

Development Finance Institutions

6.1

Development Finance Institutions (DFIs) recorded considerable headway in asset base primarily driven by investments in government securities, as borrowings particularly repo borrowing through OMOs increased significantly. Advances portfolio led to contained growth due to stressed macroeconomic conditions. However, the overall asset mix was further skewed towards risk-free government securities. The sector registered healthy margin in profitability owing to massive expansion in net-interest income. Furthermore, CAR of the sector inched up due to robust increase in capital base vis-à-vis risk-weighted assets; the CAR remains well above the regulatory benchmark.



6 Development Finance Institutions

Asset base of DFIs posted extraordinary growth on back of record borrowings led investments...

Asset base of the development finance institutions (DFIs) increased significantly (63.5 percent) during CY23 but at a slower pace than previous year (165.5 percent) (**Table 6.1.1**). The expansion in asset base was primarily driven by investments, financed through borrowing.

The advances saw a slight growth, as lending by DFIs remained virtually stagnant compared to CY22. In tandem with sluggish rise in advances, NPLs to Advances ratio, which was already on a falling trajectory, did not deteriorate further. Main reason for this below-average performance in advances was lack of demand for credit from private sector.

The increase in investments, mostly in risk free government securities, continued during CY23. Investments surged by 73.3 percent while treasury exposures increased by 82.0 percent. Aggressive participation by DFIs in Open Market Operations (OMOs)¹ facilitated this substantial size of investments. The OMOs can facilitate day-to-day asset-liability management of DFIs as they face constrained sources of funding.

Capital Adequacy Ratio (CAR) of DFIs improved to 43.3 percent in CY23 (36.5 percent in CY22). The increase is mainly attributed to faster increase in eligible capital than growth of risk weighted assets (RWAs).

Key Variables and Financial Soundness Indicators

Table 6.1.1

| | CY19 | CY20 | CY21 | CY22 | CY23 |
|---|-------|-------|-------|-------|-------|
| billion Rupees | | | | | |
| Investments (net) | 240 | 287 | 338 | 1,168 | 2,025 |
| Advances (net) | 92 | 111 | 140 | 188 | 188 |
| Total Assets | 377 | 439 | 539 | 1,430 | 2,338 |
| Borrowings | 229 | 261 | 348 | 1,223 | 2,117 |
| Deposits | 12 | 27 | 34 | 38 | 45 |
| Equity | 117 | 132 | 136 | 145 | 144 |
| NPLs | 15 | 16 | 15 | 15 | 15 |
| percent | | | | | |
| CAR | 44.9 | 43.1 | 38.7 | 36.5 | 43.3 |
| NPLs to Advances | 14.5 | 12.8 | 9.5 | 7.3 | 7.4 |
| Net NPLs to Net Advances | 4.2 | 3.1 | 1.6 | 0.9 | (1.2) |
| ROA (After Tax) | 2.7 | 3.3 | 2.4 | 1.6 | 0.9 |
| ROE (After Tax) | 7.2 | 10.7 | 8.9 | 10.1 | 13.3 |
| Cost to Income Ratio | 32.4 | 25.2 | 32.5 | 26.9 | 24.0 |
| Liquid Assets to Short-term Liabilities | 97.6 | 97.5 | 98.0 | 98.2 | 95.9 |
| Advances to Deposits | 763.8 | 405.1 | 412.6 | 493.4 | 417.7 |

