STATE BANK OF PAKISTAN

ANNUAL PERFORMANCE REVIEW

2005 - 06

Our Vision

To Transform SBP into a modern and dynamic central bank, highly professional and efficient, fully equipped to play a meaningful role, on sustainable basis, in the economic and social development of Pakistan

Our Mission

To promote monetary and financial stability and foster a sound and dynamic financial system, so as to achieve sustained and equitable economic growth and prosperity in Pakistan

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Keeping up with its tradition, the State Bank of Pakistan's (SBP) Annual Performance Report offers an account of the strategic direction, policy developments and performance of SBP for the fiscal year 2005-06.

While operating within the broader macroeconomic policy framework, SBP contributed to the strong economic growth by its ongoing emphasis on promoting further depth and breadth in the financial system and fostering competition and efficiency as well as best practices in the banking sector. At the same time, monetary tightening pursued vigorously during the year helped reigned in inflationary pressures. Similarly, the financial system in Pakistan has also been radically transformed in recent years.

This report reviews and examines the policy thrust and strategies adopted and implemented by the management during the year. Strategic policy direction of SBP in FY06 was driven by the key goals of:

1. Prudent and Effective Monetary Management
2. Banking Sector Regulation and Supervision
3. Broadening Access of Financial Services
4. Exchange Rate and Reserves Management
5. Information Technology and Infrastructure Development
6. Strengthening of Payment Systems
7. SBP Internal Restructuring, Reorganization and Human Resource Development

Prudent and Effective Monetary Management

SBP's first and foremost responsibility is to maintain overall price stability. In order to achieve this objective, SBP augmented and tightened monetary management during the year keeping in perspective the need for supportive policies to promote economic growth. Besides holding policy discount rate at 9 percent, SBP enhanced liquidity management through timely and frequent Open Market Operations. Together these policies helped contain broad money supply growth to 15.18 percent, which is below the nominal GDP growth rate (17.20 percent) and the past four years average of 18.1 percent. Monetary tightening has yielded results, albeit after a lag of some months, as evident from easing of inflationary pressure. The Consumer Price Index (CPI) inflation also came down from over 11.1 percent in April, 2005 to 7.6 percent in FY06.

Bank credit growth continued to rise significantly given the growing requirements of both the government and the private sector credit in the wake of strong business sentiments and government spending in earthquake-affected areas in addition to budgetary expenditures. Even though private credit rose at a slower pace than last year, its growth and outreach extended to all key sectors.

Banking Sector Regulation and Supervision

Another key priority of SBP is to ensure the robustness and soundness of the banking sector. Efforts continued to further restructure the banking sector, rationalize & strengthen its regulatory and supervisory framework and address outstanding deep rooted inefficiencies & weaknesses of the financial sector.

Today, Pakistan's banking sector is predominantly privately owned and competition has grown. Liberalization and deregulation, which are the core pillars of reform process, accompanied by steady consolidation has served to strengthen the banking system. Diversification of businesses and products has been impressive. With growing liberalization, banking assets grew overwhelmingly, reaching Rs. 4,029 billion by end-June CY06, representing a growth of 123 percent over CY00. The sector profitability, at over USD 1 billion in CY05, was at an all time high and was generated through enhanced business volumes and rising share of high-yielding assets. Non-core activities also made a significant contribution to bank profitability. Resultantly, the return on assets (after tax) increased from 1.2 percent in CY04 to 1.9 percent in CY05; easily surpassing the relevant international benchmarks. The rapid growth in profits also resulted in higher return on equity (after tax), which improved to 25.8 percent from 20.3 percent in CY04. Re-emergence of foreign banks as one of the key players in the industry, and professional sponsors and management at the helm of affairs of leading domestic banks have also contributed to exceptional performance of the banking sector.

SBP continued to align its prudential regulatory framework with international standards and market developments during FY06. Among others, important initiatives included the introduction of variable capital adequacy ratio based on the Institutional Risk Assessment Framework (IRAF) based rating of banks/DFIs, and laying down the road map for banks for ensuring a smooth transition from Basel-I to Basel-II. The implementation of Basel-II poses tremendous challenges for the banking system. SBP, therefore, has encouraged the financial institutions for upgrading the IT and internal control systems and enhancement of expertise in specialized areas like risk management, through in-house training, seminars and workshops. In order to have fewer but stronger financial institutions, focused regulatory measures were adopted, which resulted into various mergers and acquisitions across the industry.

Broadening Access of Financial Services

With the objective of broadening access to financial services, SBP encouraged and facilitated adequate flow of credit towards the SME and Agriculture sectors in addition to strengthening of the institutional mechanism for the outreach of microfinance services to the under-served areas. With the growing acceptance of micro finance as a viable business proposition and a critical vehicle for poverty alleviation, SBP has facilitated the establishment of Micro Finance Banks (MFBs). Licenses for two nation-wide MFBs were granted in FY06 and a few more proposals are currently in the pipeline.

Keeping in view the importance of the agriculture sector, SBP introduced a number of new products in consultation with the key stakeholders. Resultantly the total agriculture credit disbursed during FY06 surpassed the target of Rs.130 billion. Additionally, the growth in consumer finance in recent years has been instrumental in broadening access of financial services to the middle and lower middle strata of the society for whom access to institutional credit was limited previously.

The Islamic banking industry experienced tremendous growth during the year, with the issuance of a new license for a full-fledged Islamic bank, and the commencement of operations of two banks whose licenses was issued in FY05, bringing the total number of operational Islamic Banks to 4 and Islamic banking branches of conventional banks to 39 by end-FY06. The Islamic Banking Department at SBP works in close coordination with the industry, providing the necessary impetus to grow as an alternate choice to conventional banking.

Exchange Rate and Reserves Management

The FY06 ended with strong foreign exchange reserves level reaching close to a total of USD 13,136.90 million as of June, 2006. Additionally, the fair degree of exchange rate stability also helped to attract foreign remittances and Foreign Direct Investments (FDI). Notwithstanding pressures on foreign exchange and reserves management which remained high in wake of unabated increase in oil prices that reached record levels and substantial widening of the trade gap. Despite these constraints, effective management by SBP helped keep the market stable and limited volatility was observed in comparison with the previous year. Besides high level of remittances and FDI flows, effective reserve management pursued by SBP played a significant role in maintaining investor confidence.

Information Technology and Infrastructure Development

SBP is transforming itself into a modern organization with the support of information technology. Most of the activities which were previously carried out manually have all been computerized. Several major technology up-gradation projects i.e. Oracle (ERP), GLOBUS (Over-the-counter software) and Data Warehouse have been successfully implemented. This has helped the organization to streamline its business processes, reduce inefficiencies in workflows, increase accuracy and security of data information and will also enable its management and employees to access real time information, allowing them to generate various customized MIS reports, enabling them to make realistic and timely decisions.

Strengthening of Payment Systems

SBP is also making continuous progress towards the implementation of an effective and efficient Payment & Settlement System in Pakistan. The Payment & Settlement Systems are the strategic components of financial infrastructure of any country. An efficient and well functioning national payment system contributes towards the growth of an economy, stability of financial system and smooth functioning of financial markets. In view of its importance, the implementation of the Real Time Gross Settlement (RTGS) at SBP was initiated a few years ago. Termed as the 'Pakistan Real-time Inter-bank Settlement System (PRISM), it will completely integrate and automate the current manual inter-bank settlement process of large value payments at SBP. In addition, it will help to minimize the vulnerabilities and risks associated with the payments and settlements of large value transactions. PRISM is scheduled to go live in year 2007.

Internal Restructuring, Reorganization and Human Resource Development

The focus on Human Resource Development continued with the same enthusiasm and consultative deliberations. The headcount of SBP decreased to 1,339 employees in FY06. Manpower diversity at SBP has evolved with reference to the age groups of employees and period of service in the organization. This analysis implies that in future, major HR policies and procedures must be designed to cater to the various types and categories of SBP employees. Among others, succession planning, compensation, recruitment processes and employee regulation etc. have to be more aligned to the market practices and will constitute an integral element of future internal reform agenda of SBP.

In the backdrop of growing complexities of the banking system and the greater interdependencies of the world economies in the wake of globalization, role and responsibilities of the central banks have increased tremendously. The formulation and effective implementation of a monetary policy that is consistent with the emerging economic challenges is an area where central banks would increasingly need to focus upon. On the banking front, the cross-border supervisory relationships between the home-host regulators, particularly with reference to fighting the money laundering and terrorist financing activities, would gain added importance. Going ahead, as the banking industry reaches newer heights of sophistication and develops more complex and varied products, our role as the central bank would be to nudge the banking industry towards a stage where they become Self Regulatory Organizations (SROs) and the SBP's role would be confined to providing only an enabling environment through the issuance of broader guidelines.

In recognition of this trend, we are embarking on the next stage of financial sector reforms and address unfinished reforms agenda. Broadly, this would involve focus on:

- Further consolidation & restructuring of the banking sector;
- Developing capacities to cater to unmet requirements of special segments of the economy and catering to diverse needs;
- Strengthening of risk management systems;
- Diversification of the financial sector by further development of the equity and debt markets which, while fairly vibrant, need to play a more significant role in meeting the economy's financing requirements;
- Promoting financial product innovations; and
- Implementation of good corporate governance practices among banks and central bank along with effective enforcement of regulations.

In order to achieve these goals, SBP is developing a Financial Sector Road Map which would go a long way in not only enhancing our capacities as a regulator but would also help us to provide strategic guidance to the industry. It would serve as a critical step in coping with the rapid developments taking place across the financial markets, and to position the central bank at par with other regulators in the region.

To improve the governance of the central bank and enhance its capacity as a regulator, the first step has already been initiated recently with a comprehensive reorganization of the bank. The reorganization of subsidiaries is also expected to follow. The performance evaluation system and the incentive framework of SBP are also being re-evaluated to attract, retain and motivate the appropriate work force in the bank while taking into account prevalent market conditions. Further, the institutional training mechanism of the central bank, as well as the commercial banks, is being upgraded to develop a centre of excellence in banking education.

In the end, I wish to thank all our staff members whose hard work, commitment and devotion have made the change process a success. I look forward to their continued support for meeting the challenges that lie ahead

Shamshad Akhtar
Governor

Strategic Objectives of SBP

8 Broadening Access of Financial Services
9 Ensuring Soundness of the Financial Sector
10 Maintaining Price Stability with Growth
11 Exchange and Reserve Management
12 Strengthening of Payment Systems

1 BROADENING ACCESS OF FINANCIAL SERVICES

1.1 Overview

State Bank of Pakistan (SBP) has been pursuing the strategy of broadening access of financial services through rationalization of regulatory framework, introduction of prudential regulations and the development of required legal and regulatory framework to allow the private sector entry into banking with the poor and the promotion of financial services through Islamic, SME, Agriculture and micro finance windows. Resultantly, as observed the private sector interest towards establishment of micro finance banks has improved, the institutional capacities for SME financing has increased and the Islamic banking practice has started to consolidate alongside rapid growth in consumer banking overtime.

These initiatives have led to significant improvement in growth and activity in largely untapped sectors. Thus, considering economic and social importance of SME sector, SBP undertook a number of initiatives to provide formal credit and allowed commercial banks to build their capacities. Similarly, with the growing acceptance of micro finance as a viable business proposition and a critical vehicle for poverty alleviation, SBP is encouraging the private sector in establishing Micro Finance Banks (MFBs). In this reference, SBP issued guidelines for commercial banks venturing into micro finance business. Simultaneously, SBP has also focused in capacity building to regulate and supervise MFBs. The licenses for two nationwide MFBs were granted in FY2006 and some more are expected which would result in improved outreach.

Islamic banking industry experienced phenomenal growth. In order to promote the sector, SBP established a full-fledged Islamic banking department to focus on all Islamic banking issues providing the industry the necessary impetus to grow and an alternate choice to conventional banking. The drive to promote Islamic banking as a parallel system operating at a level playing field with commercial banking is aimed at building a broad based financial system in the country to enable all segments of the population to access financial services and play their due role in the overall economic development.

Keeping in view the importance of agriculture sector, SBP introduced a number of new products in consultation with the key stakeholders. The total agriculture credit disbursed during the FY2006 surpassed the target of Rs.130 billion. The exponential growth in consumer finance in recent years has been one of the major emerging areas broadening access of financial services to middle and lower middle strata of the society for whom access to institutional credit was very limited previously. At the same time, it has also provided an important avenue for banks to diversify their loan portfolio and improve profitability.

This is just a modest beginning towards broadening access of financial services to all segments of the society and still a long distance is to be covered to achieve significant progress in that direction. For SBP broadening access of financial services remains as a high priority strategic objective which it would relentlessly pursue in the years ahead.

1.2 SME Finance

It is a globally tested fact that Small and Medium Enterprises (SME) are the backbone of an economy and carry significant economic and social value. The development of SMEs leads toward creation of jobs, enhancement of competitiveness and exports while propelling the overall economic growth. They are considered as the key drivers for employment, poverty reduction and social integration. However due to smallness of their size, they are generally put in a fundamental social and economic disadvantage-in terms of access to capital resources, skilled labor, information asymmetry, cost of business transactions and technology solutions.

For a variety of reasons ranging from non-availability of skilled labor, inadequate supply of raw material, taxation issues and limited flow of credit, the SME sector in Pakistan has not been able to take full advantage of the domestic economy and increasingly accessible world markets.

1.2.1 Initiatives Undertaken by State Bank of Pakistan

One of the major objectives of financial sector reforms in Pakistan was to enable the banks to direct funds to sectors, which have a greater significance in terms of economic and social growth and have been largely under-served including the SME sector.

The State Bank has taken a number of initiatives for enhancing the outreach of formal credit to hitherto neglected sectors including SMEs. These include creation of a separate group within SBP catering to the needs of the development finance in general with a separate department for SMEs. This was coupled by various other initiatives which included, issuance of separate Prudential Regulations (PRs) for SMEs, instructions to banks for giving preference to financing needs of SMEs under SBP refinance schemes like Locally Manufactured Machine (LMM) and Export Finance Scheme (EFS), capacity building of PFIs, mass training programs for Banks/DFIs, awareness seminars for the development and promotion of SME finance and the formation of a SME Consultative Group.

1.2.2 Mass Training Workshops

SBP initiated a series of training workshops on advanced SME Financing techniques in consultation with Bankakademie International (BAI) for loan officers of banks / DFIs. Four training workshops were held where more than 120 loan officers from different banks participated. The objective of the training workshops was to enable the participants to: (i) Understand and implement the existing regulatory framework for SME Financing, (ii) Evaluate the risks associated with the financial situation of SMEs through an analysis of qualitative and quantitative information, (iii) Identify business financing needs, (iv) Understand and apply the key concepts of financial analysis to SME related risks, particularly through cash flow and budget analysis, (v) Identify viable projects and appraise SME credit requests, and (vi) Identify signs of business distress and adopt appropriate measures.

1.2.3 Seminar on SME Finance

A seminar on “SME Lending-Challenges and Potential Solutions” for banks was also arranged with the collaboration of Shore Bank Advisory Services (SAS). The participants were apprised about the regulatory framework for SME lending in Pakistan and future steps that are being taken by SBP for promotion and development of SME finance besides sharing the experience of Shore Bank in SME sector of other countries.

1.2.4 One day Seminar Series on 'SME Products and Delivery Channels of Financial Institutions'

SBP and Small and Medium Enterprise Development Authority (SMEDA) jointly organized a series of awareness seminars on 'SME Products and Delivery Channels of Financial Institutions'. The representatives from banks, SMEs, Chamber of Commerce and Industries were invited to the seminars. These seminars were held at Sialkot, Hyderabad, Gujranwala, Peshawar, and Sukkur. The objective of the seminars was to (i) apprise the participants about the initiatives taken by SBP and SMEDA for promotion and development of SME sector (ii) introduce SMEs with the SME specific products developed by the Financial Institutions especially for the respective geographically located business clusters, (iii) share ideas on SME lending and challenges being faced by the bankers, and (iv) identify the difficulties being faced by the SMEs for obtaining credit from financial institutions.

1.2.5 Secured Transaction Framework

SBP and Asian Development Bank (ADB) have agreed on a program for Technical Assistance from ADB in developing a secured transactions[1] framework that can facilitate the creation and enforcement of collateral interest by improving policies, laws, regulations, and their applications so as to increase the provision of financial services to the SMEs. The ADB is in the process of short listing of the firms/experts. The project is expected to commence by January, 2007.

1.2.6 SME Consultative Group

SBP has constituted a consultative group on SME finance with representations from all the critical public and private sector stakeholders. The objective of the SME Consultative Group (SMECG) is to review the existing regulatory and policy framework so as to propose suggestions/recommendations for the promotion and development of SME Finance in Pakistan.

1.2.7 SME Finance-Current Status

The results of initiatives undertaken by SBP and the Government of Pakistan for promotion of SME Sector can be seen from the extended outreach of financial services to SME sector. The sustained focus of banks on SMEs, consumer, and agriculture sectors reflect their desire for loan diversification as well as enhancing their earning base, which until now has remained heavily dependent on financing to the corporate sector. The rising demand for SMEs and consumer financing has mainly contributed towards persistent and broad-based loan growth. SME sector, which in terms of banks exposure is the second largest after corporate sector, gained further impetus and went up by 13.7 percent during the year (Jun 05-Jun 06). SME sector share in overall loans of the banking system stood at 16.4 percent as of June 2006 with outstanding advances of Rs.356.7 billion (**Table-1.1**).

[1] A secured transaction, regardless of its form, is intended to create a security interest in personal property or fixtures, including goods, documents, and other intangibles. A security interest is a right given to one party to secure payment and performance of an obligation. Collateral constitutes the asset over which security is granted.

Table 1.1: Sector wise Break up of Loans (Domestic Operations) * *(Billion Rupees)*

Sectors of Economy	Jun-04		Jun-05		Jun-06		% increase June 05-June 06
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)	
Corporate Sector	741.4	54.9	944.0	52.3	1,140.9	52.4	20.9
SMEs	**231.7**	**17.2**	**313.6**	**17.4**	**356.7**	**16.4**	**13.7**
Agriculture	108.7	8.0	131.5	7.3	134.0	6.1	1.9
Consumer Finance	103.2	7.6	206.1	11.4	296.5	13.6	43.9
Commodity Operations	90.0	6.7	140.3	7.8	180.0	8.3	28.3
Staff Loans	39.7	2.9	40.5	2.2	43.3	2.0	6.9
Other	36.1	2.7	28.0	1.6	27.7	1.3	(1.1)
Total	**1,350.8**	**100.0**	**1,804.0**	**100.0**	**2,179.1**	**100**	**20.8**

** Loans to both Public and Private Sector*

The growing outreach of the banking system can also be gauged by the growth in the total number of borrowers. Banks were able to increase their SME client base overtime by 134 percent (**Table-1.2**).

Table 1.2: Sector wise Break up of number of borrowers

Sectors of Economy	Dec-02	Dec-03	Dec-04	Dec-05	Jun-05	% Change Dec-02-June 06
Corporate Sector	14,256	17,743	19,333	19,881	19,604	37.5
SMEs	**67,250**	**91,663**	**106,248**	**161,316**	**158,050**	**134.1**
Agriculture	1,339,961	1,411,508	1,503,827	1,534,502	1,535,112	14.6
Consumer Finance	252,156	721,201	1,619,207	2,407,806	2,476,352	882.1
Commodity Operations	1,458	2,069	3,207	6,730	5,815	298.8
Staff Loans	72,570	69,796	72,633	72,927	70,800	(2.4)
Other	56,683	63,696	73,735	44,144	42,596	(24.9)
Total	**1,804,604**	**2,377,676**	**3,398,190**	**4,247,306**	**4,308,329**	**1,340**

1.3 Microfinance

A formal Microfinance (MF) sector emerged in Pakistan in late 1990s when government adopted Microfinance policy and initiated some landmark Microfinance projects to promote growth in the sector. A conducive and enabling policy framework was put in place in Pakistan for development of vibrant microfinance sector. Pakistan is among the few countries of the world which have a separate legal & regulatory framework for microfinance. The MF policy recognized microfinance as an important poverty alleviation tool as well as an important component of country's financial system. The existing policy and regulatory environment for Micro Finance Institutions (MFIs) in the country presents all the major features of a conducive and enabling policy environment, including sustained commitment and substantial investment by the government to help develop the sector, a responsive regulatory framework which allows institutional diversity and encourages both regulated and unregulated players to extend financial services to the poor. SBP recent initiatives over Microfinance are discussed below:

1.3.1 Issuance of Guidelines for Commercial Banks to Undertake Microfinance

On June 10, 2006, SBP issued guidelines for commercial banks venturing into microfinance business. These guidelines cover various approaches and institutional arrangements that commercial banks may undertake for extending MF services to their clients. The guidelines also discuss the issues and challenges normally faced by commercial banks active in MF sector, the applicable Prudential Regulations on MF portfolio and the MF operational set up of the commercial banks. These guidelines will facilitate especially those commercial banks which have shown interest in diversifying their lines of business by entering into potentially vast market of Microfinance.

1.3.2 Development of On-site Examination and Off-site Surveillance Manuals

The SBP developed manuals for on-site examination and off-site surveillance of Micro Finance Banks (MFBs) under risk-based principles and trained its staff in charge of supervision. The development of the Supervisory Manuals was in line with the functional strategies of SBP interalia requiring it to focus efforts on financial sector deepening, proactive supervision and regulation of financial institutions. Both the manuals were finalized in May 2006, and are now being used for supervision. The development of these manuals has enhanced the supervisory capacity of SBP to protect investors and depositors through transparency, safety, increased outreach and sustainability of the MFBs, as well as strengthening of the capacity of MFBs to access funds from the capital market.

1.3.3 Revised Loan Classification Criteria for MFBs

In order to bring the existing classification/provisioning/write-off criteria for Micro Loans in line with international best practices, while keeping in view the local conditions and the evolving phase of MFB industry in Pakistan, SBP also revised the loan classification criteria in April, 2006. The necessary amendments have been made in the existing prudential regulations for MFBs. The revision of the criterion by the regulatory authority has sent the message to MFBs for improving their collection policies and efforts.

1.3.4 Amendments in MFIs Ordinance

The amendments in MFIs Ordinance, 2001 have been made as a part of Finance Bill 2006 in order to give more supervisory powers to SBP and address evolving issues of the MF sector. The main features of the amendments were:

- Introduction of the definition for MFIs and MFBs. The MFIs have been restricted only to micro lending from their own sources while the name of MFBs has been reserved for use by licensed Microfinance banks, specifically involved in the provision of microfinance services.

- MFBs are now allowed to invest their surplus funds in marketable debt securities in addition to Pakistan Investment Bonds (PIBs) and Treasury Bills (T-Bills).
- A new tier of MFB has been introduced which is called Regional MFBs with paid up requirement of Rs.150 million. The regional MFBs comprises of 2-5 adjacent districts of a provinces.
- The State Bank has been authorized to extend the time period for the submission of audited financial statements by one month for MFBs.
- The remuneration on accounts maintained with SBP is now discontinued.
- The MFBs are allowed to appoint an external auditor for a maximum term of 5 years instead of 3 years.
- The SBP has been authorized to remove/prosecute the Directors or other managerial persons from offices.
- The SBP has been authorized to supersede the Board of Directors (BOD) of MFBs.
- The Board of Directors, auditors and employees of MFB are now required to make a declaration of fidelity and secrecy on the prescribed forms.

1.3.5 SBP Capacity Building in Microfinance

SBP organized five weeks training program in November-December 2006 for enhancement of related skills level of SBP officers in the areas of Microfinance dynamics, off-site supervision and on-site inspection of Microfinance Banks. In addition, SBP also arranged a 3-day training program in October, 2005 for the participants from the MFBs, NGOs, PMN, and SBP. The resource person for this training program was Mr. Richard Rozenberg, senior consultant of CGAP and the World Bank who shared the best international practices in Regulation and Supervision of MFBs. Moreover, a number of SBP officials working in Microfinance activities were sent for different local and foreign training programs, seminars and micro melas. The improvement in SBP MF related capacity has helped in achieving the primary objective of development of sector-friendly policies and effective supervisory framework for MFBs.

1.3.6 Outreach Performance

The Microfinance Sector in Pakistan has grown substantially over the last 6 years on the back of deep involvement of GOP, SBP, private sector investors, and the donors. This growth has been witnessed on all fronts; like increase in private sector interest in establishment of MFBs, diversification of products, growth in active borrowers and development of branch infrastructure as delivery conduits for future growth. SBP during FY 2006 granted licenses to two nationwide MFBs. The network of branches and service centers of MFBs increased from 157 to 253. The number of active borrowers increased by 25 percent to 266,720 and the outstanding credit portfolio increased from Rs. 2,000 million to Rs. 2,739 million in June 2006. Similarly, number of depositors increased by 43 percent to 35,888 while the total deposits rose by 27 percent to Rs.746 million. In view of recent emergence of two new nationwide MFBs and expected entrance of commercial banks in MF business, the outreach levels are likely to increase significantly overtime (**Table-1.3**).

Table 1.3: Outreach (Microfinance Banks) As of June 30, 2006	
Number of Branches	112
Number of Service Centers	141
Number of Borrowers	266,720
Number of Female Borrowers	51,819
Percentage share of Female Borrowers	19%
Loan Outstanding (Rs in Million)	2,739
Average Loan Size (Rs.)	10,269
Deposits (Rs. In Million)	746
Number of Depositors	35,888

1.4 Export Finance Regime

The Export Finance Scheme (EFS) has remained one of the major sources for meeting the funding requirements of our exporters through banking system during the year ended June, 2006. During FY 06, Rs.263.802 billion (Rs.74.263 billion under Part-I and Rs.189.539 billion under Part-II) were disbursed to banks under EFS by various offices of BSC SBP (Bank).Comparative position of export refinance availed by banks through BSC SBP Offices during the year 2005-06 with the preceding year 2004-05 is given in **Table 1.4 & 1.5**

(Rs. in Million)

Table 1.4:Comparison of the Export Refinance Provided During the year 2005-06 with the previous year

Refinance provided during the year 2004-05			**Refinance provided during the year 2005-06**			**% change of amount provided during 2005-06 over amount provided during 2004-05**		
Part-I	Part-II	Total	Part-I	Part-II	Total	Part-I	Part-II	Total
85,951	176,459	262,410	74,263	189,539	263,802	-14%	7%	1%

(Rs. in Million)

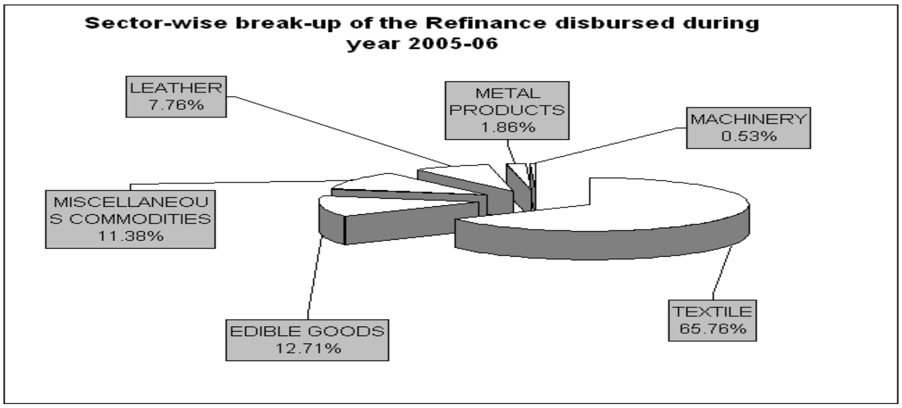
Table 1.5:Comparison of Outstanding Position of Export Refinance as on June, 06 with the Outstanding Position as on June, 05

Outstanding as on end June, 2005			**Outstanding as on end June, 2006**			**% change of amount outstanding end June, 2006 over amount outstanding end June, 2005**		
Part-I	Part-II	Total	Part-I	Part-II	Total	Part-I	Part-II	TOTAL
31,537	77,901	109,438	26,974	81,089	108,063	-14%	4%	-1%

1.4.1 Commodity-Wise Position

Commodity-wise position reveals that the highest amount (about Rs.173.484 billion) was disbursed for textile sector. Within the textile sector, the highest amount (Rs.43.505 billion or 25%) has been disbursed for the export of Ready Made Garments. In the edible goods, the highest amount has been disbursed for the export of rice (Rs.25.477 billion 76%) as per sector-wise break up is given in the pie chart (**Figure 1.1**).

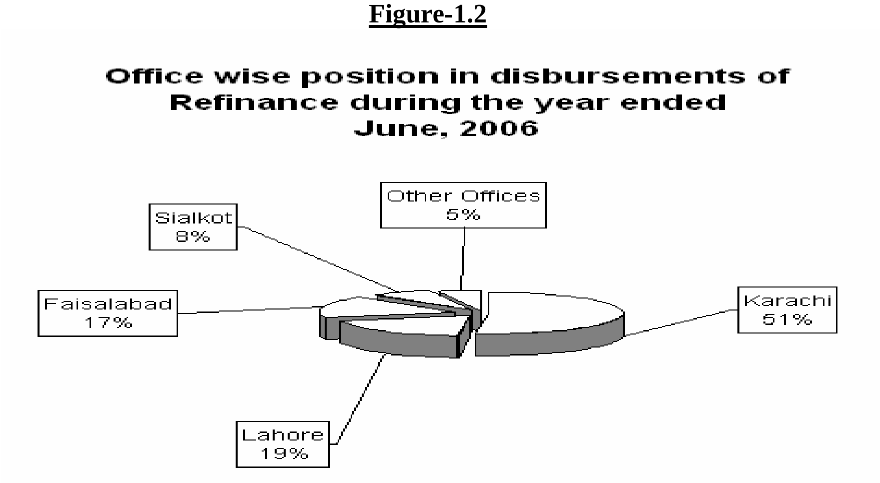
Figure 1.1



1.4.2 Office wise Position

The Karachi Office of our subsidiary has remained the largest centre followed by Lahore Office in terms of their share in the total refinance disbursed to banks during the year 2005-06. About 51% refinance was disbursed by Karachi office and 19% was disbursed by Lahore Office (**Figure 1.2**).

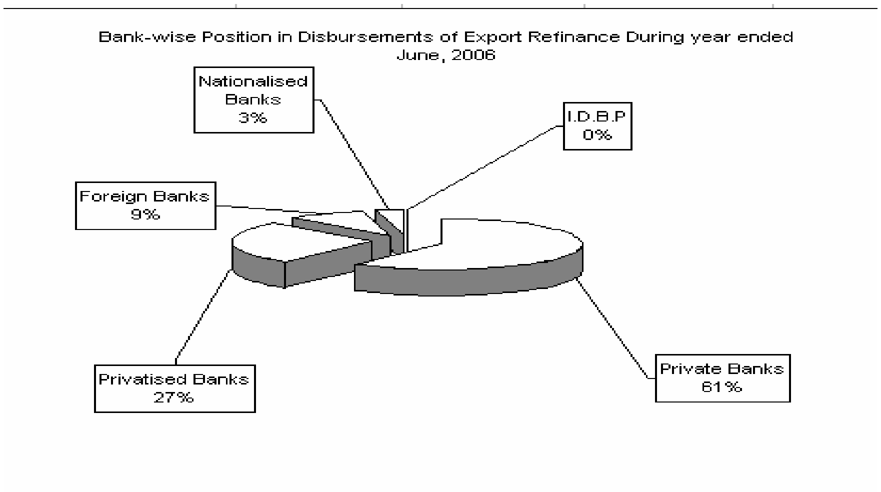
Figure-1.2



1.4.3 Bank-Wise Position

As regards the beneficiary banks, in the year 2005-06 the private sector banks remained the major beneficiary of the refinance activities as they availed about 61% of the total refinance granted, followed by Privatized Banks 27% and foreign banks 9%.The summarized position of the same is presented in the pie chart on the left (**Figure 1.3**).

Figure 1.3



1.5 Housing Finance

Keeping in view the economic and social importance of home ownership and SBP's policy stance of creating an enabling environment for the origination of housing loans by the banks, during the year 2005-06 SBP in consultation with public and private sector stakeholders continued to play a facilitating role, besides encouraging mainstream banking system to provide housing loans to general public.

The progress made by banks in the realm of housing finance during the recent years is indicative of the fact that banks are seriously considering the marketing of housing loans as part of their consumer banking portfolio. It is important to note that during the FY2006; as many as twenty nine banks/DFIs were active in providing housing loans to a cross section of the society, most of whom have a long term strategic vision of housing finance in Pakistan.

Table 1.6: The Changing Structure of Housing Finance in Pakistan

	Net Outstanding Housing Loans (Rs. Million)			Number of Housing Loans Outstanding			Average Loan Size (Rs. M)	
	Banks	**HBFC**	**Total**	**Banks**	**HBFC**	**Total**	**Banks**	**HBFC**
31-Mar-03	1,931.60	18,023.00	19,954.60	2,305.00	150,071.00	152,376.00	0.838	0.120
Percentage Share	9.68%	90.32%	100.00%	1.51%	98.49%	100.00%		
30-Jun-03	2,372.30	17,455.10	19,827.40	2,597.00	151,732.00	154,329.00	0.913	0.115
Percentage Share	11.96%	88.04%	100.00%	1.68%	98.32%	100.00%		
30-Jun-04	7,946.00	18,656.00	26,602.00	5,521.00	143,863.00	149,384.00	1.439	0.130
Percentage Share	29.87%	70.13%	100.00%	3.70%	96.30%	100.00%		
30-Jun-05	26,699.20	20,273.30	46,972.50	14,929.00	138,406.00	153,335.00	1.788	0.146
Percentage Share	56.84%	43.16%	100.00%	9.74%	90.26%	100.00%		
30-Jun-06	44,290.60	18,793.30	63,083.90	21,884.00	110,781.00	132,665.00	2.024	0.170
Percentage Share	70.21%	29.79%	100.00%	16.50%	83.50%	100.00%		

The recent activities of banks/DFIs in housing finance has resulted in increased share of banks vis-à-vis HBFC in the housing finance market from 9.68 percent to 70.21 percent by the end of FY 2006. This was mainly due to increase in their housing finance portfolios from Rs.1,931.6 million to Rs. 44,290.6 million during the aforementioned period (**Table-1.6**). Moreover, this has also resulted in increased share of banks in the aggregate number of housing loans outstanding from 1.51 percent to 16.5 percent during the aforesaid period. Their low share of 16.5 percent in the total number of outstanding loans as compared to a high share of 70.21 percent in the total housing loans outstanding indicates that the average loan size of banks/DFIs is much higher as compared to that of HBFC. Nevertheless, the tremendous increase in the housing portfolios of the banks points towards the fact that banks have been quite successful in the development and promotion of market based housing finance products, thereby bringing forth a structural change in the housing finance market in Pakistan.

Although the recent progress is encouraging, the deepening and broadening of housing finance requires continuous reforms of the policies & procedures affecting housing finance and housing sector, which can only be realized in the medium to long term. At present one of the main problems that is impeding the growth and development of housing finance is automation of revenue records and implementation of foreclosure laws. However, SBP shall continue to play its role for resolution of these matters. With a view to gearing-up its efforts, SBP has also established Infrastructure and Housing Finance Department in FY 2006.

1.6 Islamic Banking

Islamic banking industry worldwide has witnessed a phenomenal growth in recent years. Today, around 250 Islamic financial institutions including the Islamic banking windows of conventional banks are operating world wide, having US$250 billion of assets. Pakistan is no exception to this phenomenon and Islamic banking here too is witnessing unprecedented growth. SBP has been playing a leading role towards promotion and development of Islamic banking in the country. The establishment of a full-fledged Islamic Banking Department at SBP to focus on all Islamic Banking issues provided the industry the necessary impetus to grow and emerge as a preferred choice of the public. Our drive to promote Islamic banking as a parallel system, operating at a level playing field with commercial banking, is aimed at building a broad based financial system in the country to enable all segments of the population to access financial services and play their due role in the overall economic development.

1.6.1 Shariah Compliance Framework

SBP has adopted a Shariah compliance framework based on international best practices. The framework consists of (i) Central Shariah Board at SBP that advises SBP on issues referred to it by Islamic Banks; (ii) appointment of a Shariah Adviser in Islamic Banks/Islamic Banking Branches for ensuring Shariah compliance in product development, policies and procedures; (iii) periodic internal Shariah review by Islamic Banking Institutions (IBIs), and (iv) Shariah Compliance Audit of IBIs by SBP as a part of inspection. Further, issuance of license subject to certification by the Shariah advisor of the applicant bank that the modes, products, procedures and manuals to be used by the bank are in conformity with Shariah.

In order to further improve the Shariah Compliance in the Islamic banking industry and to maintain trust of the depositors and other stakeholders, SBP has worked towards enhancement of its Shariah compliance framework. A set of instructions and guidelines, are in the last stage of finalization, covering areas related to Shariah Advisor; permissible modes, Charity Fund, Shariah compliance and audit systems, investment in shares, policy for profit distribution with PLS account holders and financial reporting and general disclosure. SBP also held coordination meetings with the Shariah Advisors of the Islamic banking institutions through which various issues of immediate nature faced by the industry are resolved and it also focuses on achieving standardization of practices related to Islamic banking operations in different institutions.

1.6.2 Shariah Board

The Shariah Board established in SBP in December 2003 to advise it on modes, procedures, laws and regulation for Islamic banking, held five meetings during the year wherein amongst the most important developments included; a) Approval of Shariah Inspection Manual; b) Approval of essentials for another mode of finance viz: Diminishing Musharaka, increasing the total number of essentials of Islamic Modes to eight and c) Vetting of the duly updated Fit and Proper Criteria for Shariah Advisors and SAP(Shariah Advisors Particulars) to make it more objective, broad based and responsive to the market conditions.

1.6.3 Capacity Building

The Manual for Shariah Inspections prepared in consultation with a consultant firm has now been approved by SBP Shariah Board. This manual was finalized keeping in view the experience gained during the first Shariah based inspection conducted last year and the observations made by the auditors/Shariah Board. This will pave the way for carrying out a qualitative Shariah compliance of the Islamic banking industry. Going forward trainings regarding Shariah inspection based on the approved manual will be provided to the officials of Islamic Banking Department and the Banking Inspection Department of SBP and thereafter the Shariah compliance inspection of Islamic banking institutions will be carried out.

Taking advantage of visits of dignitaries, and experts in Islamic finance, special sessions were organized for the stakeholders. Also SBP continued to offer its services as a Distance Learning Centre to local stakeholders when Islamic Research and Training Institute, Islamic Development Bank (IDB), Jeddah conducted video conferences on various topics related to Risk Management and Islamic Finance .The initiatives have been instrumental in dispelling many conceptual misunderstandings and bringing new players in the sector.

1.6.4 Network Expansion

The Islamic banking witnessed reasonable growth during the year as the number of Islamic banking branches increased to 87 with two more conventional banks and two full fledge Islamic Banks joining the Islamic banking sector. Moreover, two more banks have also been granted Islamic banking license and they are expected to commence operations during FY 2007. National Bank of Pakistan has also been granted in-principle approval for Islamic banking branch, which is expected to start operations during current year. The **Table-1.7** gives network expansion trends since year 2003.

Table-1.7: Islamic Banking Players (End – June)

Description	2003	2004	2005	2006
Number of Islamic Banks (Operating)	1	1	2	4
a) Number of branches of Islamic banks	8	10	32	48
Number of conventional banks operating Islamic banking branches	0	5	9	11
b) Total Number of stand alone Islamic banking branches of conventional banks	0	10	30	39
Total Islamic banking branches (a+b)	8	20	62	87

The recent trends both in network expansion and new product development signals even faster growth and maturity in the sector for the medium term. **Table-1.8** gives growth trends for Islamic banks during the last 4 years.

Table-1.8: Islamic Banking Trends (Million Rupees)

Description	June 2003	June 2004	Growth (%)	June 2005	Growth (%)	June 2006	Growth (%)
Deposits	6,517	13,158	102	37,835	188	59,657	58
Financing and Investments	5,421	13,102	142	37,171	184	57,936	56
Total Assets	8,821	18,830	113	54,017	187	87,603	62

1.7 Agriculture

1.7.1 Agricultural Credit and Disbursement

The agriculture credit by banks/DFIs has witnessed a phenomenal growth during FY06 largely due to continued efforts for mainstreaming the agriculture and promotional/facilitative role of SBP in the area of policy formulation, introduction of new products in consultation with key stakeholders and capacity building for commercial banks. The policy advocacy and promotional initiatives have started bearing fruits in the form of substantially increased activity in the Agri-finance sector, led by a strong entry of commercial banks. The total agriculture credit disbursements during the year reached Rs.137.5 billion, surpassing the target of Rs.130 billion and the actual disbursements of Rs.108.7 billion last year (**Table 1.9**).

The commercial banks, which traditionally shied away from agriculture sector, perceiving it as laborious, risky and costly affair, have been leading the way in growth of Agri-finance since the last five years. During FY06, the agricultural credit disbursements stood at Rs.84.0 billion, whereas specialized institutions like ZTBL and PPCBL disbursed Rs.47.6 billion and Rs.5.9 billion respectively. A further break-up for commercial banks reveals that the five big commercial banks with Rs.68.0 billion disbursements, accounted for 81 percent of Agri-finance disbursements by commercial banks whereas the remaining 19 percent was shared by Domestic Private Commercial Banks (DPCBs) with total disbursements of Rs.16.0 billion. Total agricultural credit disbursement by banking system are still about 47 percent of the total estimated credit requirements of Rs.292 billion and outreach in terms of the number of borrowers at 1.7 million is still hovering around 26 percent of the 6.6 million rural households.

Table 1.9: Growth in Agriculture Credit
(Billion Rupee)

Description	FY05		FY06	
	Targets	Disbursed	Targets	Disbursed
Big Five Commercial Banks	38	51.3	63	68.0
ZTBL	34	37.4	43	47.6
DPCBs	5	12.4	15	16.0
Punjab Prov Coop Bank Ltd.	8	7.6	9	5.9
Total	**85**	**108.7**	**130**	**137.5**

The following activities were initiated and completed during the FY2006.

1.7.2 Prudential Regulations for Agricultural Financing

Prudential Regulations (PRs) for Agricultural Financing prepared in consultation with banks/DFIs and other stakeholders were issued during the FY2006. The PRs are intended to provide a broader regulatory framework to the banks/DFIs. These encourage banks to diversify their agricultural portfolio in terms of geographical areas; types of financing, etc. and avoid the risks of concentration of credit. Banks are also encouraged to extend agricultural financing on the basis of future cash flows, instead of relying solely on the collateral.

1.7.3 Capacity Building of Banks Through Training and Special Outreach Program

Dissemination of knowledge continued through Special Outreach and Training Programs, field visits, publicity through press and electronic media in collaboration with banks, Chambers of Agriculture, Farmers/Growers/Abadgars Associations, etc. The centers covered during the year included areas like Vehari, Rahim Yar Khan, Bhalwal, Nawabshah , Shikarpur, Haripur, and Kohat.

1.7.4 Revision of Report for Estimation of Agricultural Credit Requirements

A Methodology Report for estimation of agriculture credit requirements is a useful document to estimate agriculture credit requirements in the country. It gives standard and uniform criteria to prepare the agriculture credit estimates country-wide and province/region wise. It is also aimed at facilitating banks in estimating agricultural credit demands in their respective target areas/markets. The last Methodology Report was revised in year 2001. Since the last revision the economy has undergone robust economic changes particularly in the agriculture sector. It was deemed necessary to examine the entire methodology in the light of the changes in agriculture and rural finance. The Report has been revised in terms of cost components, cash and credit components of seeds, fertilizers and pesticides; per acre credit limits for various crops and a number of new items have been included in the list of eligible items for agriculture financing including the matured orchards and forests.

1.7.5 Guidelines for Livestock Financing

SBP issued 'Guidelines for Livestock Financing' to facilitate and encourage banks/DFIs for enhancing the flow of credit flow towards livestock sector. The Guidelines cover all areas of livestock financing business including product development and their review, purposes and objectives of loans, eligibility of borrowers, delivery channels, monitoring mechanism, etc.

However, the banks may adopt the guidelines in its present form or with some adjustments that suit their individual organizational needs.

