2 Broadening Access to Financial Sector

2.1 Overview

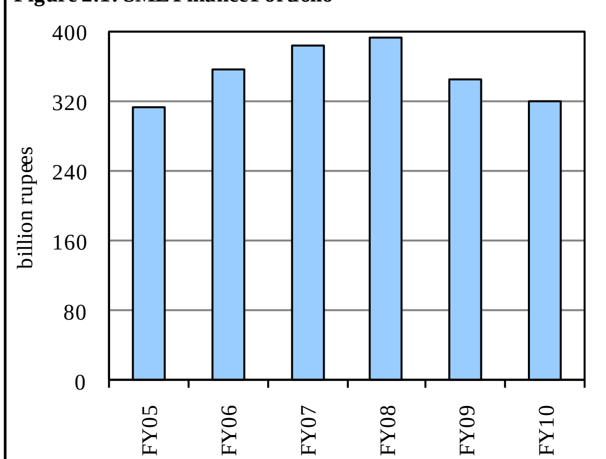
SBP had constituted the Development Finance Group (DFG) in 2006 to cover a broad range of critical areas relating to fulfillment of development finance needs of deprived sectors that needs focused attention of regulators. The DFG group within the SBP steers implementation of policy, legal, and regulatory framework for access to finance for Small, Medium and Micro enterprises, Agriculture, Rural Finance, Housing and Infrastructure Finance. Appropriate delivery of credit to these productive sectors of economy will help in promoting economic growth on sustainable basis, while generating employment, entrepreneurship, and reducing poverty.

State Bank of Pakistan introduced schemes which will greatly support the economy. To enhance storage capacity and develop agriculture produce marketing, SBP introduced Re-financing scheme for establishment of Silos, Warehouses and Cold Storages. Two Pilot Projects have been successfully completed and the third is underway to increase credit outreach in underserved agri. intensive districts of Pakistan. Relief Package was provided in the war affected areas of FATA and Khyber Pakhtunkhwa for remission/ write-off of small farmers' agricultural loans (farm & non-farm) to revive economic activities in these areas. Besides, steps like: introduction of one window operation facility in pilot districts, simplification of agri. loan documents, and reduction in turnaround time, development of National Agriculture Insurance Scheme (NAIS) were also taken for promotion of agri. finance. SBP also expanded the scope of Refinancing Facility for Modernization of SMEs by including almost all SME sectors. Further, to diversify the pool of borrowers under LTFF, SBP fixed a limit of Rs 1 billion exposure allowed to an individual borrower. Scheme for Financing Power Plants using Renewable Energy with a capacity of upto 10MW was introduced to encourage investment in the energy sector.SBP has also initiated "Market segmentation" and Cluster development surveys in coordination with IFC and LUMS with the objective to assist State Bank in improving its regulatory framework and facilitate banks in realigning their business strategies in order to come-up with customized banking products & services for SMEs. SBP has taken several steps to ensure that the microfinance industry continues on the path towards sustainable growth. These include development of the Strategic Framework for Sustainable Microfinance (2010 to 2015). SBP also took a number of policy and program initiatives in 2009 like permission to MFBs to increase limits on housing loans and implementation of the Microfinance Credit Guarantee Scheme and the Institutional Strengthening Fund. These initiatives are expected to bring about a positive impact on the performance of Development Finance Sector in the long run.

2.2 SME

The Small & Medium Enterprises (SMEs) in Pakistan have received a significant financial and economic hit due to power failures, economic meltdown, and poor law & order situation in recent times. This has resulted in a lower credit provision to this sector compared to the recent past. Due to global economic crisis, the banks adopted a cautious approach in lending to SME sector since it is considered a risky sector of an economy. To mitigate these perceived risks, SBP took a number of policy initiatives for improving the flow of credit to SME sector.

Figure 2.1: SME Finance Portfolio



2.2.1 SME Financing in Pakistan

Total SME Finance stood at Rs 319 billion (provisional) in June, 2010, compared to Rs 345 billion in June, 2009; a 7.5 percent decrease during the year. The major share of banks' credit was allocated to meet the working capital requirements, Rs 236 billion, followed by trade financing of Rs 45 billion by end of June, 2010. On the other hand, a sector-wise break up of SME finance shows that Commerce & Trading sector received 44 percent while manufacturing sector received 39% of SME finance. The economic crisis has had a significant impact on growth of SME Finance for the last two years, resulting in shrinking of SME Financing portfolio. Apart from adverse market conditions, excessive government borrowings for commodity operations financing is also a major reason of lesser availability of finance for the SMEs.

2.2.2 Initiatives taken for the Promotion of SME Finance

1. **Credit Guarantee Scheme for Small and Rural Enterprises**

SBP has launched a Credit Guarantee Scheme (CGS) for Small and Rural Enterprises which will allow banks to develop a portfolio of fresh borrowers who are creditworthy, but cannot fit into their usual credit parameters, especially when collaterals are required. It will allow banks to assess Small and Rural Enterprises on the basis of cash flows. The scheme has been bifurcated into two segments: one for Khyber-Pakhtunkhwa, FATA and Gilgit-Baltistan, whereas the other is reserved for priority clusters/areas of other parts of the country. In case of bonafide losses, SBP will share 60 percent of PFI's fresh portfolio of financing to Small & Rural Enterprises. Going forward, success of the Scheme would depend upon the participation from the banks, SME Associations, and the SMEs.

2. **SME Market Segmentation in Pakistan**

SBP in collaboration with IFC launched a joint research project to provide credible information base on key SME clusters/sub-sectors of economic importance in Pakistan. The broad objective of this research project is to create an information resource that can be used by lending institutions for identifying priority SME segments and targeting them through appropriate banking products and marketing/distribution strategies. The project is expected to assist banks in developing new customized banking products for SMEs thereby improving access to finance on fast track basis.

3. **Cluster Development Surveys**

Considering the significance of SME clusters in our economy and to get first-hand knowledge about important SME clusters, SBP has hired the services of Lahore University of Management Sciences (LUMS) to conduct primary research survey of "Fans & other Electrical/Electronic Goods Cluster- Gujrat/Gujranwala". The information, derived from this cluster survey, shall not only assist SBP in realigning its regulatory framework for SME Financing (if required) but also shall facilitate commercial banks in developing more effective lending strategies and loan products to adequately fulfill the credit needs of SMEs from banking sector. This project would be monitored by a Committee headed by Executive Director-Development Finance Geroup of State Bank and also some representatives from SMEDA and PBA. On the basis of sector analysis, seven priority clusters have been identified where surveys would be conducted in a phased manner.

