under this category.

Table 6.1: DFIs at a Glance

	(billion Rupees)							
	CY-09	%	Mar-10	%	Jun-10	%	Sep-10	%
Balances with Treasury Banks	1.7	1.3	1.7	1.3	1.7	1.2	1.8	1.4
Lending to FIs and Balances with other Banks	18.8	14.2	12.1	9.3	12.0	8.6	10.5	8.1
Investments (net)	62.1	47.0	65.1	50.0	73.2	52.1	63.5	49.1
Advances (net)	41.4	31.3	43.0	33.0	44.9	32.0	43.4	33.6
Other Assets	8.2	6.2	8.5	6.5	8.5	6.0	10.1	7.8
Total Assets	132.2	100.0	130.3	100.0	140.3	100.0	129.2	100.0
Borrowing from FIs	51.5	39.0	49.2	37.7	57.3	40.8	45.9	35.5
Deposits	18.1	13.7	16.4	12.6	17.6	12.6	17.4	13.5
Other Liabilities	5.8	4.4	6.0	4.6	7.2	5.2	7.5	5.8
Total Liabilities	75.4	56.9	71.7	55.0	82.1	58.5	70.8	54.8
Shareholders Equity								
(including revaluation surplus)/(Deficit)	56.8	42.9	58.6	45.0	58.2	41.5	58.5	45.2

Figure 6.1 : Sources of Funding for DFIs

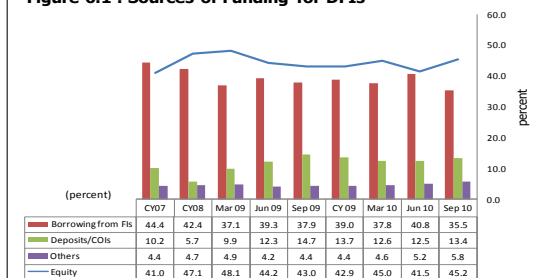


Figure 6.2: Movement in Earning Assets

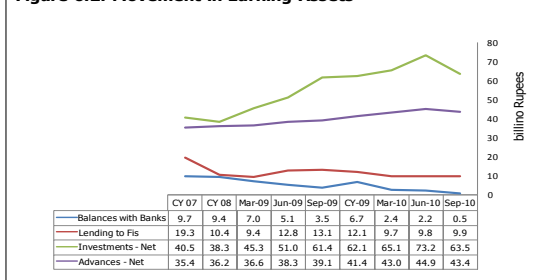
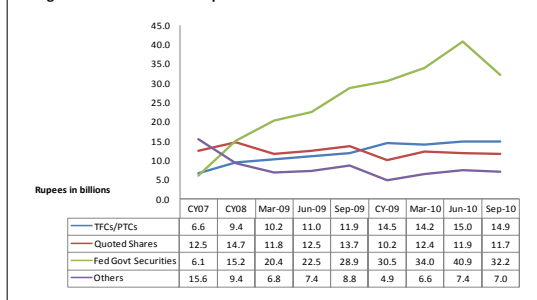


Figure 6.3: Investments Composition of DFIs



6. Development Finance Institutions

The Operating performance of DFIs remained relatively subdued in comparison with past two quarters of CY-10. The balance sheet of the DFIs experienced some contraction, while substantial increase in loan loss provisions of DFIs put strain on the profitability indicators; as ROA and ROE both declined.

During the quarter, the balance sheet footing of the DFIs registered a decline of almost 8 percent. On funding side, this decline was caused mainly by borrowings from financial institutions, which provide around two third of the total liabilities and are second biggest source of funds of the DFIs after the equity. Borrowings from financial institutions experienced a significant decline of around 20 percent over the quarter (see Table 6.1 & Figure 6.1). This significant decline in borrowings came particularly from the repurchase agreement (Repo) borrowings which hold significant share in the total borrowings. Deposits, which provide less than 15 percent of the total funds of DFIs, also experienced a slight dip of 1.25 percent during the quarter.

On the asset side, funding volume reduced mainly in the investments; investment portfolio saw a dip of 13.2 percent (see Figure 6.2) and its share in assets mix decrease by 3 percentage point. The disaggregated analysis show that decline in investments was largely shared by the MTB holdings, leading to 21 percent decline in federal government securities (see Figure 6.3).

Gross advances of DFIs experienced a marginal decline of 0.84 percent during the quarter. This decrease in advances

was shared by almost all sectors and segments. Textile and individuals (mortgage loans), however, gained some volume (See Table 6.2). The Consumer segment showed some growth in mortgage loans which represent the housing finance by a specialized DFI (see Table 6.3).

Asset quality of DFIs experienced further deterioration. The non-performing loans (NPLs) increased by 5.48 percent, while classified investments grew by 5.74 percent. Additionally a significant shift of NPLs from the 'Doubtful' to 'Loss' category increased the provisioning charge. Therefore, NPLs coverage ratio and Net NPLs to capital ratio also improved (see Table 6.4). Given the limited outreach of the DFIs and negligible exposure to SME and Agriculture, impact of a recent flood on their asset quality is expected to be negligible.

Operating performance of DFIs showed signs of slowing down due to surge in provisions charge. The income of DFIs increased by 75 increase over the quarter, however, increase in provisions (which doubled over the quarter) not only dented the profitability but also lowered ROA despite contraction in bottom line of balance sheet. The increase in NPLs also had a negative impact on CAR, which declined by 40 bps.

Majority of the DFIs are working as a joint venture between the Government of Pakistan and respective foreign governments. However, the business model of these DFIs needs to be redefined. At present they are literally competing in the market with commercial banks. In longer run this competition might prove to be one-sided in favor of

Table 6.2: Sector-wise Loans

(amount in billion Rupees, share in percent)								
	Dec-09	Share	Mar-10	Share	Jun-10	Share	Sep-10	Share
Chemical	3.18	6.2	3.65	6.9	3.70	6.89	3.68	6.91
Agriculture	0.58	1.1	0.56	1.1	1.55	2.89	1.54	2.89
Textile	5.62	10.9	5.72	10.9	5.65	10.52	6.17	11.58
Cement	1.85	3.6	1.89	3.6	1.85	3.45	1.59	2.99
Sugar	1.61	3.1	2.04	3.9	2.10	3.90	1.84	3.46
Leather	0.04	0.1	0.04	0.1	0.04	0.07	0.03	0.06
Auto	1.39	2.7	1.29	2.4	1.26	2.35	1.12	2.10
Financial	0.84	1.6	0.51	1.0	0.54	1.00	0.66	1.24
Electronics	0.89	1.7	0.88	1.7	0.82	1.53	0.95	1.79
Energy	9.20	17.9	10.42	19.8	10.91	20.31	9.70	18.22
Individuals	16.75	32.5	15.92	30.2	14.85	27.64	15.43	28.97
Others	9.53	18.5	9.73	18.5	10.46	19.47	10.54	19.79
Total	51.49	100.0	52.64	100.0	53.72	100.0	53.27	100.00

Table 6.3: Segment wise Loans of DFIs

(amount in million Rupees, share in percent)						
	Sep-09		Jun-10		Sep-10	
	Loans	Share in Loans	Loans	Share in Loans	Loans	Share in Loans
Corporate Sector	29,646	61.1	37,671	70.1	36,622	68.7
SMEs Sector	455	0.9	322	0.6	345	0.6
Agriculture Sector	-	-	-	0.0	-	0.0
Consumer sector	16,609	34.2	14,184	26.4	14,866	27.9
i. Credit cards	-	-	-	0	-	0
ii. Auto loans	8	0.0	4	0.0	3	0.0
iii. Consumer durable	1	0.0	1	0.0	1	0.0
iv. Mortgage loans	16,479	34.0	14,095	26.2	14,788	27.8
v. Other personal loans	121	0.2	84	0.2	75	0.1
Commodity financing	-	-	-	0.0	-	0.0
Staff Loans	829	1.7	883	1.6	785	1.5
Others	966	2.0	658	1.2	651	1.2
Total	48,505	100	53,718	100	53,269	100

