2 Broadening Access to Financial Sector

2.1 Overview

One of the major objectives of financial sector reforms in Pakistan was to enable banks to direct funds to sectors, which have greater significance in terms of economic and social growth and that have so far largely been under-served. To achieve this objective, State Bank of Pakistan has undertaken several initiatives to broaden financial services access to underserved and marginalized sectors of the economy. The Development Finance Group (DFG) at SBP is taking steps to develop capacities to better understand new niche areas such as Infrastructure and Housing Finance, SME and Microfinance, Agriculture and Rural Finance which have not yet been developed to their true potential. SBP also endeavors to build and strengthen an inclusive financial system, supported by effective regulatory measures, aimed at integrating these niche areas in the mainstream banking sector, on a fast track basis. SME Finance Department undertook many initiatives to increase outreach and quantum of SME credit. The department played active role in arranging timely provision of credit from banking sector for wheat procurement purposes. To boost exports and provide relief to exporters in meeting their export orders, State Bank took a number of steps to facilitate exporters during FY09. SBP reverted to providing 100 percent refinance under the Export Finance Scheme (EFS) and Long Term Financing Facility (LTFF), and also allowed a longer repayment period of financing under Part I of EFS. To mitigate the risk of banks and farming community against losses, caused by natural calamities, SBP also developed and launched a market based Crop Loan Insurance Scheme (CLIS) during the year and made the scheme initially mandatory for five major crops. Similarly for the growth and development of microfinance sector, important initiatives like; i) Microfinance Credit Guarantee Facility; ii) Institutional Strengthening Fund; and iii) Improving Access to Finance Services Fund, were also launched during 2008-09.

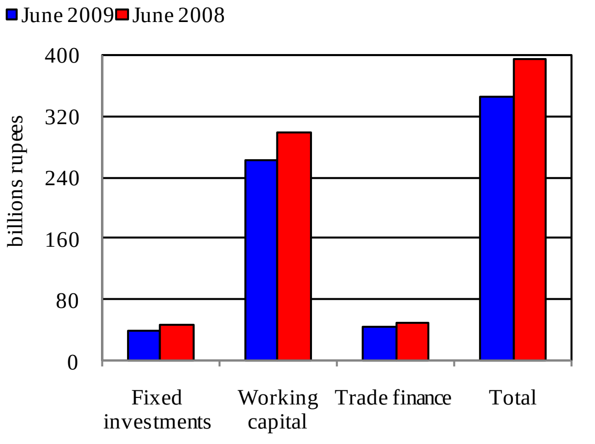
2.2 SME

Like many other developing countries, in Pakistan too, the SMEs sector is the mainstay of the economy. SMEs play a catalytic role in low cost employment generation, poverty alleviation, and economic development. SBP realizes the importance of SMEs for providing forward and backward linkages among social and economic activities of the economy, encouraging an entrepreneurial culture, and boosting Pakistan's foreign exchange earnings.

2.2.1 SME Credit Profile

SME sector finance occupies second place in terms of total finance from formal sector (10 percent) after Corporate Finance. At the end of June 2009, total outstanding loans to the SME sector stood at Rs345.1 billion compared to Rs393.6 billion in June 2008. The decline in SME credit was mainly due to power outages leading to reduced production activity, liquidity squeeze as well as more cautious SME lending approach by the banks. Adverse law and order situation in the country coupled with global recession also had negative impact on Pakistan economy. A break up of the SME loans reveal that out of the total SME portfolio of Rs345.1 billion, around 76 percent were disbursed for working capital, followed by 13 percent for trade

Figure 2.1: Advances to SME Sector



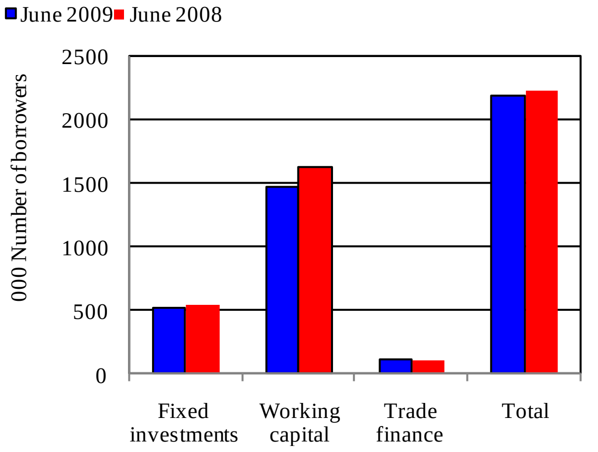
finance and 11 percent for fixed investment finance as shown in **Figure 2.1.**

The number of SME borrowers also witnessed a decrease of 2 percent during FY 09. The total numbers of SME borrowers were 219,062 at the end of June 2009 as compared to 223,675 at end June 2008 (**Figure 2.2**). However, further fall in SME credit has been arrested due to close follow up of SME Finance Department with commercial banks as well as prudent macroeconomic measures by the government.

2.2.2 SBP initiatives for growth of SME Finance

SME Finance Department, realizing the importance of SME sector as engine of economic growth and employment provider to vast population in non-agri sector has taken many initiatives to ensure that the financing needs of SMEs are met by the banking sector.

Figure 2.2: SME Number Borrowers



SME Credit Guarantee Scheme

Credit Guarantee Schemes are programs that insure the repayment of a loan, in part or full, to motivate lenders to lend to groups which would not have access to credit under normal circumstances. Credit Guarantee Programs seek to help overcome the problem of loan applicants who have good projects, and are in every respect credit worthy, but cannot offer adequate collateral to satisfy the normal requirements of a lending bank. SME Finance Department is making efforts to introduce a credit guarantee scheme with the support of UK's DFID under Financial Inclusion Program (FIP). The launch of the scheme is expected to create significant demonstration effect whereby banks will be encouraged to seize business opportunities in those segments where they normally hesitate to lend due to the borrowers' inability to offer collateral but have credible cash flows. The concept of the scheme has been in principle, approved internally and will soon be launched.

