Speech on Annual CFA Convention and Excellence Awards
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Messrs Jawaid Iqbal, Ashraf Bajwa, Governing Board of the CFA Association of Pakistan, Ladies and gentlemen:

It is indeed an honor to be invited at this annual CFA convention - a gathering of the country's finest analysts, investment and risk managers and the banking industry professionals. I also appreciate the efforts of CFA Association of Pakistan for arranging this convention at a very significant time in terms of both domestic and international economic perspectives.

The progress CFA Association of Pakistan has made in raising the educational skills and ethical standards for investment analysts is highly commendable. I am delighted to learn that the association's Charter membership of the Pakistan chapter is continuously increasing and its members are playing a significant role towards advancing professionalism in our financial institutions. Taking benefit of this opportunity, I feel it is appropriate to discuss the importance of ethics in financial businesses, and the role of corporate governance in a highly dynamic financial world and the constantly and rapidly evolving regulatory regimes. I will also briefly touch upon recent initiatives taken for promoting financial inclusion and literacy in the country.

A key issue in finance and investment management is the understanding and practice of ethical norms. If we closely analyze the recent financial turmoil,

we will certainly find misconduct of ethical norms by a few leading market participants that ultimately translated into market panic and subsequently crashes. This implies that a few individuals benefited at the expense of the entire society. It is due to that huge cost to society that we have seen increased focus on ethics and in this regard, the CFA curriculum places due emphasis on the code of ethics and professional conduct for financial analysts and investment professionals. With the growing number of chartered financial analysts, the markets are expected to be better-off from their high ethical standards and improved knowledge of the financial markets, instruments and associated risks.

We all agree to the notion that businesses need to be governed by a set of rules that protect the interests of all stakeholders. The codes of best practices and principles were in force internationally by the regulators and supervisors of various economic segments including the financial sector even before the events that led to the recent financial crises. But many of these standards were not adhered to effectively because they were either too general or perhaps the regulators had limited autonomy to implement the codes in its true spirit.

We all know what led to the 2007/2008 crisis. Those opaque derivative products led to an asset bubble and the sub-prime mortgage sector was simply the catalyst that popped that asset bubble. Essentially, it was a mispricing of those risk assets.

The current events unfolding in the international economic environment are both challenging as well as unique. Though substantial progress was made to limit the effects of the financial crisis, the vulnerability still persists in the shape and size not imagined earlier. Few would have thought that the effects of the sub-prime crisis will question the survival of the Euro Currency and would threaten the entire European region to fall into a severe recession. Meanwhile, in our domestic economy though, we have largely been successful in mitigating the effects of exogenous shocks and contagion risks of the international crisis. But we still face challenges of our own, and ensuring conservative and prudent policies, should enable us to remain resilient from exogenous shocks.

Among many other factors, the global financial crisis and domestic turbulence can also be attributed to failures in corporate ethics and

underlying weaknesses in how corporate governance is practiced. Internationally, the prevailing corporate governance practices failed to safeguard against excessive risks taken by leading financial institutions. The market players exhibited herd behavior and deviated from the ethical norms by engaging in speculative activities for self-gain. Hence, it can be argued that for efficient and well-functioning markets, a responsible and ethical behavior of the participants is a pre-requisite apart from an enabling environment, proper infrastructure, skills and knowledge. Similarly, domestically it behooves us to upgrade our corporate governance practices at all institutions to strengthen our pace of economic recovery and make the environment more challenging and productive for corporates and private institutions.

One key lesson policy makers and regulators learned from the recent sub-prime crisis is that among many other factors, weak corporate governance practices in leading financial institutions played a crucial role in creating the asset price bubble and misallocation of financial resources. As a result, policy makers in the post-crisis period are placing more emphasis on improving market transparency and Corporate Disclosure.

Similarly, regulators have also placed heavy emphasis on imposing stricter regulatory regimes and hands-on approach towards ensuring sound corporate governance practices. These measures have encouraged the Boards and management of financial institutions to improve their governance practices and eliminate knowledge gaps. The regulators also require the Boards to develop their capacity to assess the nature of risks keeping in view the size and complexity of the institutions on an ongoing basis. Similarly, the misaligned incentives and the remuneration of Directors and Executives of banks and financial institutions also came under scrutiny in the post-crisis reforms. This led to growing efforts for rationalization of compensation practices in the financial sector, with a focus on medium to longer term goals to avoid undue risk-taking and promoting transparency and meeting proper disclosure requirements.

Though corporate governance is important for every institution and business, I consider it more critical for the banks as they are the custodians of household and business sector deposits and their intermediary role is only

possible when the society has full confidence in its banking system. And, this is where the role of the central bank and other regulators of the financial system comes in.

