

Quarterly Performance Review of the Banking System

June 2009



State Bank of Pakistan
Banking Surveillance Department

Team Leader

Lubna Farooq Malik	lubna.farooq@sbp.org.pk
--------------------	--

Team Members

Muhammad Javaid Ismail	javid.ismail@sbp.org.pk
Amer Hassan	amer.hassan@sbp.org.pk
Salman Ahmed	salman.ahmed@sbp.org.pk
Abdul Samad	abdul.samad@sbp.org.pk
Muhammad Shamil	muhammad.shamil@sbp.org.pk
Asad Bilal Rizvi	asad.rizvi@sbp.org.pk
Imran Malik	imran.malik@sbp.org.pk
Farrukh Bashir	farrukh.bashirsatti@sbp.org.pk

Data Assistance

Muhammad Amjad	m.amjad@sbp.org.pk
----------------	--

Your comments	comments.qpr@sbp.org.pk
----------------------	--

Acknowledgements

The QPR team of Banking Surveillance Department (BSD) would like to extend its profound gratitude to all the divisional heads of BSD for their support and Ms. Rizwana Rifat, Mr. Mansoor Ahmad Zaidi, Mr. Muhammad Naeem and Mr. Faraz Abbas for their invaluable contribution in different technical analysis.

BSD also offers a special thanks to Islamic Banking Department for timely availability of data for QPR.

Table of Contents

1. Overview	1
2. Asset and Funding Structure	5
3. Financial Soundness of the Banking System	12
3.1. Solvency	12
3.2. Profitability	15
4. Risk Assessment of the Banking System	19
4.1 Credit Risk	19
Special Section 1: Macroeconomic Stress Testing of Credit Risk	24
Special Section 2: Related Party Dealings	26
4.2 Market Risk	31
4.3 Liquidity Risk	35
4.4 Operational Risk	38
5. Performance of Islamic Banking	41
6. Development Finance Institutions (DFIs)	44
Special Section 3: Analysis of Financial Derivative Business	47
Special Section 4: Regulatory Developments	50
Annex-I	59
Annex-II	60
Annex-III	62
Annex-IV	63
Annex-V	64
Annex-VI	65
Annex-VII	66
Annex-VIII	67
Annex-IX	68
List of Abbreviations	69
Glossary	71

This page is left blank intentionally

Quarterly Performance Review of the Banking System June 2009¹

1. Overview

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

	(billion Rupees)						
	CY04	CY05	CY06	CY07	CY08	Mar-09	Jun-09
Total Assets	3,043	3,660	4,353	5,172	5,627	5,744	6,087
Investments (net)	679	800	833	1,276	1,080	1,298	1,409
Advances (net)	1,574	1,991	2,428	2,688	3,183	3,024	3,176
Deposits	2,393	2,832	3,255	3,854	4,217	4,218	4,563
Equity	202	292	402	544	563	594	623
Profit Before Tax (PBT)	52	94	124	107	63	26	48
Profit After Tax (PAT)	35	63	84	73	43	16	29
Non-Performing Loans	200	177	177	218	359	379	398

Banking system witnessed some let up in the impacts of macroeconomic pressures that have been affecting its asset quality and growth for last few quarters, though overall macroeconomic outlook with slight improvements remained stressful. IMF's latest estimates predict that world Gross Domestic Product (GDP) would decline by 1.0 percent in 2009 followed by a modest 3.0 percent growth in 2010². Pakistan's economy also grew by 2.0 percent during FY09 – the lowest for current decade – while the projection of 3.3 percent for FY10 also remains low.

Major stress from weakened economic conditions i.e. flow of additional Non performing Loans (NPLs) that was pronounced in last couple of quarters, pacified to some extent as NPLs grew at slower pace. Nevertheless, the system continues to face a considerably heightened credit risk, which has built up since later half of CY08³. The system's asset and deposit base witnessed noticeable increase as compared to recent trends. Due to enhanced loan loss provisioning and decline in banks' risk appetite, reflecting in enhanced risk based capital adequacy position, the baseline solvency indicators registered some improvement. Accordingly, the system continued to show strong resilience towards unusual shocks in major risk factors.

The asset base of the banking system grew by 6.0 percent. The deposits, which had been showing stagnancy since Jun-08, registered an appreciable growth of 8.2 percent during the quarter under review. The advances⁴ grew by 5.0 percent; however, this increase occurred in

¹The report presents performance of the banking system on the basis of unaudited Quarterly Report of Condition submitted by banks for the quarter ended 30th June, 2009.

² IMF's World Economic Outlook, October 2009.

³ Figures for CY07 have been restated in the graphs and tables of QPR for Jun-09 as reported in annual audited financial statements for CY08, except where specifically mention.

⁴ The terms loan(s) and advance(s) have been used interchangeably except where specifically mentioned.

Table 1.2: Highlights of the quarter ended Jun-09

	(in percent)			
	Jun-08	CY08	Mar-09	Jun-09
Asset Growth	5.6	8.8	1.6	6.0
Loans Growth	4.0	18.3	(5.6)	5.0
Deposit Growth	7.8	9.4	0.0	8.2
Investments Growth	(5.5)	(15.4)	20.0	8.5
Equity Growth	3.0	3.4	1.5	4.7
Capital Adequacy	12.1	12.3	12.9	13.5
Capital to Total Assets	10.2	10.0	10.3	10.2
NPLs to Loans	7.7	10.5	11.5	11.5
Net NPLs to Net Loans	1.3	3.4	3.9	3.7
ROA (Before Tax)	2.3	1.2	1.8	1.7
ROE* (Before Tax)	22.4	11.4	17.7	16.0
Liquid Assets/ Total Deposits	41.6	38.2	41.5	41.7
Advances to Deposit Ratio	69.8	75.5	71.7	69.6

* Average Equity & Surplus

lending to public sector for its Commodity Operations and to Public Sector Enterprises (PSEs). Due to risk aversion of banks and slackened demand from private sector, lending to private sector shed by 1.8 percent. Further, banks' investments in Government papers also significantly grew by 12.9 percent during the quarter under review. Accordingly, asset mix further shifted from loans and advances to investments in government papers.

The increased macroeconomic vulnerabilities and constrained repayment capacity of borrowers have resulted in significant increase in NPLs of the banking system during last two quarters. The quarter under review, however, witnessed slowdown in infection rate as the NPLs accumulated at relatively passive rate of 4.9 percent to Rs398 billion (Rs379 billion in Mar-09, and Rs359 billion in Dec-08). Due to a matching growth in loan portfolio, the infection ratio remained at the last quarter level. This increase in NPLs occurred in Doubtful and Loss categories and banks almost fully provided for additional NPLs. Accordingly, net infection and capital impairment ratios slightly receded, and NPLs coverage after deteriorating over the last few quarters improved to 70.2 percent.

The significant increase in loans loss provisioning moderated the earnings of the system: year to date Profit before Tax (PBT) of Rs47.8 billion in Jun-09 as compared to Rs61.4 billion for corresponding period of CY08. The baseline indicators of Return on Asset (ROA) and Return on Equity (ROE) remained significantly lower than the level for corresponding period of last year, though still higher than entire year results of CY08. Satisfactory earnings, however, were not widely shared by market players and were skewed towards large and medium-sized banks as most of the small sized banks' earnings remained in red.

Accumulation in year to date earnings led to reasonable increase in equity base of the system. This growth was also augmented by improvement in revaluation surpluses on both

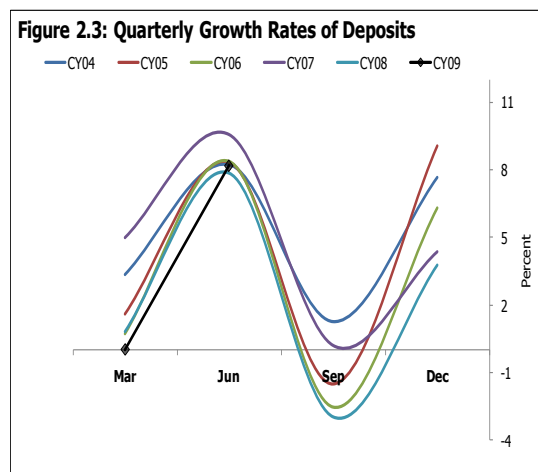
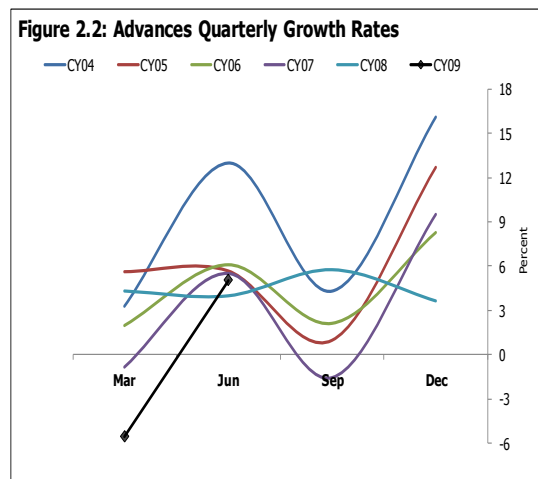
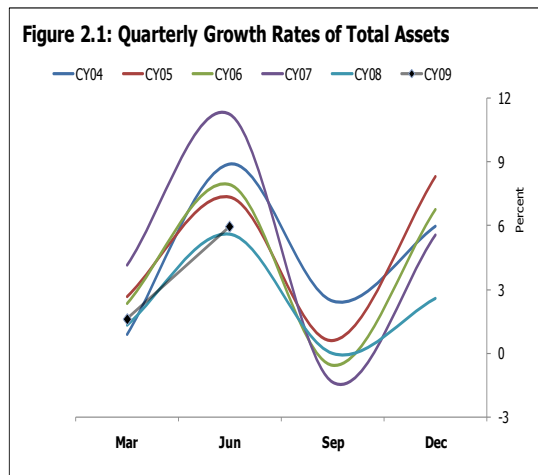
Available for Sale (AFS) equity investments and fixed income securities due to favorable movements in market prices. The net worth to total asset ratio slightly came off. However, improvement in eligible capital and reduction in Risk Weighted Assets (RWA) as the banks continued to shift their asset mix from private sector credit to investments in government papers and lending to PSEs, improved the risk based Capital Adequacy Ratio (CAR) to 13.5 percent (14.0 percent for commercial banks).

Deposits after showing stagnancy for the last few quarters, witnessed a significant increase which surpassed growth in advances, and a larger share of fresh deposits was invested in liquid assets. Resultantly, the liquidity profile of the system further improved during the quarter. Advances to deposits ratio (ADR) came off to 69.6 percent and liquid assets to total assets ratio improved to 31.2 percent. Similarly, the market risk of the system with some moderation remained subdued. Strong recovery by the capital market made for the substantial part of revaluation losses, which accumulated during later half of CY08. Interest rate risk was also low as the interest rates gradually declined during the quarter, appreciating the value of fixed income securities while re-pricing mismatches remained within acceptable ranges.

Going forward, economic slowdown and domestic security issues are likely to dampen the growth of the banking system. Low demand for banks' credit from private sector, increased risk aversion on the part of banks, and public sector demand for bank credit will further shift asset mix away from advances to government papers and lending to PSEs. Given the slackened economic activities and constrained repayment capacity of borrowers, credit risk continues to remain the foremost concern for the system. However, stress test results indicate that banks are well placed to withstand any unusual shocks in credit risk factors. Banks have though shown strong performance in attracting deposits during the quarter under review. However, future growth in earnings assets and

lending to private sector for supporting the accelerated economic activities during Oct-Dec quarter will largely depend upon banks' ability to mobilize fresh deposits. Therefore, they will have to step up their efforts for mobilizing deposits, which are again showing some stagnancy in latest post quarter statistics. Keeping in view some improvements in key economic indicators, State Bank of Pakistan (SBP) has been following the policy of discreetly easing off monetary policy for providing impetus to sustainable recovery. Accordingly, the interest rates are likely to remain relatively low compared to CY08 levels. The system, on aggregate basis, is expected to post satisfactory earnings, though the individual banks would experience mixed results, depending upon their size and earning capacities.

2. Asset and Funding Structure



The deposits and asset base of the banking system witnessed noticeable growth after experiencing passive growth during the last couple of quarters. However, the growth in asset base during the quarter under review was unique as it was largely contributed by lending to public sector and investments in govt. papers while lending to private sector further contracted. The growth pattern for key components of the asset base and funding structure i.e. advances and deposits during first half of CY09 remained in line with the seasonal growth patterns set over last many years, though the rate of growth remained low compared to the past trends (see Figures 2.1, 2.2 & 2.3).

Specifically, the assets of the banking system grew by 6.0 percent during Jun-09 quarter to Rs6,087 billion. The growth in advances and investment remained at 5.0 percent and 8.5 percent, respectively. However their constituents witnessed diverging trends as lending to public sector for commodity operations and PSEs witnessed a strong growth while lending to private sector further came off during the quarter. Similarly, increase in investments was largely contributed by investments in government papers.

The growth in the assets and advances was adequately backed by growth in deposits. The deposit after remaining stagnant in Mar-09, registered a growth of 8.2 percent (Rs345 billion) to Rs4,563 billion, slightly higher than Jun-08 growth of 7.8 percent (Rs304 billion) that was lowest growth witnessed in last many years for the June quarter (see Figure 2.3). Accordingly, ADR that increased significantly in Sep-08 and Dec-08 due to sharp increase in advances vis-à-vis passive growth or even decline in deposits, came off sharply to 71.7 percent in Mar-09 and 69.6 percent in Jun-09 - almost identical to Jun-08 level (see Figure 2.4).

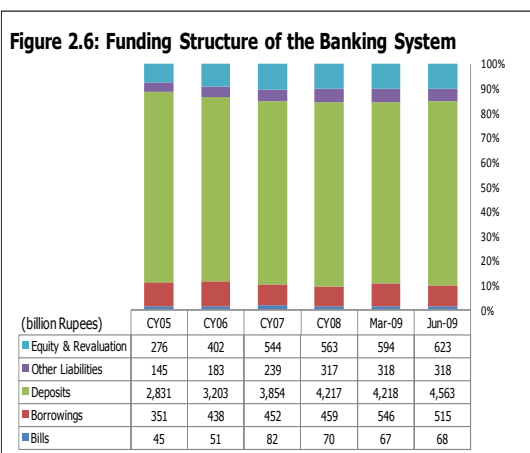
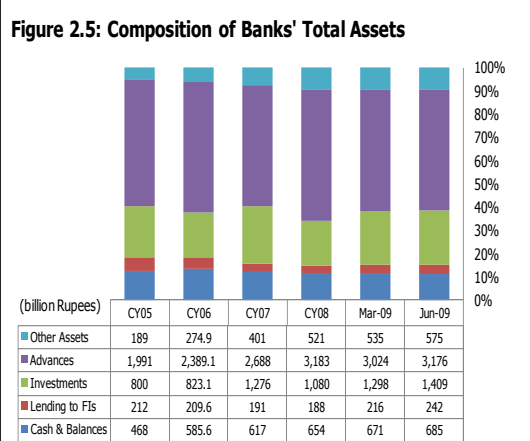
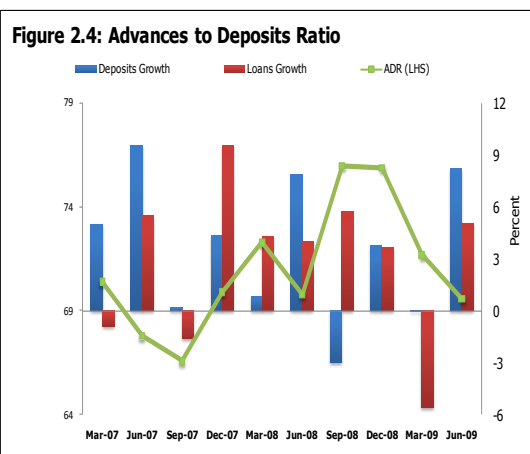


Table 2.1: Trends in Total Assets

	(billion Rupees)					
	CY05	CY06	CY07	CY08	Mar-09	Jun-09
PSCBs	724	836	1,036	1,042	1,074	1,173
LPBs	2,483	3,102	3,836	4,220	4,302	4,539
FBs	339	224	173	234	239	241
CBs	3,547	4,162	5,044	5,496	5,615	5,953
SBs	113	120	127	130	129	134
All Banks	3,660	4,282	5,171	5,627	5,744	6,087

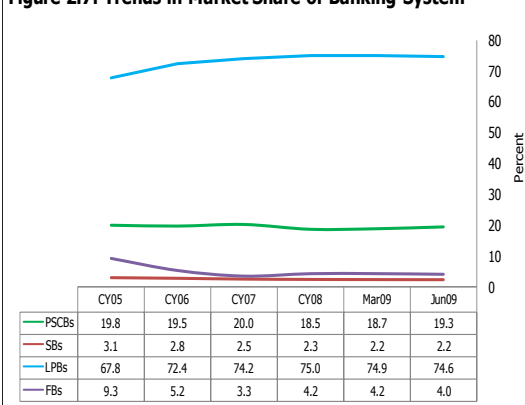
Moreover, the subordinated debt and networth grew by 5.2 percent and 4.7 percent, respectively during Jun-09. Net assets of the banking system grew largely on account of revaluation surplus, complemented by modest rise in retained earnings and paid up capital. Since the growth in equity was slightly slower than growth in asset base, share of net-worth in assets base declined marginally to 10.2 percent in Jun-09 from 10.3 percent at the end of preceding quarter.

In line with the different growth rates in major asset components i.e. advances and investments, the asset composition of the banking system changed during the quarter under review. Specifically, the share of advances (net) in total assets marginally declined to 52.2 percent in Jun-09 from 52.6 percent in Mar-08. On the other hand, the share of investment (net) increased by 53 basis points to 23.1 percent at the cost of share of advances, cash and bank balances (see Figure 2.5).

The composition of funding structure of the banking system witnessed a noticeable change during Jun-09 quarter. Precisely, in line with strong growth in deposits, the share of deposits in the funding structure increased to 75.0 percent in Jun-09 from 73.4 percent in Mar-09. This was accompanied by decline in the share of borrowings from 9.5 percent in Mar-08 to 8.5 percent by the end of Jun-09. However, due to slower growth, the share of net worth in funding structure of the system marginally decline during the quarter under review (see Figure 2.6).

According to banking group-wise analysis, the assets of the Public Sector Commercial Banks (PSCBs) has the largest growth in Jun-09 quarter primarily because of the two banks of this group. The Local Private Banks (LPBs) and specialized Banks (SBs) also witnessed moderate growth during the period under review. However, FBs grew marginally. One relatively new FB recorded significant growth while others recorded either marginal growth or negative growth during the quarter under

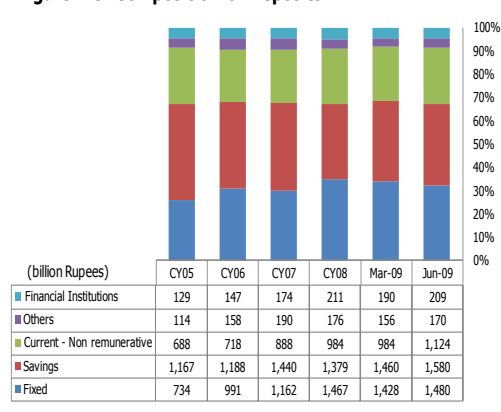
Figure 2.7: Trends in Market Share of Banking System



review. As a result, the share of PSCBs in the asset base of the banking system increased to 19.3 percent from 18.7 percent in last quarter. The market share of LPBs, which hold largest share of the market, fell marginally to 74.6 percent in Jun-09 from 74.9 percent in Mar-09 (see Table 2.1 & Figures 2.7). Group wise detailed financial position of the banking system is given at Annex-I.

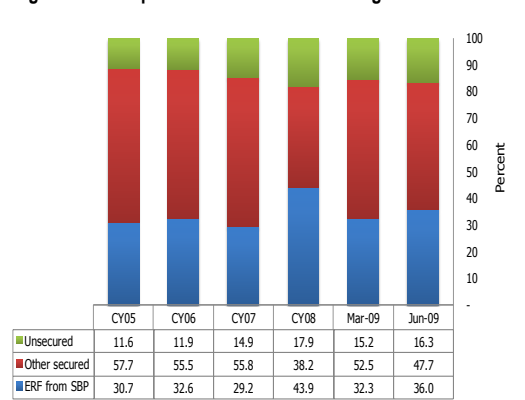
Though medium sized banks have shown a strong growth and buildup of market share in recent years, the market concentration remains a key feature of the banking system. Top five banks still holds around 51.8 percent market share in the total assets of the banking system. The weakening in business environment in recent past and growing risks in the financial system has resulted in mergers and consolidation of the small banks as the regulatory capital requirements are also on the rise for last many years. This is also evident from the fact that 10 banks have the market share between 7.7 percent and 2.5 percent. About 90 percent share is held by 18 out of 40 banks. Details of market structure on key balance sheet components and financial indicators are given at Annex-III.

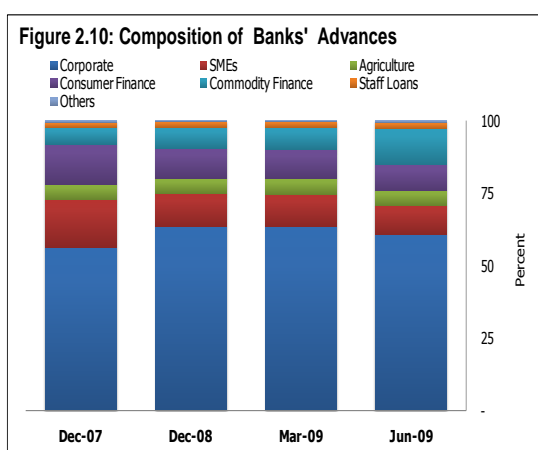
Figure 2.8: Composition of Deposits



Deposits are the largest component of the banking system's funding structure. As mentioned earlier, deposit base grew as per June quarter's time-honored trend. The share of deposits in funding structure increased to 75.0 percent in Jun-09 up from 73.4 percent in previous quarter. This noticeable growth is attributed to increase in advances and strong workers' remittances of \$2,153 million during Jun-09 quarter, up from \$2,018 million in Mar-09 and \$1,723 million in Jun-08 quarter. The disaggregated analysis of the deposits reveals that the all categories of deposits grew during the quarter. However, growth was more significant in current accounts, corroborating the influence of increased loan portfolio on deposits. Accordingly, the share of current (non-remunerative) deposits increased by 130 basis points at the cost of fixed deposits, which marginally grew by 3.6 percent. Other than this,

Figure 2.9: Composition of Banks' Borrowings





there was no significant change in the deposit composition during the quarter under review (see Figure 2.8).

With the increase in deposits base, the banks reduced their dependence on **borrowings**, which declined by 5.7 percent (Rs31 billion) to Rs515 billion by the end of Jun-09. The composition of borrowings witnessed some change from secured to unsecured sources. Total secured borrowings contracted by Rs32 billion (6.9 percent). Export Refinance from the SBP increased by 5 percent as a number of initiatives were introduced for the promotion of country's exports, while secured interbank borrowings declined by 8.0 percent by the end of the quarter. On the other hand, unsecured borrowing marginally increased by Rs0.8 billion (0.9 percent). Consequently, the share of unsecured interbank borrowings in total borrowings increased to 16.3 percent by the end of quarter (see Figure 2.9).

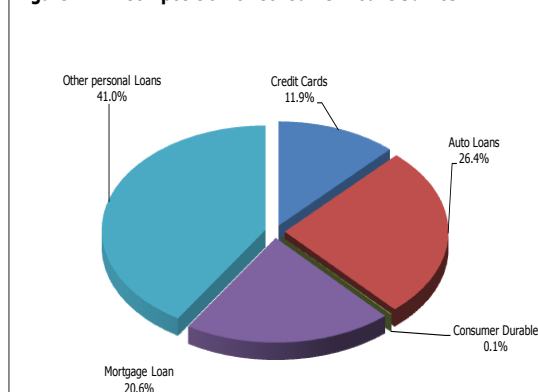
Table 2.2: Composition of Banks' Advances

	(in percent)					
	CY06	CY07	Jun-08	CY08	Mar-09	Jun-09
Public	8.1	7.6	8.0	10.8	11.0	17.4
Private	91.9	92.4	92.0	89.2	89.0	82.6

Advances (*net*) witnessed a substantial increase of Rs152 billion (5 percent) during Jun-09 quarter, that is markedly larger than Jun-08 quarter's growth of Rs112 billion. The current increase, however, came solely from lending to public sector for its commodity operations and PSEs, while the lending to private sector declined by 1.8 percent. Resultantly, the share of public sector lending in advance portfolio of the system increased significantly to 17.4 percent up from 11.0 percent in Mar-09 (see Table 2.2). A number of factors underlie this development; ongoing economic slowdown, social and political issues, and higher interest rates dampened the private sector's demand for bank credit. The deterioration in business environment and heightened credit risk in turn also increased the risk aversion on the part of banks. Therefore, banks mainly focused on lending to public sector, which had strong demand for bank credit to finance its commodity operations and large inter-corporation receivables. Segment wise analysis⁵ shows that growth in advances was largely

⁵ The following analysis of composition of advances and shift therein is based on the banks' domestic operations only.