4. SME Finance Grass Root Cluster Training Program

SBP, as part of its capacity building initiative for the commercial banks in the area of SME Finance, introduced an SME Finance Grass Root Cluster Training Program during 2009-2010 for credit officers of the banks to equip them with latest tools and technology being used in SME finance across the globe .First phase of the program has been completed covering seven cities. About 200 credit officers from commercial banks have been trained in the SME finance area at SME hubs across the country. The second phase of the program has also been launched and four training programs have been held so far in different cities where more than 130 credit officers from different commercial banks have been trained. The major areas covered included Risk Mitigation tools like Credit Scoring, Program Based Lending Schemes, Effective Marketing Strategies for SME Finance, Utilizing the area of Social Profiling in SME Finance, etc.

5. Credit Scoring Training Program

Small Business Credit Scoring brings down transaction cost of banks, reduces Turn-around-time and provides a more sophisticated tool for credit evaluation of small borrowers. SME Finance Department in collaboration with Shore Bank International conducted a two-day training program on 'Credit Scoring for SMEs' at NIBAF Islamabad. The Program was an orientation to the small business credit scoring organized for the executives of commercial banks. Around 40 senior level commercial bankers from areas of Risk Management, Product Development and SME Business participated.

6. Refinance Facility for Modernization of SMEs

To modernize the business processes of SMEs, a long-term refinancing scheme was launched which will allow SMEs to avail financing at concessional rates for local purchase/import of machinery for BMR of existing units and setting up of new units.

7. Revitalization of SMEs in KP, GB and FATA

To revitalize SMEs in KP, Gilgit-Baltistan (GB) and FATA, a refinance scheme was introduced for providing all types of financing facilities (Short Term, Medium & Long Term) with maximum tenor up to seven years.

2.2.3 Financing under Export Finance Scheme

During the year SBP took a number of steps to support the trade and industrial sector. These include schemes for Modernization of SMEs, Financing Power Plants Using Renewable Energy, and Financing Facility for Storage of Agricultural Produce. Keeping in view the global recession, extension in shipment period under Export Finance Scheme (EFS) Part-I (Pre-shipment) was allowed. Relaxations were also given under EFS to exporters having exports overdue and in performance requirements under EFS Part-II for hand knotted carpets.

Two financing schemes were introduced for rehabilitation of life in war affected areas, namely; Revitalization of SMEs in areas of KP, Gilgit-Baltistan, & FATA, and an Agriculture Loans Refinancing & Guarantee Scheme for war affected areas of KP & FATA. As announced by the Prime Minister fiscal relief to rehabilitate the economic life in KP, FATA and PATA, payment of mark-up rate subsidy on business loans was introduced.

The outstanding position of financing under EFS was Rs 185.54 billion as of June 30, 2010 showing over all flow of Rs 8.17 billion during July-June 2009-10. During FY10, Rs 472 billion were disbursed under EFS compared to Rs 390 billion in the previous year, which shows an

Table 2.1: Outstanding under EFS
million rupees

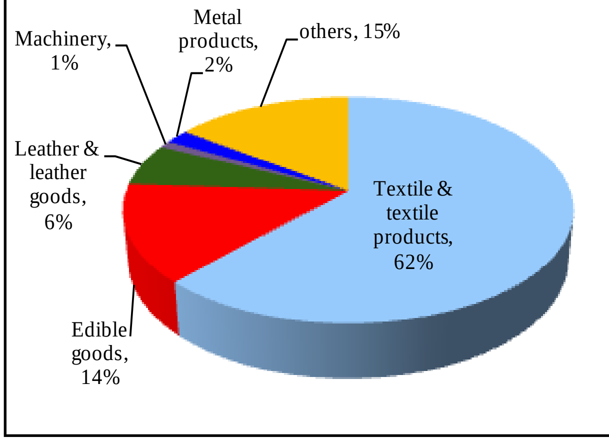
Outstanding Amount as of June, 2009			Outstanding Amount as of June, 2010			Flow (July–June) 2009-10		
Part-I	Part-II	Total	Part-I	Part-II	Total	Part-I	Part-II	TOTAL
49,545	127,830	177,375	49,347	136,194	185,541	-198	8,364	8,166

increase of Rs 82 billion. The comparative position of export refinance outstanding as of June 30, 2010 under the scheme is given in the **Table 2.1.**

Sector-wise Financing under EFS

The sector-wise position reveals that the highest amount (Rs 115.9 billion) was utilized by the textile sector. Within the textile sector, readymade garments availed the highest finance (Rs 28.4 billion). Under edible goods, the highest amount was utilized for financing exports of rice (Rs 21.2 billion). The sector-wise break up is given in pie chart (**Figure 2.2**)

Figure 2.2: Sector-wise Breakup of Refinance Outstanding as o 30-06-2010



Long Term Financing Facility

The outstanding position of funds disbursed under Long Term Financing Facility (LTFF) as of June 30, 2010 was Rs 16.85 billion against 177 borrowers while textile sector's share was Rs 9.81 billion (58%) against 146 borrowers. Overall sector wise position is as under:

Table 2.2: Sector-wise Outstanding Position of Funds under LTFF as of 30.06.2010
million rupees

Sectors	No. of borrowers	Outstanding
Textile sector	146	9,807
Engineering goods	8	3,180
Fisheries	2	10
Leather & leather products	2	75
Marble & granite	1	1,000
Rice processing	9	541
ethanol	1	29
Pharmaceutical	1	18
Generators / captive power plants	6	1,459
Others Sectors	1	726
Total	**177**	**16,846**

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

The outstanding position under LTF-EOP (defunct) shows repayments of Rs 6.6 billion during the year with net outstanding finance of Rs 25.78 billion as on June 30, 2010.