Indicative Lending Targets for Banks

State Bank of Pakistan has established a high level SME Credit Advisory Committee (SMECAC) with the objective to review the existing SME lending and make suggestions to improve the flow of financing to SMEs. The committee has also decided to assign indicative targets for SME Finance to the banks. These indicative targets work as an important benchmark to measure the banks' performance in terms of increased SME exposure through suitable alignment of their plans and strategies**.**

SME Finance Cluster Training Program

Lending to SMEs require special set of skills to be developed by the lending staff in different commercial banks. These skills are required in the area of product development, credit risk management; cash flow based lending, and product sale and marketing. To improve capacity of the bankers in these important areas, SBP conducted training program during the year 2008-09 in Lahore, Rawalpindi, Sialkot, Gujranwala, Peshawar, and Quetta with greater participation from regional SME bankers.

Development Finance Quarterly Review

During the year, SBP initiated preparing DFG Quarterly Review at the end of each quarter containing analysis of flow of credit to sectors of economic importance falling under the purview of DFG including SME, Microfinance, Agriculture, Infrastructure and Housing. DFG Quarterly Review helps in taking necessary steps to improve the flow of credit to these sectors.

Establishing Mechanism for SME Credit Rating Service

Despite rapid growth of SME sector in recent years, authentic and independent credit research in this sector has so far been minimal. With many private and public sector banks directing resources and focus towards SME lending, the need has arisen for independent credit opinions. SBP realizing the importance of SME Credit Rating service has initiated efforts for starting SME Rating Service in Pakistan. In this regard, SBP has coordinated with relevant stakeholders including existing Credit Rating Agencies. Modalities for launching of SME Rating service have been finalized and the SME Rating service would be launched soon.

2.2.3 Financing under Export Finance Scheme

In view of the global financial crisis, economic slowdown in the country and liquidity squeeze faced by banks, SBP took a number of steps to facilitate exporters during FY09. SBP reverted to providing 100 percent refinance under the Export Finance Scheme (EFS) and Long Term Financing Facility (LTFF), allowed a longer repayment period of financing under Part I of EFS. Further, a new mechanism of performance based mark up rates was introduced under the scheme to encourage high performers. Similarly under LTFF), SBP allowed one year deferment of principal amounts repayments, enhanced the scope of the scheme by including ethanol, pharmaceuticals, furniture, value added sectors of spinning and second hand machinery. SBP also allowed one time facility to refinance commercial long term loans disbursed during the period January 1, 2005 to March 31, 2009 against eligible sectors/machinery.

During FY 09, Rs437.810 billion was disbursed under EFS Scheme by various offices of SBP-BSC (Bank). Outstanding position of financing under EFS was Rs177.375 billion as of June 30, 2009 showing over all flow of Rs34.558 billion during July-June 2008-09. A comparative position of export refinance outstanding as of June 30, 09 and disbursements during FY 09 under the scheme is given in **Table 2.1**.

Sector-wise Financing under EFS

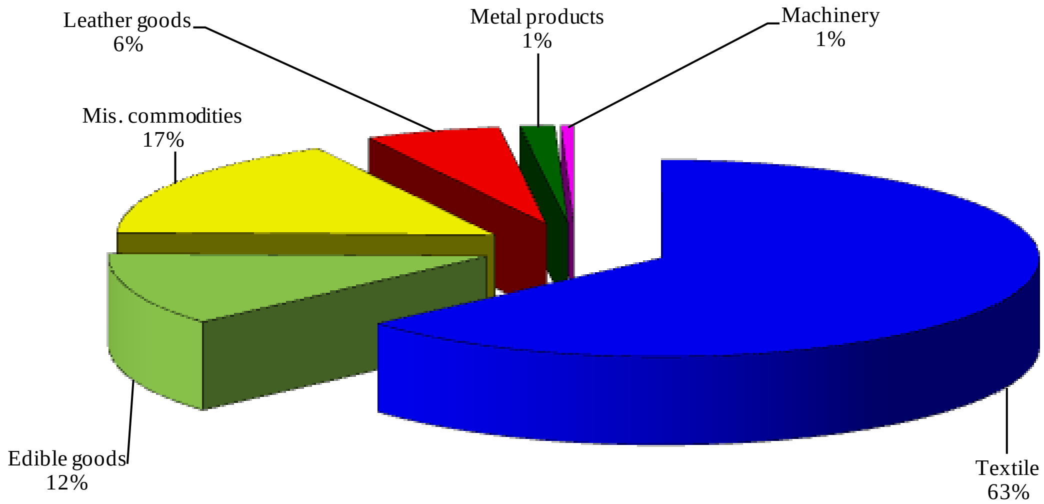
Sector-wise position reveals that the highest amount (about Rs112.6 billion) was outstanding for textile sector. Within the textile sector, readymade garments had highest outstanding amount (Rs30.7 billion). Under edible goods, the highest amount was against rice (Rs16.8 billion). The overall sector-wise break up is given in **Figure 2.3**.

Table 2.1 Export Finance Scheme

million rupees

	Outstanding			Disbursements	
	Outstanding as June			Refinance provided during	
	FY08	FY09	Absolute change	FY08	FY09
Part-I	34,296	49,545	15,249	94,633	123,371
Part-II	108,521	127,829	19,308	252,473	314,439
Total	**142,817**	**177,374**	**34,557**	**347,106**	**437,810**

Figure 2.3: Sector-wise Break-up of the Refinance Outstanding during FY09



Long Term Financing Facility

Outstanding position of funds disbursed under Long Term Financing Facility (LTFF) as of June 30, 2009 was Rs5, 603 million against 88 borrowers while textile sector share was Rs3,962 (71 percent) against 71 borrowers. Overall sector wise position is given in **Table 2.2**.

Table 2.2 Sector wise Outstanding Position of Funds under LTFF

million rupees

Sectors	Number of borrowers	Outstanding
Textile	71	3,962
Engineering goods	6	1,200
Rice processing	6	191
Leather products	1	21
Fisheries	2	14
Others	2	213
Total	**88**	**5,603**

Long Term Financing – Export Oriented Project (LTF-EOP)

Outstanding position under LTF-EOP (defunct) shows repayments of Rs6, 241 million during the year and outstanding level of financing as of June 30, 2009 was Rs32, 389 million.