Figure 2.11: Composition of Consumer Loans Jun-09



contributed by commodity finance loans, which accumulated to Rs399 billion from Rs225 billion in last quarter, constituting 98.1 percent of the increase in gross advances while all other sectors barring corporate sector witnessed decline. The borrowing of corporate sector also recorded slight increase of Rs24 billion during the quarter under review – an increase of Rs44 billion in lending to PSEs while private sector Corporations shed their banks borrowing by Rs20 billion. Resultantly, the composition of lending portfolio altered significantly during Jun-09. The share of commodity finance increased by 499 bps, reaching 12.4 percent in Jun-09. On the other hand, the share of all other sectors viz. SME and Consumer dropped appreciably (see Table 2.3).

Table 2.3: End-use of Advances (net)

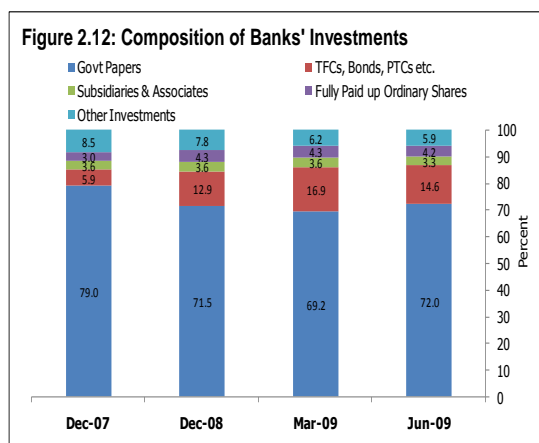
(amount in billion Rupees, share in percent)

	Dec-07		Dec-08		Mar-09		Jun-09	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Fixed Investment	609.2	22.6	738.1	23.1	731.7	24.0	766.9	23.8
Corporate Sector	549.0	20.3	694.2	21.7	691.1	22.7	727.9	22.6
SMEs	60.3	2.2	43.9	1.4	40.6	1.3	39.0	1.2
Trade Finance	415.9	15.4	480.6	15.1	459.6	15.1	474.1	14.7
Corporate Sector	348.0	12.9	438.3	13.7	420.3	13.8	435.8	13.5
SMEs	67.9	2.5	42.3	1.3	39.2	1.3	38.3	1.2
Working Capital*	1,231.6	45.6	1,562.9	49.0	1,461.8	48.0	1,596.0	49.5
Corporate Sector	623.2	23.1	883.3	27.7	817.1	26.8	788.9	24.5
SMEs	309.1	11.4	288.8	9.0	269.3	8.8	257.9	8.0
Agriculture	150.8	5.6	155.5	4.9	150.7	4.9	150.5	4.7
Commodity Financing	148.4	5.5	235.4	7.4	224.7	7.4	398.7	12.4
Consumer Finance	371.4	13.8	332.2	10.4	316.7	10.4	299.8	9.3
Credit Cards	46.8	1.7	40.7	1.3	37.8	1.2	35.8	1.1
Auto Loans	111.4	4.1	95.3	3.0	87.6	2.9	79.1	2.5
Consumer Durable	1.1	0.0	0.3	0.0	0.3	0.0	0.2	0.0
Mortgage Loan	67.4	2.5	66.9	2.1	64.6	2.1	61.7	1.9
Other personal Loans	144.7	5.4	128.8	4.0	126.4	4.1	123.0	3.8
Staff Loans	52.2	1.9	64.5	2.0	66.7	2.2	69.7	2.2
Housing Finance	36.8	1.4	46.7	1.5	47.7	1.6	50.2	1.6
Others	15.4	0.6	17.8	0.6	19.1	0.6	19.4	0.6
Others	20.6	0.8	13.5	0.4	11.9	0.4	19.5	0.6
Total	2,700.9	100	3,191.8	100	3,048.5	100	3,225.9	100

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

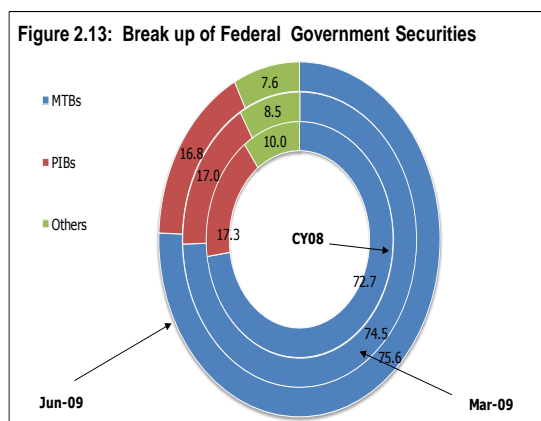
Analysis by end-use of advances reveals that except for consumer finance and staff loans categories, all end-uses of loans recorded significant rise (see Table 2.3). In *working capital finance* category, Commodity Finance mainly contributed increase while Corporate, SME and Agriculture reduced their working capital borrowings. Besides slackened aggregate demand, the decline in Corporate and SME sector's working capital loans is partially attributed to decline in global commodity prices and easing in WPI index indicating that businesses, in rupee terms, needs lesser inventories and working capital for supporting the same level of operations. The fixed investment and trade finance loans increased due to increase in demand from Corporate sector (both public and private) while SME sector's fixed investment and trade finance loans came off during the quarter under review, highlighting the fact that economic recession has more immediate impact on small scale businesses as compared to the corporate.

The **consumer finance** loans that have been declining since end of CY07, further declined by Rs16.9 billion (5.3 percent) in Jun-09 quarter (see Table 2.3). The breakup of consumer loans shows that the decline occurred in all categories of consumer loans. However, with slight changes in the relative share of these



categories during the quarter, there was no significant change in the composition of consumer loans. Precisely, the share of auto loans dropped by 129 bps whereas share of other personal loan increased by 115 bps (see Figure 2.11).

Investments, the second major component of the banks' asset base, grew by 8.5 percent (Rs110 billion) to Rs1,409 billion by the end of the quarter under review. In line with increased risk aversion among banks, investments in Government paper have been increasing since last quarter of CY08. The increase in Jun-09 was largely contributed by Government papers (Rs117.6 billion). Investment in Term Finance Certificates (TFCs) & Bonds decreased by Rs13.4 billion, while equity investments increased by Rs3.4 billion to Rs59 billion. Resultantly, the composition of investment further moved towards government papers against TFCs & Bonds and equity investments (see Figure 2.12).



The breakup of investment in government papers shows that investment in all three categories increased during Jun-09 quarter; however, bank maintained their preference for short-term papers, i.e. Market Treasury Bills (MTBs) which increased by 14.5 percent. Therefore, the relative share of MTBs increased vis-à-vis long-term PIBs and other investments (see Figure 2.13).

Going forward, economic slowdown and domestic security issues are likely to dampen the growth of the banking system. Low demand for bank credit from private sector, increased risk aversion on the part of banks, and public sector demand for bank credit will further shift asset mix away from advances to Government papers.

The latest statistics for the last week of Sep-09 also corroborate this assertion; there is marginal increase in assets and deposits base since Jun-09. Investments are showing strong increase of 11.4 percent in contrast to 1 percent decline in advances. However, with the

customary acceleration in economic activities in last quarter; private sector credit is likely to inch up. Nevertheless, banks' ability to lend private sector and further buildup earning asset will largely depend upon their ability to mobilize fresh savings. Therefore, they will have to step up their efforts for mobilizing deposits, which are again showing somewhat stagnancy in latest post quarter statistics.

3. Financial Soundness of the Banking System

3.1. Solvency⁶

Solvency position of the banking system witnessed improvement during the quarter under review, mainly due to decline in credit risk weighted assets (CRWA). The CAR of the banking system improved to 13.5 percent up by 0.6 percentage points (12.1 percent in Jun-08). However, weakening asset quality and potential loan losses continued to pose challenge for the solvency position (see Table 3.1.1⁷).

The qualifying risk-based capital (QRBC) increased by 4.1 percent to Rs553.8 billion in Jun-09. With this increase, the actual QRBC increased to almost 150 percent of the required (see Figure 3.1.1). The core capital, being the mainstay of banks' capital, rose by 4.6 percent. Resultantly, the quality of eligible capital witnessed a slight improvement as the share of core capital improved to 83.9 percent of QRBC (see Figure 3.1.2). Further analysis of the core capital shows that the shareholders' equity, which is its key component, increased by 3.5 percent in Jun-09 against a 1.2 percent decline in Mar-09 (15.9 percent increase on YoY basis). The increase is mainly attributed to the buildup of paid-up capital for meeting minimum capital requirement (MCR) and accumulation of retained earnings during the quarter.

Risk weighted assets, the other key solvency component; saw a marginal decline of 0.2 percent over the quarter (see Table 3.1.2). The decline mainly resulted from decrease in CRWA by 1.3 percent over the quarter, despite increase in advances portfolio by 5 percent. Incidentally, increase in advances came from commodity financing that carried zero risk weight. This growth coupled with decline in private sector advances reduced the CRWA in Jun-09. Market risk weighted assets (MRWA), which represent only 4.2 percent of RWA,

Table 3.1.1: Capital Adequacy Indicators

Percent	Basel-I				Basel-II			
	CY04	CY05	CY06	CY07	CY07	CY08	Mar-09*	Jun-09
CAR								
PSCBs	13.4	14.5	15.2	17.8	16.1	13.2	13.9	14.5
LPBs	10.1	10.6	12.7	12.7	11.8	12.1	12.7	13.3
FBs	17.4	16.4	15.0	13.5	14.6	21.8	22.4	23.7
CBs	11.4	11.9	13.3	13.7	12.8	12.7	13.3	14.0
SBs	(9.0)	(7.7)	(8.3)	(6.2)	(6.2)	(4.9)	(2.1)	(3.4)
All banks	10.5	11.3	12.7	13.2	12.3	12.3	12.9	13.5
Tier 1 Capital to RWA								
PSCBs	8.6	8.8	11.1	13.0	12.2	11.0	11.6	12.0
LPBs	7.5	8.3	10.4	10.5	9.9	10.2	10.7	11.2
FBs	17.1	16.1	14.3	12.9	14.0	21.3	21.9	23.1
CBs	8.6	9.1	10.8	11.1	10.5	10.8	11.3	11.8
SBs	(15.0)	(13.6)	(13.3)	(11.9)	(12.5)	(10.1)	(7.4)	(7.4)
All banks	7.6	8.3	10.0	10.5	10.0	10.2	10.8	11.3
Capital to Total Assets								
PSCBs	8.7	12.6	12.2	13.7	13.7	10.7	11.1	10.9
LPBs	6.5	7.0	9.2	10.2	10.2	10.0	10.3	10.2
FBs	8.9	9.5	10.1	11.2	11.2	14.5	14.4	14.8
CBs	7.2	8.4	9.9	10.9	10.9	10.3	10.6	10.5
SBs	(9.4)	(8.1)	(8.0)	(5.5)	(5.4)	(3.2)	(2.7)	(2.5)
All banks	6.7	7.9	9.4	10.5	10.5	10.0	10.3	10.2

Figure 3.1.1: Risk-Based Capital Position

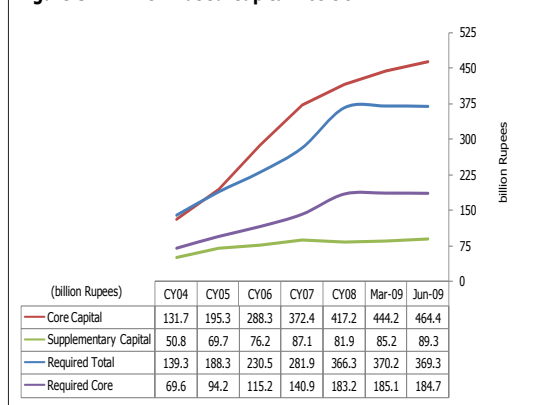
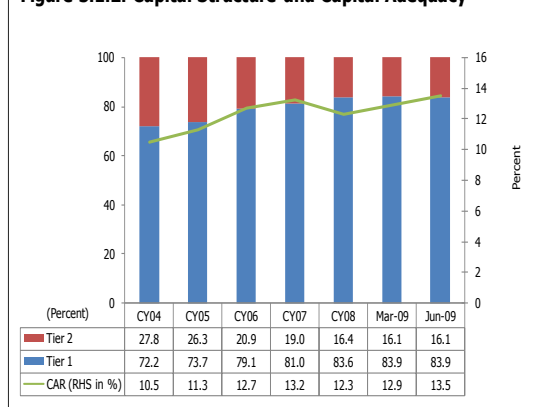


Figure 3.1.2: Capital Structure and Capital Adequacy

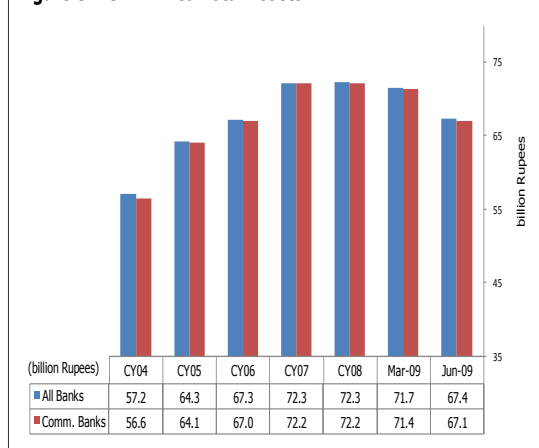
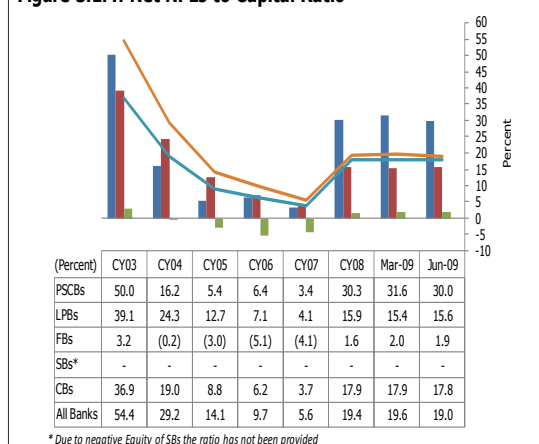


⁶ The above discussion is based on the CAR calculations on Basel-II framework. Except for three SBs which are reporting on Basel-I reporting formats, all other banks have reported on Basel II. These three banks hold 0.4 percent of the banking systems assets.

⁷ Table 3.1.1 compares capital adequacy indicators for CY07 on Basel-I and Basel-II basis.

Table 3.1.2: Risk Weighted Assets

(amount in billion Rupees, Share in percent)						
	CY08		Mar-09		Jun-09	
	Amount	Share	Amount	Share	Amount	Share
CRWA	3,459	85.0	3,441	83.7	3,397	82.8
MRWA	117	2.9	138	3.4	172	4.2
ORWA	494	12.1	534	13.0	535	13.0
Total RWA	4,070	100.0	4,113	100.0	4,104	100.0

Figure 3.1.3: RWA to Total Assets**Figure 3.1.4: Net NPLs to Capital Ratio****Table 3.1.3: Distribution of Banks by CAR**

	Total	Below 9%	9 to 10%	10 to 15 %	Over 15 %
CY04	38	1	13	9	15
CY05	39	2	7	13	17
CY06	39	3	4	15	17
CY07	39	3	6	12	18
CY08	40	4	5	10	21
Mar-09	40	4	1	13	22
Jun-09	40	6	1	12	21

* From December 31, 2008, banks are required to maintain minimum CAR of 9 percent

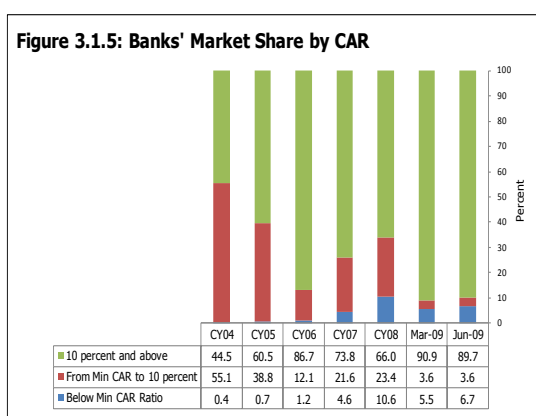
increased significantly by 24.6 percent in Jun-09. Increase in MRWA reflect increase in banks' position in rate sensitive assets and liabilities, equity holdings and foreign exchange exposure. However, operational risk weighted assets (ORWA) increased marginally by 0.1 percent over the last quarter (see Table 3.1.2).

Increase in eligible capital and decrease in RWA, led to improvement in solvency indicators. The CAR of the system improved to 13.5 percent from 12.9 percent in Mar-09, while the Core Capital to RWA increased to 11.3 percent (10.8 percent in Mar-09 and 10.2 percent in CY08). The capital to total assets ratio with slight decline of 0.1 percentage point to 10.2 percent in Jun-09, also remained in satisfactory ranges as compared to the past years' levels (6.7 percent in CY04). The improvement over the years reflects the increase in stake of owners that bode well for the overall solvency of the banking system (see Table 3.1.1). Further riskiness of the assets as represented by RWA to total assets also declined by 4.3 percentage point during the quarter (see Figure 3.1.3)

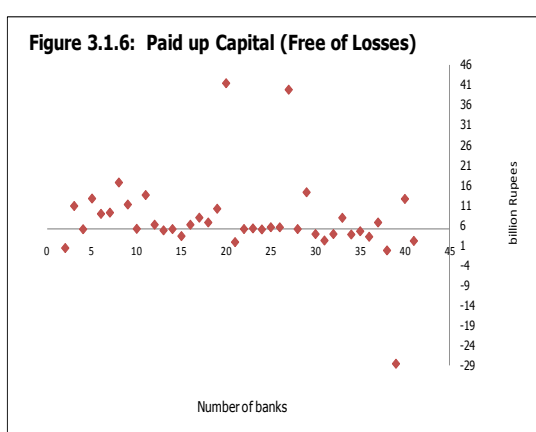
Group-wise position shows that CAR of all the groups increased except for SBs. The capital adequacy of PSCBs which declined to 13.2 percent in CY08 witnessed a healthy increase of 1.3 percentage points during the first half of CY09 following substantial capital injection in one of the PSCBs (see Table 3.1.1).

Due to deterioration in asset quality and inch up in credit risk, the risk to solvency has increased over the last few quarters. Net NPLs to Capital ratio, which indicate the fraction of banks' equity that could be impaired by loan losses, however improved during the quarter under review. The ratio had significantly deteriorated from 5.6 percent in CY07 to 19.6 percent in Mar-09. However, due to increase in provisioning coverage along with capital enhancement, the ratio marginally receded to 19.0 percent in Jun-09 (see Figure 3.1.4).

However, the disaggregated analysis indicates marginal decline in solvency position of the



banks; number of banks meeting minimum CAR of 9 percent decreased to 35 in Jun-09 from 36 to Mar-09 (see Table 3.1.3). The market share of the banks meeting CAR also decreased to 93.3 percent in Jun-09 (see Figure 3.1.5). Analysis of MCR shows that 31 banks including 5 foreign banks are fully compliant with the MCR (see Figure 3.1.6). Most of the remaining banks are in process of meeting the MCR, while 4 of these banks are under the process of restructuring/ privatization.



The quarter under review has been marked with re-strategizing the business portfolio and avoiding increased risk taking and ensuring liquidity and profitability. However, potential loan losses and provisioning due to weakening asset quality remains a risk to the solvency of the banking sector. Keeping in view the ongoing global financial and economic slowdown, SBP has rationalized the minimum paid up capital and risk-based capital requirements.⁸ Nevertheless, SBP's policy to enhance the solvency of the banking system has significantly strengthened the capital base of the banks and provided them with sufficient cushion to largely withstand, even unusual shocks in the ongoing scenario of global recession.

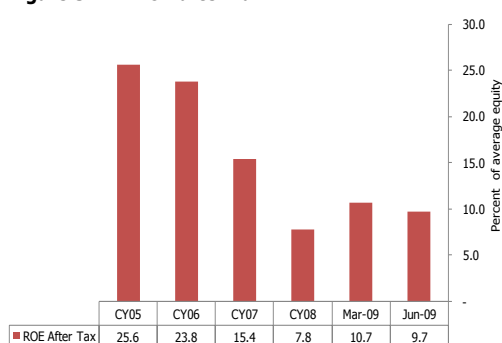
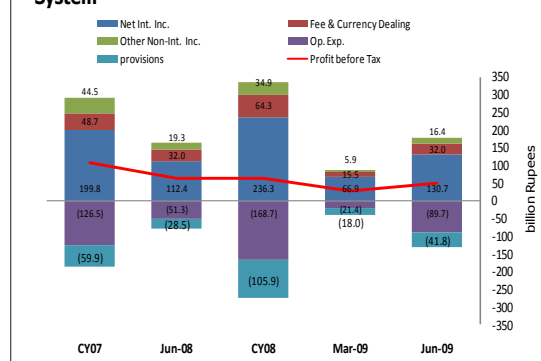
⁸ See BSD Circular No. 30 of 2008 and 7 of 2009.

Table 3.2.1: Profitability of Banking System

	(billion Rupees)							
	CY04	CY05	CY06	CY07	Jun-08	CY08	Mar-09	Jun-09
<i>Profit before tax</i>								
PSCBs	14.2	22.8	31.5	33.2	9.8	6.6	4.5	5.9
LPBs	31.0	60.5	85.6	69.5	47.0	52.5	19.8	39.7
FBs	7.2	11.6	6.3	2.4	2.1	0.0	0.6	0.5
CBs	52.4	94.9	123.5	105.2	59.0	59.0	24.9	46.0
SBs	(0.4)	(1.1)	0.1	1.7	2.4	4.2	1.3	1.7
All Banks	52.0	93.8	123.6	106.9	61.4	63.2	26.2	47.8
<i>Profit after tax</i>								
PSCBs	8.0	15.5	21.2	23.9	6.1	5.6	2.4	3.3
LPBs	21.8	41.1	59.1	47.3	36.5	34.7	12.3	24.4
FBs	5.8	8.0	4.3	1.1	1.0	0.6	0.2	0.1
CBs	35.6	64.6	84.6	72.2	43.6	41.0	14.9	27.9
SBs	(0.9)	(1.3)	(0.5)	0.9	2.4	2.3	0.9	0.8
All Banks	34.7	63.3	84.1	73.1	45.9	43.3	15.8	28.6

Table 3.2.2: Profitability Indicators

(in percent)							
	CY04	CY05	CY06	CY07	CY08	Mar-09	Jun-09
After Tax ROA							
PSCBs	1.3	2.2	2.7	2.5	0.5	0.9	0.6
LPBs	1.2	1.8	2.1	1.4	0.9	1.2	1.1
FBs	2.0	2.5	1.5	0.7	0.3	0.4	0.1
CBs	1.3	2.0	2.2	1.6	0.8	1.1	1.0
SBs	(0.8)	(1.2)	(0.4)	0.7	1.8	2.4	1.9
All Banks	1.2	1.9	2.1	1.5	0.8	1.1	1.0
After Tax ROE (based on Equity plus Surplus on Revaluation)							
PSCBs	17.2	20.9	21.7	19.5	4.4	7.8	5.3
LPBs	20.2	27.2	25.3	13.8	8.5	11.3	11.0
FBs	21.5	27.1	15.6	6.0	2.2	2.8	0.5
CBs	19.6	25.4	23.7	15.0	7.3	10.1	9.2
SBs	-	-	-	-	-	-	-
All Banks	20.3	25.8	24.2	15.4	7.8	10.7	9.7

Figure 3.2.1: ROE after Tax**Figure 3.2.2: Profit & Loss Composition of the Banking System**

3.2. Profitability

The banking system continued to post profit during first half of the CY09 though the level remained lower than the corresponding period of 2008. The system earned year to date PBT of Rs47.8 billion till Jun-09 (Rs61.4 billion in Jun-08). The dampening impact largely came from increased loan loss provisions, emanating from deteriorating credit quality of banks (see Figure Table 3.2.1).

Slow down in earning growth reflects in contraction in key earnings ratios. The ROA decreased by 11 bps to 1.0 percent. Similarly, after tax ROE declined by 100 bps to 9.7 percent (see Table 3.2.2 and Figure 3.2.1).

Group-wise analysis depicts that LPBs and PSCBs on aggregate basis registered increase in their earnings while FBs observed slight decline. However, YoY comparison shows a decline in profitability of all banking groups. The overall decrease in PBT of the banking system was 22.2 percent. However, higher increase in tax charges (23.4 percent) led to 37.6 percent drop in PAT (see Table 3.2.1). LPBs, with relatively better earning performance, observed a marginal decrease in earnings ratios; after tax ROA and ROE declines by 3 bps and 30 bps, respectively (see Table 3.2.2).

