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Pakistan's financial sector assets rise to $180 bln: Dr Akhtar

Dr Shamshad Akhtar, Governor, State Bank of Pakistan said today that the country has experienced an 'extraordinary growth' in the financial sector as its assets have grown to $180 billion or 125% of the Gross Domestic Product compared to 95% of GDP at the end of 1997.

Speaking at the convocation of the Institute of Bankers, Pakistan (IBP) in Karachi, the Governor said that financial stability in Pakistan has benefited from structural transformation of the banking sector and wide-ranging policy initiatives of the State Bank. She said the country's prudential regulatory regime has been crafted to promote and preserve financial sector stability and for this purpose the State Bank has set up a Financial Stability Department.

Dr Akhtar said the regulatory framework encourages (i) financial sector growth, diversification and innovation, (ii) healthy competition and risk taking to ensure a sustainable and aggressive income stream, (iii) opportunities for enhancing the franchise value of banks, (iv) prudent behavior and effective risk management and loan provisioning requirement are stringent enough to discourage infection of loan portfolio, and (v) safeguarding social obligations and consumer interests.

SBP Governor said the State Bank has introduced exhaustive guidelines on corporate governance, risk management, business continuity plan, internal controls and stress testing in order to promote sound banking practices. In 2007, SBP has been stringent in overseeing the Management and Board conduct, their conformity to fit and proper criterion. Furthermore, two major sets of new regulations were introduced under which banks were required to induct independent board members and adopt umbrella risk management guidelines. "There is now a survey underway to assess the compliance of banks' corporate governance with SBP regulations," Dr Akhtar added.

She said the financial sector stability has been further fostered by strengthening of banks' system-wide capital base to Rs 372 billion. "Process of consolidation has been catalyzed by 30 odd proactive mergers and acquisitions (both domestic and foreign-led), moratorium on licensing of conventional banks, and rise in minimum capital requirements for banks and DFIs," she said and added that banks have also initiated implementation of the standardized approach, as prescribed under Basel II regulations. Over the period, this is expected to augment the economies of scale and scope, and efficiencies as competition and innovation grows, she opined.

Dr Akhtar said the enhanced push from the State Bank for delivery of development finance will help diversify the credit portfolio and will alter risk profile as there is relatively low correlation of the inherent risk factors among different sectors.

She said the financial stability will further benefit from State Bank efforts to operationalize Real-Time Gross Settlement System (RTGS) named as PRISM (Pakistan Real Time Inter-bank Settlement Mechanism) in June 2008 that will allow shift from traditional paper-based, end-of-the-day settlement system to electronic payment system for large value, low volume inter-bank funds' transfers and settlements.

Dr Akhtar pointed out that money markets' stability has also improved with the SBP's efforts to develop an effective market determined yield curve for government securities which sets the stage for the corporate debt market. Moreover, derivative market, which is an important pillar for effective risk management, though still in its infancy, has taken off. The derivative market is being regulated under SBP's Financial Derivatives Business Regulation. At present, interest rate swaps are allowed in Pak Rupee and in other currencies after SBP's approval. Likewise, forward rate agreements are also allowed in Pak Rupee and other currencies with the approval of SBP. Presently there are 5 banks which have been given the status of Authorized Derivative Dealers by SBP, she added.

However, Dr Akhtar said the substantial growth in financial sector brings with it attendant risk. She said although it is comforting that financial risks are well contained, growing macroeconomic imbalances, unless addressed urgently, could threaten the financial stability. SBP Governor said one of the major risks to Pakistan's financial stability is its overall lack of financial sector diversification. "Of particular concern is the size and issues surrounding non-bank sector," she said and added that of the total financial sector assets insurance companies account for barely 3%, mutual funds 3% and are largely sponsored by banks, while other non-bank financial companies 2% of the system and holders of listed private bonds less than 1%.

Dr Akhtar said the NBFCs are fragmented and weakly capitalized, and added that there is a need to revisit the regulatory and supervisory framework of insurance sector and NBFCs. For financial sector stability, it is critical that such institutions be better capitalized and a conducive environment is created for the growth of promising segments (collective investment schemes, including mutual funds), niche markets and products for leasing, modarabas, housing finance and venture capital, and unleashing penetration in the insurance industry. While market capitalization has grown impressively, its role in raising long term risk capital or debt for new industry over the last several years has been limited, she added.

She stressed that there is also further scope for enhancing banking sector stability too. Although competition is emerging with the growth of mid-sized banks and foreign acquisitions, five largest banks hold 50.6 percent of total banking sector assets; though there is a clear reduction in the level of concentration which was at 63.2% in 2000, she added. The Governor said that presence of undercapitalized small banks is likely to pose risks particularly during periods of adverse economic cycles. “Entry of foreign presence and Islamic banks and mergers and acquisitions will enhance competition, diversify business sources and facilitate further consolidation,” she remarked.

SBP Governor pointed out that another area where there is a scope of strengthening financial sector stability is the greater credit diversification. She said that over 50% of the bank credit portfolio is concentrated in corporate sector serving fewer industries. “Diversification of banks’ loan portfolio to support more retail and infrastructure financing will be critical for the growth of banking sector,” she said and added the State Bank also needs to develop its capacities to monitor financial position and probability of default of the corporate and household sector within the stability framework.

Dr Akhtar said that taking cognizance of maturity mismatches, SBP has introduced different cash reserves requirements for demand and time liabilities to encourage banks to mobilize long term deposits. Specifically, while the demand liabilities (including time liabilities of less than one year maturity) attract CRR of 8.0 percent, time liabilities of more than one year maturity are exempted from CRR, she added.

She said the financial sector is now predominantly owned by the private sector that presents some new challenges. SBP is now working in developing adequate policy framework for consumer protection, development of *Financial Safety Nets* such as Deposit Insurance, and a well-laid out ‘Lender of Last Resort’ procedure which strike a balance between enhancing consumer protection and minimizing moral hazard concerns, she said. The State Bank has also set up the Consumer Protection Department to safeguard interest of consumers, she added. “At the same time, there is a need to encourage improvements in efficiency of financial intermediation by reducing banking spreads,” she stressed and added the State Bank is further developing capacities to monitor operational risks associated with weak internal control systems, delays in adoption of information technology solutions and outsourcing of processes by banks.

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