1.7.6 Agribusiness Finance Development Project

Under the ADB Agribusiness Finance Development Project, SBP being the implementing agency for the awareness and capacity building of selected financial institutions has hired a foreign consultant who is facilitating the process of selection of Participating Financial Institutions (PFIs) and further selection of foreign consultant to undertake the capacity building of selected PFIs. This capacity building will cover the areas like human resource, trainings, product development, information technology, risk management systems, development of procedures for portfolio assessment, loan tracking and monitoring system; preparation of standardized operational procedures. Under the project 3-5 PFIs (banks) will be provided the capacity building support that could have a time frame of 2-3 years depending upon the needs of PFIs (banks). This will translate into substantial improvement in agribusiness lending capacity of the participating banks and will also provide prototypes and business models for other banks and financial institutions to develop their agricultural credit departments and agribusiness portfolios.

1.7.7 Strengthening of Agricultural Credit Advisory Committee (ACAC)

The ACAC has been working with thirty-five members since long. In order to strengthen its capacity, nine new members have been included from reputed economic and agricultural research institutions viz. Pakistan Agricultural Research Council; Applied Economic Research Centre; University of Karachi; Punjab Economic Research Institute; Agricultural Research Institute, Sariab, Quetta; Sindh Agriculture University, Tando Jam; Pakistan Institute of Development Economics; Agricultural Research Institute, Tarnab, Peshawar; Innovative Development Strategies (Pvt) Ltd, Islamabad and Punjab AgriMarketing Company. The broadening base would provide better strategic planning and development of lasting policies for the growth of credit to agricultural sector.

1.7.8 Crop and Livestock Loan Insurance

In order to expedite the process of providing a framework for crop and livestock loan insurance acceptable to all the stakeholders, a Task Force has been constituted to formulate the framework in consultation with all stakeholders including Security and Exchange Commission of Pakistan (SECP), Ministry of Food, Agriculture and Livestock (MINFAL), GOP, Insurance Association of Pakistan, and the representatives of banks, farmers' associations and leading insurance companies. The committee will complete the work during the year 2006-07.

1.7.9 Strategy to Increase Outreach

The State Bank of Pakistan has also started consultation with stakeholders for preparation of a draft strategy as desired by ACAC in its mid term meeting to increase outreach in terms of number of borrowers through enhancement of annual credit disbursements from existing 47 percent to 75-80 percent of the estimated agriculture sector credit requirements in next 3-5 years. The draft strategy would be reviewed and endorsed by key stakeholders to undertake collaborative efforts for achieving the objectives of the strategy.

1.7.10 Agricultural Credit Targets for FY07

The ACAC has set a target of Rs. 160 billion for agriculture credit disbursements during the FY2007, which is 23 percent and 16.8 percent higher than the target and actual disbursements respectively for the preceding year. However, the targets are voluntary and indicative in nature as the mandatory targets allocation policy has been phased out from FY2006, while the targets for five big commercial banks have also been made voluntary and indicative in line with DPCBs. The flow of necessary funding to the sector will now be ensured through conducive policy and regulatory environment, policy advocacy and promotional initiatives and monitoring of Agri-disbursements and portfolio build-up plans.

Box 1.1: Guidelines for Livestock Financing

Livestock is the largest sub-sector of the agriculture accounting for 47 percent of value added of the sector and constitutes about 11 percent to the GDP. While the disbursements to the agriculture sector have witnessed appreciable rise during the last few years as a result of sector friendly policies of State Bank of Pakistan (SBP), the livestock sub-sector could not get its due share in the substantially enhanced flow of overall credit to the sector. During the fiscal year 2005, the Agriculture sector availed credit of Rs108.7 billion, out of which the share of livestock was only Rs 6.8 billion or 6.2 percent of the total disbursements.

State Bank of Pakistan has issued ‘Guidelines for Livestock Financing’ to facilitate and encourage Banks/FIs in enhancing credit flow to the livestock sector. The Guidelines cover all areas of the livestock financing business including products development and their review, purposes and objectives of the loan, eligibility of borrowers, delivery channels, monitoring mechanism, etc. Banks may adopt the guidelines in its present form or with some adjustments that suit their organizational needs and market characteristics

The guidelines, developed in consultation with key stakeholders including chambers of agriculture, farmers associations, agriculture research institutions, banking sector and MINFAL, are aimed at increasing the flow of credit to livestock sector that promises rich returns to the sector, the banks and the economy as a whole. The enhanced and sustained access of dairy and meat farms in the sub-sector to affordable financial services will attract investment in milk and meat processing and thus substantially enhance milk and milk products and meat production in the country.

In the light of the Guidelines the banks may consider establishing Livestock Research and Development Units at their Head Offices to develop livestock financing products and their rollout in the field offices. The Unit could be a part of Agri/Rural Finance Division of the banks and be responsible for Livestock activities like a) target market analysis, its characteristics, size, trends, growth potential, etc; b) development of financing products ; c) developing procedures for product marketing, delivery and monitoring mechanism, follow-up and recovery; d) monitoring growth trends and quality of the portfolio and to develop close liaison with the field force to have feedback from the grass roots level; e) review developments taking place in the livestock sector within the country as well as in other parts of the world.

2 ENSURING SOUNDNESS OF THE FINANCIAL SECTOR

2.1 Overview

SBP continued with its reforms agenda for banking system and strengthening of supervisory capacity during FY 2006 to ensure soundness of financial system. It undertook initiatives in a number of areas like enhancement of minimum capital requirements (MCR) for banks to Rs.6 billion by end of December, 2009, introduction of variable capital adequacy ratio based on Institutional Risk Assessment Framework (IRAF) rating of banks/DFIs along with outlining a road map for smooth transition from Basel-I to Basel-II. As the implementation of Basel-II poses tremendous challenges for the banking system, SBP has encouraged the financial institutions for capacity building in terms of upgrading the IT systems and enhancement of expertise in specialized areas like risk management and Anti-Money Laundering (AML) through seminars and workshops.

To further consolidate the banking system, focused regulatory measures were taken to have fewer but stronger banks resulting in Mergers & Acquisitions (M&A) during the FY 2006. At the same time, reforms process continued to aim at more competition and efficiency in the financial system by creating an enabling environment and providing a level playing field to all the stakeholders in the industry.

The role of Credit Information Bureau (e-CIB) is integral to credit risk management and promotion of a sound credit culture in financial system. With the growing complexities and emerging challenges on the financial landscape, the role of CIB as the main repository of important data/information has become even more critical. The improved CIB platform, named e-CIB, has become fully operational. In addition, SBP has taken a number of other steps to further strengthen the supervisory oversight, details of which are given in the ensuing paragraphs.

2.2 Initiatives undertaken to strengthen the Banking System Stability

2.2.1 MCR Enhancement and Variable Capital Adequacy Ratio

SBP has been actively pursuing its strategy to further strengthen the capital base of the Pakistani banking system. Following the first phase of reform process, SBP implemented the Basel-I Capital Accord to fortify the capital base of the banks. As a result, our banking system is now more resilient and capable of meeting the changing requirements as compared to its fragile condition in early 90s. However, with the increasing competition in the financial market coupled with the rising complexities in products and the associated risks, further strengthening of the capital base is inevitable.

In this regard, SBP has already given a roadmap for implementation of Basel-II. Furthermore, it formulated a strategy to enhance the minimum capital requirements for banks/DFIs and also to link it with their risk appetite. Accordingly, the banks/DFIs were required to maintain higher minimum capital (net of losses) of Rs.2 billion by the end of December 31, 2005. Further, they were required to increase the MCR in a phased manner to Rs.6 billion by the end of December 2009. As regards, aligning the capital requirements with the risk appetite of banks/DFIs, the policy of requiring banks/DFIs to maintain a Variable Capital Adequacy Ratio (CAR) has been introduced based on Institutional Risk Assessment Framework (IRAF) ratings assigned to each bank/DFI on the basis of four parameters, i.e. compliance with the standards, codes and guidelines; supervisory and regulatory information; financial performance and condition and market information and intelligence. Under this framework, banks/DFIs would need to maintain a variable CAR ranging from 8 percent to 14 percent.

2.2.2 Mergers and Acquisitions in the Banking Sector

In order to have fewer but stronger financial institutions, SBP embarked upon a policy of consolidation and restructuring in the banking sector in the late 90s, which continued during the year under review. During July 2000-June 2006, 21 mergers and acquisitions have taken place out of which 1 took place in 2005-06. In addition, 4 mergers/acquisitions have so far taken place subsequent to the reporting date of June 2006 while a few more transactions are in the pipeline. The details of the various mergers/acquisitions made during the recent past are given in **Table.2.1**

Table 2.1: List Of Mergers / Acquisitions Of Commercial Banks/DFI
For the period from 2000-2006

Sr. #	Date	Merger / Acquisition	Nature
1	25/03/2004	Merger of Bank of Ceylon-Pakistan Operations with and into Dawood Bank Limited	Merger
2	16/01/ 2004	Acquisition of Bolan Bank by Iqbal Ali Mohammed Group	Acquisition
3	19/04/2004	Merger of Credit-Agricole Indosuez-Pakistan Operations with NDLC-IFIC Bank	Merger
4	05/05/2004	Merger of Trust Investment Bank Ltd, Fidelity Investment Bank Ltd. and Doha Bank with and into Trust Commercial Bank Ltd	Merger
5	21/10/2004	Merger of Trust Commercial Bank with and into Crescent Commercial Bank Limited	Merger
6	31/05/2005	Merger of Ibrahim Leasing Limited with Allied Bank Limited	Merger
7	22/12/2005	Acquisition of majority shares of Dawood Bank Limited by Atlas Group	Acquisition
8	29/07/2006	Merger of Atlas Investment Bank with and into Atlas Bank Limited (Formerly Dawood Bank Limited)	Merger
9	05/08/2006	Merger of Rupali Bank with and into Arif Habib Rupali Bank Limited	Merger
10	25/08/2006	Merger of First Allied Modarba Limited with and into Allied Bank Limited	Merger
11	05/09/2006	Acquisition of majority shares of Union Bank Limited by Standard Chartered Bank (Pakistan) Limited	Acquisition

This policy of consolidation/mergers has led to efficiency for banks/DFIs through higher penetration of technology and greater maneuverability in enhancing their business volumes, scale and size to achieve cost efficiencies. From consumers' perspective, this will not only provide a greater sense of protection to the depositors but also enhance the competition amongst the market players resulting in provision of improved financial products and services at competitive rates with higher service quality standards.

2.2.3 Resolution of Problem Banks

One of the major functions of SBP is to ensure safety, soundness and stability of the banking system. SBP fulfils this core responsibility by systematically supervising/monitoring the performance of every bank to assess its operational and financial health, risks faced/assumed and coverage thereof and compliance with the applicable banking rules and regulations. However, despite proactive supervision of the banking system, emergence of problems/issues cannot be ruled out.

SBP has successfully resolved the problem though effective supervisory intervention. As a result, the total number of problem banks as well as their market share in the banking industry has reduced significantly.

2.2.4 Privatization of Banks

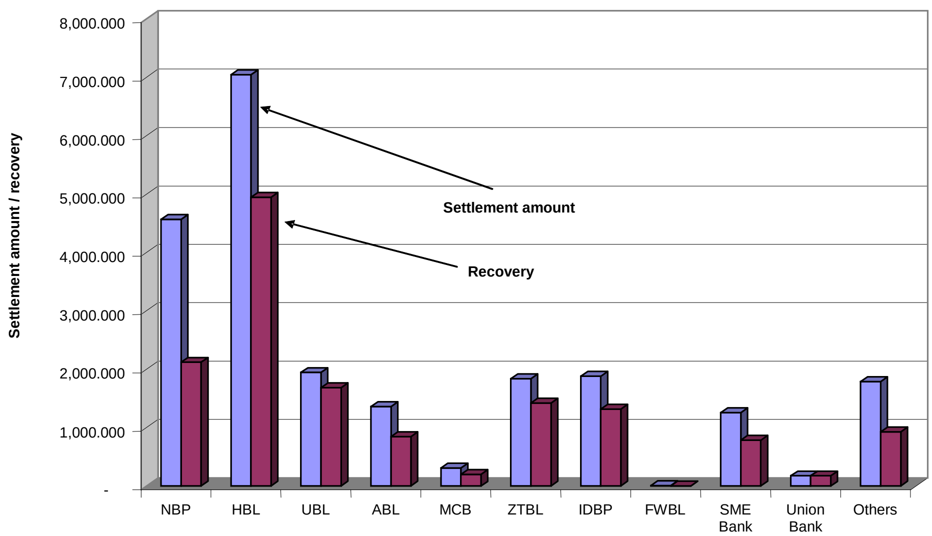
State Bank of Pakistan continued to facilitate privatization process of banks aimed at liberalization of banking sector. During the year under review, the Aga Khan Foundation for Economic Development (AKFED) made payment for acquisition of remaining 12.5 percent shares of HBL in February, 2006 to increase its shareholding to 51 percent. Further, Government has decided on secondary offer for sale of 5 percent GOP owned shares of UBL with the green shoe option of 5 percent, to general public. Furthermore, the restructuring/privatization of remaining public sector financial institutions including the Industrial Development Bank of Pakistan (IDBP), SME Bank Limited and House Building Finance Corporation is in process.

2.2.5 Initiatives to Reduce Non-Performing Loans (NPLs)

In order to facilitate the banks/ DFIs to deal with Non-performing loans in a swift manner, the State Bank of Pakistan devised a scheme in consultation with the banks/DFIs and Federation of Pakistan Chambers of Commerce and Industry (FPCCI).

The results of the scheme have been very encouraging and the banks/DFIs settled over 50,000 cases involving outstanding amount of Rs. 79.940 billion. By the end of FY 2006, banks/DFIs have made a record total recovery of Rs. 14.438 billion as against the total settlement of Rs 22.188 billion under the SBP Scheme, showing a recovery of 65.07 percent of the settlement amount as shown in the **figure-2.1** below:

Figure-2.1: Recoveries made against settlement amount



An additional recovery of more than Rs. 7 billion is expected by mid 2007 as borrowers, who have settled their cases, have been allowed a maximum period of 3 years to liquidate the entire settled amount. The settlements under the scheme thus enabled the banks to clean their balance sheets without having any adverse impact on their financial condition and profitability.

2.2.6 Growth in Banks' Branch Network

The existing branch licensing regime was introduced in year 2002 to allow the banks to independently make their branch housing decisions within broad parameters identified. The Branch Licensing policy was liberalized/rationalized with the objective of enhancing the reach of the banking services. In terms of Branch Licensing Policy, banks are required to submit their Annual Branch Expansion Plan (ABEP) by 30th November of each year. These plans are primarily considered in terms of CAMELS-S, CAELS and IRAF ratings of the banks/DFIs. SBP examines the requests of the banks in the light of stipulated parameters and grants permission to the eligible banks in principle for opening of new branches.

Resultantly, the banks' branch network recorded an increase of 5 percent from 7,352 to 7,727. Banks not only increased their domestic operations through opening of 372 new offices in the country (including Islamic bank branches) but also opened three new offices abroad. Islamic banks' and stand-alone Islamic branches of commercial banks also opened 37 new offices. Share of private sector commercial banks was overwhelming in expansion of total branch network during FY 2006. They opened 306 new offices, followed by foreign banks which opened 34 new offices. In addition, to expand the banking services, SBP has allowed some banks to open sales and service centers as well.

2.2.7 Corporate Governance

State Bank of Pakistan is continuously making efforts for promotion of good Corporate Governance regime in the banking sector. Accordingly, the revised Fit & Proper Test (FPT) was prepared with a view to enhance the scope of existing FPT and to further consolidate and promote good corporate governance in line with the international best practices.

2.3 Initiatives Undertaken to Strengthen the Supervisory System

2.3.1 Basel-II Implementation

The Basel-II Capital Accord provides a comprehensive and more risk sensitive capital allocation methodology and aligns the regulatory capital with the economic capital. Since Basel II places greater emphasis on risk management practices and processes in a financial institution, therefore, the real challenge for the banks and regulators around the globe is to inculcate a robust risk management culture in the financial system to truly benefit from the promises envisaged in Basel-II. For developing countries like Pakistan, this would entail substantial investment in IT systems and human resources to bring the risk management processes in line with the international best practices.

During the last year SBP took a number of initiatives and steps to bring about a smooth transition from Basel-I to Basel-II. After the issuance of roadmap for implementation of Basel-II in March 2005, all the banks/DFIs were asked to submit their implementation plans. Majority of the banks have expressed their intention to first adopt a comparatively simple Standardized Approach subsequently moving onto more advanced approaches with adequate buildup of systems and human resources. Since the Standardized Approach mainly relies on external ratings by rating agencies, SBP issued criteria for recognition of Eligible Credit Assessment Institutions (ECAIs) to make the process more transparent. Subsequently two domestic rating agencies viz M/s PACRA and JCR-VIS were recognized after a due diligence exercise.

The implementation of Pillar-II or the supervisory review process under Basel-II mandates the regulators to assess the capital requirement of a financial institution due to risks not covered under Pillar-I. Non-compliant banks would have to face different repercussions ranging from imposition of restrictions on acceptance of deposits and lending to cancellation of banking license. To reduce the gap between hitherto disclosure practices and requirements under market discipline pillar (Pillar-III) of Basel-II, guidelines for preparation of financial statements and their circulation to all stakeholders and publication of their abridged version in the press were issued earlier in the FY 2006.

2.3.2 Strengthened Role and Scope of Credit Information Bureau (CIB)

The role of Credit Information Bureau is integral to credit risk management and the promotion of a sound credit culture in financial system. Ever since its inception in 1992, CIB in Pakistan has been playing a pivotal role in gathering, organizing and disseminating critical information related to credit-worthiness of borrowers to assist financial institutions in their lending decisions and averting the occurrence of default.

With the growing complexities and emerging challenges on the financial landscape, the role of CIB has become even more critical. Previously, the CIB database was capturing borrowers' records of Rs

500,000 and above. With the advent of growing agriculture, consumer and SME financing portfolio, the need was felt to enhance the scope of CIB from simple, manually operated data system to a very sophisticated data base using state-of the-art technology to perform its crucial functions more efficiently. The strengthened capacity and improved operational efficiency has enabled the CIB to enlarge significantly the scope of reporting by doing away with the minimum limit of Rs.500,000.

The revamped CIB, renamed as e-CIB, has become fully operational since June 2006. The e-CIB has overcome the limitations, such as restricted information on borrowers, relatively low safeguards, low speed, low number of borrowers, etc observed in the previous system. The rejuvenated e-CIB is practicing matching standards being pursued in more advanced finance centers around the world. The e-CIB database is capturing more than 3 million borrowers' records of 101 member financial institutions. It is expected that the number of borrowers in the data base will rise up to 4-5 million once the remaining financial institutions start reporting of their borrowers to e-CIB.

The SBP has also launched its e-CIB web-page which can be accessed by using **http://www.sbp.org.pk/ecib/.** The e-CIB page provides host of information particularly with regard to functions of CIB, circulars, patterns of CIB reports, list of members' financial institutions and Frequently Asked Questions (FAQs). Besides, an exclusive web enabled e-CIB help desk has been launched. This query and complaint management system provides facilities to general public as well as financial institutions to lodge their complaints online.

2.3.3 Change in the Criteria for Classification and Provisioning Requirements

The increasing dominance of the private banks in the overall banking sector has yielded significant benefits in the form of increased competition, product innovation, technological up-gradation and diversification of business activities. However, a host of new risks have also surfaced, necessitating the adoption of better benchmarks for classification and provisioning against their loans and advances portfolio, in order to further strengthen the soundness and stability of our banking system.

Realizing the need of the hour, the criteria for classification and provisioning has since been changed, whose major features are as under:

- Other Assets Specially Mentioned (OAEM) category has been eliminated.
- Same default period has been fixed for both Short term and long term loans.
- Provisioning requirement for Sub-standard loans has been increased to 25 percent w.e.f. December 31, 2006.
- Benefit of Forced Sale Value (FSV) has been restricted to NPLs of over Rs.10 million only, w.e.f., December 31, 2006.

2.3.4 Limits for Exposures in Futures Contracts

The development of futures market is highly important for the smooth and effective working of capital markets. In this development, the institutional investors, especially the banks and DFIs have an important role to play. Though the futures contract is an effective tool to hedge the risks arising from fluctuating market conditions, the indulgence in this hedging activity, without any upper limit, however, has its own implications for the hedging institutions especially the counter party risk. In order to provide necessary impetus for the futures market by enabling the banks/DFIs to hedge their risks through future contracts a limit of 10 percent for future contracts has been prescribed.

2.3.5 Anti-Money Laundering / Combating Financing of Terrorism (AML/CFT)

With the growing sensitivity and importance of the money laundering/terrorist financing issues, SBP has since established an exclusive unit to deal with money laundering and financing of terrorism related issues. The unit, besides being responsible for issuance of Regulations/Circulars relating to AML/CFT, also receives Suspicious Transaction Reports (STRs) from banks/DFIs. The unit thoroughly analyzes each STR and collects further information from the concerned bank/DFIs. After detailed analysis, if the Unit deems it necessary to get the matter investigated, it refers the STR to the concerned law enforcement agency for further inquiry/investigation. Further, the unit also carries out enquiries related to Know Your Customer (KYC) and the ongoing Customer Due Diligence (CDD) on the request of other regulators, law enforcement agencies, general public, etc and provides meaningful information to the concerned quarters for further necessary action. Additionally the unit has been issuing instructions for freezing of assets of individuals / organizations which were involved in terrorism under various UN Security Council Resolutions and Anti-Terrorism Act, 1997.

SBP issued revised prudential regulations (M1 to M5 and G1-D) which included comprehensive set of measures for combating money laundering / terrorist financing. For example, Risk based system of KYC, ongoing CDD, record retention, due diligence in correspondent banking relationship, reporting of suspicious transactions, requirement of compliance officers, Wire Transfers, etc. To strengthen the AML/CFT regulatory regime and align it to the FATF recommendations, further amendments have since been made in Prudential Regulations (M1 – M5). In terms of these amendments the banks/DFIs are now invariably required to verify the genuineness of Computerized National Identity Cards (CNIC) from NADRA through utilizing on-line facility or where the banks/ DFIs or their branches do not have such facility through arrangement with regional offices of NADRA. The amendments also specifically require bank to exercise extra care while opening “proprietorship” accounts in view of the fact that constituent documents of such customers are not available to confirm existence or otherwise of the proprietorships.

In an effort to further strengthen the KYC profiles of the bank customers, instructions were issued to banks requiring them to obtain CNICs from all their existing customers by June 2007 who had previously opened the accounts on the basis of old NIC which have since been rescinded. For the dormant account holders, submission of the copy of CNIC has been made compulsory at the time of the activation of their accounts.

State Bank has been encouraging banks/DFIs to make use of technology and upgrade their systems and procedures in accordance with the changing profile of various risks. Accordingly all banks/DFIs have been advised to implement systems which could flag out of pattern transactions for reporting suspicious transactions. The modifications and additional requirements are expected to strengthen the regulatory framework in the context of anti-money laundering and anti-terrorist financing.

2.3.6 Stress Testing

In order to be sound and stable, financial institutions employ various risk management tools and statistical models to measure, manage and control market, credit and the operational risks. However, these models have limited application due to the non-existence of real life realities and excessive use of assumptions. In order to address such limitations, Stress Testing Technique has been developed and employed by the central banks around the globe to assess the resilience of the financial system to extreme but plausible shocks.

State Bank of Pakistan has issued a set of Stress Testing Guidelines in FY 2006 so that the same may be employed and implemented by banks to measure, monitor and control risks emerging from new developments. These guidelines provide a road map to banks/DFIs to develop and implement a stress testing framework, flexible enough to adopt advanced models. However, the scope of the Stress Testing has been restricted initially to simple sensitivity analysis due to the limitation of skill level and available resources among banks/DFIs. Five different risk factors namely; interest rate, forced sale value of collateral, non-performing loans (NPLs), stock prices and foreign exchange rate, have been identified and used for the stress testing. Moreover, the liquidity position of the institutions has also been stress tested separately.

2.3.7 Reporting Chart of Accounts

To enhance uniformity, transparency and reliability of data, the Reporting Chart of Accounts (RCOA) has been introduced to streamline the data reporting to SBP by Reporting Institutions (RIs). It aims at eliminating the redundancy and duplication of the data reporting, hence reducing the burden on the RIs. Whereas the previous system was characterized by compartmentalization and duplication of data submission through various returns, under RCOA the information is being centrally submitted and available to different departments at SBP. Also, under RCOA, the RIs have to submit the data online in a single document through their authorized administrators under different frequencies instead of 180 different returns. Further, RCOA has been made flexible to add and remove variables whenever required, while there are also built-in validation checks to enable the banks to validate the data before reporting. To transform the data under the existing system to the new system viz. RCOA, a series of activities took place during the last one year including the extensive discussions with the stakeholders for their feedback.

In order to ensure smooth transition from data submission through different returns to RCOA and test the robustness and reliability of the system, it was thought appropriate, to have parallel run by setting deadlines for data submission under various frequencies. During the parallel run, commenced from October, 2005, the RIs were required to submit their various data returns simultaneously through hard copies as they were already doing and online. In this regard, the data submission for the Weekly Statement of Affairs through RCOA has already been made fully operational in Jun-06, while the returns of other frequencies are in the parallel run phase and will be made operational shortly.

2.3.8 Disclosure Requirements for banks/DFIs

To re-enforce market discipline, the existing forms of financial statements were revised in February 2006, keeping in view the international developments on financial reporting systems, amendments in International Accounting Standards and mainly the Basel-II which necessitated enhanced disclosure requirements. Banks and DFIs are required to prepare their financial statements according to these revised forms from December 31, 2006.

The scope of disclosure has been enhanced drastically through these revised requirements. In general, for each type of risk area i.e. credit, market liquidity and operational risk, banks/DFIs must describe their risk management objectives and policies including:

- Strategies and processes
- The structure and organization of the relevant risk management function
- The scope and nature of risk reporting and/or measurement system
- Policies for hedging and /or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedge/mitigants.

Moreover, these revised requirements also cover the disclosures required under different approaches of the Basel II; these requirements will be applicable as the banks move towards implementation of advanced approaches.

2.3.9 Information Systems: Guidelines on Audits and System Switchover Planning

In the backdrop of increased usage of automated systems by banks/DFIs in their banking operations and the risks associated with Information Technology (IT), State Bank of Pakistan issued guidelines, covering audit of information systems and up-gradation / switch over of information systems in December 2005 with the aim to further strengthen the IT Security of the banks/DFIs.

The first set of guidelines focus on the audit of I.T. services. As per requirements, banks/DFIs are required to get their I.T. services audited by internal/third party auditors to ensure that adequate security and controls are in place. To ensure that best practices in the field of I.T. Security and Control are adopted and practiced in the banking industry, banks/DFIs are encouraged to establish an independent internal information system audit function for regular monitoring of I.T. organizational setup and activities. It has also been emphasized that the Information Systems (IS) audit is a continuous process and its focus should be to review the IT related internal controls and evaluate/ validate the effectiveness of control systems.

2.4 Other Initiatives

2.4.1 Introduction of Basic Banking Accounts

In order to provide affordable banking facilities to all types of depositors particularly small depositors, SBP in November 2005 introduced mandatory opening of Basic Banking Account (BBA) having limited banking features for the lower strata of the economy.

The main features of BBA include non-restriction of minimum balance in the account, no maintenance fee, ATM facility, issuance of statement of account once a year, etc. Banks were allowed to add more features/facilities if they wish to do so. Banks have since introduced this product and a large number of BBA accounts have reportedly been opened in the banks. SBP is continuously monitoring the compliance status of banks in this regard.

2.4.2 Students Loan Schemes

The Students Loan Scheme (previously Qarz-e-Hasna) was revived in collaboration with major commercial banks (NBP, HBL, UBL, MCB and ABL). Under the Scheme, financial assistance is being provided by way of Interest Free Loans to the meritorious students who do not have adequate financial means to pursue studies in scientific, technical and other professional fields within Pakistan. The Scheme is being administered by a high power committee comprising Deputy Governor, State Bank of Pakistan, Presidents of the commercial banks and Deputy Secretary, Ministry of Finance, Government of Pakistan. During last year, an amount of Rs.90.898 million was disbursed as interest-free loan in respect of 1,115 students for pursuing Graduate, Masters and Doctorate studies for the session 2005-06.

In addition to the above scheme, SBP with a view to encourage the banks/DFIs to extend student loans on commercially viable terms and conditions without any restriction of level of studies or geographical boundaries, issued Guidelines for Higher Education Financing Scheme during the year 2005-06. A systematic follow-up is being maintained by SBP with the banks in order to persuade them to venture into this area to improve upon the social fabric of the society. As per figures available, 12 banks have since developed products for Student Loan Scheme and as many as 7 banks are in the process of developing such products.

2.4.3 Resolution of Long Outstanding Issue of Utility Bills Collection by Banks

SBP resolved the longstanding issue of utility bills collection by banks, under the directives of Supreme Court of Pakistan (suo-moto case No. 04/2006). In terms of revised instructions, all banks' branches are now required to accept the payment against utility bills from general public. The new arrangements would help the public at large in payment of their utility bills with ease.

2.4.4 Unclaimed Deposits

The deposits, pay orders, demand drafts, etc in respect of which no activity has taken place during the last ten years period are considered as unclaimed deposits. In this context, a major exercise was carried out by SBP in 2005-06 to streamline the process and necessary instructions to banks/DFIs have been issued in July, 2006. Moreover, advertisements in each quarter were being placed in leading newspapers regarding unclaimed deposits up to the years 2003 and 2004 and the relevant details were placed on the SBP website. The continuous placement of advertisements in the leading newspapers coupled with the updating of data on the SBP website greatly helped the general public in getting access to the information, procedure, etc to claim their unclaimed deposits.

2.4.5 Development of Complaint Resolution System

One of the key tools through which existing policy environment can be upgraded is the redressal of complaints. This process not only provides feed back on complications/problems faced by the general public regarding banking system but also helps in creating an image of State Bank of Pakistan as a fair and trustworthy organization where general public's grievances are resolved in a professional manner.

SBP receives a large number of complaints every year through surface mail as well as through complaints' link available on SBP website. During the year 2005-06 a total of 6,625 complaints were received through surface mail and 1,872 complaints through website. All of these complaints were processed and redressal was provided to the complainants. In addition, a Committee was constituted in year 2003 for resolution of disputes on the subject of charging mark-up on mark-up. During the year 2005-06, eight cases were received from different industrial units, which were examined and disposed off as per the Terms of Reference (TOR) of the committee. Moreover, queries received through BPRD Help Desk link available on SBP website, were also being entertained in an efficient manner.

The Office of Banking Mohtasib Pakistan (BMP) was formed to deal with the complaints relating to banking system. However, in terms of sub-section (4) of Section 82E of the Banking Companies Ordinance, 1962, State Bank of Pakistan is the appellant authority against the decisions taken by the Banking Mohtasib. As such, State Bank of Pakistan has also started receiving appeals against the decisions of Banking Mohtasib and has so far received 19 appeals which have been dealt with according to the approved modus operandi.

2.4.6 Efforts Made For Rehabilitation of Earthquake Affectees in NWFP and AJK

Due to sudden earthquake on October 8, 2005 in Pakistan, SBP took immediate steps for the maximum possible facilitation to the rehabilitation of earthquake affectees which included facilitation in collection of donations, extension in banking hours for collection of donations, disbursement of compensation among the victims, allowing mobile bank branches, etc. All these measures greatly helped in facilitating the rehabilitation process launched by the government and other social welfare bodies.

2.4.7 Inspection of IT Systems of Banks

Advancements in the electronic banking products have placed more responsibilities on the supervisory authorities' the world over. These developments on the one hand have created efficiencies in the delivery of financial services but have also resulted in increased operational risks. To deal with technology driven risks efficiently, SBP enhanced its supervisory capacities for effectively conducting inspections of e-banking products and information systems of the banks/DFIs. In this regard, a separate unit for IT inspection has been created in Banking Inspection Department (BID) at SBP. This unit conducted IT inspections of four banks in Fy 2006. Efforts are also being made to further develop the supervisory capacity in this respect by developing a separate IT Inspection Manual through international consultants.

2.4.8 Updation of Inspection Manual

Banking Inspection Department has been conducting inspection of banks/DFIs on the basis of its inspection manual which was prepared by an international consulting firm in 1999. A lot of changes had since emerged on the landscape of country's banking industry necessitating review of the inspection procedures. Accordingly, an exercise has been initiated by the State Bank of Pakistan to update the inspection manual in order to further strengthen its on-site inspection process.

2.4.9 Preparation of Treasury Inspection Manual

Inspection of treasury operations of banks/DFIs requires special skill set and a different inspection methodology. Though the inspection manual does contain the basic details of treasury inspection procedures, but detailed guidelines reflecting latest techniques were not available in the documented form. BID took the initiative and has prepared a separate treasury inspection manual through indigenous efforts.

3 MAINTAINING PRICE STABILITY WITH GROWTH

3.1 Overview

State Bank of Pakistan (SBP) followed prudent and pro-active monetary policy and was quite successful in maintaining a balance between containing inflation and facilitating growth. The SBP achieved these goals through targeting money supply in accordance with the targets of real GDP growth and inflation set by the government. Further SBP continued to refine the institutional mechanism for monetary policy formulation and its implementation. Proactive management of monetary operations therefore led to significant improvement in the market mechanism. Moreover, in line with international practices, SBP started to issue its monetary policy stance through release of bi-annual Monetary Policy Statement (MPS) from January 2003 onwards. Accordingly, two monetary policy statements were issued during FY06. Two meetings of National Credit Consultative Council (NCCC) were also held during the year to discuss credit plan targets and the latest monetary and credit developments.

The SBP remained vigilant on the movement of key economic variables (both domestic and international) and continued to follow the course of monetary tightening that began in FY05 by keeping the liquidity conditions tight in the money market during FY06 through proactive conduct of open market operations and gradual rise in T-bill yields by 50 basis points for 6-month maturity. Monetary Conditions Index (based on T-bills rate)[2] as a result, rose from 101.48 in end June 2005 to 102.05 by end June 2006, indicating an increase of 0.6 percentage point. These measures helped in continuing the growth and investment momentum, maintaining export competitiveness and keeping inflation under check. In short, the State Bank remained committed to price stability and used monetary policy tools to achieve this goal.

SBP tight monetary policy proved effective in bringing down reserve money growth from 17.6 percent in FY 05 to 10.2 percent in FY06 leading to a slowdown in the pace of monetary expansion from 19.3 percent to 15.2 percent in this period. Consumer Price Index (CPI)-inflation also came down from 9.3 percent in FY 05 to 7.9 percent in FY06. Although SBP remained more concerned about inflation, it facilitated the growth initiatives as credit expansion continued through FY06. The flow of bank credit to both government and private sector continued to rise due to strong business sentiments and government spending in earthquake-affected areas in addition to budgeted expenditure. The SBP also ensured adequate flow of credit towards SME and Agriculture sectors besides encouraging further capacity expansion of vital industries and initiatives for Balancing, Modernization and Restructuring (BMR).

SBP also maintained tight liquidity conditions in money market through timely and frequent open market operations which forced the market to operate close to the discount rate of 9 percent. The

2 Hyder, Zulfiqar and M. Mazhar, Khan (2006), “Monetary Conditions Index for Pakistan”, State Bank of Pakistan, Working Paper No. 11, May 2006.

tight monetary conditions also caused pushing up of both the short-term interest rates in the Inter-bank market and banks lending rates. Moreover, the effective use of Open Market Operations (OMOs) with flexible tenors kept overnight market rates high enough to slow excessive credit off-take, in line with the monetary policy stance.

3.2 Monetary Policy Statement

Two Monetary Policy Statement (MPS) were issued in FY06 which provided the market adequate signals about expected policy stance of central bank for the next six months. In the MPS for 1st half of FY06, the SBP reiterated its commitment to keep inflation at reasonable level through timely policy actions. The SBP also showed its commitment to maintain exchange rate stability mainly to achieve competitiveness of exports.

In the MPS for second half of FY06, the SBP signaled the market about additional policy firming mainly to attain dual objectives of price stability and sustainable economic growth. While attempting to dampen inflationary expectation through additional policy firming, the SBP ensured that changes in interest rates should not significantly impair continued growth momentum in the country. SBP policy rate i.e. SBP 3-day Repo Rate was kept unchanged at 9 percent throughout FY06. However, SBP raised its benchmark rate to 9.5 percent in July 2006 to signal the markets about concerns over inflation pressures.

3.3 Conduct of Monetary and Credit Policy

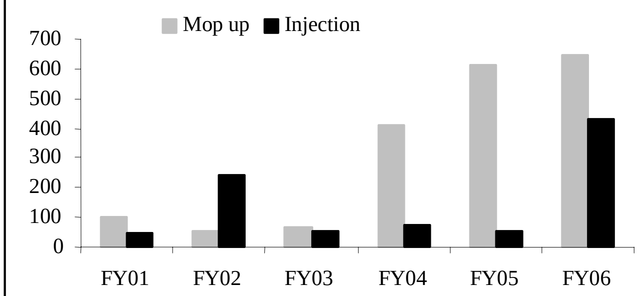
The main thrust of SBP monetary and credit policy during FY06 remained focused on ensuring adequate availability of bank credit to private sector and price stability. The rising inflationary tendency was contained by maintaining tight monetary stance and adoption of certain administrative measures to improve supply of key commodities. It kept the non-food inflation in check. Resultantly, the average CPI inflation decelerated from 9.3 percent in FY05 to 7.9 in FY06. Similarly, core inflation (non-food non-energy) also stabilized around 7.0 percent in this period. However, Core inflation, in terms of 20 percent weighted trim mean, fell from 8.8 percent in FY05 percent to 6.7 percent in FY06.

The SBP also continued to contain inflation and inflationary expectations through controlling reserve money growth. The tools of open market operations (OMOs) were frequently used which helped maintain overnight rate high enough to contain market liquidity essential to check demand for bank credit. This caused slowdown in growth of reserve money from 17.6 percent in FY05 to 10.2 percent in FY06.

The SBP has ensured ample availability of bank credit to the private sector. The bank credit to the private sector in FY06 grew by 23.5 percent against the 3-year average annual credit growth of 29.5 percent. It is important to note that credit growth was still significant despite tight monetary policy stance of the SBP. The distribution of bank credit utilization was broad based. The bulk of credit went to the manufacturing sector, followed by consumer financing, commerce, services and transport, storage and communication.

3.3.1 Open Market Operations (OMOs)

Figure 3.1 Open Market Operations (billion Rupee)



The SBP pursued tight monetary stance through proactive liquidity management approach during FY06. Instead of increasing the bench-mark rate (using traditional method of raising T-bill rates) abruptly, the SBP tended to manage tight liquidity conditions in the inter-bank money market. Consequently, the Bank intervened frequently in the Inter-bank money market and drained out excess liquidity and marginalized volatility in the Inter-bank rates. Specifically, the SBP conducted 92 OMOs and moped up surplus liquidity of Rs.733.1 billion from the Inter-bank money market against the injection of Rs. 529.6 billion during FY06 (**Figure 3.1**). The frequent OMOs with the flexible tenors helped in keeping secondary market interest rate at the desired level in line with tight monetary policy stance. The Inter-bank liquidity was managed in a way that kept the average overnight rates relatively close to policy discount rate. The tight liquidity conditions also pushed up short-term interest rates.

3.3.2 Discount Window Operations

During the past three years, the SBP intervened more frequently and aggressively in the Inter-bank money market mainly to squeeze surplus liquidity from market. Resultantly, the banks were seen more often at SBP discount window for 3-days repo facility. The banks availed discounting to the tune of Rs. 734 billion during FY06 compared to Rs.490 billion in FY05. In July 06, SBP raised discount rate by 50 bps to 9.5 percent in order mainly to check the rising inflation and curtail the private sector credit.

3.3.3 Statutory Liquidity Reserve (SLR) and Cash Reserve Requirements (CRR)

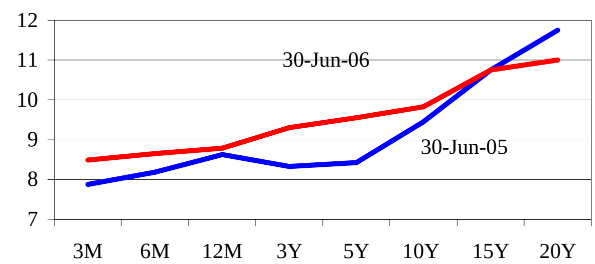
The SBP raised the SLR and CRR in July 2006[3] mainly to support the on-going tight monetary policy stance. The CRR was also designed to provide incentives for banks to convert demand and time deposits of short maturities to time deposits of more than six months maturity. Similarly, the upward adjustment in SLR was aimed at making easier for SBP to shift government budgetary borrowings to commercial banks. It also caused a decline in yield on government securities besides putting pressures on money market rates due to squeeze on excess liquidity.

[3] Weekly average of 7percent (subject to daily minimum of 4percent) of total Demand Liabilities including Time Deposits with tenor of less than 6 months) and weekly average of 3percent (subject to daily minimum of 1percent) of total Time Liabilities, including Time Deposits with tenor of 6 months and above).

3.4 Interest Rate Trends /Yield Curve

The term structure of interest rate in Pakistan also showed upward trend as the SBP continued to follow tight monetary policy during FY06. During the year, SBP conducted 26 auctions of T-bills and one auction of PIBs. Cut-off yields on T-bills was raised by 81 bps to 8.3256 percent for 3-month, 50 bps to 8.4869 percent for 6-month and 34 bps to 8.7907 percent for 12-month.The weighted average lending rates (on disbursement basis), registered a rise of 172 bps to 9.93 percent in FY 06 while weighted average deposit rates showed a smaller rise of 104 bps to 2.89 percent.

Figure 3.2: Structure of Yield Curve



The yield curve became relatively flatter owing to continuous rise in short term rates (**Figure 3.2**) while there was almost no activity in longer tenors in the absence of PIB auctions during most of the time in FY06 as only one auction of PIB was held during the year. The tight liquidity conditions were also reflected in edging up interest rates in the secondary market, particularly the short-term interest rates. The KIBOR for all tenors went up during FY06. The KIBOR with 6-month tenor rose by 100 bps on offered rate as opposed to average rate to 9.68 percent while 12-month tenor edged up by 60 bps to 10.08 percent.

3.5 Government Bond Market

The SBP continued its efforts to further develop long-term market during FY06. The introduction of Pakistan Investment Bonds (PIB) (in 2000) resulted into development of a relatively vibrant long-term government bond market. However, supply constraints caused diminutive activity in both primary and secondary market of PIBs making the longer-end of yield-curve non-representative of true long-term interest rates. In reality, the long term yield quoted in the market has become non indicative as trading activity in the long term paper become negligible. The market has started using short-term interest rates again, especially KIBOR as benchmark for the long term lending purposes, thereby jeopardizing the significant objective of the PIB floatation. Further, the floating rate Term-finance Certificate (TFCs) issued during FY05 and FY06 were benchmarked against 6-month KIBOR.

3.6 Exchange Rate Stability

SBP has successfully achieved exchange rate stability during FY 06 as rupee registered a marginal depreciation of 0.9 percent compared to 2.5 percent last year. The stability of Pak rupee was mainly contributed by prudent intervention of SBP in the inter-bank forex market and increased inflow of workers' remittances. Higher demand for dollar due to rise in oil import bill because of rising international oil prices coupled with surge in demand for imported machinery generated some pressure on Pak rupee. However, this pressure was effectively managed by SBP through provision of support for oil and commodities thus maintaining the exchange rate stability.