Source: State Bank of Pakistan

Investment portfolio grew on the back of fresh investments in floating rate PIBs

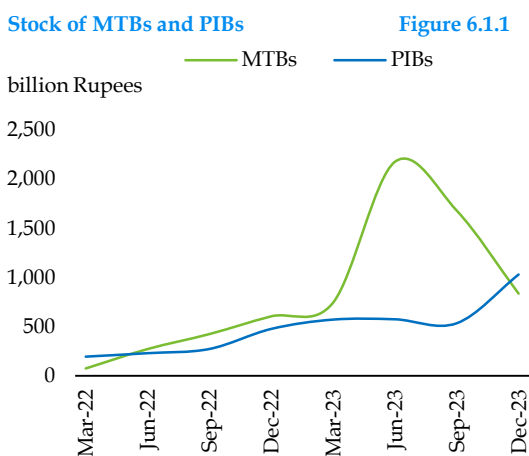
Investments demonstrated very robust growth of 73.3 percent during CY23 and their share in asset base rose to 86.6 percent (81.7 percent in CY22). Almost the entire fresh investments (91.8 percent of the increase) went to government securities which grew by 72.4 percent to Rs 1,871.5 billion, and their share in total investments remained almost unchanged to 92.4 percent (92.6 percent in CY22). On the other hand, investments in equity stock dropped by 64.6 percent to Rs 17.7 billion during the reviewed year.

Considerable volume of investment was made in floating rate PIBs and MTBs

Detailed data shows that the major increase in government securities occurred during H1CY23, and MTBs accounted for almost three-fourth of this increase, followed by floating-rate PIBs. However, a reversal of trend was observed in Q4CY23 when investments in floating-rate PIBs

¹ SBP allowed all DFIs to participate in Open Market Operations in 2022. For details see DMMD Circular No. 11 of 2022

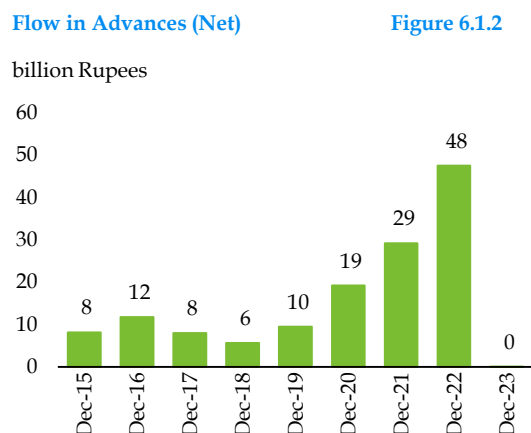
dominated shorter tenor instruments, mainly owing to a downward shift of yield curve in Q4CY23. This development reflected both (a) the access to short-term OMOs and bank funding that necessitated the investment in matching short term bills to minimize liquidity risk, and (b) rising interest rate scenario that entailed revaluation losses on longer term fixed investments bonds.² Therefore, DFIs preferred to invest in MTBs and floating rate PIBs that have relatively lower sensitivity to changes in interest rates. The portfolio of MTBs posted noteworthy increase of Rs 231.4 billion to reach Rs 838.7 billion by end December 2023; with an increase of Rs 554.6 billion, overall stock of PIBs reached Rs 1.03 trillion by end of CY23 (**Figure 6.1.1**).



Advances posted muted growth owing to rising interest rates and economic slowdown...

Growth in advances remained stagnant to 0.1 percent in CY23 compared to 33.9 percent increase in CY22 (**Figure 6.1.2**). Meagre growth in advances along with investments led expansion in assets further pushed their share in the overall asset base down to 8.0 percent in CY23 from 13.1 percent in CY22. The decrease in advances was primarily due to lack of demand for credit from private sector as well as the relatively lower amounts of fresh funding from SBP's long-term refinance schemes under LTFF,

Rs 17.9 billion (Rs 20.7 billion in CY22), Renewable Energy, Rs 3.6 billion (Rs 3.8 billion in CY22) and TERF, Rs 7.7 billion (Rs 8.0 billion in CY22).



Source: State Bank of Pakistan

Corporate sector remained the major user of DFIs financing...

