Development Finance Review

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SME Finance Department,

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EXECUTIVE SUMMARY

The Government of Pakistan, recognizing the severity of economic and social impact of recent floods, announced a number of relief packages for affected borrowers which are being implemented by State Bank in consultation with the relevant Ministries. Incentives such as Scheme For Revival of SMEs & Agricultural Activities in Flood Affected Areas, a higher sharing of bonafide losses under the Credit Guarantee Scheme, and relief in provisioning requirements on restructures/rescheduled loans are some of the important measures.

However, the DF Portfolio of the banking sector continues to stagnate due to credit constraints faced by private sector on account of high government borrowing to support commodities and sustain increasing budget deficit. The total outstanding DF portfolio recorded a marginal decline of 0.8% YoY, though recording an increase of 1.3% QoQ basis. Of the total **DF** outstanding amount, SME segment holds the largest share of 39.6% followed by Infrastructure, Agriculture, Housing and Micro Finance sectors with 31.3%, 20.0% 7.9% and 1.2% respectively.

NPLs of the Banking Industry have been increasing due to strained economic conditions; QoQ NPLs of Banking Industry rose by 3.1% while those of DF Sector recorded an increase of 1.3% (from Rs. 148.1 Billion to Rs. 150.1 Billion). Agriculture and Infrastructure Sector saw a decline of about 4.5% and 29.4% respectively, while other DF sectors witnessed rise, QoQ basis.

The total number of **DF** Sector Borrowers (excluding No of Infrastructure Borrowers) recorded at the end of December 2010 was 2,132,607 registering a decline of 1.4% YoY basis. While the decline recorded QoQ basis was 1.9%. Of the total number of outstanding borrowers, about 56% belong to Agriculture sector, 30% to Microfinance, 10% to SME and 5% to Housing sector. All DF sectors witnessed decline, QoQ basis, except Agriculture sector which saw a growth of 3.3%.

Going forward, the current challenging economic and business environment characterized by rising interest rates, law & order situation and banks' reluctance to extend credit will continue to adversely affect the growth in DF sectors. However, implementation of fiscal side reforms by the Government as well as a recovery in the agriculture sector will provide breathing space to the DF sector and enable recovery in the economy.

1.0. STATE OF SME FINANCE

According to the Census of Establishments conducted by the Federal Bureau of Statistics (FBS) there are about 3.2 million economic establishments in Pakistan. Out of these SMEs (with employment base of up to 99) constitute about 90% of all private enterprises employing approximately 78% of nonagricultural labor force[1]. SMEs contribute over 30% to GDP, 25% in export earnings besides sharing 35% in manufacturing value addition[2]. Economic indicators clearly reveal the importance and potential of SME sector in the national economy.

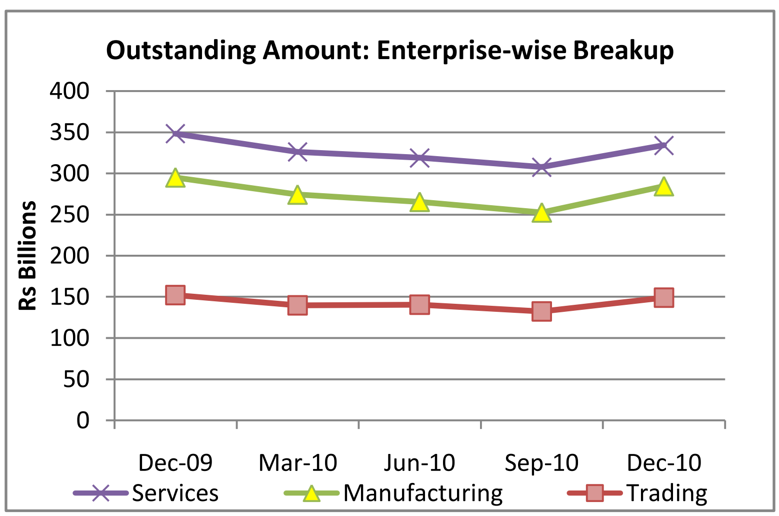
SME sector's outstanding credit stood at Rs. 334 Billion constituting about 9.6% of total outstanding **Banking Portfolio** (Corporate, SME, Agriculture, Consumer, Commodity and Staff Loans), recording an encouraging quarterly growth of 8.6% at the end of the period under review. While the corresponding increase in 2009 was recorded at 5.3%. However, there was a decline of 4.1%, YoY basis. This sector, like other priority sectors of the economy, has been experiencing difficulties due to prevailing economic challenges in the country. The decline may be attributed to many factors such as energy shortages, high interest rates and overall shyness of the industry towards the sector in the face of rising NPLs. Furthermore, another reason might be the diversion of banking funds towards investments in T-Bills as well as providing credit to the Government of Pakistan to meet the financing needs for Commodity Operations and Public Sector Enterprises.

Enterprise wise analysis revealed that ***Manufacturing*** *SMEs* share formed 40.5%, ***Trading*** *SMEs* 44.7%, and **Services** SMEs a share of 14.8% at the end of the quarter under review. Moreover, their share in total SME outstanding borrowers was 17.9%, 50.9% and 31.1% respectively.
There has been a consistent increase in the NPLs of the whole Banking Industry during the last four years and this quarter too saw a rise of about 3.1%, QoQ basis. In this regard, SME Sector was not an exception as its NPLs too rose by 5.4%, on QoQ basis. Further, the total number of borrowers saw a decline of 6.1% and SME sector again was not an exception as it too recorded a quarterly decline of about 6.1%.

1.1. OUTSTANDING AMOUNT- BREAK-UPS

Enterprise wise Break-up

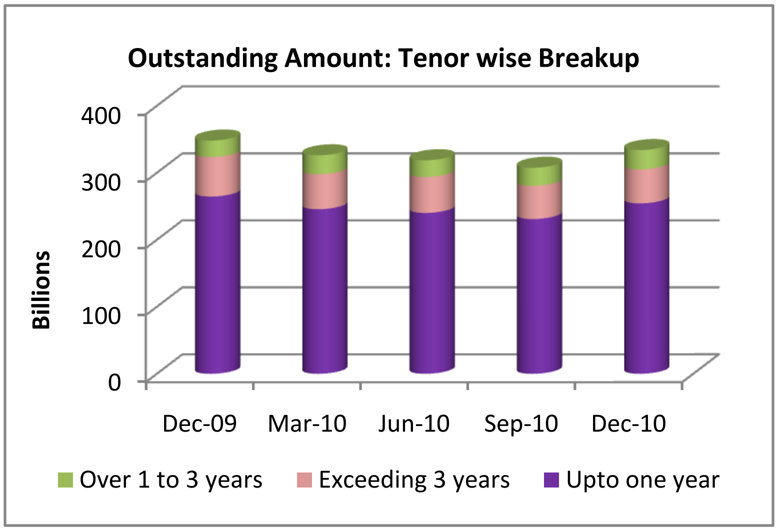
Enterprise wise break-up revealed that the absolute outstanding amount against **Trading, Manufacturing** and **Services** concerns was Rs. 149.2 Billion, Rs.135.3 billion and Rs.49.5 billion respectively at the end of December, 2010.
While their share in total SME Outstanding amount was 44.7%, 40.5%, and 14.8%



[1] Census of Establishments 2005

[2] Economic Survey of Pakistan 2003- 04

respectively. Trading and Manufacturing SMEs recorded a quarterly growth of 12.8% and 12.4% respectively, whereas the Services sector's share witnessed a decline of 9.8%. Further, the trend of outstanding financing during the past four quarters is shown in **Figure**.



Tenor wise

Tenor-wise breakup of the total SME Outstanding Amount showed that the lion's share of about 76.2% was provided as **Short Term** financing of up to one year, while the share of **Long** and **Medium** term financing was 15.2% and 8.6% respectively.

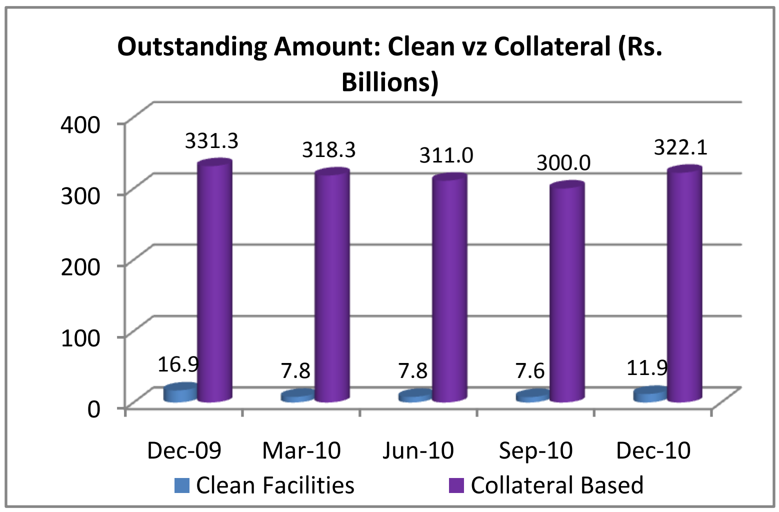
It is encouraging that the **Medium** term financing witnessed a rise of about 17.6% while **Long** and **Short** term outstanding financing witnessed a decline of 14.1% and 3.8% respectively, YoY basis.

Clean vz Collateral

The breakup of the SME Outstanding Amount viz-a-viz **Clean** and **Collateral** groups revealed that the major chunk of financing (96.4%) was collateral based while only 3.6% of the SME Outstanding amount was categorized as clean lending.

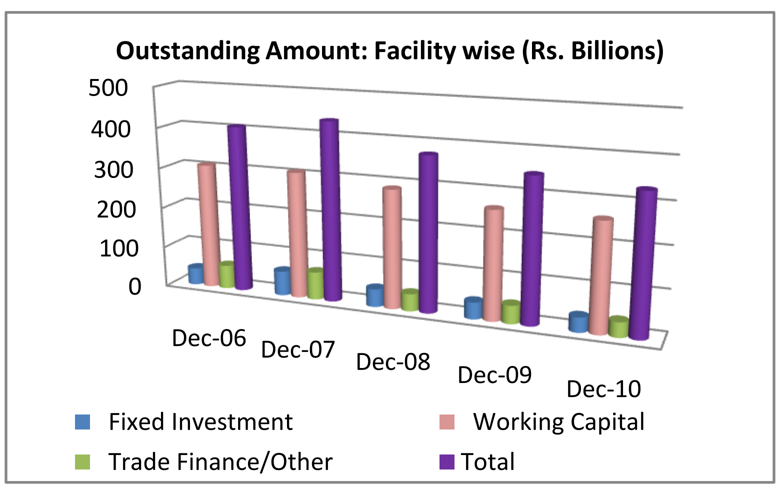
However, there was a decline of 29.3% and 2.8% in Collateral and Clean based outstanding financing respectively, in line with the overall decline in SME outstanding amount, YoY basis.

The meagure share under clean lending reflects that the industry has yet to come up with innovative products focusiing business cashflows instead of collaterals in order to fully utilise the SBP Clean lending limit of Rs 3 Million.



Facility wise

Facility wise breakup exhibited that the share in outstanding SME Amount viz-a-viz **Fixed Investment**, **Working capital** and **Trade Finance** was 10.8%, 78.3%, and 10.9% respectiveley at the end of the period under review. Fixed



Investment and Working Capital witnessed a rise of 6.7% and 12.4% whereas Trade Finance saw a decline of 11.5%, QoQ basis.

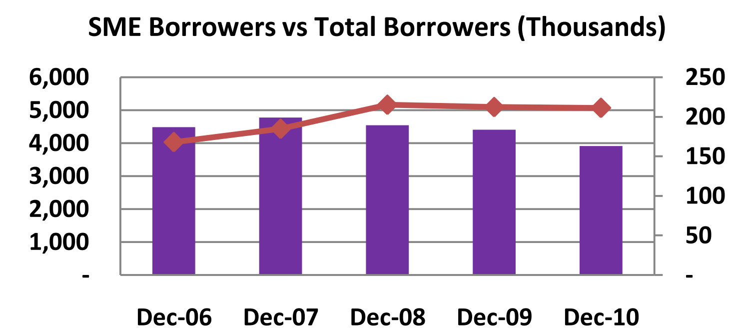
The major chunk being under working capital, may reflect the day to day needs of the businesses as well as portray the fact that long term investment and development is not considered an important business development initiative by SMEs. Realizing the fact, SBP has also introduced a Refinancing facility for modernization of SMEs.

Moreover, YoY trends under this category can be seen in the **figure**.

1.2. NUMBER OF OUTSTANDING BORROWERS

SME outstanding borrowers stood at 211,419 constituting about 5.4% of the total number of outstanding borrowers in the banking industry and recording a quarterly decline of about 6.1% at the end of the period under review. The decline is in line with the overall reduction of about 6.6% borrowers of the total banking industry.

About 89.8% of the SME borrowers availed working capital finance, 5.3% Fixed Investment and the rest Trade Finance. There has been a notable growth of 31.1% during the period Dec-05 to Dec-10 in the SME number of borrowers.



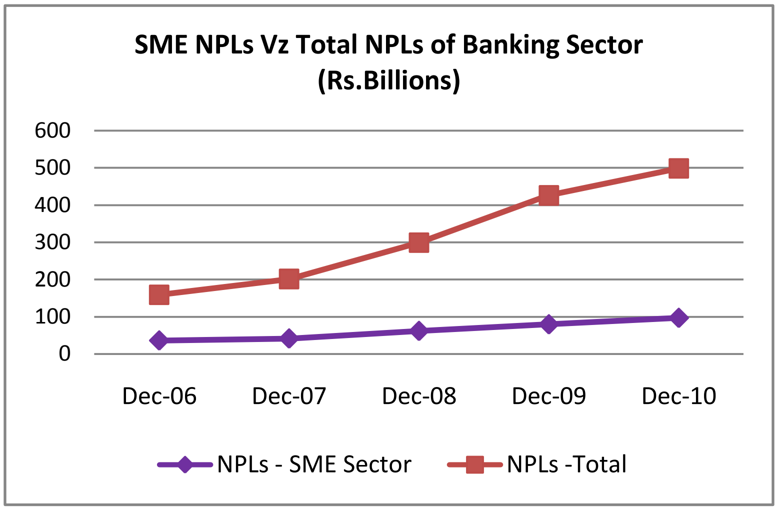
	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Total Borrowers	4,487	4,781	4,544	4,407	3,909
SMEs No of Borrowers	168	185.04	215	212	211

Likewise, the the share of the borrowers categorized as ***Trading SMEs*** had the highest with 50.9%, followed by ***Services SMEs*** with 31.1% and ***Manufacturing SMEs*** with 17.9% at the end of the quarter under review. Besides, Trading and Services SMEs saw a rise of 3.8% and 0.2% whereas Manufacturing SMEs witnessed a decline of 11.7% YoY basis.

Similarly, a duration wise analysis of the SME borrowers revealed that the share of borrowers availing ***long term loans*** (exceeding 3 years) was 48.6% , ***Short Term loans*** (up to one year) was 36.3%, and ***Medium Term loans***(1 to 3 years) constituted about 15.0% of the total outstanding SME borrowers.

In the same way, an analysis of ***Loan Size*** wise borrowers manifest that 72.6% of total SME Borrowers fell in the bracket size of ***up to Rs. 0.5 Million (M) ,*** and recorded a growth of 2.8% YoY basis**.** While the borrowers against the bracket size of loans over ***Rs. 0.5 to 1 M, Rs. 1 to 2 M, Rs. 2 to 3M,*** and ***over Rs. 3 to 5M*** had a share of *7.4%, 6.1%, 2.9%, and 3.5%* respectively; whereas the share of borrowers against the **Loan Size** of **over 5 Million** was about 7.4% to at the end of the period under consideration.

1.3. NON PERFORMING LOANS



The Non Performing Loans (NPLs) of SME Sector increased from Rs. 91.6 billion at the end of December 2009 to 96.5 Billion at the end of December 2010, constituting about 19.4% of total NPLs of the Banking industry. The quarterly increase recorded was 5.4% as compared to rise of 4.4% during the corresponding quarter of 2009.

Of the total amount about 80.4% is attributed to Working Capital finance, 16.4% to Fixed Investment Finance, and the remaining 8.6% to Trade Finance.

A closer look at the behavior of SME sector's NPLs reveals that there has been a sharp rise in NPLs since December, 2007 mainly attributed to the wave of economic slump which has been further aggravated by the unprecedented floods. Further, the increase in SME NPLs is also consistent with the rise of the total NPLs of banking industry which too recorded a quarterly rise of 3.1% at the end of the period under review.

1.4. BANKING GROUP WISE DISTRIBUTION

Banking Sector Wise Distribution (Amount ,NPLs in Billions)
As of December 2010

Banking Group	SME Outstanding			% Share of SME in Total Amount/Borrowers/NPLs			% Share in Total SME Amount/Borrowers/NPLs		
	Amount	**Borrowers**	**NPLs**	**Amount**	**Borrowers**	**NPLs**	**Amount**	**Borrowers**	**NPLs**
Public Sector	45.1	66,340	16.5	6.8%	6.7%	12.8%	13.5%	31.4%	17.1%
Specialized	9.8	38,536	7.9	8.6%	4.4%	24.3%	2.9%	18.2%	8.2%
Private	274.0	105,782	71.0	11.0%	5.5%	23.1%	82.0%	50.0%	73.6%
Islamic	4.3	637	0.8	4.3%	2.7%	10.1%	1.3%	0.3%	0.8%
Foreign	0.6	101	0.2	0.8%	0.1%	3.0%	0.2%	0.0%	0.2%
DFIs	0.3	23	0.1	0.6%	1.0%	0.6%	0.1%	0.0%	0.1%
Total-Banks	**333.7**	**211,396**	**96.5**	**9.7%**	**5.4%**	**19.9%**	**99.9%**	**100.0%**	**99.9%**
Grand Total	**334.0**	**211,419**	**96.5**	**9.6%**	**5.4%**	**19.4%**	**100.0%**	**100.0%**	**100.0%**

The share of **Public Sector Banks** i.e. NBP, FWBL, BOP, BOK and Sindh Bank constituted about 13.5% of the total SME outstanding amount at the end of the reporting period, recording a rise of 28.0% in their total outstanding share towards SME sector. Whereas their share in total NPLs of SME Sector saw a minute quarterly decline of 1.0% while their total SME Borrowers recorded a rise of about 2.1%, QoQ basis.

Private Banks share in total SME outstanding was 82.0%, the highest among the categories of banks. This category of banks consists of 19 banks. The outstanding amount in absolute terms was Rs. 274 billion; moreover, it too recorded a quarterly rise of 6.8%. Among ***Private Banks*** HBL has the highest share of 15.6% followed by ABL bank with 9.4%, Bank Alfalah with 9.0%, and NIB with 7.8% respectively in total SME financing. This category of Banks contributed about 11% of their Overall Outstanding Portfolio towards SME Sector.

Islamic Bank's absolute amount outstanding at the end of December, 2010 was Rs. 4.3 Billion constituting about 1.3% of the total SME outstanding amount. This category of banks witnessed a quarterly decline of 0.2% and 19.8% in SME Outstanding Amount and Borrowers respectively. Moreover, their NPLs recorded a rise of 6.3% at the end of the period under review. The low share of Islamic Bank's towards SME Sector is primarily due to the fact that the major chunk of their Overall Portfolio (87%) is occupied by corporate and consumer sectors.