Table 6.4: Key Performance Indicators

	CY07	CY08	Dec-09	Mar-10	Jun-10	Sep-10
Total Capital to Total RWA	43.7	53.4	51.2	54.8	53.3	52.9
Tier 1 Capital to Total RWA	44.0	53.3	51.1	54.7	53.5	53.2
Capital to Total Assets	41.0	47.1	43.1	45.0	41.5	45.2
NPLs to Total Loans	20.8	27.0	26.9	28.0	26.2	27.8
Net NPLs to Net Loans	4.6	11.2	9.8	11.8	11.7	11.4
Provision to NPLs	81.6	65.9	70.6	65.7	62.5	66.7
Net NPLs to Capital	3.2	8.4	7.0	8.6	7.3	7.1
ROA before Tax	0.8	1.5	1.8	4.0	3.5	3.1
ROA after Tax	-0.1	0.7	1.2	2.8	2.5	2.1
ROE before Tax	2.2	3.4	3.9	9.2	8.2	7.0
ROE after Tax	-0.3	1.6	2.7	6.4	5.9	4.9
Loans to Deposits	281.4	622.9	230.8	261.8	255.7	249.9
Net Interest Income to Gross Income	44.7	34.8	72.6	76.0	106.9	78.7
Non Interest Income to Gross Income	55.3	65.2	27.4	24.0	-6.9	21.3
Operating Expense to Gross Income	39.1	22.7	34.2	33.8	48.5	39.6

commercial banks. Ideally, the DFIs should provide facilities for long term projects related to infrastructure and venture capital.

7. Regulatory Developments

7.1. Domestic

This section highlights some of the key regulatory developments that have taken place during the quarter and post quarter till end October, 2010.

I. Consumer Facilitation

a. Facilitation of Watan Card Holders(WCH)

To facilitate the early resolution of problems faced by the WCH due to retention/disabling of their Cards at ATMs, bank have been advised to adhere to following guidelines:

- In case a card is captured and/or disabled by machine, the acquirer branch staff shall properly assist the card holder and facilitate him/her in lodging a complaint to issuing bank for immediate resolution.
- The acquirer branch shall send the captured card along with the complaint lodged by cardholder on the same day to the nearest branch of issuer bank. Accordingly, the acquirer branch staff shall advise the complainant to collect the card from the nearest issuer branch.
- The nearest issuer branch, after receiving the complaint along with the captured card, shall conduct due verification for authenticity and afterwards return the card within two working days to the complainant.

In case of warm/disabled cards, the acquirer branch shall assist the card holder in contacting the issuing bank for activating/reactivating the card. Branch Managers or any Designated Senior Officer of the acquirer branch shall also assist the WCH and document/log the subject event for every card holder who requires assistance in conducting transactions.

Acquirer banks shall deploy at least one POS terminal at all their branches located in flood affected areas to facilitate cash withdrawal on Watan Cards. Banks shall take all necessary steps to prevent fraudulent use of Watan Cards at their outlets. *(PSD Circular No. 4 of 2010, dated October 22, 2010)*

b. Dispute Resolution through Mediation

State Bank has encouraged banks to use the Alternate Dispute Resolution (ADR) mechanism through Karachi Centre for Dispute Resolution (KCDR). Banks/DFIs are allowed to implement the settlement reached through this mediation process after getting necessary internal approvals from their competent authority. *(CPD Circular Letter No. 1 of 2010, September 27, 2010)*

II. Risk Management

Use of Ratings – Implementation of Basel II

To clarify the instructions on use of ratings for capital adequacy purposes, State bank has defined Solicited Rating to mean a rating initiated at the request of entity being rated under a formal agreement between the rating agency and the entity being rated. To be eligible for risk weighting purposes, the rating must meet following requirements:

- agency is given access to all information required to rate the entity;
- agency is authorized to assign rating;
- and rating assigned is disclosed publically

The requirement of formal agreement between rating agency and the entity being rated, would not be applicable in case the rating is conducted by international rating agencies recognized by SBP, however rating should be publically disclosed.

Further Banks/ DFIs have been advised to use only solicited ratings assigned by recognized

External Credit Assessment Institutions (ECAIs) for the purpose of capital adequacy provided the ratings fulfill following conditions:

- All ratings used should be publically disclosed by the ECAIs along with its history.
- The rating agency should have reviewed/ assigned the rating within previous 15 months.
- Banks/DFIs should have mechanism to monitor changes in ratings (upgrade, downgrade and withdrawals) for accurate Capital Adequacy Ratio reporting. *(BSD Circular No. 5 of 2010, October 5, 2010)*

III. Development Finance And Refinancing Facility

a. *Revised Infrastructure Project Finance Guidelines*

Table 7.1: Financing Rates			
Period of financing	Rate of Refinance	PFI's Spread	End User's Rate
Up-to 3 years	9.50%	1.50%	11.00%
Over 3 years and upto 5 years	8.60%	2.50%	11.10%
Over 5 years and upto 10 years	8.20%	3.00%	11.20%

SBP, in consultation with stakeholders, has revised the guidelines for Infrastructure Project Finance to facilitate banks and DFIs in providing financing solutions to infrastructure projects. Banks / DFIs are advised to use the guidelines for developing products for financing to infrastructure sectors according to their policy and operational & market requirements, subject to compliance with relevant SBP regulations. *(IHFD Circular No. 1 of 2010, September 6, 2010)*

b. *Revision of Financing Rates under the Export Finance Scheme (EFS)*

State Bank has revised rate of refinance under the Export Finance Scheme applicable from October 1, 2010 and onward till further instructions to 9 percent per annum. *(SMEFD Circular No. 13 of 2010, September 30, 2010)*

c. *Long Term Financing Facility (LTFF) - Re-fixation of Rates of Service Charges*

Effective October 1, 2010 the rates of service charges for Participating Financial Institutions (PFIs) and rates for end users under LTTF have been revised as mentioned in Table 7.1. (SMEFD Circular No. 14 of 2010, September 30, 2010)

d. Concessional Financing & Guarantee Scheme for Canola Cultivation in Flood Affected Areas

The State Bank of Pakistan has launched a concessional financing and guarantee scheme to encourage farmers to sow canola in flood affected areas of the country in current Rabi season.

Under scheme banks and Zarai Taraqati Bank Limited (ZTBL) are allowed to obtain refinance at 5.0% per annum while banks will be permitted to charge a maximum spread of 3.0% p.a. from borrowers. Tenor of the crop production loans and its repayment will be based on the cropping cycle up-to a maximum period of 6 months. The loans extended under the scheme shall also be covered under credit guarantee scheme, where SBP would share bonafide losses of banks to the extent of 30% This scheme will remain valid up to October 31, 2011. (SMEFD Circular No. 15 of 2010, October 5, 2010)

IV. SBP Overnight Repo/Reverse Repo Facilities

The SBP Overnight Reverse-Repo (Ceiling) rate has been increased from 13.00% to 13.50% p.a. The SBP Overnight Repo facility will be available at 10.50% p.a. which will serve as the 'Floor' for the Interest Rate corridor. Hence, the Floor and Ceiling levels for the interest rate corridor are 10.50% and 13.50% p.a. respectively (i.e. width of 300 bps). These changes are effective from 30th

September 2010. *(DMMD Circular No. 2 of 2010, September 29, 2010)*

V. Government of Pakistan Ijara Sukuk

In accordance with the provisions of the notification of the GoP Ijara Sukuk Rules, 2008, another GoP Ijara Sukuk of Rs 80 billion will be issued in Oct-Dec-2010 quarter as per the prescribed Structure and Assets. To facilitate the banks/DFIs/NBFIs, State Bank has issued details covering the structure, documentation and sample Tender Form. *(FSCD Circular No. 15 of 2010, dated October 29, 2010)*

7.2 International

In the aftermath of the recent financial crisis, several regulatory and supervisory actions have taken place in international economy. This section will provide a brief summary of the recent international developments that took place in Sep-10 quarter.