Policy Changes and Incentives taken during 2009-10 are as follows

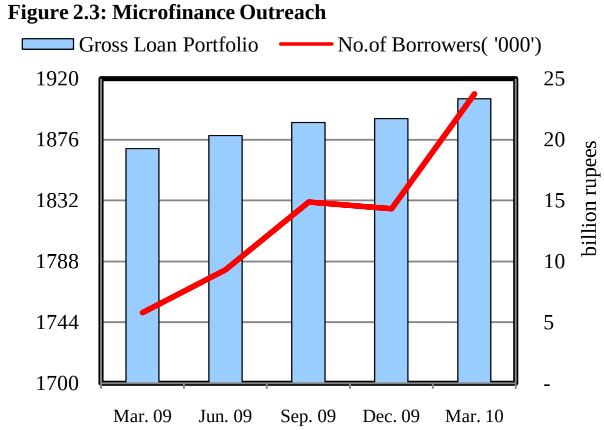
- A Financing Facility for Storage of Agricultural Produce (FFSAP) was introduced. Under this scheme financing will be available for new imported and locally manufactured plant & machinery, equipments and accessories thereof, to be used in Steel/Metal/Concrete Silos, Warehouses Cold Storages, generators and civil works.

- To encourage the use of renewable energy in the country, a scheme was introduced for financing power plants up to 10 MW using renewable sources of energy generation.
- To facilitate farmers in war affected areas, i.e., KP and FATA for resuming agricultural activities, a special Agriculture Loan Refinancing & Guarantee Scheme was introduced.
- Period of refinancing under EFS Part I was extended upto 270 days.
- Waiver up to end December 31, 2010 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 shipments due in FY09.
- An additional period of one month was allowed to the exporters having shortfall in required performance under Part-II due to load shedding and shortage of raw material, for the monitoring year 2009-2010. Accordingly they may include realization of export proceeds of July 2010 in the performance of FY 10.
- The scope of LTFF was expanded by allowing refinance facility against (i) import/purchase of second hand machinery; and (ii) by including Ethanol, Furniture, Pharmaceutical & sub-sectors (Doubling, Twisting, Combing, Slubbing, Lycra, & Yarn Dyeing) of Spinning Sector in the Scheme.
- In order to reduce the burden of rising interest rates applied to the textile sector, mark-up support of upto 5% was announced under the Textile Policy. Under the facility a 5% mark up differential was paid amounting to Rs 510 million for the six months ending February 28, 2010.
- The EFS is currently available from SBP at a markup rate of 8.5%. A further relief of up to 2.5% was announced by the Government under the Textile Policy. SBP has already disbursed Rs 839 million due for the period from September 1, 2009 to February 28, 2010 under the scheme.

2.3 Microfinance

Expansion of microfinance services is an important tool to improve livelihood opportunities for poor and marginalized segments of the population. SBP has been actively pursuing strategies to improve provision of microfinance services to poor households and microenterprises on sustainable basis. As a result, microfinance has been experiencing increased integration with overall financial system as larger NGO-MFIs have already moved towards transformation into microfinance banks, and commercial banks have started venturing into microfinance through wholesale lending models. The enabling environment and incentive structure has recently attracted interest of strong

Figure 2.3: Microfinance Outreach



private sector players to enter into microfinance business. As a result of all these developments, the sector experienced consistent growth in recent years.

Performance during 2009-2010

Portfolio quality of MFBs has so far remained satisfactory with portfolio at risk (PAR) 30 days past due between 2 to 3 percent. The deposits base has increased by almost 73 percent in 2009. The retail capacity of sector has also strengthened due to adoption of innovative alternate delivery channels instead of traditional brick and mortar branches. The MFBs licensed only 13 new branches as against more than 5,500 retail agents commissioned under the branchless banking mode, which will further boost the industry's distribution network and will lower its costs. As a result of the early adoption of branchless banking by Tameer MFB, the industry has emerged as a leader in branchless banking within the whole banking industry. Due to expansion in the distribution network, the industry has now positioned itself to offer inclusive financial services especially in rural and remote areas. Under the branchless banking models, the financial services such as bills payment, domestic remittances, and mobile phone accounts have been launched this year.

Policy Initiatives

During the year 2009-10, State Bank of Pakistan took various initiatives to enable expansion and improved performance of MFBs through products diversification, target market expansion, better credit risk management, payment system facilities, and rationalization of loans' classification and provisioning requirements. Following were the initiatives:

- To consolidate the ongoing initiatives and bring structural improvements in the sector, State Bank of Pakistan, in consultation with stakeholders, has developed a medium term microfinance strategic framework (2010-2015). The strategy has been approved by the Government, and it sets out broader parameters for accelerating growth of the industry in the next five years. The strategy recommends (a) improving quality of growth through inclusive financial services, deposit mobilization, and upscaling credit operations, (b) emphasizing organizational development through effective governance, management development & grass root level trainings, (c) reducing operating costs by encouraging the use of alternative delivery channels, (d) improving sector's discipline through consumer protection policies, financial literacy programs, and exploring options for bringing non-regulated MFIs under some kind of minimum regulatory net.
- To encourage product diversification, credit up-scaling, and market expansion, State Bank has allowed MFBs to offer housing finance with increased loan limits. In addition, SBP also revised household income maximum limits upward under the eligibility criteria for borrowers.
- To diversify funding sources, SBP allowed MFB/Is to raise foreign currency (FCY) loans from International Financial Institutions or donor agencies or specialized banks.
- To encourage long-term deposit mobilization, SBP has relaxed Cash Reserve Requirements (CRR) and Statutory Liquidity Requirements (SLR) for MFBs. Under the revised instructions, MFBs do not have to maintain CRR/SLR on long-term deposits and liabilities.

- Tameer MFB was granted membership of clearing house. This would facilitate Tameer to improve its infrastructure for deposit mobilization. In addition, Tameer was given approval for undertaking home remittances.
- The partnership of First Microfinance Bank (FMFB) and Pakistan Post (PP) to deliver the financial services through the PP outlets is running successfully. Currently, FMFB is operating through 68 post offices with total disbursement of 523 million, and more than 40,000 active borrowers as of December 2009.
- To improve credit risk management practices in the industry, a pilot of MF-specific credit information bureau (CIB) was launched in May, 2010 in Lahore. The CIB will provide robust credit information infrastructure to the industry.

Programs Initiatives

The Microfinance Department at the SBP is playing a proactive role in the development of microfinance sector through implementation of government and donor funded programs. These programs are managed with the objective to enhance provision of financial services to the unbanked segment especially the poor and women through sustainable models. The FY10 saw a major shift in the programs implementation. The Financial Inclusion Program (FIP) which relies on private sector development, a shift from the public sector driven approach, has gained success and received acclaim both domestically and internationally as an innovative program. Similarly, the Microfinance Department engaged with the GoP to reallocate microfinance legacy funds to more modern and successful interventions geared towards development of the microfinance sector.