Specialized Banks category consists of SME Bank, ZTBL, PPCBL and IDBP. The absolute outstanding amount of this category of *Banks* towards SME sector was Rs. 9.8 billion constituting about 2.9% of total SME financing at the end of the reporting period. Having a closer look at specialized banks reveals that their portfolio has been hovering around Rs. 10 billion under SME Financing for the last few years and did not witness any significant improvement, mainly on account of the diversion of their major chunk (84.8%), contributed mostly by ZTBL, towards Agricultural sector.

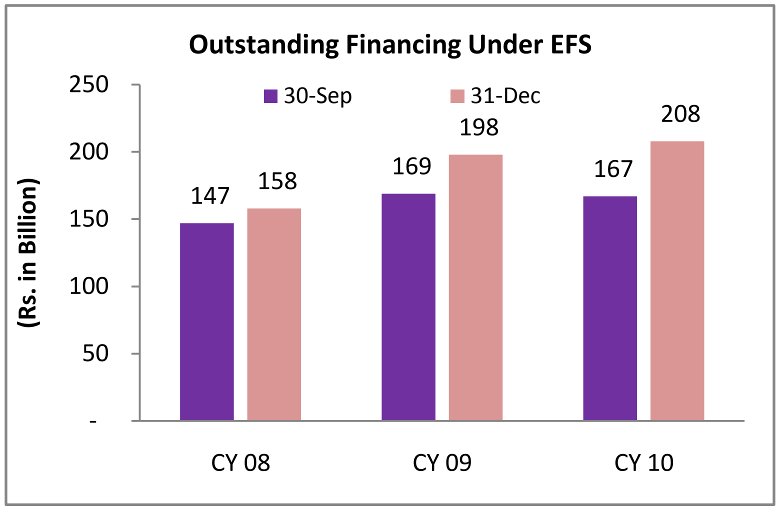
The absolute amount outstanding against **Foreign Banks'** declined from Rs 1.68 Billion (at the end of Sep-10) to about Rs.0.6 billion at the end of Dec-10, forming 0.2% of the total SME financing in the country. The share of foreign banks did not see any significant improvement as their major chunk of Overall Portfolio targets the corporate and consumer sectors.

Finally, the total outstanding amount against **DFIs** was Rs. 0.32 Billion forming about 0.1% in Total SME Outstanding Finance**.** Development Finance Institutions have the mandate to contribute to the sectors that promote development. However, the total number of borrowers served by them was 23 at the end of the period under review. The reason for lesser share towards SME sector is due to the fact that about 96.4% of the total outstanding portfolio targets corporate and consumer sectors of the economy.

Banks/DFIs need to diversify/segment their loan portfolio as well as take cognizance regarding the significance of priority sectors for the economy. By diversifying/segmenting the portfolio into pools of loans management can evaluate them in light of the bank's portfolio objectives and risk tolerances and, when necessary, develop appropriate strategies or otherwise.

2.0. SBP REFINANCE SCHEMES

Recent floods that struck the country in July 2010 have badly affected a large area of the country and deprived the people from their lives, households, livestock and crops. In order to revive the economic and agricultural activities in flood affected areas, SBP in line with the Government Policy took special steps in recent quarter and announced a Refinance Scheme for SMEs & Agricultural Activities in flood affected areas wherein financing facilities are available on subsidized rate of 8%. Further, under government initiative to support Textile Sector, SBP reimbursed mark up subsidy up to 32% out of 40% unpaid claims under Export Finance Mark-up Rate Facility and pending claims under Mark-up Rate Support for long term loans for the period 01-09-2009 to 28-02-2010. However to rationalize and align the mark up rates with the market rates , end user EFS rate was increased to 11% from 10% effective January 01, 2011.



SBP continued to provide refinance facilities for export oriented sectors during the quarter under review. The banks were allocated 9% higher limits (Rs. 242 billion) as compared to same quarter of 2009 (Rs. 222) under the Export Finance Scheme. At the end of the quarter, Rs. 208 billion was outstanding under the scheme as compared to Rs.198 billion for same period last year. The commodity wise and borrower wise analysis under EFS financing continues to show skewed distribution. Out of total credit extended under EFS, 62% was outstanding against the textile sector. Out of 1,717 top 300 beneficiaries / borrowers are availing upto 86% of the total financing under the scheme. As on December 31, 2010, Rs.22.7 billion was outstanding against the financing provided under the Long Term Financing Facility for Plant & Machinery (LTFF). Under the defunct LTF-EOP scheme, Rs. 20.7 billion was outstanding making the total financing under long term schemes to Rs. 43.4 billion.

2.1. Export Finance Scheme (EFS)

The current quarter usually witnesses an increase in outstanding financing under EFS due to rollover of loans by exporters under Part-II. This is evident from the fact that overall outstanding amount increased by 25% to Rs. 208 billion from Rs. 167 billion in the previous quarter. During the quarter, outstanding financing under EFS witnesses an increase of Rs. 41 billion as compared to last quarter and Rs.29 billion when compared to the same quarter of preceding year.

2.1.1. Banking Group-Wise Utilization of EFS

The Private Sector Banks remains the major participant in the Export Finance Scheme with highest share of Rs.180 billion (87%) in the outstanding, followed by Public-sector Banks with Rs.12 billion (6%). Compared to previous quarter, a major increase in outstanding of Rs 34 billion is exhibited in private sector banks due to rollover of refinance facility of during the quarter.

2.1.2. Commodity Wise Distribution of EFS

The commodity-wise outstanding financing of Rs. 208 billion shows textile sector at the top with Rs 130 billion (62%) followed by edible goods with Rs 30 billion (14%). Both the sectors showed increase of 15% and 77% respectively, compared to Sep-2010 quarter. Increase in edible goods is mainly due to increase in share of rice financing which constitute 69% of the edible goods financing. While comparing with previous quarter an increase of 56% was attributed to the Machinery sector. On YoY basis carpet sector showed an increase of 53%.

Banking Group Wise Outstanding Position of EFS (Rs Billions)

Banking Group	Dec-10	Sep-10	Dec-09	Δ YoY (%)
Public Sector Banks	12	9	12	0
Private Banks	180	146	172	5
Islamic Banks	6	5	5	20
Foreign Banks	10	7	8	25
Total	**208**	**167**	**198**	**5**

Commodity Wise Distribution of EFS (Rs Billions)

Sector	Dec-09	Sep-10	Dec-10	Δ YoY (%)	Δ QoQ (%)
Textile/Textile Products	123.4	112.8	130.1	6	15
Edible Goods	28.4	16.9	29.8	5	77
Leather/Leather Goods	10.0	10.4	11.6	16	11
Machinery	1.2	1.2	1.8	56	56
Metal Products	3.0	2.5	2.8	-8	12
Carpets	2.7	3.7	4.2	53	12
Sports Goods	2.2	2.5	2.6	18	2
Other Commodities	26.9	17.1	25.46	-5	49
Total	**197.6**	**167.1**	**208.3**	**5**	**25**

2.1.3. Borrower Wise Distribution of EFS Funds

During the 2nd quarter of FY 11, the total number of borrowers under EFS stood at 1,717 with a nominal increase of 3.7% and average loan size of Rs. 120 million. The increase in number of borrowers may be due to loans availed by some new exporters under part-I as the disbursements during this quarter under part-I noticed an increase of Rs.7 billion as compared to previous quarter.

2.1.4. Regional Allocation Of Borrowers

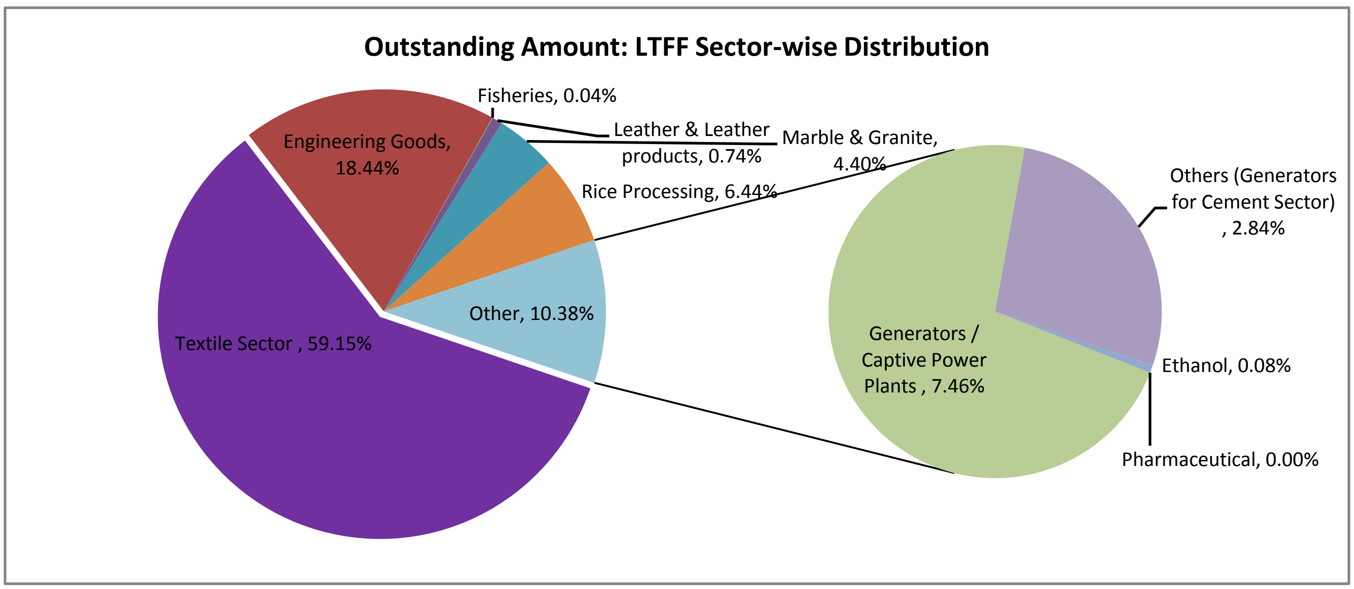
According to banks' data for the quarter ended December 31, 2010, up to 87% borrowers are from the four major cities i.e. Karachi, Sialkot, Lahore and Faisalabad, where only Karachi & Sialkot has about 62% of total beneficiaries under the Scheme. Similarly, almost 95% of EFS funds are accumulated in these four cities and almost 51% funds have been availed by only Karachi based exporters. The average loan size availed by borrowers under EFS varies from region to region. For instance, the average loan size at Rawalpindi is Rs. 326M, while at Sialkot the same is Rs. 19M. Likewise, the number of borrowers and the borrowing capacity of borrower/exporter are different at different regions.

2.2. Islamic Export Refinance Scheme (IERS)

During the quarter under review the total numbers of participating banks were 11 (4 Islamic Banks, 6 Conventional Banks' Islamic Banking Operations and 1 Foreign Islamic Bank). The limits assigned under the scheme were increased by 9% (to Rs. 21.4 billion from Rs 19.7 billion in Sep' 10), out of which Rs. 11.1 billion limit was allocated to Islamic Banks and remaining Rs. 10.33 billion to Islamic Banking Branches of Conventional Banks. The total IERS financing outstanding at the end of the quarter stood at Rs. 13.69 billion, which increased by 31% from Rs. 10.44 billion in previous quarter.

2.3. Long-Term Financing Facilities (LTFF)

Under the Long Term Financing Facility for Plant and Machinery, limits of Rs. 19.5 billion have been allocated to banks/DFIs. The outstanding amount increased to Rs. 22.71 billion from Rs. 20.11 billion in 30th Sep'10. Under LTFF major portion of financing was contributed towards Textile Sector with Rs. 13.4 Billion (59%), followed by engineering goods, with Rs. 4 billion (18%). Within the Textile sector major financing was availed by weaving textiles. During the quarter, adjustments of Rs. 2.6 billion were made under LTF-EOP (defunct scheme), and the outstanding position of LTF EOP as on Dec-10 stood at Rs. 20.7 billion. Thus, the total long term financing



outstanding under LTFF and LTF-EOP stood at Rs. 43.4 billion.

3.0. STATE OF MICROFINANCE IN PAKISTAN

While maintaining an overall positive growth during 2010, the credit growth declined by 7.5% in the last quarter. The negative growth was mainly due to the devastating floods during 3rd Quarter 2010 that gripped most parts of the country. Moreover, an overall difficult macroeconomic environment continues to challenge the credit growth of microfinance players. The year 2010 also saw rising NPLs in flood affected areas. However, so far the NPLs levels are not as high as were feared earlier. Currently, the largest MFBs have geared up their efforts on collection especially in flood-affected areas.

On the positive side, microfinance sector has seen healthy growth almost in all indicators (except credit). In particular, deposits continue the increasing trend by recording 24% growth during the last quarter. Details are given in table. It is important that along with FMFB, now KBL and Tameer MFBs have also started taking lead in the deposit mobilization efforts. Due to this strategic move, the MFBs' total deposits (Rs. 10.3 billion) have crossed the total advances (Rs. 9.99 billion) for the first time in micro-banking history (figure: 1). This indicates a positive move towards generation of low cost sustainable source of funding by MFBs which will broaden their outreach and reduce their dependence on subsidies-enabled funding mechanisms.

Total assets steadily increased over the year and stood at Rs. 21.3 billion as of December 2010, which was mainly contributed by growth in advances during the first three quarters followed by growth in cash and investments in the last quarter of 2010. Total equity also increased by 7% over the year and by 11% during the last quarter. This was mainly contributed by positive retained earnings of KB and Tameer during the year, and equity injection of FMFBL in the last quarter.

Microfinance Outreach *Amount in Rs. '000'

Outreach	Dec-09	Sep-10	Dec-10	Growth		
				(YOY) %	(QoQ)%	
Borrowers	626,219	694,263	631,238	1%	-9%	↓
Advances *	8,501,810	10,790,314	9,985,488	17%	-7.5%	↓
NPLs*	137,686	323,855	349,502	154%	8%	↑
Deposits*	7,099,205	8,357,421	10,338,682	46%	24%	↑
Assets*	17,753,993	19,170,692	21,437,837	21%	12%	↑
Equity*	5,380,410	5,217,545	5,775,137	7%	11%	↑

Though microfinance sector is gradually heading towards long term sustainability, however, other challenges – like credit risk, funding constraints, and high operating costs still pose challenge to the realization of its true performance potential. According to a latest Microfinance Banana Skins Survey – 2011 the credit risk constitutes the biggest threat to the industry over this turbulent period not only due to economic stress but also because of growing evidence of competitive pressures in the microfinance market, of greater cynicism among borrowers, and of increasing interference in the credit process by political forces

<u>Box 1: Microfinance Banana Skins Survey 2011</u>

The CSFI survey of Microfinance Risk

The overall message from the survey is that the immediate risks posed by the global economic crisis have receded – but have been replaced by larger concerns about the future direction of the industry. Below is the summary of the key risks highlighted by the survey.

The key finding of the survey is that **credit risk** constitutes the biggest threat to the industry over this turbulent period. Although this result is unchanged from the previous survey in 2009, the reasons behind it have shifted sharply. The earlier result was largely explained by the difficulties facing borrowers during the economic crisis. This time, the reasons have multiplied. There is still economic stress, but also growing evidence of competitive pressures in the microfinance market, of poor credit management by MFIs, of greater cynicism among borrowers, and of increasing interference in the credit process by political forces. Above all, credit risk is seen to reflect the fast-growing problem of **over indebtedness** among millions of microfinance customers: poor people who have accumulated larger debts than they will ever be able to repay, often as a result of pressure from business hungry MFIs.

The surge in concern about **reputation risk** (moved from No. 17 to No. 2) directly reflects view that MFIs have brought credit risk upon themselves through their aggressive lending and their desire for growth. This also accounts for the rise in the risk of **mission drift** (moved from No. 19 to No. 9) because of the perception that MFIs are abandoning their commitment to poverty alleviation in favor of financial profit. Another link is with the rise of **political interference** (moved from No. 10 to No. 5) as governments in some countries respond to the growing unpopularity of MFIs by imposing interest rate caps and encouraging repayment strikes. Although the current focus is on the Indian state of Andhra Pradesh where there have been severe political tensions over the behavior of MFIs, the concern is that political risk is spreading.

In 2010, microfinance banking in Pakistan has also completed almost 10 years. A well-developed legal and regulatory framework has enabled the microfinance industry to see a gradual shift from subsidies-dependent to market-driven approaches. In its report for 2010, the Economic Intelligence Unit (EIU) of the magazine 'The Economist' recognized Pakistan as a global leader in microfinance regulatory framework[3].

Cognizant of the structural challenges faced by the microfinance sector, increasing outreach to a large proportion of the financially excluded population on sustainable basis, SBP also released a medium-term **"Strategic Framework for Sustainable Microfinance"** which was developed in broader consultation with the Government (MoF & PPAF), microfinance industry, and donors**,** which provides a road map for the future. The objectives identified in this strategic framework are (i) broadening inclusive financial services (ii) promoting deposit mobilization to make MFBs self-sustainable in funding, iii) promotion of alternative delivery channels to

[3] Pakistan has been ranked 1st along with Cambodia & Philippines with respect to Regulatory framework (up 12.5 points from 2009) in a recent report by the Economist Intelligence Unit of the Economist magazine, which ranks and provides an analysis of the microfinance business environment in 54 countries.

expand outreach, reduce operating costs, and provide convenience to customers (iv) up-scaling the loan products to serve micro-enterprises, v) improving governance and transparency to ensure long-term institutional sustainability, vi) encouraging pro-consumer policies to gain public confidence, and vii) developing a suitable regulatory mechanism for the non-deposit taking MFIs to create market discipline.

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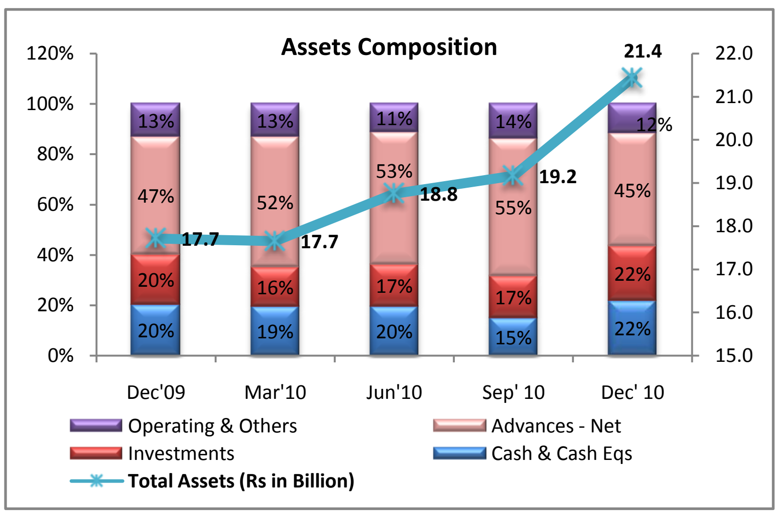
Assets' Growth		
ASSETS (MRs)	**YoY Growth**	**QoQ Growth**
Cash & Cash Equivalents	29.5%	62.6%
Investments	32.6%	45.6%
Advances - Net	16.1%	-8.0%
Operating & Other	7.9%	-5.4%
Total Assets	21.0%	11.8%

3.1. ASSETS

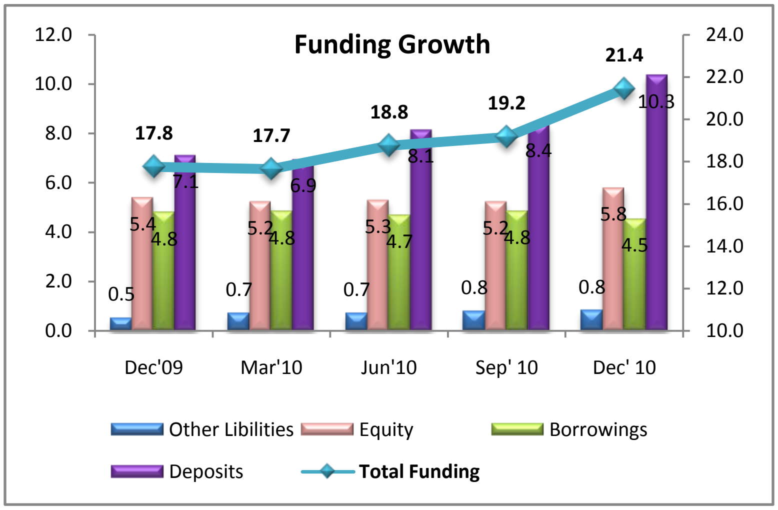
The asset base of MFBs has progressively increased during the year 2010 by a growth rate of 21% and stood at Rs. 21.4 billion as of December, 2010. **Table** shows that all asset components have shown a positive growth rate during the year 2010. However, in the last quarter the 'advances' and 'operating & other assets' categories have showed a negative growth rate due to stagnation in lending activities of most of the MFBs. Except Tameer and Kashf all other MFBs have depicted a negative growth in advances during the last calendar quarter (Section 3.4).



