Executive Summary

For the last five years, SBP has been pursuing its operational and developmental activities in line with its strategic goals. During FY20, progress was made in a number of areas, as summarized below and expounded upon further in subsequent chapters.

Enhancing Effectiveness of Monetary Policy: SBP adopted a market-based flexible exchange rate system in May 2019 to serve as the first line of defense against external shocks, to improve FX market functioning on a sustainable basis, and to eliminate the anti-export bias that had existed in previous FX policy regimes. The market-based exchange rate works as a shock absorber and helps in avoiding the build-up of external imbalances. This change not only helped Pakistan in correcting the previously accumulated external imbalance by compressing imports and encouraging exports, but as international flows dried up during the pandemic, it mitigated the pressures on foreign exchange buffers. Indeed, this new regime was subject to a real-time testing as the country witnessed a sharp reversal of portfolio investment flow in the wake of COVID-19 without excessive movement in PKR-USD parity, especially when compared with other emerging economies.

FY20 has been very challenging due to slower growth and the economic challenges amidst the COVID-19 pandemic. In line with its mandate, SBP remained proactive throughout the year and addressed emerging issues efficiently. A number of policy measures and interventions were made to support economy and stabilize the financial industry. The first phase of the year witnessed monetary tightening that continued until March 2020, wherein the Monetary Policy Committee (MPC) increased the policy rate by 100 basis points to 13.25 percent in July 2019 and maintained it at this level until March. In order to manage market expectations, the MPC for the first time provided forward-looking guidance in its policy statement.

During the pre COVID-19 period, the monetary and exchange rate policies along with fiscal consolidation improved the country’s fiscal and external accounts. The current account deficit declined by 73.1 percent to USD 2.8 billion and the fiscal deficit was contained to 3.8 percent of GDP during first nine months of the year. National CPI inflation averaged 11.5 percent during July-March FY20, which was in line with the inflation forecast range for the year.

However, the outbreak of COVID-19 and ensuing lockdown led to a dramatic change in the economic landscape with the estimated FY20 growth falling to -0.4 percent. Lockdowns of varying degrees around the globe affected both demand and supply, leading to unemployment and furloughs. Being cognizant of the unfolding impact of COVID-19 on Pakistan's economy, SBP proactively implemented unprecedented policy measures to support businesses and households.

First, SBP policy rate was swiftly eased by 625 basis points to 7.0 percent in a short span of time, one of the largest policy rate cuts amongst the emerging markets in a short span of 4 months. In addition, SBP announced several measures to ease liquidity constraints for the businesses and households while ensuring financial stability. These included the loan principal deferment, restructuring/ rescheduling and various refinance schemes like SBP’s Rozgar Scheme to prevent workers’ layoff, Temporary

Economic Refinance Facility (TERF) for new projects or BMR, and Refinance Scheme for Hospitals to Combat COVID-19. Besides this, macro prudential measures, such as reduction in Capital Conservation Buffer by 100 basis points, have also been taken with the objective of facilitating the relevant stakeholders during this crisis time. These measures have received a sizeable response. These policy support measures are estimated to have provided a stimulus of around Rs1.6 trillion or 3.9 percent of GDP.

One of the key steps towards setting price stability as a key objective of monetary policy was the announcement of medium term inflation target range of 5-7 percent by the government in the Federal Budget FY20. Besides, the Monetary and Fiscal Policies Coordination Board, among other forums, helped to align, discuss and debate the policy initiatives among the key internal stakeholders.

SBP further improved its communication by restructuring its monetary policy statement, frequent discussions with the business community, as well as regular interaction with researchers, academia and the media. With regard to economic modeling, SBP further extended Dynamic Stochastic General Equilibrium (DSGE) and Forecasting and Policy Analysis System (FPAS) models during FY20 by adding new features relevant to Pakistan’s economy. Other econometric models were also updated to better capture key economic linkages and incorporate forecasting suites. Similarly, a new survey of professional forecasters was also added to the suite of SBP’s perception surveys during FY20.

SBP also revised its Interest Rate Corridor (IRC) framework by adopting a symmetric IRC framework with the policy rate set symmetrically between the Ceiling and the Floor rate i.e. Ceiling/Floor +/- 100 basis points. As a result of stabilization measures taken by SBP during last couple of years and adoption of flexible exchange rate regime, SBP’s FX reserves have maintained strong growth during FY20. Accordingly, SBP’s FX Reserves increased from USD 7.3 billion to USD 12.1 billion as of end June 2020, showing an increase of USD 4.8 billion over the corresponding year.