Policy Changes and Incentive to Exporters

Export Finance Scheme

- To meet the growing working capital financing requirements of exporters and providing more liquidity to banks, SBP started 100 percent refinancing under EFS.
- Performance-Based Rates mechanism was introduced under EFS Part II to give incentive to well performing exporters.
- Period of refinancing under EFS Part I was extended to 270 days.
- Waiver up to end- December 31, 2009 was allowed to exporters having overdue proceeds.
- Performance requirement for hand knotted carpets against financing facilities availed under Part II of EFS during FY 2008-09 was reduced from 2.0 times to 1.50 times.
- Shipment period under EFS Part-I was extended to further 180 days for exporters with shipment falling due in FY09.

Long Term Financing Facility

- Grace period of one-year was allowed in repayment of principal amounts on the outstanding financing under SBP's long term financing schemes.
- The scope of LTFF was expanded by allowing refinance facility against; (i) import/purchase of used machinery; and (ii) by including Ethanol, Furniture, Pharmaceutical and sub-sectors (Doubling, Twisting, Combing, Slubbing, Lycra, and Yarn Dyeing) of Spinning Sector in the scheme.
- One-time opportunity was allowed to the value added non-textile sectors to Refinance 50 percent outstanding long-term loans availed from banks/DFI since January 1, 2005 to March 30, 2009 for import/purchase of plant and machinery.

2.3 Microfinance

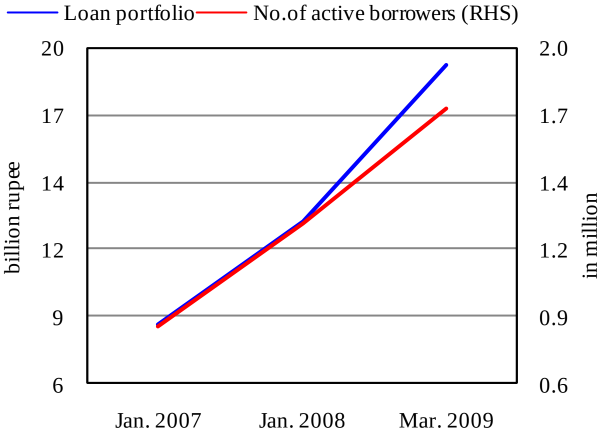
Microfinance is in the early stages of development within the financial sector of Pakistan. Currently, there are eight licensed Microfinance Banks (MFBs), out of which six operate at the national level, and two at the district level. In addition to MFBs, numerous Microfinance Institutions (MFIs), Non Governmental Organizations (NGOs) and Rural Support Programs (RSPs) are providing microfinance services in the country.

The microfinance industry has remarkably spread out to 1.8 million active borrowers from almost negligible base in 2003, out of which about 50 percent are female clients. Despite this significant growth in microfinance in recent years, financial exclusion is still considerably high in Pakistan as only 12 percent of the adult population has access to formal financial services, according to the Access to Finance Survey of 2008 sponsored by the World Bank. Furthermore, the same survey suggests that 56 percent of the adult population is completely financially excluded from access to financial services.

Microfinance has seen mixed signs of growth during 2008. And for the first time in more than 3 years, a negative trend in microcredit growth has been observed in the last quarter of 2008. However, the first quarter of 2009 ended up with slight positive growth. Outreach of Microfinance sector in term of borrowers has seen a positive growth rate of about 36 percent during 2008 compared to the annual average growth rate of 40 percent during 2003-2007.

Apart from microcredit, microfinance banks have experienced growth in all other areas, namely, enabling policy environment, supporting infrastructure, institutional development, promotion of alternate delivery channels, human resource, use of technology, increased outreach in the form of number of microfinance banks, and increase in service outlets. The commitment of the government and the State Bank of Pakistan facilitated in laying down the foundation of the sector that holds key to broadening access to financial services and expanding associated business opportunities for commercial/social investors.

Figure 2.4: Microfinance Outreach



In February 2007, State Bank, in consultation with local stakeholders, developed a national strategy for Microfinance namely 'Expanding Microfinance Outreach' (EMO) strategy. The strategy presents a diagnostic assessment of the sector, identifies critical factors limiting desired level of growth, envision outreach goals, and recommends steps/initiatives for strengthening the sector's capacity to achieve scalability and sustainability. The performance of microfinance outreach since the implementation of EMO strategy is presented in **Figure 2.4.**

During 2008, SBP had taken several initiatives in microfinance policy and development programs to promote microfinance and achieve its strategic goals of increased outreach of microfinance banks through 'Expanding Microfinance Outreach Strategy'. Key initiatives along with other developments in the sector are as under:

Pakistan Post and FMFB Partnership
The EMO strategy encouraged MFBs to find innovative solutions to promote growth in the sector. One of the key initiatives indentified in the strategy is for MFBs to utilize the vast network of Pakistan Post (PP) to reach out to rural and remote areas in cost effective manner. The First Microfinance Bank (FMFB) has successfully completed its collaborative pilot test with the Pakistan Post (PP) to deliver financial services through an alternative delivery channel. As a result of this partnership, FMFB has seen cost-effective growth, with a cost per borrower at the sub office (PP branches) being at just 37 percent of the total cost per borrower at a regular bank branch in the same area.

MF Exclusive CIB
Given the envisaged growth targets of three million borrowers by 2010, and growing competition among MFBs / MFIs in big cities, it was vital to have a dedicated MF-CIB in Pakistan for smooth functioning of MF markets. Thus establishment of MF exclusive CIB has been made part of EMO strategy. Based on the study recommendations done by an international consultant, commissioned by SBP, Pakistan Microfinance Network (PMN) in consultation with its members has initiated a pilot CIB project in Lahore. To facilitate the project, State Bank has allowed MFBs to share customer data with this pilot/private CIB(s) subject to development of comprehensive customer protection and confidentiality guidelines, approved by their Board of Directors, taking customers' consent.