On the other hand, the assets' growth (11.8%) in the last quarter has been mainly contributed by remarkable growth in cash (63%) and investments (46%) categories. This illustrates that MFBs (except Kashf and Tameer) have preferred to take extra sum of money in the form of ready cash & cash equivalent and/or invest in short term securities instead of lending to the borrowers to meet expected increase in withdrawal. This trend can also be seen in the assets composition during the last quarter. The share of advances has reduced from 55% to 45% during the 4th quarter but still constituted the largest part of the total micro-banking assets. Conversely, the shares of cash and investment categories have increased from 15% and 17% respectively to 22%.

The slight stagnation in microfinance activities especially lending is a temporary phenomenon and will eventually be stabilized by the flood relief, and other measures taken by the Government and SBP (Section 7.0). The upcoming quarters will portray the exact picture of improvements in the microfinance sector provided the other socio-economic factors improved.

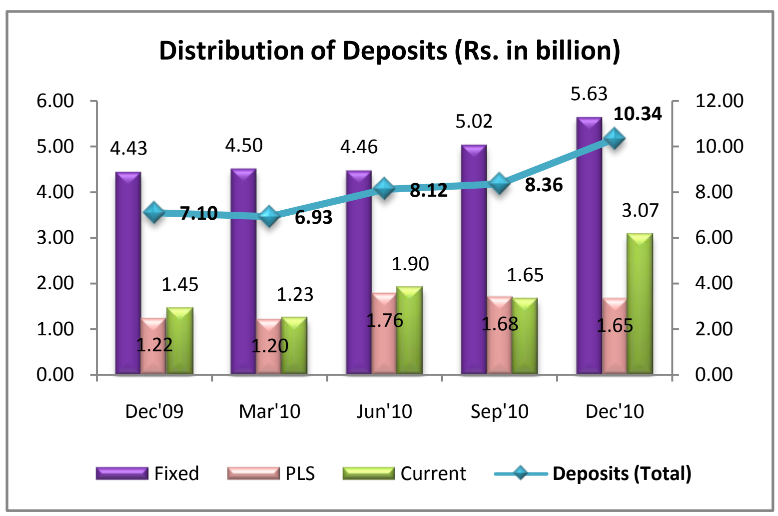
3.2. FUNDING



The total funding of MFBs has continuously improved over the period and recorded 21% growth during the year 2010, 12% growth during the 4th quarter and stood at Rs. 21.4 billion as of December 2010. This growth in funding is mainly contributed by remarkable growth in deposits (46% YoY) and equity (7% YoY). Moreover, **Figure** stipulates gradual improvement in both equity and deposits.

Total deposits, being the largest part, have contributed 48% of the total funding. Khushhali, Tameer, and Kashf MFBs have shown a remarkable growth in deposits during the last quarter (Section 3.3) as they have started their savings products as their key funding strategy. On the other hand, equity has formulated the 2nd largest part and contributed 27% of the total funding. The growth in equity has mainly contributed by positive retained earnings of KB and Tameer, and equity injection of FMFB of Rs. 330 million in the last quarter of 2010.

Borrowings category constitutes the third largest funding source for MFBs by contributing 21% share. Overall borrowings value has remained at Rs. 4.8 billion till the 3rd quarter 2010. In the last quarter it has decreased by 6% and stood at 4.5 billion as of end December 2010.



These growing trends in deposits and equity indicate that the micro-banking industry is now leading towards sustainable sources of funding instead of depending on subsidies and/or grants. This healthy trend in funding will eventually help-out the MFBs to come-out of the current stage of slowdown in growth.

3.3. DEPOSITS

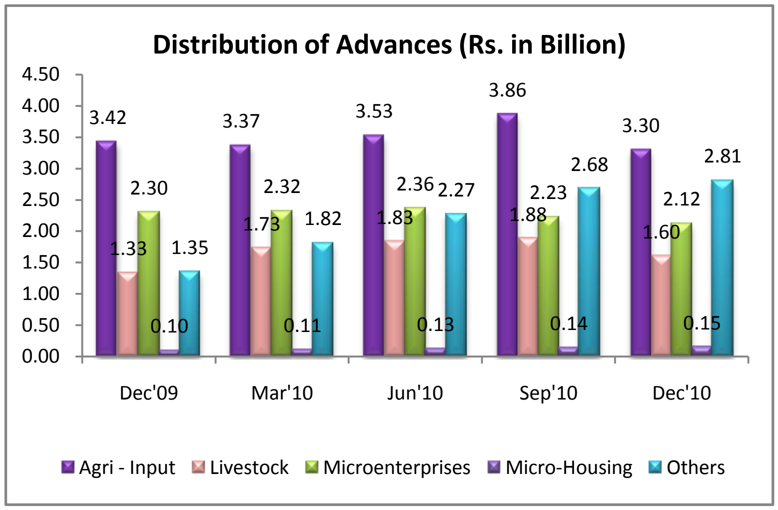
Over the quarter, deposits have witnessed a remarkable growth of 23.7% and reached at

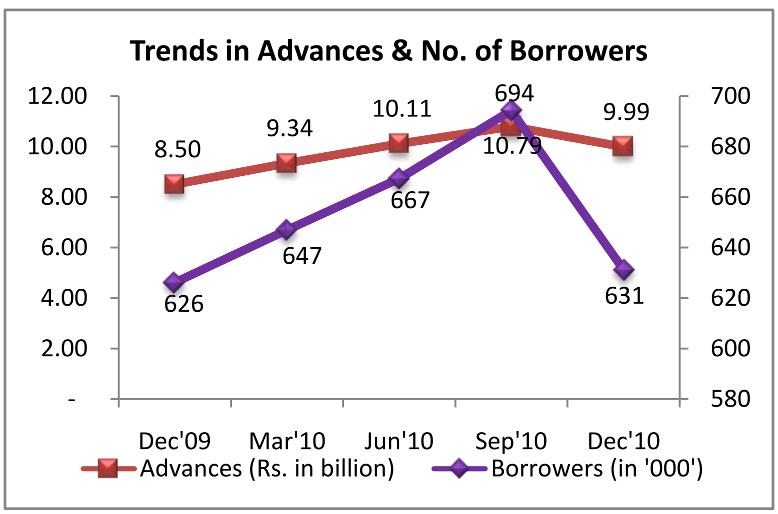
Rs. 10.34 billion from Rs. 8.36 billion in the last quarter. Though percentage increase in deposits of Khushhali Bank Limited (KBL) was recorded at 495% followed by 63% of Kashf Bank Limited, nonetheless, FMFB still continues to contribute more than half to the total deposits of Microfinance Banks. As a result of this significant growth, now the MFBs' total deposits (Rs. 10.34 billion) have crossed the total advances (Rs. 9.99 billion) for the first time in the history of micro-banking.

Saving deposits have witnessed a negative growth over the quarter; however, it has increased by 35% on YoY basis. 85% of total growth of deposits has come from current deposits while fixed deposits have increased by 12%. The recent growth in current deposits has increased their share contribution from 20% as of September 2010 to 30% as of December 2010 in total deposits.

3.4. ADVANCES

Advances have shown a mixed growth during the year 2010. They have gradually increased till the end of 3rd quarter 2010 by an average quarterly growth rate of 3% but declined by 7.5% in the last quarter and currently stood at Rs. 9.99 billion. The similar trend has also been observed in the number of borrowers as depicted in the **Figure**. The negative growth in the last quarter was mainly due to the devastating floods during the 3rd quarter, war on terror in certain regions, and deteriorating law & order situation in big cities like Karachi, Lahore.





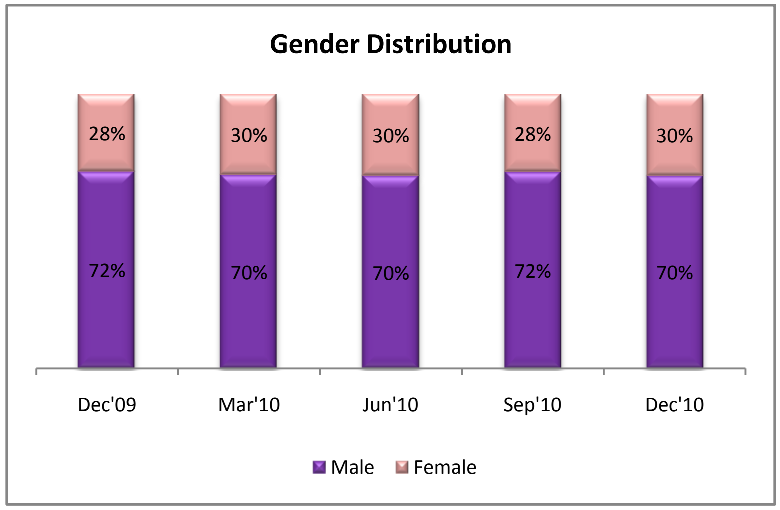
The devastating floods during July-Aug 2010 hit more than 80 districts of the country and left total micro-banking portfolio of Rs 5.5 billion at risk. The NPLs of MFBs in these districts have been increased by 10 to 15 percent on average[4] which finally led to the above stated negative growth in the loan portfolio of MFBs during the last quarter. Moreover, the rising inflationary pressures particularly in consumer goods have left the borrowers with low repayment capacity. All

[4] A limited survey conducted by SBP. Moreover, only MFBs portfolios have been considered.

these circumstances have increased the credit risk into the market. Consequently, most of the MFBs (FMFB, KB, PakOman) have stringent their credit growth and put all their efforts on recovery side.

The distribution of advances has shown that both Agri-input and livestock categories have declined by 15% during the quarter and stood at Rs. 3.30 billion and Rs. 1.60 billion respectively as of December 2010 (**Figure**). Similarly, microenterprises category has also reduced by 4% during the 4th quarter 2010 and currently stood at Rs. 2.12 billion. On the other hand, the 'others' and 'housing' categories have shown positive quarterly growth of 5% and 9.3% respectively. Tameer MFB has shared the major part of the growth in both of these categories.

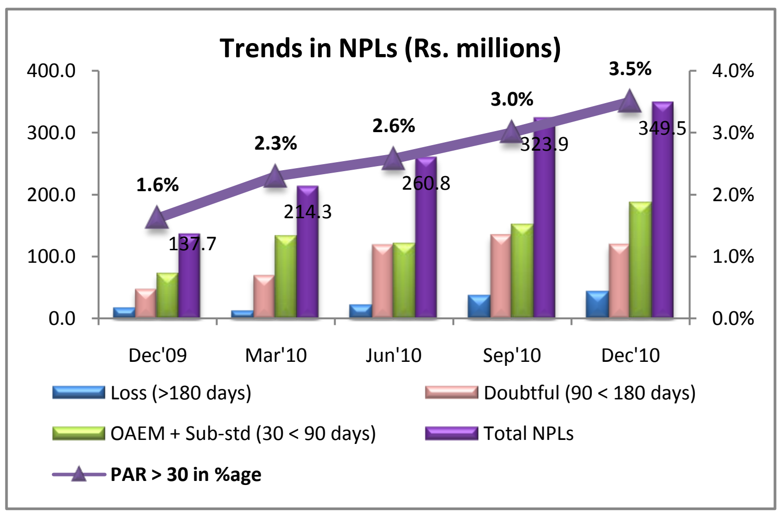
3.5. GENDER DISTRIBUTION



The share of female borrowers has improved over the quarter from 28% to 30%. In numbers, MFBs have active 187,927 female clients as of December 2010 with a total portfolio of more than Rs. 2 billion. Tameer bank has led in gender distribution as being served the bigger portion of female clients that constitute 40% of its total portfolio.

3.6. NON PERFORMING LOANS

NPLs have shown a rising trend during the year 2010 **figure**. Starting from Rs. 137.7 million as of December 2009 NPLs have increased by almost 3 times during the year reaching up-to Rs. 349.5 million as of December 2010. OAEM and sub-standard categories have formulated the bigger part (54%) of the total portfolio at risk. Both of categories of risk portfolio have increased sharply during the last two quarters. The Doubtful category has shown a mixed trend as it has increased during the first three quarters and declined in the last quarter but still formed (34%) the 2nd largest part of the total NPLs. Finally the Loss category has gradually increased over time and currently shared 12% of the total PAR. The reasons behind these rising trends in NPLs have already been discussed in the advances section.



4.0. AGRICULTURAL FINANCE

The Agricultural Credit Advisory Committee (ACAC) had set an agricultural credit target of Rs 270 billion for 2010-11. The target was 8.8 percent higher than the disbursement of Rs 248 billion in 2009-10. Out of the total target, Rs 181.3 billion were allocated to commercial banks, Rs 81.8 billion to ZTBL and Rs 6.9 billion to Punjab Provincial Cooperative Bank Limited.

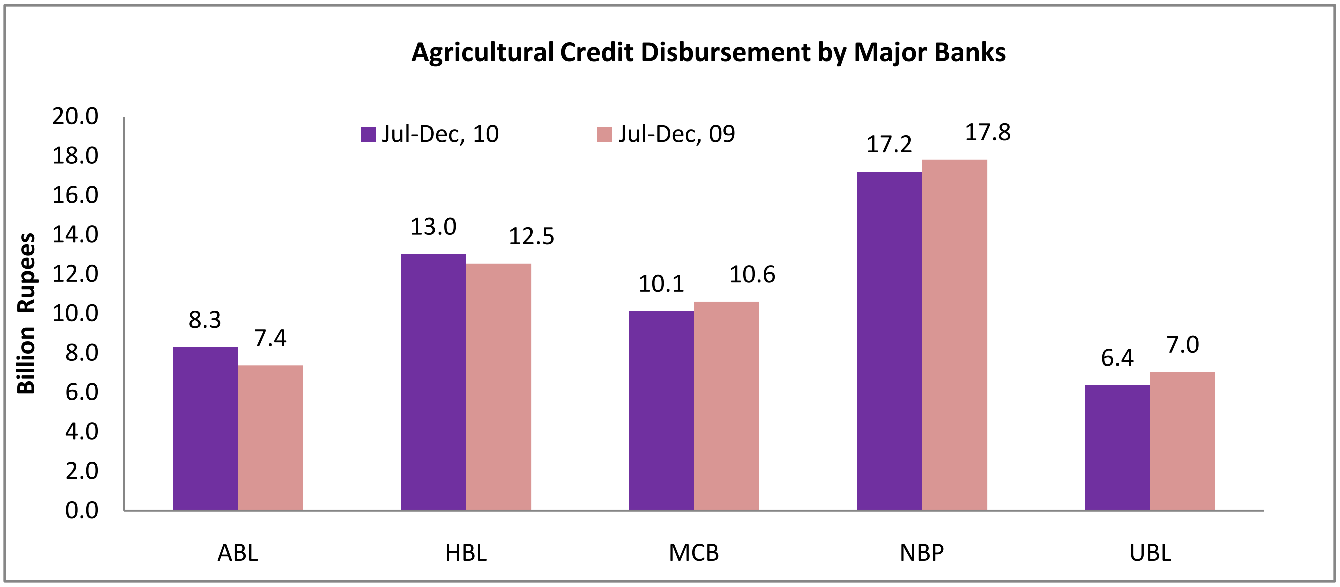
4.1. AGRICULTURAL CREDIT DISBURSEMENT

During the 1st half of FY 11, banks disbursed Rs 101.6 billion to agriculture sector as against a disbursement of Rs 106.3 billion in the same period last year. Quarter-wise disbursement reveals that banks disbursed Rs 60.1 billion during October-December, 2010 quarter compared to disbursement of Rs 41.5 billion in the preceding quarter and Rs 62.2 billion during corresponding quarter last year. Annual agri. credit targets for FY 10 & FY11 and actual disbursements by banks are given in **Table**.

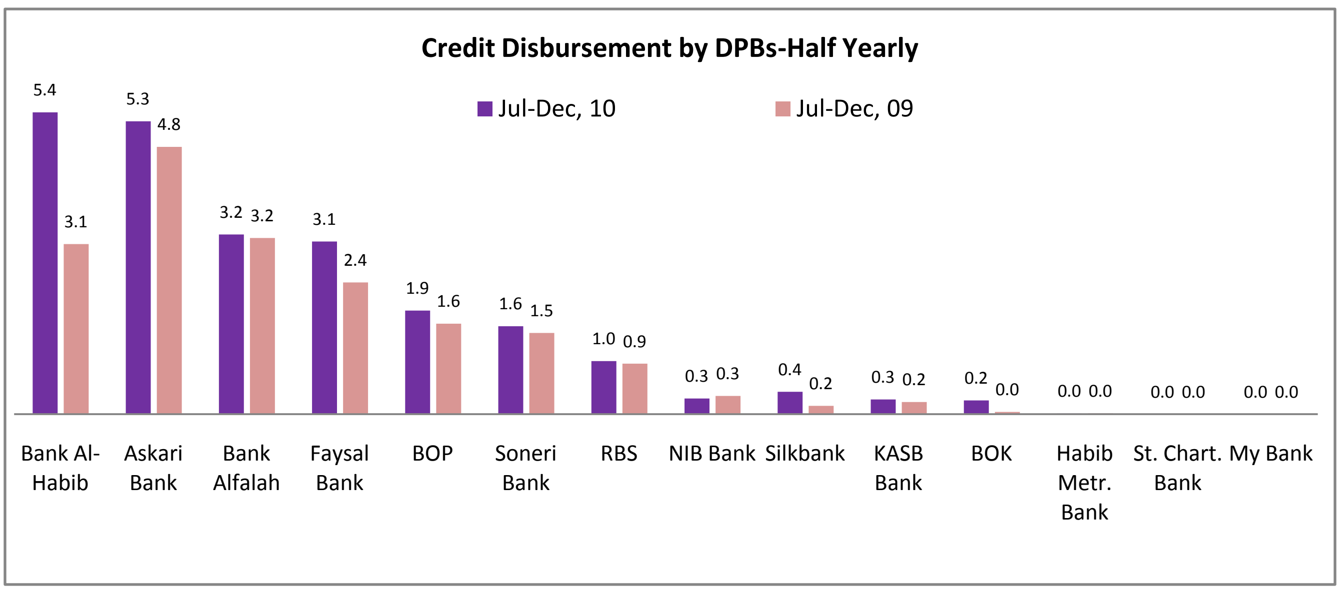
Agricultural Credit Targets and Disbursement (Rs. Billions)

Banks	Target 2010-11	Disbursement			Target 2009-10	Disbursement		
		Jul-Sep 2010	Oct-Dec, 2010	Jul-Dec 2010		Jul-Sep 2009	Oct-Dec, 2009	Jul-Dec 2009
5 Big Comm.	132.4	25.9	29.1	55.0	124.0	25.8	29.6	55.4
ZTBL	81.8	5.3	15.7	21.0	80.0	9.9	20.5	30.4
DPBs	48.9	9.4	13.3	22.7	50.0	7.8	10.4	18.2
PPCBL	6.9	0.9	2.0	2.9	6.0	0.6	1.7	2.3
Total	**270.0**	**41.5**	**60.1**	**101.6**	**260.0**	**44.1**	**62.2**	**106.3**

Bank-wise break up of agri. credit disbursement reveals that during 1st half of FY11, five major banks as a group disbursed Rs. 55.0 billion or 41.5% of their annual targets, ZTBL disbursed Rs 21 billion or 25.7% of the target, Domestic Private Banks (DPBs) disbursed Rs 22.7 billion or 46.4% of the target, while PPCBL disbursed Rs 2.9 billion or 42% of the whole year's target. During Oct-Dec, 2010 five major banks as a group disbursed Rs 29.1 billion or 22.0% of their whole year targets, ZTBL disbursed Rs 15.7 billion or 19.2% of targets, Domestic Private Banks (DPBs) disbursed Rs 13.3 billion or 27.2% of targets and PPCBL disbursed Rs 2.0 billion or 29.0% of targets. The cumulative position of agri. credit disbursements by five major banks for the period July-Dec, 2010 and, 2009 has been illustrated in **Figure**.