3.7 Strengthening of Research Function

The State Bank of Pakistan has further strengthened the scope, coverage and dimensions of research function mainly to improve the quality of analysis of economic, business, and financial events, which are important for the adoption of an appropriate, proactive and forecast based monetary policy. For the achievement of desired goals, the research function has undergone restructuring, reorganization, capacity building and skill enhancement through extensive trainings, exposure visits and induction of professionals and access to reputed journals, research bulletins and databases, etc. In order to strengthen research function, SBP took a number of initiatives, notable of them are mentioned below:

3.7.1 Research Bulletin

SBP-Research Bulletin (externally referred) was launched to further strengthen research function. The Bulletin covers research work on most important topics on Pakistan's economy with emphasis on empirical studies. It will contribute in enhancing scientific standards of SBP research work besides disseminating knowledge to policy makers, market stakeholders, and academicians. The second issue of the bulletin was released which covers the papers and proceedings of SBP International conference on "Monetary-cum Exchange Rate Regime: What Works Best for Emerging Market Economies" held in November 2005. (This should be covered after the section 3.7.3)

3.7.2 SBP Working Papers

Research and Economic Policy Departments introduced working papers on different topics. Other departments also contributed in the working paper series. The papers contain empirical analyses of economic issues and provide policy makers insights and candid feedback on policy formulation and decision making process. By end June 2006, thirteen working papers were released and posted on SBP website.

3.7.3 First SBP International Conference

Another hallmark in the research activities of the SBP was holding of the very first SBP International Conference on "Monetary-cum Exchange Rate Regime: What Works Best for Emerging Market Economies" (14-15 November 2005). The conference generated a considerable amount of very fruitful dialogue, spread over twelve papers, about the alternative monetary and exchange rate policies for Pakistan (particularly adoption of inflation targeting). It also signaled the high scientific standards of the SBP to the market in general and academics, research institutes, and multilateral institutes in particular thus enhancing the credibility of the Bank.

3.7.4 SAARC-FINANCE Seminar on conduct of Monetary Policy and Management of Capital Flows

The SBP organized the Seminar on "Conduct of Monetary Policy and Management of Capital Flows" during 29-31 August 2005 under the aegis of SAARCFINANCE – the Network of SAARC

Central Bank Governors and Finance Secretaries. The delegates from member SAARC countries shared experiences relating to capital flows and responses to the challenges posed by these flows to the policy makers of respective countries. Moreover, sharing of information through exchange of different publications/documents on various policy issues as well as visits of officers under SAARCFINANCE Staff Exchange Program also took place.

3.7.5 Macro-econometric Model

Like other central banks, State Bank of Pakistan requires forecast of key macroeconomic variables in order to form view on the future inflation and economic growth. To meet the need for reliable forecast, Research Department (old) has developed a Macro econometric Model of Pakistan economy based on annual data. Furthermore a Macroeconomic Framework based on Financial Programming Approach has also been developed in order to derive consistent forecasts for key macroeconomic variables. Forecast derived from the Macro econometric Model and Macroeconomic Framework are used as an input for policy decisions. Future outlook of Pakistan economy based on consensus view of the Bank management about projected future path of key macroeconomic variables is regularly published in Bank' s Annual and Quarterly Reports.

3.7.6 Inflation Monitor

Maintaining price stability is the primary objective of all central banks around the world including State Bank of Pakistan. Hence, the importance of continuous monitoring of inflation can hardly be overemphasized. While the State Bank of Pakistan always monitors the price trends very closely, public at large remains unaware of underlying detailed statistical analysis of price trends. In order to make the public more informed about the inflation developments, the Bank started publishing a monthly document with title "Inflation Monitor". The Inflation Monitor is based on the price data meticulously compiled by the Federal Bureau of Statistics. Objective of the monitor is to provide as much detail as possible about the price situation so that the economic agents are able to form an independent outlook for the emerging price situation and can make their economic decisions on the basis of a wider set of information.

3.7.7 Forward Looking Framework for Monetary Policy and Strengthening of Research Function

1. The Monetary and Exchange Rate Policy Committee (MERPC) has been replaced with Monetary Policy Committee (MPC) with effect from September 6, 2006. The MPC will have a broader mandate and will review the macroeconomic developments of the economy with focus on inflation, monetary and exchange developments and economic growth. MPC will be in-charge of preparing the Monetary Policy Statement for approval of SBP Board. MPC is also empowered to take corrective actions (when needed) in line with approved policy of Board.

2. In the wake of recent restructuring of SBP, the forward looking framework for the conduct of monetary policy has been developed which is likely to provide requisite support to MPC for making predicative assessment regarding short-term and medium term outlook of the economy. The new framework would also facilitate MPC in policy formulation and decision making process.

4 EXCHANGE RATE AND RESERVE MANAGEMENT

4.1 Overview

This FY 2005-06 yet again proved challenging for Exchange and Reserve Management with oil prices unabatedly testing new record levels, substantial widening of the trade gap brought both Reserves & Exchange Rate under stress for good part of the fiscal year. Despite of these constraining factors, markets remained calm and stable witnessing healthy volatility rather than excessive volatilities. Although, foreign exchange outflows, including support for Oil/Commodities and Debt, amounted to US$ 8.7bln during the current fiscal year, the Gross Reserve level grew by 4.129% to close at historic high of US$ 13,137.2.1million.

On the Reserve Management front, SBP will further enhance its internal capacity with the restructuring of all the relevant departments associated with the Reserve Management function and the creation of International Market & Investment Department within the newly formed Financial Markets & Reserve Management Cluster dedicated to strengthen SBP's Financial Market capabilities. These initiatives would result in better functional efficiency and dedicated focus to this priority area, along with the necessary capacity building initiatives.

The drive to formalize the Money Changers and bring them under the regulatory ambit of SBP initiated in the year 2003 was successfully completed during the FY 05. During FY 06, even greater challenges were to ensure effective regulatory and supervisory oversight of these newly born exchange companies, introduce necessary documentation, governance and transparency standards and substantially improve quality of their human resource.

Further efforts were also made to simplify and liberalize the Foreign Exchange regime, which included relaxation of restriction on Advance Payment against Imports along with repatriation of surplus funds by Foreign Airlines operation in Pakistan. Instructions related to Trade Loans against FE-25 deposits were also relaxed for exporters with the maximum period of loan extended to 270 days from 180 days previously.

For the development of Capital Markets in Pakistan, non-residents were allowed in July-2006 to trade in Futures Market through Special Convertible Rupee Account (SCRA). The related procedure prescribed such trading through opening of a separate sub-account under SCRA. The step besides facilitating the non-residents will help generate new interest and enhance Foreign Portfolio Investment in Pakistan.

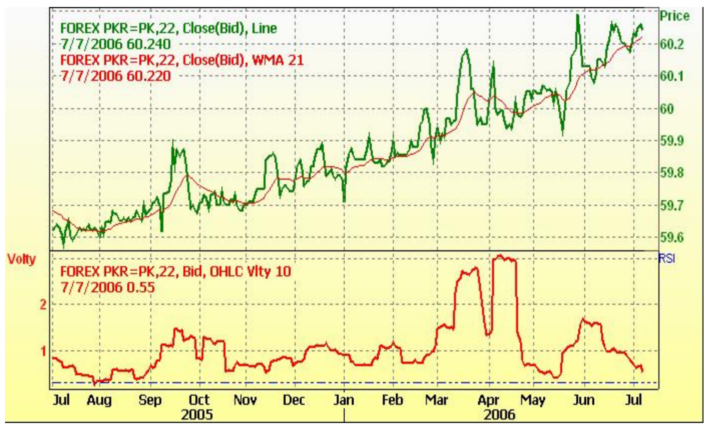
4.2 Exchange Rate Management

The Exchange Rate, on average, showed a weakening but stable trend despite widening of trade deficit by US$ 3.93 bn versus FY 2004-05. Though SBP continued to provide support for oil & commodities to the FX Market, with a net injection to the market of US$ 1.995 bn during FY 06, yet this net support was 23.5% lower as a percentage of oil support provide during FY 05. This was despite the fact that the petroleum import bill jumped by 66.9% or $ 2.67bln during FY 06, due to the fact that international oil prices rose by approximately 49.1% to an average level of US$ 60.86/bbl over average prices during FY 05 and increase in Pakistan's Oil import volume by 8.9% (**Table 4.1**).

Table 4.1: Pakistan's Oil Import Volume

	Jul - Jun: FY 2005-06 (P)				Jul - Jun: FY 2004-05			
	Quantity	Value	Unit Value		Quantity	Value	Unit Value	
	(in MT'000)	(US$ million)	(/Metric Ton)	(/ Barrel)	(in MT'000)	(US$ million)	(/Metric Ton)	(/ Barrel)
Petroleum Group	**14,818.3**	**$ 6,668.5**	**$ 450.01**	**$ 62.96**	**13,607.6**	**$ 3,999.7**	**$ 293.93**	**$ 41.12**
Petroleum Products	6,080.3	$ 2,874.5	$ 472.76	$ 66.14	5,720.8	$ 1,850.9	$ 323.53	$ 45.27
Petroleum Crude	8,738.0	$ 3,793.9	$ 434.19	$ 60.75	7,886.8	$ 2,148.8	$ 272.46	$ 38.12
	Quantity	**FY2005-06 vs FY2004-05**		**Price**				
% Change	**8.9%**	(Comparable Period)		**53.1%**				
[Table: 4.1]	**Source: Fedreal Bureau of Statistics**							

Considering the above arguments, it depicts signs of depth & normalcy returning to the FX Market with the Market managing higher trade volumes & other flows in line with demand & supply factors, which is manifesting in healthy volatility rather then one-sided pressures on the USD/PKR Exchange Rate. To further enhance market's ability to handle large volumes on its own, SBP changed its pattern of interventions in the FX Market. SBP avoided interventions in the market to inject liquidity. This is evident from the fact that SBP's Treasury did market interventions (Sale side) of merely US$103.0mln during FY2005-06 compared to US$ 1,125.0mln during the FY2004-05 (**Table 4.2**).



Commodities / Energy Prices

[Table: 4.2]	30-Jun-06	30-Jun-05	% Change
Gold ($/Oz)	$ 613.70	$ 435.50	40.92%
Silver ($/Oz)	$ 10.99	$ 7.05	55.89%
Oil (US WTI)	$ 73.75	$ 56.50	30.53%
(Brent Crude)	$ 73.70	$ 55.58	32.60%
(Arabian Light)	$ 68.19	$ 49.89	36.68%

Whenever there were demand/supply pressures on the Exchange Rate, SBP let the market manage them thereby creating healthy volatility. SBP's FX Market Management has been focused on monitoring the variations in bid/ask spreads, any one sided directional bias and/or bullet flows, so as to address any resultant excessive volatility on an intraday basis. Otherwise, SBP fully allowed the market to manage the demand/supply on its own. This was done to build capacity in the market to adjust itself with changing conditions and cultivate a prudent risk management culture in Corporate Sector's. In absence of muted volatility, chances are that pressures would built-in and in an event of crisis the break-outs would be more pronounced (**Table 4.3**).

Resultantly, the Exchange Rate moved within a range of 79.0 paisa, with 59.5750 and 60.3650 as lows/highs, both on intra-day basis, during the FY 06 and closed at 60.2150/$ (**Figure 4.1**). The Annualized Volatility was also down from 2.63% to 1.60% during FY 06 versus FY 2004-05. Though the Exchange rate has shown a gradual depreciating trend since the start of FY 2005-06, however unlike FY 2004-05, there have been no huge & abrupt movements in the Exchange Rate sending panicky sentiments to the market.

SBP - Oil Support to Market					
FY 2005-06			FY 2004-05		
Jul-2005	$	209.0	**Jul-2004**		-
Aug-2005	$	572.1	**Aug-2004**		-
Sep-2005	$	503.9	**Sep-2004**		-
Oct-2005	$	545.7	**Oct-2004**		-
Nov-2005	$	563.9	**Nov-2004**	$	407.3
Dec-2005	$	399.8	**Dec-2004**	$	409.3
Jan-2006	$	489.1	**Jan-2005**	$	302.7
Feb-2006	$	549.4	**Feb-2005**	$	378.1
Mar-2006	$	515.5	**Mar-2005**	$	332.9
Apr-2006	$	423.8	**Apr-2005**	$	316.8
May-2006	$	671.4	**May-2005**	$	357.1
Jun-2006	$	622.9	**Jun-2005**	$	413.6
	$	**6,066.5**		**$**	**2,917.8**

[Table: 4.3] [Amounts in USD million]

One other interesting phenomenon during the FY 2005-06 was the further narrowing of margin between the Kerb and the Interbank Exchange Rate. There were even instances when the Kerb Market rate remained lower then the interbank rate. The average premium between the two markets was 0.42% versus 0.76% during FY 2004-05.

4.3 Reserve Management

The Reserves Management strategy adopted last year, continued during the year under which the reserves' investment portfolio has been categorized into three kinds of portfolios based on Cash, Short Duration Liquidity Portfolio and Medium to Long-term Portfolio. The categorizations of these portfolios are segmented on the basis of liquidity calls on the Country's Reserves. Under the new strategy a portion of the reserves has been outsourced and is being invested in Fixed Income Securities through External Fund Managers since 2004; while the remaining reserves are being managed internally. The external managers are mandated with benchmarks based upon Global Fixed Income aggregated indices customized to the Bank's risk appetite. Formal reporting procedures are in place and detailed performance reviews are conducted bi-annually with all external managers.

In continuation of broad guidelines formulated in the revised Investment Policy in 2003, selection of Fund Managers & Custodians, selection of benchmarks and drafting of investment guidelines were the priority areas during 2004-05, which has been completed and implemented. Similarly, in-house capacity enhancement remained the hallmark of 2005-06 with the investment methodology further refined and operational procedures upgraded to enable efficient management with active cash-flow forecasting and liquidity management.

With our shifting from old methodology of Reserves Management to adopt new sophisticated techniques and practices, it was strategically important to bring all the reserves related functions under a single cluster to optimize the performance with focused approach. The planned restructuring of all the relevant departments associated with the Reserve Management function and the creation of International Market & Investment Department within the Financial Markets & Reserve Management Cluster, would result in better functional efficiency and dedicated focus to this priority area, along with the necessary capacity building initiatives. Furthermore, strengthening of the Risk Management and Treasury Operations units has been done with distinct & separate reporting line to that of the Dealing Room for prudent internal controls.

Improved liquidity management was achieved with active cash-flow forecasting of USD & Non-USD flows for better asset/liabilities management. Active currency & interest rate trends analysis was further instituted with better exposure management techniques, thereby facilitating active hedging & investment of also the non-dollar exposure resulting in improved gains/savings. Additionally, to maximize return and minimize idle funds consolidation of Nostro Accounts was carried out and the related operational procedures and methodologies were further refined.

Therefore, during the FY 2005-06 SBP's Reserve Management has been entirely proactive with improved exposure, duration and liquidity management. Resultantly, Investment posrtfolio out performed the overall benchmarks and has added substantial value to bank's profitability.

The Reserve Management function would continue to remain an area of high priority in the years to come in order to achieve our goal to bring SBP in line with the best practices of other Central Banks in the area of Reserves Management.

4.4 Liberalization of Foreign Exchange Regime

The foreign exchange regime liberalization efforts gathered further momentum during the year, as SBP took a number of further steps to liberalize the regime. They include:

4.4.1 Advance Payments against Imports

With a view to facilitate importers, Authorized Dealers were allowed to process the requests of the importers for remittances up to a maximum of US$ 10,000/-, or equivalent thereof in other foreign currencies, on advance payment basis against all eligible import transactions after ensuring the bona-fides of the underlying import transaction. Previously, this permission was restricted to import of spare parts/consumables by manufacturing and industrial users, for their own use, only.

4.4.2 Repatriation of Surplus Funds by Foreign Airlines Operating in Pakistan

As a further step towards the liberalization of foreign exchange regime and in order to facilitate Airlines operating in Pakistan, Airlines were allowed to repatriate their sale funds (surplus) twice a month on receipt of payments from the travel agents. Further, the Airlines were also not required to submit photocopies of Tickets/ Coupons/ Airway Bills to Authorized Dealers at the time of making request for repatriation of surplus funds. Like-wise, the requirement of submission of Encashment Certificate by the foreign nationals at the time of booking of their passage was also withdrawn.

4.4.3 Remittance of Freight Charges by Freight Forwarder/ Consolidators

In terms of the Trade Policy 2005-06, freight forwarders were allowed remittance of locally collected freight charges to their principals abroad. However, such remittances required SBP's prior approval.

In order to further facilitate the industry, it was decided to allow Authorized Dealers to affect such remittances directly on behalf of concerned freight forwarder/consolidators. Accordingly, Authorised Dealers were allowed to remit on a monthly basis, the surplus freight by the Freight Forwarder/ Consolidators, after verification of documentary evidence in support of the remittance. In order to mitigate inherent risks and establish genuineness of the transactions, Authorised Dealer were advised to have necessary verification through proper scrutiny of the necessary documents at the time of allowing monthly remittances. This step will help transformation of freight forwarders' business from informal channels to formal channels.

4.4.4 Trade Loans against FE-25 Deposits

Previously, Authorized Dealers were allowed to extend trade loans to exporters under FE 25 Scheme for a maximum period of 180 days. Further, conversion from pre-shipment loans to Post-shipment loans was also not permissible. With a view to facilitate genuine export transactions, it was decided that the instructions be relaxed. Accordingly, it was allowed that in case, maturity of a pre-shipment export loan under FE-25 deposits falls prior to the date of realization of export proceeds, exporters have the option to convert the pre-shipment loan into post-shipment loan, provided the maximum period of the loan (both pre-shipment & post-shipment) does not exceed 270 days.

4.4.5 Allowing Non-residents to Trade in Shares in Future Market

For the development of stock exchanges in Pakistan, non-residents were allowed in July 2006 to trade in Futures Market through Special Convertible Rupee Account (SCRA). The related procedure prescribed such trading through opening of a separate sub-account under SCRA. The step besides facilitating the non-residents will help generate new interest in Pakistani Stock Exchanges.

4.5 Exchange Companies 2005-06

The network of defunct Money Changers, operating in an unregulated environment, was highly susceptible to illegal use. Moreover, the network functioning as a parallel market was creating hindrance for SBP in management of the exchange rate. The Exchange Companies (ECs) framework was, therefore, enacted in FY03 to bring exchange and remittance business under a proper financial discipline. The framework required the 'Authorized Money Changers' (AMCs) to either transform into ECs or become Franchises of newly established ECs.

In the second phase, AMCs with small financial means were facilitated and encouraged to form ECs of 'B' category with a reduced paid-up capital, reserve requirement and limited scope of business viz. sale and purchase of FCY notes and coins only. In order to bring a maximum number of AMCs in the new system, minimum 5 AMCs were required to form ECs of 'B' Category. The initiative was well received and enabled a large number of smaller AMCs to transform into 'B' Category ECs. It also enabled SBP to bring almost 95 percent of the AMCs network under its new regulatory ambit.

As of 30th June 2006, 27 ECs of 'A' category with a network of 123 branches, 5 currency exchange booths, 219 franchisees and 306 Payment Booths/Outlets and 31 ECs of 'B' Category with network of 222 branches were operating in the country. Besides ECs, "Restricted Authorization" has also been granted to 3, 4 and 5 star hotels for purchase/encashment of foreign currency notes, coins and travelers cheques for the hotel customers.

With the transformation of AMCs into formal ECs, a large number of undocumented transactions have come under the fold of formal framework, which requires proper documentation, record keeping and adherence to internationally accepted Know Your Customer norms which will help SBP in effective enforcement of AML regulations. It also enabled SBP to substantially narrow the gap between interbank and kerb market exchange rates, which played an important role in improving the flow of home remittances. The balance of payments includes the receipts and payments made through the ECs which conveys a more comprehensive and realistic picture of the transactions on external account of the country.

The transformation of AMCs into formal ECs, however, has posed considerable challenges of ensuring effective regulatory and supervisory oversight, inculcating corporate culture, good governance, transparency and proper documentation and record keeping structure in ECs. The focus during the year, besides enhancing necessary supervisory capacity at SBP for effective supervision of ECs and sensitizing the ECs' management about the importance of documentation, corporate governance, systems and controls, computerization/ automation, and human resources development etc. also remained on strict compliance/enforcement of related rules & regulations on proactive basis. In order to ensure that ECs' business related agreements with outside parties/entities are in conformity with the related rules & regulations, the ECs are required to obtain clearance/approval of SBP before entering into such agreements. Further, meetings with the Heads of ECs were also held to apprise them of the challenges ahead and the necessity to create the requisite infrastructure and capacity to ensure conformity of their business practices with established international norms and governing rules and regulations.

To augment its own supervisory capacity, the 'ECs Supervision Units' at all 16 Field Offices of SBP-BSC were further strengthened for on-site and off-site supervision of 'B' Category ECs. SBP also enhanced the level of vigilance/monitoring of Exchange Companies. Compliance/ enforcement of inspection reports have been further strengthened. Proper off-site monitoring mechanism and MIS have been put in place. As a result, actions including warnings/ suspension of licenses on violation of rules & regulations, standard norms and practices were taken against the delinquent ECs which helped in creating desired disciplined operational environment in the sector. Further, as a part of enforcement action, written undertakings from the board of directors of ECs who violated governing rules & regulations were also obtained to take and to cause company's management to take all necessary corrective actions and run affairs of the companies strictly in accordance with the related rules & regulations and standard norms.

Further, to improve documentation of Foreign Currency flows and introduce necessary checks in export of Foreign Currency Notes other than USD by the ECs, a joint booth of SBP and Customs was established at Jinnah International Air Port, Karachi which is operative from April 4, 2005. Necessary arrangement for similar booth at Allama Iqbal International Air port, Lahore has also been made and the said booth will be operational by December, 2006 to facilitate the ECs operating in up-country for export of foreign currency notes.

5 STRENGTHENING OF PAYMENT SYSTEMS

5.1 Overview

The concept of payment systems covers the instruments facilitating exchange of assets and services between economic units, the institutional and organizational structure, the operational procedures and the communication network. The importance of the payment systems mainly stems from their role in the financial sector. Following the financial sector reforms that had targeted reducing financial risks and increasing reliability and speed, the payment systems have changed to a large extent. This in turn caused monetary authorities to work for establishing powerful and effective payment systems, to be used in the decision-making process of monetary policy and for avoiding systemic risks that may arise from the payment systems.

5.2 Importance of Oversight Function of Payment Systems

Oversight of payment systems is a critical function of a central bank whereby the objectives of robustness, safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these objectives and where necessary inducing change. The respective departments at SBP are continuously issuing guidelines and circulars in order to develop new policy and oversight framework to achieve these objectives. During the year 2005-2006, the following tasks were completed to further strengthen the retail payment systems in Pakistan:

5.2.1 Guidelines for Standardization of Automated Teller Machine (ATM) Operations

ATM is one of the most important delivery channels of e-banking. In order to enhance service level to international standards, SBP has issued guidelines for commercial banks and switch operators using this channel. The main features of these guidelines are:

- Pro-active resolution of suspect transactions by the ATM branches of banks
- Automatic refund of un-disbursed cash by ATM
- Time-lines for refund of un-disbursed cash
- Automatic settlement by the Switches/Banks
- Confirmation to customer for refund.

5.2.2 Guidelines for Cardholders

While enjoying convenience of e-banking consumers have to adopt the new practices to safeguard their account from fraudsters and hackers. In order to educate the consumers comprehensive guideline have been developed and issued both in English and Urdu. These guidelines suggest various precautionary measures for cardholders while executing transactions using different delivery channels of e-banking such as ATM, Points of Sale (POS), IVR and Internet. Commercial Banks have also been asked to take steps to educate and create awareness among their accountholders.

These guidelines would greatly help in reducing customer complaints and incidents of frauds and identity thefts in e-banking.

5.2.3 Master Circular of Payment Systems' Statements

In order to accomplish effective oversight of, both domestic and cross border fund transfer, a "Master Circular" was developed. This circular was issued after consultation and feedback from all the stakeholders including the ATM Switch Operators. The main objective of issuing a Master Circular was to capture data relating to all the payment systems including domestic, cross border, paper based, all the e-banking channels such as Internet, IVR, POS, ATM and ATM Switches. These variables would help in analyzing the trend of e-banking, monitoring performance of banks in delivery of e-banking products and developing policy guidelines. In addition, the data relating to ATM Switches have also been added in order to monitor the performance of ATM switch operations.

5.2.4 Reforms in ATM Switch Operation

Robust and efficient infrastructure plays vital role in successful delivery of e-banking products and services. This is also critical to develop consumers' confidence on e-banking.

In this regard, our Payment Systems Department initiated dialogue with SWITCH operators and commercial banks and agreed upon a plan to reform SWITCH operation in order to bring the service delivery standards of both M-Net and 1-Link in line with the international standards. As per the agreed plan the following tasks have already been completed:

- Signing off of a legal agreement between SWITCH operators to provide a platform for smooth operation
- Standardization of system interfaces of both the SWITCHES
- Clearing of huge backlog in inter-switch settlement which was the root cause of long outstanding customers' complaints and poor ATM service
- Signing off of Standard Operating Procedures/Service Level Agreement by both the switch operators

The State Bank of Pakistan is coordinating with the stakeholders for early completion of remaining activities under the agreed plan including:

- Implementation of end-to-end security of the systems and processes
- Provision of back-up of hardware, software, telecommunication and power
- Arrangement of Disaster Recovery Plan and
- Development of formalized Dispute Resolution mechanism between the Switch Operators

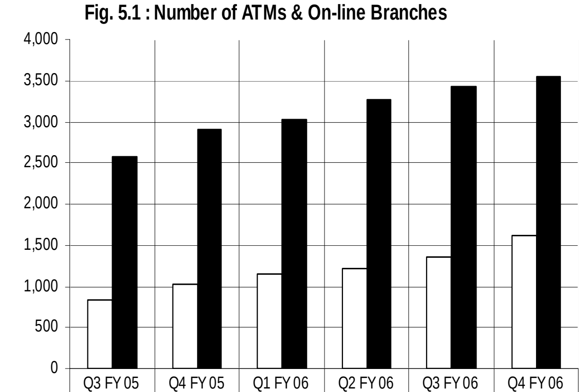
Once the plan is finally implemented, the service delivery of both the switches will be comparable to the international standards. It would also provide a platform for expansion and outreach of ATM Network in Pakistan as well as for cross border connectivity.

5.3 Performance of Retail Payment Systems

Total retail payment transactions (paper based and electronic) during FY06 increased by 44.4 percent to 361.3 million in numbers and by 28 percent in value to Rs.91.9 trillion, against last year's growth rates of 18 percent in numbers and 16 percent in value. It is, however, pertinent to note that e-banking transactions for FY06 showed robust growth at 37.9 percent in numbers and 239.7 percent in value compared with 45.8* percent in numbers and 24.5 percent in value of paper based instruments. The upsurge in electronic banking transactions is the result of rapid growth in e-banking infrastructure and increase in users' acceptance/ awareness of e-transactions which are quick, easy and cheap.

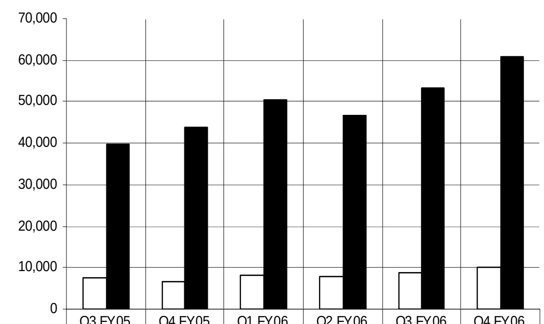
Regarding e-banking infrastructure, the number of ATMs, which was close to 207 at the end of 2000, has increased to 1,612 ATMs as of June 2006. A total of 584 new ATMs have been added to the total network in FY06, showing a growth of 57 percent over the previous year. Similarly Online branch network has also expanded to meet the funds movement needs of the customers. During FY06 a total of 658 new branches have been added to online branch network, showing a growth of 23 percent over the previous year. This has raised the total number of online branches to 3,555 branches 48 percent of the total branch network as of June 2006. The growth trend in number of ATMs and On-line Branches can be seen in **Figure-5.1.**

Fig. 5.1 : Number of ATMs & On-line Branches



	Q3 FY05	Q4 FY05	Q1 FY06	Q2 FY06	Q3 FY06	Q4 FY06
□ ATMs	842	1,028	1,141	1,217	1,363	1,612
■ On-line Branches	2,582	2,897	3,030	3,265	3,424	3,555

Figure 5.2 : ATM Transactions



	Q3 FY05	Q4 FY05	Q1 FY06	Q2 FY06	Q3 FY06	Q4 FY06
□ Transactions (000)	7,622	6,756	8,098	7,935	8,902	10,089
■ Amount (million)	39,812	43,810	50,365	46,675	53,156	60,809

The number of ATM transactions during FY06 increased by 7.1 million to 34 million showing a growth of 25 percent over the preceding year while value of ATM transactions increased by Rs. 57.3 billion to Rs. 211 billion registering a growth rate of 37 percent over the previous year. ATMs were

* A 45.8percent growth in numbers of paper based transactions is contrary to the downward trend in its pace of growth because of the two reasons viz. 1) Large number of cheques were issued to victims of the earthquake areas, and 2) Use of multiple cheques has increased after the levy of tax on cash withdrawals of more than Rs. 25000/-.

used 99 percent for cash withdrawal and only 1percent for other purposes i.e. Cash Deposits, Payment of Utility bills and Account to Account Fund Transfers. The trend in ATM usage is shown in **Figure-5.2.**

The highest contribution (percent share) in e-banking business was made by RTOBs (25 percent in numbers and 95percent in value) followed by ATMs (57 percent in numbers and 4 percent in amount). Some banks are offering fund transfer and utility bills payments through internet. However, call center and Internet banking are still in their infancy stage and thus have a very small share in the total e-banking business. In terms of business share, present payment systems are still dominated by paper-based processes. However, with the successful implementation of RTGS and launching of various e-banking initiatives by banks, payments through paper based instruments would be greatly reduced.

5.4 Inter-Bank Clearing of Paper Based Instruments

Clearing of transactions is one of the major functions of the payment system. To provide an efficient clearing facility State Bank of Pakistan has outsourced this activity to National Institutional Facilitation Technologies (Pvt.) Limited (NIFT). NIFT has established centers in 14 cities. A complete range of conventional clearing services has also been introduced which include Overnight Clearing, Same Day High Value Clearing and Intercity Clearing etc. This effectively covers the bulk of the cheque clearing transactions in the country. Besides NIFT, National Bank of Pakistan (NBP) is also providing clearing and settlement services at all those places where the SBP offices do not exist.

5.4.1 Local US Dollar Instruments Collection and Settlement System

NIFT is also providing clearing services for US $ instruments. This service is provided only for instruments issued and deposited in US dollar accounts maintained with commercial banks in Pakistan. Introduction of Local US Dollar Clearing has brought about a profound efficiency in the dollar clearing system. By avoiding routing through New York, the new settlement system will facilitate the foreign currency account holders in terms of processing time and cost. The new system has reduced the clearing time of US Dollar cheques from three weeks to only four days and has reduced the cost to the account holders.

5.4.2 Society for Worldwide Inter-bank Financial Telecommunication (SWIFT)

SWIFT is one of the most secured channel to execute cross border transaction and used by the financial institutions around the world. SWIFT is also used for executing high value local currency transactions such as RTGS. It will also be the primary communication channel for RTGS transactions in Pakistan. In order to ensure banks readiness, SBP is closely coordinating with commercial banks to upgrade their systems to handle RTGS transactions. Swift hardware and software are being upgraded to provide interfaces with RTGS and GLOBUS as well as setting up of DR/Back up site for business continuity is in progress.

5.5 Real Time Gross Settlement (RTGS)

The RTGS System named as PRISM (Pakistan Real-time Inter-bank Settlement Mechanism) will automate the current manual inter-bank settlement process of large value payments at SBP. At present, counterparties face risks like credit risk, liquidity risk and settlement risk due to time lag during the settlement of large value transactions through a manual system. The gross settlement (transaction by transaction settlement) in real time will minimize these risks. A Swedish company M/S CMA has been awarded the contract to implement RTGS at State Bank of Pakistan. The PRISM is scheduled to be live in 2007. The PRISM will provide platform to commercial banks for settlement of inter-bank transactions in real time mode using the secured and reliable messaging channel SWIFT. The PRISM will also have functionalities of Queue Management, Gridlock Resolution, and Government Securities Settlement.

5.6 Payment Systems Law

An effective legal framework is vital for smooth operation of Payment Systems. In this connection the SBP has prepared a draft law called Payment Systems and Electronic Funds Transfer Act and sent to the Federal Government for enactment. Once the law is passed it will lay down solid foundation for development and further strengthening of the payment systems in the country.

6 Human Resources Development
7 Information Technology Development

6 HUMAN RESOURCE DEVELOPMENT

6.1 Overview

FY06 was marked with consolidation of efforts made during last few years to improve HR policies in some of the more complex and difficult areas such as instituting competency based performance management, recruitment policies, promotion policies and the enhanced training opportunities. These policies led to a positive cultural change in the organization where strong acceptance was witnessed among most of the employees in their different roles, i.e. as individual contributors, team members or/and line managers. Employees' willingness to follow new policies is the testimony of their confidence and trust in the clear and transparent processes being promoted in all HR related practices.

Despite the above, there are still some critical areas where immediate improvements and structural changes are required. These include succession planning, compensation, recruitment and Oracle based self service menu which have been prioritized as future change agenda.

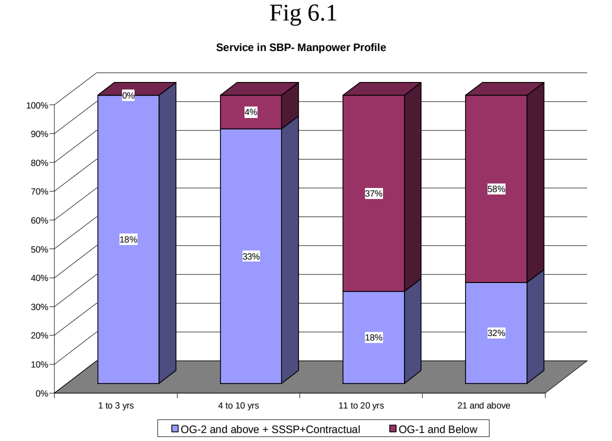
Table 6.1: Human Resource Profile of SBP

Regular Salary Structure	FY 05	FY 06
SG-1	3	3
OG-7	6	8
OG-6	41	39
OG-5	75	108
OG-4	111	120
OG-3	264	302
OG-2	310	234
OG-1	220	213
Support Staff	213	208
Specialized Salary Structure		
EL-1	40	40
HL-1	1	1
ML-1	5	5
M-1	4	4
Total	1293	1285
Contract Staff	73	54
Grand Total	**1366**	**1339**

6.2 Manpower Profile

The focus on Human Resource Development continued with the same enthusiasm and deliberations on improving the overall capacity of the HR base in SBP. The headcount of SBP decreased from 1,366 employees to 1,339 in the FY 06. The grade-wise detail of the total employees is given in **Table 6.1**.

Fig 6.1



The diversity of SBP in terms of its manpower has changed over the last five years with reference to the age group and period of service in the Bank The analysis reflects that the majority of employees having 1 to 10 years of service in SBP belongs to category of OG-2 and above plus SSSP and contractual employees, while employees who have more than 10 years of services are mostly OG-1 and below employees (**Figure 6.1**) This analysis implies that in future major HR policies and procedures must be designed and attuned to the type and category of the SBP employees. Only then SBP will be able to attract and retain its workforce. Many advances in this area have been made but efforts are being made to further align the overall focus of HRD to this fact.

6.3 Recruitment

During FY 06 efforts were made for ensuring selection of the required talent. Shorter time lines were determined and adhered thereby saving precious time and resources without compromising on the complete cycle of recruitment. The period witnessed 48 fresh graduates recruited under SBOTS and Analyst programs. The Joint Directors (JDs) recruitment process initiated in FY05 was also completed and 18 officers were recruited in this grade (**Table-6.2**).

Table 6.2: Consolidated Recruitment Position from 2000-2006
Number of Employees

FY	OG-2			OG-3	OG-4	OG-5	OG-6	SSSP	Total
	Analyst	Statistics Officers	SBOTs						
2000	0	0	0	0	0	0	0	0	0
2001	0	0	41	0	0	31	4	0	76
2002	24	12	46	0	3	2	1	0	88
2003	20	1	67	2	1	20	0	6	117
2004	0	0	28	1	0	0	0	0	29
2005	0	0	44	1	0	0	0	44	89
2006	7	0	41	1	4	18	0	0	71
Total	**51**	**13**	**267**	**5**	**8**	**71**	**5**	**50**	**470**

6.3.1 Contractual Recruitments

In addition to the permanent recruitments, professionals were also hired in various managerial and non managerial positions on contractual basis to meet the short term needs of the Bank in specialized areas (**Table 6.3**).

Table 6.3: Specialized Recruitment on Contractual Basis

Year	Managerial Positions	Non-Managerial Positions	IT Professionals
2000	10	28	13
2001	06	00	44
2002	10	01	17
2003	05	04	09
2004	03	00	56
2005	01	00	00
2006	04	03	00
Total	**39**	**36**	**139**

6.3.2 Employee Turnover

Employee turnover continues to be a challenge for SBP as the number of resignation has been increasing on a year to year basis. The details of the voluntary and involuntary Bank wide turnover are depicted in Table 6.4. Though the involuntary turnover has witnessed no major change but the rate of voluntary turnover has slightly escalated 1.2% (**Table 6.4**).

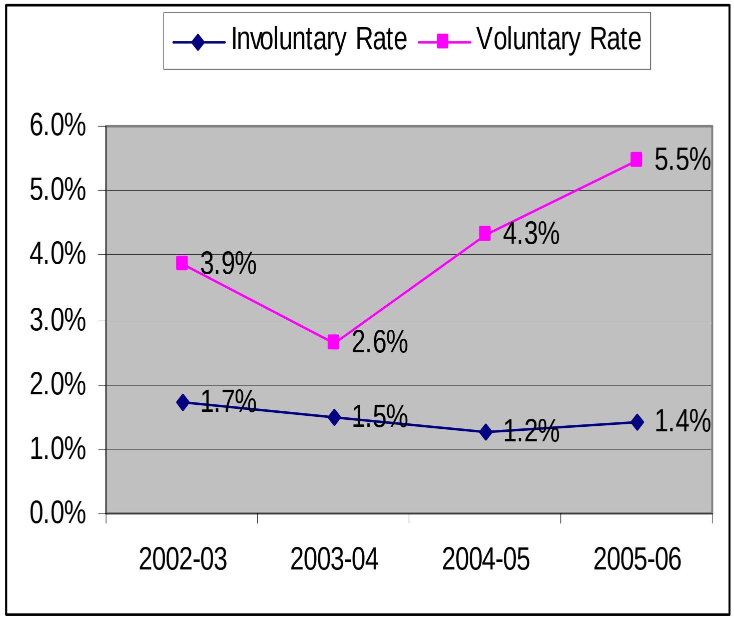
Table 6.4: Employee Turnover

Period	Involuntary Turnover[1]	Voluntary Turnover[2]	Total
2002-03	24	54	78
2003-04	21	37	58
2004-05	17	59	76
2005-06	19	73	92

[1] Includes Retired/contract expired , Dismissed and Expired employees
[2] Includes Resigned employees and Early retirements

This is a cause of concern for SBP, but it is attributed to external as well as internal forces. One major reason is expansion of the financial market, which has led to increased demand of qualified and skilled employees. SBP employees have been provided top notch trainings and developmental opportunities which make them a ready skilled and professional resource for other banking institutions. Also, with the expansion of the banking sector in small towns and cities all over Pakistan, many employees belonging to these areas prefer to work nearer to their hometown. Market based competitive salaries is also attributed to the increased rate of turnover. However SBP is fully conscious of the situation and is committed to its retention efforts in a more sustainable and professional manner (**Fig 6.2**).

Figure 6.2



Employee's Turnover Ratio

6.4 Performance Management System (PMS)

During the year under review, the automated version of the PMS was launched and the whole process was conducted on the Oracle Applications. This was the first step in implementing the Self Serivce Module, wherby each and every officer would be using the Oracle Applications to create, send and approve the PMS Forms online.

The PMS automated version was launched with the assurance of intense training and faciliation at the micro level. PMS departmental coordinators were selected for different departments and provided 4-day training on the Oracle module. These coordinators were assigned with the responsibility to provide facilitation to the users in the departments/areas allocated to them. Bank wide workshops for the employees in each department were conducted to give users demonstrations on filling up the Performance Planning Form during the planning phase 2005-06. Similar startegy was adopted for Appraisal Phase whereby Bank wide trainings were conducted on filling the automated appraisal Forms.

Another development in the PMS during the year under review was the applicability of PMS for all employees hired under the SSSP. As a recent development, all employees including OG-7, DGs, and Advisors (who were not previously covered under the PMS) and contractual employees were brought in the fold of the PMS. This recent decision to bring all employees under the coverage of PMS will greatly help the implementation of PMS in SBP in a more uniform manner.

6.4.1 Competencies

Since the implementation of PMS, feedback was being received on the methodology of evaluation of competencies. Based on the users' feedback, the concept of competencies was changed from a prescriptive format to a more flexible tool whereby both the appraisee and appraiser determine at the beginning of the performance year, the competencies, which needed to be measured. This methodology provides the much needed flexibility in identification and evaluation of competencies. The competency dictionary was also re-oriented/revamped by merging many competencies and simplifying their definitions. The behavioral examples were also adjusted to reflect SBP environment.

In the new competency dictionary, all the 27 competencies **(Table 6.5)** have been divided into 3 large groups i.e., Core Competencies Group, Role Specific Group and the Function Specific Group. These groups are further segregated in five clusters in accordance with the role of employees in the organization and the functions they perform.

A minimum of 6 and maximum of 10 competencies are required to be selected in the beginning of the performance year which is expected to be demonstrated by the employees.

Table 6.5: Four Levels of Competencies

Individual contributor Unit head	Divisional Head HOD.
Core Competencies	
1. Achievement Orientation 2. Communication	3. Team work
Achieving Results Cluster	Interpersonal Skills Cluster
1. Customer Service Orientation 2. Drive & Determination 3. Organizational Awareness 4. Planning & Organizing 5. Resource Management	1. Advocacy & Negotiation 2. Conflict Management 3. Interpersonal Skills
Personal Effectiveness Cluster	Leadership Cluster
1. Adaptability 2. Applying Knowledge 3. Concern for Detail 4. Confidence & Assertiveness 5. Innovation 6. Self Management	1. Championing and Embracing Change 2. Decision Making 3. Developing Others 4. Impact & Influence 5. Relationship Building / Leverage Network 6. Strategic Orientation
Problem Solving & Thinking Capabilities Cluster	
1. Analytical Thinking 2. Financial Acumen	3. Information Seeking & Research 4. Problem Solving

6.4.2 Compensation and Benefits

Compensation management took a new turn this year when for the first time SBP participated in a salary survey in which compensation and benefits structure of SBP was compared against 19 other organizations. The survey results will be used while making major compensation decisions in the coming years.

6.4.3 Promotion Policy

This year the promotion process was carried out in accordance with the promotion policy in vogue. A total of 184 officers were allowed structured promotion to the next grade **(Table 6.6)**, while 24 employees were promoted at the support staff level. No employee was promoted under professional growth policy. The methodology of the promotion also remained unchanged. However increased efforts were made to make the promotion interview more intensive and specific by encouraging the usage of behavioral based interviewing techniques. Fulfillment of training requirements continued to be mandatory for promotion

Table 6.6: Promotions

In Grade	**FY 05**	**FY 06**
OG-2	3	2
OG-3	56	106
OG-4	19	44
OG-5	3	26
OG-6	9	4
OG-7	-	2
Total	90	184

at all levels and despite fulfilling all the other criteria, employees were not promoted in the next cadre until they completed the required number of weeks identified for the respective grade.

The rate of salary increase on promotion to the next grade was increased from 3% to 10% effective from 1st July, 2005.