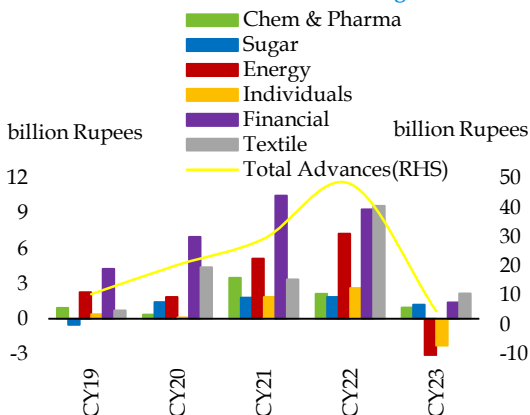
Corporate sector remained the major user of financing by DFIs. Large share of corporate sector in advances was due to working capital requirements, augmented by higher inflation and commodity prices followed by fixed investment purposes.

Advances remained broad based ...

Sector wise assessment explains that advances were well-distributed across different sectors. Textile was the major contributor followed by Financial, Chemical & Pharmaceuticals and Sugar (**Figure 6.1.3**).

² SBP raised the policy rate by a cumulative 600 bps during CY23

Sector-wise Flow in Advances Figure 6.1.3

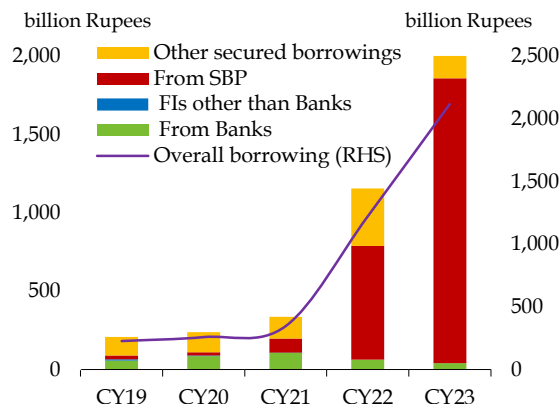


Source: State Bank of Pakistan

Repo borrowing was the leading source of funding ...

DFIs have been mainly relying on interbank market to finance their assets for years, as the mobilization of funding through deposits and other instruments remained contained due to limited outreach of capital market. However, the access to funding through OMOs in CY22 has significantly increased DFI's ability to generate liquidity. Resultantly, their reliance on borrowings has significantly increased over the last couple of years as the share of borrowing in total asset base rose to around 91.0 percent by end CY23 (86.0 percent in CY22). Of the total borrowing, secured borrowing from SBP constituted the major part i.e. 85.8 percent followed by other secured borrowings (Figure 6.1.4).

Composition of Borrowings Figure 6.1.4

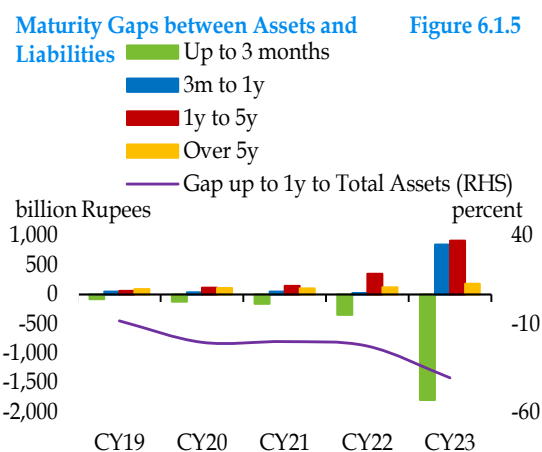


Source: State Bank of Pakistan

Maturity mismatch increased significantly, though liquidity indicators shows stable funding profile of DFIs ...

Maturity-wise breakup reveals that major part of assets and liabilities have shorter maturity, i.e. around 49.0 percent of assets and 95.0 percent of liabilities mature within one year. The maturity mismatch in this time bucket significantly increased over the year to 40.5 percent of total assets (22.5 percent in CY22) as the sector heavily relied on short-term borrowing to finance the asset base (Figure 6.1.5). However, sufficient availability of liquidity buffers in the form of low-risk assets mitigated the concerns of maturity mismatch³, as the share of liquid assets in total assets increased to 85.5 percent (77.9 percent in CY22). Furthermore, liquid assets to short-term liabilities ratio largely remained stable at 95.9 percent. Basel-based net stable funding ratio (NSFR) also improved to 133.0 percent (120.0 percent in CY22) –well above required benchmark of 100 percent.