Highlights of the initiatives taken during 2009-10 are as follows:

1. **Financial Inclusion Program – FIP**

SBP is the implementing agency for Financial Inclusion Program worth a £50 million grant from UK's Department for International Development (DFID) to manage sectoral transformation from a subsidy based informal institutional setting to a market-based regulated institutional arrangement. SBP has successfully launched four of the five FIP interventions. The remaining component led by DFID, is expected to be launched next year. Progress details on FIP interventions are as follows:

a. **Microfinance Credit Guarantee Scheme (MCGF)**

The NRSP has completed Rs 1.2 billion syndicated financing deal under the MCGF. Additional Rs 1 billion are expected to be mobilized shortly under various deals being negotiated between commercial banks and microfinance providers. The uptake of the MCGF was facilitated following the revisions in MCGF guidelines and guarantee by the microfinance department to address the concerns of commercial banks and DFIs.

b. **Institutional Strengthening Fund (ISF)**

The ISF was launched with the objective to enhance capacity of microfinance providers through matching grants. The facility has been successful in soliciting proposals for capacity building and use of alternative delivery channels. The ISF has approved grants of up to Rs400 million for various MFBs and MFIs for capacity building and systems up gradation as well as for branchless banking operations. Also, a number of additional proposals are under consideration for capacity support to the microfinance players.

c. Credit Guarantee Scheme for Small Business & Rural Enterprises (CGS-SB&RE)

CGS-SB&RE has been launched with £8 million (Rs1billion) on March, 2010 to facilitate credit to small and rural businesses. The scheme was launched after an assessment of commercial banks' risk appetite and demand for the facility. Half of the CGS-SB&RE resources have been allocated exclusively for the FATA, KP and the province of Gilgit-Baltistan (GB). The remaining half has been allocated for priority clusters across the rest of Pakistan.

d. FIP Technical Assistance component

i. Branchless Banking/Technology

Pakistan Branchless Banking Conference 2010 was organized in Karachi on April 17, 2010 in collaboration with the DFID, to highlight the existing BB developments in Pakistan, gauge the industry preparedness, and catalyze the investments and product innovation. The Conference earned overwhelming response and participation from financial sector, mobile operators, technology companies, agent networks, regulators, government, and donors who shared experiences to enhance coordination and create synergies. The aim of the conference was to further build on the already issued Branchless Banking (BB) regulations and technology related technical assistance grants provided to microfinance sector under the capacity building components of the Financial Inclusion Program. The conference had leading international and local experts and practitioners on Branchless Banking including technology experts from the World Bank's Consultative Group to Assist the Poor (CGAP), as speakers and panelists.

ii. Capacity Building of SBP Development Finance Group

To build capacity of SBP in development finance, around 14 of SBP development finance staff have attended training programs/visits abroad under the FIP capacity building component. These include participation of SBP officials in international trainings, conferences, exposure visits in areas of development finance.

iii. Pakistan Microfinance Fund (PMFF)

PMFF is a multi-donor credit enhancement fund which is in its feasibility phase. The PMFF Steering Committee includes the World Bank, ADB, KFW, USAID, IFC and others. SBP in consultation with donors is studying various alternative arrangements under which wholesale funding for on-lending purpose can be made available to Microfinance providers on market based competitive rates. PMFF will enhance market orientation and lessen dependence on grants and subsidies. SBP is providing co-financing to complete the feasibility phase.

iv. Pakistan Remittance Initiative

To promote remittances through formal channels, an initial support equivalent to £500,000 (Rs70 million) for remittances call centers and pre-departure briefings has been approved. PRI is a joint initiative of State Bank of Pakistan, Ministry of Overseas Pakistanis, and Ministry of Finance that aims to provide ownership structure in Pakistan for remittance facilitation.

v. Financial Monitoring Unit (FMU)

Money laundering and terrorism financing is a major concern in financial sector. In this regard, SBP is providing support to FMU to build its IT capacity to effectively monitor financial crimes.

2. Reallocation of Funds under MSDP and RFSDP

Microfinance Sector Development Program (MSDP) was launched in 2001 with the assistance of the ADB to establish microfinance services for provision of affordable financial services through Khushhali Bank Limited (KBL). The program, envisaged establishment of four funds: (a) Microfinance Social Development Fund (MSDF); (b) Risk Mitigation Fund (RMF); (c) Depositors Protection Fund (DPF); and (d) Community Investment Fund (CIF) which was later transformed into Emergency Livelihood Restoration Fund (ELRF) after the 2005 earthquake. These funds were structured to subsidize operational costs and help Khushhali Bank during its infancy. To make these funds accessible on level playing grounds and accelerate utilization, SBP has proposed amendments in the fund rules to the GoP. This will streamline the funds for the whole MF sector and assist MFPs in their effort for community mobilization. Moreover, availability of DPF to all would strengthen protection of public deposits with MFBs, especially small depositors and to reduce the vulnerability of microfinance/poor borrowers against natural calamities. Also, the ELRF completed its term on June 30, 2009; SBP has proposed to reallocate the remaining funds in ELRF to Credit Guarantee Scheme for Small and Rural Enterprises. Originally the scheme was launched with seed money of 8 million, which has to be increased through further allocation of funds from other sources including government and international/bilateral agencies.

Similarly, amendments have also been proposed for reallocation of US$ 15 Million New Bank Fund (NBF) established in 2006 under ADB sponsored Rural Finance Sector Development Program (RFSDP) with the objective to support district and province based MFBs in institutional strengthening and infrastructural development for delivery of micro and rural financial services. The NBF will be utilized for Microfinance Credit Guarantee Facility which will eventually converge into the private-sector managed multi-donor Pakistan Microfinance Fund being structured at present.

3. **Financial Literacy Program (FLP) under Improving Access to Financial Services Fund (IAFSF)**

SBP has finalized a Financial Literacy Program (FLP) on a pilot basis under the Improving Access to Financial Services Fund (IAFSF). FLP envisages a nationwide awareness in adults and children, on the demand side of the market, about basic money management concepts and to understand various financial products and consumer protection. FLP is the first large scale initiative of its type in the country that is expected to inculcate financial literacy amongst the financially excluded segments. The pilot is expected to be launched in early FY11 with target beneficiary size of 50,000 (25,000 Adults and 25,000 Children) in 15 districts across Pakistan.