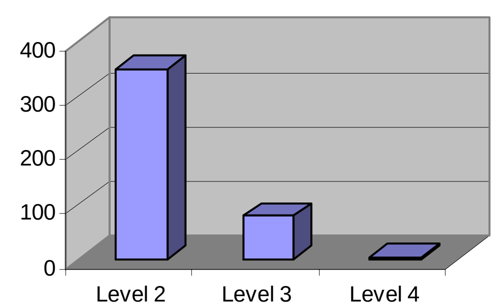
6.4.4 Succession Planning

Although there is no formal Succession Planning in the Bank, all out efforts are being made to broaden the existing skills of the human resource base. A policy worth mentioning in this area is the Interdisciplinary Skill Enhancement Policy, the scope of which has been enlarged to include all employees except those under SSSSP. Previously only employees of general side could be transferred to the specialized side and vice versa. During the year under review a total of 8 employees were allowed transfer/rotation under this Skill Enhancement Policy.

6.4.5 Reward and Recognition

The reward and recognition policy continued to be used by Departmental Heads in a robust manner resulting in 431 recipients under Level 2, 3 and 4. The reward and recognition policy continued to be used by the departmental heads in a robust manner resulting in 431 recipients under level 2, 3 & 4. (**Figure 6.3).** As compared to the previous year, a positive change has been observed in the tendency of the departmental heads to recognize and motivate their employees through this policy.

(Fig- 6.3) Level Wise



6.5 Training

Providing excellent training opportunities for continued capacity building of the staff has been a prime focus of the management particularly since the year 2000 and onwards. In compliance with this objective, a comprehensive training plan was chalked out for FY06 to deliver in-house training programs on central banking subjects as well as on soft skills. Moreover, SBP officials were encouraged to attend different training programs in other reputed domestic and international training institutes including courses offered by IMF at Singapore and Washington. The above training programs are categorized into: i) Central Banking, ii) Management and iii) Function Specific tracks.

Participation in various training programs during FY06 was encouraging; however it was low in comparison to the previous year (**Table 6.7**). A higher number of officers attended management courses which might be the outcome of FY06 being the last year for management programs conducted under TABS Project. Furthermore, meeting of mandatory training requirement for promotion by officers is another contributing factor for the increased participation at the Management Track.

Table 6.7: Participants of Training Tracks Programs

Training Tracks	Participants	
	FY05	**FY06**
Central Banking	1080	822
Management	685	809
Function Specific	850	801
Total	**2,615**	**2,432**

6.5.1 Central Banking Track

In Central Banking Track, the emphasis remained on catering the needs of employees in the foundation and intermediate level courses. **Table 6.8** gives the number of courses in each level (i.e., foundation, intermediate and advance) along with respective number of participants for FY06. The participation in Advance Level courses was at the lowest due to low number of target officers and courses offered

6.5.2 Management Track

Under management track dual training delivery strategy was adopted during FY06 where four courses on communication skills were offered by NIBAF while 12 courses focusing upon people skills, managerial skills and strategic planning were conducted by external consultants under TABS project. These outsourced programs were targeted towards improving managerial skills of middle and higher management of the Bank. In all, 809 employees participated in various programs under the management track. Details of the programs are given in **Table 6.9**.

Table 6.8: Participation of Central Banking Programs

Levels	Participants	
	Courses	**Participants**
Foundation	11	244
Intermediate	9	398
Advance	5	180
Total	**25**	**822**

Includes multiple participations in different programs by an officer

Table 6.9: Details of Courses under Management Track

Training Program	Target Audience	Days	Sessions	Participants
Training of Trainers (TOT) Part II	Selected group of officers	5	1	17
Training of Trainers (TOT) Part III	Same as above	3	1	18
Management Training for Sr. Management & Line Managers	JJDs - EDs	3	3	70
Training as People Managers	JJDs - HODs	2	3	67
Strategic Planning/Strategic Management	JJDs - HODs	4	2	43
Values and Shared Behavior	ADs - SJDs	2	6	159
HRM for Managers	JJDs - HoDs	2	3	65
Coaching and Counseling	JJDs - HODs	2	3	64
HRM Courses for HR Staff	HROs - JDs	3	1	24
Customer Services (HR + Others)	Officres - ADs	2	5	144
Performance Management (HR Staff)	HROs - JDs	2	1	28
Human Resources Planning (HR Staff)	HROs - JDs	1	0	0
Organizational Development	JJDs - HODs	5	3	88
Techniques of Counseling Staff in Careers Development	JDs - SJDs	1	1	22
Total Sessions Conducted in FY06		**37**	**33**	**809**

6.5.3 Function Specific Track

In the FY06, various programs of Function Specific Training were conducted under in-house arrangements by different departments on the relevant topics. Moreover, a number of officers also attended training programs at other reputed institutions like Pakistan Institute of Management and National Institute of Public Administration (**Table 6.10).**

Table 6.10: Function Specific Programs

#	Institution	Programs	Participants
1	In-house	61	428
2	NIPA	20	83
3	PIM	43	111
4	IBP	17	69
5	MAP	2	04
6	Others	44	106
	Total	**187**	**801**

6.5.4 Foreign Training

The State Bank's officers were also sent abroad under different programs, which are fully funded, partially funded or non-funded by host institutions. This year 139 officers in OG-2 to OG-6 were sent from various departments on foreign training. **Table 6.11** summarizes participation for various foreign training programs:

Table 6.11: Participation Wise Foreign Training

#	Institution	Participants
1	SEACEN	16
2	IMF	45
3	CCBS	04
4	ADB	01
5	Others	73
	Total	**139**

6.5.5 Higher Education

To develop sustainable HR capacity in meeting the future challenges, State Bank of Pakistan offers generous scholarships to its employees and general public for pursuing higher studies. In FY06, 17 employees were granted various scholarships as detailed in **Table 6.12**, along with comparison with last two financial years.

Table 6.12: Scholarship Beneficiaries

Discipline	FY 04	FY 05	FY 06
PhD from PIDE / QAU	-	2	-
Ex-Pakistan Study Leave	5	10	15
Study Leave in Pakistan	5	3	1
Sabbatical	-	1	1
Total	**10**	**16**	**17**

6.5.6 Internship and Attachment Programs

To contribute towards the Corporate Societal Responsibility, State Bank of Pakistan offers four internship programs to the top students of reputed universities throughout Pakistan. These programs include; i) Summer Internship Program, ii) Winter Internship Program, iii) Business Schools Internship Program and iv) Financial Reporting Internship Program.

Table 6.13: Internship Programs

#	Particulars	Duration	Participants
1	Summer Internship Program	8 Weeks	53
2	Winter Internship Program	4 Weeks	31
3	Financial Reporting Internship Program	4 Weeks	12
4	Business School Internship Program	6 Weeks	30
5	Others	1-4 Weeks	18
	Total		**144**

Furthermore, a number of domestic and international attachment programs for officials of other organizations are also offered, providing them an opportunity to benefit from the knowledge base of SBP. **Table 6.13 & 6.14** gives details of programs conducted under these categories during FY 2006.

Table 6.14: Category & Participation wise Attachment Programs

#	Category	Programs	Participants
1	Foreign Visitors	05	73
2	Government Officials	05	120
3	Students	06	258
Total		**16**	**451**

6.6 Recent Initiative on HR Restructuring in SBP

A comprehensive reorganization of SBP was carried out to strengthen its internal governance systems and to restructure itself in line with best practices of other central banks that have successfully modernized themselves to achieve similar initiatives.

This review has been undertaken by internal resources of the State Bank through comprehensive in-house stock taking of issues and study of the organizational structure and best practices prevailing in the modern Central Banks. Also, the process has been consultative with the Head of Departments being fully involved in the exercise. Consequently, after several rounds of consultation with CMT and HODs, the State Bank of Pakistan has been reorganized in September, 2006. The main features of restructuring are to create four distinct clusters in the SBP as mentioned below.

1. Banking Cluster
2. Monetary Policy & Research Cluster (MPR Cluster)
3. Financial Markets & Reserve Management Cluster (FMR Cluster)
4. Corporate Services Cluster (CS Cluster)

Each of the four Clusters is to be headed by a Deputy Governor (DG) or an Executive Director (ED) being in-charge of the day to day management of the concerned Cluster to ensure deeper oversight and systematic synergies built-in within each Cluster along the functional lines.

The principal features of changes involved are: -

1. Segregation of Banking Cluster
2. Grouping of all corporate functions
3. Restructuring of Banking Cluster and establishment of the Monetary Policy & Research Cluster and Financial Markets & Reserve Management Cluster

Each Cluster has been restructured keeping in view the emerging requirements, while ensuring that each cluster and the Groups and departments within it are of right size with appropriate and well balanced adequate number of Divisions/Units. The head of each Department/Division/Unit will be responsible for well defined goals and objectives and with an adequate manager: staff coefficient ratio. Each Group in-charge (ED/Advisor) will be responsible for aligning the department structure to conform to the spirit of reorganization elaborated above and will make amendments in their business plans, staffing and training programs to support this restructuring.

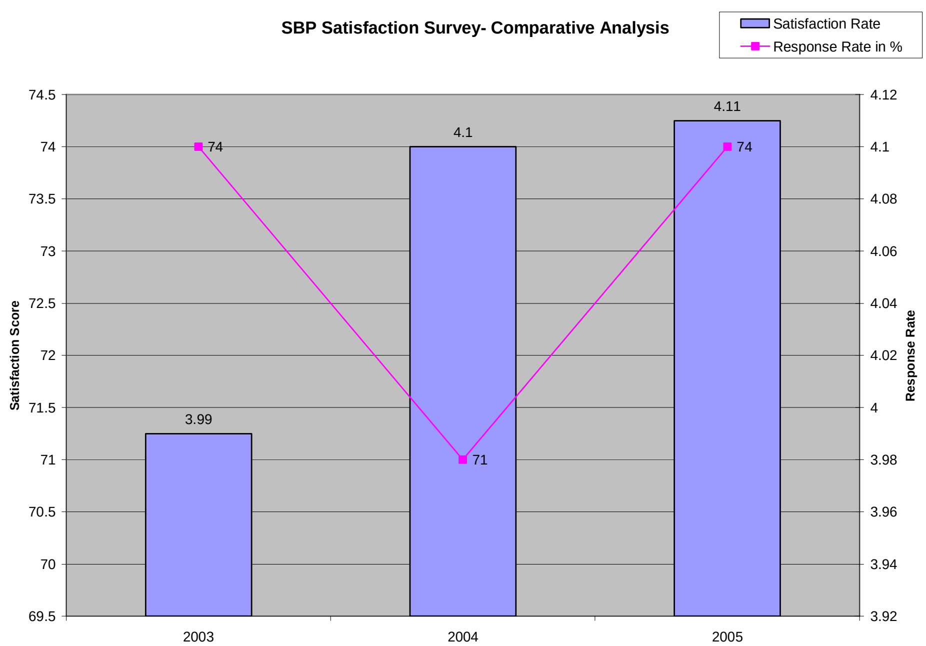
6.7 Employee Motivation Survey

Employee motivation survey has now become an annual feature of SBP's endeavors towards becoming a forward looking organization, committed to its employees' betterment through enhanced morale and motivation. Similar to the previously conducted surveys, Employee Motivation Survey 2005 was administered independently by the external consultants, M/s Ferguson Associates. The survey questionnaire was designed after an in depth comparative study of the last three survey results focusing primarily on the current level of employee satisfaction, employee motivational factors, strengths and weaknesses of employee-related policies and particularly the recently introduced change initiatives and developmental activities.

Figure 6.4

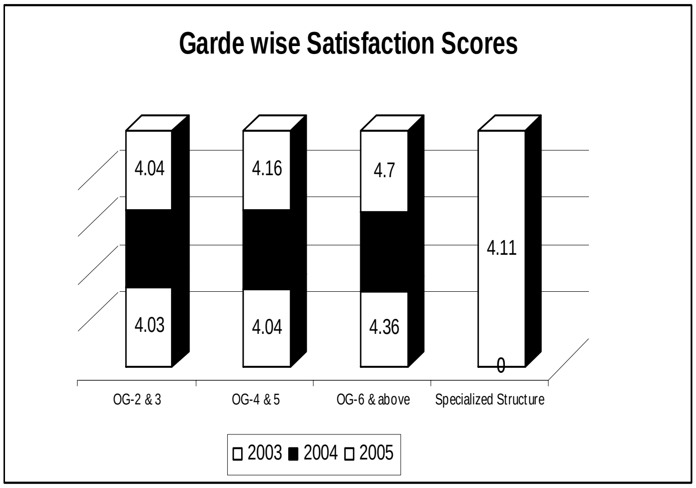
In FY 2005, response rate from 2 departments' viz. Audit and SMED stood 100%, followed closely by BSD, EcoPD, HRD, Accounts and Research indicating clearly employee confidence in the survey process. Even the overall response rate, which had previously dropped to 71%, increased to 74% whereas the satisfaction score inched forward from 3.99 to 4.11 during the last three years (**Figure 6.4**).

Figure 6.4



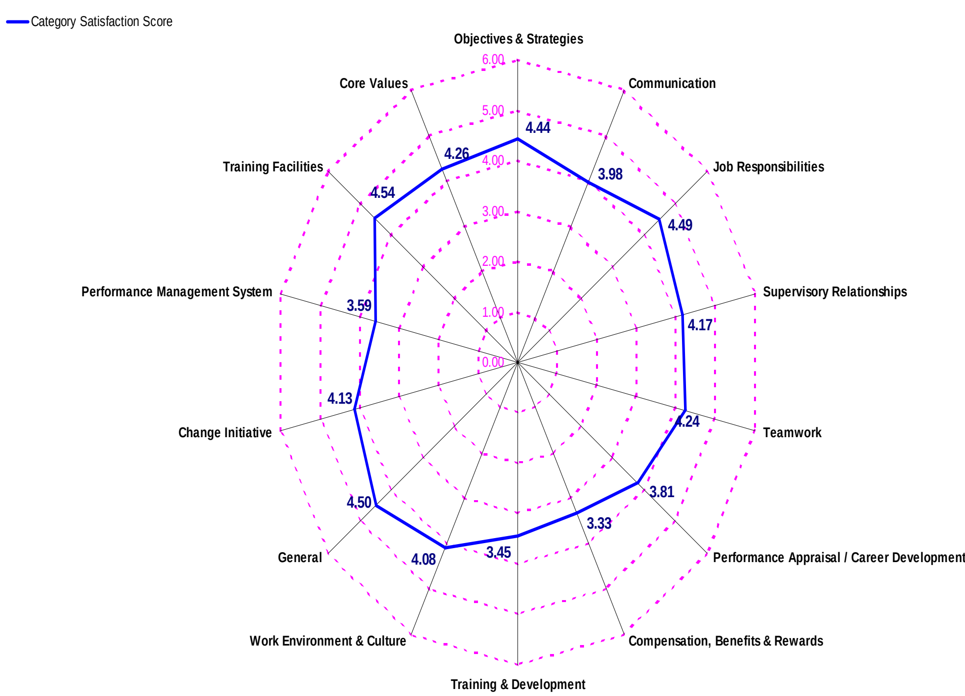
Grade-wise satisfaction score of OG-2 & 3 employees over the period of three years depict slight improvement, but continue to occupy the lowest range in comparison to other grade levels (**Figure 6.5**). The primary areas of concern for this group were reward & recognition policy, on job training and support, performance management system, salary structure, career growth opportunity and job promotion policy. Similar trend is observed in age-wise and service length wise results, where the senior employees showed a higher level of satisfaction.

Figure 6.5



Overall, the survey findings indicate that the employees are satisfied with the training and development activities, their job responsibilities, department's goals and objectives, physical working conditions and the motivation survey process it self, whereas a lot more can be done in the areas pertaining to promotion policy, compensation structure, career growth opportunities & PMS as these received low ratings (**Fig 6.6**).

Figure 6.6



7 INFORMATION TECHNOLOGY DEVELOPMENT

7.1 Overview

State Bank of Pakistan is transforming itself into a modern organization with the support of information technology. The activities which were previously carried out manually have mostly been computerized. This has helped the organization not only to stream line its business processes, reduce inefficiencies in workflows, increase accuracy and security of data information but has also enabled its employees to access real time information allowing them to make more realistic and timely decisions. In addition, employees have also been provided with separate workstations, which are equipped with personal computers connected to intranet, internet, e-mail services and other business system applications.

Since most of the IT projects have now been completed, our focus has shifted towards up gradation of the IT infrastructure and services, formulation and implementation of well defined policies and procedures, training and development of IT human resources, development of succession planning and capacity building while securing the information asset of the bank. In order to face these challenges, SBP embarked upon a recruitment plan for IT, which has recently been completed and the new officers for various functions are expected to join the organization shortly.

Given below is the area-wise progress in major Information Technology areas:

7.2 GLOBUS

During the first quarter of the year 2006 with the completion of branch rollouts, a major milestone of the automation project was achieved. Nevertheless, some work remains to be completed, which surfaced as a result of new and changed requirements. Soon after the branch rollouts and during the FY 2005-06, various end users working at main remote sites (especially Rawalpindi and Lahore) were frequently complaining about the slow system response both during the peak and normal working hours. This became a serious issue which also came to the knowledge of higher management. Teams from Information Systems and Technology Department (ISTD) conducted trouble shooting exercises, carried out detailed studies and mitigated the problems which resulted into significant improvement of systems and network performance. In this connection, IST operates helpdesks that are available to all the users of BSC field offices till the close of their daily business. Despite of all these problems and the enormous increase in the transactions volume, the year-end closing of Accounts for the year 2006-07 was carried out smoothly through the new system. Similarly cash sorting cells have been established at Karachi and Peshawar local offices of SBPBSC-Bank to efficiently manage the currency operations. The GLOBUS team developed and introduced these improvements in the system themselves. Beside, the team also introduced the new denomination notes of Rs.20 and Rs.5,000 in the system without any external help.

The SBP has achieved the task of consolidating bank balances from all the field offices that would enable Banking Supervision Departments to extract data from GLOBUS system in real time for monitoring banks' balances. Also the data from Oracle (ERP) and GLOBUS systems have been integrated with Data Warehouse System, which will enable the SBP to report online data for the

Monetary and Financial Statistics Manual (MFSM). Previously this data was prepared manually by the field offices and the respective accounts departments. The said system is in the final stages of testing and is expected to be launched soon. Once implemented, it will enable SBP to fulfill the requirements of IMF compliance.

Since the systems are now maturing, the end-users require more efficient service level availability and new product development and deployment. Therefore, a number of new projects have been planned, which include the GLOBUS Version Up gradation, connectivity with the RTGS System and introduction of inter-company transactions across BSC field offices. In the backdrop of these initiatives, it is expected that the system efficiency and end-user productivity will increase.

7.3 Enterprise Resource Planning (ERP)

The ERP is an integrated software solution used to manage company's resources. ERP systems integrate all business management functions, including planning, engineering, purchasing, accounting, finance, human resources, and more. Its major benefits include the development of a single integrated system, streamlining processes and workflows, reduce redundant data entry and processes, information sharing across departments, improved access to information and improved workflow and efficiency, which has implemented various modules of Oracle ERP system. ERP implementation at State Bank of Pakistan has automated and integrated business processes across departments onto a single enterprise-wide information system.

The Oracle roll out has been successfully completed in all the offices of SBP (BSC)-Bank. The following is a brief introduction of various ERP Modules introduced at SBP:

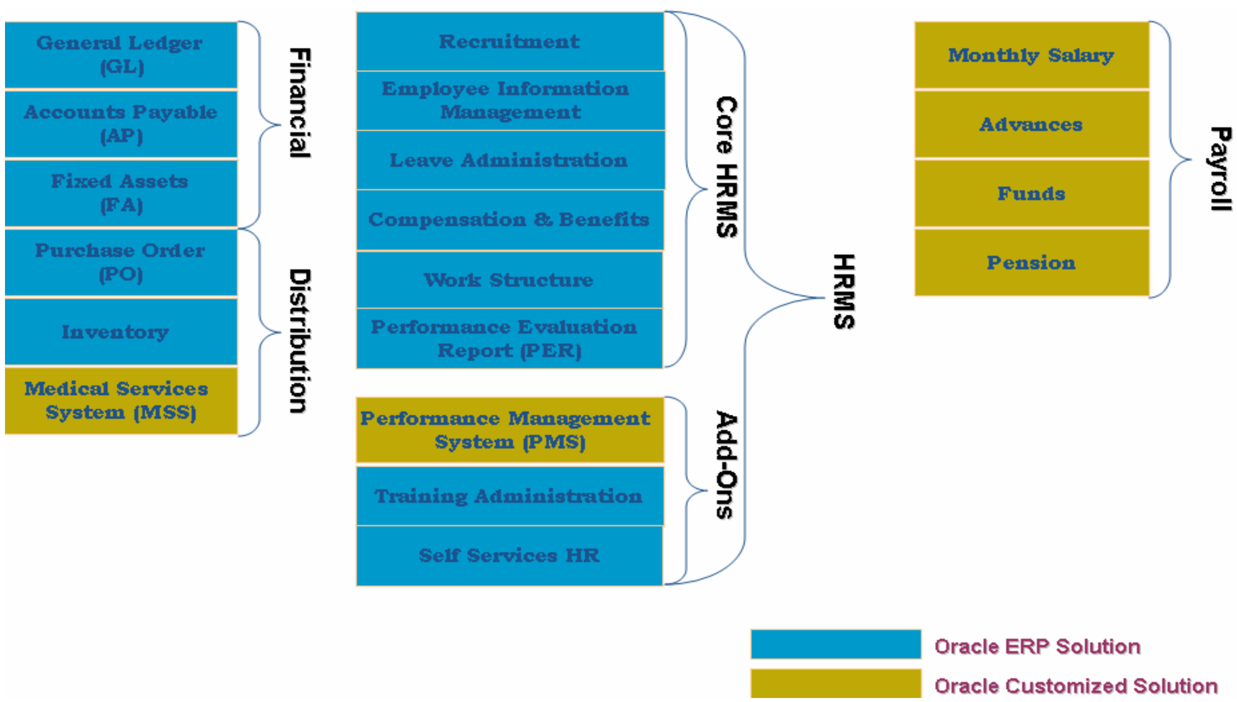
- ***General Ledger (GL) Module***: It records, classifies, consolidates and reports all the entries posted in to the books of accounts
- ***Accounts Payable (AP) Module***: It records all the due payments to vendors, suppliers and employees
- ***Fixed Assets (FA) Module:*** It gives updates to management for additions, transfers, retirements and other unrecorded changes to ensure that asset inventory remains accurate at any point in time.
- ***Purchase Order (PO) Module:*** It automates the procurement activities of the bank.
- ***Inventory Module:*** It automates the management of Asset inventory of the bank
- ***Human Resource Management System (HRMS)***: It consists of Recruitment, Employee Information Management, Leave Administration, Compensation and Benefits, Work Structure and Performance Evaluation Report that cover the entire recruitment cycle, position and career management, succession planning, leaves, benefits plans and head counts budgeting
- ***Performance Management System (PMS):*** It fully automates the traditional performance appraisal paradigm of the Bank to ensure easy administration and control of the performance management.
- ***Oracle Self Service Human Resources (SSHR)***: It enables employees to update their records, leaves, trainings, personal and other relevant information.
- ***Training Administration Module:*** This module has automated the training management processes and hence provides comprehensive planning and management control over training related matters.

In addition to above-mentioned modules, the State Bank of Pakistan has also automated the entire Payroll function of the institution. The Payroll modules which have been implemented and are functional include:

- ***Monthly Salary:*** This module has automated all the processes related to monthly salary preparation for the bank employees.
- ***Advances Module:*** This module has automated the staff loans and personal loans granted to employees.
- ***Funds Module:*** This module has automated the provident fund, insurance and benevolent fund areas
- ***Pension Module*:** This module has automated the retirement benefits offered to Bank employees.

Given below is status summary of ERP implementation (**Figure-7.1**):

Figure-7.1

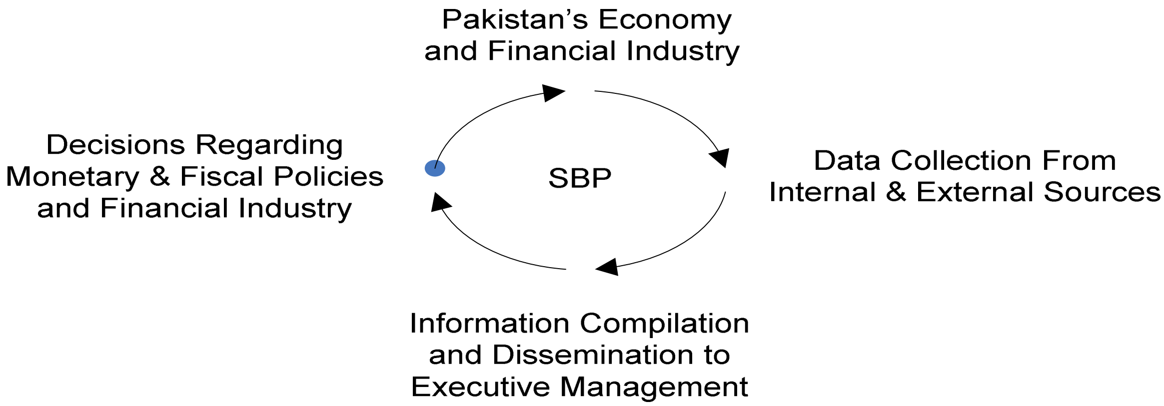


Subsequent to these implementations and deployments, State Bank of Pakistan has planned to upgrade the Oracle Applications Version from 11.5.3 to 11.5.10. The necessary user training and awareness over new Oracle version will also be carried out on need basis.

7.4 Data Warehouse

The information supply chain in State Bank of Pakistan is more or less a closed loop as mentioned in **Figure-7.2.**

Figure-7.2



The State Bank of Pakistan acquires a snapshot of the financial sector by gathering huge data from both inside and outside sources, such as different departments of SBP, SBP-BSC (Bank) and NIBAF, local and foreign banks (operating within the country), Development Finance Institutions (DFIs), Exchange Companies, Government Agencies (e.g. Central Board Revenue, Federal Bureau of Statistics Economic Affairs Division - Ministry of Finance, etc.) and other organizations such as airlines, freight forwarders, etc.

The snapshot of the economy is then built from the information supplied by these disparate sources. The acquired information is captured by SBP at departmental level utilizing desktop software such as excel and word processor, which are usually not meant to analyze data. To better manage this information supply chain, a Data Warehouse was envisioned as a part of Technology Up gradation Project (TUP).

A data warehouse is designed to support ad hoc data analysis, inquiry and reporting by end users on a real time basis. The data warehouses are supposed to provide storage, functionality and responsiveness to queries. In addition, they are set to improve the data access performance of databases.

At State Bank of Pakistan, the data warehouse has been organized into ten subject areas:

DW Subject Areas Supporting Core SBP Functions
- Banking and Money (BAM)
- Agricultural Credit (AC)
- Balance of Payments and Exchange Rates (BOP)

DW Subject Areas Supporting Auxiliary SBP Functions
- Price Trends (PT)
- External Debt (ED)
- Domestic Debt (DD)
- Capital Markets (CPM)
- Socio-Economics (SE)
- Public Finance (PF)
- Economic Growth, Savings and Investment (EGSI)

The focus of Data Warehouse team for the FY 2006-07 is to complete the remaining work and speed up the user sign-off process for completion, while ensuring that all the legacy systems and legacy processes have been replaced so as to add maximum value to the return on investment in SBP Data Warehouse.

7.5 Infrastructure and Telecom

The IT up gradation project has its foundation in the network infrastructure. The Local and Wide area networks connect the 17 offices and all departments to the SBP network.

7.6 Local Area Network (LAN)

SBP has successfully provided LAN facility at SBP, SBP-BSC (Bank) and all officers. The Main Data Center is in Karachi, which has state-of-the-art campus clustered setup for the core applications of GLOBUS and Oracle ERP. A hot back-up site has also been established clustered with the primary site over Fiber Optic cabling system, mirrored with the Primary Server farms in real time. In total more than 3,494 structured 10/100 Megabits per second Local Area Network nodes have been installed so far in SBP, SBP BSC and NIBAF. All network points are powered by conditioned electricity supplied by a heavy duty Uninterrupted Power Supply situated beside the main Data Center and similar electric and data infrastructure has been deployed across all SBP BSC offices.

7.7 Wide Area Network (WAN)

SBP WAN encompasses the nationwide network that interconnects SBP and SBP-BSC offices. Three WAN technologies have been used to connect SBP-BSC offices outside Karachi. They are:

- Microwave Wireless Bridges – for Metropolitan Area Network connectivity in Karachi
- Digital Cross Connect System (DXX)/High bit rate Digital Subscriber Line (DSL)- the Primary WAN medium and
- Single Carrier Per Channel Very Small Aperture Terminal (VSAT) links – the additional WAN connectivity. WAN connectivity over DXX/DSL and VSAT based connectivity has been obtained from reputed vendors.

SBP Infrastructure and Telecom Division have started to implement firewalls in all SBP and SBP-BSC (Bank) offices. Another task that kept this team busy throughout the year 2005-06 was the placement of backup network equipment at all the remote sites to ensure redundancy in the network connectivity, hence keeping the IT resources up and available. The work has also been started on Network Operations Center (NOC) that will ensure real-time monitoring and management of network and related resources. The ultimate goal of the NOC will be high availability and high security of SBP network infrastructure. The ultimate goal of the NOC will be high availability and security of SBP network infrastructure.

7.8 UNIX Server Hosting

In order to avoid disruption and ensure the continuity of the core banking, allied and e-CIB applications, the State Bank of Pakistan maintains two data centers each one is located in the Main Building (sixth floor) and other in the Annexe Building (Ground Floor), which have Hewlett Packard -

UNIX based entry level, mid-range servers and two HP A-Class and four titanium base servers for eCIB application.

7.9 Windows Infrastructure and Applications

The UNIX servers are inherently safer and secure; therefore all the core applications at State Bank of Pakistan are hosted on UNIX operating systems. However, the desktops applications, email, internet and shared file services are deployed on Windows based servers.

Following core services are provided to Desktop users in SBP and BSC offices:

- Enterprise Active Directory for centralized logon and security management
- County-wide setup of E-mail Servers for intranet, internet and emails
- Centralized and automated management of Internet Protocol address through out the network
- Secure Web Mail Access from Internet
- Automated management of anti virus and windows security updates
- Internet Proxy
- Centralized File Sharing services in BSC Karachi and Lahore.

Windows team is geared to upgrade the software and hardware of windows infrastructure to provide the users with up-to-date services that add speed to their work paradigm.

7.10 Training and Development

Keeping in view the importance of IT trainings and to further enhance the skills of the officers of SBP and BSC, Oracle ERP and GLOBUS Banking Application refresher training programs have been started. Initially following trainings were conducted at various locations:

Bhawalpur Office	GLOBUS
Karachi Office	HRMS and MSS
North Nazimabad Office	HRMS

Besides, SBP has also prepared a comprehensive plan for refresher trainings for the next year that will refresh IT skills of both SBP and BSC employees in all offices throughout the country.

SBP Subsidiaries

8 STATE BANK OF PAKISTAN BANKING SERVICES CORPORATION

8.1 Overview

The State Bank of Pakistan Banking Services Corporation (SBP BSC) has made considerable improvement in service delivery system to its stakeholders during FY06. It has achieved some progress in up-gradation of technology in different areas of operations after rollout of GLOBUS Banking solutions and Oracle (ERP) modules. By virtue of online automated work processes, all the field offices and departments of BSC have been inter-linked with each other. The work processes have been modified to make them compatible with the online working environment. To properly incorporate these changes in relevant manuals, the management of BSC has constituted two committees for revamping and modification of Issue Department Manual and Banking Department Manual. The task of modification of Banking Department Manual has been completed whereas the work relating to necessary amendments in Issue Department Manual is under process. BSC continued its efforts to increase the efficiency of its employees and arranged a number of courses to enhance their skill. The policy of job rotations has been implemented which have also improved skill level of employees. During the year, a number of projects to improve physical infrastructure of the bank have been completed. As a result of increased efficiency of its employees, implementation of online currency management system along with improved physical environment, BSC is in a better position to provide quality services to all of its stakeholders i.e. SBP, government departments at federal, provincial and local levels, commercial banks and general public. However there is still room for improvement in terms of systems and controls overall currency management along with reorganization of subsidiary to enhance its efficiencies.

8.2 Corporate Structure of SBPBSC (Bank)

By virtue of SBP Banking Services Corporation Ordinance-2001, all the decisions with respect to policies and future directions are taken by the Board of Directors. The Board comprises of all members of the Central Board of Directors of the SBP and Managing Director of the BSC. The Board of Directors has all the powers of managing the affairs and businesses of BSC. During FY06, the Board of Directors of SBP BSC held seven meetings i.e. three at Karachi, two at Quetta and one each at Muzaffarabad and Lahore.

8.2.1 Constitution of the Sub-committees

Different sub-committees have been constituted to support the Board of Directors to supervise policy and operational matters of particular functional areas of the BSC. There are four sub-committees constituted for this purpose.

- Sub-Committee of the Board on Human Resources
- Sub-Committee of the Board on Audit
- Sub-Committee of the Board on Budget and Expenditure
- Sub-Committee of the Board on Building Projects

The above sub-committees are actively monitoring various operations in the above mentioned functional areas of the BSC and analyzing the issues referred to them as per their terms of reference approved by the Board.

8.3 Currency Management

Management of currency in a cash-based economy is one of the main functions being performed by the BSC. BSC is actively engaged in managing stock of banknotes and coins, withdrawal of soiled notes from circulation and their disposal, note processing and destruction of soiled notes and anti counterfeit measures. In order to meet the cash transactions of the federal government, provincial governments and remittance facilities to the public, currency chests are being maintained by the Issue Division at different stations across the country. Previously BSC had been performing this function through manual work processes, which were less efficient and time consuming.

In addition risk was also involved with the manual handling of the job. Now computerized systems of issue accounting function are operational in four Issue Offices. The existing payment environment is predominately cash based and one of the strategic goals of BSC is to gradually change the environment from physical transactions to more efficient online transactions under the support and guidance of SBP. Transactions pertaining to the issuance of fresh / re-issuable notes and destruction of soiled / defective notes are being recorded and maintained through GLOBUS banking solution by the field offices.

Environment friendly techniques for destruction of soiled / defective notes through note shredding machines have been adopted by most of the offices. During FY06, BSC continued its efforts to vigorously implement the Clean Note Policy of the SBP. Consequently the quality of banknotes in circulation has improved over the years. The new banknotes of Rs.20/- and Rs.5000/- denomination were also introduced during FY06. Further a new designed note of Rs.10/- denomination has also been introduced during FY06. After stopping the issuance of Rs.5/- denomination banknote, sufficient quantity of coins of all denominations particularly Rs.5/- coins were provided to the designated branches of commercial banks to issue the same to the general public. Moreover the field offices of BSC also handled the huge task of demonetizations of Rs.5/- banknote efficiently.

8.4 Banker to the Government

BSC manages accounts of federal, provincial and local governments and provides them facilities of receipts, payments and transfer of funds etc. Government departments also carry out transactions through country-wide network of chests comprising designated branches of NBP and Treasury / Sub-Treasury Offices. For this purpose field offices of BSC replenish sufficient stock of notes / coins at these chests falling in their jurisdiction. Field offices of BSC efficiently collected all federal and provincial taxes including income tax, sales tax, central excise duty, customs duty etc., on behalf of the government. The data on these taxes was communicated to CBR and Accounts Department of BSC HOK through online computerized network on daily basis. Sixteen field offices of BSC have collected CBR taxes amounting to Rs.686.2 billion during FY06 as compared to Rs.593.0 billion in the preceding year.

The operational work relating to public debt is also managed by BSC. In addition to operational management of debt instruments like Federal Investment Bonds, Pakistan Investment Bonds, Treasury

Bills etc; various instruments of national savings schemes launched by the Central Directorate of National Savings such as Special Savings Certificates (SSC) / Defence Savings Certificates (DSC) and National Prize Bonds are also being managed by the BSC efficiently. The number of cases handled by BSC regarding sale, encashment and profit payment of one instrument SSC stood at 674,228 during FY06 as compared to 756,539 during FY05.

8.5 Operational Arm of the SBP

SBP has also assigned some other operational tasks to BSC. The BSC performs these jobs in a highly professional way. Some of the important functions are as under:

8.5.1 Export Finance-Disbursement and Monitoring

In order to provide credit to export sector, SBP has formulated credit schemes viz. Export Finance Scheme (EFS), Islamic Export Refinance Scheme (IERS) and Scheme for Long-Term Financing for the Export Oriented Projects (LTF-EOP) and is providing refinance to banks under these schemes.

All operational matters of these schemes are being managed by the BSC. The field offices of BSC provide refinance to the banker of the exporter and release the amount within 48 hours on receipt of the refinance claim complete in all respect. These offices also ensure recovery of amount granted on the respective due date by debit to the account of the concerned commercial bank. BSC is also entrusted with the responsibility of on-site verification of export refinance cases under Part I of the scheme handled by the commercial bank branches. The reason of on-site verification is to ensure that funds are utilized for the purpose they were provided to commercial banks and loans are granted strictly in accordance with the instructions of SBP. In order to streamline the verification process of export refinance cases, a Central EFS Verification Unit has been established at SBP BSC Head Office, Karachi.

The objectives of this initiative are to maintain uniformity in the on-site verification process at all field offices, provide necessary guidance to the officers deputed for the verification duty and to prepare a consolidated report on each bank on the basis of information collected by the verification teams for onward submission to SBP. In addition, the relevant authorities of commercial bank are also apprised of the lapses / irregularities detected during the course of verification, and a meeting is held with them to discuss the lapses with a view to identify ways and means to avoid the recurrence of the same. Total number of transactions handled by the field offices of BSC under Export Refinance cases i.e. grant, repayment of loan and remuneration (share of profit) stood at 128,560 during FY06 as compared to 133,064 transactions processed during the preceding year. Central EFS Verification Unit has started preparation of consolidated verification report on findings of the verification teams. So far six reports have been prepared and sent to SBP for necessary action.

8.5.2 Foreign Exchange Operations and Adjudication

SBP BSC has been assigned the operational work relating to foreign exchange under SBP BSC Ordinance 2001. While the Exchange Policy Department of SBP is engaged in formulation and implementation of foreign exchange policies, the Foreign Exchange Operations Department (FEOD) of SBP BSC is responsible for operational work relating to foreign exchange. The scope of the FEOD consists of implementation of foreign exchange policies by monitoring and overseeing the operations of the Authorized Dealers. With a view to provide timely and updated information to stakeholders FEOD home page on EBB has been revamped and information about the department such as remittances on account of Reuters and SWIFT charges, amount of Letter of Credit opened, etc were placed on board and updated regularly. In addition to the courses offered by NIBAF, a separate departmental training program has been planned to accommodate the specific requirements of the officials of the department. With a view to improve efficiency, achieve accuracy and ensure quick disposal of cases, the operations of the department has been switched over from manual to automated work processes during the FY 06. FEOD is now performing its functions on the computerized system. Packages in MS Access have been prepared with the help of Information Systems Department for the functions of Exchange Accounts and Research and Development Support. During FY06, Foreign Exchange Adjudication Department has arranged realization of stuck up export proceeds equivalent to US $ 8.287 million as compared to realization of over due export proceeds of US $ 6.260 million during the corresponding period, indicating a net increase of US $ 2.027 million. The detail of the amount realized by the Adjudication Courts at Karachi, Lahore, Faisalabad including Multan, and Sialkot during 2005-06 vis-à-vis 2004-05 is given in the following **Table-8.1.**

Table 8.1: Amount Realized By Adjudication Courts (Amount in US $)

Adjudication Court	2004-05	2005-06	Increase/Decrease (percent)
Karachi	936,323	3,851,586	311.3
Lahore	2,807,360	1,067,686	-62.0
Faisalabad	1,441,450	1,408,277	-2.3
Sialkot	1,074,718	1,959,314	82.3
Total	6,259,851	8,286,863	32.4

8.5.3 Local Credit Advisory Committees

Local Credit Advisory Committees (LCACs) have been constituted to keep close contact with all stakeholders of the SBP. LCAC at each field office continued to play its role by helping in resolution of various problems of the stakeholders during FY06, keeping in view the policies / rules formulated by SBP in respect of relevant sphere of activities. LCAC / Sub Committee under the chairmanship of Chief Managers of field offices held 61 meetings during FY06 with the representatives of business / trade associations, farmer associations and Chambers of Commerce and Industry as compared to 56 meetings last year. In addition 27 small towns were visited by Chief Managers as compared to 23 in preceding year. Through the forum of LCAC, Chief Managers of BSC updated the stakeholders at regional level regarding various schemes, policies and financial services of SBP. A review of the problems identified / discussed during LCAC meetings revealed that most of the problems related to mark up rate on Export Finance Scheme, mark up on agriculture credit and non cooperative attitude of bank employees.

8.5.4 Operational Role in Monetary Management

Field offices of BSC continued to provide operational support to SBP for implementation of the monetary policy. SBP BSC offices maintain Current Accounts and Other Deposit Accounts of stakeholders in Deposit Accounts Department to maintain their CRR and Statutory Liquidity Requirement and facilitate concerned departments of SBP for monitoring the same including providing back office support in the auction of Treasury Bills and PIBs.

8.5.5 Payment System

As an operational arm of SBP, BSC is supporting the SBP in promotion of sound and safe payment and settlement system in the economy. NIFT is providing automated clearing services. During FY06, NIFT has accepted BSC proposal for establishment of separate clearing house for each city. Consequently necessary instructions were issued to NIFT for undertaking the automated cheque clearing facilities at remaining field offices of BSC i.e. Gujranwala, Sialkot, Bahawalpur, D.I.Khan, Sukkur and Muzaffarabad in consultation with commercial banks and respective Chief Manager of BSC office. Accordingly the clearing process at all SBP BSC offices has been automated except Muzaffarabad office. BSC is also playing an important role in the development of Real-time Gross Settlement (RTGS) since the start of the project. RTGS is one of the projects initiated to establish an integrated payment and settlement in the country. The Chief Manager Karachi Office is a member of Payment Settlement Group and provides feedback to Payment Systems Department whenever necessary. BSC has also initiated the task of Standardization of Government Payment Instruments in line with the commercial market. Accordingly standardization of payment instruments (colours, shades, standard size etc) used by the federal and provincial government departments is in process. It will bring efficiency, provide more control over the payment process, minimize the chances of fraud and reduce turnaround time for the stakeholders.

8.6 Human Resources

BSC is actively engaged in improving the efficiency of its personnel. To improve the efficiency of human capital and motivate its employees to excel their skill, BSC has been taking initiatives to redesign human resource policies. BSC has also focused on effective implementation of policies relating to rotation of jobs, promotions, motivation and training etc. The total number of regular employees working in BSC at the end of June 2006 were 5,323 consisting of 643 employees at Head Office and 4,680 employees at its 16 field offices. Moreover, 207 employees were also working on contract/ daily wages or part time basis in different capacity. The details of the strength of human resource in BSC are given in **table 8.2**. BSC is constantly engaged in improving the skills of its human resource through training and development programs in different areas. During FY06, 176 officials of Head Office and 667 officials of field offices attended training programs offered by NIBAF, Institute of Bankers Pakistan and other training institutes. Further, a policy of regular rotation and promotions has been introduced which will groom the capable and committed officers for higher positions.

Table 8.2 Working Strength Of SBP BSC
As on 30-06-2006

S. #	SIDE	HOK	Field Office	Total
1	On Secondment	10	9	19
2	On Deputation	2	10	12
3	General Side	393	2,233	2,626
4	Cash Side	0	1,995	1,995
5	Engineering Side	132	137	269
6	Other Technical /Ex-Cadre etc	106	296	402
	Total	**643**	**4,680**	**5,323**

9 NATIONAL INSTITUTE OF BANKING AND FINANCE

9.1 Overview

The State Bank of Pakistan (SBP) needs to continuously strive for strengthening of its core functions and enhancement of professional competencies, to cope with the emerging challenges in the financial sector. In this regard, National Institute of Banking and Finance (NIBAF) being the training arm of SBP has been playing an important role towards development of human capital at SBP, its subsidiary and the financial sector in general.

A substantial progress was attained in the design, development and delivery of three broad categories of training programs during FY 2005-06. For the second consecutive year, the actual training delivery exceeded the targets set forth in the Business Plan (BP). A total target of 224 weeks set forth for the FY 05-06, comprising of 194 weeks for SBP, SBP (BSC), International and Rural Finance Programs while the remaining 30 weeks were allocated for outsourced programs. Against this target, the actual training delivered was 274 weeks including 205 weeks delivered by NIBAF and 69 weeks outsourced (**Table-9.1**).