³ However, repricing risk still remains



While majority of earning assets had longer maturity, their repricing maturity was relatively shorter...

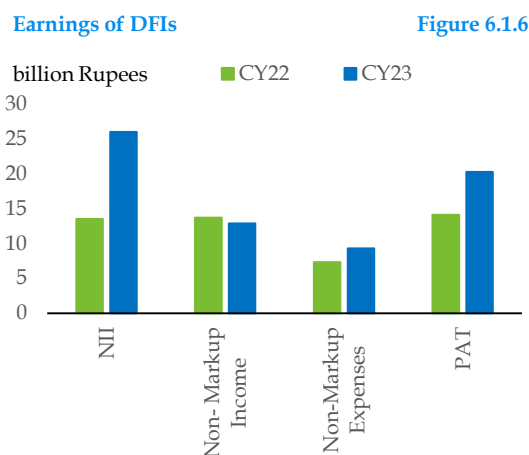
Long-term fixed investment loans were around 52.2 percent of total loans while 52.3 percent of government securities comprised PIBs at end December 2023. However, maturity analysis in terms of remaining time to repricing of assets revealed that a major portion of the loans and investments had relatively shorter maturity. That is, 56.9 percent of advances were repricing within three months and 11.2 percent in three months to one year, while 32.5 percent of investments, which form major part of the balance sheet, were repricing within three months and 64.5 percent in three months to one year.

Considerable growth in net interest income led to higher profitability ...

Profit after tax (PAT) of DFIs increased by 43.4 percent to Rs 20.3 billion in the year under review (Rs 14.1 billion in CY22), owing to enormous growth in net interest income. However, non-interest earnings declined by 6.1 percent to Rs 12.9 billion (Rs 13.7 billion in CY22). While gross income posted strong growth of 42.7 percent, operating expenses also grew at an accelerated pace i.e. 27.2 percent.

However, tax charges of the sector on aggregate basis inched up to 28.3 percent of pre-tax profit (23.3 percent in CY22).

Detailed analysis shows that major boost to gross income came from net-interest income which accelerated by 92.2 percent – due to significant growth in interest earning assets. However, non-interest income marginally declined due to a significant fall in other income, although steep rise in dividend income abated its adverse impact. On the other hand, interest expenses grew at a faster pace as the impact of rise in interest rates translated onto short-term borrowings and deposits relatively earlier as compared to assets (especially loans and long-term investments), which are repriced according to their respective terms and conditions (**Figure 6.1.6**). Accordingly, net interest margin (NIM)⁴ of the DFI sector contracted over the year to 1.2 percent from 1.6 percent in CY22.



However, ROA contracted as the growth in profitability occurred on the back of significant expansion in asset base, while ROE improved due to relatively modest growth in equity ...

With substantial buildup in asset base vis-à-vis earnings, after tax return on assets (ROA) declined to 0.9 percent during CY23 (1.6 percent in CY22).

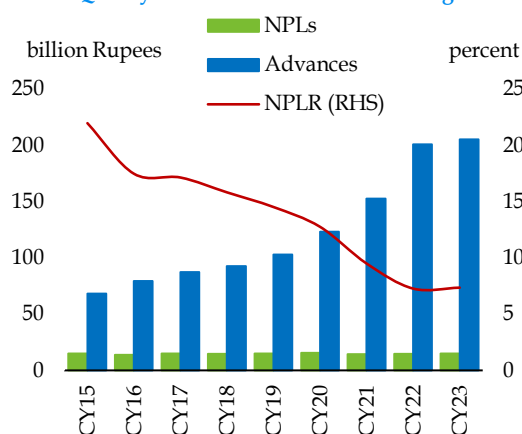
⁴ Net Interest Margin (NIM) is defined as = Net Interest Income (NII) / average earning assets.