Half yearly comparative agri. credit disbursement position of Domestic Private Banks (DPBs) for the period July-Dec, 2010 and 2009 is illustrated **in Figure.**



Sector-wise classification reveals that during 1st half of FY11 out of disbursement of Rs 101.6, an amount of Rs 65 billion or 64 percent was disbursed to farm sector and Rs 36.6 billion or 36 percent were disbursed to non-farm sector as compared with disbursement of Rs 73.8 billion and Rs 32.5 billion respectively during the corresponding period last year.

During Oct-Dec, 2010 quarter out of disbursement of Rs 60.1 billion, an amount of Rs 39.0 billion or 64.9 percent was disbursed to farm- sector and Rs 21.1 billion or 35.1 percent to non-farm sector, while during the corresponding period last year, 71.0 percent agri credit was extended to farm sector and 29.0 percent to non-farm sector. Increasing trend in non farms sector credit disbursements is mainly due to sustained disbursement in livestock and fisheries sub-sectors. High prices of meat, fish and export of livestock, attracted investment in non-farm sector. Financing to poultry sector also increased due to high prices of poultry amid strong domestic demand. Banks' disbursements to farm and non-farm sectors are illustrated in **Table**.

Credit Disbursement to Farm & Non-Farm Sectors

Sector		2009-10			2009-10	
	Jul-Sep.	Oct-	Jul-Dec,	Jul-Sep.	Oct-	Jul-Dec, 09
A **Farm Credit**	**26.0**	**39.0**	**65.0**	**29.7**	**44.1**	**73.8**
1 Subsistence Holding	**15.0**	**23.1**	**38.1**	**18.5**	**26.4**	**44.9**
i *Production*	14.2	21.9	36.1	16.0	23.5	39.5
i *Development*	0.8	1.2	2.0	2.5	2.9	5.4
2 Economic Holding	**7.0**	**9.9**	**16.9**	**6.9**	**11.1**	**18.0**
i *Production*	6.8	9.6	16.4	6.8	9.8	16.6
i *Development*	0.2	0.3	0.5	0.1	1.3	1.4
3 Above Economic Holding	**4.0**	**6.0**	**10.0**	**4.3**	**6.6**	**10.9**
i *Production*	3.8	5.6	9.4	4.1	6.1	10.2
i *Development*	0.2	0.4	0.6	0.2	0.5	0.7
B **Non-Farm Credit**	**15.5**	**21.1**	**36.6**	**14.4**	**18.1**	**32.5**
1 Small Farms	3.4	4.4	7.8	2.5	4.6	7.1
2 Large Farms	12.1	16.7	28.8	11.9	13.5	25.4
Total (A+B)	**41.5**	**60.1**	**101.6**	**44.1**	**62.2**	**106.3**

4.2. PROVINCE-WISE DISBURSEMENT

During 1st half of FY11, out of total disbursement of Rs 101.6 billion, Rs 89 billion or 87.6 percent were disbursed in Punjab, Rs 9.5 billion or 9.4 percent in Sindh, Rs 2.6 billion or 2.6 percent in Khyber Pakhtunkhwa, Rs 0.1 billion or 0.1 percent in Baluchistan and Rs 0.4 billion or 0.4 percent in AJK/ GB compared with Rs 91 billion, 11.8 billion, 2.8 billion, 0.2 billion and 0.4 billion respectively during the corresponding period last year.

During Oct-Dec, 2010 Rs 53.0 billion were disbursed in Punjab which is 25.2 percent of the target. Banks disbursed Rs 5.3 billion in Sindh and its share declined by 11.7 percent from last year's disbursement. The share of other provinces and regions is negligible in agri. credit due to weak demand, law and order situation and inadequate supply. Details of province-wise disbursements, vis-à-vis targets achieved are given in **Table.**

Province-wise Agri. Credit Targets and Disbursement (Rs Billions)								
Province	Target 2010-11	Disbursements			Target 2009-10	Disbursement		
		Jul-Sep, 10	Oct-Dec, 09	Jul-Dec, 10		Jul-Sep, 09	Oct-Dec, 09	Jul-Dec, 09
Punjab	210.6	36.0	53.0	89.0	202.8	36.6	54.4	91.0
Sindh	37.8	4.2	5.3	9.5	36.4	5.8	6.0	11.8
Khyber	16.2	1.1	1.5	2.6	15.6	1.3	1.5	2.8
Baluchistan	4.1	0.1	0.0	0.1	3.9	0.1	0.1	0.2
AJK & GB	1.4	0.1	0.3	0.4	1.3	0.2	0.2	0.4
Total	**270.0**	**41.5**	**60.1**	**101.6**	**260.0**	**44.1**	**62.2**	**106.3**

4.3. AGRI. NON-PERFORMING LOANS

Non-performing loans in agri. financing stood at Rs 34.1 billion or 18.0 percent of the outstanding loans as on 31st December, 2010 compared with Rs 32.0 billion or 17.7 percent of the outstanding loans as on 31st December, 2009. Bank wise detail of NPLs is given in **Table.** It shows NPLs' position of banks as a percentage of their outstanding loans during H1 of 2009 and 2010.

Province-wise Indicative Agri. Credit Targets and Disbursement (Rs Billions)				
	NPLs*	**Outstanding**	**NPLs**	**Outstandi**
Banks	**31-Dec-10**	**31-Dec-10**	**31-Dec-09**	**31-Dec-09**
5 big Comm. Banks	6.4	57.6	7.5	54.92
DPBs	4.8	26.7	4.5	24.94
ZTBL	18.0	95.6	14.2	91.41
PPCBL	4.9	8.9	5.8	9.23
Total	34.1	188.9	32.0	180.50
*Provisional				

4.4. NUMBER OF AGRI. LOAN BORROWERS

The number of agri. loan borrowers was 1.783 million as on 31st December, 2010 as against 1.882 million as on 31st December, 2009. Bank-wise position of outstanding number of borrowers reveals that decrease in number of borrowers was witnessed in all categories of banks. High mark up rate, increasing NPLs and defaults in repayment due to a variety of reasons, resulted in decline in outstanding number of borrowers over the period. Shown in **Table**

Number of Outstanding Borrowers								
Banks	**FY 2010-11 As on September**		**FY 2010-11 As on December**		**Quarterly Change (%)**	**FY 2009-10 As on December**		**Yearly %age Change**
	No. of Borrowers	**% Share in Total**	**No. of Borrowers**	**% Share in Total**		**No. of Borrowers**	**% Share in Total**	
5 Big Comm. Banks	472,775	25.6	425,917	23.9	**-9.9**	438,884	23.3	**-3.0**
ZTBL	1,146,993	62.1	1,133,400	63.6	-1.2	1,181,623	62.8	-4.1
DPBs	39457	2.1	38,366	2.2	-2.8	56,407	3.0	-32.0
PPCBL	188,649	10.2	185,595	10.4	-1.6	204,804	10.9	-9.4
Total	**1,847,874**	**100.0**	**1,783,278**	**100.0**	**-3.5**	**1,881,718**	**100.0**	**-5.2**

5.0. STATE OF HOUSING FINANCE

In Pakistan, rapid urbanization has become a challenge for increasing number of people. Studies indicate that lack of finance from a formal source is primarily a supply-side problem. Most of the housing finance is arranged through personal resources. The formal financial sector caters to only 1 to 2 percent of all housing transactions in the country, whereas the informal lending caters up to 10-12% of such transactions. Presently, the formal financial sector provides housing support through two major sources namely the Government owned House Building Finance Corporation (HBFC) and private commercial banks.

The property development industry suffers from low public confidence. Financial weaknesses and the absence of clear, uniform and fair business practices have affected its credibility contributing to the reluctance of financial institutions in providing development and construction finance. There is a strong need to strengthen the property titling and land administrative procedures including improvements of the legal provisions, standardization of processes, and computerization of all relevant revenue records. These steps will enhance the financing by the formal sector. Weakness in the existing legal framework also impedes the financing opportunities of the formal financial sector. Though the Financial Institution Recovery Ordinance, 2001 empowers the financial institutions in case of default to foreclose a mortgage property without recourse to the court of law, lack of full implementation of the recovery law in its letter and spirit dilutes its effectiveness in protection of rights of the respective parties, i.e., the financial institutions, mortgagors, landlords and tenants, thus needing a major improvement.

Although the regulatory framework for land registration and transfer regime exists in Pakistan, the process by which land is acquired and registered is cumbersome at times, because of number of institutions and registration procedures required to execute property transactions. Land records are manually maintained leading to errors and omissions and resultantly they have modest commercial value for the mortgagee financial institutions especially in rural and some urban areas. The lack of efficient and reliable system of ascertaining the bona-fide of property titles has forced banks to limit the access of housing finance to a certain number of urban localities within the urban centers.

National and local master plans for town planning and housing facilities are either inadequate or poorly enforced, which lead to inefficient allocation of land and uncontrolled urban development. Lack of transparency and accountability in the planning process also give opportunities to land grabbers/mafias to have valuable inside information as to future infrastructure developments or to be able to influence such plans so that value of its land increases. Over-restrictive building codes and laws on subdivision limit the efficient use of urban land and increase the price to consumers, especially in zones having relatively higher prices of lands in high land price zones. Moreover, the large scale projects often get delayed due to failure of utility companies in connecting new housing developments in time.

The “property valuers” have professional conduct requirements that were established by SBP and the Pakistan Banks’ Association (PBA), whereas majority of real estate builders and developers are working as sole proprietorships or partnerships with limited capital and informal corporate governance structures. Absence of sound governance structure within the housing developer industry creates lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in future. The unstructured and unsupervised nature of business of real estate brokers/ agencies, which could serve as natural arrangers for the provision of financial services, is also a significant constraint to the provision of housing and housing finance. Consequently, it is difficult for financial institutions to verify the character, capital, and capacity of potential clients. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders' extreme caution for transaction initiated by these venture. As a result, financial institutions are reluctant to enter this market, which in turn causes scarcity of finance and constraints in the supply of housing. In the absence of the formal arrangements between the housing developers/real estate agents etc and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner. Without using a strong regulatory authority to enforce corporate governance and allied standards for this stratum of business entrepreneurship, the quality of availability of housing facilities across population spectrum will not improve.

At present, 29 commercial banks, House Building Finance Corporation (HBFC) and one DFI is catering to housing finance needs. HBFC is the only specialized housing bank in the country, which has been providing housing finance to public since 1952. Commercial banks entered the mortgage business during 2003 contributing very small share in the housing finance system. Although HBFC's share in the total housing finance has reduced in absolute terms, it is still the only institution that continues to cater to the lower-middle and low-income groups and enjoys the largest customer base.

After demonstrating a promising growth trend till 2008, the housing finance sector is showing a declining trend. The total outstanding reported by banks and DFIs as on Dec 31, 2010 was Rs. 67 billion as compared to Rs. 74.38 billion as on Dec 31, 2009; a decline of 9.90**%**. The total number of outstanding borrowers has also decreased from 112,785 to 98,451 since Dec 2009; showing a fall of 12.71%.

Approximately 1,290 new borrowers were extended house loans during the quarter, accounting for Rs. 2.45 billion of new disbursements. HBFC accounted for 38.83% of these new borrowers and contributed 13.18% of the new disbursements equivalent to Rs. 323 million.

Financing for outright purchase continued to dominate financing for construction and renovation by comprising almost 57% share in gross outstanding portfolio. Outstanding portfolio for construction and renovation was 32% and 11**%** respectively.

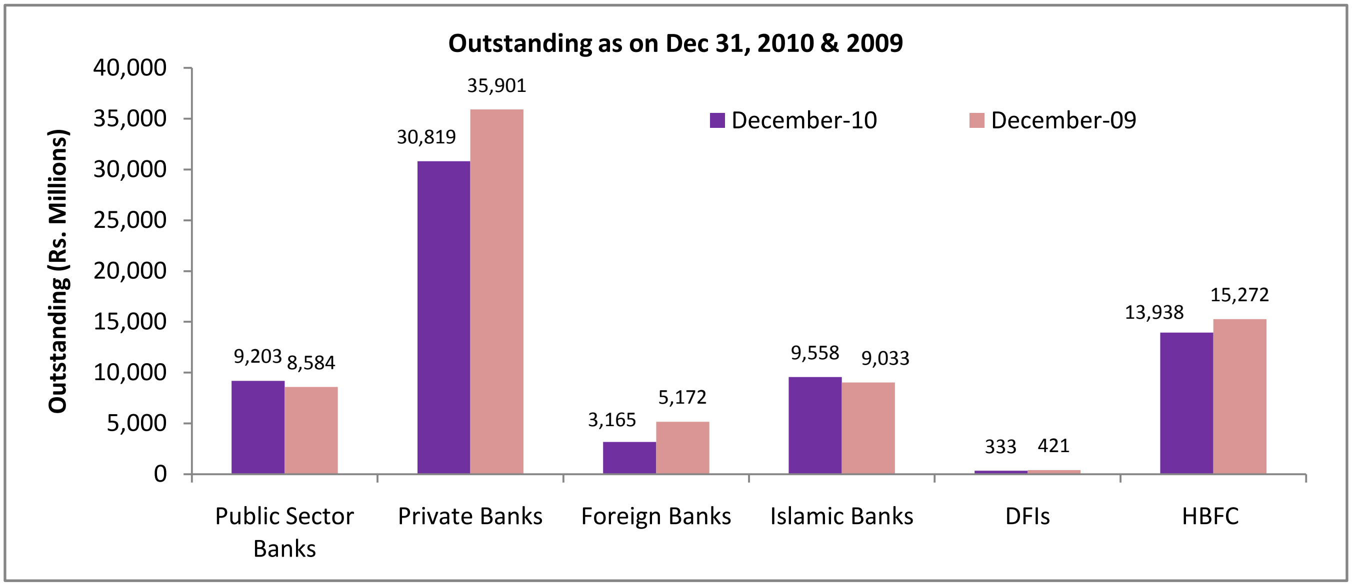
Non-performing loans have increased from Rs. 15.80 billion (Dec 2009) to Rs. 18.54 billion (Dec 2010); a 17.32% increase over the year. However, this rise in NPLs is not unique to housing finance and is only depicting the overall increase in NPLs of all sectors witnessed in the banking industry during the past year.

MAJOR TRENDS

5.1. GROSS OUTSTANDING

The total outstanding finance as on Dec 31, 2010 of all banks and DFIs stood at Rs. 67 billion. Compared to year ending Dec 31, 2009, outstanding of all commercial banks and DFIs collectively decreased by 9.9%

Banking sector-wise total outstanding on quarters ending Dec 31, 2009 & 2010 are shown in **Figure**. Of the total outstanding as on Dec 31, 2010, commercial banks accounted for Rs. 52.74 billion; a 10.13% decline since quarter ending Dec 31, 2009. Private Banks reported Rs. 30.82 billion followed by Islamic banks of Rs. 9.6 billion, public sector banks of Rs. 9.20 billion and foreign banks with Rs. 3.16 billion. The outstanding loans of HBFC were Rs. 13.94 billion; down by 8.73% over the last year. Other DFIs have a meager share of Rs. 0.333 billion in outstanding loans. **Figure**



The total outstanding housing finance as on Dec 31, 2010 of Islamic Banking Industry (06 Islamic Banks & 13 Islamic Banking Divisions of Conventional Banks) stood at Rs. 14 billion. Compared to quarter ending Sep 30, 2010 (Rs. 13.34 billion), outstanding of Islamic banking Industries increased by 4.94**%.**

Of the total outstanding Islamic housing finance, Islamic banks accounted for Rs. 9.6 billion (a 9.01% increase over the last quarter) and IBDs of conventional banks posted Rs. 4.44 billion (a 2.84% decline since quarter ending Sep 30, 2010).

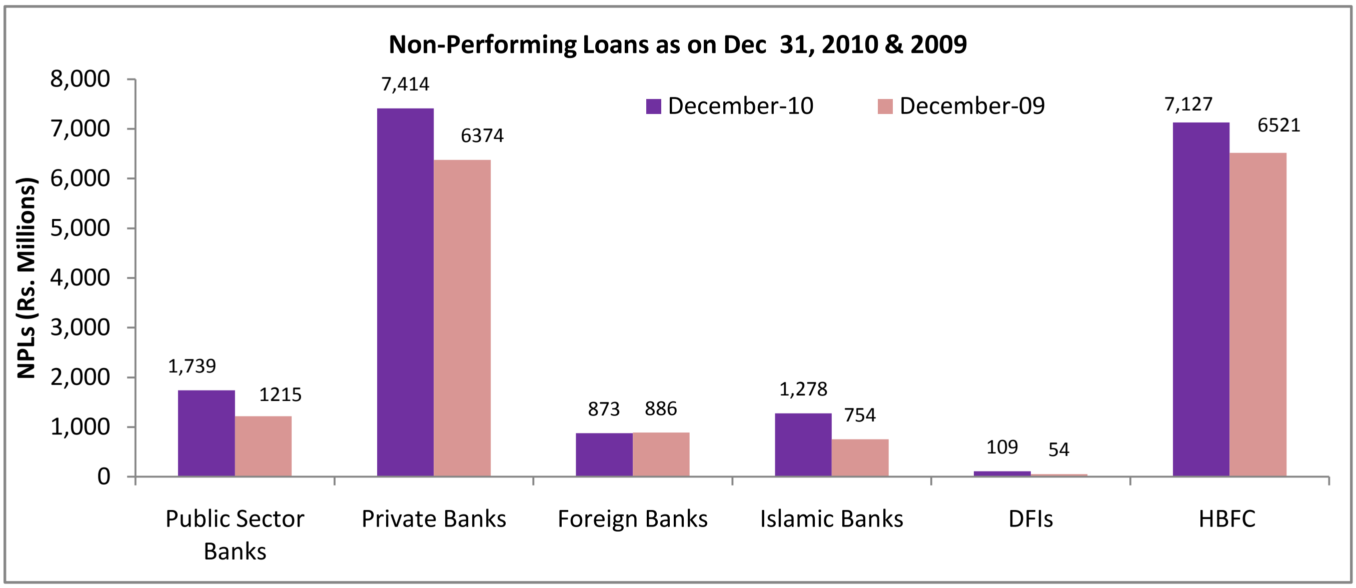
5.2. NON-PERFORMING LOANS

NPLs have increased from Rs. 15.80 billion (Dec 2009) to Rs. 18.54 billion (Dec 2010); a 17.32% increase during the year. **Figure** shows a comparison of existing NPLs status of different banking sectors with last year. NPLs as a proportion of total outstanding have witnessed an increasing trend over the last twelve months. This overall rise in NPLs is primarily due to rising inflation and high interest rates.