The disaggregated analysis of profit and loss shows that net interest income, which constitutes the dominant share of banks' income, grew at slightly slower pace during the quarter under review. However, it shows an increase of 16.3 percent when compared with results of corresponding period of last year (see Figure 3.2.2). As a result, its share in gross income increased by 4.3 percentage points to 73 percent. On the other hand, the share of non-interest income decreased to 27 percent from 31.3 percent in Jun-08 (see Figure 3.2.2).

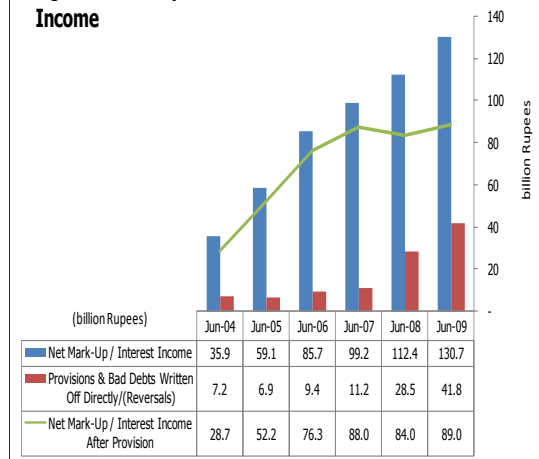
Composition of interest income reflects changes in the mix of earning assets. Due to higher growth in advances, their share in interest income have increased from 59 percent in CY03

Table 3.2.3: Mark-up / Return / Interest Earned

Items	Dec-03		Dec-07		Jun-08		Dec-08		Mar-09		Jun-09	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans & advances	67.2	58.9	273.8	71.3	158.4	72.7	359.0	74.2	108.4	73.8	210.7	72.3
Investments	40.9	35.9	80.6	21.0	44.3	20.3	92.7	19.1	30.4	20.7	65.3	22.4
Deposits, repo and others	5.9	5.2	29.8	7.7	15.3	7.0	32.4	6.7	8.1	5.5	15.6	5.3
Total	114.1	100	384.1	100	218.0	100	484.1	100	146.9	100	291.5	100

to 74 percent in CY08, while share of income from investment decreased from 36 percent to 19 percent. However, the trend has been reversing for the last couple of quarters; share of interest income from advances decreased to 72 percent and from investments increased to 22 percent (see Table 3.2.3), showing banks' increased risk averseness in the backdrop of economic slowdown.

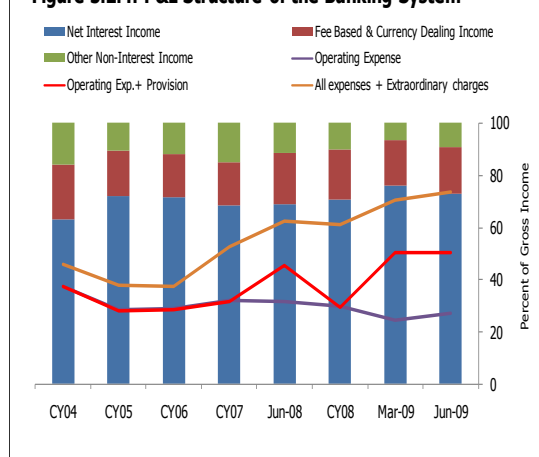
Figure 3.2.3: Impact of Provisions on Net Interest Income



Continuous increase in provisions, consumed the substantial portion of net interest income. Due to significant year to date provisioning charges of Rs41.7 billion (Rs28.5 billion in Jun-08), net interest income adjusted for loan loss provisioning shows only 6 percent increase over the corresponding period of last year (see Figure 3.2.3).

Keeping in view the healthy performance from CY05 to CY07, SBP gradually tightened the provisioning requirements for creating cushions to cope with any downturn in economic environment. Incidentally, in early 2009, due to worsening global economic outlook and stress in the major financial markets, SBP rationalized the provisioning requirements⁹. These amendments have somewhat buttressed the earnings of a number of banks. Similarly Securities and Exchange Commission of Pakistan (SECP), in the wake of unusual inactive market conditions in second half of 2008, adjusted the requirements for recognition of impairments, allowing deferment of impairment losses on AFS securities over the current¹⁰. Meanwhile, the capital markets started recovering, thereby decreasing the impairment losses. However, due to increasing NPLs, provisions for loan losses continue to increase (23.3 percent of the gross income) which affected the overall profitability.

Figure 3.2.4: P&L Structure of the Banking System



On the expense side, administrative expenses representing 49.3 percent (YoY growth of 5 percentage points) of the gross income remains the major user of the earnings. The

⁹ See BSD Circular No. 2 dated January 27, 2009 on Amendments in PR-Provisioning for loans and advances.

¹⁰ See BSD Circular No. 4 dated February 13, 2009 on Revaluation surplus / (Deficit).

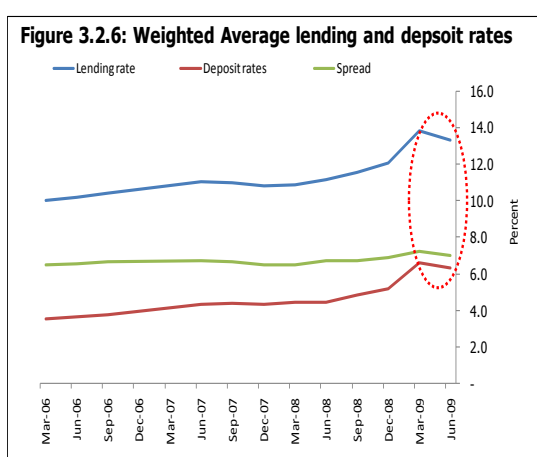
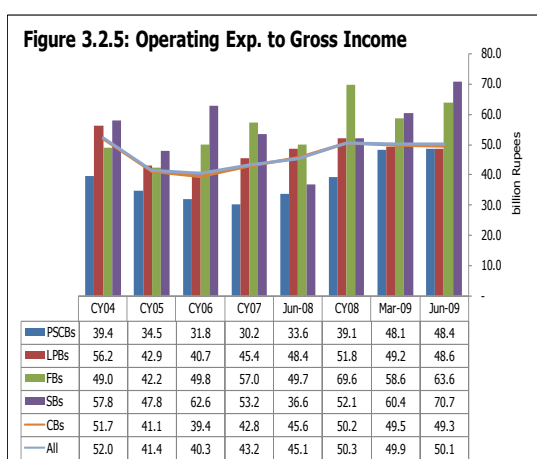


Table 3.2.4: Concentration of Earnings and Profitability

	(in percent)			
	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
ROA (After Tax)	1.9	1.4	1.3	1.0
ROE (After Tax)	18.8	15.0	12.4	9.7
Net Interest Income/ Gross Income	78.1	76.4	73.6	73.0
Income from Trading & Foreign Exchange / Gross Income	15.6	17.0	17.2	17.8
Non-Interest Expense / Gross Income	38.1	43.6	46.2	50.1

Table 3.2.5: Percentage Breakdown of Banking System's Total Assets (TA) by ROA

	CY05		CY06		CY07		Jun-08		CY08		Mar-09		Jun-09	
	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	No. of Banks	Share in TA
ROA														
0 and below	7	3.5	6	2.1	10	8.5	9	2.8	16	14.5	18	12.4	18	13.1
0 to 0.5	4	2.8	3	1.8	2	2.4	4	8.2	3	10.2	2	5.0	3	6.3
0.5 to 1	2	7	6	9.9	4	1.9	3	2.9	5	8.2	6	15.8	3	9.4
1.0 to 1.5	5	4	5	9.6	10	34.9	5	11.6	4	5.7	5	9.3	6	19.1
1.5 and Over	21	82.7	19	76.6	13	52.3	18	74.6	12	61.5	9	57.6	10	52.1

administrative expenses have remained high due to increase in operating overheads and IT related expenses. Provisions remains the second largest component of banks' expenses (see Figure 3.2.4).

Because of the stronger increase in operating expenses vis-à-vis growth in earnings since corresponding period of last year, the cost to income ratio deteriorated 50 percent compared to 45.1 percent in Jun-08. However, the ratio slightly improved for the commercial banks as LPBs witnessed a decline by 60 bps to 48.6 percent, while it increased for all other banking groups (see Figure 3.2.).

The quarter under review saw a 5 percent increase in advances, most of them for public sector commodity operations. Substantial increase in relatively low-return, risk free advances led to increase in interest income while decreasing the weighted average lending rate¹¹ (WALR) by 51 bps to 13.32 percent. Similarly, the weighted average deposit rates (WADR) also observed a decrease of 26 bps to 6.33 percent. The higher fall in WALR thus led to contraction in overall spread by 24 bps to 7 percent (see Figure 3.2.6).

Concentration analysis of earning shows that 5 big banks contribute the dominant share in profitability and augment the overall earnings of the system. Incidentally, their year to date earnings for the first half of the CY09 is more than the total earning of the system. These top five banks have ROA and ROE of 1.9 and 18.8 percent respectively against industry's average of 1 and 9.5 percent. All the earning ratios for the large five banks further reinforced their earning capabilities (see Table 3.2.4).

Trends in the breakdown of banking system assets by ROA (before tax) indicate variances in earning capacity of individual banks based on their size. Banks with ROA above one percent have increased from 14 to 16 and their market share has improved from 67 percent to 71

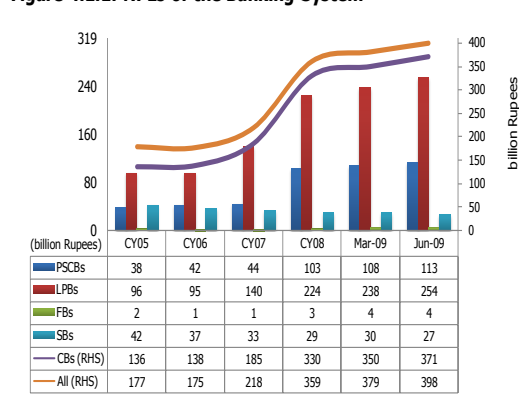
¹¹ The weighted average rates are based on the data on mark-up/interest income and expense on advances and customer deposits respectively reported in the QRC for March, 2008. In the previous reports, data on interest rate published in monthly statistical bulletin had been used.

percent. On the other hand number of banks with ROA below 1 percent decreased to 24 from 26 whereas their share in total banking sector assets has decreased by 4.4 percentage point to 28.8 percent during the quarter under review (see Table 3.2.5). These developments indicate that earning performance is concentrated towards larger and growing banks while the earning capacity of some smaller banks has been under stress.

4. Risk Assessment of the Banking System

4.1 Credit Risk

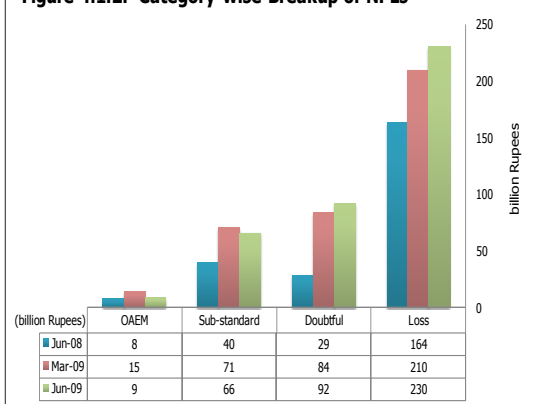
Figure 4.1.1: NPLs of the Banking System



The NPLs of the banking system increased by 4.9 percent to Rs398 billion during the quarter. Increase in NPLs is distributed across all banks, however, most of the increase came from top tier banks. Groupwise, PSCBs and LPBs contributed all the increase in NPLs of the system. Particularly, NPLs of LPBs increased by Rs16 billion, representing 76 percent of the total increase (see Figure 4.1.1). Increase in cash recovery and loan written-off have also to some extent restrained growth in NPLs.

The surge in NPLs was primarily in doubtful and loss categories. Decrease in NPLs in OAEM and substandard category show some let up in the influx of fresh NPLs, observed in last two quarters. A significant increase of Rs20 billion took place in loss category. As a result, share of NPLs in first three categories decreased by 3 percentage points to 42 percent, though still above 33 percent a year ago. With substantial amount of NPLs in substandard and doubtful categories (39.7 percent), banks still face a risk of additional loans losses and constrained earnings ahead (see Figure 4.1.2).

Figure 4.1.2: Category-wise Breakup of NPLs



With increase in NPLs and transition of NPLs into higher provisions classification categories, the provisions increased by Rs16.8 billion. This increase in provisions almost matched Rs18.6 billion increase in NPLs (see Figure 4.1.3). Further analysis show change in share pattern of general and specific provisions. Banks held 84 percent and 16 percent specific and general provisions respectively in Dec-07, which came down to 93 and 7 percent in Jun-09. The decline in general provisions seems to have resulted from higher specific provisioning requirements and utilization of some of the general provisions to provide for specific provision over the last two years. Further, the decrease in consumer portfolio, which involves

Figure 4.1.3: Provisions of the Banking System

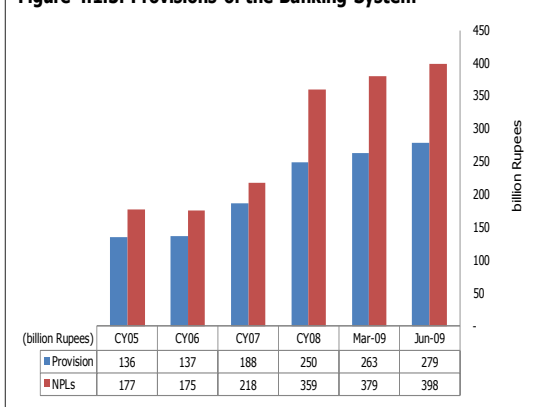
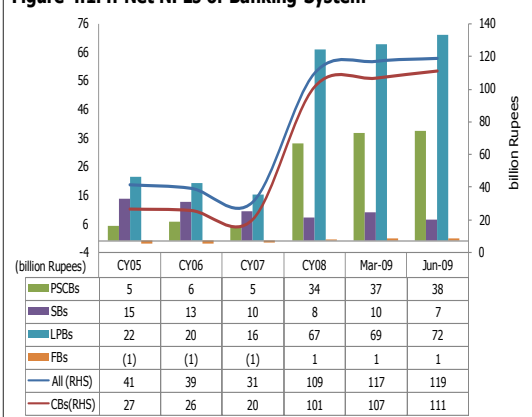


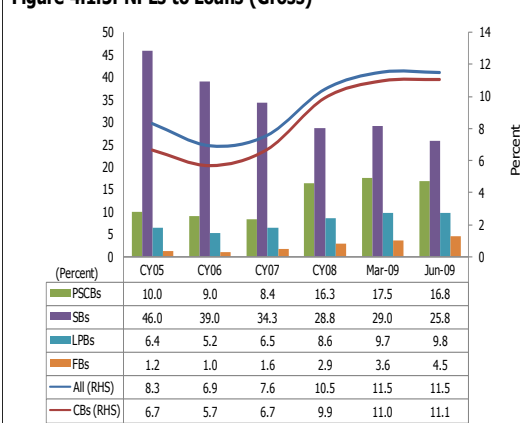
Figure 4.1.4: Net NPLs of Banking System



mandatory general provision, has also reduced the general provisions¹².

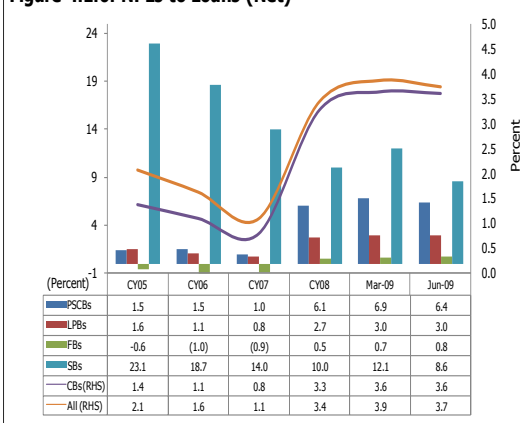
Improved provisions, which almost matched increase in NPLs, led to a marginal increase of 2 percent in net NPLs (48 percent increase in Mar-09). Conservative approach of the banks towards utilization of FSV benefit¹³ has decelerated growth of net NPLs; a number of banks are either not taking any benefit or utilizing partial FSV benefit. Further, up gradation of some NPLs to performing status has limited the increase in net NPLs (see Figure 4.1.4).

Figure 4.1.5: NPLs to Loans (Gross)



Increase in advances, deceleration in NPLs and compatible growth in loan loss provisions, marginally improved the asset quality indicators. NPLs to Loan ratio of the banking system remained at previous quarter's level. The ratio increase for LPBs by only 10 bps to 9.8 percent, while it increased by 90 bps for foreign banks (see Figure 4.1.5). Due to the factors highlighted earlier, NPLs to loans ratio (net) witnessed over the quarter declined of 13 bps to 3.7 percent. The ratio increased for FBs by 7 bps, remained at previous quarter's level for LPBs and decreased for rest of the banking groups (see Figure 4.1.6).

Figure 4.1.6: NPLs to Loans (Net)



As increase in provisions largely offset the increase in NPLs which improved the NPLs coverage ratio to 70 percent in Jun-09 (see Figure 4.1.7). Encouragingly, provisions to NPLs increased after showing decline for last 5 quarters (see Figure 4.1.7). Minor increase in net NPLs and improved capital position of the banks have also improved the capital impairment ratio; the ratio declined by 60 bps to 19 percent in Jun-09 (Annexure-II).

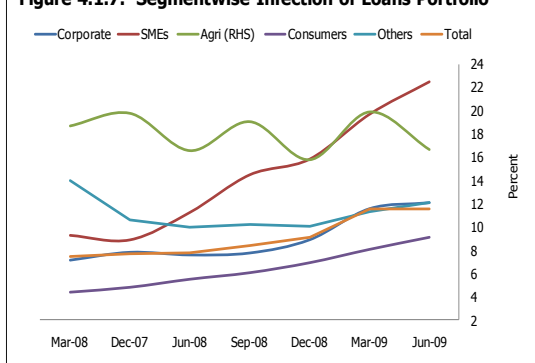
Overall trend in asset quality is observable in Segment analysis of NPLs (see Table 4.1.1). Increase in infection ratio has subsided for almost all segments while decreasing for a

¹² Prudential Regulations for Consumer Finance require maintaining general reserve of 1.5% of the secured consumer portfolio and 5% of the unsecured consumer portfolio.

¹³ Banks were allowed vide BSD Circular No. 02 of January 27, 2009 to avail the benefit of 30 percent of FSV of pledged stocks and mortgaged commercial and residential properties held as collateral against all NPLs for three years from the date of classification for calculating provisioning requirement w.e.f. 31-12-2008.

Table 4.1.1: Segmentwise Infection of Loans Portfolio

Sector	All Banks		Share in total loans (%)
	Mar-09	Jun-09	Jun-09
Corporate	11.5	12.1	60.3
SMEs	19.6	22.4	10.0
Agriculture	19.9	16.6	4.4
Consumers	8.1	9.1	9.5
Credit Cards	7.0	7.7	1.1
Auto Loans	6.2	6.6	2.3
Consumer Durables	10.2	7.8	0.0
Mortgage Loans	9.0	11.9	2.2
Others	9.1	9.5	3.8
Commodity Finance	1.5	1.0	11.5
Staff Loans	1.1	1.1	2.0
Others	11.3	12.1	2.3
Total	11.5	11.5	100.0

Figure 4.1.7: Segmentwise Infection of Loans Portfolio**Table 4.1.2: Sectorwise Infection of Loans Portfolio**

(in percent)	NPLs to loans		Share in	
	Mar-09	Jun-09	NPLs	Loans
Chemical & Pharmaceuticals	7.8	8.3	2.4	3.4
Agribusiness	11.6	7.3	3.6	5.8
Textile	17.9	18.8	28.7	17.6
Cement	9.2	11.4	2.5	2.5
Sugar	9.6	10.2	2.0	2.2
Shoes & Leather garments	8.7	11.7	0.7	0.7
Auto & Transportation	14.3	17.6	3.4	2.2
Financial	8.7	12.5	1.7	1.6
Insurance	0.6	0.1	0.0	0.0
Elec. & transmission of energy	6.5	8.2	7.1	10.0
Individuals	9.5	9.9	11.1	13.0
Others	11.0	10.3	36.8	41.0
Total	11.5	11.5	100.0	100.0

Table 4.1.3: NPLs to Loans by End Use

	(in percent)			
	Sep-08	Dec-08	Mar-09	Jun-09
Fixed Investment	10.8	12.7	13.5	13.9
Working Capital	8.6	8.7	11.7	11.5
Trade Finance	6.4	7.2	11.7	10.6
Others	6.1	6.7	7.6	8.5
Total	8.4	9.1	11.5	11.5

Table 4.1.4: Concentration-NPLs/Loans

	(in percent)					
	CY04	CY05	CY06	CY07	CY08	Mar-09 Jun-09
Top 5 Banks	11.5	8.2	6.8	6.8	9.0	10.2 10.3
Top 10 Banks	13.3	7.6	6.0	6.9	9.6	10.8 10.8
Top 20 Banks	11.0	7.6	6.2	6.7	10.1	11.2 11.2
Industry	11.6	8.3	6.9	7.2	10.5	11.5 11.5

couple. Corporate sector, which lost its share in advances, contributed 70 percent of the overall increase in NPLs. SME sector on the other hand is not only losing share in loan portfolio, both in absolute and percentage terms, but also increasing its NPLs; infection ratio of SMEs reached alarming levels of 22.4 percent (19.6 percent in Mar-09). Commodity finance and agriculture saw decline in infection ratios. Decline in agriculture is as per the past trend (see Table 4.1.1 & Figure 4.1.7). NPLs of Commodity Finance increased in absolute terms, however, unprecedented growth in commodity finance (77 percent) during the quarter reduced the infection ratio.

Consumer finance portfolio continues to worsen while losing weight in overall loan portfolio. The infection ratio of consumer finance portfolio increased by 40 bps to 9.5 over the quarter. Major deterioration occurred in mortgage loans where the NPLs increased to 11.5 percent of the mortgage loans. Further, the credit card portfolio remained under stress increasing its infected portion to 7.7 percent (7 percent in Mar-09).

Sector analysis of credit risk shows increasing trend for most sectors. Textile sector, the largest sector by share in loans, continues to show slow down; its share in overall advances decreased while NPLs increased by 6.2 percent over the last one year (see Table 4.1.2). NPLs of Electronics and Transmission of Energy, which represent 10 percent of the total loan portfolio, has jumped by 1.7 percent over the quarter. Only agribusiness saw decrease in NPLs, that also due to seasonal factors. As businesses are being affected by economic circumstances, banks are rescheduling/ restructuring both NPLs as well as their regular loans, keeping in view their financial feasibility and cash flow generation capacity.

NPLs, by end use of loans show a continuous increase in infection of fixed investment, an unhealthy trend for capital formation. Overall loan infection ratio for working capital decreased by 20 bps in Jun-09. However, it increased for corporate and SME sectors. Later

Table 4.1.5: Credit shocks

		Number of Banks with CAR		
		< 0%	0% - 9%	>9%
Pre-Shock		2	4	34
Post-Shock				
C-1	15% of performing loans moving to substandard, 15% of substandard to doubtful, 25% doubtful to loss	3	7	30
C-2	Tightening of loan classification i.e. all NPLs under OAEM require 25% provisioning, all NPLs under substandard require 50% and all NPLs in doubtful category require 100% provisioning.	3	5	32
C-3	Deterioration of loans to the textile sector (25%) directly downgraded to doubtful category	2	7	31
C-4	25% of consumer loans (auto loans, personal loans & consumer durables only) classified into doubtful category.	2	5	33

Table 4.1.6: Credit shocks-impact on CAR

Shock	Impact of Shocks	
	%point change in CAR after shock	Adjusted CAR after shock
Credit Shock C-1	(2.28)	11.20
Credit Shock C-2	(1.39)	12.10
Credit Shock C-3	(1.32)	12.10
Credit Shock C-4	(0.61)	12.90

trend is not encouraging as it shows slackness in turnover of inventories and receivables, in the wake of general slowdown in business activities (see Table 4.1.3).

Concentration analysis of NPLs to loans by size of banks depicts a changing trend over the years. Up till CY05 infection ratio for top 5 banks was comparable with the overall ratio of the banking system. During the last five years, infection ratio for top 5 banks has remained well below the industry average, mainly due to change in ownership structure and consolidation in the banking system. The ratio is marginally above the industry average for top 20 banks. The analysis also depicts that middle small sized banks have higher infection ratio than the large size banks and are impacting the overall ratio of the system (see Table 4.1.4).

In order to assess the resilience of the banking system to adverse movements in credit risk factors, lending portfolio has been stress tested for four different types of shocks (see Table 4.1.5 & 4.1.6).