On the other hand, return on equity (ROE) improved to 13.3 percent during the reviewed year (10.1 percent in preceding year) due to robust earnings and modest growth in equity. Notably, as the growth in asset-base was mainly in risk free assets, this enabled DFIs to support strong balance sheet expansion with relatively slower growth in capital base.

Asset quality indicators remained largely stable in CY23...

Over the years, infection ratio of the DFI sector has shown improvement on the back of growth in advances, better credit risk management including enhanced recovery efforts and recoveries of non-performing loans (NPLs). However, during CY23, NPL to advances ratio slightly deteriorated to 7.4 percent from 7.3 percent in CY22 (**Figure 6.1.7**). As against 3.5 percent increase in NPLs to Rs 15.1 billion, DFIs set aside higher amount of provisioning to cover loan losses. Thus, the provisioning coverage improved to 114.8 percent by end CY23 (87.9 percent in last year). Accordingly, Net NPLs to net loans and capital impairment ratios further improved over the year to -1.2 percent (0.9 percent in CY22) and -1.6 percent (1.2 percent in CY22), respectively.

Asset Quality of DFIs in CY23 **Figure 6.1.7**

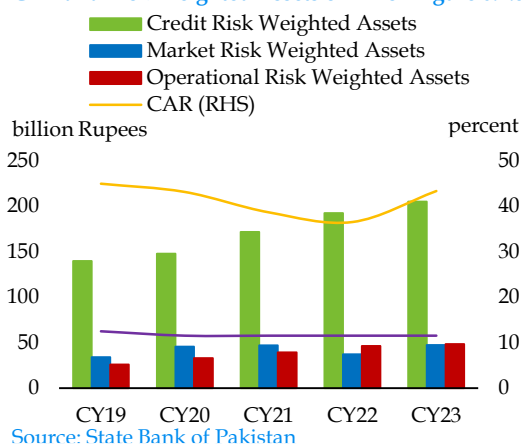


Source: State Bank of Pakistan

CAR of the DFI sector surged considerably owing to faster increase in capital base vis-à-vis RWAs...

CAR of DFI sector normally remains well above the required benchmark due to strong capital base and risk averse business strategy, as the asset base is mainly dominated by the investment in risk-free government securities vis-à-vis lending. During the year under review, CAR increased by a healthy margin to 43.3 percent (36.5 percent in previous year). The ratio remained considerably higher than the regulatory requirement of 11.5 percent (**Figure 6.1.8**).

CAR and Risk Weighted Assets of DFIs **Figure 6.1.8**



Source: State Bank of Pakistan

The robust increase in CAR was apparently due to faster increase in eligible capital (i.e. 29.3 percent) vis-à-vis the increase in RWAs (i.e. 9.0 percent). Further analysis of RWAs reflects limited positive momentum in financing activity, as credit RWAs showed suppressed growth of 6.1 percent. Furthermore, market RWAs increased by 27.3 percent owing to higher investment in government securities entailing elevated capital charge for interest rate risk. Operational RWAs also surged by 4.9 percent because of expansion in gross income emanating from growth in business volume. Relative share of credit, market and operational risks in RWAs remained 68.2 percent, 16.1 percent and 15.7 percent, respectively.

Initially, the steps to support the establishment of DFIs were carried out to enhance development finance and improve capital formation in the economy. However, various challenges curtailed the growth of DFIs and

forced them to follow a conservative business strategy. Over the decades, the challenges faced by DFIs mainly included: limited outreach to capital market, low national saving rate, competition from banks, limited mandate for deposit mobilization, absence of funding support from government or international development agencies, and relatively low demand for long-term financing due to various factors. These issues heavily restricted the growth of the DFI sector, and alongside curtailed its ability to contribute to the national economy.