Table-9.1: Training Delivery and Coverage FY06 (in weeks)

Training Programs		Target			Actual delivered			
		ISD	KHI	Total	ISD	KHI	Total	Shortfall/Excess
A	SBP	65	48	113	33	66	99	-14
	Post induction	65	0	65	33	…	33	-32
	Skill up-Gradation	…	48	48	…	66	66	+18
	a) Foundation	…	15	15	…	29	29	+14
	b) Intermediate	…	23	23	…	24	24	+1
	c) Advance	…	10	10	…	13	13	+3
B	BSC	21	10	31	33	10.5	43.5	+ 12.5
C	International Programs	15	-	15	13	…	13	- 2
D	Rural Finance	5	…	5	3	1	4	-1
E	Islamic Banking	…	…	…	3	12	15	+15
F	Other Financial Institutions	24	6	30	29.5	1	30.5	+0.5
	TOTAL WEEKS	130	64	194	114.5	90.5	205	+11
G	Total Trainees			1800	1186	1637	2823	+1023

Apart from catering to the needs of SBP and SBP (BSC) and the annual international training programs, NIBAF continued with its commitment to focus on capacity building in the financial sector. Its noteworthy contributions included need based trainings for commercial banks focused on bank credit, foreign trade and general banking practices, as well as post induction programs.

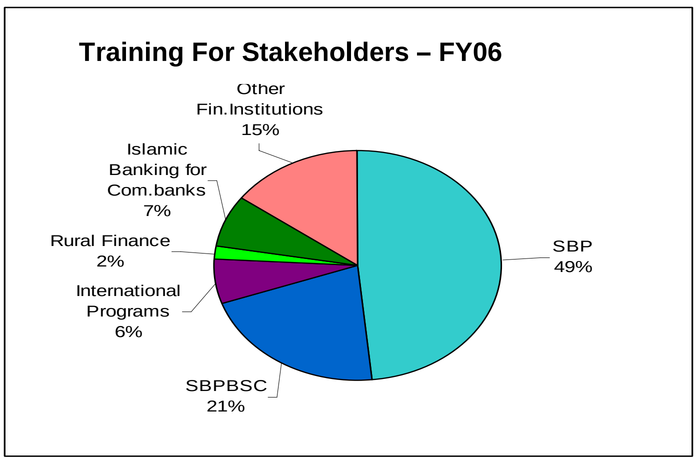
With the collaboration of SBP, NIBAF also provided trainings to financial institutions in the development areas like SME Finance and launched a Islamic Banking Certificate Course. Both of these courses have been appreciated and are in demand from the financial sector.

A significant achievement in terms of training delivery this year was that five 3 week sessions of Islamic Banking Certificate Course were delivered that was not a part of the original Business Plan. Moreover, NIBAF has had to adjust its training plan to cater to the additional training needs of SBP and SBP (BSC) by conducting 18 additional weeks in Skills Upgradation to SBP and 12 extra weeks for BSC OG-1 (Promotees) Program.

Similarly overall target set for training coverage was 1,800 participants whereas increase in coverage achieved was 2,823 that included 1,354 participants from SBP, 772 from SBP (BSC), 109 international participants, and 588 from the finance sector (**Figure 9.2**).

SBP and SBP (BSC) continue to be the main stakeholders as both account for 70percent (49percent and 21 percent respectively) of the overall training delivered by NIBAF (**Figure 9.1**). However, with a view to diversify the training base, the institute's major policy thrust was to gradually bring other financial institutions under its fold. This led to major breakthrough in marketing NIBAF's services and facilities during FY 2005-06 by increasing the scope aand size of trainings. It was mainly on account of planned efforts made by NIBAF to deliver customized programs for capacity building of local as well as foreign institutions.

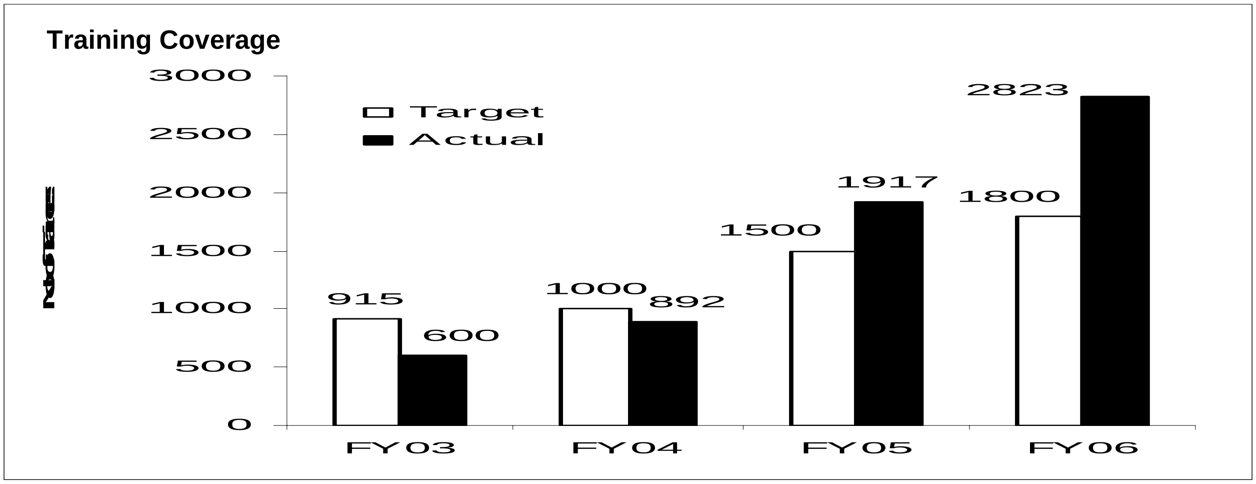
Figure 9.1



The successful launch of Islamic Banking Certificate Course for commercial bankers is another milestone in the achievements for FY06. The course was designed and developed by NIBAF through a consultative process with all stakeholders, local and foreign experts and international agencies. To meet the increased demand five certificate courses each of three weeks duration were conducted both at NIBAF Karachi and Islamabad campuses.

The two regular international courses conducted by NIBAF also received wide acclaim as the Institute succeeded in increasing the level of country participation. Last year a record number of 28 countries participated and now this training facility has been extended to more developing countries of different regions. It may be noted that participation by foreign central and commercial bankers as well as local bankers on self finance basis in NIBAF courses is also increasing.

Figure 9.2



A customized Management Development Program for Da Afghanistan Bank (DAB), central bank of Afghanistan was conducted under the Memorandum of Understanding)MOU) between DAB and SBP for capacity building of their officials during the year 2005-06. The training efforts of NIBAF were appreciated and resultantly DAB has requested SBP for further training arrangements. Similarly Afghanistan International Bank is also seeking to develop long-term relationship with NIBAF for capacity building of their staff in the areas of commercial banking, accounting, auditing, management skills etc.

In order to promote awareness and develop skills in the areas of SME and rural finance, NIBAF organized a number of seminars/workshops in collaboration with several partners and microfinance service providers. An international seminar named “Beyond Charity: Commercial Opportunities in Micro and Small Business” was organized in partnership with Shorebank International of USA. Moreover, four SME workshops were also held for banks/DFIs in collaboration with Bankakademie International of Germany. An enterprise development program of 3 weeks duration was organized for female employees of First Micro Finance Bank in collaborative arrangement with ECI and UNDP.

To be institute of International repute, a number of initiatives were undertaken for improving relevance and quality of trainings considered important for human resource development of the financial sector. These included:

- Review of SBP Training Curriculum and its realignment with the organizational goals after consultations with the curriculum committees comprising of SBP, external trainers and practitioner
- s in their respective fields.
- A series of advance courses were designed, developed and delivered for senior and middle management of SBP and SBP (BSC) to keep them abreast with the latest knowledge and practices.
- Emphasis was laid on developing a system of effective feedback and evaluations of the training programs.

9.2 State Bank of Pakistan

As highlighted in the above given tables, against the overall target of 113 training weeks set forth for trainings to SBP staff, actual trainings delivered were for 99 weeks including 33 weeks of post induction training and 66 weeks of Skill Up-gradation. Here, the actual delivery of Skill Up-gradation courses was more than the target because of increased demand from SBP. The post induction courses fell short of target as the new recruitment of trainees under SBOTS-10 joined NIBAF for training in the last quarter of FY06. As the need for foundation level courses has almost been addressed by NIBAF, therefore, the focus of training has now shifted towards intermediate and advanced level Courses that stood 56 percent of the total skill upgradation program delivered.

9.3 SBP-BSC (Bank)

Keeping in view the training needs of SBP (BSC) at all levels, a target of 31 weeks training was set, however, their demand for training exceeded the target and a total of 43.5 weeks were delivered. This was mainly due to additional demand for design and delivery of a special program for OG-1 Promotees through competitive examination in SBP (BSC). In this regard a 12 weeks customized training program was designed to cater to their needs that were delivered at NIBAF Islamabad Campus.

9.4 International Training Programs

The major success of international programs was in expanding the outreach of the two regular Training Programs of commercial and central banking under Pakistan Technical Assistance Program (PTAP) during FY06. These programs are rapidly gaining popularity and were attended by nominees from over 28 different developing countries. An increasing participation on self finance basis in our training programs reflects international recognition of quality training imparted by the institute.

NIBAF also played a key role in organizing a SAARCFINANCE seminar on “Conduct of Monetary Policy and Management of Capital Flows” in collaboration with SBP. The delegates from SAARC member countries participated in the seminar which provided an opportunity for exchanging experiences and views on a very vital issue faced by Central banks.

9.5 Training Programs for Commercial Banks and Financial Institutions

NIBAF provided need based training at post induction and skill up-gradation level to various banks in the newly emerging areas of Islamic Finance, SME Finance and Rural Finance besides training in bank credit, foreign trade and general banking. In this regard following activities are noteworthy:

- A second customized post induction ‘Management Training Program’ for KASB Bank on commercial banking of 18 weeks duration was designed and delivered at NIBAF Islamabad Campus.
- NIBAF successfully entered into partnership with Bank Alfalah and a customized skill up gradation program of 8 weeks duration was designed and delivered for middle level officers in the areas of general banking, credit and foreign trade.
- To strengthen knowledge, skills and understanding of the working and organizational role, NIBAF continued to organize programs during FY06 for the newly recruited staff of SECP in the areas of International Accounting Standards and the Company Law.

- Four workshops for commercial banks on SME finance were organized in collaboration with SBP and Bankakademia International of Germany. The objective of these programs was to develop the requisite skills/capacity for SME financing and to enhance the flow of credit to SMEs in Pakistan.
- Under a collaborative arrangement with M/s Empowerment Thru Creative Integration (ECI) an enterprise development program of 3 weeks duration was organized at NIBAF, Islamabad.
- Moreover, NIBAF facilitated training initiatives of other banks/institutions namely Ministries of Finance, Housing, Women Development, Health, Commerce; Khushali Bank, National Accountability Bureau (NAB), Pak Oman Micro Finance Bank, NEPRA and various other stakeholders in the conduct of their programs.

9.6 Rural Finance Resource Center (RFRC)

A number of reform programs were initiated by the government like Rural Finance Sector Development Program (RFSDP) with the assistance of ADB aimed at accelerating rural economic growth by addressing the key constraints in Rural Finance (RF). As implementing agency to RFSDP, SBP established RFRC at NIBAF entrusted with the task of building capacity for commercial banks, Micro Finance Banks (MFBs), NGOs and to enhance their skills through training in rural and micro finance. In order to achieve the objectives the following progress is made:

- Necessary infrastructure has been made available for in-house training that is equipping RFRC with required teaching aids and equipment.
- A comprehensive plan for training is being developed for MFBs and Commercial Banks.
- Curriculum has been designed and developed for different target groups through a specialized curriculum committee.
- A number of training programs have been arranged in collaboration and coordination with different stakeholders like UBL, Khushhali Bank, SME Bank, BSC, IBP, Bank Alfalah and Pak Oman Bank, First Micro Finance Bank.
- A three weeks course on Enterprise Development for 36 Officers of the First Micro Finance Bank and 20 Women Entrepreneurs was successfully designed and delivered aimed at developing a network of trainers cum counselors in business in Northern Areas and Chitral in collaboration with ECI.
- An International Seminar on “Beyond Charity Commercial Opportunities in Micro and Small Business” was organized in collaboration with Shorebank International for sharing knowledge and regional experiences. About 120 delegates including Leaders in micro finance and mainstream banking including SBP, Commercial Bankers, USAID, World Bank, IFC, Pakistan Microfinance Network (PMN), Tameer Micro finance Bank, Kashf Foundation, Khushhali Bank, Pakistan Poverty Allivation Fund, Grameen Foundation USA, Asasah, First Micro Finance Bank, Citi Group Bangladesh, JCR VIS, and ShoreBank International attended the seminar.
- The European Commission approached NIBAF for establishing and promoting cooperation through sharing of regional experience in the area of rural and micro finance and launching certificate course for MFBs. In this context, 1st Consultative Workshop on Development of Certification Course for Microfinance Banks in Pakistan was organized jointly by NIBAF and EC in September this year that was attended by all stakeholders, ZTBL, MFBs. etc.

9.7 Islamic Banking Certificate Course

In view of the requirements for training and education in the field of Islamic Banking, SBP took a strategic decision in December 2004 to provide the relevant trainings to both the internal and external stakeholders. In this context, NIBAF designed 3-weeks Intermediate to Advance level Certification Course keeping in view the practical requirements of the stakeholders in Islamic Banking. The course contents are based on 16 modules developed through a detailed consultative process involving professional bankers, Sharia Scholars, and Islamic Banking Division of NIBAF.

Here, a positive response was received both from the Islamic Banks and the conventional banks. So far 5 courses have been conducted at NIBAF Karachi and Islamabad and a total of 186 officers of different commercial banks have attended this course. Owing to the increasing demand 9 weeks of training delivery have been allocated for this course in the current Business Plan.

The course went very well and registered excellent success in terms of coverage, training delivery, coordination/administration and the program as a whole. The sessions also included group work on Product Development and Securitization, Case Studies and Workshops on deposit management, pricing in Murabaha (trade finance) and Diminishing Musharaka (Housing finance), AAOIFI's Accounting Standards and Documentation in Murabaha, Ijarah and Diminishing Musharaka.

The participants are evaluated for each module and at the end there is a comprehensive test. Only participants scoring above the threshold level i.e. 60percent in each of the modules and the comprehensive test with 65percent overall weighted score are awarded certificates. The participants who are not able to achieve the threshold are given one chance to make up for the deficiency.

9.8 Introducing and Strengthening Systems/Procedures

In order to impart quality training on a sustainable basis, it is important to have well-entrenched systems, procedures and the formats for improved training methodology, evaluation and conduct of training programs. A lot of efforts are being taken in this direction to gain efficiency and to deliver quality trainings. The following major initiatives have so far been taken in this direction:

9.8.1 Training Curriculum Revision

A systematic approach has been introduced to revise and revamp training curriculum on a continuous basis. The mechanism envisages a compulsory revision of curriculum according to well-developed procedures after every 2 years. For this purpose curriculum committees are formulated for different modules. These committees are comprised of professionals having relevant expertise and vast experience including director of relevant department from SBP and SBP (BSC), an academician, a professional with practical experience along with Training Manager being the convener. The procedure laid down for curriculum revision committees is as follows:

- The Training Manager, would place the current curriculum along with revisions proposed, required in the curriculum based on feedback/interaction with the trainers and trainees.
- The first draft of the revised curriculum, therefore, prepared in consultation with the Team Leader is distributed amongst the members of the committee for their review, comments, feedback and suggestions. The Training Manager would then revise and prepare a Final Draft of the curriculum that is circulated.
- A meeting of the members of the committee would then be scheduled to discuss and approve the revised draft curriculum.

The training curriculum for Post Induction and Skills Upgradation and International Training Programs that were introduced in FY 02 have now been revised and refurbished and would be implemented during the year FY-06 after following the procedures laid down in the above mechanism.

9.8.2 Development of Trainers' Database

A comprehensive database of trainers is established with a built in system of continuous updations and review. This has helped and increased the robustness of the system involving trainers' identification, selection and back up choices in case of the non-availability of lead trainer. Moreover training endeavors of other organizations are also supported and many tend to rely on trainers identified in our roster.

9.8.3 Mechanism for Trainers' Evaluation

Trainers' Ranking Criteria is developed based on their qualification, training experience, professional experience, trainees' feedback and Training Manager's feedback. Weights are assigned to the feedback mechanism and trainers are ranked accordingly. The system involves an objective approach and ranking of trainers eventually helps in selection and subsequent engagement of the trainers. Such a mechanism assists in decision making process for deployment and compensation.

9.8.4 Expanding the Range of Courses

In addition to the existing five advance level courses, four new courses are designed for SBP and SBP (BSC). These courses are based on the most recent topics and current needs including "Mergers and Acquisitions in Financial Sector", "Advanced Financial Statement Analysis", "Monetary and Exchange Rate Management", "and Risk Management and Basel-II".

Some additional modules like Payment Systems, SBP Finance Schemes, Research Methodology, Report Writing and Presentation Skills, and Islamic Banking have now been included in the Post Induction and Skills Upgradation Programs thereby enhancing scope and exposure to new recruitees.

Training program on SME Financing was introduced in collaboration with trainers from *Bankakademie* of Germany.

Moreover various modules on Post Induction programs for commercial banks are designed. These include Financial Management in Banks, Strategic Management, Treasury Operations, Marketing of Financial Services, Risk Management in Banks, change management etc.

9.9 Development of Information Systems

A web site of NIBAF has been developed to share information about NIBAF and its training programs with all the stakeholders. Further, a link has also created with SBP web page which was a long desired objective. A detailed weekly Activity Roster highlighting the upcoming programs at both the campuses of NIBAF is also being displayed regularly on SBP web page. The video conferencing equipment has been installed at Islamabad Campus and internet link with SBP Library established. A new telephone exchange has replaced the old non-functional system.

In short, most of the training programs are designed and delivered with a view to develop knowledge and skills of its internal and external. As part of its overall strategic planning, NIBAF remains committed to provision of quality training, up gradation of human resources and building of relationship with partner institutions to strengthen training endeavors

Finances of SBP and Subsidiaries

10 ANNUAL BUDGET REVIEW 2005-06

10.1 Overview

A comparison of actual versus budgeted expenditure of the SBP and its subsidiaries is given in the **table 10.3 & Figure 10.1.** The total expenditures are classified into three broad categories, namely corporate expenses, establishment expenses and operating expenses. The relative size of each of these heads in total expenditure is as under:

Table 10.1: Breakup of SBP expenditure during FY 2005-06 (in percentage terms)

Description	Budget	Actual
Corporate expenses	49.4	50.9
Establishment expenses	34.8	34.4
Operating expenses (including NIBAF expenditure)	15.8	14.7
Total	**100.0**	**100.0**

As indicated by table 11.1, on overall basis, total consolidated expenditure of SBP and its subsidiary amounted to Rs.9,996.2 million as against budget of Rs.10,015.5 million thus showing nominal positive variance of 0.2 percent. The variance of actual results against budget, in term of three major heads is as under (**Table-10.2**):

Table 10.2: Head wise variance of actual from budget (in percentage terms)

Description	Variance
Corporate expenses	(-)2.7
Establishment expenses	(+)1.4
Operating expenses (including NIBAF expenditure)	(+)6.6

The above position indicates that actual result exhibit nominal variance from the budget.

Head wise analysis of expenditure is hereunder for which details are available in **table 10.4**.

10.2 Corporate Expenses

Corporate expenses of the Bank comprise of three components viz agency commission to National Bank of Pakistan (NBP), note printing charges and charges on allocation of Special Drawing Rights (SDRs). Head wise analysis of corporate expenses is given as under.

1. *Agency Commission Charges:* Agency commission charges are paid to National Bank of Pakistan on conducting Government transactions and remittances on behalf of SBP as per agency agreement between both the parties.

   Agency commission paid to NBP showed the largest negative variance of 18.4 percent due to enhanced volume of government transactions. The government transactions have increased by 26 percent as evident from **table 10.5.**

2. *Note printing charges:* Positive variance of 10percent has been witnessed in note printing charges. During the year bank has issued new designed currency notes of Rs.10, Rs.20 and Rs.5,000.

3. *Charges on Allocation of SDRs:* The charges on allocation of SDRs also gave negative variance of 15.5 percent due to depreciation of PKR's parity with SDRs. PKR depreciated from Rs.87.37 as on 30th June 2005 to Rs.89.15 as on 30th June 2006 and increase in interest rate of SDR which was 3.71 percent on 30th June 2006 as compared to 2.54 percent last year.

Above two adverse variances in "Agency Commission Charges" and "Charges on Allocation of SDRs" were to a large extent offset by the positive variance of around 10 percent on account of note printing charges. Consequently overall variance in "Corporate Expenses" results in overall negative variance of 2.71 percent.

10.3 Establishment Expenses

Establishment expenses include employees' salaries and benefits and training expenditure. The establishment expenditure showed positive variance of 1.4 percent. The three major items showing significant variation from the budget are rest and recreation, other benefits and training expenditure. The positive variation was due to preoccupation of employees in the rollout of IT at field offices.

10.4 Operating Expenses

Operating expenses include rent rates and taxes, legal and professional charges, stationery and publications, communication, traveling expenditure, repair and maintenance, depreciation etc. On overall basis, operating expenses have shown positive variance of 7.2 percent owing primarily to decline in communication expenses, fee paid to outsiders, and depreciation. However it was partly offset by negative variance of 8.63 percent of NIBAF resulting in overall positive variance of 6.6 percent for operating expenses including NIBAF.

See *Attachment-A* on Annual Budget Review 2005-06

11 ANNUAL FINANCIAL PERFORMANCE REVIEW

11.1 Overview

During the year under review, the net income of the Bank witnessed phenomenal increase of around 120 percent over the income of preceding year. The net profit of the Bank which was Rs. 31,049 million for the financial year 2004-05 (FY04-05) increased to Rs. 68,184 million in FY 2005-06. The exceptional rise is *interalia*, attributable to rising volume of Government borrowings from the Bank, increase in the yield on such borrowings and increase in the interest rates on the foreign currency assets.

The detailed analysis of expenditure and income is given below:

11.2 Expenditure

A comparison of Bank's expenditure for the current year and immediately preceding year is as under:

Table 11.1: Corporate cost, establishment cost and operating expenses

(Rupees in million)

Description	2006	2005
Corporate cost	5,084	4,565
Establishment cost	5,421	4,441
Operating expenses	1,536	1,338
Total	**12,041**	**10,344**

The corporate cost of the Bank comprises of agency commission, note printing charges and charges on allocation of Special Drawing Rights (SDR). The increase in corporate cost is attributable to increase in agency commission paid to National Bank of Pakistan (NBP) due to enhanced volume of Government transactions and increase in charges on allocation of SDRs emanating from depreciation of PKR's parity with SDRs. PKR depreciated from Rs. 87.37 as on 30th June 2005 to Rs. 89.15 as on 30th June 2006 and increase in interest rate of SDR which was 3.71 percent on 30th June 2006 as compared to 2.54 percent on 30th June 2005.

The establishment cost has two components, namely current salaries and benefits (60.51 percent) and provisions for retirement benefits (39.49 percent) primarily based on actuarial advice. The current salaries and benefits increased by 7.33 percent, *interalia*, due to annual merit increase. The provision for retirement benefits increased by 54.58 percent which is due to increase in interest cost on rising balance of defined benefit obligation and increasing trend in the medical expenditure.

The increase in operating expenses is mainly due to increase in amortization of software and maintenance of Bank's properties and equipments.

11.3 Income

11.3.1 Net Interest Income

The primary source of increase in net profit of the Bank for FY 2005-06 is increase in net interest income which increased from Rs. 27,473 million in FY 2004-05 to Rs. 65,893 million. The net interest income has two components, namely discount, interest / markup / return earned and interest expense. The variation in each of these two heads is explained below:

11.3.2 Discount, Interest/ Markup and/or Return Earned

The income under this head represents interest income (Table 12.2) on domestic assets (Table 12.3) and interest on foreign assets (Table 12.4). The discount, interest/markup income increased from Rs. 29,757 million in FY 2004-05 to Rs. 69,940 million. The major contributories giving rise to this increase are discount income on Market Treasury Bills (MTBs), interest on foreign currency reserves and markup on loans and advances to Governments, banks and financial institutions. The increase in discount income on MTBs is attributable to exceptional rise in the Federal Government borrowings from the Bank as well as increase in the yield thereon (Table 12.3). The markup on loans and advances to banks and financial institutions primarily arise on the export refinance provided to banks and financial institutions. During the financial year 2005-06, the increase in income on export refinance is due to increase in the rate of markup. The average markup rate for FY 2005-06 was 7.5 percent as against average rate of 3.9 percent during the previous financial year.

The year under review witnessed significant increase in the interest rate in international markets. The quantum of this increase may be gauged from the increase in discount rate of Federal Reserve Bank of New York which ranged from 3.25 percent to 5.25 percent in FY 2005-06 as compared to the range of 1.25 percent to 3.0 for the FY 2004-05.

The breakup of interest income in terms of domestic and foreign assets is as under:

Table 11.2: Interest/Discount/Return Income on Foreign and Domestic Assets

(Rupees in million)

Description	**2006**	**2005**
Interest/discount income on foreign assets	23,982	15,023
Interest/discount income on domestic assets	45,958	14,734
Total	**69,940**	**29,757**

Table 11.3: Lending to Government, Banks and Financial Institutions

(Rupees in million)

Description	**2006**	**2005**
Government securities	517,626	332,129
Overdraft to Governments	26,904	22,814
Banks and financial institutions	216,584	215,180
Total	761,114	570,123
Yield on Treasury Bills	7.94 percent to 8.49 percent	2.08 percent to 7.94 percent
Markup on Export finance	7.5 percent	1.5 percent to 6.5percent

Table 11.4: Foreign Currency Reserves

(Equivalent PKR in million)

Description	2006	2005
Investments	196,421	180,149
Deposit Accounts	490,545	424,008
Current accounts	2,915	7,870
Special drawing rights with IMF	13,124	13,569
Total	**703,005**	**625,596**

11.3.3 Interest / Markup Expense

Interest / markup expense increased from Rs. 2,284 million in FY 2004-05 to Rs. 4,048 million in FY 2005-06. Bank pays interest on commercial banks' foreign currency deposits held under Cash Reserve Requirement (CRR) and borrowings from International Monetary Fund (IMF), international organizations and other central banks. The increase in interest/markup expense is due to increase in interest rates on CRR deposits (which ranged from 2.34 percent to 4.11 percent during FY 2005-06 as compared to the range of 0.87 percent to 2.13 percent during FY 2004-05). The interest expense on deposits of foreign central banks and international organizations ranged from 3.28 percent to 6.62 percent during FY 2005-06 as against a band of 1.79 percent to 4.74 percent during FY 2004-05.

11.3.4 Commission Income

The income under this head represents the income from management of public debt, issuance of Drafts and Payment Orders, Prize Bonds and National Saving Certificates. The commission income amounted to Rs. 441 million in FY 2005-06.

11.3.5 Exchange Gain/(Loss) – Net

The exchange gain /(loss) arise on the sale/purchase of foreign currencies, SDR transactions and revaluation of foreign currency assets and liabilities. Primarily, the Bank's foreign currency exposure is concentrated in two currencies, namely US dollar (USD) and SDRs. Appreciation/depreciation of Pak Rupee (PKR) against various international currencies is indicated in Table 12.5.

Table 11.5: Exchange Gain/(Loss) – Net

Currency	EXCHANGE RATE		Appreciation / (Depreciation)	
	30.06.2006	30.06.2005	2005-06	2004-05
US Dollar	60.20	59.69	(0.85) percent	(2.56) percent
Pound Sterling	109.22	108.27	(0.87) percent	(2.14) percent
Japanese Yen	0.52	0.54	3.85 percent	
Euro	75.46	71.96	(4.64) percent	(1.76) percent
SDR	89.15	87.37	(2.00) percent	(2.45) percent

Exchange gain for the year decreased from Rs. 13,828 million in FY 2004-05 to Rs. 4,376 million in FY 2005-06 (Table 12.6). The main reason for the decrease in decline in the depreciation of PKR against US dollar from 2.56 percent in FY 2004-05 to 0.85 percent in FY 2005-06. In view of the net asset exposure of the Bank in USD, the depreciation of PKR impacts favorably. However, in case of SDR, the Bank has net liabilities exposure. Accordingly, depreciation of PKR versus SDR impacts Bank's profit and loss adversely. The breakup of exchange account is as under.

Table 11.6 Breakup of the Exchange Account

(Rupees in million)

	2006	2005
Gain / (loss) on:		
- Foreign currency placements, deposits and other accounts - net	5,468	15,692
- Open market operations (including currency swap arrangements)	(15)	185
- Forward covers under Exchange Risk Coverage	147	(106)
- Payable to the International Monetary Fund (IMF)	(1,224)	(1,943)
Total	**4,376**	**13,828**

11.3.6 Dividend Income

Bank's equity portfolio comprised of investment in share capital of banks and financial institutions. The portfolio is worth Rs. 26.545 billion (at cost) as at 30th June 2006. The Bank earned dividend income of Rs. 1,975 million for FY 2005-06 as compared to dividend income of Rs. 1,502 million in the FY 2004-05. The increase in dividend income is attributable principally to enhanced dividend payout by NBP.

11.3.7 Other Operating Income

The Income under this head represents income derived from penalties on banks and financial institutions, fee from Credit Information Bureau (CIB) services, profit on sale of securities and gain or loss on mark to markets of securities and derivatives. The operating revenue for the financial year 2005-06 amounted to Rs. 799 million as compared to Rs. 328 million in previous year. The increase in income is due to increase in penalties on banks and financial institutions, and profit on sale of securities partially set off by increase in loss on re -measurement of held for trading securities.

11.3.8 Other income

The Bank's income from other than normal operations comprise of gain on disposal of property, plant and equipments, profit on sale of investments (other than held for trading), write back of provisions and liabilities no longer required and amortization of deferred income. Bank derived income of Rs. 7,289 million during the FY 2005-06 from other than normal operations as compared to income of Rs. 4,204 million in FY 2004-05. The increase in other income is primarily attributable to write back of liability on demonetization of Rs. 5 Banknote.

11.4 Distributable Profit

The distributable profit of the Bank for FY 2005-06 amounted to Rs. 68,244 million including the un appropriated profit of Rs. 60 million brought forward from previous year and after accounting for provisions for loans and advances and other assets amounting to Rs. 548 million. The distribution of above profit is given in Table 12.7.

Table 11.7: Distribution of profit

(Rupees in million)

Description	2006
Dividend	10
Transfer to Reserve Fund	19,142
Surplus profit transferable to Federal Government	49,092
Total	**68,244**

11.4.1 Summary of Profit and Loss Account

To recapitulate, the summary of profit and loss account is tabulated below:

Table 11.8: Summary Statement of Profit and Loss

(Rupees in million)

Description	2006	2005
Income		
Net Interest Income	65,893	27,473
Exchange Gain	4,376	13,828
Dividend Income	1,975	1,502
Commission	441	693
Other Operating Income	799	328
Other Income	7,289	4,203
Gross Income	**80,773**	**48,027**
Expenditure		
Corporate Costs	5,084	4,565
Establishment Costs	5,421	4,441
Other Operating Expenses	1,536	1,338
Provisions	548	6,634
	12,589	**16,978**
Net Profit	**68,184**	**31,049**

12 CONSOLIDATED FINANCIAL STATEMENTS OF SBP AND ITS SUBSIDIARIES

See Attachment-B

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
A-35, CAVISH COURT
BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the annexed consolidated financial statements comprising consolidated balance sheets of the **Issue and Banking Departments of the State Bank of Pakistan and its subsidiaries, SBP Banking Services Corporation and National Institute of Banking and Finance (Guarantee) Limited** as at June 30, 2006 and the related consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes forming part thereof, for the year then ended. We have also expressed separate joint opinions on the financial statements of the State Bank of Pakistan and its subsidiary, SBP Banking Services Corporation. The other subsidiary, National Institute of Banking and Finance (Guarantee) Limited was audited by another firm of chartered accountants, whose report has been furnished to us and our opinion in so far as it relates to the amounts included for such company, is based solely on the report of such other auditors.

It is the responsibility of the Bank's management to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with the International Accounting Standards and Accounting Policies for investments and transactions and balances with International Monetary Fund (IMF) as stated in note 4.2 and 4.14 respectively to the financial statements approved for adoption by the Central Board of the Bank. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

The Bank has maintained a provision of Rs. 2,016 million relating to net assets recoverable from the Reserve Bank of India, the Government of India and those pertaining to transactions in former East Pakistan. This provision has been recorded as other liability of the Banking department and the relevant assets and liabilities have not been netted off. Accordingly, assets of the Issue Department and Banking department are overstated by Rs. 2,433 million and Rs. 4,923 million respectively and liabilities and unrealized appreciation on gold reserve of the Banking Department are overstated by Rs. 6,118 million and Rs. 1,238 million respectively.

Except for the financial effect of the matter stated in the preceding paragraph:

(a) in our opinion the consolidated balance sheets and related consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards and Accounting Policies for investments and transaction and balances with IMF as stated in note 4.2 and 4.14 respectively to the consolidated financial statements approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied; and

(b) in our opinion and to the best of our information and according to the explanations given to us, the consolidated balance sheets, consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards and Accounting Policies for investments and transactions and balances with IMF as stated in note 4.5 and 4.14 respectively to the consolidated financial statements approved for adoption by the Central Board of the Bank, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the affairs of the Bank and its subsidiaries as at June 30, 2006 and of the profit, its cash flows and changes in equity for the year then ended.

Without further qualifying our opinion, we draw attention to the note 31 to the consolidated financial statements. The classification of SDR Allocation of IMF either as equity or debt is currently being considered by a committee formed by IMF. The decision of the committee may require a change in accounting policy as described in the said note.

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

1. STATUS AND NATURE OF OPERATIONS

State Bank of Pakistan (the Bank) is the Central Bank of Pakistan and is incorporated under the State Bank of Pakistan Act, 1956. The Bank is primarily responsible for the management of credit, foreign exchange and currency in the country and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- implementing the monetary policy;
- issuing of currency;
- facilitation of free competition and stability in the financial system;
- licensing and supervision of banks including micro finance banks, development financial institutions and exchange companies;
- organisation and management of the inter-bank settlement system and promotion of smooth functioning of payment systems;
- providing of loans and advances to the Government, banks, financial institutions and local authorities under various facilities;
- purchase, holding and sale of shares of banks and financial institutions on the directives of the Federal Government; and
- acting as depository of the Government under specific arrangements between the Government and certain institutions.

1.2 The subsidiaries of the Bank and the nature of their respective activities are as follows:

- SBP Banking Services Corporation – wholly owned subsidiary

  SBP Banking Services Corporation was established under the SBP Banking Service Corporation Ordinance, 2001 and commenced its operations with effect from January 2, 2002. It is responsible for carrying out certain statutory and administrative functions and activities principally relating to public dealing on behalf of the State Bank of Pakistan.

- National Institute of Banking and Finance (Guarantee) Limited - shareholding at 59.4%

  National Institute of Banking and Finance (Guarantee) Limited was incorporated under the Companies Ordinance, 1984 as a company limited by guarantee. The Institute is engaged in providing education and training in the field of banking, finance and allied areas.

2. STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with the requirements of International Accounting Standards (IASs) and policies for investments and transactions and balances with International Monetary Fund as stated in note 4.2 and 4.14 respectively approved for adoption by the Central Board of the Bank. Under the power conferred by the State Bank of Pakistan Act, 1956, the Central Board approved IAS-1 to IAS-38 for adoption. Where the requirements of policies adopted by Central Board differ with the requirements of International Accounting Standards adopted by Central Board, the requirements of policies adopted by Central Board take precedence.
The consolidated financial statements include collectively the financial statements of the State Bank of Pakistan (Bank) and its subsidiaries (the Group). Financial statements of the subsidiaries have been consolidated on a line-by-line basis.

All inter-group balances and transactions have been eliminated.

3. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention, except that investments, gold reserves and certain fixed assets, as referred to in notes 4.2, 4.3 and 4.4 have been included at revalued amounts.

The preparation of financial statements in conformity with International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, requires management to make judgements estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experiences and various other factors that are believed to be reasonable under the circumstances, the result of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Judgments made by the management in the application of International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, that have significant effect on the financial statements and estimate with significant risk of material judgment in the next year are discussed in note 48 to these financial statements.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4.1 Bank notes and coins

The liability of the Bank towards bank notes issued as a legal tender under the State Bank of Pakistan Act, 1956 is stated at the face value and is represented by the specified assets of the Issue Department of the Bank. The cost of printing of notes is charged to the profit and loss account as and when incurred. Any unissued bank notes lying with the Bank are not reflected in the books of account.

The Bank also issues coins of various denominations on behalf of the Government of Pakistan (GoP). These coins are purchased from the GoP at their respective face values. The unissued coins form part of the assets of the Issue Department.

4.2 Investments

All investments acquired by the Bank are initially measured at cost being the fair value of consideration given. Transaction costs are included in the initial measurement of investments. Subsequent to initial measurement, the Bank measures and classifies its investments under the following categories:

Held for trading
These securities are either acquired for generating a profit from short term fluctuations in market price, interest rate movements, dealer's margin or securities included in a portfolio in which a pattern of short term profit making exists. These instruments are subsequently re-measured to fair value. All related realized and unrealized gains and losses are recognised in the profit and loss account.

All purchases and sales of investments categorised as held-for-trading that required delivery with the time frame established by regulation or market convention ('regular way' purchases and sale') are recognised at the trade date, which is the date Bank commits to purchase or sell the investment, other wise transactions are treated as derivative until settlement occurs.

Held to maturity
These are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity other than loans and receivables. These securities are carried at amortized cost, less impairment losses, if any, and premiums and/or discounts are accounted for using effective interest method.
All regular way purchases and sale are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of impairment loss for assets carried at amortised cost is calculated as the difference between the asset's carrying amount and present value of expected future cash flows discounted at the financial instrument's original effective interest rate.

Loans and receivables
These are financial assets created by the Bank by providing money directly to a debtor. Subsequent to initial recognition, these investments are carried at amortised cost and premiums and/or discounts are accounted for using the effective interest method.
All loans and advances are recognised when cash is advanced to borrowers. When a loan is uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited in the profit and loss account.

An allowance for impairment is established if there is evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans and advances. The amount of the provision is the difference between the carrying amount and the recoverable from guarantees and collateral, discounted at the original effective interest rate of loans and advances.

Available for sale securities (AFS)
These are the securities which do not fall in any of the above three categories. Subsequent to initial recognition the changes in fair value of these securities is taken to equity except the strategic investments including investments in National Bank of Pakistan, Habib Bank Limited, Allied Bank Limited and United Bank Limited and investments in securities the fair value of which cannot be determined reliably. Gain or loss on changes in fair value is kept in equity until the investments are sold or disposed off, or until the investments are determined to be impaired, at that time cumulative gain or loss previously reported in the equity is included in profit and loss account.

Fair value of the financial instruments classified as held-for-trading and available for sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held-for-trading or available-for-sale are de-recognised by the Bank on the date it commits to sell the investments. Securities held-to-maturity is de-recognised on the day these are transferred by the Bank. Gains and losses on de-recognition of held for trading, held to maturity and AFS securities are taken to profit and loss account.

Derivative financial instruments
The Bank enters into derivative financial instruments, which include forwards and currency swaps. Derivatives are initially recorded at cost and are re-measured to fair value on subsequent reporting dates. Forwards are shown under Commitments in the note 34.2 while the asset and liability portion of a currency swap are presented in Other Assets and Other Liabilities in notes 21 and 27 to the financial statements. The resultant gains or losses from derivatives are included in the profit and loss account.

Collateralised borrowings / lending

Securities sold subject to a commitment to repurchase them at a pre-determined price, are retained on the balance sheet and a liability is recorded in respect of the consideration received in "Securities sold under agreement to repurchase". Conversely, securities purchased under analogous commitment to resell are not recognised on the balance sheet and a consideration paid is recorded in "Securities purchased under agreement to resell". The difference between the sale and repurchase price in the repurchase transactions and the purchase price and resale price in reverse repurchase transaction represents an expense and income respectively and recognised in the profit and loss account on an accrual basis.

4.3 Gold reserves

Gold reserves, including those held with the Reserve Bank of India, are stated at the revalued amounts of the fine gold content thereof in accordance with the requirements of the State Bank of Pakistan Act, 1956 and the State Bank of Pakistan General Regulations. Appreciation or depreciation, if any, on revaluation is taken to equity under the head of "unrealised appreciation on gold reserves" account. Appreciation realised on disposal of gold is credited to the profit and loss account.

4.4 Property, plant and equipment

Property, plant and equipment except land, buildings and capital work in progress are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Free hold land is stated at revalued amount. Lease hold land and buildings are stated at revalued amount less accumulated depreciation and accumulated impairment losses, if any, while capital work-in-progress is valued at cost.

Depreciation on property, plant and equipment are charged to profit and loss account applying the straight-line method whereby the cost/revalued amount of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted / disposed off. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income.

Surplus arising on revaluation of property, plant and equipment is credited to surplus on revaluation of property, plant and equipment. The surplus on revaluation realised on disposal of property, plant and equipment is transferred to equity.

4.5 Intangibles

Intangible assets are amortised using straight-line method over the period of three years. Where the carrying amount of an asset exceeds its estimated recoverable amount it is written down immediately to its recoverable amount. Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any.

4.6 Impairment

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indication exists, the recoverable amount of such assets is estimated. An impairment loss is recognised in profit and loss account whenever the carrying amount of an asset or a group of assets exceeds its recoverable amount. Balances considered bad and irrecoverable are written off from the books of account. Provisions against impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognised as income / expense in the profit and loss account.

4.7 Compensated absences

The Bank makes annual provision in respect of liability for employees' compensated absences based on actuarial estimates.

4.8 Staff retirement benefits

The Bank operates:

a) an un-funded contributory provident fund (old scheme) for those employees who joined prior to 1975 and have opted to remain under the old scheme;
b) an un-funded general contributory provident fund (new scheme) for all employees who joined after 1975 and those employees who had joined prior to 1975 but have opted for the new scheme;
c) following other staff retirement benefit schemes:
   - an un-funded gratuity scheme for all its employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled only to pension scheme benefits;
   - an un-funded pension scheme;
   - an un-funded benevolent fund scheme; and
   - an un-funded post retirement medical benefit scheme.

Obligations for contributions to defined contribution provident plans are recognised as an expense in the profit and loss account as incurred.

Annual provisions are made by the Bank to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out under the Projected Unit Credit Method. Unrecognised actuarial gains and losses are recognised in the profit and loss account over the expected average remaining working lives of the employees.

The above staff retirement benefits are payable on completion of prescribed qualifying period of service.

4.9 Deferred income

Grants received on account of capital expenditure are recorded as deferred income. These are amortised over the useful life of the relevant asset.

4.10 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on time proportion basis that takes into account the effective yield on the asset. However, income on balances with Bangladesh (former East Pakistan), doubtful loans and advances and overdue return on investments are recognised as income on receipt basis.

- Dividend income is recognised when the Bank's right to receive dividend is established.

- Gains on disposal of securities are recognised in profit and loss account at trade date.

- All other revenues are recognised on accrual basis.

4.11 Finances under profit and loss sharing arrangements

The Bank provides various finances to financial institutions under profit and loss sharing arrangements. Share of profit / loss under these arrangements is recognised on accrual basis.

4.12 Taxation

The income of the Bank is exempt from tax under section 49 of the State Bank of Pakistan Act, 1956.