Various credit shocks will reduce the CAR of the system from 61 bps to 228 bps. Movement of NPLs from lower to higher classification category under shock C-1 will be having the most adverse impact on the CAR of the system, as 4 more banks become non-compliant with the minimum CAR and one bank turns insolvent. The consumer shock C-4 will least impact the CAR and the impact is decreasing with every passing quarter (0.71 percent in Mar-09). The diminishing impact is resulting from continuous decline in consumer portfolio. For similar reasons, the impact of the textile sector specific shock C-3 has also declined over the quarter; 139 bps decline in CAR in Jun-09 against 171 bps decline in Mar-09 (see Table 4.1.6). With marginal improvement in credit risk indicators during the quarter, the results of Macro Stress Testing of Credit Risk shows that NPL to loans ratio for Sep-09 is projected to increase by only 52 bps from 11.52 in Jun-09 (see Special Section: Macro-stress Testing of Credit Risk).

Impact analysis of various stress shocks again confirms the sufficient resilience of the banking system. Given the slowdown in economy and business environment, banks need to rationalize their concentration profile and strengthen the vigilance of their large exposures. Despite enough resilience, potential for further increase in credit risk remains, in the wake of the adverse movements in financial as well as economic factors.

Special Section 1: Macroeconomic Stress Testing of Credit Risk

Figure SS 1.1: Macroeconomic Indicators

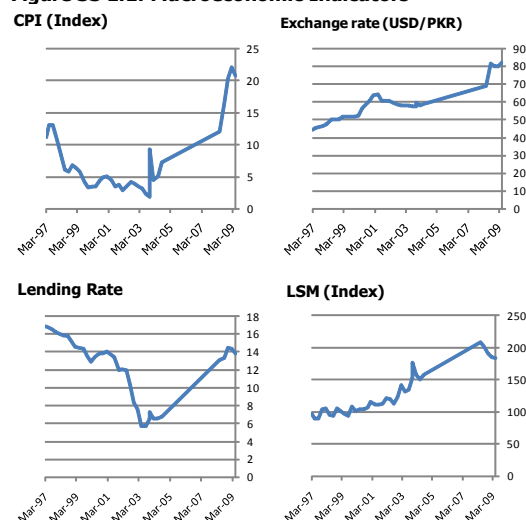
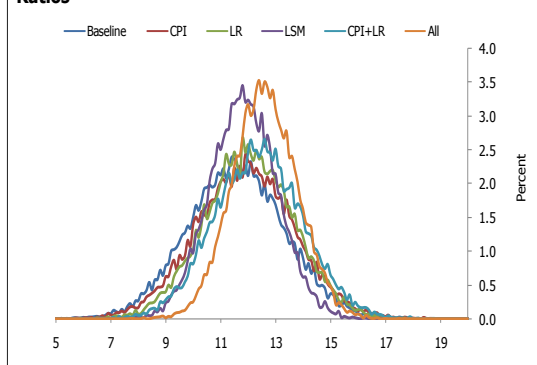


Table SS 1.1: Simulated NPL Ratios

	(in percent)			
	Baseline	CPI	LR	LSM
Average	12.04	12.41	12.44	12.31
75 Percentile	12.93	13.27	13.36	13.1
90 Percentile	13.73	14.03	14.19	13.78
95 Percentile	14.21	14.48	14.68	14.23
99 Percentile	15.11	15.34	15.71	15.01
99.5 Percentile	15.45	15.65	16.06	15.22

Figure SS 1.2: Probability Distribution of Simulated NPL Ratios



Macroeconomic stress testing is based on the assumption that the performance of macroeconomic variables impacts the NPL ratio (NPLR) of the banking system. In this regard, the Credit Portfolio View (CPV) model is employed¹⁴. The salient feature of the macroeconomic modeling exercise, using the CPV conducted for Sep-09 period is the inclusion of Large Scale Manufacturing (LSM) data in place of the constructed GDP series. The inclusion of the LSM data changes the significance of macroeconomic variables. For instance, the exchange rate variable also becomes significant which was not in earlier exercises¹⁵ (see Figure SS 1.1).

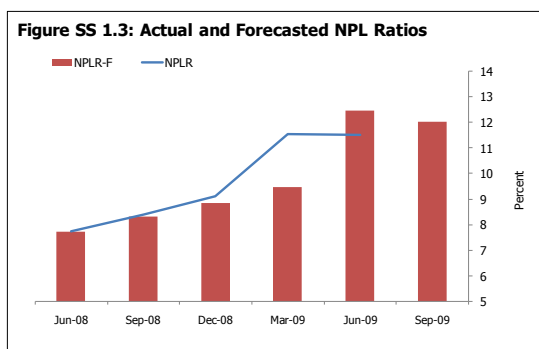
The Monte Carlo simulated NPLR for Sep-09 using the data for Mar-1997 to Jun-09 is forecasted at 12.04 percent. In case of unexpected events, the baseline (No Shock) scenario, there is 1 percent probability that the NPLR may increase beyond 15.11 percent and 0.5 percent probability that it may exceed 15.45 percent. Similarly, if the lending rate (LR) shock is applied on historical worst case scenario, the NPLR may exceed 16.06 percent with 0.5 percent probability (see Table 01).

The probability distribution of the simulations under various scenarios presents a clear deviation of the NPLR ratios from the baseline scenario. In case of shocks applied to all the macroeconomic variables, the distribution is significantly away from the baseline case (see Figure SS 1.2).

Comparison of actual NPLR with forecasted NPLR over the last six quarters shows that forecasts were close to the actual observed ratios. However, there has been a significant deviation in year CY09, primarily due to

¹⁴ The reasons for using the CPV model are (a) easiness of implementation and (b) its worldwide acceptability among financial supervisory authorities.

¹⁵ See QPRs for the period Sep-08, Dec-08 and Mar-08.



abnormal recognition of NPLs by some leading banks during Mar-09, which leads to projected value of NPLR for Jun-09. With actual value for Jun-09 below the forecasted value, the projected ratio for Sep-09 shows a moderate increase to 12.04 percent (see Figure SS 1.3).

Box SS 2.1

Core Principles for Effective Banking Supervision:

Principle 11: Exposures to related parties

In order to prevent abuses arising from exposures (both on-balance sheet and off-balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.

Essential criteria

1. Laws or regulations explicitly provide, or the supervisor has the power to provide, a comprehensive definition of "related parties". This should consider the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
2. Laws, regulations or the supervisor require that exposures to related parties may not be granted on more favorable terms (i.e. for credit assessment, tenor, interest rates, amortization schedules, requirement for collateral) than corresponding exposures to non-related counterparties.²⁶
3. The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process.
4. The supervisor requires that banks have policies and processes in place to prevent persons benefiting from the exposure and/or persons related to such a person from being part of the process of granting and managing the exposure.
5. Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties those are at least as strict as those for single counterparties, or groups of connected counterparties.
6. The supervisor requires banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures, and to monitor and report on them through an independent credit review process. The supervisor confirms that exceptions to policies, processes and limits are reported to the appropriate level of senior management and, if necessary, to the Board, for timely action. The supervisor also confirms that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
7. The supervisor obtains and reviews information on aggregate exposures to related parties.

Special Section 2: Related Party Dealings

Importance of related party transactions has been recognized globally. These transactions significantly influence risk profiles of financial institution and involve a number of corporate governance challenges. Therefore, related party regulations have become important aspect of corporate laws and prudential standards issued by financial sector regulators. The issue has gained more prominence with the emergence of financial conglomerates.

The conglomerate structures have enabled the groups to explore the potential synergies and benefit the economies of scale and scope. However, these structures have posed corporate governance challenges of ensuring equitable treatment for all the stakeholders and safeguarding of stability and interests of depositors of deposit taking institutions. Further, these structures create additional challenges for the regulators in determining the patterns of controls over regulated entity and their main beneficiary.

Related party transactions, when not accompanied by adequate governance, could affect the financial position and performance of the banks. It poses a number of risks; credit risk is the most significant. Others include the collapse of good corporate governance processes and controls; the failures of Boards to perform their fiduciary responsibilities, use of financial institutions as captive sources of finance, and the failure to correct deficiencies noted by supervisors. The stressful economic shocks usually have serve impact on the connected parties, which increase and exacerbate the risk associated with banking exposure to the group/conglomerate. Episodes of financial collapse history also show how related party exposures and dealing have brought about failures in the banking business.

International initiatives

A number of key initiatives have been taken internationally for standardization of the regulatory practices on Related Party dealings. The Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision include Principle 11 on "Exposure to related parties". The principle aims at preventing abuse arising from exposure to related parties and require the banking supervisors to put in place requirements for arm's length dealing between banks and their related companies and individuals, that such extensions of credit are effectively monitored and that other appropriate steps are taken to control or mitigate risks; and that write-offs of such exposures are made according to standard policies and processes. The principal require definition of, limits for and disclosure of dealing with connected parties.

In addition, IFRS specifies International Accounting Standard 24 on related party disclosures, The Principles of Credit Risk Management issued by BIS emphasize on establishing credit limits for group of connected parties) and the Principles for enhancing Corporate Governance for Banks emphasize avoiding conflict of interest in dealing with the connected parties.

The regulatory bodies, keeping in view the importance of the issue, have specified legal and regulatory framework for addressing the related party issues. In line with the core principles, many regulatory authorities have prescribed exposure limits for the lending to the parties connected to the lending bank. A survey of concentration limits¹⁶ show that lending to related parties or controlling interests is permitted, subject to limits. Some jurisdictions have set stricter single borrower related party limits, while others have set them at the level of general requirements; some jurisdictions have

¹⁶ Is financial stability policy now better placed to prevent systemic banking crises? Agustin Villar: BIS paper no. 28.

Box SS 2.2

Section 24 of Banking Companies Ordinance, 1962

24. Restrictions on loans and advances.—(1) No banking company shall—

- (a) make any loans or advances against the security of its own shares; or
- (b) grant unsecured loans or advances to, or make loans and advances on the guarantee of,—
 - i. any of its directors;
 - ii. any of the family members of any of its directors;
 - iii. any firm or private company in which the banking company or any of the persons referred to in sub-clause (i) or sub-clause (ii) is Interested as director, proprietor or partner; or
 - iv. Any public limited company in which the banking company or any of the persons as aforesaid is substantially interested.

(2) No banking company shall make loans or advances to any of its directors or to individuals, firms or companies in which it or any of its directors is interested as partner, director or guarantor, as the case may be, without the approval of the majority of the directors of that banking company, excluding the director concerned.

completely barred lending to related parties, while others have forbidden only unsecured facilities to related parties.

Related party dealings-Banking Sector of Pakistan.

State Bank of Pakistan has specified various concentration limits for taking exposure against the borrowers through its Prudential Regulations like single party exposure, group exposure and maximum exposure to a party. These limits are equally applicable for related party dealing. Further section 24 of the Banking Companies Ordinance, 1962 and Regulation G-4 of the Prudential Regulations for Corporate/Commercial emphasize arms length dealing with the related parties.

Banks/DFIs are specifically barred from providing unsecured loan or making loan on the guarantee of directors of the banking company, their family members or company related thereof or such persons who either individually or in concert with family members, beneficially own 5 percent or more of the equity of the bank/DFI.

SBP also requires banks to make disclosures as per IFRS on prescribed formats¹⁷. Particularly, the note 43 of the format for Annual Audited Accounts prescribed by SBP requires disclosure on:

- Investments in subsidiaries and associated concerns;
- Outstanding Advances to
 - Directors, executives or officers of the bank or any of them either severally or jointly with any other persons,
 - Companies or firms in which the directors of the bank are interested as directors, partners or in the case

¹⁷ BSD circular No. 4 of 2006.

- of private companies as members;
and
- Subsidiary companies, controlled firms, managed modarabas and other related parties.

The disclosure requires banks to disclose related party relationships where control or significant influence exists, irrespective of whether transactions have taken place among the parties. If there is any transaction with the banks related party, among others, it is necessary to disclose the nature, type and amount of transaction and any default and provisioning thereof.

Review of the Audited Annual Accounts of the Pakistani Banks for the year ended 2008 shows that most of the banks provide information on investment in their subsidiaries and associates. All the banks disclose outstanding loans and advances to related parties. Most of the banks provide information on transactions with related parties under a separate head "Related Party Transactions" in addition to above information. The coverage includes information on advances, deposits and transactions influencing P&L of the bank.

Analysis of Related Party Lending:

Table SS 2.1: Related Party Lending (RPL) analysis

	(billion Rupees)			
	Sep-08	Dec-08	Mar-09	Jun-09
Total RPL	42.5	52.5	46.9	47.2
Growth rate %	(2.0)	23.5	(10.7)	0.6
Performing RPL	42.5	52.5	46.8	47.1
Performing RPL to total RPL %	99.8	99.9	99.8	99.8
Non- Performing RPL (NPRPL)	0.05	0.05	0.07	0.07
NPRPL to total RPL %	0.15	0.12	0.16	0.15
Maximum disbursement (MD)	28.3	41.0	29.0	30.9
MD to RPL %	84.4	95.4	76.9	81.3
RPL to total loans %	1.29	1.53	1.43	1.37

The analysis of related party lending¹⁸ confirms absence of any significant preference among banks for transacting with related parties. The related party loans (RPLs) during the last four quarters have hovered around Rs50 billion (see Table SS 2.1). Related party loans are about 1.5 percent of the total loans, with 99.9 percent in performing status. Further, the frequency of settlement and turnover of the RPLs are quite high; around 80 percent of the RPL were disbursed and settled during each quarter. This shows that these are being secured for meeting the short-term working capital needs of the related parties. The low volumes of RPLs and frequent adjustments represent arms length

¹⁸ Quarterly report of conditions-unaudited figures.

Table SS 2.2: Related Party Lending (RPL)

	(billion Rupees)							
	Sep-08		Dec-08		Mar-09		Jun-09	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Directors, executives or officers	21.8	51.2	22.0	41.8	22.6	48.2	22.4	47.5
Companies or firms in which the directors of the bank are interested	10.8	25.4	6.5	12.4	4.2	8.9	6.1	13.0
Subsidiary companies and other related parties	9.9	23.3	24.1	45.8	20.1	42.9	18.6	39.5
Total	42.5	100	52.5	100	46.9	100	47.2	100

dealings and minimal influence of related parties in their dealings with the banks.

The analysis of lending show that majority share of the lending has gone to directors, executives or officers while share of lending to companies or firms in which the directors of the bank are interested has the smallest share (see Table SS 2.2), which again confirms the absence preference in dealing with related parties.

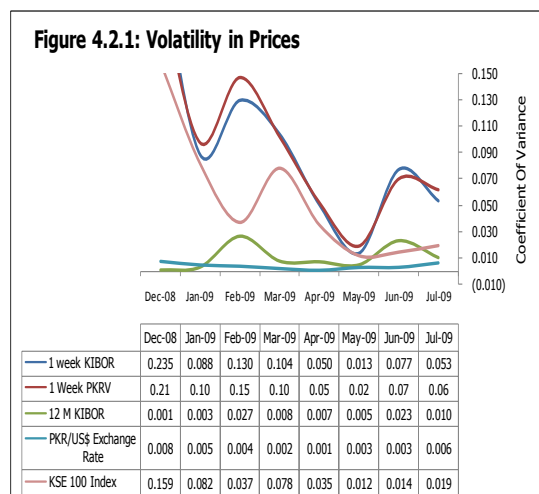
The above review shows that the existing related party framework is quite comprehensive and conforms to the internationally accepted best practices and standards on related party transactions.

References:

- i. Annual Audited Accounts of banks for the year ended 2008.
- ii. Banking Companies Ordinance, 1962.
- iii. Core Principles for Effective Banking Supervision and Core Principles Methodology, November, 2006-BIS.
- iv. International Financial Reporting Standards-International Accounting Standard 24.
- v. Is financial stability policy now better placed to prevent systemic banking crises? Agustin Villar: BIS paper no. 28.
- vi. Principles for Management of Credit Risk, Basel Committee on Banking Supervision, September 2000.
- vii. Quarterly Report of Condition submitted by banks-Sep-08 to Jun-09.
- viii. Regulations for Financing to Brokers by Banks/DFIs-BPD Circular No. 22 dated the 3rd July, 2004.
- ix. Revised forms of Annual Financial Statements BSD circular No. 4 of February 17, 2006.

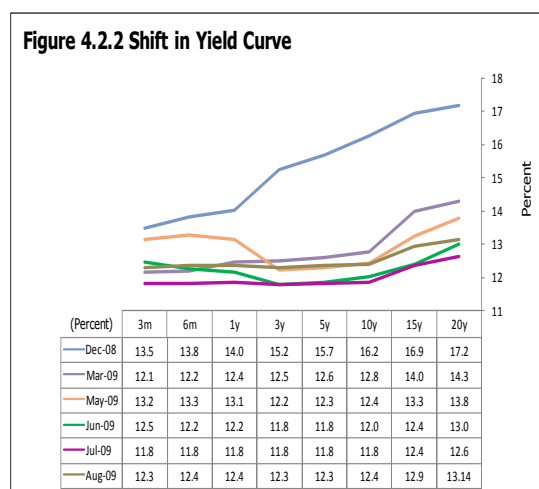
4.2 Market Risk

Figure 4.2.1: Volatility in Prices



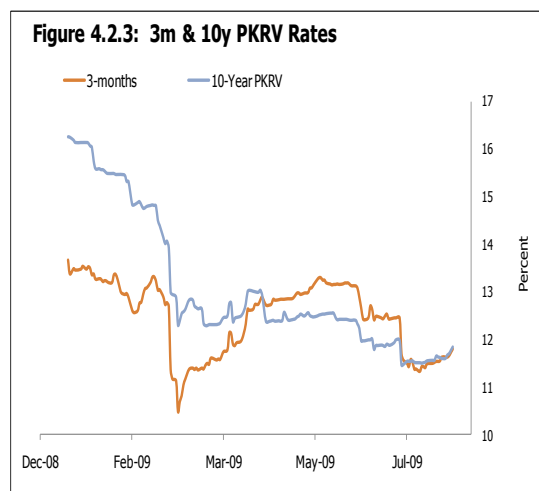
The market prices of financial assets tended to stabilize during the quarter under review. The volatility in overnight interest rates, exchange rates, and stock market index that was quite high in the last couple of quarters lowered significantly (see Figure 4.2.1). In recent quarters, a significant volatility in short term overnight interest rates had posed a significant challenge for both policy makers as well as the market. While SBP actively managed the interbank liquidity during the quarter under review, the recently introduced Interest Rate Corridor will help in stabilizing the short-term interest rates as well as the development of yield curve.

Figure 4.2.2 Shift in Yield Curve



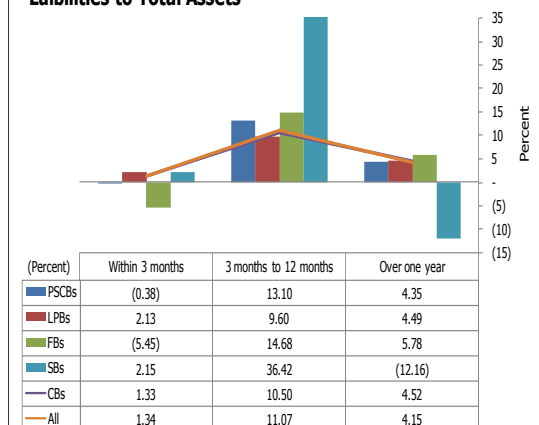
Interest rate risk, which signifies the change in value of net worth and earnings due to interest rates movements, constitutes the major component of banks' overall market risk. The interest rate risk, however, remained subdued during Jun-09. In line with improvement in banking system's liquidity profile and decline in inflation statistics, the yield curve continued to shift downward. Of late, it also straightened and normalized in near time spans, after experiencing inverted yields in April-June 2009 (see Figure 4.2.2). Similarly, the PKRV rates for 3 months tenor that rose in the first two months of the quarter under review and surpassed the longer term rates, started to decline in last month and converged to the 10 years rates by the end of July-09 (see Figure 4.2.3).

Figure 4.2.3: 3m & 10y PKRV Rates



The presence of significant re-pricing GAPS in a volatile rate scenario substantially influences the interest rate risk. The GAP position of banks however remained within comfortable ranges. For the time span of up to 3 months, 3 to 12 months and over one year time buckets, re-pricing GAPS remain within or close to the generally accepted range of ± 10 percent of total assets. All the groups barring SBs on aggregate basis also maintained more or less

Figure 4.2.4 GAP between Rate Sensitive Assets and Liabilities to Total Assets



well-contained risk positions. Though PSCBs and FBs carry slightly excess GAPs to the tune of around 13 to 15 percent of total assets in 3 months to 1 year time bucket, due to shorter duration of the tenor, these GAPs are likely to have only a limited impact on market value of equity in case of adverse movements in interest rates. The SBs unusually high re-pricing GAP in itself was created due to the significant negative equity of one specialized bank that has been covered through rate sensitive liabilities (see Figure 4.2.4).

On the Exchange Rate risk front, there has been a gradual depreciation in exchange rate since mid of last year. The announcement of IMF package and balance of payment support however kept the USD/PKR exchange rate sustainable and PKR with slight depreciation stood at Rs81.5 to a \$ as on June 30, 2009 (see Figure 4.2.5). In post quarter weeks rupee-dollar parity moved to around Rs83.3 by the end of July; however, by the third week of August, it improved to Rs82.7. Banks have effectively responded to this exchange rate scenario by keeping their NOP positions long (see Figures 4.2.6 & 4.2.7). Thus the slight depreciation in exchange rate overall had a positive effect on the earnings of the banks. Nevertheless, due to regulatory limit on the exposure which banks can take on foreign currencies and banks' general risk aversiveness the exchange risk of the system remains passive.

Figure 4.2.5 Exchange Rate and Swap Point

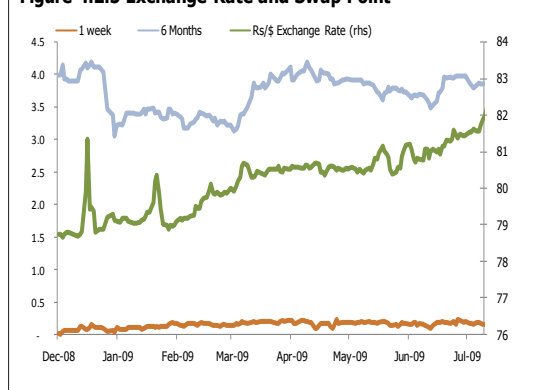
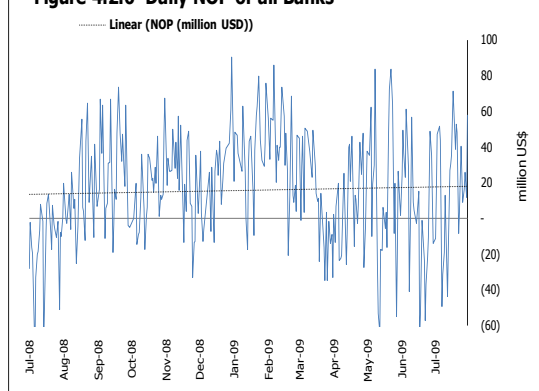
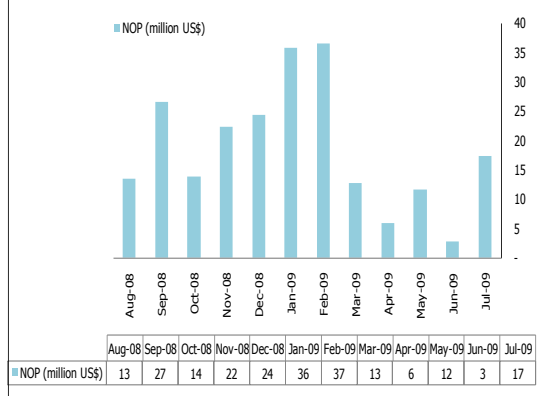


Figure 4.2.6 Daily NOP of all Banks



Equity price risk of banks primarily emanates from their exposure in equity stocks and market. Capital market maintained the pattern of recovery during the quarter under review as KSE-100 Index with muted volatility surged by 4.4 percent to 7,162 end Jun-09 thus enlivening the investor confidence. Accordingly, the equity investments of the banking system (including investments in fully paid up shares both in listed and unlisted stocks but excluding equity accounted investments in subsidiaries and associates) also increased by 6 percent to Rs59.4 billion which comes to around 9.5 percent of the system's equity, went slightly up

Figure 4.2.7 Average Daily NOP of all Banks



from last quarter's level of 9.4 percent. Group wise, LPBs continued to maintain the highest equity exposure with equity investment of Rs52.2 billion (11.3 percent of their total equity), followed by PSCBs with Rs5.8 billion investments (see Figure 4.2.8).

While banking system and its different groups on aggregate basis carry contained equity exposures, some of the individual banks have high exposures.

