

Microfinance Banks

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MFBs are key drivers of financial inclusion for low-income, underserved urban and rural customers...

The year 2025 has been important for MFBs for gaining momentum towards a gradual turnaround in some key areas while continuing to struggle with others. One of its members, Telenor Microfinance, transitioned to become a full-fledged digital bank, viz., Easypaisa Digital Bank. On the regulatory front, SBP revised the prudential regulations for the sector in areas of governance, operations, consumer protection and risk management to ensure financial stability and sustainability of the MFBs.¹

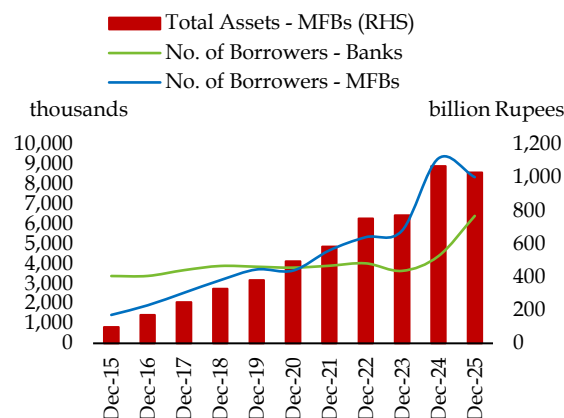
The sector has been an enforcer for growth of financial inclusion in the country, even though the total assets of the sector account for 1.3 percent of all financial sector assets, which pose low likelihood of triggering systemic risk. The comparison of Compound Annual Growth Rate (CAGR) in borrowers' base of banking sector and MFBs during the 10 years between CY15 and CY24 (before transition of one MFB to become a digital bank) suggests that MFBs are an effective channel for achieving the targets of the **National Financial Inclusion Strategy**.² However, the broad customer base of MFBs also exposes the sector to credit risk through low-income clientele, posing challenges to its portfolio quality and financial sustainability (Figure 5.1 & 5.2).

¹ ACFID Circular No. 01 of 2025

² CAGR of the number of borrowers in banking sector is 2.6 percent and for MFBs is 20.6 percent from CY15 to CY24. The number of borrowers of MFBs fell to 8.3 million by end Dec 2025 from 9.3 million in December 2024, while the number of borrowers of banking sector rose to 6.4 million at end December 2025 from 4.6 million in December 2024. A major factor in the increase in borrowers of banking sector was the fact that an MFB was able to become a digital bank, which is now part of the banking sector.

Growth in MFB Sector

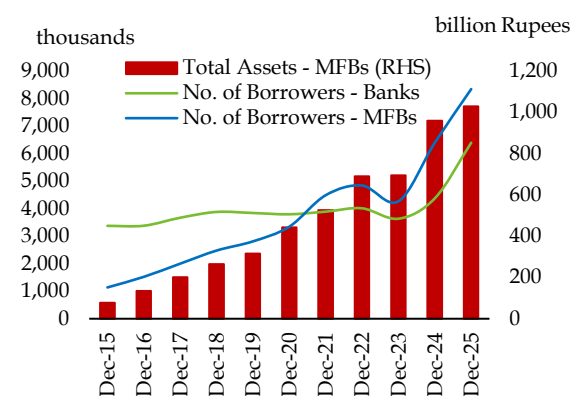
Figure 5.1



Source: State Bank of Pakistan

Growth in MFB Sector (Adjusted for departed MFB)

Figure 5.2



Source: State Bank of Pakistan

The sector experienced a contraction in its balance sheet footing...

The asset base of MFBs witnessed a contraction of 3.7 percent (which grew by 38.5 percent in CY24). The decline in assets of existing MFBs (adjusted for the departed MFB) was mainly brought by investments, which fell by Rs 75 billion or decline of 23.1 percent. Adjusted for the migration of a MFB to a full-ledged digital

bank, the assets of the 11 remaining MFBs, however, showed an expansion of 7.3 percent in CY25.