Remittances increased to a record high of USD 23.12 billion in FY20 compared with USD 21.74 billion during FY19 (an increase of 6.4 percent), despite the unprecedented COVID-19 pandemic. The increase in remittances is mainly attributed to supportive Government policies, pro-active strategy of SBP and Pakistan Remittance Initiative (PRI) and positive response of Banks and Exchange Companies (ECs) to implement the SBP/PRI strategy. Further, a regulatory framework has been prepared to facilitate cross border B2C e-commerce exports. This will help both established businesses and new start-ups to reach out to global customers through e-commerce platforms.

SBP further strengthened the AML/CFT regime in Pakistan in line with GoP’s full commitment to comply with international AML/CFT standards and requirements. Other significant measures taken during COVID-19 pandemic broadly include aggressive awareness campaigns for home remittances and donations, extension of time period for realization of export proceeds, import of goods and submission of shipping documents against advance payment and allowing consignment based export of permissible foreign currencies.

Payment System: Being the regulator of payments and financial industry, SBP played a significant role in promoting and developing payment and digital financial services in the country. SBP took numerous initiatives which primarily aimed at development of digital payment platforms, provision of a conducive regulatory environment for the industry and promotion of innovative and convenient digital payment instruments. Resultantly, the payment systems showed healthy growth both in terms of volume and value of transactions conducted during FY20. During the last five years, significant progress has been recorded in the usage of Internet Banking and Mobile Banking channels with an annual transactions growth of 31 percent and 88 percent respectively. Moreover, SBP in consultation with the stakeholders waived all charges on fund transfer transactions conducted through online channels during lockdown period due to COVID-19. In line with SBP's instructions for issuing Europay Master Visa (EMV) Chip and PIN Compliant cards, number of debit cards have increased to 26.7 million in FY20, showing a YoY growth of 7.5 percent.

SBP through World Bank's Financial Inclusion Support Framework (FISF) program, launched a comprehensive National Payment Systems Strategy (NPSS) on November 01, 2019 after consultation with all relevant stakeholders. The strategy outlines various recommendations in six major areas of national payment systems i.e. legal and regulatory framework, payment infrastructure, retail market, government payments, oversight of payment systems and remittance market. SBP is at the final stage of implementation of Micro Payment Gateway (MPG) by going live with first use case i.e. bulk transfers including government to person (G2P) transfers.

To promote digital payments during COVID-19 Pandemic and encourage adoption of new technologies in payment systems, a number of regulatory measures have been taken in FY20 which include improving payments card acceptance in Pakistan, standardization of QR Codes, digital onboarding of merchants, facilitation regarding paper-based clearing operations, measures to enhance cyber resilience, facilitation to Electronic Money Institutions, Payment System Operators and Payment Service Providers, **i**mproving Large Value Payment and Settlement System and strengthening the legal and oversight framework in line with the NPSS.

Further, SBP is also working with banks to provide Digital Accounts to Overseas Pakistanis to facilitate Non Resident Pakistanis (NRPs) for opening accounts digitally/remotely in any Pakistani bank through online banking.

As part of G2P digital payments and to facilitate the business community, SBP and Pakistan Customs are working on digitization of Duty Drawbacks refunds to businesses in the first phase. The successful implementation of this project will be a milestone towards digitization of G2P payments and will help in the government's initiatives for ease in doing business.

Strengthening Financial System Stability and Effectiveness: To further strengthen its regulatory and supervisory framework, various measures were taken which include establishment of National Financial Stability Council, publication of Financial Stability Review, conducting surveys to assess risks emanating from COVID-19, revision of stress testing guidelines, enhancing macro stress testing regime and conducting the first joint industry-wide Business Continuity Planning (BCP) drill.

In its flagship publication "Financial Stability Review (FSR)" for CY19, issued in June 2020, SBP presented performance and risk assessment of various segments of the financial sector including banks, non-banking financial institutions, financial markets, non-financial corporates and financial market infrastructures. The emerging challenge posed by COVID-19 outbreak and the mitigating measures undertaken by SBP to limit its adverse implications, for the economy and the financial sector, have also been covered in the report. FSR also focused upon assessment of banking sector resilience against economic and financial vulnerabilities, giving special emphasis to COVID-19 pandemic. An empirical study on countercyclical buffers was also undertaken to identify periods of risk excesses and assess the need for building resilience of banks against systemic risks.