Licenses to New Microfinance Banks
EMO Strategy also envisages institutional development through transformation of stronger MFIs/RSPs into regulated MFBs. As part of this initiative, SBP has issued license to KASHF microfinance bank (June, 2008), and NRSP Microfinance Bank Limited (February, 2009), transformed into banks from KASHF Foundation and NRSP. KASHF has planned to reach out to over one million savers and 350,000 borrowers through a network of 100 nationwide branches by 2012. The NRSP microfinance bank has yet to start its operations.

Branchless Banking Project by Tameer Microfinance Bank
One of the strategic objectives of EMO strategy is to encourage MFBs to adopt new technologies to reach poor and remote communities in a cost-effective manner. After issuing license by SBP under Branchless Banking Regulations, Tameer MF Bank, in collaboration with Telenor, has initiated a pilot branchless banking (agent based) project in 2008. Significant work has been done, and the bank will soon launch its first product. Recently, SBP has also signed a MoU with Tameer under which SBP will provide Rs82 million to Tameer, through Institutional Strengthening Fund (ISF), to facilitate this initiative of Branchless Banking delivery channel.

International Alliances
We have also facilitated international alliances for development of domestic microfinance market. As a result, internationally recognized organizations such as ASA and BRAC of Bangladesh, incorporated as International NGOs, have commenced operations in Pakistan.

Savings and Credit Unions (CUs)
Revitalization of SCUs sector in Pakistan is also a strategic goal of EMO Strategy. SCUs work as member based financial institutions for deposit mobilization and catering financial needs of the people at gross root level. SBP is working to revitalize the SCUs sector in the country. In this connection, a delegation of World Council of Credit Union (WOCCU) will visit Pakistan in September 2009 to assess technical assistance needs of the sector.

Updation/Revision in Policy and Regulatory Framework
As the sector has taken various innovations / initiatives such as MF-specific CIB, branchless banking, certain changes/additions/ revisions are necessary in the regulatory framework. For this purpose, SBP has entered into a dialogue with the microfinance industry stakeholders to update/revise the PR, and develop proposals for amendments in *Microfinance Institutions Ordinance 2001*. A comprehensive review of the MFIs Ordinance and PRs has been conducted in consultation with internal and external stakeholders. As a result, a proposal of necessary amendments has been drafted, incorporating the dynamic needs of the sectors for enabling regulatory environment. The work on the revision of PRs and amendments in the MFI ordinance is in final stage.

2.3.1 Progress on Microfinance Programs
The Microfinance Department is currently managing various government and donor funded programs as part of its mandate to develop microfinance sector in Pakistan. During 2008-09, MFD made considerable progress on program implementation and took a number of initiatives to launch key interventions. Some of the programs launched are as follows:

Financial Inclusion Program
According to the Access to Finance Survey conducted in 2008, only 14 percent of the adult population in Pakistan uses formal financial services, some utilize informal financial services, and most have no access at all. Thus the economy of Pakistan is largely financially under penetrated, which also hinders economic growth. A well-developed financial system can assist in mobilizing savings, investments and redistribute risks. According to Michael Spence and other renowned economists in a recent publication by the World Bank, *The Growth Report*, a financial system that excludes a significant proportion of the population has deep ramification on the growth of the economy. Consequently, household savings are stunted. People need a secure, accessible vehicle for storing their wealth. If the banks do not provide it, people will save less, or store their money in less liquid forms that do not serve the wider economy well. The absence of savings channels is inequitable as well as inefficient. The same can be said of the uneven provision of other types of financial services, including credit and secure transactions at reasonable cost.

In July 2008, SBP in partnership with the UK Department for International Development (DFID) launched Financial Inclusion Program. The Financial Inclusion Program is worth UK £ 50 million to be implemented by State Bank of Pakistan. The program was designed and developed in 2008 through broader consultations with the stakeholders and will help SBP implement Pakistan's Microfinance Strategy which was approved by the prime minister in 2007. The program aims to develop microfinance sector's capacity to reach out to 3.0 million microfinance users by the end of 2010 and 5.0 million borrowers by 2015. The program is designed to manage sector transformation from a subsidy based informal institutional setting to a market-based regulated institutional system. In addition, the program also aims to support financial inclusion through improved remittance systems, branchless banking, expansion of SME and rural financing.

The FIP is targeted at access to financial services, using market based principles, to poor and marginalized groups. Under the Financial Inclusion Program, delivering sustainable financial services to micro, small and rural enterprises is key priority, for which specialized facilities have been launched. The program has made substantial progress during its first year which was considered to be an inception phase. The Microfinance Department (MFD) has successfully launched three of the program's most important interventions namely the Microfinance Credit Guarantee Scheme (MCGF) (£10m), the Institutional Strengthening Fund (ISF) (£10m) and the Technical Assistance components. In addition, given the FIP priority on microfinance sector, the FIP office has now been merged with the Microfinance Department. A motivated team of professionals with gender balance, and an established structure necessary for the two components; ISF and MCGF is in place. In the second phase the program will focus on launching a Financial Innovation Fund (£10m), Small and Rural Financing Guarantee (£10m) and projects on remittances, branchless banking and financial literacy. A multi-donor Credit Enhancement Fund is also being developed. The details and progress of FIP facilities launched is as follows:

Microfinance Credit Guarantee Facility (MCGF)

The MCGF was launched as a response to the recent financial sector crisis and to mitigate the perceived risks of commercial lenders about the microfinance sector. Under the facility SBP issued a £10m guarantee to cover partial risks against the loans extended by commercial banks. The facility is expected to facilitate banks/DFIs to play a leading role in easing credit constraints of MFBs/ MFIs in their efforts to maximize outreach by extending credit facilities to them. The facility is expected to achieve the following objectives:

- The guarantees are expected to help building links between micro borrowers and formal financial institutions. The familiarization of the bank with the client should eventually lead to the 'graduation' of the borrower.
- Under the facility, the SBP BSC shall provide Partial Guarantees (pari passu) to cover the principal amount in default or First Loss Default Guarantees to cover the first loss, limited to a certain percentage on the principal amount only to banks/DFIs, to minimize the perceived risk premium by covering part of the losses incurred on funds made available to MFBs/MFIs with the advantage of leveraging the guarantee fund a number of times while keeping the incentive for banks/DFIs to collect the loan.
- Banks/DFIs will evaluate the prospective recipient MFBs/MFIs according to the well defined due diligence criteria. This way the credit enhancement facility will serve the banks/DFIs to develop their own sense of the risks involved in microfinance.
- The guarantee will facilitate resolution of regulatory issues that limit unsecured lending by banks/DFIs and would bring the loans to MFBs/MFIs under compliance with banking regulations. Two large transactions have materialized under this guarantee in the first year.