Disaggregated analysis shows that twelve banks with market share of 42.9 percent hold equity exposure, in terms of equity, greater than industry average. There are six banks, with market share of 23.8 percent, which hold exposure greater than 15 percent of their equity base (see Figure 4.2.9). The analysis of risk appetite by size of banks shows that top five banks, which hold 51.8 percent of the market share, have more or less proportional share in system's equity investments i.e. 50.5 percent. Moreover, in terms of exposure as calibrated to equity base, top five banks have slightly contained risk profile i.e. 9.2 percent vis-à-vis 9.5 percent for the entire system. Analysis further indicates that middle-sized banks on average have relatively higher equity exposures: top ten banks with 73 percent market share have equity investment to capital ratio of 8.9 percent; next ten medium-sized banks have the ratio of 11.8 percent, while the ratio comes to 5.2 percent for rest of the small-sized banks.

Figure 4.2.8 Exposure of Banks in Equities

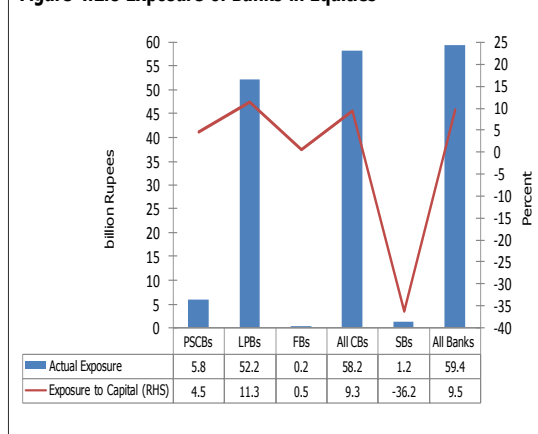
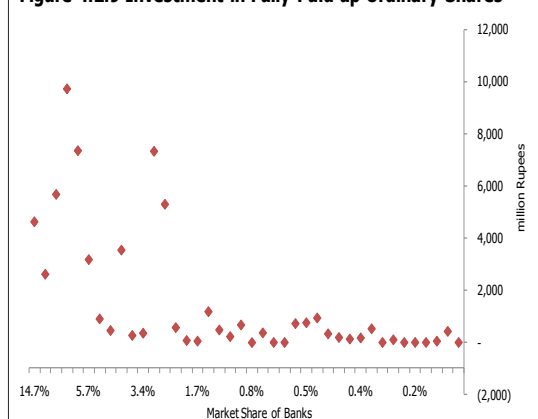


Figure 4.2.9 Investment in Fully Paid up Ordinary Shares



Though the position of banks shows subdued market risk profiles; to assess their resilience to unusual shocks, banks have been subjected to seven different shocks (see Table 4.2.1). The result of these stress tests also indicates the strong capacity of banks to withstand unusually severe movements in market prices. This capacity emanates from both strong capital adequacy positions as well as the contained risk positions.

Under interest rate shocks, banks are most vulnerable to unusually high increase in interest rates. Scenario IR-1, which envisages 500 bps

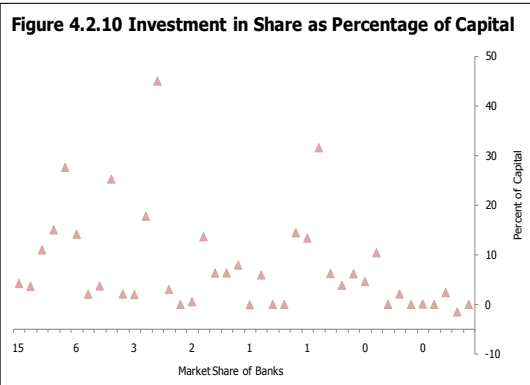


Table 4.2.1: Stress Tests - Market Risk

Interest Rate Shock

- IR-1 Increase in interest rates by 500 basis points
- IR-2 Shift coupled with flattening of the yield curve by increasing 500, 300 and 200 basis points in the three maturities respectively

Exchange Rate Shock

- ER-1 Depreciation of currency exchange rate by 25%
- ER-2 Appreciation of currency exchange rate by 25%
- ER-3 Depreciation of PRs against all currencies (25%) and deterioration of un-hedged FX loans

Equity Price Shock

- EQ-1 Fall in the equity prices by 50%.
- EQ-2 Fall in the equity prices by 60%.
- EQ-3 Fall in the equity prices by 70%.

increases in interest rates, is likely to result in 1.70 percentage points decline in CAR to 11.8 percent. CAR of three banks, which maintain CAR above 9 percent, will fall below this minimum standard and CAR of one bank falls below zero; however, this shock will also have favorable impact on some banks as one non-compliant bank becomes compliant after the shock. Similarly, the increase in yield curve and its flattening will result in reduction in CAR by 0.78 percentage points and the CAR of one bank will fall below minimum standard of 9 percent.

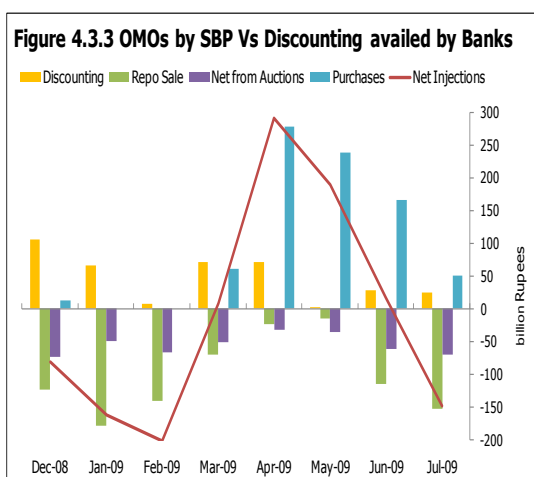
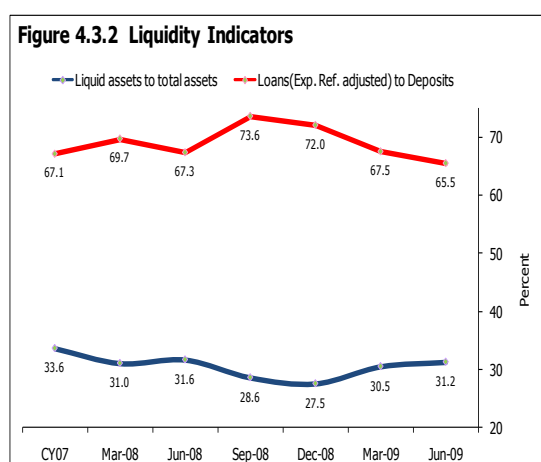
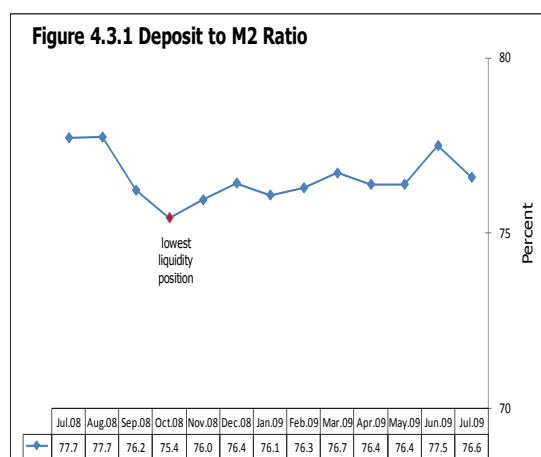
The exchange rates shocks ER-1 would lower the system's CAR by 0.29 percentage points, while under shock ER-2, the CAR increases by same percentage points, indicating that on aggregate basis banks are holding slightly short foreign currency position on the last day of the quarter under review. However, under the combined exchange rate and credit risk shock ER-3, the CAR of the system reduces by 0.53 percentage points to 13.0 percent and CAR of one compliant bank falls below the minimum standard (see Table 4.2.2).

Table 4.2.2: Impact of Shocks

Shock	% point change in CAR after Shock	Adjusted CAR after Shock
IR-1	-1.70	11.8
IR-2	-0.78	12.7
ER-1	-0.29	13.2
ER-2	0.29	13.8
ER-3	-0.53	13.0
EQ-1	-0.53	13.0
EQ-2	-0.73	12.8

Severe equity price shocks are likely to have maximum impact of around a quarter percentage point on the CAR. Under the equity price shocks EQ-1 and EQ-2, CAR of the system lowers by 0.53 and 0.73 percentage points, respectively, while CAR of only one compliant bank will breach the minimum standard of 9 percent.

Stressed CAR of the system at 12.8 percent, after a shock as high as 70 percent fall in equity prices, signifies the strong capital position of the system as well as the contained exposures of banks.

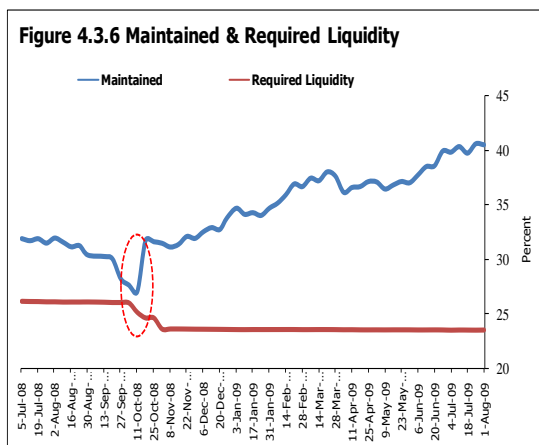
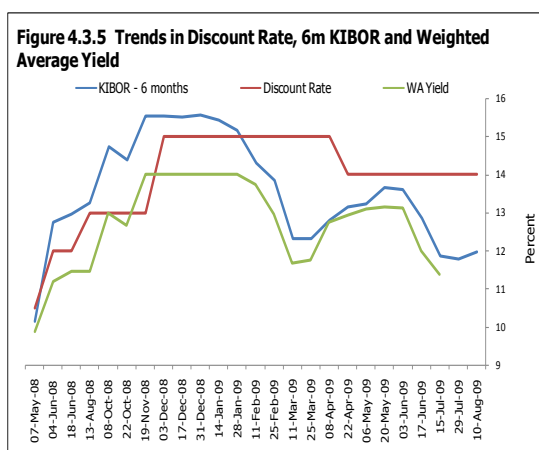
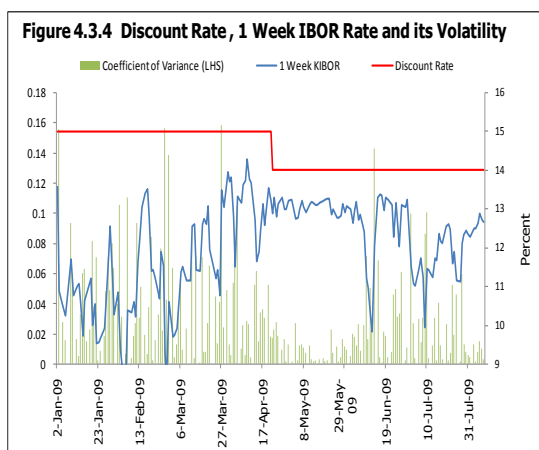


4.3 Liquidity Risk

The liquidity situation of the banking system has been gradually easing off since the liquidity stress of October 2008, which involved unusual withdrawal of bank deposits followed by slow retraction of the funds to the banking system. The quarter under review also witnessed a significant amelioration in the liquidity profile of the banking system. Expansion in reserve money and improvements in SBP's Net Foreign Assets (NFA) helped in keeping the pressure on money market interest rates in check. Further, due to significant increase in deposits prime indicator of system's overall liquidity and extent of its intermediation i.e. deposits to M2 ratio improved significantly (see Figure 4.3.1). Since a large share of fresh deposits was invested in liquid asset and advances registered relatively slower growth, baseline indicators of liquidity registered improvements (see Figure 4.3.2). Relative stability in interest rates also suggests improvements in market conditions for mobilization of funds in secondary market. In post quarter weeks, the system witnessed a decline in deposits during August and first half of September due to customary Ramadan and pre-eid deposit withdrawals. However, the overall liquidity profile of the system remained comfortable though with some inch up in interest rates, and the deposits retracted by the end of September.

In the recent months, there have been improvements in some of the key economic indicators i.e. reduction in inflation, government contained borrowing from SBP and fiscal consolidation, and improvements in external account and foreign exchange reserves. Keeping in view these improvements and need of impetus for sustainable recovery, SBP has discreetly lowered its policy rate twice by 100 bps each in third week of April 2009 and mid of August 2009.

The significant share of the additional inflow and improvements in system's liquidity profile took place in later half of the quarter under review. SBP adjusted its monetary policy operations for ensuring appropriate quantum of



liquidity in the market and stabilizing the overnight interest rates. During the first half of the quarter under review, SBP injected (on net basis) around Rs400 billion into the system and with improvements in deposits inflow and overall liquidity profile, the amount reduced to Rs125 billion for the later half (see Figure 4.3.3). Resultantly, the weekly KIBOR rates moved in a relatively narrow range and remained close to the SBP's discount rate (see Figure 4.3.4). Moreover, in line with lowering inflation statistics and overall monetary policy drive, interest rates have come down significantly since April 2009 (see Figure 4.3.5).

During the quarter under review, the system witnessed a significant increase of 8.5 percent in deposits. A larger chunk of this additional inflow went into liquid assets i.e. short-term Government papers, inter banks placements and balances, while loans and advances witnessed slower growth. Accordingly, key liquidity indicators recorded improvements – ADR (ERF adjusted) came down further to 65.5 percent while liquid assets to total assets ratio inched up to 31.2 percent, corresponding to Mar-08 level when liquidity profile of the system first started to show the signs of contraction (see Figure 4.3.2). Moreover, the aggregate statutory liquidity reserve (SLR) maintained by banks improved to 40.1 percent of TDL by the end of July 2009 (37.6 percent in March 2009) indicating surplus liquidity of 74.3 percent as compared to 59 percent in Mar-09 and 43 percent in Dec-08 (see Figure 4.3.6). The liquidity profiles of individual banks also improved, as the fewer instances of breach of SLR and cash reserve requirements were observed during the quarter under review.

Risk-free, short-term government securities i.e. MTBs in different investment categories particularly in Held for Trading (HFT) and AFS categories represent the fund-based liquidity position of banks. The MTB holdings of banks increased by 14 percent during the quarter; major increase was observed in AFS and HFT categories. These categories together represent 98 percent of the total MTB holdings of banks

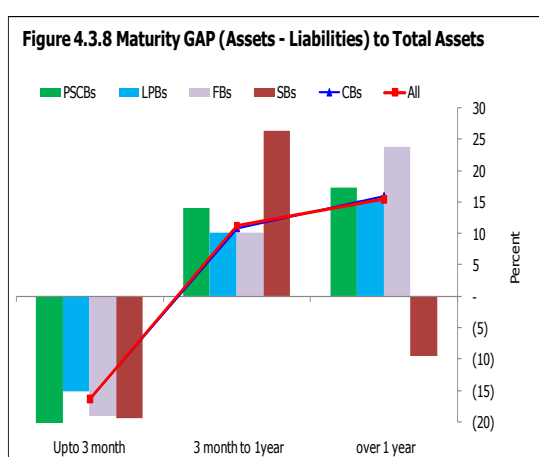
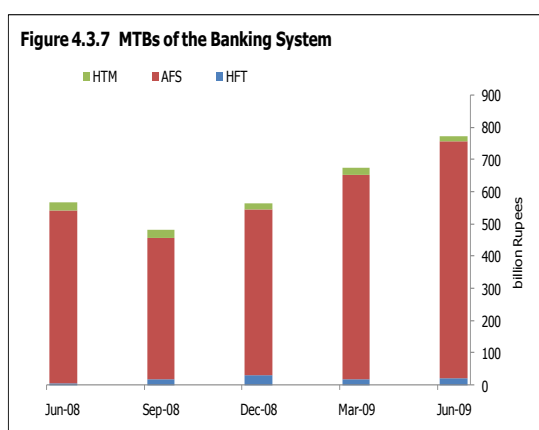


Table 4.3.1 Summary of Stress Test Results

Quarter ended	Number of Banks Becoming Illiquid after Shock			
	Liquidity Shock: Withdrawal of customer deposits by 2%, 5%, 10%, 10% and 10% for five consecutive days respectively.			
	2 days	3 days	4 days	5 days
Jun-09	0	0	2	4
Mar-09	0	1	3	6

(see Figure 4.3.7), representing their liquidity preference as well as the strong ability to meet the immediate liquidity requirements.

Although the effects of the constrained liquidity and uncertain liquidity scenario of last two quarters have largely eased off, there exists GAPs between the maturity of assets and liabilities that are slightly higher than the generally accepted benchmark of ± 10 percent. Group wise analysis indicates that PSCB, FBs and SBs were carrying higher gaps than the benchmark standard. LPBs, however, exhibit better liquidity management in terms of GAPs positions. Consequently, the GAP position of the system comes closer to the standard of ± 10 percent of total assets in different time buckets (see Figure 4.3.8). Nevertheless, a strong equity base which supports around 10.2 percent of the system's asset base allay concerns of maturity mismatches to some extent particularly for well capitalized banks that have significant volume of liquid assets and lower level of fixed and long-term assets.

The stress test results also validate Pakistani banks' adequate capacity to withstand unusual shocks of deposit withdrawals by liquidating their assets. Under the stress test, ability of the banks to repay their liabilities are assessed by calculating net cash flows (cash inflow minus cash outflows) after certain level of daily deposit withdrawals and generation of cash inflows by converting 80 percent of liquid assets and one percent of non-liquid assets into cash. This shock envisages 2 percent, 5 percent, 10 percent, 10 percent and 10 percent deposit withdrawal for five consecutive days, respectively. Under this scenario, none of the banks becomes illiquid after three days. However, after four days of consecutive withdrawal, 2 banks will become illiquid and after 5 days of consecutive withdrawal, 4 banks become illiquid. These results indicate over the quarter improvement in banks' liquidity position (see Table 4.3.1).

4.4 Operational Risk

In recent times of economic downturn, financial institutions are faced with host of risks. Operational risk is one such risk, which though has been existent, gained more importance recently. Keeping in view the need to ensure soundness and stability of the banking system, improving asset quality, business performance and implementation of Basel-II, SBP continuously encourages banks to re-prioritize their focus towards Operational Risk Management (ORM).

The Basel Committee on Banking Supervision includes the following under the definition of operational risk¹⁹:

1. People risk – Lack of awareness / proper training programs / non-following of policies & procedural manuals
2. System risk – Heavy reliance on systems, system down time, minor / major bugs, miscalculations etc.
3. Internal / external events – Fire incidents, political disruptions, earthquakes, floods etc.
4. Fraud & forgeries

Table 4.4.1: Break-up of Fraud and Forgeries
Cases outstanding

		(amount in million Rupees, share in percent)					
		Dec-08		Mar-09			
Category	No. of Cases	Amount Outstanding	Share		Amount Outstanding	Share	
			Cases	Amount		Cases	Amount
Serious frauds	186	4,017	2.9	61.3	194	4,063	3.1
Medium severity cases	399	1,112	6.3	17.0	406	1,161	6.6
Low severity cases	5,753	1,426	90.8	21.8	5,582	1,401	90.3
Total	6,338	6,555	100	100	6,182	6,625	100

Criteria for Fraud and Forgeries Categories

Serious Frauds	More than 10 million Rupees
Medium severity Cases	1 to 10 million Rupees
Low Severity Cases	Less than 1 million Rupees

Basel II also calls for separate measurement of Operational Risk Weighted Amount (ORWA) necessary for creating capital charge for covering operational risk. Under the current Basel II regime, banks may choose from among host of approaches: Basic Indicator Approach (BIA), The Standardized Approach (TSA), Alternative Standardized Approach (ASA) and Advanced Measurement Approach (AMA). The banking system of Pakistan, mainly follows the BIA for calculating capital charge under Basel-II framework and is maintaining capital of around Rs68.25 billion (11 percent of the overall risk-based capital requirements) for covering operational risk.

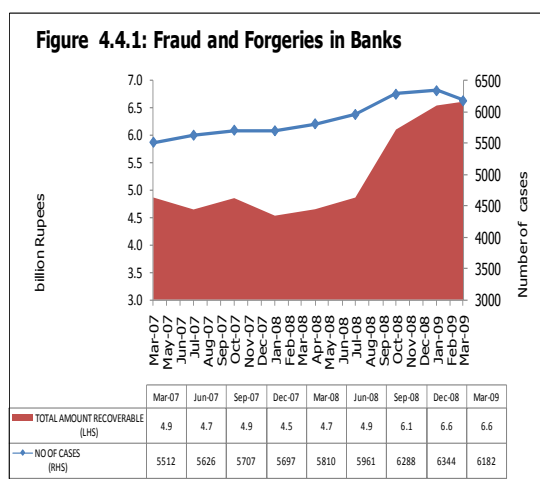
¹⁹ The Basel II definition includes legal risk, but exclude strategic and reputation risk.

Table 4.4.2: Break-up of Fraud and Forgeries
Cases detected during the quarter

Category	(amount in million Rupees, share in percent)							
	Dec-08				Mar-09			
	No. of Cases	Amount Involved	Cases	Amount	No. of Cases	Amount Involved	Cases	Amount
Serious frauds	13	687	1.6	77.4	13	596	2.1	72.2
Medium severity cases	33	126	4.2	14.2	45	169	7.2	20.5
Low severity cases	743	75	94.2	8.4	568	60	90.7	7.3
Total	789	888	100	100	626	825	100	100

Apart from ensuring sound systems and best practices in the management of operational risk, SBP monitors the magnitude and trends of the risk emanating from the failures in control environment and system of banks²⁰.

Aggregate number of fraud and forgery cases outstanding has declined. However, disaggregate analysis reveals that number of cases and amount outstanding for Serious-Fraud and Medium Severity categories increased. The downward trend in the number of fraud / forgery cases is a positive development; though the total recoverable amount in fraud and forgery cases marginally increased to Rs6.6 billion (see Figure & Table 4.4.1).



A useful comparison can be made on the basis of new cases detected and cases resolved. The volume of fraud & forgery cases detected during the quarter Mar-09 was relatively less than those detected in Dec-08. Incidents of Serious Fraud and Low Severity cases along with their amount decreased during the quarter under review. Whereas number and amount of Medium Severity cases has increased by 36.4 percent and 34.3 percent respectively (see Table 4.4.2).

Trend analysis of Fraud and Forgeries cases shows that overall number of outstanding cases closed (resolved and written off) during the quarter were substantial enough to out weight the increase reported during the quarter. This decline in number of cases outstanding particularly low severity cases coupled with marginal increase in amount vindicates the banks' resolve to deal with such cases promptly. However, banks need to be more proactive in their approach to reduce fraud and forgeries cases by investing in systems, controls, training and capacity building.

Group-wise analysis of banks reveals that big five banks' share in total cases outstanding is 15 percent which constitutes 47 percent of the total amount recoverable, whereas share of

Table 4.4.3: Category-wise Outstanding Fraud and forgery Cases
As of Mar-09

Category	(million Rupees)					
	Serious Fraud Cases		Medium Severity Cases		Low Severity Cases	
	Cases	Amount Recoverable	Cases	Amount Recoverable	Cases	Amount Recoverable
Big Five	78	2,191	269	783	601	117
SBs	2	32	12	29	1,454	970
LPBs	112	1,816	124	343	1,499	165
FBs	1	15	1	6	21	3
DFIs	1	9	0	0	2,007	146
Total	194	4,063	406	1,161	5,582	1,401

* For the sake of this database FWBL, BOK and BOP have been clubbed with the LPBs.

²⁰ See BSD Circular No. 01 of 2005 on Reporting Requirements on Frauds/Forgeries/Dacoities.

Box 4.1: Operational risk and complaints lodged at Consumer Protection Departments (CPD)

Consumer Protection Department of SBP on average received 20 complaints daily during the current quarter (see Table 4.4.4). These complaints are in addition to those directly received and resolved by banks. Majority of those were related to deposits and advances, followed by consumer credit and general banking operations. Though most of the banks have set up complaint redressal mechanisms, volume of consumer complaints received poses a significant operational risk. Managing larger complaint volumes requires more resources and time for resolving these complaints, leading to increase in operational losses. Further, complaint resolution may conclude into additional charges on the banks, causes financial losses and reputational as well as regulatory risk. Banks, therefore, need to take measures for minimizing the number of complaints.

Table B 4.1: Break-up of complaints reported to CPD

During quarter ended Jun-09

Category	Total Complaints	Disposed-Off	Outstanding
ATM/ Debit Cards	30	24	6
Auto Finance	62	57	5
Credit Cards	242	238	4
Loans/ advances	291	274	17
Operations of PLS Deposits/ Accounts	116	111	5
Total	1,798	1,504	294

Further analysis of complaints settled shows that a substantial chunk was settled in a few days, as those were made due to lack of customer's understanding of terms and conditions of the product. Thus one area which can minimize the number of complaints would be improving customer awareness on terms and conditions of each product before selling them. Particularly bank customers should be made aware of the conditions, non-compliance of which may create problems for them.