HBFC's NPLs have increased from Rs. 6.52 billion to Rs. 7.12 billion during the year; a 9.30% increase. Although growth of its NPLs remains relatively low in absolute terms when compared to some of the other banking sectors, its percentage share in its total outstanding, however, is the greatest, as 51.14% of its total outstanding constitutes NPLs. HBFC's percentage share in total NPLs is 38.44%.

Excluding HBFC, NPLs for all banks and other DFIs have increased by 22.95% over the year from Rs. 9.28 billion to Rs. 11.41 billion. The percentage share of NPLs that all banks and other DFIs (excluding HBFC) constitute is 21.50% of their total outstanding portfolio, compared to a 15.70% as on Dec 31, 2009.

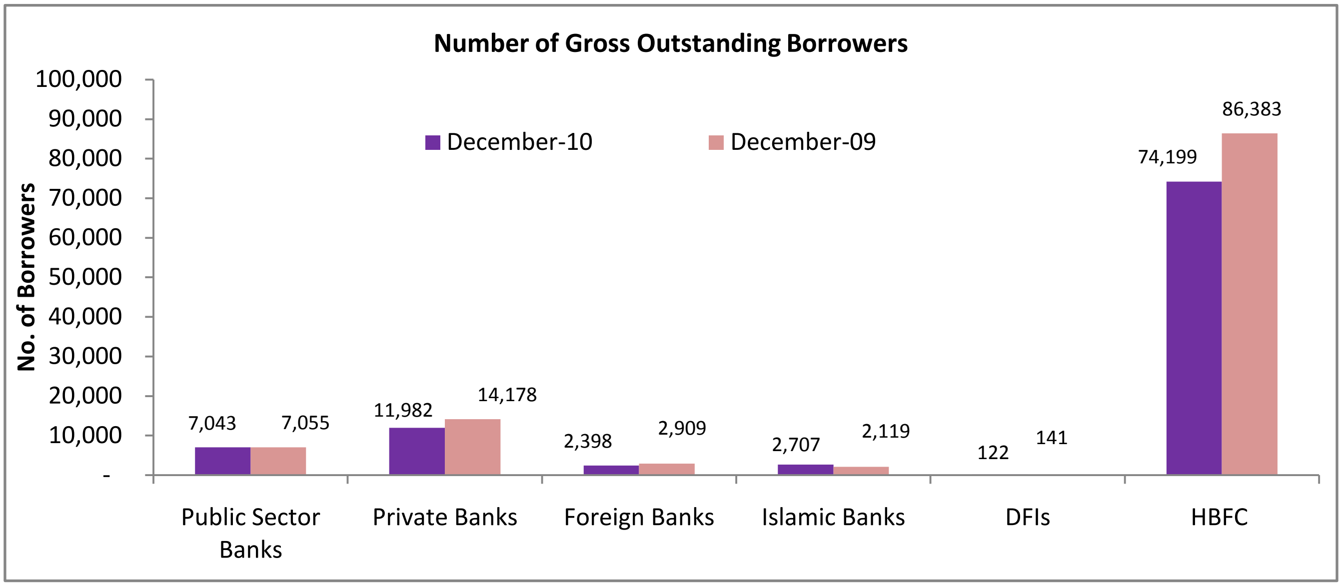
Among banks, NPLs of Islamic banks witnessed the sharpest increase of almost 69.51% during the year, from Rs. 754 million to Rs. 1.27 billion. Their NPLs constitute 13.37% of total outstanding, which was only 8.34% on Dec 31, 2009. NPLs of the public banks have increased from Rs. 1.21 billion to Rs. 1.73 billion (an increase of 43.09%) which are 18.89% of total outstanding. Private Banks' NPLs have increased by 16.32%, from Rs. 6.37 billion to Rs. 7.41 billion which is 24.06% of their total outstanding as against 17.75% on Dec 31, 2009. NPLs of foreign banks as a percentage of their outstanding portfolio increased significantly from 17.1% at the end of last year to 27.6%. However in absolute terms NPLs have increased only marginally as their portfolio has been significantly reduced due to take over of Citi bank's portfolio by Bank Islami. NPLs of DFIs (excluding HBFC) have increased from Rs. 54 million to Rs. 109 million, a 101.88% increase with 32.86% of its total outstanding classified as NPLs, which was 12.88% on Dec 31, 2009.



Non-Performing Finances (NPFs) for Islamic Banking Industry (IBs & IBDs) were reported 2.05 billion on Dec 31, 2010, which were Rs. 1.67 billion at the end of last quarter (July-Sep, 2010) showing an increase of 22.75%.

5.3. NUMBER OF BORROWERS

Total number of outstanding borrowers has decreased from 112,785 to 98,451 since Dec 2009; a decline of 12.71%. As shown in **Figure**, there is a decrease in no. of borrowers in each category except Islamic banks, where numbers increased from 2,119 to 2,707.

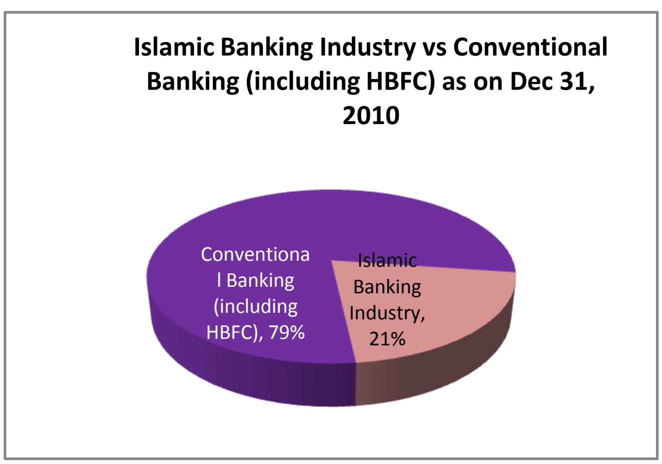


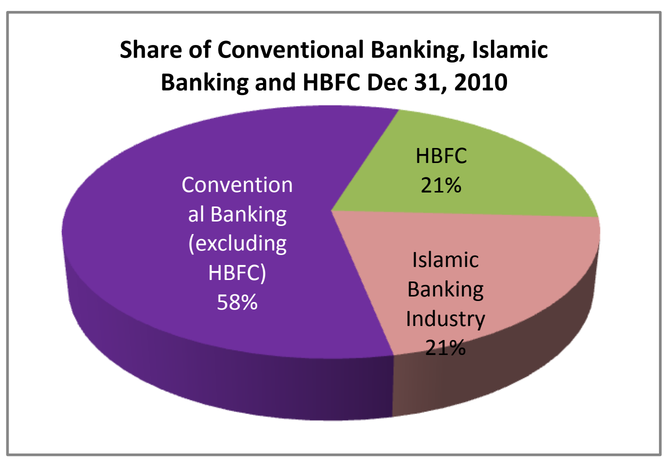
In terms of numbers, approximately 56.51% of total borrowers of housing finance borrowers have been classified as non-performing. However, this is primarily due to HBFC's number (52,259) of non-active borrowers, classified as non-performing, which comes to 70.43% of its total borrowers. Thus, excluding HBFC in such an analysis will be important as it caters to 79% of the total borrowers in housing finance sector which accounts for only 21% of total outstanding portfolio. Thus, by excluding HBFC, 14% of total borrowers of housing loans have been classified as non-performing.

Total number of customers served by Islamic Banking Industry increased from 3,658 to 4,004 (an increase of 9.45%) since Sep 2010.

5.4. SHARE OF BANKS

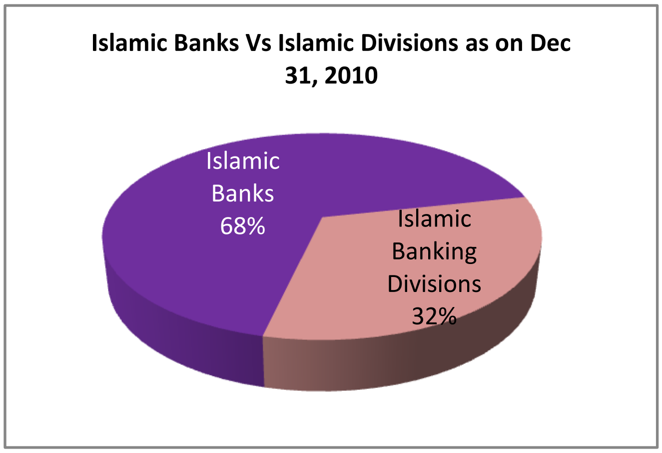
The overall market share (based on gross outstanding) of commercial banks (excluding DFIs) remained the same since the end of last year, as 79%. Within commercial banks, the share of private banks and foreign banks in the total outstanding decreased marginally from 48% to 46% and 7% to 5% respectively. The share of public sector banks and Islamic Banks in the total outstanding increased from 12% to 14%. Share of HBFC marginally increased

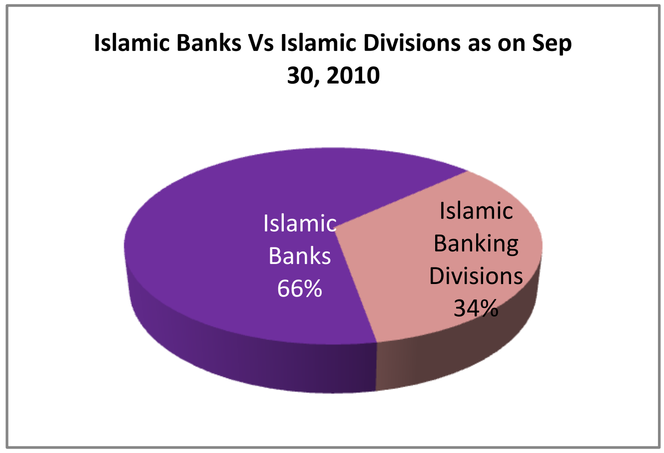




from 20% to 21%.

The share of Conventional Banking (excluding HBFC), Islamic Banking Industry and HBFC in the total outstanding was 58%, 21% and 21% respectively on Dec 31, 2010). IBDs (13 windows) and Islamic banks (06 banks) have 32% (34% in Dec 2009) and 68% (66% in Dec 2009) share in housing finance portfolio of Islamic Banking Industry, which shows that conventional banks also consider the Islamic mode of financing an important part of their business strategy. One of reasons of increasing Islamic banks outstanding portfolio is the purchase of Citibank's portfolio of Rs. 888 million by BankIslami in the quarter ending Dec 31, 2010.





5.5. DISBURSEMENTS

Fresh disbursements to the tune of Rs. 2.45 billion were made to 1,290 borrowers during the quarter ending Dec 31, 2010 (See **Table**). Islamic banks extended new disbursements of Rs. 1.27 billion followed by private banks with Rs. 749 million, public sector banks with Rs. 68 million and foreign banks with Rs. 32 million. HBFC's fresh disbursements for the quarter were reported to be Rs. 323 million. Among commercial banks, the number of new borrowers totaled 789, with private banks serving 289 borrowers and Islamic banks 466 borrowers. HBFC extended loans to 501 new borrowers during the reporting quarter.

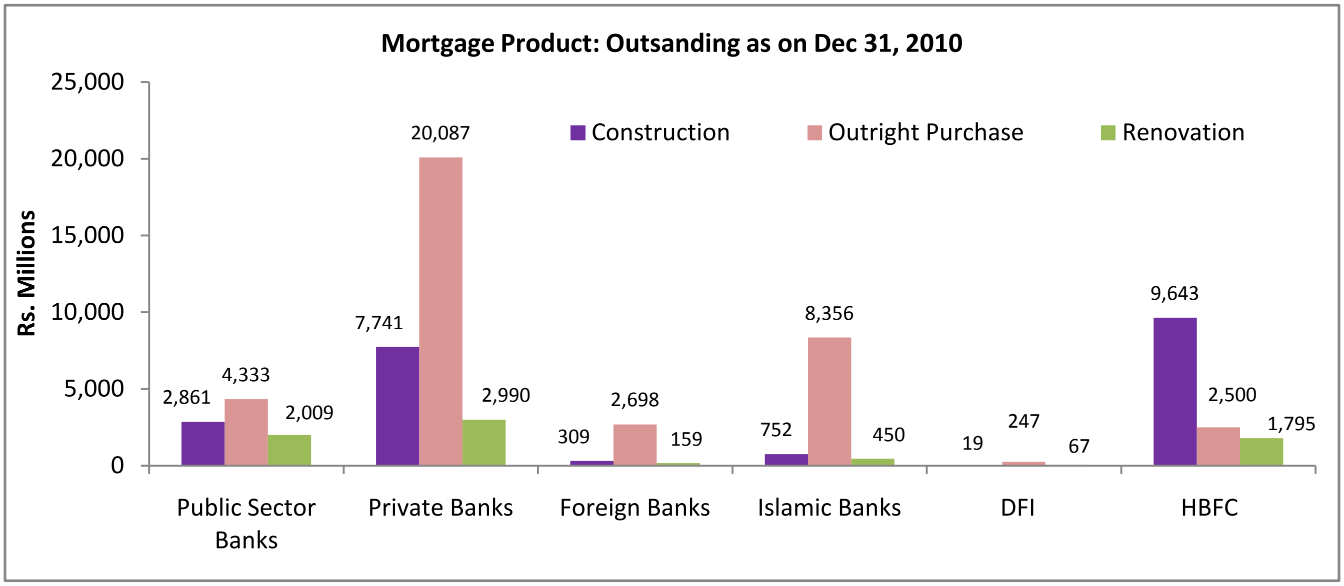
Fresh disbursement for Islamic Banking Industry was 1.45 billion to 505 new borrowers during the quarter ending Dec 31, 2010. This includes new disbursements of Rs. 174 million to 39 customers by IBDs of conventional banks.

New Disbursements during the quarter

	Amount (Rs. Millions)	No. of Borrowers
Public Sector	68	23
Private Banks	749	289
Foreign Banks	32	11
Islamic Banks	1,278	466
All Banks	**2,127**	**789**
DFIs	-	-
HBFC	323	501
Total	**2,450**	**1,290**
Islamic Industry	**1,452**	**505**

5.6. SECTORAL SHARE

The biggest share of housing finance continued to be attracted towards outright purchase as shown in the **Figure.**



The outstanding for outright purchase stood at Rs. 38.22 billion as on Dec 31, 2010; a 57% share in total outstanding of Rs. 67 billion. This is followed by the construction category where outstanding reported at quarter-end stood at Rs. 21.32 billion and that of renovation stood at Rs. 7.47 billion. Active portfolio shows that private banks have taken a lead in financing for all three sectors; construction 36%, outright purchase 53% and renovation 40%.

5.7. HOUSING FINANCE BUSINESS OF MICRO FINANCE BANKS:

Gross Outstanding

The total outstanding housing finance as on Dec 31, 2010 of Micro Finance Banks (MFBs) stood at Rs. 152.14 millions, which was Rs. 140.25 millions at the end of Sep 30, 2010, showing an increase of 8.47%, over the last quarter.

Number of Borrowers

Total number of outstanding borrowers has increased from 1,960 to 2,121 since Sep 30, 2010; an increase of 8.21%.

Non-Performing Loans

NPLs for Micro Finance Banks have increased from Rs. 1.16 millions (Sep 2010) to Rs. 1.46 millions (Dec 2010); a 25.86% increase over the last quarter. NPLs of MFBs arising out of housing finance business are around 1% of their outstanding housing finance portfolio.

5.8. ANALYSIS OF LOAN VARIABLES ADOPTED BY BANKS/DFIS & HBFC

An analysis of loan variables across all banking sectors including weighted average interest rate, Loan-to-Value ratio (% financing by banks), average maturity period, average loan size and average time for loan processing is given as under.

Weighted average interest rate

The overall weighted average interest rate was 15.5% at the end of the current quarter. Highest weighted average profit rate was reported by Islamic banks 16.4%, followed by HBFC 16.2%, foreign banks 16.1%, private banks' 15% while public sector banks average came to 14.3%

Average maturity periods

Average maturity period of outstanding loans as on Dec 31, 2010 came to 12.2 years, which is low as compared to quarter ending Dec 31, 2009 when it was 12.6 years. HBFC's average maturity period is reported to be 13.3 years, while that of Islamic banks is 10 years. Among commercial banks, foreign sector banks have extended housing loans for an average tenure of 14.8 years followed by private sector banks with 11 years and public sector banks with 10.6 years

Loan to Value ratio

The percentage of financing (Loan to Value ratio) extended by banks and DFIs decreased during last year from 58.6% to 48.3%. Average LTVs of commercial banks have decreased from 59.2% to 54.7%. The average LTV for HBFC has decreased from 60% to 41.9% during the last year, which is a significant change.

Average time for loan processing

The reported average time for loan processing is approx. 26 days for all banks and DFIs (except HBFC), which was 24 days in Dec 31, 2009. Average time taken by HBFC presently is 40.4 days which is significantly high than 30 days reported last year. Currently, the application processing of most of the banks is a centralized process, where branches forward applications to central branches/head offices for assessment and approvals.

Average loan size

Average loan size for disbursements made during the quarter ending Dec 31, 2010 is Rs. 2.5 million for all banks, except HBFC. The average loan size for HBFC is reported to be Rs. 1.2 million for the reporting quarter. Islamic as well as private banks reported an average finance size of Rs. 2.9 million, foreign banks Rs. 1.7 million and public sector banks reported Rs. 1.1 million. The housing finance market is still inclined towards lending to high income groups.

Conclusion

The quarter ending Dec 31, 2010 depicted a slight decrease as compared to quarter ending Sep 30, 2010, in overall portfolio. NPLs of the housing finance portfolio display a rising trend and banks continue to show signs of cautious lending amidst decreased affordability of the borrowers. However, lack of a conducive institutional framework and secondary mortgage market and high interest rates are still the major constraints towards the growth of housing and housing finance sector which is one of the potential key drivers of the economy.

6.0. OVERVIEW OF INFRASTRUCTURE FINANCE

The stock of infrastructure finance, which was hovering around Rs. 260 billon for some time in previous quarters, rose to Rs. 286 billion in last quarter i.e. July-September 2010. However, at the end of the quarter under review, this again settled down at Rs. 264 billion. There are some structural changes underway at the government level which also account for the recent decrease in outstanding portfolio. A power holding company was formed to resolve the issue of circular debt and it has taken the responsibility of some of the outstanding dues of power sector. The outstanding of power transmission sector, which was Rs. 28 billion in last quarter, now stands at Rs. 7.7 billion – a 72.5% decrease from the previous quarter. Petroleum sector also saw a significant decrease from Rs. 17.8 billion to Rs. 11.8 billion in one quarter. On the disbursement side, Power Generation sector is again at top with Rs. 5.4 billion followed by Petroleum sector with Rs. 3.9 billion. Telecom sector, which was the mainstay of infrastructure sector portfolio in previous years, is lying dormant since last two years and watching its share being declined by every passing quarter. Total NPLs are now at Rs. 4.8 billion for this quarter while same were Rs. 7 billion at the end of December 2009. International experience emphasizes the need of institutional capacity for project development to achieve meaningful progress in infrastructure financing. The countries that have created dedicated institutions for infrastructure project development have excelled in attracting private sector investment for infrastructure development. The capacity of developing viable projects is as big an issue as securing finance. Thus such an institution can play a pivotal role in developing marketable projects in the diversified areas like roads, mass transit, ports and Agri. infrastructure etc.