I. Stress Testing European Banks (July 2010)

The Committee of European Banking Supervisors conducted the second stress tests on its banking system in collaboration with the EU and ECB. The overall objective of the second exercise was to provide policy makers the information regarding resilience of the EU banking system to plausible and adverse macroeconomic shocks and to gauge the resilience of the banks in absorbing credit, market and sovereign risks. A total of 91 major European banks participated in the stress testing exercise. The stress testing was conducted on panel data (bank by bank basis) using the bank specific information.

The selection of financial institutions was made in such a way that it covers at least 50 percent asset share of banking sector of each of 27 member states of the EU. Further, the overseas branches of the institutions were also considered along with their subsidiaries.

Two different scenarios were tested for the credit risk and for the simulations of profits and losses. In the benchmark scenario, the EU Commission Autumn 2009 forecast and the European Commission Interim 2010 forecasts were employed to reflect recent macro-economic developments in the member states. Whereas; in the adverse (extreme) scenario, the estimates of ECB were employed including the sovereign risk shock. Both of the shocks were then simulated to see its impact on

Phase-in Arrangements

	2013	2014	2015	2016	2017	2018 Jan	2019
Minimum Common Equity Capital Ratio	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer				0.625%	1.250%	1.875%	2.500%
Minimum common equity plus capital	3.5%	4.0%	4.5%	5.1%	5.8%	6.4%	7.0%
	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Minimum Tier 1 Capital	4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus conservation	8.00%	8.00%	8.00%	8.625%	9.25%	9.875%	10.50%

Source: BIS

macroeconomic aggregates of the member countries.

A total of seven banks failed the stress tests and in policy response, the banks were instructed to raise their capital base by 3.5 billion Euros.

II. BASEL III (September 2010)

In response to recent financial crisis, the Basel Committee on banking Supervision issued comprehensive set of regulatory and supervisory reforms aimed at addressing to the issues in the existing Basel II framework. The main reforms are referred as Basel III and it includes;

1. Raising the quality, consistency and transparency of capital base.
2. Counterparty credit risk.
3. Supplementing the risk-based capital requirements with leverage ratio.
4. Reducing pro-cyclicality and promoting counter cyclical buffers.
5. Introducing a global liquidity standard with supervisory monitoring tools.

The Basel III reforms are expected to be implemented in a phased manner and the full Basel III reforms will be fully implemented by January 2019 (see Phase arrangements).

III. Principles for reducing reliance on Credit Rating Agency (October 2010)

The Financial Stability Board in response to the issues raised in the aftermath of the crisis related to the ratings issued principles to reduce reliance on Credit Rating Agencies (CRA). The principles are aimed at reducing the threats to financial stability, herding behavior and hindering the cliff effects which mainly originate from CRA ratings. Moreover, the FSB also aims to reduce reliance on CRA as to re-develop and encourage the banks, investors and other

market participants to use their own risk assessments for measuring counterparty risks.

The principles for reducing reliance include;

1. Reduce reliance on CRA ratings in standards, laws and regulations.
2. Reduce market reliance on CRA ratings.
3. Central banks to conduct their own credit ratings judgments and banks must not fully rely on CRA ratings for assessing the creditworthiness of the borrowers. Large banks are expected to assess credit risk of every asset it holds.
4. Supervisors to review the limiting and margining policies of market participants and central counterparties to guard against undue reliance on CRA.
5. Issuers of securities should provide comprehensive disclosures and timely information to the investors to make their own judgments.

Annex-I

Group wise Balance Sheet and Income Statement of Banks

September 30, 2010

(million)

Financial Position	PSCB	LPB	FB	CB	SB	All Banks
ASSETS						
Cash & Balances With Treasury Banks	86,009	377,451	36,162	499,622	2,250	501,872
Balances With Other Banks	29,429	121,969	11,475	162,873	7,746	170,619
Lending To Financial Institutions	34,516	194,720	51,652	280,888	-	280,888
Investments - Net	338,328	1,463,660	57,081	1,859,069	14,379	1,873,448
Advances - Net	609,551	2,379,305	84,138	3,072,994	94,106	3,167,100
Operating Fixed Assets	30,609	181,438	2,768	214,815	4,912	219,727
Deferred Tax Assets	19,074	46,734	6,018	71,826	368	72,193
Other Assets	88,532	232,402	7,821	328,754	11,218	339,972
TOTAL ASSETS	1,236,046	4,997,679	257,115	6,490,840	134,979	6,625,819
LIABILITIES						
Bills Payable	8,513	63,299	3,896	75,709	373	76,082
Borrowings From Financial Institution	53,127	365,314	15,468	433,910	83,414	517,324
Deposits And Other Accounts	972,178	3,858,721	176,836	5,007,736	13,577	5,021,313
Sub-ordinated Loans	-	48,129	-	48,129	3,405	51,535
Liabilities Against Assets Subject To Finance Lease	120	36	-	156	9	165
Deferred Tax Liabilities	2,950	6,997	211	10,158	-	10,158
Other Liabilities	62,812	173,297	23,713	259,822	33,778	293,600
TOTAL LIABILITIES	1,099,700	4,515,795	220,124	5,835,620	134,556	5,970,176
NET ASSETS	136,346	481,884	36,990	655,220	423	655,643
NET ASSETS REPRESENTED BY:						
Share Capital	24,030	282,644	36,918	343,593	15,507	359,100
Reserves	34,977	117,098	93	152,168	6,159	158,327
Unappropriated Profit	55,955	44,780	261	100,995	(24,996)	75,999
Share Holders' Equity	114,962	444,522	37,272	596,755	(3,330)	593,426
Surplus/Deficit On Revaluation Of Assets	21,384	37,362	(281)	58,465	3,752	62,217
TOTAL	136,346	481,884	36,990	655,220	423	655,643
PROFIT AND LOSS STATEMENT						
Mark-Up/ Return/Interest Earned	83,073	360,210	17,299	460,583	7,076	467,659
Mark-Up/ Return/Interest Expenses	50,612	192,069	9,071	251,751	3,282	255,033
Net Mark-Up / Interest Income	32,461	168,142	8,229	208,832	3,794	212,626
Provisions & Bad Debts Written Off Directly/(Reversals)	7,167	38,809	2,287	48,264	1,276	49,540
Net Mark-Up / Interest Income After Provision	25,294	129,332	5,942	160,568	2,518	163,086
Fees, Commission & Brokerage Income	7,550	24,155	1,584	33,289	44	33,333
Dividend Income	1,075	3,568	3	4,646	80	4,726
Income From Dealing In Foreign Currencies	1,802	9,321	3,055	14,177	1	14,178
Other Income	2,814	10,744	(800)	12,758	3,487	16,244
Total Non - Markup / Interest Income	13,241	47,787	3,841	64,870	3,611	68,481
	38,535	177,120	9,783	225,438	6,129	231,567
Administrative Expenses	23,050	113,828	7,723	144,600	4,523	149,124
Other Expenses	263	1,328	66	1,657	10	1,666
Total Non-Markup/Interest Expenses	23,313	115,156	7,788	146,257	4,533	150,790
Profit before Tax and Extra ordinary Items	15,222	61,964	1,995	79,180	1,597	80,777
Extra ordinary/unusual Items - Gain/(Loss)	-	-	461	461	9.74	471.19
PROFIT/ (LOSS) BEFORE TAXATION	15,222	61,964	1,533	78,719	1,587	80,306
Taxation	4,668	24,261	666	29,596	1,721	31,318
PROFIT/ (LOSS) AFTER TAX	10,554	37,702	867	49,123	(135)	48,988

Financial Soundness Indicators

(In percent)