...overall, the picture was reflected in both borrowings and deposits...

On liability side, deposits recorded a healthy growth of 13.3 percent (or increase of Rs 97 billion) while borrowing declined by 55.0 percent (Rs 112 billion) in CY25. The borrowings from banks normalized after a major spike in CY24. MFBs took advantage of more accessible advances from banks in Q4CY24, due to ADR-related tax regulations, which resulted in multifold growth in borrowings which were retired in the next quarters until normalization Q4CY25. Accordingly, the share of assets financed by deposits rose to 80.7 percent in CY25 from 68.6 percent in CY24 while the share of borrowing to assets fell to 8.9 percent in CY25 from 19.1 percent in CY24.

Loans portfolio recorded a broad-based increase during the year....

Despite the departure of an MFB to the banking sector, the advances (net) portfolio of MFBs grew by 11.2 percent in CY25 (10.9 percent in CY24), which was broad-based across all the business segments (**Figure 5.3**).

Break-up of Advances

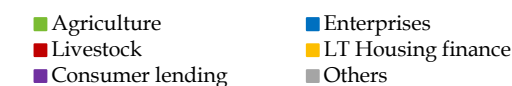
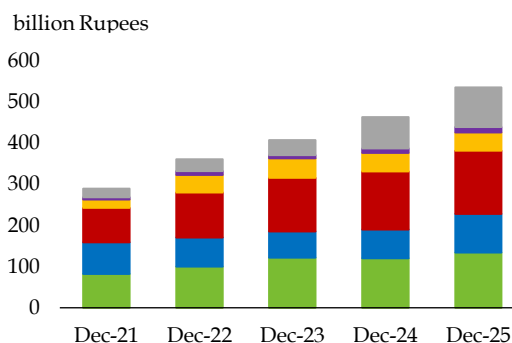


Figure 5.3



Source: State Bank of Pakistan

Advances to enterprises experienced an increase of 35.2 percent, which was the highest growth among other segments with Rs 24 billion. Loans for the livestock and agriculture sectors experienced increases of Rs 11 billion (8.3 percent) and Rs 13 billion (11.5 percent), respectively. The expansion in advances to these three segments can be partly attributed to Prime Minister's Youth Business and Agriculture Loan Scheme (PMYB&ALS), which started in December 2022.³ The objective of the scheme was to provide microloans for business and agriculture to small borrowers. In February 2025, PMYB&ALS introduced a 'Tier-4' with new loan products targeting students and prospective overseas workers.⁴ To boost agriculture financing, GoP introduced a Risk Coverage Scheme for Small Farmers and Underserved Areas, which also partly contributed to the growth in advances to the sector.⁵

Consumer lending experienced a rise of 17.8 percent in CY25. However, adjusting for the base effect due to migration of one MFB, the portfolio of remaining MFBs experienced more than ten-fold rise from Rs 1 billion in CY24 to Rs

³ IH&SMEFD Circular No. 12 of 2022

⁴ SH&SFD Circular No. 01 of 2025

⁵ ACFID Circular No. 02 of 2025

12 billion in CY25. Major thrust came from bullion based collateralized lending, where a significant increase in gold prices incentivized individuals to avail higher microloans. Long-term housing finance, on the other hand, experienced a modest increase of 0.1 percent.

Asset quality shows improvement during CY25...