SBP also conducted fourth and fifth wave of Systemic Risk Survey (SRS), in July 2019 and January 2020, which helped to gauge the views of market participants and experts about various existing and emerging risks that can potentially undermine the stability of the financial system. In order to assess the implication of COVID-19 pandemic for financial institutions, SBP conducted two surveys in March and April 2020. SBP issued an advisory circular to ensure availability and continuity of financial services based on the findings of first of these surveys.

The Terms of Reference of Joint Task Force of SBP and SECP for consolidated supervision framework were also reviewed and updated and a quantitative criterion was developed to supervise and assess banking groups on consolidated basis. Further, forecasting and scenario analysis suite of econometric models for stress testing has been strengthened by inclusion of latest models. Guidelines for stress testing were also updated to align with the changing local dynamics and international best practices.

Under Risk Based Supervision (RBS), pilot testing of certain significant activities in two selected banks was conducted to fine tune the developed methodologies. Capacity building of supervisory resources and key executives of financial institutions (FIs) was also carried out through a series of training and awareness sessions.

In order to enhance financial inclusion, SBP revised the Branchless Banking (BB) Regulations for Financial Institutions (FIs) to increase outreach of BB operations. Further, SBP issued Rules and Regulations to Banks/Microfinance Banks (MFBs) for digital on-boarding of Merchants to facilitate growth of digital payments in the country.

To ensure smooth provision of banking services throughout the country, SBP took a number of measures which mainly include extension in deadline for Biometric verification for BB, deferment in repayment of principal loan, reduction in Capital Conservation Buffer (CCB) from 2.50 percent to 1.50 percent to provide additional loans, enhancement in regulatory retail portfolio from Rs.125 million to Rs.180 million and relaxation in debt burden requirement for consumer loans from 50 percent to 60 percent.

SBP also made some important amendments in its regulatory framework to further align AML/ CFT Regulations with the recommendations of Financial Action Task Force (FATF). This will provide further clarity on implementation of AML/ CFT requirements on Risk Based Approach (RBA), Customer Due Diligence (CDD), Targeted Financial Sanctions (TFS) on Terrorism Financing and Proliferation Financing (PF), reporting of Suspicious Transaction Reports (STRs)/Cash Transaction Reports (CTRs), record keeping, identification of ultimate beneficial ownership and politically exposed persons (PEPs), correspondent banking and wire transfers/ funds transfers.

SBP issued approximately 800 new branch licenses to commercial banks/microfinance banks during FY20 to enhance outreach of financial services to general public. Out of these new branches, at least 23 percent of branches have been opened in rural, underserved and unbanked areas. Special focus remained on the priority areas of Baluchistan, Khyber Pakhtunkhwa, AJK and Gilgit Baltistan for which 164 new branches were approved during FY20.

During FY20, regular as well as focused on-site inspections of Banks, DFIs, MFBs and Exchange Companies were conducted. Areas of supervisory concerns included assessment of corporate governance, weaknesses in systems and controls, cyber security, compliance with AML/CFT regime, business conduct, etc. which were taken up with the banks' Board of Directors and senior management for corrective actions. Similarly, thematic inspections during FY20 included assessment of high risk customers in high risk geographies, cyber security assessment review of NGO/NPO/INGO accounts, review of transaction monitoring and sanctions screening systems in Exchange Companies (ECs) and inspection of outlets of Exchange Companies in high risk jurisdictions.

To strengthen its Fair Treatment of Consumer regime, SBP conducted four years (2016-2019) review of consumer complaints against Banks/MFBs/DFIs to have insights on complaints management trends. The salient features of the review were published to emphasize SBP’s narrative regarding responsible complaint handling and to boost banks’ performance in handling complaints. A project was also initiated in FY20 to assess ease of lodgment of complaints with banks especially for vulnerable segments of society including disabled, illiterate, women in rural areas, senior citizen, etc., recording of complaints in the system, processing of complaints as per Turn Around Time (TATs), root cause analysis and corrective actions taken by the banks.

In pursuance of Ease of Doing Business (EODB), SBP, in collaboration with the SECP, World Bank and Board of Investment, proposed legal amendments in the Financial Institutions (Secured Transactions) Act 2016 which were issued through a Presidential Ordinance in April 2020 to improve Pakistan's score in “Getting Credit” indicator of the EODB index.