LPBs and SBs in cases outstanding is 28 and 24 percent, respectively. Share in amount for LPBs and SBs stands at 35 and 16 percent (see Table 4.4.3).

Other important factor in estimation is the compilation of time series data on transactional losses. As the Basel framework was implemented effective from January, 2008, the data for the two years is not sufficient for estimating the operational risk losses. However, some highlight on transactional side can be made on the basis of volume of complaints being managed at SBP and Banking Mohtasib (see Box 4.1).

Another important area of operational risk is its quantification, which is still a relatively new field. Although, banks are in the process of establishing ORM frameworks, the overall progress in developing objective models still has a long way to go and banks have to work towards managing the challenges faced in

formulation of ORM.

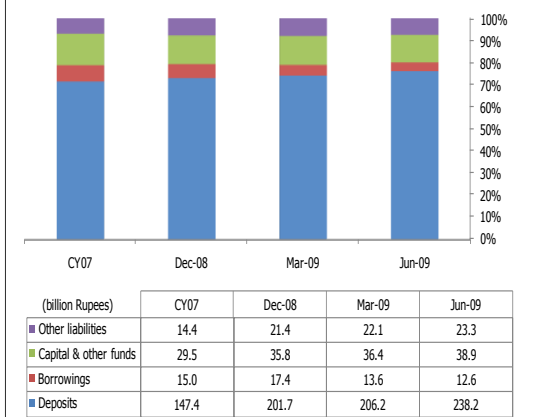
5. Performance of Islamic Banking

Table 5.1: Islamic Banking Growth over quarters

	(in percent)		
	Dec-08	Mar-09	Jun-09
Advances	1.8	(5.9)	3.0
Investment	4.7	16.1	9.3
Asset	10.1	0.7	12.4
Equity	10.1	1.8	6.8
Profitability (after Tax)	0.3	(0.7)	1.0
Share of Islamic Banking in Assets of Banking Industry	4.9	4.8	5.1
Deposits	17.7	2.3	15.5
	(in numbers)		
No. of Islamic Banks Network	514	521	528
Islamic Banking Branches (IBBs)	130	135	137

After experiencing a passive growth during the last quarter, Islamic banking regained impetus. The assets grew at appreciable rate of 12.4 percent to Rs313 billion (Rs278 billion in Mar-09). The share of Islamic banking in banking system has marginally increased by 30 bps to 5.1 percent in Jun-09. Likewise, the growth in outreach of Islamic Banking continued, though at a slower pace. Branch network grew by 1.7 percent to 528 branches (551 branches by end September 2009) compared to 521 branches at the end of Mar-09 (see Table 5.1).

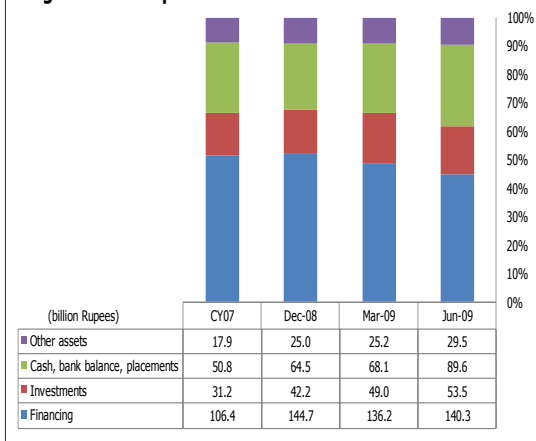
Figure 5.1: Composition of Liabilities



Analysis of the sources of funds depicts that deposits continued as a dominant source for the system. Deposits grew at an impressive rate of 15.5 percent (2.3 percent Mar-09). As a result, their share in overall funding structure further improved to 76.1 percent from 74.1 percent in Mar-09 (see Figure 5.1). Most of this increase came from increase in deposits of the Islamic banks.

Financing, the major end use of funds, regained some momentum in the quarter after observing a decline in Mar-09; it increased by 3 percent as growth in financing was slower than growth in other liquid assets viz. placements and banks balances, the share of financing in overall composition of assets declined to 44.8 percent (48.9 percent in Mar-09). Investments also registered steady growth, showing an increase of 9.3 percent. However, like financing, its share in overall asset structure declined to 17.1 percent (17.6 percent in Mar-09). While IBs are pursuing cautious approach to financing, lack of investment avenues are forcing them to keep their funds in low-earning and liquid avenues; cash balances and placement increased by 45 percent while their share in other assets increased by 5.3 percentage points to 28.6 percent (see Figure 5.2).

Figure 5.2: Composition of Assets



As growth in deposits outweighed the increase in financing, financing to deposits ratio (FDR)

Table 5.2: Asset Quality Indicators

Indicator	Jun-08	Dec-08	Mar-09	Jun-09
	(billion Rupees)			
Non-performing Financings	2.8	3.4	6.3	7.3
Provisions held	1.7	2.3	3.2	4.0
Net NPFs	1.0	1.1	3.1	3.3
	(in percent)			
Net NPFs to Capital (ratio)	3.3	3.1	8.5	8.5
NPFs to total financing	2.1	2.3	4.5	5.0
Net NPFs to net financing	0.8	0.8	2.3	2.4
Provision to NPFs	62.2	67.6	50.6	54.4

further decreased to 58.9 percent (66 percent in Mar-09).

The financing risk which rose sharply during last quarter, further inched up though at slower pace. NPFs increased by 15.4 percent to Rs7.3 billion (Rs6.3 billion in Mar-09). However, IBIs set aside significant loan loss provisions to cover deterioration in asset quality – provisions increased by 25 percent. Accordingly, NPFs coverage ratio, which was continuously declining for the last four quarters, improved to 54.4 percent (50.6 percent in Mar-09) and the impairment ratio i.e. Net NPF to capital remained at the last quarter's level. The increase in NPFs translated into increase in NPFs to financing ratio by 50 bps to 5.0 percent; while on account of higher provisioning net-NPFs to financing observed only a marginal increase of 10 bps (see Table 5.2).

Analysis of types of financing shows a continuation of past trend with minor shift in share of financing. Murabaha financing, after declining in Mar-09 increased by 10.5 percent, thus enhancing its share in overall financing to 40 percent. Diminishing Musharakah, the second major type of financing, increased by 3 percent. Musharakah and Mudarba financing, witnessed a healthy increase of 51 percent and 84 percent, respectively. However, due to their small size, their share in total financing increased by 130 bps to 3.4 percent. Salam and Ijarah financing declined during the quarter by 4.4 percent and 11.7 percent respectively (see Figure 5.4) The GroupWise analysis shows that most of the increase in financing came from Islamic banks, while IBBs saw a net retirement (see Table 5.4)

Composition of deposit shows that customer deposits increased by 16.2 percent while deposits from financial institutions saw a marginal increase of 5.5 percent in Jun-09. The share of customer deposits inched up by 0.6 percentage points to 92 percent while that of financial institutions deposits decreased to 8.0 percent (8.6 percent in Mar-09). Of the customer deposits, savings deposits registered a strong increase of 19.1 percent, while fixed

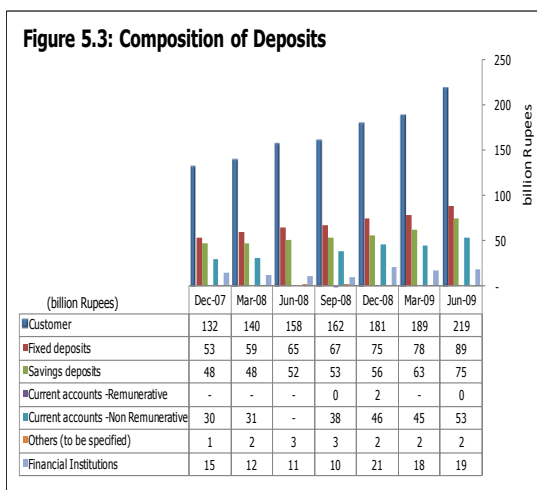
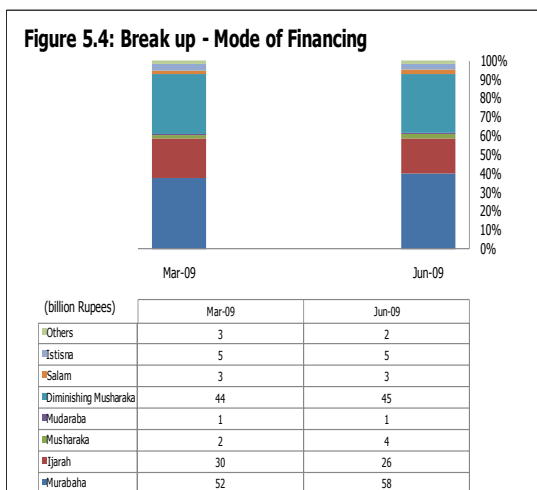
Figure 5.3: Composition of Deposits**Figure 5.4: Break up - Mode of Financing**

Table 5.3: Income Statement

	CY07	Mar-08	Jun-08	Dec-08	Mar-09	Jun-09
	(billion Rupees)					
Markup Income	12.7	4.2	9.1	22.0	7.8	15.4
Markup Expense	6.8	2.1	4.5	11.3	4.1	8.3
Net Markup Income	5.9	2.2	4.5	10.6	3.7	7.2
Provision Expense	0.8	0.2	0.3	1.0	0.9	1.7
Non Markup Income	2.4	0.5	1.1	2.1	0.5	1.6
Operating Expense	5.9	2.0	4.2	9.7	2.8	5.7
Profit Before Tax	1.7	0.5	1.2	2.0	0.5	1.4
Tax	(0.2)	0.1	0.2	0.2	0.0	0.3
Profit After Tax	1.6	0.4	1.0	1.8	0.5	1.1
Equity	29.5	31.2	32.2	35.8	36.4	38.9
	(in percent)					
Net Markup Income to total assets	2.9	4.1	3.9	4.5	1.3	2.2
Non Markup Income to total assets	1.2	1.0	1.0	0.9	0.2	0.5
Operating Expense to Gross Income	70.0	74.3	73.5	76.0	66.0	65.1
ROA (average assets)	0.9	0.8	0.9	0.8	0.8	0.8

deposits increased by 13.7 percent. However, fixed deposits continued to be the leading component with 37.3 percent share in total deposits (see Figure 5.3).

The overall profitability of Islamic banks remained firm during Jun-09 as Profit after tax increased to Rs1.11 billion (Rs1 billion in Jun-08). The earnings were augmented by a healthy increase in mark-up and non mark-up income, which doubled over the quarter. The worsening asset quality as evident in increasing provisioning and substantial increase in operating expenses moderated the increase in earnings (see Table 5.3). Improved performance also reflected in earning ratios; particularly, the Islamic banking succeeded in maintaining the ROA at 0.8 percent level.

Table 5.4: Share of Banks & IBBs

	Sep-08		Dec-08		Mar-09		Jun-09	
	Banks	IBBs	Banks	IBBs	Banks	IBBs	Banks	IBBs
Assets	67.0	33.0	68.0	32.0	70.0	30.0	70.0	30.0
Deposit	74.0	26.0	71.0	29.0	72.0	28.0	72.0	28.0
Advances (Net)	66.0	34.0	66.0	34.0	66.0	34.0	69.0	31.0
Investment (Net)	69.0	31.0	68.0	32.0	68.0	32.0	65.0	35.0
Equity	77.0	23.0	75.0	25.0	77.0	23.0	76.0	24.0
Profitability (after Tax)	24.0	76.0	15.0	85.0	5.0	95.0	(21.0)	121.0
Islamic Banking Network	71.0	29.0	75.0	25.0	74.0	26.0	74.0	26.0

Though the Islamic banks have majority share of the market in terms of assets and different components of balance sheet, the earning performance showed opposite different trend. The profitability of the IBBs has been gradually improved with every passing quarter; their share in profitability increased from 76 percent in Sep-08 to 121 percent in Jun-09. The IBBs profitability for the first half of 2009 has actually offset the overall losses posted by the Islamic banks. Main reason behind better earning performance of IBBs remains in the synergies provided by the infrastructure of their parent commercial banks. IBBs have opportunities to market and sell Islamic banking products through specialized Islamic banking windows set-up in conventional branches. Existing operational set up and available infrastructure also minimizes cost of operations of IBBs, thus augmenting their operating performance (see Table 5.4).

6. Development Finance Institutions (DFIs)

Table 6.1: DFIs at a Glance

	(billion Rupees)				
	CY06	CY07	CY08	Mar-09	Jun-09
Assets	135.3	116.3	103.3	106.9	116.9
Lending to FIs	17.2	19.8	8.2	9.4	12.8
Investments (Net)	42.1	41.4	38.6	45.3	50.9
Advances (Net)	53.5	33.4	36.6	36.6	38.3
Liabilities	94.3	68.7	54.6	55.4	65.3
Borrowing from FIs	58.6	51.7	43.8	39.7	45.9
Deposits/COIs	29.4	11.9	5.9	10.5	14.3
Equity	41	47.6	48.7	51.4	51.7
Profit (After Tax)	3.3	-0.1	0.7	-0.1	-0.6
ROA (Before Tax)	2.0%	0.8%	1.5%	1.2%	-0.4%

The DFI sector comprises of eight development finance institutions. These institutions differ in their asset size as top four DFIs hold 68 percent market share, while three smaller sized DFIs are quite new and are striving to build their market share.

The sector registered relatively stronger growth in its asset base as well as deposits during the quarter under review. Due to improvement in asset loss provisioning, credit risk profile improved. However, losses posted by a few institutions in the face of emerging vulnerabilities in macroeconomic environment, the year to date losses further accumulated during the quarter under review.

The asset base of DFIs increased by 9.4 percent to Rs116.9 billion in Jun-09. This growth was well supported by growth in deposits & COIs (Rs3.8 billion) and interbank borrowings (Rs6.2 billion). However, major part of the additional funds was invested in relatively liquid avenues. A significant increase was observed in lending to financial institutions which increased by Rs3.4 billion (36 percent), while investment grew by Rs5.6 billion and advances by Rs1.7 billion (12 percent). Due to further accumulation in year to date losses during the quarter, DFIs' Equity, on the aggregate basis, registered a decline of Rs0.6 billion. This decline was however, made up by increase in revaluation surpluses, and the net worth increased by Rs0.3 billion. Nevertheless, due to faster growth in asset base, leverage of the sector inched up – net worth to total asset ratio came off by 3.9 percentage points to 44.2 percent; though the ratio still remains in highly comfortable range indicating sector's high reliance on owners' equity.

Given the slackened economic conditions, prevailing both at home and globally, DFIs have opted to remain liquid. This has resulted in a significant increase in their Cash, Bank Balances, Lending to financial institutions, and

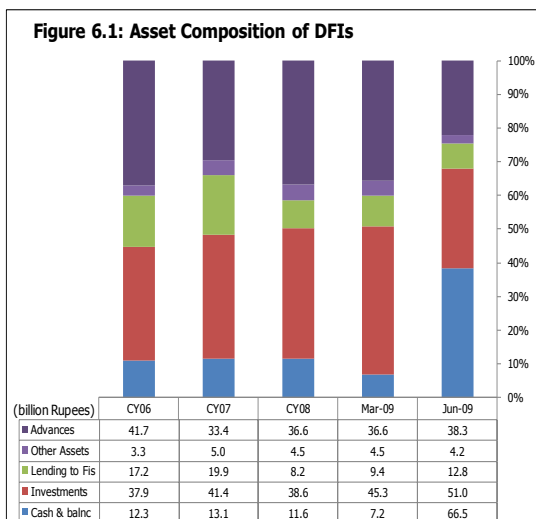


Table 6.2: Investment Portfolio of DFIs

	(billion Rupees)				
	CY06	CY07	CY08	Mar-09	Jun-09
TFCs/PTCs	4.8	6.6	9.4	10.2	11
Quoted Shares	13	12.5	14.7	11.8	12.5
FedGovt Sec	7.8	6.1	15.2	20.4	22.5
Others	11.3	9.3	5.5	6.8	7.4

short term govt. papers that absorbed 36 percent of the overall increase in asset base. Resultantly, the share of other assets contracted (see Figure 6.1). Nevertheless, instead of mainly focusing on their prime objective i.e. providing finance for longer-term development projects, DFIs have been relying on investments and secondary market operations for quite some time.

A break up of Investment portfolio of DFIs indicates that government securities are providing safer and better returns in the near future, which were up by 10 percentage points. Government securities constitute around 42 percent share of the total investment portfolio. Share of TFCs and quoted shares was observed at 20 and 23 percent respectively (see Table 6.2), indicating an insignificant change.

Table 6.3: Sector-wise Concentration of Loans & Advances

	(amount in million Rupees, share in percent)			
	Mar-09	Share	Jun-09	Share
Chemical	2,221	4.9	2,667	5.6
Agri	110	0.2	99	0.2
Textile	4,721	10.5	5,189	11.0
Cement	1,550	3.5	1,527	3.2
Sugar	1,075	2.4	1,241	2.6
Leather	132	0.3	127	0.3
Auto	985	2.2	1,168	2.5
Financial	854	1.9	663	1.4
Insurance	-	-	-	-
Electronics	717	1.6	1,113	2.3
Energy	6,548	14.6	7,488	15.8
Individuals	17,812	39.7	17,647	37.3
Others	8,183	18.2	8,432	17.8
Total	44,907	100	47,359	100

The loan portfolio of the DFIs, constituting around 33 percent of the asset base, is concentrated in the corporate sector. The highest share of funds was lent to Individual, Energy and Textile sectors. As financial institutions face higher uncertainty in the current climate, DFIs have started to focus on key promising sectors of the economy. Sectors like Energy, Electronics & Transmission of Energy, Auto & Transportation, and Chemical & Pharmaceutical have attracted the higher share of funds (see Table 6.3).

The solvency position of DFIs remained strong at the back of low leverage and high risk-based capital position. The capital adequacy ratio (CAR) of DFIs remained at comfortable levels of 51.1 percent despite a decline 5 percentage points. This decline was mainly caused by increase in loans and advances which also increased the Risk weighted assets, while capital base contracted slightly. Tier-1 Capital to RWA also decreased by 4.7 percentage points to 51.0 percent over the quarter.

Asset quality indicators have seen a minor improvement from Mar-09 quarter. NPLs of DFIs, witnessed a negligible increase of 0.8 percent to Rs12.8 billion (Rs.12.7 billion in Mar-09). Further, as the sector set aside significant

Table 6.4: Key Performance Indicators

	(in percent)				
	CY06	CY07	CY08	Mar-09	Jun-09
Total Capital to Total RWA	41.0	43.7	53.4	56.1	51.1
Tier 1 Capital to Total RWA	38.0	44.0	53.3	55.6	51.0
Capital to Total Assets	31.0	41.0	47.1	48.1	44.2
NPLs to Total Loans	21.0	20.8	27.0	28.2	27.0
Net NPLs to Net Loans	13.0	4.6	11.2	12.0	9.9
Provision to NPLs	43.0	81.6	65.9	65.3	70.3
Net NPLs to Capital	17.3	3.2	8.4	8.6	5.3
ROA before Tax	2.0	0.8	1.5	1.2	-0.4
ROA after Tax	2.0	-0.1	0.7	0.0	-1.1
ROE before Tax	7.0	2.2	3.4	2.5	-0.8
ROE after Tax	7.6	-0.3	1.6	0.0	-2.3
Loans to Deposits	182.0	281.4	622.9	347.4	267.4
Net Interest Income to Gross Income	44.2	44.7	34.8	77.4	88.0
Non Interest Income to Gross Income	55.8	55.3	65.2	22.6	12.0
Operating Expense to Gross Income	37.6	39.1	22.7	31.8	39.0

loan loss provisioning during the quarter under review, infection ratio (net NPLs to net Loans), provisioning coverage and capital impairment (net NPLs to Capital) indicators reflect improvements in credit risk profile as compared to last couple of quarters (see Table 6.4).

Profitability & Earnings indicators came under further stress in Jun-09. The year to date losses of the sector on aggregate basis accumulated to Rs0.6 billion (loss of Rs0.1 billion in Mar-09). This decline in profitability was largely caused by increased asset loss provisioning and trading losses. Accordingly, ROE and ROAs (before & after tax) deteriorated over the quarter. Further, due to net trading losses during the quarter, operating expenses to Gross Income ratio increased from 31.8 percent to 39.0 percent in Jun-09 (see Table 6.4).

In terms of both scope and scale of operations, DFIs are operating below their optimal levels. Given their strong capital base and presence of promising areas of economy, the sector has wide leveraging available to further expand its operations in line with its prime charter. This warrants broad basing of advances and funding structure of DFIs. However, due to constraints like the security situation in some part of the country and inflationary pressures compounded by the ongoing economic slowdown both at home and abroad, the DFIs witnessed another uneventful quarter. These conditions, coupled with tough competition from commercial banks pose significant challenge to DFIs and demands ingenious strategy responses for their sustainable growth in coming periods.

Special Section 3: Analysis of Financial Derivative Business

Background:

Financial derivatives are still at a nascent stage in Pakistan; the first recognized derivative transaction in banking sector was carried out in the second half of CY03. Keeping in view the high risks which could involve imprudent use of derivatives, the SBP initially adopted a cautious prior approval based approach for allowing financial derivatives transaction to banks. Later in CY04, with an objective to develop an over the counter (OTC) financial derivatives, SBP allowed Banks/DFIs to undertake derivatives business, provided they meet the eligibility criteria and obtain Authorized Derivatives Dealer (ADD) or Non-Market Maker Financial Institution (NMI) status from SBP. For the purpose, SBP issued Financial Derivatives Business Regulations (FDBR), which contains the regulatory framework for the OTC financial derivative transactions as well as the specifics of the permissible types of derivative transactions. The permitted types of transactions include G-7 Foreign Currency Options, PKR Forward Rate Agreements (FRA) and PKR Interest Rate Swaps (IRS). However, banks/DFIs can undertake other forms of transaction with prior approval of SBP, and Cross Currency Swap (CSS) has emerged as leading product, which is approved on case-to-case basis.

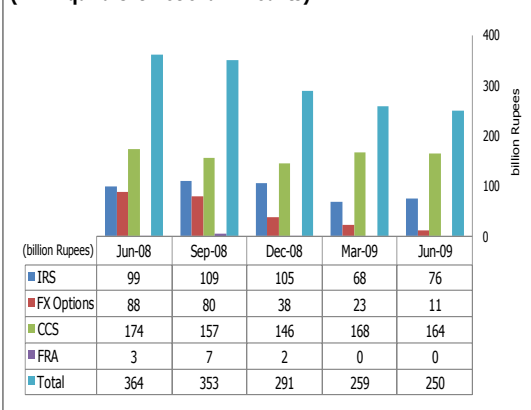
So far, SBP has granted ADD status to five financial institutions, however no institution has obtained the status of NMI. Any institution other than the five ADDs interested in undertaking derivative business is obliged to obtain prior approval from SBP.

Analysis of Derivative Business

The following paragraphs discuss the trend, composition, and mark-to-market dynamics of financial derivative business of the banks.

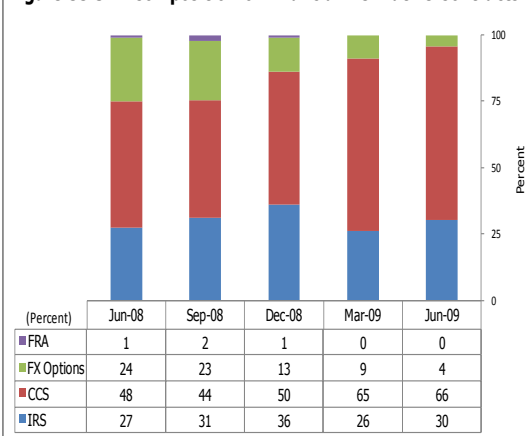
After witnessing momentous growth over a couple of years, Banks' financial derivative business has witnessed significant decline over

Figure SS 3.1: Financial Derivatives Contracts (PKR Equivalent Notional Amounts)



the last one-year or so. This trend of steep decline has somewhat muted during the quarter under review as the outstanding notional amount of all derivatives products declined by only 3 percent to Rs250 billion²¹ (11 percent and 17 percent decline in Mar-09 and Dec-08 quarters, respectively), giving a 31 percent decline since corresponding quarter of last year (see Figure SS 3.1). Though the overall volume of derivative transaction registered passive decline during the quarter, the individual components of banks' derivative portfolio followed different trends and their relative share accordingly changed over the time (see Figure SS 3.2)

Figure SS 3.2: Composition of Financial Derivative Contracts

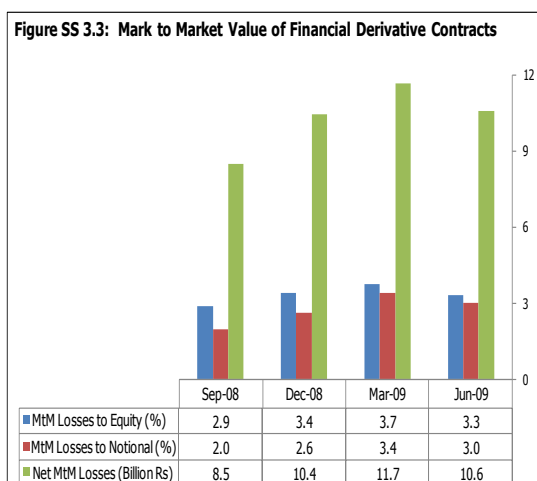


The most significant decline was observed in *Foreign Exchange Options (FX Options)*²² which declined by 54 percent over the quarter (88 percent in YoY basis) to Rs11 billion and their relative share declined to around 4 percent by the end of Jun-09. The FX Options now have the lowest share in banks' derivative portfolio as compared to leading share during the first quarter of last year.