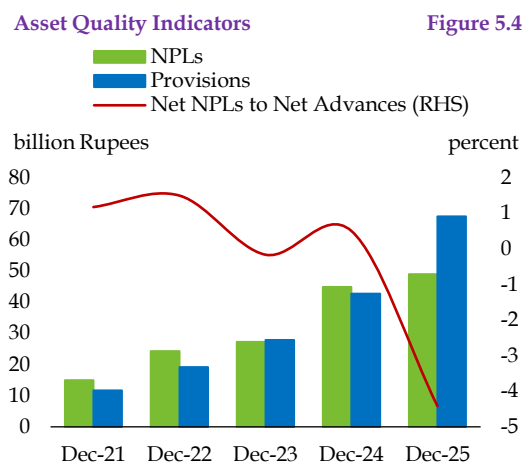
The soundness of the sector had slightly improved, albeit still under stress. The infection ratio fell to 9.1 percent in CY25 from 9.7 percent in CY24. Adjusted for the former MFB, the infection ratio was 9.4 percent in CY24. The falling trend in infection ratio is encouraging. However, the total NPLs have gone up from Rs 44 billion in CY24 to Rs 48 billion in CY25. The infection ratio declined because gross advances grew by 15.5 percent, increasing the total loan portfolio. Although NPLs rose, advances grew faster, causing the infection ratio to fall.

Further, MFBs have started transitioning from unsecured to secured financing, resulting in improved asset quality and solvency. The secured loan portfolio of the MFB sector rose to Rs 244 billion in CY25 from Rs 188 billion in CY24, mainly due to 26.2 percent increase in gold-backed lending.

The legacy issues of MFBs have seen some reprieve in CY25, with improved macroeconomic conditions amid continued stability. MFBs faced asset quality concerns since the onset of COVID-19 pandemic, which were further compounded by the floods in the summer of 2022, consequent inflationary pressures and tighter financial conditions during CY23 and CY24.

However, there is also an improvement in the provisioning coverage for NPLs in CY25, improving to 138.1 percent from 95.2 percent in CY24. The MFBs have raised their provisioning from Rs 42 billion to Rs 67 billion in CY25, to

build financial cushion and resilience against shocks. As a result, the net infection ratio (net NPLs to net advances) fell to a *negative* 4.0 percent from 0.5 percent in CY24 (**Figure 5.4**). The capital impairment ratio (net NPLs to Capital) stood at 388.2 percent and depicts a decrease in credit risks from delinquencies as provisioning coverage has gone above 100.⁶



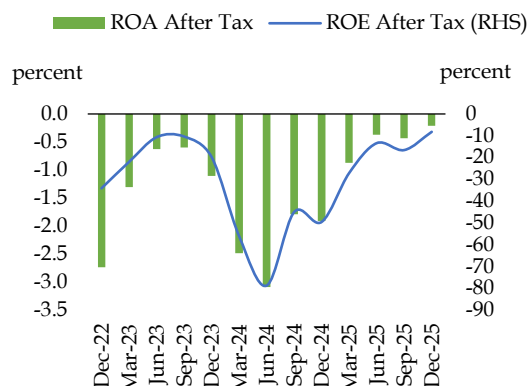
The sector continues to contain losses ...

Although the MFBs sector has registered losses for the seventh consecutive year, those losses have come down recently. For instance, the size of the pre-tax loss has been significantly reduced from Rs 25 billion in CY24 to Rs 2 billion in CY25. Consequently, the sector's after-tax ROA improved to *negative* 0.2 percent in CY25 from *negative* 1.9 percent in CY24, whereas the after-tax ROE stood at *negative* 8.2 percent in CY25 versus a *negative* 49.6 percent in CY24 (**Figure 5.5**). There is also a significant improvement in the Operational Self Sufficiency (OSS) from 75.2 percent in CY24 to 84.7 percent in CY25. The administrative expenses also decelerated for the first time by 8.5 percent in the year under review, which had grown by 145 percent in the last five years.

⁶Net NPLs and regulatory capital of MFBs both became negative since June 2025.