Broadening Access to Financial Services: During FY20, significant progress was made under National Financial Inclusion Strategy which include creating an enabling legal and regulatory environment, establishing financial market infrastructure, developing innovative products & services, new alternate delivery channels and enhancing capacity building and awareness initiatives.

During second half of FY20, Pakistan’s agricultural sector faced multiple challenges due to COVID-19 and threats of locust attacks, which reduced the sector’s growth prospects and put millions of farmers under distress. Despite ongoing challenges, Participating Financial Institutions (PFIs) were able to disburse around Rs.1,215 billion, being 90 percent of the overall target and 3.5 percent higher than the disbursements of Rs.1,174 billion of corresponding period.

At the close of FY20, MFBs’ assets base crossed Rs.400 billion from Rs.350 billion recorded in previous corresponding period. MFBs also witnessed a growth of 5.2 percent (i.e. Rs.10.9 billion) in its microcredit portfolio to reach Rs.218.3 billion as against Rs.207.5 billion at the end of preceding fiscal year. Likewise, the number of MFBs’ borrowers recorded an increase of 1.6 percent to grow over 3.5 million by the end of FY20. The number of depositors increased by 15 million to reach 49.3 million in FY20 from 34.3 million in FY19, registering an impressive growth of 43.8 percent in outreach of deposit services.

Further, all key indicators of Branchless Banking (BB) exhibited an encouraging growth, which bodes well for the gradual adoption of digital channels and usage of basic financial services in the country. The number of BB accounts reached 52.5 million with an annual growth of 47 percent. BB deposits also increased by 42.8 percent during FY20 to reach Rs.36.7 billion from Rs.25.7 billion, compared to the previous year. Branchless Banking players have also increased their agent network throughout the country to reach 445,181 by FY20 as compared to 421,053 in previous year, showing a growth of 5.7 percent. The number of transactions made during FY20 through BB channel were 1.49 billion with total value of around Rs.5.2 trillion.

The outstanding portfolio of SME Financing by Banks/ DFIs as of June, 2020 stood at Rs.401 billion as compared to Rs.464 billion as of June, 2019, showing YoY decline of 13.7 percent. Main reason for the decline was COVID-19 pandemic which affected businesses and their borrowing capacity.

Prime Minister’s Kamyab Jawan Youth Entrepreneurship Scheme (PMKJ-YES) was launched in October, 2019 to enable youth to avail affordable financing for starting up new business or strengthening their existing business. As of June 2020, disbursement of Rs.655 million has been made to 1,595 borrowers under the scheme by the banks.

To support the business community and health sector during COVID-19 pandemic, a number of refinance schemes were introduced which included Temporary Economic Refinance Facility (TERF), Refinance Facility for Combating COVID-19 (RFCC), Refinance Scheme for Payment of Wages and Salaries to the Workers and Employees of Business Concerns and Relaxations on financing under SBP’s Refinance Schemes. Further, banks have been allowed to release and use the general provision maintained in terms of Regulation HF-9 of Prudential Regulations for Housing Finance, against the specific provision requirement of the housing finance portfolio until December 31, 2021.

The financing to infrastructure projects from banks and DFIs witnessed 5.43 percent increase during FY20. As of June 2020, the outstanding financing for infrastructure projects reached Rs.767.7 billion as compared to Rs.728.1 billion as of June 2019.

Islamic Banking: The Islamic Banking Industry continued its growth trend during FY20. The assets and deposits of the Islamic banking industry grew by 21.4 percent and 22 percent, respectively. Financing to Deposit Ratio (FDR) of Islamic Banking Industry was recorded at 57.6 percent, which is higher than the overall banking industry’s advances to deposits ratio of 46.3 percent. The Islamic Banking Institutions (IBIs) are providing Shariah-compliant products and services through their networks of 3,274 branches in 122 districts. To enhance outreach of Islamic banking products and services, IBIs added 361 branches to their branch network during FY20. SBP also issued Shariah guidelines in April 2020 to facilitate the customers of IBIs for smooth implementation of relaxation, provided by SBP regarding deferment of principal or rescheduling and restructuring of financing facilities due to COVID-19 pandemic. Further, SBP notified adoption of three Shariah Standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

Institutional Strengthening: The five year strategic plan, SBP Vision 2020, ended in FY20. Significant achievements have been made to accomplish the strategic goals. At SBP, the strategic plan is operationalized through annual business planning exercises, chaired by the Governor, wherein strategic goals are cascaded down at departmental level as their development projects and initiatives. During the currency of SBP Vision 2020, more than 1200 development projects linked with strategic goals/ tactical objectives of SBP Vision 2020 have been undertaken. Effective implementation of the strategic plan has been also ensured through a regular monitoring mechanism which is also overseen by Strategic Planning Steering Committee (SPDC).