4.13 Foreign currency translation

Transactions denominated in foreign currencies are translated to Pak Rupees at the foreign exchange rate ruling at the date of transaction. Monetary assets and liabilities in foreign currencies are translated into rupees at the rates of exchange prevailing at the

balance sheet date or at contracted rates. Exchange gains and losses are taken to the profit and loss account except for certain exchange differences on balances with the International Monetary Fund, referred to in note 4.14, which are transferred to the Government of Pakistan account.
Exchange differences arising under Exchange Risk Coverage Scheme and on currency swap transactions are recognized in the books of account on accrual basis.

Commitments for outstanding forward foreign exchange contracts disclosed in note 34.2 to the financial statements are translated at forward rates applicable to their respective maturities. Contingent liabilities / commitments for letters of credit and letters of guarantee denominated in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date.

4.14 Transactions and balances with International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards and the guidelines contained in the IMF Manual, Aide Memoir and specific arrangements entered into between the Bank and the Government. A summary of the policies followed by the Bank for recording of these transactions and balances is as follows:

- The Government's contribution for quota with the IMF is recorded by the Bank as depository of the Government and exchange differences arising under these arrangements are transferred to the Government account.

- Exchange gains or losses arising on revaluation of borrowings from the IMF are recognized in the profit and loss account.

- The cumulative allocation of Special Drawing Rights by the IMF is treated as capital receipt and is not revalued.

- from the current year on the directive of Government of Pakistan, all income or charges pertaining to balances with the IMF are taken to the profit and loss account, previously, income or charges pertaining to balances with the IMF were taken to the Government account, except for the following which were taken to the profit and loss account:

  - Charges on borrowings under credit schemes other than fund facilities,
  - Charges on net cumulative allocation of Special Drawing Rights; and
  - Return on holdings of Special Drawing Rights.

4.15 Provisions

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are reviewed at each balance sheet date and are adjusted to reflect the current best estimates.

4.16 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities that are realizable in known amounts of cash within three months and which are subject to insignificant changes in value.

4.17 Financial instruments

Financial assets and liabilities are recognized at the time when the Bank becomes a party to the contractual provisions of the instrument. The Bank derecognizes financial asset when it loses control of the contractual rights that comprise the financial asset. The Bank derecognizes a financial liability when the liability is extinguished, discharged, cancelled or expired.

Any gain or loss on the derecognizing of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include foreign currency reserves, investments, loans and advances, government accounts, other deposits accounts and liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

4.18 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

13 FINANCIAL STATEMENTS OF SBP

See Attachment-C

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
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M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
A-35, CAVISH COURT
BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the annexed balance sheets of the Issue and Banking Departments of the **State Bank of Pakistan** as at June 30, 2006 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof (here-in-after referred to as the 'financial statements'), for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Bank's management to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with the International Accounting Standards and Accounting Policies for investments and transactions and balances with International Monetary Fund (IMF) as stated in note 4.2 and 4.14 respectively to the financial statements approved for adoption by the Central Board of the Bank. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

The Bank has maintained a provision of Rs. 2,016 million relating to net assets recoverable from the Reserve Bank of India, the Government of India and those pertaining to transactions in former East Pakistan. This provision has been recorded as other liability of the Banking department and the relevant assets and liabilities have not been netted off. Accordingly, assets of the Issue Department and Banking department are overstated by Rs. 2,433 million and Rs. 4,923 million respectively and liabilities and unrealized appreciation on gold reserve of the Banking Department are overstated by Rs. 6,118 million and Rs. 1,238 million respectively.

Except for the financial effect of the matter stated in the preceding paragraph:

(c) in our opinion the balance sheets and related profit and loss account, cash flow statement and statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards and Accounting Policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 respectively to the financial statements approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied; and

(d) in our opinion and to the best of our information and according to the explanations given to us, the balance sheets, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards and Accounting Policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 to the financial statements approved for adoption by the Central Board of the Bank, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the Bank's affairs as at June 30, 2006 and of the profit, its cash flows and changes in equity for the year then ended.

Without further qualifying our opinion, we draw attention to the note 31 to the financial statements. The classification of SDR Allocation of IMF either as equity or debt is currently being considered by a committee formed by IMF. The decision of the committee may require a change in accounting policy.

KPMG TASEER HADI & CO. **CHARTERED ACCOUNTANTS** **KARACHI**	**M. YOUSUF ADIL SALEEM & CO.** **CHARTERED ACCOUNTANTS** **KARACHI**
DATE: 07th September 2006	**DATE: 07th September 2006**

State Bank of Pakistan
Notes to the Financial Statements
For the year ended June 30, 2006

1. STATUS AND NATURE OF OPERATIONS

State Bank of Pakistan (the Bank) is the Central Bank of Pakistan and is incorporated under the State Bank of Pakistan Act, 1956. The Bank is primarily responsible for the management of credit, foreign exchange and currency in the country and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- implementing the monetary policy;
- issuing of currency;
- facilitation of free competition and stability in the financial system;
- licensing and supervision of banks including micro finance banks, development financial institutions and exchange companies;
- organisation and management of the inter-bank settlement system and promotion of smooth functioning of payment systems;
- providing of loans and advances to the Government, banks, financial institutions and local authorities under various facilities;
- purchase, holding and sale of shares of banks and financial institutions on the directives of the Federal Government; and
- acting as depository of the Government under specific arrangements between the Government and certain institutions.

2. STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with the requirements of International Accounting Standards (IASs) and policies for investments and transactions and balances with International Monetary Fund as stated in note 4.2 and 4.14 respectively approved for adoption by the Central Board of the Bank. Under the power conferred by the State Bank of Pakistan Act, 1956, the Central Board approved IAS-1 to IAS-38 for adoption. Where the requirements of policies adopted by Central Board differ with the requirements of International Accounting Standards adopted by Central Board, the requirements of policies adopted by Central Board take precedence.

3. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention, except that investments, gold reserves and certain fixed assets, as referred to in notes 4.2, 4.3 and 4.4 have been included at revalued amounts.

The preparation of financial statements in conformity with International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, requires management to make judgements estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experiences and various other factors that are believed to be reasonable under the circumstances, the result of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Judgments made by the management in the application of International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, that have significant effect on the financial statements and estimate with significant risk of material judgment in the next year are discussed in note 49 to these financial statements.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4.1 Bank notes and coins

The liability of the Bank towards bank notes issued as a legal tender under the State Bank of Pakistan Act, 1956 is stated at the face value and is represented by the specified assets of the Issue Department of the Bank. The cost of printing of notes is charged to the profit and loss account as and when incurred. Any unissued bank notes lying with the Bank are not reflected in the books of account.

The Bank also issues coins of various denominations on behalf of the Government of Pakistan (GoP). These coins are purchased from the GoP at their respective face values. The unissued coins form part of the assets of the Issue Department.

4.2 Investments

All investments acquired by the Bank are initially measured at cost being the fair value of consideration given. Transaction costs are included in the initial measurement of investments. Subsequent to initial measurement, the Bank measures and classifies its investments under the following categories:

Held for trading

These securities are either acquired for generating a profit from short term fluctuations in market price, interest rate movements, dealer’s margin or securities included in a portfolio in which a pattern of short term profit making exists. These instruments are subsequently re-measured to fair value. All related realized and unrealized gains and losses are recognised in the profit and loss account.

All purchases and sales of investments categorised as held-for-trading that required delivery with the time frame established by regulation or market convention (‘regular way’ purchases and sale’) are recognised at the trade date, which is the date Bank commits to purchase or sell the investment, other wise transactions are treated as derivative until settlement occurs.

Held to maturity
These are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity other than loans and receivables. These securities are carried at amortized cost, less impairment losses, if any, and premiums and/or discounts are accounted for using effective interest method.
All regular way purchases and sale are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of impairment loss for assets carried at amortised cost is calculated as the difference between the asset’s carrying amount and present value of expected future cash flows discounted at the financial instrument’s original effective interest rate.

Loans and receivables
These are financial assets created by the Bank by providing money directly to a debtor. Subsequent to initial recognition, these investments are carried at amortised cost and premiums and/or discounts are accounted for using the effective interest method.
All loans and advances are recognised when cash is advanced to borrowers. When a loan is uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited in the profit and loss account.

An allowance for impairment is established if there is evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans and advances. The amount of the provision is the difference between the carrying amount and the recoverable from guarantees and collateral, discounted at the original effective interest rate of loans and advances.

Available for sale securities (AFS)
These are the securities which do not fall in any of the above three categories. Subsequent to initial recognition the changes in fair value of these securities is taken to equity except the strategic investments including investments in National Bank of Pakistan, Habib Bank Limited, Allied Bank Limited and United Bank Limited and investments in securities the fair value of which cannot be determined reliably. Gain or loss on changes in fair value is kept in equity until the investments are sold or disposed off, or until the investments are determined to be impaired, at that time cumulative gain or loss previously reported in the equity is included in profit and loss account.

Fair value of the financial instruments classified as held-for-trading and available for sale is their quoted bid price at the balance sheet date.
Financial instruments classified as held-for-trading or available-for-sale are de-recognised by the Bank on the date it commits to sell the investments. Securities held-to-maturity is de-recognised on the day these are transferred by the Bank. Gains and losses on de-recognition of held for trading, held to maturity and AFS securities are taken to profit and loss account.

Derivative financial instruments
The Bank enters into derivative financial instruments, which include forwards and currency swaps. Derivatives are initially recorded at cost and are re-measured to fair value on subsequent reporting dates. Forwards are shown under Commitments in the note 34.2 while the asset and liability portion of a currency swap are presented in Other Assets and Other Liabilities in notes 21 and 27 to the financial statements. The resultant gains or losses from derivatives are included in the profit and loss account.

Collateralised borrowings / lending
Securities sold subject to a commitment to repurchase them at a pre-determined price, are retained on the balance sheet and a liability is recorded in respect of the consideration received in "Securities sold under agreement to repurchase". Conversely, securities purchased under analogous commitment to resell are not recognised on the balance sheet and a consideration paid is recorded in "Securities purchased under agreement to resell". The difference between the sale and repurchase price in the repurchase transactions and the purchase price and resale price in reverse repurchase transaction represents an expense and income respectively and recognised in the profit and loss account on an accrual basis.

4.3 Gold reserves

Gold reserves, including those held with the Reserve Bank of India, are stated at the revalued amounts of the fine gold content thereof in accordance with the requirements of the State Bank of Pakistan Act, 1956 and the State Bank of Pakistan General Regulations. Appreciation or depreciation, if any, on revaluation is taken to equity under the head of "unrealised appreciation on gold reserves" account. Appreciation realised on disposal of gold is credited to the profit and loss account.

4.4 Property, plant and equipment

Property, plant and equipment except land, buildings and capital work in progress are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Free hold land is stated at revalued amount. Lease hold land and buildings are stated at revalued amount less accumulated depreciation and accumulated impairment losses, if any. Capital work-in-progress is valued at cost.

Depreciation on property, plant and equipment are charged to profit and loss account applying the straight-line method whereby the cost/revalued amount of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted / disposed off. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income.

Surplus arising on revaluation of property, plant and equipment is credited to surplus on revaluation of property, plant and equipment. The surplus on revaluation realised on disposal of property, plant and equipment is transferred to equity.

4.5 Intangibles

Intangible assets are amortised using straight-line method over the period of three years. Where the carrying amount of an asset exceeds its estimated recoverable amount it is written down immediately to its recoverable amount.

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any.

4.6 Impairment

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indication exists, the recoverable amount of such assets is estimated. An impairment loss is recognised in profit and loss account whenever the carrying amount of an asset or a group of assets exceeds its recoverable amount. Balances considered bad and irrecoverable are written off from the books of account. Provisions against impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognised as income / expense in the profit and loss account.

4.7 Compensated absences

The Bank makes annual provision in respect of liability for employees' compensated absences based on actuarial estimates.

4.8 Staff retirement benefits

The Bank operates:

a) an un-funded contributory provident fund (old scheme) for those employees who joined prior to 1975 and have opted to remain under the old scheme;
b) an un-funded general contributory provident fund (new scheme) for all employees who joined after 1975 and those employees who had joined prior to 1975 but have opted for the new scheme;
c) following other staff retirement benefit schemes:
   - an un-funded gratuity scheme for all its employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled only to pension scheme benefits;

- an un-funded pension scheme;

- an un-funded benevolent fund scheme; and

- an un-funded post retirement medical benefit scheme.

Obligations for contributions to defined contribution provident plans are recognised as an expense in the profit and loss account as incurred.

Annual provisions are made by the Bank to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out under the Projected Unit Credit Method. Unrecognised actuarial gains and losses are recognised in the profit and loss account over the expected average remaining working lives of the employees.

The above staff retirement benefits are payable on completion of prescribed qualifying period of service.

4.9 Deferred income

Grants received on account of capital expenditure are recorded as deferred income. These are amortised over the useful life of the relevant asset.

4.10 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on time proportion basis that takes into account the effective yield on the asset. However, income on balances with Bangladesh (former East Pakistan), doubtful loans and advances and overdue return on investments are recognised as income on receipt basis.

- Dividend income is recognised when the Bank's right to receive dividend is established.

- Gains on disposal of securities are recognised in profit and loss account at trade date.

- All other revenues are recognised on accrual basis.

4.11 Finances under profit and loss sharing arrangements

The Bank provides various finances to financial institutions under profit and loss sharing arrangements. Share of profit / loss under these arrangements is recognised on accrual basis.

4.12 Taxation

The income of the Bank is exempt from tax under section 49 of the State Bank of Pakistan Act, 1956.

4.13 Foreign currency translation

Transactions denominated in foreign currencies are translated to Pak Rupees at the foreign exchange rate ruling at the date of transaction. Monetary assets and liabilities in foreign currencies are translated into rupees at the rates of exchange prevailing at the balance sheet date or at contracted rates.

Exchange gains and losses are taken to the profit and loss account except for certain exchange differences on balances with the International Monetary Fund, referred to in note 4.14, which are transferred to the Government of Pakistan account.

Exchange differences arising under Exchange Risk Coverage Scheme and on currency swap transactions are recognised in the books of account on accrual basis.

Commitments for outstanding forward foreign exchange contracts disclosed in note 34.2 to the financial statements are translated at forward rates applicable to their respective maturities. Contingent liabilities/commitments for letters of credit and letters of guarantee denominated in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date.

4.14 Transactions and balances with International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards and the guidelines contained in the IMF Manual, Aide Memoire and specific arrangements entered into between the Bank and the Government. A summary of the policies followed by the Bank for recording of these transactions and balances is as follows:

- the Government's contribution for quota with the IMF is recorded by the Bank as depository of the Government and exchange differences arising under these arrangements are transferred to the Government account.

- exchange gains or losses arising on revaluation of borrowings from the IMF are recognised in the profit and loss account.

- the cumulative allocation of Special Drawing Rights by the IMF is treated as capital receipt and is not revalued.

- from the current year on the directive of Government of Pakistan, all income or charges pertaining to balances with the IMF are taken to the profit and loss account, previously, income or charges pertaining to balances with the IMF were taken to the Government account, except for the following which were taken to the profit and loss account:

  - charges on borrowings under credit schemes other than fund facilities,
  - charges on net cumulative allocation of Special Drawing Rights; and
  - return on holdings of Special Drawing Rights.

4.15 Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are reviewed at each balance sheet date and are adjusted to reflect the current best estimates.

4.16 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities that are realisable in known amounts of cash within three months and which are subject to insignificant changes in value.

4.17 Financial instruments

Financial assets and liabilities are recognised at the time when the Bank becomes a party to the contractual provisions of the instrument. The Bank derecognises financial asset when it loses control of the contractual rights that comprise the financial asset. The Bank derecognises a financial liability when the liability is extinguished, discharged, cancelled or expired.

Any gain or loss on the derecognition of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include foreign currency reserves, investments, loans and advances, government accounts, other deposits accounts and liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

4.18 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Bank has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

14 FINANCIAL STATEMENTS OF SBPBSC (BANK)

See Attachment-D

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
A-35, CAVISH COURT
BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the annexed balance sheet of the **SBP Banking Services Corporation** as at June 30, 2006 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Corporation's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the International Accounting Standards and Accounting Policy for investments as stated in note 4.1 to the financial statements approved for adoption by the Board of Directors of the Corporation. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

a) in our opinion the balance sheet and related profit and loss account, cash flow statement and statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards and Accounting Policy for investments as stated in note 4.1 to the financial statements approved for adoption by the Board of Directors of the Corporation; and
b) in our opinion and to the best of our information and according to the explanations given to us, the balance sheet, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards and Accounting Policy for investments as stated in note 4.1 to the financial statements approved for adoption by the Board of Directors of the Corporation, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the Corporation's affairs as at June 30, 2006 and of the profit, its cash flows and changes in equity for the year then ended.

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

15 FINANCIAL STATEMENTS OF NIBAF

See Attachment-E

SYED HUSAIN ZAFAR NAVEED & CO.
CHARTERED ACCOUNTANTS
3-B ATS CNTRE, 30-WEST,
FAZAL-UL-HAQ ROAD, BLUE AREA,
ISLAMABAD

AUDITORS' REPORT TO THE MEMBERS

We have audited the annexed balance sheet of **National Institute of Banking and Finance (Guarantee) Limited** as at June 30, 2006, and the related income and expenditure account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state t5hat we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the company's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the approve accounting standards and the requirements of the Companies Ordinance, 1984. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

a) In our opinion , proper books of account have been dept by the company as required by the Companies Ordinance, 1984;

b) In our opinion:
   (i) the balance sheet and income and expenditure account together with the notes thereon have been drawn up in conformity with the Companies Ordinance, 1984, and are in agreement with the books of account and are further in accordance with accounting policies consistently applied.
   (ii) The expenditure incurred during the year was for the purpose of the company's business; and
   (iii) The business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the company;

c) In our opinion and to the best of our information and according to the explanations given to us , the balance sheet, income and expenditure account, cash flow statement and statement of changes in equity, together with the notes forming part thereof conform with approved standards as applicable in Pakistan, and, give the information required by the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of the company's affairs as at June 30, 2006 and of the surplus and its cash flows and changes in equity for the year then ended; and

d) In our opinion, no Zakat was deductible at source under the Zakat and Ushr Ordinance, 1980.

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SYED HUSAIN ZAFAR NAVEED & CO.
CHARTERED ACCOUNTANTS
ISLAMABAD

DATE: 8th September 2006

Finances of SBP and Subsidiaries

10 ANNUAL BUDGET REVIEW 2005-06

10.1 Overview

A comparison of actual versus budgeted expenditure of the SBP and its subsidiaries is given in the **table 10.3 & Figure 10.1.** The total expenditures are classified into three broad categories, namely corporate expenses, establishment expenses and operating expenses. The relative size of each of these heads in total expenditure is as under:

Table 10.1: Breakup of SBP expenditure during FY 2005-06 (in percentage terms)

Description	Budget	Actual
Corporate expenses	49.4	50.9
Establishment expenses	34.8	34.4
Operating expenses (including NIBAF expenditure)	15.8	14.7
Total	**100.0**	**100.0**

As indicated by table 11.1, on overall basis, total consolidated expenditure of SBP and its subsidiary amounted to Rs.9,996.2 million as against budget of Rs.10,015.5 million thus showing nominal positive variance of 0.2 percent. The variance of actual results against budget, in term of three major heads is as under (**Table-10.2**):

Table 10.2: Head wise variance of actual from budget (in percentage terms)

Description	Variance
Corporate expenses	(-)2.7
Establishment expenses	(+)1.4
Operating expenses (including NIBAF expenditure)	(+)6.6

The above position indicates that actual result exhibit nominal variance from the budget.

Head wise analysis of expenditure is hereunder for which details are available in **table 10.4**.

10.2 Corporate Expenses

Corporate expenses of the Bank comprise of three components viz agency commission to National Bank of Pakistan (NBP), note printing charges and charges on allocation of Special Drawing Rights (SDRs). Head wise analysis of corporate expenses is given as under.

1. *Agency Commission Charges:* Agency commission charges are paid to National Bank of Pakistan on conducting Government transactions and remittances on behalf of SBP as per agency agreement between both the parties.

   Agency commission paid to NBP showed the largest negative variance of 18.4 percent due to enhanced volume of government transactions. The government transactions have increased by 26 percent as evident from **table 10.5.**

2. *Note printing charges:* Positive variance of 10percent has been witnessed in note printing charges. During the year bank has issued new designed currency notes of Rs.10, Rs.20 and Rs.5,000.

3. *Charges on Allocation of SDRs:* The charges on allocation of SDRs also gave negative variance of 15.5 percent due to depreciation of PKR's parity with SDRs. PKR depreciated from Rs.87.37 as on 30th June 2005 to Rs.89.15 as on 30th June 2006 and increase in interest rate of SDR which was 3.71 percent on 30th June 2006 as compared to 2.54 percent last year.

Above two adverse variances in "Agency Commission Charges" and "Charges on Allocation of SDRs" were to a large extent offset by the positive variance of around 10 percent on account of note printing charges. Consequently overall variance in "Corporate Expenses" results in overall negative variance of 2.71 percent.

10.3 Establishment Expenses

Establishment expenses include employees' salaries and benefits and training expenditure. The establishment expenditure showed positive variance of 1.4 percent. The three major items showing significant variation from the budget are rest and recreation, other benefits and training expenditure. The positive variation was due to preoccupation of employees in the rollout of IT at field offices.

10.4 Operating Expenses

Operating expenses include rent rates and taxes, legal and professional charges, stationery and publications, communication, traveling expenditure, repair and maintenance, depreciation etc. On overall basis, operating expenses have shown positive variance of 7.2 percent owing primarily to decline in communication expenses, fee paid to outsiders, and depreciation. However it was partly offset by negative variance of 8.63 percent of NIBAF resulting in overall positive variance of 6.6 percent for operating expenses including NIBAF.

See *Attachment-A* on Annual Budget Review 2005-06

11 ANNUAL FINANCIAL PERFORMANCE REVIEW

11.1 Overview

During the year under review, the net income of the Bank witnessed phenomenal increase of around 120 percent over the income of preceding year. The net profit of the Bank which was Rs. 31,049 million for the financial year 2004-05 (FY04-05) increased to Rs. 68,184 million in FY 2005-06. The exceptional rise is *interalia*, attributable to rising volume of Government borrowings from the Bank, increase in the yield on such borrowings and increase in the interest rates on the foreign currency assets.

The detailed analysis of expenditure and income is given below:

11.2 Expenditure

A comparison of Bank's expenditure for the current year and immediately preceding year is as under:

Table 11.1: Corporate cost, establishment cost and operating expenses

(Rupees in million)

Description	2006	2005
Corporate cost	5,084	4,565
Establishment cost	5,421	4,441
Operating expenses	1,536	1,338
Total	**12,041**	**10,344**

The corporate cost of the Bank comprises of agency commission, note printing charges and charges on allocation of Special Drawing Rights (SDR). The increase in corporate cost is attributable to increase in agency commission paid to National Bank of Pakistan (NBP) due to enhanced volume of Government transactions and increase in charges on allocation of SDRs emanating from depreciation of PKR's parity with SDRs. PKR depreciated from Rs. 87.37 as on 30th June 2005 to Rs. 89.15 as on 30th June 2006 and increase in interest rate of SDR which was 3.71 percent on 30th June 2006 as compared to 2.54 percent on 30th June 2005.

The establishment cost has two components, namely current salaries and benefits (60.51 percent) and provisions for retirement benefits (39.49 percent) primarily based on actuarial advice. The current salaries and benefits increased by 7.33 percent, *interalia*, due to annual merit increase. The provision for retirement benefits increased by 54.58 percent which is due to increase in interest cost on rising balance of defined benefit obligation and increasing trend in the medical expenditure.

The increase in operating expenses is mainly due to increase in amortization of software and maintenance of Bank's properties and equipments.

11.3 Income

11.3.1 Net Interest Income

The primary source of increase in net profit of the Bank for FY 2005-06 is increase in net interest income which increased from Rs. 27,473 million in FY 2004-05 to Rs. 65,893 million. The net interest income has two components, namely discount, interest / markup / return earned and interest expense. The variation in each of these two heads is explained below:

11.3.2 Discount, Interest/ Markup and/or Return Earned

The income under this head represents interest income (Table 12.2) on domestic assets (Table 12.3) and interest on foreign assets (Table 12.4). The discount, interest/markup income increased from Rs. 29,757 million in FY 2004-05 to Rs. 69,940 million. The major contributories giving rise to this increase are discount income on Market Treasury Bills (MTBs), interest on foreign currency reserves and markup on loans and advances to Governments, banks and financial institutions. The increase in discount income on MTBs is attributable to exceptional rise in the Federal Government borrowings from the Bank as well as increase in the yield thereon (Table 12.3). The markup on loans and advances to banks and financial institutions primarily arise on the export refinance provided to banks and financial institutions. During the financial year 2005-06, the increase in income on export refinance is due to increase in the rate of markup. The average markup rate for FY 2005-06 was 7.5 percent as against average rate of 3.9 percent during the previous financial year.

The year under review witnessed significant increase in the interest rate in international markets. The quantum of this increase may be gauged from the increase in discount rate of Federal Reserve Bank of New York which ranged from 3.25 percent to 5.25 percent in FY 2005-06 as compared to the range of 1.25 percent to 3.0 for the FY 2004-05.

The breakup of interest income in terms of domestic and foreign assets is as under:

Table 11.2: Interest/Discount/Return Income on Foreign and Domestic Assets

(Rupees in million)

Description	**2006**	**2005**
Interest/discount income on foreign assets	23,982	15,023
Interest/discount income on domestic assets	45,958	14,734
Total	**69,940**	**29,757**

Table 11.3: Lending to Government, Banks and Financial Institutions

(Rupees in million)

Description	**2006**	**2005**
Government securities	517,626	332,129
Overdraft to Governments	26,904	22,814
Banks and financial institutions	216,584	215,180
Total	761,114	570,123
Yield on Treasury Bills	7.94 percent to 8.49 percent	2.08 percent to 7.94 percent
Markup on Export finance	7.5 percent	1.5 percent to 6.5percent

Table 11.4: Foreign Currency Reserves

(Equivalent PKR in million)

Description	2006	2005
Investments	196,421	180,149
Deposit Accounts	490,545	424,008
Current accounts	2,915	7,870
Special drawing rights with IMF	13,124	13,569
Total	**703,005**	**625,596**

11.3.3 Interest / Markup Expense

Interest / markup expense increased from Rs. 2,284 million in FY 2004-05 to Rs. 4,048 million in FY 2005-06. Bank pays interest on commercial banks' foreign currency deposits held under Cash Reserve Requirement (CRR) and borrowings from International Monetary Fund (IMF), international organizations and other central banks. The increase in interest/markup expense is due to increase in interest rates on CRR deposits (which ranged from 2.34 percent to 4.11 percent during FY 2005-06 as compared to the range of 0.87 percent to 2.13 percent during FY 2004-05). The interest expense on deposits of foreign central banks and international organizations ranged from 3.28 percent to 6.62 percent during FY 2005-06 as against a band of 1.79 percent to 4.74 percent during FY 2004-05.

11.3.4 Commission Income

The income under this head represents the income from management of public debt, issuance of Drafts and Payment Orders, Prize Bonds and National Saving Certificates. The commission income amounted to Rs. 441 million in FY 2005-06.

11.3.5 Exchange Gain/(Loss) – Net

The exchange gain /(loss) arise on the sale/purchase of foreign currencies, SDR transactions and revaluation of foreign currency assets and liabilities. Primarily, the Bank's foreign currency exposure is concentrated in two currencies, namely US dollar (USD) and SDRs. Appreciation/depreciation of Pak Rupee (PKR) against various international currencies is indicated in Table 12.5.

Table 11.5: Exchange Gain/(Loss) – Net

Currency	**EXCHANGE RATE**		**Appreciation / (Depreciation)**	
	30.06.2006	30.06.2005	2005-06	2004-05
US Dollar	60.20	59.69	(0.85) percent	(2.56) percent
Pound Sterling	109.22	108.27	(0.87) percent	(2.14) percent
Japanese Yen	0.52	0.54	3.85 percent	
Euro	75.46	71.96	(4.64) percent	(1.76) percent
SDR	89.15	87.37	(2.00) percent	(2.45) percent

Exchange gain for the year decreased from Rs. 13,828 million in FY 2004-05 to Rs. 4,376 million in FY 2005-06 (Table 12.6). The main reason for the decrease in decline in the depreciation of PKR against US dollar from 2.56 percent in FY 2004-05 to 0.85 percent in FY 2005-06. In view of the net asset exposure of the Bank in USD, the depreciation of PKR impacts favorably. However, in case of SDR, the Bank has net liabilities exposure. Accordingly, depreciation of PKR versus SDR impacts Bank's profit and loss adversely. The breakup of exchange account is as under.

Table 11.6 Breakup of the Exchange Account

(Rupees in million)

	2006	2005
Gain / (loss) on:		
- Foreign currency placements, deposits and other accounts - net	5,468	15,692
- Open market operations (including currency swap arrangements)	(15)	185
- Forward covers under Exchange Risk Coverage	147	(106)
- Payable to the International Monetary Fund (IMF)	(1,224)	(1,943)
Total	**4,376**	**13,828**

11.3.6 Dividend Income

Bank's equity portfolio comprised of investment in share capital of banks and financial institutions. The portfolio is worth Rs. 26.545 billion (at cost) as at 30th June 2006. The Bank earned dividend income of Rs. 1,975 million for FY 2005-06 as compared to dividend income of Rs. 1,502 million in the FY 2004-05. The increase in dividend income is attributable principally to enhanced dividend payout by NBP.

11.3.7 Other Operating Income

The Income under this head represents income derived from penalties on banks and financial institutions, fee from Credit Information Bureau (CIB) services, profit on sale of securities and gain or loss on mark to markets of securities and derivatives. The operating revenue for the financial year 2005-06 amounted to Rs. 799 million as compared to Rs. 328 million in previous year. The increase in income is due to increase in penalties on banks and financial institutions, and profit on sale of securities partially set off by increase in loss on re -measurement of held for trading securities.

11.3.8 Other income

The Bank's income from other than normal operations comprise of gain on disposal of property, plant and equipments, profit on sale of investments (other than held for trading), write back of provisions and liabilities no longer required and amortization of deferred income. Bank derived income of Rs. 7,289 million during the FY 2005-06 from other than normal operations as compared to income of Rs. 4,204 million in FY 2004-05. The increase in other income is primarily attributable to write back of liability on demonetization of Rs. 5 Banknote.

11.4 Distributable Profit

The distributable profit of the Bank for FY 2005-06 amounted to Rs. 68,244 million including the un appropriated profit of Rs. 60 million brought forward from previous year and after accounting for provisions for loans and advances and other assets amounting to Rs. 548 million. The distribution of above profit is given in Table 12.7.

Table 11.7: Distribution of profit

(Rupees in million)

Description	2006
Dividend	10
Transfer to Reserve Fund	19,142
Surplus profit transferable to Federal Government	49,092
Total	**68,244**

11.4.1 Summary of Profit and Loss Account

To recapitulate, the summary of profit and loss account is tabulated below:

Table 11.8: Summary Statement of Profit and Loss

(Rupees in million)

Description	2006	2005
Income		
Net Interest Income	65,893	27,473
Exchange Gain	4,376	13,828
Dividend Income	1,975	1,502
Commission	441	693
Other Operating Income	799	328
Other Income	7,289	4,203
Gross Income	**80,773**	**48,027**
Expenditure		
Corporate Costs	5,084	4,565
Establishment Costs	5,421	4,441
Other Operating Expenses	1,536	1,338
Provisions	548	6,634
	12,589	**16,978**
Net Profit	**68,184**	**31,049**

12 CONSOLIDATED FINANCIAL STATEMENTS OF SBP AND ITS SUBSIDIARIES

See Attachment-B

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
A-35, CAVISH COURT
BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the annexed consolidated financial statements comprising consolidated balance sheets of the **Issue and Banking Departments of the State Bank of Pakistan and its subsidiaries, SBP Banking Services Corporation and National Institute of Banking and Finance (Guarantee) Limited** as at June 30, 2006 and the related consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes forming part thereof, for the year then ended. We have also expressed separate joint opinions on the financial statements of the State Bank of Pakistan and its subsidiary, SBP Banking Services Corporation. The other subsidiary, National Institute of Banking and Finance (Guarantee) Limited was audited by another firm of chartered accountants, whose report has been furnished to us and our opinion in so far as it relates to the amounts included for such company, is based solely on the report of such other auditors.

It is the responsibility of the Bank's management to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with the International Accounting Standards and Accounting Policies for investments and transactions and balances with International Monetary Fund (IMF) as stated in note 4.2 and 4.14 respectively to the financial statements approved for adoption by the Central Board of the Bank. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

The Bank has maintained a provision of Rs. 2,016 million relating to net assets recoverable from the Reserve Bank of India, the Government of India and those pertaining to transactions in former East Pakistan. This provision has been recorded as other liability of the Banking department and the relevant assets and liabilities have not been netted off. Accordingly, assets of the Issue Department and Banking department are overstated by Rs. 2,433 million and Rs. 4,923 million respectively and liabilities and unrealized appreciation on gold reserve of the Banking Department are overstated by Rs. 6,118 million and Rs. 1,238 million respectively.

Except for the financial effect of the matter stated in the preceding paragraph:

(a) in our opinion the consolidated balance sheets and related consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards and Accounting Policies for investments and transaction and balances with IMF as stated in note 4.2 and 4.14 respectively to the consolidated financial statements approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied; and

(b) in our opinion and to the best of our information and according to the explanations given to us, the consolidated balance sheets, consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards and Accounting Policies for investments and transactions and balances with IMF as stated in note 4.5 and 4.14 respectively to the consolidated financial statements approved for adoption by the Central Board of the Bank, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the affairs of the Bank and its subsidiaries as at June 30, 2006 and of the profit, its cash flows and changes in equity for the year then ended.

Without further qualifying our opinion, we draw attention to the note 31 to the consolidated financial statements. The classification of SDR Allocation of IMF either as equity or debt is currently being considered by a committee formed by IMF. The decision of the committee may require a change in accounting policy as described in the said note.

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

1. STATUS AND NATURE OF OPERATIONS

State Bank of Pakistan (the Bank) is the Central Bank of Pakistan and is incorporated under the State Bank of Pakistan Act, 1956. The Bank is primarily responsible for the management of credit, foreign exchange and currency in the country and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- implementing the monetary policy;
- issuing of currency;
- facilitation of free competition and stability in the financial system;
- licensing and supervision of banks including micro finance banks, development financial institutions and exchange companies;
- organisation and management of the inter-bank settlement system and promotion of smooth functioning of payment systems;
- providing of loans and advances to the Government, banks, financial institutions and local authorities under various facilities;
- purchase, holding and sale of shares of banks and financial institutions on the directives of the Federal Government; and
- acting as depository of the Government under specific arrangements between the Government and certain institutions.

1.2 The subsidiaries of the Bank and the nature of their respective activities are as follows:

- SBP Banking Services Corporation – wholly owned subsidiary

  SBP Banking Services Corporation was established under the SBP Banking Service Corporation Ordinance, 2001 and commenced its operations with effect from January 2, 2002. It is responsible for carrying out certain statutory and administrative functions and activities principally relating to public dealing on behalf of the State Bank of Pakistan.
- National Institute of Banking and Finance (Guarantee) Limited - shareholding at 59.4%

  National Institute of Banking and Finance (Guarantee) Limited was incorporated under the Companies Ordinance, 1984 as a company limited by guarantee. The Institute is engaged in providing education and training in the field of banking, finance and allied areas.

2. STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with the requirements of International Accounting Standards (IASs) and policies for investments and transactions and balances with International Monetary Fund as stated in note 4.2 and 4.14 respectively approved for adoption by the Central Board of the Bank. Under the power conferred by the State Bank of Pakistan Act, 1956, the Central Board approved IAS-1 to IAS-38 for adoption. Where the requirements of policies adopted by Central Board differ with the requirements of International Accounting Standards adopted by Central Board, the requirements of policies adopted by Central Board take precedence.
The consolidated financial statements include collectively the financial statements of the State Bank of Pakistan (Bank) and its subsidiaries (the Group). Financial statements of the subsidiaries have been consolidated on a line-by-line basis.

All inter-group balances and transactions have been eliminated.

3. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention, except that investments, gold reserves and certain fixed assets, as referred to in notes 4.2, 4.3 and 4.4 have been included at revalued amounts.

The preparation of financial statements in conformity with International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, requires management to make judgements estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experiences and various other factors that are believed to be reasonable under the circumstances, the result of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Judgments made by the management in the application of International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, that have significant effect on the financial statements and estimate with significant risk of material judgment in the next year are discussed in note 48 to these financial statements.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4.1 Bank notes and coins

The liability of the Bank towards bank notes issued as a legal tender under the State Bank of Pakistan Act, 1956 is stated at the face value and is represented by the specified assets of the Issue Department of the Bank. The cost of printing of notes is charged to the profit and loss account as and when incurred. Any unissued bank notes lying with the Bank are not reflected in the books of account.

The Bank also issues coins of various denominations on behalf of the Government of Pakistan (GoP). These coins are purchased from the GoP at their respective face values. The unissued coins form part of the assets of the Issue Department.

4.2 Investments

All investments acquired by the Bank are initially measured at cost being the fair value of consideration given. Transaction costs are included in the initial measurement of investments. Subsequent to initial measurement, the Bank measures and classifies its investments under the following categories:

Held for trading
These securities are either acquired for generating a profit from short term fluctuations in market price, interest rate movements, dealer’s margin or securities included in a portfolio in which a pattern of short term profit making exists. These instruments are subsequently re-measured to fair value. All related realized and unrealized gains and losses are recognised in the profit and loss account.

All purchases and sales of investments categorised as held-for-trading that required delivery with the time frame established by regulation or market convention (‘regular way’ purchases and sale’) are recognised at the trade date, which is the date Bank commits to purchase or sell the investment, other wise transactions are treated as derivative until settlement occurs.

Held to maturity
These are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity other than loans and receivables. These securities are carried at amortized cost, less impairment losses, if any, and premiums and/or discounts are accounted for using effective interest method.
All regular way purchases and sale are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of impairment loss for assets carried at amortised cost is calculated as the difference between the asset's carrying amount and present value of expected future cash flows discounted at the financial instrument's original effective interest rate.

Loans and receivables
These are financial assets created by the Bank by providing money directly to a debtor. Subsequent to initial recognition, these investments are carried at amortised cost and premiums and/or discounts are accounted for using the effective interest method.
All loans and advances are recognised when cash is advanced to borrowers. When a loan is uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited in the profit and loss account.

An allowance for impairment is established if there is evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans and advances. The amount of the provision is the difference between the carrying amount and the recoverable from guarantees and collateral, discounted at the original effective interest rate of loans and advances.

Available for sale securities (AFS)
These are the securities which do not fall in any of the above three categories. Subsequent to initial recognition the changes in fair value of these securities is taken to equity except the strategic investments including investments in National Bank of Pakistan, Habib Bank Limited, Allied Bank Limited and United Bank Limited and investments in securities the fair value of which cannot be determined reliably. Gain or loss on changes in fair value is kept in equity until the investments are sold or disposed off, or until the investments are determined to be impaired, at that time cumulative gain or loss previously reported in the equity is included in profit and loss account.

Fair value of the financial instruments classified as held-for-trading and available for sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held-for-trading or available-for-sale are de-recognised by the Bank on the date it commits to sell the investments. Securities held-to-maturity is de-recognised on the day these are transferred by the Bank. Gains and losses on de-recognition of held for trading, held to maturity and AFS securities are taken to profit and loss account.

Derivative financial instruments
The Bank enters into derivative financial instruments, which include forwards and currency swaps. Derivatives are initially recorded at cost and are re-measured to fair value on subsequent reporting dates. Forwards are shown under Commitments in the note 34.2 while the asset and liability portion of a currency swap are presented in Other Assets and Other Liabilities in notes 21 and 27 to the financial statements. The resultant gains or losses from derivatives are included in the profit and loss account.

Collateralised borrowings / lending

Securities sold subject to a commitment to repurchase them at a pre-determined price, are retained on the balance sheet and a liability is recorded in respect of the consideration received in “Securities sold under agreement to repurchase”. Conversely, securities purchased under analogous commitment to resell are not recognised on the balance sheet and a consideration paid is recorded in “Securities purchased under agreement to resell”. The difference between the sale and repurchase price in the repurchase transactions and the purchase price and resale price in reverse repurchase transaction represents an expense and income respectively and recognised in the profit and loss account on an accrual basis.

4.3 Gold reserves

Gold reserves, including those held with the Reserve Bank of India, are stated at the revalued amounts of the fine gold content thereof in accordance with the requirements of the State Bank of Pakistan Act, 1956 and the State Bank of Pakistan General Regulations. Appreciation or depreciation, if any, on revaluation is taken to equity under the head of “unrealised appreciation on gold reserves” account. Appreciation realised on disposal of gold is credited to the profit and loss account.

4.4 Property, plant and equipment

Property, plant and equipment except land, buildings and capital work in progress are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Free hold land is stated at revalued amount. Lease hold land and buildings are stated at revalued amount less accumulated depreciation and accumulated impairment losses, if any, while capital work-in-progress is valued at cost.

Depreciation on property, plant and equipment are charged to profit and loss account applying the straight-line method whereby the cost/revalued amount of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted / disposed off. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income.

Surplus arising on revaluation of property, plant and equipment is credited to surplus on revaluation of property, plant and equipment. The surplus on revaluation realised on disposal of property, plant and equipment is transferred to equity.

4.5 Intangibles

Intangible assets are amortised using straight-line method over the period of three years. Where the carrying amount of an asset exceeds its estimated recoverable amount it is written down immediately to its recoverable amount. Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any.

4.6 Impairment

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indication exists, the recoverable amount of such assets is estimated. An impairment loss is recognised in profit and loss account whenever the carrying amount of an asset or a group of assets exceeds its recoverable amount. Balances considered bad and irrecoverable are written off from the books of account. Provisions against impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognised as income / expense in the profit and loss account.

4.7 Compensated absences

The Bank makes annual provision in respect of liability for employees' compensated absences based on actuarial estimates.

4.8 Staff retirement benefits

The Bank operates:

a) an un-funded contributory provident fund (old scheme) for those employees who joined prior to 1975 and have opted to remain under the old scheme;
b) an un-funded general contributory provident fund (new scheme) for all employees who joined after 1975 and those employees who had joined prior to 1975 but have opted for the new scheme;
c) following other staff retirement benefit schemes:
   - an un-funded gratuity scheme for all its employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled only to pension scheme benefits;
   - an un-funded pension scheme;
   - an un-funded benevolent fund scheme; and
   - an un-funded post retirement medical benefit scheme.

Obligations for contributions to defined contribution provident plans are recognised as an expense in the profit and loss account as incurred.

Annual provisions are made by the Bank to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out under the Projected Unit Credit Method. Unrecognised actuarial gains and losses are recognised in the profit and loss account over the expected average remaining working lives of the employees.

The above staff retirement benefits are payable on completion of prescribed qualifying period of service.

4.9 Deferred income

Grants received on account of capital expenditure are recorded as deferred income. These are amortised over the useful life of the relevant asset.

4.10 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on time proportion basis that takes into account the effective yield on the asset. However, income on balances with Bangladesh (former East Pakistan), doubtful loans and advances and overdue return on investments are recognised as income on receipt basis.

- Dividend income is recognised when the Bank's right to receive dividend is established.

- Gains on disposal of securities are recognised in profit and loss account at trade date.

- All other revenues are recognised on accrual basis.

4.11 Finances under profit and loss sharing arrangements

The Bank provides various finances to financial institutions under profit and loss sharing arrangements. Share of profit / loss under these arrangements is recognised on accrual basis.

4.12 Taxation

The income of the Bank is exempt from tax under section 49 of the State Bank of Pakistan Act, 1956.

4.13 Foreign currency translation

Transactions denominated in foreign currencies are translated to Pak Rupees at the foreign exchange rate ruling at the date of transaction. Monetary assets and liabilities in foreign currencies are translated into rupees at the rates of exchange prevailing at the

balance sheet date or at contracted rates. Exchange gains and losses are taken to the profit and loss account except for certain exchange differences on balances with the International Monetary Fund, referred to in note 4.14, which are transferred to the Government of Pakistan account.
Exchange differences arising under Exchange Risk Coverage Scheme and on currency swap transactions are recognized in the books of account on accrual basis.