Earning Indicators

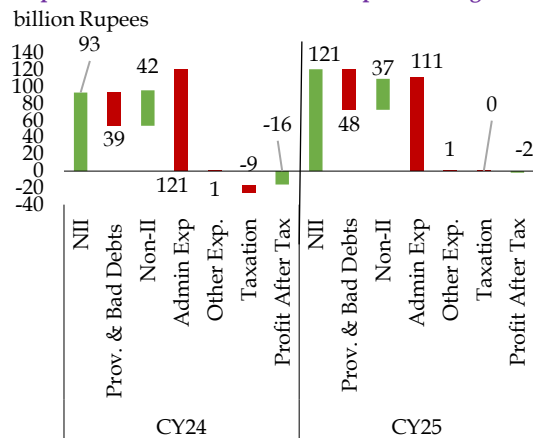
Figure 5.5



Source: State Bank of Pakistan

Furthermore, profitability analysis of MFBs indicates that the net interest income has grown by 30 percent (YoY) versus 31.7 percent in CY24 (Figure 5.6). This is in line with improving macroeconomic conditions and easing financial conditions with a cumulative reduction of 250 bps in the policy rate during CY25. However, the non-interest income fell by 12.9 percent on a YoY basis, which had grown in CY24 by 25.7 percent. The fall in non-interest income mainly emanated from in Fees, Commission & Brokerage Income, which fell by 13 percent in CY25. Despite the decline in non-interest income, the cost-to-income ratio has substantially improved from 89.8 percent in CY24 to 70.6 percent in CY25.

Composition of MFBs' Income and Expenses Figure 5.6

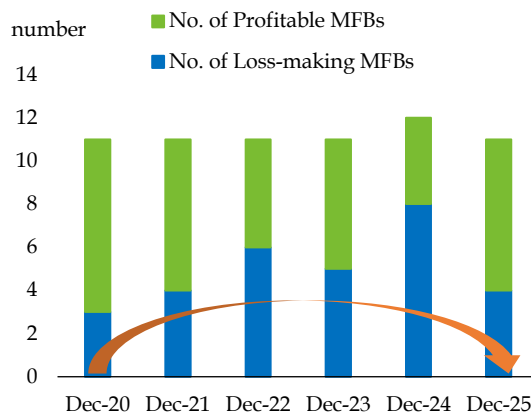


Source: State Bank of Pakistan

The total number of loss-making entities in the sector dropped to four (out of 11). This is an improvement from CY24 when there were eight (out of 12) loss-making entities (Figure 5.7). Higher administrative expenses are an inherent feature of the microfinance banking model, given their extensive and low-income borrower base and the need for continuous engagement with their customers. Amid persistent NPLs in the sector, provisioning expenses increases the burden further. However, in CY25, the sector has shown resilience and improvement with some issues they have been struggling with for the last few years.

Count of MFBs Relative to Earnings

Figure 5.7



Source: State Bank of Pakistan

Liquidity indicators show a decline...

The liquidity position of the sector has slightly deteriorated with a decrease in total liquid assets of around 30.0 percent (from Rs 466 billion in CY24 to Rs 326 billion in CY25). In CY24, the liquid assets to total assets ratio was 43.6 percent, which went down to 31.7 percent in CY25. The driver behind this was the drop in investments (net), as MFBs reduced their exposure to government securities.

The contraction in asset portfolio (which was mainly due to decline in investments) translated into a concomitant drop in MFBs' borrowings. Borrowing mainly financed rise in investments

and hence asset expansion in the past few years. The decline in investments in CY25 also resulted in fall in the liquid assets to short-term liabilities ratio to 36.7 percent in CY25 from 61.2 percent in CY24 (Table 5.1).