4. **Grass-root level Training Program for Credit/Loan Officers of MFBs/MFIs under the IAFSF**

Also, a grant of up to Rs15 million has been approved for a series of training programs which will be conducted in different cities of the country targeting about 1,000 loan and field officers across Pakistan. The program aims to provide capacity building support to the industry. The training programs will develop understanding within the industry through mutual sharing of knowledge and ideas besides aiding to the development of a resource pool of trainers from within the industry.

Future outlook

In view of the recent developments and enthusiasm of new private sector players to undertake microfinance business, the industry is now ready for transformational change through rapid expansion in distribution network, provision of inclusive financial services, reaching out to remote and rural areas, and business processes reengineering. SBP is endeavoring to advance the banking infrastructure, encourage the use of successful global practices, and undertake regulatory and supervisory responsibilities. Importantly, the sector would require improving its corporate governance especially in view of its emerging functional expansion and operational complexity.

It is hoped that microfinance providers would now increase their contribution in increasing geographical penetration offering diverse financial services on sustainable basis.

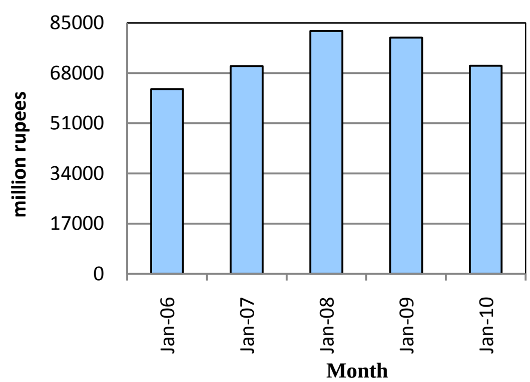
2.4 Housing Finance Market

After demonstrating a promising growth trend during previous five years, the housing finance sector reported a decline in outstanding portfolio over the last one and half a year. Efforts are underway to promote housing finance activities. But still a large part of the population is unable to obtain mortgage finance 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) as on June 30, 2010 was Rs70.4 billion; a decline of 12 percent since June 2009. The figure 2.4 shows the growth trend in housing finance since June 2006.

Of the total outstanding, HBFC constitutes 20 percent of the portfolio while commercial banks and other DFIs have 80 percent. The total number of outstanding borrowers decreased from 117,535 to 101,632 over the last twelve months. Of the total borrowers, HBFC constitutes 75 percent and commercial banks house 25 percent.

Figure 2.4: Housing Portfolio as on June 30, 2010



HBFC is the only institution that caters 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 Rs 1.2 million whereas the average loan size of commercial banks is Rs 3.5 million (as on June 30, 2010). Average loan size, however, has slightly increased for HBFC and decreased for banks since June 2009.

NPLs have increased from Rs13.9 billion (June 2009) to Rs17.4 billion (June 2010); a 25 percent increase during the 12 months. However, this rise in NPLs is not unique to housing finance; all other sectors also witnessed increase in NPLs during the reporting months.

HBFC's NPLs as a percent share in total outstanding is the greatest; a 45 percent of its total outstanding is NPLs. Excluding HBFC, NPLs for all banks and other DFIs constitute 19.5 percent of their respective total outstanding.

Approximately 2176 borrowers were served during the 12 months (July 2009 to June 2010) and over Rs 6.27 billion were disbursed. Weak property rights and an embryonic property development framework continue to restrain the financial sector from achieving its full potential in the housing finance sector.

The overall weighted average interest rate for the year ended June 2010 is reported to be around 15.7 percent; a decrease of approximately 0.1 percentage points compared to June 2009. The weighted average interest rate reported by HBFC is 16 percent and that reported by banks and other DFIs (except HBFC) is 16 percent. Average maturity periods are 12.5 years (June 2010).

The average LTV ratios for housing finance were reported to be 50 percent during quarter ended June 2010.

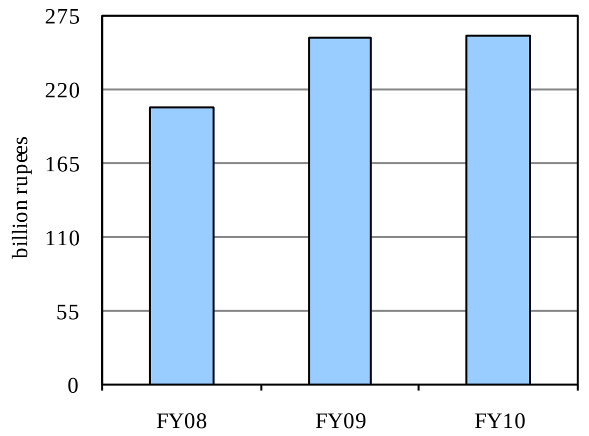
The 12-month reporting period continues to give signs of cautious lending from banks amidst decreased affordability of the borrowers and unfavorable macroeconomic conditions. Signs of cautious lending include, fall in LTVs (with the exception of HBFC) and a slight decline in average loan size. It is 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 a constraint towards the development of overall housing finance sector.

2.4.1 SBP's Initiatives to Promote Housing Finance

- A project of creating a Mortgage Refinance Company (MRC), to support development of secondary mortgage market, is in advanced stage. Equity commitments have been received from various stake-holders. The government of Pakistan has also endorsed this project and has committed 20 percent equity participation. The IFC/World Bank and ADB are also supporting this initiative and are expected to take equity stake in MRC.
- Housing Finance Guidelines have been drafted with an objective to help and facilitate the banking industry to develop expertise and to conduct housing finance business efficiently. The draft guidelines are in the process of review by stakeholders.
- Separate Housing/Mortgage Finance Prudential Regulations would be developed this year, in consultation with concerned stakeholders.
- Efforts would be initiated for establishment of housing observatory in coordination with Ministry of Housing & Works and multilaterals.
- A stake holders' conference on housing finance has also been planned in 3rd quarter of 2010-11.
- A Housing Outreach Survey was conducted in 2009-10. Measures would be initiated to implement recommendations formed as outcome of the survey. This include:
    - Broadening of scope of eCIB database,
    - Encouraging banks for geographical diversification, and
    - Implementation of credit policies
- Measures for identifying possible solutions for enhancing access of finance to large scale real estate developers.
- Capacity building programs of financial sector will remain among the priorities of SBP. Training Programs/Workshops have been planned for different cities in next year on Mortgage Financing and Legal Documentation.