6.1. OUTSTANDING PORTFOLIO

Total financing outstanding at close of December 2010 was Rs. 264 billion against Rs. 286 billion at the end of previous quarter ending September 30, 2010. The volume of outstanding portfolio was Rs. 262.3 billion at the end of December 2009. The analysis shows, as in **Figure**, that power generation sector stood out among all the sectors of infrastructure. A number of factors like power policy, availability of sovereign guarantees in case of IPPs, expertise of financial sector in this area and demand of energy are the main reasons of its consistent lead over the other sectors.

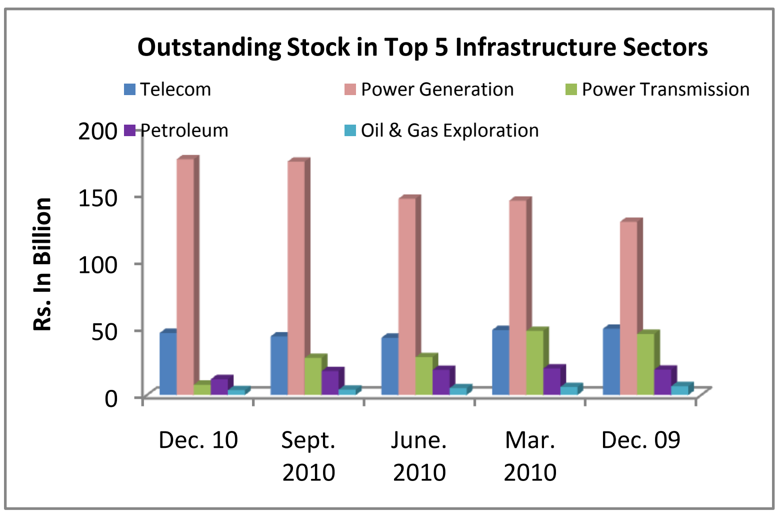
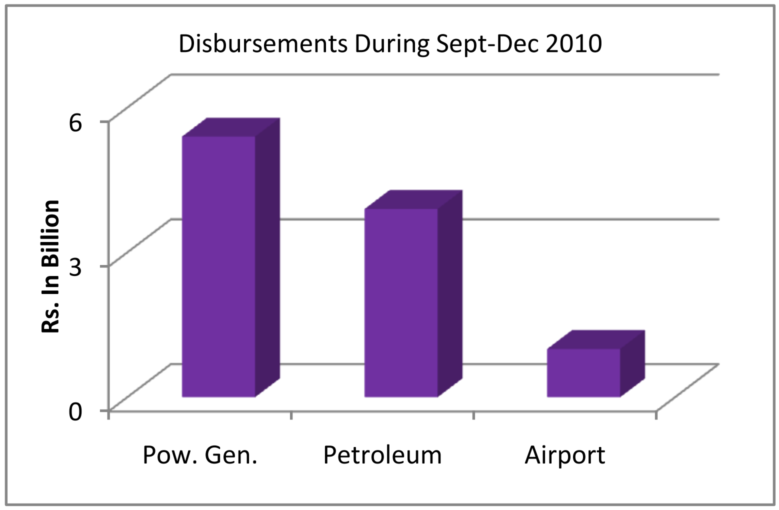
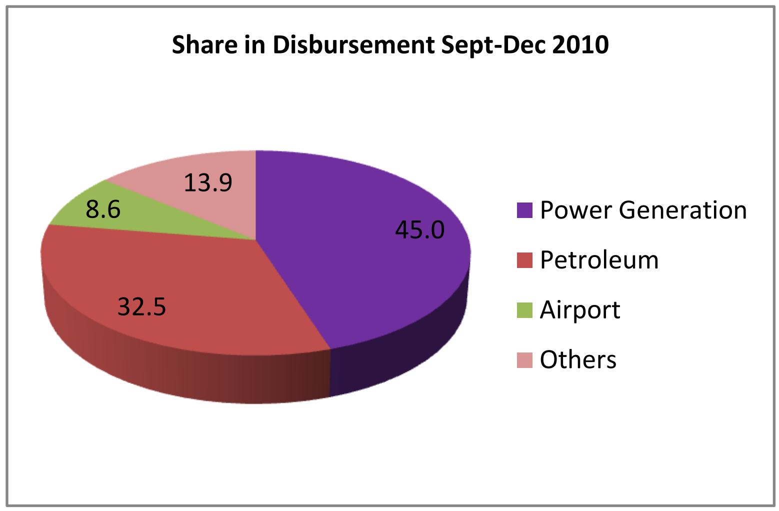


Figure shows the quarterly position of top five sectors from December 2009 to December 2010. All the top five sectors, except Power Generation, are showing a decline in their respective volume of outstanding over the year. However, the steep decline was witnessed in Power Transmission and Distribution sector due to transfer of its outstanding from banks to a power holding company. The outstanding volume in this sector was Rs 45.5 billion at the end of December 2009 which reduced to Rs 7.8 billion at the end of December 2010.

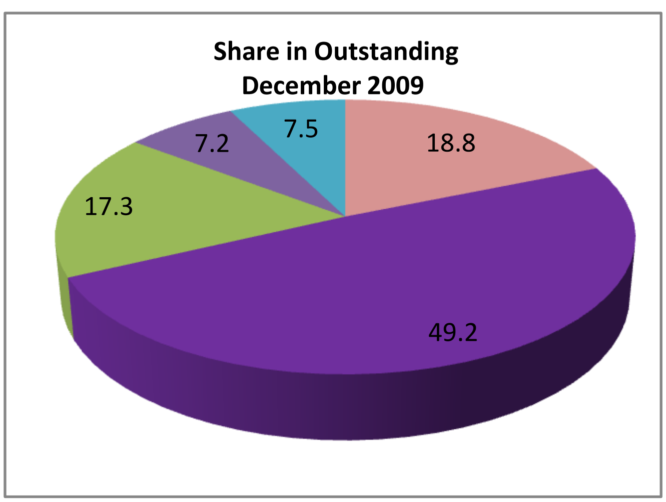
6.2. DISBURSEMENTS





Total Rs. 12 billion were disbursed during October-December 2010 quarter in all infrastructure sectors against Rs. 7.9 billion in the previous quarter. The disbursement during October-December 2009 quarter was Rs. 27.4 billion. **Figures** show the amount disbursed and share of each sector during the quarter under review. Power generation sector received Rs. 5.4 billion, which is a steady 45% share of overall disbursement. Share of power generation sector in disbursement was a robust 91% in previous quarter with Rs. 7.2 billion whereas it was 63.7% (Rs. 17.5 billion) during October-December 2009. Petroleum sector also got significant financing of Rs 3.9 billion (31.9%) in this quarter while Airport sector was recipient of over a billion rupee financing in this quarter. Ports and Shipping together with Container & Terminal sectors were some of the other beneficiaries in this quarter. Telecom and Power Transmission sectors were conspicuous by their absence in this quarter. The absence of bank financing in oil & gas sector has been a real concern considering its real potential to play an important role in the economic activity of the Country.

6.3. SECTORAL SHARE IN INFRASTRUCTURE PORTFOLIO



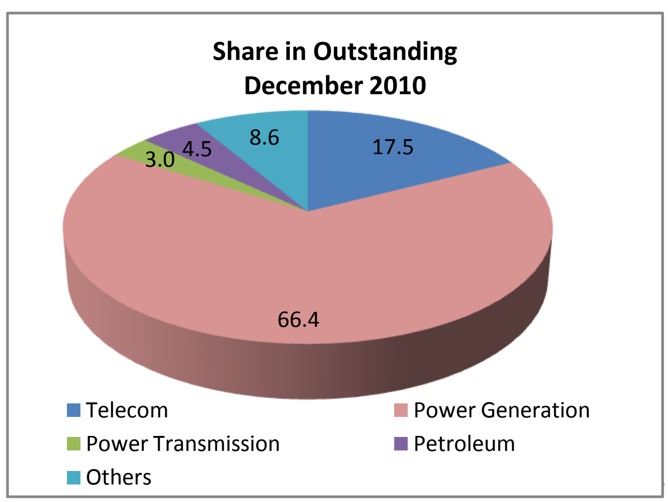
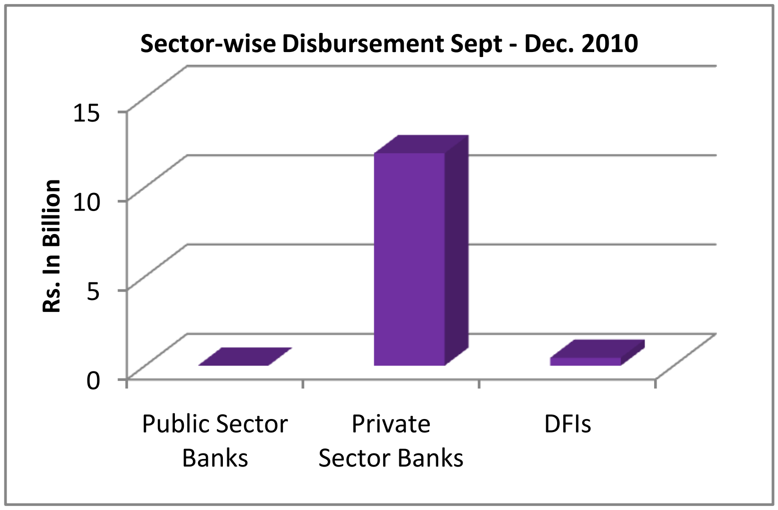


Figure shows the comparison of top five sectors in outstanding infrastructure financing at the end of December 2009 with the status existing on December 31, 2010. At the end of December 2009, power generation sector had 49.2% of the total stock followed by telecommunication sector with 18.8%. After a year, the top slot continues to be held by power generation sector with a substantial 66.4% share in the pie. All other major sectors in graph showed a declining trend. The Telecommunication sector remained at second place with 17.5% share. Petroleum sector, despite having huge potential, had been on the downside from 7.2% to 4.5% in a year. The reduction of Power Transmission sector is due to shifting of some of its outstanding to a power holding company.

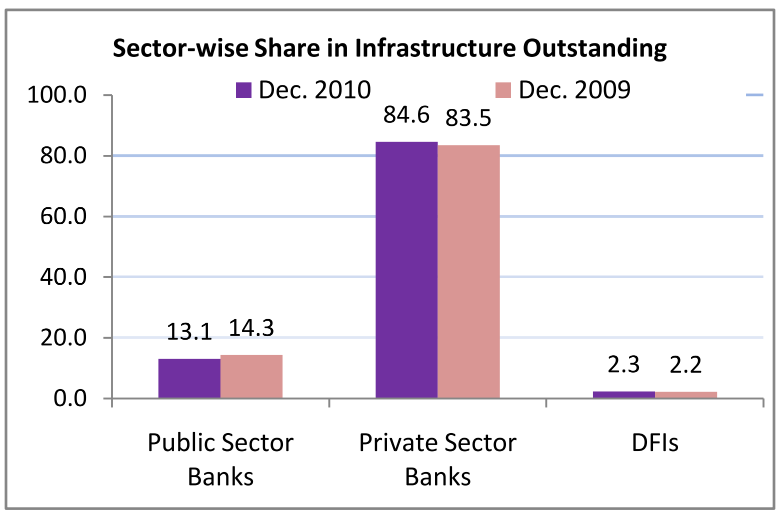
6.4. BANKING SECTOR-WISE DISBURSEMENTS

Figure shows that private sector commercial banks disbursed Rs. 11.5 billion (96%) out of total Rs. 12 billion financing in infrastructure sectors during the quarter. Public sector banks disbursed Rs. 1 million (less than 1%) while DFIs disbursed Rs. 452 million (3.8%) despite having a mandate of development finance. In same quarter last year, private sector banks disbursed Rs. 19.7 billion (71.9%) while public sector banks disbursed Rs. 6.9 billion. DFIs' share in disbursements during the quarter ending December 2009 was also minimal at Rs. 800 million (2.9%).



6.5. BANKING SECTOR-WISE SHARE IN OUTSTANDING

Figure shows the category-wise share of banking sector in outstanding stock of infrastructure financing. The trend remains almost the same throughout the year. Share of private sector banks rose marginally from 83.5% to 84.6%, while share of public sector banks declined from 14.3% to 13.1% after a year. The share of DFIs remained below par through-out the year. Though private banks enjoy a major share, portfolio diversification beyond limited infrastructure sectors is highly desirable.



6.6. NEW INDUSTRY INITIATIVES IN THE QUARTER

A new 560MW Combined Cycle Power Project by KESC at Bin Qasim was initiated in this quarter. The cost of project is PKR 38,250 million with 67:33 debt equity ratio. The long term loan has been provided by Asian Development Bank, International Finance Corporation and a syndicate of local banks. The local syndicate is providing PKR 8,500 million facility. The BQPS-2, as the project is called, is the biggest thermal power project under construction in country.

7.0. KEY DEVELOPMENT FINANCE INITIATIVES – POLICY AND INDUSTRY

Appreciating the critical role and significance of Development Finance for the sustainable economic growth in the country the following key measures were taken during the Calendar 2009-2010;

Credit Guarantee Scheme for Small and Rural Enterprises

SBP has launched a Credit Guarantee Scheme (CGS) for Small and Rural Enterprises in March 2010, which will allow banks to develop a portfolio of fresh borrowers who are creditworthy, but cannot fit into their usual credit parameters, especially when collaterals are required. It will allow banks to assess Small and Rural Enterprises on the basis of cash flows. The scheme has been bifurcated into two segments: one for Khyber-Pakhtunkhwa, FATA and Gilgit-Baltistan, whereas the other is reserved for priority clusters/areas of other parts of the country. In case of bonafide losses, SBP will share 60 percent of PFI's fresh portfolio of financing to Small & Rural Enterprises. Under the scheme, limits have been allocated to participating banks for utilization.

Going forward based on our experience some improvements are being suggested in CGS that primarily reflects on the CR coverage and flexibility for the banks.

SME Training Programs

SBP held capacity building programs for officers of commercial banks during 2009-2010 to equip them with latest tools and technology being used in SME finance across the globe. So far, around 400 credit officers have been imparted training in the SME finance area at SME hubs across the country. Major areas covered in these trainings included Risk Mitigation tools like Credit Scoring, Program Based Lending Schemes & Effective Marketing Strategies. In light of the success of previously conducted programs, a series of grass-root training program, in phases, has been conducted in major cities across Pakistan.

Besides, State Bank, in collaboration with IFC, has finalized three Capacity Development Programs for Senior Officials of banks. Of the three programs, first program was conducted at Karachi and attended by more than 30 officials of banks. While the second program was held at Lahore; a program at Islamabad will be held shortly. These programs will greatly help banks in improving their understanding of SME Banking needs and coming up with improved strategies.

Training Program on using Credit Scoring in Small Business lending:

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

SME Market Segmentation in Pakistan

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

Cluster Development Surveys

Considering the significance of SME clusters in our economy and to get first-hand knowledge about important SME clusters, SBP has hired services of Lahore University of Management Sciences (LUMS) to conduct primary research survey of "Fans Cluster- Gujrat/Gujranwala". The information, derived from this cluster survey, shall not only assist SBP in realigning its regulatory framework for SME Financing (if required) but shall also facilitate commercial banks in developing more effective lending strategies and loan products to adequately fulfill the credit needs of SMEs from banking sector.

Awareness Seminars

SME Finance Department launched a series of Awareness Seminars in collaboration with Development Finance Support Department (DFSD) of SBP-BSC to disseminate the salient features of CGS/SBP Schemes. The seminars were attended by the members of trade associations, chambers, farmers association, SMEDA and regional SME & agriculture heads, credit officials of banks and officials posted in the DFSU. The discussions and interactions proved quite useful as these Seminars not only created the desired atmosphere in each region for effective utilization of the Scheme but also provided opportunity to the SMEFD officials to listen to the view points of end users of these facilities.

So far, these seminars have been organized in cities having concentrated presence of SMEs like Karachi, Peshawar, Sialkot, Faisalabad, Multan and Lahore.

Secured Transactions Framework

Secured Transaction Framework helps banks to create charge on moveable assets beside immovable assets that greatly help in improving access to finance by SMEs. Under ADB Technical Assistance, an initial study was conducted on the need and feasibility of Secured Transaction Framework which gave their final report with the following recommendations:

- Establishment of Registry Office will greatly improve the SME Finance Environment.
- The legal framework for the Registry Office should be provided through separate law to be approved by the Parliament.

Next step is the implementation of the above recommendations, i.e. drafting and approval of STF law and establishment of Registry Office. For the purpose, State Bank is communicating with MOF, GOP to arrange required funds for STR Project Phase 2 implementation. However, the primary responsibility lies with MOF, Government of Pakistan

Refinance Scheme for Revitalization OF SMEs in NWFP, Gilgit-Baltistan (GB) AND FATA

To revitalize SMEs in NWFP, Gilgit-Baltistan (GB) and FATA SBP issued the captioned Scheme through SMEFD Circular No. 2 dated march 19, 2010. Under the Scheme, the banks may provide short term/working capital facilities or medium to long term financing. However, Financing already extended and outstanding shall be ineligible for availing refinance.

Mark up Rate Support for Textile Sector against Long Term Loans

Effective September 1, 2009 the Government of Pakistan announced a Markup Rate Support for Textile Sector on their outstanding running balances of principal amount of floating rate loans availed by the industry from commercial banks/DFIs for financing import / purchase of textile machinery. SBP circulated detailed procedure / criteria to avail the Support/Subsidy vide SMEFD Circular No. 04 dated March 22, 2010.

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

The refinance rates under the Export Finance Scheme were increased by 0.5% through SMEFD Circular No. 5 dated March 31, 2010. Effective April 1, 2010 the end user rate increased to 9% from 8.5% and simultaneously the benefits allowed under SMEFD Circular No. 6 of 2009 were also adjusted in view of the revision.

Enhancement in token fine on Late/Non Submission of EPRC under the EFS

Under Part-I of the Export Finance Scheme, a token fine of Rs.5000/- was being imposed on banks, on failure to submit EPRC within the prescribed time period. Subsequently on submission of EPRC the fine already recovered was refunded to respective banks. In order to make the monitoring of the Scheme more effective, and to ensure compliance of its procedure, the fine charged on account of non submission of EPRC has been enhanced from Rs.5,000/- to Rs.20,000/-. Further, 25% of this fine i.e. Rs.5, 000/-, would be non refundable even on late submission of EPRC.

Financing Facility for Storage of Agricultural Produce

In order to develop the agricultural produce marketing and enhance storage capacity SBP issued a Scheme for "Financing Facility for Storage of Agricultural Produce (FFSAP)" to encourage Private Sector to establish Silos, Warehouses and Cold Storages through SMEFD Circular No. 08 dated June 4, 2010. The financing shall be available on long term basis for establishment, expansion and balancing, modernization & replacement (BMR) of Steel/Metal/Concrete Silos, Warehouses & Cold Storage facilities for storing agricultural produce. Financing shall be available for a maximum period of seven years including a maximum grace period of six months.