Indicators	2007	2008	2009	Mar-10	Jun-10	Sep-10
CAPITAL ADEQUACY						
Risk Weighted CAR						
Public Sector Commercial Banks	16.1	13.4	15.1	13.7	13.9	12.5
Local Private Banks	11.8	11.9	13.9	13.8	14.0	14.1
Foreign Banks	14.6	21.8	23.0	22.4	22.7	23.9
Commercial Banks	12.8	12.6	14.5	14.1	14.3	14.2
Specialized Banks	(6.2)	(4.9)	(1.5)	(0.5)	(1.5)	2.2
All Banks	12.3	12.2	14.0	13.7	13.9	13.8
Tier 1 Capital to RWA						
Public Sector Commercial Banks	12.2	10.9	12.6	11.6	11.9	10.4
Local Private Banks	9.9	10.0	11.4	11.4	11.7	11.8
Foreign Banks	14.0	21.3	22.5	22.0	22.3	23.6
Commercial Banks	10.5	10.6	12.0	11.8	12.1	12.0
Specialized Banks	(12.5)	(10.1)	(5.8)	(5.3)	(5.6)	(3.4)
All Banks	10.0	10.1	11.6	11.4	11.7	11.6
Capital to Total Assets						
Public Sector Commercial Banks	13.7	10.7	11.3	11.1	10.0	11.0
Local Private Banks	10.2	10.0	9.9	10.2	9.9	9.6
Foreign Banks	11.2	14.5	14.8	14.0	14.6	14.4
Commercial Banks	10.9	10.3	10.4	10.5	10.1	10.1
Specialized Banks	(5.4)	(3.2)	(1.7)	(0.9)	(1.3)	0.3
All Banks	10.5	10.0	10.1	10.3	9.9	9.9
ASSET QUALITY						
NPLs to Total Loans						
Public Sector Commercial Banks	8.4	16.3	16.9	17.6	16.5	17.6
Local Private Banks	6.5	8.7	11.1	11.6	11.6	12.6
Foreign Banks	1.6	2.9	6.7	7.3	8.6	9.2
Commercial Banks	6.7	9.9	12.1	12.7	12.5	13.6
Specialized Banks	34.3	28.8	25.5	24.2	24.9	27.9
All Banks	7.6	10.5	12.6	13.1	12.9	14.0
Provision to NPLs						
Public Sector Commercial Banks	89.0	66.9	67.8	68.0	72.3	69.3
Local Private Banks	88.5	70.2	71.0	72.1	74.1	72.2
Foreign Banks	157.0	81.9	75.2	78.1	78.7	80.5
Commercial Banks	89.1	69.3	70.1	71.0	73.7	71.5
Specialized Banks	68.6	72.4	65.7	68.1	66.5	65.1
All Banks	86.1	69.6	69.9	70.9	73.2	71.1
Net NPLs to Net Loans						
Public Sector Commercial Banks	1.0	6.1	6.1	6.4	5.2	6.2
Local Private Banks	0.8	2.7	3.5	3.5	3.3	3.9
Foreign Banks	(0.9)	0.5	1.8	1.7	2.0	1.9
Commercial Banks	0.8	3.3	4.0	4.0	3.6	4.3
Specialized Banks	14.0	10.0	10.5	9.3	10.0	11.9
All Banks	1.1	3.4	4.1	4.2	3.8	4.5
Net NPLs to Capital						
Public Sector Commercial Banks	3.4	30.3	27.4	28.8	24.3	27.6
Local Private Banks	4.1	15.9	17.4	17.2	15.9	19.1
Foreign Banks	(4.1)	1.6	4.4	4.1	4.5	4.4
Commercial Banks	3.7	17.9	18.8	18.8	17.0	20.1
Specialized Banks	-	-	-	-	-	-
All Banks	5.6	19.4	20.4	20.2	18.4	21.8
EARNINGS						
Return on Assets (Before Tax)						
Public Sector Commercial Banks	3.5	0.6	1.5	1.9	1.8	1.6
Local Private Banks	2.0	1.3	1.3	1.9	1.8	1.7
Foreign Banks	1.5	0.0	(0.3)	0.1	0.6	0.3
Commercial Banks	2.3	1.1	1.3	1.8	1.8	1.6
Specialized Banks	1.4	3.2	3.1	2.0	2.6	1.7
All Banks	2.2	1.2	1.3	1.8	1.8	1.6

Financial Soundness Indicators

(In percent)

Indicators	2007	2008	2009	Mar-10	Jun-10	Sep-10
Return on Assets (After Tax)						
Public Sector Commercial Banks	2.5	0.5	1.3	1.3	1.2	1.1
Local Private Banks	1.4	0.9	0.9	1.2	1.1	1.0
Foreign Banks	0.7	0.3	(0.3)	0.1	0.4	0.1
Commercial Banks	1.6	0.8	0.9	1.2	1.1	1.0
Specialized Banks	0.71	1.8	1.2	0.1	0.6	0.0
All Banks	1.5	0.8	0.9	1.1	1.1	1.0
ROE (Avg. Equity & Surplus) (Before Tax)						
Public Sector Commercial Banks	27.2	5.2	13.3	16.7	16.8	15.1
Local Private Banks	20.4	12.9	13.2	18.8	18.2	16.8
Foreign Banks	13.1	0.0	(2.4)	0.7	3.8	2.7
Commercial Banks	21.8	10.6	12.4	17.4	17.1	15.8
Specialized Banks	-	-	-	-	-	-
All Banks	22.6	11.4	13.2	17.8	17.7	16.2
ROE (Avg. Equity & Surplus) (After Tax)						
Public Sector Commercial Banks	19.5	4.4	11.4	11.3	11.2	10.5
Local Private Banks	13.8	8.5	8.6	11.7	11.2	10.2
Foreign Banks	6.0	2.2	(2.3)	0.4	2.5	1.5
Commercial Banks	15.0	7.3	8.6	11.0	10.7	9.9
Specialized Banks	-	-	-	-	-	-
All Banks	15.4	7.8	8.9	11.1	10.9	9.9
NI/Gross Income						
Public Sector Commercial Banks	65.9	65.4	63.0	68.5	70.0	71.0
Local Private Banks	70.7	73.2	75.9	75.8	77.2	77.9
Foreign Banks	59.1	61.3	64.8	72.2	68.4	68.2
Commercial Banks	69.2	71.2	73.3	74.4	75.6	76.3
Specialized Banks	42.8	46.6	44.7	57.8	46.6	51.2
All Banks	68.2	70.3	72.4	74.0	74.7	75.6
Cost / Income Ratio						
Public Sector Commercial Banks	30.2	39.1	47.5	47.4	49.5	51.0
Local Private Banks	45.4	51.6	50.1	51.2	52.4	53.3
Foreign Banks	57.0	69.6	77.5	68.0	63.2	64.5
Commercial Banks	42.8	50.0	50.9	51.2	52.4	53.4
Specialized Banks	53.2	52.1	61.3	76.2	57.8	61.2
All Banks	43.2	50.1	51.2	51.8	52.6	53.6
LIQUIDITY						
Liquid Assets/Total Assets						
Public Sector Commercial Banks	37.0	30.6	31.1	29.7	33.6	29.4
Local Private Banks	32.5	26.8	32.3	32.2	33.6	33.8
Foreign Banks	41.6	45.2	55.0	58.2	58.5	59.6
Commercial Banks	33.8	28.3	32.9	32.8	34.6	34.0
Specialized Banks	27.9	24.5	19.8	15.5	17.3	15.9
All Banks	33.6	28.2	32.7	32.4	34.2	33.6
Liquid Assets/Total Deposits						
Public Sector Commercial Banks	47.1	38.9	40.1	38.0	41.9	37.4
Local Private Banks	42.9	35.0	43.4	42.7	44.0	43.8
Foreign Banks	61.1	71.6	82.4	88.3	85.7	86.6
Commercial Banks	44.3	37.1	44.0	43.4	44.9	44.1
Specialized Banks	247.7	229.4	167.1	148.9	134.5	157.7
All Banks	45.1	37.7	44.5	43.7	45.3	44.4
Advances/Deposits						
Public Sector Commercial Banks	60.0	68.4	65.2	63.9	58.3	62.7
Local Private Banks	70.1	75.1	66.6	65.4	62.7	61.7
Foreign Banks	75.2	68.9	56.1	51.2	49.6	47.6
Commercial Banks	73.8	73.6	66.0	64.6	61.4	61.4
Specialized Banks	507.3	577.0	560.8	669.3	534.5	693.1
All Banks	69.7	75.2	67.7	66.4	63.0	63.1