Commitments for outstanding forward foreign exchange contracts disclosed in note 34.2 to the financial statements are translated at forward rates applicable to their respective maturities. Contingent liabilities / commitments for letters of credit and letters of guarantee denominated in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date.

4.14 Transactions and balances with International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards and the guidelines contained in the IMF Manual, Aide Memoir and specific arrangements entered into between the Bank and the Government. A summary of the policies followed by the Bank for recording of these transactions and balances is as follows:

- The Government's contribution for quota with the IMF is recorded by the Bank as depository of the Government and exchange differences arising under these arrangements are transferred to the Government account.

- Exchange gains or losses arising on revaluation of borrowings from the IMF are recognized in the profit and loss account.

- The cumulative allocation of Special Drawing Rights by the IMF is treated as capital receipt and is not revalued.

- from the current year on the directive of Government of Pakistan, all income or charges pertaining to balances with the IMF are taken to the profit and loss account, previously, income or charges pertaining to balances with the IMF were taken to the Government account, except for the following which were taken to the profit and loss account:

  - Charges on borrowings under credit schemes other than fund facilities,
  - Charges on net cumulative allocation of Special Drawing Rights; and
  - Return on holdings of Special Drawing Rights.

4.15 Provisions

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are reviewed at each balance sheet date and are adjusted to reflect the current best estimates.

4.16 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities that are realizable in known amounts of cash within three months and which are subject to insignificant changes in value.

4.17 Financial instruments

Financial assets and liabilities are recognized at the time when the Bank becomes a party to the contractual provisions of the instrument. The Bank derecognizes financial asset when it loses control of the contractual rights that comprise the financial asset. The Bank derecognizes a financial liability when the liability is extinguished, discharged, cancelled or expired.

Any gain or loss on the derecognizing of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include foreign currency reserves, investments, loans and advances, government accounts, other deposits accounts and liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

4.18 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

13 FINANCIAL STATEMENTS OF SBP

See Attachment-C

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
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M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
A-35, CAVISH COURT
BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the annexed balance sheets of the Issue and Banking Departments of the **State Bank of Pakistan** as at June 30, 2006 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof (here-in-after referred to as the 'financial statements'), for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Bank's management to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with the International Accounting Standards and Accounting Policies for investments and transactions and balances with International Monetary Fund (IMF) as stated in note 4.2 and 4.14 respectively to the financial statements approved for adoption by the Central Board of the Bank. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

The Bank has maintained a provision of Rs. 2,016 million relating to net assets recoverable from the Reserve Bank of India, the Government of India and those pertaining to transactions in former East Pakistan. This provision has been recorded as other liability of the Banking department and the relevant assets and liabilities have not been netted off. Accordingly, assets of the Issue Department and Banking department are overstated by Rs. 2,433 million and Rs. 4,923 million respectively and liabilities and unrealized appreciation on gold reserve of the Banking Department are overstated by Rs. 6,118 million and Rs. 1,238 million respectively.

Except for the financial effect of the matter stated in the preceding paragraph:

(c) in our opinion the balance sheets and related profit and loss account, cash flow statement and statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards and Accounting Policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 respectively to the financial statements approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied; and

(d) in our opinion and to the best of our information and according to the explanations given to us, the balance sheets, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards and Accounting Policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 to the financial statements approved for adoption by the Central Board of the Bank, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the Bank's affairs as at June 30, 2006 and of the profit, its cash flows and changes in equity for the year then ended.

Without further qualifying our opinion, we draw attention to the note 31 to the financial statements. The classification of SDR Allocation of IMF either as equity or debt is currently being considered by a committee formed by IMF. The decision of the committee may require a change in accounting policy.

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

State Bank of Pakistan
Notes to the Financial Statements
For the year ended June 30, 2006

1. STATUS AND NATURE OF OPERATIONS

State Bank of Pakistan (the Bank) is the Central Bank of Pakistan and is incorporated under the State Bank of Pakistan Act, 1956. The Bank is primarily responsible for the management of credit, foreign exchange and currency in the country and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- implementing the monetary policy;
- issuing of currency;
- facilitation of free competition and stability in the financial system;
- licensing and supervision of banks including micro finance banks, development financial institutions and exchange companies;
- organisation and management of the inter-bank settlement system and promotion of smooth functioning of payment systems;
- providing of loans and advances to the Government, banks, financial institutions and local authorities under various facilities;
- purchase, holding and sale of shares of banks and financial institutions on the directives of the Federal Government; and
- acting as depository of the Government under specific arrangements between the Government and certain institutions.

2. STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with the requirements of International Accounting Standards (IASs) and policies for investments and transactions and balances with International Monetary Fund as stated in note 4.2 and 4.14 respectively approved for adoption by the Central Board of the Bank. Under the power conferred by the State Bank of Pakistan Act, 1956, the Central Board approved IAS-1 to IAS-38 for adoption. Where the requirements of policies adopted by Central Board differ with the requirements of International Accounting Standards adopted by Central Board, the requirements of policies adopted by Central Board take precedence.

3. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention, except that investments, gold reserves and certain fixed assets, as referred to in notes 4.2, 4.3 and 4.4 have been included at revalued amounts.

The preparation of financial statements in conformity with International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, requires management to make judgements estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experiences and various other factors that are believed to be reasonable under the circumstances, the result of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Judgments made by the management in the application of International Accounting Standards 1 to 38 and policies for investments and transactions and balances with IMF as stated in note 4.2 and 4.14 approved for adoption by the Central Board of the Bank, that have significant effect on the financial statements and estimate with significant risk of material judgment in the next year are discussed in note 49 to these financial statements.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4.1 Bank notes and coins

The liability of the Bank towards bank notes issued as a legal tender under the State Bank of Pakistan Act, 1956 is stated at the face value and is represented by the specified assets of the Issue Department of the Bank. The cost of printing of notes is charged to the profit and loss account as and when incurred. Any unissued bank notes lying with the Bank are not reflected in the books of account.

The Bank also issues coins of various denominations on behalf of the Government of Pakistan (GoP). These coins are purchased from the GoP at their respective face values. The unissued coins form part of the assets of the Issue Department.

4.2 Investments

All investments acquired by the Bank are initially measured at cost being the fair value of consideration given. Transaction costs are included in the initial measurement of investments. Subsequent to initial measurement, the Bank measures and classifies its investments under the following categories:

Held for trading

These securities are either acquired for generating a profit from short term fluctuations in market price, interest rate movements, dealer’s margin or securities included in a portfolio in which a pattern of short term profit making exists. These instruments are subsequently re-measured to fair value. All related realized and unrealized gains and losses are recognised in the profit and loss account.

All purchases and sales of investments categorised as held-for-trading that required delivery with the time frame established by regulation or market convention (‘regular way’ purchases and sale’) are recognised at the trade date, which is the date Bank commits to purchase or sell the investment, other wise transactions are treated as derivative until settlement occurs.

Held to maturity
These are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity other than loans and receivables. These securities are carried at amortized cost, less impairment losses, if any, and premiums and/or discounts are accounted for using effective interest method.
All regular way purchases and sale are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of impairment loss for assets carried at amortised cost is calculated as the difference between the asset’s carrying amount and present value of expected future cash flows discounted at the financial instrument’s original effective interest rate.

Loans and receivables
These are financial assets created by the Bank by providing money directly to a debtor. Subsequent to initial recognition, these investments are carried at amortised cost and premiums and/or discounts are accounted for using the effective interest method.
All loans and advances are recognised when cash is advanced to borrowers. When a loan is uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited in the profit and loss account.

An allowance for impairment is established if there is evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans and advances. The amount of the provision is the difference between the carrying amount and the recoverable from guarantees and collateral, discounted at the original effective interest rate of loans and advances.

Available for sale securities (AFS)
These are the securities which do not fall in any of the above three categories. Subsequent to initial recognition the changes in fair value of these securities is taken to equity except the strategic investments including investments in National Bank of Pakistan, Habib Bank Limited, Allied Bank Limited and United Bank Limited and investments in securities the fair value of which cannot be determined reliably. Gain or loss on changes in fair value is kept in equity until the investments are sold or disposed off, or until the investments are determined to be impaired, at that time cumulative gain or loss previously reported in the equity is included in profit and loss account.

Fair value of the financial instruments classified as held-for-trading and available for sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held-for-trading or available-for-sale are de-recognised by the Bank on the date it commits to sell the investments. Securities held-to-maturity is de-recognised on the day these are transferred by the Bank. Gains and losses on de-recognition of held for trading, held to maturity and AFS securities are taken to profit and loss account.

Derivative financial instruments

The Bank enters into derivative financial instruments, which include forwards and currency swaps. Derivatives are initially recorded at cost and are re-measured to fair value on subsequent reporting dates. Forwards are shown under Commitments in the note 34.2 while the asset and liability portion of a currency swap are presented in Other Assets and Other Liabilities in notes 21 and 27 to the financial statements. The resultant gains or losses from derivatives are included in the profit and loss account.

Collateralised borrowings / lending

Securities sold subject to a commitment to repurchase them at a pre-determined price, are retained on the balance sheet and a liability is recorded in respect of the consideration received in “Securities sold under agreement to repurchase”. Conversely, securities purchased under analogous commitment to resell are not recognised on the balance sheet and a consideration paid is recorded in “Securities purchased under agreement to resell”. The difference between the sale and repurchase price in the repurchase transactions and the purchase price and resale price in reverse repurchase transaction represents an expense and income respectively and recognised in the profit and loss account on an accrual basis.

4.3 Gold reserves

Gold reserves, including those held with the Reserve Bank of India, are stated at the revalued amounts of the fine gold content thereof in accordance with the requirements of the State Bank of Pakistan Act, 1956 and the State Bank of Pakistan General Regulations. Appreciation or depreciation, if any, on revaluation is taken to equity under the head of “unrealised appreciation on gold reserves” account. Appreciation realised on disposal of gold is credited to the profit and loss account.

4.4 Property, plant and equipment

Property, plant and equipment except land, buildings and capital work in progress are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Free hold land is stated at revalued amount. Lease hold land and buildings are stated at revalued amount less accumulated depreciation and accumulated impairment losses, if any. Capital work-in-progress is valued at cost.

Depreciation on property, plant and equipment are charged to profit and loss account applying the straight-line method whereby the cost/revalued amount of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted / disposed off. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income.

Surplus arising on revaluation of property, plant and equipment is credited to surplus on revaluation of property, plant and equipment. The surplus on revaluation realised on disposal of property, plant and equipment is transferred to equity.

4.5 Intangibles

Intangible assets are amortised using straight-line method over the period of three years. Where the carrying amount of an asset exceeds its estimated recoverable amount it is written down immediately to its recoverable amount.
Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any.

4.6 Impairment

The carrying amounts of the Bank’s assets are reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indication exists, the recoverable amount of such assets is estimated. An impairment loss is recognised in profit and loss account whenever the carrying amount of an asset or a group of assets exceeds its recoverable amount. Balances considered bad and irrecoverable are written off from the books of account. Provisions against impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognised as income / expense in the profit and loss account.

4.7 Compensated absences

The Bank makes annual provision in respect of liability for employees’ compensated absences based on actuarial estimates.

4.8 Staff retirement benefits

The Bank operates:

a) an un-funded contributory provident fund (old scheme) for those employees who joined prior to 1975 and have opted to remain under the old scheme;
b) an un-funded general contributory provident fund (new scheme) for all employees who joined after 1975 and those employees who had joined prior to 1975 but have opted for the new scheme;
c) following other staff retirement benefit schemes:
    - an un-funded gratuity scheme for all its employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled only to pension scheme benefits;

- an un-funded pension scheme;

- an un-funded benevolent fund scheme; and

- an un-funded post retirement medical benefit scheme.

Obligations for contributions to defined contribution provident plans are recognised as an expense in the profit and loss account as incurred.

Annual provisions are made by the Bank to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out under the Projected Unit Credit Method. Unrecognised actuarial gains and losses are recognised in the profit and loss account over the expected average remaining working lives of the employees.

The above staff retirement benefits are payable on completion of prescribed qualifying period of service.

4.9 Deferred income

Grants received on account of capital expenditure are recorded as deferred income. These are amortised over the useful life of the relevant asset.

4.10 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on time proportion basis that takes into account the effective yield on the asset. However, income on balances with Bangladesh (former East Pakistan), doubtful loans and advances and overdue return on investments are recognised as income on receipt basis.

- Dividend income is recognised when the Bank's right to receive dividend is established.

- Gains on disposal of securities are recognised in profit and loss account at trade date.

- All other revenues are recognised on accrual basis.

4.11 Finances under profit and loss sharing arrangements

The Bank provides various finances to financial institutions under profit and loss sharing arrangements. Share of profit / loss under these arrangements is recognised on accrual basis.

4.12 Taxation

The income of the Bank is exempt from tax under section 49 of the State Bank of Pakistan Act, 1956.

4.13 Foreign currency translation

Transactions denominated in foreign currencies are translated to Pak Rupees at the foreign exchange rate ruling at the date of transaction. Monetary assets and liabilities in foreign currencies are translated into rupees at the rates of exchange prevailing at the balance sheet date or at contracted rates.

Exchange gains and losses are taken to the profit and loss account except for certain exchange differences on balances with the International Monetary Fund, referred to in note 4.14, which are transferred to the Government of Pakistan account.

Exchange differences arising under Exchange Risk Coverage Scheme and on currency swap transactions are recognised in the books of account on accrual basis.

Commitments for outstanding forward foreign exchange contracts disclosed in note 34.2 to the financial statements are translated at forward rates applicable to their respective maturities. Contingent liabilities/commitments for letters of credit and letters of guarantee denominated in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date.

4.14 Transactions and balances with International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards and the guidelines contained in the IMF Manual, Aide Memoire and specific arrangements entered into between the Bank and the Government. A summary of the policies followed by the Bank for recording of these transactions and balances is as follows:

- the Government's contribution for quota with the IMF is recorded by the Bank as depository of the Government and exchange differences arising under these arrangements are transferred to the Government account.

- exchange gains or losses arising on revaluation of borrowings from the IMF are recognised in the profit and loss account.

- the cumulative allocation of Special Drawing Rights by the IMF is treated as capital receipt and is not revalued.

- from the current year on the directive of Government of Pakistan, all income or charges pertaining to balances with the IMF are taken to the profit and loss account, previously, income or charges pertaining to balances with the IMF were taken to the Government account, except for the following which were taken to the profit and loss account:

  - charges on borrowings under credit schemes other than fund facilities,
  - charges on net cumulative allocation of Special Drawing Rights; and
  - return on holdings of Special Drawing Rights.

4.15 Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are reviewed at each balance sheet date and are adjusted to reflect the current best estimates.

4.16 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities that are realisable in known amounts of cash within three months and which are subject to insignificant changes in value.

4.17 Financial instruments

Financial assets and liabilities are recognised at the time when the Bank becomes a party to the contractual provisions of the instrument. The Bank derecognises financial asset when it loses control of the contractual rights that comprise the financial asset. The Bank derecognises a financial liability when the liability is extinguished, discharged, cancelled or expired.

Any gain or loss on the derecognition of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include foreign currency reserves, investments, loans and advances, government accounts, other deposits accounts and liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

4.18 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Bank has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

14 FINANCIAL STATEMENTS OF SBPBSC (BANK)

See Attachment-D

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
A-35, CAVISH COURT
BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the annexed balance sheet of the **SBP Banking Services Corporation** as at June 30, 2006 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Corporation's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the International Accounting Standards and Accounting Policy for investments as stated in note 4.1 to the financial statements approved for adoption by the Board of Directors of the Corporation. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

a) in our opinion the balance sheet and related profit and loss account, cash flow statement and statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards and Accounting Policy for investments as stated in note 4.1 to the financial statements approved for adoption by the Board of Directors of the Corporation; and
b) in our opinion and to the best of our information and according to the explanations given to us, the balance sheet, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards and Accounting Policy for investments as stated in note 4.1 to the financial statements approved for adoption by the Board of Directors of the Corporation, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the Corporation's affairs as at June 30, 2006 and of the profit, its cash flows and changes in equity for the year then ended.

KPMG TASEER HADI & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
KARACHI

DATE: 07th September 2006

15 FINANCIAL STATEMENTS OF NIBAF

See Attachment-E

SYED HUSAIN ZAFAR NAVEED & CO.
CHARTERED ACCOUNTANTS
3-B ATS CNTRE, 30-WEST,
FAZAL-UL-HAQ ROAD, BLUE AREA,
ISLAMABAD

AUDITORS' REPORT TO THE MEMBERS

We have audited the annexed balance sheet of **National Institute of Banking and Finance (Guarantee) Limited** as at June 30, 2006, and the related income and expenditure account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state t5hat we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the company's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the approve accounting standards and the requirements of the Companies Ordinance, 1984. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

a) In our opinion , proper books of account have been dept by the company as required by the Companies Ordinance, 1984;

b) In our opinion:
   (i) the balance sheet and income and expenditure account together with the notes thereon have been drawn up in conformity with the Companies Ordinance, 1984, and are in agreement with the books of account and are further in accordance with accounting policies consistently applied.
   (ii) The expenditure incurred during the year was for the purpose of the company's business; and
   (iii) The business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the company;

c) In our opinion and to the best of our information and according to the explanations given to us , the balance sheet, income and expenditure account, cash flow statement and statement of changes in equity, together with the notes forming part thereof conform with approved standards as applicable in Pakistan, and, give the information required by the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of the company's affairs as at June 30, 2006 and of the surplus and its cash flows and changes in equity for the year then ended; and

d) In our opinion, no Zakat was deductible at source under the Zakat and Ushr Ordinance, 1980.

SYED HUSAIN ZAFAR NAVEED & CO.
CHARTERED ACCOUNTANTS
ISLAMABAD

DATE: 8th September 2006

Annexure

A Chronology of Policy Announcements
B Governance Structure
C Organizational Chart
D Management Directory
E List of Publications

A Chronology of Policy Announcements

A.1 Exchange Policy

Date of Announcement	Circular #	Policy Decision
2005 07- July	Cir. Letter No. 13	**Placement Of invoice & Packing List Inside Containers** As per Model Customs Collectorate Karachi's instructions, authorized dealers were informed that they can open L/Cs in the case of certain imports without condition of placing invoice and the containers.
2005 14- July	Cir. Letter No. 14	**6% Research And Development Support To The Garments Industry** In order to facilitate the exporters' eligible to 6% Research and Development Support to the Garments Industry, last date for submission of claims pertaining to zero-period was extended to July 31, 2005 (inclusive).
2005 25- July	FE Cir. No. 07	**Import Of Raw Sugar** Authorized Dealers was clarified that the import of raw sugar by the private sector was allowed without limit / time bar, from worldwide sources except India and Israel. Therefore, Authorized Dealers may establish L/Cs for the import of raw sugar without obtaining prior approval from State Bank.
2005 01-August	FE Cir. No. 08	**Travel Health Insurance Coverage For The Schengen Countries** In order to facilitate Pakistani travelers to meet the guidelines for issuance of travel visa to Schengen Countries, it was decided to allow insurance companies to issue health/medical policy in foreign currency subject to the given conditions.
2005 09-August	FE Cir. No. 09	**Repatriation Of Surplus Sales Funds By Foreign Airlines Operating In Pakistan** As a further step towards the liberalization of foreign exchange regime and in order to facilitate Airlines operating in Pakistan, amendments carried out in the existing procedure for remittances of surplus sales funds.

Date of Announcement	Circular #	Policy Decision
2005 12-August	FE Cir. No. 11	**Investment Abroad By Locally Established Mutual Funds** In continuation of State Bank of Pakistan's policy towards liberalization of Foreign Exchange regime, it has been decided to allow locally established mutual funds to invest abroad for the purposes of diversification of their asset classes / portfolio, to the extent of 30% of the aggregate funds mobilized (including foreign currency funds), in permissible categories subject to a cap of US$ 15 million at any given time.
2005 12-August	Cir. Letter No. 15	**6% Research And Development Support To The Garments Industry** In order to facilitate the exporters who are eligible to 6% Research and Development Support to the Garments Industry could not submit their claims related to zero period, it has been decided to extend the last date for submission/ re-submission of claims pertaining to zero-period, to August 31, 2005 (inclusive).
2005 13-August	FE Cir. No. 12	**Advance Payments Against Imports** To further facilitate the importers, it has been decided to extend the scope of the above permission to all eligible import transactions up to a maximum of US$ 10,000/- or equivalent thereof in other foreign currencies, per invoice. Accordingly, Authorized Dealers are now allowed to process the requests of the importers for remittances up to a maximum of US$ 10,000/-, or equivalent thereof in other foreign currencies, on advance payment basis against all eligible import transactions.
2005 20-August	Cir. Letter No. 16	**Import Of Raw & Refined Sugar** Ministry of Commerce, Government of Pakistan in terms of SRO No. 788(I)/2005 dated the 6th August 2005 allowed import of Raw & Refined Sugar from India. Authorized Dealers may therefore establish L/Cs for the import of raw and refined sugar without obtaining prior approval from State Bank, including import of sugar on CFR Free Out basis.
2005 01-September	Cir. Letter No. 17	**Agreements by Exchange Companies / Exchange Companies of 'B' Category** It was announced that Exchange Companies of category A or B cannot enter into business related agreements with each other or with outside parties without obtaining prior approval/clearance in writing from State Bank of Pakistan.

Date of Announcement	Circular #	Policy Decision
2005 23-September	FE Cir. No. 13	**6% Research And Development Support To The Garments Industry** In order to facilitate the exporters to submit their claims of exports to Canada, made between 12th April, 2005 and the issuance of this Circular (both dates inclusive), it was decided that such cases would be submitted by the Authorized Dealers on or before November 30, 2005.
2005 03-October	Cir. Letter No. 18	**Remittances by Hajj Group Organizers for Hajj-2006** The procedure for remittances in the case of Hajj Group Organizers (HGOs) for Hajj 2005 as contained in F.E. Circular No. 13 dated September 17, 2004 would remain applicable for the Hajj-2006 also.
2005 03-October	Cir. Letter No. 19	**Remittances by Hajj Group Organizers for Hajj-2006** Exchange Companies would observe the same procedure for remittances as contained in F.E. Circular No. 13 dated September 17, 2004 for the Hajj-2006.
005 10-October	Cir. Letter No. 21	**6% Research And Development Support To The Garments Industry** Authorized Dealers were advised to give adequate attention to ensure proper scrutiny of material aspects of 6% R&D support claims before submitting these at SBP-BSC Offices. Authorized Dealers were further advised not to approach Field Offices for receiving back the rejected/ discrepant cases for rectification and subsequent resubmission in spite of repeated telephonic reminders from SBP-BSC Officials.
2005 26-October	Cir. Letter No. 22	**Foreign Remittances on account of Donations/Aid for Earthquake Victims** With a view to streamlining the reporting process of the transactions of Foreign Remittances on account of Donations/Aid for Earthquake Victims, it was decided that the Authorized Dealers would report all such transactions on Schedule “J” along with Form “R”.
2005 27-October	FE Cir. No. 14	**6% Research And Development Support To The Garments Industry** In order to further facilitate exporters availing 6% Research and Development Support to the Garments Industry, all the applications originally submitted on or before September 30, 2005, i.e. within 90 days of the realization of export proceeds, but returned due to certain discrepancies, will be allowed to be re-submitted irrespective of the 90 days time limit and will be processed/ paid by SBP-BSC Offices accordingly.

Date of Announcement	Circular #	Policy Decision
2005 02- December	Cir. Letter No. 24	**Amendment In Import Policy Order 2005** As per SRO, the Federal Government has made an amendment in the Import Policy Order 2005 whereby Import of poultry and poultry products and other captive live birds (pet/game/wild/exotic/fancy birds) from Far Eastern, Central Asian countries including China on account of Avian Influenza H5N1 strain, shall not be allowed till further orders. This ban shall however not apply to de-sugared or de-glucosed whole egg powder from China."
05 19- December	Cir. Letter No. 25	**Import Of Corrugated Galvanized Iron Sheets From India** As per SRO, the Federal Government made an amendment in the Import Policy Order 2005 whereby corrugated galvanized iron sheets falling under respective H.S. headings shall also be importable from India for a period of one month commencing from the 14th December, 2005 and ending on the 13th January, 2006, via land route as well, for exclusive use in rehabilitation of earthquake victims, subject to the verification and recommendation of the Federal Relief Commission".
2005 27- December	FE Cir. No. 16	**Scheme for Warehousing in Kenya – Facilitation to the Exporters** In order to encourage exports to Kenya through a Warehousing Scheme, announced by the Export Promotion Bureau, it was decided to facilitate the exporters utilizing EPB's Warehousing Scheme in Kenya.
2005 29- December	FE Cir. No. 17	**Collection Of Voluntary Contribution For Earthquake Relief Through E-Forms** Under the initiative taken by stakeholders including EPB and FPCCI, it was decided to initiate a voluntary scheme for contribution to the noble cause of helping the earthquake victims of Northern areas of Pakistan and Azad Kashmir.
2005 29- December	FE Cir. No. 18	**Inter-bank Foreign Exchange Swaps – Extension in cut-off time** In order to facilitate Authorized Dealers (ADs) to better manage their cash flows, it has now been decided to extend the cut-off time for Foreign Exchange Swaps in the inter bank market up to 4:30 pm Monday through Friday and up to 1:00 pm on Saturday.
2006 06- January	Cir. Letter No. 02	**Liberalization of Foreign Exchange – Information Technology Services** It was informed to the Banks that submission of an NOC from Pakistan Software Export Board is not required, for remittances up to US$ 100,000/-, in case of utilization of Information Technology Services.

Date of Announcement	Circular #	Policy Decision
2006 20- January	Cir. Letter No. 03	**Exports Of Fresh Fruits / Vegetables** In order to address the issues of exporters of fresh fruits/vegetables to bulk buying agents/agents aboard, it was clarified that the Advance Payments would be admissible for shipments to destinations other than the remittance originating country.
2006 31- January	FE Cir. No. 01	**Export of Surplus Cash US Dollars by the Authorized Dealers** It was decided that effective February 1, 2006, only three offices of SBP Banking Services Corporation, namely Karachi, Lahore and Rawalpindi, will be accepting cash US Dollars from ADs in the prescribed manner and the facility shall cease to be available at all other locations of SBP-Banking Services Corporation.
2006 10- February	Cir. Letter No. 04	**Collection Of Voluntary Contribution For Earthquake Relief Through E-Forms** It was clarified that the amounts of contributions collected by the ADs through their branches on account of Earthquake Relief must be consolidated at the appropriate regional/Head Office level and at the end of each month.
2006 10- February	Cir. Letter No. 05	**Import Of Corrugated Galvanized Iron Sheets From India** As per SRO, the Federal Government has made a further amendment in the Import Policy Order 2005 whereby the corrugated galvanized iron sheets falling under respective H.S. headings shall also be importable from India w.e.f 14th December, 2005 till 31st March, 2006, via land route as well, for exclusive use in rehabilitation of earthquake victims.
2006 14- April	FE Cir. No. 04	**6% Research And Development Support To The Garments Industry** Attention of the Authorized Dealers was invited to FE Circular No. 06 dated June 18, 2005 wherein it was advised that in terms of Ministry of Commerce’s letter No. 1(8)/2005-Tex dated January 19, 2006, 6% R&D Support, which is already available on export of textile readymade garments will also be admissible for the exports of readymade garments made from Export Processing Zones of Pakistan (EPZs).

Date of Announcement	Circular #	Policy Decision
2006 09-May	FE Cir. No. 05	**Import of Cement and Disbursement of Freight Subsidy** In terms of the decision made by Economic Coordination Committee (ECC) of the Cabinet in case No. ECC - 69/4/2006, dated April 14, 2006, import of cement from all countries including India by rail, road and sea, was allowed. Further, freight subsidy of Rs. 60/- per 50 Kg bag of imported cement was also allowed in terms of directives of Ministry of Industries, Production and Special Incentives, Government of Pakistan.
2006 15-May	Cir. Letter No. 06	**6% Research And Development Support To The Garments Industry** With a view to further facilitate the exporters, in terms of Ministry of Commerce decision, it was advised that all time barred claims for 6% R&D Support, where shipment was made and proceeds there against realized during the period June 18, 2005 to September 30, 2005 (both dates inclusive), may now be processed for payment.
2006 15-May	FE Cir. No. 06	**Remittance of Freight Charges by Freight Forwarder/ Consolidators** Authorized Dealers were allowed to remit on a monthly basis, the surplus freight by the Freight Forwarder/ Consolidators, after verification of documentary evidence in support of the remittance.
2006 01-June	Cir. Letter No. 07	**Establishment of Temporary Currency Exchange Booths at Hajj Camps during Hajj Seasons** In order to facilitate Hajj Pilgrims, it was decided to allow the Exchange Companies established under F.E. Circular No.09 dated July 30, 2002 to setup their own currency exchange booths at Hajj Camps during Hajj Seasons.
2006 12-June	Cir. Letter No. 08	**Procedure for Disbursement of Subsidy on the Imported Whole Gram Black** In terms of Ministry of Industries, Production and Special Initiatives' Notification No. 2(1)/2003 P&I-II dated 12th June, 2006, the subsidy of Rs. 8 per Kg on imported whole gram black (for splitting into Dal Channa) would be given to importers up to 100,000 tones of imports on first come first served basis.

Date of Announcement	Circular #	Policy Decision
2006 16-June	Cir. Letter No. 08	**Amendment In The Import Policy Order 2005** Authorized Dealers were advised to bring to the notice of their constituents certain amendments in the Import Policy Order 2005 introduced by Ministry of Commerce vide SRO dated 31st May, 2006
2006 17-June	FE Cir. No. 07	**Trade Loans against FE-25 Deposits** With a view to facilitate genuine export transactions, it was decided that in case maturity of a pre-shipment export loan under FE-25 deposits falls prior to the date of realization of export proceeds, exporters would have the option to convert the pre-shipment loan into post-shipment loan, provided the maximum period of the loan (both pre-shipment & post-shipment) does not exceed 270 days.

A.2 Banking Policy, Inspection and Supervision Departments

Date of Announcement	Circular #	Policy Decision
2005 1-July	BPD-26 Circular Letter	**Information under Sec 19 of NAB Ordinance** The authorized officials of NAB have been allowed to collect information directly from the banks / DFI's on case to case basis.
2005 13- July	BPD-27 Circular Letter	**PRs for Comm / Corporate Banking Utilization of Unsecured / Clean loans for subscription in IPO Regulation R-6**. The banks have been advised to institute necessary checks, so that clean loans are not used for subscription in IPO. The following two requirements have been suggested: • At the time of sanctioning of a clean loan an undertaking be given by the customer that it would not be used for an IPO. • The banks should induce an internal system, whereby, no cheques, drafts and / or payment instructions will be made for an IPO subscription account from a clean personal loan/ credit line account.
2005 20-July	BPD-28 Circular Letter	**SBP Instruction on Compliance Function – Reporting Line of the Head of Compliance** It has been clarified to the banks that the Head of Compliance should report directly to the President / CEO of the bank/DFI.
2005 23- July	BPD-23 Circular	**Guidelines for Infrastructure Financing** In order to enable the banks / DFI's to undertake the infrastructure financing; guidelines have been issued keeping in view the best international practices.
2005 26- July	BPD-29 Circular Letter	**Acceptance of Lease hold land as collateral / security** It has been decided that henceforth, the banks/DFIs may themselves decide, in consultation with their lawyers, about i) accepting leased land as collaterals, and ii) determining the relationship between such collateral and the loan, on the basis of their own approved lending policies/requirements.

Date of Announcement	Circular #	Policy Decision
2005 18- August	BPD-30 Circular Letter	**L.G. Election 2005 Bank Holiday on Polling Day** August 18 & 25, 2005 declared as bank holidays only in those districts where 1st & 2nd phase of Local Government elections are held. All banks/ DFI's in those areas to remain closed.
2005 24 - August	BPD-31 Circular Letter	**L.G. Election 2005 Bank Holiday on Polling Day** In line with the decision of the Federal Government it has been clarified that all offices/branches of banks/DFIs shall remain open for business transaction on 25th August, 2005, however, all bank employees are free to cast their votes for Local Government Elections on 25th August, 2005 during polling hours.
2005 27- August	BPD-24 Circular	**PRs – Requirement of Desktop and full-scope evaluation** R-8 & R-11 of Corp & Comm Banking & SME respectively. Definition of desktop evaluation along with scope of the evaluator given.
2005 29- August	BPD-32 Circular Letter	**PR M-1. Requirement of Bank Customers having CNIC without photograph** With reference to Prudential Regulation M-1, it has been clarified to the banks that for opening of bank accounts of those CNIC holders issued by NADRA which do not bear photographs, banks are required to obtain any other valid document from the customer which bear their photograph. It has, further, been decided that the banks may allow their clients to open the accounts subject to provision of (i) a copy of photograph duly attested by gazetted officer/Nazim (b) a copy of CNIC without photograph duly attested by the same person who attested the copy of photograph (iii) a confirmation in writing to the effect that they have no other document bearing their photograph.

Date of Announcement	Circular #	Policy Decision
2005 1- September	BPD-25 Circular	**Prudential Regulations** In definition of secured under para A, serial no. 23 & 19 of PRs for Corporate / Comm Banking the following two para's have been added. (ii) The banks may also take exposure against Trust Receipt. They are, however, free to take collateral/securities, to secure their risks/exposure, in addition to the Trust Receipt. (iii) Banks / DFIs will be free to decide about obtaining security/collaterals against the L/C facilities for the interim period i.e. from the date of opening of L/C till the receipt of title documents to the goods In PRs for Consumer Financing (R-4) it has been clarified that the general reserve at the prescribed rate, as mentioned in regulation R-4, will be maintained for the performing potion only of consumer portfolio, instead of for the whole consumer portfolio.
2005 1- September	BPD-33 Circular Letter	**Deposit Mobilization Schemes** The banks have been directed to ensure that all advertisements in media (print, electronic or in any other form) soliciting deposit from the general public should explicitly indicate the annualized rate of expected return. The words "conditions apply" or other similar wording should not be used. Correct and complete information regarding various issues need to be given.
2005 5- September	BPD-34 Circular Letter	**PRs - Housing Finance in Rural Areas & Agri-Financing against Urban properties.** It has been clarified that (a) the banks may allow housing loans in rural areas under Prudential Regulations for Consumer Financing, provided all relevant guidelines/regulations on the subject are complied with by them. (b) The banks may also accept urban property against agricultural financing and/or financing to agriculturists, provided the lending banks are ready to accept the credit risks associated with such transactions.

<table>
<tr><th>Date of Announcement</th><th>Circular #</th><th>Policy Decision</th></tr>
<tr><td>2005
23- September</td><td>BPD-35 Circular Letter</td><td>PRs – “Clean Exposure” under Prudential Regulations for Consumer and SME Financing

The Clean exposure to an SME entity would not include the clean consumer financing limits (credit card, personal loan etc) allowed to the sponsor of the firm under PR for consumer financing. However, the banks/DFIs aggregate exposure on account of different clean facilities under the three heads of Corporate, SMEs and Consumer Financing will not exceed equity of the bank/DFI.</td></tr>
<tr><td>2005
3- October</td><td>BPD-37 Circular Letter</td><td>Business & Office hours during the month of Ramazan notified.

During the ensuing Holy month of Ramzan-ul-Mubarak, the following office hours will be observed in the State Bank of Pakistan: -

<table><tr><th>Days</th><th>Office Hours</th></tr><tr><td>Monday to Thursday & Saturday</td><td>08.30 A.M. to 1.45 P.M. (without break)</td></tr><tr><td>Friday</td><td>08.30 A.M. to 12.30 P.M. (without break)</td></tr></table>After the holy month of Ramzan-ul-Mubarak, office will automatically be reverted to pre Ramzan-ul-Mubarak timings.</td></tr>
<tr><td>2005
4- October</td><td>BPD-38 Circular Letter</td><td>Bank Holiday
Bank Holiday for 1st Ramazan notified.</td></tr>
<tr><td>2005
11- October</td><td>BPD-26 Circular</td><td>Classification of Dormant / Inoperative Account

It has been decided that banks should immediately develop a well defined and transparent policy duly approved by the President of the bank for classification purpose. A clause in the account opening form may be added informing the prospective account holder about the bank’s policies with regard to the classification of accounts as dormant / inoperative and its subsequent reactivation. For the existing accounts holders, the bank should advise in writing the same while sending the half yearly statement of account of through a separate letter. The account holders whose accounts have already been classified as dormant/inoperative may also be advised.</td></tr>
</table>

Date of Announcement	Circular #	Policy Decision
2005 11- October	BPD-39 Circular Letter	**PRs for Corp / Comm Banking - Investment in COI's / Inter Bank Placements with NBFCs** Para 2(d) of Regulation R-4 has been replaced as "Investment in COIs / inter-bank placements with NBFCs, provided the investee NBFC is rated 'A+', 'A' or 'A-' for long-term rating and at least 'A2' for short-term rating or equivalent by a credit rating agency on the approved panel of the State Bank of Pakistan or Standard & Poors, Moody's and Fitch-Ibca."
2005 14- October	BPD-40 Circular Letter	**PRs for Corp / Comm. Banking. Regulation R-6(1-B)20% limit on investment in shares** It was decided to broaden the exposure in shares from the existing limit of 20% & 35% to 30% & 45% of the banks and DFIs and Islamic Banks equity respectively provided their exposure, at any point of time, does not exceed the level of (i) 20% & 35% (for DFIs and Islamic Banks) of their equity of their direct equity investment in ready and cash market, and (ii) 10% of their equity in future contracts.
2005 15- October	BPD-41 Circular Letter	**Extension of Business Hours – Collection of Donation** Business hours extended up to 03:00 pm during Ramazan except Friday for collection of donations for the victims of earthquake.
2005 22- October	BPD-27 Circular	**PRs for Agricultural Financing** In order to boost the agriculture financing being extended by the banks/ DFI's, Prudential Regulations for Agricultural Financing were issued as a minimum standard. They were developed after consulting all the major stakeholders particularly the banks. They pertain to the risk management area only.
2005 22- October	BPD-28 Circular	**Withdrawal of redundant / old instructions** In order to update the instructions of SBP and to weed out those that have become redundant with the passage of time a number of circulars / circular letters issued by SBP from time to time have been withdrawn. Out of these 3 circulars are on norms of efficiency, 13 circulars / circular letters are on bank charges, 3 circulars on donation by banks, 6 circulars / circular letters on depreciation of fixed assets and control on expenditure, 1 circular on rate of profit / service charges on PLS deposit account.

Date of Announcement	Circular #	Policy Decision
2005 22- October	BPD-29 Circular	**Amendment in Regulation M-1 of PR for Corp / Comm. Banking** Para 5(a) of PR M1 for Corporate & Commercial Banking amended. Banks/DFIs are prohibited from opening of government accounts in the personal name of officials. Any such account, which is to be operated by an officer of the Federal/Provincial/Local Government in his/her official capacity, shall be opened only on production of a special resolution/authority from the concerned administrative department duly endorsed by the Ministry of Finance or Finance Department of the concerned Provincial or Local Government.
2005 26- October	BPD-42 Circular Letter	**Relief efforts for earthquake victims – Opening of accounts** Banks are advised to open the accounts of NGO's and other welfare organization while following the PR M-1 (KYC) for Corporate and Commercial Banking. Foreign currency deposits under FE-25 deposit scheme of the NGOs and other Welfare Organizations which are for the above mentioned purpose shall be excluded from the limit on FE-25 deposits scheme prescribed under para 6 of Regulation O-5 of the Prudential Regulations for Corporate and Commercial Banking.
2005 31- October	BPD-43 Circular Letter	**Bank Holiday** Bank holiday due to Eid ul Fitr notified. Bank closed from 3rd to 5th November.
2005 31- October	BPD-44 Circular Letter	**Bank Holiday** Bank holiday due to Iqbal Day notified. Bank closed on 9th Nov.
2005 2- November	BPD-45 Circular Letter	**Opening of Bank Accounts in Earth Quake affected areas in the absence of CNIC and other documents** In order to facilitate the relief efforts being undertaken by the government, identification even if CNIC is not available subject to the following condition. Introduction on the AOF can be given by either of the two i.e. Patwari, Any Government Official, Member of Legislative Assembly, Member of Union council, Postmaster / post man and any other elected representative. No other instruments except cross cheque issued by the relief commissioner can be deposited in such accounts.

Date of Announcement	Circular #	Policy Decision
2005 26- November	BPD-46 Circular Letter	**PR M-1. Obtaining CNIC From all the Bank Clients** In consultation with the PBA, the deadline for obtaining the CNIC from the existing customers has been extended till June 30, 2006.
2005 29- November	BPD-30 Circular	**Introduction of Basic Banking Account** In order to facilitate and provide basic banking facilities to the low income people in Pakistan, it was decided that all commercial banks operating in Pakistan will open a Basic Banking Account. It would be a non-remunerative account with an initial deposit of Rs 1000 and no service charges due to minimum limit.
2005 29- November	BPD-31 Circular	**Guidelines for Higher Education Financing Scheme** Realizing the importance education plays in developing the social fabric of the country, banks / DFI's given guidelines to undertake education financing on a commercially viable basis. These guidelines are separate from the Student Loans Scheme erstwhile Qarz-e-Hasna.
2005 29- December	BPD-47 Circular Letter	**Bank Holiday** Bank holiday notified on Monday 2nd January due to year end closing of accounts.
2006 5- January	BPD-01 Circular Letter	**Notification** The appointment of Dr. Shamshad Akhtar as Governor is notified.
2006 5- January	BPD-02 Circular Letter	**Public Holiday** Bank holiday due to Eid-ul-Azha notified for 10th, 11th & 12th January.
2006 23- January	BPD-03 Circular Letter	**Clarification. Levy of Service Charges on Zakat Accounts** In pursuance of Section 8 (c) (iii) para-2, Zakat & Ushr Ordinance, 1980, banks advised not to recover service charges on Zakat accounts.

Date of Announcement	Circular #	Policy Decision
2006 1- February	BPD-04 Circular Letter	**Benchmarking of Corporate Lending Products to KIBOR** To desist the banks/DFIs from using long tenor benchmark rates for shorter tenor loans, banks/DFIs are advised to use the benchmarking procedure for corporate loans.
2006 6- February	BPD-05 Circular Letter	**Public Holiday** Bank holiday due to Ashura notified for 8^{th} & 9^{th} February.
2006 22- February	BPD-06 Circular Letter	**Meeting of Board of Directors** For banks incorporated in Pakistan and having foreign equity in excess of 51%, the limit of holding overseas meeting of Board of Directors is enhanced from 2 to 4.
2006 22- March	BPD-07 Circular Letter	**Public Holiday** Bank holiday due to Pakistan Day 23^{rd} March notified
2006 10- April	BPD-08 Circular Letter	**Public Holiday** Due to 12^{th} Rabi ul Awwal is notified for April 11.
2006 28-April	BPD-09 Circular Letter	**Public Holiday** Bank holiday due to May day notified
2006 29- May	BPD-01 Circular	**Auto Loans** Banks / DFI's are advised not to report to CIB those vehicles which have been snatched or stolen provided the respective bank/DFI is fully secured to recover the outstanding amount from an insurance company.
2006 2- June	BPD-02 Circular	**Aggregate Clean Exposure** The existing instruction for banks/DFIs to ensure that aggregate exposure against all their clean facilities shall not at any point in time, exceed the amount of equity have been reviewed on advice of the PBA. Banks/DFIs are allowed higher limits for unsecured exposure on case to case basis taking into account CAMEL rating of the bank/DFI, quality of unsecured portfolio in terms of percentage of classified advances and write-offs/ charge-offs and past track record of dealing with clean portfolio.