2.5 Infrastructure Finance Market

Figure 2.5: Infrastructure Lending (Stock)

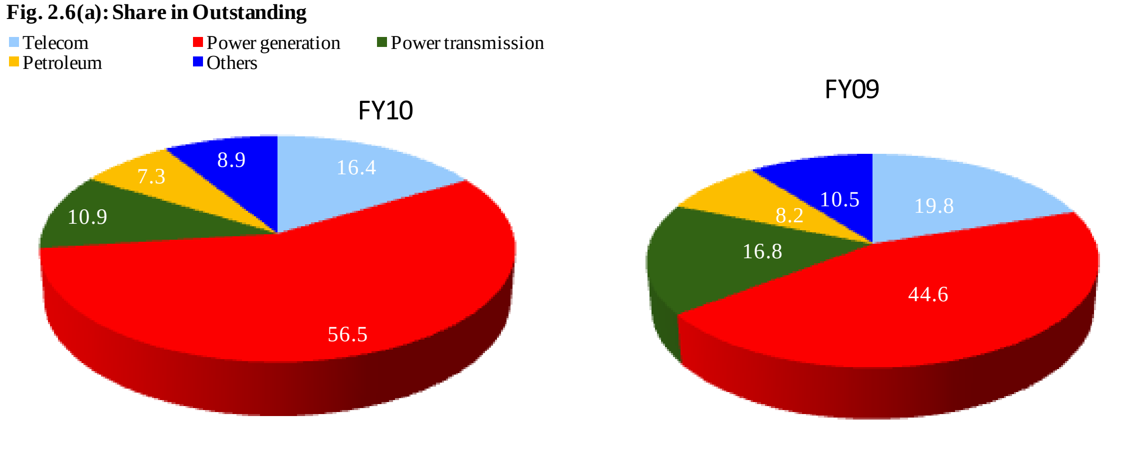


The stock of Infrastructure Finance hovered around Rs 260 billon throughout the year. There was no major shift in total outstanding portfolio of infrastructure project finance but some internal shifts within different infrastructure sectors were observed. The outstanding stock of Power Generation sector escalated significantly from Rs 115 billion in June 2009 to Rs 146.5 billion in June 2010. The 27.4 percent increase in power generation outstanding was lower compared to staggering 116 percent increase in outstanding volume of power generation from June 2008 to June 2009. During FY 09, 53 new projects got financial close against only 10 projects in FY 10. Majority of new initiatives were taken in power generation sector. The data points towards couple of worrying trends like projects in other than power sector were facing huge difficulties in reaching financial close due to inherent risks. The private sector participates only when there is clear assurance of project's viability and government's support, wherever required. Apart from commercial banks, the role of DFIs is disappointing as they have only around 2 percent share in total outstanding portfolio of infrastructure project finance.

2.5.1 Sectoral Share

Figure 2.6 shows the share of key sectors in infrastructure stock. Only power generation sector has increased its share over the year from 44.6 percent in FY09 to 56.5 percent in FY10. Telecom sector was the leader couple of years ago but since then no new big project has been initiated in this sector. Since the outstanding portfolio of infrastructure was more or less same over the year so the declining market share of different sectors is due to the declining volume of outstanding stock of these sectors. The analysis shows that more than 67 percent infrastructure lending is consumed by energy sector alone, which enjoys sovereign guarantee from the government. Thus,

Fig. 2.6(a): Share in Outstanding



a facilitating government policy is essential in creating an enabling environment for other key sectors of infrastructure.

2.5.2 Major Departmental Initiatives and Achievements
Appreciating the critical role of infrastructure sector in propelling the domestic economy, following key initiatives were taken by SBP to further develop market based mechanisms and enhance the flow of credit to this priority sector.

2.5.3 Capacity building Program
Infrastructure & Housing Finance Department (IHFD) at the SBP, with the assistance of World Bank Group conducted a comprehensive Training Program on Infrastructure Project Finance from July 12-16, 2010 at SBP's Learning Resource Centre in Karachi. For the first time such a high level massive training program on Infrastructure Project Finance was held in Pakistan. This was a joint initiative of Infrastructure & Housing Finance Department of SBP and World Bank Group to address the issue of lack of expertise in the financial sector on project development and financing. Cambridge Economic Policy Associates (CEPA), a very renowned organization for working in infrastructure development and training sector, prepared the course manual and delivered it in the training. Around 60 professionals associated with infrastructure development and financing from banks, DFIs, and federal and provincial governments participated in this training program. IHFD intends to continue this training program in different cities of Pakistan to enhance the capacity building of financial institutions, infrastructure units, and divisions of provincial governments.

2.5.4 Infrastructure Development and Financing Institution (IDFI)
IHFD, with the help of government is pursuing a very significant objective of establishing a dedicated Infrastructure Development and Financing Institution (IDFI). IDFI will be mandated with broad scope of identifying, developing, structuring, and financing projects in key areas of infrastructure. Key multilaterals like World Bank, IFC, ADB and IDB are on board with keen interest to participate in the form of either technical assistance or financial participation. Negotiations with consultants are underway to prepare business model and feasibility report of IDFI, which is expected to be completed by the end of October 2010.

2.5.5 Revised Guidelines for Infrastructure Project Finance
Revised guidelines for Infrastructure Project Finance have been submitted for approval and are expected to be notified during the next quarter. The revised guidelines will facilitate financial institutions to structure their lending mechanism in line with international best practices for assessing and mitigating risk inherent in large infrastructure projects.

2.6 Agricultural Finance
The Agricultural Credit Advisory Committee (ACAC) of SBP had set an agricultural credit disbursement target of Rs 260 billion for banks for 2009-10. The target was 11.6 percent higher than the disbursement of Rs 233 billion in 2008-09. Out of Rs 260 billion, Rs 174 billion were to be loaned by commercial banks, Rs 80 billion by ZTBL, and Rs 6 billion by Punjab Provincial Cooperative Bank Limited (PPCBL).