Cross Currency Swaps (CCS) constitutes the largest share of banks' financial derivatives portfolio. After witnessing an increase during the last quarter, the value of CCS marginally declined by 2.3 percent during the quarter under review to Rs164 billion. Over the last one year or so, the CCS has witnessed somewhat stable position, i.e. a YoY decline of 5 percent; however, due to significant decline in other components, the relative share of CCS significantly increased to 66 percent (65 percent in Mar-09, 50 percent in Dec-08 and 48 percent in Jun-08). The leading factor behind the popularity of CCS has been the high gap between domestic and international interest rates. The high interest rate differentials have induced the local corporate, particularly those with sufficient export volumes, to swap their

²¹ The amount pertains to 8 banks including 5 ADDs, excluding the hedging transactions with Resident/non Resident banks.

²² As stated in the FDBR, dealing in FX options is permitted in G-7 currencies only. While there is no restriction on the minimum or maximum size of 'notional principal' amounts of FX options, the maximum tenor is restricted to one year.

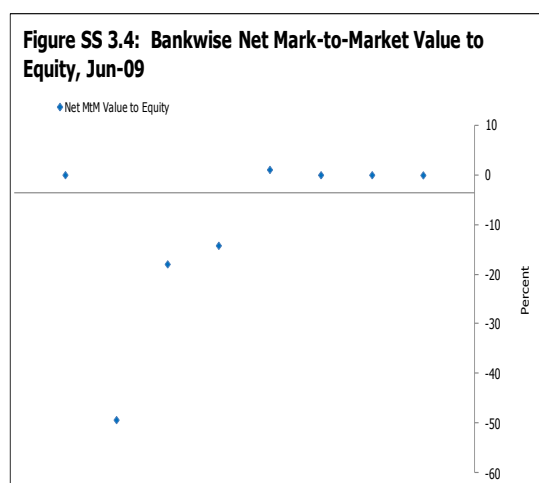


local currency exposures with EURIBOR or LIBOR.

*Interest Rate Swaps (IRS)*²³ which experienced a significant decline in last quarter increased by 11 percent during the quarter under review to Rs76 billion. In line with changes in customers' expectation of interest rate scenario, the volume of the IRS has changed over time. YoY basis their value has shrunk by 24 percent and now these contracts are the second major component of banks' overall financial derivative portfolio.

All *Forward Rate Agreements (FRAs)*²⁴ which were a recent phenomenon in Pakistani derivative market matured or cancelled during last quarter and the quarter under review witnessed no activity in FRAs. Nevertheless, their share had remained negligible in the value of total outstanding derivatives transactions.

The outstanding financial derivatives transactions pertain to eight banks including five ADDs. These banks belong to different banking group: 5 LPBs, 2 FBs and a PSCB. The mark-to-market position shows slight improvement over the quarter. Total mark-to-market losses during the quarter under review declined by 10 percent to Rs10.6 billion (Rs11.7 billion in Mar-09 and Rs10.4 billion in Dec-08). These mark-to-market losses come to around 3.3 percent of the equity of banks engaged in derivate business and 3.0 percent of outstanding notional principal amounts (see Figure SS 3.3). Disaggregated analysis shows that four banks are carrying mark-to-market losses on their derivative portfolio. A couple of banks have significantly risky exposures as reflected by high percentages of mark-to-market losses; these banks could face further stresses in case of any further adverse movements in underlying prices (see Figure SS 3.4).



²³ As per FDBR, IRS transactions are permitted in PKR only, with a maximum tenor of 5 years and there is no restriction on the minimum or maximum size of 'notional principal' amounts of IRS.

²⁴ In the FDBR, dealing in FRAs is permitted in PKR only, with a maximum tenor of 2 years.

Special Section 4: Regulatory Developments

SBP, being the regulator of banks, perform its functions through issuance of new regulations and guidelines, and revision of existing ones. Following paragraphs highlight the regulatory developments that have taken place since January, 2009. During the period, major regulations and guidelines have been issued in the areas of Consumer Finance, Corporate Governance, Islamic Banking and Risk Management.

I. Consumer Finance and Consumer Protection:

i) *Operational Guidelines for Credit Card Business in Pakistan-PSD Circular No. 1 dated January 17, 2009:* Credit Card business is an important segment of consumer financing offered by Banks and DFIs. Increase in volume of transactions and complex nature of the product coupled with lack of awareness is resulting in rising number of complaints and disputes. To streamline the process and institutionalize well defined procedures, 'Operational Guidelines for Credit Card Business in Pakistan' were issued with following objectives:

- a. Set the minimum standard of services
- b. Promote good banking practices in Credit Card operation.
- c. Enhance transparency in Credit Card processing.
- d. Promote fair and cordial relationship between institutions and their customers.
- e. Foster customer confidence in e-banking products and banking system.

ii) *Amendments in Prudential Regulations for Consumer Financing- BPRD Circular No. 04 of February 11, 2009-* Following amendments have been made in the prudential regulations for Consumer Financing:

- a. Banks / DFIs have been advised to obtain a written declaration on the prescribed format from the borrower, divulging details of various facilities already obtained from other banks/financial institutions, at the time of granting consumer financing facility.
- b. Before allowing any facility, banks / DFIs shall obtain a consumer credit report from the eCIB of SBP or from any consumer Credit Information Bureau of which they are member.
- c. REGULATION R-3 - Banks / DFIs shall ensure that the total monthly amortization payments of consumer loans should not exceed 50 percent of the net disposable income of the prospective borrower.
- d. REGULATION R-7 - Bank/DFI may issue credit card to one person with a maximum unsecured limit not exceeding Rs 1,000,000/, subject to mandatory credit check & prescribed debt burden and condition that total unsecured credit card limits availed by that person from all banks/DFIs does not exceed Rs. 1,000,000
- e. REGULATION R-17 - Banks/DFIs have been allowed to extend mortgage loans for housing up to any tenure defined in the bank's/DFI's duly approved credit policy and keeping in view the maturities profile of their assets & liabilities.
- f. REGULATION R-23 - Banks/DFIs may assign personal loan limits to one person with a maximum unsecured limit not exceeding Rs 1,000,000/- subject to mandatory credit check & prescribed debt burden and condition that total unsecured personal loans limits availed by that person from all banks/DFIs does not exceed Rs. 1,000,000.

As a result of above revision in credit card limits and clean limit for personal loans, regulation concerning prime customers stands withdrawn.

iii) *Sharing of Customer Data with pilot/ Private CIB-MFD Circular No. 01 of January 05, 2009:* To allow Microfinance Banks to improve risk management processes and assess credit worthiness of their customers, MFBs have been

allowed to share their customers' data with pilot/private CIB(s) subject to development of comprehensive customer protection and confidentiality guidelines duly approved by their Board of Directors. Further, it has been made mandatory to obtain express customer consent for sharing customer data with other institutions/ CIB and the duty of maintaining confidentiality will remain with the Microfinance Bank.

II. Risk Management:

i) REGULATION R-1- LIMIT ON EXPOSURE TO A SINGLE PERSON/GROUP *BPRD Circular No. 01 of January 17, 2009*: The limit on exposure to a single person/group, has been revised in a phased manner over the next five years (see Table SS 4.1).

Effective date	(fund and non-fund based exposure limit)	Fund based outstanding limit	(fund and non-fund based exposure limit)	Fund based outstanding limit
31-12-2009	30	20	45	35
31-12-2010	30	20	40	35
31-12-2011	30	20	35	30
31-12-2012	30	20	30	25
31-12-2013	25	25	25	25

ii) *Provisioning for Loans and Advances - BSD Circular No. 02 of January 27, 2009*: Banks / DFIs were allowed to avail the benefit of 30 percent of FSV of pledged stocks and mortgaged commercial and residential properties held as collateral against all NPLs for three years from the date of classification for calculating provisioning requirement w.e.f. 31-12-2008 subject to compliance with the following conditions:

- The additional impact on profitability arising from availing the benefit of FSV against pledged stocks and mortgaged commercial and residential properties shall not be available for payment of cash or stock dividend.
- Heads of Credit of respective banks/DFIs shall ensure that FSV used for taking benefit of provisioning is determined accurately as per guidelines contained in PRs and is reflective of market conditions under forced sale situations.
- Party-wise details of all such cases where banks/DFIs have availed the benefit of FSV shall be maintained for verification by State

Bank's inspection teams during regular /special inspection.

Any misuse of FSV benefit detected during regular/special inspection of SBP shall attract strict punitive action under the relevant provisions of the Banking Companies Ordinance, 1962. Furthermore, the benefit of FSV may also be withdrawn from banks/DFIs found involved in its misuse.

iii) *Valuation of Listed equity investment held in Available for Sale (AFS) Category-BSD Circular No. 04 of February 13, 2009:* The SECP issued a notification relating to accounting treatment of impairment losses (SECP's Notification No.SRO.150 (1)/2009 dated the 13th February, 2009). SBP also allowed the banks /DFIs, if they so desire, to adopt the aforesaid Notification of SECP for treatment of impairment loss recognized as on 31-12-2008 on valuation of listed equity investment held in Available for Sale (AFS) Category. This was subjected to full disclosure and restriction on dividend as required vide Para 3 and Para 1-(iii) of the said Notification. However, early recognition of full impairment loss by Banks / DFIs was encouraged.

iv) *Impairment on Available for Sale (AFS) Securities-BSD Circular No. 08 of August 01, 2009:* Banks / DFIs, which have provided for the impairment on Available for Sale (AFS) securities as on December 31, 2008, were allowed to adjust their impairment losses, due to recovery in market prices during the year 2009. However, this adjustment shall be only to the extent which is in excess of already created impairment as on 31-12-2008. Such adjustments, authenticated by the statutory auditors of Banks / DFIs, shall be taken to Revaluation Surplus / (Deficit) account and not to be routed through Profit & Loss account, with adequate disclosures in the financial statements.

In cases where impairment on AFS equity investment, made as on 31-12-2008 is sufficient to cover the impairment required during the

year 2009, no additional impairment is to be made.

III. Islamic Banking

i) *Guidelines on Islamic Financing for Agriculture- ACD Circular No. 01 of February 03, 2009:*

There has always been a great demand from agricultural customers to have Islamic financing products for agriculture sector. The Islamic banks and IBBs too have also shown great interest in adopting Shariah Compliant agriculture finance as a viable business line.

Keeping in view the potential and demand for Islamic banking products in the area of agriculture, SBP, in consultation with stakeholders, has developed the guidelines on Islamic financing for agriculture to facilitate banks in developing specific Shariah compliant products to meet financing needs of the farming community. Banks may use these guidelines for developing their own Shariah compliant products according to their policy and operational & market requirements, subject to compliance with SBP regulations and approval from their Shariah Advisor.

ii) *Handbook of Islamic Banking Products & Services:* Islamic Banking Industry of Pakistan has made considerable growth in the last few years both in terms of outreach and the range of products and services being offered. The product range broadly covers areas like: Corporate /SME Banking, Investment Banking, Trade Finance, General Banking and Consumer Banking. Model agreements (for Musharakah, Mudaraba, Murabaha, Musawamah, Leasing, Salam and Istisna) were issued by the SBP through Essentials and Model Agreements for Islamic Modes of Financing in 2004. These model agreements are flexible and IBIs can modify these agreements with the approval of their Shariah Adviser.

Consequently, the industry has managed to offer a wide array of products encompassing different modes of Islamic Financing, both on

the asset side as well as on the Liability side. In addition, IBIs are offering investment banking products and services including Sukuk Arrangement, Financial Advisory, Private Placement, Syndication, Trusteeship, Underwriting, Structured Finance, and Project Financing.

In order to keep a record of all Shariah compliant product Offerings in Pakistan, SBP has developed a Handbook of Islamic Banking Product & Services. This will facilitate in putting together all product offerings of IBIs in one place—highlighting inter alia description of the product, underlying mode, sector targeted, limit, tenor, and collateral required.

IV. Licensing:

Policy for Opening of Overseas Offices & Establishment of a Subsidiary Banking Company Outside Pakistan - BPRD Circular No. 05 of March 05, 2009: In view of the importance of overseas operations a policy for establishment of overseas offices and establishment of a subsidiary banking company outside Pakistan has been issued. The new policy deals with matters like opening/ shifting/ closing/ performance monitoring of overseas offices, and establishment of subsidiary banking company outside Pakistan.

Further, following Executive positions for overseas operations in branch/subsidiary mode have been subjected to Fit & Proper Test issued vide regulation G-1 of Prudential Regulations for Corporate and Commercial banking:

- (a) Head of overseas operations of a bank at head office level
- (b) Country Head/Regional Head (where a region is consisting of more than one foreign countries),
- (c) CEO/Head of subsidiary banking company outside Pakistan and
- (d) CEO of Joint Venture (where majority stake is with the bank incorporated in Pakistan & authority to appoint CEO).

V. Capital Adequacy:

Minimum Capital Requirements for Banks/DFIs- BSD Circular No. 07 of April 15, 2009: In view of the general global slowdown in growth and capital accumulation by financial institutions and representations from shareholders, the minimum Paid up Capital (free of losses) requirements for banks have been revised (see Table SS 4.2).

Table SS 4.2: Minimum Paid up Capital Requirement

S. No	Minimum Paid up Capital (free of losses)	Time frame
1	Rs 6 billion	31.12.2009
2	Rs 7 billion	31.12.2010
3	Rs 8 billion	31.12.2011
4	Rs 9 billion	31.12.2012
5	Rs 10 billion	31.12.2013

While capital adequacy standards will continue as previously and all banks/DFIs shall be required to increase CAR to 10 percent w.e.f., December 31, 2009 irrespective of their CAMELS-S rating, till further instructions.

Branches of foreign banks (FBs) operating in Pakistan are also required to raise their assigned capital (net of losses) to Rs. 10 billion within the above prescribed timelines. However, those foreign banks whose Head Offices hold Paid up capital (free of losses) of at least equivalent to US\$ 300 million and have a CAR of at least 8 percent or minimum prescribed by their home regulator, whichever is higher, will be allowed with prior approval of the State Bank to maintain assigned capital as under:

- (a) FBs operating with up to 5 branches are required to raise their assigned capital to Rs. 3 billion latest by 31st December 2010.
- (b) FBs operating/desirous of operating with 6 to 50 branches are required to raise their assigned capital to Rs. 6 billion latest by 31st December 2010.

VI. Corporate Governance:

i) *Deposit of Sponsor Shares in Blocked Account with Central Depository Company of Pakistan(CDC)-BPRD Circular No. 09 of May 16, 2009:* The sponsor shares and subsequently issued bonus/right shares issued to sponsors of Microfinance Banks (MFB) that were previously entrusted in the custody of State Bank shall now

be deposited in the Central Depository Company of Pakistan Ltd (CDC) in the following manner:-

- a. All sponsor shares and subsequent right and bonus shares, including those deposited with SBP Banking Services Corporation (BSC), shall be deposited in a blocked account with the CDC.
- b. No withdrawal of the sponsor shares from CDC blocked account would be allowed without prior written permission of SBP; blocked account should be opened by the sponsor shareholders of MFBs exclusively for deposit of the sponsor shares and subsequently right and bonus shares issued thereon; and Charges for opening and operating of the blocked account with CDC will be borne by the sponsor shareholders.

These instructions shall not be applicable to the shareholding of Federal and Provincial governments in MFBs.

ii) Amendments in Part "C – Management" of Prudential Regulations G-1:

- a. Para 3 of Prudential Regulation has been amended to read as under:

"3. Chairman of the Board of Directors may, if deemed necessary, appoint one advisor to advise and facilitate him in discharge of his duties/responsibilities. The appointment of such an advisor will be subject to the following conditions:

1. The advisor must possess the required technical experience relating to banking and finance at a senior level to enable him/her to render a professional advice to the Board.
2. The terms of reference of the advisor shall be approved by the Board.
3. A reasonable remuneration may be paid to the advisor with the approval of the Board of Directors.
4. The advisor may attend the meetings of Board of Directors and Board Committees in which his/her

participation is required but he/she will not be a member of the Board and/or its committees.

5. The advisor shall be required to sign an appropriate confidentiality agreement to ensure confidentiality of documents / information that may come to his/her knowledge, before assuming any such role."

b. Para 2 of Prudential Regulation has been amended to read as under:-

"2. The banks/DFIs during a calendar year may pay a reasonable and appropriate remuneration for attending the Board or its committee(ies) meeting (s), to their non-executive directors and chairman. The scale of remuneration to be paid to the non-executive directors and chairman for attending the Board and/or committee meetings shall be approved by the shareholders on a pre or post facto basis in the Annual General Meeting (AGM). However, no such remuneration shall be paid to the executive directors except usual TA/DA as per bank's/DFI's standard rules and regulations. No consultancy or allied work will be awarded to the non-executive directors or to the firms/ institutions/ companies etc. in which they hold substantial interest".

Group wise Balance Sheets and Income Statements of Banks **as of June 30, 2009**

(Amount in million Rupees)

Financial Position	PSCB	LPB	FB	CB	SB	All Banks
ASSETS						
Cash & Balances With Treasury Banks	107,184	343,038	35,482	485,703	2,536	488,239
Balances With Other Banks	35,503	129,030	15,869	180,403	16,683	197,085
Lending To Financial Institutions	22,966	199,320	19,440	241,726	481	242,207
Investments - Net	274,313	1,057,998	63,298	1,395,609	12,891	1,408,500
Advances - Net	597,147	2,403,857	89,965	3,090,970	85,375	3,176,345
Operating Fixed Assets	28,539	193,793	4,119	226,451	4,988	231,438
Deferred Tax Assets	14,722	31,755	5,075	51,552	2	51,554
Other Assets	92,760	180,623	7,640	281,024	10,556	291,580
TOTAL ASSETS	1,173,134	4,539,414	240,888	5,953,437	133,512	6,086,949
LIABILITIES						
Bills Payable	13,410	50,414	3,231	67,055	1,079	68,133
Borrowings From Financial Institution	52,941	354,016	20,964	427,921	87,229	515,150
Deposits And Other Accounts	918,062	3,474,424	156,513	4,548,999	14,296	4,563,295
Sub-ordinated Loans	-	37,642	-	37,642	3,405	41,047
Liabilities Against Assets Subject To Finance Lease	55	93	-	148	18	165
Deferred Tax Liabilities	2,933	6,040	261	9,235	106	9,340
Other Liabilities	57,314	154,915	24,347	236,576	30,687	267,263
TOTAL LIABILITIES	1,044,715	4,077,543	205,316	5,327,575	136,820	5,464,395
NET ASSETS	128,420	461,870	35,572	625,862	(3,308)	622,554
NET ASSETS REPRESENTED BY:						
Share Capital	21,339	244,573	33,652	299,564	15,507	315,071
Reserves	31,556	124,998	76	156,630	2,447	159,077
Unappropriated Profit	48,231	57,925	1,889	108,045	(24,797)	83,248
Share Holders' Equity	101,126	427,496	35,617	564,239	(6,844)	557,395
Surplus/Deficit On Revaluation Of Assets	27,294	34,374	(45)	61,623	3,536	65,159
TOTAL	128,420	461,870	35,572	625,862	(3,308)	622,554
OPERATING POSITION						
Mark-Up/ Return/Interest Earned	46,594	227,036	11,208	284,839	6,708	291,547
Mark-Up/ Return/Interest Expenses	28,783	121,620	6,166	156,568	4,252	160,820
Net Mark-Up / Interest Income	17,811	105,417	5,043	128,271	2,456	130,727
Provisions & Bad Debts Written Off Directly/(Reversals)	7,220	31,735	2,733	41,688	71	41,759
Net Mark-Up / Interest Income After Provision	10,591	73,682	2,309	86,583	2,385	88,968
Fees, Commission & Brokerage Income	4,673	16,514	935	22,121	48	22,169
Dividend Income	488	2,210	3	2,701	80	2,781
Income From Dealing In Foreign Currencies	1,697	5,863	2,229	9,789	9	9,798
Other Income	758	8,947	612	10,317	3,351	13,668
Total Non - Markup / Interest Income	7,616	33,533	3,779	44,928	3,489	48,417
Administrative Expenses	12,204	66,671	5,571	84,446	4,193	88,639
Other Expenses	106	884	38	1,028	2	1,030
Total Non-Markup/Interest Expenses	12,310	67,554	5,609	85,473	4,195	89,669
Profit before Tax and Extra ordinary Items	5,897	39,661	480	46,038	1,679	47,716
Extra ordinary/unusual Items - Gain/(Loss)	-	-	-	-	(45)	(45)
PROFIT/ (LOSS) BEFORE TAXATION	5,897	39,661	480	46,038	1,724	47,762
Taxation	2,561	15,228	396	18,185	928	19,113
PROFIT/ (LOSS) AFTER TAX	3,336	24,433	83	27,853	796	28,648

Financial Soundness Indicators

(In percent)						
Indicators	2006	2007*	Jun-08	2008	Mar-09	Jun-09
CAPITAL ADEQUACY						
Risk Weighted CAR						
Public Sector Commercial Banks	15.2	16.1	15.5	13.2	13.9	14.5
Local Private Banks	12.7	11.8	11.6	12.1	12.7	13.3
Foreign Banks	15.0	14.6	14.0	21.8	22.4	23.7
Commercial Banks	13.3	12.8	12.4	12.7	13.3	14.0
Specialized Banks	(8.3)	(6.2)	(0.7)	(4.9)	(2.1)	(3.4)
All Banks	12.7	12.3	12.1	12.3	12.9	13.5
Tier 1 Capital to RWA						
Public Sector Commercial Banks	11.1	12.2	11.9	11.0	11.6	12.0
Local Private Banks	10.4	9.9	9.5	10.2	10.7	11.2
Foreign Banks	14.3	14.0	13.4	21.3	21.9	23.1
Commercial Banks	10.8	10.5	10.1	10.8	11.3	11.8
Specialized Banks	(13.3)	(12.5)	(7.8)	(10.1)	(7.4)	(7.4)
All Banks	10.0	10.0	9.7	10.2	10.8	11.3
Capital to Total Assets						
Public Sector Commercial Banks	12.2	13.7	12.8	10.7	11.1	10.9
Local Private Banks	9.2	10.2	9.8	10.0	10.3	10.2
Foreign Banks	10.1	11.2	10.5	14.5	14.4	14.8
Commercial Banks	9.9	10.9	10.4	10.3	10.6	10.5
Specialized Banks	(8.0)	(5.4)	0.4	(3.2)	(2.7)	(2.5)
All Banks	9.4	10.5	10.2	10.0	10.3	10.2
ASSET QUALITY						
NPLs to Total Loans						
Public Sector Commercial Banks	9.0	8.4	9.9	16.3	17.5	16.8
Local Private Banks	5.2	6.5	6.5	8.6	9.7	9.8
Foreign Banks	1.0	1.6	1.7	2.9	3.6	4.5
Commercial Banks	5.7	6.7	7.0	9.9	11.0	11.1
Specialized Banks	39.1	34.3	29.8	28.8	29.0	25.8
All Banks	6.9	7.6	7.7	10.5	11.5	11.5
Provision to NPLs						
Public Sector Commercial Banks	84.5	89.0	85.2	66.9	65.3	65.9
Local Private Banks	78.7	88.5	84.8	70.2	71.2	71.6
Foreign Banks	191.7	157.0	133.8	81.9	81.3	83.4
Commercial Banks	81.5	89.1	85.2	69.3	69.5	70.0
Specialized Banks	64.1	68.6	73.7	72.4	66.4	72.8
All Banks	77.8	86.1	84.0	69.6	69.2	70.2
Net NPLs to Net Loans						
Public Sector Commercial Banks	1.5	1.0	1.6	6.1	6.9	6.4
Local Private Banks	1.1	0.8	1.1	2.7	3.0	3.0
Foreign Banks	(1.0)	(0.9)	(0.6)	0.5	0.7	0.8
Commercial Banks	1.1	0.8	1.1	3.3	3.6	3.6
Specialized Banks	18.7	14.0	10.0	10.0	12.1	8.6
All Banks	1.6	1.1	1.3	3.4	3.9	3.7
Net NPLs to Capital						
Public Sector Commercial Banks	6.4	3.4	6.2	30.3	31.6	30.0
Local Private Banks	7.1	4.1	5.9	15.9	15.4	15.6
Foreign Banks	(5.1)	(4.1)	(2.6)	1.6	2.0	1.9
Commercial Banks	6.2	3.7	5.6	17.9	17.9	17.8
Specialized Banks	-	-	-	-	-	-
All Banks	9.7	5.6	6.9	19.4	19.6	19.0
EARNINGS						
Return on Assets (Before Tax)						
Public Sector Commercial Banks	4.0	3.5	1.9	0.6	1.7	1.1
Local Private Banks	3.1	2.0	2.4	1.3	1.9	1.8
Foreign Banks	3.2	1.5	2.3	0.0	1.0	0.4
Commercial Banks	3.2	2.3	2.3	1.1	1.8	1.6
Specialized Banks	(1.3)	1.4	3.6	3.2	3.8	3.3
All Banks	3.1	2.2	2.3	1.2	1.8	1.7

*Data for 2007 has been restated on the basis of audit for the year, CAR and Tier 1 to RWA is on the basis of Basel-II.