Date of Announcement	Circular #	Policy Decision
2006 5- June	BPD-03 Circular	**Suo-Moto case 4/2006. Proper arrangement in banks for submission of utility bills** In compliance with the instructions of the apex judiciary with regards to the submission of utility bills by the general public, banks are advised to complete all formalities in this regard by July 31, 2006.
2006 9- June	BPD-04 Circular	**Margin Restriction for Financing against security of sugar stock** With a view to discourage hoarding of sugar and to ensure stability in prices of sugar, banks/DFIs are advised to ensure that the existing advances are to be fully adjusted by July 31, 2006 and fresh advances to be subjected to a 50% cash margin.
2006 17- June	BPD-10 Circular Letter	**Opening of Bank Account in the Earthquake affected areas in the absence of CNIC and other documents** With reference to BPD Circular Letter 45 dated November 2, 2005, in order to facilitate the people stricken by the earthquake, to opening of accounts without identification documents, including CNIC (subject to pre-conditions) has been extended till December 31, 2006.
2006 30- June	Circular Letter BPD-11	**Bank Holiday** Bank holiday notified on Saturday July 1st due to closing of accounts.
2005 16-July	(BSD-04) Circular	**Weekly Statement of Position** In order to remove redundancies and reduce the burden of reporting of banks and DFIs, SBP decided to revise the format of the Weekly Statement of Position. Banks and DFIs were advised to ensure the submission of the Weekly Statement of Position within 2 working days following each weekend. Further, all the banks and DFIs shall also submit Quarterly Position, in addition to the Weekly Statement of Position on the same format, if the date of quarter-end differs from the date of weekend. However, the Quarterly Position will be submitted within five working days following the quarter-end.

<table>
<tr><th>Date of Announcement</th><th>Circular #</th><th>Policy Decision</th></tr>
<tr><td>2005
27- October</td><td>(BSD-05)
Circular</td><td>Guidelines on Stress Testing

SBP, in pursuance of its goal to further strengthen the country’s banking system, has designed stress-testing guidelines for banks and DFIs to proactively manage their risks. Keeping in view the divergence of skill level and available resources among banks and DFIs, the model, initially, focuses on “Simple Sensitivity Analysis”. However, with the increasing know-how and availability of more data the model will over time undergo further refinement.</td></tr>
<tr><td>2005
28- October</td><td>(BSD-06)
Circular</td><td>Minimum Capital Requirements For Banks/DFIs

In order to further strengthen the solvency of individual banks/DFIs, it has been decided to raise the minimum paid up capital as well as Capital Adequacy Ratio (CAR) based on Risk Weighted Assets (RWA) as under:
i) The existing minimum paid up capital requirement for locally incorporated banks/DFIs has been raised to Rs 6 billion (net of losses) to be achieved in a phased manner as follows:

<table>
<tr><th>Minimum Paid-up Capital</th><th>Deadline by which to be increased</th></tr>
<tr><td colspan="2">(Net of losses) to be increased to:</td></tr>
<tr><td>a) Rs 3 billion</td><td>By 31-12-2006</td></tr>
<tr><td>b) Rs 4 billion</td><td>By 31-12-2007</td></tr>
<tr><td>c) Rs 5 billion</td><td>By 31-12-2008</td></tr>
<tr><td>d) Rs 6 billion</td><td>By 31-12-2009</td></tr>
</table>

The branches of foreign banks operating in Pakistan will also be required to increase their assigned capital to Rs6 billion within the above timelines prescribed for the locally incorporated banks/DFIs. However, those branches of foreign banks whose Head Offices hold a minimum paid up capital of US $ 100 million (net of losses) and have a CAR of 9% (determined as per Basel-I or Basel-II Accord) can be allowed to continue to maintain the minimum assigned capital of Rs2 billion (net of losses). All such branches of foreign banks shall, however, be required to seek specific permission from SBP to maintain the minimum assigned capital (net of losses) of Rs2 billion effective from 31st December 2005.</td></tr>
</table>

<table>
<tr><th>Date of Announcement</th><th>Circular #</th><th>Policy Decision</th></tr>
<tr><td></td><td></td><td> Cont…
(ii) The required minimum CAR, on consolidated as well as on stand-alone basis, would continue to be 8%. However, the existing uniform requirement for CAR has been replaced with the variable CAR, which will be based on the Institutional Risk Assessment Framework (IRAF) Rating assigned by SBP to each bank and DFI. Under IRAF, each bank and DFI is rated on a scale of 1 to 5 based on its (a) compliance with standards, codes and guidelines; (b) supervisory and regulatory information; (c) financial performance and condition; and (d) market information and intelligence. The required variable CAR to be maintained by each bank/DFI will be determined as follows:
<table>
<tr><th>IRAF Rating</th><th colspan="2">Required CAR effective from</th></tr>
<tr><td></td><td>31st Dec. 2005</td><td>31st Dec., 2006 and onwards</td></tr>
<tr><td>1 & 2</td><td>8%</td><td>8%</td></tr>
<tr><td>3</td><td>9%</td><td>10%</td></tr>
<tr><td>4</td><td>10%</td><td>12%</td></tr>
<tr><td>5</td><td>12%</td><td>14%</td></tr>
</table>
However, the banks/DFIs at the margin of the IRAF rating category which, in the opinion of the regulator, have high risk propensity may be asked to further increase the required CAR by One (1) percentage point.
The required minimum paid up capital as well as CAR can be achieved by the banks/DFIs either by fresh capital injection or retention of profits. The stock dividend declared after meeting all the legal and regulatory requirements, and duly reflected as such in the Annual Audited Accounts will be counted towards the required paid up capital of the bank/DFI pending completion of the formalities for issuance of bonus shares. “Any bank/DFI that fails to meet the minimum paid up capital requirement or CAR within the stipulated period shall render itself liable to the following actions:
i) Imposition of such restrictions on its business including restrictions on acceptance of deposits and lending as may be deemed fit by the SBP.
ii) De scheduling of the bank, thereby converting it into a non-scheduled bank.
iii) Cancellation of the banking license if SBP believes that the bank is not in a position to meet the minimum paid up capital requirement or CAR.” </td></tr>
</table>

Date of Announcement	Circular #	Policy Decision
2005 01- November	(BSD-07) Circular	**Amendments In Prudential Regulations - Classification And Provisioning For Loans And Advances** Following amendments in the existing classification and provisioning criteria prescribed under the Prudential Regulations were made: • Elimination of OAEM category. • Revision of aging criteria whereby now the loans /advances overdue by 90 days will be classified as Substandard, 180 days as Doubtful and one year or more as Loss. • Increase in provisioning requirement for substandard category to 25 percent. The revised criteria will be applicable to all types of financing facilities The benefit of forced sale value (FSV) of collateral allowed shall be available against the financing facilities of Rs5 million and above only Furthermore, the benefit of FSV of collateral under the aforesaid provisions of Prudential Regulations shall be further restricted to financing facilities of Rs10 million and above only with effect from December 31, 2006. SBP shall review the position to withdraw the benefit of FSV altogether after December 31, 2006.
2005 12- December	(BSD-08) Circular	**Information Systems: Guidelines On Audits And System Switchover Planning** Banks/DFIs should get their I.T. services audited by internal / third party auditors to ensure that adequate security and controls are in place. The internal/ third party auditors so engaged should review the IT related internal controls and evaluate/ validate the effectiveness of control systems. The board and the management should ensure that the independence, authority and accountability of the Information System Audit function are maintained and established by appropriate organizational setup in line with the international best practices. Therefore, the banks/DFIs are encouraged to upgrade their systems and related software. Banks /DFIs should also ensure that before introduction of new I.T. driven processes and systems for launching new products, the inherent operational risk is fully assessed and mitigated.

Date of Announcement	Circular #	Policy Decision
2006 13- January	(BSD-01) Circular	**Guidelines on Internal Controls** In term of Para 7 (c) of guidelines on internal controls issued vide BSD Circular No.07 dated May 27 , 2004, the banks/DFIs are required to get the Statement on Internal Controls attested from their external auditors. The compliance of this requirement regarding attestation of statement by the External Auditors was, however, deferred for one year till December 31, 2005 vide BSD Circular Letter No. 03 dated January 26, 2005. Now, on the suggestion of Pakistan Banks' Association (PBA) and the Institute of Chartered Accountants of Pakistan (ICAP), it has been decided to allow further time of one year to banks/DFIs to enable them to fully comply with the State Bank's Guidelines on Internal Controls. Accordingly, the compliance of the requirement regarding attestation of the statement by the External Auditors as per Para 7 (c) of the above referred Circular is being deferred for one year and will now be effective from the year ending on December 31, 2006.
2006 14- January	(BSD-02) Circular	**Amendments In Prudential Regulations - Classification and Provisioning For Loans And Advances** The classification and provisioning requirements as advised under BSD Circular No.7 dated November 1, 2005 have been revisited on the representation of Pakistan Banks' Association, and it has been decided to allow the banks/DFIs to meet the provisioning requirement of 25% against Substandard category in a phased manner i.e. 10% from 31st December 2005 and 25% from 31st December 2006, as also the benefit of Forced Sale Value (FSV) against Housing Loans under Prudential Regulation R-23 of the Prudential Regulations for Consumer Financing. Further, In terms of Regulation R-4 of Prudential Regulations for Consumer Financing, banks and DFIs are required to maintain a general reserve at the specified rates against their consumer portfolio. It is clarified that on classification of a performing/regular consumer loan into a non-performing/classified loan, the underlying general reserve created against such loan can be used against the specific provision and the banks/DFIs will be required to create only the balance provision to meet the specific provisioning requirement against such classified loan.

Date of Announcement	Circular #	Policy Decision
2006 15- February	(BSD-03) Circular	**Statutory Liquidity and Cash Reserve Requirements** WAPDA Sukuk has been declared as approved security for the purposes of meeting Statutory Liquidity Requirement (SLR) under Section 29 of the Banking Companies Ordinance, 1962 for banks having Islamic banking licenses either as full-fledged Islamic bank or Islamic banking branch. Further, SBP has also decided to revise the Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR) for IBs / IBBs as under :- As in the case of conventional banks, IBs / IBBs will maintain CRR of 5% of their time and demand liabilities on weekly average basis subject to daily minimum of 4%. In addition to the CRR, IBs/IBBs will maintain SLR of 8% of their TDL on overall basis, in the form of investment in WAPDA Sukuk not exceeding 5% of their TDL and remaining in the shape of cash balance with SBP in Special Deposit Account.
2006 17- February	(BSD-04) Circular	**Revised Forms Of Annual Financial Statements** SBP amended the existing forms of Accounts and Balance Sheet of banks. All banks were directed to prepare their Annual Financial Statements on the revised forms, effective from the accounting year ending 31st December, 2006. Further, SBP also decided that in order to ensure certain minimum disclosure to stakeholders, the DFIs will also be required to adopt the forms with suitable modification(s) in line with their nature of business, to prepare their Annual Financial Statements effective from the accounting year ending 31st December, 2006.
2006 20-April	(BSD-05) Circular	**Minutes of The Board of Directors'/General Meetings** The banks/DFIs, incorporated in Pakistan, shall submit certified copies of the approved minutes of meeting of their Board of Directors (BoD) and the general meetings (AGMs / EOGMs), within fifteen days of the date of the meeting in which these minutes were approved, alongwith the particulars of the directors present in the said meeting. It must be ensured that the minutes also contain the details of matters decided/resolved through circulation.

Date of Announcement	Circular #	Policy Decision
2006 08-May	(BSD-06) Circular	**e-CIB Data Reporting Limit** State Bank of Pakistan was working on a project of extending the scope of Credit Information Bureau (CIB) by removing the existing CIB data reporting limit of Rs. 500,000. This project was undertaken to cater to the increasing consumer credit information of the financial institutions. The new system is now fully operational and financial institutions can generate separate credit information reports in respect of consumer and corporate borrowers irrespective of size of outstanding amount of exposure. State Bank of Pakistan has decided to discontinue the reporting to CIB on old system.
2006 20-May	(BSD-03) Circular Letter	**Minimum Capital Requirements for Banks/DFIs** State Bank of Pakistan has decided that the General Provision against consumer finance held under Regulation R-4 of Prudential Regulation for Consumer Financing be eligible for inclusion in overall General Provision or General Reserves for loan losses under Tier 2 (Supplementary) Capital. However, the maximum limit of overall General Provision or General Reserve for loan losses would remain 1.25% of total Risk Weighted Assets.
2006 30-May	(BSD-07) Circular	**Held to Maturity Securities** State Bank of Pakistan has observed that some of the banks and DFIs have moved their risky portfolio to the Held-to-Maturity category to avoid booking revaluation deficit and categorized their good portfolio in rest of the two i.e. Held-for-Trading and Available-for-Sale categories. At the same time they are using Held-to-Maturity securities for managing liquidity by entering into repo transactions in the inter-bank market. This implies that they have categorized their securities as Held-to-Maturity without taking into consideration their ability to hold such securities till maturity. In order to discourage such practices, State Bank of Pakistan has decided that the securities classified as Held-to-Maturity by the banks and DFIs should neither be sold nor used for entering into repo transactions in the inter-bank market or borrowing under SBP repo facility/discount window with effect from July 01, 2006.

Date of Announcement	Circular #	Policy Decision
		Cont… However, the banks and DFIs are allowed for a one time reclassification of their securities so that they can rationalize the distribution of their investments in the three categories as per their liquidity requirements and holding capacity. This process of reclassification should be completed by June 15, 2006. The banks and DFIs shall also ensure that the securities acquired/ purchased after June 15, 2006 shall at the time of their acquisition/purchase be categorized into any of the three categories i.e. Held-for-Trading, Available-for-Sale or Held-to-Maturity and the decision taken to that effect shall be recorded in writing on the investment proposal/deal ticket.
2006 27-June	(BSD-08) Circular	**Minimum Capital Requirements – Implementation Of Basel II** The State Bank of Pakistan issued detailed instructions for adoption of various approaches for calculating capital adequacy requirements for credit, market and operational risks under Pillar I of Basel II Capital Accord and given the time frame for adoption of Basel II.
2006, July 22.	BSD Circular No. 10	**Statutory Liquidity and Cash Reserve Requirements** CRR has been revised for Islamic Banks/ Islamic Bank Branches to Weekly average of 7% (subject to daily minimum of 4%) of total Demand Liabilities (including Time Deposits with tenor of less than 6 months); and Weekly average of 3% (subject to daily minimum of 1%) of total Time Liabilities (including Time Deposits with tenor of 6 months and above) beside Statutory Liquidity (SLR) of 8% (excluding CRR) of their Time and Demand Liabilities.
2006, July 18.	BSD Circular No. 9	**Maintenance of Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR)** SLR and CRR of total Time and Demand Liabilities of Islamic Banks/Islamic Bank Branches has been changed. Further, all Time and Demand Liabilities, except borrowings from SBP and inter-bank borrowings, shall be accounted for in the calculation of Time and Demand Liabilities for the purpose of CRR and SLR.
2006 14-September	BSD Circular Letter No. 7	**Panel Of Auditors – Under Section 35(1) Of Banking Companies Ordinance, 1962** M/s Mehmood Idrees Masood & Co., listed in category 'C' of the State Bank's panel of auditors, has changed the name of their firm to "M/s Mehmood Idrees Qamar & Co."

Date of Announcement	Circular #	Policy Decision
2006 12-June	BSD Circular Letter No. 6	**e-CIB Services Charges:** State Bank has enhanced the scope of its Credit Information Bureau (CIB) by eliminating the existing reporting limit of Rs 500,000/- and SBP has decided to reduce the CIB reporting charges.
2006 10-June	BSD Circular Letter No. 5	**Data Reporting To CIB** After replacing old system of CIB with eCIB all the financial institutions are advised to send their data to the new system and ensure reporting all the credentials of the borrower.
2006 30-May	BSD Circular Letter No. 4	**Panel Of Auditors – Under Section 35(1) Of Banking Companies Ordinance, 1962** Inclusion of the Chartered Accountancy Firms in the Panel of Auditor's of SBP.
2006 20-May	BSD Circular Letter No. 3	**Minimum Capital Requirements For Banks/DFIs** General provision against consumer finance held under Regulation R-4 of Prudential Regulations for Consumer Financing, be eligible for inclusion in overall General Provisions or General Reserves for loan losses under Tier 2 (Supplementary) Capital.
2006 6-Feburary	BSD Circular Letter No. 2	**Panel Of Auditors– Under Section 35(1) Of Banking Companies Ordinance, 1962** Inclusion of the Chartered Accountancy Firms in the Panel of Auditor's of SBP.
2006 18-January	BSD Circular Letter No. 1	**Panel Of Auditors– Under Section 35(1) Of Banking Companies Ordinance, 1962** M/s Ebrahim & Co., listed in category 'A' of the State Bank's panel of auditors, has changed the name of their firm to "M/s BDO Ebrahim & Co."
May 05, 2006	IBD Circular Letter No 1 Of 2006	**Submission Of Returns To IBD** Islamic Banking Institutions were advised to submit the copies of returns (i.e. Weekly, Quarterly and Annual statements) to IBD as well which they submitted to Banking Supervision Department.

Date of Announcement	Circular #	Policy Decision
July 21, 2005	SMED Circular No.1	**Creation Of SME Department** After creation of SME Department all relevant mails that were previously submitted by banks to BPD and BSD were redirected to SMED.
January 30, 2006	SMED Circular No.1	**Markup Rates For Financing Commodity Operations** Banks were advised that markup rate for financing provided to the Governments and their agencies under commodity operations shall be negotiated bilaterally on the basis of relevant tenure of KIBOR.
February 28, 2006	SMED Circular No. 4	**Rates Of Service Charges Under LTF-EOP Scheme** To aid the industry the rates for different tenures of refinancing under Scheme for Long Term Financing for the Export Oriented Projects (LTF-EOP) notified vide BPD Circular No.7 dated March 3, 2005 were maintained for the next period till further instructions as under:-
March 14, 2006	SMED Circular No. 5	**Private Sector Participation In Wheat Procurement** To encourage private sector participation in wheat procurement banks have been allowed to provide financing to their eligible borrowers for procurement of indigenous wheat only during procurement season 2006. Banks were advised to fix a minimum margin requirement of 10% on such borrowings.
13/04/2006	SMED Circular No. 7	**Amendments in PRs # 12 &14 for MFBs** To bring ‘Classification and Provisioning’ for Microfinance loans in line with international best practices
27/06/2006	SMED Circular No. 10	**Guidelines for Commercial Banks to undertake Microfinance Business** Guidelines for carrying out Microfinance Business by Commercial Banks, 4 modes/options offered to CBs for conducting MF business; (i) MF counters, (ii) Standalone MF branches, (iii) independent MF subsidiary, (iv) partnership with NGOs for extending MF business.

Rates announced vide BPD Circular No. 7			
Tenure	**Service Charge**	**Spread**	**Rate for End User**
6 months	4.00%	3%	7.00%
Over 2 yrs to 3 yrs	4.00%	3%	7.00%
Over 3yrs to 7½ yrs	5.00%	3%	8.00%

<table>
<tr><th>Date of Announcement</th><th>Circular #</th><th>Policy Decision</th></tr>
<tr><td>27/06/2006</td><td>SMED Circular No.11</td><td>Prudential Regulations for Commercial Banks to undertake Microfinance Business

PRs applicable for various modes of Microfinance Business by Commercial Banks.</td></tr>
<tr><td>June 30, 2006</td><td>SMED Circular No.13</td><td>Service Charges Under LMM-Scheme

Service charges announced under the Scheme for Locally Manufactured Machinery (LMM) vide BPD Circular No.22 dated June 30, 2005 were maintained for the next period. Till further instructions as under:-
<table>
<tr><th colspan="4">Rates announced vide BPD Circular No. 22</th></tr>
<tr><th>Tenure</th><th>Service Charge</th><th>Spread</th><th>Rate for End User</th></tr>
<tr><td>6 months</td><td>8.00%</td><td>2%</td><td>10.00%</td></tr>
<tr><td>Over 6 months to 2 yrs</td><td>8.50%</td><td>2%</td><td>10.50%</td></tr>
<tr><td>over 2yrs to 7½ yrs</td><td>9.50%</td><td>2%</td><td>11.50%</td></tr>
</table></td></tr>
<tr><td></td><td></td><td>Rates Under Export Finance Scheme

Rates under Export Finance Scheme (EFS) are announced on monthly basis for the forthcoming period. However, rates announced vide BPD Circular No. 21 dated July 1, 2005 remained unchanged upto June 30, 2006 as under:
<table>
<tr><th colspan="3">Rates announced vide BPD Circular No. 21</th></tr>
<tr><th>Refinance Rate</th><th>Spread</th><th>Rate for End User</th></tr>
<tr><td>7.5</td><td>1.5</td><td>9.0</td></tr>
</table></td></tr>
</table>

A.3 Payment Systems

Date of Announcement	Circulars No.	Policy Decision
27-08-2005	PSD Master Circular/2005	**Master Circular Of Payment Systems' Statements** Issuance of Master Circular to Banks for supply of Payment Systems Statements to PSD SBP.
05-12-2005	PSD/DIR/Policy Guidelines/110/102/81	**Guidelines For Card Holders** Issuance of Guidelines for Card Holders in English.
03-02-2006	PSD/DIR/Policy Guidelines/110/102/81	**Guidelines For Card Holders** Issuance of Guidelines for Card Holders in Urdu.
06-04-2006	PSD Circular No. 1	**Guidelines For Standardization Of ATM Operation** Issuance of Guidelines to Banks for Standardization of ATM Operations.
July 31/August 31, 2005	SMED Circular No.2 – 7	**Monthly Rates Under Export Finance Scheme** Commercial banks who extended Export Finance Scheme at 7.5%, there maximum margin/spread should not exceed 1.5%.
Jan. 31/Feb 28, 2006	SMED Circular No.2 – 3	**Monthly Rates Under Export Finance Scheme** 7.5% Export Finance Scheme shall be applicable for the month of February and March, 2006.
March 31, 2006	SMED Circular No.6	**Monthly Rates Under Export Finance Scheme** 7.5% Export Finance Scheme shall be applicable for the month of April 2006.
April 29/May 31, 2006	SMED Circular No.8 – 9	**Monthly Rates Under Export Finance Scheme** Export Finance Scheme is notified i.e 7.5% p.a., shall continue to be applicable for the month of May and June 2006.
27/06/2006	SMED Circular No. 10	**Guidelines for Commercial Banks to undertake Microfinance Business** Guidelines for carrying out Microfinance Business by Commercial Banks, 4 modes/options offered to CBs for conducting MF business; (i) MF counters, (ii) Standalone MF branches, (iii) independent MF subsidiary, (iv) partnership with NGOs for extending MF business.
June 30, 2006	SMED Circular No.12	**Monthly Rates Under Export Finance Scheme** Export Finance Scheme is notified i.e. 7.5% p.a., shall continue to be applicable for the month of July 2006. However the margin of commercial banks should not be more than 1.5%.

B Governance Structure

The governance framework of the SBP is specified in the SBP Act of 1956. During 1990s SBP Act, 1956 has been amended to give exclusive authority to the State Bank for regulating the banking sector, conducting an independent monetary policy and setting limit on Government borrowings from the Bank. A bill, passed in February 1994, amended the State Bank of Pakistan Act, 1956, in terms of which monetary policy was made the sole responsibility of the State Bank of Pakistan. The Central Board of the Bank was given larger responsibility to regulate and supervise monetary and credit system keeping in view the national policy objectives of the Government. On January 21, 1997, the State Bank of Pakistan Act was further amended to strengthen autonomy of the Bank. The Act provides for an independent Central Board of Directors to oversee the affairs of the SBP.

B.1 The Central Board of Directors

Under the provisions of the SBP Act 1956, the "general superintendence and direction of the affairs and business of the bank" rests with the Central Board of Directors. Through an amendment in the SBP Act in February 1994, the Central Board of Directors was enlarged which now consists of the Governor, Secretary Finance, Government of Pakistan and seven directors nominated by the Federal Government. From these seven Directors, one Director from each province is nominated while ensuring representation to agriculture, banking and industrial sectors.

Given the nature of SBP's statutory objectives, and the complexity and breadth of the role it is expected to play in the development of the country, it is essential that members of the Central Board represent the major sectors of the economy. The Directors bring a wide range of experience ranging from the agriculture, banking and industrial sectors to the deliberations of the Board. The range of experiences provides for an appropriate balance of expertise and views to be brought to the deliberation on the range of issues affecting the strategic direction of the SBP.

The Governor is the Chairperson of the Central Board and all decisions are taken by majority of the members present and voting with the provision that in the event of equality of votes, the Governor may exercise a casting vote.

The Corporate Secretary acts as the Secretary to the Board, who ensures that the Board who is provided information and updates on a regular basis. The Secretary attends and records minutes of all meetings of the Board and provides a link among Directors in case of any query on any issue.

B.1.1 Members of the Board during 2005-06

1. Mr. Nawid Ahsan
2. Mr. Khair Mohamed Junejo*
3. Mr. Abdul Razak Dawood
4. Mr. M. Yaqoob Vardag*
5. Mr. Alman A.Aslam**
6. Mr. Kamran Y. Mirza
7. Mr. Mohsin Aziz
8. Dr. Wasim Azhar

Current Members of Central Board of Directors

1. Mr. Nawid Ahsan
2. Mr. Abdul Razak Dawood

*Retired on 19-08-2006 on completion of their tenure
**Resigned on 08-05-2006 due to his Professional engagements.

3. Mr. Mohsin Aziz
4. Dr. Wasim Azhar
5. Mr. Kamran Y. Mirza
6. Mr. Iftikhar A. Allawala
7. Mr. Zaffar A. Khan
8. Mr. Sardar Mohammad Ali Jogezai

B.1.2 Management

The Governor is the Chief Executive Officer and on behalf of the Central Board directs and controls the whole affairs of the Bank on day-to-day basis. The Governor has the authority to conduct the business, control the functions and manage the affairs of the bank except in matters required to be done specifically by the Central Board or by the Bank in general meeting.

B.1.3 Sub-Committees of the Board

The Board has constituted seven Sub-Committees with the objective of enabling meaningful deliberations and comprehensive analysis of the matters / issues relating to the respective areas assigned, so that credible basis / reasoning is established in respect of proposals put up for final decision by the Board.

The Sub-Committees of the Board were reconstituted in the meeting of the Board held on 20th December 2003 and again due to induction of two new members the Committees were reconstituted on 15th May, 2005. The current setup of each sub-committee is discussed in more detail below.

Audit

The members of the Audit Sub-Committee are Mr. Kamran Y. Mirza, Mr. M. Yaqoob Vardag,[*] Mr. Mujahid Eshai; Ex- President of Institute of Chartered Accountants of Pakistan (ICAP) The Committee is chaired by Mr. Kamran Y. Mirza with the Director Audit acting as the Secretary to the Sub-Committee.

The Audit Sub-Committee is responsible for the review function of Audit department as well as clears financial statements of the organization to oversee development of a system of internal audit on modern lines.

Monetary and Credit Policies

The Monetary and Credit Policies Sub-Committee consists of Mr. Abdul Razzak Dawood, Mr. Alman A. Aslam[*] and the Economic Advisor. Mr. Abdul Razzak Dawood is the Chairman of the Sub-Committee while the Economic Advisor is the Secretary of the Committee.

The Sub-Committee has the mandate to deal with all matters relating to the formulation and Implementation of monetary & credit policies.

Budget and Expenditure

The members of the Budget and Expenditure Sub-Committee are Mr. Mohsin Aziz and Dr. Wasim Azhar. The Director Accounts Department acts as the Secretary of the Sub-Committee.

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[*] Retired on 19-08-2006.on completion of their tenure.

The Sub-Committee is responsible for reviewing the budget and expenditure of the SBP. It also examines proposals for write off and re-scheduling, concessions and waivers in respect of SBP's loans/Investments outstanding against banks/DFIs etc. In addition, the committee evaluates and gives recommendations on any other matter referred to it by the Governor.

Human Resources

This Sub-Committee comprises of Mr. Khair Mohammad Junejo* and Mr. Kamran Y.Mirza. The Director Human Resources acts as the Secretary of the Sub-Committee.

The Sub-Committee deals with matters pertaining to the human resource policies regarding recruitment, promotion, compensation, performance evaluation and retirement; oversees the Human Resource Audit and acts as the Interview Committee for promotion of OG-6 Officers to the next grade as well as dealing with all matters relating to training policies, their implementation and monetary sanctions, etc.

Automation

The members of the Automation Sub-Committee include Mr. Mohsin Aziz, Dr. Wasim Azhar and Deputy Governor (Management). Mr. Mohsin Aziz chairs the Sub-committee while the Director ISD acts as the Secretary to the Sub-Committee.

The Sub-Committee is empowered to deal with all matters relating to implementation of Information Systems Strategy Plan, Procurement of IT related items outside the Information Systems Strategy Plan and may also undertake any other assignment if referred by the Governor.

Building Projects

The Building Projects Sub-Committee comprises of Mr. M.Yaqoob Vardag[*] (Chairman), Mr. Khair Mohamed Junejo* and The Director Engineering Department acts as the Secretary of the Sub-Committee.

The Sub-Committee is empowered to sanction /approve expenditure in respect of construction of SBP's buildings and their maintenance as well as matters pertaining to the acquisition and disposal of moveable and immovable assets. In addition, the Sub-Committee may also oversee other works/projects as may be referred to it by the Governor.

[*] Retired on 19-08-2006.on completion of their tenure.
**Resigned on 08-05-2006 due to his professional engagements.

Investment

The Sub-Committee on Investment consists of Mr. Nawid Ahsan, Mr. Abdul Razzak Dawood, Mr. Alman A. Aslam[**] and Deputy Governor (Banking). Mr. Nawid Ahsan is the Chairman while. Mr. Zafar M. Sheikh acts as a Co-Opted Member. ED (FRM) acts as Secretary of the Sub-Committee.

The Sub-Committee is responsible for providing guidance to streamline Foreign Exchange Reserves Management; ensure optimal placement/investment of Foreign Exchange Reserves of the country and to periodically review the mechanism of investment of Foreign Exchange Reserves.

B.1.4 Main Decisions of the Board from July, 2005 to June, 2006

The Board held ten meetings during the FY2006 at different centers and following issues came up for discussion/deliberations and who resolved:

Accounts

a) Increase in Auditor's Fee for FY 2004-05
b) Accounting for Investments
c) Spill over of Unutilized Capital Expenditure to the next year
d) Bank's Profit for FY2004-05 Appropriation of.
e) Proposals for Expenditure Budget & Capital Expenditure Budget of SBP and its subsidiaries for the year 2005-06
f) Annual Accounts of the Bank for the year ended 30th June,2005
g) Launching of Rs20/= Bank Note-Media Campaign
h) Review of Budget vis-à-vis Expenditure for July,2005 to September,2005
i) Review of Estimates of Profit & Loss Accounts(July-05 to November-05)
j) "On account " Payment of Surplus Profit to the Federal Government
k) Actual Profit & Loss Account for the period July to December-05 and the Estimates of Profit & Loss Account for the period January to June-06
l) Review of Budget vis-à-vis Expenditure from July to December-06
m) Appointment of Auditors and Fixation of their Fee- FY 2005-06
n) Revision of State Bank of Pakistan Expenditure Regulations-2004
o) Actual Profit & Loss for the Period July,2005- March,2006 and Estimates for the Period April to June,2006
p) Review of Budget vis-à-vis Expenditure from July 01,2005-March,2006
q) Revision of State Bank of Pakistan Expenditure Regulations-2004

Agriculture Credit

a) Re-imbursement of bonafide losses in respect of Agricultural Loans Guaranteed by ABL, MCB, NBP, UBL during the year 2000 under the State Bank of Pakistan's Guarantee Scheme

Banking Policy

a) New Guidelines on Write off of Irrevocable Loans and Advances

Banking Supervision

a) Quarterly Performance Review of the Banking system for the quarter ended March 31, 2005.
b) Performance Review of the Banking System for the quarter ended June 30, 2005.
c) Performance Review of the Banking System for the quarter ended September, 2005.

Corporate Services

a) SBP Memorial Chairs in Economics at various universities-Revision of the Scheme
b) Appointment of Dr. Shamshad Akhtar as Governor, State Bank of Pakistan.

Exchange and Debt Management

a) Maintenance & Service Support Change in respect of Hardware, Communication & Network Equipment, Standard Software and Licensing Fee for six months,
1st July -31 December,2005

Economic Policy

a) Credit Plan for FY2005-2006 and Monetary Policy Statement for July-December,2005
b) Monetary Policy Statement (2005-06)-Mid Term Review

Human Resource

a) Renewal of contracts of IT Professionals
b) Renewal of contract – Consultant to the Shariah Board
c) Appointments of Investment Analyst
d) Appointments of Consultant for SBP Museum
e) Appointments of Manager Back Office/Settlement Operations
f) SBP Staff Regulations (2005)
g) Appeal of two SBP officers against their Performance Appraisal for 2003-04 under SBP Staff Regulation 35.
h) Merit/Provincial/Regional Quotas.
i) Staff Loans
j) Appointments on Regular basis in Separate Salary Structure for Specialized Professionals/Renewal of contract of Employment in the Bank
k) Revision in AMI Budget and Bell Curve Distribution
l) Regulation 17(i) of SBP Staff Regulations-2005
m) Annual Merit Increase(AMI) & Performance Bonus for the Period July 2004 to June 2005
n) Renewal of contract of Director Islamic Banking Department
o) Request for increase in Compassionate Allowance – Ex-Deputy Director Mr. Ahmed Ashraf
p) Appointment of Head of Treasury.
q) Car Loan Depreciation Policy-Deceased officers
r) Annual Leave – Review of Accrual Guidelines
s) Amendments in Benevolent Fund Scheme
t) Increase in Salary on promotion

u) Revision of SBP Salary Scales and Employees Compensation
v) Appointment of Executive Director
w) Re-appointment of Executive Secretary to the Governor
x) Renewal of contract of Project Manager RTGS
y) Training Courses at NIBAF
z) Proposal for conducting Compensation and Benefit Survey
aa) Appointments in the Bank
bb) Renewal of Contract of 36 officers of Information System Department
cc) Renewal of Contract of Co-Director ISD
dd) Renewal of Contract of 06 officers working on RTGS Project Management
ee) Waiver of Recovery against Leave Salary & Educational Expenses on Humanitarian Ground
ff) Re – imbursement of re-location expenses
gg) Hiring of Consultant on Research

Information System

a) Procurement of SWIFT Hardware
b) Maintenance & Services Support through M/S Hyundai Information Technology-objection raised by PPRA(Public Procurement Regularity Authority)

Islamic Banking

a) Reappointment of members of State Bank Shariah Board

Research

a) Financial Sector Assessment Report 2004
b) Report on the working of the Bank for the year ended June 30, 2005.
c) SBP Conference –Monetary- cum- Exchange Rate Regime Detailed Break-up
d) The State of Pakistan's Economy – 1st quarterly report for July – September, 2005.
e) The State of Pakistan's Economy – 2nd quarterly report FY 2005-06

Strategic Planning

a) Performance Report for December 1999- November 2005

Investment Services

a) Performance Review & options to add value in the existing Investment Process & Conduct of Due Diligence of the new and existing Fund Managers
b) Performance Review of External Fund Managers- Findings & Recommendations of Due Diligence Meetings.

Project Management

a) Maintenance & Service Support Change in respect of Hardware, Communication & Network Equipment, Standard Software and Licensing Fee for six months,
1st January -30 June,2005
b) Maintenance & Service Support through M/s Hyundai Information Technology

Small & Medium Enterprises

a) Creation of Emergency Livelihood Restoration Fund (ELRF) under ADB's Microfinance Sector Development Program Loan

B.1.5 Main Issues Considered by Sub-Committees of the Board During July, 2005 to June, 2006

Audit

The Sub-Committee met six times during the year, and issues on financial statements, budgets and internal controls including the following came up for discussion:

- Change in the format of the weekly Statement of Affairs of the Issue and Banking Department.
- Proposed appropriations of the profit for the FY 2004-05.
- Annual Accounts for the year ended 30th June, 2005.
- Budget for the period 2005-06.
- Accounts for the period July 2005 to November, 2005.
- Profit & Loss for the period July to December, 2005 and estimates of Profit and Loss for the period December, 2005 to June, 2006.
- Matters arising out of previous meetings – Aging of amount overdue & loans & Advances.
- Management letter issued by the Auditors on their review of financial statements as on 30th June, 2005.
- To review and consider the re-appointment of present Auditors namely, KPMG Taseer Hadi & Co and M. Yousuf Adil Saleem & Co.
- A note for the review of Governor's financial powers under Expenditure Regulations – 2004.
- Estimates of profitability for 2005-06.
- Auditor's remuneration for 2005-06.
- A paper on appropriation of profits to reserves.

Monetary and Credit Policies

The Sub-Committee met twice during the year and deliberated on the following issues:

- Monetary Policy Statement (July-December, 2005)
- Credit Plan for FY06
- Monetary Policy Statement (January-June, 2006)

Budget and Expenditure

The Sub-Committee met four times during the year and the following issues came up for discussion:

- Consolidated Budget of SBP for the year 2005-06.
- To review the budget viz-a-viz expenditures for the period of July, 2005 to September, 2005.
- To review the budget viz-a-viz expenditures for the period of July, 2005 to December, 2005.
- To review the budget viz-a-viz expenditures for the period of July, 2005 to March, 2006.

Human Resources

The committee met fifteen times during FY06.

Automation

The committee met two times during FY06.

Building Projects

Twenty-two meetings of the Sub-Committee were held during FY 2005 for decisions and recommendations on the following:

- To discuss the Capital/Revenue Budget of Engineering Department and all Field Offices in respect of engineering works for the fiscal year 2005-06.
- To finalize the Capital/Revenue Budget of Engineering Department and all Field Offices in respect of engineering works for the fiscal year 2005-06.
- Progress Report on action taken on decision arrived at previous meetings of the Sub-Committee of Directors of Central Board on Building projects.
- Summary on decision taken by the Committee during the last one year.
- Discussion on outstanding bills due to various issues.
- Progress Report on action taken on decision arrived at previous meetings of the Sub-Committee of Directors of Central Board on Building Projects.
- Status report of completed works during the last one year in the form of Graph (Bar Chart).
- Claim of M/s Progressive Consultant (Pvt.) Ltd in respect of Bank’s office building Sialkot.
- Accounts Department note for setting up automated in house currency sorting cell (CSC).
- Details of Capital Budget for the fiscal year 2005-06 approved by the Central Board for information.
- Approval of Bar Chart format for presentation of status report of projects as approved in the last Meeting.
- Visit to Khuzdar for settlement of some issues regarding Bank’s Plot.
- Status report of the projects/works.
- Status report of the projects/works approved in the Budget for the fiscal year 2005-06.
- For negotiation of price of land with the owner also discuss with the contractor, the plans for construction of Boundary wall at the premises.
- Status report of the project/works.
- Supply & installation of 100 KVA Diesel Generator Set at Sukkur Office.
- Conversion of Stats Bank of Pakistan, Library Building, Karachi into Art Gallery and Museum.
- To discuss various issues in respect of engineering works and to review the status report of on going projects/works.
- To discuss various issues in respect of engineering works and to review the status report of on going projects/works.

- To discuss various issues in respects of engineering works. Further a surveyof entire building premises of Muzaffarabad Office will be carried out by the Sub-Committee on March 25, 2000 to oversee the adverse effect of recent earthquake caused to the building and adoption of preventive measures for future.
- To discuss various issues in respect of engineering works.
- To visit the site of under construction office building at Sialkot.
- To discuss the deferred Notes and other items in respect of Engineering works alongwith budget of engineering works for the fiscal year 2006-07.

Investment

The Sub-Committee met twice for deliberations during the year where Mr. Garry Hawker of M/s. Mercer made a presentation on the performance of Externally Managed Reserves Portfolio. An update on “Acquisition of Deutsche Assets Management by Aberdeen” and proposed further course of action. A presentation was also made by Mr. Sikander H. Khawaja on findings and recommendations based on the due diligence trip.

C Organizational Chart

D Management Directory

Name	Designation	E-mail	Phone
Dr. Shamshad Akhtar	Governor	shamshad.akhtar@sbp.org.pk	+92-21-9212447 +92-21-9212448
Mansur -ur-Rehman Khan	Deputy Governor (Corporate Services)	mansur.rehman@sbp.org.pk	+92-21-9212455
Riaz Riazuddin	Economic Adviser (Policy & Research)	riaz.riazuddin@sbp.org.pk	+92-21-9212535
Muhammad Kamran Shehzad	Executive Director (Banking Policy & Regulation)	kamran.shehzad@sbp.org.pk	+92-21-9212512
Jameel Ahmed	Executive Director (Financial Resources Mngt)	jameel.ahmed@sbp.org.pk	+92-21-9212507
Mushtaque Jinadi	Advisor (Infrastructure Finance/ Banking Regulation)	mushtaq.jindani@ sbp.org.pk	+92-21-9211869
Syed Ali Azhar Naqvi	Advisor (Advisor Training / HR)	Azhar.naqvi@ sbp.org.pk	+92-21-9211870
Azhar Iqbal Kureshi	Advisor (Development Finance)	azhar.kureshi@sbp.org.pk	+92-21-9212459
Amer Aziz	Advisor (Banking Supervision)	amer.aziz@sbp.org.pk	+92-21-9212496
Asad Qureshi	Advisor (Financial Markets/Reserve Mngt)	asad.qureshi@sbp.org.pk	+92-21-9212453
Muhammad Askraf Khan	Director, Agriculture & Rural Credit	ashraf.khan@sbp.org.pk	+92-21-9217216
Inayat Hussain	Director, Banking Inspection (on-site)	inayat.hussain@sbp.org.pk	+92-21-9211059
Syed Irfan Ali	Director, Banking Policy & Regulation	syed.irfan@sbp.org.pk	+92-21-9213580
Lubna Farooq Malik	Director, Banking Surveillance	lubna.farooq@sbp.org.pk	+92-21-9212507
Amjad Manzoor	Director, Business Support Services	amjad.manzoor@sbp.org.pk	+92-21-9212398
Mohammad Mansoor Ali	Director, Economic Analysis	mansoor.ali@sbp.org.pk	+92-21-9212464
Syed Samar Hasnain	Director, Exchange Policy	samar.husnain@sbp.org.pk	+92-21-9212483
Syed Wasimuddin	Director, External Relations	syed.wasimuddin@sbp.org.pk	+92-21-9212562

Aftab Mustafa Khan	Director, Finance	aftab.khan@sbp.org.pk	+92-21-9212481
Sara Bukhtiar	General Counsel, General Counsel's Office	Sara.bukhtiar@sbp.org.pk	+92-21-9212541
Akram Durrani	Head /Director, Human Resources	akram.durrani@sbp.org.pk	+92-21-9211489
Pervez Said	Director, Islamic Banking	pervez.said@sbp.org.pk	+92-21-9212495
Sabah uz Zaman	CIO, Information Systems & Technology	sabah.zaman@sbp.org.pk	+92-21-9212539
Noman Ahmed Qureshi	Director, Internal Audit & Compliance	noman.qureshi@sbp.org.pk	+92-21-9212499
Asma Ibrahim	Director, Museum & Art Gallery	asma.ibrahim@sbp.org.pk	+92-21-9211867
Aftab Mustafa Khan	Corporate Secretary, Office of the Corporate Secretary	aftab.khan@sbp.org.pk	+92-21-9212522
Hasan Rashid	Director, Off-site Supervision & Enforcement	hasan.rashid@sbp.org.pk	+92-21-9212602
Muhammad Saleem Rahmani	Director, Payment System	muhammed.rehmani@sbp.org.pk	+92-21-9212549
Saeed Siddiqui	Project Manager, RTGS Project Management Office	saeed.siddiqui@sbp.org.pk	+92-21-9212442
Suleman Chhagla	Head, Risk Management Cell	suleman.chhagla@sbp.org.pk	+92-21-9212467
Qasim Nawaz	Director, SME & Microfinance	qasim.nawaz@sbp.org.pk	+92-21-9212979
Mansoor Hassan Siddiqui	Director, Strategic & Corporate Planning	mansoor.hassan@sbp.org.pk	+92-21-9212596
Dr. Azizullah Khattak	Director, Statistics & Data Warehouse	aziz.khattak@sbp.org.pk	+92-21-9212565
Mazharul Haq	Director, Training & Development	mazharul.haq@sbp.org.pk	+92-21-9212473

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