

Contents

Executive Summary	1
Chapters	
1. Operating Environment and Structure of the Financial Sector	13
1.1 Structure and Performance of the Financial Sector	13
1.1.1 Structure of the Financial Sector	13
1.1.2 Key Indicators of Financial Sector Performance	15
1.2 Macroeconomic Environment	17
1.2.1 Policy Framework	18
1.2.2 Investment Climate	19
2. Financial Infrastructure : An Assessment	21
2.1 Reforms and Regulations – Recent Developments	21
2.1.1 Prudential Regulations for Banks and DFIs	21
2.1.2 Financial Derivatives Business Regulations	22
2.1.3 Implementation of Basel II	23
2.1.4 Credit Information Bureau	23
2.2 Prudential Regulations for Microfinance Institutions	24
2.3 Legal Framework	24
2.3.1 (Draft) Payment Systems and Electronic Funds Transfer Act, 2005	24
2.3.2 Financial Institutions (Recovery of Finances) Ordinance, 2001	25
2.4 Guidelines for Infrastructure Project Financing (IPF)	26
2.5 Liquidity Windows	26
2.5.1 SBP Repo Window	26
2.5.2 Open Market Operations	26
2.6 Institutional Risk Assessment Framework	27
2.7 Payment System	28
2.7.1 Non-cash Payment System	30
2.7.2 Electronic Transactions	31
2.8 Voluntary Pension System Rules, 2005	33
2.9 Conclusion	34
3. Bank Credit	37
3.1 Sector-wise Allocation of Bank Credit	39
3.1.1 Agriculture Credit	39
3.1.2 Commodity Finance	44
3.1.3 Consumer Finance	45
• Credit Cards	47
• Auto Loans	47
• Housing Finance	48
• Personal Finance	49
3.1.4 Corporate Sector Credit	50
• Working Capital and Fixed Investment Financing	51
• Trade Finance	52
3.1.5 SME Financing	55
3.1.6 Micro Finance	58
3.2 Changing Credit Profile – Potential Risks and Mitigants	60
3.2.1 Changing Macroeconomic Environment	60
3.2.2 Corporate Profitability	61
3.2.3 Inflated Asset Prices	61
3.2.4 Credit Information Bureaus	61
3.2.5 Finance for Equity Investments	61

3.3	Conclusions and Future Outlook	62
4.	Islamic Financial Services	65
4.1	Evolution and Origins of Islamic Banking in Pakistan	65
4.2	Regulatory and Policy Framework	66
4.2.1	Shariah Board	66
4.2.2	Regulatory Developments	67
4.2.3	Accounting Standards	67
4.2.4	Development of Shariah Compliant Inspection Expertise	67
4.2.5	Taxation Issues	68
4.3	Islamic Financial Sector in Pakistan	68
4.3.1	Deposits and Credit Growth	68
4.3.2	Islamic Export Refinance Scheme	71
4.4	Islamic Non-Banking Financial Institutions	71
4.5	Islamic Capital Markets	71
4.5.1	Local Developments	72
4.5.2	International Sukuk Issuances	72
4.6	<i>Takaful</i> - Islamic Mode of Insurance	73
4.6.1	General Takaful	73
4.6.2	Family Takaful	73
4.6.3	Takaful in Pakistan	74
4.7	Future Prospects and Challenges	75
5.	Dynamics of the Banking Sector	77
5.1	Banking Sector Assets and Liabilities	77
5.1.1	Deposits	77
5.1.2	Loans and Advances	79
5.1.3	Investments	80
5.1.4	Banking Sector Dynamics and Associated Risks	81
5.2	Managing Risks of the Banking Sector	83
5.2.1	Capital : A Defense Line	83
5.2.2	Implementation of Basel II	84
5.2.3	Managing Risks of Consumer Finance	84
5.2.4	Mark to Market Requirements and Market Risk	84
5.2.5	Exposure towards Equity Markets	84
5.2.6	Real Estate and the Banking Sector	85
5.2.7	Asset Securitization : New Funding Products	86
5.2.8	Human Resource Risk	86
5.3	Impact of Macroeconomic Environment on the Banking Sector	87
5.4	Conclusion	90
6.	Financial Performance of NBFIs	91
6.1	Recent Developments in the NBFIs Sector	91
6.1.1	Structure and Consolidation process during FY04	92
6.2	Performance of NBFIs in 2004	92
6.2.1	Development Finance Institutions	93
6.2.2	Investment Banks	98
6.2.3	Leasing Companies	100
6.2.4	Modaraba Companies	103
6.2.5	Housing Finance Companies	105
6.2.6	Mutual Funds	107
6.2.7	Discount Houses	109
6.2.8	Venture Capital Companies	110
6.3	Future Direction of NBFIs	110

7. Financial Savings and Interest Rate Structure	113
7.1 Structure of Financial Savings	113
7.2 Contractual Savings	115
7.2.1 Central Directorate of National Savings	115
7.2.2 Insurance	117
7.2.3 Social Protection Funds	118
7.2.4 Private Pension Schemes	122
7.3 Interest Rate Structure and Levels	123
7.3.1 Rate of Interest on NSS	124
7.3.2 Banking Spread	126
8. Insurance Sector	129
8.1 Overview of Recent Developments	129
8.1.1 International Perspective	130
8.2 Non-Life Insurance Industry	130
8.2.1 Equity Structure of Non-Life Insurance Companies	131
8.2.2 Composition of Assets and Investments	132
8.2.3 Composition of Premiums and Claims	132
8.2.4 Categories of Non-Life Insurance	133
8.2.5 Performance Analysis of Non-Life Insurance Companies	134
8.3 Life Insurance Products	135
8.3.1 Performance of Life Insurance Companies	138
8.3.2 Classification of Life Insurance Business	139
8.3.3 Investment Income of Life Insurance Companies	142
8.4 Postal Life Insurance	143
8.5 Review of Reinsurance	144
8.6 Conclusion	145
9. Performance of Financial markets	151
9.1 Overview	151
9.2 Financial Markets – Developments, Issues and Policy Implications	151
9.2.1 Money Market	151
9.2.2 Bond Market	156
9.2.3 Forex Market	159
9.2.4 Equity Market	162
9.3 Role of Financial Markets in Monetary Policy Transmission Mechanism	165
9.3.1 Transmission to Major Interest Rates	166
9.3.2 Transmission to Exchange Rates	167
9.4 Derivatives	167
9.4.1 Policy Environment	168
9.4.2 Current Status	168
10. Macroeconomic and Financial Sector Comparison with SAARC and ASEAN countries	169
10.1 SAARC countries	169
10.1.1 A Brief Background	169
10.1.2 Macroeconomic Performance Indicators	171
10.1.3 Financial Sector Performance Indicators	173
10.2 ASEAN countries	176
10.2.1 A Brief Background	176
10.2.2 Macroeconomic Performance Indicators	177
10.2.3 Financial Sector Performance Indicators	179
10.3 Conclusion	180

Conclusion	183
Annexes	189
Acronyms	201