Institutional Strengthening Fund (ISF)

In December 2008, the Institutional Strengthening Fund (ISF) worth UK £10 million was launched for microfinance sector. ISF aims to strengthen the human resource base, improve governance mechanisms, introduce new products and delivery systems hinging on technology and refining strategic direction of microfinance organizations. The fund will directly make microfinance institutions in Pakistan more competitive, moving them away from donor support and indirectly add to the depth and breadth of microfinance services in Pakistan. Thus far Rs297 million has been approved as grants under the ISF to the Pakistan Microfinance Network (PMN), Tameer Bank and the National Rural Support Program (NRSP). PMN will use the grant for capacity building and transparency of the microfinance sector, Tameer for developing branchless banking capacity and NRSP for developing Management and Information Systems. ISF grants will be used to cover one-time costs or investments along with a proportion of investment from partner institutions to ensure long-term sustainability of these projects.

Besides MCG and ISF, other facilities under FIP will be made operational in 2009. These include the Financial Innovation Challenge Fund, Small and Rural Credit Guarantee Facility, and the technical assistance for the financial sector especially in the areas of remittances and technology. These components will be available to a variety of private sector players including microfinance institutions and commercial banks. The rationale behind involvement of private sector is to build on their strengths and ability to innovate by providing technical assistance, which may not be available to these players otherwise. Innovations, funding, and assistance will reduce some of the barriers to access including access points and an enabling environment.

Improving Access to Financial Services Fund

In December 2008, Improving Access to Financial Services (endowment) Fund – IAFSF worth US$ 20 million was launched by SBP for a period of 20 years under ADB sponsored Improving Access to Financial Services Program – IAFSP. This facility is in addition to the ISF launched under the FIP. The IAFSF grants are available to support institutional capacity building initiatives of the stakeholders and basic and financial literacy of end users detailed as under:

- capacity building and training of financial services providers to promote expansion into rural areas; product and service innovation, including savings, remittances and Islamic financial services; adoption and integration of new technologies and applications for improving access to financial services;
- capacity building and training of government and regulatory authorities to support development of an inclusive financial sector and implementation of measures under the program; and
- Literacy programs (financial and basic) conducted by or on behalf of financial services providers for clients and potential clients to improve access to financial services and the utilization of finance.

2.4. Housing and Infrastructure Finance

According to the UN-Habitat, half of humanity lives in cities today, and that the urban population will increase to 60 percent within the next two decades. Developing world with highest growth rate of urban population absorbs on an average about 5 million new urban residents every month and thus accounts for 95 per cent of the world's urban population growth. Urban growth is a result of a combination of factors namely; geographical location, natural population growth, rural-to-urban migration, infrastructure development, national policies, corporate strategies, and other major political, social and economic forces.

Infrastructure and housing sectors are key forces driving an economy towards sustained growth that help keep pace with rapid urbanization. Therefore, the government and financial institutions are required to respond adequately and timely to this resultant increase. The ability of financial institutions to meet this demand in turn hinges on the country's overall institutional and regulatory framework for infrastructure and housing finance.

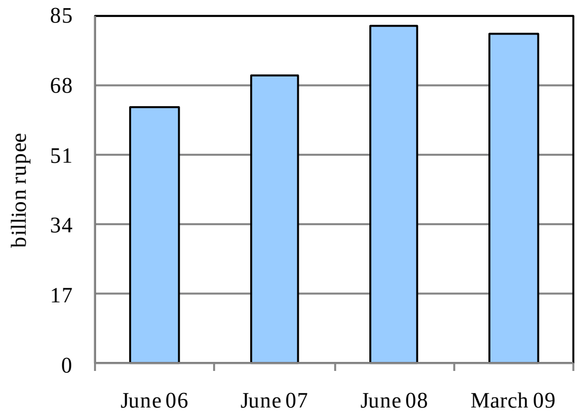
2.4.1 Housing Finance Market in Pakistan

Though the mortgage market in Pakistan is moving in the right direction and efforts are afoot to promote housing finance activities, a large part of the population continues to be unable to obtain a mortgage loan due to high cost of borrowing and lack of an enabling legal framework (including land titling issues). The total housing finance portfolio reported by banks and Development Finance institutions (DFIs) on March 31, 2009 was Rs80.87 billion (see **Figure 2.5**); reporting a slight decline of 1.78 percent since June 2008.

Of the total outstanding, HBFC constitutes 20 percent of the portfolio while commercial banks and other DFIs constitute 80 percent. The total number of outstanding borrowers also decreased from 125,149 to 121,368 over nine months. Of the total borrowers, HBFC has 76 percent and commercial banks 24 percent

As more banks have entered the mortgage market, the share of HBFC in terms of value has reduced over the time. But remains the only institution that caters mainly to the middle and lower-middle groups, and enjoys the largest customer base. This is evident from the fact that the average loan size of HBFC is reported to be Rs1.08 million where as the average loan size of commercial banks is reported at Rs2.52 million (as on March 31, 2009). Average loan sizes, however, have slightly increased for HBFC and decreased for banks since June 2008.

Figure 2.5: Housing Portfolio



NPLs have increased from Rs9.8 billion (June 2008) to Rs13.09 billion (March 2009); a 33.6 percent increase during the nine months. However, this rise in NPLs is not specific to housing finance and is only depicting the overall increase in NPLs of all sectors witnessed in the banking industry during the reporting months. HBFC's NPLs as a percent share in total outstanding are the greatest; a 39 percent of its total outstanding. NPLs for all banks and other DFIs constitute 10.37 percent of its respective total outstanding.