Annex-III

Selected Indicators for Different Categories of Banks **in terms of Size - September 30, 2010**

(In percent)

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	50.4%	73.6%	92.2%	100%
Share of Total Deposits	52.7%	76.2%	92.7%	100%
Share of Gross Income	60.0%	77.8%	94.7%	100%
Share of Risk Weighted Assets	51.5%	72.4%	91.9%	100%
Capital Adequacy				
Capital/RWA	16.3%	14.1%	14.0%	13.8%
Tier 1 Capital / RWA	13.4%	11.4%	11.5%	11.6%
Net Worth / Total Assets	11.3%	10.1%	9.9%	9.9%
Asset Composition				
Sectoral Distribution of Loans				
- Corporate Sector	50.0%	71.6%	88.7%	100%
- SMEs	38.7%	56.1%	84.5%	100%
- Agriculture	28.3%	37.8%	95.4%	100%
- Consumer Finance	52.3%	69.9%	85.7%	100%
- Commodity Financing	72.2%	86.6%	93.6%	100%
- Staff Loans	55.5%	71.4%	88.0%	100%
- Others	90.9%	94.8%	95.5%	100%
- Total	51.8%	70.7%	89.2%	100%
NPLs / Gross Loans	12.2%	12.6%	13.4%	14.0%
Net NPLs / Capital	12.3%	16.8%	20.1%	21.8%
Earning & Profitability				
ROA (After Tax)	2.0%	1.5%	1.2%	1.0%
ROE (After Tax)	18.0%	15.3%	11.9%	10.0%
Net Interest Income / Gross Income	79.4%	78.4%	75.9%	75.6%
Income from Trading & Foreign Exchange / Gross Income	15.2%	15.7%	16.8%	16.9%
Non-Interest Expense / Gross Income	41.1%	46.9%	50.4%	53.6%
Provision Expense to Gross Income	13.9%	14.5%	17.2%	17.6%
Liquidity				
Liquid Assets / Total Assets	32.5%	33.2%	33.5%	33.6%
Liquid Assets held in Govt. Securities / Total Liquid Assets	58.1%	61.9%	61.5%	60.0%
Liquid Assets / Total Deposits	41.0%	42.3%	44.0%	44.4%

Annex-IV

Bank-wise Major Statistics **September 30, 2010**

(million Rupees)

S. No.	Name of the Banks	Assets	Advances	Deposits	Equity
Public Sector Commercial Banks					
1	National Bank of Pakistan	931,776	447,997	744,096	118,660
2	First Women Bank Limited	12,838	7,245	10,125	1,101
3	The Bank of Punjab	247,399	134,667	189,730	10,519
4	The Bank of Khyber	44,033	19,641	28,228	6,066
Local Private Banks					
5	Allied Bank Limited	412,482	220,845	328,575	32,199
6	Bank Alfalah Limited	387,052	199,337	308,082	22,450
7	Askari Bank Limited	289,593	148,111	229,977	15,898
8	Bank Al Habib Limited	280,079	111,719	232,024	14,735
9	Mybank Limited	35,844	17,165	27,340	4,700
10	SAMBA Bank Limited	25,828	9,909	15,253	7,910
11	Atlas Bank Limited	25,870	16,994	20,167	1,150
12	Faysal Bank Limited	169,375	94,755	132,479	12,755
13	Habib Bank Limited	831,331	413,033	658,806	85,628
14	KASB Bank Limited	57,685	30,726	47,155	3,285
15	Arif Habib Bank Limited	41,382	21,033	31,137	3,411
16	JS Bank Limited	35,250	11,187	23,520	5,183
17	MCB Bank Limited	544,775	228,577	422,272	75,313
18	United Bank Limited	621,740	334,833	491,249	65,380
19	The Royal Bank of Scotland Limited	85,797	40,615	67,130	6,716
20	Habib Metropolitan Bank Limited	229,022	106,759	156,938	19,700
21	BankIslami Pakistan Limited	40,108	16,157	33,026	4,727
22	Emirates Global Islamic Bank	19,674	10,161	15,823	2,680
23	Soneri Bank Limited	101,765	49,164	78,332	8,766
24	SILKBANK Limited	73,064	42,450	54,928	5,240
25	NIB Bank Limited	161,736	82,424	101,973	13,693
26	Meezan Bank Limited	143,422	32,641	119,001	10,216
27	Dubai Islamic Bank Pakistan Limited	40,424	21,153	31,562	6,054
28	Standard Chartered Bank	329,689	114,703	222,468	49,575
29	Dawood Islamic Bank Limited	14,692	4,853	9,503	4,521
Foreign Banks					
30	Albaraka Islamic Bank B.S.C. (E.C.), Pakistan Operations	31,017	18,326	24,213	2,897
31	Citibank N.A. (Pakistan Operations)	94,822	21,182	64,743	8,762
32	Deutsche Bank AG (Pakistan Operations)	17,079	2,699	7,162	5,176
33	HSBC Bank Middle East Limited - (Pakistan Operations)	59,001	21,996	47,406	6,019
34	Oman International Bank S.A.O.G (Pakistan Operations)	3,991	409	693	2,886
35	The Bank of Tokyo-Mitsubishi UFJ Limited (Pakistan Operations)	8,677	3,133	2,795	4,601
36	Barclays Bank PLC (Pakistan Operations)	42,527	16,393	29,824	6,650
Specialized Banks					
37	The Punjab Provincial Cooperative Bank Ltd	13,041	5,859	1,686	6,647
38	Industrial Development Bank of Pakistan	4,266	111	3,285	(28,035)
39	Zarai Taraqiati Bank Limited	112,182	85,826	6,577	20,172
40	SME Bank Limited	5,490	2,310	2,029	1,639
Total		6,625,819	3,167,100	5,021,313	655,643

Annex-V

Results of Stress Test of Banking System- September 30, 2010

		Number of Banks with CAR		
		< 0%	0% - 10%	> 10%
Pre-Shock		3	3	34
Post-Shock				
Credit Shocks				
C-1	15% of performing loans moving to substandard, 15% of substandard to doubtful, 25% of doubtful to loss.	4	7	29
C-2	Tightening of loan classification i.e. NPLs under substandard category downgraded to doubtful and all doubtful NPLs downgraded to loss Category.	4	4	32
C-3	25 % of loans to the textile sector directly downgraded to doubtful category.	4	5	31
C-4	25% of consumer loans (auto loans, personal loans & consumer durables only) classified into doubtful category.	3	3	34
C-5	Deterioration in performing loans of the SME sector (50%) and Agri Sector (50%) directly downgraded to loss category of NPLs.	5	8	27
C-6	Critical Infection Ratio (The ratio of NPLs to Loans where capital wipes out).	3	37	0
Interest Rate Shocks				
IR-1	An increase in interest rates by 300 basis points.	3	5	32
IR-2	Shift coupled with flattening of the yield curve by increasing 500, 300 and 200 basis points in the three maturities respectively.	3	4	33
Exchange Rate Shocks				
ER-1	Depreciation of Pak Rupee by 25% against all Currencies.	3	6	31
ER-2	Appreciation of Pak Rupee by 5% against all Currencies.	3	3	34
Equity Price Shocks				
EQ-1	Fall in the equity prices by 30%.	3	4	33
EQ-2	Fall in the equity prices by 50%.	4	4	32
Combined Credit & Market Shocks				
COMB-1	Interest rates increase (3%), deterioration of loans to the textile sector (25%) directly downgraded to doubtful category, and fall in equity prices by 30%.	4	7	29
COMB-2	Deterioration in loan portfolio (performing to substandard: 15%, substandard to doubtful: 15%, doubtful to loss: 20%), fall in the equity prices (50%).	4	7	29
Liquidity Shock		Number of Banks		
		Becoming Illiquid after Shock for		
		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	3	4