Financial Soundness Indicators (FSIs) of MFBs Table 5.1

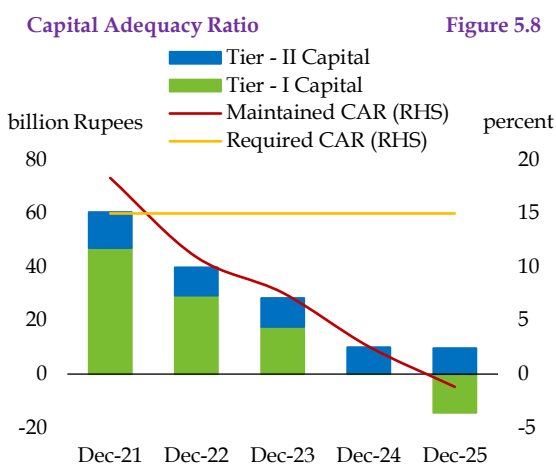
	percent			
	Dec-22	Dec-23	Dec-24	Dec-25
Capital				
Total Capital to Total RWA	10.9	7.6	2.6	-1.2
Tier 1 Capital to Total RWA	8.1	4.7	0.1	-3.6
Asset Quality				
NPLs to Total Loans	6.7	6.7	9.7	9.1
Provision to NPLs	78.8	102.3	95.3	138.1
Net NPLs to Net Loans	1.5	-0.2	0.5	-4.0
Net NPLs to Capital	12.9	-2.2	21.4	388.2
Earnings				
ROA before Tax	-3.4	-1.5	-3.0	-0.2
ROE before Tax	-42.9	-26.4	-77.9	-7.3
Operational Self Sufficiency (OSS)	69.8	78.8	75.2	84.7
Liquidity				
Liquid Assets to Short Term Liabilities	31.9	42.1	61.2	36.7

Source: State Bank of Pakistan

Solvency indicators dropped further below the minimum required level...

The solvency position of MFBs remains a major concern, as the capital adequacy ratio (CAR) dropped to *negative* 1.2 percent in CY25 from 2.6 percent in CY24 – significantly below the regulatory requirement of CAR of 15 percent (Figure 5.8). Adjusted for the departed MFB, the historical CAR of the sector indicates further stress as the sector's Tier-1 Capital became negative in CY24 before further deterioration in CY25. While profitability indicators have improved significantly, the sector is still experiencing losses albeit in lesser amounts, which has contributed to declining CAR. The aggregate CAR of MFBs has been below minimum regulatory requirement since June 2022 and was triggered by the heavy floods of 2022, which severely affected the income levels

of MFBs' low net worth borrowers and resulted in substantial delinquencies. Later, macroeconomic shocks further dented the capital position of MFBs. However, not all MFBs have CAR below minimum regulatory requirement, i.e., only four (out of the 11) MFBs are CAR non-compliant compared with five (out of 12) in CY24. SBP is closely engaged with these undercapitalized MFBs, and significant progress has been made toward their re-capitalization.⁷



Source: State Bank of Pakistan

Keeping in view the solvency issues of the MFBs and their importance from the financial inclusion perspective, SBP continued its enhanced supervision of the sector and engagement with individual institutions.

MFBs continue to lead financial inclusion objectives through branchless banking...

Despite their small share in the financial sector, MFBs have been instrumental in widening financial inclusion through Branchless Banking (BB). The BB accounts provide easy access and a cost-effective way of delivering financial services to the unbanked and underserved population. MFBs account for around 42.4 percent of the total BB accounts of banks and

⁷ MFBs collectively injected Rs 22 billion in CY25 as additional capital, compared Rs 17 billion in CY24.

MFBs combined in CY25 (80 percent in CY24).⁸ During CY25, the number of BB accounts rose by 18.9 percent (10.6 percent in CY24), reaching 150 million with MFBs serving 63 million of those accounts.

MFBs are positioned for sustainable and inclusive growth amid improving financial conditions

With a broad base of customers under their ambit, MFBs are the primary drivers of financial inclusion, which makes their success a potent catalyst towards further growth despite their limited size in assets of overall financial sector.

The last few years have been challenging for the MFB sector. However, the squeezing losses of the sector suggest a silver lining. MFBs have started to control their administrative expenses, which was often a major drag on earnings due to their very nature of operations and scattered borrower clientele.

Going forward, in a rapidly changing environment, the success of the sector depends on how the institutions adjust their business model to the changing landscape, especially in the wake of a thrust for digitization. With the revision in the PRs for MFBs, the operating environment is expected to become more conducive and will help in improving solvency position of the sector.

⁸ With Easypaisa Digital Bank formerly known as Telenor Microfinance, the MFB sector accounted for 80 percent of all Branchless Banking accounts before the bank's conversion from an MFB to a digital bank.