Approximately 5,964 borrowers were served during the nine months (June 2008 to March 2009) and over Rs13 billion were disbursed. Weak property rights and an embryonic property development framework continue to constrain the financial sector from achieving its full potential in the housing finance sector.

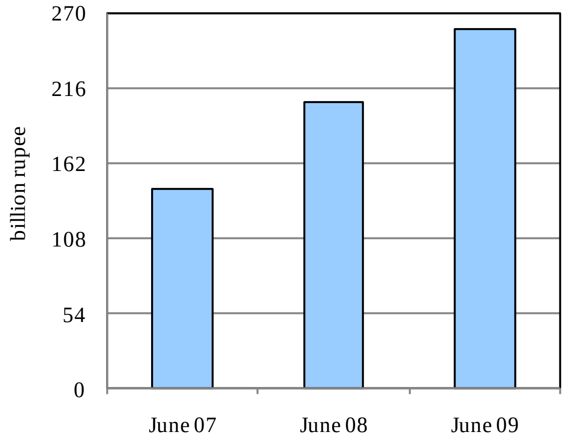
Average interest rate for the quarter ended March 2009 is reported to be 15.42 percent; an increase of approximately 2 percentage points compared to June 2008. Average interest rate reported by HBFC is 11.88 percent; a decrease of 1.83 percentage points compared to the quarter ended June 2008. Banks and other DFIs (except HBFC) reported 15.6 percent; a 2.31 percentage point increase over the nine months. Average maturity periods have slightly declined from 12.92 years (June 2008) to 12.5 years (March 2009). The LTV ratios for housing finance fell from 58.1 percent during June 2008 to 52.8 percent during March 2009.

The nine month reporting period shows signs of cautious lending from banks amid decreased affordability of the borrowers and unfavorable macroeconomic conditions. Signs of cautious lending include fall in LTVs (with the exception of HBFC) and a slight decline in average loan size. It is due to the small size of the housing finance portfolio that financial institutions are currently managing housing-related risk. However, absence of a secondary mortgage market is still an obstacle in the development of overall housing finance sector.

2.4.2 Infrastructure Finance Market

The stock of infrastructure Finance has grown from Rs206.25 billion in June 2008 to Rs259.25 billion in June 2009 (see **Figure 2.6**). There is 25.7 percent increase in outstanding stock of infrastructure financing during the last twelve months which signifies that financing landscape in infrastructure sector is still thriving in the face of economic gloom. The increasing energy demand in the country has shoved the power generation sector to increase its generation capacity, with a corresponding increase in lending demand. The outstanding stock of power generation sector rose from Rs53 billion in June 2008 to Rs115 billion in June 2009. This 116 percent increase in outstanding volume of power generation reflects the robustness of banking sector, and favorable policy of government in allowing sovereign guarantees to power projects, which acts as an incentive to banking sector, in financing power projects. Apart from growth in infrastructure stock, there is need to increase and diversify the financing portfolio in other important infrastructure sectors like, water and sanitation, road, bridge, flyover construction, and mass transportation. The share of DFIs in infrastructure lending needs to be enhanced.

Figure 2.6: Infrastructure Lending (Stock)



Sectoral Share

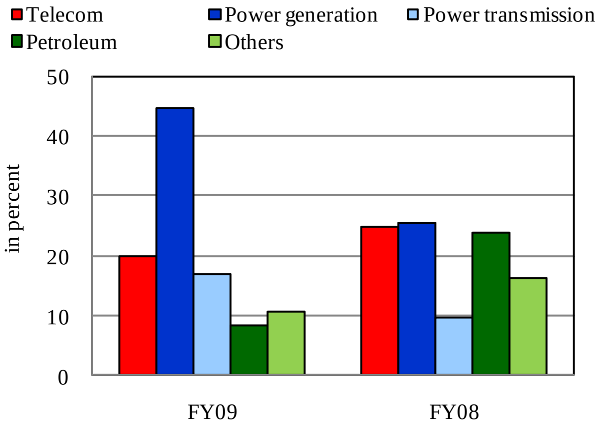
The analysis shows that more than 90 percent infrastructure lending is consumed by four key sectors (see **Figure 2.7**) which points to an important factor that a facilitating government policy is essential in creating an enabling environment where banks can finance other risky projects which they otherwise feel reluctant to finance in absence of a clear government risk sharing.

2.4.3 SBP Initiatives to Promote Housing and Infrastructure Financing

Infrastructure Finance

Appreciating the critical role of infrastructure sector in propelling the domestic economy, SBP has taken the following initiatives to further develop market based mechanisms and enhance the flow of credit to this priority sector.

Figure 2.7: Share in Outstanding



Dissemination of Infrastructure Task Force Report

The SBP constituted a task force on Infrastructure Finance, and delegated it with a mandate to identify institutional bottlenecks and recommend an institutional mechanism for risk management of project financing. A set of recommendations aimed at enhancing flow of credit to project financing have been made by the task force. One of the key recommendations focuses on development of long-term funding mechanism through establishment of dedicated Infrastructure Lending Organization, which is under consideration. Numbers of recommendations of the infrastructure task force were disseminated to several ministries with a view that the issues identified would be taken care of by the concerned ministries which in turn will lead to enhanced public-private partnership initiatives for development of infrastructure services.

Capacity building Program

In addition to initiatives taken to institutionalize project financing, SBP realizes that a simultaneous development of human capital will play a critical role in ensuring sustainability of project financing. In this regard a training program titled 'Frontiers in Infrastructure Financing' is planned in partnership with World Bank.

Revised Guidelines for Infrastructure Project Finance
The existing guidelines for infrastructure project finance were revisited to incorporate current market requirements and international best practices which can further facilitate project financing. The revised guidelines are expected to be available in first quarter of 2009-10.

Housing Finance
Dissemination of the Housing Advisory Group (HAG) Recommendations
SBP established a Housing Advisory Group (HAG) to conduct a thorough analysis on the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations to enhance access of financial services for the development of housing sector. SBP has already disseminated the recommendations to the concerned stakeholders and is working closely with some of them to ensure its implementation.