Annex-VI

Group wise Balance Sheet and Income Statement of Islamic Banks/Branches - September 30, 2010

(million Rupees)

Financial Position	Islamic Banks	Islamic Banking Branches	Total Islamic Banking
ASSETS			
Cash & Balances With Treasury Banks	21,968	11,748	33,716
Balances With Other Banks	27,014	8,474	35,489
Due from Financial Institutions	57,408	2,850	60,258
Investments - Net	42,507	38,183	80,691
Financing - Net	103,291	49,517	152,809
Operating Fixed Assets	9,327	3,055	12,382
Deferred Tax Assets	2,468	0	2,468
Other Assets	25,352	20,933	46,285
TOTAL ASSETS	289,337	134,760	424,097
LIABILITIES			
Bills Payable	4,783	993	5,777
Due to Financial Institution	8,682	5,475	14,158
Deposits And Other Accounts	233,128	105,089	338,217
Sub-ordinated Loans	0	0	-
Liabilities Against Assets Subject To Finance Lease	24	0	24
Deferred Tax Liabilities	8	15	23
Other Liabilities	11,616	10,770	22,386
TOTAL LIABILITIES	258,242	122,342	380,584
NET ASSETS	31,094	12,419	43,513
NET ASSETS REPRESENTED BY: -			
Share Capital	31,647	7,673	39,320
Reserves	1,315	13	1,328
Unappropriated Profit	(2,112)	3,952	1,840
Share Holders' Equity	30,850	11,638	42,488
Surplus/Deficit On Revaluation Of Assets	245	780	1,025
TOTAL	31,094	12,419	43,513
PROFIT AND LOSS STATEMENT			
Mark-Up Income	19,014	9,025	28,039
Mark-Up Expenses	10,649	4,880	15,529
Net Mark-Up	8,366	4,144	12,510
Provisions & Bad Debts Written Off Directly/(Reversals)	1,972	352	2,323
Net Mark-Up After Provision	6,394	3,793	10,187
Fees, Commission & Brokerage Income	912	414	1,326
Dividend Income	101	23	124
Income From Dealing In Foreign Currencies	1,150	63	1,213
Other Income	199	256	455
Total Non - Markup	2,363	755	3,118
	8,757	4,548	13,305
Administrative Expenses	8,607	2,783	11,391
Other Expenses	121	31	153
Total Non-Markup	8,729	2,815	11,543
Profit before Tax and Extra ordinary Items	28	1,733	1,762
Extra ordinary/unusual Items -- Gain/(Loss)	0	0	0
PROFIT/ (LOSS) BEFORE TAXATION	28	1,733	1,762
Taxation	83	0	83
PROFIT/ (LOSS) AFTER TAX	(55)	1,733	1,678

Balance Sheet and Income Statement of DFIs-
September 30, 2010

(million)

Financial Position	All DFIs
ASSETS	
Cash & Balances With Treasury Banks	1,792
Balances With Other Banks	541
Lending To Financial Institutions	9,916
Investments - Net	63,519
Advances - Net	43,386
Operating Fixed Assets	2,899
Deferred Tax Assets	1,458
Other Assets	5,731
TOTAL ASSETS	129,241
LIABILITIES	
Bills Payable	-
Borrowings From Financial Institution	45,886
Deposits And Other Accounts	17,360
Sub-ordinated Loans	-
Liabilities Against Assets Subject To Finance Lease	16
Deferred Tax Liabilities	-
Other Liabilities	7,504
TOTAL LIABILITIES	70,766
NET ASSETS	
NET ASSETS REPRESENTED BY: -	
Share Capital	48,278
Reserves	7,040
Unappropriated Profit	2,717
Share Holders' Equity	58,035
Surplus/Deficit On Revaluation Of Assets	440
TOTAL	58,475
OPERATING POSITION	
Mark-Up/ Return/Interest Earned	10,281
Mark-Up/ Return/Interest Expenses	5,615
Net Mark-Up / Interest Income	4,666
Provisions & Bad Debts Written Off Directly/(Reversals)	506
Net Mark-Up / Interest Income After Provision	4,160
Fees, Commission & Brokerage Income	291
Dividend Income	312
Income From Dealing In Foreign Currencies	-
Other Income	658
Total Non - Markup / Interest Income	1,260
	5,421
Administrative Expenses	2,238
Other Expenses	112
Total Non-Markup/Interest Expenses	2,349
Profit before Tax and Extra ordinary Items	3,071
Extra ordinary/unusual Items -- Gain/(Loss)	-
PROFIT/ (LOSS) BEFORE TAXATION	3,071
Taxation	920
PROFIT/ (LOSS) AFTER TAX	2,151

Annex-VIII

Capital Structure and Capital Adequacy Ratio of Banks and DFIs - September 30, 2010

(million Rupees)

	All Banks and DFIs	PSPB	LPB	FB	SB	All Banks	DFIs
Equity							
1.1 Fully Paid-up Capital/Capital Deposited with SBP	412,709	34,254	280,279	36,918	15,507	366,959	45,750
1.2 Balance in Share Premium Account	13,405	38	10,839	-	-	10,877	2,528
1.3 Reserve for issue of Bonus shares	-	-	-	-	-	-	-
1.4 General Reserves as disclosed on the Balance Sheet (including statutory reserve)	122,222	17,267	91,679	93	6,159	115,198	7,024
1.5 Un-appropriated/Unremitted profits (net of accumulated losses, if any)	78,771	55,955	44,890	261	(24,996)	76,110	2,661
1.6 Minority interest	-	-	-	-	-	-	-
1.7 Sub-Total (1.1 to 1.5)	627,106	107,514	427,687	37,272	(3,330)	569,143	57,963
Deductions							
1.80 Goodwill	38,545	638	37,590	286	15	38,530	16
1.90 Shortfall in Provisions required against	18,130	16,570	1,560	-	-	18,130	-
1.10 Deficit on account of revaluation of AFS investment	6,433	1,413	2,488	440	476	4,816	1,617
1.11 Any increase in equity capital resulting from a securitization transaction	-	-	-	-	-	-	-
1.12 Investments in TFCs of other banks	764	-	232	-	-	232	532
1.13 Other Deductions	12,156	2,140	8,703	-	158	11,001	1,155
1.14 Sub-Total (1.7 to 1.10)	76,028	20,762	50,572	726	648	72,708	3,320
1.15 Total Eligible Tier 1 capital	551,079	86,752	377,115	36,545	(3,978)	496,435	54,644
Supplementary Capital							
2.1 Freely available General Provisions or reserves for loan losses-up to maximum of 1.25% of Risk Weighted Assets	12,877	2,061	8,702	518	1,414	12,694	183
2.2 Revaluation reserves eligible up to 45%	34,020	10,577	20,744	4	2,047	33,373	647
2.3 Foreign Exchange Translation Reserves	24,567	7,448	17,120	-	-	24,567	-
2.4 Undisclosed reserves	-	-	-	-	-	-	-
2.5 Subordinated debt-up to maximum of 50% of total equity	39,221	-	36,016	-	3,204	39,221	-
2.6 Total Tier 2 Supplementary Capital(2.1 - 2.5)	110,452	20,086	82,348	522	6,666	109,855	830
Deductions							
Other deductions	12,156	2,140	8,703	-	158	11,001	1,155
Total Deductions	12,156	2,140	8,703	-	158	11,001	1,155
Total eligible tier 2 capital	98,296	17,946	73,645	522	6,508	98,854	(325)
2.7 Eligible tier 3 (as worked out in 3.9 below)							
2.8 Total Supplementary Capital eligible for MCR(maximum up to 100% of Total Equity)	98,296	17,946	73,645	522	6,508	98,621	(325)
2.9 TOTAL CAPITAL (1.12+2.8)	649,375	104,698	450,761	37,067	2,530	595,056	54,319
Risk Weighted Amounts							
3.3 Total Credit Risk Weighted Assets	3,504,800	648,146	2,570,989	119,340	98,393	3,436,869	67,931
3.4 Total Market Risk Weighted Assets	277,722	81,154	164,657	8,112	58	253,981	23,741
Total Operational Risk Assets	617,983	108,788	453,141	27,713	17,240	606,882	11,101
3.5 Total Risk Weighted Amount	4,400,505	838,088	3,188,787	155,166	115,690	4,297,732	102,773
Capital Adequacy Ratios (CAR)							
Tier 1 capital to Total Risk Weighted Amount	12.5%	10.4%	11.8%	23.6%	-3.4%	11.6%	53.2%
Total Capital Adequacy Ratio	14.8%	12.5%	14.1%	23.9%	2.2%	13.8%	52.9%
Tier 2 capital to Total Risk Weighted Amount	2.2%	2.1%	2.3%	0.3%	5.6%	2.3%	-0.3%
OTHER DEDUCTIONS FROM TIER 1 AND TIER 2 CAPITAL							
(amount in thousand Rupees)							
1.1 Investments in equity and other regulatory capital of majority owned securities or other financial subsidiaries not consolidated in the balance sheet	17,620	2,102	15,122	-	315	17,539	81
1.2 Significant minority investments in banking, securities and other financial entities (para 1.1 scope of Application)	5,559	2,179	1,496	-	-	3,675	1,884
1.3 Equity holdings (majority or significant minority) in an insurance subsidiary (para 1.1 scope of Application)	505	-	160	-	-	160	345
1.4 Significant minority and majority investments in commercial entities exceeding 15% of bank's capital	628	-	628	-	-	628	-
1.5 Securitization exposure subject to deduction (para 4.3.1 of instructions)	-	-	-	-	-	-	-
1.6 Others	-	-	-	-	-	-	-
1.7 Total Deductible Items to be deducted 50% from Tier 1 capital and 50% from Tier 2 capital	24,312	4,281	17,406	-	315	22,002	2,310