Financial Soundness Indicators

(In percent)

Indicators	2006	2007	Jun-08	2008	Mar-09	Jun-09
Return on Assets (After Tax)						
Public Sector Commercial Banks	2.7	2.5	1.2	0.5	0.9	0.6
Local Private Banks	2.1	1.4	1.8	0.9	1.2	1.1
Foreign Banks	2.1	0.7	1.1	0.3	0.4	0.1
Commercial Banks	2.19	1.6	1.7	0.8	1.1	1.0
Specialized Banks	(1.8)	0.71	3.6	1.8	2.4	1.9
All Banks	2.08	1.5	1.7	0.8	1.1	1.0
ROE (Avg. Equity & Surplus) (Before Tax)						
Public Sector Commercial Banks	32.4	27.2	14.6	5.2	14.7	9.5
Local Private Banks	36.2	20.4	23.6	12.9	18.1	17.8
Foreign Banks	30.0	13.1	21.5	0.0	6.7	2.8
Commercial Banks	34.7	21.8	21.4	10.6	16.8	15.2
Specialized Banks	-	-	-	-	-	-
All Banks	35.2	22.6	22.4	11.4	17.7	16.0
ROE (Avg. Equity & Surplus) (After Tax)						
Public Sector Commercial Banks	21.7	19.5	9.0	4.4	7.8	5.3
Local Private Banks	25.0	13.8	18.3	8.5	11.3	11.0
Foreign Banks	20.4	6.0	9.8	2.2	2.8	0.5
Commercial Banks	23.7	15.0	15.8	7.3	10.1	9.2
Specialized Banks	-	-	-	-	-	-
All Banks	23.8	15.4	16.7	7.8	10.7	9.7
NII/ Gross Income						
Public Sector Commercial Banks	69.5	65.9	68.6	65.4	68.6	70.0
Local Private Banks	73.5	70.7	71.2	73.3	78.9	75.9
Foreign Banks	65.8	59.1	52.5	61.3	54.8	57.2
Commercial Banks	72.1	69.2	69.7	71.3	76.1	74.1
Specialized Banks	40.1	42.8	43.4	46.6	65.9	41.3
All Banks	70.9	68.2	68.7	70.4	75.8	73.0
Cost / Income Ratio						
Public Sector Commercial Banks	31.8	30.2	33.6	39.1	48.1	48.4
Local Private Banks	40.7	45.4	48.4	51.8	49.2	48.6
Foreign Banks	49.8	57.0	49.7	69.6	58.6	63.6
Commercial Banks	39.4	42.8	45.6	50.2	49.5	49.3
Specialized Banks	62.6	53.2	36.6	52.1	60.4	70.6
All Banks	40.3	43.2	45.1	50.3	49.9	50.1
LIQUIDITY						
Liquid Assets/Total Assets						
Public Sector Commercial Banks	33.9	37.0	32.3	30.5	31.4	30.2
Local Private Banks	31.1	32.5	31.5	27.4	29.5	30.5
Foreign Banks	41.0	41.6	37.6	45.3	49.6	54.7
Commercial Banks	32.2	33.8	31.9	28.7	30.7	31.5
Specialized Banks	23.0	27.9	21.0	24.5	21.6	22.2
All Banks	31.9	33.6	31.6	28.6	30.5	31.2
Liquid Assets/Total Deposits						
Public Sector Commercial Banks	42.6	47.1	40.7	38.8	40.3	38.6
Local Private Banks	40.6	42.9	40.7	35.7	39.3	39.9
Foreign Banks	61.1	61.1	54.6	71.9	79.6	84.2
Commercial Banks	42.0	44.3	41.1	37.6	41.0	41.2
Specialized Banks	205.4	247.7	203.5	229.4	243.7	206.9
All Banks	42.7	45.1	41.6	38.2	41.5	41.7
Advances/Deposits						
Public Sector Commercial Banks	64.6	60.0	63.7	68.4	65.2	65.0
Local Private Banks	74.5	70.1	69.4	75.4	71.4	69.2
Foreign Banks	80.1	75.2	66.5	69.1	65.1	57.5
Commercial Banks	72.7	73.8	68.2	73.8	69.9	67.9
Specialized Banks	528.4	507.3	559.9	577.0	721.3	597.2
All Banks	74.6	69.7	69.8	75.5	71.7	69.6

*Data for 2007 has been restated on the basis of audit for the year, CAR and Tier 1 to RWA is on the basis of Basel-II.

Selected Indicators for Different Categories of Banks **in terms of Size June 30, 2009**

(In percent)

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	51.8	73.1	92.5	100
Share of Total Deposits	54.7	77.3	93.2	100
Share of Gross Income	59.0	75.8	94.5	100
Share of Risk Weighted Assets	51.8	72.0	92.3	100
Capital Adequacy				
Capital/RWA	14.4	13.5	13.4	13.5
Tier 1 Capital / RWA	11.7	11.0	11.1	11.3
Net Worth / Total Assets	10.3	9.7	10.1	10.2
Asset Composition				
Sectoral Distribution of Loans (Domestic)				
- Corporate Sector	51.0	75.0	93.1	100
- SMEs	41.0	61.3	89.1	100
- Agriculture	27.8	38.8	94.8	100
- Consumer Finance	51.4	76.1	94.2	100
- Commodity Financing	83.1	93.0	98.7	100
- Staff Loans	57.9	74.6	91.3	100
- Others	76.8	94.6	95.0	100
- Total	53.5	74.7	93.5	100
NPLs / Gross Loans	10.3	10.8	11.2	11.5
Net NPLs / Capital	15.0	18.5	18.8	19.0
Earning & Profitability				
ROA (After Tax)	1.9	1.4	1.3	1.0
ROE (After Tax)	18.8	15.0	12.4	9.7
Net Interest Income / Gross Income	78.1	76.4	73.6	73.0
Income from Trading & Foreign Exchange / Gross Income	15.6	17.0	17.2	17.8
Non-Interest Expense / Gross Income	38.1	43.6	46.2	50.1
Provision Expense to Gross Income	19.2	21.8	22.2	23.3
Liquidity				
Liquid Assets / Total Assets	30.0	30.1	30.7	31.2
Liquid Assets held in Govt. Securities / Total Liquid Assets	50.9	52.4	55.7	54.0
Liquid Assets / Total Deposits	37.9	38.0	40.7	41.7

Bank-wise Major Statistics June 30, 2009

(Amount in million Rupees)

S. No.	Name of the Banks	Assets	Advances	Deposits	Equity
Public Sector Commercial Banks					
1	National Bank of Pakistan	897,812	451,600	692,721	109,850
2	First Women Bank Limited	9,307	3,956	7,816	1,181
3	The Bank of Punjab	232,841	130,081	194,236	12,359
4	The Bank of Khyber	33,174	11,510	23,289	5,030
Local Private Banks					
5	Allied Bank Limited	386,181	212,152	312,777	26,655
6	Bank Alfalah Limited	344,309	188,356	295,603	22,487
7	Askari Bank Limited	221,927	129,130	180,658	14,035
8	Bank Al Habib Limited	213,435	103,636	171,670	12,994
9	Mybank Limited	44,191	19,758	28,401	6,209
10	SAMBA Bank Limited	18,167	6,956	10,014	5,048
11	Atlas Bank Limited	31,109	19,550	26,143	2,978
12	Faysal Bank Limited	152,622	94,847	105,818	11,782
13	Habib Bank Limited	767,582	416,278	621,050	71,653
14	KASB Bank Limited	60,404	30,723	43,238	8,487
15	Arif Habib Bank Limited	32,626	17,743	24,382	5,666
16	JS Bank Limited	28,765	9,486	19,051	5,360
17	MCB Bank Limited	467,818	258,985	361,835	64,808
18	United Bank Limited	632,698	368,380	508,707	51,730
19	The Royal Bank of Scotland Limited	105,973	54,497	77,831	9,697
20	Habib Metropolitan Bank Limited	207,540	105,532	131,489	18,117
21	BankIslami Pakistan Limited	26,965	8,141	20,604	4,957
22	Emirates Global Islamic Bank	22,342	10,519	16,874	3,766
23	Soneri Bank Limited	88,055	45,857	66,464	7,604
24	SILKBANK Limited	63,212	32,563	48,730	3,557
25	NIB Bank Limited	191,268	84,656	99,942	41,286
26	Meezan Bank Limited	99,744	38,588	81,561	8,685
27	Dubai Islamic Bank Pakistan Limited	33,194	19,249	25,420	5,182
28	Standard Chartered Bank	287,628	123,309	189,947	44,059
29	Dawood Islamic Bank Limited	11,658	4,967	6,216	5,069
Foreign Banks					
30	Albaraka Islamic Bank B.S.C. (E.C.), Pakistan Operations	26,391	14,955	20,152	2,143
31	Citibank N.A. (Pakistan Operations)	103,226	32,927	62,388	9,817
32	Deutsche Bank AG (Pakistan Operations)	16,004	3,725	7,370	4,951
33	HSBC Bank Middle East Limited - (Pakistan Operations)	48,313	22,036	39,912	5,293
34	Oman International Bank S.A.O.G (Pakistan Operations)	3,689	385	507	2,777
35	The Bank of Tokyo-Mitsubishi UFJ Limited (Pakistan Operations)	7,790	1,900	2,288	3,868
36	Barclays Bank PLC (Pakistan Operations)	35,476	14,037	23,896	6,722
Specialized Banks					
37	The Punjab Provincial Cooperative Bank Ltd	13,712	6,734	1,837	3,696
38	Industrial Development Bank of Pakistan	4,930	142	3,797	(28,150)
39	Zarai Taraqati Bank Limited	108,701	75,921	6,287	19,056
40	SME Bank Limited	6,168	2,578	2,375	2,090
Total		6,086,949	3,176,345	4,563,295	622,554

Results of Stress Test of Banking System

Position Based on June 30, 2009

		Number of Banks with CAR		
		< 0%	0% - 9%	>9%
Pre-Shock		2	4	34
Post-Shock				
<u>Credit Shocks</u>				
C-1	15% of performing loans moving to substandard, 15% of substandard to doubtful, 25% doubtful to loss	3	7	30
C-2	Tightening of loan classification i.e. all NPLs under OAEM require 25% provisioning, all NPLs under substandard require 50% and all NPLs in doubtful category require 100% provisioning.	3	5	32
C-3	Deterioration of loans to the textile sector (25%) directly downgraded to doubtful category	2	7	31
C-4	25% of consumer loans (auto loans, personal loans & consumer durables only) classified into doubtful category.	2	5	33
<u>Market Shocks</u>				
<u>Interest Rate Shocks</u>				
IR-1	An increase in interest rates by 500 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
<u>Exchange Rate Shocks</u>				
ER-1	Depreciation of exchange rate by 25%	2	4	34
ER-2	Appreciation of exchange rate by 25%	3	6	31
ER-3	Depreciation of PRs against all currencies (25%) and deterioration of unhedged FX loans	3	4	33
<u>Equity Price Shocks</u>				
Eq-1	Fall in the equity prices by 50%.	2	5	33
Eq-2	Fall in the equity prices by 70%.	2	5	33
<u>Combined Credit & Market Shocks</u>				
COMB-1	Interest rates increase (5%), deterioration of loans to the textile sector (25%) directly downgraded to doubtful category, and fall in equity prices by 50%.	3	13	24
COMB-2	Interest rates increase (5%), migration of loan portfolio (performing to substandard: 15%, substandard to doubtful: 15%, doubtful to loss: 20%), stock market price depreciation (50%).	3	14	23
<u>Liquidity Shock</u>		Number of Banks		
		Becoming Illiquid after Shock		
		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	2	4

Group wise Balance Sheets and Income Statements of Islamic Banks/Branches - June 30, 2009

(Amount in million Rupees)

Financial Position	Islamic Banks	Islamic Banking Branches	Total Islamic Banking
ASSETS			
Cash & Balances With Treasury Banks	16,717	8,357	25,074
Balances With Other Banks	23,996	9,894	33,890
Due from Financial Institutions	30,181	500	30,681
Investments - Net	34,632	18,908	53,540
Financing - Net	96,420	43,886	140,306
Operating Fixed Assets	8,651	3,018	11,669
Deferred Tax Assets	1,003	0	1,003
Other Assets	8,696	8,145	16,841
TOTAL ASSETS	220,294	92,709	313,003
LIABILITIES			
Bills Payable	2,645	657	3,302
Due to Financial Institution	7,540	5,033	12,573
Deposits And Other Accounts	170,828	67,341	238,169
Sub-ordinated Loans	0	0	0
Liabilities Against Assets Subject To Finance Lease	60	0	60
Deferred Tax Liabilities	525	1	526
Other Liabilities	8,894	10,509	19,404
TOTAL LIABILITIES	190,492	83,541	274,033
NET ASSETS	29,802	9,168	38,970
NET ASSETS REPRESENTED BY: -			
Share Capital	29,927	6,388	36,315
Reserves	973	6	979
Unappropriated Profit	(1,239)	2,149	910
Share Holders' Equity	29,660	8,543	38,203
Surplus/Deficit On Revaluation Of Assets	142	625	768
TOTAL	29,802	9,168	38,970
PROFIT AND LOSS STATEMENT			
Mark-Up Income	10,483	4,958	15,441
Mark-Up Expenses	5,637	2,652	8,289
Net Mark-Up	4,846	2,306	7,152
Provisions & Bad Debts Written Off Directly/(Reversals)	1,570	90	1,661
Net Mark-Up After Provision	3,276	2,215	5,491
Fees, Commission & Brokerage Income	618	145	763
Dividend Income	72	36	108
Income From Dealing In Foreign Currencies	557	22	578
Other Income	45	74	120
Total Non - Markup	1,292	277	1,569
Administrative Expenses	4,533	1,105	5,637
Other Expenses	(7)	45	37
Total Non-Markup	4,525	1,149	5,675
Profit before Tax and Extra ordinary Items	43	1,343	1,385
Extra ordinary/unusual Items -- Gain/(Loss)	0	0	0
PROFIT/ (LOSS) BEFORE TAXATION	43	1,343	1,385
Taxation	279	0	279
PROFIT/ (LOSS) AFTER TAX	(237)	1,343	1,106

Balance Sheets and Income Statements of DFIs- June 30, 2009

(Amount in million Rupees)

Financial Position	All DFIs
ASSETS	
Cash & Balances With Treasury Banks	1,553.8
Balances With Other Banks	5,091.3
Lending To Financial Institutions	12,814.3
Investments - Net	50,986.3
Advances - Net	38,347.6
Operating Fixed Assets	3,031.6
Deferred Tax Assets	964.7
Other Assets	4,177.2
TOTAL ASSETS	116,966.9
LIABILITIES	
Bills Payable	-
Borrowings From Financial Institution	45,984.5
Deposits And Other Accounts	14,342.1
Sub-ordinated Loans	-
Liabilities Against Assets Subject To Finance Lease	34.8
Deferred Tax Liabilities	-
Other Liabilities	4,900.1
TOTAL LIABILITIES	65,261.4
NET ASSETS	51,705.5
NET ASSETS REPRESENTED BY: -	
Share Capital	44,013.9
Reserves	7,787.8
Unappropriated Profit	(1,741.6)
Share Holders' Equity	50,060.1
Surplus/Deficit On Revaluation Of Assets	1,645.4
TOTAL	51,705.5
OPERATING POSITION	
Mark-Up/ Return/Interest Earned	5,935.4
Mark-Up/ Return/Interest Expenses	3,060.0
Net Mark-Up / Interest Income	2,875.3
Provisions & Bad Debts Written Off Directly/(Reversals)	2,069.1
Net Mark-Up / Interest Income After Provision	806.2
Fees, Commission & Brokerage Income	99.8
Dividend Income	135.0
Income From Dealing In Foreign Currencies	36.9
Other Income	121.1
Total Non - Markup / Interest Income	392.8
Administrative Expenses	1,260.2
Other Expenses	14.2
Total Non-Markup/Interest Expenses	1,274.3
Profit before Tax and Extra ordinary Items	(75.2)
Extra ordinary/unusual Items -- Gain/(Loss)	141.0
PROFIT/ (LOSS) BEFORE TAXATION	(216.2)
Taxation	370.4
PROFIT/ (LOSS) AFTER TAX	(586.7)

Capital Structure and Capital Adequacy Ratio of All Banks and DFIs as of June 30, 2009

(Amount in million Rupees)

		All Banks and DFIs	PSPB	LPB	FB	SB	DFIs	All Banks
E q u i t y								
1.1	Fully Paid-up Capital/Capital Deposited with SBP	369,085	31,339	244,573	33,652	15,507	44,014	325,071
1.2	Balance in Share Premium Account	30,470	38	30,433	-	-	-	30,470
1.3	Reserve for issue of Bonus shares	-	-	-	-	-	-	-
1.4	General Reserves as disclosed on the Balance Sheet (including statutory reserve)	104,216	15,212	78,268	(243)	2,447	8,532	95,684
1.5	Un-appropriated/Unremitted profits (net of accumulated losses, if any)	80,732	48,119	57,829	2,208	(24,818)	(2,606)	83,338
1.6	Minority interest	2,775	-	2,775	-	-	-	2,775
1.7	Sub-Total (1.1 to 1.5)	587,279	94,708	413,879	35,617	(6,864)	49,940	537,339
Deductions								
1.8	Goodwill	58,995	6	58,684	252	46	7	58,988
1.9	Shortfall in Provisions required against Classified assets	2,347	-	2,067	-	279	-	2,347
1.10	Deficit on account of revaluation of AFS investment	4,378	1,213	1,372	171	553	1,069	3,309
1.11	Any increase in equity capital resulting from a securitization transaction	-	-	-	-	-	-	-
1.12	Investments in TFCs of other banks	-	-	-	-	-	-	-
1.13	Other Deductions	9,576	1,692	6,430	-	158	1,296	8,280
1.14	Sub-Total (1.7 to 1.10)	75,296	2,911	68,554	423	1,036	2,372	72,924
1.15	Total Eligible Tier 1 capital	511,983	91,797	345,324	35,193	(7,900)	47,568	464,415
Supplementary Capital								
2.1	Freely available General Provisions or reserves for loan losses-up to maximum of 1.25% of Risk Weighted Assets	14,391	2,175	9,912	908	1,173	223	14,169
2.2	Revaluation reserves eligible up to 45%	33,661	12,539	17,891	-	2,016	1,216	32,445
2.3	Foreign Exchange Translation Reserves	19,869	6,305	13,564	-	-	-	19,869
2.4	Undisclosed reserves	-	-	-	-	-	-	-
2.5	Subordinated debt-up to maximum of 50% of total equity	33,668	-	30,464	-	3,204	-	33,668
2.6	Total Tier 2 Supplementary Capital (2.1 - 2.5)	101,590	21,020	71,831	908	6,393	1,438	100,152
Deductions								
	Other deductions	9,576	1,692	6,430	-	158	1,296	8,280
	Total Deductions	9,576	1,692	6,430	-	158	1,296	8,280
	Total eligible tier 2 capital	92,014	19,328	65,400	908	6,235	142	91,871
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)	89,488	19,328	64,871	908	4,239	142	91,871
2.9	TOTAL CAPITAL (1.12+2.8)	601,471	111,125	410,195	36,102	(3,661)	47,710	556,286
Risk Weighted Amounts								
3.3	Total Credit Risk Weighted Assets	3,456,001	617,825	2,566,455	122,312	90,141	59,268	3,396,734
3.4	Total Market Risk Weighted Assets	195,009	47,390	119,241	5,775	50	22,553	172,456
	Total Operational Risk Assets	546,072	101,078	391,764	24,516	17,240	11,473	534,599
3.5	Total Risk Weighted Amount	4,197,081	766,294	3,077,461	152,603	107,431	93,293	4,103,788
Capital Adequacy Ratios (CAR)								
	Tier 1 capital to Total Risk Weighted Amount	12.20%	11.98%	11.22%	23.06%	-7.35%	50.99%	11.32%
	Total Capital Adequacy Ratio	14.33%	14.50%	13.33%	23.66%	-3.41%	51.14%	13.56%
	Tier 2 capital to Total Risk Weighted Amount	2.13%	2.52%	2.13%	0.60%	5.80%	0.15%	2.24%
OTHER DEDUCTIONS FROM TIER 1 AND TIER 2 CAPITAL								
(Rs. In Thousands)								
1.1	Investments in equity and other regulatory capital of majority owned securities or other financial subsidiaries not consolidated in the balance sheet	12,929	1,514	11,018	-	315	81	12,848
1.2	Significant minority investments in banking, securities and other financial entities (para 1.1 scope of Application)	5,265	1,870	1,544	-	-	1,852	3,414
		126	-	126	-	-	-	126
1.3	Equity holdings (majority or significant minority) in an insurance subsidiary (para 1.1 scope of Application)	398	-	98	-	-	300	98
		-	-	-	-	-	-	-
1.4	Significant minority and majority investments in commercial entities exceeding 15% of bank's capital	-	-	-	-	-	-	-
1.5	Securitization exposure subject to deduction (para 4.3.1 of instructions)	-	-	-	-	-	-	-
1.6	Others	435	-	75	-	-	360	75
1.7	Total Deductible Items to be deducted 50% from Tier 1 capital and 50% from Tier 2 capital	19,152,730	3,383,922	12,860,896	-	315,457	2,592,455	16,560,275

Group-wise Composition of Banks June 30, 2009

2006	2007	2008	Jun-09
A. Public Sector Com. Banks (4) National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab B. Local Private Banks (24) Askari Commercial Bank Ltd. Bank Alfalah Ltd. Bank AL Habib Ltd. Mybank Ltd. Faysal Bank Ltd. Habib Metropolitan Bank Ltd. KASB Bank Ltd. Prime Commercial Bank 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 Rupali Bank Ltd. Dubai Islamic Bank Pakistan Ltd. BankIslami Pakistan Ltd. JS Bank Ltd. C. Foreign Banks (7) ABN AMRO Bank N.V. Albaraka Islamic Bank B.S.C. Bank of Tokyo - Mitsubishi UFJ, Ltd. Citibank N.A. Deutsche Bank AG Oman International Bank S.A.O.G. The Hongkong & Shanghai Banking Corporation Ltd. D. Specialized Banks (4) Zarai Taraqati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. All Commercial Banks (35) Include A + B + C All Banks (39) Include A + B + C + D	A. Public Sector Com. Banks (4) National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab B. Local Private Banks (26) 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 C. Foreign Banks (6) 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. D. Specialized Banks (4) Zarai Taraqati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. All Commercial Banks (36) Include A + B + C All Banks (40) Include A + B + C + D	A. Public Sector Com. Banks (4) National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab B. Local Private Banks (25) 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. SAMBANK 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 C. Foreign Banks (7) 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 Middle East Ltd. D. Specialized Banks (4) Zarai Taraqati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. All Commercial Banks (36) Include A + B + C All Banks (40) Include A + B + C + D	A. Public Sector Com. Banks (4) National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab B. Local Private Banks (25) 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. SAMBANK 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. C. Foreign Banks (7) 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 Middle East Ltd. D. Specialized Banks (4) Zarai Taraqati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd. All Commercial Banks (36) Include A + B + C All Banks (40) Include A + B + C + D

* Formerly Saudi Pak Commercial Bank.

List of Abbreviations

ADD	Authorized Derivatives Dealer
ADR	Advances to Deposits Ratio
BIA	Basic Indicator Approach
bps	Basis Points
CAR	Capital Adequacy Ratio
CB	Commercial Bank
CCF	Credit Conversion Factor
CCS	Cross Country Swaps
CDR	Credit to Deposit Ratio
CPI	Consumer Price Index
CPV	Credit Portfolio View
CRM	Credit Risk Mitigants
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
FR	Forward Rate Agreements
FSV	Forced Sale Value
GDP	Gross Domestic Product
Govt.	Government
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
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
PICIC	Pakistan industrial Credit and Investment Corporation
PKR	Pak Rupee
PSCB	Public Sector Commercial Bank
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
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