SBP strives to promote a performance-oriented culture and create an enabling environment for employees to contribute towards achievement of organizational objectives. During FY20, SBP witnessed major initiatives in the areas of workforce rationalization, talent resourcing, career growth, capacity building and automation. Being an equal opportunity employer, SBP facilitates the evolving role of women and the strategic significance of their inclusion in the workforce to achieve organizational objectives. Against a national requirement of 10 percent, SBP’s workforce consists of 11 percent of female employees in diverse roles at each level of hierarchy.

IT Strategy, being an important area of Strategic Plan, was implemented to provide uninterrupted services to SBP and its subsidiaries. Further, IT Policy Framework has been developed in line with international standards and best practices. Similarly, important developments were made in implementation of Knowledge Management system which included Business Process Management (BPM), Internal Case Management System (ICM), Enterprise Content Management (ECM), External Case Processing Portal, pilot launch of Inspection Management System and a Knowledge Transfer Framework. A multi-factor (MFA) based Single Sign-On (SSO) service was also developed during COVID-19 pandemic to access data warehouse application from home. Access of BPM and ECM to employees during COVID-19 has facilitated the continuity of business processes in an efficient and effective manner.

In order to ensure organization wide resilience and preparedness, an effective Business Continuity Management has been put in place. During FY20, more than 175 BCP exercises were performed by the Critical Time Sensitive Departments, Critical Support Function Departments and SBP-BSC Offices at their respective Back-up Sites.

To identify and address critical gap areas regarding cyber risk management, SBP completed multiple risk-assessment exercises during FY20. These engagements included collaboration with the World Bank, Microsoft Professional Services, as well as SWIFT Belgium Cyber Resilience and Operational Excellence Teams.

During FY20, SBP issued its ‘Risk Policy Statement’ under the Enterprise Risk Management (ERM) framework, applicable to SBP and its subsidiaries. The risk policy statement resolves to successfully implement ERM framework, which is critical for the Bank in achieving its objectives such as monetary and financial stability and inclusive financial system. The risk policy statement underpins the three lines of defence model to ensure that the risks are effectively managed at the entity level.

SBP Subsidiaries: The SBP Act, 1956 provides for the establishment of subsidiaries for managing functions such as receipt, supply and exchange of currency notes and related operational functions to protect small depositors and for training and development needs of its employees. SBP has four subsidiaries including State Bank of Pakistan-Banking Services Corporation (SBP-BSC), National Institute of Banking and Finance (NIBAF), Pakistan Security Printing Corporation (PSPC) and Deposit Protection Corporation (DPC). All subsidiaries of SBP continued to provide seamless support and services to banking industry, government agencies and people of Pakistan to ensure smooth functioning of banking operations across the country.

Financial Performance: The stability in the exchange rate allowed SBP to return to profitability after incurring loss in the preceding year. The profit so earned by the Bank in the year ended June 30, 2020 is highest in its history. The high interest rate prevalent in the first three quarters of the year allowed the Bank to accrue significant amount of interest income from the interest sensitive assets, particularly lending to the Government and income from the Bank's open market operations. Further, during the year, the liquidity mopping up operations were relatively on reduced scale and hence the interest expense registered a substantial decline.

The total assets stood at Rs.12,273 billion as at June 30, 2020 as compared to Rs.11,467 billion on June 30, 2019, registering an increase of Rs.806 billion primarily due to increase in foreign currency accounts and investments. Similarly, the total liabilities of the bank stood at Rs.11,219 billion as at June 30, 2020 as compared to Rs.10,761 billion as at June 30, 2019, registering an increase of Rs.458 billion. This rise was primarily led by increase in currency in circulation.

SBP introduced certain interest free/subsidized refinancing schemes during COVID-19 pandemic. As per the requirements of IFRS-9, the subsidized loans are required to be recorded at fair value. Accordingly, an amount of Rs.4,194 million has been recognized as fair valuation adjustment against these loans. This fair valuation adjustment will be amortized and recorded as income over the period of loans.