Group-wise Composition of Banks **September 30, 2010**

2007	2008	2009	Sep-10
<u>A. Public Sector Com. Banks (4)</u> National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab <u>B. Local Private Banks (26)</u> Askari Bank Ltd. Bank Alfalah Ltd. Bank AL Habib Ltd. Mybank Ltd. Faysal Bank Ltd. Habib Metropolitan Bank Ltd. KASB Bank Ltd. ABN AMRO Bank (Pakistan) Ltd. Saudi Pak Commercial Bank Ltd. PICIC Commercial Bank Ltd. Soneri Bank Ltd. Standard Chartered Bank (Pakistan) Ltd. MCB Bank Ltd. Allied Bank Ltd. United Bank Ltd. Meezan Bank Ltd. NIB Bank Ltd. Crescent Commercial Bank Ltd. Habib Bank Ltd. Atlas Bank Ltd.. Arif Habib Bank Ltd. Dubai Islamic Bank Pakistan Ltd. BankIslami Pakistan Ltd. JS Bank Ltd. Emirates Global Islamic Bank Ltd. Dawood Islamic Bank Ltd <u>C. Foreign Banks (6)</u> Albaraka Islamic Bank B.S.C. Bank of Tokyo - Mitsubishi UFJ, Ltd. Deutsche Bank AG Citibank N.A. Oman International Bank S.A.O.G. The Hongkong & Shanghai Banking Corporation Ltd. <u>D. Specialized Banks (4)</u> Zarai Taraqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. <u>All Commercial Banks (36)</u> Include A + B + C <u>All Banks (40)</u> Include A + B + C + D	<u>A. Public Sector Com. Banks (4)</u> National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab <u>B. Local Private Banks (25)</u> Askari Bank Ltd. Bank Alfalah Ltd. Bank AL Habib Ltd. Mybank Ltd. Faysal Bank Ltd. Habib Metropolitan Bank Ltd. KASB Bank Ltd. The Royal Bank of Scotland Ltd. Saudi Pak Commercial Bank Ltd. Soneri Bank Ltd. Standard Chartered Bank (Pakistan) Ltd. MCB Bank Ltd. Allied Bank Ltd. United Bank Ltd. Meezan Bank Ltd. NIB Bank Ltd. SAMBA Bank Ltd. Habib Bank Ltd. Atlas Bank Ltd.. Arif Habib Bank Ltd. Dubai Islamic Bank Pakistan Ltd. BankIslami Pakistan Ltd. JS Bank Ltd. Emirates Global Islamic Bank Ltd. Dawood Islamic Bank Ltd <u>C. Foreign Banks (7)</u> Albaraka Islamic Bank B.S.C. Bank of Tokyo - Mitsubishi UFJ, Ltd. Deutsche Bank AG Citibank N.A. Oman International Bank S.A.O.G. Barclays Bank PLC HSBC Bank Millde East Ltd. <u>D. Specialized Banks (4)</u> Zarai Taraqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. <u>All Commercial Banks (36)</u> Include A + B + C <u>All Banks (40)</u> Include A + B + C + D	<u>A. Public Sector Com. Banks (4)</u> National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab <u>B. Local Private Banks (25)</u> Askari Bank Ltd. Bank Alfalah Ltd. Bank AL Habib Ltd. Mybank Ltd. Faysal Bank Ltd. Habib Metropolitan Bank Ltd. KASB Bank Ltd. The Royal Bank of Scotland Ltd. Silk Bank Ltd Soneri Bank Ltd. Standard Chartered Bank (Pakistan) Ltd. MCB Bank Ltd. Allied Bank Ltd. United Bank Ltd. Meezan Bank Ltd. NIB Bank Ltd. SAMBA Bank Ltd. Habib Bank Ltd. Atlas Bank Ltd.. Arif Habib Bank Ltd. Dubai Islamic Bank Pakistan Ltd. BankIslami Pakistan Ltd. JS Bank Ltd. Emirates Global Islamic Bank Ltd. Dawood Islamic Bank Ltd. <u>C. Foreign Banks (7)</u> Albaraka Islamic Bank B.S.C. Bank of Tokyo - Mitsubishi UFJ, Ltd. Deutsche Bank AG Citibank N.A. Oman International Bank S.A.O.G. Barclays Bank PLC HSBC Bank Millde East Ltd. <u>D. Specialized Banks (4)</u> Zarai Taraqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. <u>All Commercial Banks (36)</u> Include A + B + C <u>All Banks (40)</u> Include A + B + C + D	<u>A. Public Sector Com. Banks (4)</u> National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab <u>B. Local Private Banks (25)</u> Askari Bank Ltd. Bank Alfalah Ltd. Bank AL Habib Ltd. Mybank Ltd. Faysal Bank Ltd. Habib Metropolitan Bank Ltd. KASB Bank Ltd. The Royal Bank of Scotland Ltd. Silk Bank Ltd Soneri Bank Ltd. Standard Chartered Bank (Pakistan) Ltd. MCB Bank Ltd. Allied Bank Ltd. United Bank Ltd. Meezan Bank Ltd. NIB Bank Ltd. SAMBA Bank Ltd. Habib Bank Ltd. Atlas Bank Ltd.. Summit Bank Ltd. Dubai Islamic Bank Pakistan Ltd. BankIslami Pakistan Ltd. JS Bank Ltd. Emirates Global Islamic Bank Ltd.* Dawood Islamic Bank Ltd. <u>C. Foreign Banks (7)</u> Albaraka Islamic Bank B.S.C.* Bank of Tokyo - Mitsubishi UFJ, Ltd. Deutsche Bank AG Citibank N.A. Oman International Bank S.A.O.G. Barclays Bank PLC HSBC Bank Millde East Ltd. <u>D. Specialized Banks (4)</u> Zarai Taraqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. <u>All Commercial Banks (36)</u> Include A + B + C <u>All Banks (40)</u> 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			