During FY 10, banks disbursed Rs 248.1 billion or 95.4 percent of the annul target compared with Rs 233 billion or 93.2 percent of the target during FY09. Credit disbursement to agriculture sector witnessed an increase of Rs 15.1 billion or 6.5 percent over the last year. However, it remained Rs 11.9 billion short of FY 10 target as the farmers used lesser credit lines because of having pocketed increased cash flows due to high prices of agri. produce. Consolidation of loan portfolio, and risk averse behavior of commercial banks particularly of the smaller banks in the backdrop of their rising NPLs also contributed to missing the disbursements target during the year (see **Table 2.3**).

Table 2.3: Agricultural Credit Disbursements against Targets

billion rupees

Banks	2007-08		2008-09		2009-10	
	Target	Disbursement	Target	Disbursement	Target	Disbursement
5 Big Comm. Banks	96.5	94.7	119.5	110.7	124	119.6
ZTBL	60	66.9	72	75.1	80	79
DPBs	35.5	43.9	52.5	41.6	50	43.8
PPCBL	8	5.9	6	5.6	6	5.7
Total	200	211.6	250	233	260	248.1

Province-wise disbursement reveals that major portion of agricultural credit that is 213.5 billion or 86.1 percent was disbursed in Punjab during 2009-10 followed by Rs 26.7 billion in Sindh. An amount of Rs 6.5 billion was disbursed in KP, Rs 0.6 billion in Balochistan and Rs 0.8 billion in AJK/GB. Details of province wise disbursements vis-a-vis targets achieved during 2008-09 and 2009-10 are given in **Table 2.4**

Table 2.4: Province-wise Agricultural Credit Target and Disbursement

value in billion rupees and share in percent

Province	2008-09			2009-10		
	Target	Disbursement	Share in total	Target	Disbursement	Share in total
Punjab	195	196.1	84.2	202.8	213.5	86.1
Sindh	35	27.6	11.8	36.4	26.7	10.8
KP	15	7.9	3.4	15.6	6.5	2.6
Baluchistan	3.8	0.6	0.3	3.9	0.6	0.2
AJK/GB	1.3	0.8	0.3	1.3	0.8	0.3
Total	**250**	**233**	**100.0**	**260**	**248.1**	**100.0**

2.6.1 SBP's Initiatives in Agricultural Credit

SBP has taken the following measures/ key steps during FY 2009-10 for the promotion of agri/ rural finance in the country:

Completion of Pilot Project Phase II. After successful implementation of the Sindh Pilot Project, the Pilot Project Phase II (PP-II) was launched in 28 agriculture intensive districts of the country from Rabi Season 2009-10 that is from September 2009 to February 2010 for deepening of agri. credit outreach on fast track basis and creating linkages among stakeholders. It included 14 districts of Punjab, 9 of Sindh, 3 of KP and 2 of Balochistan. At completion of the project, banks have disbursed Rs 42.7 billion as against a target of Rs 44.1 billion or 97 percent of the target. Borrowers served were around 336,000 against a target of 286,000 borrowers. Fresh disbursed borrowers were 183,000 against target of 102,000 including around 82,000 borrowers served through credit lines to National Rural Support Program.

Introduction of One Window Operation in Pilot Districts. To address issues of delays in issuance of passbook and timely completion of revenue formalities, a framework for 'One Window Operation' was developed and the Operation was launched in the Pilot districts of Sindh, Punjab, KP and Balochistan by their respective provincial Boards of Revenue from Kharif Season

2009. The Operation has facilitated banks and farming community in timely completion of revenue formalities and access to finance on fast track basis.

Introduction of Pilot Project Phase III. Encouraged by the successful completion of PP-II and on the basis of the feedback received from banks for the extension of Pilot Project Phase III (PP-III) from Kharif season 2010, SBP has planned to launch PP-III from Kharif 2010. Besides 28 districts of PP-II, 23 new districts (13 in Punjab, 4 in Sindh, 3 each in KP and Baluchistan) have been selected for inclusion in PP-III based on the number of farm households and agricultural activities. With the inclusion of these 23 districts, the coverage of the PP-II will be extended to 51 districts and 75 percent of total farm households in the country.

Relief Package for Small Farmers of Malakand Division and FATA. The Prime Minister of Pakistan announced a relief package for remission/ write-off of small farmers' agricultural loans (farm & non-farm) in the war affected areas of Malakand Division and FATA, in the Kissan Convention 2009. Accordingly, SBP vide ACD Circular No. 02 dated December 2, 2009 advised banks to implement the relief package and stop recovery and accrual of mark-up on all agricultural loans of small/ subsistence farmers of the districts of Malakand Division namely; Swat, Buner, Shangla, Lower Dir, Upper Dir, Malakand & Chitral and FATA (Bajaur Agency, Kurram Agency and Khyber Agency). The cost thereof shall be borne by the federal government. The scheme will facilitate farmers in war affected areas of KP and FATA in settlement of their outstanding agri. loan liabilities and enable them to obtain fresh loans from banks to resume agricultural activities.

Internship Program for Agricultural Students. To provide training to agri. graduates on banking and finance particularly on agriculture financing, SBP has introduced 6-weeks specialized internship program on bi-annual basis, in January and July. The program will include 2-weeks training at SBP Karachi wherein the participants will be briefed about SBP, its departments, functions, policy and regulatory framework for Development Finance and agriculture financing, etc. Thereafter, the internees will be posted to commercial banks' agri. designated branches to learn agri. lending processes and systems of banks in terms of identification of borrower, cash flow analysis, credit requirements, etc. at grass root level. The internees will also complete a report/ research paper on the topic agreed in consultation with respective chief manager of SBP-BSC and the commercial bank. After successful completion of the program/report, an internship certificate will be awarded to the internees. Around 50 agri. graduates/post-graduates will benefit from the program every year.

Amendment in Revolving Credit Scheme for Agriculture. To facilitate farming community in repayment of crop production loans under SBP Revolving Credit Scheme based on their cropping cycle and cash flows, ACD vide its circular No. 1, dated September 1, 2009 has allowed banks to segregate the repayments by borrowers in two stages, i.e., at least 50 percent of the utilized credit during the year after harvest of each Rabi and Kharif crop instead of existing condition of one

Box 2.1: Crop Loan Insurance Scheme

SBP, for the first time in the history of Pakistan has successfully implemented Mandatory Crop Loan Insurance Scheme (CLIS) for five major crops, i.e., wheat, rice, sugarcane, maize, and cotton in collaboration with banks and leading insurance companies.