Establishment of Mortgage Refinance Company
SBP is in the process of initiating measures for the establishment of a Mortgage Refinance Company (MRC); a common agenda of SBP and the World Bank. Work on the business model and the financial feasibility of the company is underway. The MRC will explore fixed rate or hybrid models of mortgages, improve liquidity of the financial system and enable banks and housing finance companies to prudently address/reduce the mismatching of maturity profile of their assets and liabilities.

Housing Observatory
Establishment of a housing observatory is under consideration with the financial and technical support of the World Bank. The observatory for real estate market aims at minimizing information asymmetries and providing a platform for reliable and updated information for players in housing and housing finance markets.

Capacity building Program
Realizing the importance of strengthening the housing finance institutions, simultaneous efforts to develop human capital is also being ensured. A cooperation agreement was signed between International Finance Corporation (IFC) and SBP to launch a housing finance training program in Pakistan, conducted by Canada Mortgage and Housing Corporation (CMHC). The first session was conducted by experts from CMHC. Two subsequent sessions were then conducted by SBP through local experts in Pakistan. The training covered all aspects of housing finance from product development, loan marketing/distribution and origination to loan underwriting, servicing and risk management. Till date, approximately 200 bankers from over 20 banks have received training in the mortgage business.

2.5 Agricultural Credit Targets for FY09
SBP had set agricultural credit target of Rs250 billion for 2008-09, 25 percent higher than the previous year's target. This was also 18.1 percent higher than the disbursements of Rs211.6 billion

Table 2.3: Agricultural Credit Disbursements against Targets
(billion rupees)

	FY07		FY08		FY09	
Banks	**Target**	**Disbursement**	**Target**	**Disbursement**	**Target**	**Disbursement**
5 Big Comm. Banks	80	80.4	96.5	94.7	119.5	110.7
ZTBL	48	56.5	60	67	72	75.1
DPCBs	23	23.9	35.5	44	52.5	41.6
PPCBL	9	8	8	5.9	6	5.6
Total	**160**	**168.8**	**200**	**211.6**	**250**	**233**

last year. Despite difficult economic and financial conditions, banks achieved 93 percent of the annual target of 2008-09 and disbursed Rs233.0 billion (see **Table 2.3**). The disbursement was higher by 10 percent or Rs21.4 billion compared with Rs211.6 billion last year. Bank-wise break up of agri. credit disbursement reveals that five major banks, as a group, disbursed Rs110.7 billion or 92.6 percent of the whole year targets, compared with Rs94.7 billion or 98.2 percent of the targets disbursed in 2007-08. ZTBL disbursed Rs75.1 billion or 104.4 percent of the target against disbursement of Rs66.9 billion last year. PPCBL disbursed Rs5.6 billion against Rs5.9 billion last year and DPBs disbursed Rs41.6 billion or 79.3 percent of the target as against Rs43.9 billion or 123.8 percent of the target last year.

The major portion of agricultural credit that is Rs196.1 billion was disbursed in Punjab during FY09, followed by Rs27.6 billion in Sindh. An amount of Rs7.9 billion was disbursed in NWFP, Rs0.6 billion in Balochistan, and Rs0.8 billion in AJK& NAs. Percentage share of Punjab and Sindh in total disbursement showed improvement, whereas the share of NWFP and Balochistan declined, mainly due to law & order situation and low absorption capacity in these provinces. Details of province-wise disbursements vis-à-vis targets achieved during FY 2007-08 and FY 2008-09 are given in **Table 2.4.**

Table 2.4: Province-wise Agricultural Credit Targets and Disbursements

value in billion rupees and share in percent

	2008-09			2007-08		
Province	**Targets**	**Disbursement**	**Share in total**	**Targets**	**Disbursement**	**Share in total**
Punjab	195	196.1	84.2	156	176.4	83.4
Sindh	35	27.6	11.85	28	24.7	11.6
NWFP	15	7.9	3.4	12	9.1	4.3
Baluchistan	3.75	0.6	0.26	3	0.7	0.3
AJK/NAs	1.25	0.8	0.34	1	0.7	0.3
Total	**250**	**233**	**100**	**200**	**211.6**	**100**

2.5.1 SBP's Initiatives for Promotion of Agricultural Credit

Owing to increased activities in the agriculture sector and expanding demand for credit in the sector, SBP has taken the following steps for the promotion of agri/ rural finance during 2008-09:

Development and implementation of Crop Loan Insurance Scheme

Non availability of crop loan insurance was a major reason in non-repayments by the farmers/borrowers in case of losses due to natural calamities. Therefore, to mitigate the risk of banks and farming community against losses caused by natural calamities, SBP developed a market based Crop Loan Insurance Scheme (CLIS), in consultation with stakeholders. The scheme was made mandatory by the government for five major crops namely wheat, rice, sugarcane, cotton and maize from Rabi Crop 2008-09. The government is bearing the cost of premium on account of subsistence farmers up to a maximum of 2 percent per crop. The scheme has been extended to MFBs from Rabi crop 2009-10. This scheme will not only safeguard the interests of banks and farmers, but will also save huge amount of funds spent by the Government of Pakistan in the shape of frequent write off / waivers of agri. loans of ZTBL's borrowers.

Guidelines on Islamic Financing for Agriculture

Keeping in view the rising demand for Islamic banking products for Agriculture, the Guidelines on Islamic Financing for Agriculture were issued to facilitate banks in developing Shariah compliant products for agriculture financing.

Revision of Report on Agri. Credit Estimation Methodology

Since the last revision of the report, various changes have taken place in agri. Credit, and prices of inputs have also increased enormously, thereby resulting in high production cost to the farmers. Therefore, SBP revised the Report on Estimation of Agri. Credit Requirements in December, 2008 in consultation with stakeholders in terms of around 70 percent increase in per acre credit limits of major and minor crops to cope with the increase in prices of farm inputs like seed, fertilizer and pesticides; enlarged list of crops, orchards & forestry; list of eligible items. Besides, year-wise per acre indicative credit limits for growing of orchards namely mango, citrus, apple, banana, coconut, dates and agro forestry namely acacia, shesham, bamboo have also been provided. The report is aimed at facilitating banks in assessing the credit requirement of the farmers and farming community in getting loans for growing of crops, orchards, agro forestry, etc.