The corporate governance revolves around three basic principles of fairness, transparency and accountability. SBP has been on the forefront in promoting sound corporate governance practices and fair competition in the banking sector by introducing various reforms and prudential regulations. The SBP has implemented a comprehensive corporate governance regime for the banks, which is supported by a robust legal and regulatory framework, risk-based supervision and detailed banking sector reforms, notably, privatization, liberalization and consolidation of banks. The measures taken by SBP have enabled the corporate governance regime for banks and its different elements are not only compatible with international best principles but are also parallel with most other emerging economies.

Central Banks are vital in instilling confidence in the economy. They are key towards the promotion of trust and confidence in the financial sector. Interested groups on the other hand may attempt to disrupt the regulatory framework and in turn confidence in the institution. Accordingly, we must provide constant reassurance to the public of the confidence in the Central Bank.

Cognizant of the international regulatory developments, the SBP regularly reviews the international regulatory standards and best practices issued by the Financial Stability Board (FSB), Bank for International Settlements (BIS) and other multilateral agencies and standard setting bodies and assesses them for their possible implementation in its banking system.

The SBP's regulatory approach towards promoting and strengthening of corporate governance has been successful in inducing a positive change in the corporate governance culture in the banking sector that has transformed them into healthy and profitable financial institutions. It also positively impacted the solvency profile of the banking system, that has enhanced their market value and attracted substantial foreign investment in the banking sector during the 2004-2009 period.

I am pleased to state that, the World Bank's country review of Pakistan based on OECD Principles on Corporate Governance (Report on Observance of Standards and Codes) rated Pakistan above average on most

of the Principles1. Further, in a survey, the World Bank rated Pakistan as the leader on the robustness of corporate governance standards and practices in South Asia.

Adoption of ethical standards in dealing with bank customers is an important attribute of corporate ethics, which improves the standing of the financial institutions. Effective treatment of banks' customers, ensuring provision of services to prospective customers and their proper education are key traits necessary for providing strength to the institution. While banks are continuously trying to provide best services to their customers, SBP has been playing its part in improving financial literacy, enhancing depth and reach of financial services, and resolving issues faced by the bank customers. For the purpose, the SBP has not only embarked upon providing a conducive regulatory framework for financial inclusion encompassing promotion of microfinance banking and alternate delivery channels like mobile banking.

The SBP has recently launched a Nationwide Financial Literacy Program (NFLP) with the collaboration of multilateral agencies including Asian Development Bank (ADB) and local private partners including Pakistan Banks Association (PBA), Pakistan Microfinance Network (PMN), Pakistan Poverty Alleviation Fund (PPAF) and Bearing Point. This first-ever financial literacy initiative is expected to impart financial knowledge covering basic concepts such as budgeting, savings, investments, debt management, financial products and branchless banking among the masses.

Our branchless banking regulatory framework has been ranked number 1 by the Economist magazine. The fast growing network of BB agents has now reached over 26,000 as of March 31st, 2012 and total volume of transactions have increased to 25.3 million (up 23%). Deposits have grown by 18% to Rs 594 million. This fits well into our Financial Inclusion strategy. In fact, Central Bank should have an expanded mandate to include those sectors of Financial Exclusion. This adds to overall growth of the economy and women should be an important component to this effort. I have always stated that how can we as an economy grow when 50% of our population is in a non-productive capacity.

On the issue of consumer protection, availability of an effective redressal system adds to the confidence of the financial system and ensures that customers are being served without any discrimination. Consumer protection is primarily based on institutional arrangements that include a formal set of disclosure requirement and addressing grievance mechanisms. Besides, customers also desire proper handling and maintenance of their accounts, and privacy of their personal financial information. For cost effective and quick redressal, SBP has issued necessary guidelines to the banks regarding complaint handling along with institutionalization of the Banking Mohtasib Pakistan.

The State Bank has also taken considerable interest in enhancing the capacity of its own human resource as well as that of the banking sector that is an important element for ensuring the effective implementation of the regulatory requirements. SBP through its subsidiary,NIBAF, is providing world class training and arranging specialized courses in banking, economics and finance. Further, SBP also encourages its employees to gain international certifications like the CFA, to boost their professional capacity.

I am confident that the steps taken by the SBP to promote financial literacy and inclusion and capacity building of the banking sector professionals will be highly useful in creating a professional, sound and vibrant financial culture. Similarly, the regulations to promote corporate governance are also expected to promote corporate ethics in the banking sector. It is now up to the young generation – like many of you to improve the skill-set and take keen interest in striving for excellence and maintaining professionalism. The State Bank looks forward to working with you and the whole community towards achieving our shared goals of economic growth and social prosperity.

Thank you.