Agriculture has always been vulnerable to the vagaries of nature. And it is the only livelihood of many resource constrained Pakistani farmers. Thus, the impact of natural calamities is always huge on the farming community. The farmers not only have to bear a loss of their produce/crop but also have to face defaults for the bank credit. The need to safeguard the interests and investments of farmers is, therefore, of paramount importance.

Crop insurance is a risk management mechanism designed to even out agricultural risks and blunt the consequences of natural disasters to make losses, especially to the marginalized farmers, more bearable. Non availability of crop insurance has always been a key impediment in increasing the flow of formal credit to farmers. Therefore, to mitigate the risk of losses borne by agricultural borrowers due to natural calamities resulting in defaults of such borrowers, SBP Task Force on Crop Loan Insurance Scheme comprising all stakeholders developed a commercially viable and sustainable CLIS. The scheme was made mandatory by the government for the agri. borrowers of banks for five major crops, i.e., wheat, rice, sugarcane, cotton, and maize from Rabi Season 2008. Subsequently, the mandatory CLIS was extended to the agri. borrowers of MFBs.

The scheme covers crop losses from time of sowing or transplanting till harvesting against excessive rain, hail, frost, flood, drought, and crop related diseases like viral and bacterial attacks or damage by locusts. The amount of indemnity is outstanding agri. loans of the borrower against the crop. Claims for damage directly caused by the Insured Risks to be based on declaration of Calamity by the competent authority (Provincial or Federal) in the area where the insured risk is located and such declaration is notified in the Gazette. All agri. lending banks have made arrangements with the insurance companies. Under the scheme, the cost of premium on account of subsistence farmers is being borne by the government up to a maximum of 2 percent per crop. The banks are advised to pay the insurance premium of subsistence farmers and submit their claims to SBP on half yearly basis for onward submission to MoF for reimbursement after verification as per MoF criteria. The cost of premium, in case of economic and above economic holdings is borne by the borrowers. So far, insurance premium of Rs 331.11 million has been reimbursed by the government to banks from July 2008 to December 2009. Thirteen calamities have been declared during August 2008 to June 2010 and Rs 77 million has been paid by the insurance companies to the banks for the settlement of the outstanding agri. loans to of farmer borrowers till December 31, 2009. The participating insurance companies are New Jubilee Insurance Co, EFU General Insurance Ltd, East West Insurance Co, National Insurance Company Limited, UBL Insurer, The Metropolitan Life Assurance, United Insurance Company, and Silver Star Insurance Co. Ltd.

Further, the Cabinet while introducing mandatory CLIS advised that after its successful implementation, the government would launch National Agriculture Insurance Scheme (NAIS) especially for small farmers which will also cover all farmer borrowers of existing CLIS.

Accordingly, SBP Task Force in collaboration with stakeholders has developed NAIS. The salient features of NAIS are similar to CLIS, except that the amount of indemnity will cover the cost of production of specific crops as determined by MINFA. Moreover, under NAIS, the claims will directly be paid to the farmer by the insurance company. Likewise, the prerequisites for launching of NAIS would require comprehensive database of the farmers, crops cultivated, cropping area, etc. Government support, streamlining of calamity announcements and automation of land record will play a critical role in successful implementation of NAIS. The NAIS was presented to the senior officials of MoF and MINFA in a meeting held on May 31, 2010 under the chair of Mr. Nazar Muhammad Gondal, Minister for Food & Agriculture. As per decision of the meeting, the scheme is also being shared with the provincial governments and relief commissioners before finalization and implementation by the government.

The successful implementation of NAIS would not only safeguard farmers against losses due to natural calamities and saving millions of rupees in national exchequer paid in such cases but will also facilitate government in achieving the goal of agriculture development, poverty alleviation, and economic growth of the country.

time annual clean up for renewal of the facility. Total repayments in the loan account during the year equals to the maximum amount availed/ outstanding during the year shall also be treated as clean up of the account. The payment of mark up and other charges, however, shall be required to be made as per agreed terms and conditions. Further, the date of repayment/adjustment of individual borrower shall be determined by the bank on the basis of crop cycle, harvesting period, etc., in respective areas.

Simplification of documents and Turnaround time. To ease disbursement of agri. credit, a committee comprising Agri. Heads, heads of CAD, and risk management of banks was constituted to review the current practices and make recommendations for simplifying the agri. loan documentation and loan disbursement procedure. The committee has accomplished its task of eliminating unnecessary documents and lengthy activities and has introduced a unified and simple process. The circular will be issued soon.

Training Workshop for CAD/Risk Management Departments. To develop the understanding of CAD and RMD officials about the dynamics of agri. lending, SBP developed two days training workshop on important topics such as overview of agri. sector, SBP regulations regarding agri. finance, agri. credit risk management tools and techniques, loan appraisal and documentation, agri. passbook and other documents of revenue department in consultation with banks. In this connection, four training workshops have so far been conducted at Karachi, Lahore, Multan, and Islamabad during 2010, which were attended by around 170 senior officials of agri. lending banks, SBP and DFSD, SBP-BSC.

Agri Commodities Physical Trade and Market Development. Pakistan's agri. sector suffers from a compounded problem of a lack of infrastructure and market structure. Infrastructure side includes a lack of proper warehousing, whereas on market side, there is a lack of grading and testing, collateral management, post harvest financing, and trading. To develop storage, marketing and post harvest financing, SBP is leading a committee of key stake holders including Karachi Stock Exchange, National Commodities Exchange (NCEL), Pakistan Banks Association (PBA), Competitiveness Support Fund (CSF), and Pakistan Farmers Association, towards an initiative which will evolve proper storage, fair and transparent price mechanism, and post harvest financing system.

The proposal is to develop a National Collateral Management Company (NCM), under private management and private / public equity, to manage warehouse system and provide services of testing, standardization, collateral management, finance and trading of Electronic Warehouse Receipts (EWR). EWR will be integrated with trading, clearing and settlements system of NCEL. CSF and USAID are providing Technical Assistance to fund study to develop blueprint which would include operational structure, legal and regulatory framework and financials. To encourage private sector participation in infrastructure development, SBP has also launched a refinance scheme for agri product storage (silos, warehouses, and cold storage), at subsidized rates.