Crash Training Program

To facilitate banks in capacity building and training of their agri. credit officers, SBP launched one week Crash Training Program in consultation with banks and Development Finance Support Department, SBP-BSC. More than 600 Agri. field officers of banks, SBP and SBP-BSC were trained in 20 sessions throughout the country during 2008-09. The program covered major dimensions of agri. financing including SBP's policies and schemes, agri. financing tools and techniques, security and loan documentations, loan monitoring and recovery mechanism, agri. credit risk management, group based lending to farmers, agri. loan marketing & sales system, etc.

Handbook on Best Practices in Agri/ Rural Finance

For the awareness of banks, farming community, researchers and other stakeholders regarding international best practices vis-à-vis Pakistan's experience in agri/rural finance, Handbook on Best Practices in Agri/ rural Finance was compiled. The handbook provides an overview of the policies and strategies of the successful Agri/ rural financial institutions in improving access to finance to the rural/ farming community. It also highlights their key achievements in terms of outreach, rate of recovery, lending methodology, sustainability, profitability and the level of confidence of their clients in these institutions, depicted in their vertical and horizontal expansion. The handbook will help banks to revise and devise their lending strategies to grasp the vast untapped agri/ rural market.

APRACA FinPower Knowledge Sharing Program on Rural Finance

State Bank of Pakistan arranged a two-day knowledge sharing program on rural finance with Central Bank of Sri Lanka in December 2008 at Karachi under IFAD funded, Asia Pacific Rural & Agricultural Credit Association's (APRACA) FinPower Program of twinning sharing of policy & regulatory environment in rural finance. Around 200 policy makers and practitioners from commercial banks, Microfinance institutions, NGO-MFIs, Pakistan Microfinance Network (PMN), Pakistan Poverty Alleviation Fund (PPAF) and SBP participated in the program. The program provided opportunity to learn from the experience and practices of central bank of Sri Lanka in agri/rural finance.

Induction of MFBs into Agri. Financing

To increase the outreach of agriculture finance and meet the requirements of farming community, SBP has inducted Microfinance Banks in the Agriculture Finance Network. A proper database on agri. microfinance is being developed for this purpose. Moreover, the Mandatory Crop Loan Insurance Scheme has also been extended to MFBs to cover their risks.

Increasing Agri. Credit on Fast Track Basis

For deepening the outreach of agri. credit on fast track basis in the underserved districts, a pilot project was launched in seven agri. intensive districts of Sindh namely Hyderabad, Tando Allahyar, Benazirabad (old Nawabshsh), Sanghar, Khairpur, Mirpur Khas and Larkana from Kharif Season 2009. Under the pilot project, banks disbursed agri. loans of Rs3.9 billion against the target of Rs5.2

billion achieving 75 percent of the disbursements targets and 13,000 new farmers have been provided agri. loans. The project has provided learning opportunities to banks to align their lending policies/practices according to the local culture, repayment behavior, crops/farming practices, etc. of the farmers. After successful implementation of the pilot project, it is being replicated in other underserved agri. intensive districts of Punjab, Sindh, NWFP and Baluchistan.

One Window Operation in Sindh

To address issues of delays in issuance of passbook and timely completion of revenue formalities, a framework for 'One Window Operation in Sindh' was developed and introduced in collaboration with the Sindh Board of Revenue in the pilot districts for two days a week. The Operation has facilitated banks and farming community in timely completion of revenue formalities and to obtain access to finance on a fast track basis.

Development of Benazir Zarai Credit Card Scheme

To improve farmers' access to institutional credit Benazir Zarai Card Scheme (BZCS) has been developed under the existing Revolving Credit Scheme being offered by banks for agricultural production loans. The scheme is being test launched by NBP and ZTBL in one of district each of the four provinces, on pilot basis, before expanding its coverage. The scheme will facilitate farmers in getting quality inputs at reasonable prices on credit through vendors/sellers in the pilot districts..

Awareness Meetings/Agri-Melas

To enhance farmers' and other stakeholders' awareness and understanding about SBP and financial sector initiatives for increasing flow of funds to the agriculture sector, field units of Developemnt Finance Support Department, SBP-BSC arranged 10 Agrifinance Melas during 2008-09. These Melas attracted large number of farmers and got significant media coverage and have been quite successful in creating awareness about banking products among the target stakeholders.

Focus Group on Agri. Finance

A focus group comprising of agricultural experts, progressive farmers and leading agri. finance banks has been constituted for delibrating on the issues in agri. finacncing and making recommendations in this regard to ACAC for policy formulation. In addition, regional focus groups on agriculture finance have been formed at field offices of SBP-BSC having representation of banks' regional chiefs, agri associations, relevant government departments, NGOs, etc. The members meet on a quarterly basis to discuss issues, developments, etc. in their respective sectors. In addition to being an effective forum for dissemination of SBP policies, the groups are also an important source of grassroots level feedback on SBP policies and initiatives regarding Agri. Finance.

Inter Provincial Workshops on Agri. Finance

SBP and SBP-BSC maintains close coordination and liason with provincial agricultural, livestock and revenue departments to share and disseminate the provincial governments' initiatives and best practices for facilitating the farming community. In this respect, interprovincial agricultural workshops were arranged by the Developmet Finance Support Department at Karachi and Lahore in June 2008 and May 2009 to bring banks and the relevant government departments closer to each other and share their observations/concerns, experiences and plans.

Agricultural Surveys

Agricultural surveys of Sukkur and Gujranwala districts were carried out to explore the components of rural economies of these districts, the demand for financial services, and issues faced by the rural population in accessing institutional finance. The survey findings have been placed on the SBP website for wider dissemination.

Way Forward

Going forward, SBP is working on the development of a National Crop Insurance Scheme, launching a pilot project for deepening of agri. loans, credit guarantee scheme for small farmers, capacity building of banks, awareness of farming community, simplification of agri. lending procedures, group based lending for small farmers, implementation of Benazir Zarai Card Scheme, introduction of shariah compliant agri. credit products through Islamic banks, etc.