Expansion in Scope of Scheme for Modernization of SMEs

In order to improve the access to finance for SMEs, the scope of the Scheme for Modernization of SMEs (issued through SMEFD Circular No.14 of 2009 and SMEFD Circular No. 17 of 2009) was expanded to cover a wide range of SME Clusters/Sectors, through SMEFD Circular No. 07 dated May 6, 2010. The financing will be available for purchase of new imported/local Plant & Machinery for BMR of existing and setting up of new units. Financing for import/ local purchase of new generators up-to a maximum capacity of 500 KVA shall also be eligible under the Scheme. The tenor for financing under the scheme has also been enhanced from 7 years to 10 years.

Reduction in Export Performance Requirements under Part-II of EFS for Hand Knotted Carpets for FY 2009-10

The required performance for financing facilities availed under Part II of EFS during FY 2009-10 be fixed at 1.50 times as against existing performance requirements of 2.0 times for Hand knotted Carpets through SMEFD Circular No. 9 dated June 28, 2010. The entitlement of limits for FY 2010-11 shall, however, continue to be fixed as per existing criteria / instructions.

Relaxations to Exporters under Part-II of Export Finance Scheme

State Bank of Pakistan had received representations from chambers / exporters' associations that heavy load shedding and shortage of raw material has adversely affected their production. As a result some of the exporters could not ship export consignments in time leading to delay in export proceeds realization during FY 2009-10. In order to address the problems faced by the exporters it was decided through SMEFD Circular No. 12 of 2010, dated July 9th, 2010 to allow an additional period of one month for export proceeds realization under Part-II for the monitoring year 2009-2010.

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

The refinance rates under the Export Finance Scheme were increased through SMEFD Circular No. 13 dated September 30, 2010. It was decided that rate of refinance under the Export Finance Scheme applicable from October 1, 2010 and onward till further instructions will be 9% p.a. The commercial banks will ensure that where financing facilities are extended by them to the exporters for availing refinance facilities under the Export Finance Scheme, their maximum margin / spread does not exceed 1% p.a.

Refinance Scheme For Revival of SMEs & Agricultural Activities in Flood Affected Areas & Financing Scheme for Canola Cultivation In Flood Affected Areas

In line with the Government policy for revival of agriculture activities and SBP relief measures for improving access to financing in flood affected area, SBP launched Refinance Scheme for SMEs and Agricultural activities in flood affected areas and financing Scheme for Canola Cultivation vide SMEFD Circular No. 16 & 15 dated November 2 & October 5, 2010 respectively. Under the both schemes Rs. 10 and 0.5 billion respectively have been allocated to encourage financing to farmers and SMEs in the districts affected by floods. Refinance rate for banks is 5.0% per annum and maximum spread the banks is 3.0% p.a. The mark up rate for the borrower is at 8%. The Schemes are valid up to October 31, 2011.

Payments of Claims under Mark-Up Rate Facilities for Textile Sector

In pursuance of Government announcement, SBP vide SMEFD Circular Letter No. 14 dated December 22, 2010, has advised commercial banks and DFIs to approach the respective SBP BSC Offices for processing of pending claims with respect to Export Finance Mark-up Rate Facility and Mark-up Rate Support for Textile Sector against the long-terms loans to get reimbursement up-to 32% out of 40% un-paid claims for the period from 01-09-2009 to 28-02-2010.

Rationalization of Rate under Export Finance Scheme (EFS)

SBP continued its strategy to gradually rationalize mark-up rate of EFS and mitigate market distortions caused by subsidized rate of financing. Therefore, refinance rates under the Export Finance Scheme was increased by 1% through SMEFD Circular No. 17 dated December 31, 2010. The rate is effective from January 1, 2011 and as a result exporters will get financing at 11% by including 1% spread of banks.

Major Steps Taken by Microfinance Department during the Year 2010

In order to promote the sector on sound basis, several initiatives were undertaken to enable MFBs to diversify their product line, build revenues, attain financial stability, and ensure consumer protection. Key initiatives are given as under:

- To showcase Pakistan's progress and recent developments in the branchless banking, SBP arranged an international conference at SBP, Karachi on 17 April, 2010.
- To strengthen the MFBs' deposit base which is necessary for them to finance their loan portfolio, SBP granted direct membership of clearing house to Tameer Microfinance Bank in 2009. Other MFBs are also working on developing their systems and capabilities to become eligible for membership of clearing house.
- The PR No. 12 regarding classification of assets and provisioning requirements has been amended vide MFD Circular No. 3 of 2010. The revised instructions state that in addition to cash as collateral, gold (including both bullion and ornaments) shall also be considered in specific provision against non-performing loans.
- Addition in Prudential Regulation No. 17 has been introduced regarding Record Retention. As per the latest instruction of the State Bank of Pakistan, MFBs are required to keep identification record and transaction record at least for five years.
- The State Bank of Pakistan, in MFD Circular No. 2 of 2010, amended its Prudential Regulation No. 6 and 27 for microfinance banks regarding maintenance of Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR). MFBs shall now maintain CRR equivalent to not less than 5% of its deposits. These include demand deposits and time deposits with tenors of less than one year. Likewise, time liabilities of tenors of a year and above will not require any SLR. This significant move has been geared towards creating more working space for MFBs, and to encourage them to mobilize long term deposits.
- SBP has set up a "Microfinance Credit Guarantee Facility (MCGF)", with £10 million funding support from UK Department for International Development (DFID), to incentivize the commercial banks to provide wholesale funds to the microfinance sector for on-lending to the poor and marginalized segments. So far, the Facility has mobilized funds of nearly Rs.2 billion for the sector that will go a long way in promoting the growth of the sector.
- SBP issued guidelines allowing foreign currency (FCY) borrowing by microfinance banks and institutions.

- SBP has launched Improving Access to Financial Services Fund (IAFSF), for improving financial literacy amongst existing and potential microfinance clientele that will enhance their capability to access and make productive use of financial resources.
- SBP facilitated the establishment of MF-specific Credit Information Bureau (CIB) to provide robust credit information infrastructure to the industry. The Pakistan Microfinance Network launched the pilot of the CIB in Lahore in May, 2010.
- Under the joint initiative taken by Microfinance Department and NIBAF, five-day's crash training program was held at SBP-BSC Karachi and Hyderabad during the year. The microfinance training program is aimed for the capacity building of loan/field officers of microfinance banks/institutions
- The Microfinance Department of SBP organized a one week exposure visit for a delegation of the central bank of Ethiopia, the National Bank of Ethiopia to facilitate them in re-engineering and re-organization of their supervisory systems and Processes. The National Bank of Ethiopia's team visited SBP from 12 to 16 of July of 2010. During the week SBP officials from various departments shared their experience in the area of regulations and supervision of microfinance as well as commercial banking.
- In a series of flood relief measures, SBP allowed the MFBs to reschedule their loans in flood affected areas.

Introduction & Completion of Pilot Project Phase III

Encouraged by the successful completion of PP-II and on the basis of the feedback received from banks for the extension of Pilot Project Phase III (PP-III) from Kharif season 2010, SBP has launched phase III from Kharif season 2010, besides 28 districts of PP-II, in 23 new districts have been selected for inclusion in PP-III based on the number of farm households and agricultural activities. With the inclusion of these 23 districts, the coverage has been extended to 51 districts of the country covering 75% of total farm households in the country.

The achievement of performance targets of PPIII were hampered due to severe floods which caused devastation of the farming land in the country. Nevertheless at the completion of Pilot Project Phase III, banks have disbursed Rs 46.8 billion or 87% against a target of Rs 53.5 billion, serving 348,907 borrowers which are 85% of the target of 409,172 borrowers. In terms of fresh borrowers, banks achieved 93% of the target by serving 121,628 fresh borrowers against the target of 130,175 borrowers.

Introduction of One Window Operation in Pilot Districts

To address issues of delays in issuance of passbook and timely completion of revenue formalities, a framework for 'One Window Operation' was developed and launched in the Pilot districts of Sindh, Punjab, Khyber-Pakhtunkhwa and Baluchistan by their respective provincial Boards of Revenue from Kharif Season 2009.

Training Workshop for CAD/Risk Management Departments of Banks on Agri. Loan Documents/Procedures

Therefore, in order to develop the understanding of officials of Credit Administration Department (CAD) and Risk Management Department (RMD) of banks about the dynamics of agri. lending, SBP developed two days training workshop on important topics such as overview of agri. sector, SBP regulations regarding agri. finance, agri. credit risk management tools & techniques, loan appraisal and documentation, agri. passbook and other documents of revenue department, etc. in consultation with banks. During 2010 four training workshops were arranged at Karachi, Lahore, Multan and Islamabad which were attended by around 170 senior officials of agri. lending banks, SBP and DFSD, SBP-BSC.

Agri. Commodities Physical Trade & Market Development

Pakistan's agri. sector suffers from a compounded problem of lack of infrastructure & market structure. Infrastructure side includes a lack of proper warehousing, whereas on market side, there is a lack of grading & testing, collateral management, post harvest financing and trading. To develop the storage, marketing & post harvest financing, SBP is leading a Committee of key stake holders including Karachi Stock Exchange, National Commodities Exchange Limited (NCEL), Pakistan Banks Association (PBA), Competitiveness Support Fund (CSF) & Pakistan Farmers Association, towards an initiative which will evolve proper storage, fair & transparent price mechanism & post harvest financing system. After deliberations with stakeholders a primary framework of commodity operations has been finalized and the assignment has been shifted to NCEL for its implementation.

Agribusiness Finance Workshop at Netherlands

A one week training workshop on Agribusiness Finance was arranged from 23-27 August, 2010 at Utrecht, Netherlands in collaboration with Rabobank International Advisory Services (RIAS).

The workshop was aimed at creating awareness and building capacity of banks in enhancing the outreach of agri. credit. The training workshop covered best agri. financing practices, agri. lending processes & practices, warehouse receipt systems, cooperatives in the agriculture sector, out grower scheme & linkage programs, agricultural value chain financing, material risk analysis model, business analysis, development financing, etc. followed by a one day field visit.

The workshop was attended by the senior officials of SBP & SBP-BSC, lead by Muhammad Ashraf Khan, ED (DFG) and officials of agri lending banks viz. HBL, MCB, ABL, UBL, ZTBL, Faysal Bank, BOP, Askari Bank, Silk Bank, Standard Chartered Bank (Pakistan) and United Insurance Company.

The workshop will help in replicating agri. financing and lending policies of Rabobank in terms of strategy development & segmentation in agri. credit, improving lending assessment mechanism and developing innovative products, etc.

Internship Program for Agricultural Graduates

Agricultural Credit Department (ACD) in collaboration with Training & Development Department (T&DD) has launched 6-weeks specialized Internship Program for 25 students of Agricultural Universities/Departments from 5th July, 2010 at SBP. In the first batch, 24 participants from 11 Agriculture Universities/ Departments were selected for the training program.

The program will facilitate in provision of quality human resource for banks in agri. financing to achieve the overall objective of access to finance to the farming community.

Revision of PIU Value of Land in the Passbook

ACD vide its Circular No. 01 of 9th August, 2010 communicated to banks the enhanced Produce Index Unit (PIU) value of land in the passbook from Rs 1200 to Rs 2000 by Finance Division (Internal Finance Wing), Government of Pakistan vide Notification S.R.O No. F. 12(1) IF-I/2009-879 dated 12th July, 2010. The banks were advised to carry out necessary amendment in the Loans for Agricultural Purpose Rules, 1973 and also issue instructions to their branches for necessary action in this regard. However, SBP instructions on accepting agricultural land as security on the basis of realizable/forced sale value in addition to PIU or market value shall remain unchanged.

Streamlining of Agricultural Lending Procedures and Documentation

In order to ensure timely disbursement of agri. credit to the farming community, ACD vide its Circular No. 02 of 11th August, 2010, revised the list of documents to be obtained by banks against various kinds of agri. loans and streamlined the turnaround time for agri. loan processing.

Further, to strengthen the existing agri. lending structure and remove lapses in agri. loan management, banks were advised to take measures like; a comprehensive Agriculture Finance policy in line with PRs, set up and maintain a fully dedicated Agri. Finance Department/Division/Unit equipped with qualified agri. financing staff, develop an overall annual regional agricultural portfolio plan, increase number of agri. designated branches and ACOs, delegate adequate powers to agri. designated branches for sanctioning small agri. Loans, launch financial literacy programs for awareness of the farming community, etc. by the end of the current calendar year.

Implementation of Housing Advisory Group's Recommendations

As part of its earlier efforts, SBP had established a Housing Advisory Group (HAG) with an intention to conduct a thorough analysis of the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations stressing on the need to enhance access of financial services for the development of housing sector. These include reforms in legal and regulatory framework, establishment of secondary mortgage market, development of market intelligence, provision of affordable/low income housing finance products. SBP had already disseminated the recommendations to the concerned stakeholders and is currently coordinating with the Ministry of Housing & Works, Pakistan Banks' Association (PBA), Association of Mortgage Bankers (AMB) and Association of Builders and Developers (ABAD) for implementation of some of the key recommendations.

Mortgage Refinance Company

SBP and World Bank Group have agreed to work together for implementing key recommendation of HAG for creating financing environment conducive to growth of housing sector by focusing on: establishment of Mortgage Refinance Company, availability of low cost housing finance and establishment of an observatory for real estate market. Work on the establishment of Mortgage Refinance Company is now being pursued aggressively. IFC developed a detailed business plan and feasibility for the Mortgage Refinance Company. Principal buy-in of the Ministry of Finance has been elicited and equity commitments from the GoP, commercial banks and HBFC have been received. Memorandum & Articles of Association of the proposed company have been developed and the company is expected to be established during the current financial year.

Capacity building Program-Housing Finance

In addition to initiatives taken to institutionalize housing finance, SBP realizes that a simultaneous development of human capital will play a critical role in ensuring sustainability of housing finance. In accordance with the Cooperation Agreement signed between International Finance Corporation (private sector arm of the World

Bank Group) and SBP, a comprehensive housing finance training program was launched. The training covered all aspects of housing finance from product development, loan marketing/distribution and origination to loan underwriting, servicing and risk management. Till date, approximately 300 bankers from over 20 banks have been trained in the mortgage business.

During the quarter under review, one day Islamic Housing Finance session was conducted at SBP-BSC Lahore.

Development of Housing Finance Guidelines

Infrastructure & Housing Finance Department of SBP is in process of developing guidelines of housing finance to increase the efficiency of mortgage bankers by adopting best international practices. After consultation with internal and external stakeholders, including PBA, draft of the guidelines has been finalized and forward for approval of the competent authority.

Revised Guidelines for Infrastructure Project Finance

The department issued guidelines for infrastructure project finance. The new guidelines cover a broad array of concepts like project insurance, requirement of technical feasibility, risk assessment and allocation matrix, financing during development phase, emphasis on Operation & Maintenance Agreement for initial years, financial covenants, technical monitoring of projects during loan tenure and requirement of Supply and Off-take agreements.

Capacity Building Program- Infrastructure Finance

A comprehensive Training Program on Infrastructure Project Finance was conducted with the assistance of the World Bank Group from 12 to 16 July 2010 at SBP's Learning Resource Centre in Karachi. This was for the first time that such a high level massive training program on Infrastructure Project Finance was held in Pakistan. This SBP-World Bank joint initiative was taken to address the issue of lack of expertise in the financial sector on project development and financing. Cambridge Economic Policy Associates (CEPA), a very renowned organization for working in infrastructure development and training sector, prepared the course manual and delivered the training. IHFD has planned to continue this capacity building initiative in this business year with the help of local trainers. The next training program is scheduled in May 2011.

8.0. DEVELOPMENT FINANCE NEWS FROM AROUND THE WORLD

The following are some of the important news concerning Development Finance across the Globe during the year 2010.

HKMC Signs SME Financing Guarantee Scheme

The Hong Kong Mortgage Corporation Limited (HKMC) held a signing ceremony for its guarantee scheme, which was first announced last month and to assist local small and medium-sized enterprises (SMEs) to obtain sustainable local bank financing.

The SME Financing Guarantee Scheme, to be launched on January 1, 2011, aims to assist non-listed enterprises with business operations in Hong Kong to obtain loans from banks so as to provide general working capital for their business operations or to acquire equipment and assets. In order to qualify for the Scheme, firms must be at least one year old and have a good loan repayment record.

Under the scheme, the HKMC will provide guarantee coverage on 50%, 60% or 70% of the bank financing for eligible enterprises. The maximum loan amount for each enterprise or each group of enterprises under the cover is HKD12m (USD1.54m), with both term loan and revolving credit facilities being eligible. The maximum guarantee period for each loan facility is five years, and the minimum annual guarantee fee will range from 0.5% to 2.5% of the loan facility.

SME Finance Forum: Ensuring access to credit to small businesses

In the first meeting of the SME Finance Forum, possible means to improve the current situation of access to finance were discussed, such as the introduction of a grace period for firms in difficulties, the involvement of credit mediators and improved loan guarantees. Convened by Vice-President Antonio Tajani, leading European banking and business organizations examined ways to strengthen their efforts to ensure the continuous flow of funding to firms, especially small and medium-sized ones. This was the first time that such a high level group was convened to tackle the issue of access to credit and finance for small businesses.

New CBI/ACCA survey explores small business financing options

Small and medium-sized businesses (SMEs) are using a wide variety of financing options to access finance, including credit from trading partners and late payment. But they are also becoming increasingly important as creditors in their own right, according to a new survey by the Confederation of British Industry (CBI) and the Association of Chartered Certified Accountants (ACCA).

Small business finance and the recovery, a survey of 380 UK small and medium-sized firms and nearly 100 accountancy practices, found that bank overdrafts are the most popular form of business finance, with 33% of respondents applying for them with a success rate of 73%.

Entrepreneurial Finance Lab Wins G-20 SME Finance Challenge

The Entrepreneurial Finance Lab (EFL) at the Center for International Development (CID) at Harvard University has been selected as a winner of the G-20 SME Finance Challenge for addressing the problem of access to finance for small and medium enterprises (SMEs) in developing countries.

The EFL was co-founded by Asim Ijaz Khwaja, professor of public policy at Harvard Kennedy School, and Bailey Klinger, a CID fellow. EFL is pioneering the use of psychometric screening tools of entrepreneurial ability and honesty to unlock large-scale bank finance for SMEs in developing countries.

Facilities at new SME incubator

An incubator being established by the Public Establishment for Industrial Estates (PEIE) at the Knowledge Oasis Muscat for Omanis who want to start up their own Small and Medium Enterprises (SMEs) will have several facilities. The SME incubator facility will provide comprehensive training and consulting support to budding Omani entrepreneurs, said Shaikh Salah al Maawali, Director General for the development of SMEs (DGSMEs).

The type of assistance to be provided at the upcoming SME Incubator Facility will focus on how to prepare and implement a business plan; how to effectively start up and/or manage a business; how to engage in strategic business planning; how to manage employees, operations and inventory; how to evaluate and effectively use technology; and legal advisory information.

SME Finance Summit

C-5 (Formerly EuroForum) in collaboration with the IFC, Banking Association for Central & Eastern Europe (BACEE), and European Banking Federation held an SME Finance Summit in London, UK. The summit aimed at addressing the challenges to finance SMEs which have been recognized as the growth engines. The sessions included were: Steering SMEs Back on the Development Path, Innovation – The Key Success Factor for SME Growth, Identifying the Right Approach to Provide Adequate Funding for SMEs, Mitigating Risks to Optimize Capital Investments and Financial Security, Exploring the Roles of Regulators, DFIs and Financial Institutions for Facilitating Financial Access, Developing the 'Missing Middle' – Breaking the Boundaries of SME Finance, Promoting Small Businesses in the Developing Market, Enhancing SMEs in Europe through Innovation and Growth, Optimizing Infrastructure and Increasing Capacity for SMEs to Maximize Growth and Accelerate ROI.

