Box 3.1.2: Analysis of the Overseas Operations of Banks in CY17

Banks, generally, provide cross-jurisdictional financial services through foreign branches, subsidiaries, representative offices etc. Besides trade facilitation, such operations enable banks to reap some benefits including diversification (geographical, financial product-wise or through different currencies etc.), technology transfer, investment in human capital, business expansion with expanded market etc.

The banking sector of Pakistan has presence in various jurisdictions around the world. As of December 31, 2017, nine (9) local banks, having 117 branches, 17 representative office (ROs) and eight subsidiaries are operating in 36 jurisdictions including Export Processing Zone in Pakistan. Largest number of branches are operating in

Bangladesh and UAE (18 in each country) followed by Bahrain and Sri Lanka (13 in each country).

Foreign operations of banks are, generally exposed, to various risks including non-compliance to laws and regulations of host countries as well as to their changing macro financial conditions. Besides, legal issues could also create significant stress. Other than monetary loss, any materialization of such risks can expose the banks to reputational loss.

The foreign branches of local banks, though performing reasonably well, have recently been exposed to some critical risks. In 2017, one-off settlement payment made by a large local bank resulted in sizeable impact on its bottom line.

In this backdrop, it is imperative to assess the performance and soundness of foreign operations, particularly, their loss absorbing capacity.

The consolidated financials reveal that, the scaling back of operations by some banks in response to emerging challenges, the **asset** base of the overseas branches has slightly contracted by 3.99 percent during CY17 (Average 5-years' growth: 8.15 percent) **(Table 1**). However, the overseas operations still contribute 4.49 percent to the overall asset base of the banking sector as of end December, 2017.

Table 1

Consolidated Position of Overseas Branches of Banks

	CY15	CY16	CY17
Key Variables			
Assets	883.6	867.0	832.3
Gross Loans	421.3	458.4	463.7
Investments	228.8	273.8	234.2
Deposit	641.0	626.4	594.0
Pre-Tax Profit (YTD)	9.4	10.5	5.3
After-Tax Profit (YTD)	8.3	8.6	5.9
NPLs	62.1	66.0	78.3
Provisioning	40.2	60.0	68.5
NPLs-Net	21.9	5.9	9.8
Financial Soundness Indicators			
ADR	59.50	73.19	78.07
NPLs to Total Loans	14.70	14.39	16.88
Net NPLs to Net Loans	5.70	1.48	2.47
ROA	1.10	1.00	0.70

Source: SBP

The foreign branches seems to be playing relatively better financial intermediary roles than their local counterparts with advances to deposit ratio of 78.1 percent. During CY17, **Gross loans** have slightly risen to PKR 463.7 billion from PKR 458.4 billion in CY16. The major chunk of advances is disbursed to sectors including financial, automobile and transportation as well as individuals.

On the contrary, **investments** have declined by 14.5 percent during the same period due to divestment in federal govt. securities as well as bonds/TFCs etc.

In line with the asset growth trajectory, **deposits** have also contracted to PKR 234.2 billion (primarily due to non-remunerative current deposits) in CY17 from PKR 273.8 billion in CY16.

The asset quality of the foreign operations has declined a bit with rise in absolute Non-**performing loans** (NPLs) to PKR 12.3 billion and infection ratio to 16.88 percent in CY17. However, most of the bad loans are already provided-for with net NPLs to net loans ratio at 2.5 percent. Moreover, investigations reveal that NPLs are not broad based as most of the banks are having negligible infection ratio.

Profitability of the overseas banks' branches is not that encouraging in CY17 as pre-tax profit has declined to PKR 5.3 billion from PKR 10.5 billion in CY16. This is mainly on account of increased provisioning and administrative expenditures in CY17. Accordingly, return on asset (ROA) has slowed down to 0.7 percent in CY17 from 1.0 percent in CY16.

Overall, the overseas branches are contributing positively to the operations of the banks. However, the risks emanating from such operations demand a careful and in-depth review of the system and controls of these branches by the banks. Also, keeping in view that a significant portion of foreign business pertains to remittances and correspondent banking, it is imperative to strengthen the AML-CFT regime at these branches in line with best international practices. SBP, in its supervisory capacity, is working closely with the banks to address any concerns.