List of Abbreviations

ADD	Authorized Derivatives Dealer
ADR	Advances to Deposits Ratio
AFS	Available For Sale
ALM	Asset Liability Management
BIA	Basic Indicator Approach
bps	Basis Points
CAR	Capital Adequacy Ratio
CB	Commercial Bank
CCF	Credit Conversion Factor
CCS	Cross Country Swaps
CDNS	Central Directorate of National Saving
CPI	Consumer Price Index
CPV	Credit Portfolio View
CRR	Cash Reserve Requirements
CRWA	Credit Risk Weighted Amounts
CY	Calendar Year
DFIs	Development Finance Institutions
ERF	Export Refinance
EURIBOR	Euro Interbank Offered Rate
EXR	Exchange Rate
FB	Foreign Bank
FDBR	Financial Derivatives Business Regulations
FDR	Financing to Deposits Ratio
FRA	Forward Rate Agreements
FSV	Forced Sale Value
GDP	Gross Domestic Product
GoP	Government of Pakistan
HFT	Held For Trading
HTM	Held-to-Maturity
IBIs	Islamic Banking Institutions
IRS	Interest Rate Swaps
KIBOR	Karachi Interbank Offered Rate
KSE	Karachi Stock Exchange
LIBOR	London Interbank Offered Rate
LoLR	Lender of Last Resort
LPB	Local Private Bank
LR	Interest Rate
LSM	Large Scale Manufacturing
MCR	Minimum Capital Requirement
MRWA	Market Risk Weighted Amounts
MTB	Market Treasury Bill
NII	Net Interest Income

NMI	Non-Market Maker Financial Institution
NOP	Net Open Position
NPF	Non Performing Finance
NPL	Non Performing Loan
NPLR	Loan Infection Ratio
NSS	National Saving Scheme
OMO	Open Market Operation
ORWA	Operational Risk Weighted Amounts
OTC	Over the Counter
PAT	Profit After Tax
PIB	Pakistan Investment Bond
PKR	Pak Rupee
PSCB	Public Sector Commercial Bank
PSE	Public Sector Enterprise
PTCs	Participation Term Certificates
QoQ	Quarter on Quarter
QPR	Quarterly Performance Review
QRC	Quarterly Report of Condition
ROA	Return on Asset
ROE	Return on Equity
RSA	Rate Sensitive Assets
RSL	Rate Sensitive Liabilities
RWA	Risk Weighted Assets
SA	Standardized approach
SB	Specialized Bank
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SLR	Statutory Liquidity Requirements
SME	Small and Medium Enterprise
TFCs	Term Finance Certificates
USD	United States Dollar
WALR	Weighted Average Lending rate
WPI	Wholesale Price Index
YoY	Year on Year

Glossary

Capital Adequacy Ratio is the amount of risk-based capital as a percent of risk-weighted assets.

Coefficient of Variance The coefficient of variance is the ratio of Standard Deviation to Arithmetic Mean. The coefficient is a useful statistical tool for comparing the degree of volatility of more than one data sets when their means are significantly different from each other.

Consumer Financing means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as Consumer Financing include credit cards, auto loans, housing finance, consumer durables and personal loans.

Corporate means and includes public limited companies and such entities, which do not come under the definition of SME.

Credit risk arises from the potential that a borrower or counter-party will fail to perform an obligation or repay a loan.

Discount rate is the rate at which SBP provides three-day repo facility to banks, acting as the lender of last resort.

Duration (Macaulay's Duration) is a time weighted present value measure of the cash flow of a loan or security that takes into account the amount and timing of all promised interest and principal payments associated with that loan or security. It shows how the price of a bond is likely to react to different interest rate environments. A bond's price is a function of its coupon, maturity and yield.

Force Sale Value (FSV) means the value that can currently be obtained by selling the mortgaged / pledged assets in a forced / distressed sale conditions. This value fully reflects the possibility of price fluctuations.

GAP is the term commonly used to describe the rupee volume of the interest-rate sensitive assets versus interest-rate sensitive liabilities mismatch for a specific time frame; often expressed as a percentage of total assets.

Gross income is the net interest income (before provisions) plus non-interest income; the income available to cover the operating expenses.

Interbank rates are the two-way quotes namely bid and offer rates quoted in interbank market are called as interbank rates.

Interest rate risk is the exposure of an institution's financial condition to adverse movement in interest rates, whether domestic or worldwide. The primary source of interest rate risk is difference in timing of the re-pricing of bank's assets, liabilities and off-balance sheet instruments.

Intermediation cost is the administrative expenses divided by the average deposits and borrowings.

Liquid assets are the assets that are easily and cheaply turned into cash – notably cash and short-term securities. It includes cash and balances with banks, call money lending, lending under repo and investment in government securities.

Liquidity risk is the risk that the bank will be unable to accommodate decreases in liabilities or to fund increases in assets. The liquidity represents the bank's ability to efficiently and economically accommodate decreases in deposits and to fund increases in loan demand without negatively affecting its earnings.

Market risk is the risk that changes in the market rates and prices will impair an obligor's ability to perform under the contract negotiated between the parties. Market risk reflects the degree to which changes in interest rates, foreign exchange rates, and equity prices can adversely affect the earnings of a bank.

Net interest income is the total interest income less total interest expense. This residual amount represents most of the income available to cover expenses other than the interest expense.

Net Interest Margin (NIM) is the net interest income as a percent of average earning assets.

Net loans are the loans net of provision held for NPLs.

Net Non-Performing Loans (NPLs) is the value of non-performing loans minus provision for loan losses.

Net NPLs to net loans means net NPLs as a percent of net loans. It shows the degree of loans infection after making adjustment for the provision held.

Non-Performing Loans (NPLs) are loans and advances whose mark-up/interest or principal is overdue by 90 days or more from the due date.

NPLs to loans ratio/Infection ratio stands for NPLs as a percent of gross loans.

Paid-up capital is the equity amount actually paid by the shareholders to a company for acquiring its shares.

Rate Sensitive Assets (RSA) are assets susceptible to interest rate movements; that will be re-priced or will have a new interest rate associated with them over the forthcoming planning period.

Repricing risk arises from timing differences in the maturity of fixed rate and the repricing of floating rates as applied to banks' assets, liabilities and off-balance sheet positions

Return on assets measures the operating performance of an institution. It is the widely used indicator of earning and is calculated as net profit as percentage of average assets.

Return on equity is a measure that indicates the earning power of equity and is calculated as net income available for common stockholders to average equity

Risk weighted Assets: Total risk weighted assets of a bank would comprise two broad categories: credit risk-weighted assets and market risk-weighted assets. Credit risk weighted assets are calculated from the adjusted value of funded risk assets i.e. on balance sheet assets and non-funded risk exposures i.e. off-balance sheet item. On the other hand for market risk-weighted assets, first the capital charge for market risk is calculated and then on the basis of this charge amount the value of Market Risk Weighted Assets is derived.

Secondary market is a market in which securities are traded following the time of their original issue.

SME means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing/ service concern) and 50 persons (if it is trading concern) and also fulfils the following criteria of either 'a' and 'c' or 'b' and 'c' as relevant:

(a) A trading / service concern with total assets at cost excluding land and building upto Rs50 million.

(b) A manufacturing concern with total assets at cost excluding land and building upto Rs100 million.

(c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs300 million as per latest financial statements.

Tier-I capital: The risk based capital system divides capital into two tiers- core capital (Tier I) and supplementary capital (Tier II and Tier III). Tier 1 capital includes fully paid up capital, balance in share premium account, reserve for issue of bonus shares, general reserves as disclosed on the balance-sheet and un-appropriated /un-remitted profit (net of accumulated losses, if any).

Tier-II capital or Supplementary Capital (Tier II & III) is limited to 100 percent of core capital (Tier I). Tier II includes; general provisions or general reserves for loan losses, revaluation reserves, exchange translation reserves, undisclosed reserves and subordinated debt.

Tier-III capital consists of short-term subordinated debt and is solely held for the purpose of meeting a proportion of the capital requirements for market risks.

Yield risk is the risk that arises out of the changes in interest rates on a bond or security when calculated as that rate of interest, which, if applied uniformly to future time periods sets the discounted value of future bond coupon and principal payments equal to the current market price of the bond.

Yield curve risk materializes when unanticipated shifts have an adverse effect on the bank's income or underlying economic value.