EAC and World Bank sign grant agreement of USD 16 million

The East African Community (EAC) and the World Bank (WB) recently signed a grant agreement worth USD 16 million to fund the EAC Financial Sector Development and Regionalization Project.

ICB Study Tour to Pakistan

To assess the viability of microfinance lending, the State Bank of Pakistan (SBP) recently organized a study tour for representatives of the Indonesian Central Bank (ICB) in Tando Allah Yar, to observe the current socio-economic conditions of low-income households in Pakistan.

Pakistan Being the Global Leader in Microfinance Regulatory Framework

A recent publication of the Economist Intelligence Unit on 'Global microscope on the microfinance business environment in 2010' ranked Pakistan number one in terms of regulatory environment.

The State Bank of India launched 'SBI Tiny no frills account' in Dimapur

It is part of the Reserve Bank of India's 'Financial Inclusion Programme'**.** "The State Bank of India with over sixteen thousand four hundred plus branches has taken up this challenge by introducing `SBI Tiny no frills account` for the urban slum communities & Rural India. In this new account there is no need of `KYC` (or Know Your Client) documents and the account can be opened with a zero balance. In this account one can deposit or withdraw from Rs.10/- to Rs.10,000/- the upper limit for this account is Rs.50,000/-. Bank has various loan schemes to cater different needs of rural farmers and urban slum based persons."

ADB Plans to set up $250 Million Guarantee Fund for Microfinance

The Asian Development Bank (ADB) is constituting a US$250 million (around INR1,135 crore) facility to offer guarantees against loans to MFIs extended by banks in the Asia-Pacific region where it operates, including India. The move is aimed at encouraging banks to lend more to MFIs.

Pakistan Unveils Draft Micro-insurance Regulations

The Securities and Exchange Commission of Pakistan (SECP) and Centre for International Private Enterprise (CIPE) organized a policy roundtable to lay down possible solutions for overcoming hindrances to micro-insurance in the country. The roundtable resulted in unveiling of Draft SECP Micro Insurance Rules 2011.

"A pilot project for micro-insurance will be launched by June this year," Asia Care Insurance CEO Mehdi Kazmi informed the participants. The pilot project will be jointly executed by Asia Care, Allianz-EFU, Adamjee and State Life insurance companies with logistical support from Tameer Bank and First Micro Insurance Agency (FMIA).

Bangladesh Government Investigates Grameen Anomalies

Bangladesh's government will probe Grameen Bank for possible misappropriation of aid funds. Despite a report absolving Grameen Bank of any wrongdoing, the government has created a committee to review Grameen Bank's financial transactions and its dealings with sister organizations.

President inaugurates housing scheme for PIA employees

Shaheed Mohtarma Benazir Bhutto–Apna Ghar Scheme for PIA employees was formally inaugurated by President Asif Ali Zardari at PIA Head Office, Karachi. The land for the housing scheme has been granted by the government of Pakistan. Under the scheme, the employees will not be required to make any down payment; 50 per cent of the total cost of the apartment will be paid by the employees fund while the remaining 50 per cent will be arranged by the PIA through financial institutions of repute at very low interest rates. The airline has already submitted its business plan to the government for approval. The president also announced that Apna Ghar Scheme will be offered in other cities of Pakistan as well and will be for employees of PIA and CAA Pakistan.

BankIslami acquired Citibank`s housing portfolio

BankIslami acquired Citibank Pakistan`s House Financing portfolio amounting to Rs. 953 million. For the first time in Pakistan, a Bank has acquired mortgage assets of another Bank. It is expected that this transaction would open door for other similar transactions enabling banks to acquire entire business or product lines. The added significance of the transaction is that this is the first time an Islamic bank has acquired business of a conventional bank.

SC directs action against bogus housing schemes

A full Supreme Court (SC) bench headed by Chief Justice of Pakistan Justice Iftikhar Muhammed Chaudhry directed to spend money acquired by auctioning 81 plots on development of a Housing Scheme. The SC disposed of petitions filed under public benefit. The apex court directed Secretary Housing to draw up a survey regarding bogus housing schemes and plan crackdown on such schemes.

BRDB of Malaysia plans $437m investment in Pakistan

Bandaraya Development Berhad (BRDB) of Malaysia is investing US$437 million in Pakistan to develop a Golf Resort, a five star hotel, five housing schemes, condominiums and shopping areas. According to BRDB, the investment started in 2006 and would complete in2015. BRDB intends to construct 18 hole Golf course, five housing schemes consisting two Kanal, one Kanal, fourteen marla and ten marla housing units, five condominiums, clubs and shopping areas. According to the details provided by BRDB, in the first nine years, it will construct 420 housing units, five condominiums containing 400 units and shopping facilities containing 121 shops. BRDB is introducing concept of condominiums in Pakistan due to their popularity in Malaysia. The condominium is a multi story housing complex equipped with civic amenities like community hall, gymnasium, playing area, mosque, retail centre, and swimming pool. According to BRDB, 98% of the work on Phase-I of the project has been completed and was ready to be handed over to its Pakistani partner after provision of electricity and gas connection by WAPDA and SNGPL.

BBC Dragon's Pakistan housing project gets underway

The first lot of 120 planned houses in a village hit by Pakistan's floods has been completed, bringing Dragons' Den entrepreneur James Caan one step closer to fulfilling his dream of rebuilding the entire village. The canalside village of Jan Lunda, 100 miles north-west of Islamabad, in Khyber Pakhtunkhwa province, was among several villages in Pakistan that were wholly submerged by flood waters last July. Responding to the catastrophe, Pakistani-born Caan, who also appears on BBC Television's Dragons' Den, vowed to oversee the rebuilding of Jan Lunda through his James Caan Foundation charity. The project includes 120 houses, a mosque, girl's school, clean water and access to toilet facilities, as well as a program to get people earning their own living. Each house is costing just under £1,200 to build. The project is being endorsed by Prince Charles and the prince's charities, and is supported by the UK government. Aid agencies including Islamic Relief are also heavily involved in delivering each facet of the project. Reconstruction costs are expected to come to around £180,000-£250,000, and will be underwritten entirely by Caan's Foundation. After the village is "tried and tested", Mr Caan intends on building two more villages.

Saudi may delay mortgage law for inflation

Saudi Arabia may again delay the enforcement of the long-awaited mortgage law because of a surge in rents and property prices as this could trigger a US-style subprime crisis, a Saudi newspaper has reported. SAMA has expressed fears that the enforcement of the law could spur a lending spree to the housing sector, adding that SAMA views property prices as unfair at present. SAMA is expressing reservation about the endorsement of the mortgage law while analysts believe the property sector is currently beset with risks Banks themselves are also worried that in case they lavished loans to that sector, there could be a wave of sharp declines in housing prices and this could inflict heavy losses on them...this could lead to a mortgage crisis as most of those who are expected to borrow for housing will be employees who will pay back the loan by monthly installments from their salaries."

China to transfer solar power technology

An agreement reached with China during the recent visit of Premier Wen Jiabao to Pakistan to generate 2,300MW of electricity through wind turbines and solar panels.

Wind power projects of 1,000MW each would be set up in Punjab and Sindh. A 200MW solar power project would be set up in Punjab and another of 100MW in Sindh. Total expected investment is $6.5 billion.

An agreement signed between the China International Water and Electric Corporation and the Alternate Energy Development Board would also involve transfer of technology and China would assist Pakistan in manufacturing solar panels and turbines.

Punjab government, Chinese company to sign MoU

Memorandum of understanding was signed recently between Punjab government and China International Water & Electric Corporation in energy and infrastructure sectors. China Dongfang Electric Corporation has expertise in manufacturing of equipment and plants of power generation.

Pakistan is facing severe energy crisis including shortage of 5,000MW electricity, which is leaving a negative impact on the economy.

Japan would invest in Pakistan's Karachi Circular Railway (KCR) project

Japan would invest in Pakistan's Karachi Circular Railway (KCR) project this will be a boost for foreign investment attraction in the country. Japan will provide PKR128.6bn (US$1.5bn) loan for the project. The railway will be operational by 2011.

Wapda, Harpo Hydropower Consultants sign agreement

An agreement was signed between Pakistan Water & Power Development Authority (Wapda) and Harpo Hydropower Consultants - a joint venture of three Pakistani and German firms at Wapda House for updating of feasibility study of Harpo Hydropower Project.

ADB Supports Pakistan's First Privately Owned Wind Farm

The Asian Development Bank will be providing a loan to help fund the first privately owned and financed wind farm in Pakistan. This will help in attracting other private entrepreneurs to invest in wind power sector and contribute bridging the gap in power sector and in improving the energy mix of the country by reducing reliance on fossil fuels.

The total cost of the project is $147 million with 30% financed through equity provided by Zorlu Enerji and the rest through US dollar-denominated loans from ADB, the International Finance Corp., the ECO Trade and Development Bank and a Pakistan rupee loan from Habib Bank.

Pak-China Business Corporation Summit

Board of Investment has organized Pak-China Business Corporation Summit during 3rd week of December 2010 with the collaboration of FPCCI, TDAP and CCPIT China. Premiers of Pakistan & China inaugurated the ceremony. Almost 250 Chinese delegates and 150 representatives of Pakistan from different investment sectors participated in summit while a B2B meeting was also organized among business communities of both the countries.

Foreign Direct Investment Inflows Touched $2.21 Billion in 2009-10

Total Foreign Direct Investment for the fiscal year 2009-2010 i.e., from 1st July 2009 to 30th June 2010 touched $2.21 billion.

Pakistan an Investor Friendly Heaven

The World Bank recognized Pakistan the most business friendly country in the region in its annual 'Ease of Doing Business' report. Recent reforms improved our position and helped sustain our position as the first most business friendly location in our region.

Economies are ranked on their ease of doing business, from 1 - 183, with first place being the highest. The ease of doing business index averages the economy's percentile rankings on 10 topics, made up of a variety of indicators, giving equal weight to each topic. The rankings are from the Doing Business 2010.

9.0. SPECIAL SECTION – MORTGAGE MARKET OF PAKISTAN

Pakistan is facing an issue of high rate of urbanization and population growth. The consequences of such unprecedented changes are seen in the form of unplanned, unregulated and uncontrolled urbanization which pose a major problem to the city dwellers. Provision of adequate housing for a common man is a perpetual problem. Housing shortages currently hovers in the vicinity of around 8 million housing units and is increasing by approximately 300,000 units annually. Mortgage Debt to GDP ratio, which measures the depth of housing finance market, remains below 1%, which is one of the lowest in the world. At present, 29 commercial banks, a specialized housing finance company - House Building Finance Company (HBFC) and one DFI is catering to housing finance needs in Pakistan.

Key impediments hindering housing finance growth

Key stumbling blocks impeding the growth of housing finance sector in Pakistan include unclear/weak property titles, high mark-up rates, high property prices, magnitude of costs involved in ownership transfer, lack of a reliable housing market information system, ineffective foreclosure laws, lack of long term funds, unorganized large-scale real estate developers, high inflation & low GDP growth, deficient underwriting skills and weak political will to make housing a vibrant sector of Pakistan economy.

Mortgage Liquidity Facility

To fulfill the increasing needs of housing finance, some institutions have been set up in different countries, which act as secondary market and provide liquidity to primary mortgage lenders. Such liquidity may be provided through refinancing the housing portfolio or through outright purchase of portfolio under securitization. In this way, banks and companies offering housing finance products get liquidity on long-term basis to prudently match the maturity profile of their long term mortgages. The mortgage liquidity companies leverage themselves through issuance of corporate bonds/Sukuk and Mortgage-backed securities (MBS). Different models of mortgage liquidity facilities have been adopted in different countries.

Successful International Models

There are numerous international mortgage liquidity facilities that include Egyptian Mortgage Refinance Company (EMRC), Caisse de Refinancement de l' habitat (CRH - France), Palestine Mortgage & Housing Corporation (PMHC), Federal Home Loan Banks (FHLBs-USA), Fannie Mae (FNM) – USA, Cagamas Berhad (Malaysia). As an example, few features of Cagamas Berhad (Malaysia), which is one of the successful stories in the region, are given below:

- Incorporated in December 1986 as a public-private partnership company with an initial paid up capital of $14 mn. Owned 20% by Central Bank of Malaysia and 80% by 24 other financial institutions
- Operational Model:
  - Purchase with recourse
  - Purchase based on pre-determined eligibility criteria.
  - Liquid asset status for Cagamas Papers
  - Funds obtained from Cagamas exempted from Statutory Reserve and Liquidity requirements
- The Cagamas Bonds were granted special privileges till 2004:
  - 10% weightage for risk weighted capital ratio framework
  - Class 1 liquefiable status under the liquidity framework
  - Exempted from Single Customer Credit limit
  - Primary issuance allowed through Principal Dealers network
  - Holdings by Insurance companies granted low risk asset status
- Entered the Mortgage Securitization market in 2004
- Extended its range of products to include loan refinancing and purchases, Islamic house financing, industrial property loans, hire purchase and leasing debts, and Islamic hire purchase debts.
- At Dec 31, 2007, refinancing of $3.7 bn ($2.7 bn mortgage refinancing) and $4 bn in mortgage/Islamic housing assets

Mortgage Liquidity Facility in Pakistan – Establishment of Mortgage Refinance Company (MRC)

SBP had constituted an Advisory Group on Housing Finance, comprising eminent bankers and housing sector specialists, for identifying bottlenecks, besides, proposing measures for instituting an effective and broad-based housing finance system in the country.

This Housing Advisory Group (HAG) after an in-depth study has come up with a set of recommendations. Provision of long term funding through the formation of a Mortgage Refinance Company is one of the 10 recommendations put forward by the HAG committee. MRC is not only aimed at providing liquidity facility to primary mortgage lenders and enabling them to prudently match maturity profile of their assets and liabilities, it would also help in developing hybrid mortgage models and develop capital markets.

SBP engaged IFC to conduct a feasibility study and prepare a preliminary business plan for setting up a mortgage liquidity facility in Pakistan i.e. the Mortgage Refinance Company (MRC) through public-private partnership. As a non-depository DFI, it will be regulated by the SBP. The SECP will oversee the MRC's capital market operations.
Significant progress has been made since the development of feasibility report, as firm equity commitments have been secured from commercial banks/DFIs and Government of Pakistan. IFC and ADB have indicated that they might invest up to 15% of the total paid-up capital of MRC. FMO, a development bank of Netherlands, has also expressed interest to provide equity investment to MRC. In addition to this, WBG has been requested through the Government of Pakistan to consider a credit line for MRC.

Objectives of MRC

The creation of a mortgage liquidity facility, being called MRC, would help address the long term funding constraint hindering the growth of the primary mortgage market. MRC would serve as a secured source of long-term funding at attractive rates while ensuring sound lending habits amongst PMLs. This would help reduce maturity mismatch risk for Primary Mortgage Lenders (PMLs), ensure the availability of fixed rate and hybrid mortgages and increase available loan terms. This would in turn help improve the affordability of mortgages and extend the number of potential borrowers and result in the expansion of the primary mortgage market and thus home ownership in the country. Additionally, MRC can act as a conduit to efficiently connect long-term investors with PMLs generating long-term assets in Pakistan, thus helping develop a debt market and a longer term yield curve. In emerging markets like Pakistan, where interest rates and inflation are relatively volatile and can dampen confidence in the markets, the availability of long term fixed rates financing by mortgage liquidity facilities like MRC, can instill a degree of certainty which can help the markets develop with confidence. In times of a credit crunch, MRC can also help a bank cover an unexpected short-term deposit outflow (or other temporary losses of funds), thereby avoiding potentially costly short-term borrowing or asset liquidation.

Potential benefits of MRC to various segments are tabulated hereunder.

Home Buyers	Lenders	Govt. and Economy
• Obtain easy access to housing loans at reasonable cost • Obtain attractive and affordable housing loan packages characterized by fixed rates for longer periods	• Hedges interest rate risks • Obtain liquidity at a competitive cost for longer terms to originate more housing loans and enhance lending operations • Price loan products competitively • Improve CAR if they sell without recourse basis.	• Helps to achieve its policy of encouraging home ownership • Makes housing loans more affordable to the middle/lower income group without any interest subsidy being incurred by the authorities • Encourages property development and related spin-off effect.

Capital market	Investors
• Provides additional instruments for investing surplus funds • Provides opportunity for bond dealers to undertake transaction in bonds on large scale • Paves the ways for other cooperation to raise funds in the domestic market • Creation of a long term yield curve	• High quality papers to investors • Attractive channel for investment by the pension funds, insurance companies and banks with large surplus long-term funds seeking long-term investment assets.

Proposed Business Model of MRC

Refinancing (in short to medium term)

MRC will raise funds initially from equity contributions from its shareholders and potentially through a long-term loan from an International Financial Institution (IFI). As soon as possible, it will start raising funds from the capital market by becoming a well rated and regular issuer of bonds, Sukuk and MBS. MRC will initially provide loans (refinance) to PMLs that are secured by the PMLs portfolio of mortgage financing, meeting pre-determined eligibility criteria, with overcollateralization and by the PMLs commitment/undertaking to replace/substitute any ineligible or delinquent cases i.e. with full recourse to the PMLs. It may also purchase Shariah-compliant housing finance portfolios of Islamic banks, conventional banks with Islamic banking operations and HBFC, with recourse to these PMLs.

Securitization (in medium to long term)

Subsequently, MRC will also be able to purchase portfolios without recourse to the PMLs. It will fund these subsequent operations through securitization either directly or through a separately capitalized subsidiary or a Special Purpose Vehicle (SPV). Securitization would be started after overcoming the issues like the lack of portfolio history, lack of experience with credit risk management, the difficulties of monitoring originator and servicer behavior and the lack of demand of complex securities in the bond market.

10.0. Development Finance - Future Outlook

Given the challenges faced by the economy, not only Post 2008 global financial crises but also due to the recent unprecedented floods in the country and the strenuous fiscal situation, credit availability to neglected sectors will be crucial for economic growth. Pakistan's economy has witnessed a moderate recovery in FY10 with real GDP growth rising to 4.1 percent despite the challenges. The energy shortages, reduction in subsidies, rising inflation, law and order situation, and other economic imbalances will continue to restrain positive growth in the DF sectors. However, serious reforms on the fiscal side need to be implemented to enable economic growth in general and DF Sectors in particular.

The total outstanding amount to **DF** Sector at the end of December, 2010 was Rs. 843.5 Billion recording a marginal decline of 0.8%, YoY basis. NPLs of the Banking Industry too have been rising, with the DF sector NPLs increasing by 16.2%, YoY basis reflecting the strained economic conditions.

Going forward, the potential of the DF sector can only be exploited with strong rebuilding efforts in the flood affected areas, continuous credit support, smooth supply of energy and a reliable infrastructure. The current challenging economic and business environment continues and may adversely affect the growth of DF sector.

However, various SBP initiatives taken such as relief package for Flood Affected Areas, improvement in the Credit Guarantee Scheme, disbursements relating to markup rate subsidies, improvement in the Micro Credit Guarantee Facility, and Micro Finance Specific CIB, introduction of branchless banking facilities, and streamlining various guidelines for agriculture lending procedures, embody the potential to offset the adversity and severity of the situation; specially, when GOP succeeds to lessen the intensity of on-going energy crisis and improving the overall socio-economic conditions in the country.